

**IRS-SJSU Small Business Tax Institute**  
***Assisting New and Growing Businesses***  
**June 18, 2014**

# **Forms of Business**

Joel Busch, CPA, Esq. — SJSU MST Program  
Tamara Pow, Esq., Strategy Law LLP

## **Choice of Entity in California: Non-Tax Considerations**

IRS / SJSU Small Business Tax Institute

Presented by  
Tamara B. Pow, Esq.  
June 18, 2014

**STRATEGY**LAW LLP

## California Entity Choices

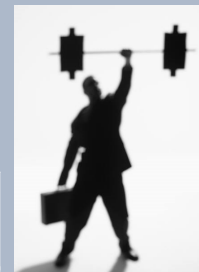
- Sole Proprietorship
- General Partnership
- Limited Partnership
- Limited Liability Company
- Corporation (C or S)
- Limited Liability Partnership



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## Sole Proprietorship

Limiting Liability	No liability protection
Dealing with Co-Owners/Shareholders	Not applicable
Management	Not applicable



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## General Partnership

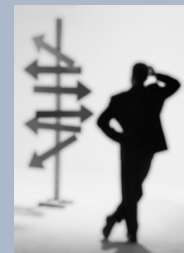


Limiting Liability	No liability protection No filing required with the Secretary of State Filing a GP-1 is optional
Dealing with Co-Owners/Shareholders	Partnership Agreement
Management	All general partners per agreement

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## Do you really need an entity?

- Liability protection
- Taxes
- Plan for life events
- Lender requirements
- Assist with succession planning
- Plan for the sale of the business and/or real estate



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## C-Corporation



Limiting Liability	If the corporation is properly formed and operated, shareholders, directors and officers are not legally responsible for corporate liabilities
Dealing with Co-Owners/Shareholders	Multiple classes of shares No limits on shareholders
Management	Shareholders/directors/officers Formalities – meetings, minutes, resolutions

STRATEGY LAW LLP

## S-Corporation



Limiting Liability	If the corporation is properly formed and operated, shareholders, directors and officers are not legally responsible for corporate liabilities
Dealing with Co-Owners/Shareholders	One class of shares only Limit on shareholders (number and type)
Management	Shareholders/directors/officers Formalities – meetings, minutes, resolutions

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## Limited Liability Company



Limiting Liability	Limited liability for all members
Dealing with Co-Owners/Shareholders	Single member – disregarded entity Multiple Member Capitalization No limit on owners, but limited types of businesses
Management	Member managed Manager managed Officers



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## Limited Partnership



Limiting Liability	No liability protection for general partners Liability for nonmanaging limited partners Limited liability can be obtained through the use of an entity as the general partner
Dealing with Co-Owners/Shareholders	General partner(s) and limited partner(s) Partnership Agreement
Management	Limited to General Partners

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# Limited Liability Partnership



Limiting Liability	Partners will not be personally liable for the partnership debts. However, partners will be personally liable to third parties based on their own tortious conduct or malpractice.
Dealing with Co-Owners/Shareholders	Public Accountancy Practice of Law Practice of Architecture
Management	Partners manage like a general partnership, subject to the LLP Agreement



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## Do you need more than one entity?



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# Federal Tax Selected Start-Up Issues

Cesar Atud, Group Manager  
Internal Revenue Service

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## Topics

- Federal Entity Selection
- And:
  - Flow-Through Loss Limitation issues

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## Choice of Entity

- Five major entities:
  - Sole proprietorships
  - Partnerships (general and limited)
  - LLCs
  - S corporations
  - C corporations

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## Election & Default Rules

- One member
  - Sole Proprietorship (default) / Corporation
- More than one member
  - Partnership (default) / Corporation
- Taxpayer selects “effective” date:
  - 75 days < “filing date” < 12 months
  - §301.7701-3(c)(1)(iii)



**Election, Check the Box, Form 8832**

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Form <b>8832</b> <small>(December 1998)</small> <small>Department of the Treasury</small> <small>Internal Revenue Service</small>	<b>Entity Classification Election</b>	OMB No. 1545-1516
<b>Please Type or Print</b>	Name of entity	Employer identification number (EIN)
	Number, street, and room or suite no. If a P.O. box, see instructions.	
	City or town, state, and ZIP code. If a foreign address, enter city, province or state, postal code and country.	
<p><b>1 Type of election</b> (see instructions):</p> <p>a <input type="checkbox"/> Initial classification by a newly-formed entity (or change in current classification of an existing entity to take effect on January 1, 1997)</p> <p>b <input type="checkbox"/> Change in current classification (to take effect later than January 1, 1997)</p> <p><b>2 Form of entity</b> (see instructions):</p> <p>a <input type="checkbox"/> A domestic eligible entity electing to be classified as an association taxable as a corporation.</p> <p>b <input type="checkbox"/> A domestic eligible entity electing to be classified as a partnership.</p> <p>c <input type="checkbox"/> A domestic eligible entity with a single owner electing to be disregarded as a separate entity.</p> <p>d <input type="checkbox"/> A foreign eligible entity electing to be classified as an association taxable as a corporation.</p> <p>e <input type="checkbox"/> A foreign eligible entity electing to be classified as a partnership.</p> <p>f <input type="checkbox"/> A foreign eligible entity with a single owner electing to be disregarded as a separate entity.</p> <p><b>3</b> Election is to be effective beginning (month, day, year) (see instructions)     . . . . . ▶ / /</p> <p><b>4</b> Name and title of person whom the IRS may call for more information     <b>5</b> That person's telephone number</p>		
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## Sole Proprietorship

- One owner – non-incorporated
- Form 1040
- Individual & Self-Employment (SE) tax rates
- The owner and business have same tax year
- Formation is easy and tax-free
- Dissolution is easy and generally tax-free
- Unlimited liability

## Partnerships

- 2 or more owners
- Flow through of profit and loss to the owners
- Tax is at the owners' level and tax rates (exception for General Partners (SE Tax § 1402(a)).
- Same tax year as the owners
- Formation is usually tax-free
- Dissolution usually tax-free (inside / outside basis)
- Limited liability (except for General Partners)

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## Limited Liability Companies (LLC's) Can be taxed as:

- Partnership: Form 1065 (IRS Audit issue: SE Tax?)
- Corporation: Form 1120 or Form 1120S or
- Disregarded:
  - Form 1040
  - Form 1065
  - Form 1120
  - Form 1120S

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## Example: LLC Disregarded Entity

Q: Stanford is a partnership that operates a successful family restaurant chain. They decide to open up a bar located next to one of the restaurants, but had concerns regarding the potential liability. So they establish Stanford Bar & Grill (SB&G) LLC, no entity election is made. How is this reported?

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## Example: LLC Disregarded Entity

Q: Stanford is a partnership that operates a successful family restaurant chain. They decide to open up a bar located next to one of the restaurants, but had concerns regarding the potential liability. So they establish Stanford Bar & Grill (SB&G) LLC, no entity election is made. How is this reported?

A: Since SB&G LLC has only one member, although it is a separate legal entity for state purposes, it is disregarded for federal tax purposes; treated as a division of Stanford. SB&G LLC's income, loss or deductions will be included as part of Stanford's Form 1065.

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## S Corporations

- Limited ownership: 100 SH's, no foreign investors
- 'Usually' no tax at the corporate level
- Tax is at the owner's level and tax rates
  - **IRS audit issue:** "reasonable compensation"
- S-Corp is usually on a calendar year
- Dissolutions can be taxable
- Distributions are usually tax-free
- Limited liability to the owners

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## C Corporations

- No restrictions on the type of owner
- Separate tax rates for a C Corp
- Double taxation
- Unrestricted on choice of tax year (almost)
- Dissolutions / Distributions are usually taxable
- Limited liability to the owners
- **IRS Audit Issue:** Debt vs. Dividend

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## Loss Limitation Issues (Big IRS Audit Issue)

- Sole Proprietorship: Full allowance
- C Corp: Full allowance
- Partnership Debt Allocation standard:
  - Recourse: “economic risk of loss”; § 1.752-2(b)(1)
  - Non-Recourse: Based on “3” tiers §1.752-3(a)
- S Corp Debt Allocation:
  - The § 1366(d) ceiling on loss deductions includes a shareholder's adjusted basis for debt claims against the S corp.
  - A mere guarantee by a shareholder is ordinarily not sufficient; “economic outlay” required.

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## Contacts

- [www.irs.gov](http://www.irs.gov)
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# An Overview of California Taxation of Business Entities

IRS / SJSU SMALL BUSINESS TAX INSTITUTE – JUNE 18, 2014

Joel Busch, SJSU MST Program



## Main Areas Covered

- ▶ Primary California taxes, fees and compliance requirements on business entities
- Focus on California taxes on LLCs and S Corporations
- ▶ California Tax Withholding Overview



## Overview of Critical California Differences from Federal Taxation

### Limited Liability Companies

- ▶ Unlike at the Federal level, a limited liability company (LLC) that is organized in California, conducts business or has the right to do business generally must file an annual California LLC tax return – both for single-member and multi-member LLCs
- ▶ Critical item – Annual California LLC taxes and potential annual LLC fees are imposed directly on the LLC itself.

## LLC Tax Return

- ▶ The California tax return for Limited Liability Companies is California Form 568
  - 1) Very similar to California Partnership tax return (Form 565)
  - 2) Additional items include computation of potential LLC tax & fee
  - 3) For a disregarded entity, single-member LLC, Form 568 provides filing information concerning the single-LLC member (i.e., what California tax form was used to report the revenues and expenses of the LLC – such as Form 540, Form 100)
  - 4) Form 568 due April 15 for calendar year LLCs – normal automatic extension until October 15 for filing return

## LLC Tax

- ▶ Generally every LLC that conducts business in California or has the right to do business in California must pay an annual \$800 LLC tax to the State of California.
- ▶ Tax is due by April 15 of the taxable year
- ▶ Is usually imposed even if LLC has no net income or does not conduct business in the state (if it has the right to do business in the state)

## The \$800 Annual LLC Tax Continues Until .....

..... ALL THREE OF THESE OCCUR:

- ▶ 1) The LLC files its FINAL Form 568 return and pays the \$800 LLC tax for the final tax year (if not already prepaid),
- ▶ 2) The LLC does not do business in California after the final taxable year, AND
- ▶ 3) Files necessary documents with the California Secretary of State for the LLCs cancellation in California within 12 months of a timely filed final Form 568



## LLC Fees for LLC's With California Gross Receipts of \$250K or More

- ▶ Very critical that LLC owners and tax practitioners are aware of California's LLC fee.
- ▶ If a LLC has at least \$250,000 in California-based gross receipts (not to be confused with net income) then IN ADDITION TO the \$800 LLC tax, a LLC FEE will apply.
- ▶ The annual LLC fee ranges from \$900 to .....**\$11,790!**

## LLC Fee Schedule (Based on California-Based Gross Receipts)

<u>California Gross Receipts</u>	<u>LLC Annual Fee</u>
▶ \$250,000 to \$499,999	\$900
▶ \$500,000 to \$999,999	\$2,500
▶ \$1,000,000 to \$4,999,999	\$6,000
▶ \$5,000,000 +	\$11,790

..... Again this is in ADDITION TO the \$800 annual LLC tax

## LLC Fee Adjustments when LLCs are Members of *other* LLCs

- ▶ If the LLC is a member of another LLC who pays California LLC fees based on its California gross receipts, then the California LLC can exclude the other LLC's California gross receipts from its LLC fee calculation.

## LLC Fee Adjustments when LLCs are Members of *other* LLCs

### Example

- ▶ The Noriko LLC is a 50% member in Aiko LLC.
- ▶ Aiko LLC has \$600,000 of California gross receipts which is subject to the amount of California LLC fees Aiko must pay for the year. Of the \$600,000, \$300,000 flows-through to the Noriko LLC (based on its 50% ownership).
- ▶ The Noriko LLC has a grand total of \$450,000 of California-based gross receipts (including the \$300,000 attributable to its 50% ownership in the Aiko LLC)
- ▶ Because the Noriko LLC can exclude the \$300,000 of California gross receipts attributable to its 50% ownership of Aiko LLC, the Noriko LLC will not owe any LLC fee for the year (\$150,000 in net California gross receipts is less than the \$250,000 LLC fee floor).



## Sourcing of California Income for LLC Fee Calculation – Sales of TPP

### Sales of Tangible Personal Property – General Rules

- ▶ Normally California sourced if delivered to California customer in California
- ▶ If seller ships from a location in California, normally sourced to California even if delivered to outside of California (unless seller is subject to tax in buyer's state)
- ▶ If sold from within California and delivered to the U.S. government, the sale is normally sourced to California – even if the seller is subject to tax in the other state.

## Sourcing of California Income for LLC Fee Calculation: Services, Rental of TPP, Real Property & Intangible Property

### Sourcing – General Rules

- ▶ Starting for taxable years beginning 1/1/13, must source to California based on the market assignment approach for services, rental of TPP, real property and sales of *intangible* property.

## Sourcing of California Income for LLC Fee Calculation: Services, Rental of TPP, Real Property & Intangible Property

Gross receipts generally California sourced if:

- 1) Service recipient receives the benefit of the services in California
- 2) For sales of intangible property, if the property is used in California
- 3) For sales and leases of real property – if the real estate is in California
- 4) For rental/lease/licensing of tangible personal property – if property is located in California.

## “Doing Business” in California – An Overview for LLCs

- ▶ California defines doing business as “actively engaging in any transaction for the purpose of financial or pecuniary gain or profit.”
- ▶ In addition, “doing business” in California includes, among other situations, when any of the LLC's members, managers, or other agents “conducts business” in California on behalf of the LLC.



## “Doing Business” in California – An Overview for LLCs

- ▶ Large differences of opinion of what constitutes “conducting business” in California by LLC members based in California.

## S Corporations

- ▶ Important: California imposes a 1.5% net income tax on most S corporations that are incorporated in California, have the right to do business in California or do business in California
- ▶ Higher tax rate for financial S corporations (3.5%)
- ▶ Filed on Form 100S – Due March 15 (for calendar year corps.)
- ▶ Automatic extension to file until October 15 (not available to corporations under suspension)

## S Corporations (Cont.)

- ▶ Normally subject to the minimum franchise tax of \$800 per year if the 1.5% net income tax is less than \$800, unless in the first year of the corporation (but still subject to the normal 1.5% net income tax in the first year).
- ▶ For most multi-state corporations, starting in 2013 business income is apportioned to California using a sole sales-based apportionment factor.

## LPs and LLPs

- ▶ Both Limited Partnerships and Limited Liability Partnerships are normally subject to an \$800 annual California tax if they have the right to conduct business in California or conduct business in California.
- ▶ LPs and LLPs note their limited liability status on the partnership tax return (Form 565).



## C Corporations

- ▶ Most C Corporations pay a flat 8.84% net income tax based on their California-based net income – with a minimum \$800 franchise tax for almost all corporations.
- ▶ 10.84% rate for banks and financial corporations
- ▶ The minimum franchise tax is not applicable to the first year of the corporation, but subject to 8.84% income tax

## C Corporations (Cont.)

- ▶ As previously stated, for multi-state corporations, starting in 2013 business income is apportioned to California using a single sales-based apportionment factor.
- ▶ California Form 100 due March 15 for calendar year corporation – usual automatic extension until October 15 (unless under suspension)

## General Partnerships



- ▶ Generally no California tax or fees due on General Partnerships.
- ▶ Partnership tax return (Form 565) due April 15 for calendar year partnerships, usual automatic extension until October 15.

## General Partnerships



- ▶ Generally no California tax or fees due on General Partnerships.
- ▶ Partnership tax return (Form 565) due April 15 for calendar year partnerships, usual automatic extension until October 15.



## Sole Proprietorships

- ▶ No Schedule C per se filed on Form 540 (only adjustments off the Federal Schedule C amounts – reported on California Schedule CA, Part I, Section A, Line 12)
- ▶ No self-employment taxes on net self-employment income in California
- ▶ Simply the California self-employment net income is subject to California income tax

## California Tax Withholding

- ▶ California has a very stringent set of withholding rules for payees who derive income from California sources.
- ▶ California payors are generally required to withhold California tax on amounts paid to non-California residents.

## California Tax Withholding

Payments to non-California payees generally require California tax withholding once payments to the payee exceed \$1,500 for the year.

### Payee Examples

	<u>Rate</u>	<u>Base</u>
▶ Non-California (but in U.S.) partner	7%	Calif. income <u>distributed</u>
▶ Non-California (& <u>non-U.S.</u> ) Non-corp. partner	12.3%	Allocable share of Calif. <u>Income</u>
▶ Non-California (& <u>non-U.S.</u> ) <u>Corporate</u> partner	8.84%	Allocable share of Calif. <u>Income</u>
▶ Non-California (& <u>non-U.S.</u> ) <u>financial corp.</u> partner	10.84%	Allocable share of Calif. <u>Income</u>

### Notes:

- 1) "Non-corporate" partners include individuals, partnerships, estates/trusts
- 2) "Non-California" includes business entities with a permanent place of business in California and the right to do business in California

## California Tax Withholding

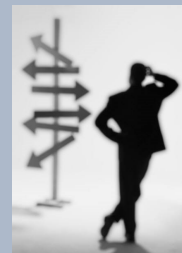
- 1) Reduced withholding rates (including full exemptions) are potentially available via waiver requests from the FTB.
- 2) Withholdings must generally be remitted to the FTB quarterly based on payments made during each calendar year quarter (4/15 for 1Q; 6/15 for 2Q; 9/15 for 3Q; 1/15 of following year for 4Q)
- 3) Payees with California taxes withheld are required to receive information on the amount of their California tax withholding (typically Form 592-B) by January 31 of the following year.

## Recent Changes in California Apportionment Rules – Overview

- ▶ For tax years beginning on or after January 1, 2013 multi-state businesses now require the use of a sole sales apportionment factor when apportioning business income to the various states where it conducts business for California tax purposes.
- ▶ For 2011 and 2012 most businesses not primarily in the agricultural, mining, or banking/financial industries could use (by default) a double-weighted sales (vs. payroll and property) factor apportionment formula unless they *elected* to use the single weighted sales factor.

### Before you form an entity

- Choose a jurisdiction
- Choose a type of entity
- Seek professional advice from your CPA, attorney or lender
- Consider other necessary agreements



## How to form an entity

The infographic lists various legal documents and forms: Articles of Incorporation, SI-350, Minutes, Tax Voucher, Stock Ledger, BE-605, Form D, Articles of Organization, Partnership Agreement, Shareholder Agreement, Bylaws, Operating Agreement, Form SS-4, Stock Certificates, Stock Ledger, Form DE-1, Form LLC-12, SI-200, and Form 25102(f). Three items are highlighted with red circles and a diagonal slash: 'DIY', 'CPA', and 'LEGAL ZOOM?'. The logo for STRATEGY LAW LLP is at the bottom.

## Jurisdiction

Two license plates are shown side-by-side. The left one is for California, featuring the text 'CALIFORNIA' and 'The Golden State'. The right one is for Delaware, featuring the text 'THE FIRST STATE' and 'DELAWARE'. The logo for STRATEGY LAW LLP is at the bottom.

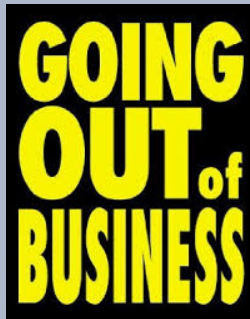
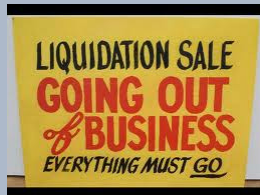


# Maintenance



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# Shutting down



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**Dissolve Business Entity**

- Tell your advisors
- Notify Employees
- Turn Off Utilities
- Cancel Permits/Licenses
- Terminate Contracts
- Shut Down Website
- Collect Accounts Receivable
- Distribute Remaining Assets
- Sell off Inventory
- Abandon FBN
- Notify Creditors
- Liquidate Assets
- Final Tax Returns
- Forward mail/email
- Terminate Leases
- Close Bank Accounts

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 Founding Partner

**STRATEGY** LAW, LLP

# IRS-SJSU Small Business Tax Institute

Assisting New and Growing Businesses

June 18, 2014

## What it Takes to be a Successful Entrepreneur

Presenter: Steve Bennet, Adjunct Faculty, SJSU; Partner, CrossCoin Ventures; Managing Director, Bodega Partners

This presentation will compare the differences between traditional small businesses and high growth startup companies and focus on some of the characteristics attributed to successful entrepreneurs. Today's startup climate is highly competitive, but at the same time, the rewards are at staggering levels. While a number of private companies have raised over \$100 million in financing at valuations in excess of \$1 billion, many more struggle to raise any capital or grow their businesses.

What is it that separates the two groups? Many in both camps share the same entrepreneurial characteristics. Traits often associated with successful entrepreneurs include integrity, drive, malleability, sense of urgency, leadership, ability to recruit, domain expertise, creativity, tenacity, passion, tolerance for ambiguity, vision, self-confidence, risk-taking, problem solving, focus, resiliency, competitiveness, and decisiveness. Of course, a little bit of luck doesn't hurt.

There are many books available on successful entrepreneurs such as Anita Roddick, Richard Branson, and Mark Zuckerberg. However, this presentation will look at a number of entrepreneurs who are not household names and that the presenter has worked directly with and how their entrepreneurial drive, leadership, and management skills have impacted their businesses. These case studies will provide an overview on different approaches entrepreneurs take and how they approach the challenges inherent in any startup. Entrepreneurs to be profiled in this presentation are:

- Logan Green (co-founder and CEO, Lyft)
- Peter Yolles (founder and CEO, WaterSmart Software)
- Liza Falzone (co-founder and CEO, Revel Systems)
- Gary Kremen (serial entrepreneur – Match.com, Clean Power Finance, Sociogramics)
- Reza Raji (founder iControl Networks, SocialParent)
- Kevin Hartz (co-founder and CEO, Eventbrite)

# What it Takes to be a Successful Entrepreneur

IRS-SJSU Small Business Tax Institute

June 18, 2014

Steve Bennet



# Who is Steve Bennet?



**Steve Bennet**

**@ProfessorVC**

Startup CFO, Angel Investor, Professor. Fan of SF Giants, SJ Sharks, Cal Bears. Golfer/Skier. Passionate about education + entrepreneurship. Penn/UCLA grad  
Palo Alto · <http://professorvc.com>

# Small Business vs Startup



# What is Entrepreneurship?

- \* The relentless pursuit of opportunity without regard to tangible resources currently controlled
- \* A complete process from identification to harvesting
- \* A way of managing

# Entrepreneurial Process

- \* Identify a Good Opportunity
- \* Gain access to the resources needed
- \* Launch the venture
- \* Grow the business
- \* Exit the business
  
- \* ..... Repeat, if necessary

# Keys to Business Success

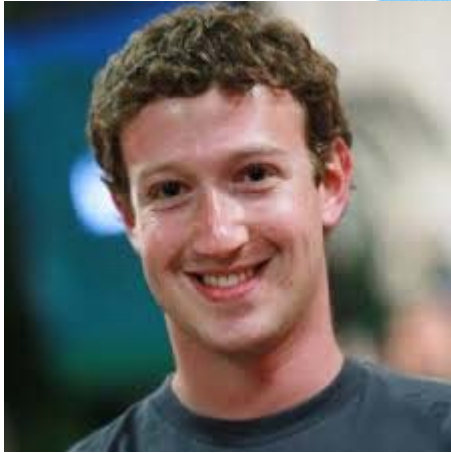
- \* Business Concept
- \* Market Understanding
- \* Industry Health
- \* Strong Management
- \* Solid Business Model
- \* Capital
- \* Financial Control
- \* Consistent Business Focus
- \* Ability to Anticipate Change
- \* Timing
- \* Execution, Execution, Execution

# Entrepreneurial Characteristics





# Not going to focus on these entrepreneurs?



# These Entrepreneurs aren't household names (yet)





# Logan Green: Zimride to Lyft

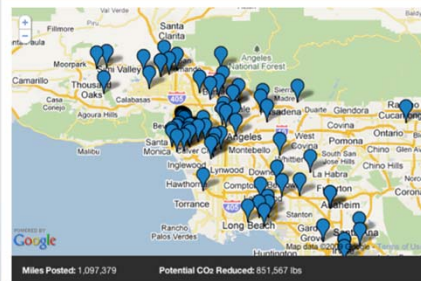


PHOTOGRAPH BY ROD ROLLE



**zimride** UCLA

Zimride helps you share rides with friends, classmates, and coworkers.



**Commute Origins** (View all)

- Los Angeles 83 rides
- Long Beach 6 rides
- Glendale 5 rides
- Irvine 5 rides
- Burbank 3 rides

**Travel Destinations** (View all)

- San Diego 4 rides
- Los Angeles 3 rides
- Cerritos 1 ride
- Irvine 1 ride
- Placer 1 ride

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Zimride is a fun and easy way to share the seats in your car or catch a ride. With Zimride, you can find UCLA friends, classmates, and coworkers going the same way you are.

**Have a car? Need a ride?**

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Communities aren't born. They're made. Built on the shoulders of shared experiences. Created by people with a common cause, a common history, or in our case, a common destination.

Welcome to zimride.

We zimride because we agree on music. Because we disagree about politics. Because we care about the environment. Because we care about our wallets. But most of all, because

LIFE IS BETTER WHEN YOU SHARE THE RIDE.



# Peter Yolles: WaterSmart Software



IMAGINE |  | H<sub>2</sub>O

**WATER EFFICIENCY PRIZE** *Runner Up*

 **WaterSmart** BETA  
SOFTWARE, INC.



City of San Jose WaterSmart

YOUR HOME WATER REPORT

WaterScore: 77 (out of 100)

You used more water than most of your neighbors.

