Tax Digest

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

June 2015

FEDERAL

Plan sponsors must pay health plan fee by July 31, 2015

Jill Harris, Director, Washington National Tax

The patient-centered outcomes research (PCOR) fee on health plans for plan years ending in 2014 is due by July 31, 2015. The plan sponsor must pay the fee if the health plan is self-insured, whereas the insurance company pays the fee for insured plans. The fee applies to all types of employers, including tax-exempt organizations and governmental entities. Most health plans, including major medical, prescription drug and retiree-only plans are subject to the PCOR fee regardless of the number of plan participants. Special rules apply to health reimbursement accounts and health flexible spending accounts. The fee is based on the average number of employees, spouses and dependents covered by the plan and is $2.08 per covered person. PCOR fees are reported on Form 720, *Quarterly Federal Excise Tax Return*, which must be filed each year by July 31.

IRS answers questions on small taxpayer relief from the tangible property regulations

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At a recent American Bar Association meeting, IRS panelists fielded questions on IRS guidance that allows qualifying small taxpayers to adopt the final tangible property regulations without filing any Forms 3115 (requests for changes in methods of accounting), reviewing prior-year expenditures, or calculating any catch-up adjustments. The guidance applies to trades or businesses with less than $10 million in gross assets or $10 million or less in average annual gross receipts for the prior three years. These thresholds apply at the trade or business level, and therefore, the guidance may apply to individual members of a consolidated group (or disregarded entities), while not applying to all members. Although the guidance provides welcome flexibility, following the guidance results in forfeiting catch-up adjustments for prior year expenditures and audit protection for prior-year treatment. The IRS stated that since the guidance does not require an election statement, a qualifying taxpayer that fails to affirmatively elect out of the guidance will be deemed to have applied the guidance, even if the taxpayer does not actually implement the regulations. As a result, a qualifying taxpayer that does not intend to adopt the guidance must include with its 2014 return a statement electing out of the guidance. To the extent a 2014 tax return has been filed without an election out of the guidance, there may be temporary opportunities to retroactively elect out of the guidance. All taxpayers should work with their tax advisors to ensure that appropriate steps are taken to adopt the regulations for 2014.

Penalty abatement may be available to taxpayers subject to first-time penalties

Charles Schultz, Partner, Washington National Tax

Certain penalties can be waived or abated if the taxpayer has a past history of compliant behavior. In effect, the IRS rewards taxpayers with a history of compliant behavior with a one-time penalty amnesty. This relief is of particular value for two of the most common penalties: the failure to file (delinquency) and failure to pay penalties. For

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businesses, this relief also applies to the failure-to-deposit penalty for payroll taxes. The first step regarding an abatement request is determining whether you qualify. The request for abatement applies only to certain penalties and certain returns. For example, this request does not apply to federal estate and gift tax returns, the estimated tax penalty or the accuracy-related penalty. As stated above, you must demonstrate a history of compliant behavior. Specifically, you cannot have had penalties of a significant amount assessed in the prior three years on the same type of tax return for which you are seeking abatement, and you must have filed all required tax returns for the past three years. Though "significant" has never been defined by the IRS, the IRS has taken a position that any prior penalty amount is significant when it comes to qualification for abatement. If an abatement request is made by phone, there is an unpublished ceiling on the penalty amount that the IRS will abate under this program. If your penalties are substantial, you should request abatement in writing. If you do request abatement in writing, you should provide all relevant penalty relief arguments, including any reasonable cause arguments, to increase the chances of success of your penalty abatement request. Of course, if you happen to be subject to IRS penalties, your first call should be held with your tax advisors, who are best-equipped to help you mitigate, or even eliminate, these tax penalties.

INTERNATIONAL

As FFIs begin to provide information to the IRS, doors may be closing for taxpayer relief

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The number of foreign financial institutions (FFIs) disclosing the offshore holdings of U.S. citizens directly to the IRS has risen significantly, with disclosure reports coming in to the IRS from FFIs in many countries across the world. The Foreign Account Tax Compliance Act (FATCA), the driving force behind this increase in disclosures, requires FFIs to disclose to the IRS accounts associated with U.S. citizens. An FFI may be required to make its initial disclosure this year, depending on its jurisdiction. Taxpayers who hold or have signature authority over foreign assets may be required to disclose those holdings, and failure to do so may result in substantial penalties. This disclosure requirement affects those who maintain (or have signature authority over) offshore holdings, which may include a bank account used while residing or working abroad, a pension related to current or prior expatriate employment, or a joint interest in a foreign bank or investment account. IRS programs, such as the Offshore Voluntary Disclosure Program and its offshoots, may allow taxpayers to avoid the penalties that can result from a failure to disclose these assets. However, these options are not available to the taxpayer if the IRS is provided information about such assets directly from the FFI before the taxpayer discloses ownership. As a result, taxpayers who have undisclosed foreign financial assets should seek consultation as soon as possible to determine whether they are at risk and how to correct the issue.

