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Federal Circuit Partially Reverses Claims Court On STARS Transaction

Salem Financial Inc., CA-FC, May 14, 2015

The U.S. Court of Appeals for the Federal Circuit has affirmed a ruling by the Court of Federal Claims that a U.S. taxpayer's Structured Trust Advantaged Repackaged Securities (STARS) trust transaction lacked economic substance and should be disregarded for federal tax purposes. However, the Federal Circuit, reversing the Claims Court, held that a second feature of the STARS transaction involving a $1.5 billion loan had economic substance. Therefore, interest paid by the U.S. taxpayer on the loan was properly deductible for U.S. income taxes.

- ***Take Away.*** The Claims Court examined the trust and the loan both as separate transactions and as part of a single integrated transaction. Either way, the transactions lacked economic substance. On appeal, the IRS and the taxpayer agreed that the tax consequences of the transactions should be viewed separately. This gave the appeals court an opening to treat the loan transaction as having substance, even though it rejected the trust transaction as lacking substance.
- ***Comment.*** Other courts have examined STARS transactions. In *Bank of New York Mellon Corp., Dec. 59,651(M) (2013)*, the Tax Court also concluded that the loan aspect of the transaction had substance, even if the trust feature did not. In *Santander Holdings USA, Inc., 2013-2* USTC *¶50,564*, a federal district court concluded that the entire transaction had economic substance. The cases are on appeal.

Background

The taxpayer, a U.S. bank, entered into a STARS transaction with a British bank. In the transaction, the taxpayer transferred $5.75 billion of U.S.-based income-generating assets to a trust that had a British trustee and was therefore subject to British taxes. The British bank contributed $1.5 billion to the trust, which, in effect, was a loan to the taxpayer. The taxpayer received distributions of the trust's income, reduced by an amount to pay the United Kingdom taxes and a management fee. The British bank also made an additional monthly payment to the taxpayer.

The transaction would generate profits for the U.S. and British banks only if the British bank obtained certain U.K. tax benefits and if the taxpayer could claim foreign tax credits. The taxpayer agreed to "make-whole" the British bank if and to indemnify it if the tax benefits did not materialize.

The IRS disallowed the taxpayer's claim of foreign tax credits of $498 million and interest deductions of $74 million. The IRS also imposed $112 million in penalties. The Claims Court agreed that the transactions were economic shams. Applying the economic substance doctrine, the court concluded that the transactions lacked objective economic reality and a bona fide non-tax business purpose. The court also upheld the accuracy-related penalties.

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Chief Counsel Reviews Code Sec. 6694(b) Preparer Penalty For Amended Returns Not Filed, Other Scenarios

CCA 201519029

The IRS may assess the Code Sec. 6694(b) return preparer penalty for understatement of liability due to willful or reckless conduct if the return preparer made an amended return that was never filed, Chief Counsel has determined. However, Chief Counsel determined that the Code Sec. 6694(b) penalty should not be assessed merely because the return preparer made and filed a claim for refund after the limitations period had expired.

- ***Take Away.*** If a return or claim for refund includes an understatement of liability due to an unreasonable position or reckless or willful conduct, the preparer is liable for an understatement penalty under Code Sec. 6694(b). For returns prepared after May 25, 2007, the penalty amount with respect to reckless or willful conduct is either $5,000, or 50 percent of the income derived (or to be derived) by the preparer with respect to the return or claim, whichever is greater.

Background

A preparer made amended returns for three consecutive years which contained an understatement of liability due to willful or reckless conduct. The taxpayer filed the year 1 amended return but not the other returns, waiting to see what action the IRS would take. The IRS disallowed the refund claimed on the year 1 amended return. The IRS subsequently obtained a copy of the amended returns for all three years from the taxpayer. Each return had the return preparer's signature on them.

Chief Counsel's analysis

Chief Counsel first noted that Code Sec. 6694(b) does not require that a return be filed for the penalty to apply, only that a return is prepared. Further, Reg. §1.6694-1(a)(2) provides that a return is prepared when it is signed. "A strict reading of the Code suggests that if an amended return made by a return preparer contained an understatement of liability due to willful or reckless conduct, the penalty under Code Sec. 6694(b) could technically apply if the amended return is either signed by the return preparer, or if not signed by the return preparer, if the amended return is filed," Chief Counsel determined.

However, an understatement of liability does not include refund claims that are barred by the period of limitations.

Reference: TRC PENALTY: 3,108.

Economic Substance

Continued from page 241

- ***Comment.*** The IRS issued proposed regs on STARS transactions in 2007 that denied foreign tax credits. The IRS provided that transactions entered into before the regs' effective date would be analyzed under anti-abuse doctrines such as economic substance.

Court's analysis

The Federal Circuit found that the economic substance doctrine could apply to a transaction that was also governed by a substance-over-form provision. To apply the economic substance test, the court first examined the economic reality of the trust transaction based on objective evidence, apart from the taxpayer's subjective motivation. The court considered whether the transaction meaningfully altered the taxpayer's economic position, apart from its tax consequences, and whether the taxpayer had a reasonable possibility of profit.

The court found that the additional payments made by the British bank to the taxpayer were income to the taxpayer and were not merely a tax effect. This conclusion mirrored the opinion in *Santander*. However, the court concluded that the trust transaction was not capable of generating a profit, aside from the foreign tax credits. The trust transaction's profit depended solely on the tax benefits; the taxpayer had no economic risk; and the transaction had no realistic objective prospect of producing a profit.

The court then examined whether the transaction had a bona fide business purpose and concluded that it did not. The court also upheld the imposition of accuracy-related penalties on the trust transaction, concluding that the taxpayer's reliance on various tax advisors was unreasonable because they were not objective.

Loan

The Federal Circuit also held that the loan had substance and that the taxpayer was entitled to deduct interest payments on the loan. The loan resulted in a substantive change in the taxpayer's position, the loan was not designed solely for claiming interest deductions and it was not assured that the loan would result in an economic loss; the latter depended on the use of the loan proceeds.

