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INSIDE THIS ISSUE

IRS Reevaluating Rulings On Code Sec. 355 Spinoffs Having Minimal Trade Or Business Assets

The IRS Office of the Associate Chief Counsel (Corporate) is reevaluating whether it will continue to issue private letter rulings (PLRs) on Code Sec. 355 spinoffs where the corporation being spun off owns minimal assets in an active trade or business (ATB). The Office has alerted practitioners that the policy is under reconsideration and that they should call the Office before submitting a ruling request that may implicate ATB concerns.

- ***Take Away.*** The issue is one of avoiding double taxation on the distribution of appreciated passive assets, according to Dan White, partner, Bryan Cave LLP, St. Louis (and co-author of "Federal Taxation of Corporations & Shareholders," CCH Expert Treatise Library). By spinning off a significant amount of passive assets like stock as part of a broader transaction that is otherwise tax-free under Code Sec. 355, the corporation avoids a corporate level tax on the gain in those passive assets and a shareholder level tax on the distributions, White told Wolters Kluwer.
- ***Comment.*** There is no official size requirement for ATB assets relative to other assets not used in the ATB, White said. In Rev. Rul. 73-44, the IRS approved a spinoff where the amount of ATB assets was less than half of the total value in the corporation, he indicated. As recently as Rev. Proc. 2003-3, the IRS required a representation that at least five percent of the fair market value of the gross assets consisted of those used in an active trade or business. Subsequently, the IRS stopped requiring this representation, raising speculation about whether the IRS had concerns at all about the relative size of ATB assets, White said.

Law

In a spinoff, a parent corporation (distributing) that owns a controlling interest in a subsidiary corporation (controlled) distributes all of the stock of the subsidiary to its shareholders, so that following the transaction the shareholders own the stock of the subsidiary as a separate corporation. Under Code Sec. 355, both corporations must be engaged in an active trade or business immediately after the spinoff; the corporations must have conducted the business throughout the five-year period ending on the date of the spinoff; and the active business generally must not have been acquired in a taxable transaction within the five-year period immediately before the spinoff.

An active trade or business is a group of activities carried on for the purpose of making a profit. Passive activities, such as holding stock, land or other property for investment, do not qualify as an active trade or business.

- ***Comment.*** Another requirement under Code Sec. 355 is that the spinoff cannot be a device for distributing earnings and profits, White said. If the ATB assets of the controlled corporation are minimal, it could raise a question whether the transaction is a device, he said.

continued on page 254

Proposed Regs Address Treatment Of Federal Financial Assistance To Banks And Thrifts

NPRM REG-140991-09

The IRS has issued proposed regs on transactions involving the receipt of federal government financial assistance (FFA) by banks and thrifts (savings and loan associations) that were affected by the financial crisis in the 1980s. The proposed regs modify and clarify the existing final regs that were issued in 1995.

- ***Take Away.*** Initially, in 1981, FFA was tax-free, and the recipient did not have to reduce the basis of any assets. In 1988, Congress modified the tax treatment by requiring that the acquirer reduce the basis of assets by one-half of the FFA received. In 1989, Congress decided that FFA should be taxable.
- ***Comment.*** The regs will be effective on the publication of final regs. A taxpayer may elect to apply the final regs retroactively, unless the statute of limitations has expired for applying Code Sec. 597 to the transaction.

Background

Congress first took action on the savings and loan crisis in 1981. The federal government provided aid through one of several agencies: the Federal Savings and Loan Insurance Corporation, the Federal Deposit Insurance Corporation, the Resolution Trust Corporation, and any predecessor or successor of these federal agencies. The aid could be money, property, or a debt instrument issued by an agency.

In a typical transaction, the federal agency took over a troubled bank or thrift ("bank") as receiver. The agency then sold the bank's assets to another bank and provided FFA to the acquiring company. The acquirer agreed to assume the troubled bank's deposit liabilities.

Existing regs

The current regs reflect the legislative history:

- FFA generally is treated as ordinary income to the troubled bank that is being compensated for its losses. However, the taxation may be deferred until the bank recognizes sufficient losses to offset the income.
- A bank should not get a tax benefit from losses for which it received FFA.
- The timing of the income recognition should match the recognition of the bank's losses.
- The income tax consequences of receiving FFA should not depend on the form of the acquisition of the troubled bank (asset purchase or stock purchase).

The acquisition of a troubled bank is treated as a taxable asset transfer. The regs describe a "taxable transfer" as a transfer of deposit liabilities (if FFA is provided), a transfer of any asset for which a federal agency has a financial obligation (such as a guarantee to compensate the bank for losses on the disposition of specific assets), and certain deemed asset transfers.

If the acquirer obtains certain bank assets at a price less than the asset's fair market value, the basis of the asset is its fair market value, and the acquirer must recognize the excess of the value over the purchase price, by including it ratably in income over a six-year period. To ensure that FFA is included in the income of a transferor or its consolidated group, the existing regs also provide that a bank that was a member of a consolidated group remains a member, unless an election is made to disaffiliate.

