

NEWS YOU CAN USE FROM

ANDERSEN TAX

for the RECORD



Student-Athlete/Athlete-Employee: Tax Consequences, For Sure



Last March the football team at Northwestern University gathered to cast votes regarding whether or not they wanted to form the first union for college athletes. It seems unlikely that anyone stood up at that meeting before the vote and asked, "Wait, dude, has anyone considered the tax consequences of all of this?"

We suspect not, and as discussed below, there are likely significant tax consequences to both the student-athletes and to the school that need to be considered. Instead of second and one it's third and long.

The National Labor Relations Board's ("NLRB") decision to allow the Northwestern students to form a union hinged primarily on whether or not those student-athletes' participation on the football team constituted an employer-employee relationship with the school. As employees, the student-athletes would be able to use their new union to seek fair compensation, negotiate better contracts (including scholarship deals), and pursue long-term

health insurance (to name a few). However, regardless of how important or justified those actions may seem, they could come with two potentially deal breaking taxation-related "penalties" – first for the students, and second for the school. And unfortunately, they are not "offsetting."

First, if the courts ultimately grant the team their wish to be treated as employees, the student-athletes of the Northwestern football team could one day find themselves in the unfortunate situation of having to declare the annual value of their scholarships as taxable income.

Section 117 of the Internal Revenue Code governs all scholarships — academic or athletic. Students do not typically need to declare scholarships as income provided that the school grants the scholarships with "no strings attached." The school cannot expect quid pro quo from the students in return for the scholarship. Unfortunately for student-athletes everywhere, the tax code leaves no room for interpretation on this issue.

Any form of compensation that the student-athletes may receive in return for playing would invalidate the tax-exempt nature of their scholarships. Because many Division I athletes receive scholarships for full tuition and housing, the additional income they would need to report to IRS as employees could be \$50,000 or more each year. Even at the lowest 2014 taxes rates, the tax on that income would be over \$10,000 annually, or \$40,000 for a four-year degree. The financial burden of that tax could be more than many of the athletes could afford.

In this scenario, schools could find themselves obliged to increase the size of the scholarships such that the recipients would have enough cash left over after tuition and housing to pay the tax bills. Given the annual volume of athletic scholarships around the country (over \$1.4 billion according to *US News and World Report*), schools could have to spend hundreds of millions just to cover the new taxes.

A second potential consequence of granting student-athletes the status of employee could have grave repercussions for the school's athletic department. Athletic departments enjoy a tax-exempt status because of their close relationship to the central educational mission of the school. The decision to treat student-athletes as employees could fundamentally invalidate that relationship. If the NLRB and other courts ultimately grant student-athletes employee status, a key factor in that decision will likely involve the fact that those activities have more to do with the entertainment industry than with education. Therefore, it is also likely that IRS will cease to acknowledge the tax-exempt status of athletic departments. The subsequent tax hit from Unrelated Business Income Tax ("UBIT") could be substantial—15-35% at the federal level alone.

But paying UBIT is only the tip of the iceberg. The most severe consequence for athletic departments would stem from the elimination of tax-deductible contributions. Contributions are by the far the largest source of income for athletic departments. Without their tax-deductible status, those donations would not be tax-exempt by the donor. This may not deter most small donations, but it could make the larger donors think twice before making a substantial commitment.

Furthermore, any gift over \$14,000 would be subject to the gift tax. Not only would substantial donors no longer be able to deduct their donations, they would also have to pay IRS up to 45% of the value of any gift over the \$14,000 threshold. It is not a stretch to think that this might effectively end large contributions to athletic departments. If this were the case, athletic departments would likely need to restructure the way they receive funding. The drain on schools' resources in that situation could be enormous, perhaps too much to handle.

Last, but not least, issuance of tax-exempt bonds may no longer be possible. Tax-exempt bonds in the past have helped to support the construction of major facilities, fields, and stadiums. Issuing bonds at commercial loan rates

would serve to further drain the resources of the department.

In short, granting student-athletes employee status could be bad for students but catastrophic for athletic departments.

The NLRB's decision in favor of treating the Northwestern football team as employees is currently on appeal by the school, and the discussion will likely continue to higher courts if the NLRB rejects the appeal. But even if the football team ultimately wins, they will need to take into account the enormous implications of the change in tax status for themselves and the athletic department before they move forward with their plan to unionize. It is possible that the unintended tax consequences could one day act as the deciding factor in this issue. One never likes to have the tax tail wag the dog, but in this case it just might. Time to huddle up.



