Simplifying the complexities of payroll taxes and year-end planning

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Larry Mohr
Tax Partner
Baker Tilly Virchow Krause

Martin Rule
Payroll and Employment Tax Specialist
Presentation topics

- Development of year-end work plan
- Management and completion of year-end tasks
- Form W-4 compliance
- Social Security number (SSN) verification
- Form W-2 reporting
- National Research Program (NRP) employment tax audits
- Taxation of fringe benefits
- Accountable and nonaccountable plans
- Wage gross-ups
- Supplemental wages
- Nonqualified deferred compensation (NQDC)
- Other executive compensation issues
- Mergers and acquisitions
- Legislative updates
Development of year-end work plan

- Establish major year-end objectives
- Develop timeline with task owners (internal and external)
- Reconcile 2013 federal, state, and local deposits/filings
- Prepare reports (federal, state, local, and general accounting)
- Provide employees with 2013 Forms W-2
- Prepare for 2014
- Proceduralize routine tasks and identify unique situations that require additional research and expertise
- Sample year-end work plans can be found in professional publications provided by APA, BNA, PPC, or RIA
Management and completion of year-end tasks

Operate in “year-end mode” throughout the year and test data to ensure:

> Correct withholding totals
> Sufficient employment tax deposits are made
> Correct G/L postings
> Form 941 and 941-X filings equal YTD wage and withholding totals
> Exceptions and unique items are addressed
Payroll processing and employment tax compliance resources

> Publication 15, (Circular E), Employer’s Tax Guide
> Publication 15-A, Employer’s Supplemental Tax Guide
> Publication 15-B, Employer’s Tax Guide to Fringe Benefits
> Publication 509, Tax Calendars
> SSA BSO website [http://www.socialsecurity.gov/bso/bsowelcome.htm](http://www.socialsecurity.gov/bso/bsowelcome.htm)
> State and local departments of revenue and employment security websites
> Subscription-based payroll compliance resources
  – APA (*The Payroll Source* and many other publications)
  – BNA (*Payroll Library*)
  – CCH (*Payroll Management Guide*)
  – RIA (*Payroll Practitioner’s Compliance Handbook*)
Employer responsibilities

> Federal income tax withholding is based on a valid Form W-4

> Form W-4 tells the employer:
  – Rate of withholding (e.g., single, married, head of household, etc.)
  – Number of withholding allowances
  – Additional withholding amounts
  – Exemption from withholding

> Default to “single with no allowances” if no Form W-4 is on file
Employer responsibilities

> Develop a written policy supporting solicitation, retention, and withholding standards
> New employees must provide signed Form W-4 on or before the first date of employment
> No withholding changes without a new valid Form W-4 to support the changes
> No adjustment for withholdings for pay periods prior to the effective date of the W-4
> Retain Forms W-4 for all active employees until audit period has closed
> Request new Forms W-4 by Feb. 15 of the current year from employees who claimed “exempt” from withholding on Form W-4
Invalid Forms W-4

> A Form W-4 may be invalid if:
  – any part of the form is altered (e.g., under penalty of perjury declaration is scratched out)
  – any writing is on the form that is not requested (e.g., employee requests a flat amount of withholding)
  – any written or verbal statement by the employee that any information on the form is false

> If an invalid form is provided, continue to withhold based on the employee’s previously provided Form W-4 or if a new employee, withhold at single and 0
Did you experience more Form W-4 adjustments as a result of the 0.9 percent Medicare surtax?
Social Security number verification

> Decentralized correspondence (DECOR) notice from SSA
  – Previously known as “no-match” letters
  – SSA attempts to resolve W-2 postings with name and number mismatches
  – Unresolved mismatches are placed in the SSA earnings suspense file
  – SSA will first attempt to contact employee to resolve mismatch
  – If SSA fails to make contact with employee, SSA will send DECOR notice to employer