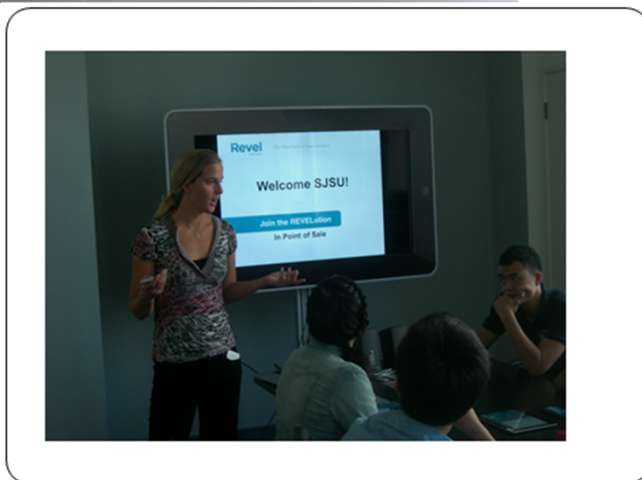
Below the Bay (2016)

Neighborhood	Water Score
Midwest neighbors	77
Bay Area neighbors	75
You	77

Are we comparing you fairly?

How much you could be saving

# Lisa Falzone: Revel Systems





# Gary Kremen

## From Match.com to Solar Finance



**match.com™**  
ONLINE MATCHMAKING

More than  
**1,000,000**  
singles have used our  
service worldwide!



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Free Trial

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Clean Power  Finance

# Reza Raji: iControl Networks





# Kevin Hartz: Eventbrite



## Couples who make their relationship work, at work

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Kevin and Julia Hartz, the husband and wife team who founded online ticket company Eventbrite, started the business right after moving in together and getting engaged. They don't argue or show affection in front of employees.

Photo: Lance Iversen / The Chronicle

# Closing Thoughts on Entrepreneurship

- \* Not for the faint of heart
- \* No one size fits all
- \* Entrepreneurship is personal
- \* “Just Do It”

## Ethics and Advising an Emerging Business

IRS-SJSU Small Business Tax Institute

June 18, 2014

Kip Dellinger, CPA

### The Tax-Business Adviser Faces a Plethora of Rules

- - AICPA Code of Professional Conduct
- - AICPA Statements on Standards for Tax Services (“SSTS’s”)
- - Treasury Dept. Circular 230
- - Statutory misconduct penalties
- - Specific Rules of Conduct of the Boards of Accountancy - behavior
- - Malpractice exposure

## Circular 230

- Subpart A – Authority to Practice

Subpart B – Duties and Restrictions (Sec. 10.20 through 10.37)

Subpart C – Sanctions for Violations of Cir. 230 (18 categories of violation plus gross negligence with regard to 10.34, 10.36 & 10.37 as set forth in 10.51 & 10.52)

Subpart D – Disciplinary proceedings – the ‘process’

Subpart E – General provisions – effective date

## Emerging Business Advice is Likely a Non-Attest Service

- So what’s our guidance? Independence, GAAP and GAAS Compliance are not likely involved
- AICPA Code of Conduct principal controlling rules
  - *Integrity* (always)
  - *Objectivity* (always)
  - Addressing *conflicts of interest* issues
  - *Due professional care* (tax advice given)

## What About Specific SSTs and Circular 230

- Advice with regard to a multitude of issues including entity selection involve tax positions
  - but they're usually routine in terms of law: SSTs No. 1 and, if written, SSTs No. 8
  - exceptions might be partnership substantial economic effect issues and corporate debt v equity issue
- Circular 230, Sec. 10.34 'tax positions' similar in intent to AICPA rules (or vice versa)

## What About Specific SSTs and Circular 230 (continued)

- Circular 230, Sec. 10.22 'due diligence'
  - as to tax positions that will end up on a reflected on a return
- Circular 230, Sec. 10.29 'conflicting interests'
  - the start up *adviser* is not 'representing' a client in before IRS (or any tax authority)
- But, as we shall see, conflicts are a big issue



## The Lawyer

- 'Do it yourself' non-lawyers are begging for trouble
- Entities should be formed by lawyers
- Contractual relationships should be memorialized by lawyers
- 'Did it ourselves' clients should be directed to legal counsel

## Adviser Issues

- The adviser should have expertise in any area where advice is given
- Formation of the enterprise (e.g. partnership, LLC, S Corp, C Corp):
- Familiarity and facility with the pros and cons and evidence client was informed

### Adviser Issues (continued)

- Scope of taxes and nexus issues
- Choice of year end
- Accounting methods (specialized industry?)

### Adviser Issues (continued)

- Small business stock – Sec. 1244
- NOLs (choice of entity)
- Employees v Independent Contactor (significant adviser exposure)
- Many more....

## Adviser and the Lawyer

- The expertise of the lawyer affects the liability of the non-lawyer adviser
- Lawyers lack of tax knowledge can shift responsibility to accountant
- Have a clear understanding of who is responsible for what
- Engagement understandings
- Document ALL communications with client

## Dealing with and Advising the Parties

- Conflicts are the watchword
  - not a Circular 230 issue, not 'representation'; rarely a return prep or IRS issue
- Advising multiple potential conflicting parties (now or in the future) is a professional practice issue
- AICPA Code of Professional Conduct – ET 102-2

## Potential conflicts?

- Determination of and allocation of profits and losses
- Compensation issues
- Capitalization v Expensing
- Any number of other issues

## The Parties

- Who do you represent?
- Who do the parties reasonably believe you represent?
- How would a third party view the situation? How about a jury?

## Question about 'Appearances;

- Existing client 'initiates' the business arrangement with one or more 'new' parties?
- Existing client has been approached to engage in a proposed business (she's got the \$ and want her adviser to advise all parties)?
- Two new people (or three or ten) walk through the door?

## The Parties

- AICPA Interpretation is general and somewhat vague
- Does not preclude multiple representation
- But let's borrow from our lawyer friends....



## Advising the Parties

- The lawyer rule as 'Intermediary' (Model Rule 2.2)
- Potential conflicting relationships (adjusting relationships between the parties including organizing or reorganizing a business for two or more clients)
- How to do it.....

## Advising the Parties

- Consults with each regarding the implications of common rep
- Advises of advantages and risks involved
- Effect on attorney-client privilege (CPA confidentiality obligations)
- Reasonably believes the matter can be resolved on term's compatible with (all) client's best interests

## Advising the Parties

- There is little risk of material prejudice of to the interests of any client involved
  - Consider plaintiff lawyer's view of materiality
- Reasonably believes that the common representation can impartially and without improper effect on other responsibilities the client has to any of the clients

## Advising the Parties

- Obtain the multiple party acknowledgements
- Share the advice with ALL parties
- Document *everything* (i.e. oral advice provided at meetings)
- Document in an all inclusive manner – *pursuant the understanding the two* (or three or ten of) *you reached...*

## Advising the Parties

- Ask for acknowledgement from all parties if your 'gut' sends you a message
- Recommend that one more parties seek independent counsel if you fear a 'problem'
- Resign if you can't sleep

## Seem like a lot of work for a company that may never go anywhere?

- But what if it does go somewhere? And then the parties get into a dispute....
- Remember...responding to discovery, preparation for and giving depositions can be very time consuming and expensive
- Remember what Einstein said 'time is money'...it was Einstein, wasn't it?

## Resources for New Small Business Owners

### **Obtaining necessary licenses and permits:**

#### **Federal Licenses and Permits**

<http://www.sba.gov/content/what-federal-licenses-and-permits-does-your-business-need>

If you have business activities which are supervised and regulated by federal agencies (such as selling alcohol, firearms, etc.), you should check out this webpage for information on obtaining a federal license or permit.

#### **Find Business Licenses & Permits**

<http://www.sba.gov/licenses-and-permits>

This SBA tool helps you identify the specific licenses or permits your business may need. Simply enter your zip code and business type to view a list of the licenses or permits you'll need, together with information and links to the application process.

#### **CalGold**

<http://www.calgold.ca.gov/>

To assist you in finding the appropriate permitting information for your business, the CalGOLD database provides links and contact information that direct you to agencies that administer and issue business permits, licenses and registration requirements from all levels of government.

#### **Register Your Business**

<http://www.sanjoseca.gov/index.aspx?NID=3518>

The City of San Jose puts together a good page summarizing all the steps in registering a new company and registering a company to pay sales taxes, payroll taxes, unemployment insurance, and city and county taxes. This is a good checklist to go over.

### **Tax registrations:**

#### **Obtain Your Federal Business Tax ID (*Income Tax*)**

<http://www.sba.gov/content/obtain-your-federal-business-tax-id-ein>

The article provides information on Employer Identification Number (EIN), also known as a Federal Tax Identification Number. You can also find the online application link here.

#### **Register for a Permit, License, or Account (*Sales & Use Tax*)**

<http://www.boe.ca.gov/info/reg.htm>

You must obtain a seller's permit if you operate business in California. This article specifies the conditions to obtain a seller's permit and a use tax account. The article also explains how you can register online or in person.

#### **Permits & Licenses (*Sales & Use Tax*)**

[http://www.boe.ca.gov/permits\\_licenses.htm](http://www.boe.ca.gov/permits_licenses.htm)

The Board of Equalization administers many tax and fee programs. Depending on the type of your business, you may need one or more permits, license or accounts. This article walks you through how to register for a permit, how to renew a license, the types of common permits, licenses and accounts you may need and etc. You can find links to articles that cover specific topics.

Prepared by SJSU MST student Jun Xie; June 2014.

E-version to be posted to 6/18/14 IRS-SJSU Small Business Tax Institute website at "history" link – <http://www.tax-institute.com>.

### **Am I Required to Register as an Employer? (Payroll Tax)**

[http://www.edd.ca.gov/Payroll\\_Taxes/Am\\_I\\_Required\\_to\\_Register\\_as\\_an\\_Employer.htm](http://www.edd.ca.gov/Payroll_Taxes/Am_I_Required_to_Register_as_an_Employer.htm)

You are subject to California employment tax if your business hires employees. You need to register with the Employment Development Department (EDD) for Employer Payroll Tax Account Number. On this webpage, you can find information regarding California payroll tax, as well as the link to online registration.

### **Tax Resources:**

#### **Starting a Business**

<http://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Starting-a-Business>

This IRS webpage provides general information about some federal tax considerations, such as whether the taxpayer has a hobby or a business, recordkeeping and links to relevant IRS publications.

#### **Small Business and Self-Employed Tax Center**

<http://www.irs.gov/Businesses/Small-Businesses-&Self-Employed>

This IRS webpage provides tax resources for small business and self-employed taxpayers who file Form 1040, Schedules C, E, F or Form 2106, as well as small businesses with assets under \$10 million. You can select topics using the A-Z index listing.

#### **IRS Publication 334: Tax Guide for Small Business**

<http://www.irs.gov/pub/irs-pdf/p334.pdf>

This publication provides general information about federal tax laws that apply to small business owners. The publication has information on business income, expenses, and tax credits.

#### **Determine Your Federal Tax Obligations**

<http://www.sba.gov/content/business-structure-and-tax-implications>

Depends on the form of your business (Sole Proprietorship, Partnership, Corporation, S Corporation or LLC), you can find a direct link to the IRS's website which lists all the forms you may be required to file.

#### **Business Taxes**

<http://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Business-Taxes>

This article introduces four general types of business taxes: Income Tax, Estimated Tax, Self-Employment Tax and Employment Tax.

#### **Employment Taxes (Federal)**

<http://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Employment-Taxes-2>

If your business hires people, you need a good understanding of employment taxes. This article introduces different types of federal employment taxes. The article also contains links for employment tax due dates and filing forms.

#### **FTB Publication 1060: Guide for Corporations Starting Business in California**

<https://www.ftb.ca.gov/forms/misc/1060.pdf>

This guide provides an overview of the basis of California tax. It intends to help you file your corporation's first Form 100, Form 100S or Form 100-ES. (Applicable if the form of your business is a corporation.)

### **Payroll Tax Seminars (State)**

[http://www.edd.ca.gov/Payroll\\_Tax\\_Seminars/](http://www.edd.ca.gov/Payroll_Tax_Seminars/)

The EDD offers free payroll tax seminars to help business comply with State payroll tax laws. The seminars are held either in classroom-style or online. You can find more information about the courses here.

### **Small Business Fairs Schedule**

<http://www.boe.ca.gov/sutax/sbf.htm>

This is a schedule of free seminars hosted by several tax agencies to assist small business owners with tax aspects of your business. You will have the opportunity to speak to experts from the Board of Equalization, IRS, Franchise Tax Board and Employment Development Department.

### **Finding Funds:**

#### **Loans and Grants Search Tool**

<http://business.usa.gov/access-financing>

Check out this “Access Financing” Wizard from BusinessUSA to help you identify what government financing programs may be available to your business.

#### **General Small Business Loans: 7(a)**

<http://www.sba.gov/7a-loan-program>

The 7(a) Loan Program is SBA’s most common loan program. At this site, you can find information on program eligibility, loan proceeds, special types of 7(a) loans, application procedure and etc.

#### **Microloan Program**

<http://www.sba.gov/content/microloan-program>

SBA provides loans up to \$50,000 to small businesses through specially designated intermediary lenders. Each intermediary lender has its own lending and credit requirements. To find an approved microloan lender, you can contact your local SBA Office or view a listing attached to this article. The average microloan is about \$13,000.

#### **Real Estate & Equipment Loans: CDC/504**

<http://www.sba.gov/category/navigation-structure/loans-grants/small-business-loans/sba-loan-programs/real-estate-and-eq>

The CDC/504 Loan Program provides financing for major fixed assets such as equipment or real estate. At this site, you can find information on program eligibility, loan proceeds, application process and etc.

#### **Research Grants for Small Businesses**

<http://www.sba.gov/content/research-grants-small-businesses>

If your small business is engaged in scientific research and development, you may qualify for federal grants under the Small Business Innovation Research (SBIR) and the Small Business Technology Transfer (STTR) programs. You can find more information about these two programs in this article.

#### **Small Business Investment Companies (SBIC)**

<http://content.govdelivery.com/accounts/USSBA/bulletins/aedd2a>

Small Business Administration (SBA) partners with private investors to provide equity capital, long-term loans and expert management assistance to high-growth small businesses. The SBIC



program has been around since 1958 with many great success stories such as Costco, Apple and Staples.

### **Surety Bonds**

<http://www.sba.gov/surety-bonds>

SBA's Surety Bond Guarantee (SBG) Program helps small business contractors obtain surety bonds. SBA will make an agreement with a surety to guarantee that SBA will assume part of the loss in the event the contractor should breach the terms of the contract. SBA can guarantee bonds for contracts up to \$5 million, with the exception up to \$10 million for certain contracts.

### **Financial Development Corporation Programs**

<http://www.business.ca.gov/Programs/SmallBusiness/FinancialDevelopmentCorporationPrograms.aspx>

The California Small Business Loan Guarantee Program (SBLGP) helps a small business establish a favorable credit history with a lender and obtain future loans on its own. Through this program, a financing institution makes a small business loan directly to a small business with a state guarantee up to 80%. At this site, you can find more information on program overview, requirements, qualification, and etc.

### **Online Business Loans**

<http://www.business.ca.gov/LinkClick.aspx?fileticket=FvkML5y8rXw%3d&tabid=77&mid=1091>

This is the presentation from GO-Biz Online Leading Webinar took place in May 2014. The presentation provides an introduction to this new business loan area, which may be a good financing option for your small business.

### **Obtaining General Business Advice, Others:**

#### **Business Resources**

<http://www.sos.ca.gov/business/be/resources.htm>

This is a one-stop shop for a list of Federal and State agencies that a business may need to contact. Included are link and a short description of each agent or program.

#### **Thinking About Starting a Business?**

<http://www.sba.gov/thinking-about-starting>

Are you ready to start your own business? This site provides resources about what it takes to start a business. The articles help you start thinking about the basics you need to start and succeed in business.

#### **Learn about Business Law & Regulations**

<http://www.sba.gov/category/navigation-structure/starting-managing-business/starting-business/business-law-regulations>

This site provides information on laws and regulations that may apply to your business.

#### **Small Business Learning Center**

<http://www.sba.gov/tools/sba-learning-center/search/training>

Small Business Administration (SBA) offers free online courses on various business topics. You can watch videos which interest you at your own pace.

### **Small Business Development Center (SBDC)**

<http://www.asbdc-us.org/index.html>

SBDC network is the most comprehensive small business assistance network in the United States. It is a partnership of government, higher education and the private sector. Small business owners can go to your local SBDCs for free, face-to-face business consulting and at-cost training on writing business plans, accessing capital, marketing, regulatory compliance, international trade and more.

### **California Get Your Business Online**

<http://www.gybo.com/california>

This is a Google-led program that provides small businesses the resources they need to succeed online. There are free videos and virtual workshops.

### **Business Matchmaking 2014**

<http://www.businessmatchmaking.com/events.shtml>

Business Matchmaking provides opportunities for small businesses to secure selling opportunities from government agencies and major corporations. You can find dates and locations for upcoming business matchmaking events.

### **Service Core of Retired Executives (SCORE)**

<http://www.score.org/>

SCORE is a nonprofit organization dedicated to offer free and confidential small business advice for entrepreneurs. With 364 offices and 12,400 volunteer counselors nationwide, SCORE provides face-to-face mentoring as well as online counseling and workshops.

### **Silicon Valley Chamber Calendar**

<http://web.sjchamber.com/events?oe=true>

Check out the Chamber Calendar for chamber's upcoming networking news, workshops and seminars. Consider attending to build business connections.

### **BusinessOwner Space**

<http://www.businessownerspace.com/>

This is San Jose-Silicon Valley's one-stop resource for launching and growing a business in San Jose metropolitan area.

Also search for "accelerators" and "incubators" using a search engine to find locations where new businesses may find inexpensive space and resources to help them start and grow a business.

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# Small Business Tax Update

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Professor Annette Nellen

MST Program

San José State University

[http://www.cob.sjsu.edu/nellen\\_a/](http://www.cob.sjsu.edu/nellen_a/)

**IRS-SJSU**  
**Small Business Tax Institute**  
*Assisting New and Growing Businesses*  
**June 18, 2014**

1

**Outline with additional materials starts on page 41.**

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## Credits and Deductions

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2

## Alternative Simplified Research Credit

- Final, temp and prop regs issued June 2014
- Allow limited option to elect ASC on amended return (prior regs – only on original)
- Only if have not already claimed credit on the original return.
  - So – no option to change from regular to ASC on original return.
  - IRS concern – could otherwise result in credit having to be audited twice.

Form **6765**

[See outline.](#)

3

## Business deductions under §162

- *Canatella*, TC Memo 2014-102
  - Sch C lawyer denied \$338K of expenses
    - Was only able to show were paid by check or credit card
    - Unable to show they fell under 162 (and some also needed to meet 274(d))
    - Also, FTF timely penalty as both preparer and C signed after Oct 15
    - No reasonable cause shown to have penalties abated
  - Also: IRS had to summons bank records
  - Morale – keep receipts and document expenses and cooperate with IRS examiner.

Code Section	Tax Year(s)	Paid preparer?	Counsel at trial?	Initial deficiency	Winner	Penalty?
162	2009	yes	no	\$132,005	IRS	6651 - \$6,602 6662 - \$26,401

[See outline.](#)

## More Substantiation Problems

- Need to have records of expenses
- Payments by cash problematic
- No excuse if too busy to keep records
- Cohan rule n/a if no evidence at all about nature of expenses.

*Van Velzor*, TC Memo 2014-71

*Miller*, TC Memo 2014-105

See outline.

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## Interest expense troubles

- Form 1098 Not Enough to Support Mortgage Interest Deduction – In *Azimzadeh and Ehsan*, TC Memo 2013-169
  - Unable to prove what three 1098s were for
  - Lost entire mortgage interest deduction of \$54K (1098s totaled \$82K)
  - T had a business
    - So likely, some of the debt should have been traced to business to produce T or B interest expense

**Moral – Some clients need both tax and recordkeeping assistance.**

Links and further details in outline.

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## Reasonable cause and FTP employment taxes

- *Stevens Technologies, Inc.*, TC Memo 2014-13
  - Delays in paying employment taxes for a few years
  - President of company and two family members had significant health problems during this time
  - S argued reasonable cause for FTP taxes
  - Court – no – ST “was able to continue its operations, market its services to clients and potential clients, increase its workforce, and hire an accounting firm to prepare its Forms 941.”
  - Decision not to pay was “deliberate” – ST focused more on business than tax compliance.

See outline. 7

## Simplified home office deduction option

- IR-2013-5
  - 2010 - about 3.4 million taxpayers claimed home office deduction
- Rev Proc 2013-13
  - Starts for 2013
  - New, optional safe harbor method to claim home office deduction
    - Allowable square feet (max of 300) x \$5
    - IRS may later adjust the \$5 amount
    - Alternative to claiming home expenses (other than taxes and mortgage interest) including depreciation and \$179 expense
      - Mtg interest and Prop Tax – no proration; all on Schedule A
    - Year by year election
    - Later year when don't use safe harbor, need to use appropriate MACRS depreciation table for the proper year per placed in service date.
  - Must still meet all §280A requirements
  - If spouses use different portions of home, each may claim up to 300 sq feet
  - Requested comments by 4/15/13
  - <http://www.irs.gov/pub/irs-drop/rp-13-13.pdf>



## Example

- Gus – self employed consultant
  - Gross receipts of \$180,000
- Home office
  - Exclusive use
  - 250 square feet
  - 2013 utilities, insurance, repairs \$900
- Other expenses - \$43,000
- Standard home office deduction = \$1,250
- Deducts mortgage interest and prop tax on home on Schedule A
- No depreciation deduction if claim standard home office ded
- Year to year – decide if want to use std deduction

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## Standard mileage rates updated

Notice 2013-80 – starting 1/1/14

- Per mile:
  - 56 cents for business
    - 22¢ per mile represents depreciation
  - 23.5 cents for medical or moving purposes
  - 14 cents for service to charitable organizations (set in §170(i))
- ½ cent less than for 2013
- Must follow Rev. Proc. 2010-51 if use rates

□ <http://www.irs.gov/pub/irs-drop/rp-10-51.pdf>

<http://www.irs.gov/pub/irs-drop/n-13-80.pdf>

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## Misclassified worker

- *Rahman*, TC Summary Opinion 2013-35
  - Manager of group home for health care provider (H)
  - Full-time + on call 24/7
  - Numerous responsibilities
  - H covered costs of groceries, repairs, etc.
  - R – nothing out-of-pocket
  - R – had not reported 1099 from H or 1099-G from gov't for unemployment comp
  - Court – 7 factor analysis used
    - R is employee
    - R does not owe SE tax
    - Did owe \$6662 penalty.

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## 7 classification factors used by court

1. Control – Employee
2. Investment in Facilities – Employee
3. Opportunity for Profit or Loss – Employee
4. Right to Discharge – Employee
5. Integral Part of Regular Business
6. Permanency of Relationship – Employee
7. Relationship Contemplated by the Parties – Contractor

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# Entity updates

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## Relief for late S election

### Rev. Proc. 2013-30

- Relief and simplification
  - Exclusive procedures for late elections for
    - S corp
    - Electing Small Business Trust (ESBT)
    - Qualified Subchapter S Trust (QSST)
    - Qualified Subchapter S Subsidiary (Qsub)
    - Corporate classification elections
- Where intent was for all to take effect on same date intended to elect S corp status.
- Modifies and supersedes a few RPs
  - 30 pages including helpful flowchart
  - <http://www.irs.gov/pub/irs-drop/rp-13-30.pdf>

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## SE Tax – H&W Schedule Cs

### *Fitch*, TC Memo 2013-244 (10/28/13)

- H – CPA business – loss
- W – real estate agent – income
- California – community property rules
- §1402(a)(5) – if business income is community income – attribute to spouse who runs it.
  - If jointly operated, split per respective distributive share of GI and deductions.
- §1402(a)(5) modified in 2004; reg not yet updated
- §6017 – SE tax computed separately for H and W
  - MFJ - Liability is joint and several (§6013(d)(3)).