BALTIMORE BOSTON CHICAGO DALLAS GREENWICH HARRISBURG
HOUSTON LONG ISLAND LOS ANGELES NEW JERSEY NEW YORK CITY PALO ALTO
PHILADELPHIA SAN FRANCISCO SEATTLE WASHINGTON, D.C. WEST PALM BEACH



© Andersen Tax LLC 2014 | 100 First Street, Suite 1600, San Francisco, CA 94105
AndersenTax.com | Privacy Policy | Terms & Conditions | Disclaimer

NEWS YOU CAN USE FROM

ANDERSEN TAX

for the RECORD



Research Tax Credit Update – Alternative Simplified Credit Election Allowed on Amended Returns



The Treasury Department recently released final and temporary regulations permitting some taxpayers to elect the alternative simplified credit (“ASC”) on amended returns.

Previously, the ASC election could only be made on a timely-filed original tax return (including extensions), requiring taxpayers who had not included the research credit on an original return to use the regular credit method for amended returns. This is a significant decision that will allow more taxpayers to take advantage of the research credit. Taxpayers may rely on the temporary regulations in making the ASC election for tax years preceding June 3, 2014, if the election is made prior to the expiration of the period of limitations for that year.

Overview of the Research Credit

The research credit is available to taxpayers under Sec. 41 and is computed by utilizing one of two methods: the regular credit method, or the ASC method. The regular credit method results in a credit equal to 20 percent of the excess of a taxpayer's current-year qualified research expenses over a base-period amount. The base-period amount is calculated through an analysis of prior-year gross receipts and qualified research expenditures in a fixed base period. The ASC is an alternative method resulting in a 14 percent credit of current-year research expenditures exceeding 50 percent of a taxpayer's average qualified research expenditures incurred over the three prior years. Although the research credit expired for expenditures made after December 31, 2013, it is widely anticipated that the research credit will be extended retroactively for 2014.

Difficulties in Claiming the Research Credit

Claiming the research credit has not been without its challenges for many taxpayers, however, as the regular method requires taxpayers to use a fixed base period reaching back to 1984-1988 (special rules apply to companies not in existence during the fixed base period). The ASC method was first made available for taxable years beginning after December 31, 2006. The ASC method allows a taxpayer to look back to the three prior years of any filing year. However, the ASC election could only be made on a timely filed original return (including extensions). Therefore, taxpayers who had not claimed the research credit on the original return were unable to claim the research credit based on the ASC on an amended tax return. These taxpayers now have an opportunity to elect the ASC on an amended tax return and harvest unclaimed research credits.

ASC Allowed on Amended Returns

In response to requests made related to the burdens of the regular method and the inability to file amended returns using the ASC method, the Treasury Department and IRS issued TD 9666, finally allowing some taxpayers to elect the ASC method on amended returns. While the regulations do allow for the election of the ASC method in amended years, it does not allow the amended ASC election if a previously filed regular credit was claimed. Furthermore, controlled group members may also not make an amended ASC election if any member of the controlled group previously claimed a non-ASC credit method on that year's return.

The regulations are effective for taxable years ending on or after June 3, 2014, and are set to expire on June 2, 2017. However, taxpayers may rely on the temporary regulations in making the ASC election for tax years ending before June 3, 2014, if the election is made prior to the expiration of the period of limitations for that year.

Summary

Companies devoting resources to the development of new products or processes, or to an improvement to an existing product or process, may be eligible for the research credit. Companies that did not include the research credit on an original tax return because of net operating losses may also benefit from electing the ASC on an amended tax return prior to the expiration of the statute of limitations. Many industries that have been able to take advantage of the research credit include the following:

- Manufacturing
- Information technology
- Professional, scientific, and technical services
- Wholesale and retail trade
- Finance and insurance
- Utilities

- Many other sectors

If your company has not claimed the research credit in prior years, now is a great opportunity to take advantage of these favorable regulations. Andersen Tax can help you assess whether your research activities qualify under Sec. 41, calculate any unclaimed credits, and amend returns for prior periods to claim these credits.

Related Content on andersentax.com: [Services>For Businesses>Asset & Credit Practice>Research Tax Credits & Other Tax Incentives](#)



BALTIMORE BOSTON CHICAGO DALLAS GREENWICH HARRISBURG
HOUSTON LONG ISLAND LOS ANGELES NEW JERSEY NEW YORK CITY PALO ALTO
PHILADELPHIA SAN FRANCISCO SEATTLE WASHINGTON, D.C. WEST PALM BEACH



© Andersen Tax LLC 2014 | 100 First Street, Suite 1600, San Francisco, CA 94105
[AndersenTax.com](#) | [Privacy Policy](#) | [Terms & Conditions](#) | [Disclaimer](#)

NEWS YOU CAN USE FROM

ANDERSEN TAX

for the RECORD



Recent CCA shows IRS continuing to challenge taxpayer's cash repatriation strategies that try to side step Section 956.



