A MONTHLY DIGEST OF KEY STATE, FEDERAL AND INTERNATIONAL TAX DEVELOPMENTS TO KEEP YOU ABREAST OF CURRENT AND PENDING TAX CONCERNS

TAX INSIGHTS

Highlighting tax developments of interest to today's companies on the move.

In this issue:

TAX REFORM

Is state tax reform coming in waves?

By: Brian Kirkell, Principal

Contending with several quarters of weak growth in overall state tax collections, between 25 and 40 states are facing revenue shortfalls. The budget season is heating up with a flurry of legislation proposed to close those budget gaps for the 2018 fiscal year. Many of the proposals include sales tax base expansion, nexus expansion, new and higher "sin taxes" (taxes on cigarettes and alcohol), fuel tax increases, and even new Ohio CAT-style gross receipts tax proposals. At heart, among the states the key driver in all of these proposals has been budget deficits, and not the murky prospects of near-term federal comprehensive tax reform. However, recent events suggest that is about to change.

Anyone that closely follows federal tax reform has learned to be patient—this is going to be a long and involved process in Congress, likely without a draft bill until later in 2017. The reform proposals from the president and the GOP-controlled House are similar but still have significant differences. Almost all the proposals would have an impact on state revenues. For example, an increase of the standard deduction or a repeal of the federal estate tax could negatively impact state revenues in states that are coupled to the federal provisions or that rely on federal estate tax audits, respectively.

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Alternatively, an increase to the federal tax base and a limitation of deductions may result in state tax revenue increases.

With all these moving parts and uncertainties at the federal level, the states have learned to be patient too, and are focusing their legislative energy on revenue raisers independent of the federal tax system. Right? Well, maybe not.

Recently, one of the first affirmative signs that states are thinking preemptively about federal reform came out of Oklahoma. On May 12, 2017, Oklahoma Gov. Mary Fallin signed House Bill 2348, freezing the standard deductions currently coupled to the federal standard deductions. While this state-level change will increase revenue in the short term (the federal deduction is increased for inflation, whereas the new Oklahoma provision is not), the intent behind the legislation appears targeted at the federal reform proposals which have essentially called for doubling the standard deduction—a measure certain to decrease state revenue. Why address this issue now? The simple answer...states might not have time to address it later.

Gone are the days where tax reform was to be addressed in the "first 100 days," and, instead, the enactment of federal reform is likely to wait until the end of the year with retroactivity to the beginning of 2017. This federal legislative calendar does not leave the states any time to respond, which means they will have to cover both their own budget crises and the potential impact guessed-at federal tax reform now, and then address both issues again after federal tax reform is enacted. This two-wave approach at the state-level means that taxpayers will have to be prepared to address significant state tax changes in the near-term and then again after once federal tax reform runs its course.

Bookmark our tax reform resource center for continuing coverage as the process unfolds.

Tax planning in anticipation of reform: What you should know (and do)

By: Charlie Ratner, Senior Director

LIVE WEBCAST | July 18, 2017

Join Charlie Ratner as he walks through the broad implications to you of potential tax reform and how to be ready to act if and when reform occurs.

In this one hour session, he will cover:

- How to review your income and gift tax returns for issues and opportunities
- The implications of tax reform for income, estate, charitable giving and life insurance planning
- Steps to consider now for proactive planning in each of these important areas

Register

TRENDING IN TAX

Tax Court holds taxpayer not liable for accuracy-related penalties

By: Patti Burquest, Principal; Alina Solodchikova, Manager; and John Deininger, Manager

The United States Tax Court recently issued an opinion in which the court determined that a taxpayer was not liable for section 6662 accuracy-related penalty assessed against her due to her reliance on a tax professional to accurately prepare her tax returns.

Summary of the facts of the case[1]

In 1982, Dr. Carolyn Whitsett, a physician specializing in blood transfusions, purchased 4,000 shares of Immucor, Inc. stock for $11,000. In 2011, TPG Capital acquired Immucor and issued a stock redemption offer for $27 per share. At the time of the offer, Whitsett owned 63,594 shares due to stock splits and other offers. Whitsett accepted the redemption offer and in January 2012, she received a check for $1,717,038. Included with the check, TPG Capital's agent sent a letter captioned "Corporate Action Advice" showing the payment date as Aug. 19, 2011, and the tax year as 2012. The letter also stated that the stock redemption was processed on Jan. 4, 2012.

