Tax Digest

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

August 2015

EVENTS

More tax events and webcasts

FEDERAL

IRS issues new policy on estate tax closing letters

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Settling an estate can be an arduous task for taxpayers, attorneys and accountants. Recently, the IRS added yet another hurdle to jump through before an estate can be officially closed. Instead of automatically receiving an estate tax "closing letter" in the mail, the taxpayer, or his accountant or attorney, will now need to request a closing letter from the IRS, which will further extend the estate settlement time period. Even though fewer estate tax returns are being filed now that the lifetime exclusion amount is $5.43 million ($10.86 million for a married couple), the IRS' issuance of routine closing letters was apparently an expendable expense. Most estates, however, need a closing letter to prove to a court or an executor that no additional taxes are owed. Closing letters are required by judges to obtain an order terminating a probate court proceeding. Closing letters are also needed to permit a trustee or executor to distribute assets or fund bequests without fear that the sums distributed would leave the estate without sufficient cash to cover additional liabilities. While releases and refunding agreements prepared by attorneys can be used in certain situations as stop-gap measures, they are not viable substitutes for closing letters. Thus, accountants and attorneys will be compelled to follow the new procedure and contact the IRS to obtain the closing letters.

Keep an eye on extender bill provisions affecting S corporations

Jerry Kissell, Partner, Minneapolis, Minnesota

While Congress recently has been unable to agree on much, they are starting to find bipartisan support as they move to extend many favorable tax provisions that expired at the end of 2014. On July 21, 2015, in a 23-3 vote, the Senate Finance Committee voted to extend 52 tax provisions, generally for a two-year period. The bill still faces an uncertain future as the full Senate and the House now considers how to proceed. While many of the tax provisions, such as the 50 percent bonus depreciation and the expanded $500,000 section 179 deduction, would impact S corporations and their shareholders, there are two provisions that solely affect S corporations. The first of these provisions would reduce the built-in gains recognition period from 10 to five years through 2016. The second provision relates to charitable contributions of appreciated property and would limit a shareholder's stock basis adjustment to the shareholder's pro rata share of the adjusted basis of the property, rather than its fair market value. At this point, it is difficult to know when the extenders will ultimately be addressed. The House has suggested they may not take up the issue until September. Nonetheless, it is encouraging to see Senate activity now and to see Congress acknowledge that waiting until December is in no one's best interest.

Affordable Care Act penalties on employer health plans

Jill Harris, Director, Washington National Tax

As a reminder, due to the Affordable Care Act (ACA), certain employers that do not offer employee health coverage that meets ACA standards could face a penalty of up to $2,000 per employee starting in 2015. This penalty is called an

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"employer shared responsibility payment" or a "pay or play" penalty. It applies to for-profit and nonprofit employers, including churches and governmental entities. This new penalty affects employers with an average of at least 50 full-time employees (including full-time equivalents). Employers with less than 50 full-time employees generally are exempt from the penalty. However, small employers can have penalty exposure if they are related to other companies due to common owners, directors or services, and the companies together have at least 50 full-time employees (including full-time equivalents). To avoid penalties, employers generally must offer a group health plan to all employees working at least 30 hours per week. The health plan must meet a minimum value standard and be affordable to the employees based on ACA criteria. The IRS will determine which employers owe the penalty for 2015 based on information provided on the Forms 1095-C and 1094-C that employers will file in 2016.

Penalties increase for failure to properly report Affordable Care Act information

Bill O'Malley, Director, Washington National Tax

The Affordable Care Act (ACA) requires large employers (generally those with more than 50 full-time employees, including full-time equivalents) to file new Form 1095-C with the IRS for 2015 to report whether or not they offered ACA-compliant health coverage to their employees. Small employers with less than 50 employees that sponsor self-insured health coverage have an obligation to file Form 1095-B. The IRS can assess penalties on employers that fail to file these forms, file incorrect information or fail to provide required information to their employees. Recent legislation increased these penalty amounts from $100 to $250 for each form that is not filed or furnished and doubles the maximum penalty per calendar year for these failures to $3 million. The higher penalty amounts are effective for forms filed after Dec. 31, 2015. For more information about Forms 1095 and 1094 and who is required to file, please read our article, *New information reporting requirements under the Affordable Care Act*.

