# Tax Digest

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

January 2014

## FEDERAL

### Affordable Care Act impact on certain health care plans

*Jill Harris, Director, Washington National Tax*
*Bill O'Malley, Director, Washington National Tax*

The IRS recently issued Notice 2013-54, which impacts tax-favored arrangements for paying employee health insurance premiums and medical expenses. The affected arrangements include section 125 cafeteria plans, premium-only plans, premium reimbursement plans, health reimbursement arrangements, medical expense reimbursement plans (also known as section 105 plans) and health flexible spending accounts. Effective for plan years beginning in 2014, employers generally may not offer tax-favored treatment for individual health insurance policies through any of these arrangements. In addition, arrangements that reimburse employees for certain out-of-pocket medical expenses will need to be integrated with a group health plan. Employers may need to restructure or terminate these arrangements in order to avoid a $100-per-day-per-employee excise tax on the employer.

### A reminder on IRS notices relating to merchant card and third-party network transactions reported on Form 1099-K

*Bob Adams, Partner, Washington National Tax*
*Patti Burquest, Principal, Washington National Tax*

An article in the January 2013 Tax Digest alerted readers that the IRS had begun issuing notices to taxpayers relating to merchant card and third-party network transactions reported on Form 1099-K. The 2013 Forms 1099-K will be issued soon. It is timely to emphasize that the IRS uses information on these forms to check on a taxpayer's compliance and help minimize the tax gap—the amount of tax that should be paid but that is not.The four IRS Form 1099-K notice templates each begin with, "Your gross receipts may be underreported." Many are sent to taxpayers whose credit sales as a percentage of total sales are higher than the norm for the industry and taxpayer location. One letter simply asks the taxpayer to review reported income and ensure that gross receipts from all sources were reported accurately. The other three letters require a response within 30 days and require the taxpayer to 1) verify that receipts from all sources, including payment card and noncard sources such as cash and checks, are fully reported, and 2) provide explanations for why noncard gross receipts appear unusually low. Clearly, taxpayers receiving one of the latter three notices could have great difficulty complying with the 30-day turnaround requirement. In order to ensure a prompt and complete response upon receipt of a notice, impacted taxpayers should carefully maintain underlying records documenting receipts from all sources and share such information with their tax advisors. In order to prevent further IRS inquiries, notice recipients should seek advice from their tax advisors on the completeness of their responses prior to submission.

### IRS provides guidance regarding the deduction of certain bonus liabilities under the all-events test

*Justin Silva, Manager, Washington National Tax*
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In a recently issued Field Attorney Advice, the IRS ruled that an accrual-method taxpayer was unable to deduct certain bonus liabilities until the taxable year the bonuses

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were paid. Under the three different bonus plans at issue, the taxpayer either (1) maintained the ability to modify or rescind the bonuses until paid, or (2) calculated the bonus amounts based partly on factors occurring after the year in which the related services were provided. The IRS determined that these terms and conditions prevented the bonus liabilities from becoming fixed and determinable until the year in which the bonuses were paid. Accrual-method taxpayers with discretionary and nondiscretionary bonus plans should take time to determine whether the terms of such plans may prevent the taxpayer's liability from meeting the all-events test of section 461 until the taxable year in which the bonuses are paid. Taxpayers that are improperly accelerating the deduction of bonus liabilities should discuss with their tax advisors whether requesting a change in method of accounting for such liabilities is advisable.

## Senator Baucus releases proposal to reform energy tax incentives

*Tom Windram, Partner, Washington National Tax*
*Steve Pashley, Manager, Washington National Tax*

Recently, Senator Max Baucus, chairman of the Senate Finance Committee, released a discussion draft on energy tax reform. Under the proposal, the 42 energy tax incentives currently in effect would be consolidated into a clean energy credit and a clean transportation fuel tax credit. The stated goals of the reforms are to:

- Eliminate incentives that are inefficient or deemed no longer necessary
- Focus energy policy on stimulating the production of domestic, clean electricity and transportation fuels
- Ensure that all energy incentives are technology-neutral
- Provide increased certainty to businesses and investors

The clean energy credit and clean transportation fuel tax credit would apply to any technology producing electricity or fuel approximately 25 percent cleaner than the average of existing technologies. Each credit could be taken as either a production or investment tax credit. While tax reform efforts take time to develop into legislation, these recent developments provide some insight into the likely future direction of energy tax incentives. In the meantime, the fate of many existing incentives remains uncertain.

## Trustees should consider deploying the 65-day rule

*Audrey Young, Director, Washington National Tax*

Though the 2013 calendar year has ended, several 2013 trust-planning strategies remain available due to the generous rule set forth in section 663(b). Under this rule, the IRS allows a 65-day grace period, until March 6, 2014, for a trustee to distribute net income from a trust and treat it as distributed in 2013. The maximum trust income tax rate and the 3.8 percent Medicare surcharge are assessed on trust taxable income over $11,950. Trustees should consider whether it makes sense to accelerate income distributions to beneficiaries in lower income tax brackets to 2013. Also, distributing capital assets, in kind, to beneficiaries in a lower tax bracket may result in significant income tax savings. For example, a distribution of a capital asset followed by a subsequent sale by the beneficiary may result in capital gain recognition at a modest 15 percent rate versus having these assets sold while in the trust, which would result in tax at a 23.8 percent rate (20 percent capital gain tax rate plus the 3.8 percent Medicare surcharge). Due to the harsh trust income tax rules, some families may even decide to dissolve existing trusts, should there be no personal motivation to keep assets in trust.

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