> Potential penalty for incorrect Forms W-2
  – IRC §§ 6721 and 6722 may impose civil penalties of up to $100 for each failure of an employer to provide a timely and correct Form W-2 to the employee or the SSA
  – Employers that can establish reasonable cause for Form W-2 reporting failures may avoid assessment of some or all civil penalties
Social Security Number Verification Service (SSNVS)

- Employers can verify SSNs of new and current employees with the SSA
- SSA provides two Internet options to verify employee SSNs
  - Registered users of the (SSNVS) can check up to 10 SSNs online (process can be repeated)
  - Registered users may also upload up to 250,000 names and SSNs and receive results within the next government business day
- An online tutorial and registration instructions for the SSNVS can be found at www.ssa.gov/employer/bsotut.htm
Social Security number verification

Suggested SSN and name compliance procedures

> Document procedures to obtain correct name and SSN.
> Obtain a copy of employee’s Social Security card for new hires.
> Remind employees to report name changes to the SSA.
> Validate employees’ SSNs when hired through the SSNVS at http://www.ssa.gov/employer/ssnv.htm.
> Note the name and SSN verification procedures discussed above generally relate to Form W-2 compliance and not necessarily procedures to determine an employee’s eligibility to work. For work eligibility procedures and tools, see the Department of Homeland Security and SSA website at www.uscis.gov.
Form W-2 reporting

Electronic Form W-2

> Providing Forms W-2 to employees electronically can result in cost savings as well as greater distribution efficiency

> Employers may provide Form W-2 to employees through any electronic means if the provisions under Treas. Reg. §§ 1.6041-2(a)(5) and 31.6051-1(j) are met. These provisions generally require the employer to:
  – Obtain employee consent for an electronic Form W-2
  – Inform the employee a hard copy Form W-2 will be provided if consent is not received
  – Allow employee to withdraw consent prior to furnishing the Form W-2
  – Provide employee with instructions on how to obtain a hard copy
  – Provide notification when the electronic Form W-2 is made available
  – Allow access to the electronic Form W-2 through Oct. 15 of the following year
SSA 2013 Form W-2 reporting due dates

> Provide Forms W-2 to employees on or before Jan. 31, 2014
> If not required to file electronically and are submitting Forms W-2 on paper, file with SSA on or before Feb. 28, 2014
> If filing electronically, file with SSA on or before March 31, 2014
> For a more comprehensive listing of filing and deposit deadlines, see IRS Pub. 509 “Tax Calendars”
In 2010, the IRS launched a three-year employment tax audit initiative that focuses on:
- Worker classification
- Fringe benefits
- Nonfilers
- Officer compensation

The IRS has selected 2,000 random audits each year under the program (2010-2012)

Emphasis for audit selection was small employers
Employers selected for employment tax audits under this initiative should have received either:

- IRS Letter 3850-B
- IRS Letter 3851-B

Generally, NRP audits are detailed audits used to compile statistical data to improve IRS audit selection of other employers/taxpayers.

The IRS expects to complete the NRP employment tax audits and analysis in the summer of 2014.
Taxation of fringe benefits

- Definition of gross income
  - All income from whatever source derived
- Valuation of taxable fringes
  - Fair market value
  - Statutory method
- When fringes are considered paid
- Withholding on fringes
- Deposit of taxes withheld
Excluded fringe benefits

> Cafeteria plans allow employees to choose cash or benefits, but cannot include:
  – Athletic facilities
  – De minimis benefits
  – Educational assistance
  – Employee discounts
  – Lodging or meals
  – Moving expense reimbursements
  – No additional cost services
  – Qualified transportation benefits
  – Working condition benefits
Excluded fringe benefits

> Accident and health benefits
  – Employer contributions on behalf of an employee

> Achievement awards
  – Must be either length of service or safety achievement based
  – $1,600 limit for “qualified plan awards”
  – $400 limit for “nonqualified plan awards”

> Adoption assistance excludes $12,970 in 2013, $13,190 in 2014
  – Exempt for withholding purposes
  – Subject to Federal Insurance Contributions Act (FICA) and Federal Unemployment Tax Act (FUTA)
Excluded fringe benefits

