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.

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TAX REFORM

State gross receipts taxes—a new trend in state tax law?

By: Brian Kirkell, Principal

President Trump, his administration, and the GOP-controlled Congress have suggested major changes to the Affordable Care Act, Medicaid, trade and immigration policy, and the federal tax structure. Many of the proposed changes are likely to have some impact on state economies and budgets—both positively and negatively, although it is much too early to determine the extent of that impact.

Facing the uncertainty of federal tax reform, and in addition to widespread budget deficits and lackluster economic growth, several states are considering new (or bringing back old) methods of revenue generation. In addition to rolling back spending, increasing tax rates, and broadening tax bases, one trend developing in state legislatures are proposals for state gross receipts taxes.

In 2005, Ohio enacted a commercial activity tax (CAT) that was scheduled to, and ultimately did, replace the corporate franchise tax. The Ohio CAT applies to most businesses, regardless of the type of business organization, with taxable gross receipts of more than $150,000 in the calendar year. The CAT applies a bright-line economic nexus standard to out-of-state taxpayers $50,000 in Ohio property, $50,000 in Ohio payroll, or $500,000 in taxable gross

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receipts; or at least 25 percent of the person's total property, total payroll, or total taxable gross receipts within the state.

That factor-presence standard was recently challenged in *Crutchfield Corp. v. Testa*. The Ohio Supreme Court found that a physical presence was not required in order for the state to impose the CAT on out-of-state businesses with taxable receipts in Ohio. The taxpayers eventually settled with the state in lieu of an appeal to the U.S. Supreme Court.

In 2015, Nevada enacted its Commerce Tax, a tax imposed on gross receipts exceeding four million dollars. At least three other states are considering a statewide gross receipts tax in 2017: Louisiana, Oregon, and West Virginia.

Faced with a half-billion dollar budget shortfall and likely taking notice of the success of the Ohio CAT, West Virginia Gov. Jim Justice proposed a gross receipts tax as part of a larger tax package that would include lowering the sales tax. The Oregon Senate proposed a state constitutional amendment that would create a new business privilege tax in the form of a gross receipts tax. Based on Senate Joint Resolution 41, introduced on Feb. 14, 2017, the tax would be 0.7 percent on receipts in excess of $5 million. In Louisiana, Gov. John Bel Edwards released details on a proposed gross receipts tax similar to the Ohio CAT that would be imposed on taxable receipts of at least $1.5 million.

Half the states are feeling the impacts of revenue shortfalls with estimates that up to 40 states will need to fill budget gaps for fiscal year 2018. With the success of the Ohio CAT, and the recent blessing of the factor-presence nexus standard by the Ohio Supreme Court, other states are looking very closely at whether a gross receipts tax would be the X-factor in balancing state budgets and reducing or eliminating state corporate income taxes. The legislative season is still young, and regardless of whether any state enacts a gross receipts tax in 2017, we may be hearing a lot more about these taxes in the next few years.

TRENDING IN TAX

How middle market companies can manage the transfer pricing life cycle

A transfer pricing guide for internationally active companies

By: Bob Bamsey, Senior Manager; Tansy Jefferies, Senior Manager and Matt Wynia, Senior Manager

Transfer pricing presents numerous challenges for internationally active middle market companies—especially for those exploring off-shore opportunities for the first time. Now, with countries around the world adopting the guidance issued by the Organisation for Economic Co-operation and Development in relation to its base erosion and profit shifting (BEPS) initiative in order to ensure that value created in their markets is appropriately recognized and taxed, companies face an even tougher challenge and an even more rapidly evolving transfer pricing environment.

Managing your transfer pricing life cycle walks middle market companies through the four basic guideposts of a successful transfer pricing program:

1. Transfer pricing planning
2. Analysis and documentation
3. Economic analysis
4. Implementation and beyond

From mapping your footprint to identifying your risks and opportunities, from identifying and analyzing the right data to developing supportable economic analyses, Managing your transfer pricing life cycle offers clear, practical insights and includes links to more in-depth thought leadership on key transfer pricing topics.

Transfer pricing is not a one-and-done activity. It should be a regularly monitored aspect of your tax planning and compliance risk management program. This concise guide offers executives a clear view of the challenges involved and an outline for addressing them.

Download the e-book

2017 UPPO conference highlights key trends in unclaimed property

By: Amir Ali, Supervisor; Catherine Del Re, Partner and Yudit Freda, Senior Manager

During the week of March 20, 2017, over 580 unclaimed property professionals, attorneys, state administrators, and holders gathered in Austin, Texas for the Unclaimed Property Professionals Organization's (UPPO) Annual Conference.