References: 2015-1 USTC ¶50,304; TRC SALES: 3,154.

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 Questions Taxpayer's Right To Increase Loss Deduction Limit Under Code Sec. 382

FAA 20151702F

The IRS, in field attorney advice, questioned a taxpayer's claim on audit that the Code Sec. 382 limitation on losses deductible by a new loss corporation can be increased for income that the taxpayer attributed to its lease of intangible property. The IRS disagreed with the taxpayer's legal arguments and indicated that the case needed additional factual development.

- ***Take Away.*** If a taxpayer has a net unrealized built-in gain (NUBIG), it can increase its Code Sec. 382 limit for deducting post-change losses by its recognized built-in gain (RBIG). RBIG includes gain recognized for five years after the ownership change on the disposition of any asset, if the gain is attributable to the pre-change period. The taxpayer conceded that it did not have a disposition of an asset; however, it was unclear whether any post-change payments were attributable to pre-change income and could be RBIG.

Background

The taxpayer, a U.S. corporation, acquired a corporation that had net operating losses (NOLs), a "loss corporation". The acquisition resulted in an ownership change under Code Sec. 382. The loss corporation then liquidated into the taxpayer. The purchase price was allocated among Developed Technology, Goodwill, and other assets. The taxpayer is claiming that it has recognized built-in gain with respect to a platform contribution payment (PCT), which the IRS believes is included in the Developed Technology asset.

In a redacted portion of the FAA, the IRS refers to a payment, an amended cost-sharing arrangement (CSA), and a buy-in license agreement. The CSA provides that "acquired intangibles" may be added to the joint research program. The IRS states that the CSA does not grant taxpayer's subsidiary any royalty-free rights in the loss corporation's intangible property; however, the property, as an acquired intangible, may be included in the CSA's joint research program if a royalty payment is made.

PCT payment

According to the IRS, the loss corporation's loss is not attributable solely to the development of the software included in the CSA. However, the taxpayer argues that the pre-change loss *is* attributable to the software, that the PCT is attributable to the use of the software, and that the PCT payment was earned entirely in the first year after the ownership change. The IRS claims that a PCT is not the equivalent of a royalty payment or license fee.

RBIG

Under Code Sec. 382(h)(6)(A), income that is "attributable" to the pre-change period and that is "properly taken into account" during the five-year recognition period is also RBIG. The taxpayer argued that the PCT payment is RBIG because it is attributable to the pre-change period.

The IRS disagreed. Income is attributable to the pre-change period if that is when performance occurred and expenses were incurred to earn the income. However, prepaid income is only attributable to the post-change period (and is not RBIG) because that is when performance occurs. The loss corporation's intangible property did not generate any income in the pre-change period.

IRS recommendations

The taxpayer had not established that the PCT payment is RBIG. There were significant factual questions whether some of the payment is unrelated to the intangible property lease. If payments would be for the use of intangible property, it was unclear if they were earned in the pre-change period.

The IRS recommended that the IRS audit team determine which items were specifically contributed to the joint research program, and value each item to identify whether the taxpayer's payment corresponds to the value of the lesser of the loss corporation's intangible property or of some other items.

Reference: TRC NOL: 36,150.

IRS Reminds Small Employers Of Code Sec. 45R Credit

The IRS has reminded small employers of the Code Sec. 45R small employer health insurance tax credit and other provisions of the *Patient Protection and Affordable Care Act* (PPACA). The IRS also highlighted the PPACA's employer shared responsibility requirements (employer mandate), which generally do not impact small employers.

- ***Comment.*** On its website, the IRS explained that the Code Sec. 45R credit is subject to sequestration. Refund payments processed on or after October 1, 2014, and on or before September 30, 2015, issued to a tax-exempt taxpayer claiming the Code Sec. 45R credit, will be reduced by the fiscal year (FY) 2015 sequestration rate of 7.3 percent.

Code Sec. 45R credit. The Code Sec. 45R credit is targeted to employers that have fewer than 25 full-time equivalent employees with average annual wages of less than $50,000, the IRS noted. The employer must cover at least 50 percent of their full-time employees' premium costs. For tax years beginning in 2014 or later, the small employer generally must contribute toward premiums on behalf of each employee enrolled in a qualified health plan through the SHOP Marketplace.

Employer mandate. If an employer has fewer than 50 full-time employees, including full-time equivalent employees, on average during the prior year, the employer is not an applicable large employer for purposes of the employer mandate, the IRS explained.

HCTT-2015-31; TRC BUSEXP: 55,850.

Agencies Post Updated PPACA FAQs

FAQs About Affordable Care Act Implementation (Part XXVI)

The IRS and the U.S. Department of Health and Human Services (HHS) and Labor (DOL) have posted Frequently Asked Questions (FAQs) regarding coverage of certain preventive services under the *Patient Protection and Affordable Care Act* (PPACA). The FAQs update prior postings about preventative services and other issues.

- ***Take Away.*** Some religious employers have opposed requirements for their insurance to cover birth control. In response, the agencies have issued regs that exempt these employers from the birth control requirements and that provide a mechanism for the employers to opt out of the coverage. While the new FAQs do address birth control coverage, they do not appear to invoke the concerns of religious employers.
- ***Comment.*** According to the agencies, they issue FAQs to answer questions from stakeholders (such as insurers and employers) to help people understand and benefit from the PPACA.

Background

Sec. 2713 of the Public Health Service (PHS) Act and the related regs require nongrandfathered group health plans, and health insurance coverage offered to groups and individuals, to provide certain preventive services without requiring the insured to pay a portion of the costs (cost-sharing).

The law requires that women's preventive services that are recommended by medical studies be covered without cost-sharing for plan years beginning on or after August 1, 2012. These services include preventive care and screening recommended in comprehensive guidelines supported by HHS's Health Resources and Services Administration (HRSA).