On Jan. 11, 2012, Whitsett contacted her longtime tax return preparer, Joe Whittemore, and provided to him the documents she received with regards to the stock redemptions. After speaking to Whitsett and reviewing the documents, Whittemore prepared her 2011 return and made a series of errors, including improperly reporting the stock sale in the 2011 tax year, incorrectly calculating gain by miscalculating the stock's cost basis, completing the return several months after the extension due date, and ultimately not actually filing her 2011 return. Whittemore did have the taxpayer pay $154,776 as her extension estimate and $5,393 as her balance due. Each time, Whitsett promptly paid the amounts.

In early 2013, the taxpayer received a Form 1099-B, *Proceeds From Broker and Barter Exchange Transactions*, for the stock sale showing proceeds of $1,717,038 with a Jan. 4, 2012, sale date. Whitsett again provided this information to Whittemore, as she engaged him to complete her 2012 return, unaware of the problems with her 2011 filing. Whittemore filed her 2012 return, although late, and did not properly attribute the stock sale to 2012.

On Dec. 9, 2013, Whitsett received a notice from the IRS stating she had a credit of $165,562 for her 2011 tax year, but no 2011 return was filed. She responded with a letter stating her understanding that Whittemore did file the return and enclosed a copy of the 2011 return he provided to her. She later sent a second payment of $5,393, which the IRS credited to her account. Mr. Whittemore assured the taxpayer there was no need to refile her 2011 return because he already e-filed it. On Sept. 15, 2014, a second IRS notice

1 http://www.ustaxcourt.gov/UstcInOp/OpinionViewer.aspx?ID=11262

was sent to Whitsett, which she again responded to by saying that her 2011 return was electronically filed.

On Oct. 27, 2014, Whitsett received a notice that the information reported on her 2012 return did not match the records related to the stock sale sent to it by Immucor's agent. That notice informed her that she had a balance due of $680,086 for the 2012 tax year. She executed a Power of Attorney to allow Whittemore to communicate with the IRS on her behalf. In February 2015, Whittemore sent Whitsett an email stating she should have reported the Immucor stock sale in 2012 and that he would file amended returns for both 2011 and 2012, although the 2011 return would have been the original return. Whittemore never filed any returns. After receiving no response from the taxpayer, the IRS issued a notice of deficiency for 2012 in the amount of $541,522 and an accuracy-related penalty of $107,995.

At this point, Whitsett sought a new counsel. Whitsett agreed that the stock sale was attributable to the 2012 tax year and her basis in the stock was $11,000. She did not agree that she was liable for the accuracy-related penalty.

To read more, go to: http://rsmus.com/what-we-do/services/tax/lead-tax/tax-controversy/tax-court-holds-taxpayer-not-liable-for-accuracy-related-penalti.html

Economic sales and use tax nexus laws

What are they? Where are they? And what's next?

By: Mo Bell-Jacobs, Manager; Ryan Carnes, Senior Associate; and Brian Kirkell, Principal

Article updated from original posting on March 30, 2017.

[Download white paper]()

How did we get here?

Historically, state budgets have relied heavily on sales and use taxes considering combined sales and use tax collections account for over 30 percent of total state tax revenues. Sales and use taxes are some of the most stable and reliable as a revenue stream—with aggregate national collections only falling during periods of significant economic downturn such as the recession of 2008.

Not surprisingly, states have attempted to expand sales and use tax collections by increasing rates (often unpopular and unsuccessful with voters), expanding the sales tax base to professional services and other traditionally exempt items, increasing "sin taxes" (sales taxes on cigarettes and alcohol), requiring use tax notification and reporting of remote seller sales, and pushing the boundaries of traditional sales and use tax nexus concepts. Concerning the latter, states have enacted new sales and use tax nexus laws in response to the changing digital economy (and tax revenue lost due to remote commerce) through concepts such as "click-through nexus" and employing broader applications of affiliate nexus. Most significantly, however, states have begun to directly challenge the physical presence nexus standard laid out in the 1992 U.S. Supreme Court case, *Quill Corp. v. North Dakota*.

In his concurrence to the U.S. Supreme Court's 2015 opinion in *Direct Mktg. Ass'n v. Brohl*—a case out of Colorado challenging use tax reporting requirements—Justice Kennedy concluded that the combination of tax loss from individual purchase use tax non-compliance and far-reaching systemic and structural changes in the economic and social activities wrought by the expanding use of the internet were indicative of a need for the Court to revisit the *Quill* physical presence. Kennedy called for the states to provide the Court with a case suitable to address whether the rationale in *Quill* is still viable in the modern world. The states quickly moved in response.

