Tax Digest

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

January 2015

FEDERAL

McGladrey issues flowcharts to assist in applying the tangible property regulations

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Since the tangible property regulations govern the treatment of all costs related to tangible property, virtually all taxpayers that purchase or produce tangible property are affected by these new rules. At this point, taxpayers should have all the necessary guidance from the IRS to fully implement the tangible property regulations for the 2014 tax year. Although the final regulations provide a significant amount of direction in determining whether an expenditure should be treated as a deductible or capitalizable cost, the regulations are over 200 pages long and can be cumbersome to navigate. To aid taxpayers in applying the final regulations, McGladrey has developed three flowcharts to help clarify common items of confusion. Although these flowcharts are intended to assist and provide clarification with respect to applying the regulations, taxpayers should consult with their tax advisors before making any decisions regarding the federal income tax treatment of any costs paid or incurred with respect to tangible property.

Payments to LLCs not automatically exempt from information reporting

Marc Lamothe, Partner, Boston, Massachusetts

Payments to corporations are generally exempt from otherwise applicable information reporting requirements. The IRS recently reminded taxpayers that this exemption does not generally apply to a limited liability company (LLC) treated as a partnership or a disregarded entity for tax purposes. Such an LLC is not a "corporation" for these purposes. In particular, the IRS explained that all persons engaged in a trade or business who, in the course of that trade or business, make payments of $600 or more to another person are required to report the payments to the IRS. While an exemption from this reporting requirement exists for payments made to a corporation, a corporation for this purpose does not include an LLC unless the LLC has elected to be treated as an association on a valid Form 8832. However, under the one exception to this rule, information reporting to an LLC treated as a partnership is not required if all of the members of the LLC are themselves corporations and the LLC has notified the payor of this fact in the manner described in the regulations.

Final regulations require unbundling fees that contain costs subject to 2 percent floor

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Taxpayers employing a corporate fiduciary to administer irrevocable family trusts are accustomed to paying a wrap fee. Beginning in 2015, such wrap fees must be "unbundled" to allow the fiduciary to properly account for estate or trust expenses that are miscellaneous itemized deductions subject to the 2 percent floor and the alternative minimum tax. Miscellaneous itemized deductions may be deducted by an individual taxpayer only to the extent that the deductions exceed 2 percent of the taxpayer's adjusted gross income. Section 67(e) applies the same rule to estates and trusts but creates an exception for costs incurred in the administration of the estate or trust that are not customarily incurred

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by individual taxpayers. Fees for investment advice are commonly incurred by individuals and are therefore subject to the 2 percent floor. Any "reasonable method" can be used to determine what portion of a bundled fee is attributable to investment advice.

More taxpayers required to report uncertain tax positions to the IRS

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Corporate taxpayers that issue (or are included in) audited financial statements that report reserves for contingent U.S. income tax liabilities for positions in the taxpayer's Form 1120 may be required to file Schedule UTP, *Uncertain Tax Positions*, to disclose the position with the IRS if the filing threshold is met. The filing threshold applies to corporations with assets that equal or exceed $10 million at either the beginning or end of taxable years beginning in 2014 or later. The threshold was reduced from previous tax years, now subjecting a broader base of taxpayers to the requirement. Taxpayers must understand that the IRS looks at every Schedule UTP that is filed, which raises the risk that the taxpayer will be subject to a tax audit. IRS examiners and specialists have been trained expressly on how to use the information on filed Schedules UTP for taxpayers under an IRS audit. As a result, taxpayers should be aware that their financial reporting positions will directly impact the U.S. tax reporting requirements beyond just their taxable income. Impacted taxpayers should consider exploring planning opportunities to potentially eliminate the requirement to file Schedule UTP and concurrently reduce the audit risk profile with the IRS.