> Athletic facilities
  – Exclude value of an employee’s use of an on-premises gym or other athletic facility operated by the employer if substantially all the use of the facility is by the employees, their spouses, and their children

> De minimis fringe benefits
  – Described as an employer-provided fringe benefit that has so little value, accounting for it would be unreasonable or administratively impracticable
  – Examples may include copy machine use, holiday gifts, life insurance on spouse (if less than $2,000), meals, parties and picnics, tickets for entertainment or sporting events, transportation fare, typing
**Excluded fringe benefits**

> **Dependent care assistance**
>  – Services an employer pays for directly or provides under a dependent care assistance program
>  – Up to $5,000 each year (must be coordinated with spouses benefit)
>  – Excluded portion (up to $5,000) is reported in box 10 of Form W-2
>  – Dependent care benefits in excess of $5,000 are considered wages and should be included in boxes 1, 3, and 5 of Form W-2

> **Educational assistance**
>  – Made permanent under the American Taxpayer Relief Act of 2012
>  – Up to $5,250
>  – Amounts over $5,250 possibly excluded as a working condition benefit
>  – Includes graduate and undergraduate classes
Excluded fringe benefits

> No additional cost services
  – Services provided must be offered in the employer’s line of business
  – Services can be excluded from employee’s income
  – Employer cannot incur substantial additional costs
  – Cannot discriminate in favor of highly compensated employees

> Employee discounts
  – Price reductions given to an employee on property or services offered to customers in the ordinary course of business
  – Services may be discounted up to 20 percent of the price you charge nonemployee customers
  – Merchandise may be discounted up to the employer’s profit percentage multiplied by price you charge nonemployee customers for the property
Excluded fringe benefits

> Group-term life insurance coverage
  – You can exclude up to $50,000 in coverage from income, Social Security, and Medicare taxes
  – You can generally exclude all group-term life insurance coverage from federal income tax withholding

> Lodging if:
  – furnished on employer’s premises
  – furnished for employer’s convenience
  – employee accepts the lodging as a condition of employment
Excluded fringe benefits

> Meals
  – De minimis meals have little value, are provided infrequently, and would be administratively impracticable to account for (holiday lunch, coffee, doughnuts, soft drinks, etc.)
  – Meals for the convenience of employer or from employer-operated eating facility for employees

> Moving expense reimbursement
  – Excludible reimbursements generally include reasonable expenses for:
    o transporting personal effects from old home to new home
    o travel of employee and dependents from old home to new home
Excluded fringe benefits

> Transportation benefits (commuting)
  – De minimis transportation
  – Qualified transportation benefits
    o Parking $245 per month in 2013, $250 in 2014
    o Public transportation $245 per month in 2013 reverts to $125 in 2014

> Working condition fringe benefit
  – Property or service provided so that the employee can perform his or her duties
    o Mileage to provide service for customers or client
    o Supplies
    o Professional dues and subscriptions
Employee business expense reimbursements

> The IRS defines two categories of employee expense arrangements:
  – Accountable plans
  – Nonaccountable plans

> Reimbursements of employee business expenses may be excluded from wages if reimbursed under an accountable plan

> Reimbursements of employee business expenses that are not provided under an accountable plan are deemed paid under a nonaccountable plan and are included in the employee’s wages
Employee business expense reimbursements

The accountable plans must meet the following three requirements:

– Business connection
  o Expense must be work-related

– Adequate substantiation
  o Must be provided within a reasonable period of time
  o Treasury regulations provide two safe harbors for “reasonable period of time”
  o Receipts required for lodging and for expenses in excess of $75 or more

– Return of excess payment
  o Must be returned within a reasonable period of time
  o Treasury regulations provide two safe harbors for “reasonable period of time”
    • Fixed date method
    • Periodic statement method
Wage gross-ups

Taxes paid on behalf of the employee

> An employer may use a wage “gross-up” to provide a fringe benefit or bonus to an employee net of any tax consequence

> Payment of taxes by an employer for an employee creates additional compensation subject to withholding

> Rev. Rul. 86-14 provides a method to compute the economic benefit of wage gross-ups that can be summarized as follows:
  – 100% – payroll tax % = net %
  – Payment ÷ net % = grossed-up wage
  – Check gross-up calculation related to payroll tax to be remitted
In 2013, ABC Corporation experienced record profits and wanted to reward John Smith for a job well done. John’s base salary was $100,000. ABC paid him a $10,000 bonus at the end of the year and absorbed the employee federal and state income tax withholding (FITW and SITW) and FICA tax applicable to the bonus so John actually received $10,000 cash.

