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INSIDE THIS ISSUE

IRS Treats Series Of Prearranged Corporate Transactions As Separate Transactions Under Code Secs. 351 And 368

Rev. Rul. 2015-9

The IRS has determined that the tax treatment of a series of prearranged transactions involving a U.S. parent corporation and several foreign subsidiaries can follow the transactions' form and does not have to be collapsed. The IRS revoked Rev. Rul. 78-130, which analyzed the same series of transactions and concluded that they should be recast as part of an integrated plan.

- ***Take Away.*** "This is welcome guidance and provides clarity," Lisa Zarlenga, partner and co-chair, Tax Group, Steptoe & Johnson LLP, Washington, D.C., told Wolters Kluwer. "The government had issued rulings that were inconsistent with Rev. Rul. 78-130, so this provides more certainty. If you're doing drops [of assets] to a subsidiary and they are 351 transactions, you can generally follow the 351 form, as long as there is no other reason to recharacterize the transaction," Zarlenga said. "Rev. Rul. 2015-9 revokes the 1978 ruling. This is more helpful than obsoleting the ruling, because it shows the government is changing its position," she said.
- ***Comment.*** At the same time, the IRS released Rev. Rul. 2015-10 on a similar transaction. *See the related coverage in this newsletter.*

Background

P is a U.S. corporation that owns all the stock of foreign corporations S-1 and S-2. S-1 is an operating company; S-2 is a holding company. S-2 owns all of the stock of foreign corporations X, Y, and Z, which, like S-1, are operating companies.

The four operating companies will be combined into N, a new subsidiary formed by S-2. S-2 will continue to conduct the businesses of X, Y, Z, and S-1.

The plan is as follows:

(1) P will transfer all of its S-1 stock to S-2, in exchange for voting stock of S-2 (P's transfer);
(2) X, Y, Z, and S-1 will transfer all of their assets (subject to liabilities) to N, in exchange for additional shares of N's common stock (the subsidiary transfers); and
(3) X, Y, Z and S-1 will all liquidate and distribute all of their N stock to S-2 (the subsidiary liquidations).

Law

Under Code Sec. 351(a), no gain or loss will be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in Code Sec. 368(c)) of the

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IRS Clarifies When It Will Recast A Series Of Corporate Transactions Involving Code Sec. 351

Rev. Rul. 2015-10

The IRS has concluded, in Rev. Rul. 2015-10, that a series of prearranged corporate transactions will be analyzed so that some transactions are treated separately for tax purposes, while other transactions are collapsed and recast. The IRS cited Rev. Rul. 67-274 as support for recasting a portion of the transaction.

- ***Take Away.*** At the same time, the IRS issued Rev. Rul. 2015-9 (*see separate coverage in this newsletter*), providing that each step of a prearranged series of transactions will be analyzed separately, even though the transactions are part of the same plan.

Background

P, a U.S. corporation, owns all of the interests in a U.S. limited liability company (LLC) that elected to be taxed as a corporation. The transactions are as follows:

(1) P owns all the stock of S1 and will transfer its interests in LLC to S1 for S1 voting stock.

(2) S1 owns all the stock of S2 and will transfer its interests in LLC to S2 for S2 voting stock.

(3) S2 owns all of the stock of S3 and will transfer its interests in LLC to S3 for S3 voting stock.

(4) LLC will elect to be treated as a disregarded entity, effective no sooner than one day after S2's transfer.

S1, S2, and S3 are all holding companies. After the transfers, S3 will conduct the business previously conducted by LLC.

Law

A "D" reorganization includes a transfer by a corporation of all or part of its assets to another corporation if immediately after the transfer the transferor or one or more of its shareholders is in control of the corporation to which the assets are transferred. Under the plan, stock or securities of the corporation to which the assets are transferred must be distributed in a transaction which qualifies under Code Secs. 354, 355, or 356.

IRS analysis

The IRS stated that a transfer of property may be respected under Code Sec. 351 even though it is followed by subsequent transfers of the same property under a prearranged, integrated plan. However, a transfer will not qualify as a Code Sec. 351 exchange if the substance of the transaction should be treated in a different manner.

Here, the successive transfers of interests in LLC by P and S1 satisfy the requirements of Code Sec. 351. The transaction should not be treated in a manner different from its form.

However, based on the analysis in Rev. Rul. 67-274, S2's transfer of the LLC interests to S3, followed by LLC's election to be a disregarded entity, is more properly characterized as a "D" reorganization, rather than a Code Sec. 351 exchange followed by a Code Sec. 332 liquidation.

References: FED ¶46,315;
TRC REORG: 18,050.

Section 351

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corporation. Control generally means ownership of 80 percent of the total combined voting power of the corporation's stock.

A "D" reorganization includes a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or one or more of its shareholders is in control of the corporation to which the assets are transferred. Under the plan, stock or securities of the corporation to which the assets are transferred must be distributed in a transaction which qualifies under Code Sec. 354, 355, or 356.

IRS analysis

The IRS stated that a transfer of property will be respected under Code Sec. 351 even if it is followed by subsequent transfers as part of a prearranged, integrated plan. However, a transfer of property will not qualify as a Code Sec. 351 exchange if a different treatment is warranted to reflect the substance of the transaction.

In the present transaction, P's transfer of S-1 stock in Step (1) satisfies the requirements of Code Sec. 351, including the control requirement. The fact that P's transfer and liquidation are steps in a prearranged plan does not dictate that P's transfer be treated in a different manner from its form under Code Sec. 351, in order to reflect the substance of the transaction. Accordingly, P does not recognize gain or loss on the transfer of S-1 stock to S-2.

S-1's transfer of its assets in Step (2), followed by S-1's liquidation in Step (3), is a D reorganization. Similarly, X, Y, and Z's transfer of assets, followed by their liquidations, are also D reorganizations.

References: FED ¶46,314;
TRC REORG: 18,050.

REFERENCE KEY

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

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IRS Adds More Designated Private Delivery Services To List For "Timely Mailed Is Timely Filed Rule"

Notice 2015-38

The IRS has updated its list of designated private delivery services that taxpayers may use to submit documents to the agency while qualifying for the "timely mailing treated as timely filing rule." Four new delivery services have been added to the list; five have been removed. Taxpayers who use a designated private delivery service from the list to mail a document to the IRS by that document's due date will generally be considered timely filed under Code Sec. 7502, the agency explained.

