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Congressional Leaders Highlight Tax Reform Proposals

As the new administration and Congress get to work, tax reform is high on the agenda. Although legislative language has not yet been released, statements from tax writers in Congress shed some light on various proposals.

Tax reform

House Ways and Means Chair Kevin Brady, R-Texas, has predicted that tax reform will lower the tax rates for all businesses. "We are proposing a corporate rate of 20 percent and for small businesses, a top rate of no more than 25 percent," Brady said. As for the timeline of tax reform, Brady said that tax reform legislation will be unveiled in the "coming months." Senate Finance Committee Chair Orrin Hatch, R-Utah, has said that the Senate will work through its own tax reform process. "No one should expect the Senate to simply take up and pass a House tax reform bill," Hatch said. Hatch added that Senate tax writers are in the early stages of drafting a tax reform proposal. Hatch did not provide details of the proposal but said that House and Senate Republicans generally agree on basic principles, such as lower tax rates for individuals and businesses.

One area of potential friction is the House GOP's so-called "border adjustability" proposal. Hatch has questioned whether the border adjustment proposal, essentially taxing imports but not U.S. exports, is "in line with international trade obligations" and whether "adjustments would need to be made to prevent shifting a tax burden onto specific industries." Democrats, although in agreement that the tax code is in need of reform, have been critical of Republicans' proposed solutions as appearing to focus on tax cuts for the wealthy. "They (Republicans) are for trickle-down economics…giving tax breaks to the wealthy, it trickles down and if somebody gets a job, that's great, if they don't, so be it," House Minority Leader Nancy Pelosi, D-Calif., said. "You don't receive economic security by tossing the rich even more tax breaks," she added.

Affordable Care Act

The Affordable Care Act (ACA) included a host of tax-related provisions. The ACA created the net investment income (NII) tax, the additional Medicare Tax, an excise tax on certain medical devices, and more. The ACA also imposes shared responsibility requirements on individuals and employers (known and the individual and employer mandates). Although President Trump and Republicans in Congress have called for repeal and replacement of the ACA, it is not clear at this time whether repeal includes the ACA's tax provisions. Hatch said that all of the ACA's taxes "need to go." The timeline for Congressional action on the ACA is expected to be known soon. **Note**: Changes to the ACA are still pending.

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Tax Scams Proliferate During Filing Season

The filing season is the most active time of the year for tax scams. These scams take every shape and form, ranging from telephone calls to individuals to sophisticated schemes targeting employers and businesses. The goal of all these scams is identity theft. Using legitimate identities of unsuspecting individuals allows criminals to file fraudulent returns and claim bogus refunds.

Phone scams

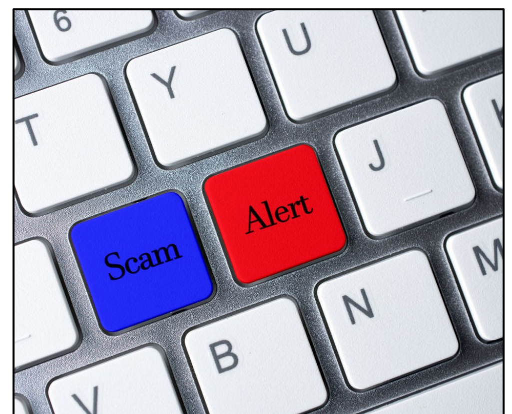
Phone and email scams are among the most common scams. Every day, individuals receive calls and emails from criminals pretending to be IRS employees. Scammers often alter caller ID numbers to make it look like the IRS or another agency is calling. Criminals use IRS employee titles and fake badge numbers to appear legitimate. They may also use the victim's name, address, and other personal information to make the call sound official. The phone calls often threaten legal action or arrest if the taxpayers do not immediately make a payment, usually with a debit or gift card. Taxpayers receiving threatening telephone calls should hang up immediately. The IRS will never demand immediate payment using a specific payment method, such as a prepaid debit card, gift card or wire transfer. The IRS also will never threaten arrest.

Email scams

Email scams often ask recipients to provide personal and financial information in order "to verify" a tax obligation or claim a "refund." The emails appear to be genuine communications from the IRS. Criminals create websites that appear legitimate in the hope that individuals will take the bait and provide money, passwords, Social Security Numbers, and other personal information. Scam emails also can infect a taxpayer's computer with malware. The malware can give criminals access to the computer, laptop tablet, or other device, enabling them to access all sensitive files or track keyboard strokes, exposing login information. The IRS has repeatedly emphasized that it never initiates contact with taxpayers via email about a bill or refund. Taxpayers should delete these emails immediately.

