

Dear Client,

This letter highlights some of the more important tax developments that have come out during the third quarter months of 2012. Most are documents from the Internal Revenue Service, but some are important cases and legislative changes you might want to be aware of for you or your business.

Final Rules on Use of Corporate Aircraft for Entertainment Travel: IRS issued final rules ([T.D. 9597](#)) on the use of business aircraft for entertainment which contain few changes from controversial 2007 proposed rules. The rules address a tighter tax deduction for the personal use of corporate aircraft for entertainment travel by executives. Among other aspects of the final rules, IRS denied a request to limit disallowed expenses and said it could not provide a safe harbor for charter rates the IRS said it was considering when the proposed rules were issued.

Research Credit: In *U.S. v. Davenport*, a federal district court held that taxpayers that customized commercially available software were not entitled to claim the research and development tax credit because the process of customizing and testing the software did not come within the definition of “qualified research.” In granting the government's motion for summary judgment, the court said that the activities of the taxpayers in customizing the software did not involve a process of experimentation that qualified as research. In *Union Carbide Corp. v. Comr.*, the Second Circuit held that the company was entitled to claim a research credit only for the cost of supplies it used in research, not for all the supplies it used in the production of a product. In upholding the Tax Court's decision, the appeals court said that the company could not claim the research credit for all the supplies it used in the production process regardless of whether any research was performed.

New Markets Tax Credit: The IRS finalized rules ([T.D. 9600](#)) that provide for the ability for investors claiming the new markets tax credit to reinvest returns in certified community development financial institutions as a way to make it easier for them to promote investments in non-real estate businesses. The current rules made it tough to use for investments aimed at providing working capital and equipment loans to non-real estate businesses because such loans are ordinarily amortized over a term of five years or less.

Determining Debt Instrument Price for Traded Property: The IRS unveiled final rules ([T.D. 9599](#)) on when property will be considered to be traded on an established market for purposes of determining the issue price of a debt instrument, with changes that reflect the easing of the debt markets in recent years. The IRS said the rules come in response to the increased liquidity and transparency of the debt markets. This has largely done away with concerns about unavailable information on sales and pricing, the IRS said. The final rules eliminate a requirement that property be listed on an exchange, increase an exception for small debt issues from \$50 million to \$100 million, and require that issue price be reported consistently by issuers and holders.

Proposed Simplified Cost Allocation Rules: The IRS proposed, in [REG-126770-06](#), that taxpayers who produce or resell property get guidance from IRS that will make it easier for them to account for some costs for tax purposes. The proposed rules offer simplified ways to account

for such property under [§263A](#), including a newly streamlined production method. The guidance also prohibits the use of negative costs in some [§263A](#) cost allocations.

NOL Treatment in Corporate Equity Reduction Transactions: The IRS proposed regulations ([REG-140668-07](#)) regarding the treatment of net operating losses in corporate equity reduction transactions, including multistep plans for acquisition of stock and CERTs involving members of a consolidated return group. The rules would specify that both taxable and tax-free transactions can require CERT testing under [§172\(b\)\(1\)\(E\)](#) and [\(h\)](#).

Outbound Transfers of Intangible Property Under §367(d): In [Notice 2012-39](#), the IRS announced that [§367\(d\)](#) regulations will contain some modifications to outbound transfers involving intellectual property (IP). [Notice 2012-39](#) specifically addresses some tax planning structures that the notice characterizes as permitting foreign earnings to be repatriated without U.S. tax consequences. The rules provided in the notice aim to ensure that, with respect to all outbound [§367\(d\)](#) transfers, the total income to be taken into account under [§367\(d\)](#) is either: (1) included in income by the U.S. transferor in the year of the reorganization; or (2) included in income over time by qualified successors (where appropriate).

Model Intergovernment Agreements and Signed U.K. Agreement Under FATCA: The Treasury Department unveiled a long-awaited model agreement for government-to-government information sharing under the Foreign Account Tax Compliance Act (FATCA). Under the model, financial institutions in participating countries would not be required to report information directly to IRS under FATCA. Instead, they would report to their own governments, followed by automatic exchanges of information under bilateral tax treaties or tax information exchange agreements. In addition, the Treasury announced that the United States has signed a bilateral agreement with the United Kingdom to implement information reporting and withholding tax provision under FATCA.

MAP-21 Pension Stabilization Legislation: MAP-21, [P.L. 112-141](#), stabilized the interest rates that are used to calculate minimum funding contributions for single employer defined benefit pension plans by establishing a floor and a ceiling for variable rates. The pension funding stabilization rules generally are effective for plan years beginning after 2011, but you may elect to not have the rules apply for the 2012 plan year. In [Notice 2012-55](#), the IRS issued the 25-year average segment rates. Some plan sponsors are required to disclose the effect of rate stabilization in annual funding notices distributed to participants and beneficiaries for plan years beginning after 2011 and before 2015.

Employee Eligibility Under ACA: The IRS issued [Notice 2012-58](#) and [Notice 2012-59](#), that provide guidance on how employers can determine which workers are full-time employees who must be offered coverage under the health care reform law, and how their wages can be calculated in determining whether coverage is affordable.

FICA Taxes: Payments a company made to employees as part of the company's severance program were not subject to tax under the Federal Insurance Contributions Act, the Sixth Circuit held in *U.S. v. Quality Stores Inc.* In upholding the rulings of the bankruptcy court and the district court, the appeals court expressly rejects the Federal Circuit's holding in *CSX Corp. v.*

U.S. that the payments were dismissal pay subject to tax. The bankruptcy court and the district court both held that the payments were not subject to tax.

Conservation Easements: The Tenth Circuit, in *Trout Ranch LLC v. Comr.*, held that the incorporation of post-valuation data into the income analysis to value a conservation easement for a charitable deduction claim was properly exercised by the lower court. The court said the Tax Court properly used its discretion by incorporating post-valuation data into the income analysis because if the post-valuation data was excluded, it would have left the Tax Court “unequipped to make an informed finding as to value.”

Good Faith Determination for Foreign Charities: The IRS issued proposed rules ([REG-134974-12](#)) on the standards affecting private foundations when making good faith determinations that foreign organizations are charities when considering grants. The proposed regulations would modify existing guidance and identify a broader class of tax practitioners upon whose written advice a private foundation may base a “good faith determination.” Expanding the class of practitioners will lower the costs of seeking professional advice regarding these determinations and will allow foundations to engage in international philanthropy in a more cost-effective manner.

Interest Netting: The Second Circuit, in *Exxon Mobil Corp. v. Comr.*, held that global interest netting under [§6621\(d\)](#) applies where the limitations period remains open for at least one overlapping “leg” of underpayments and overpayments.

Audits: The IRS, in LB&I-4-0812-010, is replacing the tiered issue process it uses to prioritize audit resources with an approach employing specialized issue practice groups for domestic examinations and international practice networks or global audits. The IRS said it now plans to assess risk and conduct audits of formerly tiered issues in the same way as other issues, with the help of the new practice groups.

Please do not hesitate to contact me if you have any concerns about how any of these new developments would affect you.

Sincerely,

Jenkins CPA, LLC