March 2013

Tax Digest

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

FEDERAL

Instructions for taxpayers to retroactively claim 2012 fuel tax credits

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

The American Taxpayer Relief Act of 2012 retroactively extended several fuel tax credits that originally expired on Dec. 31, 2011, including credits for alternative fuels, alternative fuel mixtures, biodiesel, biodiesel mixtures and cellulosic biofuels. Since several of these credits are claimed on Schedule C of Form 720, *Quarterly Federal Excise Tax Return*, it may be necessary for taxpayers to file amended Forms 720X to retroactively claim 2012 fuel tax credits for any claims arising after Dec. 31, 2011. Taxpayers should consult with their tax advisors to ensure they are taking advantage of any potential credits.

Demutualization and stock basis: Recent decisions hold against "open transaction," but disagreements remain

Ying Liu, Manager, Vienna, Va.

When a mutual insurance company demutualizes, policyholders generally receive either shares of the demutualized company or cash along with their continuing policies. The question of what, if any, basis the policyholder receives in the stock of the demutualized company has been an area of significant controversy between taxpayers and the government. Two recent decisions held contrary to a 2008 decision allowing application of the "open transaction" doctrine to a demutualization. However, these decisions disagreed on whether the taxpayer received basis in the stock of the demutualized company.

Identity theft of sensitive employee data is on the rise

Bob Adams, Partner, Washington National Tax
Patti Burquest, Principal, Washington National Tax

It is truly a hassle to deal with the fallout from fraudulent income tax returns filed by criminals posing as real taxpayers in order to get refunds. In one very common scenario, a thief steals a list of Social Security numbers from the records of a medical service office or a company's payroll department and uses the numbers along with counterfeited Forms W-2 to file U.S. income tax returns and acquire tax refunds. The victims of this type of identity theft encounter difficult administrative hassles with the IRS when trying to straighten out their records and collect any real refunds they are due. Until the taxpayer satisfies the IRS as to his or her *bona fides*, the IRS will not process the real income tax return, or any future return, and will not issue any refund due. If a refund is delayed for months, it can disrupt plans for a spring break trip, the acquisition or refinancing of a mortgage, etc. Any business that maintains taxpayers' Social Security numbers and other personal information, whether on paper or in digital form, should create procedures to safeguard such information from access by anyone other than authorized personnel. Businesses should use locked desks and file cabinets, passwords, encrypted software, and whatever else it takes to protect against the hassles described above and the productivity losses related to employees who have become victims of identity theft.

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Tax Digest

Take a closer look at who is a 5 percent shareholder under section 382

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

In recently issued PLR 201305001, the IRS addressed whether a family of target-date mutual funds would be considered an "entity" within the meaning of Reg. section 1.382-3(a)(1). The ruling held that a family of funds was not required to be viewed as a single 5 percent shareholder, despite the funds having the same advisor and investment strategy, sharing many of the same board of trustee members, investing in the taxpayer, and subsequently requiring the taxpayer to redeem their investments. Regardless of whether the funds filed a single SEC Schedule 13D or 13G, only individual funds owning 5 percent or more would be considered 5 percent shareholders. In practice, this ruling may be applicable to many public companies, as well as privately held corporations with mutual fund shareholders. For example, a family of funds owning shares will generally file a single Schedule 13D or 13G reporting their stock ownership. However, for purposes of section 382, it may be possible to disregard the funds as a 5 percent shareholder, which may allow a loss corporation to avoid a section 382 ownership change and corresponding limitation on tax attributes. Similar rulings have been issued with respect to Schedules 13D and13G filings by investment advisors, which may further benefit taxpayers hoping to avoid section 382 ownership changes. However, each case is fact-specific and requires an analysis of the specific Schedule 13 and underlying facts.

Stock options on preferred stock can be troublesome

Steve Levin, Director, Washington National Tax

Stock options are typically designed to be exempt from the complex income tax requirements applicable to deferred compensation plans. As a key condition for meeting the exemption, the stock that is the subject of the grant must be common stock of the employer (or parent company). If granted on preferred stock, the stock options must run the gamut of complying with the deferred compensation requirements, even if the options are granted at a fair market value exercise price. If, as is normally the case, the stock options can be exercised at the discretion of the option holder, they will automatically be noncompliant, and this may result in significant, adverse income tax consequences to the option holder. Accordingly, stock options on preferred stock can be troublesome and should only be utilized if reviewed by an experienced tax advisor.