Employers

Criminals are increasingly disguising emails to make it appear as if the email is from a company or organization executive. Typically, this email is sent to an employee in the payroll or human resources departments, requesting a list of all employees and their Forms W-2, Wage and Tax Statement. This scam is sometimes referred to as business email compromise (BEC) or business email spoofing (BES). This scam targets all types of businesses: school districts, tribal casinos, chain restaurants, temporary staffing agencies, healthcare, and shipping and freight. Businesses that received the scam email last year also are reportedly receiving it again this year. The IRS has asked employers and businesses to forward these bogus emails to the agency at phishing@irs.gov.



Identity theft

The IRS is making progress in identifying and curbing tax-related identity theft, according to the Treasury Inspector General for Tax Administration (TIGTA). The IRS and tax professionals and the tax software community have joined together to better protect taxpayer information. The agency has upgraded its return processing identity theft filters and taken other behind-the-scenes

measures to uncover fraudulent returns. All of these measures, TIGTA reported in February, have helped to deter tax-related identity theft, but criminals continue to look for ways to trick taxpayers and the IRS.

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Lessons Learned – TIGTA Report Points to Changes in 2017 Filing Season

The Treasury Inspector General for Tax Administration (TIGTA), in its recently released final report for the 2016 filing season, highlighted the IRS's response to what was good and what was bad about its performance. It signals what the IRS is doing during the 2017 filing season currently underway to improve things (TIGTA, Ref. No. 2017-40-014). Nevertheless, although the IRS had improved in a number of areas with respect to the 2016 filing season, TIGTA reports that the agency continues to be plagued by numerous challenges.

The overarching objective of TIGTA's review of the previous filing season is to assess whether the IRS timely and accurately processed individual paper and e-filed tax returns during the 2016 filing season. Although the IRS agreed with TIGTA's recommendations for addressing its shortcomings, budget cuts and a shrinking workforce will arguably limit the IRS's success with respect to the immediate 2017 filing season.

Fraud detection

The TIGTA report suggests that the IRS is seeing continued success in detecting and preventing tax refund fraud. There has been a continued decreasing trend in the number of fraudulent tax refunds that the IRS detects and stops, which is attributable to the IRS's expansion of its processes to prevent fraudulent tax returns from entering the tax processing system. The IRS continues to implement ways to combat taxpayer fraud. In fall 2016, the IRS entered a partnership with industry professionals and state revenue agencies—the Security Summit—to focus on fighting fraud. In addition, a change in the law to require all wage statements to be submitted to the IRS by January 31, were implemented with the intent to combat fraudulent filings in the 2017 filing season.

Challenges

TIGTA has consistently reported, from year to year, that a challenge that the IRS faced each year in processing tax returns was the implementation of new tax law changes and the extension of expired tax provisions. The 2016 tax season proved no different, as the IRS failed to establish or update key processes and made numerous processing errors. With fewer of these changes for the 2016 tax year to be faced during the current 2017 filing season, the IRS is guardedly optimistic for a smoother overall track record.

HCTC

TIGTA found that the IRS did not establish adequate processes to ensure that documentation required to support a claim for the health coverage tax credit (HCTC) was associated and reviewed before processing claims and allowing the credit. As the HCTC claims are processed manually, employee errors could delay the issuance of refunds. This is significant, as the IRS received 20,437 e-filed returns claiming HCTCs that totaled approximately $40.8 million. However, as of the time that TIGTA conducted its review, the IRS had completed processing of only 5,481 of the returns claiming HCTCs, which amounts to only 27 percent of all such returns. TIGTA reported that it notified IRS management throughout the filing season of its concerns regarding the inaccurate processing of HCTC claims, resulting in IRS management making a number of changes during the filing season to alleviate some of the issues. TIGTA plans to issue additional reports on the IRS's progress in implementing the HCTC during calendar year (CY) 2017.

PATH Act

TIGTA found that the IRS has not taken actions to implement key provisions of the Protecting Americans From Tax Hikes Act of 2015, as the agency had not developed processes to systemically identify and disallow the Earned Income Tax Credit, Child Tax Credit, Additional Child Tax Credit, and American Opportunity Tax Credit claims without the data needed to determine the issuance date of Social Security Numbers and Individual Tax Payer Identification Numbers. With the start of the new year, the IRS has begun expiring ITINs not used for three consecutive tax years and those issued between CY 1996 and 2000. The IRS will continue these actions on ITINs issued prior to CY 2013. TIGTA will report on the IRS's expiration of ITINs during fiscal year (FY) 2017.

