April 2014

Tax Digest

A periodic newsletter highlighting developments of interest to today's companies on the move.

FEDERAL

Relief available for corporations that failed to identify new subsidiary on a Form 1122

Peter Enyart, Manager, Washington National Tax
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A new IRS procedure provides automatic relief to consolidated groups that have failed to timely file Form 1122, *Authorization and Consent of Subsidiary Corporation To Be Included in a Consolidated Income Tax Return*, in order to include a new subsidiary in consolidated tax return filings. Failure to timely file the form could result in the IRS disallowing the inclusion of a subsidiary in a consolidated group's filed returns. Further, the missed election could go undetected for years, only to become a due diligence issue when the group is acquired. Historically, relief for the missed election could only be obtained through a time-consuming and costly letter ruling procedure or, more recently, through a determination letter issued by the IRS Examination Division. With an effective date of March 24, 2014, Rev. Proc. 2014-24 outlines the conditions and procedure for obtaining automatic relief. If the conditions are not met, a consolidated group can obtain relief for a missed election only through the determination letter process. Despite the availability of automatic relief, groups should continue to ensure that a newly added corporate subsidiary is identified to the IRS on a timely filed Form 1122.

Affordable Care Act employer mandate delayed for many employers

Bill O'Malley, Director, Washington National Tax
Jill Harris, Director, Washington National Tax

The employer mandate provisions of the Affordable Care Act (ACA) apply to employers with at least 50 full-time or full-time equivalent employees. Under the mandate, an employer can be subject to a penalty tax if it does not offer health coverage meeting certain requirements to substantially all of its full-time employees and their dependents. The mandate was scheduled to go into effect in 2014, but the IRS previously delayed the effective date until 2015. The IRS has now announced that the employer mandate will apply to companies with 100 or more full-time or full-time equivalent employees for plan years starting in 2015. However, employers that have more than 49, but less than 100, full-time or full-time equivalent employees will not be subject to the employer mandate provision until plan years starting in 2016 if they make certain certifications to the IRS about their workforce and health coverage. Other transitional rules apply over the next two years. Employers should take action now to determine how the employer mandate applies to them.

New information reporting requirements under the Affordable Care Act

Jill Harris, Director, Washington National Tax
Bill O'Malley, Director, Washington National Tax

Employers face new information reporting responsibilities under the Affordable Care Act starting with the 2015 calendar year. Employer-sponsored health plans of all sizes will need to tell the IRS about employees and family members enrolled in the plans. Insurers will be responsible for reporting this information to the IRS for insured plans, but employers will be responsible for reporting this information for self-insured plans. In addition, employers with at least 50 full-time employees (including full-time equivalent employees) will be required to identify employees who were offered affordable, minimum value coverage, including employees who declined the coverage. For 2015, this reporting is simplified for employers with less

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than 100 full-time employees. The IRS is currently developing new forms and systems for reporting this information, patterned after the Form W-2 reporting process. Information for the 2015 calendar year will need to be provided to employees by Jan. 31, 2016, and filed with the IRS by Feb. 28, 2016 (March 31, 2016, if filed electronically). Employers should take action now to ensure that their internal systems will be able to collect the needed data.

Camp proposal would limit use of cash method of accounting

Ed Decker, Director, Washington National Tax

Among the many intriguing proposals included in Rep. Dave Camp's (R-MI) comprehensive tax reform plan released Feb. 26, 2014, is a proposal to simplify the rules regarding the use of the cash method of accounting. His proposal would generally require that any business with average gross receipts exceeding $10 million utilize the accrual method of accounting. While this could provide opportunities for taxpayers currently precluded from using the cash method (e.g., C corporations with gross receipts in excess of $5 million), it would eliminate the cash method as an option for many service businesses (e.g., attorneys, accountants, physicians and engineers) that currently utilize the cash method without regard to a gross receipts threshold. Although it is questionable whether Camp's comprehensive plan will gain significant support in Congress, proposals such as these may reappear in future, possibly less comprehensive, tax reform initiatives. For that reason, it is something that service businesses should continue to monitor.