Preventative services

The FAQs clarify that the following services must be provided without requiring cost-sharing:

- Preconception and prenatal care for pregnant women if the plan covers dependent children;
- Screening for breast cancer susceptibility genes (BRCA 1 or 2); and
- Anesthesia provided in connection with colonoscopies to screen for colorectal cancer.

The U.S. Preventive Services Task Force recommends screening of women with family members with breast, ovarian, tubal or peritoneal cancer, to identify a family history that may be associated with increased risk for potentially harmful mutations of BRCA genes. The FAQs clarify that a plan or insurance issuer must cover without cost-sharing any recommended genetic counseling and genetic testing for women who have not been diagnosed with BRCA-related cancer but who previously had breast, ovarian, or other cancer.

Women with positive screening results should receive genetic counseling and, if indicated, BRCA testing, as determined by the woman's attending provider (individuals who are licensed under state law to provide direct care to a patient). If a recommendation or guideline does not specify the frequency, method, treatment, or setting for the provision of a recommended preventive service, the plan or issuer may use reasonable medical management techniques to determine any such coverage limitations, the agencies explained.

Other issues

The HRSA guidelines recommend all birth control methods, sterilization procedures, and patient education and counseling that are approved by the Food and Drug Administration (FDA) and prescribed by the patient's health care provider. The new FAQs require plans and issuers to cover at least one form of contraception for each of the 18 methods identified by the FDA in its birth control guide.

Reference: TRC HEALTH: 9,114.25.

IRS Updates FAQs On FATCA's International Data Exchange Services System And Other Information Management

The IRS recently added new frequently asked questions (FAQs) to the existing FAQs on the International Data Exchange Services (IDES) system. The IDES system allows the IRS to exchange taxpayer information with foreign tax authorities that is collected under the Foreign Account Tax Compliance Act (FATCA). FATCA requires that U.S. taxpayers report their foreign financial assets that exceed a specified threshold and that foreign financial institutions (FFI) and other foreign entities report accounts and assets owned by U.S. taxpayers, directly or indirectly. FFIs that fail to report the required information must withhold 30 percent of any payments made to these foreign accounts.

Use of ICMM system. The IRS also uses the International Compliance Management Model (ICMM) system in connection with the IDES system to send, receive, process, store, and manage FATCA data received from various sources to support the IRS's FATCA compliance activities. The IRS uses the ICMM system to transmit encrypted documents to an FFI, direct reporting non-financial foreign entity (NFFE), or host country tax authority (HCTA), after it receives a FATCA Report electronically or on a paper Form 8966, FATCA Report.

More FAQs. The latest FAQs include FAQ D-10 on data transmission; FAQ E-8 on data encryption and security; and FAQs F1-3 on IDES use for entities not required to obtain a GIIN (global intermediary identification number). Certain entities, such as U.S. withholding agents, that submit information on behalf of another entity are not required to obtain a GIIN. Instead, they must obtain a FATCA ID number to enroll in and use IDES.

FATCA IDES Technical FAQs, www.irs.gov; TRC INTL: 36,050.

District Court Imposes 40 Percent Penalty On Sham Tax Shelter, But Rejects Stacking

Chemtech Royalty Associates, L.P., DC-La., May 8, 2015

A federal district court has found that a limited partnership held to be a sham owed the 40 percent penalty for a gross valuation misstatement under Code Sec. 6662. The parties agreed that the penalty applied, following a Fifth Circuit decision (*Chemtech, 2014-2* USTC *¶50,431*) that remanded the case so that the district court could consider the 40 percent penalty.

- ***Take Away.*** In *Heasley (5th Cir. 1990)*, the Fifth Circuit held that the valuation penalties did not apply where the IRS totally disallows a deduction or credit. The Supreme Court effectively overruled *Heasley* in *U.S. v. Woods, 2013-2* USTC *¶50,604*, a decision issued after the district court in *Chemtech* had held that the penalty did not apply.

Background

From 1993 through 2006, the taxpayer followed the Special Limited Investment Partnerships (SLIPs) tax strategy by establishing two limited partnerships, with several banks as limited partners, that purportedly generated approximately $1 billion in royalty expenses and depreciation deductions. When the IRS challenged the partnerships, the district court in a 2013 opinion disregarded the partnerships on three grounds: sham, lack of economic substance, and lack of partners (the banks' interests were debt, not equity).

The district court imposed the 20 percent negligence and substantial understatement penalties but found that the substantial valuation and gross valuation penalties could not apply, because of *Heasley*. On appeal, the Fifth Circuit affirmed the holding that the partnership was a sham. The appeals court expressed no opinion on the 20 percent penalties but, after noting that *Woods* had overruled *Heasley*, directed the district court to consider the valuation penalties.

District court on remand

The district court found that the 20 percent penalties for negligence and substantial understatement still applied for the tax years 1997 through 2006. The court also held that the partnership transaction purported to increase the basis of one of taxpayer's chemical plants from $27 million to over $400 million.

This increase of over $370 million was well over the 400 percent requirement for a gross valuation misstatement. The court therefore upheld the imposition of the 40 percent gross valuation penalty for the years 1998–2006. The court emphasized, however, that there was no stacking of penalties and that the 20 percent penalties did not apply on top of the 40 percent penalty.

References: 2015-1 USTC *¶50,301;*
TRC PENALTY: 3,110.25.

Retiree Liable For Tax On Portion Of Payments Based On Service Years

Sewards, CA-9, May 12, 2015

Affirming the Tax Court, the Court of Appeals for the Ninth Circuit has found that a retired former employee of a county sheriff's department was not entitled to exclude the full portion of his retirement benefits from income. The Ninth Circuit found that the portion of his retirement allowance that was based on his years of service, rather than his disability, was taxable income.

- ***Take Away.*** Code Sec. 104(a)(1) and its regulations exclude from gross income certain amounts received by an employee under a workmen's compensation act or statute that provides compensation to employees for personal injuries or sickness incurred in the course of employment. Reg. §1.104-1(b) states, however, that the exclusion does not apply to a retirement pension or annuity determined by reference to, among other things, the employee's age or length of service.

