

Tax Digest

Second Quarter 2010

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

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Obama Signs Bill Creating Tax Breaks for Hiring Workers

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LEGISLATIVE

House Passes Health Care Reform Bills

On March 21, the House passed the Patient Protection and Affordable Care Act (H.R. 3590) by a vote of 219-212. The bill was originally passed by the Senate on Dec. 24, 2009. President Obama signed the bill into law on March 24. The House also passed the Health Care and Education Affordability Reconciliation Act (H.R. 4872), which modifies key provisions of H.R. 3590, by a vote of 220-211. H.R. 4872 modifies H.R. 3590 by raising additional revenues from high-income households and reducing the impact that new excise taxes on high-cost health insurance policies will have on middle-class households. After removing two provisions related to Pell Grants, and addressing several other proposed amendments, the Senate sent the reconciliation bill back to the House where it is expected to pass before the two-week Spring recess that begins on March 29. See our Special Tax Digest release, [House Passes Health Care Reform Bills](#).

Obama Signs Bill Creating Tax Breaks for Hiring Workers

Passed on March 17, 2010, the Hiring Incentives to Restore Employment (HIRE) Act offers employers a tax credit and a limited "payroll tax holiday." Other provisions include enhanced expense treatment for new equipment, extended eligibility for tax credit bond issuers, and increased funding to highway and transit programs. To maximize tax advantages, companies need to act quickly, as stated in our extended article, [HIRE Act Offers Tax Breaks for Employers and Other Incentives](#).

Tax Extenders Moving Closer to Passage

The Senate passed H.R. 4213 on March 10, which extends \$31B in expired tax provisions. The bill also includes \$9.9B in extended COBRA subsidies. The House had already passed a version of H.R. 4213 in Dec. 2009. The Senate bill carries more provisions than the House bill, including an extension of the section 45 renewable energy tax credit for refined coal products used for fuel. Both bills provide for a seamless one-year extension of the research tax credit. The Senate bill pays for the extenders by denying paper mills a biofuels tax credit for their use of black liquor fuel, codifying the economic substance doctrine, and imposing new tax penalties on tax avoidance transactions. In contrast, the House bill pays for the extenders by increasing foreign taxpayer compliance and denying capital gains treatment for carried interest. It is unclear where final funding will come from given that some of the offsets in both bills have been included as a means to pay for pending health care legislation.



State and Local

**Proposed Relief Legislation
for Michigan SBT
Disregarded Entities**

International

Value Added Tax

**Canadian Unlimited
Liability Companies**

FEDERAL

District Court Rules that Severance Pay Not Subject to Social Security Taxes

After nearly two years of believing the issue was settled, employers received news last month that certain severance benefits may not be subject to taxation under the Federal Insurance Contributions Act (FICA). In *United States v Quality Stores, Inc.*, No. 1:09-cv-44 (W.D. Mich. Feb. 23, 2010), a decision affirming a Bankruptcy Court decision, the U.S. District Court for the Western District of Michigan highlighted the historical uncertainty regarding whether certain severance payments made to employees pursuant to an involuntary reduction in force were not “wages” that are subject to FICA taxation. In this instance, the court held that such payments were not subject to FICA, as they did not constitute wages. For more information, see our extended article, *Severance Pay not Subject to Social Security Taxes*.

Certification Awarded to RSM McGladrey Retirement Resources RSM McGladrey has attained the ASPPA record-keeper certification for its

Third Party Administration (TPA) services for employer sponsored retirement plans. Record-keeping providers, advisors and plan sponsors should have an additional level of confidence working with RSM McGladrey knowing that these services have passed this rigorous process. For additional information on this prestigious award, see our extended article, *Certified Record Keepers/Third-Party Administrators*.