Proposed regs

The regs would clarify that the fair market value of an asset includes potential loss guarantee payments from a federal

continued on page 255

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355 Spinoffs

Continued from page 253

Announcement

At a May 19 program of the District of Columbia Bar, Isaac Zimbalist, a senior technician review with the Associate Chief Counsel (Corporate), told practitioners that the Office is concerned that some corporations are attempting to satisfy the ATB requirement for spinoffs with a minimum amount of business assets, compared to the amount of passive assets held by the controlled corporation involved in the spinoff. The office announced that it is studying the area and that it is possible the Office will decide not to issue rulings on this issue.

In the meantime, Zimbalist said that practitioners who want a ruling on a transaction that could raise concerns under the ATB requirement should call the Office and check whether they can still get a ruling. Alison Burns, deputy associate chief counsel (corporate), said that this informal procedure will give the office a chance to gauge whether a particular ruling request touches on its concerns and whether it will decline to rule. Burns said that as soon as the Office makes a decision about its rulings policy, it will tell practitioners.

Reference: TRC CCORP: 39,252.10.

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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Treasury Proposes Changes To U.S. Model Income Tax Treaty To Address BEPS And Other Multinational Tax Abuses

TDNR JL-10057, Select Draft Provisions of the U.S. Model Income Tax Convention

The Treasury Department has issued proposed revisions to the U.S. Model Income Tax Convention ("Model Treaty") to address base erosion and profit-shifting (BEPS) activities and other tax abuses by multinational corporations (MNCs). The revisions focus on foreign "special tax regimes" with very low tax rates, corporate inversions by U.S. MNCs, and limitation on benefit (LOB) provisions that limit treaty-shopping.

- ***Take Away.*** "The revisions would make significant changes to the U.S. Model Treaty, more than we've seen in a while," Manal Corwin, national leader, International Tax Practice, KPMG LLP, and former deputy assistant secretary for international tax affairs, Treasury Office of Tax Policy, told Wolters Kluwer. "The Model Treaty is the starting point for negotiations with another country. The proposed revisions reflect the U.S.'s position on ways to address BEPS in the context of allocating appropriate taxing rights [between the U.S. and its treaty partners]. The Treasury Department recognizes that countries likely will be changing their tax laws in response to the BEPS initiative, and thus is building flexibility into the model in anticipation of those changes," Corwin said.
- ***Comment.*** "The draft provisions we are releasing today for comment reflect the fact that the tax regimes of our treaty partners are more likely to change over time than they have in the past, and that they sometimes change in ways that encourage base erosion and profit shifting or BEPS, by multinational firms," Deputy Assistant Secretary for International Tax Affairs Robert Stack said in a May 20 statement. "Treaties exist to eliminate double taxation, not to create opportunities for BEPS, and today's updates fully take account of the new international tax environment," Stack said.

Treasury's proposals

The proposals include changes in the rules to address "so-called Exempt Permanent Establishments (PEs)," payments by expatriated entities, and "special tax regimes." The proposal on PEs is intended to prevent residents of third countries from inappropriately obtaining the benefits of a bilateral tax treaty for income that is not subject to tax by a treaty partner because it is attributable to a PE located outside the country. The provision on corporate inversions would impose full withholding taxes on dividends and on base-stripping payments such as interest and royalties paid by U.S. companies that are expatriated entities. The proposals on special tax regimes are intended to avoid instances of stateless income or double non-taxation.

- ***Comment.*** "The Treasury's perspectives on addressing BEPS concerns is reflected in the 2016 Administration budget proposals, in its longstanding treaty policy, and in the positions it has taken in the context of the BEPS initiative," Corwin said. "The model proposals are consistent with these policy perspectives and are independent of the actions of the Organisation for Economic Cooperation and Development (OECD). There are three BEPS-related provisions, Corwin said. The first is proposed Article 28 which provides flexibility to turn off certain treaty benefits as a result of subsequent changes in law. The second is the special tax regime rule, which turns off beneficial withholding rates if a country has a ruling regime or other special regime that disproportionately favors or eliminates taxes on certain income. The third is the provision that limits treaty benefits for payments made to certain third-country permanent establishments," she indicated.

New Article 28

Treasury's proposals include a new Article 28 to address "Subsequent Changes in Law" by a treaty partner that reduce the general rate on company taxes below 15 percent or entirely eliminate the taxes.

- ***Comment.*** "Article 28 gives the United States the option to turn off treaty benefits (such as lower withholding) when there is a significant change in the law of the treaty partner," Corwin said. "This provision arguably extends the long-standing U.S. policy not to enter into a tax treaty with a country that does not raise double tax concerns for US investors (because of the absence of an income tax, for example). Article 28 would provide the option to preserve that policy where there is a change in circumstances. Suppose a country had a robust tax system that raised double tax concerns for US business (so that the U.S. was willing to enter into a treaty),

continued on page 256

Banks

Continued from page 254

agency. The fair market value would be its "expected value," equal to the price a third party would pay, plus the amount a federal agency would guarantee to the seller. The regs would remove references to the asset's "highest guaranteed value."