<https://www.ustaxcourt.gov/InOpHistoric/FitchMemo.Vasquez.TCM.WPD.pdf>

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## *Fitch* - continued

- F – W “did not substantially manage and control the realty business”
  - So, per reg, treat as H’s SE income under 1402/
- IRS –
  - Reg is outdated
  - Also have prenuptial agreement opting of out CA’s community property laws
  - W ran the real estate business
- Court
  - W involved in RE business + kept the accounting records
  - Even with outdated reg – W owes SE tax
  - Cannot reduce W’s SE income by H’s SE loss

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# Affordable Care Act

17

## IRS Resource Website - Topics

- 33 topics summarized with links to more details
- <http://www.irs.gov/uac/Affordable-Care-Act-Tax-Provisions>

- |   |   |
|---|---|
| 1. IRC §7216, Disclosure or Use of Information by Tax Return Preparers  | 17. Health Coverage for Older Children  |
| 2. Medical Loss Ratio (MLR)   | 18. Excise Tax on Indoor Tanning Services   |
| 3. Reporting Employer Provided Health Coverage in Form W-2  | 19. Adoption Credit   |
| 4. Net Investment Income Tax  | 20. Transitional Reinsurance Program  |
| 5. Additional Medicare Tax  | 21. Medicare Shared Savings Program   |
| 6. Minimum Value  | 22. Qualified Therapeutic Discovery Project Program   |
| 7. Information Reporting on Health Coverage by Employers  | 23. Group Health Plan Requirements  |
| 8. Information Reporting on Health Coverage by Insurers   | 24. Annual Fee on Health Insurance Providers  |
| 9. Disclosure of Return Information   | 25. Tax-Exempt 501(c)(29) Qualified Nonprofit Health Insurance Issuers                                    |
| 10. Small Business Health Care Tax Credit   | 26. Medicare Part D Coverage Gap "donut hole" Rebate  |
| 11. Application of the Affordable Care Act to Health Reimbursement Arrangements, Health Flexible Spending Arrangements and Certain Other Employer Healthcare Arrangements | 27. Additional Requirements for Tax-Exempt Hospitals  |
| 12. Health Flexible Spending Arrangements   | 28. Annual Fee on Branded Prescription Pharmaceutical Manufacturers and Importers                         |
| 13. Medical Device Excise Tax   | 29. Modification of Section 833 Treatment of Certain Health Organizations                                 |
| 14. Changes to Itemized Deduction for Medical Expenses  | 30. Limitation on Deduction for Compensation Paid by Certain Health Insurance Providers (amended §162(m)) |
| 15. Health Insurance Premium Tax Credit   | 31. Employer Shared Responsibility Payment  |
| 16. Individual Shared Responsibility Provision  | 32. Patient-Centered Outcomes Research Institute  |
|   | 33. Retiree Drug Subsidies  |

## Helpful resources – government

- ACA law - <http://www.hhs.gov/healthcare/rights/law/index.html>
- ACA resources from HHS
  - <http://www.healthcare.gov>
  - <http://www.hhs.gov/iea/acaresources/>
- Centers for Medicare & Medicaid Services (CMS)
  - Fact Sheets and FAQs - <http://www.cms.gov/ccio/resources/fact-sheets-and-faqs/index.html>
- Dept. of Labor - <http://www.dol.gov/ebsa/healthreform/>
- Small Business Administration - <http://www.sba.gov/healthcare>
- Congressional Research Service (CRS) reports

## Helpful resources – government

- IRS - <http://www.irs.gov/uac/Affordable-Care-Act-Tax-Provisions-Home>
- ★ □ Guidance <http://www.irs.gov/uac/Affordable-Care-Act-of-2010:-News-Releases.-Multimedia-and-Legal-Guidance>
- List <http://www.irs.gov/uac/Affordable-Care-Act-of-2010:-News-Releases.-Multimedia-and-Legal-Guidance>
- FAQs <http://www.irs.gov/uac/Newsroom/Affordable-Care-Act-Tax-Provisions-Questions-and-Answers>
- Joint Committee on Taxation – technical explanations
  - Technical Explanation of Revenue Provisions of ACA (3/21/10)
    - <https://www.ict.gov/publications.html?func=startdown&id=3673>
  - Bluebook (page 252-383) <https://www.ict.gov/publications.html?func=startdown&id=3775>
  - ★ □ 2013 summary - Present Law And Background Relating To The Tax-Related Provisions In The Affordable Care Act (JCX-6-13; 3/4/13)
    - <https://www.ict.gov/publications.html?func=startdown&id=4511>
    - Useful Table of Contents and text for deeper understanding of ACA

## Affordable Care Act Tax Provisions

**Affordable Care Act Topics**

- Individuals and Families
- Employers
- Other Organizations
- List of Tax Provisions
- Legal Guidance and Other Resources
- **Affordable Care Act Tax Provisions Home**

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- Disposiciones Tributarias de la Ley de Cuidado de Salud a Bajo Precio

### Affordable Care Act (ACA) Tax Provisions

News

Health Insurance Marketplace Opens – find out more

You may be eligible for the Premium Tax Credit

Premium Tax Credit electronic flyer (IRS Publication 5120) released

[More ...](#)

Individuals & Families

The Affordable Care Act (ACA), or health care law, includes new health insurance coverage and financial assistance options, including the Premium Tax Credit, for individuals and families purchasing insurance through the Marketplace. The IRS administers the tax provisions included in the law. Visit [HealthCare.gov](#) for more information on coverage options and assistance.

[More ...](#)

Employers

The Affordable Care Act (ACA), or health care law, contains many tax and other provisions for employers. The IRS administers the tax provisions included in the law. Visit [HealthCare.gov](#) and [SBA.gov/healthcare](#) for more information on other provisions.

[More...](#)

Other Organizations

- Insurers
- Certain Business Types
- Tax-Exempt & Government Organizations

[More ...](#)



**HealthCare.gov**

Get more information about the Affordable Care Act from the Department of Health & Human Services.

[Go to HealthCare.gov](#)

Related Links

- [Small Business Administration](#)
- [Department of Labor](#)
- [BusinessUSA](#)

<http://www.irs.gov/uac/Affordable-Care-Act-Tax-Provisions-Home>

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## Helpful resources – non government

- **AICPA timeline and links**
  - <http://www.aicpa.org/Research/HCR/Pages/Timeline.aspx>
- **AICPA Health Care Reform Resources Center**
  - <http://www.aicpa.org/research/hcr/pages/health-care-reform.aspx>
- **AICPA Health Care Reform Toolkit**
  - <http://www.aicpa.org/InterestAreas/PrivateCompanies/PracticeSection/QualityServices/Delivery/TaxResources/Pages/HealthcareReformToolkit.aspx>
- **Consumers Union**
  - <http://consumerreports.org/cro/health/health-insurance/index.htm>
  - <http://consumersunion.org/topic/health-care/tax-credit/>
- **Kaiser Family Foundation**
  - <http://kff.org/health-reform/>
  - **Health Insurance Subsidy Calculator**
    - <http://kff.org/interactive/subsidy-calculator/>
  - **FAQ**
    - <http://kff.org/health-reform/faq/health-reform-frequently-asked-questions/>
  - **More – visit KFF website**

## Key resource for tax provisions ...

**Code, regulations and IRS notices and related documents**

**“SEC. 36B. REFUNDABLE CREDIT FOR COVERAGE UNDER A QUALIFIED HEALTH PLAN.**  
**(a) IN GENERAL.**—In the case of an applicable taxpayer, there shall be allowed as a credit against the tax imposed by this subtitle for any taxable year an amount equal to the premium assistance credit amount of the taxpayer for the taxable year.  
**(b) PREMIUM ASSISTANCE CREDIT AMOUNT.**—For purposes of this section—  
 “(1) **IN GENERAL.**—The term ‘premium assistance credit amount’ means, with respect to any taxable year, the sum of the premium assistance amounts determined under paragraph (2) with respect to all coverage months of the taxpayer

DEPARTMENT OF THE TREASURY  
 Internal Revenue Service

26 CFR Parts 1 and 602  
 [TD 9590]  
 RIN 1545-BJ82

**Health Insurance Premium Tax Credit**  
 AGENCY: Internal Revenue Service (IRS), Treasury.  
 ACTION: Final regulations.

6056.  
 Accordingly, as a general method, these regulations provide that the section 6056 return may be made by filing Form 1004-C (a transmittal) and Form 1095-C (an employee statement) or other forms the IRS designates. Alternatively, the section 6056 return may be made by filing a substitute form. Under these regulations, a substitute form must include all of the information required to be reported on Forms 1094-C and 1095-C or other forms the IRS designates and comply with applicable

## Caution: penalty for improper group health plan

### Notice 2013-54

- ❑ Employer reimburses employee for all or part of cost of individual health insurance policy (Rev. Rul. 61-146)
- ❑ Notice 2013-54 – plans must meet certain “market reforms”
  - Exceptions include (see the Notice for details):
    - ❑ Group health plan with less than 2 participants
    - ❑ Group health plan regarding provision of excepted benefits
- ❑ Form 8928
- ❑ IRS Q&A - <http://www.irs.gov/uac/Newsroom/Employer-Health-Care-Arrangements>

# Property Transactions

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## §280F dollar amounts for 2014

**Rev Proc. 2014-21**

### Limits for vehicles placed in service in 2014

Year	Cars	Trucks and vans
1	\$3,160	\$3,460
2	\$5,100	\$5,500
3	\$3,050	\$3,350
thereafter	\$1,875	\$1,975

§280F also applies to lessees (special tables in RP 2014-21)  
<http://www.irs.gov/pub/irs-drop/rp-14-21.pdf>

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## Repair vs Capitalization

- Rev. Proc. 2014-17
  - Various depreciation automatic changes
  - Relevant mostly to 2013 tax returns!!
  - <http://www.irs.gov/pub/irs-drop/rp-14-17.pdf>
- Rev Proc. 2014-16
  - <http://www.irs.gov/pub/irs-drop/rp-14-16.pdf>
- Be ready for method changes for 2014
- Review safe harbors in regs

See outline.

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## Virtual currency guidance

- Notice 2014-21
  - Treat as property
    - Convertible to a “real” currency.
    - As if you were using gold to pay for your transactions.
    - So, need to track the value of the VC when purchased and when used.
      - Character – look at IRC §1221
    - Mine Bitcoin – generate income!
      - May also owe SE tax if a T or B
  - Issues:
    - What exchange rate to use?
    - Track by specific identification or FIFO?

□ <http://www.irs.gov/pub/irs-drop/n-14-21.pdf>

□ <http://21stcenturytaxation.blogspot.com/2014/03/guidance-on-taxation-of-virtual-currency.html>

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## Virtual Currency Issues

- Which exchange rate should be used if more than one is available? Is averaging allowed?
- Ok to track using FIFO or must you use specific ID?
- Is VC a foreign financial asset under §6038D, possibly reportable on Form 8938, *Statement of Specified Foreign Financial Assets*?
- Should a "Bitcoin wallet" be reported on the Report of Foreign Bank and Financial Accounts (FBAR)?

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## Virtual Currency Issues

- Is "mining" production for §263A purposes?
- Does §6045, *Returns of brokers*, apply to a person that handles exchanges of VC for dollars?
- Is one VC considered like-kind to another VC for §1031 purposes? Is VC like-kind to any other type of investment property?

[http://www.21stcenturytaxation.com/Virtual\\_Currency\\_Tax.html](http://www.21stcenturytaxation.com/Virtual_Currency_Tax.html)

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## VC continued

- Your client accepts payment in Bitcoin.
  - Tax effect if all handled by an exchanger?
  - Tax effect if client uses own bitcoin wallet for all?
  
  - Need to look at facts and circumstances.

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## Miscellaneous

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## Circular 230 updated

- TD 9668 (6/12/14)
- Key changes include:
  - Covered opinion rule at 10.35 removed.
    - No more email penalty disclaimers needed.
    - Consider appropriate disclaimers though
  - Written advice – new §10.37 on reasonableness of what you can rely on
  - General standard of competence – new §10.35 requires practitioner to have “the appropriate level of knowledge, skill, thoroughness, and preparation necessary for the matter for which the practitioner is engaged.”

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## Circular 230 - more

- Procedures to ensure compliance – §10.36 modified to require a person in a firm, subject to Circular 230, who has “principal authority and responsibility for overseeing a firm’s practice governed” by Circular 230 to be sure appropriate procedures for compliance are in place and that they are followed.
- Electronic negotiation of taxpayer refunds – §10.31 updated to make it clear that not only may a practitioner not endorse or negotiate a tax refund, but may not direct or accept payment by any means of a taxpayer refund.

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## IRS Services Guide (Pub 5136)

- Resource guide for
  - General tax law info
  - Preparing a federal return
  - Check status of refund or amended return
  - Make a tax payment
  - Understand a notice
  - Get a transcript
  - Get an EIN or ITIN
  - ID theft issues
  - Get a form or pub
  - Contact local Taxpayer Advocate

See copy in these materials.

<http://www.irs.gov/pub/irs-pdf/p5136.pdf>

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## Regulations list for 2014

- See list at
  - [http://www.cob.sjsu.edu/nellen\\_a/2014regs.html](http://www.cob.sjsu.edu/nellen_a/2014regs.html)



FEDERAL REGISTER

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# Services Guide



## Help for Individual Taxpayers

If you need help with	Here's where to find it
General tax law information	<ul style="list-style-type: none"> <li>• Enter <b>ITA</b> into the Search feature on <a href="http://www.irs.gov">www.irs.gov</a> for the <b>Interactive Tax Assistant</b>, a tool that will ask you questions and provide tax law answers</li> <li>• Enter <b>IRS Tax Map</b> or <b>Tax Trails</b> into the Search feature for more detailed information by tax topic</li> <li>• Enter <b>Pub 17</b> into the Search feature to get Pub 17: Your Federal Income Tax for Individuals, which features details on tax-saving opportunities, 2013 <b>tax changes</b> and thousands of interactive links to help you find answers to your questions</li> <li>• Call TeleTax: 1-800-829-4477 for recorded information on a variety of tax topics</li> <li>• Access tax law information in your electronic filing software</li> <li>• Go to <a href="http://www.irs.gov">www.irs.gov</a> and click on the <b>Help &amp; Resources</b> tab for more information</li> </ul>
Preparing a federal tax return	<p>Find free options on IRS.gov or in your community for those who qualify</p> <ul style="list-style-type: none"> <li>• Go to <a href="http://www.irs.gov">www.irs.gov</a> and click on the Filing tab</li> <li>• Enter <b>Free File</b> into the Search feature to use brand name software to prepare and e-file your return for free</li> <li>• Enter <b>VITA</b> into the Search feature, download the free <b>IRS2Go</b> app, or call 1-800-906-9887 to find the nearest Volunteer Income Tax Assistance or Tax Counseling for the Elderly location for free tax preparation</li> <li>• Enter <b>TCE</b> into the Search feature or call 1-888-227-7669 to find the nearest Tax Counseling for the Elderly location for free tax preparation</li> </ul>
Checking on the status of a refund	<ul style="list-style-type: none"> <li>• Go to <a href="http://www.irs.gov">www.irs.gov</a> and click on <b>Where's My Refund</b></li> <li>• Download the free <b>IRS2Go</b> app to your smart phone</li> <li>• Call the automated refund hotline: 1-800-829-1954</li> </ul>
Checking the status of an amended return	<ul style="list-style-type: none"> <li>• Go to <a href="http://www.irs.gov">www.irs.gov</a> and click on the Tools tab and select the <b>Where's My Amended Return</b> tool</li> </ul>
Making a tax payment	<p>Go to <a href="http://www.irs.gov">www.irs.gov</a> and click on the <b>Payments</b> tab and select:</p> <ul style="list-style-type: none"> <li>• Pay by <b>Debit or credit card</b></li> <li>• Pay by <b>Electronic Funds Withdrawal</b></li> <li>• Pay by <b>Electronic funds transfer</b></li> <li>• Pay by <b>Check or money order</b></li> </ul> <p>Instructions for additional payment options</p> <ul style="list-style-type: none"> <li>• Enter <b>OPA</b> into the Search feature to get an Online Payment Agreement application</li> <li>• Enter <b>EFTPS</b> into the Search feature to make recurring payments</li> <li>• Enter <b>Payment Plan</b> into the Search feature to get a payment plan or <b>Installment Agreement</b></li> </ul>

Understanding an IRS Notice or Letter	<ul style="list-style-type: none"> <li>• Enter <b>understanding your notice</b> in the Search feature on <b><a href="http://www.irs.gov">www.IRS.gov</a></b> to find additional information about your IRS notice or letter</li> </ul>
Getting a transcript or copy of a return	<ul style="list-style-type: none"> <li>• Go to <b><a href="http://www.irs.gov">www.IRS.gov</a></b> and enter “<b>Order a Transcript</b>” in the Search box.</li> <li>• Call the transcript toll-free line: 1-800-908-9946</li> <li>• Mail in Form 4506-T (available on <a href="http://irs.gov">irs.gov</a>)</li> </ul>
Getting an Employer Identification Number (EIN)	<ul style="list-style-type: none"> <li>• Go to <b><a href="http://www.irs.gov">www.IRS.gov</a></b> and enter <b>EIN</b> in the Search feature to access the <b>Online EIN Application</b></li> </ul>
Getting an Individual Taxpayer Identification Number (ITIN)	<ul style="list-style-type: none"> <li>• Go to <b><a href="http://www.irs.gov">www.IRS.gov</a></b> and enter <b>ITIN</b> in the Search feature to learn more and to get an application</li> </ul>
Understanding Identity Theft issues	<ul style="list-style-type: none"> <li>• Go to <b><a href="http://www.irs.gov">www.IRS.gov</a></b> and enter <b>Identity Theft</b> in the Search feature for information and videos</li> <li>• Contact the Identity Protection Specialized Unit at 1-800-908-4490 if you believe you’re at risk due to a lost/stolen purse or wallet, questionable credit card activity or credit report, etc.</li> </ul>
Obtaining a tax form or publication	<ul style="list-style-type: none"> <li>• Go to <b><a href="http://www.irs.gov">www.IRS.gov</a></b> and click on the <b>Forms and Pubs</b> tab</li> <li>• Call toll-free at 1-800-829-3676</li> <li>• Visit a <b>Taxpayer Assistance Center</b> near you</li> </ul>
Contacting a local Taxpayer Advocate	<ul style="list-style-type: none"> <li>• Go to <b><a href="http://www.irs.gov">www.IRS.gov</a></b> and enter <b>Taxpayer Advocate</b> in the Search box or call them at 1-877-777-4778 or TTY/TTD: 1-800-829-4059</li> </ul>



## Help for Tax Professionals

If you need help with	Here’s where to find it
General Tax Professional Information	<ul style="list-style-type: none"> <li>• Go to <b><a href="http://www.irs.gov">www.IRS.gov</a></b> and click on the <b>For Tax Pros</b> tab</li> </ul>
Getting a Preparer Tax Identification Number (PTIN)	<ul style="list-style-type: none"> <li>• Enter <b>PTIN</b> into the Search feature to get PTIN requirements and renew or sign up for a PTIN</li> <li>• Call toll-free: 1-877-613-7846</li> <li>• International: 1-915-342-5655 (not toll-free)</li> <li>• TTY: 1-877-613-3686</li> </ul>
Getting a Power of Attorney (POA)	<ul style="list-style-type: none"> <li>• Go to <b><a href="http://www.irs.gov">www.IRS.gov</a></b> and enter <b>POA</b> in the Search feature for information on Form 2848 and Instructions</li> <li>• Fax: 855.214.7519 for: AL, AR, CT, DE, DC, FL, GA, IL, IN, KY, LA, MA, MD, ME, MI, MS, NH, NJ, NY, NC, OH, PA, RI, SC, TN, VT, VA, WV</li> <li>• Fax: 855.214.7522 for: AK, AZ, CA, CO, HI, ID, IA, KS, MN, MO, MT, NE, NV, NM, ND, OK, OR, SD, TX, UT, WA, WI, WY</li> <li>• International Fax: 267.941.1017 or 855.772.3156</li> </ul>
Contacting the Practitioner Priority Service	<ul style="list-style-type: none"> <li>• Call toll-free: 1-866-860-4259 for help with a client account issue</li> </ul>
Obtaining a tax form or publication	<ul style="list-style-type: none"> <li>• Go to <b><a href="http://www.irs.gov">www.IRS.gov</a></b> and click on the <b>Forms and Pubs</b> tab</li> <li>• Call toll-free: 1-800-829-3676</li> </ul>
Keeping up with the latest IRS information affecting tax professionals	<ul style="list-style-type: none"> <li>• Go to <b><a href="http://www.irs.gov">www.IRS.gov</a></b> and enter “<i>Join e-news</i>” in the Search feature to subscribe to <b>e-News for Tax professionals</b></li> <li>• Follow IRS on <b>Twitter</b>, at: <a href="http://twitter.com/irstaxpros">http://twitter.com/irstaxpros</a></li> <li>• Like IRS on <b>Facebook</b>, at: <a href="https://www.facebook.com/IRStaxpros">https://www.facebook.com/IRStaxpros</a></li> </ul>
Professional responsibility information	<ul style="list-style-type: none"> <li>• Go to <b><a href="http://www.irs.gov">www.IRS.gov</a></b> and enter <b>Circular 230</b> in the Search feature for information on the standards of practice for tax professionals and frequently asked questions</li> </ul>



# California



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## CA Enterprise Zone Changes

AB 93 (Chap 69) and SB 90 (Chap 70) (7/11/13)

- ❑ Generally effective 1/1/14
- ❑ New employment credit for certain workers, based on wages > 150% of minimum wage
  - Can't claim on amended return.
- ❑ State sales tax credit on certain manufacturing and research equipment (starts 7/1/14)
- ❑ California Competes Tax Credit - \$380 million of income tax credits to be distributed by GO-Biz

[http://www.leginfo.ca.gov/pub/13-14/bill/asm/ab\\_0051-0100/ab\\_93\\_bill\\_20130711\\_chaptered.pdf](http://www.leginfo.ca.gov/pub/13-14/bill/asm/ab_0051-0100/ab_93_bill_20130711_chaptered.pdf)

[http://www.leginfo.ca.gov/pub/13-14/bill/sen/sb\\_0051-0100/sb\\_90\\_bill\\_20130711\\_chaptered.pdf](http://www.leginfo.ca.gov/pub/13-14/bill/sen/sb_0051-0100/sb_90_bill_20130711_chaptered.pdf)

<http://gov.ca.gov/news.php?id=18137>

[http://www.business.ca.gov/Portals/0/AdditionalResources/Reports/California%20Competes\\_FAQ\\_3.0.pdf](http://www.business.ca.gov/Portals/0/AdditionalResources/Reports/California%20Competes_FAQ_3.0.pdf)

[http://www.business.ca.gov/Portals/0/AdditionalResources/Reports/CA%20Economic%20Development%20Initiative\\_July%202013.pdf](http://www.business.ca.gov/Portals/0/AdditionalResources/Reports/CA%20Economic%20Development%20Initiative_July%202013.pdf)

[https://www.ftb.ca.gov/businesses/Economic\\_Development\\_Incentives/NEC\\_FAQs.shtml](https://www.ftb.ca.gov/businesses/Economic_Development_Incentives/NEC_FAQs.shtml)

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## Comparisons

	SUT Exemption	New Employment Credit	CA Competes Credit
Tax affected	State level sales tax (4.1875%)	PIT or corporate income tax	Income taxes (see details on "net tax" and more)
Zone requirement?	No (SB 90)	Yes	No
Other requirements	<input type="checkbox"/> NAICS specified list  Need special exemption certificate	<input type="checkbox"/> Wage level. <input type="checkbox"/> FT EEs > than in base year. <input type="checkbox"/> "Qualified taxpayer" <input type="checkbox"/> Some businesses excluded unless small. <input type="checkbox"/> Original return only. <input type="checkbox"/> Must reserve in advance with FTB	<input type="checkbox"/> Specified factors to be considered by committee. <input type="checkbox"/> Fund has dollar limits per year. <input type="checkbox"/> 25% reserved for small businesses.
Timeframe	7/1/14 to 6/30/22 (SB 90)	TY beg on or after 1/1/14 and before 1/1/21	TY beg on and after 1/1/14 and before 1/1/25
Key R&T statute	6377.1	17053.73 23626	17059.2, 23689 18410.2

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## Prop reg 1525.4

- 1/31/14 – 3<sup>rd</sup> Discussion Paper released
  - Topic – *Manufacturing and Research & Development Equipment*
  - Related to new exemption at R&T 6377.1
    - AB 93 (Stats. 2013, Chap 69), amended by SB 90 (Stats. 2014, Chap 70)
  - Discussed at 4/22/14 BOE meeting

<http://www.boe.ca.gov/meetings/pdf/1525-4TDPweb.pdf>

## SUT exemption vs CAEATFA

### Manufacturing Exemption vs. California Alternative Energy and Advanced Transportation Financing Authority (CAEATFA)

The table below highlights the differences between the manufacturing exemption and CAEATFA

	Manufacturer's Partial Exemption	SB1128/SB71 CAEATFA Sales and Use Tax Exclusion
Eligible Participants	All manufacturers described in NAICS codes 3111 to 3399, 541711, or 541712	Companies that design, manufacture, produce or assemble advanced transportation technologies or alternative source products, components or systems
Exempt Tax Rate	State portion only, currently at 4.1875 percent	Full rate including local and district taxes
Application requirements	None	Participants must apply with <a href="#">CAEATFA</a> and be approved for a "project" for the exclusion to apply. The property purchased must be included approved "project."
Fee requirements	None	Applicants are subject to an <a href="#">application and administration fee</a>

If you are accepted into the CAEATFA program, you may also take advantage of the manufacturer's exemption where appropriate. Generally the CAEATFA sales and use tax exclusion will take precedence over the manufacturer's exemption for property that is considered a "project" under the CAEATFA program. This is to your benefit since you will obtain the exclusion for the full sales and use tax rate.

You may not provide an exemption certificate for both the CAEATFA exclusion and the manufacturer's exemption for the same property. If you purchase property that is not considered part of a "project" under the CAEATFA program, but still qualifies for the manufacturer's exemption, you may provide an exemption certificate for the partial exemption.

Please click [here](#) for more information on the CAEATFA program.

[http://www.boe.ca.gov/sutax/manufacturing\\_exemptions.htm#Purchasers](http://www.boe.ca.gov/sutax/manufacturing_exemptions.htm#Purchasers)

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## New Employment Credit

### “Qualified taxpayer”

- Engaged in business in “designated census tract or economic development area”
  - Special requirements if move to a zone.
- Pays or incurs “qualified wages”
- Excludes (unless a “small business”)
  - Temp help services
  - Retail trade
  - Primarily engaged in providing food services
  - Casinos, casino hotels, drinking places
  - “Sexually oriented business” – **NEVER qualifies, even if small**

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## New Employment Credit

### “Small business”

- Trade or business with < \$2 million gross receipts less returns and allowances, reportable to CA, in prior TY
- If partnership or S corp
  - GR limit applied to entity and each partner or shareholder
- Small excludes a “sexually oriented business”

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## New Employment Credit

### “Qualified FT Employee”

- Perform at least 50% of work in zone
- Starting wages at least 150% of minimum wage
  - Special rule for Designated Pilot Areas (above \$10)
- Hired on or after 1/1/14
- Hired after Dept of Finance certifies the zone is qualified (for Designated Census Tracts)
- Average 35 hours per week (special rule for salaried EE)
- When hired meets one of the following:
  - Unemployed at least 6 months (special rule for college grad)
  - Veteran separated within last 12 months
  - EITC or CalWORKS recipient
  - Ex-offender

**Check the details of all definitions!**

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## New Employment Credit

### “Qualified wages”

- Portion paid or incurred for each “qualified FT EE” that exceeds 150% of minimum wage but does not exceed 350% of minimum wage
- Or – if a “Designated Pilot Area,” over \$10/hour but does not exceed 350% of minimum wage.
  - Will only be 5 DPAs
    - Fresno, Merced and Riverside selected in early 2014  
<http://gov.ca.gov/news.php?id=18491>

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## Minimum Wage in CA

Today = \$8 / hour

AB 10 (9/25/13)

- 7/1/14 - \$9 / hour
- 1/1/16 - \$10 / hour

<http://gov.ca.gov/news.php?id=18224>

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## To reserve NEC with FTB ...

- Within 30 days of submitting new EE paperwork to EDD for the qualified EE
- Thereafter – by 15<sup>th</sup> of 3<sup>rd</sup> month of TY
- Provide to FTB for the EE
  - Name
  - SSN
  - Start date
  - Pay rate
  - Taxpayer's gross receipts less returns and allowances\*
  - Whether EE is resident of a targeted employment area\*

**Check the details of all definitions!**

\* For initial reservation request.