Background

Section (Sec.) 956 is designed to treat the U.S. monetization of foreign earnings as a deemed dividend to the U.S. shareholder from the foreign entity. It only applies to controlled foreign corporations ("CFC"). A foreign corporation is a CFC if U.S. persons, who own 10 percent or greater of its shares by vote, collectively own greater than 50 percent of the vote or value of its shares. For example, the types of transactions typically caught by Sec. 956 are:

1. Loans from a CFC to the U.S.
2. Pledges by a U.S. shareholder of 66 2/3 percent or more of the CFC shares to obtain a loan.

The amount of inclusion under Sec. 956 is limited to the earnings and profits ("E&P") of the CFC. And, to determine

the amount included, the amount of investment in U.S. property is determined at the end of each quarter, and then averaged.

Recent Guidance – the IRS attacks

In Chief Counsel Advice (“CCA”) 201420017, the taxpayer tried to minimize the deemed dividend amount under Sec. 956, by using a foreign partnership (“FP”) owned by a number of CFCs (CFC1, CFC2, CFC3), then made a loan to CFC1 from FP and from another CFC (CFC4) in the group. CFC1 then took all the cash and made a large loan to the U.S. What the taxpayer was apparently trying to accomplish here, was to minimize the Sec. 956 inclusion by limiting the E&P in the entity making the loan. They argued that the loans from FP and CFC4 did not move E&P into CFC1. IRS disagreed and sought a CCA.

The CCA sided with IRS by using the related-party and anti-abuse rules to essentially shift the E&P from the other CFC partners of FP that made the loan to CFC1, which made the loan back to the U.S. The taxpayer argued unsuccessfully that the related-party and anti-abuse rules should not apply because there was an inclusion, although small, under Sec. 956.

A more common way that cash is repatriated is through a return of capital from CFC1. (Profile is key and you need high tax basis in CFC1’s shares with low E&P). One can surmise from the CCA here, that the basis in CFC1’s shares was probably low, therefore, a distribution would ultimately have produce a capital gain. Therefore, they tried the back-to-back loan route, unsuccessfully. We may find this the subject of future litigation.

Note that in its annual budget, the Obama administration is proposing legislation essentially shutting down the loan and return of capital strategy. (IRS probably has more difficulty invoking the anti-abuse rule with a return of capital than with a loan.) The legislation, if enacted, would shift the E&P from the CFC making the loan to the CFC making the distribution – turning a tax-free return of capital into a taxable dividend. Although significant U.S. tax legislation seems unlikely before 2015, some interim piecemeal legislation is quite possible – which might include the shutdown of loan and return of capital strategy. Accordingly, taxpayers may want to consider this strategy now.

Takeaway

Section 956 is complex and can be difficult to maneuver in a cash repatriation context. In addition, IRS continues to chip away at these strategies. However, there are still many viable cash repatriation strategies available. For these strategies to work you need a strong business case to identify the plan that fits your profile, coupled with careful evaluation, planning, documentation and execution.





© Andersen Tax LLC 2014 | 100 First Street, Suite 1600, San Francisco, CA 94105
[AndersenTax.com](#) | [Privacy Policy](#) | [Terms & Conditions](#) | [Disclaimer](#)

NEWS YOU CAN USE FROM

ANDERSEN TAX

for the RECORD



The Rewards of Risk-Aware Investing: What is your risk premium?



Over the last three years, the S&P Index has increased by approximately 80 percent. During this period, the S&P Index has not suffered a decline of 10 percent or more - something that has historically occurred about once a year.

