

Tax Digest

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

Second Quarter 2011

FEDERAL

Much Anticipated Guidance on Bonus Depreciation

The IRS has issued new guidance on the 100 percent bonus depreciation allowance for qualifying new property acquired and placed in service after Sept. 8, 2010 and before Jan. 1, 2012. The new guidance, Rev. Proc. 2011-26, addresses a range of circumstances, including:

- acquisition date for property acquired under a written binding contract
- acquisition date for self-constructed assets
- 100% bonus depreciation for components where work on a larger self-constructed property began before Sept. 9, 2010
- ability to elect 50% in lieu of 100% bonus depreciation for 2010
- electing out of bonus depreciation entirely for the whole year
- a safe harbor regarding the recovery of excess depreciation for luxury automobiles

The rules are quite favorable. Read more in [Bonus Depreciation Questions Answered](#).

Natalie Tucker, Director, Washington National Tax

Tom Windram, Managing Director, Washington National Tax

Proposed Regulations Define Publicly Traded Debt

Treasury has expanded the definition of "publicly traded" as it relates to determining a debt instrument's issue price, which can be important in determining cancellation of indebtedness income when there is a significant modification of the debt and the issue price on the new debt is less than the principal amount of the old debt. Read about the rules and the exceptions.

Nick Gruidl, Managing Director, Minneapolis, MN

Sales-Based Royalties and Vendor Allowances

Proposed regulations under sections 263A and 471 require taxpayers to treat sales-based royalties as production costs that may be recovered immediately through cost of goods sold, and as a reduction in cost, not an increase in gross receipts, for sales based vendor allowances. While the regulations will apply to taxable years ending on or after the date the regulations are finalized, the IRS has recently issued field guidance clarifying its position with respect to taxpayers that are currently under audit or in appeals. Read the article, [Recent Guidance on Sales-Based Royalties and Vendor Allowances](#).

Natalie Tucker, Director, Washington National Tax

Roger Wilkins, Director, Seattle, WA

Improper Section 263A Method does not bar Section 199 Deduction

Taxpayers that qualify for the Domestic Production Activities Deduction under section 199 are frequently subject to the inventory capitalization rules under section 263A. Do the section 199 regulations require taxpayers to be on a proper 263A inventory capitalization method in order to take the section 199 deduction? Find out what IRS National Office thinks.

Tom Windram, Managing Director, Washington National Tax

Cody Villella, Senior Associate, Washington National Tax

Individually Designed Retirement Plans

Individually designed retirement plans have a regular five-year remedial amendment cycle (five-year cycle). In advance of each year in the cycle, IRS issues an annual cumulative list of changes in plan qualification requirements. For a link to the 2010 Cumulative List, applicable to plans with an amendment



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period running from Feb. 1, 2011 to Jan. 31, 2012, see our article, [New Restatement Cycle for Individually Designed Plans](#).

Bill O'Malley, Managing Director, Peoria, IL

Lifetime Income Disclosure Act of 2011 (S. 267)

This bill would require defined contribution plans to provide plan participants with an annual statement that estimates what the employee's existing account balance would buy in the form of a monthly annuity at normal retirement. Is this valuable information or will it merely confuse plan participants into thinking the monthly benefit on their 401(k) statement is guaranteed? Read a summary of the bill.

Rosemarie Panico-Marino, Managing Director, Chicago, IL

Electing Small Business Trusts and the Passive Loss Rules

ESBTs are taxpaying trusts eligible to own S corporation stock. When the S corporation passes a business loss through to the ESBT shareholder, is it possible for the ESBT to establish that it materially participated in the business operations of the S corporation in order to avoid the limitations on deducting passive activity losses?

Carl Dolson, Managing Director, Peoria, IL

IRS Provides Safe Harbor for Success-based Fees

In an attempt to limit the ongoing controversy of whether success-based fees are deductible or capitalized, the IRS has issued [Rev. Proc. 2011-29](#), providing a safe harbor election for deducting 70 percent of such fees in lieu of maintaining the documentation otherwise required by Treas. Reg. section 1.263(a)-5(f).

Natalie Tucker, Director, Washington National Tax
Nick Gruidl, Managing Director, Minneapolis, MN

Bonus Depreciation Questions Answered

Much anticipated IRS Guidance on a number of bonus depreciation issues can be found in [Rev. Proc. 2011-26](#), and our extended article above. We include also a second and

separate article, [Bonus Depreciation Guidance Addresses Section 280F Limitation](#), which addresses the favorable bonus depreciation safe harbor available for luxury automobiles.