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## CA – New Employment Credit

- Expanded FTB website
  - Annual certification tool added

[https://www.ftb.ca.gov/online/New\\_Employment\\_Credit\\_Reservation/](https://www.ftb.ca.gov/online/New_Employment_Credit_Reservation/)

The screenshot shows the State of California Franchise Tax Board website. The header includes the CA.GOV logo, the text "State of California Franchise Tax Board", and navigation links for "Home", "Individuals", "Businesses", "Tax Professionals", and "News & Events". A search bar is located in the top right corner. On the left side, there is a "Access MyFTB Account" section with links for "Login" and "Register", and a list of services: "File", "Pay", "Online Services", "Notices / Collections", "Withholding", and "Help". The main content area is titled "New Employment Credit" and contains the following text: "The New Employment Credit (NEC) is available for each taxable year beginning on or after January 1, 2014, and before January 1, 2021, to a qualified taxpayer that hires a qualified full-time employee on or after January 1, 2014, and pays or incurs qualified wages attributable to work performed by the qualified full-time employee in a designated census tract or economic development area (herein referred to as a designated geographic area (DGA)), and that receives a tentative credit reservation for that qualified full-time employee. In addition, an annual certification of employment is required with respect to each qualified full-time employee hired in a previous taxable year. In order to be allowed a credit, the qualified taxpayer must have a net increase in the total number of full-time employees in California." Below this text are four bullet points: "• NEC Quick Facts - Use this document to see if your business may qualify for the NEC.", "• Frequently Asked Questions - These FAQs outline the requirements, credit computation, and how to claim the credit.", "• DGA Mapping Tool - Use this tool to determine if a location is in a DGA.", "• New Employment Credit Reservation - Use this tool to request a reservation.", and "• Annual Certification of Employment - Use this tool to certify your employees each year." A "LiveChat" button is visible at the bottom left of the page.

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## California Competes Credit



- Income tax credit
- To entice businesses to stay in or move to CA
- Negotiated by GO-Biz
- Approved by new “California Competes Tax Credit Committee”
  - State Treasurer, Director Dept of Finance, GO-Biz director, appointees from Senate and Assembly
  - Look at jobs to be created or retained, investment in state, economic impact to state, and more.
- Awards made public
- **Any location in CA**
- \$380 million allocated through 2017/2018
  - 25% reserved for small businesses (GR < \$2 million)

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## CA – California Competes Opens

- Emergency regs finalized 2/20/14
  - Expire 8/20/14
- <http://www.business.ca.gov/Portals/0/CA%20Competes/Docs/California%20Competes%20Tax%20Credit%20Regulations.pdf>
- Application period opened March 19 to April 14, 2014.
  - <http://business.ca.gov/Programs/CaliforniaCompetes.aspx>
- Watch for announcements of who was selected.



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# Looking Forward

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## Marketplace Fairness Act Update

### House Judiciary Committee hearing 3/12/14

- Exploring Alternative Solutions on the Internet Sales Tax Issue – including:
    - SSUTA for remote sales only
    - Origin sourcing
    - Reporting (like Colorado)
    - Something similar to International Fuel Tax Agreement
  
  - **Relevance if enacted:**
    - Remote vendors may need to collect sales tax in states where have customers (if sell taxable items).
    - De minimis exception will exist (details in the works)
- 

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## More federal affecting state and local taxation

- Mobile Workforce State Income Tax Simplification Act - H.R. 1129
  - Standardize rules among states
  - Generally, employee must be working in the state over 30 days during year to be subject to tax (and employer withholding)
  - <http://thomas.loc.gov/cgi-bin/bdquery/z?d113:h.r.01129:>
- Internet Tax Freedom Act
  - Expires 11/1/14
  - Various proposals to make permanent (H.R. 434, H.R. 3086, S. 31, S. 1431)
  - Might it be combined with MFA?

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## Expired and expiring provisions

- 57 provisions expired at 12/31/13
- A few more expire over next few years
  - AOTC for example
  - JCT list - <https://www.jct.gov/publications.html?func=select&id=10>

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## Comprehensive tax reform

- To lower corporate and individual rate
- Move from worldwide to territorial
- In revenue neutral manner
  - So, also broaden the tax bases.
- Over 50 hearings since 2011
- Detailed discussion draft from Congressman Camp
- Suggestions from others
- Likely more hearings this year, no action until after 2014.

55

**Camp proposal**



Press release  
2/26/14

# The Tax Reform Act of 2014

[DISCUSSION DRAFT]  
FEBRUARY 21, 2014

113TH CONGRESS  
2D SESSION

## H. R. \_\_\_\_\_

To amend the Internal Revenue Code of 1986 to provide for comprehensive tax reform.

**Tax Reform Act of 2014**  
Discussion Draft  
Section-by-Section Summary



COMMITTEE ON  
**WAYS AND MEANS**  
CHAIRMAN DAVE CAMP

**THE TAX REFORM ACT OF 2014**  
Finding the Simple Tax Code So That It Works For American Families and Job Creators



House Ways and Means Committee  
tax.house.gov

Joint Committee on Taxation

- [JCT Technical Explanation Title I Individual JCX 12 14 022614](#)
- [JCT Technical Explanation Title II AMT Repeal JCX 13 14 022614](#)
- [JCT Technical Explanation Title III Business JCX 14 14 022614](#)
- [JCT Technical Explanation Title IV Participation Exemption System JCX 15 14 022614](#)
- [JCT Technical Explanation Title V Tax Exempt Entities JCX 16 14 022614](#)
- [JCT Technical Explanation Title VI Tax Administration and Compliance JCX 17 14 022614](#)
- [JCT Technical Explanation Title VII Excise Taxes JCX 18 14 022614](#)
- [JCT Technical Explanation Title VIII Deadwood Provisions JCX 19 14 022614](#)
- [JCT Revenue Estimate JCX 20 14 022614](#)
- [JCT Distributional Effects JCX 21 14 022614](#)
- [JCT Macroeconomic Analysis JCX 22 14 022614](#)

Executive Summary



**TAX REFORM**

OUR TAX CODE IS TOO COMPLEX, TOO CONFUSING, AND TOO COSTLY

House Ways & Means Committee  
Tax Reform website

Additional tax reform information and links from Professor Annette Nellen - <http://www.21stcenturytaxation.com/>

[http://www.cob.sjsu.edu/nellen\\_a/taxreform/TaxReformAct2014\\_Links.pdf](http://www.cob.sjsu.edu/nellen_a/taxreform/TaxReformAct2014_Links.pdf)

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## TRA 2014 broad categories (# changes)

- i. Tax reform for individuals (78)
- ii. AMT repeal (2)
- iii. Business tax reform (169)
- iv. Participation exemption system for the taxation of foreign income (16)
- v. Tax exempt entities (20)
- vi. Tax administration and compliance (25)
- vii. Excise taxes (5)
- viii. Deadwood and technical provisions (85)

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## Selected individual provisions

- 10% and 25% rate + 10% surtax if taxable income > \$450,000 (MFJ)
  - Surtax n/a to qualified domestic manufacturing income (25% max rate); phased in over 3 years.
  - Some tax preferences limited to 25% benefit.
- Same rate for capital gains and dividends
  - 40% exclusion
- Repeal head-of-household filing status

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## Selected individual provisions - more

- Increase standard deduction
  - Today – 33% of filers itemize
  - Estimated under TRA 2014 – 5% would itemize
- Repeal personal exemption – instead:
  - Larger standard deduction
  - Expanded child and dependent tax credit
- Expand child and dependent tax credit
  - Child credit \$1,500, under age 18
  - \$500 for non-child dependents
  - Index for inflation
  - High phase-out range
  - Partially refundable
- Repeal dependent care credit

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## More - individual

- Consolidate education provisions
  - Keep a reformed American Opportunity Tax Credit
  - Repeal employer-provided educational assistance exclusion
- Repeal most credits
- EITC – modify to refund employment taxes
  - HWM analysis – *“Exempting a portion of wages from payroll tax would represent a tax cut, whereas the current EITC constitutes government spending.”*
- Charitable contributions
  - Deduct if pay by April 15 of next year
  - Only deduct amount > 2% AGI
  - Donation = to adj basis (not FMV), with exceptions

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## And more - individual

- Only deduct state and local taxes for carrying on a trade or business or producing income
- No deduction for
  - Personal casualty or theft losses
  - Medical expenses
  - Moving expenses
  - Miscellaneous itemized deductions
  - Alimony (and not taxable to recipient)

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## Individuals - homes

- Mortgage interest deduction
  - Gradually reduce to AI of \$500,000
  - Phase out home equity rule
  - But not for existing debt
  - No deduction for new equity loans
- Gain exclusion on sale of principal residence
  - Own and use 5 of 8 years
  - Use once every 5 years
  - Phase out exclusion if MAGI > \$500,000 (MFJ)

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# Corporate and Individual AMT repealed

Use MTC over 3 years

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## Selected business reforms

- Top corporate rate dropped to flat 25%
  - Phased in
- Repeal MACRS
  - Use system like ADS
- §179 expensing
  - \$250,000 / \$800,000 phase-out start
  - Includes software and certain real property
- NOL deduction limited to 90% TI
- SE tax applies to income of p/s, LLC, S corp
  - Generally, 70% taxed

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## R&D and acquired intangibles

- Write off R&D over 5 years
  - Includes software development costs
  - Phased in
- Research credit modified and made permanent
  - Simplified credit at 15%
  - No supplies
  - No computer software development
- Amortization of intangibles – increased to 20 years

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## More business reforms

- Advertising – deduct 50%, amortize balance over 10 years; phased in
- Several special deductions repealed
- §199 deduction phased out
- Repeal like-kind exchange deferral (§1031)
- Repeal §1202 QSBS exclusion
- Repeal §1235 on sale of patents
- Most credits repealed
- Tax portion of carried interest as ordinary income

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## TRA 2014 - Accounting methods

- Cash only if GR  $\leq$  \$10 million or farming or sole proprietor
- Expand LT contract use of % completion
- Repeal LIFO
- Repeal LCM

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## International reforms

- Participation exemption system for taxation of foreign income
  - 95% deduction for foreign-source dividends from foreign corps by domestic corps that are US shareholders
- FTC modifications
- Subpart F modifications
- Prevent base erosion
  - Tax foreign intangible income at reduced rate
  - Deny interest deduction of US Shareholders who are members of worldwide affiliated groups with excess domestic debt

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## TRA 2014 - misc

- Repeal medical device excise tax
- Quarterly excise tax of 0.035% of *systemically important financial institution's* total consolidated assets in excess of \$500 billion
- IRS prohibitions
  - No conferences until TIGTA reviews
  - No personal email for official business
  - Review exam selection procedures
  - Pre-populated returns prohibited

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## TRA 2014 – return due dates

Return	Current due dates	Proposed due date	Proposed extended due date
<b>1065</b>	April 15/Sept 15	March 15	Sept 15
<b>1120S</b>	March 15/Sept 15	March 15	Sept 30
<b>1120</b>	March 15/Sept 15	April 15	October 15
<b>FBAR</b>	June 30	April 15	October 15

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## Senator Wyden

- Prior bills (S. 727, 112<sup>th</sup> Cong)
  - 24% flat corporate rate
  - (but higher individual rate)
- 6/56/14 – announced
  - Summer hearings as first in series on “issue areas that are essential to a modern, effective tax code”
    - June – education tax incentives
    - July – ID theft and privacy protection  
- modernizing corporate

<http://www.finance.senate.gov/newsroom/chairman/release/?id=afb45d67-7bb3-4d0c-bbd7-0c154b930a8d>

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## President Obama proposals

- Supports lower corporate tax rate
- Tax increase for higher income individuals
- Reduce fossil fuel preferences
- Help small businesses
  - Extend higher 179 expensing
  - 100% gain exclusion for qualified small business stock
- Administrative reforms

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## President Obama's Elements of Business Tax Reform

- I. **Eliminate dozens of tax loopholes and subsidies, broaden the base and cut the corporate tax rate to spur growth in America:** The Framework would eliminate dozens of different tax expenditures and fundamentally reform the business tax base to reduce distortions that hurt productivity and growth. It would reinvest these savings to **lower the corporate tax rate to 28 percent**, putting the United States in line with major competitor countries and encouraging greater investment in America.
- II. **Strengthen American manufacturing and innovation:** The Framework would refocus the manufacturing deduction and use the savings to reduce the effective rate on manufacturing to no more than 25 percent, while encouraging greater research and development and the production of clean energy.
- III. **Strengthen the international tax system, including establishing a new minimum tax on foreign earnings, to encourage domestic investment:** Our tax system should not give companies an incentive to locate production overseas or engage in accounting games to shift profits abroad, eroding the U.S. tax base. Introducing a minimum tax on foreign earnings would help address these problems and discourage a global race to the bottom in tax rates.
- IV. **Simplify and cut taxes for America's small businesses:** Tax reform should make tax filing simpler for small businesses and entrepreneurs so that they can focus on growing their businesses rather than filling out tax returns.
- V. **Restore fiscal responsibility and not add a dime to the deficit:** Business tax reform should be fully paid for and lead to greater fiscal responsibility than our current business tax system by either eliminating or making permanent and fully paying for temporary tax provisions now in the tax code.

<http://www.treasury.gov/resource-center/tax-policy/Documents/The-Presidents-Framework-for-Business-Tax-Reform-02-22-2012.pdf>

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## Disclaimer

- This information is provided for educational purposes. Many of the topics covered could easily be individual lessons on their own. This update serves as awareness of key developments and the basics of each. It is not intended to answer specific tax questions or provide details of the underlying law noted in each update. Application of any item requires the user to consult the primary authority referenced and related rules, and consider the particular facts at hand.

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## Small Business Tax Update

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<http://www.21stcenturytaxation.com>

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## Trade or Business versus Hobby

1. Hobby Loss – *Schlievert*, TC Memo 2013-239 (10/22/13) – loss denied and accuracy penalty assessed. S paid expenses of a band their daughter managed (which was also part of the oral agreement between S and the band). No income was generated. Expenses were paid from personal checking account, no written agreement, no other band managed or recorded, no evidence that S was key to band’s recording (thanked among 31 others) and S had no experience or expertise in the activity (other than reading a book). S also had other sources of income (H’s job with income over \$200,000). Appeared to court to be a way for the parents to help their daughter get her music career started.

2. Gambling with 5 Years of Losses Is Not a Business – [Estate of John F. Chow and Esther K. Chow](#), TC Memo 2014-49 (3/24/14) (Mr. Chow died before the Tax Court petition was filed) – Ms. Chow gambled “extensively and exclusively” on slot machines. Per the Morongo Casino, in 2006, her “total coin-in” was about \$4.5 million and “total coin-out” was about \$3.3 million. Her total jackpots were about \$992,000 and total loss \$192,000. Other years at this casino also involved gambling in the millions of dollars.

The Chows filed an extension for their 2006 return, but it was not mailed until 5/14/08. An extension was also filed for 2007 and the return was mailed on 8/15/08. An extension was also filed for the 2008 return; the return was mailed 2/5/10. Each year’s return included a Schedule C that listed gambling as the business. The IRS issued a notice of deficiency for each year challenging the business status, income, cost of sales and expense amounts. The IRS used amounts from Forms W-2G and limited losses to gambling winnings. Penalties under §6651 (late filing for 2006 and 2008) and §6662 were assessed.

The court first noted that it had previously ruled on Ms. Chow’s gambling activities for 2004 and 2005, finding that “she pursued gambling with a profit objective” but that it was a “close case.”

For the new years at issue, the court noted that she continually had substantial losses in excess of her winnings and “sustained large net losses from her gambling activities during the five-year period 2004 through 2008.” Thus, the court found that she had not engaged in this activity with “an actual and honest objective of making a profit.” Per the court:

“Ms. Chow failed to carry her burden of showing here that during the years at issue she (1) had a business plan for her gambling activities, (2) had a budget for her gambling activities, (3) maintained a separate bank account for her gambling activities, (4) attempted to change her gambling methods in an effort to make them profitable, (5) did any research in slot machine gambling about ways to improve her chances of making a profit from her gambling activities, (6) consulted anyone with expertise in slot machine gambling about ways to improve her chances of making a profit from her gambling activities, or (7) otherwise engaged in her gambling activities in a businesslike manner. Unlike *Chow I*, this is not a close case.”

Finally, the court upheld the penalties finding no showing of reasonable cause. In addition, the court noted that claiming of the gambling losses in each year was contrary to §165(d). “In doing so, they intentionally disregarded the law and were negligent.”

## Income

Classification of Payments from Manufacturers to Dealers – In [AM 2014-004](#) (5/9/14), the IRS analyzed the tax treatment of payments received by car dealers from manufacturers to encourage the dealers to improve their facilities and present a “standard brand image.” The expected changes might be either structural or cosmetic. Typically, there is a contract between the dealer and manufacturer as to what is expected and the payment arrangement. Field agents discovered that dealers treat these payments inconsistently, finding treatment as non-shareholder contributions to capital under §118, basis reductions to the constructed assets, purchase price adjustments to inventory acquired from the manufacturer, or as income.

The GLAM analyzed three scenarios, concluding for each that the payment from the manufacturer (M) should be treated as income to the dealer (D).

1	D eligible to receive payments from M equal to x% of the project’s construction costs to modernize the look of the dealership.	Not all Ds are eligible.	D gets 50% at start of project and balance upon completion. M has right to inspect the completed project.	If not completed to M’s satisfaction, D must repay all or some of the payments
---	--	--------------------------	---	--

2	D must improve facilities, upgrade software and Internet and web, and train sales and services employees.	All Ds eligible to participate.	Must complete within 2 years. Payments made quarterly per a formula based on number of cars purchased in prior quarter..	Might receive payments after completion of project because not all payments tie to the construction
3	D must modernize look of the dealership facilities. Must complete project by end of stated term.	All Ds eligible to participate.	Two types of payments. One is \$x for each vehicle sold during the Program. Other type of payment is based on formula using expected costs of improvements. It is paid at start and completion of the project.	M must approve final outcome.

Gross income is broadly defined. Generally, if a supplier pays funds to a retailer to encourage them to buy merchandise, the payments are adjustments to the cost of the goods purchased. To properly classify the payment, it is important to consider the intent of the parties and the purpose of the payment. Substance controls over the form or language used.

For a payment to be a non-taxable contribution to capital by a non-shareholder under §118, the Supreme Court applies five factors to determine if it is a contribution to capital (*Chicago, Burlington, & Quincy Railroad Co.*, 412 US 401 (1973)):

- “1. The transfer certainly must become a permanent part of the transferee’s working capital structure;
2. The transfer must not be compensation, such as a direct payment for a specific, quantifiable service provided;
3. The transfer must be bargained for;
4. The transferred asset foreseeably must result in benefit to the transferee in an amount commensurate with its value; and
5. The transferred asset ordinarily, if not always, will be employed in or contribute to the production of additional income and its value assured in that respect.”

Also: “Where the transfer is not made with the purpose of receiving direct service or recompense, but only of obtaining advantage for the general community, the result is a contribution to capital.”

The IRS held that all of the payments were income under §1 because Ds are responsible for the construction projects and own the properties. Ds “receive payments to defray their expense for construction of, or improvements, to their property. Therefore, the dealerships have an accession to wealth over which they have complete dominion and control. Accordingly, the dealerships must recognize gross income at the time they receive Payments or appropriately accrue the right to receive Payments under their methods of accounting.” Also, the payments will not reduce D’s basis in the constructed property.

The payments are not purchase price adjustments for the car inventory as there was no intent to lower the purchase price. Also, the payments “were paid for a consideration separate from the selling price of its products.”

Finally, §118 does not apply because there was no intent to benefit the general community. Instead, there is a customer relationship between Ds and Ms.

## Deductions

1. Business Deductions - [Canatella](#), TC Memo 2014-102 (5/28/14) – C was a sole proprietor lawyer with a firm named Cotter & Del Carlo. C had signature authority over accounts at four banks. C and his spouse filed an extension for 2007, but filed the return late - on 10/29/08. C's Schedule C indicated receipts of \$441,124 and expenses of \$423,182 including \$257,772 of "other expenses." During the examination, C did not provide requested documents to the Revenue Agent so summons were issued to the banks. The agent performed a bank deposit analysis and determined that Schedule C income should have been about \$46,000 higher. The agent also disallowed about \$338,000 of expenses. IRS also assessed penalties under Sections 6651 and 6662.

At trial, C was asked why he was entitled to deduct the claimed expenses. C's basic answer was because he could prove he paid them via credit card or check and that should be sufficient. The court described that as a "misunderstanding, or a disregard, of the requirements of section 162(a)." Per the court, whether an expenditure meets the ordinary and necessary requirement of §162 is a question of fact. The court found that C failed to carry his burden to prove he was entitled to any of the \$338,048 of claimed business expenses. Thus, they were disallowed. The court also observed in a footnote that the requirements of §274(d) would also have to be met for some of the expenditures.

The court upheld the failure to timely file penalty (§6651) as no reasonable cause was shown for why both preparer and taxpayers signed after October 15. The substantial understatement of tax penalty (6662) was also upheld. The court did not find that C showed reasonable cause by relying on C's preparer. The preparer testified that he relied on handwritten summary schedules form C.

2. Business Deduction Substantiation:
  - a. [Van Velzor](#), TC Memo 2014-71 (4/28/14) – the court agreed with the IRS that V was not entitled to a Schedule C deduction of \$24,584 for contract labor. V claimed that the payments were made in cash to a consultant from El Salvador. Per V, the consultant only wanted cash because "El Salvador is a cash society." V also claimed he obtained the cash from funds borrowed from friends and family and a box he kept in his attic. The court did not find the receipts from the consultant to be credible. Also, although they gave V time to get an affidavit or other proof, he failed to do so. Thus, the deduction was denied.
  - b. [Miller](#), TC Memo 2014-105 (6/2/14) – M was a self-employed handyman. He did not file for 2006 – 2009, but had received Forms 1099-MISC, totaling between \$62,000 and \$79,000 for each year. The IRS used the information to file substitutes for returns for M. At trial, M was unable to refute the 1099-MISC evidence. As to expenses, M did not produce invoices or other evidence, noting "he was too busy to keep records." He later indicated the records were lost when he moved due to the breakup of his marriage. M argued that under the Cohan rule, he should be allowed a deduction based on a flat percentage of his income. The court disagreed noting it was not obligated to make any estimate under the Cohan rule where no evidence about the nature of the expenses was provided. Finally, the court upheld failure to file, failure to pay, and estimated tax penalties. The court did not impose the frivolous position penalty of 6673 as he "did not advance classic 'tax-protester' arguments." Noting that they could impose it, they did not but warned M that next time they would be less generous.
3. Enhanced Charitable Donation of Inventory by C Corporation – [CCA 201414014](#) (4/4/14) – Corporation (C) donated inventory items consisting of "wrinkle creams, hair gels, perfumes, hair sprays, hair texturizers, curling irons, hair dyes, nail polishes, epilators, and hair restoration treatments" to Charity X, a 501(c)(3) organization. X gave C letters for the donations as required under 170(e)(3) which provides a special rule for corporate donations of inventory. Generally, a donation of inventory under 170 is valued at the lower of FMV or the taxpayer's basis due to the special rule for property that if sold, would not produce a long-term capital gain (170(e)(1)).

Under the special rule, rather than basis, the C corporation can obtain an “enhanced” deduction for “qualified contributions” of inventory to a charity “solely for the care of the ill, the needy, or infants.” For such donations, instead of reducing the FMV by the amount of gain that would not be long-term capital gain, the FMV is reduced by an amount no greater than the sum of (i) half of the amount of gain produced if sold that would not be long-term capital gain, and (ii) “the amount (if any) by which the charitable contribution deduction” under 170 “for any qualified contribution (computed by taking into account the amount determined in clause (i), but without regard to this clause) exceeds twice the basis of such property.”

The IRS ruled that the donation was not for the care of the ill, the needy or infants as defined in Reg. §1.170-4A. Per these regulations, ill means someone requiring medical care and “care of the ill” means alleviating or curing an existing illness. The beauty products are not for medical care. The regulations define an “infant” as a minor child. “Care of an infant” means “the performance of parental functions and provision for the physical, mental, and emotional needs of the infant.” The donation does not meet this requirement because they “are luxury items rather than necessities of life.” Finally, the regulations define a needy person as someone “who lacks the necessities of life, involving physical, mental, or emotional well-being, as a result of poverty or temporary distress.” The IRS found that the donated items did not help meet a “necessity of life such as the need for food, clothing, or shelter (or other basic needs).”

Review of the deduction if §170(e)(3) had applied:

Example: X Corporation, a C corporation, donates medicine to a hospital that has a basis to X of \$100 and a FMV of \$300. The medicine is inventory to X. Normally, the donation amount would be \$100. But, because the special rule of 170(e)(3) applies, the donation amount is \$200 (\$300 less \$100 equals \$200 donation amount). Here, clause (ii) is zero because the amount of the contribution after applying (i) is \$200 which does not exceed 2x the basis of the inventory.

Example: Same example, only now the inventory’s FMV is \$500. The donation amount is \$200. Here, clause (ii) is \$100 because the amount of the contribution after applying (i) is \$300 which exceeds 2x the basis by \$100. So the total reduction to FMV is \$300 leaving an enhanced donation amount of \$200 (\$500 less \$300).

As described in Rev. Rul. 85-8, “If the amount of the charitable contribution that remains after [the clause (i)] reduction exceeds twice the basis of the contributed property, then the amount of the charitable contribution is reduced a second time to an amount that is equal to twice the amount of the basis of the property.” Note that in each example, the donation amount does not exceed 2x basis.

4. §199 and Cooperative Advertising Income – [AM 2014-001](#) (1/10/14) – the allowance received by Retailer from Vendor under a cooperative advertising agreement might be DPGR for Retailer. Whether the allowance should be treated as gross receipts or a reduction to inventory cost (part of COS) depends on the facts and circumstances and the terms of the agreement. If the allowance is really a trade discount, it is not gross receipts and cannot be DPGR. If the purpose of the allowance is to reimburse Retailer for advertising Vendor’s products, then it likely is gross income and then could potentially be DPGR. Generally, advertising revenue is a service and not DPGR. However, if the exception of Reg. §1.199-3(i)(5)(ii) is met, it can be DPGR.