Background

The taxpayer had completed 34 years of service when he retired from the sheriff's department on account of a service-connected disability. He first obtained a retirement allowance based on his years of service, then later began to receive a service-connected disability retirement allowance, which under state law equaled one-half of his final salary.

Court's analysis

The Ninth Circuit upheld the Tax Court. The payment the taxpayer received based on his service-connected injuries under the state statute was excluded from gross income. However, the additional amount he received based on his years of service was taxable. The regs specify that retirement benefits calculated with reference to an employee's age or length of service are taxable, even if the recipient was eligible for retirement because of a service-connected disability, the Ninth Circuit found.

The Ninth Circuit rejected the taxpayer's argument that an individual's retirement benefit is determined by age or length of service *only* when those factors are used to decide whether the individual qualifies for retirement. This interpretation was not supported by the regs or the IRS's interpretation of those regs in Rev. Ruls. 72-44 and 80-44.

References: 2015-1 USTC *¶50,299;*
TRC COMPEN: 45,354.

Tax Court Finds No Stepped-Up Basis In Shares Gifted To Nonresident Alien Spouse

***Hughes*, TC Memo. 2015-89**

The purported transfer of shares by gift from a taxpayer to his nonresident alien spouse did not result in a stepped-up basis of the shares for the nonresident alien spouse, the Tax Court has held. The Tax Court imposed a significant valuation misstatement penalty.

- ***Take Away.*** The husband purportedly filed the amended return because he came to believe the transfer of stock to his non-resident wife became a taxable event for him and, therefore, the wife should have taken a fair market value basis in the property received under Code Sec. 1041(d).

Background

The husband was a CPA and partner in an international accounting firm. While working as a partner, he received an allocation and issue of two groups of stock shares representing the firm's equity interests in a spin-off consulting business. The husband purportedly transferred these shares to his wife, a U.K. citizen and non-U.S. resident. The firm sold both groups of shares in 2001, remitted net proceeds from the sale of one group of shares to the husband and reported the husband's distributive share from the sale of the second group of shares on a Schedule K-1, Partner's Share of Income, Credits, Deductions, etc. On their 2001 tax return, the taxpayers reported a significant short-term capital loss from an unrelated transaction and long-term capital gain from the firm's stock sales. The taxpayers originally claimed zero basis in the stock. In 2005, the taxpayers filed an amended return for 2001, reduced the claimed loss on the unrelated transaction, claimed a stepped-up basis in the stock under Code Sec. 1041(d) and decreased the amount of reported capital gain.

Court's analysis

There was no evidence supporting the taxpayers' assertion that the basis in either group of stock shares exceeded zero, the Tax Court found. The stock would have a zero basis regardless of whether the transfer to the wife was a completed gift—therefore the court assumed for the sake of argument that the purported transfer of stock was a gift and that the wife took the stock with a transferred basis of zero from the husband.

The Tax Court upheld the IRS's imposition of the gross-valuation misstatement penalty. The Tax Court also found that while the IRS had not established negligence or disregard of the rules for purposes of applying the Code Sec. 6662(a) accuracy-related penalty, a recalculation of the tax liability might support the penalty based on substantial understatement of tax.

References: Dec. 60,303(M);
TRC SALES: 6,100.

No Private Right Of Action Under Code Sec. 6050H, District Court Finds

***Rovai v. Select Portfolio Servicing, Inc.*, DC Calif., May 11, 2015**

A federal district court has found that Code Sec. 6050H provides no private right of action. The court rejected the taxpayer's argument to create a private remedy under Code Sec. 6050H against the mortgagor.

- ***Take Away.*** Another federal district court reached a similar conclusion in 2014 (*Barbieri v. Wells Fargo & Co., E.D. Pa. December 22, 2014*). In that case, the plaintiff asked the court to use its equitable powers to create a private remedy under Code Sec. 6050H. The court found that Code Sec. 6050H does not provide individuals with a private right of action for the failure of a mortgage lender or servicer to provide a mortgage interest statement to the individual debtor.

Background

An individual brought a prospective class action against a corporation. The individual alleged, among other allegations, a violation of Code Sec. 6050H. The corporation moved to dismiss the complaint. The corporation countered that Code Sec. 6050H provides no private right of action.

Court's analysis

The court first found that Code Sec. 6050H requires every person engaged in a trade or business (including governments and their agencies) to file an information return for each calendar year in which the person receives in the course of its trade or business payments from an individual of interest on a mortgage aggregating $600 or more. A copy of the information return is provided to the individual.

In *Cort v. Ash, 422 U.S. 66 (1975)*, the U.S. Supreme Court set forth a test to determine if a statute implicitly includes a private cause of action. The plaintiff must be one of the class for whose special benefit the statute was enacted. There must be an indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one. Additionally, it must be consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff and it would be appropriate to infer a cause of action based solely on federal law.

The court further found that some statutes explicitly create private rights of action. Code Sec. 6050H, however, does not explicitly create a private cause of action. Requiring a mortgagor to provide its Forms 1098 to the mortgagee, in addition to the IRS, permits a mortgagee to stay apprised of the accruing tax burden and benefit, but it does not follow that this entitles a mortgagee to private recourse under the statute, the court held.

References: 2015-1 USTC ¶50,303;
TRC INDIV: 12,108.

IRS Chief Counsel Addresses Low-Income Housing Credit Commitment Rule

PMTA 2015-3

IRS Chief Counsel has recommended that the agency withdraw a 2007 memorandum on the extended low-income housing commitment rule for purposes of the Code Sec. 42 low income housing tax credit (LIHTC). IRS revenue agents should determine that an extended low-income housing commitment is in effect at the end of the tax year(s) at issue, Chief Counsel explained.

- ***Take Away.*** The LIHTC is intended to encourage the private sector to invest in the construction and rehabilitation of housing for low- and moderate-income families. Credits are awarded on a competitive basis to nonprofit and for-profit sponsors of eligible housing projects. The credit equals the applicable percentage of the qualified basis of each qualified low-income building. The applicable percentage is determined by the IRS monthly.

