Tax Digest

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

November 2013

FEDERAL

No penalties triggered by failure to distribute ACA exchange notice

Jill Harris, Director, Washington National Tax
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Due to the Affordable Care Act (ACA), employers subject to the Fair Labor Standards Act were required to provide a written notice about the health insurance exchange to their employees by Oct. 1, 2013. The Department of Labor (DOL) recently announced that there is no fine or penalty for failing to provide the notice. This is good news for employers that failed to timely issue the notice. Even in the absence of a penalty, it is recommended that any employer that did not distribute an exchange notice by Oct. 1, do so now. The purpose of the notice is to inform employees about the health insurance exchange (also known as the marketplace). The notice explains that (1) employees may be eligible for federal assistance toward the cost of health insurance purchased through the exchange, and (2) employees will lose their employer's contribution, if any, to the employer's health plan if they purchase health insurance through the exchange. The DOL has issued two model notices — one for employers that offer a health plan to employees, and another for employers that do not offer a health plan. Employers should provide the notice to all employees regardless of part-time or full-time status or enrollment in a health plan.

Potential repeal of favorable inventory methods

Natalie Tucker, Director, Washington National Tax
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Earlier this year, the Treasury Department released its explanation (the Green Book) of the Obama administration's fiscal 2014 revenue proposals (including detailed revenue estimates) contained in the president's proposed budget. Included in the president's proposed budget are two significant proposals to repeal certain inventory accounting methods for taxable years beginning after Dec. 31, 2013, including (1) the last-in, first-out (LIFO) method of accounting for inventories, and (2) the lower-of-cost-or-market (LCM) and subnormal goods methods of accounting for inventories. Although similar proposals to repeal LIFO and LCM have been included in prior years' budgets without being enacted, this year has seen a significant amount of tax reform discussion, largely focusing on the simplification of the Code. Additionally, the planned retirement of Senate Finance Committee Chair Max Baucus is expected to result in a greater push for passing a tax reform bill before the end of 2014. This may mean that the proposed repeals of LIFO and LCM are more likely to be enacted than they have been in the past. Taxpayers currently utilizing these methods may benefit from taking the time now to determine if these budget proposals, if adopted, could substantially impact their businesses and, if so, weigh the benefits of changing their methods of accounting in advance of a possible repeal.

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Sequester-related reduction rate for section 1603 grants in effect

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As the government sequester continues into a new fiscal year, the Department of Treasury has begun announcing changes to the sequestration rates affecting various federal tax credits and incentives. In March 2013, the IRS announced an 8.7 percent reduction in the amounts it would pay under section 1603 of the American Recovery and Reinvestment Act of 2009, under which a taxpayer could elect to receive payments equal to 10 or 30 percent (depending on the type of property) of the eligible basis of energy property in lieu of energy tax credits. For the fiscal year beginning Oct. 1, 2013, this rate has been changed to 7.2 percent, effectively reducing the payments to 90.28 percent of the original grant, which translates to 27.84 percent of the eligible basis of the property. Every award made to a section 1603 applicant between Oct. 1, 2013, and Sept. 30, 2014, will be reduced by 7.2 percent, regardless of when the application was received by the Treasury.

Recent Tax Court opinion outlines "net gifts" and "net, net gifts"

Audrey Young, Director, Washington National Tax

Under our transfer tax system, the donor is primarily responsible for paying the gift tax owed on a gift that he or she makes. The amount of the gift is measured by the value of the transferred property in excess of any consideration received by the donor from the donee in money or money's worth. If a donor makes a gift subject to the condition that the donee pays the tax, then the value of the gift is reduced by the amount of the gift tax. In the estate planning world, this is known as a "net gift." Net gifts showcase the advantage of lifetime giving. Making gifts and paying gift tax remove those assets (and any subsequent appreciation) from the donor's taxable estate. The estate tax is payable on transferred property, as well as on the percentage of the estate used to pay the estate tax. Cognizant of this discrepancy, Congress enacted section 2035(b) — the so-called "gross-up" rule — to deter death-bed giving. Section 2035(b) pulls the gift tax paid back into a decedent's taxable estate if the decedent dies within three years of making the gift. In a recent case, the Tax Court ruled that the value of the heirs' assumption of the section 2035(b) estate tax liability could in certain circumstances constitute additional consideration and result in a "net, net gift." In a divided opinion, the Tax Court instructed the trial judge to reconsider the facts of this case in light of its ruling.

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Required reporting of uncertain US income tax positions to the IRS

Bob Adams, Partner, Washington National Tax

Some CEOs and CFOs may want to become more involved in decisions on the positions taken in their companies' income tax returns. For the last four years, companies that filed corporate income tax returns (principally Form 1120) and that had audited financial statements containing reserves for contingent U.S. income taxes have been required to describe to the IRS each issue for which the reserves had been established. This is done by attaching to the return Schedule UTP (Uncertain Tax Position Statement). The requirements applied to 2010 and 2011 returns that reported total assets of $100 million or more on the tax return balance sheet. For 2012 and 2013, the total asset threshold was reduced to $50 million. For taxable years 2014 or later, the total asset threshold is only $10 million. If the criteria apply to the company, the tax return signer is obligated to attach Schedule UTP to the return. Furthermore, the IRS closely reviews each uncertain tax position issue description that is reported and considers the information in risk assessing that return for audit. Many tax questions do not have certain answers, and many aggressive positions are taken on returns. Before audited financial statements are finalized, careful consideration should be given to the requirements to notify the IRS of uncertain positions taken in corporate income tax returns that would require establishing reserves for contingent U.S. income tax.

Favorable final regulations increase ability to utilize tax attributes

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The Treasury Department and the IRS recently issued final regulations providing simplifying exceptions to the application of the section 382 segregation rules. The changes will likely allow many taxpayers to avoid ownership changes that would otherwise limit utilization of valuable tax attributes such as net operating losses and credit carryovers. The new regulations simplify the segregation rules by limiting, as compared to the prior rules, the number of new shareholder groups created as a result of certain transactions involving the corporation's stock. The new regulations appropriately recognize that the transactions subject to the simplifications do not fall within the intent of section 382, which is to avoid trafficking in losses. Rather, these transactions involve relatively small changes in shareholdings by shareholders that generally own only a small interest in the corporation. These new regulations are welcome guidance as they simplify and lessen the impact of the segregation rules. Further, while these rules are not fully retroactive, they do allow taxpayers to elect to apply these rules to testing periods that began prior to Oct. 22, 2013, in certain circumstances.

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