Per the IRS:

- “the test for whether a payment, credit, allowance or rebate is a purchase price adjustment is what the parties intend and for what purpose the payment, credit, allowance, or rebate was paid. If the purpose was to adjust the price of the item between the parties, then the consideration given, regardless of the time or manner of the adjustment, is a purchase price adjustment and is not a separate item of gross income. “

- “if the purpose and intent of the Allowance is to reach an agreed upon price for the Retailer’s products and is not compensation for services, then the Allowance is a purchase price adjustment and is not a separate item of gross income for purposes of §61 and, as such, may not be included in DPGR under §199.”
- “Section 1.199-3(i)(5)(ii) of the regulations provides that a taxpayer’s gross receipts that are derived from the disposition of newspapers, magazines, telephone directories, periodicals, and other similar printed publications that are MPGE in whole or in significant part within the United States include the advertising income from advertisements placed in those media, but only if the gross receipts, if any, derived from the disposition of the newspapers, magazines, telephone directories, or periodicals are (or would be) DPGR.” In one of the GLAM examples, the Retailer’s flyers were found to be “other similar publications” under § 1.199-3(i)(5)(ii).

## Payroll and Worker Classification

1. Help for When a Small Business Is Behind on Payroll Tax Payments – Small businesses who owe payroll taxes may be able to enter an *In-Business Trust Fund Express Installment Agreement* (IBTF-Express IA). The amount owed (tax, penalties and interest) must be \$25,000 or less. It is permissible to pay the debt down to this level in order to enter the agreement. The business does not need to submit financial statements. The balance must be paid by the earlier of 24 months or the collection statute expiration date. For details, see <http://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/In-Business-Trust-Fund-Express-Installment-Agreement>. If the business owes over \$25,000 and is unable to pay the balance down to \$25,000 to use the IBTF-Express IA, it should consider the [offer-in-compromise](#) procedures.
2. What is Reasonable Cause for Late Filing and Payment of Payroll Taxes – [Stevens Technologies, Inc.](#), TC Memo. 2014-13 (1/27/14) – Stevens owned companies that had a few government contracts to provide computer consulting and IT services. She was also the president of the company. For a few years, S had personal and family health problems (heart problems, surgery, mother died of cancer, baby born with cancerous tumor) which the court described as “significant.” The court did not find though, that these problems were reasonable cause for not filing or paying payroll taxes timely. The court noted that during this 4-year time period, the employer “was able to continue its operations, market its services to clients and potential clients, increase its workforce, and hire an accounting firm to prepare its Forms 941.” The court viewed the payroll failures as caused by “the company’s deliberate choice to focus on business matters rather than on tax compliance.” The company had also applied for some awards (funds) and S had appeared on the Today Show in 2010 after winning an award.

S also argued she had reasonable cause due to delayed payment by a government client and inability to sign Forms 941 as she was not sure they were correct. In footnote 23, the court explains that part of this uncertainty was due to “the company’s unorthodox practice of making payments to Stevens that Stevens would immediately repay to the company.” S noted this was to enable the company to meet the requirements of a woman-owned business which put it in a better position to obtain government contracts. The court said the company should have known it would have to figure out how to report all of this.

The court held that the IRS did not violate §6330(e) when it issued a summons to the bank related to §6672 trust-fund recovery penalties. Per [§6330](#), the IRS may not levy a taxpayer’s property if it has not notified the taxpayer of right to a collection-review hearing. Per §6330(e)(1), when the taxpayer request a hearing, the levy actions are suspended until the hearing is completed. Because Stevens’ liability for the trust-fund penalty under §6672 is different from the company’s liability to pay employment taxes, §6330(e) “does not limit the IRS’s ability to levy to collect the trust-fund-recovery penalties from Stevens.”



Finally, the court held that the Appeals Office did not abuse its discretion in not accepting the installment agreement due to the “company’s history of failing to pay its tax liabilities.”

3. Department of Labor Misclassification Initiative – The DOL has a [website](#) indicating continuing activities at the federal level and in particular states to find misclassified workers. There is also a link to a Memo of Understanding ([MOU](#)) with the IRS and news about results of its activities. The DOL also has agreements with 14 states. The goal is to reduce misclassification, reduce the tax gap and improve compliance with labor laws (such as the Fair Labor Standards Act on overtime pay).
4. IRS National Taxpayer Advocate Concern with Worker Classification: The NTA’s 2013 [Annual Report](#) to Congress (Jan. 2014) includes as a problem that increases taxpayer burden – “Current Procedures Cause Delays and Hardships for Businesses and Workers by Failing to Provide Determinations Timely and Not Affording Independent Review of Adverse Decisions.” The problem described in the report involves the time delays and rejection rate for SS-8. The NTA states that for FY2013, 81% of the SS-8 cases were in “overage.” Problems noted include that IRM procedures let the IRS reject SS-8s even for minor defects, such that the taxpayer has to resubmit and restart the process. Also, applicants who receive an adverse determination “do not automatically receive administrative appeal options.” The NTA suggests that the IRS give applicants “the right to an independent, administrative appeals review of adverse determinations.”

Data on the inventory and processing of SS-8 forms per the NTA:

**FIGURE 1.19.3, SS-8 Submissions and Returns**<sup>35</sup>

Form SS-8 Submissions	Fiscal 2011	Fiscal 2012	Fiscal 2013
Filed by workers.	9,198	5,392	3,982
Filed by firms	645	264	128
Returned	0	3,104	3,905

The NTA describes the SS-8 process as requiring “lengthy fact gathering, investigation, and application of law.”

The NTA’s 2013 repeats a recommendation from the 2012 report that taxpayers have “an electronic self-help tool for employers or workers to determine employment status.”

5. Draft Revision of SS-8 – on 4/23/13 ([FR23981](#)) the IRS solicited comments on Form SS-8. In April 2014, draft [form](#) and [instructions](#) were issued. The form appears to have been finalized as of May 2014 (per IRS [website](#) on SS-8). The instructions still appear to be in draft form as of June 2014.

In May 2014, the ABA Tax Section submitted [comments](#) to the IRS on SS-8. Their recommendations included having separate forms for workers and employers. They also suggest a booklet be created for both forms so the parties understand what the IRS is requesting. They also asked for more space for providing answers to the questions, noting that the limited answer space may mistakenly cause the filer to think the information is not important. The ABA also suggested that the note about disclosure of information be updated and made more prominent given its importance.

6. §4980H and Worker Classification – the final regulations under §4980H ([TD 9655](#) (2/12/14)), explain the relevance of worker classification for this penalty that may apply to “applicable large employers.” Section XII of the preamble and §54.4980H-1(a)(15) defining employee note the following:
  - a. Per (a)(15): “Employee means an individual who is an employee under the common-law standard. See §31.3401(c)-1(b). For purposes of this paragraph (a)(15), a leased

employee (as defined in section 414(n)(2)), a sole proprietor, a partner in a partnership, a 2-percent S corporation shareholder, or a worker described in section 3508 is not an employee.”

- b. If an employer is entitled to Section 530 relief to misclassify a worker for payroll tax purposes, such relief does not apply for purposes of the §4980H penalty. In the preamble, the IRS noted that some commentator thought IRS should provide such relief, such suggestion was not adopted because Treasury and IRS were concerned that it “would serve to increase the potential for worker misclassification by significantly increasing the benefit of having an employee treated as an independent contractor.” (TD 9655, 2/12/14; FR 8568).

Worker classification becomes a more significant issue starting in 2015 when the §4980H becomes effective. An employer might not think they are an “applicable large employer” because they have fewer than 50 full-time employees (as measured on average for the preceding calendar year) only to find that some contractors are really employees. A similar issue can arise regarding the number of covered employees or if a contractor received a premium tax credit and is really an employee.

7. Worker Classification Cases - [Rahman](#), TC Summary Opinion 2013-35 (4/15/14) – R received unemployment compensation for the first part of 2010 and then became employed by a health care provider (H) to manage a group home. As such, he had various duties to produce financial forecasts, buy groceries, maintain the home, schedule staff and help residents with personal needs. H paid all of these costs; R had no out-of-pocket expenses. R worked full-time and was on call 24/7 should there be a problem at the group home. R was discharged in early 2011. H provided R a Form 1099-MISC for 2010.

R hired a CPA to prepare his 2010 return. Neither his unemployment compensation or 1099-MISC was reported (the case does not explain why). R received a notice from the IRS for the unreported income. R filed a petition for redetermination arguing that he was an employee in 2010 and not liable for SE tax.

In analyzing whether R was an employee or contractor, the court noted that involved “a factual question to which common law principles apply.” The court used 7 factors to make the employment classification determination, with no single factor being determinative and equal weighting not necessary. The factors:

- “(1) the degree of control exercised by the principal over the details of the work;
- (2) the taxpayer’s investment in the facilities used in his or her work;
- (3) the taxpayer’s opportunity for profit or loss;
- (4) the permanency of the relationship between the parties;
- (5) the principal’s right of discharge;
- (6) whether the work performed is an integral part of the principal’s regular business;  
and
- (7) the relationship that the parties think they are creating.”

The court determined that R was an employee. A summary of how the court analyzed and applied the 7 factors follows, along with the conclusion for each:

- 1) Control – Employee - “Although not the exclusive inquiry, the degree of control exercised by the principal over the worker is the most important consideration in determining the nature of a working relationship. ... The degree of control necessary to find employment status varies with the nature of the services provided by the worker.” It is not whether the employer controls all of the worker’s actions, but



whether he has the right to do so. Here, H gave R specific responsibilities and instructed R on how to carry them out. The court found that H exercised “a high degree of control” over R’s work.

- 2) Investment in Facilities – Employee - H paid for groceries and repairs. R had no out-of-pocket expenses.

Observation: It is not clear why the court did not ignore this factor in that managing a group home would not require an investment in facilities. The way the court analyzed this factor looks more like the factor of opportunity to make a profit or loss.

- 3) Opportunity for Profit or Loss – Employee – R was paid by the hour.
- 4) Right to Discharge – Employee – H did discharge R in early 2011.
- 5) Integral Part of Regular Business – Employee – R ran a home for H which was H’s main business.
- 6) Permanency of Relationship – Employee – While R and H had no contract, the nature of R’s work appears to have been intended to be ongoing/long-term, rather than temporary or ending upon completion of a particular result or task.
- 7) Relationship Contemplated by the Parties – Contractor – H did not withhold any taxes from R’s payments and issued R a Form 1099-MISC indicating H believed R was a contractor.

Concluding that R was not a contractor, he was not liable for SE taxes. The court upheld the §6662 substantial understatement of tax penalty as there was no showing of reasonable cause for omitting the 1099 income from his return. R did not state that he gave the information to his CPA or that the CPA told him it was not income.

*Observations:* As an employee, R should have paid FICA and HI taxes from his wages, matched by the employer. This seems though, to be a liability of H. It seems logical that the IRS should conduct an employment tax on H. It is not clear why the IRS did not determine that R was an employee given the nature of his work (it seems clear that H had the right to control R’s work and did indeed highly control it).

H probably should have filed an SS-8 to ask the IRS to determine his classification. Doing so would have also allowed H to file [Form 8919](#), *Uncollected Social Security and Medicare Tax on Wages*, with his 2010 Form 1040 to enable him to pay his share of payroll taxes and, per the instructions to Form 8919, have his social security earnings credited to his social security record.

8. Tax Court Jurisdiction and Employment Taxes - [SECC Corporation](#), 142 TC No. 12 (4/3/14) – this case involved worker classification but primarily was a procedure question of whether the Tax Court had jurisdiction over the case. The court concluded they did have such jurisdiction.

S was in business of connecting cable lines and had between 117 and 145 workers. Workers received W-2 wages as well as payments for use (rental) of their tools and equipment, reported on Form 1099-MISC. An audit adjustment was made to treat all of the payments as wages and S was assessed additional payroll taxes. The IRS also determined that the tool rentals were not made under an accountable plan per §62(c) and thus were subject to employment taxes. The 30-day letter from the IRS noted it was a “final determination” and that the employment tax changes were “not based on a worker classification determination.”

In November 2008, S filed a protest with the Examination Division arguing that the equipment lease payments were not wages, the workers were contractors for all purposes, that S qualified for Section 530 relief, and that no penalties were warranted. In January 2009, Appeals acknowledged that it has S’s case and S’s representative met with an Appeals officer. In November 2009, Appeals returned the case to Exam for further case development.

A memo from Appeals noted that the workers were employees and not dual capacity workers. Thus, all payments were subject to employment taxes and reportable on W-2; Section 530 did not apply.

In April 2011, S received a letter from Appeals that employment tax liabilities would be assessed. This letter was not sent by certified or registered mail. In May 2011, IRS sent S a notice of adjustment. In February 2012, S filed a petition in Tax Court. The IRS never sent S a Letter 3523, Notice of Determination of Worker Classification (NDWC). [See [IRM 4.8.10](#) for information about this notice.]

Both S and the IRS argued that the court did not have jurisdiction over the case because no NDWC was issued. The IRS believed dismissal of the case would let the assessments stand. S believed that without an NDWC, the assessment is not valid and the disputed taxes cannot be collected by the IRS until an NDWC is provided. Per S, the NDWC would then provide the right of S to petition the Tax Court per §7436 (governing when the court has jurisdiction over employment and Section 530 matters).

The court noted that it was important under §7436 to first determine if S received a determination letter (such as the letter received in April 2011). Per the IRS, the April 2011 letter was Letter 4451, a closing letter for employment tax and Section 530 cases. S argued that only issuance of an NDWC would give the court jurisdiction under §7436.

The court agreed with the IRS noting that the court has jurisdiction if a determination has been made by the IRS; an NDWC is not critical. The court also referred to the legislative history to the Taxpayer Relief Act of 1997 (P.L. 105-34) that enacted §7436.

The court also found that the petition was timely because the 90-day limitation did not apply where no notice of determination was sent by certified or registered mail.

Thus, the court determined that it had jurisdiction over the case. A concurring opinion noted that the majority's interpretation of 7436 was "correct as a matter of law; it is also correct as a matter of tax policy." Two judges dissented.

## 9. §6672

- a. TIGTA Report (5/23/14) – in reviewing the IRS process of assessing the 6672 penalty, TIGTA found a few problems and made recommendations. Per the [report](#):

### **“WHY TIGTA DID THE AUDIT**

As of June 30, 2012, employers owed the IRS approximately \$14.1 billion in delinquent employment taxes. This audit was initiated to determine whether the Collection Field function is taking adequate and timely TFRP actions on trust fund cases.

### **WHAT TIGTA FOUND**

TFRP actions were not always timely or adequate. Specifically, TIGTA found untimely TFRP actions, expired assessment statutes, unsupported collectibility determinations, and incomplete TFRP investigations associated with installment agreement and currently not collectible cases. TFRP actions were untimely and/or inadequate in 99 of the 265 cases reviewed in a statistically valid sample. For 59 of the 99 cases, the untimely actions averaged more than 500 days to review and process the TFRP assessment.

When TFRP assessments are not made timely, taxpayers' financial ability to pay can decline, thereby decreasing the IRS's chances to collect the trust fund taxes due. In addition, the Government's interest is not protected if potential TFRP assessments are overlooked or missed.

In recent years, the IRS has introduced new TFRP guidance to better control the TFRP process and has achieved some improvement in the average time it takes to complete investigations and assess the TFRP. However, significant untimeliness still exists.

#### **WHAT TIGTA RECOMMENDED**

TIGTA recommended that the IRS emphasize to group managers their responsibilities to monitor TFRP cases and ensure that revenue officers take timely TFRP actions; enhance TFRP communication and training; ensure completion and adequacy of scheduled system improvements and take appropriate actions to implement the changes; and revise TFRP guidance regarding the accuracy of the collectibility determination support and controlling the completion of TFRP investigations when installment agreements or currently not collectible closures are approved.

In their response to the report, IRS officials agreed with all of our recommendations and plan to take corrective actions.”

### ***Retirement Plans, Fringes, Compensation and Employee Expenses***

1. IRS updated [Fringe Benefit Guide](#) (95 pages) (Jan. 2014) – written for examiners, but useful background for practitioners.
2. Qualified Plans and Same-Sex Couples - [Notice 2014-19](#) addresses the application of Windsor and Rev Rul 2013-17 to retirement plans qualified under §401(a) using 9 Q&As. Key points:
  - a. Reference and requirement of rules referring to a married participant includes one married to a same sex spouse
  - b. “Qualified retirement plan operations must reflect the outcome of Windsor as of June 26, 2013. A retirement plan will not be treated as failing to meet the requirements of section 401(a) merely because it did not recognize the same-sex spouse of a participant as a spouse before June 26, 2013.”
  - c. Deadline to adopt plan amendments per this notice is later of “otherwise applicable deadline under section 5.05 of Rev. Proc. 2007-44” (or its successor) or 12/31/14.

[Notice 2014-37](#) (5/15/14) amplifies Notice 2014-19, by clarifying Q&A-8 regarding mid-year amendments.

3. Maximum Vehicle Values – [Notice 2014-11](#) (2014-13 IRB 880) – provides the “maximum vehicle values for 2014 that taxpayers need to determine the value of personal use of employer-provided vehicles under the special valuation rules” of Reg. 1.61–21 (d) and (e). The limits for the “vehicle cents-per-mile valuation rule” for 2014 are \$16000 for a passenger car and \$17,300 for a van or truck. The limits for the “fleet-average valuation rule” are \$21,300 for a passenger car and \$22,600 for a van or truck.
4. HSA and Inflation – Per IRS “[Revenue Procedure 2014-30](#) provides the 2015 inflation adjusted deduction limitations for annual contributions made to a health savings account (HSA) under section 223. These deduction limitations are updated annually pursuant to section 223(g) to reflect the cost-of-living adjustments.” For 2014, the annual limitation for self-only coverage for a high deductible health plan is \$3,350. For an individual with family coverage under a high deductible health plan, it is \$6,650.

Also see HHS information on benefits which may call for different dollar amounts.

[Fact Sheet from CMS.](#)

2015 [Actuarial Value Calculator and Methodology](#) from CMS

5. Penalty Relief for Small Retirement Plans – In June 2014, the IRS began a 1-year pilot program for small businesses that owe penalties for not filing retirement plan reporting documents. The IRS realizes some of these taxpayers may not have known they had filing obligations. See [IR-2014-66](#) (5/22/14) and [Rev. Proc. 2014-32](#) (5/9/14).
6. Pension Plan Penalty Relief – Two rulings were released by the IRS on this topic on 5/9/14.
  - a. [Rev Proc 2014-32](#) “establishes a one-year pilot program to provide relief to plan administrators who fail to timely file Form 5500 EZ.”
  - b. “[Notice 2014-35](#) applies administrative relief to late filers of Form 5500 who satisfy the requirements of this notice and the Delinquent Filer Voluntary Compliance (“DFVC”) Program administered by the Department of Labor (“DOL”) Employee Benefits Security Administration.”
7. Retiree Health Benefits – Per IRS (5/8/14): “[Revenue Ruling 2014-15](#) provides guidance to employers funding their retiree health benefits through a wholly owned subsidiary. The ruling concludes that the arrangement is insurance for federal income tax purposes.”
8. §403(b) plans – per IRS – “[Revenue Procedure 2014-28](#) modifies Rev. Proc. 2013-22, 2013-18 I.R.B. 985, which sets forth the procedures of the Internal Revenue Service (Service) for issuing opinion and advisory letters for § 403(b) pre-approved plans (that is, § 403(b) prototype plans and § 403(b) volume submitter plans).”
9. Non-qualified Deferred Compensation under §457A - [Rev. Rul. 2014-18](#) amplifies Notice 2009-8 and addresses the treatment of a nonstatutory stock option and stock-settled stock appreciation rights granted to a service provider, here, an LLC, by a service recipient that is a foreign corporation and non-qualified entity. The items were found not to be deferred compensation subject to §457A. Per the IRS (6/10/14): “Revenue Ruling 2014-18 provides that a nonstatutory stock option or a stock appreciation right (each, a stock right) granted by a nonqualified entity for purposes of section 457A is treated as exempt from section 457A, provided that the stock right is exempt from section 409A, and further provided that the stock appreciation right at all times by its terms must be settled, and is settled, in service recipient stock for purposes of section 409A.”

## Accounting Methods

1. §263A and Sales-Based Royalties and Vendor Chargebacks/Allowances - Per IRS (5/6/14): “[Revenue Procedure 2014-33](#) provides the exclusive procedures by which a taxpayer obtains the consent of the Commissioner under §446(e) to (1) change its method of accounting for royalties described in § 1.263A-1(e)(3)(ii)(U)(2), (2) change its method of accounting for sales-based vendor chargebacks described in § 1.471-3(e)(1), or (3) change its simplified production method or simplified resale method for costs allocated only to inventory property that has been sold, to comply with final regulations under §§ 263A and 471. The final regulations ([TD 9652](#)) were published in the Federal Register on January 13, 2014.”
2. Call for Repeal of LIFO – Pros and Cons – Calls for tax reform with a lower tax rate and broader base have included repeal of LIFO. President Obama’s revenue proposals have called for repeal (for example, see [FY2015 Greenbook](#), page 93) as has Congressman Camp’s reform proposal, the Tax Reform Act of 2014 ([summary, page 92](#)). In addition to helping pay for a lower tax rate, arguments offered to support repeal include simplification and that LIFO is not allowed under IFRS. Congressman Camp’s proposal eases repeal by allowing a 4-year spread of LIFO reserve over four years starting in 2019 and small businesses would be subject to a 7% tax rate on their reserves.

In May 2014, a group of 113 members of Congress sent a [letter](#) to Congressman Camp urging him to remove LIFO repeal from his tax reform plan. They note that “LIFO is a legitimate and longstanding accounting methodology” that is not a loophole or subsidy. They are concerned that

repeal of LIFO will have an adverse economic impact. They refer to the taxation of the LIFO reserve as “an unprecedented retroactive tax increase.”

## Business Credits

1. Research tax credit regulations – [TD 9666](#) (6/3/14) provides final and temporary regulations on how to elect the alternative simplified credit (ASC) of §41(c)(5) (as well as proposed regulations - [REG-133495-13](#) (6/3/14)). As previously explained in TD 9528 (6/10/11), use of the ASC formula to compute the research credit is elected on [Form 6765](#), *Credit for Increasing Research Activities*, on an original return. The 2014 regulations provide a limited option for making the ASC election on an amended return. Per §1.41-9T(a)(2) – “A taxpayer may make an election under section 41(c)(5) for a tax year on an amended return, but only if the taxpayer has not previously claimed the section 41 credit on its original return or an amended return for that tax year. An extension of time to make an election under section 41(c)(5) will not be granted under §301.9100-3 of this chapter. A taxpayer that is a member of a controlled group in a tax year may not make an election under section 41(c)(5) for that tax year on an amended return if any member of the controlled group for that tax year previously claimed the research credit using a method other than the ASC on an original or amended return for that tax year.”

Per the preamble to TD 9666, the IRS did not provide greater options for electing ASC on an amended return because it “could result in more than one audit of a taxpayer’s research credit for a tax year.”

This rule applies to election for tax years ending on or after 6/4/14. They may also be relied on to make an ASC election for a tax year ending before 6/3/14 if made before the statute of limitations expires for that year. Per §1.41-9T(e), “this section expires on June 2, 2017.”

2. Research tax credit - *Shami* (5th Cir., 1/23/14) - investors appealed a Tax Court decision ([TC Memo 2012-78](#)) denying the research tax credit to Farouk Systems, Inc., an S corporation. FSI, founded by Shami, develops, manufactures and sells hair care and cosmetics products. About 18 to 27 of FSI’s several hundred employees were involved in R&D. FSI hired a consultant to determine its research credit for 2003 to 2005. Qualified research expenses (QRE) were determined to be between \$4 million and \$16 million of wages each year with about 80% of that attributable to the work of Shami, FSI’s COE and president, and McCall, as FSI’s co-chairman. Neither employee had training in chemistry or engineering.

The Tax Court denied the wages attributable to the executives. In calculating the taxpayer’s deficiency, the IRS omitted the supplies which T argued IRS had conceded should be included. IRS disagreed and T appealed.

T argued that it was not allowed to submit about 4,500 pages of evidence, but was instead limited to providing information per sampling. The Tax Court disagreed. “In this case, introduction of all of the laboratory-test records would have resulted in needless delay, wasted time, and unnecessary cumulation of evidence, which substantially outweighed the minimal probative value of the additional records.”

T’s argument that IRS required a particular form of documentation was not accurate per the court.

The court also noted that the *Cohan* rule was not applicable here. “the *Cohan* rule is not implicated unless the taxpayer proves that he is entitled to some amount of tax benefit. In the context of the § 41 credit, a taxpayer would do so by proving that its employee performed some qualified services. In this case, a careful reading of the Tax Court’s opinion reveals that the Tax Court made no such finding.”

Additional procedural matters were discussed and the court concluded that supply costs should have been included in the credit calculation.



3. §45K – Nonconventional Source Fuel Credit – [Notice 2014-25](#) provides the inflation adjustment factor and reference price for 2013 for coke or coke gas.
4. Production Tax Credit (§45) and Investment Tax Credit (§48) and Sequestration - Per the IRS (6/10/14): "[Notice 2014-39](#) answers two questions for recipients of Section 1603 Awards. First, this notice provides that the Section 1603 Payment resulting from sequestration during the affected time period does not affect the amount of the Section 1603 Award or the basis of the specified energy property taken into account for purposes of determining the Section 1603 Award. Consequently, taxpayers may not partition the basis of property for which they receive a Section 1603 Award and claim a tax credit under section 45 or 48 of the Code on any part of the basis of the same property. Second, this notice provides that under section 48(d)(3)(B), taxpayers must reduce the basis of the specified energy property by 50 percent of the amount of the actual Section 1603 Payment."
5. §45Q – Credit for CO2 Sequestration – [Notice 2014-40](#) has the inflation adjustment factor for 2014.