Credits

TIGTA found that the IRS had not implemented computer programming changes to correct residential energy efficient property credit processing errors identified during the 2015 filing season. Further exacerbating issues, TIGTA also found that IRS employees continued to incorrectly work residential energy efficient property credit claims. As a result, the IRS incorrectly limited the credit on 731 tax returns, amounting to $1.2 million less in credits for taxpayers than they were entitled to receive. IRS management has stated that the agency has requested revisions to computer programming for the 2017 filing season. However, at the time of the report, the IRS could not provide an implementation date, citing limited resources and competing priorities as challenges affecting completion of the work.

Taxpayer assistance

TIGTA reported that the IRS had answered 14.1 million calls and provided a 69 percent level of service during the 2016 filing season. Although this call-service data represents a significant uptick from the prior year, the IRS continued to decrease the number of taxpayers it assisted at its Taxpayer Assistance Centers (TACs), only assisting 4.5 million taxpayers in FY 2016. The IRS attributed this 20 percent decrease from FY 2015 to budget cuts and its strategy of appointment service at certain TACs, in conjunction with the agency's push of alternative service options. On taking office, President Trump

ordered a federal government hiring freeze. Traditionally, the IRS hires temporary workers during the filing season to assist with increased call volumes. Although the hiring of temporary workers is excluded from the President's hiring freeze mandate, it remains to be seen how budget restrictions will affect the level of in-person and phone service available to taxpayers.

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Consider Claiming Federal Fuel Tax Credit

Do you actually qualify for the federal fuel tax credit? The IRS has uncovered significant fraud associated with the fuel tax credit and is watching for fraudulent claims. The credit is available only to qualified taxpayers, such as taxpayers engaged in farming. However, some ineligible taxpayers claim the credit in order to inflate their refunds. Fuel tax credit fraud can result in a penalty of $5,000.

Qualified taxpayers

The credit is available to qualified taxpayers for the amount of excise taxes included in the price of gasoline used on a farm for farming purposes, for other off-highway business use, by local transit systems, and by the operators of intercity, local or school buses. A special rule applies to diesel and aviation fuel.

Form 4136

Generally, eligible taxpayers may claim fuel taxes as a credit against income tax for the year in which the qualifying use occurred. A claim for credit is made on the taxpayer's income tax return and should be accompanied by Form 4136,"Credit for Federal Tax Paid on Fuels," which is used to compute the credit. The credit may be claimed within three years after the due date for filing the return on which the credit may be claimed or within two years from the time the tax was paid, whichever is later. If the amount of the credit would be $1,000 or more for gasoline or for diesel and special motor fuels used during any of the first three quarters of the tax year ($200 for alcohol mixture), a taxpayer may elect to file a quarterly claim for refund.

Partnerships

A special rule applies to partnerships. Partnerships (other than electing large partnerships) cannot use Form 4136. Instead, they must include a statement on Schedule K-1 (Form 1065) showing the allocation to each partner specifying the number of gallons of each fuel used during the tax year, the applicable credit per gallon, the nontaxable use or sale, and any additional information required to be submitted.

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Deal with IRS Letter Regarding a Suspicious Return

Tax-related identity theft spikes during the filing season. Many taxpayers discover for the first time that they are victims of identity theft when they receive a letter from the IRS.

A taxpayer may receive a letter when the IRS stops suspicious tax returns that have indications of being identity theft but contains a real taxpayer's name and/or Social Security Number. Once the identity is verified, the taxpayers can confirm whether or not they filed the return in question. If they did not file the return, the IRS can take steps at that time to assist them.

One communication that the IRS uses is Letter 5071C. This letter is mailed through the U.S. Postal Service to the address on the return. It asks the taxpayer to verify his or her identity in order for the IRS to complete processing of the return if the taxpayer did file it or reject the return if the taxpayer did not file it. The IRS will explain how taxpayers can contact the agency. The IRS has recommended that taxpayers should have available a copy of the letter they received, their prior year's return (if one was filed) and the current year's return (if one was filed), including supporting documents for each return. This would encompass Forms W-2's, 1099's, Schedule C, Schedule F, and other supporting documents.

Note: The IRS never asks a taxpayer to verify his or identity by email. If a taxpayer receives such an email, it is a scam, sent by criminals trying to trick the taxpayer into revealing personal and financial information.

Another communication that the IRS uses is Letter 4883C. This letter also is mailed through the U.S. Postal Service and asks taxpayers to verify their identities. The IRS will explain what steps to take.

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California Franchise Tax Board (FTB) Releases Guidance on the Other State Tax Credit

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The FTB released Legal Ruling 2017-01, explaining when taxpayers may claim the Other State Tax Credit (OSTC) or a deduction for taxes paid to another state. The ruling outlines the general rules for claiming the OSTC or deducting other state taxes, and then goes through specific fact patterns addressing taxes paid to Arizona and business taxes paid to Tennessee, Texas, Manhattan, Kentucky, and New York.

