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Final Regs Affirm Ability To Elect Alternative Simplified Research Credit On Amended Return

◆ *TD 9712*

The IRS has issued final regs on the alternative simplified research credit (ASC) that affirm the ability of taxpayers to elect the ASC on an amended return, as provided in temporary regs (TD 9666) issued in 2014. A taxpayer can elect on an amended return if it did not previously elect the regular research credit for the same year.

■ ***Take Away.*** "The alternative simplified credit is very important for taxpayers," Kendall Fox, partner and National Leader, Research Credit Practice, PricewaterhouseCoopers LLP, New York, told Wolters Kluwer. "The ASC makes it much easier to claim the research credit. It allows taxpayers to look only at their prior three years to determine their base amount. The trade-off is that a 14 percent rate is applied to the expense increment, rather than the 20 percent rate for the regular credit."

■ ***Comment.*** The research credit is a temporary provision. Congress and the White House support a permanent research credit but disagree over how to pay for it. While the House Ways and Means Committee has approved a permanent credit, others believe that a permanent credit should wait for tax reform.

Background

Code Sec. 41(a) provides a tax credit for increased research activities (the "regular" credit), equal to 20 percent of certain research expenses. Code Sec. 41(c)(5) gives taxpayers an election to claim the ASC instead. The ASC equals 14 percent of the amount by which qualified research expenses exceeds 50 percent of average research expenses for the preceding three years.

■ ***Comment.*** "Companies with a history use their sales from the 1984-1988 base period to calculate the regular research credit," Fox said. "The research credit keeps expiring. Rather than refresh the base period, Congress just keeps rolling it forward," he explained.

Taxpayers electing the ASC must continue to claim the ASC in subsequent years. However, the IRS has granted automatic consent to revoke the election in a subsequent year.

Prior regs

The IRS issued final regs on the ASC in 2011 (TD 9528). The regs required that taxpayers elect the ASC with a timely filed (with extensions) original income tax return. Taxpayers could not make the election on an amended return or request an extension of time to make the election.

After receiving comments, the IRS issued the 2014 temporary regs that allow taxpayers to elect the ASC on an amended return, providing the taxpayer did not elect the regular research credit on an original or amended return. A taxpayer claiming the ASC had to make the election before the expiration of the limitations period for assessing tax for the original year.

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Partnership Audits Increase; Other Business Audits Drop In FY 2014

◆ *www.irs.gov*

Just-released audit coverage statistics show a slight increase in audits of partnerships, but decreases in audits of large corporations and S corporations in fiscal year (FY) 2014. For all types of businesses, the FY 2014 audit coverage rate was 0.57 percent, representing a decline from 0.71 percent in FY 2012 and 0.61 percent in FY 2013. Audits of large corporations experienced the steepest decline, according to the IRS.

■ ***Take Away.*** The IRS is moving to auditing more large partnerships, IRS officials said recently in Washington, D.C. but must balance its audit work with available resources. "In the case of large partnerships, we do not want to assess 1,000 or 10,000 partners," one senior counsel in the IRS Office of Associate Chief Counsel told practitioners. One goal is to make the audit process more streamlined for large partnerships.

Partnerships

Unlike other categories, audits of partnerships increased in FY 2014. In FY 2013, the audit coverage rate for partnerships was 0.42 percent. The audit coverage rate for partnerships increased slightly to 0.43 percent in FY 2014.

■ ***Comment.*** Since FY 2007, the audit coverage rate for partnerships has been in the neighborhood of 0.40 percent, the IRS reported.

Large and small corporations

For large corporations (corporations with assets more than $10 million), the audit coverage rate in FY 2014 was 12.23 percent, compared to 15.84 percent in FY 2013 and 17.78 percent in FY 2012. The FY 2014 audit coverage rate was 0.95 percent for small corporations (corporations with assets less than $10 million). The rate was unchanged from FY 2013 but reflected a decline from FY 2012, when the audit coverage rate for small corporations was 1.12 percent.

■ ***Comment.*** IRS Commissioner John Koskinen highlighted the decline in audits of large corporations. Audits for corporations with more than $10 million in assets fell by 20 percent between FY 2013 and FY 2014, Koskinen said. According to Koskinen, audits for large corporations are at the lowest rates in a decade.

S corporations

The IRS also reported that audits of S corporations declined. The audit coverage rate for S corporations in FY 2014 was 0.36 percent, reflecting a decline from 0.42 percent in FY 2013, and a decline from 0.48 percent in FY 2012.

Impact of budget cuts

Koskinen attributed the decline in audit coverage to recent cuts in the agency's budget. The IRS budget has fallen by more than $1.2 billion in the last five years, Koskinen said. Like overall IRS staffing, the number of compliance employees who conduct audits has also fallen sharply during this period.

■ ***Comment.*** The *Consolidated and Further Continuing Appropriations Act, 2015* reduced the agency's FY 2015 budget by approximately $346 million. President Obama has proposed to fund the IRS at $12.9 billion for FY 2016, reflecting a $2 billion increase over FY 2015. This would help the IRS stop this decline in enforcement efforts and help improve critical taxpayer services, Koskinen predicted. Koskinen is scheduled to testify before House and Senate panels this week about the agency's FY 2016 budget request.

Research Credit

Continued from page 109

Final regs

The final regs adopt the temporary regs in most respects, allowing taxpayers to claim the ASC on an amended return. The IRS again rejected a proposal to allow taxpayers to request an extension of time to make the election, stating that this was unnecessary in light of the ability to make an election on an amended return. The IRS also declined to extend the period for filing an amended return to include the period for making a refund claim under Code Sec. 6511, or to include a closed year where the taxpayer sought to carry forward the credit to an open year.

■ ***Comment.*** "It's very important for taxpayers to understand that the ability to make an election on an amended return is based on the statute of limitations for assessment (generally three years), not the limitations period for a refund," Fox said.

However, the final regs clarify that a taxpayer making a Code Sec. 280C election on Form 6765 to take a reduced credit is not treated as claiming the regular credit if the taxpayer leaves the rest of the form blank. The regs also clarify that the election is denied if the taxpayer previously claimed the credit under Code Sec. 41(a)(1), but not for claims under Code Sec. 41(a)(2) or (3), because the ASC does not affect the credit allowable under the latter provisions.