The conference highlighted the extraordinary changes currently occurring in the field of unclaimed property, and the challenges and opportunities they bring for all stakeholders. Conference sessions covered hot topics such as the 2016 Revised Uniform Unclaimed Property Act (RUUPA), current litigation and audit trends, and many day-to-day essential topics for holders trying to maintain or improve their unclaimed property compliance procedures.

Revised Uniform Unclaimed Property Act

Perhaps the most important session at this year's conference, demonstrated by the number of attendees and time allocated, was "Breaking Down the Uniform Unclaimed Property Act," which covered the Uniform Law Commission's (ULC) adoption of the RUUPA in 2016. Members of UPPO served as advisors to the ULC as the RUUPA was being drafted, and were available to provide first-hand insight on the new act.

Last revised in 1995, the provisions of the RUUPA were designed to address many of the challenges faced by the holder community including how advances in technology have changed the way companies do business. For example, the RUUPA includes guidance on what constitutes customer contact and last activity, defines the term "stored value cards," and contains new express exemptions for game-related digital content and loyalty cards. The RUUPA also includes a welcome five-year statute of limitations on assessments after the holder has filed a non-fraudulent report, and a 10-year statute of repose if no report was filed or a fraudulent report was filed. However, many updates the holder community had been seeking were not included in the revised act. For example, the RUUPA does not contain an exclusion for foreign addressed property, the use of third-party contingency fee auditors is still permitted, and the RUUPA does not contain a "business-to-business" exemption (although a prefatory note was included to give states the option to include such exemption "without offending the goal of achieving substantial uniformity").

It was also noted during the session that the American Bar Association (ABA) has not endorsed the RUUPA. The ABA Business Law Section had raised concerns as to the constitutionality of many provisions of the RUUPA and in early March, released its own draft model act for comments.

The key takeaways from this session were that the RUUPA contains both advantages and disadvantages for the holder community and it is clear that non-uniformity will continue to be an issue as states consider adopting RUUPA in whole or in part. States including Delaware (Senate Bill 13) and Utah have adopted some provisions of the RUUPA. Tennessee and Illinois currently have bills pending, and it is anticipated that additional states will be proposing legislation to revise their unclaimed property laws in 2017.

Delaware Senate Bill 13

Another hot topic at the conference was Delaware's enactment of Senate Bill 13. Earlier this year, Delaware enacted a major overhaul of its unclaimed property laws which reduced the look-back period for audits and voluntary disclosure agreements, aligned the statute of limitations with record retention requirements, and enacted provisions for certain groups of holders to convert their existing audits to expedited audits or voluntary disclosure agreements.

A representative from Delaware announced that the forms for the audit conversions will be released in early April. Additionally, regulations providing clarity on the state's required estimation methods will be released for comment by the Delaware Secretary of Finance in early April. Comments will be due in early May so that the estimation regulations may be promulgated by July 1, 2017.

Litigation update

This year's litigation update focused on two ongoing and heavily watched cases; *Marathon Petroleum v. Cook* and *Delaware v. Pennsylvania*, both of which are challenges to audits and address unclaimed property priority rules—that is, which state should be accorded the primary right and power to escheat before others.

In addition, last summer's settled *Temple-Inland* case continued to be heavily discussed given its enormous impact on today's unclaimed property landscape. Many provisions of recently enacted Delaware Senate Bill 13 seem to directly address the many constitutional concerns brought forward in *Temple-Inland*. It was evident at the conference that other states have also taken note of the case and it is anticipated that as additional states move forward in updating their unclaimed property legislation they too will take into consideration the challenges raised in the case.

Audit trends and landscape

A number of courses held at the conference focused on the current audit landscape, audit trends and best practices to mitigate exposure. Audit trends highlighted at the conference included an increase in audits of smaller companies , multistate audits where Delaware was neither the lead audit state nor a participating state , and comments from many holders that their submission of a signed non-disclosure agreement no longer prevented additional states from joining a multistate audit.

The use of third-party auditors continues and appears to be on the rise. Although some states have placed limits on their use, the RUUPA still permits the use of third-party or contingent fee auditors. More third-party audit firms have emerged, thereby increasing the likelihood of an audit being performed by a third party.