Background

In the 2007 memorandum, one LIHTC property was located in a state-level jurisdiction offering an abatement of property taxes to owners of residential rental housing if the owner rents to low-income households. No household can have income above 80 percent of the area's median gross income (AMGI). If a tenant's income is determined to be in excess of 80 percent of AMGI at the time of the annual income recertification, the tenant would be evicted.

The memorandum concluded that the taxpayer violated statutory protections that protect initially qualifying households from being displaced as their incomes rise. If it is established that the taxpayer has implemented policies and/or procedures that are in conflict with the requirements of Code Sec. 42, the building's qualified basis would be reduced to zero; that is, the building would not be part of a qualified low-income project at all times during the 15-year compliance period under Code Sec. 42.

Chief Counsel's recommendation

Chief Counsel recommended that SB/SE's 2007 memorandum be withdrawn. Instead, IRS revenue agents should determine that an extended low-income housing commitment is in effect at the end of the tax year(s) at issue. If there is no commitment in effect, or the commitment does not meet the statutory requirements, then no credit would be allowed, subject to a correction period, Chief Counsel explained.

Reference: TRC BUSEXP: 54,200.

TAX BRIEFS

Internal Revenue Service

The IRS has published the inflation adjustment factors and reference prices to be used in computing the renewable electricity production credit for calendar year 2015. The inflation adjustment factors and references prices apply to sales in calendar year 2015 of kilowatt hours of electricity produced in the United States or a U.S. possession from qualified energy resources.

Notice 2015-32, FED ¶46,322; TRC BUSEXP: 54,550

The IRS has made available the grant application package and guidelines for organizations interested in applying for a low-income taxpayer clinic (LITC) matching grant for the 2016 grant year, which runs through June 15, 2015. The IRS will award a total of up to $6,000,000 to qualifying organizations, subject to the limitations of Code Sec. 7526, for matching grants.

Low Income Taxpayer Clinic Grant Application Package Available, FED ¶46,320; TRC IRS: 12,380

Jurisdiction

A couple's claim for refund of an overpayment attributable to partnership items was barred by the limitations period in Code Sec. 6511(a); therefore, it was properly dismissed for lack of subject matter jurisdiction.

McNaughton, CA-FC, 2015-1 USTC ¶50,302; TRC IRS: 36,052.05

Summons

An IRS summons issued to an individual to appear, testify and produce documents relating to the individual's federal tax liability was ordered enforced. The individual failed to rebut the government's *prima facie* case for enforcement and his contention that his Fifth Amendment rights were violated was rejected because he failed to assert the privilege properly.

Belcik, DC Fla., 2015-1 USTC ¶50,297; TRC IRS: 21,300

Income

A married couple did not fail to report cancellation of indebtedness (COD) income for the tax year at issue. The couple did not receive a Form 1099-C, indicating that the loan was discharged and a reasonable person would not agree to pay an unenforceable debt to save a fraction of that debt on taxes. The second loan was discharged while the couple was insolvent and, therefore, was not includible in income. The taxpayers were not liable for the accuracy-related penalty under Code Sec. 6662(a) as there was no underpayment.

Johnston, Jr, TC, Dec. 60,305(M), FED ¶48,015(M); TRC IRS: 27,054

Tax Credits

An individual was not entitled to file as head of household or to claim dependent

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exemptions, the Earned Income Tax Credit (EITC), the Child Tax Credit (CTC) or the child care credit as he did not have any qualifying children.

Rolle , TC, Dec. 60,307(M), FED ¶48,017(M); TRC FILEIND: 6,154.25

Liens and Levies

A developer was not entitled to quiet title to property it purchased at a property tax sale. The government filed tax liens against the property more than 30 days before the tax sale but did not receive notice of the sale as required by Code Sec. 7425.

Cottonwood Development v. Moter, DC La., 2015-1 USTC ¶50,296; TRC IRS: 48,210.15

Refund Claims

An employee's refund action against her employer for over-withheld employment taxes was dismissed because she failed to exhaust her administrative remedies. Code Sec. 7422 applied because the money the employee sought to have returned was tagged as money to pay federal taxes (even though it was wrongfully withheld by her employer and used to pay the employer's taxes).

Ednacot v. Mesa Medical Group, PLLC, CA-6, 2015-1 USTC ¶50,300; TRC LITIG: 9,062

Collection Due Process

The qualified offer rule did not make a widow a prevailing party with respect to two disputes with the IRS. She made the offer before one of the disputes began, and the other dispute was settled by a settlement rather than a judgment.

Angle, TC, Dec. 60,306(M), FED ¶48,016(M); TRC LITIG: 3,154.05

Tax Assessments

The government was entitled to a judgment for unpaid federal income tax, interest and penalties assessed against an individual for four tax years at issue. The individual failed to provide evidence to cast doubt on the date or amounts of the assessments, the propriety of the notice given or that the carryback loss should have been allowed.

Pollak, DC Conn., 2015-1 USTC ¶50,305; TRC IRS: 27,202

Deficiencies and Penalties

The IRS established that two business owners underreported the income from their two nail salons using the bank deposits method and they were liable for accuracy-related and fraud penalties. The "badges of fraud" demonstrated that one individual evaded payment of tax he knew to be owed and the other individual offered no reliable evidence that she attempted to assess her tax liability correctly.

Duong, TC, Dec. 60,304(M), FED ¶48,014(M); TRC ACCTNG: 3,156

An individual's petition challenging a notice of deficiency was properly dismissed because it was filed late. The individual received a faxed copy of the notice from her authorized representative 60 days before her petition was due in the Tax Court, which was sufficient time for her to prepare and file the petition, and the 90-day limitation period is jurisdictional and not subject to waiver.