■ ***Comment.*** "The amended return provision is very important," Fox said. "The provision on the 280C election also is very helpful. Code Sec 280C allows taxpayers to elect a reduced credit, rather than having to add back the credit and reduce their Code Sec. 174 expenses."

References: FED ¶47,009; TRC BUSEXP: 54,164.15.

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Reference Key

FED references are to *Standard Federal Tax Reporter*
USTC references are to *U.S. Tax Cases*
CCH Dec references are to *Tax Court Reports*
TRC references are to *Tax Research Consultant*

Tax Court Declines To Adopt Federal Common Law Successor In Interest Standard

◆ *TFT Galveston Portfolio, LTD, 144 TC No. 7*

In consolidated cases, the Tax Court has affirmed that state law controlled to determine if a taxpayer was a successor in interest for federal employment tax liability. The court rejected the IRS's argument to disregard state law in favor of federal common law.

■ ***Take Away.*** "The IRS's argument was a nonstarter," Bill O'Malley, director, Washington National Tax Office, McGladrey, LLP told Wolters Kluwer. Historically, the Tax Court has followed state law to determine the rights of business entities, O'Malley explained.

Background

The taxpayer was in the business of property management and was the successor in interest to several previous entities. One individual effectively controlled all of the partnerships as owner.

The taxpayer engaged the services of various individuals, including managers and maintenance workers. Managers were provided onsite housing and had certain expenses paid as part of their compensation. Managers were also provided with supplies and equipment. The owner hired the managers, established all of their duties and supervised all aspects of their work. The owner also had authority to discharge managers. The maintenance workers did general cleanup, roofing, carpentry, landscaping, and other activities. Maintenance workers were hired by managers but the owner had final approval over all hiring decisions.

The IRS determined that the managers and maintenance workers were employees. The IRS issued notices to the previous entities and the taxpayer for unpaid employment taxes.

Court's analysis

The court first found that a successor in interest is one that follows another in ownership or control of property. A successor in interest retains the same rights as the original owner, with no change in substance. If state law permits, successor liability may be asserted when a partnership transfers its assets to another entity.

Here, the court agreed with the IRS that the uniform imposition and collection of employment taxes is a significant federal interest. However, the Supreme Court has rejected uniformity as a sufficient reason for adopting federal common law, the court held.

■ ***Comment.*** "The natural desire of the IRS for uniformity is understandable but the ability of a state to determine its own laws is protected by the Tenth Amendment," O'Malley noted.

Next, the court turned to state (Texas) law. The court found that Texas provides that a person acquiring property may not be held responsible or liable for a liability or obligation of the transferring domestic entity that is not expressly assumed by the person. However, there are exceptions, such as where the transaction amounts to a de facto merger; the successor is a mere continuation of the seller company; and the transaction is entered into fraudulently to escape liability. The exceptions did not apply, the court found.

■ ***Comment.*** In CCA 200840001, IRS Chief Counsel emphasized the necessity of consulting state law when considering successor liability. While most jurisdictions have adopted four theories imposing successor liability, courts have not uniformly applied the theories, Chief Counsel noted.

Turning to worker classification, the court found that whether an employer-employee relationship exists in a particular situation is a question of fact. Generally an employer-employee relationship exists when the person for whom services are performed has the right to hire, control, direct, and discharge the individual who performs the services. In this case, the court found that the owner controlled nearly every aspect of the work performed by the managers. Work performed by the maintenance workers was also subject to the owner's final approval. The workers, the court concluded, were employees and not independent contractors.

References: Dec. 60,283;
TRC PAYROLL: 6,106.40.

Supreme Court To Hear Oral Arguments In Challenge To Code Sec. 36B Regs

At press time, the U.S. Supreme Court is scheduled to hear oral arguments in *King v. Burwell, 2014-2* USTC *¶50,367,* on March 4. The Supreme Court has taken up a challenge to regs extending the Code Sec. 36B premium assistance tax credit to enrollees in federally facilitated Marketplaces as well as enrollees in state-run Marketplaces.

■ ***Comment.*** "If the Supreme Court decides on behalf of the plaintiffs, we do not have an administrative action we can take that can undo the damage," Health and Human Services Secretary Sylvia Burwell told lawmakers at a recent hearing. Several lawmakers have questioned Burwell and other officials if the administration has a contingency plan in the event the Court strikes down the Code Sec. 36B regs.

Background. In *King,* the Court of Appeals for the Fourth Circuit upheld Code Sec. 36B regs. The Fourth Circuit found that the regs were not, as the plaintiffs argued, contrary to the *Patient Protection and Affordable Care Act* (PPACA) and qualified enrollees in federally facilitated Marketplaces could claim the credit.

Oral argument. In Court filings, the administration has argued that the Fourth Circuit correctly held that the IRS's interpretation is a reasonable one entitled to deference. The plaintiffs counter that the PPACA authorizes tax credits only for individual health coverage obtained through state-run Marketplaces. The regs, they argue, contradict the statute.

King, 2014-2 USTC *¶50,367; TRC HEALTH: 3,300.*

Tax Court Reversed: Taxpayer Can Claim Ordinary Loss On Abandoned Securities

◆ *Pilgrim's Pride Corp., CA-5, February 25, 2015*

Reversing the Tax Court, the Court of Appeals for the Fifth Circuit has found that a taxpayer can claim an ordinary loss for abandoned securities, even though the securities were not worthless and could have been sold to another party. The Tax Court had held that the taxpayer had a capital loss under Code Sec. 1234A when it abandoned the securities.

- ***Take Away.*** Code Sec. 1234A was enacted to address straddles. Code Sec. 1234A mandates capital loss treatment for a loss from the termination of a contract, even though no sale or exchange occurs. Code Sec. 165(g) also requires capital loss treatment, where a security becomes worthless, even if there is no sale or exchange.

Background

The taxpayer sold one of its businesses to another corporation. As part of the sale, the taxpayer agreed to purchase certain securities from the corporation for $98.6 million, as security for the corporation to obtain a bridge loan that would facilitate the purchase.

