



CERTIFIED PUBLIC ACCOUNTANTS

Tax News Flash

In This Acuity Update:

- IRS Asks “C” Corporations to Spill Beans About Tax Reserves
- Revenue Raising Bills Passed as Legislature Adjourns

IRS Asks “C” Corporations to Spill Beans About Tax Reserves

On April 19, the Internal Revenue Service took major steps to require large corporations to report their uncertain tax positions (UTPs) on their annual tax return, beginning with the 2010 tax year. The Service released a draft form that will be a required attachment to 2010 returns for certain corporations, and instructions for that form.

What Does the Form Look Like?

SCHEDULE UTP (Form 1120) <small>Department of the Treasury Internal Revenue Service</small>	Uncertain Tax Position Statement ▶ File with Form 1120, 1120-F, 1120-L, or 1120-PC. ▶ See Instructions.	<small>OMB No. 1545-0000</small> 2010
<small>Name of entity as shown on page 1 of tax return</small>		<small>EIN of entity</small>

This Part I, Schedule UTP (Form 1120) is page _____ of _____ Part I pages.

Part I **Uncertain Tax Positions For the Current Tax Year.** See instructions for how to complete columns A through F. Enter, in Part III, a description for each Uncertain Tax Position (UTP).

Check this box if the corporation was unable to obtain information from related parties sufficient to determine whether a tax position is a UTP (see instructions) ▶

A. UTP No.	B. Primary IRC sections (e.g., "61", "108", etc.)	C. Timing Codes (check if Permanent, Temporary, or both)	D. Pass-Through Entity EIN	E. Check If Administrative Practice	F. Maximum Tax Adjustment (size of issue)
		P T	-	<input type="checkbox"/>	
		P T	-	<input type="checkbox"/>	

Part II of the form will ask for UTPs for *prior* tax years. Part III of the form will ask for narrative descriptions of the UTPs.

Who Needs to File This Form?

The form needs to be filed by:

- C corporations (or consolidated groups) with \$10 million in assets,

- Which have recorded a reserve for a UTP on an audited financial statement, *or* which have determined *not* to record a reserve based on an expectation to litigate or an IRS administrative practice.

Corporations that qualify will attach Schedule UTP to Form 1120, 1120-F, 1120-L, or 1120-PC. Entities filing other types of returns, such as Form 990, 1065, 1120-S, or 1120-RIC, will not be required to file this form in 2010.

What does this mean? Here are some answers according to the current draft of the form and instructions:

- Will I have to report a UTP for tax reserves established in 2009 or prior years?
 - No, tax positions taken in a tax year beginning before December 15, 2009 do not have to be reported.
- Do I have to report if I established a reserve in 2009 but added to it in 2010 because of an unfavorable case decided in 2010?
 - No, the reporting requirement is triggered only when the reserve is established.
- What if my company determined not to establish a reserve because it expects to litigate the issue and think the company has a better than 50% likelihood of prevailing?
 - This type of position must be reported.
- What if my company determined not to record a reserve because of a widely understood administrative practice (as defined in ASC 740, formerly known as FIN 48)? For example, we have a large capitalization threshold and the Service has never had a problem with it.
 - This type of position must be reported. The box in Column E should be checked.
- What is a Maximum Tax Adjustment (MTA) in column F?
 - It is the amount of additional tax that would be assessed if the tax position described is disallowed in full. You can determine the amount in isolation, that is, without considering collateral effects on other positions in the same return.
- Do you mean we have to disclose the amount of the reserve?
 - No.
- Do we calculate expected penalties and interest in determining MTA?
 - No.
- How do you determine the MTA for a valuation issue?

- You don't, but you need to describe the issue in the narrative as a valuation issue. The same goes for transfer pricing.
- What if my company is a foreign corporation that is simply filing a protective Form 1120-F because we think the tax treaty between the U.S. and our company's country entitles us not to file a U.S. tax return?
 - Protective returns are not exempt from the Schedule UTP requirement.
- If my company discloses a tax position on Schedule UTP, will it also need to file Form 8275 or 8275-R for these positions?
 - No. If a position is completely and accurately disclosed on Schedule UTP, then there is no need to disclose the same position on Form 8275 or 8275-R.
- Are these disclosures only for the benefit of IRS or will they be sharing them with other tax agencies such as States or foreign countries?
 - According to a webcasted interview that PricewaterhouseCoopers had with the IRS Chief Counsel, the IRS has information sharing agreements in place with different States and countries, and Schedule UTP information will be shared like any other tax return information.