DOL releases guidance on who is an employee

Anne Bushman, Senior Manager, Washington National Tax

Responding to increasing worker complaints and confusion in some business models, the U.S. Department of Labor (DOL) released Administrator's Interpretation 2015-1 to explain its position on the classification of a worker as an employee. Employers classifying any workers as independent contractors should review this interpretation for an understanding of the factors the DOL analyzes in determining employee status. Importantly, the guidance describes the broad "suffer or permit to work" standard of the Fair Labor Standards Act (FLSA), of which the employer's control over the worker is only one aspect. The DOL states "most workers are employees under the FLSA's broad definitions. " The interpretation is just that and does not represent a change in the law. Furthermore, it does not necessarily extend to the IRS, which uses a common law definition of employee, although the DOL and IRS entered an agreement in 2011 to share information related to employee classification cases. However, employers should be aware of the DOL interpretation because beyond income tax withholding and employment tax consequences with the IRS, misclassification under federal and state employment laws can cause significant legal exposure for employers. Employers would be prudent to review current worker classifications to assess any risk under the DOL's broad standard.

IRS penalties for information returns have doubled

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The Trade Preferences Extension Act of 2015 (the Act) increases the penalty amounts charged by the IRS for failing to file or incorrectly filing information returns and for failing to furnish or furnishing incorrect information returns to a payee. Examples of information returns affected by the new law are Forms W-2, 1042-S, 1098, the 1099 series and new information returns for the Affordable Care Act. The Act doubles the maximum penalty charge per calendar year to $3 million for both failure to file with

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the IRS and failure to furnish all required information to payees, making the total potential maximum $6 million. The changes are effective for information returns due after Dec. 31, 2015. The reduced penalties that the IRS charges for quickly corrected failures have also increased, as have the maximum penalty amounts for filers with gross receipts under $5 million. In light of the Jan. 1, 2016, effective date, it is important for payors to ensure that their information return filing processes and systems, and those of their service providers, are updated and adequate to meet all the filing requirements in order to avoid the steep penalties described above. Avoiding penalties for late filing, not filing or filing incorrect information returns is much less costly than fighting for abatements of such penalties. Payors, especially businesses that hire independent contractors, should heed this new development and obtain accurate information from payees before the information returns are due to be filed with the IRS and furnished to the payees.

FASB votes to finalize one-year deferral of new revenue recognition standard

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At its July 9, 2015, meeting, the Financial Accounting Standards Board (FASB) voted to finalize deferral of the effective date of the new revenue recognition standard by one year. For public companies reporting on generally accepted accounting principles (GAAP) basis, the new standard is effective for fiscal years and interim periods within those fiscal years beginning after Dec. 15, 2017. Private companies using GAAP are required to apply the new standard for fiscal years and interim periods within those fiscal years beginning after Dec. 15, 2018. However, both public and private companies are allowed to early-adopt the standard for annual periods beginning after Dec. 15, 2016. The delay is due in part to efforts by the FASB and the International Accounting Standards Board to clarify certain areas of the converged revenue recognition standard that are causing implementation problems for some financial statement preparers (e.g., intellectual property and identifying performance obligations). The FASB plans to issue the final accounting standards update by the end of the third quarter 2015. Companies with concerns about implementing the standard should take advantage of the one-year deferral period by beginning the transition process now to ensure effective implementation of the new standard.