The taxpayer offered the securities back to the corporation. The taxpayer proposed a price of $31.5 million, but the corporation countered with an offer of only $20 million. The taxpayer decided that a $98.6 million ordinary loss, from abandoning the securities, would be more valuable than a sale for $20 million and a capital loss. The taxpayer irrevocably abandoned the securities for no consideration and reported a $98.6 million ordinary loss deduction.

The parties agreed that the securities were capital assets. The IRS asserted that the loss from their abandonment was capital under Code Sec. 165(g), which treats the loss from worthless securities as a capital loss. After asking the parties to address Code Sec. 1234A, the Tax Court held that the loss was a capital loss under Code Sec. 1234A, which mandates capital loss treatment for a loss attributable to the termination of a right or obligation with respect to a capital asset.

Court's analysis

A capital loss is a loss from the sale or exchange of a capital asset, under Code Sec. 165(f). Abandoning a capital asset without consideration is not a sale or exchange. However, the court noted, several code provisions require that certain transactions be treated like a sale or exchange, including Code Sec. 1234A.

The court found that Code Sec. 1234A does not apply to the abandonment of a capital asset. The provision applies to the termination of "rights or obligations with respect to capital assets" (derivative or contractual rights to buy or sell capital assets), not to the termination of ownership of the capital asset itself. The IRS agreed that the provision does not apply to the abandonment of a capital asset, but argued that it applied indirectly here because the abandonment of securities terminates rights and obligations inherent in stock ownership.

The court found this argument too convoluted. Congress could have phrased the statute differently if its intent was to treat the abandonment of a capital asset as a capital loss. The court also found that the IRS argument would render a portion of Code Sec. 1234A superfluous, violating the rule of statutory interpretation that a court should give effect to every word in a statute.

Further, the court also rejected the IRS's argument that Code Sec. 165(g) applied since the securities were worthless. Although the parties had agreed that the securities were worth at least $20 million, the IRS argued that the securities were subjectively useless, and therefore worthless, to the taxpayer. Here, the securities were not objectively worthless.

References: 2015-1 USTC ¶50,211; TRC SALES: 45,202.

Taxpayers Not Required To Re-File If Premium Credit Reflects Incorrect Form 1095-A, Treasury Announces

Treasury has provided relief for certain taxpayers who received an incorrect Form 1095-A, Health Insurance Marketplace Statement. If the taxpayer has already filed a return for 2014 and received a higher Code Sec. 36B premium assistance tax credit as a result of the error, the taxpayer may keep it. The IRS will not pursue collection action against that taxpayer. If, due to the error, a taxpayer who has already filed a 2014 return received a lower credit than he or she was entitled to receive, the individual may amend the tax return.

Background. The 36B Code Sec. premium assistance tax credit for the entire year is computed based in part on an individual's monthly premium for the applicable second lowest cost silver plan (SLCSP). In February, the U.S. Department of Health and Human Services (HHS) reported that it had issued some 800,000 incorrect Forms 1095-A. The incorrect forms referenced Marketplace benchmark plans for 2015 rather than 2014. The incorrect forms accounted for approximately 20 percent of taxpayers who received insurance through the Health Insurance Marketplace.

Form correction. HHS is in the process of issuing corrected Forms 1095-A. HHS has advised affected individuals to expect to receive a corrected Form 1095-A in early March 2015. In turn, the has advised affected taxpayers who have not already filed to wait for the corrected form before filing.

IRS Issues More Guidance On PPACA's Health Insurance Provider Fee

◆ *TD 9711, NPRM REG-143416-14*

The IRS has issued final, temporary and proposed regs on the health insurance provider fee imposed by Section 9010 of the *Patient Protection and Affordable Care Act* (PPACA). The IRS explained who is liable for the fee, who is exempt, and who must report its net insurance premiums written on U.S. health risks.

■ ***Take Away.*** The fee is one of the revenue-raising provisions in the PPACA. The PPACA sets the aggregate fee at $8 billion for 2014, its first year, and $11.3 billion for 2015 and 2016. The aggregate fee continues to rise after 2016.

Background

The PPACA imposes an annual fee on any "covered entity" that provides health insurance for United States health risks (citizens and residents). The fee is apportioned among providers based on a ratio that reflects their relative share of U.S. health insurance business.

■ ***Comment.*** Health insurance does not include accident or disability income insurance; indemnity insurance; insurance for a specific disease; long-term care insurance; and supplementary Medicare plans.

Each covered entity must report its net premiums taken into account for the prior calendar year (the "data" year) by April 15 of the "fee" year (the year in which the fee is paid). In calculating its net premiums, the entity disregards its first $25 million in premiums, counts half of the next $25 million in premiums, and then includes 100 percent of premiums over $50 million.

The IRS calculates each provider's fee and sends a bill that the provider must pay by September 30 each year. There are penalties for late reporting of net premiums without cause.

■ ***Comment.*** The PPACA provides several exclusions to a covered entity, including government entities; employers that self-insure; nonprofits that receive more than 80 percent of their revenue from government programs for targeted groups; and VEBAs (voluntary employee beneficiary associations) maintained by a union or other non-employer entity to provide health care benefits.

Guidance

The IRS issued final regs (TD 9643) on the health insurance provider fee in 2013. The agency subsequently issued Notice 2014-47 for the 2014 fee year on the definition of a covered entity. The temporary regs provide further guidance on covered entities for 2015 and after, incorporating the general approach in the notice.

To avoid covered entity status, an entity must qualify for one of the exclusions for the entire data year ending on the prior December 31, or for the entire fee year beginning on January 1. An entity that qualifies for an exclusion should not report its net premiums. The temporary regs impose a consistency requirement that binds an entity to its initial selection of either the data year or the fee year as its test year.

The IRS noted that an entity using the fee (current) year as its test year will claim an exclusion and not pay a fee on September 30. If the entity then fails to qualify for the exclusion for the current (fee) year, the entity must use the data year as its test year in subsequent years.

■ ***Comment.*** The IRS requested comments on whether to allow an entity to change its test year.

The final regs provide that a controlled group must report net premiums for each member of the group, but only if the member would have been a covered entity if it was not a member of the controlled group. Even if the member's premiums are not counted, the member remains jointly and severally liable for the group's fee, the IRS explained.

Reference: TRC EXCISE: 13,108.