Revenue Raising Bills Passed as Legislature Adjourns

As debates over the State's fiscal situation continued to the end of the regular session, lawmakers recently voted to send a number of revenue raising bills to Governor Lingle's desk. She now has 45 days to decide whether to sign or veto them, or let them become law without signature.

In the following descriptions, **red** titles are used for bills that are dead, **green** titles are used for bills sent to the Governor's desk, and **black** titles are for bills that have become law.

GET Exemptions Dodged the Swatter!

STATUS: DEAD

SB 2402 CD1 "temporarily" suspended a list of exemptions from the general excise tax, which would instead be taxed at 0.5% from July 1, 2010, to June 30, 2015. After reporting this bill out, lawmakers recommitted it to conference committee. It did not move out before the deadline.

In a previous update, we recommended immediate action to take advantage of the grandfather provision in CD1. The need for that action has evaporated.

Adoption of Federal Tax Changes – or Lack Thereof, With Extras

STATUS: PASSED ON APRIL 27 AND SENT TO GOVERNOR

Every year, the Department of Taxation submits, and the Legislature considers, a bill that would adopt some or all of the Federal changes that took place in the past year. House and Senate versions of the bill were reconciled by a Conference Committee into **HB 2594 CD1** which proposes nonconformance to Federal income tax law in these areas, among others:

- Additional sales tax deduction on large purchases (Federal allows an itemized deduction or an addition to the standard deduction, State allows neither)
- NOL carryback (Federal allows up to 5 years, State only allows 2 years)
- Roth IRA conversions (Federal spreads the income inclusion over 4 years; State taxes it all in the first year)
- Federal subsidy of COBRA coverage (Federal excludes it from the unemployed worker's income, State doesn't)
- Unemployment benefits (Federal excludes \$2,400, State doesn't)
- Bonus depreciation (State has never allowed this)
- Section 179 expensing (State has only allowed \$25,000)
- Grants for special energy property in lieu of tax credits (Federal excludes from income but requires basis adjustment, State doesn't exclude from income)

There are several other, more specialized areas of proposed nonconformance.

The conference draft also conforms to expanded reporting provisions in the HIRE Act, health care reform legislation, and last year's changes. Taxpayers will need to conform to Federal provisions reporting the following:

- Miscellaneous income payments made to corporations for goods, services, or both (federal change effective for payments after December 31, 2011);
- Foreign financial assets owned by individuals or certain domestic entities in excess of \$50,000 (federal change from HIRE Act effective now)
- Actions affecting basis in securities (federal change effective January 1, 2011)
- Payments in settlement of credit and debit card transactions (federal change effective January 1, 2011)

Finally, the bill reduces the interest rate on taxes paid under protest from 8% to 4% (by cross-referencing the Federal interest rate, see Rev. Rul. 2009-37, 2009-52 I.R.B. 957) if the taxpayer prevails. If the taxpayer owes tax, 8% interest is charged.

High Technology Credit...Poof

STATUS: PASSED ON APRIL 27 AND SENT TO GOVERNOR

SB 2001 HD1 gives another year of life to the tax credit for research activities, sometimes known as the 20% refundable R&D credit, but in the process would repeal the technology infrastructure renovation tax credit and the high technology business investment tax credit. The repeal would take effect on May 1, 2010 and would not affect credits earned before the effective date, including carryover credits.

STATUS: PASSED ON APRIL 27 AND SENT TO GOVERNOR

SB 2401 HD1, on the other hand, does affect credits previously earned, including carryover credits. The bill makes the credits unusable for three years. They can neither be refunded nor used to reduce tax liabilities for tax years beginning in 2010, 2011, or 2012. They will carry over to 2013...unless something else happens to them.

Foes of the above bills are now taking their case to the Governor. Both bills squeaked by the full Senate with a vote of 14 to 11, and would likely not survive a veto.

Limiting Itemized Deductions and the Capital Goods Credit

STATUS: PASSED ON APRIL 27 AND SENT TO GOVERNOR

HB 1907 CD1 imposes a hard maximum on the amount of itemized deductions that a taxpayer may claim. The caps are: \$50,000 for married filing jointly or surviving spouse with AGI over \$300,000; \$25,000 for single or married filing separately with AGI over \$150,000; and \$37,500 for head of household with AGI over \$225,000.

The bill also makes the Capital Goods Excise Tax Credit nonrefundable until 2015. This credit can be used to reduce tax liability but will not generate a refund, and presumably may be carried forward until utilized.

Interest on Tax Refunds

STATUS: PASSED ON APRIL 29 AND SENT TO GOVERNOR

Under current law, the State does not have to pay interest on a State tax refund if the refund order is given within 90 days after the return is filed or the return is due, whichever is later. This year, the Department of Taxation raised eyebrows when it announced that it would not pay any 2009 tax refunds until July 1st at the earliest. The administration later said that it intended to do this every year in the foreseeable future. **HB 1948 CD1** requires refunds to taxpayers within 90 days of the filing of the return or the due date of the tax return, whichever is later. It would apply to taxable years beginning in 2010.