Mabbett, CA-10, 2015-1 USTC ¶50,293; TRC IRS: 30,202.10

Bankruptcy

A debtor in bankruptcy could avoid a federal tax lien on real property because the liens on the property exceeded its value. The IRS's claim was the fourth claim against the property. There was no dispute as to the value of the property, the amount of the IRS's lien or the fact that the aggregate liens on the property exceeded its value.

In re Rodriguez, BC-DC Md., 2015-1 USTC ¶50,298; TRC IRS: 57,106

Tax-Exempt Status

A tax-exempt organization was not entitled to a preliminary injunction preventing a state attorney general from enforcing state donor disclosure requirements.

Center for Competitive Politics v. K.D. Harris, CA-9, 2015-1 USTC ¶50,295; TRC EXEMPT: 21,554

Retirement Plans

For pension plan years beginning in May 2015, the IRS has released the 30-year Treasury bond weighted average interest rate, the unadjusted segment rates, Highway and Transportation Funding Act of 2015 (HATFA) (P.L. 113-159) adjusted rates, the MAP-21 adjusted rates and the minimum present value segment rates.

Notice 2015-39, FED ¶46,321; TRC RETIRE: 15,304.10

An individual's refund action challenging the taxation of her pension income under Code Sec. 104 was barred by collateral estoppel. The individual conceded that in her federal district court petition she raised the same facts and legal issues already adjudicated by the Tax Court.

Walker , DC Md., 2015-1 USTC ¶50,294; TRC LITIG: 3,054.10

State Must Give Full Credit For Out-Of-State Income Taxes, Supreme Court Holds

The U.S. Supreme Court has held that the state of Maryland must give full credit for out-of-state income taxes. Maryland residents who earned pass-through income from an S corporation that earned income in several states had not been allowed to claim a full income tax credit against county taxes on their Maryland income tax return for taxes paid to those other states. The state's treatment violated the dormant Commerce Clause of the Constitution.

- ***Comment.*** "For Maryland and other states with similar regimes, the decision will cause affected taxpayers to file claims for refund for prior tax periods that remain open under the statute of limitations," Katina Peterson, partner, Dorsey & Whitney, LLP, Minneapolis, told Wolters Kluwer.

Writing for the majority, Justice Alito explained that the dormant Commerce Clause precludes states from discriminating between transactions on the basis of some interstate element. "If every state adopted Maryland's tax structure, interstate commerce would be taxed at a higher rate than intrastate commerce," Alito wrote.

Comptroller of the Treasury of Maryland v. Wynne, SCt., May 18, 2015

Trade Bills Include Important Tax Provisions

In recent weeks, trade legislation has been high on Congress' agenda. Several bills have moved out of committee and either have passed or await action by lawmakers. Included in the trade package are a number of tax provisions: extension of the Health Coverage Tax Credit (HCTC), new information reporting requirements, a change to the child tax credit, and a corporate estimated tax shift. While the tax provisions have not garnered the same attention as the trade provisions, they potentially impact a significant number of taxpayers, both individuals and businesses. Congress is likely to wrap up negotiations over a trade package before June, sending a bill to the White House for President Obama's expected signature.

- ***Comment.*** At press time, the Senate had approved the Trade Preferences Extension Act of 2015 (HR 1295) on May 14 by a vote of 97–1. The Trade Preferences Extension Act of 2015 includes new information reporting requirements and a corporate estimated tax shift, discussed below. Pending legislation, the Trade Adjustment Assistance Reauthorization Act of 2015 (Sen. 1268) addresses the TAA program and the HCTC, discussed below, as well as a corporate estimated tax shift and the child tax credit. Additionally, the Trade Facilitation and Trade Enforcement Act of 2015 (HR 644) would revoke or deny U.S. passports to taxpayers with seriously delinquent tax debts.

Trade Adjustment Assistance

Trade Adjustment Assistance (TAA) is a group of programs that provide federal job-training and other assistance to workers, firms, farmers, and communities that have been adversely impacted by foreign trade, including workers who have been separated from employment because their jobs moved overseas or as a result of increased imports. The TAA was originally created by the *Trade Expansion Act of 1962* and has been subsequently reauthorized.

Generally, a petition must be filed with the U.S. Department of Labor (DOL) by or on behalf of a group of workers who have lost or may lose their jobs or experienced a reduction in wages as a result of foreign trade. After DOL investigates the facts behind the petition, it applies statutory criteria to determine whether foreign trade was an important cause of the threatened or actual job loss or wage reduction. If DOL grants the petition to certify the worker group, individual workers in the group may apply to their state workforce agency for TAA benefits and services. In 2010, DOL certified 2,718 TAA petitions, covering 280,873 workers. More than two-thirds of covered workers accessed TAA benefits, DOL reported.

> *"While the tax provisions have not garnered the same attention as the trade provisions, they potentially impact a significant number of taxpayers, both individuals and businesses."*

Trade Readjustment Allowances (TRA) are available to covered workers to provide income support while they participate in full-time training. The amount of each weekly TRA payment is based on the weekly unemployment insurance (UI) benefit amount already received by the covered worker. A covered worker must have been entitled to receive UI benefits before he or she may receive TRA and must have exhausted his or her UI entitlement. There are three types of TRA: Basic TRA, Additional TRA, and Completion TRA. Another program, the Alternative Trade Adjustment Assistance (ATAA) program, provides benefits to workers age 50 or older who do not earn more than $50,000 annually in their new employment, to accept reemployment at a lower wage.

- ***Comment.*** Training programs include classroom training, on-the-job training, customized training designed to meet the needs of a specific employer or group of employers, apprenticeship programs, post-secondary education, or remedial education, which may include GED preparation, literacy training, basic math, or English as a Second Language.

Health Coverage Tax Credit

Various tax and trade bills have extended and/or enhanced the HCTC in recent years. The current trade proposals contain similar provisions. Under its most recent iteration (now expired), the HCTC provided a refundable credit for 72.5 percent of a covered individual's premiums for qualified health insurance of the individual and qualifying family members. For purposes of the HCTC, qualifying family members are the covered individual's spouse and any dependent for whom the individual is entitled to claim a dependency exemption. A covered individual will receive an HCTC Eligibility Certificate from the IRS HCTC Program.

