July 2013

Tax Digest

A monthly newsletter highlighting tax developments of interest to today's companies

FEDERAL

Plan sponsors must pay new health plan fee by July 31, 2013

The Affordable Care Act requires a new patient-centered outcomes research (PCOR) fee on health plans of $1 per person covered under the plan. For plan years ending in October, November or December of 2012, the fee is due by July 31, 2013. The plan sponsor must pay the fee if the health plan is self-insured, whereas the insurance company pays the fee for insured plans. PCOR fees are reported annually on Form 720, *Quarterly Federal Excise Tax Return*. The due date of the return is July 31, and the fee can be mailed to the IRS with the form. The fee applies to all types of employers, including tax-exempt organizations and governmental entities. Most health plans, including major medical plans, prescription drug plans, retiree-only plans, and Health Reimbursement Accounts, are subject to the PCOR fee, regardless of the number of plan participants. Therefore, employers should take action now to determine if they are responsible for the PCOR fees for any of their health benefits.

Jill Harris, Director, Washington National Tax

Update on state estate and inheritance laws

May was an active month for many state legislatures with respect to state laws governing gift and estate taxes. On May 11, 2013, the Indiana legislature repealed the state inheritance tax, retroactive to Jan. 1, 2013. Conversely, Delaware eliminated the planned sunset of its estate tax, though its exemption amount does track the federal exemption amount. Ohio repealed its estate tax, effective Jan. 1, 2013. Minnesota is on the new tax side of the ledger. Last month, the state legislature enacted a new gift tax imposed at a flat rate of 10 percent, effective June 30, 2013. The statute adopts the federal definition of a "taxable gift" and provides a $1 million lifetime tax exemption. Only Minnesota and Connecticut have a gift tax. The Minnesota legislature also enacted legislation to prevent non-residents from converting real property into intangible property through the use of a pass-through entity, such as a limited liability corporation or family limited partnership, to avoid the Minnesota tax. Minnesota joins other states, like Maine and New York, which have passed similar laws. This is an emerging area of legislation, and taxpayers need to be aware of the estate planning implications.

Audrey Young, Director, Washington National Tax
Charles Schultz, Partner, Washington National Tax

Taxpayer-friendly ruling provides guidance on applying the 70 percent safe harbor for success-based fees

In a recent ruling, the IRS issued taxpayer-friendly guidance stating that a section 351 transaction with "boot" represented a covered acquisitive transaction as defined within Reg. section 1.263(a)-5(e)(3).

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This ruling provides insight into the IRS's view of a common transaction structure utilized by private equity and strategic acquirers where the selling shareholders retain a continuing interest in the corporate acquirer. Prior to this ruling, it was unclear whether the IRS viewed this type of transaction as an acquisitive transaction. This ruling appears to clarify the IRS's view that taxpayers can in fact avail themselves of the bright-line date rule and success-based fee safe harbor that allows taxpayers to deduct 70 percent of any success-based fee incurred without having to otherwise satisfy the stringent documentation requirements of the regulations, greatly minimizing audit risk on the deductibility of such costs.

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

IRS transcripts can help you discover and fix IRS account problems

Have you ever been unpleasantly surprised by an IRS notice? Is the IRS billing you for penalties or interest and you do not know why or whether the amount is correct? Do you want to know whether the IRS has recorded certain elections that you believe were made? Valuable account information can be obtained by requesting an IRS transcript. There are many kinds of transcripts that can be used to discover different types of information. An account transcript provides information on payments credited to your account, tax returns filed, and assessments and accruals of interest and certain penalties. If you are getting ready to file a carryback claim (net operating loss, capital loss or tax credit), order the account transcript to ensure that the "before adjustment" amounts on the claim match the IRS records and to avoid a surprise rejection of the claim. Entity-type elections (entity classifications, REIT status, etc.) are shown on the ENMOD (entity module) transcript, which is created from information contained on certain filings by the taxpayer, beginning with the initial Form SS-4 (the federal tax identification number application). Penalty and interest computations can be checked by ordering and reviewing a Penalty and Interest Notice and Explanation (PINEX) report (a type of transcript). Contact your tax advisor to learn more about the types of transcript information available to you.

Patti Burquest, Principal, Washington National Tax

Partnership tax planning opportunities—the real estate rebound

The real estate market is one bright spot in the recovering economy due to shortages of supply, low interest rates and pent-up demand. For a new real estate project, the form of ownership or choice of business entity is one critical decision that warrants careful consideration. Generally, five choices of entity are available: 1) sole proprietorships, 2) S corporations, 3) C corporations, 4) partnerships, or 5) limited liability companies. However, the most prevalent choice of entity for holding real property is a partnership and, more recently, a limited liability company treated as a partnership for federal and state tax purposes. Using a partnership (or an entity treated as a partnership) to hold or operate real estate provides many economic and tax advantages to the partners. Because a partnership is a pass-through entity, the partners are generally subject to a single level of tax, at either individual or capital gains rates. A partnership can be relatively inexpensive to form, operate and liquidate and, with certain limits, affords the partners the ability to contribute and distribute partnership property on a tax-free basis. In addition, a partnership operating agreement can provide great latitude in allocating economic results among the partners and, within limits, can specially allocate items of income, gain, losses and deductions among the partners. Finally, a partnership can be structured to limit legal liability, clearly define management rights and responsibilities, and facilitate debt financing. The choice of business entity is a critical step towards the success of any real estate venture and should be carefully considered.

Mark Edwards, Partner, Orlando, Fla.