S Corporations with Pre-S Election Retained Earnings

For S Corporations with retained earnings from years prior to their S election, this year may be a final window on taking out those earnings at the currently low dividend income tax rate. A corporation with accumulated earnings from pre-S election years can lose its S election if passive investment income exceeds 25 percent of its gross receipts for three consecutive years. The remedy is to pay taxable dividends to the extent of the old earnings. If all shareholders agree, an S corporation can elect to treat distributions to shareholders as taxable dividends to remove these pre-S election earnings. Those dividends will generally qualify for the maximum federal income tax rate of 15 percent. This rate is scheduled to expire at the end of 2010 and revert to the top individual income tax rate. Congress could act to reduce the dividend rate below the top individual rate in 2011, but that would require new legislation.

Annual Opportunity - Elective Capitalization under Treas. Reg. 1.263(a)-4(f)(7)

While the 12-month rule for eligible prepaids is a non-elective method, taxpayers do have the ability to annually elect to capitalize prepaids otherwise subject to the 12-month rule. The election is made by capitalizing the amounts with respect to all similar transactions during the tax year on the timely filed original federal income tax return (including extensions) for the tax year during which such amounts are paid. This is not considered a method change. For example, a taxpayer may elect to capitalize its costs of prepaying insurance contracts for 12 months, but may continue to apply the 12-month rule to its costs of entering into non-renewable 12-month service contracts. This provides taxpayers with

the ability to increase taxable income to utilize expiring NOL carryforwards or to extend the period for credit carryforwards. In the case of a consolidated group, the election is made separately by each member and not for the group as a whole. In the case of an S corporation or partnership, the election is made at the entity level and not by the shareholders or partners. Once the election is made for a specific tax year, it is only revocable with the consent of the Commissioner. In addition, the election only applies to the tax year for which it is made. Thus, prepayments made in the subsequent tax year that are subject to the 12-month rule should be deducted, unless an election for a category of similar transactions for that year is made as well.

STATE AND LOCAL

Proposed Relief Legislation for Michigan SBT Disregarded Entities

On Feb. 5, 2010 the Michigan Department of Treasury outlined new filing requirements for taxpayers in a “Notice to Taxpayers” regarding the appellate decision in *Kmart Michigan Property Services LLC v Dep’t of Treasury* (Kmart).

The Notice was issued in response to the Kmart decision which held that a federal disregarded entity would not be disregarded for Michigan Single Business Tax (SBT) purposes and that the result of the decision will be applied retroactively for all open tax years. For more information on the MI SBT disregarded entities, see our extended article, *Proposed Relief Legislation for Michigan SBT Disregarded Entities*.

INTERNATIONAL TAX

Value Added Tax

The United Kingdom instituted significant changes to its Value Added Tax (VAT) system effective Jan. 1, 2010. Changes were made to coincide with intra-European Union (EU) changes adopted in 2008 and currently being implemented.

Modifications made to the “place of supply” and “time of supply” rules increase efficiency and introduce a “reverse charge” system, which now captures transactions between EU countries and foreign businesses. Through the reverse charge system, VAT is attributed to the location where the recipient is established and receiving businesses are required to account for VAT by self-reporting. The rules are subject to phase-in procedures.

The change to the system affects every business operating in the United Kingdom and Europe including those whose parent companies are in the United States.

Canadian Unlimited Liability Companies

On Jan. 1, 2010, new anti-hybrid rules introduced as part of the Fifth Protocol to the U.S.-Canada Income Tax Treaty came into effect. These rules deny certain treaty benefits, such as reduced withholding rates on dividends, interest and royalties for transactions involving Canadian Unlimited Liability Companies (ULCs). On March 4, 2010, the Canada Revenue Agency issued a ruling stating that certain transactions regarding ULCs will qualify for the reduced withholding rates specified in the treaty. This ruling does not apply to all transactions involving ULCs but does provide significant planning opportunities for taxpayers to avoid the 25 percent withholding tax in Canada. For more information, see our extended article, *Canadian Unlimited Liability Companies*.

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