The regs would reduce the balance in a bank's deferred (untaxed) FFA for payments made by a third party that is a member of its affiliated group, even if the parties do not file a consolidated return.

The regs also would clarify that a third-party entity that is related to the bank and that holds an asset (such as a loan) is the owner of the asset. Payments to the bank of FFA must reduce the basis of the asset to its owner. Additionally, the regs would make two changes to facilitate electronic filing by a consolidated group that includes a distressed bank, by eliminating the requirements to attach certain elections to the return and to make certain notations on the return.

References: FED ¶49,649; TRC CCORP: 30,054.

IRS Issuing Refunds To RTRP Exam Takers

www.irs.gov, IRS statement, May 21, 2015

Individuals who took the Registered Tax Return Preparer (RTRP) examination will receive refunds of their test fees, the IRS announced in updated frequently asked questions (FAQs) on its website. The RTRP program is now defunct.

- ***Take Away.*** "The IRS's decision to refund the RTRP exam fees to all preparers who took the exam is welcomed," Cindy Hockenberry, EA, Director, Education and Research Services, National Association of Tax Professionals (NATP), told Wolters Kluwer. "The IRS has gone on record as saying they no longer recognize the RTRP designation so the fact that a preparer took and passed the exam has no validity. It's probable that some form of preparer regulation will resurface in the future as there are several proposed bills that would give the IRS the authority it needs to regulate the industry."

Background

The IRS launched the RTRP program in 2011. The RTRP generally required unenrolled preparers to satisfy continuing education requirements and successfully complete an examination to earn the designation RTRP. In 2014, the U.S. Court of Appeals for the District of Columbia Circuit struck down the RTRP program as exceeding the IRS's statutory authority (*Loving, 2014-1* USTC *¶50,175*). After the RTRP program ended, individuals who had taken the examination requested a refund of the test fees they had paid. The RRTP test fee was $116.

Refunds

Individuals seeking a refund of RTRP test fees do not need to take any action, the IRS advised. The IRS is alerting qualified individuals by mail. Letter 5475, RTRP Refund Notification Letter, will be mailed May 28, 2015, to individuals due an RTRP test refund. Refund checks will be mailed separately beginning approximately June 2, 2015, The IRS will mail the refund checks to the return preparer's address in the Preparer Tax Identification Number (PTIN) system.

Refunds will be issued to the individual who took the test. Third parties, such as employers, who paid the exam fee(s) will need to resolve any reimbursement issues directly with the individual who took the RTRP exam, the IRS explained.

AFSP

The IRS also reminded unenrolled preparers that to have limited representation rights for clients beginning January 1, 2016, unenrolled preparers will need to participate in the Annual Filing Season Program (AFSP). CPAs, enrolled agents, and attorneys will continue to have unlimited representation rights, regardless of participation in the AFSP.

Reference: TRC IRS: 3,200.

No Current Penalty For Failing To Update EIN Information, IRS Chief Counsel Determines

IRS Chief Counsel recently determined that there is no penalty for failing to provide updated employer identification number (EIN) information. In 2013 (TD 9617), the IRS announced that taxpayers with employer identification numbers (EINs) will be required to provide updated information to the IRS.

Background. To obtain an EIN, a business must complete an Application for Employer Number Form. When the IRS issued TD 9617, the agency explained that nominees were being listed as principal officers, general partners, grantors, owners, and others in the EIN application process. A nominee is not one of these people. Rather, nominees are temporarily authorized to act on behalf of entities during the formation process. Any person issued an EIN would be required to provide updated information to the IRS in the manner and frequency required by forms, instructions, or other appropriate guidance.

Chief Counsel's review. In a highly redacted memorandum, Chief Counsel described the requirement that persons issued EINs provide updated information. Chief Counsel noted that there are currently no directly-applicable penalties for failure to provide updated EIN information.

CCA 201520011; TRC FILEBUS: 12,106.05.

Model Treaty

Continued from page 255

> but then decided to reduce significantly or eliminate certain taxes. New Article 28 would provide the U.S. with the flexibility to limit the availability of treaty benefits if the change in law obviates the need for double tax relief," she said.

There is also a taxpayer-favorable rule that would broaden the application of the "derivative benefits rule" to allow more third-country taxpayers to qualify for treaty benefits without violating the limitation on benefits (LOB) provisions.

- ***Comment.*** "Previous derivative benefits rules were narrow and generally limited to European Union countries and NAFTA countries (Canada and Mexico)," Corwin said. "In the past, the U.S. resisted a broader derivative benefits policy. The proposed broader model provision will be welcome."

Mandatory arbitration

Although not included in the proposals recently released for comment, Treasury stated that it intends to include in the next Model Treaty a new article to resolve disputes between tax authorities through mandatory binding arbitration.