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INTERNATIONAL

Appellate court upholds gross valuation penalty in case involving no valuation of property

On June 17, 2013, the U.S. Court of Appeals for the Third Circuit denied a loss claimed by the Taxpayer in *Rovakat LLC v. Commissioner* (No. 12-01779) arising from a structured transaction entered into to generate $5.5 million of ordinary loss from the disposition of foreign currency, concluding that the taxpayer failed to establish its basis in the currency. In this case, the taxpayer, a partnership, claimed that built-in losses on stock that was redeemed in exchange for cash and Swiss francs carried over to the taxpayer when it received some of the Swiss francs in a complex series of transactions, including tax-free partnership contributions. The appellate court agreed with the Tax Court, which concluded that the built-in losses did not carry over because the taxpayer acquired the francs in a taxable transaction. Moreover, the appellate court upheld imposition of the 40 percent gross valuation misstatement penalty (along with other penalties) even though the taxpayer had relied on two opinions of counsel. The court disregarded these opinions because one was provided by a law firm affiliated with the promoter of the transaction and the other was provided years after the transaction had been consummated. This case is very significant because the court upheld the application of the gross valuation misstatement penalty to an erroneous application of the law as opposed to an incorrect valuation of property. This is an unusual application of the valuation penalty and may be viewed as an expansion of the type of cases in which taxpayers may be subject to the penalty. The case is also a reminder to corporate tax executives that *independent* tax advice should be obtained on a reasonably contemporaneous basis, e.g., before the tax return is filed.

Ramon Camacho, Principal, Washington National tax

Mexico's Supreme Court holds that stock losses may not offset ordinary business income

In a stunning reversal of position, the Mexican Supreme Court held that losses on the sale of shares of any company (Mexican or foreign) may only be offset against capital gains. Thus, under current Mexican tax law, losses incurred by a Mexican taxpayer on the sale of shares of any legal entity may be offset only against capital gains. The loss can be used to offset capital gains in the current year and carried forward for 10 years to offset future gains. Taxpayers should carefully consider the treatment of any stock sales that will generate losses to ensure the availability of capital gains to offset the losses within the 10-year limitation period. Otherwise, the loss may be forfeited. It should be noted that non-Mexican individuals or companies that sell shares of a Mexican legal entity are not affected by the Supreme Court's ruling since they cannot recognize losses for Mexican tax purposes on such types of sales. U.S. businesses that have operations in Mexico should pay special attention to any share sale transactions taking place through their Mexican companies for which a loss will be incurred. If no capital gains are anticipated, any loss incurred may not be utilized currently. Although the loss can be carried forward for 10 years, taxpayers should assess whether tax planning will be necessary to avoid a write-down on the value of the loss for financial statement purposes.
Edgar Lopezlena, Director, Schaumburg, Ill.
Liz Ruvalcaba, Senior Associate, Schaumburg, Ill.

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Certain Mexican Land Trusts may not be trusts

The filing of Forms 3520 and 3520-A for certain Mexican Land Trusts, otherwise known as the Fideicomiso, may no longer be required. In a recent revenue ruling, the IRS concluded that the Mexican Land Trust (MLT) is not a trust under certain situations. The Mexican Federal Constitution prohibits non-Mexican persons from directly owning residential real property in certain areas of Mexico (restricted zones). However, non-Mexican persons can hold residential real property located in the restricted zones through an MLT with a Mexican bank after obtaining a permit from the Mexican Ministry of Foreign Affairs. An MLT is a contractual arrangement between a Mexican bank and a non-Mexican resident under which the bank becomes the legal owner of the property and the non-Mexican resident remains the beneficial owner. By its terms, the scope of the ruling is limited. For example, if under the MLT the bank holds legal title to any assets other than the property or is permitted or required to engage in any activity beyond holding legal title to the property, the holding of the revenue ruling does not apply. Accordingly, each MLT agreement should be reviewed to determine whether the MLT meets the standards outlined in the ruling.

Dennis Marquardt, Partner, Irvine, Calif.
Ramon Camacho, Principal, Washington National Tax

STATE AND LOCAL

Iowa statute goes beyond "click-through" nexus

On June 11, 2013, Governor Branstad signed Iowa HF 625, which provides that a retailer will be presumed to have Iowa nexus if any person that has Iowa nexus, other than a person acting in its capacity as a common carrier, conducts any activities in Iowa that are significantly associated with the retailer's ability to establish and maintain an Iowa market for its sales. At first glance, HF 625 appears to be aimed at imposing a sales tax collection responsibility on remote sellers that utilize commissioned third-party "click-through" advertisers located within the state. However, the statutory language is much broader than that contained in the click-through nexus provisions enacted by other states and may arguably be used to impose sales tax collection responsibility on remote sellers regardless of whether they engage or pay the in-state click-through advertisers at issue. This statute is likely to be challenged on due process grounds because the activities of in-state persons can be *significantly associated* with a remote seller’s Iowa sales without purposeful availment of the Iowa market by the seller.

Brad Hershberger, Des Moines, Iowa
Todd Hendricks, Cedar Rapids, Iowa

Remote sellers can prepare for Marketplace Fairness Act legislation

The Marketplace Fairness Act (MFA) of 2013 is working its way through Congress, and while several important variables are still on the table, the potential impact on remote sellers in the middle market is clear. Any scenario currently under discussion will come with an increased compliance burden and associated costs. Remote sellers should begin considering how they will react to the legislation, which allows states the authority to require remote sellers to collect sales tax on all sales subject to tax in the state where goods or services are delivered, regardless of nexus within a state. Absent clear instruction on how the final bill will read, companies can prepare for expected changes by taking a closer look at the legislation and their own business operations. Some level of tax automation software will likely be part of the compliance solution, and businesses need to plan now for how they will cost-effectively

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implement an appropriate tax technology platform in a timely manner. Understanding the potential scenarios today will make adapting to the legislation tomorrow significantly less painful for middle market companies with remote sales. Read more in our article The Marketplace Fairness Act: Five proactive strategies remote sellers should consider now.

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