ABC computed the gross-up based on FITW 25%, SITW 7%, FICA 7.65%, and computed the gross-up as follows:

<table>
<thead>
<tr>
<th>Step 1: Grossed-up wages =</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 – .25 – .07 – .0765 = .6035</td>
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<table>
<thead>
<tr>
<th>Step 2: Grossed-up wages =</th>
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<tbody>
<tr>
<td>$10,000 ÷ .6035 = $16,570</td>
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<table>
<thead>
<tr>
<th>Step 3: Check</th>
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</thead>
<tbody>
<tr>
<td>$16,570 X .3965 = $6,570</td>
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</table>
Supplemental wages

> Supplemental wages are described in IRS Pub. 15 as “wage payments to employees that are not regular wages.” Examples may include:
  – Bonuses, commissions, overtime, severance, awards, and prizes
  – Back pay, retroactive pay increases

> Federal income tax withholding for supplemental wages is 25 percent (the third-lowest tax rate for single filers)

> However, a higher withholding rate of 39.6 percent applies to supplemental wage payments exceeding $1 million (Treas. Reg. 31.3402(g)-1(a)(2))
Nonqualified deferred compensation

IRC § 409A

> Amounts deferred after 2004 must meet requirements of IRC § 409A

> Amounts deferred before 2005 generally are governed by prior law, unless the NQDC plan was materially modified after Oct. 3, 2004

> Failure to meet the requirements of IRC § 409A will result in immediate recognition of the deferred compensation and a 20 percent penalty imposed on the NQDC participant
FICA general timing, special timing, and nonduplication rules

> General timing: An employee’s compensation is subject to FICA taxes in the year actually or constructively received by the employee
> Special timing rule: FICA is assessed as of the later of when services are performed or there is no longer a substantial risk of forfeiture
> All amounts required to be taken into account for FICA purposes are included in the employee’s FICA taxable wages
> Amounts attributable to a former spouse are not included in the employees federal income taxable wages
> Nonduplication rule: Once amounts deferred are taken into account for FICA tax purposes, they are never again subject to these taxes (IRC § 3121(v)(2)(B))
> Any earnings credited to amounts deferred after the date taken into account for FICA purposes should not be subject to FICA tax
Nonqualified deferred compensation

Form W-2 reporting requirements

> Note employers are **no longer** required to report deferrals or earnings as defined under IRC § 409A in box 12 of Form W-2 using code Y

> Once deferred compensation amounts are actually or constructively received or the plan fails to meet the requirements of IRC § 409A, the amounts must be included in the employee’s Form W-2

> Amounts included in income because the plan failed to meet the section 409A requirements are reported in box 12 of Form W-2 using code Z
Alternate payee reporting and tax consequences related to distributions made to a former spouse

> All amounts required to be taken into account for FICA purposes are included in the employee’s FICA taxable wages
> Amounts attributable to a former spouse are not included in the employee’s federal income taxable wages
> Amounts attributable to a former spouse are includable in the former spouse’s gross income and reported on Form 1099-MISC, box 3 other income
Other executive compensation issues

> Athletic skyboxes/cultural entertainment suites
> Awards/bonuses
> Club memberships
> Corporate credit card
> Executive dining room
> Loans
> Qualified employee discounts
> Relocation expenses
> Security-related transportation
> Spousal dependent life insurance
> Spousal or dependent travel
> Wealth management