## Corporations

1. Triangular Reorgs and Foreign Corporations – Per IRS (4/25/14): "[Notice 2014-32](#) announces modifications and clarifications to the regulations under section 367(b) of the Internal Revenue Code relating to the treatment of property used to acquire parent stock or securities in certain triangular reorganizations involving foreign corporations (colloquially referred to as the “Killer B regulations”). The notice eliminates the deemed contribution model under the existing regulations. In addition, the notice modifies the amount of income and gain taken into account for purposes of applying the priority rules of section 367(a) and (b). Further, the notice clarifies the application of the anti-abuse rule.”
2. [Form 1122](#), *Authorization and Consent of Subsidiary Corporation To Be Included in a Consolidated Income Tax Return*, Relief – [Rev. Proc. 2014-24](#) (4/30/14) provides three conditions; if any are met, the IRS will treat a subsidiary member of an affiliated group as if it had filed Form 1122. If satisfied, this is the exclusive procedure to treat a subsidiary as having joined the group. The conditions:
  - “(1) The consolidated return did not include a Form 1122 for the non-filing subsidiary due to a mistake of law or fact, or to inadvertence, provided that the affiliated group believed that the non-filing subsidiary was a member of the affiliated group for the taxable year and included the non-filing subsidiary’s income and deductions in the consolidated return as if the non-filing subsidiary was a member of the affiliated group;
  - (2) The consolidated return did not include a Form 1122 for the non-filing subsidiary due to a mistake of law or fact, or to inadvertence, provided that all of the non-filing subsidiary’s income and deductions were included on the consolidated return as part of the income and deductions of another member of the group. For example, the affiliated group believed that the non-filing subsidiary was disregarded as an entity separate from its owner for Federal income tax purposes or had formally ceased to exist pursuant to a merger or liquidation into another member of the group; or
  - (3) The consolidated return did not include a Form 1122 for the non-filing subsidiary because the affiliated group believed that the non-filing subsidiary was taxable as a partnership for Federal income tax purposes, provided that all of the nonfiling subsidiary’s income and deductions were included on the consolidated return as part of the income and deductions of its partners.”

## Partnerships

1. EIN When Two-Partner Entity Loses a Partner – [CCA 201351018](#) (12/20/13) - A & B were partners and B later gave up his interest and became an employee of the entity. Thus, under state law, the partnership terminated. A continued to file employment tax returns with partnership EIN and issued B a K-1 rather than W-2s. IRS examiner needed statute extension on the employment tax returns and to issue deficiency notice for the reclassification of B as an employee. What EIN should be used?

Answer – Should continue to use old EIN for employment tax purposes. “Rev. Rul. 2001-61 provides that, when a partnership becomes a disregarded entity, and if the disregarded entity chooses to calculate, report, and pay its employment tax obligations under its own name and EIN pursuant to Notice 99-6, the disregarded entity “must retain the same EIN for employment tax purposes it used as a partnership.” (For all federal tax purposes other than employment obligations or except as otherwise provided in regulations or other guidance, a disregarded entity must use the TIN of its owner.) Though Notice 99-6 was obsoleted by T.D. 9356, that T.D. also provides that the disregarded entity reports its employment tax obligations, not the owner. See Treas. Reg. § 301.7701-2(c)(2)(iv)(B).”

Once the partnership became a disregarded entity, the deductions belong on A’s Schedule C.

A should sign the statute extensions as owner of the disregarded entity and deficiency notices should be issued to A.

2. Profits interest issue – [Crescent Holdings, LLC, et al](#), 141 TC No. 15 (12/2/13) – “The issue is whether P or the other partners should recognize the undistributed partnership income allocations attributable to the 2% interest for the years at issue.

“Held: The 2% interest is a partnership capital interest, not a partnership profits interest. Rev. Proc. 93-27, 1993-2 C.B. 343, and Rev. Proc. 2001-43, 2001-2 C.B.191, are inapplicable because they apply only to partnership profits interests.

Held, further, I.R.C. sec. 83 applies to a nonvested partnership capital interest transferred in exchange for the performance of services.

Held, further, under sec. 1.83-1(a)(1), Income Tax Regs., the undistributed partnership income allocations attributable to the nonvested 2% partnership capital interest are to be recognized in the income of the transferor.

Held, further, Holdings was the transferor of the 2% partnership capital interest. The undistributed partnership allocations attributable to the 2% capital interest are allocable to the partners holding the remaining interest in Holdings.”

3. LLC Member, Debt and §465 – In [AM 2014-003](#) (4/4/14), the IRS addressed the tax effects of an LLC member guaranteeing LLC debt and the relevance under the at-risk rules. The three conclusions reached by the IRS:

“1. When a member of an LLC classified as a partnership or disregarded entity for federal tax purposes guarantees the LLC’s debt, the member is at risk with respect to the amount of the guaranteed debt, without regard to whether such member waives any right to subrogation, reimbursement, or indemnification from the LLC, but only to the extent that the member has no right of contribution or reimbursement from persons other than the LLC, the member is not otherwise protected against loss within the meaning of § 465(b)(4), and the guarantee is bona fide and enforceable by creditors of the LLC under local law.

2. When a member of an LLC classified as a partnership for federal tax purposes guarantees qualified nonrecourse financing of the LLC, the member’s amount at risk is increased by the amount guaranteed, but only to the extent such debt was not previously taken into account by that member, the guaranteeing member has no right of contribution or



reimbursement from persons other than the LLC, the guaranteeing member is not otherwise protected against loss within the meaning of § 465(b)(4), and the guarantee is bona fide and enforceable by creditors of the LLC under local law.

3. When a member of an LLC guarantees qualified nonrecourse financing of the LLC, the amount of the guaranteed debt no longer meets the definition of “qualified nonrecourse financing” under § 465(b)(6)(B) if the guarantee is bona fide and enforceable by creditors of the LLC under local law, and the amount of the guaranteed debt will no longer be includible in the at-risk amount of the other non-guarantor members of the LLC.”
4. §47 Rehabilitation Credit Allocation in a Partnership – [Rev. Proc. 2014-12](#) (12/30/13) lays out the safe harbor requirements such that the IRS “will not challenge partnership allocations of §47 rehabilitation credits by a partnership to its partners.”

## Health Care - Businesses

### **New for 2014**

1. Small Business Health Credit – §45R – for 2014, need to purchase insurance on the exchange (SHOP) to be eligible for the credit. (IRS [website](#) on this credit and [11/27/13 HHS blog post](#).)
2. Premium Tax Credit – §36B – see updates in section below.
3. Individual Shared Responsibility Payment (ISRP) – [IRC §5000A](#) – see updates in section below.
4. Forms will be needed for the PTC and ISRP, as well as for reporting by employers and insurance providers.

### **Effective for 2015**

1. Employer Shared Responsibility Payment – §4980H and Reporting – as enacted, effective for months beginning after 2013. On 7/9/13, Treasury Department extended the effective date one year ([Notice 2013-45](#)). Notice 2013-45 also provided transition relief for the reporting requirements for certain employers and insurers under §6055 and §6056. Employers with fewer than 100 full-time and full-time equivalent employees may obtain additional transitional relief for 2015. The transition rules are detailed; be sure to read the preamble to the final §4980H regs ([TD 9655](#) (2/12/14)).

### **Penalties Related to Market Reforms – Form 8928**

§4980D – Watch out for significant tax (penalty) - [§4980D, Failure to meet certain group health plan requirements](#). This provision predates the ACA, but has renewed impact with the ACA the need for insurance plans to meet the [minimal essential coverage](#) requirements of the ACA. The tax (penalty) is \$100 per day per individual to which the failure relates. There are exceptions for reasonable cause and certain insured small employer plans. [Form 8928](#), *Return of Certain Excise Taxes Under Chapter 43 of the IRC*, is used to pay the tax.

Read the following IRS [Q&A](#) on this topic:



#### Affordable Care Act Topics

- [Individuals and Families](#)
- [Employers](#)
- [Other Organizations](#)
- [List of Tax Provisions](#)
- [Legal Guidance and Other Resources](#)
- [Questions and Answers](#)
- [Health Care Tax Tips](#)
- [Affordable Care Act Tax Provisions Home](#)

- [Disposiciones Tributarias de la Ley de Cuidado de Salud a Bajo Precio](#)

## Employer Health Care Arrangements



**Q1. What are the consequences to the employer if the employer does not establish a health insurance plan for its own employees, but reimburses those employees for premiums they pay for health insurance (either through a qualified health plan in the Marketplace or outside the Marketplace)?**

Under IRS Notice 2013-54, such arrangements are described as employer payment plans. An employer payment plan, as the term is used in this notice, generally does not include an arrangement under which an employee may have an after-tax amount applied toward health coverage or take that amount in cash compensation. As explained in Notice 2013-54, these employer payment plans are considered to be group health plans subject to the market reforms, including the prohibition on annual limits for essential health benefits and the requirement to provide certain preventive care without cost sharing. Notice 2013-54 clarifies that such arrangements cannot be integrated with individual policies to satisfy the market reforms. Consequently, such an arrangement fails to satisfy the market reforms and may be subject to a \$100/day excise tax per applicable employee (which is \$36,500 per year, per employee) under section 4980D of the Internal Revenue Code.

**Q2. Where can I get more information?**

On Sept. 13, 2013, the IRS issued [Notice 2013-54](#), which explains how the Affordable Care Act's market reforms apply to certain types of group health plans, including health reimbursement arrangements (HRAs), health flexible spending arrangements (health FSAs) and certain other employer healthcare arrangements, including arrangements under which an employer reimburses an employee for some or all of the premium expenses incurred for an individual health insurance policy.

DOL has issued a notice in substantially identical form to Notice 2013-54, [DOL Technical Release 2013-03](#), and HHS will shortly issue guidance to reflect that it concurs with Notice 2013-54. On Jan. 24, 2013, [DOL](#) and [HHS](#) issued FAQs that addressed the application of the Affordable Care Act to HRAs.

*Page Last Reviewed or Updated: 13-May-2014*

## Small Business Tax Credit

1. [Notice 2014-6](#) (12/17/13) - guidance under 45R “for certain small employers that cannot offer a qualified health plan (QHP) through a Small Business Health Options Program (SHOP) Exchange because the employer’s principal business address is in a county in which a QHP through a SHOP Exchange will not be available for the 2014 calendar year. (See section IV of this notice for a list of those counties.) With respect to those employers, this notice provides guidance on how to satisfy the requirements for the section 45R credit for the 2014 taxable year.”
2. For 2014, need to purchase insurance on the exchange (SHOP) to be eligible for the credit. (IRS [website](#) on this credit and [11/27/13 HHS blog post](#).)

## Employer Shared Responsibility Payment – §4980H

1. [FAQs](#) related to final regulations (TD 9655; 2/12/14) on this provision under [IRC §4980H](#). This penalty applies to “applicable large employers” which generally means “an employer who employed an average of at least 50 full-time employees on business days during the preceding calendar year.”

- [Basics of the Employer Shared Responsibility Provisions](#): Questions 1-3
  - [Which Employers are Subject to the Employer Shared Responsibility Provisions](#): Questions 4-14
  - [Identification of Full-Time Employees](#): Questions 15-17
  - [Liability for the Employer Shared Responsibility Payment](#): Questions 18-23
  - [Calculation of the Employer Shared Responsibility Payment](#): Questions 24-26
  - [Making an Employer Shared Responsibility Payment](#): Questions 27-28
  - [Transition Relief](#): Questions 29-39
  - [Basics for Small Employers](#): Questions 40 - 42
  - [Additional Information](#): Questions 43-46
2. Treasury [Fact Sheet](#) on the Shared Responsibility Payment.
  3. Transition rules exist for 2014-2016 – See [Notice 2013-45](#) (11/26/13) and preamble to final §4980H regs ([TD 9655](#) (2/12/14)). As enacted, this penalty is effective for months beginning after 2013. On 7/9/13, Treasury Department extended the effective date one year ([Notice 2013-45](#)). Notice 2013-45 also provided transition relief for the reporting requirements for certain employers and insurers under §6055 and §6056. Employers with fewer than 100 full-time and full-time equivalent employees may obtain additional transitional relief for 2015. The transition rules are detailed; be sure to read the preamble to the final §4980H regulations ([TD 9655](#) (2/12/14)).
  4. The preamble to the final regulations ([TD 9655](#) (2/12/14)) points out that where the regulations refer to a full-time employee is certified as having received a premium tax credit, also includes such an employee who received a cost-sharing reduction “because, in connection with Exchange coverage, only individuals who qualify for the premium tax credit can qualify for a cost-sharing reduction.”
  5. See earlier section on payroll and worker classification for the interaction of §4980H and worker classification per the final regulations under §4980H.

## Resources

- a. IRS [website](#) – tips, links to regulations and other guidance.
- b. U.S. Department of Health & Human Services (HHS) main health care website – <http://www.healthcare.gov>
- c. HHS health care [blog](#) – may include tips not in other guidance.
- d. HHS – [March 2014 Enrollment Report](#) – shows how many people signed up in the marketplace exchanges by state and gender, type of plan, and financial assistance.
- e. CMS.gov - <http://www.cms.gov/>
  - i. [Health Insurance Market Reforms](#)
  - ii. [Fact Sheets and FAQs](#)
- f. DOL – <http://www.dol.gov/ebsa/healthreform/>
  - i. [FAQs](#)
  - ii. [Self-Compliance Tool for Part 7 of ERISA: Affordable Care Act Provisions](#)
  - iii. [Consumer Information on the ACA](#)
  - iv. And more - <http://www.dol.gov/ebsa/healthreform/>
- g. Joint Committee on Taxation, *Present Law And Background Relating To The Tax-Related Provisions In The Affordable Care Act*, [JCX-6-13](#) (3/4/13).

- h. Small Business Administration – [Federal Compliance Contacts and Resources](#) list (health care and many other federal laws).
- i. Congressional Research Service (CRS) reports:
  - i. [Individual Mandate under ACA](#), R41331 (5/5/14)
  - ii. [Patient Protection and Affordable Care Act \(ACA\): Resources for Frequently Asked Questions](#), R43215 (4/3/14)
  - iii. [Health Insurance Premium Credits in the Patient Protection and Affordable Care Act \(ACA\)](#), R41137 (3/12/14)
  - iv. [Individual Mandate Under ACA](#), R41331 (3/6/14)
  - v. [The Affordable Care Act and Small Business: Economic Issues](#), R43181 (2/25/14)
  - vi. [Private Health Insurance Market Reforms in the Affordable Care Act \(ACA\)](#), R42069 (3/13/14).
  - vii. [Tax-Advantaged Accounts for Health Care Expenses: Side-by-Side Comparison, 2013](#), R21573 (11/8/13).
  - viii. [Private Health Plans Under the ACA: In Brief](#), R43233 (9/19/13).
  - ix. [Potential Employer Penalties Under the Patient Protection and Affordable Care Act \(ACA\)](#), R41159 (7/22/13).
  - x. [Health Insurance Exchanges Under the Patient Protection and Affordable Care Act \(ACA\)](#), R42663 (1/31/13)
  - xi. [List](#) of older reports from the NCSL.
- j. [Tax penalty calculator](#) from Tax Policy Center.
- k. [Health Insurance Subsidy Calculator](#) from Kaiser Family Foundation.
- l. AICPA timeline and links
  - i. <http://www.aicpa.org/Research/HCR/Pages/Timeline.aspx>
- m. AICPA Health Care Reform Resources Center
  - i. <http://www.aicpa.org/research/hcr/pages/health-care-reform.aspx>
- n. AICPA Health Care Reform [Toolkit](#)
- o. Consumers Union
  - i. <http://consumerreports.org/cro/health/health-insurance/index.htm>
  - ii. <http://consumersunion.org/topic/health-care/tax-credit/>
- p. Kaiser Family Foundation
  - i. <http://kff.org/health-reform/>
  - ii. Health Insurance Subsidy Calculator - <http://kff.org/interactive/subsidy-calculator/>
  - iii. FAQ - <http://kff.org/health-reform/faq/health-reform-frequently-asked-questions/>
- q. National Conference of State Legislatures (NCSL) – health care [website](#).
- r. Urban Institute – [Health Policy Center](#) – various studies and articles on health care reform.

## Property Transactions

### **Repair versus Capitalization**

1. [Rev. Proc. 2014-17 \(2014-12 IRB 661\)](#) – “modifies the procedures in Rev. Proc. 2012-20, 2012-14 I.R.B. 700, and Rev. Proc. 2011-14, 2011-4 I.R.B. 330, regarding certain changes in method of accounting for dispositions of tangible depreciable property. This revenue procedure supersedes Rev. Proc. 2012-20 and provides the procedures by which a taxpayer may obtain the automatic consent of the Commissioner of Internal Revenue to change to the methods of accounting provided in §§ 1.167(a)-4 and 1.168(i)-7 of the Income Tax Regulations, §§ 1.167(a)-4T, 1.168(i)-1T, 1.168(i)-7T, and 1.168(i)-8T of the temporary regulations, and §§ 1.168(i)-1, 1.168(i)-7, and 1.168(i)-8 of the proposed regulations. This revenue procedure also modifies Rev. Proc. 2011-14 and allows a late partial disposition election under Prop. Reg. § 1.168(i)-8 or a revocation of a general asset account election under § 1.168(i)-1T or Prop. Reg. § 1.168(i)-1 to be treated as a change in method of accounting for a limited period of time. Finally, this revenue procedure modifies section 6.01 of the APPENDIX of Rev. Proc. 2011-14 to waive a scope limitation in certain circumstances.” (91 pages long)

#### **Mostly applicable to 2013 tax returns!**

Issued in relation to repair versus capitalization regulations (TD 9636 and REG-110732-13 released in September 2013). The changes added to the automatic method change Rev. Proc. 2011-14 are:

- 6.29 Disposition of a building or structural component (section 168; § 1.168(i)-8T, and Prop. Reg. § 1.168(i)-8)
  - 6.30 Dispositions of tangible depreciable assets (other than a building or its structural components) (section 168; § 1.168(i)-8T and Prop. Reg. § 1.168(i)-8)
  - 6.31 Dispositions of tangible depreciable assets in a general asset account (section 168(i)(4); § 1.168(i)-1T and Prop. Reg. § 1.168(i)-1)
  - 6.32 General asset account elections (section 168(i)(4); § 1.168(i)-1T, and Prop. Reg. § 1.168(i)-1)
  - 6.33 Late partial disposition election (section 168; Prop. Reg. § 1.168(i)-8)
  - 6.34 Revocation of a general asset account election (section 168; § 1.168(i)-1T and Prop. Reg. § 1.168(i)-1)
  - 6.35 Partial dispositions of tangible depreciable assets to which the IRS’s adjustment pertains (section 168; Prop. Reg. § 1.168(i)-8)
  - 6.36 Depreciation of leasehold improvements (sections 167, 168, and 197; § 1.167(a)-4)
  - 6.37 Permissible to permissible method of accounting for depreciation of MACRS property (section 168; § 1.168(i)-7)
2. [AICPA Resource Website](#) – includes a helpful summary of the regulations and a Sample Written Book Capitalization Policy for De Minimis Safe Harbor, and more.

### **Intangibles**

1. Capitalization - [CCA 201405014](#) (1/31/14) – held that “construction support payments” made by Taxpayer to retailers did not have to be capitalized under §1.263(a)-4. T produces Z products and

distributes them through a network of retailers. If the retailers enter an agreement with T, they get construction support payments a portion of which are paid upon groundbreaking and the balance upon start of operations of the facility. Retailers must meet seven “critical image elements” in the design, such as an elevated glass display, certain colors, and specified signage. Retailers are not required under the agreement to purchase any particular quantity of Z products. The only obligation for the retailers in taking the payments is that they conform to the seven elements.

The IRS analyzed the benefit T received by requiring the retailers to conform to its design concepts. The IRS noted that T obtained no tangible benefit in that it had no interest in the facility created by the retailers. Under the §1.263(a)-4regs, IRS analyzed possible capitalization requirements as follows:

- a. Create or enhance a separate and distinct intangible asset per §1.263(a)-4(b)(3)? No. T’s “rights have no value apart from the promotion of Taxpayer’s Z product line.”
- b. Creation of a financial interest under §1.263(a)-4(d)(2) as creating a financial interest? No. The agreement is not a forward contract or option in that retailers are not required to purchase any specific quantity of products and the price is not fixed.
- c. Creation of a contract right per §1.263(a)-4(d)(6)? No. “an agreement does not provide the taxpayer a right to provide services if the agreement merely provides that the taxpayer will stand ready to provide services if requested, but places no obligation on another person to request or pay for the taxpayer’s services. Section 1.263(a)-4(d)(6)(iv).” Here, retailers are not required to purchase any specific amount of T’s products or services.
- d. Improvement to real property owned by another with a reasonable expectation of producing significant economic benefit to T per §1.263(a)-4(d)(8)? No. The seven critical elements relate to marketing, rather than to real property.

In this CCA, the IRS also noted the relevance of *Indopco* today – “In *Indopco, Inc. v. Commissioner*, 503 U.S. 79, 86 (1991), the Court established the test for capitalization as being whether an expense results in a significant future benefit. Currently, the capitalization of intangibles is governed by §§ 1.263(a)-4 and 1.263(a)-5 which define the exclusive scope of the significant future benefit test, generally by providing specific categories of intangible assets for which capitalization is required.”

2. Transfer of Goodwill – *Bross Trucking, Inc., et al*, TC Memo 2014-107 (6/5/14) – Mr. Bross created Bross Construction in 1972 for road construction projects. As business grew, he organized additional companies to provide services and equipment for the projects. Mr. B’s experience, knowledge, and the relationships he developed with clients, were key factors in the success of the company.

B organized Bross Trucking in 1982, owning 100% through a revocable living trust. B had no employment contract with BT and no noncompete agreement. BT leased most of its equipment from CB Equipment, wholly owned by B. BT had independent contractors drive the trucks. Key customers of BT were entities owned by B family members (wife and children).

BT had some complaints and investigations from the Missouri Dept of Transportation. Thinking that BT was under “heightened regulatory scrutiny,” B ended BT’s operations. In 2003, B and his three sons met with an attorney and they created LWK Trucking operated by the sons. The sons used a different attorney and offered services beyond what BT had offered. The stock was acquired through Roth IRAs each son established, with 1.8% of the stock owned by an unrelated third party. Nothing was transferred from BT to LWK. LWK entered into a new equipment lease with CB Equipment. Some of the equipment still had the BT logos on it, which caused the DOT to continue to closely monitor the trucks. That led LWK to get the old logos covered.

CB Asphalt, owned by B, also leased equipment from LWK.



In 2011, B, wife and three sons organized Bross Holding Group. BHG became sole owner of BC and CB Equipment, but not BT. B and wife gave ownership interests in BHG to the sons. Valuations were obtained and the Bs filed gift tax returns.

At issue was whether BT distributed appreciated intangible assets to Mr. B who then gave them to his sons and whether gifts should have been reported for 2004. The assets that IRS believed BT distributed to its sole shareholder, Mr. B were “(1) goodwill; (2) established revenue stream; (3) developed customer base; (4) transparency of the continuing operations between the entities; (5) established workforce including independent contractors; and (6) continuing supplier relationships.” The court noted that it was not clear whether the IRS viewed these as separate intangibles or just goodwill.

Also involved with the question of whether BT made a distribution under 311 to its shareholder is whether BT even owned the assets. Citing *Martin Ice Cream*, 110 TC 189 (1998), where customer relationships and distribution rights were held to be the personal assets of the shareholder rather than corporate assets.

The court ruled that BT’s “goodwill was primarily owned by Mr. Bross personally, and the company could not transfer any corporate goodwill to Mr. Bross in tax year 2004.” The regulatory infractions brought against BT caused it to lose its corporate goodwill as it damaged the corporate name. This was evidenced by the fact that LWK worked to remove or cover up the BT logo on the trucks. Per the court:

“Mr. Bross’s solution was to find or create another business to take over the trucking needs for the Bross family businesses. This is the antithesis of goodwill: Bross Trucking could not expect continued patronage because its customers did not trust it and did not want to continue doing business with it.” It also noted that LWK “was trying to hide any relationship with Bross Trucking because association with the targeted company was seen in a negative light.” If there had been any goodwill transferred, LWK would not want to hide the BT logo.

Per the court, the only possible asset transferred from BT to LWK was workforce in place.

The other assets listed above stemmed from Mr. B’s personal relationships. The court also held that BT’s revenue stream was due to the personal relationships. The court also noted that Mr. B did not transfer any goodwill to BT as there was no employment contract or noncompete agreement. Thus, Mr. B was still able to benefit from these assets personally.

In addition, the court did not find any true transfer of workforce in place as LWK was involved in business activities beyond those of BT and hired employees. Any BT employees hired by LWK were viewed as “hired away on their own merit.” Also, BT did not transfer any cash, licenses or insurance contracts.

## **Depreciation**

1. Full meaning of “placed in service” – In *Brown*, TC Memo 2013-275 (12/3/13), taxpayer purchased a \$22 million plane on 12/30/03 for use in his insurance business. He made two trips in it to visit clients before year end. Although there is some dispute as to the time involved and documentation of the meetings with the fuel receipts and flight logs, the bigger issue tied to whether the plane was ready for use in 2003 or not until 2004 when a conference table and screen were installed that B indicated he needed for use of the plane in his business. So, the question was whether it was enough that B flew the plane for business use or did the plan have to be fully ready for its intended purpose.

Installation of the conference table was a big deal as it would require a reconfigure of the plane and because that would increase the seating capacity, it also required the installation of a digital flight-data recorder. The installation and some additional customization was estimated to take six weeks.



After reviewing several “placed in service” cases, the court stated: “These cases teach us that not just any use of an asset will satisfy the placed-in-service standard. An asset must instead be available for *its intended use on a regular, ongoing basis* before we can find it “placed in service” in the tax year in question.”

Per the court, “without those two post-2003 modifications, the Challenge wasn’t “in a state of availability for the specific intended function in” Brown’s insurance business in 2003. We do agree with Brown that the case law does *not* require that an asset actually be used before it’s regarded as “placed in service.” This last point is per *Sears Oil*, 359 F.2d 191 (2nd Cir. 1966), aff’g in part, rev’g in part TC Memo. 1965-39, where the barge could not be used, even though it was ready for use, because it was frozen in the canal.