Reference: TRC INTL: 18,000.

Medical Device Sold Through Doctors Qualifies For Retail Exemption From PPACA Excise Tax

CCA 201520006

IRS Chief Counsel has concluded in a letter ruling to a medical device company that one of its medical devices falls within the retail exemption of Code Sec. 4191(b)(2)(D) and is therefore exempt from the 2.3-percent tax imposed under Code Sec. 4191(a). The device at issue was of a type that is generally purchased by the public at retail for individual use, Chief Counsel determined.

- ***Take Away.*** Currently a bipartisan bill calling for repeal of the medical device excise tax is expected to be marked up in the House of Representatives during June 2015. The bill's sponsor, Rep. Erik Paulsen, R-Minn., has previously stated, "The medical device tax continues to stifle innovation, cost American jobs, and drive up health care costs despite bipartisan opposition in both houses of Congress. It is clear repealing this tax should be one of the priorities for the new Congress."

Background

Code Sec. 4191(a) imposes a 2.3-percent tax on the sale of a taxable medical device by its manufacturer, producer, or importer. However, Code Sec. 4191(b)(2) exempts from the definition of "taxable medical device" those medical devices of a type which is generally purchased by the general public at retail for individual use ("retail exemption").

Reg. §48.4191-2(b)(2) provides that a device will be considered to be of a type that is generally purchased by the general public at retail for individual use if, among other things, the design of the device demonstrates that it is not primarily intended for use in a medical institution or office or by a medical professional. The regs also provide that the fact that a device requires a prescription is not a factor in the determination of whether or not the device falls under the retail exemption.

Reg §§48.4191-2(b)(2)(i)–(ii) provide several factors relevant in determining whether a device is designed primarily for use in a medical institution or office or by a medical professional. Among other things, these factors ask for the device's cost to consumers; whether consumers can use the device safely with minimal or no training from a medical professional; and whether the device generally must be implanted, inserted, operated, or otherwise administered by a medical professional.

Chief Counsel's analysis

The medical device company was a manufacturer of a particular medical device. However, the company sold the medical device directly to doctors rather than to patients. Patients would be unable to obtain the device without first obtaining a prescription from a doctor.

After reviewing the facts and circumstances, particularly in light of the relevant factors listed in Reg. §§48.4191-2(b)(2)(i)–(ii), Chief Counsel determined that the medical device qualified for the retail exemption and was not taxable. First, the prescription requirement was not useful for purposes of determining application of the retail exemption. Second, the design of the medical device demonstrates that it was not primarily intended for use in a medical institution or office or by a medical professional; and furthermore, once a patient obtained the device, he or she would be able to use it safely and effectively for its intended medical purpose with minimal or no training from a medical professional.

Reference: TRC EXCISE: 6,162.15.

CFC Not Required To Use Parent's 52–53 Week Year To File Consolidated Return

LTR 201520001

Although its parent used the 52–53 week tax year, the IRS consented to a subsidiary's switch to a calendar year while still being able to file a consolidated return with its 52–53 week parent. Controlled foreign corporations (CFCs) owned by the U.S. subsidiary were partners in foreign partnerships that were required under the foreign jurisdictions to use the calendar year.

- ***Take Away.*** Without this IRS consent, the IRS observed that subsidiary would have been required to make burdensome computations to use a 52–53 week year for U.S. tax purposes. It was apparently sufficient reason to allow a mismatch of the tax years of parent and subsidiary on a consolidated return.

Background

Controlled foreign corporations (CFCs) owned by Sub 1 are partners in Country X partnerships. Under Country X law, these partnerships cannot have a calendar year that exceeds 12 months. Furthermore, under recent changes in Country X law, the CFCs as partners must make burdensome computations if they wish to have a 52–53 week tax year. As a result, the CFCs changed to a calendar year.

To avoid difficult computations due to the different calendar years, Sub 1 wants to change its tax year to a calendar year for consolidated return purposes, even though Parent would remain on a 52–53 week tax year.

Holding

The IRS granted consent under Reg. § 1.1502-76 for Sub 1 to file a consolidated return with Parent using a calendar year even though the Parent remains on a 52–53 week tax year. The IRS agreed to this change in tax year provided, among other representations:

- The tax years of all members of Group will end within the same 7-day period;
- The use of a 52–53 week taxable year will clearly reflect the consolidated income of Group (for example, depreciation, amortization, state and local franchise and prop-

continued on page 258

Tax Court Finds Secondary Residence Not Converted Into Rental Property To Allow Ordinary Losses

Redisch, TC Memo. 2015-95

The Tax Court has held that a married couple did not convert their secondary residence into property held for the production of income. Consequently, the taxpayers were not entitled to an ordinary loss deduction.

- ***Take Away.*** Property is no longer treated as a residence when it is converted to business or investment property. As a result, gain as well as loss is recognized in the year of its disposition. Five factors, the court explained, are used to determine a taxpayer's intent in converting a property, including offers to rent and offers to sell.