Let's Stick the Smokers Again, and Get the Insurers While We're At It

STATUS: SIGNED INTO LAW AS ACT 59

HB 1985 CD1 increases the tobacco tax rate from 11 cents to 15 cents per cigarette effective July 1, 2010, and then increases it another penny one year later. It also repeals the Hawaii itemized deduction for political contributions effective in 2011, and doubles the user fees for insurance licenses and certificates "temporarily" from July 1, 2010 to June 30, 2014. (The prior version of the bill doubled the user fees until June 30, 2013.)

Also, Let's Make Sure We Tax Those Stogies

STATUS: PASSED ON APRIL 27 AND SENT TO GOVERNOR

On the subject of tobacco tax, **SB 1230 CD1** applies a technical fix to the tax in order to provide a weightier definition of "large cigars" (actually, the new definition is based on the weight of the stogie) and clarifying that large cigars are subject to tobacco tax equal to 50% of the wholesale price.

Since October 1, 2009, little cigars have been taxed the same as cigarettes.

The Resurrected Barrel Tax

STATUS: VETOED BY GOVERNOR APRIL 25; VETO OVERRIDEN APRIL 29

Chapter 243, HRS, imposes the fuel taxes. Among them is the environmental response tax, which is currently imposed at 5 cents (\$0.05) per barrel of petroleum product sold by a distributor. **HB 2421 CD1** would rename the tax, raise it to \$1.05 per barrel (an increase of 2000%) and divide the booty among the general fund and four special funds, one of which would be created by the bill. The general fund would receive 50 cents per barrel.

General Excise Tax as a Trust Fund Tax?

STATUS: PASSED ON APRIL 27 AND SENT TO GOVERNOR

[HB 2595 CD1](#), originally sponsored by the Department of Taxation, would deny the benefit of any lower rate, credit, deduction, or income split, unless the taxpayer files a return within one year after the return is due.

For this part of the bill, the Conference Committee deleted exemptions for tax-exempt charities and certain types of income thought to be nonbusiness in nature. The committee report explained that there was no need to have these exemptions, but the committee's reasoning is open to question. If this bill is enacted, the Department may be under some pressure to adopt exemptions for these items.

The bill would also impose personal liability against a "responsible person" in a business that fails to pay the general excise tax, just as the IRS does for businesses that withhold tax from employees and fail to pay that tax over to the government.

Raid!!!

STATUS: PASSED ON APRIL 27 AND SENT TO GOVERNOR

[HB 2542 CD1](#), originally sponsored by the Department of Budget and Finance, would authorize the transfer of monies from a number of special funds to the State general fund. The sheer length of the list of special funds raided (just the tip of the iceberg) gives us an idea of just how labyrinthine our State finances have become:

- (1) \$1,000,000 from the Agricultural Loan Reserve Fund;
- (2) \$1,500,000 from the State Motor Pool Revolving Fund;
- (3) \$2,000,000 from the State Risk Management Revolving Fund;
- (4) \$2,000,000 from the Stadium Special Fund;
- (5) \$1,500,000 from the Medicaid Investigations Recovery Fund;
- (6) \$1,000,000 from the Hawaii Community Development Revolving Fund;
- (7) \$2,000,000 from the Convention Center Enterprise Special Fund;
- (8) \$300,000 from the Foreign Trade Zones Special Fund;
- (9) \$1,500,000 from the Compliance Resolution Fund – Business Registration Fund

Account;

(10) \$1,400,000 from the Department of Commerce and Consumer Affairs Special Drivers Education Fund;

- (11) \$3,200,000 from the Loss Mitigation Grant Fund;
- (12) \$1,000,000 from the Department of Education Drivers Education Fund Account;
- (13) \$1,000,000 from the Deposit Beverage Container Deposit Special Fund;
- (14) \$7,200,000 from the Hawaii Tobacco Settlement Special Fund;
- (15) \$1,000,000 from the Neurotrauma Special Fund;
- (16) \$7,000,000 from the Special Fund for Disability Benefits;
- (17) \$1,000,000 from the Land Conservation Fund;
- (18) \$500,000 from the Natural Area Reserve Fund;
- (19) \$500,000 from the Federal Reimbursement Maximization Special Fund;
- (20) \$2,000,000 from the University of Hawaii Housing Assistance Revolving Fund;
- (21) \$2,500,000 from the University Revenue-Undertakings Fund;
- (22) \$400,000 from the University of Hawaii Research and Training Revolving Fund;
- (23) \$2,000,000 from the Judiciary Computer System Special Fund;
- (24) \$1,500,000 from the Driver Education and Training Fund; and
- (25) \$1,000,000 from the Disaster Loan Revolving Fund.

