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2010 Tax Update – Highlights of Business & Individual Hot Topics ©

By Dennis J. Gerschick, Attorney, CPA, CFA

I. Preliminary Points

- A. On March 18, 2010, President Obama signed the Hiring Incentives to Restore Employment (HIRE) Act. Under it, two new tax benefits are available to employers who hire certain previously unemployed workers (“qualified employees”).
 - 1. The first, referred to as the payroll tax exemption, provides employers with an exemption from the employer’s 6.2 percent share of social security tax on wages paid to qualifying employees, effective for wages paid from March 19, 2010 through December 31, 2010.
 - 2. In addition, for each qualified employee retained for at least 52 consecutive weeks, businesses will also be eligible for a general business tax credit, referred to as the new hire retention credit, of 6.2 percent of wages paid to the qualified employee over the 52 week period, up to a maximum credit of \$1,000.
 - 3. See the IRS’s web site at www.irs.gov for FAQs
- B. On March 30, 2010, President Obama signed the Health Care and Education Reconciliation Act which amends the Patient Protection and Affordable Care Act of 2010 which he signed on March 23rd. This health care legislation contains many tax provisions.
- C. On March 25th, the U.S. House of Representatives passed the Small Business and Infrastructure Jobs Tax Act of 2010. H.R. 4849 would amend the Internal Revenue Code to provide tax incentives for small business job creation, extend the Build America Bonds program, and provide other infrastructure job creation tax incentives.
 - 1. The Senate Finance Committee was expected to take the bill up in April.

D. Later this year, Congress may address the “no estate tax in 2010” situation.

II. Economic Substance Doctrine is Codified

A. The economic substance doctrine has been used by the IRS and Courts for many years. Some refer to it as the substance vs. form doctrine. In general, the doctrine provides that transactions will be taxed in accordance with the economic substance of the transaction; the form of the transaction(s) alone will not dictate the tax consequences.

B. A good discussion of the doctrine can be found in Coltec Industries, Inc. v. U.S., 454 F.3d 1340 (Fed. Cir. 2006). However, courts have varied in interpreting exactly what was required in order for the doctrine to apply.

C. **New Code Section 7701(o)** is added by Section 1409 of the Reconciliation bill. It also amends the penalty provisions of Code Sections 6662, 6662A, 6664, and 6676.

D. New Code Section 7701(o)(1) provides:

In the case of any transaction to which the economic substance is relevant, such transaction shall be treated as having economic substance only if:

(A) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer’s economic position; **and**

(B) the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction.

E. Noteworthy points about new Section 7701(o):

1. The test is conjunctive; both parts must be met

2. A state or local income tax effect that is related to the federal income tax effects is treated as a federal income tax effect. See 7701(o)(3).

3. The new code section applies only for income tax purposes; the old judicial doctrine may still apply for estate and gift tax purposes.

4. Codification is not intended to impact the determination of whether the doctrine is relevant to a particular transaction. See 7701(o)(5)(C)

5. For individuals, the new section applies only to transactions entered into in connection with a trade or business or an activity engaged in the production of income. See 7701(o)(5)(B)

6. The term “transaction” includes a series of transactions. See 7701(o)(5)(D)

7. The new provision applies to transactions entered into after March 30, 2010
- F. The penalty provisions were revised too
1. Key point: No exceptions, including the reasonable cause exception, are available to the imposition of the penalty for any underpayment, or reportable transaction understatement attributable to a transaction lacking economic substance. See Sections 6664(c)(2) and (d)(2).
 - a. Outside tax opinions will not help if the transaction lacks economic substance

III. Health Care Tax Provisions

A. Preliminary Points

1. The health care legislation noted above is more than 2,000 pages.
2. The new law contains many tax provisions but the starting applicability date varies from 2010 to 2018.
3. The new law was touted as being revenue neutral. However, there is already talk of repealing or modifying the new law because it may turn out the expense of providing health care was understated significantly so benefits will be reduced and/or taxes will be increased
4. Who do the new provisions apply to? Look for terms like “applicable individuals” and “applicable large employer” – generally one that employed an average of at least 50 full-time employees during the preceding calendar year.

B. Some Highlights of Provisions Applicable in 2010

1. The general exclusion for reimbursements for medical care expenses under an employer-provided accident or health plan is extended for any child of an employee who has not attained age 27 as of the end of the tax year.
 - a. See Internal Revenue Bulletin: 2010-20 (5-17-10)

Notice 2010-38 Tax Treatment of Health Care Benefits Provided With Respect to Children Under Age 27

As amended by the Affordable Care Act, the exclusion from gross income under § 105(b) applies with respect to an employee’s child who has not attained age 27 as of the end of the taxable year, including a child of the employee who is not the employee’s

dependent within the meaning of § 152(a). Thus, the age limit, residency, support, and other tests described in § 152(c) do not apply with respect to such a child for purposes of § 105(b).

The exclusion applies only for reimbursements for medical care of individuals who are not age 27 or older at any time during the taxable year. For purposes of §§ 105(b) and 106, the taxable year is the employee's taxable year; employers may assume that an employee's taxable year is the calendar year; a child attains age 27 on the 27th anniversary of the date the child was born (for example, a child born on April 10, 1983 attained age 27 on April 10, 2010); and employers may rely on the employee's representation as to the child's date of birth.