Background

In 2004, the taxpayers purchased a condominium in an oceanfront community as a seasonal home. The taxpayers made some improvements to the condominium, such as installing new carpet, track lighting and custom closets. After the death of their daughter, the couple decided that they could no longer stay in the condominium. The taxpayers contacted a real estate agent to assist them in renting the property. A slow rental market eventually motivated the taxpayers to revisit their decision to rent the residence and they put the condominium up for sale. The condominium sold in 2010 for $725,000 (and the furniture in the residence sold for $80,000). The IRS and the taxpayers disagreed if the condominium had been converted to a property held for the production of income and if the taxpayers were entitled to an ordinary loss deduction on the sale of the property.

Court's analysis

The court first found that no deduction is generally allowed for personal, living, or family expenses. However, an individual can deduct all ordinary and necessary expenses paid or incurred during the taxable year for the management, conservation, or maintenance of property held for the production of income. Whether property has been converted to one held for the production of income is a question of fact, the court noted.

Here, the court found that the condominium had not been converted to a rental property. The taxpayers had discussions with the real estate agent about renting the property but they never moved forward. The court characterized their efforts to rent the property as "minimal."

- ***Comment.*** The taxpayers testified that the real estate company featured the condominium in a portfolio in its office and would tell prospective buyers that it was available.

The court further found that the taxpayers were not entitled to a deduction under Code Sec. 165(a). This provision allows a deduction for any loss sustained during the tax year that is not otherwise compensated. For an individual to deduct the loss, it must be incurred in a trade or business, be incurred in any transaction entered into for profit, though not connected with a trade or business, or arise from some sort of casualty or theft. Additionally, the court upheld the accuracy-related penalty, finding that the taxpayers offered no evidence to show why the penalty should be removed.

References: Dec. 60,309(M); TRC REAL: 15,054.

Corporation's Treatment Of Bank's Interest In Preferred Stock As Equity Triggered Negligent Underpayment Penalty

The Court of Appeals for the Second Circuit has found that a federal district court should not have rejected the IRS's imposition of the 20-percent accuracy-related penalty under Code Sec. 6662 on a bank corporation for negligence and disregard of the rules. The corporation did not have a reasonable basis for treating an interest in preferred stock as equity rather than debt.

The corporation's underpayment of taxes was attributable to negligence rather than supported by an argument with a reasonable basis, the court found. The banks' interests were designed to have a superficial appearance of equity participation. The corporation's attempt to create the appearance of a legitimate tax position failed to comply with the Tax Code. The corporation also failed to provide evidence to show that it made a proper investigation of the correctness of its tax position.

- ***Comment.*** The Second Circuit noted that the district court had relied on various inapposite authorities that treated preferred stock as equity for tax purposes. In a previous case involving the same entity (*TIFD III-E, Inc. v. United States, 2006-2* USTC *¶50,442*), the Second Circuit had rejected such an analogy to preferred stock as equity as being inapt; the corporation's interests overwhelmingly were in the nature of a secured lender's interest.

TIFD III-E Inc., CA-2; 2015-1 USTC ¶50,308; TRC PENALTY: 3,106.10.

Consolidated Return

Continued from page 257

erty taxes, vacation pay accruals, and items of a similar nature as though their taxable year consisted of 12 calendar months);

- Any deferred intercompany transaction between members of Group will be accounted for in the same consolidated return year;
- If deferred gain must be restored under the regulations, the consolidated return year of the member causing the restoration will control; and
- The CFC's tax year will result in the least deferral of income to all U.S. shareholders, as defined in Prop. Reg. §1.898-3(a)(4)(i).

Reference: INTLOUT: 9,454.30.

Emancipation Day Shifts 2016 Filing Deadline To April 18 For Most Taxpayers

Rev. Rul. 2015-13

A Washington, D.C. holiday, Emancipation Day, will shift the 2016 filing deadline from April 15 to April 18, 2016, the IRS has announced. Taxpayers in two states—Maine and Massachusetts—will have one additional day to file because of Patriots Day, which will be observed on April 18, 2016 in those states.

- ***Take Away.*** In Notice 2011-17, the IRS described the impact of Emancipation Day on the filing deadline. Because Emancipation Day is a legal holiday in the District of Columbia, in certain years (such as 2016) it has implications for taxpayers nationwide with respect to the filing deadlines for all tax forms and payments required to be filed or completed on or before April 15, including the Form 1040 series tax returns. Rev. Rul. 2015-13 clarifies and amplifies Notice 2011-17.

Background

Code Sec. 6072(a) provides that individual income tax returns made on the basis of the calendar year shall be filed on or before the 15th day of April following the close of the calendar year. However, when April 15 falls on a Saturday, Sunday, or legal holiday, a return is considered timely filed if it is filed on the next succeeding day that is not a Saturday, Sunday, or legal holiday. For filing purposes, legal holidays include holidays observed in the District of Columbia.