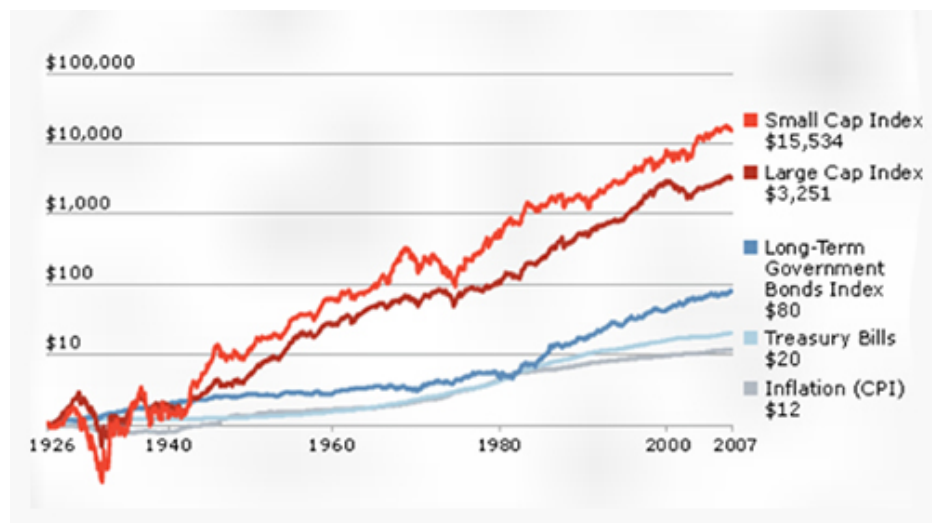
This exceptional performance has led many popular financial media sources to share their caution about the potential for a market correction. As we approach the sixth year of a bull market, this is an opportune time for investors to review a few basic principles of portfolio composition to help develop an asset allocation they can confidently rely on no matter what the market may bring.

Investment portfolios today are generally constructed in two stages. In the first stage, a determination is made to allocate investor resources across various asset classes. Ideally, this exercise objectively assigns amounts to different asset classes based on the particular goals, objectives, and risk tolerance of the investor. The mix of assets designated relies on empirical analysis of historical asset class returns and how they are expected to perform

relative to one another throughout various market cycles. After the allocation decisions are finalized, the next stage involves the actual selection of investment managers and/or funds to obtain the desired exposure to the various asset classes determined during the first stage. From this point forward, periodic performance reviews and rebalancing the mix of asset classes are essential to help keep the portfolio in alignment with the investor's specific objectives.

Accepting uncertainty is inevitable in this process. Investors must be willing to accept a given level of risk in order to obtain returns that exceed those of "risk-free" asset alternatives such as money market funds and bank deposits. History has indeed proven this to be worthwhile, as over long enough periods of time, riskier assets like stocks have generally outperformed safer assets like bonds (see table below). The amount of excess return an investor expects over the risk-free rate of return is known as the "risk premium" and, as the term implies, does not come without a cost. Riskier assets are generally more volatile and may be subject to periods of extreme short-term fluctuation. Being keenly aware of the various uncertainties in a portfolio is very important for investors since risk is both a key component in the allocation process as well as a factor in evaluating performance.

Long-Run Returns by Asset Class



There are two main categories of investment risk. "Systematic risk", also referred to as "market risk" or "un-diversifiable risk", is the risk resulting from being invested in the broad market, asset class, or industry. Some asset classes are inherently more volatile and carry more systematic risk than other asset classes. Conversely, "unsystematic risk" (a.k.a, "specific risk" or "diversifiable risk"), is based on company-specific traits. For example, news about a strike at a company will likely impact that company's stock price more than the broader market.

Modern portfolio theory is based on the fact that investors care about both risk and expected return. Since various asset classes are not perfectly correlated with one another, diversification should allow for each of the following:

- For a given level of expected return, there exists a minimum level of risk necessary to achieve that level of expected return.
- For a given level of risk accepted, there exists a maximum level of expected return achievable.

If investors chose only to account for systematic risks, the portfolio chosen could be implemented with a selection of index funds and/or exchange traded funds from each of the various asset classes, since these are composed of a significant amount of underlying positions that essentially diversify away the unsystematic (i.e. company-specific)

risks. However, if a specific manager or fund could be identified in one or more asset classes that could consistently outperform their benchmark index after accounting for fees, the investor might choose to use such an actively managed approach. Viewed in this light, active managers and funds should only be utilized if the investor believes they have the ability to outperform their benchmark after fees over the investment horizon.

The graph shown above clearly illustrates that investors have been generally rewarded for accepting risk over long periods of time. Inexperienced investors might draw the conclusion that taking on more risk in a portfolio will lead to a higher expected return. More astute investors never disregard the understanding that taking risk may subject a portfolio to shorter-term fluctuations that can have unfavorable consequences.

To best prepare for whatever the markets and characteristics of their specific investments may bring them, investors must carefully construct portfolios with an awareness of the various types and levels of risks they are willing to accept and be certain that they are being fairly compensated for doing so. The portfolio should also be evaluated periodically to analyze how the portfolio as a whole as well as each contributing component has fared against appropriate benchmarks and anticipated uncertainties. The most effective performance reviews will also be accompanied with a determination of whether any rebalancing of the asset mix is appropriate. During periods of increased market volatility and while considering any changes to manager and/or fund selections, the importance for this type of analysis and review only increases. The process of allocating investment resources requires careful diligence, but the result should be long-term expected rewards.