Enforcement, Services, And IT Suffer From Budget Cuts, Koskinen Says

IRS Commissioner John Koskinen outlined the impact caused by an estimated $1.2 billion in cuts to the IRS's budget in recent years. According to Koskinen, the successive budget reductions have ensured that current staffing levels are insufficient to meet the IRS's needs. As a result, Koskinen stressed that enforcement, taxpayer services and information technology (IT) will suffer. Koskinen spoke at an event sponsored by the New York State Bar Association Section of Taxation on February 24, 2015.

Budget cuts. Koskinen said that the agency's $346 million cut from its fiscal year (FY) 2015 budget actually amounts to a $600 million reduction when factoring in its responsibilities for new initiatives, such as new reporting and enforcement requirements under the *Patient Protection and Affordable Care Act* and the *Foreign Account Tax Compliance Act.* The agency had previously absorbed an estimated $600 million cut due to sequestration in 2013.

■ ***Comment.*** Koskinen has cautioned that employee furlough days may be necessary to save money before the end of fiscal year (FY) 2015. Any furlough days would take place after filing season, he predicted.

Other impacts. The budget cuts also mean that taxpayer services will continue to decline; and the IRS's information technology systems will remainexposed to system failures and security breaches because the agency lacks the funding to upgrade its computer equipment and software, Koskinen said. In addition, the IRS will likely be forced to delay its progress in publishing formal guidance, issuing private letter rulings, and performing outreach to tax professionals.

Tax Court Sanctions Taxpayer With $20,000 Penalty For Delay Tactics

◆ *Kanofsky, TC Memo. 2015-34*

The Tax Court has found that an IRS settlement officer did not abuse her discretion by closing a taxpayer's case after he failed to respond to a request for documentation and did not call in for his scheduled collection due process (CDP) hearing. The IRS's motion for summary judgment was granted, and in addition, the Tax Court sanctioned the taxpayer for instituting court proceedings primarily for purposes of delay.

■ ***Take Away.*** If the Tax Court finds that a frivolous proceeding was brought before the court, it may impose a penalty under Code Sec. 6673 of up to $25,000 if a taxpayer: (1) instituted or maintained a proceeding primarily for delay; (2) took a frivolous position; or (3) unreasonably failed to pursue available administrative remedies.

Background

Following a Tax Court judgment upholding the IRS's deficiency determination against the taxpayer—also upheld by the Court of Appeals for the Third Circuit—the IRS issued a Final Notice of Intent to Levy to the taxpayer. The taxpayer timely requested a CDP hearing without offering a collection alternative. The IRS Appeals Settlement Officer scheduled a CDP hearing by telephone, but the taxpayer did not submit the requested documentation, did not call in for the hearing, did not respond to the IRS's follow-up call, and did not attempt to reschedule. The IRS settlement officer closed the case and sustained the levy.

The taxpayer timely sought review, claiming he had been continually subject to fraud and corruption and that various international events and crises had relevance. The IRS moved for summary judgment and requested imposition of the penalty under Code Sec. 6673(a)(1).

Court's analysis

The court found that the settlement officer had not abused her discretion by closing the case and sustaining the levy. A settlement officer does not abuse her discretion by declining to consider collection alternatives where a taxpayer has not raised any valid challenge to the appropriateness of the proposed collection action, declined to submit any documents, and refused to participate in the CDP hearing, the court explained.

Further, the Tax Court imposed the Code Sec. 6673 penalty in the amount of $20,000. The noted that the taxpayer had received warnings against making frivolous arguments in prior proceedings, but had persisted in doing so anyway.

■ ***Comment.*** The Tax Court had previously imposed a $10,000 penalty under Code Sec. 6673 in a prior case involving the taxpayer's liabilities for the 1996 through 2000 tax years.

References: Dec. 60,241(M);
TRC PENALTY: 3,308.

IRS Releases Proposed Regs On New Method Of Making AFR Adjustments For Tax-Exempt Obligations

◆ *NPRM REG-136018-13*

The IRS has issued proposed regs describing a new method for determining the adjusted applicable federal rates (AFRs) under Code Sec. 1288 to take into account the tax exemption for interest on tax-exempt obligations and the long-term tax-exempt rate and the adjusted Federal long-term rate under Code Sec. 382(f). The proposed regs address many of the comments received in response to Notice 2013-4 suggesting possible modifications to the method by which the adjusted AFRs and adjusted federal long-term rate are determined.

■ ***Take Away.*** The AFRs are used for many purposes, one of which is computing the Code Sec. 382 limitation on the use of net operating losses (NOL) of corporations that have undergone an ownership change described under Code Sec. 382(g). The long-term tax-exempt rate is one component used for computing the Code Sec. 382 limitation. The current methodology for computing the long-term tax-exempt rate has provided results inconsistent with what Congressional intended when it enacted Code Sec. 382, the IRS explained.

Background

Code Sec. 382(f) defines the long-term tax-exempt rate and Code Sec. 382(f)(2) defines the term adjusted Federal long-term rate. The Conference Report for the *Tax Reform Act of 1986,* which added Code Sec. 382(f) to the Tax Code, explained that the long-term tax-exempt rate should be lower than the federal long-term rate. Since 2008 certain market changes have sometimes caused market yields of prime, general obligation tax-exempt obligations to exceed market yields of comparable U.S. Treasury obligation, meaning that at times the adjusted federal long-term rate and each adjusted AFR exceeded the corresponding AFRs.

Proposed regs

The proposed regs provide the new method by which the IRS and the Treasury Department would determine the adjusted AFRs under Code Sec. 1288 to take into account the tax exemption for interest on tax-exempt obligations.

Under the proposed regs, the adjusted federal long-term rate under Code Sec. 382(f) would continue to be determined in the same manner as the adjusted AFRs under Code Sec. 1288. The IRS would use historical market data to create an appropriate adjustment factor based on individual tax rates.

The proposed adjustment factor is one minus the product of a tax rate and a fixed percentage. The tax rate is the sum of the maximum individual tax rate under Code Sec. 1 and the maximum individual tax rate under Code Sec. 1411 (net investment income tax).

References: FED ¶49,638;
TRC ACCTNG: 36,162.05.