2016 filing deadline

In 2016, the District of Columbia will celebrate Emancipation Day on Saturday, April 16, 2015. When Emancipation Day falls on a Saturday, as it will in 2016, the preceding day is the observed holiday. As a result, the holiday will be observed on Friday, April 15, 2016. Consequently, the filing deadline for 2015 individual income tax returns will shift to Monday, April 18, 2015, the IRS explained.

Maine and Massachusetts

April 18 is a legal holiday in two states. Maine and Massachusetts will observe Patriots Day on Monday, April 18, 2016. Individuals in Maine and Massachusetts will have an extended filing deadline of Tuesday, April 19, 2016.

References: FED ¶46,324; TRC FILEIND: 15,200.

AFRs Issued For June 2015

Rev. Rul. 2015-14

The IRS has released the short-term, mid-term, and long-term applicable interest rates for June 2015.

Applicable Federal Rates (AFR) for June 2015

	Annual	Semiannual	Quarterly	Monthly
Short-Term				
AFR	.43%	.43%	.43%	.43%
110% AFR	.47%	.47%	.47%	.47%
120% AFR	.52%	.52%	.52%	.52%
130% AFR	.56%	.56%	.56%	.56%
Mid-Term				
AFR	1.60%	1.59%	1.59%	1.58%
110% AFR	1.76%	1.75%	1.75%	1.74%
120% AFR	1.92%	1.91%	1.91%	1.90%
130% AFR	2.08%	2.07%	2.06%	2.06%
150% AFR	2.40%	2.39%	2.38%	2.38%
175% AFR	2.80%	2.78%	2.77%	2.76%
Long-Term				
AFR	2.50%	2.48%	2.47%	2.47%
110% AFR	2.75%	2.73%	2.72%	2.71%
120% AFR	3.00%	2.98%	2.97%	2.96%
130% AFR	3.25%	3.22%	3.21%	3.20%

Adjusted AFRs for June 2015

	Annual	Semiannual	Quarterly	Monthly
Short-term adjusted AFR	.43%	.43%	.43%	.43%
Mid-term adjusted AFR	1.52%	1.51%	1.51%	1.51%
Long-term adjusted AFR	2.50%	2.48%	2.47%	2.47%

The Code Sec. 382 adjusted federal long-term rate is 2.50%; the long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months) is 2.50%; the Code Sec. 42(b)(2) appropriate percentages for the 70% and 30% present value low-income housing credit are 7.47% and 3.20%, respectively, however, the appropriate percentage for non-federally subsidized new buildings placed in service after July 30, 2008, and before January 1, 2015, shall not be less than 9%; and the Code Sec. 7520 AFR for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest is 2.0%.

References: FED ¶46,323; TRC ACCTNG: 36,162.05.

Supreme Court Holds Fiduciaries Have Continuing Duty To Monitor Plan Investments

Tibble v. Edison Int'l., SCt., May 18, 2015

In a unanimous decision, the Supreme Court has held that fiduciaries have a continuing obligation to monitor retirement plan investments. The Court remanded a case that had found claims for breach of fiduciary duty were time-barred.

- ***Take Away.*** The Supreme Court did not articulate the scope of this continuing duty. The justices remanded the case for a determination at what point a fiduciary would be treated as having violated the continuing duty to monitor plan investments.

Background

ERISA generally provides that a breach of fiduciary duty complaint is timely if filed no more than six years after the date of the last action which constituted a part of the breach or violation or in the case of an omission the latest date on which the fiduciary could have cured the breach or violation. In the case before the Supreme Court, which was filed in 2007, the plaintiffs argued that plan trustees had breached their fiduciary duties in 1999 and 2002. A federal district court and the Ninth Circuit Court of Appeals found that the claims arising from 1999 were untimely because they were not filed within the six year period. The Ninth Circuit found the plaintiffs had not established a change in circumstances that might trigger an obligation to review and to change investments within the six year period.

Supreme Court's holding

Justice Breyer delivered the Supreme Court's opinion. ERISA's fiduciary duty is derived, Breyer explained, from the common law duty of trusts. "An ERISA fiduciary must discharge his responsibility with the care, skill, prudence, and diligence that a prudent person acting in a like capacity and familiar with the matters would use, " Justice Breyer wrote. The Uniform Prudent Investor Act, Breyer added, confirms that managing embraces monitoring and that a trustee has continuing responsibility for oversight of the suitability of the investments already made.

Further, the Ninth Circuit did not consider the role of a fiduciary's duty of prudence when it rejected the plaintiffs' claims as untimely. "The duty of prudence involves a continuing duty to monitor investments and remove imprudent ones under trust law," Justice Breyer wrote. "The Ninth Circuit erred by applying a six-year statutory bar based solely on the initial selection of the three funds without considering the contours of the alleged breach of fiduciary duty."

Reference: TRC RETIRE: 66,450.