Credit or deduction

The ruling states that the determination as to whether the payment of a tax to another state is eligible for the OSTC or is deductible for California purposes, turns on:

1. Whether the tax is properly characterized as a tax on, or according to, or measured by income; and, if it is, then
2. Whether the tax is properly characterized as a net income tax.

If the tax is not properly characterized as a tax on, or according to, or measured by income, then the inquiry ends, and the taxpayer may claim a California deduction for the tax (assuming all other requirements are met), but the taxpayer may not claim the OSTC.

If the tax is properly characterized as a net income tax, a further determination must be made as to whether the tax is imposed by and paid to the other state such that the taxpayer may claim the OSTC. If the other state's tax is not a single, indivisible tax, but rather a multifaceted tax consisting of a conglomeration of "separate and independent taxes," each of the separate taxes is analyzed independently. Therefore, it is possible for some portion of a multifaceted tax to be based on net income and eligible for the OSTC and not deductible, while another portion is not based on income and is deductible but not eligible for the OSTC.

The Revised Texas Franchise Tax (RTFT)

In the ruling, the FTB states that the RTFT does not qualify for the OSTC because it is not a tax on, or according to, or measured by income, regardless of the manner in which the entity's taxable margin is determined. The FTB states that the tax is a single, indivisible tax, because a taxpayer can only be subject to paying one tax on one base in any year, regardless of the number of activities in which the business engages. This is true even though the taxpayer may compute multiple margins in order to comply with the requirement that the lesser margin be utilized as the base upon which the tax is computed.

As a result, the FTB has found that each computation method cannot be analyzed on its own, but the tax as a whole must be analyzed to determine its character. The RTFT is a tax on many

types of business activities, including manufacturers, merchandisers, miners, and service providers, so there is a potential for cost of goods sold (COGS) to be included in the tax base. Although the RTFT offers several methods for computing the taxpayer's margin, not all of the methods remove COGS from the tax base, and that is the FTB's basis for their determination that the tax is not on, or according to, or measured by income. The analysis states that all RTFT taxpayers must calculate and compare their respective margins under Texas Tax Code Section 171.101 to determine their respective lowest taxable margin, which is apportioned and used as the measure of tax, which could result in a measure not constituting net or gross income for some taxpayers subject to the RTFT. Although the tax does not qualify for the OSTC, it would be a deductible tax under this analysis.

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Pennsylvania and Virginia Tax Amnesty Programs

Pennsylvania adopted a temporary tax amnesty plan that runs from April 12, 2017 through June 19, 2017. Under the plan, all penalties and 50% of the interest will be waived for applicants with tax delinquencies as of December 31, 2015 who pay their tax liabilities. Virginia also recently enacted a similar law to provide a 60- to 75-day tax amnesty program sometime between July 1, 2017 and June 30, 2018.

Information on the Pennsylvania amnesty program is available at http://www.revenue.pa.gov/taxamnesty/Pages/default.aspx#.WNmmV2_ytJ4.

Information on the Virginia program is available at www.tax.virginia.gov/guidelines-virginia-tax-amnesty-program.

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Reminder: Form 571-L Business Property Statement Due Date Fast Approaching

The due date for filing a 2017 Form 571-L, Business Property Statement (BPS), is April 1, 2017, but May 8, 2017 is the last day to file and avoid a late penalty. The BPS declares cost information of all personal property owned or leased by a business in California. All property that is not real property is considered personal property.

Business owners with personal property having an aggregate cost of at least $100,000 on December 31, 2016, must file a BPS with the county assessor, detailing costs of all supplies, machinery, equipment, and fixtures at each business location. Multiple locations will file a statement for each location. Business owners with personal property having an aggregate cost below the $100,000 threshold are required to file only if requested by the county assessor. Certain types of property are exempt from personal property tax, such as business inventory, licensed vehicles, and intangible assets.

Late filings are assessed a 10% penalty. If a business is required to file and fails to do so, the county assessor will estimate a value and add a penalty of 10% of the estimated assessed value of the unreported property.

Once the BPT statements are filed, the county assessor establishes the assessed value of all personal property and delivers the assessment roll to the treasurer-tax collector to prepare and mail personal property tax bills (also known as unsecured property tax bill), which are due by August 31, 2017.

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Headquarters

111 West Ocean Boulevard

Twenty-Second Floor

Long Beach, CA 90802

562.435.1191

Orange County Office

18201 Von Karman Avenue

Suite 1060

Irvine, CA 92612

949.271.2600

Los Angeles Office

601 South Figueroa Street

Suite 4950

Los Angeles, CA 90017

213.239.9745

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