November 2012

Tax Digest

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

FEDERAL

Understanding the new tangible asset regulations

Natalie Tucker, director, Washington National Tax
Tom Windram, partner, Washington National Tax

Tangible asset regulations introduced by the IRS and Treasury in December 2011 generally took effect in January 2012. These regulations may have a significant impact on the way your business characterizes both capitalized assets and repairs or maintenance to those assets, as well as how you account for materials and supplies and dispositions of assets (or components thereof). These rules create the potential for up to 19 automatic accounting method changes that will need to be filed with the IRS. Changes in accounting methods for the various aspects of the new rules may also include changes to processes to input and capture data into accounts, in addition to changes to fixed asset systems in order to maintain the information now needed for tax purposes. Thus, it is imperative for every business taxpayer to take time now to determine the impact of complying with the tangible asset regulations.

Severance benefits conditioned on employee delivery of a release of claims

Steve Levin, director, Washington National Tax

It is a common practice for employers to require exiting employees to execute a release of claims as consideration for the receipt of severance and other separation payments. Historically, many thought this practice had little to do with deferred compensation. However, if the release of claims affords the employee the ability to control the timing of the commencement of severance benefits by accelerating or delaying delivery of the release, it may constitute a failure to comply with deferred compensation requirements. Such a failure could result in additional tax to the employee and possible withholding tax exposure to the employer. The IRS has issued a transitional relief program that expires on Dec. 31, 2012, for correcting defective release of claims provisions. Companies should review their release of claims provisions with their tax advisors to determine whether any corrective action is needed before this transitional relief opportunity expires on Dec. 31, 2012.

Remain alert for technical terminations resulting from partner transfers

Rich Nichols, partner, New York, N.Y.

While common in today's ever-changing economic and tax climate, transfers of partnership interests can technically terminate the partnership if within a 12-month period there is a sale or exchange of 50 percent or more of the total interests in partnership capital and profits. While sales or exchanges do not include redemptions, otherwise tax-free transfers such as those to corporations or family limited partnerships are considered exchanges for this purpose. The termination date determines the filing obligations of the partnership, and, absent proper notification of these transfers, the unintended consequences can be quite substantial. A partnership can face penalties for failure to file (return is due on the 15th day of the fourth month after termination unless extended) of $195 per month, per partner (up to 12 months or $2,340) and failure to provide timely Forms K-1 at $100 per Form K-1, as well as other penalties depending on other required forms. While the AICPA recently began

CKP Choi, Kim & Park, LLP
CERTIFIED PUBLIC ACCOUNTANTS & CONSULTANTS

An Independently Owned Member
McGLADREY ALLIANCE
McGladrey

©2012 McGladrey LLP. All Rights Reserved. Used with Permission.

seeking guidance on penalty relief, partnerships need to ensure the monitoring of transfers over two tax years and the existence of a mechanism for timely notification of such transfers. This should be considered when amending or drafting partnership agreements.

Substance versus form really matters

Rick Bailine, principal, Washington National Tax

A recent tax court case confirms what many taxpayers and practitioners have always thought to be true – in tax planning, substance versus form really does matter. In this case, it was vitally important that a class of stock have the right to participate in corporate growth. To achieve this objective, the taxpayer gave the stock a right to participate based on a formula. Both the IRS and the court reviewed that formula and concluded that it was really a mere façade. There was no substance to the holder's right to participate based on that formula. As a result, the court agreed with the IRS that the stock did not participate in corporate growth and, therefore, the tax planning done by this taxpayer failed. Sound tax planning is more than mere formalisms – substance versus form really matters.

Non-taxable expense allowance plans must satisfy accountable plan rules

Patti Burquest, principal, Washington National Tax

Does your company offer employees an allowance for expenses such as tools, supplies, autos or business mileage? Expense allowance plans may be excluded from an employee's income if the accountable plan rules are met. Those rules require that the arrangement (1) have a business connection, (2) require substantiation of the expenses, and (3) require the return of allowance amounts in excess of substantiated expenses. The IRS has been scrutinizing expense allowance plans and recently released a revenue ruling that provides guidance for employers that use allowance plans as part of an hourly wage rate paid to employees. The ruling concludes the business connection requirement is not satisfied if the employer pays an amount to the employee regardless of whether the employee incurs, or is reasonably expected to incur, deductible business expenses. If a plan fails to meet the business connection requirement, the allowance may be treated as an impermissible wage recharacterization by the employer and subject to employment taxes and withholding. Employers should review and make any necessary modifications to these plans to limit potential findings of impermissible wage recharacterizations, which could lead to additional employment taxes and withholding.

INTERNATIONAL TAX

Are you ready for FATCA?

Ramon Camacho, principal, Washington National Tax

Mario De Castro, director, Vienna, Va.

In 2010, Congress passed the Foreign Account Taxpayer Compliance Act (FATCA) requiring U.S. withholding agents to withhold from any payments made to foreign persons 30 percent of the gross amount of U.S. source investment income and the amount of gross proceeds from the sale of items that generate such income. This tax could affect many common cross-border investment flows, including related- and third-party interest paid to non-U.S. lenders. While the IRS has published a substantial amount of guidance, much of it remains in proposed form despite an effective date of Jan. 1, 2013, for the relevant statutory provisions. Though U.S. withholding agents will not be required to begin withholding until Jan. 1, 2014, they should assess the extent to which FATCA will create withholding tax exposure and take steps to mitigate that exposure by, for example, obtaining documentation to support a relevant exemption to withholding or renegotiating the terms of the commercial arrangement creating the exposure. Failure to do so may result in significant U.S. tax liability because the U.S. withholding agent has primary liability for the 30 percent FATCA tax.