See the IRS Executive Compensation- Fringe Benefit Audit Technique Guide (02-2005) at:
The employment tax compliance requirements in the year of acquisition or statutory merger can be complex

> Failure to comply with specific reporting requirements can lead to time-consuming corrections as well as penalties and interest

> Generally, employers must report the acquisition or merger activity on Form 941 Schedule D “Report of Discrepancies Caused by Acquisitions”

> The type of merger or acquisition will determine the appropriate employment tax compliance requirements (see Rev. Rul. 62-60 and Rev. Proc. 2004-53)
### Legislative updates

#### 2014 and 2013 retirement plan limits

<table>
<thead>
<tr>
<th>Plan Type</th>
<th>2014</th>
<th>2013</th>
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<tr>
<td><strong>IRAs</strong></td>
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<tr>
<td>IRA Contribution Limit</td>
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<tr>
<td>IRA Catch-Up Contributions</td>
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<td><strong>IRA AGI Deduction Phase-out Starting at</strong></td>
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<td>Joint Return</td>
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<td>Single or Head of Household</td>
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<td><strong>SEP</strong></td>
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<td>SEP Minimum Compensation</td>
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<tr>
<td>SEP Maximum Compensation</td>
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<td>255,000</td>
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<td><strong>SIMPLE Plans</strong></td>
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<tr>
<td>SIMPLE Maximum Contributions</td>
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<tr>
<td>Catch-up Contributions</td>
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<tr>
<td><strong>401(k), 403(b), Profit-Sharing Plans, etc.</strong></td>
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<tr>
<td>Annual Compensation</td>
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<tr>
<td>Elective Deferrals</td>
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<td>Catch-up Contributions</td>
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<td>Defined Contribution Limits</td>
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<td>ESOP Limits</td>
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<td></td>
<td>210,000</td>
<td>205,000</td>
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<tr>
<td><strong>Other</strong></td>
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<td>HCE Threshold</td>
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<td>Defined Benefit Limits</td>
<td>210,000</td>
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<tr>
<td>Key Employee</td>
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<tr>
<td>457 Elective Deferrals</td>
<td>17,500</td>
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</table>
2014 Social Security and Medicare wage base and rates

> Social Security wage base increased to $117,000
> Social Security rate unchanged at 6.2 percent
> Medicare unchanged with no wage base limit and rate of 1.45 percent
> See link below for explanation of the wage base computation
  http://www.ssa.gov/OACT/COLA/cbbdet.html
Severance payments and FICA tax

> Conflicting decisions in the Court of Appeals for the Federal and 6th Circuits

- In *CSX Corp. v. United States*, 518 F.3d 1328 (Fed. Cir. 2008), the court held severance payments are subject to FICA.
- In *U.S. v. Quality Stores, Inc.*, No. 10-1563 (6th Cir. Sept. 7, 2012), the Sixth Circuit held payments are not subject to FICA taxes.
- US Supreme Court will decide
  - Practitioners believe a decision may be reached in June 2014
  - IRS has estimated the amount at stake as $1 billion
- Continue to subject severance payments to FICA tax!
Severance payments and FICA tax (continued)

Employers should be prepared to file protective refund claims to keep statute open

– Quantify FICA tax paid on severance pay for all open years
– For 2010, protective refund claims should be filed by April 15, 2014
– For refund claims previously filed and rejected, you must submit Form 907, Agreement to Extend the Time to Bring Suit, for each denied claim
Have you filed protective FICA tax refund claims on severance payments?
Payroll implications and opportunities as a result of the Supreme Court decision in *United States v. Windsor*

- In *Windsor*, the Supreme Court held that section 3 of DOMA is unconstitutional because it violates the principles of equal protection.
- Under Rev. Rul. 2013-17, individuals of the same sex will be considered to be lawfully married under the Internal Revenue Code as long as they were married in a state in which laws authorize the marriage of two individuals of the same sex, even if they are domiciled in a state that does not recognize the validity of same-sex marriages.
- Employer-provided benefits to legally married same-sex couples is not taxable.
- Refund opportunities exist for employers and individuals.
- IRS Notice 2013-61 provides administrative relief when filing employment tax refund claims.
Medicare surtax on wages