BALTIMORE BOSTON CHICAGO DALLAS GREENWICH HARRISBURG
HOUSTON LONG ISLAND LOS ANGELES NEW JERSEY NEW YORK CITY PALO ALTO
PHILADELPHIA SAN FRANCISCO SEATTLE WASHINGTON, D.C. WEST PALM BEACH



© Andersen Tax LLC 2014 | 100 First Street, Suite 1600, San Francisco, CA 94105
AndersenTax.com | [Privacy Policy](#) | [Terms & Conditions](#) | [Disclaimer](#)

NEWS YOU CAN USE FROM

ANDERSEN TAX

for the RECORD



Value Added Tax for e-services? Why bother when there is no company presence?



Specific regulations for charging and reporting Value Added Tax (“VAT”) apply to U.S. companies that provide electronic services (e.g., cloud computing, software, server facilities, online films, music, books, etc.) to non-taxable private individuals based in the European Union (“EU”). This impacts all companies – whether these companies have a presence in the EU or not.

What are e-services?

Any services supplied digitally are considered electronic services (e-services). This includes the following:

- Cloud computing;
- Servers for websites and data storage;

- Subscriptions to internet games, newspapers; and
- Downloads of text, pictures, music or videos (e.g., apps).

When must the VAT regulations on e-services be considered?

These regulations are already in force for non-EU companies. However, new rules with simplifications will apply on January 1, 2015, for EU companies. With this in mind, the local Tax Authorities may investigate non-EU companies to ensure that they are charging VAT when providing e-services to private individuals.

Why bother with European VAT?

There are potential adverse consequences to not complying with the EU VAT provisions, which include:

- It is considered tax evasion if a company ignores the local VAT requirements and significant penalties could apply.
- The local tax authority will likely not come to the U.S. and knock on your door; however, they will go public – therefore, there is reputation at risk.
- The collaboration between the various local European tax authorities is improving including tracking offenders and they have the motivation to do so.

What are the consequences?

Companies performing e-services to private individuals have to register for VAT in each country where their customers are resident. Then, the company must charge local VAT on the service provided and must declare it on a local VAT return.

An alternative could be the so called “Mini One Stop Shop” (“MOSS”). This alternative enables businesses to register for VAT in one single country of the European Union, submit quarterly VAT returns in that country and pay their total VAT liability in this country. The company will still have to report the amount of VAT due per country of their customers’ residency; however, the centralized MOSS authority will remit the tax to the other EU countries according to the declaration report.

Know your customer

The new EU VAT rules beginning January 1, 2015, will introduce some additional compliance requirements that will need to be followed by all e-businesses – European as well as non-EU. Among other things, these businesses will need to provide:

- Identification of the customers – business to business or business to consumer in the EU;
- Identification of the country of residence for the business to consumer supplies;
- For business to consumer supplies, charge VAT at the local VAT rate where the customer resides; and
- Identification of business to consumer supplies outside of the EU (e.g., Norway and Switzerland) and comply with the local VAT regulations.

What about countries outside of the EU?

If non-EU countries are involved, the applicable local VAT regulations have to be considered. For example, Norway and Switzerland operate similar EU type VAT systems. As with the EU, e-businesses performing e-services to private individuals have to register for VAT and charge local VAT at the local VAT rate which has to be declared

with the local tax authority.

Summary

On January 1, 2015, new VAT rules on e-services to private individuals (business to consumer) will become effective in the EU. U.S. companies which do not have any presence in the EU but are providing e-services will be impacted and should be aware of the following:

- Local VAT registration is required in every single country with a business to consumer supply;
- Local VAT has to be charged and reported with the local tax authority;
- Simplification is possible by registering only in one EU country (Mini-One-Stop-Shop);
- Know-your-client is getting more and more important; and
- VAT regulations of countries outside the EU must also be considered as similar regulations may apply.

Andersen Tax has the expertise and resources to assist with VAT planning and compliance.



BALTIMORE BOSTON CHICAGO DALLAS GREENWICH HARRISBURG
HOUSTON LONG ISLAND LOS ANGELES NEW JERSEY NEW YORK CITY PALO ALTO
PHILADELPHIA SAN FRANCISCO SEATTLE WASHINGTON, D.C. WEST PALM BEACH



© Andersen Tax LLC 2014 | 100 First Street, Suite 1600, San Francisco, CA 94105
AndersenTax.com | [Privacy Policy](#) | [Terms & Conditions](#) | [Disclaimer](#)