Tax Digest

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

December 2013

FEDERAL

Final regulations issued on net investment income tax

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The IRS on Nov. 26, 2013 released much-anticipated guidance regarding the 3.8 percent net investment income tax. Highlights include the following:

- Taxpayer-friendly guidance excluding from net investment income certain self-rentals and other rental income that is properly grouped with a nonpassive trade or business activity.
- A useful safe-harbor provision for qualified real estate professionals who participate in rental real estate activities for more than 500 hours per year.
- Taxpayer-friendly revisions that will allow taxpayers with losses in excess of gains to, in some cases, offset other investment or business income with the excess losses.
- Favorable changes with respect to calculating allowable deductions for items such as investment expenses.

The guidance also includes new proposed regulations dealing with issues not previously addressed by the IRS or where there were significant modifications to the earlier proposed regulations. This guidance includes rules governing guaranteed payments to partners and rules governing the disposition of an ownership interest in an S corporation or partnership. Taxpayers should consult with their tax advisors to determine the impact of the new guidance.

Biodiesel mixture tax credits not includable in gross income

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The IRS recently released guidance clarifying that biodiesel mixture tax credits are not includable in a taxpayer's gross income. Taxpayers producing biodiesel mixtures for sale to third parties are eligible to claim a tax credit up to the amount of their fuel tax liabilities. To the extent the credit exceeds a taxpayer's quarterly fuel tax liability, a taxpayer may receive a cash payment or a refundable income tax credit. Because Congress specifically provided that the biodiesel and renewable diesel tax credits, under a different section of the tax law, should be included in gross income but did not do the same for section 6426(c) biodiesel mixture tax credits, the IRS concluded that Congress intended to exclude these items from gross income.

Employer health plans impact employee exchange coverage

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Bill O'Malley, Director, Washington National Tax

Despite the federal government shutdown this fall, the new health insurance exchange (also known as the marketplace) opened for enrollment on Oct. 1, 2013. Individuals applying for health insurance through the exchange must answer questions about health coverage offered by their employers. The answers to these questions directly impact the individual's eligibility for premium tax credits that can reduce the individual's

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cost of exchange coverage. Individuals are encouraged to obtain information about their employers' plans via an Employer Coverage Tool. The tool is a one-page form that reports (1) the employer's name, EIN and contact information; (2) details about the employer's health plan, including eligibility, cost and compliance with the minimum value standard; (3) the employee's eligibility for the employer's health plan; and (4) future changes the employer intends to make to the plan. Employers should be prepared to complete the Employer Coverage Tool upon receiving a request from an employee.

Opportunity for refund of FICA taxes

Steve Levin, Director, Washington National Tax

Did your company pay FICA tax on severance benefits paid to involuntarily terminated employees resulting from a reduction in workforce or the closing of a plant or business operation during the period from 2010-2013? If so, you may want to file a protective refund claim (Form 941-X requesting a refund of FICA taxes that meets IRS requirements) pending the U.S. Supreme Court's review of the Sixth Circuit's decision in *Quality Stores* that is expected to be heard next June. The Sixth Circuit Court of Appeals decision in *Quality Stores* held that supplemental unemployment compensation benefits are not taxable wages for FICA purposes. The deadline to file a protective claim for the 2010 payroll year is April 15, 2014. While the protective claim will allow for consideration of the refund, the IRS will likely reject refund claims pending the Supreme Court's decision. If the IRS denies the claim, the employer has two years from the date of denial to bring a suit. This two-year date can be extended to a future date by agreement with the IRS on Form 907.

Cafeteria plan use-or-lose modifications

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The IRS recently announced that employers can amend the "use-it-or-lose-it" provision of their health flexible spending account (FSA) plans to allow participants to carry forward up to $500 of unused contributions to the next plan year. While generally good news, the decision to adopt this change is not as easy as it might seem. Many FSA plans have a two-month and 15-day grace period after the end of the plan year, during which participants can apply expenses incurred during the grace period to unused prior-year contributions. However, an FSA cannot use both the $500 carryover rule and the grace period rule. Another complication is the interaction of an FSA with a health savings account (HSA). The HSA rules restrict employees from contributing to an HSA in the same year they are participating in a general purpose FSA. More guidance will be needed from the IRS as to whether the FSA carryover rule could restrict employees from participating in an HSA portion of a high-deductible health plan offered by their employer. Employers may want to review their current flexible spending account plans for potential changes.

Year-end charitable gifting strategy–qualified charitable distributions

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While the American Taxpayer Relief Act of 2012 (ATRA) may be largely a misnomer, a few provisions are beneficial to taxpayers. One such provision is the extension through this year of the qualified charitable distribution (QCD). This provision permits an IRA holder who is age 70½ or older to make a distribution from his or her IRA account directly to a public charity and exclude the distribution from gross income. Such a charitable distribution can be made in an amount up to $100,000 and satisfies any required minimum distribution for 2013. Since the amount of a QCD is excluded from gross income, it does not increase a taxpayer's adjusted gross income (AGI) and is not taken into account in determining any deduction for charitable contributions. The distribution may be taxable under state law unless the applicable state relies on federal AGI in computing state taxable income. A taxpayer making a QCD does not get a charitable deduction on his or her Form 1040, however. Under ATRA, this provision was only extended through the end of this year, and it is unknown whether Congress will move to reauthorize this favorable tax provision for 2014.

IRS expands its Fast Track Settlement program

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On Nov. 6, 2013, the IRS announced that its Small Business/Self-Employed (SB/SE) Division will expand its Fast Track Settlement (FTS) program coverage from a limited list of locations to nationwide, thus making it available to many small businesses under IRS audit. FTS is a streamlined program using alternative dispute resolution techniques to quickly settle factual or legal issues, generally within 60 days. Participation in FTS is optional, and the results are nonbinding. If the taxpayer and the examination team do not reach a settlement during the FTS session, the taxpayer can appeal the IRS adjustments to IRS Appeals, which can also settle the issues under a formal appeals process. This formal process involves a much longer timeframe, from several months to more than a year. FTS may be requested at any time after an issue has been fully developed by the IRS, but preferably before the issuance of a 30-day letter or equivalent notice.

INTERNATIONAL

Senate Finance Committee releases comprehensive international tax reform proposals

Ramon Camacho, Principal, Washington National Tax

On Nov. 19, 2013, the staff of the U.S. Senate Finance committee released a discussion draft containing alternative international tax reform proposals that would substantially revise the U.S. international tax system and would likely affect every taxpayer with cross-border activities or investments. The draft contains three distinct sets of proposals, "Option Y," "Option Z," and a set of proposals that would be enacted along with either Option Y or Z. Under the draft, the earnings of foreign corporations would likely be subject to a minimum tax of 60 percent (or more), and pre-enactment earnings accumulated offshore would be subject to tax at 20 percent. The draft contains many other provisions affecting the taxation of international business activities and would likely increase statutory complexity. While enactment of any significant tax reform is unlikely in the current political environment, these proposals may form the basis of a future tax reform package if and when tax reform gains momentum. The provisions relating to deferral of foreign earnings will continue to be a focus of debate, and while the future is uncertain, any significant tax reform package will likely modify the taxation of income earned through foreign corporations. Taxpayers should monitor these developments closely and assess the potential impact of these provisions (and any other subsequent proposals) on their business interests.

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