Chief Counsel Reviews Application Of Code Sec. 6676 Penalty, Deficiency Procedures

◆ *PMTA 2015-15*

In Program Manager Technical Advice (PMTA), IRS Chief Counsel has determined that the Code Sec. 6676 penalty on an erroneous refund claim lacking a reasonable basis may apply regardless of whether the claim had been made on an original return or amended return. Chief Counsel also generally determined that deficiency procedures apply to the penalty where the excessive amount subject to the penalty is attributable to a refundable credit.

■ ***Take Away.*** Code Sec. 6676 does not apply if there is reasonable basis for the claimed tax treatment. Chief Counsel determined that reasonable basis for purposes of the Code Sec. 6676 penalty should track the definition of reasonable basis for the Code Sec. 6662 penalty.

Background

The penalty may be imposed on a taxpayer who files an erroneous claim for refund or credit with respect to federal income tax, other than a claim relating to the earned income credit (EIC), that is excessive in amount and for which there is no reasonable basis for the claimed tax treatment. Code Sec. 6676 does not apply to an excessive amount of a claim for refund or credit that is subject to the accuracy-related penalty under Code Sec. 6662, the understatement penalty on reportable transactions under Code Sec. 6662A, or the fraud penalty under Code Sec. 6663.

Chief Counsel's analysis

Chief Counsel explained that an erroneous refund claim made on an original return will generally result in an underpayment regardless of whether a refund is paid. As a result, the Code Sec. 6676 penalty may apply to a refund claim on a taxpayer's return to the extent that the refund claim is based on a refundable credit other than the EIC and does not have a reasonable basis. In the case of erroneous claims for refund or credit made on an amended return, the penalty may apply if the refund or credit claimed is not paid or allowed. If the refund or credit is paid, and later is determined to be erroneous, the penalty may apply only if the refund claim is based on erroneously-claimed refundable credits other than the EIC, Chief Counsel determined.

Chief Counsel also explained that if a penalty is not dependent on the determination of a deficiency, then the penalty is not subject to deficiency procedures. Where a disallowed refund on an original return is based on a refundable credit, the portion of the refundable credit will not be part of an underpayment; it will be part of a deficiency determination. However, the penalty can apply to the refundable credit only if the Tax Court agrees there is a deficiency.

Code Sec. 6676 does not require any specific taxpayer notification requirements, Chief Counsel added. If deficiency procedures apply to the penalty, Chief Counsel noted that a statutory notice of deficiency must be sent to the taxpayer. Also, Chief Counsel observed it has been the agency's practice to provide administrative appeal rights prior to assessment of the Code Sec. penalty.

Reference: TRC PENALTY: 3,332.

Internal Revenue Service

The IRS, in its series of notices reminding taxpayers of their rights, has issued a Fact Sheet on Right No. 5 of the Taxpayer Bill of Rights, the right to appeal an IRS decision in an independent forum. Taxpayers are entitled to a fair and impartial appeal of most IRS decisions, including many penalties, and they have the right to receive written response regarding the Office of Appeals' decision.

FS-2015-11, FED ¶46,264; TRC IRS: 24,054

Retirement Plans

The IRS has modified its procedures for submitting applications for opinion and advisory letters for 403(b) pre-approved plans. In particular, the IRS has changed the addresses to which applications for opinion and advisory letters for 403(b) pre-approved plans should be submitted and has added a user fee for an advisory letter for a 403(b) volume submitter specimen plan that is a minor modifier of a 403(b) volume submitter specimen plan of a mass submitter.

Rev. Proc. 2015-22, FED ¶46,265; TRC RETIRE: 69,062

Jurisdiction

An individual's action seeking to rescind a disclaimer of interest executed to allow her deceased husband's individual retirement account (IRA) to pass to a revocable trust was dismissed for lack of subject matter jurisdiction. The individual failed to show that the government has waived its sovereign immunity or consented to be sued, the court held.

Van Vliet v. Van Vliet, DC Va., 2015-1 USTC ¶50,209; TRC LITIG: 9,254.05

Income

Married individuals could not exclude from income gain from the sale of a house they owned. In addition, the taxpayers could not add the cost of claimed improvements to their basis in the house. They could also not deduct business expenses due to lack of substantiation. Finally, the court found that the taxpayers were liable for penalties for failing to file returns, failing to pay tax, and failing to make estimated tax payments.

Villegas, TC, CCH Dec. 60,240(M), FED ¶47,950(M); TRC REAL: 15,154

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Tax Briefs

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A casino bartender did not underreport his tip income for the tax years at issue. He kept detailed contemporaneous daily logs in which he recorded his cash and charge tips that more accurately reflected his income that the IRS's reconstruction, the Tax Court held.

Sabolic, TC, CCH Dec. 60,239(M), FED ¶47,949(M); TRC COMPEN: 6,050

Deductions

Married individuals were denied deductions because they were either personal or unsubstantiated. Their corporation's income was reconstructed by the IRS. Deductions for the husband's computer business were disallowed because the business was not pursued for profit. Accuracy-related penalties applied based on negligence and substantial understatement; reasonable cause was not shown.

Shah, TC, CCH Dec. 60,237(M), FED ¶47,947(M); TRC INDIV: 6,052

An individual was not entitled to moving-expense deductions for two tax years; penalties for late filing, late payment and failure to make estimated payments were imposed. The court found he was not entitled to deduct the expenses of moving from South Carolina because he never lived there; the expenses were attributable to his wife, as her belongings were moved, not his.

Palmer, TC, CCH Dec. 60,236(M), FED ¶47,946(M); TRC INDIV: 39,104

Liens and Levies

A lien for restitution owed by an individual took priority over federal tax liens that attached to his marital property. Because the restitution lien was entitled to treatment equal to a federal tax lien, it had priority because it was first in time. Moreover, while state (Florida) law provides that entireties property is not subject to execution to satisfy one spouse's debt, federal tax law preempts any state rights afforded to a taxpayer who holds entireties property, the court found.

De Cespedes, CA-11, 2015-1 USTC ¶50,213; TRC IRS: 48,150

A financial institution was not entitled to quiet title to property it received via a deed in lieu of foreclosure. The property was transferred subject to the federal tax liens under Code Sec. 7425 because the mortgagee failed to give proper notice.