- ***Take Away.*** Speaking at the American Bar Association Section of Taxation May 2015 Meeting in Washington, D.C. on May 8, Rochelle Hodes, Attorney-Adviser, Office of Tax Policy, Treasury, reminded taxpayers that in addition to delivery by the United States Postal Service, taxpayers may use certain designated private carriers to deliver returns or other documents to the IRS. Code Sec. 7502(f) authorizes the IRS to designate certain private delivery services for purposes of applying the "timely mailing treated as timely filing rule." Prior to Notice 2015-38, the list was last updated by Notice 2004-83.

Background

A return or other document, such as a refund claim or Tax Court petition, or a payment delivered by the U.S. Postal Service, is considered timely filed if its postmark is no later than the due date of the return or payment and is sent to the proper address. Returns sent by registered mail are deemed to be postmarked on the date of registration. Returns sent by certified mail are deemed to be postmarked on the date stamped on the receipt.

Code Sec. 7502(f) further provides that returns and documents timely mailed through certain private carriers designated by the IRS may also qualify for the "timely mailing treated as timely filing rule." The date recorded or the date marked by the private delivery service in its electronic database—or on the cover of the item—as the date on which an item was given to it for delivery is treated as the postmark date for purposes of the rule.

Updated list

Effective May 6, 2015, the IRS has added the following new services to the list of designated delivery carriers:

- FedEx First Overnight
- FedEx International First Next Flight Out
- FedEx International Economy
- UPS Next Day Air Early AM

Also effective May 6, 2015, the IRS has removed the following services previously designated because the carrier had substantially altered or discontinued them since the list was last updated in 2004:

- DHL Same Day Service
- DHL Next Day 10:30 am
- DHL Next Day 12:00 pm
- DHL Next Day 3:00 pm
- DHL 2nd Day Service
- ***Comment.*** The full list of 15 services is enumerated in Notice 2015-38.
- ***Comment.*** Only the specific delivery services enumerated in the full list provided in Notice 2015-38 are designated delivery services for purposes of this rule. The IRS further cautioned taxpayers that not all FedEx or UPS services are designated delivery services.

References: FED ¶46,316; TRC FILEBUS: 15,054

IRS Reminds Tax-Exempt Organizations Of Filing Deadline, Automatic Revocation For Failure To File

The IRS has reminded calendar-year tax-exempt organizations of the May 15 filing date for Form 990-series returns. Tax-exempt organizations with average annual receipts above $50,000 must generally file a Form 990, Return of Organization Exempt From Income Tax, or 990-EZ depending on their gross receipts and assets. Private foundations file a Form 990-PF. Small tax-exempt organizations with average annual receipts of $50,000 or less must file an electronic notice, Form 990-N (e-Postcard), which asks organizations for a few basic items of information.

- ***Comment:*** Small tax-exempts with gross receipts that are normally $50,000 or less have been required to file the e-Postcard under provisions of the *Pension Protection Act of 2006*. The only exceptions to this requirement are for organizations that are included in a group return, churches, their integrated auxiliaries, and conventions or associations of churches, and organizations that are required to file a different return, the IRS explained.

Automatic revocation. Organizations that fail to file annual reports for three consecutive years will have their federal tax exemptions automatically revoked as of the due date of the third required filing, the IRS cautioned. Organizations that have had their exemptions automatically revoked and wish to have that status reinstated must file an application for exemption and pay the appropriate user fee.

Social Security numbers. The IRS also cautioned tax-exempt organizations not to include Social Security numbers (SSNs) on their filings, parts of which the IRS may be required to disclose to the public. Public release of SSNs and other personally identifiable information about donors, clients or benefactors could give rise to identity theft, the IRS warned.

- ***Comment.*** The IRS also encouraged organizations to use electronic filing. Organizations that need additional time to file a Form 990, 990-EZ or 990-PF may obtain an extension. No extension is available for filing the Form 990-N (e-Postcard).

IR-2015-78; TRC EXEMPT: 12,252.15.

IRS Expands Right To Depreciate Precious Metals That Cannot Be Recovered From Manufacturing Process

Rev. Rul. 2015-11

Taxpayers may capitalize and depreciate the cost of precious metals that are used in various manufacturing processes and that cannot be recovered, the IRS has concluded in a revenue ruling. Precious metals that can be recovered and reused can be capitalized but cannot be depreciated, the agency explained.

- ***Take Away.*** The IRS chose to expand the application of a 1997 revenue ruling and a 2003 appeals court decision to allow the depreciation of any precious metal. The key factor is whether the metal is recoverable or unrecoverable. If any portion is unrecoverable, the taxpayer can take depreciation deductions.
- ***Comment.*** A change in the taxpayer's treatment of precious metals to follow Rev. Rul. 2015-11 is a change of accounting method.

Depreciation

Under Reg. §1.167(a)-2, the depreciation allowance for tangible property is based on the property's wear and tear, decay or decline from natural causes, exhaustion, and obsolescence. In *O'Shaughnessy, CA-8, 2003-1* USTC *¶50,235,* the taxpayer used tin that declined in volume and purity during a manufacturing process. The court concluded that the tin's decline in volume and purity was exhaustion, wear and tear; therefore, the tin was depreciable. In *Arkla, CA-5, 1985, 85-2* USTC *¶9,536*, the court allowed depreciation for unrecoverable cushion gas, but not for recoverable cushion gas.

IRS analysis

The IRS announced it is adopting the approach in *O'Shaughnessy* and *Arkla*. These authorities require an examination of the extent to which precious metals are subject to exhaustion, wear and tear, or other obsolescence—whether the property is recoverable or unrecoverable, and whether the asset has a determinable estimated useful life.

Scenarios

Situation 1. The taxpayer uses gold to fabricate jewelry samples to show to customers. Every three years the taxpayer melts down the samples, recovering all of the gold content. Since the gold can be recovered and reused, its utility does not diminish. Accordingly, it is not subject to exhaustion, wear and tear, or obsolescence, and is not depreciable.

