June 2013

Tax Digest

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

FEDERAL

IRS releases guidance on repairs of steam or electric power generation property

Natalie Tucker, Director, Washington National Tax
Kate Abdoo, Manager, Washington National Tax

On April 30, 2013, the IRS released Rev. Proc. 2013-24, providing guidance for determining whether expenditures to maintain, replace or improve steam or electric power generation property constitute capitalizable improvements versus deductible repairs. Revenue Proc. 2013-24 also provides procedures for obtaining automatic consent to change to a method of accounting that uses all or some of the unit of property and major component definitions provided in the revenue procedure. This comes as welcome and significant guidance for taxpayers that own applicable steam or electric power generation property. Taxpayers with a depreciable interest in such property should consult with their tax advisors on whether adopting or changing to one or more of the definitions provided in Rev. Proc. 2013-24 is advisable for tax years ending on or after Dec. 31, 2012. Rev. Proc. 2013-24 notably does not apply to property used to produce electricity from alternative energy sources (e.g., wind or photovoltaic).

Partnership allocations of cancellation of indebtedness income

Bob Gaughan, Director, Phoenix, Ariz.

After five years, as the country continues to dig through a weak economy, many taxpayers are dealing with cancellation of indebtedness income (CODI). A lot of time is spent trying to figure out what CODI is and why it is a good thing (e.g., the benefits of section 108) or why it is a bad thing (e.g., CODI is ordinary income, not capital gain, and depending on the work-out arrangement, one type of income may result versus the other). Often, when it comes to partnerships, not enough time is spent trying to figure out which partners should be allocated CODI, how much CODI they should be allocated, and why. Partnerships that have realized CODI should use extra effort to understand the options and how they affect allocations to partners. One partner may have an appetite for CODI that differs from the other partners. Depending on the circumstances, that partner might be accommodated without "substantially" affecting results for other partners.

Tax Court provides guidance on timing of bad debt deductions

Natalie Tucker, Director, Washington National Tax

A recent Tax Court decision provides guidance for taxpayers in determining whether a debt is both bona fide and worthless (and thus deductible as a bad debt) pursuant to section 166. These determinations are highly factual issues that frequently arise and cause uncertainty for taxpayers, and the Tax Court's discussion provides taxpayers with valuable guidance in determining when a bad debt deduction is available. Taxpayers and their tax advisors should take time to review taxpayers' current methodologies for determining the existence of bona fide, worthless debt in light of the Tax Court's decision and should determine whether changing methodologies (to either accelerate bad debt deductions or limit exposure for improper deductions) is advisable.

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Tax Digest

Safe harbor treatment of eligible milestone payments will not be challenged by exam

Natalie Tucker, Director, Washington National Tax
Nick Gruidl, Partner, Washington National Tax

In a change of position from a chief counsel advice issued in 2012, the IRS Large Business & International Division (LB&I) on April 29, 2013, issued a directive providing that if certain requirements are satisfied, LB&I examiners will not challenge a taxpayer's treatment of nonrefundable milestone payments paid or incurred in the course of covered transactions under Reg. section 1.263(a)-5(e)(3). The directive applies only to non refundable milestone payments for investment banking services that are creditable against a success-based fee. The directive effectively upholds a taxpayer's application of the safe-harbor method of Rev. Proc. 2011-29 to such nonrefundable milestone payments and is welcome news to taxpayers that presently have tax returns under exam for years in which the safe-harbor method was applied to eligible milestone payments. Taxpayers currently incurring eligible milestone payments in connection with a covered transaction should discuss with their tax advisors whether they are eligible to apply the safe-harbor method to milestone payments paid or incurred during any taxable year for which a tax return has not yet been filed.

Material participation and the timing of research deductions in computing non-corporate AMT liabilities

Tom Windram, Partner, Washington National Tax
Steve Pashley, Manager, Washington National Tax

While a taxpayer is allowed to currently deduct research and experimental expenses under section 174(a) for regular tax purposes, a special rule contained in section 56 provides that for alternative minimum tax (AMT) purposes, non corporate taxpayers must capitalize and amortize research and experimental expenses over 10 years. An exception to this rule applies to the extent a taxpayer materially participates in the activities for which the deductions apply. A recent IRS chief counsel technical advice memorandum analyzes the application of the material participation rules in the context of a complex trust and highlights the opportunity for individual and pass-through taxpayers to qualify for an exemption to this rule under the right circumstances. If a taxpayer can satisfy the material participation test by establishing that it regularly, continuously and substantially participated in the activities of the business, the section 56 limitation will not apply, and the taxpayer will be able to currently deduct research and experimental expenses for AMT purposes.

Treasury and the IRS publish long-awaited final regulations under section 336(e)

Nick Gruidl, Partner, Washington National Tax
Amy Kasden, Manager, Boston, Mass.

The Treasury and IRS recently published long-awaited final regulations under section 336(e), expanding the application of deemed asset sale transactions beyond sections 338 and 338(h)(10) for certain corporate target entities. With the issuance of these final regulations, taxpayers now have the ability to make a section 336(e) deemed asset sale election on a qualifying stock disposition of target company stock. The new regulations adopt many of the provisions of sections 338 and 338(h)(10), with certain modifications. This expansion of the deemed asset sale rules allows non corporate taxpayers as acquirers and allows certain distributions, including tax-free distributions, to qualify as stock dispositions for purposes of the election.