First Financial Bank, N.A., DC Ind., 2015-1 USTC ¶50,207; TRC IRS: 48,106.05

Collection Due Process

The government's collection action against an individual was timely because the statute of limitations did not apply. The three-year statute of limitations under Code Sec. 6501 never began to run because the individual failed to file tax returns, the court held.

Miller, DC Ind., 2015-1 USTC ¶50,208; TRC IRS: 27,212

Collection proceedings instituted against an individual by the IRS were upheld. The taxpayer was not entitled to a face-to-face Collection Due Process hearing. Sanctions for advancing frivolous arguments were not imposed.

Portwine, TC, CCH Dec. 60,235(M), FED ¶47,945(M); TRC IRS: 51,056.20

Tax Assessments

The government was entitled to reduce tax assessments against a couple and their trust to judgment and foreclose federal tax liens against four properties held by two trusts as nominees and/or alter egos of the taxpayers. The government presented Form 4340, Certificate of Assessments and Payments and Other Specified Matters, which was presumptive proof of valid tax assessments that the taxpayers failed to rebut.

G. O'Shea, DC W.Va., 2015-1 USTC ¶50,206; TRC IRS: 45,158

Innocent Spouse

The Tax Court properly denied an individual's petition for innocent spouse relief under Code Sec. 6105(f). The individual's argument that she was not liable for tax deficiencies arising from jointly filed returns because her husband had abused her and excluded her from financial decisions regarding their jointly owned business was rejected.

Deihl, CA-9, 2015-1 USTC ¶50,212; TRC INDIV: 18,052.05

Transferee Liability

A corporation's shareholders were properly held liable as transferees with respect to their respective shares of the corporation's unpaid federal tax liability. The shareholders were liable as transferees under state (Wisconsin) law for their proportionate shares of corporation's unpaid tax liability because the transaction was in substance a liquidation and dissolution, and the shareholders received a cash distribution from the corporation.

Feldman, CA-7, 2015-1 USTC ¶50,210; TRC IRS: 60,052

Whistleblower Claims

An award received by an independent contractor to settle his whistleblower retaliation claim was not excludable from his taxable income because the payment was not compensation for a physical injury or sickness.

Duffy, FedCl, 2015-1 USTC ¶50,205; TRC INDIV: 6,354.20

Self-Prepared Returns Trend Higher As Filing Season Progresses

Self-prepared e-filed returns are trending nearly seven percent higher this filing season than last year, the IRS has reported. At the same time, the number of individual returns prepared and filed electronically by tax professionals is down almost four percent from the same time last year.

Individual returns. As of February 27, the IRS had received approximately 47.1 million returns, an increase of 1.1 percent from the same time in 2014. Of these returns, 23.7 million were prepared by taxpayers using home computers and 23.4 million returns were prepared by tax professionals. At this time last year, the IRS had received 21.9 million self-prepared returns and 24.6 million returns prepared by tax professionals. The IRS indicated that it expects to receive some 150 million individual returns through the end of the year.

Refunds. The IRS issued 39.9 million refunds as of February 27, down from 40.3 million refunds at the same time last year. The average refund amount was $3,120, up $4 from this time in 2014. More than 92 percent of refunds were directly deposited into taxpayer accounts.

IR-2015-34; TRC FILEIND: 15,200.

Filing Season Special Enrollment Provides Opportunity To Avoid PPACA Shared Responsibility Penalty For 2015

Passage of the *Patient Protection and Affordable Care Act* (PPACA) has linked the administration and delivery of health care and health insurance, and taxes closer than ever before. This is the first filing season that individuals must report if they have minimum essential coverage, are exempt from the requirement to carry minimum essential coverage, or must make a shared responsibility requirement. Since late 2014, the IRS and the U.S. Department of Health and Human Services (HHS) have engaged in numerous public outreach projects to remind taxpayers about the individual shared responsibility requirement. However, HHS discovered that some individuals were not aware of the individual shared responsibility requirement until they filed their 2014 federal income tax returns. In response, HHS launched a special filing season enrollment period for federally facilitated Marketplaces. The filing season special enrollment period does not exempt individuals from making a shared responsibility payment for 2014 but can help them avoid making a larger payment for 2015.

■ ***Comment.*** Filing season special enrollment is available to qualified individuals living in the 37 states with federally facilitated Marketplaces. Some state-run Marketplaces are also opening a similar filing season special enrollment period. For example, the special enrollment period for California's state-run Marketplace runs through April 30, 2015.

> *"The filing season special enrollment period does not exempt individuals from making a shared responsibility payment for 2014 but can help them avoid making a larger payment for 2015."*

Individual shared responsibility requirement

Code Sec. 5000A generally requires individuals and their dependents to carry minimum essential health coverage or make a shared responsibility payment, unless exempt. Nearly all types of employer-provided health insurance coverage is treated as minimum essential coverage, as is coverage under Medicare, Medicaid, TRICARE, the Children's Health Insurance Program (CHIP), and other government programs. Coverage through the Health Insurance Marketplace is also minimum essential coverage for purposes of the individual shared responsibility requirement. The PPACA also carves out a number of exemptions, including exemptions for a hardship(s) (such as homelessness, natural disaster, domestic violence), in cases where the lowest-priced coverage available to the individual would cost more than eight percent of household income, in cases where the individual has a religious objection, and more.

■ ***Comment.*** A grandfathered plan qualifies as minimum essential coverage. A grandfathered plan is basically a group health plan or health insurance coverage in which the individual was enrolled on March 23, 2010, the date the PPACA was signed into law by President Obama.

■ ***Comment.*** For more details about the exemptions from the individual shared responsibility requirement see the Practitioners' Corner in the January 22, 2015 issue of this newsletter.

For 2014, the individual shared responsibility payment is the greater of: one percent of household income that is above the tax return filing threshold for the individual's filing status; or the individual's flat dollar amount, which is $95 per adult and $47.50 per child, limited to a family maximum of $285, but capped at the cost of the national average premium for a bronze level health plan available through the Marketplace in 2014. For 2015, the monthly national average premium for qualified health plans that have a bronze level of coverage and are offered through the Marketplace is $204 per individual and $1,020 for a shared responsibility family with five or more members.