Expatriate to Puerto Rico

Ramon Camacho, principal, Washington National Tax

Jerry Martin, partner, Minneapolis, Minn.

Puerto Rico recently enacted legislation that provides significant tax incentives to businesses that relocate to the island. In particular, qualifying businesses can obtain

©2012 McGladrey LLP. All Rights Reserved. Used with Permission.

a ruling from Puerto Rico tax authorities granting a 4 percent local income tax rate. Distributions of earnings to Puerto Rico residents may be free of federal and local income tax, while distributions to U.S. persons may be taxed under qualified dividend rates (currently 15 percent). These tax benefits are available to a wide variety of businesses. Eligible activities include research and development and various services, including consulting, architectural, management, professional, graphics arts, advertising and public relations, computer, hospital and medical and many other services. While net tax benefits may be limited by U.S. transfer pricing and anti-deferral rules, significant benefits may nonetheless be available depending on a taxpayer's specific situation.

STATE AND LOCAL TAX

State implications of gift tax planning

Chuck Schultz, partner, Washington National Tax

Many taxpayers are focused on the expiring federal tax provisions and the consequent importance of proper 2012 gift planning. However, an important state transfer tax issue exists as well. Many states have decoupled their estate tax calculations from the federal estate tax liability, resulting in an additional state "pick-up" tax that is due nine months from the date of death. The District of Columbia and the following states have separate estate or inheritance tax calculations: Connecticut, Delaware, Hawaii, Illinois, Indiana, Iowa, Kentucky, Maine, Maryland, Massachusetts, Minnesota, Nebraska, New Jersey, New York, North Carolina, Ohio, Oregon, Pennsylvania, Rhode Island, Tennessee, Vermont and Washington. Many states have an estate tax rate that caps out at 16 percent, which can result in a sizable state estate tax liability. Conversely, no state other than Connecticut has a gift tax. Thus, gifts made in the "decoupled" states referenced above will not be subject to gift tax and will avoid the state estate tax. This opportunity substantiates the need for a proper gift planning program, which can result in profound savings to taxpayers.

Alabama ruling limits the use of pre-1999 NOLs on consolidated returns

Louis Alvarez, Jr., director, Orlando, Fla.
Brian Kirkell, director, Washington National Tax

On Aug. 15, 2012, an Alabama administrative law judge (ALJ) in *Coca-Cola Enterprises, Inc. v. Ala. Dept. of Rev.* ruled that pre-1999 net operating losses (NOLs) incurred by an Alabama affiliated group member could be utilized on the group's Alabama consolidated return only to the extent of the loss member's current year income. *Coca-Cola* reversed in part *Weyerhaeuser USA Subsidiaries v. State of Alabama*, in which the same ALJ ruled that pre-1999 NOLs could be shared between group members. Taxpayers that relied upon *Weyerhaeuser* in utilizing pre-1999 NOLs on consolidated returns may have substantial exposure and should review the returns on which the NOLs were claimed. *Coca-Cola* also confirmed that post-1998 separate return year NOLs of a loss member could be utilized without limitation on a group's consolidated return as long as the loss member met the statutory requirements for inclusion in the affiliated group in the loss years. This portion of the ALJ's decision conforms closely with the implications of the reasoning applied in *Weyerhaeuser*. To the extent that a taxpayer did not utilize post-1998 separate return year NOLs on a later consolidated return, refund opportunities may be available.

Final D.C. combined reporting regulations hold some surprises

Eric Cheek, director, Baltimore, Md.

On Sept. 14, 2012, the District of Columbia (D.C.) Office of Tax and Revenue promulgated combined reporting regulations effective for tax years beginning after Dec. 31, 2010. Reflecting a significant change from the draft regulations, a unitary group now includes partnerships and unincorporated businesses. Most partnerships and unincorporated businesses have already filed their 2011 D.C. tax returns, some of which may now require amendment. Since some aspects of the final combined reporting regulations differ dramatically from the originally anticipated regulations, taxpayers should revisit the new rules to evaluate the need to file on a combined basis for 2011 and subsequent years.

©2012 McGladrey LLP. All Rights Reserved. Used with Permission.

November 2012

FEDERAL

Understanding the new tangible asset regulations

Severance benefits conditioned on employee delivery of a release of claims

Remain alert for technical terminations resulting from partner transfers

Substance versus form really matters

Non-taxable expense allowance plans must satisfy accountable plan rules

INTERNATIONAL TAX

Are you ready for FATCA?

Expatriate to Puerto Rico

STATE AND LOCAL TAX

State implications of gift tax planning

Alabama ruling limits the use of pre-1999 NOLs on consolidated returns

Final D.C. combined reporting regulations hold some surprises

Information provided in this publication has been obtained by Choi, Kim & Park, LLP from sources believed to be reliable. However, Choi, Kim & Park, LLP guarantees neither the accuracy nor completeness of any information and is not responsible for any errors or omissions or for results obtained by others as a result of reliance upon such information. This publication does not, and is not intended to, provide legal, tax or accounting advice.

McGladrey Alliance is a premier affiliation of independent accounting and consulting firms. McGladrey Alliance member firms maintain their name, autonomy and independence and are responsible for their own client fee arrangements, delivery of services and maintenance of client relationships. McGladrey Alliance is a business of McGladrey LLP, a leading professional services firm providing tax and consulting services. McGladrey is the brand under which McGladrey LLP serve clients' business needs. McGladrey, the McGladrey logo and the McGladrey Alliance signatures are used under license by McGladrey LLP.

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.

Tax Digest

November 2012

Printed in the U.S.A.

©2012 McGladrey LLP. All Rights Reserved. Used with Permission.