INTERNATIONAL

Participation in basket contracts must be disclosed to the IRS

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The Treasury and the IRS recently issued notices to designate "basket option contracts," "basket contracts," and any transaction that is substantially similar as reportable transactions. Basket option contracts, and the broader category of basket contracts, are used by hedge funds and high-net-worth individuals as part of a strategy for converting short-term capital gain and ordinary income to long-term capital gain subject to lower tax rates. Because the IRS identified basket option contracts as "listed transactions" and basket contracts as "transactions of interest," taxpayers engaged in such transactions are now required to disclose their participation to the IRS and possibly face additional scrutiny. Generally, the notices apply retroactively to transactions in effect on or after Jan. 1, 2011, with respect to years for which the statute of limitations on assessment has not expired. Taxpayers with return years that are not closed by the statute of limitations must file Form 8886, *Reportable Transaction Disclosure Statement*, with the Office of Tax Shelter Analysis no later than Nov. 5, 2015, if they have participated in a transaction covered by one of the notices, even if they have already filed returns for the affected tax years. Failure to comply with the reporting requirements can result in substantial penalties, disallowance of interest deductions, forced disclosure of tax accrual workpapers and extended statutes of limitations. Taxpayers involved in basket contracts should seek the assistance of their tax advisor in order to ensure proper disclosure.

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Tax Digest

Senate Finance Committee bill would extend key international tax provisions

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The Senate Finance Committee has passed a tax extenders bill with broad bipartisan support to extend many expired provisions through 2016. With an estimated cost of $95.2 billion, the package would extend two key international tax provisions: (1) the controlled foreign corporation (CFC) look-through rule, and (2) the active financing exception. The CFC look-through rule allows multinational corporations to defer U.S. tax liability on passive interest, rents and royalties of a foreign subsidiary as long as these amounts are attributed to the active conduct of a related party. The active financing exception allows multinational financial services companies to defer U.S. income tax on income from active banking, financing, insurance or similar business activities. While the introduction of an extenders bill early in the legislative cycle is welcomed, some have questioned whether an extenders bill diminishes the chances of greater tax reform occurring this year. Some in the House believe that a two-year extension will distract from the greater goal of permanent reform, specifically international tax reform that may include a dividend exemption system and a repatriation tax holiday. Indeed, the presence of an extenders bill combined with the focus on the upcoming presidential election cycle may make it difficult for this Congress to focus on a serious tax reform effort over the next year.

STATE AND LOCAL

Indiana announces details of 2015 tax amnesty program

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On July 22, 2015, the Indiana Department of Revenue announced that the state's 2015 tax amnesty program will run from Sept. 15 through Nov. 16 of this year. This program is a limited-time opportunity for individuals and businesses to pay past-due taxes for periods ending prior to Jan. 1, 2013, free of penalties, interest and collection fees. The program applies to all taxes managed by the department, and participants will receive release from tax liens that have been imposed in relation to existing liabilities and will not be subject to civil or criminal prosecution for settled matters. This program represents an opportunity for taxpayers to limit their costs when coming into compliance or resolving uncertainties and was implemented as part of this year's package of Indiana tax legislation. For more information regarding these 2015 Indiana tax changes and the amnesty-enabling legislation, read our May 18, 2015, article, *Indiana enacts significant tax law changes, falls short of complete reform*.

In wake of *Wynne*, states begin allowing credit for local income taxes paid

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On May 18, 2015, the U.S. Supreme Court ruled in *Comptroller of the Treasury of Maryland v. Wynne, et ux*, that a Maryland resident owner of a flow-through entity may utilize a credit for income taxes paid to other states to offset both Maryland state-level and county-level personal income taxes. Although the calculation of the amount of the credit, which historically has been limited solely to state income taxes paid, was not an issue in *Wynne*, it is arguable that underpinning the Court's ruling was the presumption that local income taxes are equivalent to state income taxes for the purposes of constitutional analysis because they are authorized and imposed under the state taxing authority and that, therefore, no distinction should be made between state-level and local-level income taxes. Accordingly, it is arguable that the amount of an individual's credit for income taxes paid to other states should include local income taxes paid to jurisdictions outside of the individual's state of residence, resulting in potential refund claims and going-forward savings. Taking this position was expected to be contentious. However, two states have already conceded the issue: Maryland through the issuance of Form 502LC and Kansas in advice to the state's legislature. For more information on the *Wynne* case and its impact on state individual income taxes, read our tax alerts, *US Supreme Court issues Wynne ruling* and *Maryland updates Wynne FAQ*.

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