For 2015, the individual shared responsibility payment is the greater of two percent of household income that is above the tax return filing threshold for the individual's filing status or the individual's flat dollar amount, which is $325 per adult and $162.50 per child, limited to a family maximum of $975, but capped at the cost of the national average premium for a bronze level health plan available through the Marketplace in 2015. For 2015, the monthly national average premium for qualified health plans that have a bronze level of coverage and are offered through the Marketplace is $207 per individual and $1,035 for a shared responsibility family with five or more members.

■ ***Comment.*** For 2016, the percentage amount and the dollar amount increase to 2.5 percent and $695, respectively. For calendar years beginning after 2016, the $695 amount is adjusted for inflation.

■ ***Comment.*** According to HHS, 10 to 20 percent of taxpayers who were uninsured for all or part of 2014 will

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Washington Report

by the Wolters Kluwer Washington News Bureau

SFC tax reform working groups to make reports in May

Senate Finance Committee Chair Orrin Hatch, R-Utah, is planning on having his tax reform working groups report to him on May 25 with their findings. The five working groups will review all the areas of the tax system and use their findings as discussion points when the panel begins work on revamping the Tax Code.

The five working groups, Individual Income Tax, Business Income Tax, Savings and Investment, International Tax and Community Development and Infrastructure, are currently engaged in what are referred to as tax reform education sessions. By late March, the groups are expected to start preparation for roundtable discussions. Hatch has set April 14 as a tentative date for the first of several roundtable discussions, which would take place twice a week.

Each of the bipartisan groups are working in tandem with the Joint Committee on Taxation (JCT) to produce an in-depth analysis of options and potential legislative solutions within its assigned area, with the goal of having one final comprehensive report featuring recommendations from each of the five categories. By the beginning of May, the working groups are slated to begin preparation of their reports, which are scheduled to be presented on May 25 to Hatch and ranking member Ron Wyden, D-Ore.

House approves 529 college savings bill

The House on February 25 approved legislation (HR 529) to Code Sec. 529 college savings plans. The final vote was 401 to 20. The House bill would allow the purchase of a computer to be considered a qualified expense, remove distribution aggregation requirements and allow a student who receives a refund of any 529 qualified expenses to redeposit those funds into their 529 plan in a timely manner, without penalty. The bill now moves to the Senate.

Lawmakers seek answers to incorrect Forms 1095-A

Sens. Charles Grassley, R-Iowa, and Rob Portman, R-Ohio, have asked the Obama administration to explain why some 800,000 individuals received incorrect Forms 1095-A, Health Insurance Marketplace Statement, earlier this year. “It is clear that the current methods used to calculate subsidy eligibility are not working,” Grassley and Portman wrote to Health and Human Services Secretary Sylvia Burwell. “This has immediate negative impacts on people who now must pay money back to the IRS. It is crucial that steps be taken to address this problem.”

Grassley and Portman noted in their letter that there are many reasons a person’s eligibility for subsidies could change throughout the year. They said that, currently, there is no simple way for people to report that information and there is no way for a health insurance provider to report the information for them. Instead, an individual must log on to the Marketplace website and update their information every time there is a change in employment, income or a life event. “Not only is this an onerous process for individuals, but it also results in a greater number of incorrect subsidies,”" they wrote.

IRS opens FATCA IDES gateway

The IRS Large Business & International Division announced on March 2 the opening of the International Data Exchange Service (IDES) gateway. Enrollees may use the system to send information reports on financial accounts held by U.S. persons. IDES operates on all major browsers. Data transmitted via IDES is encrypted at both the file and transmission level to safeguard sensitive tax information, the IRS explained.

IRS struggling to answer taxpayers’ questions, Olson says

National Taxpayer Advocate Nina Olson told payroll professionals on March 2 in Washington, D.C., that the IRS is struggling to answer all of the calls it receives from taxpayers this filing season. According to Olson, wait times to speak with an IRS customer service representative have more than doubled compared to last year. Olson spoke at an event sponsored by the American Payroll Association.

On February 25, Olson told Congress that taxpayer service is the number one most serious problem facing taxpayers in 2015. Olson testified that taxpayers are receiving the “worst levels” of taxpayer service since the IRS implemented its current performance measures in 2001. Olson reported that during the period January 1 through February 14, the IRS answered only 43 percent of the calls it received from taxpayers seeking to speak with a customer service representative. And those taxpayers who managed to get through were on hold for an average of about 28 minutes. Olson further stated that the IRS is now answering only the most basic of tax law questions through April 15 and none after that date.

“I do not see any substitute for sufficient personnel if the IRS is to provide high-quality taxpayer service,” Olson added. “The only way the IRS can assist taxpayers seeking to speak with an IRS employee is to have enough employees to answer their calls. The only way the IRS can timely process taxpayer letters is to have enough employees to read the letters.”

Practitioners' Corner

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qualify for an exemption from the requirement to have minimum essential coverage. An estimated two to four percent of individuals will be required to make a shared responsibility payment because they did not carry minimum essential coverage, HHS added.

Special enrollment

Annual enrollment for the Marketplace for 2015 coverage closed on February 15, 2015. The filing season special enrollment period runs from March 15, 2015 to April 30, 2015. During this time, qualified individuals will be able to obtain health insurance coverage through the Marketplace for 2015. If a consumer enrolls in coverage before the 15th of the month, coverage will be effective on the first day of the following month, HHS explained.

■ ***Comment.*** In a conference call with reporters, HHS officials described the filing season open enrollment period as a one-time event. HHS has reportedly reviewed extending the 2016 annual enrollment period beyond mid-February but no details have yet been released.

Eligibility

The filing season special enrollment period is only open to individuals who satisfy certain criteria. Individuals must live in states with a federally-facilitated Marketplace (individuals who reside in states with state-run Marketplaces should follow instructions, if any for their state's special enrollment period). Individuals also must not be already enrolled in health insurance coverage through the Marketplace for 2015. Additionally, individuals must attest that when they filed their 2014 tax return they paid the shared responsibility payment for not having minimum essential coverage in 2014; and attest that they first became aware of, or understood the implications of, the individual shared responsibility requirement after the end of open enrollment (February 15, 2015) in connection with preparing their 2014 tax returns.