The bill also changes the fuel tax credit for commercial fishers to be paid out of the State Highway Fund, and changes the way the tobacco tax is distributed among the general fund and four (!) special funds.

Taxing Dead People, Especially Those Who Don't Live Here

STATUS: VETOED BY GOVERNOR APRIL 25; VETO OVERRIDEN APRIL 29

In addition to the income tax, the Federal government imposes an estate tax. The estate tax, as it existed at the end of last year, offered a State death tax credit when it was imposed. Hawaii, like many other states, imposed an estate tax in the same amount so that bereaved families would not have to pay out additional dollars to the State but would, in effect, redirect dollars that otherwise would have been paid to Uncle Sam. [HB 2866 CD1](#) preserves the ability of the state to pick up the State death tax credit, and in addition taxes the transfer of an estate located in Hawaii by a nonresident who is not a citizen of the United States. A decedent under this law is entitled to all applicable exclusion or exemption amounts as determined under the Internal Revenue Code as of December 31, 2009, including a \$3.5 million applicable exclusion amount.

Allowing the Dynasty Trust...with a Price

STATUS: PASSED ON APRIL 27 AND SENT TO GOVERNOR

Current Hawaii law states that a trust must end within 90 years or 21 years following the death of someone alive at the time the trust was drafted, whichever is longer. This law is based on an ancient English common law rule known as the Rule Against Perpetuities. The Rule was of little estate planning consequence until the federal Tax Reform Act of 1986 created a new tax known as the Generation-Skipping Transfer Tax (GSTT). If a wealthy individual attempted to leave assets directly to grandchildren or more remote heirs at death, then the estate would have to pay this large extra tax. However, the decedent could leave assets in trust but that trust cannot last longer than state law allows. Acting on this exception, Alaska, Delaware, South Dakota and other states abolished their Rule Against Perpetuities to allow their trusts to last forever. In effect, this allows a wealthy individual to leave assets in trust and those assets will never be charged with the GSTT.

[SB 2842 CD1](#) adds the Permitted Transfers in Trust Act, which does away with Hawaii's Rule Against Perpetuities as to irrevocable trusts established under the Act. Such trusts may only be funded with cash, marketable securities, life insurance contracts, and non-private annuities (not real estate).

The bill, of course, makes its users pay for its benefits: it imposes a 1% excise tax on the fair market value of all assets transferred to a trust established under the Act.

Streamlined Sales Tax Agreement

STATUS: DEAD

Hawaii, like many other states, has been missing out on collecting GET or Use Tax on goods sold to residents by out-of-state sellers that are outside of the reach of the State's taxing jurisdiction. Although the tax does indeed apply to purchasers of such goods, it is not cost effective for the State to chase multitudes of small purchasers. Thus, there is interest in the increased collection from remote sellers that is supposed to come with joining the Streamlined Sales Tax Project (SSTP), a national initiative by many similarly situated states. In 2003, the State of Hawaii became a participant in the SSTP. A further act in 2005 advanced the State's efforts to comply with the terms and conditions of the conforming legislation reflected in the SSTP model agreement and act. However, there is currently a large issue: The SSTP requires

a maximum of one tax rate per state, but the GET and Use Tax now have two major rates, namely the wholesale and retail rates.

Legislation to split off the wholesale from the retail rates was passed in 2009 but was vetoed by the Governor, who cited concerns with ceding control to the SSTP governing body, providing amnesty, payment of a collection fee to an out-of-state vendor, and an ambiguous effective date. The SSTP rate split-off legislation passed through a couple of different bills and is now in [SB 2405 CD1](#). The bill creates a committee composed of six members, three each chosen by the Senate President and House Speaker, that would oversee the SSTP implementation. The balance of the legislation would be effective when Hawaii becomes a party to the SSTP agreement. The Senate cleared the bill on April 14th, but the House killed it on the last day of the legislative session.

Information on these and other bills moving through the Legislature may be obtained from the Legislature's web site, www.capitol.hawaii.gov.

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 Thomas Yamachika at thomas.yamachika@accuityllp.com



First Hawaiian Center, 999 Bishop Street, Suite 1900, Honolulu, HI 96813
Ph: (808) 531-3400 | Fax: (808) 531-3433

Pursuant to the provisions of Treasury Circular 230 and comparable State law, any tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or any comparable state law, or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.