Generally, a covered individual is an individual who is:

- An eligible TAA recipient;
- An eligible alternative TAA recipient;
- An eligible Pension Benefit Guaranty Corporation (PBGC) pension recipient.
- ***Comment.*** An individual is an eligible PBGC pension recipient for any month if the individual is age 55 or over as of the first day of the month and (2) receives a benefit for the month, any portion of which is paid by the PBGC.

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WASHINGTON REPORT *by the Wolters Kluwer Washington News Bureau*

Tax bills on Congress' agenda before Memorial Day recess

A number of tax bills await action by lawmakers before they break for their Memorial Day recess. A package of trade bills with tax provisions is moving in the Senate. On May 14, the Senate approved the Trade Preferences Extension Act of 2015 (HR 1295) by a vote of 97–1, which includes new information reporting requirements and a corporate estimated tax shift. The Senate also continues to debate the Trade Adjustment Assistance Reauthorization Act of 2015 (Sen. 1268), which would renew the health coverage tax credit (HCTC) and modify the child tax credit. (*For more details about the tax provisions in the trade bills, see this week's Practitioners' Corner in this newsletter*.)

Meanwhile, the House is expected to vote on the American Research and Competitiveness Act of 2015 (H.R. 880), which would make permanent the research tax credit. A vote is also scheduled on a temporary extension of federal highway and transportation funding. Lawmakers could not reach an agreement on how to fund a long-term highway and transportation bill. President Obama had proposed to pay for highway and transportation spending with a package of international tax reforms. The President's proposals failed to gain traction in the House.

SFC tax reform groups making progress, Hatch says

Senate Finance Committee (SFC) Chair Orrin Hatch, R-Utah, said on May 13 that the committee's working groups on tax reform are making progress. Hatch predicted that the groups will finish their work by May 31. Hatch indicated that he will not alter the deadline to give the working groups more time. "The deadline is set and then the reports are to be coming in, so we'll know what they're suggesting and we'll know what information they have for us so we can hopefully make some decisions based upon that information, in part. We have a lot of other information too; we're not sitting back and doing nothing. We're working on it," he said.

House passes fallen officer tax relief bill

The House on May 12 approved the Don't Tax Our Fallen Public Safety Heroes Bill (HR 606), which clarifies federal law to ensure that both federal and state benefits for fallen public safety officers are treated the same in the Tax Code. Under the legislation, neither would be subject to the federal income tax.

The bill was introduced by Ways and Means members Erik Paulsen, R-Minn., Bill Pascrell, D-N.J., and Rep. Dave Reichert, R-Wash. Joining Paulsen in introducing the legislation were the bipartisan co-chairs of the House Law Enforcement Caucus. Companion legislation has been introduced in the Senate by Sens. Kelly Ayotte, R-N.H., and Jeanne Shaheen, D-N.H. The House also approved the Defending Public Safety Employees' Retirement Bill (HR 2146). The bill allows allow federal law enforcement officers, firefighters and air traffic controllers to make penalty-free withdrawals from governmental plans after age 50.

Bipartisan bill would impose identity theft requirements on IRS

A group of senators recently introduced the Social Security Identity Defense Bill of 2015, to require the IRS to notify potential victims of identity theft. The bill also requires that the IRS notify law enforcement. The bill's sponsors include Senators Ron Johnson, R-Wisc., and Mark Warner, D-Va. Johnson said he was prompted to introduce the legislation after a Wisconsin couple brought the problem to his attention. The couple said they were receiving calls from collections agencies and delinquent payment notices, despite having a clean debt record. Johnson said the IRS was aware the Social Security number was being used fraudulently but failed to notify the victims.

IRS expands efforts to curb cybercrime

The IRS Criminal Investigation (CI) office is establishing a cybercrime unit to combat large scale Internet-related crimes, such as identity theft, CI Chief Richard Weber told reporters at a May 11 news conference. The creation of the unit reflects the increasing threat of cybercrimes to tax administration, Weber said.

Three years ago, when Weber became chief of CI, identity theft took up less than three percent of CI's activity. Now, according to Weber, it takes up 18 percent of CI's activity at the national level, and as much as 50 percent in some field offices.

The IRS is concerned that cybercriminals who obtain taxpayer identification numbers and other personal information will be able to use the information to attack the IRS's systems, Weber explained. When criminals steal taxpayer's data such as Form W-2 wage records, Social Security numbers, addresses or dependent information, their actions can mirror that of real taxpayers and be difficult for the IRS to detect. The concern is that filters used by the IRS may not pick up identity-theft activities.

NCCPAP holds Washington conference

The National Conference of CPA Practitioners recently concluded its Washington, D.C. conference. "Our top three agenda items were received very well," NCCPAP Member and PR Chair Robert Brown, CPA said. "Members of Congress take our ideas very seriously because we are on the ground working with taxpayers and carrying out the policy that Congress implements at the top."

Identity theft prevention was one item at the top of NCCPAP's agenda. Stephen Mankowski, CPA, Chair of NCCPAP's Tax Policy Committee, discovered it was also a concern for many Senators and Representatives. "As the constituents, family and friends of our nation's leaders get hit with identity theft, our leaders are starting to witness the complications this type of theft causes in people's lives and the need to implement some safeguards at the policy level," he said.

Practitioners' Corner

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Covered individuals may elect advance payment of the HCTC. In some cases, the HCTC may be paid retroactively.