To read more, go to: http://rsmus.com/what-we-do/services/tax/state-and-local-tax/topics/nexus/economic-sales-and-use-tax-nexus-laws.html

Canada identifies US partnerships that it will treat as corporations

By: Kyle Brown, Manager

In a recent ruling, the Canadian Revenue Agency (CRA) provided further insight into the factors it considered in reaching its conclusion in prior guidance that a Delaware LLLP should be classified as a corporation for Canadian income tax purposes. (For additional coverage of this issue see our prior article [here]())

In *CRA Views 2015-0587691I7*, consistent with its IFA-2016 Position, the CRA ruled that a Delaware LLLP, which had been dissolved, had been a corporation for Canadian income tax purposes. In reaching its conclusion, the CRA analysis broke down several relevant factors of both the Delaware Revised Uniform Limited Partnership Act (DRULPA) and the entity's partnership agreement in reaching this conclusion.

Specifically, the CRA employed a so called "two-step" approach, considering the facts of the entity in conjunction with a combined interpretation of the entity's partnership agreement and the DRULPA to support its conclusion. The CRA noted two main factors in its analysis, the first being the existence of a separate legal entity recognized under the DRULPA. That is to say, the Delaware LLLP had full legal capacity to carry on its own activities and incur its own liabilities, acquire and own property, and sue and be sued. Secondly, the CRA noted that the Delaware LLLP afforded limited liability to all of its members. Using this approach, the CRA reaffirmed their IFA-2016 Position, concluding that the Delaware LLLP should be classified as a corporation for Canadian income tax purposes.

In light of its recent administrative grandfathering approach for existing Florida and Delaware LLLP's, and given that the LLLP in question had already been dissolved, the CRA ultimately suggested that this particular LLLP should be treated as a partnership for the purposes of the Canadian Income Tax Act.

To read more, go to: http://rsmus.com/what-we-do/services/tax/international-tax-planning/canadian-tax-services1/canada-identifies-us-partnerships-that-it-will-treat-as-corporat.html

Net operating losses: One size does not fit all

Rules often unclear, vary by state

By: Matt Arnold, Senior Manager; Mo Bell-Jacobs, Manager; and Nicole Rooney, Manager

Understanding a target's net operating losses (NOLs) is an important part of due diligence, but simply being aware of the state implications is not enough. An analysis of the limitation on federal NOL's without analysis of state attributes may result in misstatements of the value of deferred tax assets and state income tax exposure for the taxpayer.

Internal Revenue Code (IRC) section 382 limits a company's ability to use NOLs after a corporation is deemed to have an ownership change. Similar to the federal NOL limitations, the majority of states also place limitations on the NOL usage that may be more or less stringent than the federal limitation. Many states do not conform to section 382, and instead rely on completely separate tests to determine if NOLs can be utilized after an ownership change. However, many businesses fail to analyze the impact of significant transactions on state NOLs. Businesses should consider which state NOLs are significant to the business and consider the potential loss or limitation of an NOL before mergers or acquisitions occur. Companies should strive to understand the state NOL profile before entering into acquisitions, reorganizations or other material transactions, and consider opportunities to modify proposed deal structures to maximize the value of state NOLs.

If a federal section 382 study has been conducted, taxpayers often oversimplify the state NOL limitation by taking the federal NOL multiplied by the state apportionment rate and booking the resulting figure. That analysis is technically correct in some, but not all states. Businesses that take the "one size fits all" approach can result in adjustments on audit, even for tax years otherwise outside the statute of limitations because some states allow the modification of NOLs utilized in open years. For example, consider a taxpayer that takes the federal section 382 limitation multiplied by the state apportionment percentage for a 2005 acquisition and applies that method to all states. In 2015, upon audit, the state disallows the NOLs in the current years because the state does not conform to section 382. The NOLs are lost, because the years where the company could have used the benefit are already closed under statute.

Before using an approach that may have NOLs expiring and financial statement valuation misstatements there are some key questions that should be asked.

- Are the NOLs completely lost due to the change event?
- Is there a way to structure the deal which provides the best use of state NOLs?
- For states that do not conform to section 382, or may have additional rules on NOL utilization such as state specific separate return limitation year considerations, are those properly taken into account?
- In states where section 382 does apply, does the limitation apply on a pre- or post-apportionment basis?
- If the state applies a post-apportionment methodology, does section 382 apply based on the year of ownership change or is the company required to recalculate each year?
- If the business is acquiring a consolidated group of companies, while federal section 382 limits might be calculated at the group level, will any of the states require computations on a company-by-company basis?
- Are there any state differences in how the section 382 is calculated based on state modifications?