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2. Small businesses that provide health insurance for its employees are eligible for a tax credit as part of the Section 38 general business credit.
 - a. "Small businesses" defined as businesses with 25 or fewer full-time and whose employees have annual full-time equivalent wages that average no more than \$50,000.
 - b. For tax years 2010 – 2013, the credit will be 35%.
 - c. In 2014 and later, eligible small employers who purchase coverage through the Insurance Exchange will be eligible for a tax credit for two years of up to 50% of their contribution.
 3. For 2010, the maximum adoption credit is increased to \$13,170 per eligible child; an increase of \$1,000. This increase applies to both non-special needs adoptions and special needs adoptions. The adoption credit is made refundable.
 4. For adoption-assistance programs, the maximum exclusion is increased to \$13,170 per eligible child (a \$1,000 increase).
 5. After 2011, the adoption credit will revert to its pre-EGTRRA provisions – a \$6,000 credit for special needs children only and the income exclusion will disappear.
 6. Tanning excise tax – New Code Section 5000B imposes a 10% tax on amounts paid for indoor tanning services on or after July 1, 2010.

C. Some Highlights of Later Applicable Provisions

1. New Code Section 5000A requires U.S. citizens and legal residents to maintain minimum amounts of health insurance coverage. Individuals who fail to maintain the minimum amount of coverage will be subject to a penalty equal to the greater of: (a) 2.5% of the amount by which the

taxpayer's household income for the year exceeds the threshold amount of income required for income tax return filing under section 6012(a)(1); or (b) \$695 per uninsured adult in the household. The penalty is passed in for 2014 – 2016. The new law provides liens and seizures are not authorized to enforce this penalty. Is the new excise tax constitutional?

2. New Code Section 36B provides a premium assistance credit to help individuals afford medical insurance. The credit will be based on household incomes between 100% and 400% of the federal poverty level (for the family size involved) who do not receive health insurance thru an employer.
3. Large businesses that provide inadequate health coverage are subject to an excise tax.
4. Starting in 2013, the medical expense deduction threshold is increased from 7.5% of AGI to 10% of AGI; for individuals age 65 and over, the effective date is delayed until 2017.
5. Beginning in 2013, individuals with AGI of \$200,000 or more (\$250,000 for a married couple filing jointly) the Medicare tax will increase from 1.45% to 2.35% on wages earned above those levels. The same individuals will also be subject to a new 3.8% Medicare tax on their net investment income. Net investment income includes interest, dividends, royalties, rents, gross income from a passive trade or business, and capital gains.

IV. Uncertain Tax Positions

A. Announcement 2010-9

1. The IRS announced it would develop a schedule requiring certain business taxpayers to report uncertain tax positions on their tax returns.
2. The proposal does not require the taxpayer to disclose the taxpayer's risk assessment or tax reserve amounts even though the IRS can compel the production of this information through a summons. U.S. v. Arthur Young, 465 U.S. 805, 815 (1984).
3. The IRS noted that many taxpayers are required by FASB Interpretation No. 48 to identify and quantify uncertain tax positions taken in its tax return for financial accounting purposes.
4. The IRS will develop a schedule that will require certain taxpayers to give a concise description of each uncertain tax position.
5. The IRS solicited comments with respect to eight questions it raised.

B. Announcement 2010-17

1. The IRS asked for input on certain other questions
2. The IRS extended the comment period to Announcement 2010-9 until June 1, 2010

C. Announcement 2010-30

1. The draft schedule and instructions were issued on April 19, 2010.
2. They provide that, beginning with the 2010 tax year, the following taxpayers **with both uncertain tax positions and assets equal to or exceeding \$10 million** will be required to file Schedule UTP if they or a related party issued audited financial statements:

Corporations who are required to file a Form 1120, U.S. Corporation Income Tax Return;

Insurance companies who are required to file a Form 1120 L, U.S. Life Insurance Company Income Tax Return or Form 1120 PC, U.S. Property and Casualty Insurance Company Income Tax Return; and

Foreign corporations who are required to file Form 1120 F, U.S. Income Tax Return of a Foreign Corporation.

2. The **draft Schedule UTP** and instructions also provide that, for 2010 tax years, the Service will not require a Schedule UTP from Form 1120 series filers other than those identified above (such as real estate investment trusts or regulated investment companies), pass-through entities, or tax-exempt organizations. The Service will determine the timing of the requirement to file Schedule UTP for these entities after comments have been received and considered.
3. The Service is reviewing the extent to which the proposed Schedule UTP duplicates other reporting requirements, such as Form 8275, Disclosure Statement; Form 8275-R, Regulation Disclosure Statement; Form 8886, Reportable Transaction Disclosure Statement; and the Schedule M-3, Net Income (Loss) Reconciliation for Corporations With Total Assets of \$10 Million or More. The draft instructions provide that a taxpayer will be treated as having filed a Form 8275 or Form 8275-R for tax positions that are properly reported on Schedule UTP. The Service is considering other circumstances under which a tax position reported on Schedule UTP need not be separately reported elsewhere on the tax return or another disclosure statement.