Impact of expired tax credits and incentives on financial reporting

Tom Windram, Partner, Washington National Tax
Steve Pashley, Manager, Washington National Tax

As many as 50 federal income tax credits and incentives, including the research and development (R&D) tax credit, expired at the end of 2013. While we believe many of these incentives will eventually be extended, competing tax reform efforts in the House and Senate make it unlikely that any consensus will be reached prior to the November 2014 midterm elections. The House effort, led by Rep. David Camp (R-MI), would extend the R&D credit and make it permanent but would repeal most other business tax credits and incentives. The Senate effort, led by Sen. Ron Wyden (D-OR), would retroactively extend upwards of 50 tax credits to encourage continued business investment, while serving as a bridge to more comprehensive tax reform in the future. Under the financial accounting principles applicable to income taxes, companies cannot record tax benefits related to these expired incentives in their first quarter 2014 financial statements because they are no longer part of enacted tax law. If the incentives are extended at some point during the year, companies would then record discrete items for the full benefit of the incentives in the quarter the legislation is enacted.

Treasury clarifies compensatory rules on restricted property transfers

Peter Enyart, Manager, Washington National Tax

The transfer of property subject to forfeiture (e.g., restricted stock) generally is not taxable to the recipient until the restriction lapses. To help assure income deferral is properly applied when restricted property is issued, the IRS has released new regulations clarifying the existing rules. The new regulations provide for income deferral only if restricted property is subject to a service condition or a condition related to the purpose of the transfer, with limited exception. Further, the IRS has made it clear it will consider the likelihood that the conditions will be met or enforced. Income deferral will be prevented if it appears obvious the condition will be met, or if the recipient is not subject to a genuine risk of forfeiture. The new regulations were issued Feb. 26, 2014, but apply to transfers occurring on or after Jan. 1, 2013. Taxpayers should review restricted property agreements to ensure the agreements comply with the new rules. Failure to comply will negate income deferral, therefore, generating negative tax consequences such as underreported income for the recipient or lost deductions for the company.

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Tax Digest

Investments containing both equity and debt securities

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Due to the tax benefits provided by corporate-level interest deductions, many private equity funds, investors and strategic acquirers alike structure investments with a mix of debt and equity. However, in many situations, the debt and equity investments are intended to be held by the investor throughout the life of the investment and are not necessarily separable, which brings into question the issue of whether the investments are "stapled." Where a debt and equity investment is stapled, the IRS may consider the stapled instrument to be strictly an equity investment, thereby eliminating the tax benefit associated with the debt. Taxpayers should involve their tax advisors when structuring combined debt and equity financing arrangements to avoid the creation of stapled instruments and disallowed interest deductions.

President Obama's 2015 budget and the ghosts of estate planning past

Chuck Schultz, Partner, Washington National Tax
Audrey Young, Director, Washington National Tax

The Obama administration's fiscal year 2015 budget proposal mirrors prior attempts to limit the estate and gift planning strategies available to high-net-worth individuals under current law. The proposal would (1) require all grantor retained annuity trusts (GRATs) to have a minimum 10-year term, (2) eliminate the estate tax benefits of sales made to defective grantor trusts, and (3) limit the value of multiple-generation dynasty trusts by limiting the number of years that dynasty trusts can remain estate and generation-skipping tax free to 90 years. In addition, the proposal would eliminate the present interest requirement (known as the Crummey withdrawal right) for gifts that qualify for the annual gift tax exclusion (currently $14,000 per donee) and instead create a new category of transfers. An annual limit of $50,000 per donor would apply to transfers made to trusts and pass-through entities, as well as transfers of interests subject to a prohibition on sale and other transfers of property where the immediate liquidation of the gifted interest by the donee is barred. Although the president's budget has little chance of being enacted as written, one or more of these provisions could very well be tacked on to unrelated legislation. Therefore, individuals should strongly consider implementing gift planning strategies that may be curtailed, such as those associated with GRATs, grantor trusts and dynasty trusts– and the sooner the better. These provisions would be effective as of Jan. 1, 2015.

