Tax Digest

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

January 2016

EVENTS

More tax events and webcasts

FEDERAL

Generous tax extenders package enacted

President Obama signed a massive spending and tax bill on Friday, Dec. 18 that makes permanent several popular tax incentives, extends most others for two years or more, and adds some important new, permanent tax provisions including provisions affecting real estate investment trusts and foreign investments in real estate. Among the most important longer-term extensions are:

- Research and development tax credit made permanent and liberalized for certain small businesses
- Section 179 equipment expensing made permanent, with higher limits and phase-outs
- Bonus depreciation extended through 2019
- Work Opportunity Tax Credit extended through 2019

Please click here to read a summary of the extended and other tax provisions that are most relevant to leaders and owners of middle market businesses.

IRS continues to examine worker classification

Colleen Fogerty, Director, Boston, Massachusetts

It is the age-old conundrum for a small business owner: making the determination as to whether a worker is an independent contractor or an employee. Recently, the IRS has renewed its efforts to identify misclassified workers. Generally, an individual is an independent contractor if the business only has the right to control or direct the result of the work and not the means and methods of accomplishing the result. The IRS considers three aspects of control when determining whether an individual is an employee or an independent contractor:

- Behavioral control: If a business has a right to direct and control how the worker does the task, the individual will often be classified by the IRS as an employee.
- Financial control: Individuals who must make a significant financial investment in the work (e.g., by buying equipment or supplies) often are classified by the IRS as independent contractors. Likewise, individuals who could either realize a profit or a loss typically are classified as independent contractors.
- The type of relationship between the parties: Individuals who receive benefits such as paid leave or insurance often are classified by the IRS as employees.

As the penalties for misclassification can be substantial, it is important to review each person whom you currently classify as an independent contractor to ensure he or she still fits the definition.

Real estate fund sponsors should be aware of potential new guidance on the fractions rule

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A long-awaited Treasury regulations project focusing on the *fractions rule* is reportedly underway. At its core, the fractions rule aims to prevent the shifting of losses to taxable entities (or the shifting of income to tax-exempt entities) when they co-invest in real estate assets through

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partnership structures. While neither Treasury nor IRS officials have provided any insight into the timing or content of the new guidance, they have confirmed that the project is indeed in the pipeline. This should come as welcome news for real estate fund sponsors. Certain qualified tax-exempt organizations, namely pension plans and college endowments, often deploy significant capital to real estate funds. For real estate funds with qualified organizations as investors, the fractions rule has long-served as a popular tax structuring technique by helping to mitigate the qualified organization's exposure to the unrelated business income tax. Potential changes stemming from this project may ease the burdens created by the existing rules and could significantly affect high-level tax structuring decisions made by fund sponsors. The decision of whether to employ a fractions rule structure, as opposed to a structure that utilizes a real estate investment trust or other corporate blocker, not only impacts a fund itself, but can have a trickle-down effect on a fund's underlying investments and joint venture partners. For now, fund sponsors should continue to evaluate the potential viability of a fractions rule structure and monitor the development of guidance that may make this type of structure more appealing to employ and less burdensome with respect to compliance.

Upcoming retirement plan deadline

Bill O'Malley, Senior Director, Washington National Tax

Employers that are using IRS pre-approved defined contribution plans, including 401(k) and profit sharing plans (but not 403(b) plans), have until April 30, 2016, to adopt updated plan documents. The update is required by the Pension Protection Act of 2006 as well as the Heroes Earnings Assistance and Relief Tax Act of 2008, and the Worker, Retiree, and Employer Recovery Act of 2008. This legislation involved enhanced benefits for employees returning from military service, changes to participant disclosure rules, automatic contribution plan designs, protections for providing employees investment advice, and many other changes. A failure to restate a pre-approved plan by this deadline can jeopardize the plan's tax qualified status and be expensive to fix. Employers should confirm with their plans' administrative service providers that their plan documents have been or will be timely updated. This is also an opportunity to review with your advisor the overall design of the plan to ensure the various provisions of the plan regarding eligibility, vesting, including the definition of eligible plan compensation, etc. continue to meet your company's needs.

Pros and cons of using an LLC versus a private foundation for charitable gifts

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Mark Zuckerberg, the 31-year-old co-founder of Facebook and billionaire, and his spouse, Priscilla Chan, pledged recently to donate 99 percent of their Facebook stock to charity. Instead of immediately funding a private foundation with Facebook stock and beginning to make charitable gifts from the foundation, Zuckerberg and Chan opted to transfer the Facebook stock to a wholly owned LLC, which is disregarded for tax purposes. Their decision to use an LLC instead of a private foundation has caused other donors to consider the benefits of this structure. An LLC can invest in for-profit companies and make political donations. Gifts of appreciated stock can be made directly to charities, with the LLC owners able to utilize the charitable deduction. A private foundation, meanwhile, has to make annual distributions of 5 percent of the average fair market value of the foundation's investment assets to section 501(c)(3) charities and is subject to the self-dealing rules, excise taxes on unrelated business income, and IRS oversight. From an estate tax perspective, Zuckerberg and Chan have not reduced their

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taxable estates, which could have been accomplished by donating stock to a private foundation. Rather, they have merely shifted assets from one pocket to another. While Zuckerberg and Chan are young, with long life expectancies, many donors are seeking to reduce their taxable estates and have the appreciation on donated assets occur outside their taxable estates. Private foundations can accomplish these goals.

INTERNATIONAL TAX

Delinquent taxes may result in loss of passport

Jamison Sites, Manager, Washington National Tax
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Recently enacted legislation authorizes the IRS to work with the U.S. Department of State to revoke or deny the passports of taxpayers with an outstanding tax liability. The Fixing America's Surface Transportation Act (FAST Act) directs the Secretary of the Treasury to notify the Secretary of State of those taxpayers with 'seriously delinquent tax debt' so that their passport privileges can be revoked or limited. Seriously delinquent tax debt is generally defined as a federal tax liability greater than $50,000 with respect to which the taxpayer has exhausted all administrative rights of appeal or review. While the IRS has not yet outlined the procedural aspects of the law, the FAST Act should quickly prove to be an important tool for the collection of tax liabilities. Taxpayers with outstanding IRS liabilities should contact their tax advisors to determine whether their passport privileges are at risk. Furthermore, businesses should assess whether key executives are delinquent in their tax obligations and whether internal procedures should be adjusted to better monitor the tax compliance of key employees who travel.

Government officials discuss recent anti-inversion guidance

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At a recent D.C. Bar meeting, representatives from the Treasury and the IRS discussed the latest inversion guidance, a notice issued Nov. 19, 2015. The notice supplements guidance issued over a year ago that was designed to make corporate inversions unattractive after the business community announced a number of high-profile inversion transactions. In an inversion transaction, a foreign corporation takes ownership of a U.S. domiciled business in order to reduce its U.S. corporate tax liability. Although legislation exists to limit the benefits of inverting, companies can still invert in limited cases and achieve tax benefits. To the surprise of many practitioners, the notice did not address earnings stripping transactions in which companies inject debt into the U.S. arm of a multinational business that moves its headquarters abroad. Despite inquiries by practitioners, government officials refused to confirm whether earnings stripping guidance would be issued soon. Because future guidance could significantly limit post-inversion earnings stripping, taxpayers that have inverted or that are considering inverting should consider whether an inversion would still appear attractive if future guidance were to limit the extent to which intercompany debt can be used to reduce the U.S. tax liabilities of U.S. operations.

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