Lastly, the judicial and legislative landscape, discussed above, is having a profound impact on the future of unclaimed property audits and is forcing states to reevaluate their audit procedures, specifically as they relate to estimation methodology. Delaware's new legislation providing for the promulgation of regulations on estimation by July 1, 2017, is a small step forward. Although there is still ambiguity regarding the estimation methodologies employed by states on audits, at this time, it appears that the use of estimation in unclaimed property audits is here to stay.

The first IRS issues-based campaigns: A brief overview of each release

What are the initial 13 large business and international campaigns?

VIDEO | April 03, 2017

By: Patti Burquest, Principal and David Click, Senior Director

In the fall of 2015, the IRS Large Business and International (LB&I) Division announced a move away from traditional IRS examinations to issue-specific examinations. They refer to this as a "campaign approach" where a compliance issue is identified and then taxpayers with that issue may be selected for examination.

The first 13 campaigns were announced at the end of January 2017 and cover three IRS practice areas: enterprise activity, pass-through entities and global. During an early February webcast, our tax controversy team provided an overview of each of the first 13 campaigns. Watch the video below to see their explanation of the campaign approach and then listen to the campaign-specific segments that may be important to your business.

Download the video.

EVENTS AND WEBCASTS

FATCA and the new Common Reporting Standards

RECORDED WEBCAST | March 30, 2017

Join Samuel Dale, editor of HFMCompliance of Hedge Fund Management Week, Aureon Herron-Hinds, national lead of RSM's Foreign Account Tax Compliance Act (FATCA) and global information reporting services team and Josh Johnson, a senior manager in our international tax group, for a moderated discussion about the Common Reporting Standard (CRS) and FATCA's requirements and the results of a survey conducted by RSM and HFMWeek readers.

Learn more about:

- Key requirements under each regime
- Areas funds find most challenging
- Upcoming reporting deadlines and what funds are doing to prepare them
- Key differences between CRS and FATCA and how funds intend to manage risk associated with both

Don't miss this chance to learn more about these pressing compliance challenges and how other funds plan to address them.

Download webcast slides

BUSINESS GROWTH

Understanding how the R&D tax credit can offset payroll taxes

By: Jennifer Stanik, Senior Manager and Tom Windram, Partner

In addition to making the research and development (R&D) tax credit permanent, the Protecting Americans from Tax Hikes Act of 2015 (PATH Act), provides key incentives to eligible small businesses for taxable years beginning on or after Jan. 1, 2016. One such incentive provides that businesses with less than $5 million in gross receipts in the current taxable year and that have no gross receipts for any taxable year prior to the five-taxable-year period ending with the current taxable year can offset the employer portion of OASDI (Social Security tax) by up to $250,000 each year with the R&D tax credit (referred to as the payroll tax credit). The payroll tax credit is enabled by the interaction of new IRC sections 41(h) and 3111(f).

On March 30, 2017, the IRS issued interim guidance in the form of Notice 2017-23 that describes how eligible small businesses can apply all or part of their research credit against their payroll tax liability. This guidance focuses on the definition of gross receipts, aggregation rules, and the time and manner of making the election to claim the payroll tax credit.

Missing from the interim guidance are several items that many tax professionals had hoped to see addressed, including: (1) a de minimis test in regards to gross receipts, (2) an exclusion for grants, and (3) leniency with regards to the test for controlled groups and/or trades or businesses under common control.

The following addresses some frequently asked questions in relation to the R&D payroll tax credit:

What is the definition of gross receipts for purposes of applying the five-year and $5M gross receipts limitations?

- When determining eligibility for the payroll tax credit, gross receipts must be no more than $5M in the current tax year, and the taxpayer must not have had any gross receipts prior to the five-year period ending with the current tax year (e.g. for tax year 2016, there must be no gross receipts prior to 2012). For purposes of this measurement, gross receipts are defined under section 448(c)(3) (without regard to section 448(c)(3)(A)) and are also defined in sections 1.448-1T(f)(2)(iii) and (iv). Accordingly, gross receipts include total sales (net of returns and allowances) and all receipts received for services, as well as income from investments, including interest, dividends, rents, royalties and annuities. Gross receipts also include proceeds from the sale of property (described in section 1221(2)) used in a trade or business, reduced by the adjusted basis in the property. Notice 2017-23 clarifies that the definition of gross receipts under section 41(c)(7) and section 1.41-3(c) does not apply for purposes of section 41(h).
- Notice 2017-23 does not provide a de minimis test in regards to gross receipts. As it is written, a company receiving minimal gross receipts in the form of bank interest or a dividend in any year prior to the five-year period referenced above would be ineligible to elect the payroll tax credit.

Is aggregation required when determining whether the gross receipts requirements are satisfied?