TAX BRIEFS

Due to the Memorial Day Holiday, the IRS and the courts released a limited number of tax developments this past week. In addition to the news covered in articles within this newsletter, the following developments, as reported in the Standard Federal Tax Reporter, were released:

False Tax Returns

A taxpayer's action against the manager of business entities for filing fraudulent information returns was not dismissed. The manager's argument that he was an improper party since the returns were filed by the entities and he was only involved in preparing the returns was rejected.

Angelopoulos v. Keystone Orthopedic Specialists, S.C., DC Ill., 2015-1 USTC ¶50,306; TRC PENALTY: 3,202.35

Collection Due Process

The IRS was entitled to a summary adjudication that a settlement officer (SO) did not abuse her discretion in rejecting an individual's proposed collection alternatives and sustaining a notice of federal tax lien. The taxpayer raised no genuine dispute as to any material fact. The delay in scheduling a Collection Due Process hearing was caused by the taxpayer's failure to provide requested documents and transfers of the case among Appeals officers, and did not support a finding of abuse of discretion.

Frierson-Harris, TC, Dec. 60,308(M), FED ¶48,018(M); TRC IRS: 51,056.20

Tax-Exempt Status

The Tax Court correctly held that an organization that proposed to operate as a flower broker, with all profits being directed to charities selected by customers, was not exempt from taxation as it was not operated exclusively for exempt purposes. The primary activity of the organization was not a charitable one, but a commercial activity.

Zagfly, Inc., CA-9, 2015-1 USTC ¶50,307; TRC EXEMPT: 3,102

IRS Reports Rise In National Home Price Average Used By Issuers Of Mortgage Bonds/Credit Certificates

The IRS has released its annual update to the average residential purchase prices relied upon by issuers of mortgage bonds under Code Sec. 143 and issuers of mortgage credit certificates under Code Sec. 25 in entering commitments for residences generally purchased after May 22, 2015 (with transition rules applicable). The update reflects an increase in the nationwide average price from $214,000 in 2012; $225,400 in 2013; and $245,500 in 2014, to $255,300 in 2015.

Purchase price safe harbors. The IRS has also updated for mortgage bonds and credit purposes its list of average area purchase price safe harbors for residences located in the statistical areas of each U.S. state, the District of Columbia, and U.S. territories.

Rev. Proc. 2015-31; FED ¶46,326, TRC SALES: 51,360.

How The IRS Resolves An Identity Theft Case

Just as the incidence of tax-related identity theft continues to increase, the IRS's procedures for addressing the problem continue to evolve. The IRS has responded to criticism from the Treasury Inspector General for Tax Administration (TIGTA) and the National Taxpayer Advocate, among others, that resolution of identity theft accounts took too long by increasing its measures to flag suspicious tax returns, prevent issuance of fraudulent tax refunds, and to expedite identity theft case processing. As a result, the IRS's resolution time has experienced a moderate improvement from an average of 312 days, as TIGTA reported in September 2013 to an average of 278 days as reported in March 2015. (The 278-day average was based on a statistically valid sampling of 100 cases resolved between August 1, 2011, and July 31, 2012.) The IRS has recently stated that its resolution time dropped to 120 days for cases received in filing season 2013.

While it is possible that when the statistics for the 2014 and 2015 filing seasons are compiled, they could reveal an increased drop in resolution time, in the meantime, taxpayers who find themselves victims of tax refund identity theft can still find the road to resolution a frustrating and time-consuming process. This article seeks to explain the various pulleys and levers at play when communicating with the IRS about an identity theft case.

- ***Comment.*** Testifying before Congress recently, Acting Assistant Attorney General Caroline Ciraola, Tax Division, U.S. Department of Justice, said that the high potential for financial gain and low physical risk have made stolen identity refund fraud the new crime of choice for drug dealers and gangs. "For taxpayers whose identities are stolen, the economic and personal consequences can be severe and often long-term."

Initiating an ID theft case

A taxpayer may become aware that he or she is a victim of tax-related identity theft when the IRS rejects their tax return because someone has already filed a return using the taxpayer's name and/or Social Security number. A taxpayer may also receive correspondence directly from the IRS that informs them, prior to filing, that someone has filed a suspicious return under their information. In other cases, a taxpayer may have had his or her identity information compromised and wishes to alert the IRS as to the possibility that he or she may be targeted by an identity thief.

"TIGTA reported that identity theft cases are frequently reassigned to multiple tax assistors, and there are often long lag times where no work is accomplished toward resolution."

For all such cases, the IRS has created Form 14039, Identity Theft Affidavit. Taxpayers who are actual or potential victims of tax-related identity theft may complete and submit the Affidavit to ensure that the IRS flags the tax account for review of any suspicious activity. Taxpayers who have been victimized are asked to provide a short explanation of the problem and how they became aware of it.

The Identity Theft Affidavit may also be submitted by taxpayers that have not yet become victims of tax-related identity theft, but who have experienced the misuse of their personal identity information to obtain credit or who have lost a purse or wallet or had one stolen, who suspect they have been targeted by a phishing or phone scam, etc. The form asks these taxpayers to briefly describe the identity theft violation, the event of concern, and to include the relevant dates.