Situation 2. The taxpayer uses a catalyst made from platinum and chemicals, to refine petroleum. Ten percent of the platinum is lost over the platinum's reasonable expected useful life in the refining process. The remaining 90 percent is recoverable and can be reused. The taxpayer may capitalize and depreciate the 10 percent amount, but not the 90 percent that is recoverable.

Situation 3. The taxpayer manufactures flat glass with a process that involves the use of molten tin. During the manufacturing process, the tin declines in purity and volume. After seven years, all of the original tin is lost. The taxpayer may capitalize and depreciate the entire cost of the original tin.

References: FED ¶46,318; TRC DEPR: 15,160.

IRS Issues Guidance To Update Regs For Code Sec. 1022 Election

NPRM REG-107595-11

The IRS has issued guidance to update existing regs for the Code Sec. 1022 election by qualified estates of decedents dying in 2010. The election provides for modified carryover basis.

- ***Take Away.*** The *Economic Growth and Tax Relief Reconciliation Act of 2001* abolished the federal estate tax for decedents dying after 2009. However, the *Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010* restored the federal estate tax. The 2010 Tax Relief Act gave estates of decedents dying after December 31, 2009 and before January 1, 2011, the option to elect not to come under the revived estate tax.

Background

The 2010 Tax Relief Act allows estates of decedents dying in 2010 to elect modified carryover basis rules (Code Sec. 1022 election). Generally, the provisions of chapter 11 (estate tax) would not apply to the decedent's estate, but rather the provisions of Code Sec. 1022 apply. The IRS explained that although Code Sec. 1022 is applicable only to decedents dying in 2010, basis determined under that section will continue to be relevant until all of the property whose basis is determined under that section has been sold or otherwise disposed of.

Proposed regs

The proposed regs, the IRS explained, would make changes to a number of provisions. These include amendments to Reg. §§1.179-4(c)(1)(iv), 1.267(d)-1(a)(3), 1.336-1(b)(5)(i)(A), and 1.355-6(d)(1)(i)(A)(2) providing that property received from a decedent with a basis determined under Code Sec. 1022 is not acquired by purchase or exchange for purposes of Code Secs. 179, 267, 336, and 355(d). Other provisions would amend Reg. §1.467-7(c)(2), which provides that Code Sec. 467 recapture does not apply to a disposition on the death of a transferor if the basis of the property in the hands of the transferee is determined under Code Sec. 1022.

Additionally, the IRS proposed amendments to Reg. §1.684-3(c) to clarify the application of Code Sec. 684 to transfers of property by reason of death of a U.S. transferor decedent dying in 2010. If the executor of a

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Proposed Regs Aim To Clarify Oil, Gas And Other Income As Qualifying Income For PTPs

NPRM REG-132634-14, IRS Statement

The IRS has released much-anticipated proposed regs under Code Sec. 7704(d)(1)(E) intended to clarify that qualifying income of a publicly traded partnership (PTP) includes only the income and gains from "qualifying activities." The proposed regs, the IRS explained, provide an exclusive list of the qualifying activities that make up the exploration, development, mining or production, processing, refining, transportation, and marketing of minerals or natural resources. The IRS also described when support activities are treated as qualifying activities but provided a transition period for taxpayers that received private rulings that had allowed for a more expansive definition of what qualifies. The proposed regs are generally viewed as narrowing the scope of qualifying activities for PTPs.

- ***Take Away.*** The proposed regs help to clarify that fracking and the materials that go into fracking are part of the oil and gas industry, Francis J. Gariepy, CPA, partner, National Tax Office, Eide Bailly LLP, Denver, told Wolters Kluwer. With all of the services that have developed in fracking, questions were raised, Gariepy explained.

Background

Under Code Sec. 7704(a), a PTP is treated as a corporation. However, Code Sec. 7704(c)(1) provides that Code Sec. 7704(a) does not apply to any PTP for any tax year if the partnership met the gross income requirements of Code Sec. 7704(c)(2) for the tax year and each preceding tax year beginning after December 31, 1987, during which the partnership or any predecessor was in existence. A partnership meets the gross income requirements for any tax year if 90 percent or more of the gross income of the partnership for the tax year consists of qualifying income.

Generally, qualifying income is passive-type income, such as interest, dividends, and rent. Code Sec. 7704(d)(1)(E) provides that qualifying income also includes income and gains derived from the exploration, development, mining or production, processing, refining, transportation, or marketing of minerals or natural resources.

Proposed regs

Exploration. The IRS explained that exploration is an activity performed to ascertain the existence, location, extent, or quality of any deposit of mineral or natural resource before the beginning of the development stage of the natural deposit.

Development. Under the proposed regs, development is an activity performed to make minerals or natural resources accessible.

Mining or production. The IRS explained that mining or production is an activity performed to extract minerals or other natural resources from the ground.

Processing or refining. Generally, an activity is processing or refining if it is done to purify, separate, or eliminate impurities. The IRS provided industry-specific rules in the proposed regs for processing and refining activities. The IRS explained that processing and refining activities vary among different minerals or natural resources.

Transportation. Under the proposed regs, transportation is the movement of minerals or natural resources and products produced from processing and refining, including by pipeline, barge, rail, or truck. Transportation, the IRS explained, generally does not include transportation of oil or gas (or oil or gas products) to a place that sells or dispenses to retail customers.

Marketing. Generally, marketing constitutes activities undertaken to facilitate sale of minerals or natural resources, or products produced from processing and refining. Marketing, the IRS explained, may also include some additive blending into fuels provided to a customer's specification. However, marketing does not include retail sales (sales made in small quantities directly to end users), the IRS explained.

Support activities

Under the proposed regs, a support activity may qualify as an intrinsic activity. In this case, any income received from the activity would be qualifying income. The IRS described three requirements for a support activity to be intrinsic to Code Sec. 7704(d)(1)(E) activities. The support activity:

- Must be specialized to support the Code Sec. 7704(d)(1)(E) activity;
- Must be essential to the completion of the Code Sec. 7704(d)(1)(E) activity; and
- Must require the provision of significant services to support the Code Sec. 7704(d)(1)(E) activity.