For purposes of the HCTC, qualified health insurance eligible for the credit is:

- COBRA continuation coverage;
- State-based continuation coverage provided by the state under a state law that requires such coverage;
- Coverage offered through a qualified state high risk pool;
- Coverage under a health insurance program offered to state employees or a comparable program;
- Coverage through an arrangement entered into by a state and a group health plan, an issuer of health insurance coverage, an administrator, or an employer;
- Coverage offered through a state arrangement with a private sector health care coverage purchasing pool;
- Coverage under a state-operated health plan that does not receive any federal financial participation;
- Coverage under a group health plan that is available through the employment of the eligible individual's spouse;
- Coverage under individual health insurance if the eligible individual was covered under individual health insurance during the entire 30-day period that ends on the date the individual became separated from the employment which qualified the individual for the TAA allowance, the benefit for an eligible alternative TAA recipient, or a pension benefit from the PBGC, whichever applies; and
- Coverage under an employee benefit plan funded by a voluntary employee beneficiary association (VEBA) established under an order of a bankruptcy court (or by agreement with an authorized representative).

Sen. 1268 would extend the HCTC through 2019 for eligible TAA recipients, alternative TAA recipients, and PBGC recipients. The Senate bill also eliminates the 30-day requirement as a requirement for individual health insurance to be qualified health insurance for purposes of the HCTC.

- ***Comment.*** Covered individuals who elect to receive the HCTC cannot also take advantage of the Code Sec. 36B premium assistance tax credit. The Code Sec. 36B credit helps to offset the cost of health insurance obtained through the PPACA Health Insurance Marketplace.
- ***Comment.*** Last minute negotiations to extend the HCTC before the end of 2014 collapsed. However, supporters pledged to include a renewal of the HCTC in any TAA reauthorization proposed in 2015.

Information reporting

The trade legislation also aims to improve information reporting on unreported and underreported financial accounts. Generally, current provisions require that every person who makes a payment of reportable interest of $10 or more to any other person during any calendar year report the aggregate amount of the payment and information identifying the recipient on an information return (Form 1099-INT) to the IRS. This report is not required to be filed for payments to exempt recipients and certain non-U.S. persons. The Tax Code also requires that the payor furnish the corresponding information statements to payees named on the information returns showing the information that is reported to the IRS.

HR 1295 would revise the reporting requirement to eliminate the minimum interest threshold of $10 and apply information reporting requirements and penalties for banks and other persons that hold non-interest bearing deposits. The change would apply to returns filed after December 31, 2015.

Child tax credit

Taxpayers are generally entitled to offset their income tax liability by a tax credit for each qualifying child they support during the tax year. The child tax credit is limited if modified adjusted gross income is above a certain amount. The amount at which this phase-out begins varies depending on filing status. For married taxpayers filing a joint return, the phase-out begins at $110,000. For married taxpayers filing a separate return, it begins at $55,000. For all other taxpayers, the phase-out begins at $75,000.

A U.S. citizen or resident living abroad may be eligible to elect to exclude from U.S. taxable income certain foreign earned income and foreign housing costs. The maximum amount of foreign earned income that an individual may exclude in 2015 is $100,800. The maximum amount of foreign housing costs that an individual may exclude in 2015 is, in the absence of Treasury adjustment for geographic differences in housing costs, $16,128. The combined foreign earned income exclusion and housing cost exclusion may not exceed the taxpayer's total foreign earned income for the tax year.

Sen. 1268 would provide that taxpayers who elect to exclude from gross income for a tax year any amount of foreign earned income or foreign housing costs would not be able to claim the refundable portion of the child tax credit for the tax year. The change in treatment would be effective for tax years beginning after December 31, 2014.

Passports

Sen. 644 would revoke or deny a U.S. passport to a taxpayer with a seriously delinquent tax debt. The bill defines a seriously delinquent tax debt as including any outstanding debt for federal taxes in excess of $50,000, including interest and any penalties, for which a notice of lien or a notice of levy has been filed. The $50,000 amount would be adjusted for inflation. A debt would not be considered seriously delinquent if the taxpayer entered into an installment agreement or an offer in compromise or collection is suspended because collection due process or innocent spouse relief was requested.

Corporate estimated tax shift

Included in Sen. 1268 is a corporate estimated tax shift. For corporations with at least $1 billion in assets, the amount of corporate estimated tax due in July, August or September 2020 would be increased by 2.75 percent and the amount of the next required installment would be reduced to reflect the prior increase.

COMPLIANCE CALENDAR

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 2
Deadline for sponsors and administrators of retirement plans not covered by Title I of ERISA to file their Form 5500 or 5500-EZ returns and qualify for penalty relief under the IRS's pilot program.

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

June 5
Employers deposit Social Security, Medicare, and withheld income tax for May 30, 31, June 1, and 2.

June 10
Employers deposit Social Security, Medicare, and withheld income tax for June 3, 4, and 5.

Employees who received $20 or more in tips during May report them to their employers using Form 4070.

TRC TEXT REFERENCE TABLE

The cross references at the end of the articles in Federal Tax Weekly (FTW) are text references to 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 "Wolters Kluwer Tax Research Consultant" Helpline (1-800-344-3734).

Q Can the foreign tax credit be used to reduce the excess advance premium tax credit repayment now due after reconciliation?

A Yes. On Form 1040, the total credits (the sum of lines 48 through 54—including the foreign tax credit on line 48) are netted against (subtracted from) the tax listed on line 47. Line 47 equals the total of lines 44 through 46, which includes the excess advance premium tax credit repayment. Therefore, the foreign tax credit is properly used to reduce the tax, of which the excess advance premium tax credit repayment is a part. *See TRC HEALTH: 3,322 for more information.*

Q What is the treatment of paid and unpaid interns when adding hours of service of employees who might be full-time or full-time equivalent employees for purposes of determining applicable large employer status under the Affordable Care Act?

A Paid and unpaid interns are treated like all other employees for purposes of determining hours of service for applicable large employer status. An hour of service for purposes of determining whether an employee is full-time or full-time equivalent is defined as (1) each hour for which an employee is paid for the performance of duties; and (2) each hour for which an employee is paid on account of a period of time during which no duties are performed due to vacation, holiday, illness, incapacity (including disability), layoff, jury duty, military duty or leave of absence. *See TRC HEALTH: 6,052.*