INTERNATIONAL

IRS releases some final W-8 forms

Ramon Camacho, Principal, Washington National Tax
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The IRS recently released final versions of Forms W-8BEN and W-8ECI. Individual taxpayers must use Form W-8BEN to certify non-U.S. status and to claim benefits under a U.S. income tax treaty or to claim certain exemptions from U.S. withholding tax. Non-U.S. taxpayers with a U.S. trade or business must use Form W-8ECI to claim exemption from U.S. withholding tax on their trade or business income. Both forms, in addition to other W-8 forms, will be key to complying with the Foreign Account Taxpayer Compliance Act. Unfortunately, the IRS has not yet issued final versions of several other important W-8 forms, including the forms that apply to non-U.S. entities (W-8BEN-E), tax-exempt entities (W-8BEN-EXP), and certain non-U.S. partnerships and trusts (W-8BEN-IMY). Taxpayers should be prepared for the possibility that the IRS may not release final versions of these forms prior to the July 1, 2014, FATCA deadline.

Upcoming FATCA deadlines rapidly approaching

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Beginning July 1, 2014, the Foreign Account Taxpayer Compliance Act (FATCA) requires U.S. withholding agents to withhold 30 percent of the gross amount of certain U.S.-source payments made to foreign persons unless an exemption applies. In many cases, a foreign payee

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must register with the IRS in order to claim an exemption. Before a U.S. withholding agent can make payments free of FATCA withholding, the withholding agent must verify the foreign payee's registration against an official list of registered payees that the IRS will publish periodically. The IRS has announced that taxpayers that wish to be on the first such list must register on the IRS website by April 25, 2014. Accordingly, taxpayers should assess immediately whether they have obligations under FATCA and whether they should register on the IRS website or take other steps to comply given the rapidly approaching deadlines. Although FATCA applies to financial institutions, U.S. companies that make payments to foreign payees must also withhold under FATCA unless an exemption applies. Thus, nonfinancial companies should also carefully assess the impact of FATCA on their business.

Taxpayers with foreign investments should not overlook the 3.8 percent Medicare tax election

Greg Pudenz, Manager, Minneapolis, Minn.
Ramon Camacho, Principal, Washington National Tax

In 2010, Congress enacted a 3.8 percent Medicare tax on net investment income, which includes dividends, interest and other passive income, effective for tax years beginning in 2013. However, this tax generally does not apply to several forms of "deemed" foreign income that are currently taxable for regular income tax purposes. In particular, the Medicare tax does not apply to subpart F income of foreign corporations or deemed income arising from a passive foreign investment company with a special "QEF" (i.e., current inclusion) election in place. Under new IRS regulations, the Medicare tax applies to these categories of income only when the taxpayer actually receives the income, even though the taxpayer may be deemed to receive the income at an earlier time for income tax purposes. While this rule creates a deferral benefit, the resulting mismatch in the timing of income for Medicare and regular income tax purposes could create significant administrative burdens for taxpayers. To alleviate this, taxpayers may make a conformity election to pay the Medicare tax on foreign income at the same time regular income tax is due. For the 2013 year, U.S. partnerships that wish to make a conformity election may do so only with the consent of all partners. Therefore, tax matters partners should assess whether they should obtain specific consent from their partner in order to make this potentially significant election.

STATE and LOCAL

Alabama creates independent tax tribunal

Mike Williams, Partner, Dallas, Texas

On March 11, 2014, Alabama Governor Robert Bentley signed into law 2014 HB 105, creating an independent tax tribunal, an executive branch agency empowered to hear appeals involving all matters administered by the Alabama Department of Revenue (DOR) and by revenue departments of participating self-administered counties and cities. Effective Oct. 1, 2014, this new tribunal will replace the DOR's Administrative Law Division, allowing taxpayers to appeal final assessments and resolve tax controversies in a forum outside of the control of the DOR without taking on the expense of filing in Alabama circuit court. Alabama joins a growing list of states that enacted similar legislation, and taxpayers involved in a controversy with the tax authority in any state should consult with their tax advisors to discuss the availability and benefits of this type of independent avenue for appeal.

New Mexico extends NOL carryforward period

Jim Barash, Director, Phoenix, Ariz.

On March 10, 2014, New Mexico Governor Susana Martinez signed into law 2014 SB 106, extending the business net operating loss (NOL) carryforward period from five years to 20 years, bringing New Mexico in line with neighboring states. The new 20-year carryforward period applies to all losses incurred in tax years beginning on or after Jan. 1, 2013. Prior losses remain subject to the five-year carryforward period provided under prior law. Given the split expiration period, businesses with New Mexico NOLs should review their NOL carryforward tracking policies and procedures and should exercise additional care in reporting and utilizing New Mexico NOLs going forward.

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