“What we can glean from that holding is that it’s possible for a taxpayer to place an asset in service for a certain tax year even without using it that year. ... Contrary to what Brown contends, however, *Sears Oil* *doesn’t* stand for the different proposition that as long as an asset has been “used” in a certain year, it has also been “placed in service” that year.”

While B tried to emphasize that the conference table and screen were not crucial, the court observed that this was in conflict with earlier testimony. “The problem is that this post trial framing just doesn’t square with the trial testimony, in which Brown testified that those two modifications were “needed” and “required”. We therefore find that the Challenger [the plane] simply was not available for its intended use on a regular basis until those modifications were installed in 2004. Brown thus didn’t place the Challenger in service in 2003 and can’t take bonus depreciation on it that year.”

After a discussion of whether the fraud penalty should apply for this deduction, the court concluded it should not. There was concern over the client letters, but they were obtained after the return was filed and fraud intent must exist when the return is filed. There was also concern over the flight logs, fuel receipts and client letters that did not all tell the same story. The substantial understatement of tax penalty was assessed as B could not show he had relied on anyone’s advice in claiming the bonus depreciation in 2003.

The IRS had conceded that he could be entitled to bonus depreciation in 2004.

2. Asset Class 57.0 – [CCA 201404001](#) (1/24/14) – T, a cash method taxpayer in the business of “wholesale, retail, and leasing distributor of lighting and construction related products with associated administrative activities and professional engineering services, and a lessor of building space and the use of certain improvements.” T plans to own a building for its business, but later lease out all or a portion of the building to the general public. T also leases property from a third party and plans to remodel it and may later sublease it to the general public. These properties will involve use of two kinds of “interior non-load bearing drywall partition systems:
  - (1) Zip type partitions which T states are not inherently permanent structures under the *Whiteco* factors (65 TC 664 (1975)). T wants a ruling that these partitions fall into Asset Class 57.0 of Rev Proc. 87-56 with a 5 year life.
  - (2) Conventional drywall partitions are inherently permanent structure per the *Whiteco* factors. T wants a ruling that these partitions are nonresidential real property under §168 (e)(2)(B).

“The Whiteco factors are: (1) Is the property capable of being moved, and has it in fact been moved? (2) Is the property designed or constructed to remain permanently in place? (3) Are there circumstances that tend to show the expected or intended length of affixation, that is, are there circumstances that show the property may or will have to be moved? (4) How substantial a job is removal of the property, and how time consuming is it? (5) How much damage will the property sustain upon its removal? (6) What is the manner of affixation of the property to the land?”

The IRS ruled that the zip partitions are tangible personal property and given T's business, fall into Class 57.0. When the property is leased out, the classification depends on the use by the lessee or sublessee per §1.167-11(e)(3)(iii), but leasing property to the general public falls under Class 57.0.

The IRS ruled that the drywall partitions are structural components of the buildings, and nonresidential real property.

3. Ethanol Property – Per IRS (5/20/14): “[Revenue Ruling 2014-17](#) holds that tangible assets used in converting corn to fuel grade ethanol are properly included in asset class 49.5 of Rev. Proc. 87-56, 1987-2 C.B. 674, for depreciation purposes. The Internal Revenue Service will not apply the revenue ruling to tangible assets that are used in converting biomass to a liquid fuel such as fuel grade ethanol that a taxpayer places in service before June 9, 2014.”
4. Depreciation and E&P and Change in Accounting Method – [PLR 201410029](#) (3/7/14) – includes a few reminders about accounting method changes and the effect on E&P as well as reminders about the depreciation system for E&P. T had filed a Form 3115 to change its accounting method for asset D for which it was using 5-year GDS for regular tax and 9-year ADS for E&P. T will change to use the appropriate GDS and ADS for non-residential real property (for D placed in service after 1986).

The IRS ruled that:

- Changing the depreciation method for regular tax “requires a correlative change” for E&P purposes. Thus, separate consent for the E&P change is not needed. With the changes, additional changes are required to E&P per §312 and the regulations.
  - Per Rev. Proc. 79-47, T takes the §481(a) adjustment into account over 4 years for both regular tax and E&P purposes.
  - “§1.446-1(e)(2)(ii)(d)(5)(iv) or (v) ... provide how a taxpayer corrects a change in the useful life, or a change in the placed-in-service date, of a depreciable asset for taxable income purposes. Neither change generally is a change in method of accounting under §§446(e) and 481(a). However, § 1.446-1(e)(2)(ii)(d)(5)(iv) or (v) does not provide guidance on how to change depreciation for E&P purposes.”
  - See §312(k) and §1.312-6 for rules on depreciation for E&P.
5. Construction and Bonus Depreciation – [FAA 20140202F](#) (1/10/14) – involved a casino complex project. After it was complete, T performed a cost segregation study which identified the property eligible for bonus depreciation. T also argued the project was a “turnkey project” with final acceptance assumed to occur with the contractor completed the work in Year 6. The IRS disagreed, finding it was a “design-bid-build method” project and not a turnkey one. The IRS thus ruled that each property had to be analyzed to determine if it was eligible for bonus depreciation.

Self-constructed property is eligible for 50% bonus depreciation if T began manufacturing, constructing, or producing the property after 12/31/07 and before 1/1/14 (§1.168(k)-1(b)(4)(iii)(A)). Among the definitions and special rules for self-constructed property is a 10% safe harbor where physical work is not considered to start until more than 10% of the total cost of the property (excluding cost of land and preliminary planning or design work) is incurred. For an accrual method taxpayer, the all events test and economic performance requirement are used to determine when the costs are incurred.

The IRS found that T had not met its burden of showing when the costs were incurred. Thus, T was not entitled to bonus depreciation.

Also see [PLR 201210004](#) (3/9/12) also mentioned in the ruling. These rulings provide information on when and how bonus depreciation is available for constructed property.

## Virtual Currency

1. It's Property – In [Notice 2014-21](#) (3/25/14) – the IRS stated that a convertible virtual currency (such as Bitcoin) should be treated as property for tax purposes (rather than as a currency). Per the IRS, because virtual currency (VC) is not legal tender in any jurisdiction, it is not currency. The notice includes 16 Q&As on various tax treatments. In addition to stating that the currency is to be treated as property, additional guidance includes:
  - a. If a person receives VC for rendering services, it is included in gross income at the fair market value of the VC. Just as with other forms of payment, W-2s and 1099s might be required to be issued.
  - b. FMV is determined as of the date of payment or receipt of the VC. If the VC is listed on an exchange where the exchange rate is determined by market supply and demand, the exchange rate can be used, “in a reasonable manner that is consistently applied.” (Q&A5)
  - c. When VC is used to purchase goods and services, there will be a gain or loss based on the basis of the VC compared to its FVM when used. Character depends on the normal character rules (that is, §1221).
  - d. A person who “mines” VC must include the FMV of the VC in income on the date of receipt. If mining is a trade or business, the net earnings from the mining is subject to self-employment tax.
  - e. A person who “contracts with a substantial number of unrelated merchants to settle payments between the merchants and their customers is a third party settlement organization (TPSO).” and may be required to issue a 1099-K to the merchant and IRS depending on the merchant's volume of transactions. (Q&A15)

The IRS is seeking comments on “the tax consequences of virtual currency not addressed in this notice that warrant consideration.”

2. Issues Not Addressed by Notice 2014-21 and in Need of Guidance (as identified by A. Nellen)
  - a. Which exchange rate should be used? Must the taxpayer get the rate as of the moment of the transaction or the end of the “normal” business day? Or should an average be computed for the day?
  - b. When Bitcoin is used, it is confirmed (through algorithms and the Blockchain). Thus, a specific coin was used or received. Thus, it would seem that specific identification must be used to determine the basis of Bitcoin used (rather than FIFO, if FIFO is even allowed). The default of FIFO is provided at Reg. §1.1012-1(c), but only for securities. For ease of tracking for some taxpayers, should they be allowed to use FIFO? How will the IRS verify gain or loss on use of Bitcoin upon examination?
  - c. Would “mining” ever not be taxable upon discovery? Bitcoin has a finite number of coins. Thus, it seems that a “miner” is finding something of value, rather than creating something from scratch, as would be the case with an artist or carpenter (who would not have income until the item created was sold). Additional guidance from the IRS on the rationale for treating “mining” as income would be useful so as to apply to other types of VCs and to help all Bitcoin miners know the rationale.
  - d. Is mining "production" for §263A purposes? "Produce" is broadly defined, but it is also more like finding rather than creating anything new. But, there can be significant costs involved in mining - equipment, electricity, labor.
  - e. A merchant using an exchange to convert Bitcoin to dollars needs guidance on whether it has the gain or loss to report on any difference in value between Bitcoin when received and when converted and paid by the exchanger (assuming the merchant is using an exchanger). Or, does any gain or loss belong to the exchanger. The answer might depend

on the particular facts and circumstances of the arrangement between the merchant and exchanger.

- f. Broker reporting – Does §6045, *Returns of brokers*, apply to a business that exchanges VC for dollars? Would the broker have to issue a 1099-B or have to track the customer’s basis? The answer may depend on whether VC is considered a “commodity” and IRS interpretation of §6045. In March 2014, Reuters reported that the Commodity Futures Trading Commission was looking into whether it should regulate virtual currencies (“[U.S. swaps watchdog says considering bitcoin regulation.](#)” 3/11/14, Reuters).
- g. §475(e) treatment – whether Bitcoin and other VCs is a “commodity” is also relevant for 475 purposes allowing dealers and traders to possibly mark to market under §475, *Mark to market accounting method for dealers in securities*.
- h. Is Bitcoin considered a foreign financial asset for possible reporting on Form 8938, *Statement of Specified Foreign Financial Assets*? For example, Coinbase ([coinbase.com](#)) advertises that it is “an international digital wallet.” Rules are needed to enable taxpayers to determine where their virtual currency is located.
- i. Like-kind? Is one VC considered like-kind to another VC for §1031 purposes? Is a VC considered like-kind to any other type of investment property? In Rev. Rul. 82-166, the IRS held that gold bullion was not like-kind to silver bullion even if both were held for investment because the nature of the underlying metals was different, and as metals, gold and silver are used differently. In Rev. Rul. 82-96, the IRS held that gold bullion was like-kind to Canadian Maple Leaf gold coins. Because the Canadian coins were not “a circulating medium of exchange” because the value of their gold content was greater than the face value of the coin. Thus, both types of gold were considered bullion-type coins and “like-kind.” Other rulings on this topic from the IRS:

Ruling	Item 1	Item 2	Like-kind?	Rationale
Rev. Rul. 76-214	Mexican 50-peso gold coins	Austrian 100-corona gold coins	Yes	Both coins are bullion-type, with value measured by their gold content. Neither is considered currency in the issuing country. When they are not circulating currencies, the differences “are primarily of size, shape, and amount of gold content.” Thus, the nature or character of the coins is the same.
Rev. Rul. 79-143 (also see GCM 37811 (1/5/79))	\$20 gold numismatic-type coins	South African Krugerrand bullion-type gold coins	No	Although both are gold, the underlying investments are different (bullion-type coins versus numismatic-type coins). In the GCM, the IRS states that the numismatic coins may be valued for their condition, age or beauty, in addition to their gold content. In contrast, bullion coins are valued based on the price of gold.

Rev. Rul. 82-96	Gold bullion	Canadian Maple Leaf gold coins	Yes	While the Canadian coin was legal tender in Canada to its face value of \$50, they were not being used that way because the gold value was greater than \$50. Thus, both coins were viewed as bullion-type coins with similar nature and character.
Rev. Rul. 82-166 (also see GCM 38899 (9/27/82))	Gold bullion held for investment	Silver bullion held for investment	No	Gold and silver are different metals, used in different ways (gold for investment; silver as an industrial commodity). In the GCM, the IRS stated that a taxpayer who exchanges gold bullion for silver bullion “is not in essentially the same economic situation after the exchange as he or she was in before the exchange.” The IRS also noted that gold and silver as commodities were subject to different market forces.
<i>California Federal Life Insurance Company</i> , 76 TC 107 (1981), aff’d 680 F2d 85 (9 <sup>th</sup> Cir. 1982)	Swiss francs	U.S. Double Eagle gold coins	No	The gold coins are of numismatic value, “valued primarily for their rarity, as collector items.” Swiss francs represent a circulating currency. Thus, the items are not of the same nature or character.

- j. No de minimis rule – Even if a taxpayer has a nominal amount of VC, it will need to track the basis when acquired and FMV when used. Query: Section 988(e)(2) allows up to a \$200 per transaction gain exclusion for exchange rate gain if derived from a “personal transaction.” Can the IRS create a de minimis rule or would Congress have to do so? Of course, the 988(e) rules requires tracking to know if one has a gain over \$200. What about a de minimis rule that an individual can exclude VC gains and losses if at no time during the tax year they own more than \$x of VC? Such a rule would benefit an individual with, for example, a Bitcoin wallet that never has more than \$200 FMV and is only used for small transactions.
3. Practical Considerations of Bitcoin and other Virtual Currency
- a. Dealing with uncertainty regarding issues noted above and others.
  - b. Understanding a client’s transactions which likely involve the need to understand technical (for example, software and algorithms) of the VC.

- c. Tracking the basis and FMV of VC when used and getting this information efficiently reported on the tax return.
- d. Asset protection and documentation considerations – Bitcoin is represented by an address. That address might be stored by the owner in a computer file, bitcoin wallet or recorded on a piece of paper. Individuals will want to be sure their bitcoin asset is known to be part of their assets for purposes of documenting transactions, transfer upon death, as a measure of their assets (such as needed for estate tax or bankruptcy or solvency measure).
- e. A business that accepts Bitcoin or other VC from customers will need to determine its tax consequences. If it is handling the transactions through its own wallet, there should not be any tax consequence until the business uses the VC. If the business is using an exchanger or payment processor to convert the Bitcoin to dollars (similar to a company that processes credit card transactions), the details of the arrangement should be reviewed to determine who has the gain or loss for the time between receipt of the Bitcoin or VC and its conversion into dollars – the merchant or exchanger.
- f. Vendors who take bitcoin or other VC may need to get more information from the customer if the goods or services sold are subject to sales tax and the vendor needs to know if it is required to collect in that jurisdiction (if it has nexus).
- g. Ethics: Some people think Bitcoin or other VCs are a way to hide income or money from the government. A Bitcoin transaction can be completed without the merchant knowing the customer's name. However, depending on the transaction, there may be other documentation (such as when goods are shipped to the customer). Tax preparers should be cautious if clients indicate they are using VC for tax planning purposes. Also, individuals who convert Bitcoin or other VC to dollars or vice versa for people, may be required to register with the Treasury Department per the Bank Secrecy Act (see [FIN-2013-G001](#)) and state law (such as governed by the [California Department of Business Oversight](#)) to avoid violating the law. (For example, see California CBO, [What You Should Know About Virtual Currencies](#).)

If your client pays vendors or employees with virtual currency, you may want to check if the client has verified if any federal or state laws apply to them.

If concerned about a client's activities, such as because they are unaware of possible regulation applicable to their exchange activities, you should refer them to an attorney.

#### 4. Other Government News on VC

- a. SEC – On 5/7/14, the SEC issued an [“investor alert”](#) that states that Bitcoin investments “may have heightened risk of fraud.” Per the SEC, “users may be targets for fraudulent or high-risk investment schemes.” It notes that investors have limited recovery options and “unique risks” exist.
- b. FinCEN (Treasury Department) – Two [rulings](#) were released in January 2014 on the application of FinCEN regulations to
  - i. Mining of virtual currency
  - ii. Software development and certain investment activity
- c. Department of Justice – in a [1/28/14 press release](#), the DOJ announced that charges were brought against specified Bitcoin exchangers related to “Silk Road” drug trafficking.

#### 5. Author's [website](#) on Virtual Currency and Taxation.



## Practice & Procedure

### Code Interpretations

1. Veterinary Clinics and 1099-MISCs – In [CCA 201349013](#) (12/6/13), the IRS held that a corporation that provides veterinary services is considered engaged in providing medical and healthcare services under §1.6041-3(p)(1). Therefore, is it not an exempt payee. A business (such as a zoo or pet shop) that pays \$600 or more to such a corporation must issue it a 1099-MISC. The IRS relief on Rev Rul 91-30 that held that a veterinarians provided services in the field of health for §448 qualified personal service corporation purposes. In contrast, the §4191 medical device excise tax limits the term “medical” and “healthcare” to treatment of humans.
2. Fast-Track Settlement for Small Business – the IRS has made permanent a trial program started in 2006. This program uses alternative dispute resolution techniques to resolve audit issues more quickly (generally 60 days or less). It is modeled under a program used in the LB&I Division. See [IR-2013-88](#) (11/6/13) and fast-track [website](#).
3. Refundable Tax Credits and Calculation of Substantial Understatement Penalty – in [Rand and Klugman](#), 141 TC No. 12 (11/18/13), the court held that in “determining the amount shown as tax on the return under I.R.C. sec. 6664(a)(1)(A), the earned income credit, additional child tax credit, and recovery rebate credit are taken into account but do not reduce the amount shown as tax below zero.” Thus, for purposes of calculating §6662 penalties, the refundable credits do not yield negative tax liability.

### IRS Activities and Programs

1. IRS Adopts Taxpayer Bill of Rights – In June 2014, the IRS announced that it had adopted a “Taxpayer Bill of Rights” ([IR-2014-72](#) (6/10/14)). They have been posted and explained on an IRS [website](#) and added to Pub 1, Your Rights as a Taxpayer.” The 10 rights are:
  - i. The Right to Be Informed
  - ii. The Right to Quality Service
  - iii. The Right to Pay No More than the Correct Amount of Tax
  - iv. The Right to Challenge the IRS’s Position and Be Heard
  - v. The Right to Appeal an IRS Decision in an Independent Forum
  - vi. The Right to Finality
  - vii. The Right to Privacy
  - viii. The Right to Confidentiality
  - ix. The Right to Retain Representation
  - x. The Right to a Fair and Just Tax System
2. IRS Services – In [Pub 5136](#), the IRS lists and briefly explains the services it provides to help taxpayers and practitioners, such as IRS Tax Map, checking the status of a refund, and obtaining a transcript.
3. Regulating Paid Return Preparers – The IRS program rolled out in 2010 hit a significant roadblock in February 2014 with the DC Circuit Court of Appeals ruled for the unenrolled preparers in the *Loving* case.
  - a. Per IRS data on who has a PTIN, the majority of preparers are not a CPA, attorney or Enrolled Agent. During 2011, the National Taxpayer Advocate estimates that about 54% of returns were prepared by unregulated paid preparers. [NTA, [2013 Annual Report to Congress](#), pp. 61–62.]
  - b. The Senate Finance Committee held a [hearing](#) on 4/8/14 – Protecting Taxpayers from Incompetent and Unethical Return Preparers.



- i. GAO testimony released for the hearing addresses a limited study in which GAO found that preparers “made significant errors.” [[GAO-14-467T](#), 4/8/14]
    - ii. Joint Committee on Taxation report – *Present Law and Background Related to the Regulation of Conduct of Paid Tax Return Preparers* ([JCX-34-14](#); 4/4/14).
  - c. The government did not ask the US Supreme Court to hear the case.
  - d. See Nellen, [Regulating all return preparers: Back to the drawing board](#); *AICPA Tax Insider*, 3/13/14.
  - e. In May 2014, the IRS [announced](#) that due to the *Loving* decision, practitioners sanctioned under Circular 230 between August 2, 2011 and February 11, 2014, may obtain or renew PTINs and prepare federal tax returns.
4. Voluntary Registration Program?
- a. In April 2014, the IRS suggested to its registered CE providers that it was considering a voluntary certification program called an Annual Filing Season Certification (AFSC). It would involve completing 15 hours of CE annually through an IRS-approved CE provider. Unenrolled preparers would need to be sure the 15 hours included three hours of a filing season refresher course with a comprehension test. A “confidential” memo was sent to IRS CE providers with more details on 5/8/14. Details were apparently also shared with practitioner organizations because the AICPA and NAEA both submitted comments to the IRS expressing concerns with such a voluntary program and urging the IRS not to pursue it.
  - b. As noted by the AICPA in its [letter](#) of 5/21/14: “As a practical matter, any voluntary regime constructed would still not address the problems with unethical and fraudulent tax return preparers. Finally, we are concerned that that the IRS is rapidly moving forward without widely disseminating the proposal or seeking public comments.” The AICPA also noted that the certification would create confusion in the marketplace. In addition, the AICPA noted that the IRS should move actively pursue the penalties it has authority to administer such as under Sections 6694 and 6695.
  - c. Summary of the NAEA position was reporting in *Accounting Today*, 6/1/14, “[NAEA ‘Troubled’ Over Certification Proposal](#),” by Stimpson. The NAEA also submitted [testimony](#) for the record for the April 8, 2014 Senate Finance Committee [hearing](#) on Protecting Taxpayers from Incompetent and Unethical Return Preparers. In this testimony, the NAEA stated: “In the interest of long run stability, NAEA believes taxpayers and the tax administration system are best protected by national standards for all paid return preparers and oversight of the entire community.”
5. Identity Theft Resources and Information
- a. IRS – [FS-2014-1](#) (Jan 2014) – IRS Combats Identity Theft and Refund Fraud on Many Fronts.
  - b. IRS – [FS-2014-2](#) (Jan 2014) – Tips about Identity Theft.
  - c. IRS report on work to combat ID theft – [IR-2014-50](#) (4/10/14).
  - d. DOJ – 2/24/14 [press release](#) on efforts to address tax refund fraud – from 2008 through May 2012, over 550,000 taxpayers had their identities stolen so the thief could claim a false tax refund.
  - e. AICPA Checklists (for members):
    - i. [Identity Theft Checklist](#)
    - ii. [Guide on Best Practice for Keeping Client Data Secure](#)

## Rules of Conduct

1. Circular 230 Changes Finalized – In June 2014, Treasury issued final regulations ([TD 9668](#) (6/12/14)) related to proposed regulations issued in 2012. Key changes include:
  - a. Covered opinion rule at 10.35 was removed. This was one of the longest (and most confusing) parts of Circular 230. It was also the provision that led practitioner to include penalty disclaimers in emails and elsewhere. Such disclaimers are no longer needed (although preparers may want to include disclaimers that make any communications more clear to the recipient). For details, see new §10.37, Requirements for written advice. (CPAs who are members of the AICPA should also see SSTS No. 7.)
  - b. Written advice – new §10.37 provides that written advice must be based on “reasonable factual and legal assumptions (including assumptions as to future events).” Also, reliance on advice from others is not reasonable if they know it should not be relied upon or that the other person is “not competent or lacks the necessary qualifications to provide the advice” or knows the other person has a conflict of interest.
  - c. General standard of competence – new §10.35 requires a practitioner to have “the appropriate level of knowledge, skill, thoroughness, and preparation necessary for the matter for which the practitioner is engaged.”
  - d. Procedures to ensure compliance – §10.36 was modified to require a person in a firm, subject to Circular 230, who has “principal authority and responsibility for overseeing a firm’s practice governed” by Circular 230 to be sure appropriate procedures for compliance are in place and that they are followed.
  - e. Electronic negotiation of taxpayer refunds – §10.31 was updated to make it clear that not only may a practitioner not endorse or negotiate a tax refund, but may not direct or accept payment by any means of a taxpayer refund.
2. Office of Professional Responsibility Enforcement Activities
  - a. In 2013, 11 tax professionals were disbarred from practice before the IRS compared to only two in 2012. ([1/29/14 OPR press item from BNA](#)).
  - b. Per the [OPR disciplinary stats website](#), activity for [2013](#) was as follows:

<b><u>Activity</u></b>	<b><u>Attorney</u></b>	<b><u>CPA</u></b>	<b><u>EA</u></b>	<b><u>Other</u></b>	<b><u>Totals</u></b>
Total Receipts					<b>784</b>
Disbarments (FAD/Consent)	1	4	4	2	<b>11</b>
Suspensions (FAD/Consent)	1	1	1	-	<b>3</b>
Expedited Suspensions	16	24	4	4	<b>48</b>
DDA	2	4	6	1	<b>13</b>
Censure	-	2	-	1	<b>3</b>
Reprimand/Soft Letter					<b>128</b>
Cease & Desist					<b>25</b>
CWOS, CWOA, Referred, Other					<b>509</b>
Reinstatement Request					<b>26</b>
Total Dispositions	20	35	15	8	<b>766</b>

- c. OPR is seeking information about tax practitioners who entered the OVDI program because such activity indicates a Circular 230 violation. OPR is also interested in

knowing about any practitioners who helped clients hide offshore accounts. ([1/29/14 OPR press item from Tax Notes Today](#))

3. CPA's Connection to Improper Deductions – In June 2014, the Department of Justice announced that a CID investigation led to a CPA pleading guilty to assisting a business client in preparing false returns for five years ([DOJ press release of 6/5/14](#)). Deductions were claimed for personal expenses. Per the DOJ:
  - a. The CPA “admitted that after the false return was filed with the IRS on behalf of [client], he created a false summary that he retained in his records to support the false income reported on that return.”
  - b. “At sentencing, Couchot faces a statutory maximum sentence of three years in prison, a \$250,000 fine and one year of supervised release for each of the two charges.”
4. AICPA Standards for Personal Financial Planning – AICPA members providing personal financial planning (PFP) services are subject to a new ethics statement effective July 1, 2014. This new item is the [Statement on Standards in Personal Financial Planning Services No. 1](#). Generally, the statement applies if a member provides PFP services and either (i) represents to the public or clients that they provide PFP services, (ii) engage in activities requiring registration as an investment adviser per federal or state law, or (iii) sell a product as an outcome of an engagement. Details are in the Statement and see additional [resources](#) from the AICPA Personal Financial Planning Section.

Responsibilities covered include competency with PFP principles and theory, identifying and addressing conflicts of interest, exercising professional judgment in obtaining and analyzing information, documentation, and more.

AICPA [FAQs](#) are provided.

*Observations:* An AICPA member providing tax planning might find they are not subject to the PFP standard. However, they would be subject to the AICPA Rules of Professional Conduct and the AICPA SSTSS.