While some states have defined how section 382 applies or have otherwise described NOL carryforward limitations by statute, in other states, companies must determine treatment based on case law. There is however, a silver lining. Because of the disparity between federal and state treatment of NOLs, you may have increased or accelerated NOL utilization in some states that do not conform to section 382. It is important to be proactive when it comes to state NOLs and significant corporate transactions, and to collaborate with RSM's state and local tax professionals to properly document the positions to maximize opportunities and mitigate risks.

EVENTS AND WEBCASTS

Retirement plan issues and insights

LIVE WEBCAST | August 03, 2017

Attend our webcast series addressing the key challenges and opportunities found in designing, implementing and maintaining company retirement plans.

Aligning executive plans with traditional employee plans
How can you create a plan design that attracts and retains highly compensated employees? What are the opportunities in non-qualified plans?
Thursday, Aug. 3, 2017

Register

The economy's impact on retirement plans
An RSM economist discusses how the U.S. economy is affecting retirement planning.
Thursday, Nov. 2, 2017

Register

Fiduciary rules in the new world: Top 10 ways to reduce your liability
What fiduciary responsibilities do you have as a plan sponsor? Where are the blind spots and risks?

[Download webcast slides]

Top 10 retirement plan internal control pitfalls—and how to avoid them
A lively examination of a number of widespread mistakes and oversights that companies make—and how to avoid them.

[Download webcast slides]

SUCCESSION PLANNING

What business owners need to know about value before selling

WHITE PAPER | June 20, 2017

[Download white paper]

What's the value of my company? This is an age-old question that all business owners ponder as they consider whether to sell their most important investment. However, the questions they should ask first are: how will buyers go about determining the value of my company? And, what can I do to enhance what someone is willing to pay in order to acquire what I have worked so hard to create?

Mitch Gorochow, senior advisor with RSM's Center for Business Transition and Ken Sanginario, founder of Corporate Value Metrics and creator of the Value Opportunity Profile®, recently discussed how business owners can view value through the eyes of buyers and then what they can do today to plan for a successful event down the road. Excerpts of their conversation follow below:

When most business owners talk about what their company is worth, they immediately go to some multiple of earnings they have been told is standard in their industry. Is that the way sophisticated buyers really determine what they are willing to pay?

Owners should understand that value is not derived from multiples but, rather, multiples are derived from value, and value is very significantly affected by the underlying quality of the subject company.

Unfortunately, business owners are often misled into thinking about the value of their businesses in terms of standard industry multiples. In reality, nearly every industry exhibits a wide range of transaction multiples based on the relative quality of the underlying companies. In any given year, within any given industry and size parameters, there is often a range of three to four turns between the low and high multiples in transactions. That amounts to a 70 to 80 percent spread between the low and high transaction values.

Sophisticated buyers use discounted cash flow (DCF) analyses, in addition to looking at market multiples, to determine value. They go to great lengths to assess the underlying quality of prospective target companies, and their assessments determine the discount rate to be used in their DCF models. The discount rate reflects the riskiness of the company and helps them determine whether they will make any offer to purchase and, if so, at what value and on what terms.

More often than not, deals either fall apart entirely, or offers get traded again because of qualitative issues that are identified in due diligence. Some refer to this as the due diligence slaughterhouse, where very few companies come out unscathed.

As a business owner who thinks about selling a company in the future, why not just focus on growing my revenue to drive the value and ultimate sale price of the business? Wouldn't that focus be the best strategy to try to maximize my ultimate selling price?

Revenue growth is obviously a factor in determining value, but the quality of revenue growth can mean the difference between creating value and eroding value. Too often, companies chase revenue in an attempt to be able to show growth, and they wind up with revenue that is not a good fit, strategically, with their core business. Examples include achieving revenue that is nonrecurring or outside of the company's core competency; gaining a larger contract than the company can reasonably fulfill; or reducing prices to drive more volume which hurts margins in the process. When companies employ such tactics, there are often unintended consequences that actually erode value rather than create value. Any growth adds business risk, but nonstrategic growth can strain the organization, consume capital, damage customer relationships, and hurt the company's reputation. We've seen it many times where companies end up in a distressed situation because they were chasing revenue as a strategy to drive value. Alternatively, strategic revenue growth, supported by an overall balanced organization that can effectively support the growth, can certainly drive value creation. However, that's a much more holistic approach than just chasing revenue.

To read more, go to: http://rsmus.com/what-we-do/services/tax/private-client/business-ownership-and-management-succession-planning/center-for-business-transition/what-business-owners-need-to-know-about-value-before-selling.html

FROM THE BLOG

[Employers with self-insured health plans owe PCOR fee by July 31, 2017]

[Tax planning for ESOP-owned S corporations]

[Navigating nuances in transfer pricing]

[Apportionment of net recognized built-in gains in California]

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