Natalie Tucker, Director, Washington National Tax

Guidance for the Telecommunications Industry on Repairs and Unit of Property Issues

The IRS recently released favorable guidance that includes:

- a safe harbor method for determining the recovery period for depreciation of certain tangible assets used by wireless telecom carriers; and
- two alternative safe harbor methods for determining the amount of network asset repair and replacement expenditures that must be capitalized.

The guidance provides certainty on how to treat numerous telecom assets and maintenance expenditures. Particularly welcome is the asset classification guidance and the unit of property safe harbors.

Natalie Tucker, Director, Washington National Tax
Cody Vilella, Sr. Associate, Washington National Tax

Fourth Circuit Holds Tax Credit Exchange Constitutes Disguised Sale

In *Virginia Historic Tax Credit Fund 2001 LP v. Commissioner*, the court held that transactions involving the exchange of partnership investments for state historic rehabilitation tax credits were disguised sales; therefore, the contributions were includable in the partnerships' income. The decision rested on whether the tax credits met the definition of "property" for purposes of section 707. The court held that the tax credits were property because they were "both valuable and imbued with some of the most essential property rights." This case is significant because it will likely change the structure of deals with similar credits and will likely lead the IRS to appeal the same issue in the *Historic Boardwalk Hall* case.

Tom Windram, Managing Director, Washington National Tax
Cody Vilella, Sr. Associate, Washington National Tax

STATE AND LOCAL

State Adoption of Bonus Depreciation

A number of the provisions in the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, will affect state income tax computations. Full expensing of property eligible for bonus depreciation is one such provision, and the expectation is that many states will decouple from this bonus depreciation. More information is available in our article, [State Adoption of Bonus Depreciation](#).

Joe Neff, Managing Director, Pasadena, CA

Ohio Use Tax Enforcement Activity

The Ohio Department of Taxation has established the Use Tax Education Program (UTEF) to inform Ohio businesses of their responsibility to remit use tax on untaxed purchases. Additionally, UTEF will help businesses clear up any past unpaid use tax liabilities.

Michael Baker, Director, Cleveland, OH

John Bird, Managing Director, Chicago, IL

INTERNATIONAL TAX

Field Directive Released Relating to the 2011 OVDI

Following the February announcement of the 2011 Offshore Voluntary Disclosure Initiative (OVDI), the IRS released a [Field Directive](#) memorandum to field agents that provides rigid instructions on assessing penalties under the initiative. The memorandum instructs field agents to settle cases as follows:

1. Assess all tax and interest due for years 2003 to 2010 and require the offending taxpayer to file or amend all returns and Forms TD F 90-22.1 and all other documents set forth in the submission requirements.
2. Assess an accuracy-related penalty on all years (no reasonable cause exception may be applied), and assess failure to file penalties where applicable.

3. In lieu of all other penalties that may apply, including FBAR and information return penalties, assess an offshore penalty equal to 20 percent of:

1. The amount in foreign financial accounts plus the value of foreign assets
2. That were acquired with untaxed funds or that were producing untaxed income
3. Where the amount is determined in the year with the highest aggregate value of all such accounts, entities and assets

The terms of the 2011 initiative are more severe than the prior initiative. Furthermore, the memorandum reinforces the fact that examiners and their managers have no authority to negotiate penalties. These terms apply only to taxpayers who make voluntary disclosure requests and fully cooperate with the IRS. In these circumstances, it is important that taxpayers have the advice of their tax specialists when approaching the IRS under this program.

Chad Koebnick, Managing Director, Minneapolis, MN

Subscribe to Border Crossing

Border Crossing, compiled by RSM International, is a quarterly electronic newsletter about international tax developments from around the world. To start receiving *Border Crossing* each quarter, [subscribe here](#).

Multinational Tax Proposals will Impact Businesses

The proposed budget from President Obama released in March addresses perceived abuses in the U. S. tax system of foreign income. Long-held U.S. tax policies related to foreign investment by American companies are targeted, reflecting a growing trend among politicians and commentators to view multinational enterprises unfavorably.

Chad Koebnick, Managing Director, Minneapolis, MN

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