## California

### **Conformity**

The FTB's annual [conformity report](#) for 2013 is 205 pages long. It lists federal changes in 2013, such as tax rates, and the relevance to California tax calculations. It also lists federal legislation that does not impact California (such as legislation to expand the vaccine excise tax). Also see [FTB conformity website](#).

### **Miscellaneous**

1. FTB [instructions](#) on how to pay business tax liabilities via credit card. Other payment options are described on the FTB “[Payment Options](#)” website.
2. Fire Fee – per a 3/28/14 [memo](#) from the BOE, the fire prevention fee for FY 2013-14 is \$152.33 per habitable structure. Some structures are entitled to a \$35 reduction.
3. BOE Makes Data Available Online – On 5/1/14, BOE Member Betty Yee [announced](#) that the BOE launched the “Open BOE Data Portal” allowing access to historical data.

<http://www.boe.ca.gov/dataportal/>

### Samples of data:

Taxes collected in 1933-1934	\$33,129,000
Number of permits	0
Taxes collected in 2012-2013	\$21,056,390,000
Number of permits	1,052,655 + 111,491 use tax permits

### Use tax reported on FTB returns:

## Basic Statistics for Sales and Use Tax and Property and Special Taxes

[OPEN BOE](#) » Use Tax Reported on Franchise...

[Help](#) | [Feedback](#)

### USE TAX REPORTED ON FRANCHISE TAX BOARD (FTB) RETURNS

Fiscal Year	Category	Value
2004-05	Use Tax Reported (Millions of \$)	3.68
2005-06	Use Tax Reported (Millions of \$)	4.55
2006-07	Use Tax Reported (Millions of \$)	5.65
2007-08	Use Tax Reported (Millions of \$)	6.14
2008-09	Use Tax Reported (Millions of \$)	10.42
2009-10	Use Tax Reported (Millions of \$)	11.63
2010-11	Use Tax Reported (Millions of \$)	12.43
2011-12	Use Tax Reported (Millions of \$)	15.83
2012-13	Use Tax Reported (Millions of \$)	17.67

## Looking Forward

### 1. Treasury/IRS Priority Guidance Plan

- a. [Notice 2014-18](#) – IRS seeking comments for items for their “to do” list for 2014-2015, by 5/1/14. In determining what should go on the list, Treasury and IRS consider the following:

- “1. Whether the recommended guidance resolves significant issues relevant to many taxpayers;
2. Whether the recommended guidance promotes sound tax administration;
3. Whether the recommended guidance can be drafted in a manner that will enable taxpayers to easily understand and apply the guidance;
4. Whether the recommended guidance involves regulations that are outmoded, ineffective, insufficient, or excessively burdensome and that should be modified, streamlined, expanded, or repealed;
5. Whether the Service can administer the recommended guidance on a uniform basis; and
6. Whether the recommended guidance reduces controversy and lessens the burden on taxpayers or the Service.”

- b. The current plan and updates can be found here - <http://www.irs.gov/uac/Priority-Guidance-Plan>.
  - c. The plans tend to have over 200 projects on them!
- 2. Federal Tax Reform
  - a. AICPA's Tax Reform Center [website](#)
  - b. Professor Nellen – <http://www.21stcenturytaxation.com>
- 3. Congressman Camp's [Tax Reform Act of 2014](#) discussion draft and related documents.
- 4. Senator Baucus [Discussion Drafts](#) for Tax Reform (2013-2014)
- 5. Links to various tax reform proposals and reports - [http://www.cob.sjsu.edu/nellen\\_a/txrefupd.html](http://www.cob.sjsu.edu/nellen_a/txrefupd.html)

**Disclaimer**

This information is provided for educational purposes. Many of the topics covered could easily be individual lessons on their own. This update serves as awareness of key developments and the basics of each. It is not intended to answer specific tax questions or provide details of the underlying law noted in each update. Application of any item requires the user to consult the primary authority referenced and related rules, and consider the particular facts at hand.

# Startup Expenses

Michael Adams, Group Manager, IRS  
Masha Herzbrun, CPA - Sensiba San Filippo LLP

**IRS-SJSU**  
**Small Business Tax Institute**  
*Assisting New and Growing Businesses*  
**June 18, 2014**



## New Business Expenses

June 18th, 2014  
Presenter: Masha Herzbrun, CPA

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## Types of Expenses

- Start-up (IRC 195) – costs otherwise ordinary and necessary under IRC 162
- Organizational (IRC 248, 709) – costs of formation (legal fees, filing fees)
- Syndication (IRC 709(a)) – costs of promoting or selling partnership interest
- Research & Development Costs (IRC 174)

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## Start-up Costs Defined

IRC Section 195(c)(1):

Start-up costs are amounts paid/incurred in:

- (a) investigating the creation or acquisition of an active trade or business,
- (b) creating a new active trade or business,
- (c) any preopening activity occurring in anticipation of the commencement of a trade or business.

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## Examples of Start-Up Costs

- An analysis or survey of potential markets, products, labor supply, transportation facilities, etc.
- Advertisements for the opening of the business.
- Salaries and wages for employees who are being trained and their instructors.
- Travel and other necessary costs for securing prospective distributors, suppliers, or customers.
- Salaries and fees for executives and consultants, or for similar professional services.

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## Tax Treatment

Deemed Election under Reg. 1.195-1:

Deducting and amortizing start-up costs.

2013 Start-up Costs = \$18,000

Deduct = \$5,000 (reduced \$-for-\$ but not below zero for the cumulative start-up costs exceeding \$50,000.

Amortize = \$13,000 over 180-month period beginning at the time active trade or business begins

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## Tax Treatment Continued

Affirmative Election under Reg. 1.195-1(b):

Allows to capitalize its start-up expenditures.

The election statement should indicate the following:

- Election to capitalize under Reg. 1.195-1(b)
- Describe Costs
- Date Incurred
- Amounts

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## What if. . .

Taxpayer fails to take a deduction for start-up costs and does not make a separate election to forego the deduction:

### ***Incorrect Accounting Method***

If left uncorrected for two or more years, under IRC 446 and 481(a), the taxpayer would have to request a change in accounting method (Form 3115)

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## Non-Qualifying Start-Up Costs

- Interest
- Taxes
- Research and experimental costs (IRC 174, 59(e))
- Depreciation – excluded under IRC 167(a)(1)

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## Organizational Costs

- 1) Legal fees incurred in drafting agreement, bylaws
- 2) Filing fees for registering with state and local authorities
- 3) Other related costs

### Non-Qualifying Organizational Costs:

- Costs for issuing and selling stock or securities, such as commissions, professional fees, and printing costs.
- Costs associated with the transfer of assets to the corporation.

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## Tax Treatment

Deemed Election to Deduct and Amortize under IRC 248 and 709(a):

Allowed to deduct amount equal to the lesser of:

- a. The amount of organizational costs, or
- b. \$5,000 (reduced \$-for-\$ by the amount that exceeds \$50,000 but not below zero; similar to start-up costs)
- c. The remainder must be amortized over 180-month period (15 years) once active trade or business begins.

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## Tax Treatment Continued

Affirmative Election under Reg. 1.248-1 and 1.709-1(b)(2):

Allows to capitalize its organizational expenditures. The election statement should indicate the following:

- Election to capitalize under Reg. 1.709-1(b)(2)
- Describe Costs
- Date Incurred
- Amounts

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## Tax Benefit

Partnership

- Decrease in the capital gain or increase in the capital loss
- Capital treatment, not ordinary
- If amortized, the deduction is subject to phase out on Form 1040 Sch A, hence not many taxable LP's (especially GP's) are able to take advantage of this expense.

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## Syndication Costs

- 1) Fees and commissions paid to brokers to sell interests
- 2) Costs for printing the offering memoranda
- 3) Legal and accounting fees for tax opinions and projections of income or cash flow

Syndication costs can occur any time a partnership interest is marketed to investors.

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## Tax Treatment

- Nondeductible expenditure
- Charged to capital (permanently capitalized)
- They do not reduce the outside tax bases of the partners' interest in the partnership (IRC 705)
- No benefit UNTIL:
  - Selling of partnership interest
  - Partnership liquidation

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## Tax Treatment Continued

- Only affects partner's capital gain or loss
- If syndication is abandoned, the accrued syndication costs are nondeductible but remain capitalized
- Technical termination (IRC 708)
  - IRC 709(a) is silent as to deductibility
  - Statute's intent is to prohibit these expenses from being deductible

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## Research & Development

- Reasonable costs incurred in trade or business for activities intended to provide information to help eliminate uncertainty about the development or improvement of a product.
- Whether expenses qualify as R&D depends on the nature of the activity to which these expenditures relate.
- Include all expenses incident to the development or improvement of a product, including expenses of obtaining a patent, attorney's fees related to patent application.

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## Product

- Formula
- Invention
- Patent
- Pilot Model
- Process
- Technique
- Similar Property

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## Expenditures Not Included

- Quality control testing
- Advertising or promotions
- Consumer surveys
- Efficiency surveys
- Management studies
- Research in connection with literary, historical, or similar projects
- Acquisition of another's patent, model, production, or process.

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## Tax Treatment

- The expenditures of research and development (“R&D”) are generally capital expenses.
- May deduct in the tax year, in which paid or incurred (Sec 174)
- May amortize such expenditures over a period of not less than 60 months (IRC 174(b))
- Write-off ratably over a 10-year period (IRC 59(e)) – affirmative election

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## When does a Business Commence?

Organization Costs (Sec 248 and 709):

- In the month it starts the business operations for which it was organized
- Acquisition of operating assets necessary to conduct business

Start-up Costs (195 and 162)

- Active trade or business begins
- Economic benefit / revenue
- Product available

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## Continued. . .

- Sections 248 and 709 provide that organizational expenses of corporations and partnerships must be treated as deferred expenses and “ allowed as a deduction ratably over [a] 180-month period ....” However, IRC §195(a) clearly states that “ [e]xcept as otherwise provided in this section, no deduction shall be allowed for start-up expenditures.
- Uncertainty due to failure to use identical language in describing trade or business in different Code sections
- What we DO know is: signing agreements and / or registering to do business in a state does not constitute the beginning of business

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## IRS/SJSU Small Business Tax Institute

# Start-Up Expenses

– *An Auditor’s Perspective*  
– *IRC: 195, 709 & 248*



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Date: June 18, 2014

## Definition of Start-Up Expenses

IRC 195 (c) - (1) **Start-up expenditures** The term “start-up expenditure” means any amount—

(A) paid or incurred in connection with—

- (i) **investigating** the creation or acquisition of an active trade or business, or
- (ii) **creating** an active trade or business, or
- (iii) any **activity engaged in for profit and for the production of income** before the day on which the **active trade or business** begins, in anticipation of such activity becoming an active trade or business, and...



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## Definition of Start-Up Expenses - Continued

IRC 195 (c) - (1) **Start-up expenditures** The term “start-up expenditure” means any amount—

(B) which, if paid or incurred in connection with the operation of an existing active trade or business (in the same field as the trade or business referred to in subparagraph (A)), would be allowable as a deduction for the taxable year in which paid or incurred.

The term “start-up expenditure” **does not include** any amount with respect to which a deduction is allowable under section **163 (a), 164, or 174.**



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## Deductible Non Start-Up Expenses

Taxes (IRC 164)  
Interest (IRC 163)  
Research & Experimental  
expenditures (IRC 174)



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## Start-Up Capitalized Expenses

IRC 195

(a) **Capitalization of expenditures** - Except as otherwise provided in this section, no deduction shall be allowed for start-up expenditures.



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## Examples of Other Costs Not Included in Start-Up Expenses

- Routine ongoing efforts to refine, enrich or otherwise improve quality of existing products or services.
- Costs of acquiring or constructing long lived assets.
- Cost of acquiring or producing inventory.
- Business expansion costs.



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## Example of Costs Included in Start-Up Expenses

- Advertising expenses
- Salaries and wages paid to employees being trained
- Payments to the instructors training employees
- Executive pay
- Consultant expenses
- Professional services
- Non-recurring costs associated with setting up a business



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## Amortization Period

Start-up expenditures are amortized over 180-months beginning with the month in which the active trade or business begins. §195(b)(1)(B).



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## What is the Start of an Active Trade or Business?

- An active trade or business begins when the taxpayer begins to function as a going concern and performs activities for which it was organized.
- An acquired active trade or business begins when the taxpayer acquires it. §195(c)(2)(B).



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## A Going Concern?

- Whether your activity is a going concern is a facts and circumstances oriented problem. See the example below:

*An individual who paid start-up expenses for a retail business was not entitled to deduct those expenses in the year he incurred them because the business did not begin operating until the following year.*

- *R.F. Bernard*, 75 TCM 1594, TC Memo. 1998-20.



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## A Going Concern - Continued

- See another example:

*The corporation engaged in significant testing of the product before it was ready for sale. The date that active business began was the date that the manufacturing process met the required standards, production resulted in products that were ready for sale, and the corporation was ready to receive revenue from the sale of the products.*

- IRS Letter Ruling 9047032, August 27, 1990.



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## Investment vs. Business Acquisition as Start-Up Costs

The point at which a taxpayer makes its decision whether to acquire a business and which business to acquire is the point at which expenses related to the acquisition are capital in nature.

Rev. Rul. 99-23



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## Examples of Start-Up Costs Before Acquisition

- Analysis or survey of potential markets, products, labor supply, transportation facilities
- Industry research
- Review of public financial information
- Legal fees
- Brokerage Fees
- Accounting Fees
- Appraisal Fees



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## Examples of Non-Start-Up Costs After Acquisition

- Amounts paid or incurred as part of the acquisition cost of a trade or business
- Property which may be depreciated
- Costs of acquiring or producing inventory
- In-depth review of books and records
- Appraisals of assets after the whether and which decision
- Costs to facilitate an acquisition
- Legal fees
- Brokerage Fees
- Accounting Fees
- Appraisal Fees



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## IRC 709 - Treatment of Organizational Costs

Note: Publication 583, included:

- IRC 709 Organizational Costs paid or incurred to organize a Partnerships are subject to the same capitalization rules as IRC 195 Startup Costs after October 22, 2004.
- See IRC 709(b) for election rules.



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## IRC 709- Treatment of Organization Costs

709(b)(3) Organizational expenses defined.

The organizational expenses to which paragraph (1) applies, are expenditures which

709(b)(3)(A) are incident to the creation of the partnership;

709(b)(3)(B) are chargeable to capital account; and

709(b)(3)(C) are of a character which, if expended incident to the creation of a partnership having an ascertainable life, would be amortized over such life.



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## Example of Costs Included in IRC 709 Organizational Costs

- Legal fees for services incident to the organization of the partnership, such as negotiation and preparation of a partnership agreement;
- Accounting fees for services incident to the organization of the partnership; and
- Filing fees.



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## Example of Non-IRC 709 Organizational Costs

- Expenses connected with acquiring or transferring assets for the partnership;
- Expenses connected with the admission or removal of partners other than at the time the partnership is first organized;
- Expenses connected with a contract relating to the operation of the partnership trade or business (even where the contract is between the partnership and one of its members); and syndication expenses.



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## IRC 709 - and Syndication Fees

Regulation: 1.709-2., Definitions

- (b) Syndication expenses...are expenses connected with the issuing and marketing of interests in the partnership.
  - Some examples include: brokerage fees; registration fees; legal fees; accounting fees; and printing costs of the prospectus,
  - These expenses are not subject to the election under IRC 709(b) and must be capitalized.



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## IRC 248- Organizational Costs

Note: Publication 583, “also” includes:

– IRC 248 Organizational Costs paid or incurred to organize a Corporation are subject to the same capitalization and election rules as IRC 195 Startup Costs after October 22, 2004.

- See IRC 248(a) for election rules.



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## IRC 248- Organizational Expenditures

248(b) Organizational Expenditures Defined.

—The term “organizational expenditures” means any expenditure which —

248(b)(1) is incident to the creation of the corporation;

248(b)(2) is chargeable to capital account; and

248(b)(3) is of a character which, if expended incident to the creation of a corporation having a limited life, would be amortizable over such life.



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## Example of Costs Included in IRC 248 Organizational Costs

- Legal services incident to the organization of the corporation, such as drafting the corporate charter, by-laws, minutes of organizational meetings, terms of original stock certificates, and the like;
- Necessary accounting services;
- Expenses of temporary directors and of organizational meetings of directors or stockholders; and
- Fees paid to State of incorporation.



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## Example of Non-IRC 248 Organizational Costs

- Expenditures connected with issuing or selling shares of stock or other securities, such as commissions, professional fees, and printing costs.
- Expenditures connected with the transfer of assets to a corporation.
- Expenditures connected with the reorganization of a corporation, unless directly incident to its creation are not organizational expenditures.



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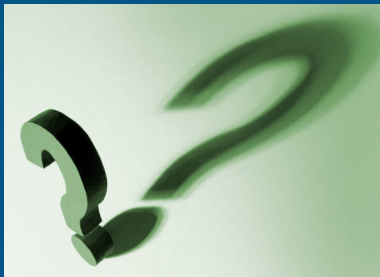
## IRS Guidance on Start-Up Expenses

- Publication 583, Starting a Business and Keeping Records
- Publication 535 Business Expenses
- Publication 334 Tax Guide for Small Businesses
- Publication 1066-C, Virtual Small Business Workshop DVD
- Visit IRS.gov – use search keywords “startup expenses”



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## Questions



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# Worker Classification – Hiring Correctly

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IRS Small Business/Self-Employed Division  
(by phone)

• **Note: Slides without IRS logo are from Todd and Rona.** •

## Independent Contractor or Employee?

- For federal and state tax purposes this is an important distinction
- Affects how you pay income tax
- How you pay social security/Medicare tax
- How you file tax returns
- Affects eligibility for social security and Medicare benefits

## Original Common Law Factors have been modified

- Original 20 common law Factors
- Now replaced with three categories
  1. Behavior Control
  2. Financial Control
  3. Relationship of the Parties

## Rev. Rul. 87-41 Original Common Law Factors

- In 1987 IRS issued Rev. Rul.
- Over the years courts identified case-by-case various facts or factors
- Relevant in determining employer-employee relationships

## Rev. Rul 87-41

### Original Common Law Factors

1. Instructions
2. Training
3. Integration
4. Services rendered personally
5. Hiring, supervision, and paying assistants
6. Continuing relationships
7. Set hours of work
8. Full time required
9. Doing work on employer's premises
10. Order or sequence test

## Rev. Rul. 87-41

### Original Common Law Factors

11. Oral or written reports
12. Payment by the hour, week, or month
13. Payment of business and/or traveling expenses.
14. Furnishing tools and materials
15. Significant investment
16. Realization or profit or loss
17. Working for more than one firm at a time
18. Marking service available to the general public
19. Right to discharge
20. Right to terminate

## New Way of Looking at the Issue

### IRS Three Categories of Evidence

1. Behavior Control
2. Financial Control
3. Relationships of the Parties

## Behavior Control

Directing and controlling how the work is done. Who controls:

- When, Where, or how to do the job?
- What tools or equipment to use?
- What work must be performed by individual?
- What order or sequence to follow when working?
- What supplies and services are used?
- Where to acquire supplies and services?
- Training and procedures?
- Meetings and reports?

Or who retains the right to control?

## Behavioral Control

### Degree of Instruction

Generally, the more detailed the instructions, the more control the business exercises over the worker.

More detailed instructions indicate that the worker is an employee. Less Detailed instructions reflects less control, indicating the worker is more likely an independent contractor.

## Behavioral Control

### Training

If the business provides the worker with training on how to do the job, this indicates that the business wants the job done in a particular way.

This is strong evidence that the worker is an employee. Periodic or on-going training about procedures and methods is even stronger evidence of an employer-employee relationships.

Conversely, independent contractors ordinarily use their own methods.

## Financial Control

### Directing and Controlling the Business Aspects of the Worker's Job

- Who controls the assets?
- Who controls method of payments?
- Are expenses reimbursed?
- Are services available to relevant market?
- Is there opportunity for profit or risk of loss?

## Financial Control Significant Investment

- An independent contractor often has a significant investment in equipment used.
- Certain trades this rule doesn't apply, construction trades for example often have their own tools.
- Materiality levels?

## Financial Control

### Unreimbursed Expenses

- Independent contractors are more likely to have unreimbursed expenses than are employees.
- Fixed ongoing costs that are incurred regardless of whether work is currently being performed are considered.
- Certain employees can have unreimbursed expenses in connection with services they do for their

## Financial Control

### Opportunity for Profit or Loss

- If significant investments in tools and unreimbursed expenses there is a greater change the individual may loss money on the activity.
- The possibility of losing money is a strong indicator of independent contractor status.

## Financial Control Method of Payment

- Employees generally are guaranteed a regular wage
- Hourly, weekly, or other period of time
- Even if wage supplemented by commissions
- An independent contractor is usually paid by a flat fee for the job, or may receive hourly rates such as in the performance of professional services (legal, accounting)

## Types of Relationships Relationship of the Parties

The way the business and the worker perceive their relationship (their intent). Issue to consider:

- Fringe benefits
- Ability to discharge or terminate
- Worker integration into business
- Permanency of relationship
- Written contracts



## Types of Relationships

### Written Contracts

- Written contracts specifying employee or independent contractor status NOT always controlling.
- IRS doesn't have to follow the contract status.
- How the parties work together determines employee or independent contractor status.

## Types of Relationships

### Employee Benefits

- Employee benefits include such things are insurance, pension plans, vacation, sick leave, disability insurance.
- Such benefits indicate employee status.
- Generally fringe benefits are not provided to independent contractors.

## Types of Relationships

### Permanency of the Relationships

- Employee generally have continued employment, often for years and years.
- Independent contractors generally work on a project basis, which may or may not repeat.

## Types of Relationships

### Services Provided as Key Activity of the Business

- If the worker provides services that are a key aspect of the business it is more likely that the business will have the right to direct and control the activities.
- This factor can become difficult to determine and distinguish.

Take the example of hiring a lawyer:

- Who hired the lawyer? What business?
- an individual party (client) hires a lawyer,
- or a company hires an internal counsel,
- or a law firm hires a staff attorney.

The determination changes based upon the above questions.

## Statutory Employee

Even if independent contractors qualify under common law rules to be independent contractors some workers may nevertheless be treated as employees by statute (statutory employees) for certain employment tax purposes.

## Statutory Employee

### Four categories

1. Certain drivers (beverages (not milk) meat, vegetables, fruit, baked goods, laundry)
2. Full-time insurance sales agents,
3. Certain home workers, if working on materials you supply that must be returned to you, and you give instructions,
4. Full-time traveling or city salespersons who works on your behalf and turns in orders to you from others (wholesales, retailers, contractors, hotels, restaurants)

And who meet the following Social Security and Medicare tax conditions (on next slide)

## Statutory Employee Social Security and Medicare Tax Conditions

Withhold Social Security and Medicare Taxes from the wages of statutory employees if all three of the following conditions apply.

1. The service contract states or implies that substantially all the services are to be performed personally by them.
2. They do not have a substantial investment in the equipment and property used to perform the services (other than an investment in transportation facilities).
3. The services are performed on a continuing basis for the same payer.

## Statutory Non-Employee Three Categories

1. Direct sellers
2. Licensed real estate agents
3. Certain companion sitters (if not employed by an agency, and you didn't hire the agency).

For 1 and 2 above payments must be for services as direct sellers or real estate agents related to sales or output and not based upon number of hour worked, and services are performed based upon a written contract providing they will not be treated as employees for Federal tax purposes.

## Consequences of Misclassification of Employees

If you classify an employee as an independent contractor and you have no reasonable basis for doing so, you may be held liable for employment taxes for that worker.

### Why it Really Matters in California

1. Specific Liability for misclassifying (Labor Code Sec. 226.8)
2. Advisors face liability (Labor Code Sec. 2753)
3. Issues do not always arise with the IRS first

## California Specific Liability

1. Unlawful to willfully misclassify
2. \$5,000 to \$15,000 fine for first violation
3. \$10,000 to \$25,000 fine if there is a pattern and practice
4. If the employer is a licensed contractor: CSLB will initiate disciplinary action
5. Public notice required (website or on premises) for one year

## California Specific Liability “Willful Misclassification”

“Willful misclassification”  
means:

avoiding employee status  
for an individual by  
voluntarily and knowing  
misclassifying that individual  
as an independent  
contractor.

## Advisor Liability

A person who, for money or other valuable consideration, knowingly advises and employer to treat an employee as an independent contractor is jointly and severally liable if there was a misclassification.

Exempted from liability:  
employees who give advice to their employers, and attorneys.

## Other Agencies Where Issue Can Arise

- California Labor Commission (wage claims)
- U.S. Department of Labor (wage claims)
- Workers' Compensation Appeals Board (Injury claims)
- Employment Development Department (Unemployment claims)

# The Voluntary Classification Settlement Program (VCSP)



Presenter: Gerry Kelly-Brenner

IRS Senior Stakeholder Liaison

## What is VCSP?

- Voluntary Classification Settlement Program
- Similar to CSP offered in exams
- Allows taxpayers to voluntarily reclassify workers as employees for future tax periods
- Provides partial relief from federal employment taxes





## VCSP Eligibility

Eligible taxpayers:

- Must be currently treating workers as nonemployees
- Must have consistently treated workers as nonemployees, including having filed 1099s for past 3 years
- Cannot be under an IRS employment tax audit or worker classification audit by DOL or state agency



## VCSP Application Process

- Complete Form 8952, Application for Voluntary Classification Settlement Program
- File 60 days prior to treating workers as employees
- IRS reviews application to verify eligibility and contacts the taxpayer to complete the process



## VCSP Acceptance

- IRS prepares and sends a closing agreement for taxpayer signature
- Taxpayer sends full payment with signed closing agreement to IRS
- IRS sends the finalized closing agreement for taxpayer records



## VCSP Advantages

- The application and process are simple
- Taxpayers pay a reduced rate (Section 3509(a)) with no interest and no penalties on this amount
- Results in just over 1% of amounts paid to workers for the past completed year
- Audit protection for past years on workers being reclassified
- Program provides certainty for Federal Employment Tax purposes



## Resources

- Form 8952 and instructions
- VCSP pages of IRS.gov, including FAQs
- Announcement 2012-45



## Questions



Joining for questions:

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