Effective date/transition period

The regs (except for the rules on the transition period) would apply to income earned by a partnership in a tax year beginning on or after the date the regs are finalized. The transition period in the proposed regs would end on the last day of the partnership's tax year that includes the date that is 10 years after the date the regs are finalized. The IRS explained that during the transition period, a partnership may treat income as qualifying income if it received a private letter ruling stating that the income was qualifying income. PTPs that engage in activities after May 6, 2015, but before the date the regulations are finalized may treat income from those activities as qualifying income during the transition period if it is qualifying income under the proposed regs.

References: FED ¶49,646;
TRC PART: 3,254.05.

Proposed Regs

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U.S. decedent elected out of the estate tax and to apply Code Sec. 1022, there is gain recognition. Any basis increase that the executor allocates under Code Sec. 1022 will reduce the amount of gain in that property for purposes of Code Sec. 684. Proposed amendments to Reg. §1.1014-4(a) provide that the basis of property acquired from a decedent, including basis determined under Code Sec. 1022, is uniform in the hands of every person having possession or enjoyment of the property.

References: FED ¶49,648;
TRC ESTGIFT: 51,060.10.

IRS Issues More Guidance On Notional Principal Contracts

TD 9719, NPRM REG-102656-15

The IRS has issued temporary and proposed regs under Code Secs. 446 and 956 on the treatment of nonperiodic payments made or received under certain notional principal contracts (NPCs). Notably the temporary regs under Code Sec. 446 provide that an NPC with nonperiodic payments must generally be treated as two separate transactions: an on-market, level payment swap and a loan. In a departure from the current regs, this treatment will apply to all such NPCs regardless of whether the nonperiodic payment is significant.

- ***Take Away.*** The guidance release also included temporary regulations regarding an exception from the definition of United States property under Code Sec. 956. The IRS has accordingly withdrawn the prior proposed regulations from 2011, NPRM REG-107548-11.

Background

Final regs published in 1993 (TD 8491) under Code Sec. 446(b) provided that when a "significant" nonperiodic payment was made under an NPC, the contract should generally be treated as two separate transactions consisting of an on-market level payment swap and an embedded loan. In other words, if the embedded loan rule applies, then the loan must be accounted for independently of the swap, and the time value component associated with the loan is not included in the net income or net deduction from the swap; instead it is recognized as interest.

Under the 1993 regs, the parties to an NPC providing for a nonperiodic upfront payment were required to determine whether that payment was significant or not for purposes of the embedded loan rule. In addition, the regs provided that the IRS could treat any nonperiodic payment as one or more loans, whether or not the payment was significant.

The IRS received numerous comments in response to the 1993 regs. Among these comments were warnings against the potentially burdensome tax consequences of treating upfront payments as one or more loans. Other comments stated that the lack of a clear definition of a "significant" nonperiodic payment resulted in uncertainty and inconsistent application of the embedded loan rule.

Nonperiodic payment

Reg. §1.446-3T(g)(4)(i) of the new temporary regs provides that, subject to two exceptions, an NPC with a nonperiodic payment must be treated as two separate transactions. An example of such treatment is listed under Reg. §1.446-3T(g)(6), Example 2.

- ***Example.*** On January 1, 2016, two parties enter into an interest rate swap contract with a notional principal amount of $100 million. The first party agrees to make five annual payments to the second party in the amount of the London Interbank Offered Rate (LIBOR)—which as of the contract start date is 10 percent—times $100 million. In return, the second party agrees to pay the first party six-percent of $100 million annually, plus an upfront payment on January 1, 2016. The upfront payment was determined as the present value of 10 percent, compounded annually, of five annual payments representing the difference between the first party's payment to the second party and the second party's payment to the first party.
- ***Example.*** In such a case, the regs provide that the entire transaction is to be treated as a loan repaid in installments over the contract's term and an interest rate swap between the parties, where the second party immediately pays the installment payments on the loan back to the first party. The regs also cover which party will recognize interest income and which may claim the interest deduction.

Exceptions

The temporary regs contain two exceptions to the embedded loan rule that an NPC with a nonperiodic payment must be treated as two transactions. First, except for purposes of Code Secs. 514 and 956, the temporary regulations provide an exception for a nonperiodic payment made under an NPC with a term of one year or less (short-term exception). Second, the temporary regulations provide an exception for certain NPCs with nonperiodic payments that are subject to prescribed margin or collateral requirements (full-margin exception).

Code Sec. 956 regs

Temporary and proposed regs under Code Sec. 956 also provide an exception to the definition of United States property for certain obligations of United States persons arising from upfront payments made with respect to NPCs that qualify for the full margin exception to the embedded loan rule in the temporary regulations under Code Sec. 446. To qualify for the United States property exception, the upfront payment must be made by a controlled foreign corporation that is either a dealer in securities or a dealer in commodities.

References: FED ¶¶47,016, 49,647; TRC SALES: 45,254.05.

IRS Announces Filing And Penalty Relief For Kentucky Victims Of Severe Storms/Tornadoes

The IRS has postponed certain deadlines and will abate certain penalties and interest for taxpayers who reside or have a business in the parts of Kentucky that the president has declared a federal disaster area due to severe storms, tornadoes, flooding, landslides, and mudslides that took place beginning on April 2, 2015. Individuals and businesses in the following counties may qualify for this relief: Bath, Bourbon, Carter, Elliott, Franklin, Jefferson, Lawrence, Madison, Rowan, and Scott. The relief postpones until July 31, 2015, many deadlines falling on or after April 2, and on or before July 31.

KY-2015-08; TRC FILEIND: 15,204.25.

Tax Court Greenlights Charitable Deduction For Real Property Sold To Charity At Bargain Sale

***Davis*, TC Memo. 2015-88**

The Tax Court has allowed a donor to claim a charitable deduction for real property sold to a 501(c)(3) organization at a bargain sale. The taxpayer could claim the difference between the market value of the property and the price paid by the nonprofit organization for the land. The court also rejected the IRS's claim that the taxpayer lacked charitable intent and failed to satisfy substantiation requirements.

- ***Take Away.*** The court noted that the taxpayer evidenced a genuine philanthropic interest in helping his community. The taxpayer had engaged in many discussions with the nonprofit, which was seeking real property on which to build a retirement community.

