Tax Digest

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

September 2015

EVENTS

More tax events and webcasts

FEDERAL

The IRS issues a draft of revised Form 3115

Kate Abdoo, Manager, Washington National Tax
Kari Peterson, Senior Manager, Washington National Tax
Christian Wood, Principal, Washington National Tax

Anytime a taxpayer requests permission to make an accounting method change, the taxpayer must complete a Form 3115, *Application for Change in Accounting Method*; submit the form to the IRS's national office (if non-automatic) or the Ogden, Utah service center (if automatic); and attach the form to the filed tax return for the year of change. On July 15, 2015, the IRS released a draft of a revised Form 3115. The draft Form 3115 incorporates modifications and additions to the accounting method change procedures of Rev. Proc. 2015-13 and Rev. Proc. 2015-14 and is expected to be finalized for use by December 2015. Until the IRS finalizes the revised Form 3115, taxpayers must continue to use the existing Form 3115. If your company plans to submit any method change requests toward the end of the year, you may have to update the application if the IRS finalizes the draft Form 3115 prior to your company's submission. One way to avoid having to update the application is to submit the application earlier, before the IRS has a chance to finalize the new form. Taxpayers should work with their tax advisors to determine the appropriate and most optimal procedures to follow when requesting one or more changes in accounting method and to ensure that all required forms and accompanying statements are properly prepared and filed.

Update on employee versus independent contractor status

Anne Bushman, Senior Manager, Washington National Tax
Bill O'Malley, Director, Washington National Tax

The IRS recently released Fact Sheet 2015-21 to remind employers of the importance of correctly classifying employees and independent contractors. The fact sheet comes one month after the Department of Labor's (DOL's) release of Administrator's Interpretation 2015-1 on the same topic—see our August *Tax Digest* article, *DOL releases guidance on who is an employee*. The IRS guidance does not change any existing rules but serves to confirm that the IRS and DOL continue to follow different standards when classifying individuals as employees. Specifically, the IRS refers to common law rules and links the fact sheet to other IRS explanations of factors to consider when determining whether a common law employee relationship exists. The DOL interpretation describes a broader view of who is an employee. Consequences for misclassification will depend upon which agency's definition has been violated. For example, the IRS has authority to administer many Affordable Care Act (ACA) provisions, which are dependent upon an employer's number of employees. Employers that have not already done so should analyze their workers using the IRS definition to ensure no ACA penalties result from not providing coverage to certain workers. However, even if an employer has determined a worker is not an employee from the IRS perspective, the employer is not protected from potential consequences related to DOL violations if the same individual is an employee in the DOL's view.

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

An Independently Owned Member
McGLADREY ALLIANCE
McGladrey

Tax Digest

Partnership target capital account guidance is finally in the pipeline

Jennifer Seaton, Partner, Chicago
John Luksis, Manager, Washington National Tax

A long-awaited guidance project concerning target capital account allocation provisions recently made its debut in the IRS' 2015-2016 Priority Guidance Plan. While the IRS has given no indication as to when the guidance might be issued, this is a welcome step in the right direction. Partnerships across a variety of industries often prefer target allocation provisions over "layer-cake" arrangements because target capital language more closely aligns the allocation of partnership profit and loss items with the underlying economics of the deal. Despite the prevalence of such provisions in modern-day partnership agreements, lingering uncertainty remains as to whether the resulting allocations will be respected under the statutory rules governing partnership allocations. As explained in the preamble to the recently released proposed regulations on disguised payments for services: "The Treasury Department and the IRS generally believe that existing rules under §§1.704-1(b)(2)(ii) and 1.707-1(c) address this circumstance by requiring partner capital accounts to reflect the partner's distribution rights as if the partnership liquidated at the end of the taxable year, but request comments on specific issues and examples with respect to which further guidance would be helpful." Practitioners are hopeful that forthcoming guidance will provide clarity. In the meantime, partnerships that use target capital account arrangements should be mindful of the uncertainty and inherent risk under the existing guidance.

Beware of disappearing basis

Richard Wehrheim, Partner, Davenport, Iowa

When an S corporation makes an election to treat a wholly-owned subsidiary as a qualified subchapter S subsidiary (QSub), there is a potentially costly trap. By virtue of the election, the subsidiary is deemed to liquidate into the parent S corporation (P), and the liquidation is generally nontaxable. P's tax basis in the stock of QSub goes away, and P takes a carryover basis in the QSub's assets. What is important to note here is that if P's tax basis in the stock of QSub is greater than P's carryover basis in the assets (which often will be the case if P acquires the subsidiary's stock and makes a subsequent QSub election), the excess basis vanishes and will never be recovered. For example, assume that P purchases 100 percent of the stock of corporation X, a regarded entity, for $1 million cash, and the parties do not elect to treat the stock purchase as a purchase of assets. If P makes a QSub election for X immediately following the purchase and X's tax basis in the assets is $600,000, P will permanently lose $400,000 of tax basis upon the deemed liquidation of X. Potential solutions do exist but must be addressed prior to the acquisition. Therefore, S corporations that plan to acquire another company should consult their tax advisors to ensure they avoid this trap.