- All members of a controlled group or a group of trades or businesses under common control, as defined in section 1.41-6(a)(3)(ii), are treated as a single taxpayer. Thus, the aggregate gross receipts of all members of a controlled group for the taxable year must be considered when determining whether the requirements of the Notice are satisfied. For example, this would require each taxpayer to consider all related parties (foreign and domestic) that fit the ownership requirements for purposes of applying the gross receipts measurement. This could potentially limit the applicability of the payroll tax credit election for some taxpayers.

To read more, go to: http://rsmus.com/what-we-do/services/tax/credits-and-incentives/investment-incentives/research-and-development-tax-credits/understanding-how-the-rd-tax-credit-can-offset-payroll-taxes.html

SUCCESSION PLANNING

Employee stock ownership plans: Fact vs. perception

The reality of often misunderstood concepts

By: Anne Bushman, Senior Manager

Employee stock ownership plans (ESOPs) are an attractive tool for closely held business owners who are evaluating succession planning options. ESOPs can provide unique benefits to selling shareholders, employees and the company. Despite the potential benefits of an ESOP and their existence for over 40 years, the exit strategy is often unknown or misunderstood by business owners. For an overview of an ESOP as an ownership transition tool, see our overview article.

For those who have heard of an ESOP, it can be difficult to sift through all of the information to understand if the option may apply to your business and how an ESOP may affect the future of the business. Not only is there an ocean of information to absorb on ESOPs, but also some of the information you hear may be incorrect or misinterpreted. The following lists common ESOP myths and explains the context of each issue to help you interpret the reality of these statements.

Selling to an ESOP requires owners to give up control of the business.

What is true: An ESOP owns company stock so current owners of the company do have to give up some portion of company ownership to implement an ESOP. The ESOP may purchase shares of any one or all shareholders so the effect on current owners may be different for each owner, depending on how the stock sale is structured.

What is not true: Giving up some company ownership is not always synonymous with losing control of the business, though. First, an ESOP can own any percentage of the company stock so it is possible for existing owners to retain control through continuing to hold a majority of the shares. Second, control of company operations and control of voting matters are two different things. Ownership will govern voting rights, and a trustee will be responsible for the ESOP's shares in most voting matters (exceptions do exist for large transactions such as mergers or liquidations which require employee participants in the ESOP to vote), but day-to-day operational control of the company remains with the management team and the board of directors, similar to any other corporate governance situation. See our separate article on control for more detail.

ESOP transactions place a large amount of debt on employees.

What is true: Most ESOP transactions result in the company incurring debt to finance the transaction, because essentially, the company is buying its own stock and transferring that stock to employees as part of their retirement benefit.

What is not true: The employees are not individually responsible for the debt. Ultimately, the value of the stock allocated to employees in their ESOP accounts will be affected by the debt on the company's balance sheet, because liabilities reduce the value of equity. However, employees are allocated shares, not a direct portion of any debt. Also, employees will receive an annual statement that shows the number of shares in their account and the net value per share; they will not receive information that shows the debt the company incurred to purchase the shares, and they will never owe any money back to the company if they leave before the debt is repaid because the debt is not their individual obligation.

Small companies cannot do an ESOP.

What is true: Company size is a factor in whether an ESOP will be successful for the company. The measures that are most important in determining "size" of the company are number of employees, value of the company and annual net cashflow. Exactly what level of each of these factors is necessary for an ESOP to be feasible depends upon the level of the other factors. An ESOP does come with initial and ongoing costs so there is some size that would be small enough that the costs outweigh the ESOP benefits.

What is not true: What is "too small" to make an ESOP feasible is not as "big" as one might think. Often, having 15-20 employees may be enough for an ESOP to work so long as the value of the company being transferred to those employees can fit within certain tax limitations for employee benefit levels and it makes sense from a business perspective to provide employee benefit levels that align with the value being transferred to them. From the perspective of company value, companies worth $5 million or more may be good ESOP candidates, depending on the number of employees such that the benefit provided per employee is perceived as valuable enough to outweigh the costs of the ESOP. And from the net annual cashflow perspective, the level of cashflow necessary is not a fixed number, but rather depends on the other variables—it is likely something more than $0 since there are annual fixed costs of the ESOP, but depending on the transaction structure, tax savings may help outweigh some of the new costs so the exact cashflow needed cannot easily be generalized.

To read more, go to: http://rsmus.com/what-we-do/services/tax/lead-tax/employee-stock-ownership-plans-fact-vs-perception.html

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