Background

The taxpayer was a longtime real estate investor. In 2005, the taxpayer sold real property, which he claimed had a fair market value of $4.1 million to the nonprofit for $2 million. The taxpayer reserved an easement on the real property.

The taxpayer claimed a charitable deduction of $2.1 million. The IRS disallowed the deduction. According to the IRS, the taxpayer lacked charitable intent when he sold the real property to the nonprofit organization, the taxpayer failed to satisfy substantiation requirements for the donation, and the fair market value of the real property did not exceed $2 million.

Court's analysis

The court first found that the taxpayer had a charitable intent when he sold the real property to the nonprofit organization. The taxpayer genuinely believed that he was selling the land to the nonprofit for less than its fair market value and he intended to transfer the excess value to the nonprofit as a charitable contribution, the court found.

The court rejected the IRS's argument that the taxpayer lacked a charitable intent because he had investigated the tax benefits of a bargain sale in connection with the sale of the land and had been motivated to obtain the maximum deduction. The court also rejected the IRS's argument that the taxpayer's retention of an easement reflected a lack of charitable intent. The easement, the court found, was merely 12 feet and insignificant in the overall transaction.

The court further found that the taxpayer claiming a deduction of $250 or more is required to obtain and keep a contemporaneous written acknowledgment for a charitable contribution. To be contemporaneous the written acknowledgment must generally be obtained by the taxpayer no later than the date the taxpayer files the return for the year the contribution is made. The written acknowledgment must state whether the charitable organization provides any goods or services in consideration for the contribution and describe the property and include the amount of any cash contributed. Here, the taxpayer did not receive any goods or services other than the $2 million in consideration of his sale of the real property to the nonprofit organization.

Turning to valuation, the taxpayer's expert testified that the real property had a value of $4.1 million as of the time of the sale to the nonprofit organization. The IRS's expert countered that the real property had a value of $1.69 million. The court found that the opinion of the taxpayer's expert was more persuasive than the evidence set forth by the IRS's expert. The taxpayer's expert had been a longtime real estate appraiser in the community and focused almost entirely on commercial real estate appraisals. However, the court found that flood zone restrictions added value to the land though less than if the land was buildable land. The court adopted a 15 percent negative adjustment to reflect the flood zone restrictions.

References: Dec. 60,302(M); TRC INDIV: 51,052.

IRS Processes Inadequate To Stop Erroneous Claims For Education Credits, TIGTA Reports

Although the IRS has developed processes to identify erroneous education credit claims, those processes only identified 50 percent of the more than 3.6 million erroneous claims, the Treasury Inspector General for Tax Administration (TIGTA) has reported. TIGTA discovered that the IRS approved American Opportunity Tax Credits (AOTCs) on behalf of students who had already claimed the credit for the maximum number of years or who were otherwise unqualified to receive the credit.

Return preparers. TIGTA found that as of the end of 2013, more than 49 percent of the 3.6 million tax returns with questionable education credit claims identified were prepared by a tax return preparer. This occurred despite the IRS's plans to increase the coordination among its operating divisions and staffing in the Office of Professional Responsibility. The IRS also started identifying questionable AOTC claims prepared by tax return preparers for its Automated Questionable Credit Program and freezing the portion of the refund related to the questionable AOTC claim.

Recommendations. TIGTA made five recommendations. Following release of the report, the IRS stated that it had taken a number of steps to ensure education credit compliance and had reduced the number of claims by $4.5 billion in one year. Instead, the IRS efforts in this area are hampered by the complexity of laws affecting education credits and by funding limitations. The IRS also stated that the dollar amounts in the TIGTA report had been overstated.

TIGTA Report No. 2015-40-027; TRC INDIV: 60,156.

TAX BRIEFS

Tax Crimes

The IRS and its employees were entitled to enter a taxpayer's premises for the purpose of searching and seizing the taxpayer's personal property and assets. There was probable cause to believe that assets subject to levy were on the premises and the statutory requirements were met.

In the Matter of the Tax Indebtedness of Voulgarelis, DC S.C., 2015-1 USTC ¶50,285; TRC IRS: 51,054.10

Income

A married couple and their corporation were subject to tax on unreported income. The taxpayers were not allowed to deduct certain nonpassive losses. First, the IRS disallowed most of the taxpayer's deduction for the lease of equipment and determined that the taxpayers received a constructive dividend from their corporation, which paid for construction work to the husband's office building to accommodate the equipment. The IRS also determined that the taxpayers' other claimed losses were from rental real estate activities and, therefore, were passive. Finally, the taxpayers were liable for accuracy-related penalties.

Coastal Heart Medical Group, Inc., TC, Dec. 60,298(M), FED ¶48,008(M); TRC INDIV: 6,054

Deductions

A married couple was not entitled to a charitable contribution deduction for their donation of a conservation easement to their county land bank, realized long-term gain on sale of their development rights and the accuracy-related penalty was imposed. The couple failed to obtain a "qualified appraisal."

Costello, TC, Dec. 60,301(M), FED ¶48,011(M); TRC INDIV: 51,458.05

Tax Credits

An individual was not entitled to a file as head of household, a dependent exemption, the Earned Income Tax Credit (EITC) or the additional Child Tax Credit (CTC) because she did not have a qualifying child.

Cowan, TC, Dec. 60,299(M), FED ¶48,009(M); TRC FILEIND: 6,156.05

Liens and Levies

An individual's claim that the IRS wrongfully levied her car to pay her husband's tax debt was dismissed. The taxpayer was aware that the IRS had filed tax liens against her husband's property and the liens arose before the husband had purchased a luxury automobile for her purportedly as a gift. The cash the husband used to purchase the vehicle was subject to the IRS's lien.

Hansen v. Black, DC Utah, 2015-1USTC ¶50,291; TRC IRS: 48,158.05

A federal district court refused a nonliable spouse's request to reconsider the order finding her husband liable for the trust fund recovery penalty and foreclosing and selling his half-interest in their personal residence to satisfy the tax liens. The wife's claim that she failed to submit evidence that her one half-interest from the foreclosure sale was insufficient to obtain an equivalent home in an equivalent neighborhood was without merit. The wife failed to demonstrate a special prejudice.