Reporting related employers on Form 1094-C

Jill Harris, Director, Washington National Tax

Employers with at least 50 full-time or full-time equivalent employees must file new Forms 1095-C and 1094-C with the IRS by Feb. 29, 2016 (March 31 if filing electronically). These forms provide the IRS with information about an employer's 2015 workforce and health plan, as required under the Affordable Care Act. The employer also must disclose to the IRS the names and employer identification numbers of related employers. Employers are related if they are in a "controlled" or "affiliated service" group. There are several types of controlled groups. A parent-subsidiary controlled group exists when one company owns at least 80 percent of one or more other companies. Brother-sister controlled groups occur when the same five or fewer individuals, estates or trusts have both a controlling interest (80 percent common ownership) and effective control (50 percent identical ownership). Tax-exempt organizations could be in a controlled group if at least 80 percent of the directors or trustees of one organization are representatives of or controlled by another organization. Firms that provide professional services (e.g., health care, law, engineering and accounting firms) or management services might be in an affiliated service group if they have common owners, provide services for each other or work together to provide services to customers. Because these rules are complex, employers should work with their tax advisors now to determine controlled and affiliated service groups in order to properly report related employers on Form 1094-C in early 2016. For more information about Forms 1095-C and 1094-C, please see our article, New information reporting requirements under the Affordable Care Act.

INTERNATIONAL

IRS announces new anti-abuse rules for partnerships

Jamison Sites, Supervisor, Washington National Tax
Ramon Camacho, Principal, Washington National Tax

Almost two decades ago, Congress repealed the tax on transfers of property to foreign partnerships but gave the IRS authority to issue regulations to require recognition of gain on transfers to partnerships in abusive situations. On Aug. 6, 2015, the Treasury and the IRS released a notice announcing the intent to issue new regulations that will require U.S. transferors to recognize gain, either immediately or periodically, on transfers of certain built-in-gain property to a partnership with foreign partners. Under the new rules, nonrecognition will only be available to partnerships that (1) agree to apply a special method of accounting that generally ensures pre-contribution gain is allocated to the partner(s) that contributed property with built-in gain, and (2) follow strict reporting rules. In addition, the notice announced that new transfer pricing regulations will be issued to address transfers involving related partnerships that are parties to a cost-sharing agreement. The new partnership regulations will generally apply retroactively to transfers occurring on or after Aug. 6, 2015, but the new transfer pricing regulations will apply on or after the date of publication. Taxpayers that have transferred property to partnerships with foreign related partners should carefully consider the application of these rules and assess whether the gain should be recognized on the transfer.

Tax Court invalidates key rule in cost-sharing regulations

Jamison Sites, Supervisor, Washington National Tax
Ramon Camacho, Principal, Washington National Tax

On July 27, 2015, the U.S. Tax Court, in *Altera Corp. and Subsidiaries v. Commissioner*, invalidated a key federal tax regulation that requires participants in a qualified cost-sharing arrangement (QCSA) to include the cost of stock-based compensation (SBC) in the pool of costs to be shared among the participants. If sustained, *Altera* could result in significant benefits for taxpayers with QCSAs because it effectively would allow these taxpayers to assign more profit from exploitation of an intangible to a low-tax jurisdiction. In a QCSA, a group of related taxpayers agrees to share costs incurred to develop an intangible based on the relative benefits each member of the group receives. Payments received by the developer from other members of the group are generally income to the developer. Removing SBC from the cost base would result in members paying less to the developer of the intangible and would reduce the developer's income. The *Altera* case provides taxpayers with a basis for taking the position that SBC may be excluded from a QCSA, and this position could result in reduced taxable income to the developer. Taxpayers should also consider whether to file amended returns for open years subject to a QCSA and should consider the financial statement impact of the case with respect to such years. However, the government may appeal the *Altera* decision or may decide to issue guidance limiting its effect. Thus, taxpayers should carefully discuss any strategy with their advisors.

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

For additional information or change of address, contact Tim Yu or Kiho Choi at (213)480-9100 or e-mail them at timyu@ckpcpas.com or kihochoi@ckpcpas.com.

Tax Digest

September 2015

Printed in the U.S.A.

Tax Digest

September 2015

EVENTS

More tax events and webcasts

FEDERAL

The IRS issues a draft of revised Form 3115

Update on employee versus independent contractor status

Partnership target capital account guidance is finally in the pipeline

Beware of disappearing basis

Reporting related employers on Form 1094-C

INTERNATIONAL

IRS announces new anti-abuse rules for partnerships

Tax Court invalidates key rule in cost-sharing regulations