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Tax News Flash

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Save the Date! Baker Tilly International Tax Forum on Nov. 4

You may have heard that Accuity LLP is the exclusive Hawaii member of Baker Tilly International, one of the largest international networks of independent accounting firms. This year, just prior to the Asian-Pacific Economic Cooperation (APEC) Leaders' meeting in Honolulu, Accuity will be hosting the Baker Tilly World Conference.

To showcase the reach and power of the Baker Tilly network, Baker Tilly International will be sponsoring an International Tax Forum on timely and relevant cross-border topics. It will be open to our clients and selected guests. Mark your calendars for:

What: **The Baker Tilly International Tax Forum**
Topic: *Investment Options: From U.S. to Other APEC Countries; From Other APEC Countries to U.S.*
Place: The Kahala Hotel, 5000 Kahala Avenue, Honolulu, HI 96816
Time: 8:30 AM to 10:00 AM, Friday, November 4, 2011. Check-in opens at 8:00 AM.
Cost: Free with advance registration. Light refreshments will be provided.

Register by clicking on this link.

Rare Move! IRS Hikes Mileage Reimbursement Rates Effective July 1

On June 23, the Internal Revenue Service announced an increase in the optional standard mileage rates for the final six months of 2011. Taxpayers may use the optional standard rates to calculate the deductible costs of operating an automobile for business and other purposes.

The rate will increase to 55.5 cents a mile for all business miles driven from July 1, 2011, through Dec. 31, 2011. This is an increase of 4.5 cents from the 51 cent rate in effect for the first six months of 2011.

The IRS normally updates the mileage rates only once a year, in the fall for the next calendar year. The mid-year rate increase was announced to give taxpayers some relief given the recent surge in gasoline prices.

The optional business standard mileage rate is used to compute the deductible costs of operating an automobile for business use in lieu of tracking actual costs. This rate is also used as a benchmark by the federal government and many businesses to reimburse their employees for mileage.

The new six-month rate for computing deductible medical or moving expenses will also increase by 4.5 cents to 23.5 cents a mile, up from 19 cents for the first six months of 2011. The rate for providing services for charitable organizations is set by statute, not the IRS, and remains at 14 cents a mile.

The new rates are contained in Announcement 2011-40. Taxpayers always have the option of calculating the actual costs of using their vehicle rather than using the standard mileage rates.

Mileage Rate Changes (cents per mile)

Purpose	1/1/11 - 6/30/11	7/1/11 - 12/31/11
Business	51.0	55.5
Medical/Moving	19.0	23.5
Charitable	14.0	14.0

Dept. of Taxation Releases Taxpayer-Friendly Guidance on Act 105 Grandfather Clause

In a previous Accuity News Flash, we reported on Act 105, Session Laws of 2011, that suspended for three years a number of General Excise Tax exemptions. A provision in the law allows a taxpayer to continue to take exemptions for income earned under a binding written contract signed prior to July 1, 2011, but only if that contract does not permit the passing on of increased rates of taxes. On June 23, the Department of Taxation released Announcement 2011-10, providing some fairly liberal guidance on what they will consider a grandfathered contract.

The Announcement is written primarily for taxpayers in the construction industry that are concerned with the subcontract deduction, but there is nothing in the Announcement preventing other taxpayers from relying on it.

The Announcement sets forth three elements needed for a contract to qualify for grandfather clause relief:

- First, the contract must not permit the increase in the tax to be passed on to the consumer.
- Second, the contract must be in writing.
- Third, the contract must be binding prior to July 1, 2011.

Task Orders and Change Orders

Under the Announcement, task orders and change orders relate back to the original contract. So if the original contract qualifies as a grandfathered contract, a change order or task order issued under the contract also qualifies.

> *Example:* On May 21, 2011, Contractor and Owner enter into a contract where Contractor agrees in writing to build a house for $450,000 plus 4.712% tax (the number is stated in the contract). This is a grandfathered contract because it is for a fixed price, in writing, and binding before July 1, 2011. (If the contract only said $450,000 “plus tax,” or “plus applicable taxes,” then the contract *would* permit tax increases to be passed on and *would not* be a grandfathered contract.) Therefore, Contractor may continue to deduct amounts paid to the subcontractors under the contract with Owner.
>
> On July 31, 2011, Contractor and Owner sign a change order where Contractor agrees to build additional cabinets in the house and Owner agrees to pay an additional $15,000 plus 4.712% tax. Although the change order is binding after July 1, 2011, the change order relates back to the original contract, which is grandfathered, and Contractor may continue to deduct amounts paid to subcontractors under the change order as well as under the original contract.

Subcontracts

The Announcement also treats subcontracts issued under the original contract as change orders.

> *Example:* In the example above, on July 5, 2011, the Contractor enters into a subcontract with Subcontractor A to install the glass windows in the building and on July 12, 2011, Subcontractor A enters into a subcontract with Subcontractor B to install a portion of the windows. Because the contract between the Contractor and Owner is grandfathered, Contractor may still take the subcontract deduction for payments made to Subcontractor A. Furthermore, the contract between Subcontract A and Subcontractor B will be treated like a change order. Therefore, because the prime contract (between Contractor and Owner) is grandfathered, Subcontractor A will be able to deduct the amounts paid to Subcontractor B for general excise tax purposes.

Government Contracts

The Announcement states that for purposes of the temporary suspension of the exemptions in Chapter 237, including but not limited to the subcontractor's deduction, provided in Act 105, the Department will consider the following to be a "binding written contract" if: (1) done prior to July 1, 2011: (a) a bid is submitted in response to an invitation for bids issued by a local, state, or federal government; or (b) an award for a contract is made in response to a bid or proposal prepared for the local, state, or federal government; and (2) the accepted bid or award results in a fully executed written contract.

> *Example:* A contractor submits a bid to a State agency on June 1, 2011 in response to an invitation to bid, the bid is accepted or awarded on July 15, 2011, and the award results in a fully executed contract on December 15, 2011. The resulting contract is grandfathered because the bid was submitted prior to July 1, 2011.

This section of the Announcement clearly applies to taxpayers other than construction contractors.

> *Example:* In response to an invitation to bid Supplier submits a bid to a Federal agency on June 1, 2011, agreeing to supply 15,000 widgets at $10 per widget. The bid is accepted or awarded on July 15, 2011, and the award results in a fully executed contract on December 15, 2011. As a result, Supplier furnishes 15,000 widgets to the Government and is paid $150,000. The contract is grandfathered because the bid was submitted prior to July 1, 2011. Thus, although the GET exemption for tangible personal property sold to the federal government is suspended by Act 105, Supplier is still allowed the exemption as to the $150,000.

This rule should not be relied upon for non-government contracts entered into after June 30, 2011, especially if price negotiation takes place after June 30 (indicating that the parties were not bound before July 1).

If you have questions about any of these news items, your client service team at Accuity can bring you the resources that you may need. Please do not hesitate to contact your client service team for more information or Tom Yamachika at (thomas.yamachika@accuityllp.com)

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