Davis, DC Mich., 2015-1 USTC ¶50,284; TRC IRS: 45,160

Refund Claims

A corporation's claim for refund of penalties and interest imposed for failure to pay estimated taxes was denied. The plain language of Code Sec. 6655(d)(1)(B) provides that the safe harbor does not apply if the corporation did not file a return showing a tax liability for the prior year.

Cal Pure Pistachios, Inc., DC Calif., 2015-1 USTC ¶50,290; TRC PENALTY: 3,062

A sea vessel captain's complaint seeking a refund of a tax overpayment was dismissed for lack of subject matter jurisdiction. The individual failed to satisfy the jurisdictional prerequisite by filing an administrative claim for refund with the IRS within three years from the date he filed his original tax return or two years after the IRS applied the tax overpayment.

Martti, FedCl, 2015-1 USTC ¶50,289; TRC LITIG: 9,056

An individual's refund claim was barred by *res judicata*. The individual's argument that his refund claim was based on an issue that was not decided by the Tax Court was rejected. *Res judicata* barred him from relitigating issues that could have been raised in an earlier action.

Rosinski Jr., DC Ill., 2015-1USTC ¶50,286; TRC LITIG: 3,052

Collection Due Process

An IRS settlement officer's (SO) rejection of a married couple's installment agreement was not an abuse of discretion. The taxpayers had a history of noncompliance and failed to make estimated tax payments sufficient to satisfy their current tax liability.

Hull, TC, Dec. 60,300(M), FED ¶48,010(M); TRC IRS: 51,056.15

Bankruptcy

A Chapter 13 trustee's objection to debtors' proof of claim filed on behalf of the IRS for post-petition taxes was upheld. Since the taxes were incurred and became payable after the bankruptcy petition was filed, they fell within the scope of section 1305(a)(1) of the Bankruptcy Code and only the IRS was authorized to file the proof of claim.

In re DeVries, BC-DC Ida., 2015-1USTC ¶50,287; TRC IRS: 57,062

Tax-Exempts

A tax-exempt organization was not entitled to punitive damages for the IRS's wrongful disclosure of its unapproved Form 1024, Application for Recognition of Exemption Under Section 501(a). The IRS admitted that it wrongfully disclosed the organization's application but the organization failed to show that the disclosure was the result of gross negligence.

Citizen Awareness Project, Inc., DC Colo., 2015-1USTC ¶50,292; TRC IRS: 9,350

PRACTITIONERS' CORNER

King v. Burwell: What To Expect From The Supreme Court's Decision On The Code Sec. 36B Regs

In late June, the U.S. Supreme Court is expected to announce its decision in the much-watched challenge to the Code Sec. 36B regs for the premium assistance tax credit. The plaintiffs in *King v. Burwell, 2014-2* USTC *¶50,367,* argue that the regs are inconsistent with the *Patient Protection and Affordable Care Act* (PPACA). The government has defended the regs as a valid interpretation of the statute. This Practitioners' Corner explores the scope of the Code Sec. 36B credit, its impact on individuals and employers, and the litigation surrounding the IRS's regs under Code Sec. 36B.

- ***Comment.*** "If the Supreme Court rules against the government, it's hard to see how they continue to administer the law as originally envisioned," Dustin Stamper, Director, Washington National Tax Office, Grant Thornton, LLP, told Wolters Kluwer. "Credits would be limited to individuals in just 14 states, and employers outside those states would generally no longer face excise taxes for coverage failures. Still, it's hard to see how they could fix it even in the face of such a crisis. If Republicans use reconciliation, then their replacement bill will have to raise revenue, and the President will oppose any bill that totally guts his original legislation."

Background

The PPACA provides for the creation of Health Insurance Marketplaces (previously referred to as Health Insurance Exchanges) in each state. If a state elects not to create a Marketplace, the federal government will create and operate a Marketplace in that state. According to the Congressional Research Service (CRS), 27 states have Marketplaces established and run entirely by the federal government (federally-facilitated Marketplaces). Seven states maintain partnership Marketplaces, which the U.S. Department of Health and Human Services (HHS) treats as federally-facilitated Marketplaces. Three states have federally supported state-based Marketplaces, which rely on the IT platform of federally-facilitated Marketplaces.

"If the Supreme Court upholds the Code Sec. 36B regs, nothing would apparently change. Much more uncertainty arises if the Supreme Court strikes down the Code Sec. 36B regs."

To help offset the cost of health insurance coverage for individuals who obtain coverage through the PPACA Marketplace, the PPACA provides for the Code Sec. 36B premium assistance tax credit. Only enrollees in Marketplace coverage can claim the Code Sec. 36B credit if they qualify. Among other requirements, an individual must not have access to affordable coverage through an eligible employer plan that provides minimum value, must not be eligible for coverage through Medicaid or another government program, and must have household incomes between 100 percent and 400 percent of the federal poverty line for their family size. When an individual enrolls in Marketplace coverage, the Marketplace makes the initial determination if an individual qualifies for the credit. Based on that determination, the enrollee in Marketplace coverage can elect to have the credit paid in advance to the insurer. Individuals must reconcile on their income tax return the amount of any advance payments with the actual credit.

The IRS issued final regs under Code Sec. 36B in 2012 (TD 9590). The regs allow enrollees in state-run Marketplaces and federal-facilitated Marketplaces to claim, if eligible, the Code Sec. 36B credit. The regs, in effect, make no distinction between individuals with coverage through state-run or federally-facilitated Marketplaces.

- ***Comment.*** In the preamble to the regs, the IRS stated that "the legislative history does not demonstrate that Congress intended to limit the premium tax credit to state exchanges." The IRS further stated that its interpretation of the statute "is consistent with the language, purpose, and structure of section 36B and the Affordable Care Act as a whole."

Litigation

Almost immediately after the IRS issued the final regs, legal challenges to the regs arose. In *King*, the plaintiffs argue that the regulations are contrary to the language of the PPACA. According to the plaintiffs, the Code Sec. 36B credit is available only to individuals enrolled in health insurance through a Marketplace established by a state. Therefore, the plaintiffs argue, the statute precludes the IRS's interpretation that the credit is also available to individuals who obtain coverage through a federally-facilitated Marketplace.