Read the full Tax Alert.

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Tax Digest

INTERNATIONAL

IRS releases draft Forms W-8BEN and W-8BEN-E in light of upcoming FATCA deadlines

Ramon Camacho, Principal, Washington National Tax

Under the provisions of the Foreign Account Taxpayer Compliance Act (FATCA), U.S. withholding agents on Jan. 1, 2014, must begin withholding an amount equal to 30 percent of certain U.S. source payments made to a wide variety of foreign entities unless the U.S. withholding agent receives appropriate documentation showing that the payee is entitled to an exemption or reduced rate of withholding. In light of this upcoming deadline, the IRS has released new draft Forms W-8BEN and W-8BEN-E that taxpayers must use to document any claim to a reduced rate related to or an exemption from the FATCA tax. At eight pages, Form W-8BEN-E is substantially longer than the one-page form it replaces and reflects the dozens of new regulatory categories that the final FATCA regulations require U.S. withholding agents (including both financial and non financial firms) to apply in classifying payees. Taxpayers will generally be required to use the forms beginning six months after the forms are finalized. The forms will likely be finalized in time for U.S. withholding agents to use them as documentation for payees that are documented on or after Jan. 1, 2014, the date FATCA withholding is set to begin. Because substantial penalties exist for failure to properly withhold without collecting valid payee documentation, all U.S. withholding agents should become familiar with the categories of FATCA payees.

STATE AND LOCAL

Florida expands sales tax exemption for manufacturing machinery and equipment

Dave Elder, Director, West Palm Beach, Fla.

On May 17, 2013, Florida enacted HB 7007, which creates a new sales and use tax exemption for industrial machinery and equipment purchased by an eligible manufacturing business. The exemption is available for purchases made from the date of enactment on May 17, 2013, through April 30, 2017, at which time it expires. For the purposes of this exemption, the term "industrial machinery and equipment" generally means tangible personal property or other property that has a depreciable life of three years or more and is used as an integral part in the manufacturing, processing, compounding or production of tangible personal property for sale. The term "eligible manufacturing business" means any business, at the location where the industrial machinery and equipment is located, the primary activity of which is classified under NAICS code 31, 32 or 33. Prior to the enactment of HB 7007, purchases of industrial machinery and equipment were only exempt if made by new and expanding businesses.

Indiana ruling potentially creates throwback refund opportunity

John Bird, Partner, Chicago, Ill.
John Wojcik, Director, Schaumburg, Ill.

On April 24, 2013, the Indiana Department of Revenue issued Letter of Findings 02-20120562, ruling that the Texas franchise tax is a net income tax for Indiana corporate income tax purposes. As such, a taxpayer is required to add back to its Indiana tax base that the Texas franchise tax deducted on its federal income tax return. It is arguable that this ruling should likewise apply to

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Indiana's throwback rule, under which a sale of tangible personal property that is shipped to a purchaser in another state from a storage place in Indiana is sourced to Indiana for sales factor purposes when the seller is not subject to a net income tax in the state of the purchaser. Accordingly, a taxpayer that threw back Texas sales to Indiana based on the presumption that the Texas franchise tax was not a tax on net income may be entitled to refunds.

Application period for second round of Ohio incumbent workforce training vouchers expected to open summer of 2013

Mark Blawas, Director, Chicago, Ill.
Mike Baker, Director, Cleveland, Ohio

On June 30, 2011, Ohio enacted 129 HB 153, creating the Incumbent Workforce Training Voucher Program (the program). Under the program, Ohio set aside a total of $50 million over two years for the purpose of building an exceptional state workforce with advanced skills and technological know-how in Ohio's key business sectors. Ohio divided the $50 million into two rounds of reimbursable grants issued by application on a first-come, first-served basis. The application period for the first round of grants opened on Jan. 7, 2013, and the entire grant amount was allocated within 24 hours. The application period for the second round of grants, totaling $30 million, is expected to open in June or July 2013. Given the number of excess requests from the first round, it is anticipated that this round of grants will be spoken for very shortly after the state begins accepting applications.

Washington State Court of Appeals rules that the seller of wireless subscription services is subject to use tax on transfers of cellular telephones without charge

Brad Hershberger, Partner, Des Moines, Iowa

On April 30, 2013, the Washington State Court of Appeals issued its ruling in *Sprint Spectrum, LP v. DOR*, No. 42304-9-II, holding that a cellular telephone and wireless service retailer was the consumer of cellular phones it provided without charge to customers that signed extended wireless service plans and, therefore, was subject to use tax on the cost price of the telephones transferred for free. In issuing its decision, the Court of Appeals agreed with the Washington State Department of Revenue's argument that *Activate, Inc. v. Department of Revenue*, 209 P.3d 524 (2009) was controlling precedent and found that the sale of the telephones for $0 was a promotional use that triggered the imposition of use tax. However, in dicta, the Court of Appeals indicated that, if the seller had charged a penny for the telephones, use tax would not apply because a deep-discount sale is still a sale subject to sales tax and not a promotional transfer subject to use tax. The Court of Appeals' approach in this decision could have substantial impact on the sales and use tax treatment of a transfer of tangible personal property as part of a sale of services and, in light of the dicta, may provide an opportunity to structure transactions to achieve sales and use tax efficiencies.

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