- D. The principal author **Kathryn A. Zuba (202) 622-7583** (not a toll-free call).

V. Registration of Tax Preparers

- A. In June 2009, the IRS launched a review of the oversight of federal tax return preparers. The IRS requested input on the standards of conduct for the tax return preparer community. See Notice 2009-60.
- B. The IRS kicked off the 2010 tax filing season by issuing a report proposing new registration, testing and continuing education of paid tax return preparers. With more than 80 percent of American households using a tax preparer or tax software, higher standards for the tax preparer community will significantly enhance protections and service for taxpayers, increase confidence in the tax system, and result in greater compliance with tax laws over the long term.
- C. Upcoming Requirements
 1. Requiring **all** paid tax return preparers to sign-up with the IRS, pay a registration fee, and obtain a preparer tax identification number (PTIN). If you already have a PTIN, you must still sign-up under the new process.
 2. Requiring competency tests for all paid tax return preparers **except** attorneys, certified public accountants (CPAs) and enrolled agents who are active and in good standing with their respective licensing agencies.
 3. Requiring continuing professional education of 15 hours per year for all paid tax return preparers **except** attorneys, CPAs and enrolled agents.
 4. Conducting tax compliance checks on all tax return preparers.
 5. Extending Circular 230 ethics standards to all preparers.

VI. Frivolous Positions

A. Internal Revenue Bulletin: 2010-17 (4-26-10)

Notice 2010-33 *Frivolous Positions*

I. Purpose

Positions that are the same as or similar to the positions listed in this notice are identified as frivolous for purposes of the penalty for a “frivolous tax return” under section 6702(a) of the Internal Revenue Code and the penalty for a “specified frivolous submission” under section 6702(b). Persons who file a purported return of tax, including an original or amended return, based on one or more of these positions are **subject to a penalty of \$5,000** if the purported return of tax does not contain information on which the substantial correctness of the self-assessed determination of tax may be

judged or contains information that on its face indicates the self-assessed determination of tax is substantially incorrect. Likewise, persons who submit a “specified submission” (namely, a request for a collection due process hearing or an application for an installment agreement, offer-in-compromise, or taxpayer assistance order) **based on one or more of the positions listed in this notice are subject to a penalty of \$5,000.** The penalty may also be applied if the purported return or any portion of the specified submission is not based on a position set forth in this notice, yet reflects a desire to delay or impede the administration of Federal tax laws for purposes of section 6702(a)(2)(B) or 6702(b)(2)(A)(ii). The penalty will be imposed only when the frivolous position or desire to delay or impede the administration of Federal tax laws appears on the face of the return, purported return, or specified submission, including any attachments to the return or submission.

46 different frivolous positions are described in the Notice

The principal author of this notice is Emily M. Lesniak, Office of the Associate Chief Counsel, Procedure and Administration. For further information, contact Emily M. Lesniak at 202-622-4940 (not a toll-free number).

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Dennis Gerschick has a unique background. He is the only individual who is an Attorney, CPA, Chartered Financial Analyst, and Venture Capitalist and has work experience in each field.

Mr. Gerschick graduated Florida Atlantic University in 1978 (major in accounting). He passed the May, 1978 CPA exam on his first attempt. He then worked as a CPA with Ernst & Young, one of the Big 4 accounting firms, before graduating from Drake Law School in 1983.

After law school, Mr. Gerschick worked in the tax department of one of Atlanta's largest law firms, Powell, Goldstein. Later, Mr. Gerschick opened his own law firm. His practice focused on representing closely-held businesses and their owners. For many clients, he also acts as a business and financial advisor.

Mr. Gerschick is the President of VenCap Advisory Group, Inc. which is the sole general partner of VenCap Opportunities Fund, L.P., a venture capital fund. Mr. Gerschick's duties include finding companies in which to invest, reviewing and evaluating hundreds of business plans, as well as negotiating, structuring, documenting, and monitoring the fund's investments. He has also served on several boards of directors and audit committees.

Mr. Gerschick served on the American Institute of CPA's Business Valuation Subcommittee.

Mr. Gerschick also provides a variety of legal and consulting services. He provides tax, investment, financial and business advice to a variety of companies and investors. He consults with other CPAs and attorneys to help them better serve their clients, or he provides a second opinion. See www.Gerschick.com

Mr. Gerschick speaks frequently at seminars and conferences throughout the country regarding a variety of investment, legal, and tax topics. He has spoken about the purchase or sale of a business, real estate, corporate governance, financing businesses, financial statement analysis, and many other topics. See www.RegalSeminars.com

Mr. Gerschick has written many articles, relating to growing and financing businesses that have been published by the Technology Law Section of the Georgia Bar and the Michigan Association of CPAs. Mr. Gerschick has authored two monographs, [Raising Capital](#) and [Attracting Investors to Your Start-Up](#), both of which are offered by the Capital Formation Finance Institute in Washington DC. See www.cfi-institute.org. An interview with Mr. Gerschick was also published in [American Venture](#), a magazine targeted at entrepreneurs and accredited investors.