> Additional 0.9 percent of Medicare FICA tax, for total of 2.35 percent, on wages in excess of $200,000 ($250,000 if married filing jointly; $125,000 if married filing separately)
  – Effective beginning Jan. 1, 2013
  – Some IRS guidance (20 FAQs on IRS website)

> Employer withholds additional tax from wages in excess of $200,000 paid to an employee, regardless of marital and tax return filing status
Medicare surtax on unearned income

> 3.8 percent tax on net investment income to extent a taxpayer’s modified adjusted gross income is greater than $200,000 ($250,000 for joint filers; $125,000 for married filing separate)
  – Effective beginning Jan. 1, 2013

> Not an employer withholding issue; however, may be factor in Form W-4 changes
FUTA

> The FUTA tax rate is 6 percent (6.2 percent prior to July 1, 2011)
> Once state credits of 5.4 percent are taken into account, the revised effective FUTA tax rate will be 0.6 percent (0.006)
> Approximately 19 states will have the 5.4 percent state credit reduced by either 0.3 percent, 0.6 percent, or 0.9 percent in 2012
  – DOL will provide 2013 credit reduction states after Nov. 10, 2013
  – IRS will provide Form 940 Schedule A with credit reductions in mid-November or early December
> The reduction relates to the failure of these jurisdictions to repay federal loans under FUTA
> A listing of the credit reduction states can be found in Form 940 Schedule A
Have you taken into account the reduced state unemployment tax credit for budgeting purposes?
Employer-provided health care cost reporting

> Health care cost reporting requirements for Form W-2
>  – The cost of employer-provided health care must be reported on 2013 Forms W-2 in box 12 code DD
>  – IRS Notices 2010-69 and 2011-28 provide valuation and reporting guidance on the Form W-2 reporting requirements
> IRS Notices 2011-28 and 2012-9 provided 2012 transition relief for small employers that file fewer than 250 Forms W-2 for the prior year
> The transition relief should be available until further guidance is issued by the IRS
Qualified educational assistance provisions made permanent

> IRC § 127 will no longer be subject to expiration as it has been since 1978
> $5,250 of employer-provided educational assistance reimbursements may be excluded from an employee’s compensation
Transportation benefits (commuting)

> Absent further congressional action the transit monthly exclusion will be reduced from $245 in 2013 and revert back to $125 on Jan. 1, 2014

> Parking monthly exclusion increased to $250 in 2014 from $245 in 2013
Food service employers tip and wage reporting

> Rev. Rul. 2012-18 provides guidance on the difference between tips and service charges for employers and employees

– Effective Jan. 1, 2014, employers should:
  o Report as wages amounts related to compulsory service charges paid by customers
  o Example of a compulsory service charge includes an 18 percent charge added to all bills for parties of six or more customers
  o Food service and hospitality employers should change their tip reporting procedures to treat these compulsory service charges as wages and not tips reported to the employer by the employee
  o Service charges are not eligible for the tip credit claimed on Form 8846 and are not eligible for the general business credit claimed on Form 3800
Frequently asked payroll questions

Common payroll compliance questions

> How are payments to a deceased employee’s beneficiary reported?
> What methods can be used to reduce employment tax penalties?
> How do we report severance payments to a former employee?
> Are gift cards taxable compensation to an employee?
> How are settlement payments to a former employee and their attorney reported?
> How are wages of a predecessor employer reported?
> When is a worker considered an independent contractor?
> When should an employee’s compensation be grossed-up?
> When should wages be treated as supplemental wages?
> What fringe benefits are included in an employee’s compensation?
> Are employer-reimbursed moving expenses taxable?
> When should an employer include the use of an automobile in an employee’s compensation?
> Are loans to employees taxable?
Questions
Contact information

Larry Mohr
612 876 4630
lawrence.mohr@bakertilly.com

Martin Rule
847 620 5178
martin.rule@cpa.com
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