The Fourth Circuit Court of Appeals rejected the plaintiffs' argument in July 2014. The Fourth Circuit found that the PPACA mandates the existence of state Marketplaces and directs the federal government to establish Marketplaces when states fail to do so. The court further found that the language of the statute is ambigu-

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WASHINGTON REPORT *by the Wolters Kluwer Washington News Bureau*

House to vote on tax relief for fallen officers/firefighters

The House is expected to approve before May 15 the bipartisan Don't Tax Our Fallen Public Safety Heroes Act (HR 606). The bill, introduced by Rep. Erik Paulsen, R-Minn., and Rep. Bill Pascrell, D-N.J., would clarify that federal and state death benefits for fallen police officers and firefighters, who died in the line of duty, are exempt from federal income tax, Paulsen explained. "This common sense legislation ensures the families of fallen public safety officers receive that same kind of commitment while avoiding an unfair tax burden in the wake of a devastating loss," Pascrell said in a statement. The legislation is supported by the Fraternal Order of Police, National Association of Police Organizations, and other organizations.

Schumer optimistic about tax reform

As the Senate Finance Committee bipartisan working groups on tax reform approach a May 31 deadline to issue their reports, Sen. Charles Schumer D-N.Y., of the international tax working group, is optimistic that reform in that area will take place. "I think on the international side there's a real hope we can get something done," Schumer said on May 5 following a meeting with his working group. On chances of international tax reform making its way to the president's desk, Schumer replied: "Better than I would have thought three months ago."

Passthrough provisions being reviewed by lawmakers

As tax writers tackle business tax reform, there is hope that there will be some action on passthrough entities. Speaking at the American Bar Association Section of Taxation 2015 May Meeting in Washington, D.C., Mark Prater, chief tax counsel for the Senate Finance Committee, and George Callas, chief tax counsel for the House Ways and Means Committee, discussed passthrough entities.

"Passthroughs are a growing factor in terms of a revenue base and the numbers are growing," Callas said. Because they are a popular form of businesses, both the Senate Finance and Ways and Means Committees are looking at all possible ways to thread the needle with respect to inserting language in tax reform, Callas added. Callas acknowledged that the passthrough issue is important for the real estate industry and now lawmakers are waiting to see how it all plays out.

IRS TE/GE leader describes progress in division

IRS Tax Exempt and Government Entities (TE/GE) Commissioner Sunita Lough on May 8 described new approaches that the TE/GE Division is developing to improve its effectiveness. Lough spoke at the American Bar Association Section of Taxation 2015 May Meeting in Washington, D.C. Lough described the division's approach as "test and learn.

Pre-approved plans (PAPs) make up two-thirds of the EP population but only 10 percent of its applications, so the PAP program provides for a good use of resources. In another area, Lough said that one-third of EP's inventory on individual plans involves applications for new and terminating plans, while the other two-thirds involve amendments to existing plans. She said that EP intends to focus resources on rulings for new and terminating plans, and to stop issuing rulings on amended plans. Instead, EP will provide model language for plans to follow. EO created Form 1023-EZ to provide a streamlined process for smaller charities to apply for tax-exempt status, Lough said. In December 2014, EO decided to select 1,400 entities for post-issuance review. So far, EO has established 400 exams. Its findings indicate that the streamlined process was used appropriately and can be an effective tool to reduce (or prevent) an application backlog.

Penalty relief for Code Sec. 36B available, IRS official notes

Individuals who have a balance due on their 2014 returns as a result of reconciling advance payments of the Code Sec. 36B premium assistance tax credit against the actual credit may qualify for penalty relief, Kathryn A. Zuba, deputy associate chief counsel (Procedure and Administration), IRS, said on May 8. Zuba spoke at the American Bar Association Section of Taxation 2015 May Meeting in Washington, D.C.

"Last year, we discovered that many individuals had not correctly calculated the amount of their advance premium tax credit," Zuba said. In response, the IRS issued Notice 2015-9, providing penalty relief in limited circumstances. The IRS imposed three conditions, Zuba explained. The IRS will abate the Code Sec. 6651(a)(2) penalty for tax year (TY) 2014 for taxpayers who: (1) are current with their filing and payment obligations; (2) have a balance due for tax year 2014 due to excess advance payments of the Code Sec. 36B credit; (3) and report the amount of excess advance credit payments on their 2014 tax return timely filed, including extensions. Additionally, individuals may qualify for waiver of the Code Sec. 6654 penalty for an underpayment of estimated tax for TY 2014.

FinCen offers alternative FBAR e-filing method

Treasury's Financial Crimes Enforcement Network (FinCEN) has created an alternative e-filing method for individuals filing the Report of Foreign Bank and Financial Accounts (FBAR). Filers can choose between the current method of filing using an Adobe PDF or use the new online form that only requires an internet browser to file. The PDF form allows filers to save the form locally so it may be reused or resubmitted as an amendment. The online form downloads as a read-only copy of the information submitted and cannot be edited for reuse. These options are only available for individuals filing an FBAR. Agents filing the FBAR on behalf of a client must register to become an e-filer and file as an institution, rather than an individual, FinCEN explained.

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ous. However, the court found that it could not say definitely that Congress intended to limit tax credits to individual who obtain insurance through state Marketplaces. Additionally, widely available tax credits are essential to fulfill the PPACA's goals, the court found.

- ***Comment.*** On the same day the Fourth Circuit upheld the Code Sec. 36B regs, a panel of the Court of Appeals for the District of Columbia Circuit reached the opposite conclusion in *Halbig v. Burwell, 2014-2* USTC *¶50,366*. In a 2–1 decision, the panel found that a federally-facilitated Marketplace is not a Marketplace established by a state and Code Sec. 36B does not authorize the IRS to provide tax credits for health insurance purchased on a federally-facilitated Marketplace. To depart from the PPACA's plain meaning, there must be evidence that Congress meant something other than what it literally said, the panel held. The panel concluded that there was no evidence that Congress meant something else.