■ ***Comment.*** At this time, it is unclear how the Marketplace will verify an individual's claim that he or she first became aware of, or understood the implications of, the individual shared responsibility requirement after February 15, 2015.

■ ***Example.*** Amber, age 36, is unmarried and has no dependents. Amber resides in a state with a federally-facilitated Marketplace. Amber's employer does not offer health insurance coverage and Amber did not obtain minimum essential coverage through the Marketplace or any other source for 2014. Amber also did not qualify for any exemption to the requirement to carry minimum essential coverage. Amber's household income for 2014 is $41,000 and her filing threshold is $10,150. Amber begins to prepare her 2014 individual income tax return on February 17, 2015 and discovers that she is responsible for making a shared responsibility payment under Code Sec. 5000A. Amber makes her shared responsibility payment when she files her 2014 return on February 24, 2015. One week later, Amber discovered that the regular open enrollment period for Marketplace coverage had expired after February 15, 2015. Amber appears to be eligible for the filing season special enrollment period because she made her shared responsibility payment when she filed her 2014 return and first became of, or understood the implications of, the individual shared responsibility requirement after the end of open enrollment (February 15, 2015) in connection with preparing her 2014 return.

Non-filing season special enrollment

Some qualifying life events may make an individual eligible for non-filing season special enrollment in the federally-facilitated Marketplace. The requirements for general special enrollment are different from the requirements for filing season special enrollment. These requirements are linked to qualifying life events which, HHS has explained, include marriage or divorce, having a baby, adopting a child or placing a child for adoption or foster care; change of residence, gaining citizenship, leaving incarceration; and losing other coverage. An individual who experiences a complex situation may also qualify for general special enrollment. These include exceptional circumstances, such as where the individual faced a serious medical condition or natural disaster that kept the individual from enrolling in the Marketplace during open enrollment. Additionally, individuals whose COBRA coverage is exhausted are eligible for special enrollment. Individuals who also experienced problems in automatic re-enrollment in 2014 coverage for 2015 may also qualify for special enrollment. Generally, individuals have a limited window (such as 30 or 60 days after the qualifying event) to obtain coverage during special enrollment.

■ ***Example.*** Alex, age 29, is married and has no children. Alex resides in a state with a federal-facilitated Marketplace. Since 2011, Alex has had minimum essential coverage through his employer. In March 2015, Alex's employer downsizes and Alex is without employment effective April 30, 2015. Alex's spouse works part-time and does not have access to employer-provided health insurance coverage. Loss of minimum essential coverage because of a job furlough/lay off, voluntary resignation or involuntary severance from employment, is a qualifying life event for purposes of general special enrollment. Alex may obtain health insurance coverage through the Marketplace even though the annual open enrollment period ended February 15, 2015. Alex is ineligible for filing season special enrollment because he does not meet the requirements set out by HHS.

■ ***Comment.*** Loss of coverage that is not minimum essential coverage does not make an individual eligible for regular special enrollment, HHS explained. Examples are coverage for only accident or disability income insurance, or any combination thereof; workers' compensation; automobile medical payment insurance; and credit-only insurance.

If the Marketplace denies an individual's request for general special enrollment, the individual may file an appeal. In limited cases, individuals may seek an expedited appeal.

■ ***Comment.*** Presumably, the Marketplace will provide an appeal process for individuals who are denied enrollment during filing season special enrollment. HHS has not yet provided any details about appeals from filing season special enrollment.

Compliance Calendar

■ **March 6**
Employers deposit Social Security, Medicare, and withheld income tax for February 28, March 1, 2, and 3.

■ **March 10**
Employees who received $20 or more in tips during February report them to their employers using Form 4070.

■ **March 11**
Employers deposit Social Security, Medicare, and withheld income tax for March 4, 5, and 6.

■ **March 13**
Employers deposit Social Security, Medicare, and withheld income tax for March 7, 8, 9, and 10.

■ **March 16**
Corporations file a 2014 calendar year income tax return (Form 1120) and pay any tax due.

S corporations file a 2014 calendar year income tax return (Form 1120S) and pay any tax due. Provide each shareholder with a copy of Schedule K1 (Form 1120S), Shareholder's Share of Income, Deductions, Credits, etc., or a substitute Schedule K1.

S corporations file Form 2553, Election by a Small Business Corporation, to elect to be treated as an S corporation beginning with calendar year 2015.

Electing large partnerships provide each partner with a copy of Schedule K1 (Form 1065B), Partner's Share of Income (Loss) From an Electing Large Partnership, or a substitute Schedule K1.

TRC Text Reference Table

The cross references at the end of the articles in CCH Federal Tax Weekly (FTW) are text references to CCH Tax Research Consultant (TRC). The following is a table of TRC text references to developments reported in FTW since the last release of New Developments.

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Conferences

March 6: The Federal Bar Association hosts its annual conference on federal taxation in Washington, DC. The program will feature notable speakers from the private and public sectors who will provide an in-depth look at current topics in tax law. Visit *www.fedbar.org* for more information or to register.

March 10: Wolters Kluwer presents a webinar "Affordable Care Act Forms and Reporting for the 2014 Filing Season" that will discuss Forms 1095-A, 8962, 8965, and Form 1040 – Lines 46, 61 and 69. Visit *www.krm.com/cch* to register or call (800) 775-7654.

March 12: Wolters Kluwer presents a webinar "Executive Compensation for Not-for-Profit Organizations: Best Practices" that will provide a practical discussion to help not-for-profit organizations and their advisors navigate the potential pitfalls and meet compliance responsibilities. Visit *www.krm.com/cch* to register or call (800) 775-7654.

March 18–20: The 51st Washington Non-Profit Legal & Tax Conference will take place in Washington, D.C. The conference addresses all issues of relevance to nonprofit organizations and will feature keynote speakers from the IRS and Congress. For more information or to register, visit *www.taxexemptresources.com.*

March 22–25: The Tax Executives Institute sponsors its 65th Midyear Conference in Washington, D.C. The conference will cover numerous hot topics in taxation, including the *Patient Protection and Affordable Care Act,* tax accounting, and international taxation and policy. For more information visit *www.tei.org* or call (202) 638-5601.