December 2012

Tax Digest

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

FEDERAL

Final tangible asset regulations effective date delayed

Natalie Tucker, director, Washington National Tax
Mike Metz, partner, National Tax

On Nov. 20, 2012, the IRS and Treasury Department released a notice delaying the effective date of the final regulations regarding the deduction and capitalization of expenditures related to tangible property. The regulations will now take effect for taxable years beginning on or after Jan. 1, 2014, but provide taxpayers with the option to apply the temporary regulations to taxable years beginning on or after Jan. 1, 2012. The notice indicates areas where additional revisions to the regulations may occur prior to finalization. The ability of taxpayers to selectively apply provisions of the temporary regulations before 2014 heightens the importance of taking time now to scope which areas of the rules may result in tax benefits, and taxpayers should also determine what information and resources will be needed to implement the new rules once finalized.

Adverse court ruling for taxpayer attempting to qualify ERP-related expenses for research tax credit

Tom Windram, partner, Washington National Tax
Steve Pashley, manager, Washington National Tax

A recent federal District Court ruling held that a taxpayer did not provide sufficient documentation showing that it met the "process of experimentation" test for purposes of the section 41 research tax credit. While the taxpayer was able to establish that its employees were involved in testing of the ERP implementation, it was unable to provide supporting documentation showing that the employees were working to resolve uncertainties that existed at the beginning of the project. As a result, the IRS was entitled to recover amounts related to the credit that it had previously refunded to the taxpayer. This decision highlights the importance for taxpayers to properly support their research tax credit claims with relevant documentation.

Should you change from a pass-through entity to a C corporation?

Bob Adams, partner, Washington National Tax

Current headlines often refer to the reduction of corporate tax rates. With this potential for corporate tax reduction, in what form should business owners plan to operate their businesses in the future–C corporations or pass-through entities? President Obama has proposed lower corporate tax rates and changes to the corporate base, which many view as a harbinger of impending reforms and a reason for business owners to reconsider the tax structures of their businesses. Because the tax entity decision can be affected by many issues, any structural tax planning should be accompanied by thorough due diligence, including: analyzing the impact of (1) scheduled tax rate increases (which would raise individual, dividend and capital gains tax rates); (2) the introduction of the Affordable Care Act 3.8 percent tax on net investment income; and (3) various other reforms that could soon become reality. In order to determine the most tax-efficient entity in which to conduct business in the future, business owners should consult with their business and tax advisors for a thorough evaluation.

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Tax Digest

INTERNATIONAL

Increased importance of identifying your foreign partners

Moshe Metzger, partner, New York, N.Y.

While it is critical for many reasons for a partnership to accurately identify its foreign partners, the recent enactment of the Foreign Account Tax Compliance Act (FATCA) further elevates the importance of doing so. If partners do not provide adequate proof of foreign status, the FATCA withholding regime will require U.S. withholding, not only on certain income allocable to such partners, but also on gross proceeds from the sale of property that can produce U.S. source income. Though the FATCA withholding rules are not yet operative, many entities have wisely commenced the process of implementing the FATCA-required identification process. The U.S. tax withholding regime is complex, and noncompliance can be costly. With so much at stake, how can partnerships ensure proper identification of foreign partners? The partnership must obtain from every partner the relevant tax identification forms. These are Forms W-9 (for U.S. persons), W-8BEN (for foreign persons) and W-8IMY (for foreign intermediaries). In general, the partnership can rely on properly completed forms to establish the partner's tax status and potential eligibility for treaty benefits.

New tax rules that apply to foreign currency hedging transactions may produce unexpected results

Ramon Camacho, principal, Washington National Tax

A taxpayer holding foreign currency debt as an asset or liability may enter into hedges to minimize exposure to exchange rate fluctuations. Under current federal law, a foreign currency debt instrument and associated hedge may be taxed as a single debt instrument if the taxpayer elects "integration" treatment. Taxpayers making this election generally do not recognize foreign currency gain or loss, unless the hedge is terminated before the debt instrument matures, or vice versa. However, under new regulations effective for hedge terminations occurring on or after Sept. 6, 2015, taxpayers that hedge a foreign currency debt instrument with multiple hedges and subsequently terminate some, but not all, of the hedge positions must recognize gain or loss on the debt and all of the related hedges, even those that have not been terminated. Though many taxpayers previously recognized gain or loss only with respect to positions the taxpayer actually terminated, the new regulations make clear that this reporting position is no longer viable. As a result, taxpayers may be required to recognize more gain or loss than anticipated, which could affect the calculation of earnings and profits, subpart F income and the foreign tax credit. These rules could result in significant book-tax differences that taxpayers should consider, as when performing periodic assessments of currency hedging strategies.

Tax Digest

Proposed W-8 BEN and other forms could increase international tax compliance burdens

Ramon Camacho, principal, Washington National Tax

In order to facilitate compliance with the Foreign Account Taxpayer Compliance Act of 2010 (FATCA), the IRS on June 6, 2012, released drafts of new Forms W-8 BEN and W-8 BEN-E. New drafts of Forms W-8 IMY, W-8EXP and W-8ECI were also released. While not required to withhold under FATCA in 2013, U.S. withholding agents will still be required to withhold under existing U.S. withholding rules that apply to payments made to foreign persons, and will likely be required to use the new Forms W-8 BEN or W-8 BEN-E to document their foreign payees. The use of these forms could impose significant new burdens on U.S. withholding agents, as well. For example, the new forms require U.S. withholding agents to obtain from each foreign payee a taxpayer identification number issued by his or her foreign country. Moreover, U.S. withholding agents will likely be required to validate this foreign tax identification number by comparing it against information provided by the IRS, and may even be required to include the number in the information reports issued by the U.S. withholding agent to both the IRS and the payee. This requirement, along with other changes to Form W-8BEN, could force taxpayers to make changes to their existing reporting systems. Taxpayers who report under either the current or draft Forms W-8 will also be required to obtain a U.S. individual taxpayer identification number (ITIN) from their foreign payees. U.S. withholding agents should encourage payees who lack an ITIN to file a request for one immediately because of the long turnaround times currently experienced by taxpayers.

STATE & LOCAL

Delaware regulation limits look-back period for unclaimed property holders under audit

Catherine Del Re, director, New York, N.Y.
Yudit Freda, manager, New York, N.Y.

The Delaware Department of Finance's Division of Unclaimed Property recently adopted a regulation, effective Dec. 1, 2012, that temporarily affects the holder look-back period to be used by the Delaware State Escheator. The regulation provides that all unclaimed property holders currently under audit, or that become subject to an examination prior to the effective date, will have a look-back period limited to Jan. 1, 1986, provided that the examination is completed by June 30, 2015. For holders that become subject to an examination on or after the effective date, or whose examinations are not completed by June 30, 2015, the Delaware State Escheator will apply its existing policy of looking back to Jan. 1, 1981. For purposes of the regulation, an examination is deemed to be complete for any category of property as of the date the Audit Manager mails the statement of findings and request for payment. Holders currently under audit by the State Escheator should consider requesting a preliminary Report of Examination, in order to determine whether it makes sense to terminate remediation efforts, in order to obtain the benefit of the Jan. 1, 1986, look-back period. Holders not currently under audit by the State Escheator or a third-party audit firm should consider entering into Delaware's new unclaimed property voluntary disclosure program, which offers a substantial reduction in look-back periods.

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Tax Digest

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