The plaintiffs in *King* petitioned the Supreme Court to review the Fourth Circuit's decision. The Court granted certiorari and heard oral arguments on March 4, 2015. At oral argument, the justices peppered both the plaintiffs and the government with questions."If Congress did not want the phrase established by the state to mean what that would normally be taken to mean, why did they use that language," Justice Samuel Alito asked. Justice Elena Kagan said that the courts frequently look to the entirety of a statute to ascertain meaning of certain provisions. "We look at the whole text, the particular context, the more general context, to try to make everything harmonious with everything else," Kagan said. Justice Antonin Scalia questioned if the explanation for the challenged provision was intentional. "It prevents the federalization of the entire thing," Scalia said.

Impact

If the Supreme Court upholds the Code Sec. 36B regs, nothing would apparently change in the administration of the credit. Qualified individuals who enroll in coverage both in federally-facilitated Marketplaces and state-run Marketplaces would be able to claim the credit. Marketplaces would continue to make the initial determination of eligibility for the credit and any advance payments of the credit would be reconciled when the individual files his or her income tax return.

Much more uncertainty arises if the Supreme Court strikes down the Code Sec. 36B regs. The Obama administration has repeatedly said it has no contingency plans in the event the Supreme Court finds the IRS regs are invalid. What administrative actions, if any, the Obama administration would take after an adverse decision by the Supreme Court are unclear.

- ***Comment.*** HHS Secretary Sylvia Burwell has indicated that HHS would not take any administrative action. "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," Burwell told lawmakers in February. IRS Commissioner John Koskinen has made similar comments. "We basically play the hand we're dealt. The Supreme Court will make a decision, and then we will respond," Koskinen said at an April Congressional hearing on the agency's challenges in implementing the PPACA.

Some lawmakers have indicated they are working on a legislative response if the Supreme Court strikes down the Code Sec. 36B regs. S. 673, introduced by Sen. Ben Sasse, R-Nebraska, would generally allow the Code Sec. 36B credit through August 2017. Another bill, S. 1016, would generally grandfather current recipients of the credit. In the House, tax writers on the Ways and Means Committee are reportedly preparing legislation in the event the Supreme Court strikes down the regs.

- ***Comment.*** The Supreme Court could limit its ruling so that taxpayers who claimed the credit would not have to repay any amounts. In a recent report to Congress, CRS explained that it was not aware of any example where a court struck a credit or other tax benefit and the taxpayers who had already received the benefit were required to pay it back.

Individual mandate. The PPACA generally requires individuals (and their dependents) to carry minimum essential health coverage or make a shared responsibility payment, unless exempt. An individual may qualify for an exemption if the minimum amount that he or she pays for annual premiums for coverage is more than eight percent of the individual's household income. Without the Code Sec. 36B credit, an individual could find that the cost of coverage is more than eight percent of his or her household income.

Employer mandate. The PPACA generally imposes a shared responsibility requirement on applicable large employers that fail to offer minimum essential health coverage to qualified employees. Under Code Sec. 4980H, an applicable large employer must make a shared responsibility payment if either:

- The employer does not offer or offers coverage to fewer than 95 percent (70 percent in 2015) of its full-time employees (or a combination of full-time and part-time employees that is equivalent to 95 percent of full-time employees) and their dependents the opportunity to enroll in minimum essential coverage and one or more full-time employee is certified to the employer as having received a Code Sec. 36B premium assistance tax credit or cost-sharing reduction (Section 4980H(a) liability); or
- The employer offers to all or at least 95 percent of its full-time employees (or a combination of full-time and part-time employees that is equivalent to 95 percent of full-time employees) and their dependents the opportunity to enroll in minimum essential coverage under an eligible employer-sponsored plan and one or more full-time employees is certified to the employer as having received a Code Sec. 36B premium assistance tax credit or cost-sharing reduction (Section 4980H(b) liability).

Currently, the Code Sec. 36B credit is available to qualified enrollees in state-run Marketplaces and federally-facilitated Marketplaces. If the credit were not available to enrollees in states with federally-facilitated Marketplaces, applicable employers may not be liable under Code Sec. 4980H if they elect not to offer affordable coverage to employees.

COMPLIANCE CALENDAR

■ May 15
Employers deposit Social Security, Medicare, and withheld income tax for May 9, 10, 11, and 12.

■ May 20
Employers deposit Social Security, Medicare, and withheld income tax for May 13, 14, and 15.

■ May 22
Employers deposit Social Security, Medicare, and withheld income tax for May 16, 17, 18, and 19.

■ May 28
Employers deposit Social Security, Medicare, and withheld income tax for May 20, 21, and 22.

■ May 29
Employers deposit Social Security, Medicare, and withheld income tax for May 23, 24, 25, and 26.

■ June 3
Employers deposit Social Security, Medicare, and withheld income tax for May 27, 28, and 29.

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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FROM THE HELPLINE

The following questions have been answered recently by our "CCH Federal Tax Service" Helpline (1-800-449-8114).

Q Congress created ABLE Accounts in 2014. Has the IRS issued any guidance?

A The IRS issued Notice 2015-18 earlier this year providing advance notification of proposed regulations to be issued under Code Sec. 529A. The *Stephen Beck, Jr., Achieving a Better Life Experience Act of 2014* (ABLE Act) was enacted on December 19, 2014, as part of the *Tax Increase Prevention Act of 2014*. The ABLE Act created new Code Sec. 529A that allows a state to create a new kind of tax-advantaged savings program (qualified ABLE program) under which contributions may be made to an ABLE account established for the purpose of meeting the qualified disability expenses of the designated beneficiary of the account who is a state resident and who is disabled. *See TRC INDIV: 30,550.*

Q Has the filing season special enrollment period for the PPACA Health Insurance Marketplace ended?

A In February, the U.S. Department of Health and Human Services (HHS) announced a special filing season enrollment period for the Health Insurance Marketplace. Generally, the special enrollment period was available to individuals who discovered they owed a shared responsibility penalty for 2014 too late to avoid it for 2015 because the regular open enrollment period had closed. The special enrollment period for taxpayers who paid a 2014 individual shared responsibility fee began on March 15, 2015, and ended at 11:59 p.m. ET on April 30, 2015.