INTERNATIONAL

Congress passes international tax extenders

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Enacted on Dec. 19, 2014, the Tax Increase Prevention Act of 2014 provides a one-year retroactive extension of several business and individual tax provisions that had previously expired at the end of 2013. Included in the act is the extension of two key international tax provisions: the controlled foreign corporation (CFC) look-through rule and the active financing exception. Generally, U.S. parent corporations must recognize the passive income of foreign subsidiaries in the current tax year, regardless of whether that income has been "repatriated" to the U.S. parent. The CFC look-through rule allows multinational corporations to defer U.S. tax liability on passive interest, rents and royalties of a foreign subsidiary that are attributable to the active conduct of a related party's trade or business. The active financing exception allows multinational financial companies to defer U.S. income tax on income from active banking, financing, insurance or similar business activities. Both of these exceptions are available to middle-market companies with qualifying foreign operations. Taxpayers preparing their financial statements may need to take these changes into account. Because these extensions expired again at the end of 2014, taxpayers should consider strategies to manage and reduce potential tax increases that may result if Congress fails to extend the provisions for 2015.

IRS provides relief in final reporting rules for foreign financial assets

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On Dec. 12, 2014, the IRS published final rules requiring taxpayers to report certain foreign financial assets on Form 8938, *Statement of Specified Foreign Financial Assets*. Prior regulations were set to expire at the end of 2014. Generally, taxpayers are required to report on Form 8938 foreign deposit accounts, investment accounts, and accounts with signatory authority. Significant changes made by the final regulations may affect many taxpayers. For example, the regulations expand the definition of a "financial account" to include retirement accounts, pension accounts, and certain nonretirement

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savings accounts that were not previously included. Additionally, unvested assets received in connection with an individual's performance of personal services as an employee of a foreign employer are now exempt from reporting entirely (i.e., the final rules do not require reporting until the rights in the asset vest). Another major change relates to a new section 6038D reporting exemption for a dual resident individual taxpayer who, pursuant to a treaty provision, claims to be a foreign resident. There was broad concern that requiring these individuals to report these assets could cause noncompliance issues, even if inadvertently. New rules also specify that an individual is treated as owning the foreign assets of a disregarded entity and, thus, must report foreign financial assets to the extent of his or her interest in the entity. Taxpayers, along with their advisors, should promptly determine how the new rules will affect them.

STATE AND LOCAL

Colorado addresses in-state employee nexus—consider structural planning

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On Dec. 12, 2014, the Colorado Department of Revenue (DOR) released a private letter ruling originally issued on July 28, 2014, concluding that the proposed presence of a company's employees in Colorado would be sufficient to establish Colorado nexus and that the company would, therefore, be required to collect and remit sales tax on online sales to Colorado residents. The company filed a request for a private letter ruling with Colorado, asking whether the company would have Colorado nexus if (1) it hires an employee located in Colorado whose sole duty would be to identify Colorado wine cellars for acquisition, transportation outside of the state, and eventual sale over the Internet, and (2) its out-of-state employees fly into Colorado, taste a sample of the wines in question and then, assuming the wine meets quality standards, approve acquisition of the wine. The company specifically stipulated that these employees would not be involved in the Internet sales process. The DOR found that the proposed activities of the employees would establish nexus for the company in Colorado for sales tax purposes and that it was irrelevant that the activities were not directly related to the sales transactions that would be subject to tax. Businesses contemplating hiring employees in, or sending current employees into, a state should consider the nexus implications of those employees' activities and determine whether employment structural planning can be used to limit sales tax collection and remittance responsibilities.

Internet Tax Freedom Act extended to October 2015

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On Dec. 16, 2014, President Obama signed 2014 H.R. 83, extending the Internet Tax Freedom Act (ITFA) through Oct. 1, 2015. The ITFA imposes a moratorium on the states from imposing taxes on Internet access or placing discriminatory taxes on e-commerce and was the key factor in the Illinois Supreme Court's decision in *Performance Marketing Association, Inc. v. Hamer* that Illinois' click-through nexus law was pre-empted by the ITFA and, therefore, void. The extension of the ITFA, which was originally due to expire on Nov. 1, 2014, but had been previously extended by joint resolutions, keeps this argument available as more states seek to impose sales tax on remote e-commerce through the enactment of click-through nexus provisions similar to those in New York and Illinois. However, continued extension of the ITFA past Oct. 1, 2015, is likely to be hotly contested, and may be tied up in Congressional arguments over the Marketplace Fairness Act.

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