IRS eliminates the de minimis rule for testing substantiality of partnership allocations

Larry Hirsh, Partner, Cleveland, Ohio

In T.D. 9607, the Internal Revenue Service retroactively removed the de minimis rule regarding substantiality contained in the partnership regulations, which had been perceived by many as very broad and open to abuse. This rule provided that for purposes of determining substantiality of the economic effect of an allocation, the tax attributes of a partner owning less than 10 percent of the capital and profits of a partnership (and allocated less than 10 percent of each item of income, gain, loss, deduction and credit) were not taken into account. Before finalizing the regulations, the IRS received numerous comments about these rules, including recommendations on how to reduce the burden of complying with the substantial economic effect rules. However, the IRS has indicated it needs more time to consider these comments and may address them in the future.

STATE & LOCAL

Delaware enhances incentives for participating in unclaimed property voluntary disclosure

Catherine Del Re, Director, New York, N.Y.
Yudit Freda, Manager, New York, N.Y.

On Jan. 30, 2013, Delaware added incentives for companies to participate in the state's new unclaimed property voluntary disclosure agreement (VDA) program.

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Holders that enter into the program on or before June 30, 2013, will have an extra year, until June 30, 2015, to enter into an agreement and make payment (or enter into a payment plan) and will receive a waiver of interest and penalties. Further, holders that enter into the program on or before June 30, 2013, will receive a limited lookback period to 1996, while holders that enter into the program between July 1, 2013, and June 30, 2014, will receive a limited lookback period to 1993. Holders that had entered into a VDA with Delaware prior to June 30, 2012, are eligible for the new VDA program for other property types, periods, subsidiaries or related entities not included in the earlier VDA. Qualifying holders considering entering into the VDA program should act quickly (by June 30, 2013) in order to receive the maximum benefit of the 1996 lookback period.

Indiana SUT on software maintenance agreements

Mark Soltys, Director, Elkhart, Ind.
Brian Kirkell, Director, Washington National Tax

On Jan. 30, 2013, the Indiana Department of Revenue (DOR) issued Letter of Findings No. 04-20120209, denying a taxpayer's protest against the imposition of sales and use tax (SUT) on the purchase of a software maintenance agreement because the taxpayer failed to show that it did not receive tangible personal property pursuant to the agreement. Indiana subjects the sale of a software maintenance agreement to sales tax if, under the agreement, the seller provides tangible personal property, including software updates, upgrades, patches, fixes, versions, modifications, releases, corrections and enhancements. Indiana presumes that software maintenance agreements are taxable and places the burden of proof on the taxpayer to rebut this presumption. There are two ways in which a taxpayer can meet its burden of proof. First, the taxpayer can show that the maintenance agreement does not provide for the transfer of any tangible personal property. Second, the taxpayer can show that no tangible personal property was transferred under the agreement. This Letter of Findings serves as a good reminder that states have taken various, and sometimes contradictory, positions on this issue. Given that software maintenance agreements are commonly tied to the licensing of enterprise software that may be used by a taxpayer in many states, it is important to understand the implications of such use on a state-by-state basis rather than relying on the treatment in the state of purchase.

Consumer's use tax amnesty in Ohio ending soon

Michael Baker, Director, Cleveland, Ohio

On Jan. 28, 2013, the Ohio Department of Taxation issued a tax alert reminding eligible taxpayers they have until May 1, 2013, to take advantage of the state's consumer's use tax amnesty program. Eligible taxpayers include any entities that have not taken advantage of a prior consumer's use tax amnesty and to which the Department of Taxation did not issue a use tax assessment prior to Sept. 29, 2011. The amnesty carries particularly favorable terms. First, all use tax liabilities incurred prior to Jan. 1, 2009, will be waived. Second, under this amnesty, taxpayers not currently registered with the Department of Taxation can pay past liabilities without incurring interest or penalties. Taxpayers that are behind in their use tax obligations or unfamiliar with the use tax program should consult with their tax advisors before the May 1 deadline in order to assess the potential benefits this amnesty has to offer.

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For additional information or change of address, contact Hyong Sik Yoon or Kiho Choi at (213)480-9100 or e-mail them at hyongsikyoon@ckpcpas.com or kihochoi@ckpcpas.com.

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Printed in the U.S.A.

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