International tax reform update

Jamison Sites, Supervisor, Washington National Tax

The slow march towards international tax reform continues to build momentum. With the Senate Finance and the House Ways and Means Committees holding joint sessions, Rep. Charles Boustany, Jr. (R-La.) is on record as stating that he expects draft legislation to be ready this summer. Building off of the proposal made by former House Ways and Means Committee Chairman David Camp, the draft international tax reform is expected to include a lower corporate rate, adopt a dividend exemption system and expand the Camp "patent box" concept to include other intangibles. Staffers on the Hill also continue to claim that a repatriation tax

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holiday is still possible as part of a package to finance domestic infrastructure projects. As the momentum for international tax reform builds, multinationals should be attentive to the proposals and drafts made public. Timing is crucial to many business decisions, and this is especially true for tax planning. Legislative changes can create planning opportunities, and corporations with significant operations abroad will benefit from closely monitoring all legislative proposals. In some cases, taxpayers will want to take action immediately after passage of legislation, but in other cases, taxpayers may need to act *before* legislation is enacted.

Major changes coming to the US Model Income Tax Treaty

Jamison Sites, Supervisor, Washington National Tax

The U.S. Treasury recently released for public comment proposed revisions to the U.S. Model Income Tax Convention (U.S. Model), which contains the baseline text used when negotiating tax treaties. These proposed changes to the U.S. Model may be significant and may not be welcomed by all. One significant proposed change would modify the limitation on benefits (LOB) article. The LOB article determines who can qualify for treaty benefits. Large multinational corporations often find the LOB article confusing, as it requires an analysis that, at times, can be very complex. Among the proposed changes to the U.S. Model's LOB article is an additional requirement that would disallow treaty benefits to those corporations that are deemed to benefit from a "special tax regime" in the foreign country. Among the chief concerns to multinational corporations is the lack of clarity as to what constitutes a special tax regime. Depending on how this term is defined, a corporation may qualify for treaty benefits one year, but fail to do so in the next due to a change in the foreign country's internal tax incentives. Multinational businesses should review the proposed revisions and convey any concerns to the U.S. Treasury in writing.

STATE AND LOCAL

MTC sets its sights on intercompany transactions

Brian Kirkell, Principal, Washington National Tax

On May 7, 2015, the Multistate Tax Commission (MTC) Executive Committee voted to approve the Arm's Length Adjustment Services (ALAS) final program design. This represents a significant step in the MTC's effort to assist the states in using transfer pricing challenges to address intercompany transactions that result in multistate income shifting. Under the program, the MTC will perform transfer pricing audits on the states' behalves, as well as provide the states with audit and litigation support, training and a Web-based resource to enable the states to efficiently and effectively challenge businesses' transfer pricing on intercompany transactions, including allocations of income and cost. Historically, states have challenged the tax benefits generated by intercompany transactions using the sham transaction doctrine, intercompany addback rules, and forced combination and have generally steered clear of transfer pricing challenges. However, with the MTC ALAS program coming online, taxpayers will have to be prepared to answer state-specific challenges to their transfer pricing studies and the structure of their intercompany transactions.

New York Tax Appeals Tribunal rules LLC member personally liable for LLC's tax

Harlan Kwiatek, Partner, New York

On May 14, 2015, the New York Tax Appeals Tribunal ruled that the member of a limited liability company (LLC) was personally responsible for the LLC's unpaid taxes from the period during which the member had managerial responsibilities for the LLC and was authorized to act

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on the LLC's behalf in financial matters. Pursuant to New York law, a member of an LLC may be held personally responsible for an LLC's unpaid taxes. However, per the division of taxation's policy, an LLC member with less than a 50 percent capital and profits interest in the LLC will not be held responsible under a duty to act on behalf of the LLC in complying with the state's tax law unless the facts indicate otherwise. The member in question owned only 22 percent of the LLC, but he (1) had the authority to make financial payments, sign payroll checks and hire and fire employees, (2) was in charge of the LLC's day-to-day operations, and (3) was not prevented in any way from exercising his authority. Accordingly, the member was under a duty to act on behalf of the LLC in complying with New York's tax law and could be held personally responsible for the LLC's unpaid taxes regardless of the fact that he owned less than 50 percent of the LLC. Members and managers of LLCs that do business within New York and are subject to New York taxes should consider the implications of this ruling when determining the extent of their personal liability for unpaid LLC New York taxes.

State tax considerations for partnerships

Alan Paul, Partner, Boston, Massachusetts

Many large businesses are now being operated in a flow-through form (e.g., as a partnership or limited liability company), affording owners the benefit of only one layer of income tax at the federal level. While the states generally follow the federal approach to taxing these flow-through entities and their owners, businesses should be aware of some important differences. First, some states, such as New Hampshire and Kentucky, subject some or all flow-through entities to an income or gross receipts tax at the entity level. Second, many states require nonresident owners to participate in a composite tax filing at the entity level or estimated tax withholding, which may be based either on actual distributions or an owner's distributive share of the flow-through entity's income without regard to whether it has been distributed or retained in the business. Third, states generally attribute flow-through entity activities to the owners for the purposes of determining whether the owners have nexus with the state and, thus, may be subject to the state's taxing jurisdiction. In certain circumstances, some states apply this nexus attribution approach to attribute in-state activities from owners to their flow-through entities, across flow-through entities with the same owners and across owners in the same flow-through entity. This type of nexus attribution can be particularly troublesome in combination with bright-line factor or economic nexus tests and market sourcing. For example, a flow-through entity that provides loans or buys loan pools throughout the United States from a single location in a single state may be deemed to have nexus in another state if its interest receipts or portfolio value attributable to the market in that state exceeds a certain threshold, such as $500,000. All of these issues, which have been subject to rapid change in recent years, should be considered by businesses operating as flow-through entities.

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