- ***Comment.*** Along with the Affidavit describing the problem, a taxpayer must submit a clear and legible photocopy of one of the official documents listed on the Form 14039 to verify identity. Accepted documents include a copy of a passport, driver's license, Social Security Card, and other valid U.S. Federal or State government issued identification (but not an employee badge).
- ***Comment.*** TIGTA reported that the IRS has successfully introduced a new policy of marking returns submitted with an attached Identity Theft Affidavit with a special processing code that ensures the return is sent to a specialized identity theft group within the IRS. TIGTA's review of its sampling of 2013 tax returns indicated that returns flagged with this code were processed approximately 100 days faster on average than the overall time required to resolve all identity theft accounts in the sampling.

Once the Form 14039 has been completed and submitted, the taxpayer should expect to receive a Notice CP01S from the IRS by mail. The Notice CP01S simply acknowledges that the IRS has received the taxpayer's Identity Theft Affidavit and reminds the taxpayer to continue to file all federal tax returns.

IDVerify.irs.gov

The IRS has implemented a pre-screening procedure for suspicious tax returns. Rather than halt the refund process entirely, which can prevent a refund claimed on a legitimately filed return,

continued on page 263

WASHINGTON REPORT *by the Wolters Kluwer Washington News Bureau*

House approves permanent extension of research tax credit

On May 20, the House approved the American Research and Competitiveness Bill of 2015 (HR 880). The bill makes permanent the research tax credit. The bill, however, contains no revenue offsets. President Obama has promised to veto the measure, which is estimated to add $180 billion to the federal deficit over the next 10 years.

The bill also would make permanent the alternative simplified method for calculating the research tax credit and increases the rate to 20 percent. That is, the research credit is equal to 20 percent of qualified research expenses that exceed 50 percent of the average qualified research expenses for the three preceding tax years. The rate is reduced to 10 percent if a taxpayer has no qualified research expenses in any one of the three preceding tax years. The provision repeals the traditional 20 percent research credit calculation method. The measure also would make permanent the basic research credit and the energy research credit—both with credit rates of 20 percent—and changes the base period for the basic research credit from a fixed period to a three-year rolling average.

Short-term highway funding bill has no additional offsets

House lawmakers on May 19 passed the Highway and Transportation Funding Bill of 2015 (HR 2353), a two-month extension of current funding through the Highway Trust Fund. No additional revenue offsets were needed for this short-term extension. Lawmakers had sought a longer extension, at least until the end of 2015, but were unable to reach an accord. The cost of such an extension would have required $11 billion in revenue offsets. Senate Finance Committee Chair Orrin Hatch, R-Utah, who had taken responsibility for finding revenue offsets, said he had devised a 50/50 plan that includes offsets and spending cuts. Hatch added, however, that he was willing to go along with the House short-term extension.

President Obama has proposed some international tax reforms to fund highway and transportation spending. The Generating Renewal, Opportunity, and Work with Accelerated Mobility, Efficiency, and Rebuilding of Infrastructure and Communities throughout America Act (GROW AMERICA Act) would impose a one-time 14 percent transition tax on the up to $2 trillion of untaxed foreign earnings that U.S. companies have accumulated overseas.

Ryan discusses carried interest, tax extenders

As House Ways and Means Chair Paul Ryan, R-Wisc., moves forward with business tax reform, he has no plans to address carried interest, which he considers an individual tax issue. Speaking at a May 19 conference of the American Institute of Certified Public Accountants (AICPA) in Washington, D.C., Ryan said that issue belongs in the conversation about individual based broadening and individual-based tax reform.

Ryan explained he wanted to avoid speaking of specifics in what he is focusing on, but he did make clear that carried interest would not be one of them. "That is on the individual side of the Tax Code, so it's not something we're looking at right now," he explained. "That's what we see as a 2017 conversation; as part of the broader overhaul for how do you broaden the base of lower individual tax rates," he added.

Ryan also said he wants to see what Congress can do to add some more certainty in tax law by getting tax extenders fixed "once and for all," and "not just on an annual basis or a retroactive basis, but on a permanent basis." Congress extended the temporary tax incentives through 2014 and is expected to revisit the extenders this year.

House panel reviews implementation of PPACA

Lawmakers on May 20 held a hearing on implementation of *Patient Protection and Affordable Care Act* (PPACA). The hearing was held by a subcommittee of the House Ways and Means Committee.

Elizabeth P. Papez, former deputy assistant attorney general, Office of Legal Counsel, Department of Justice, told lawmakers that the constitutional questions that surround recent administrative efforts to implement the PPACA "reflect the separation of powers among the three federal branches of government as well as the division of sovereign authority between the federal government and the states." Papez said that laws and practices that push separation of powers boundaries appear, such as *King v. Burwell, CA-4, 2014-2* USTC *¶50,367.*

Grassley asks IRS to clarify employee disciplinary policy

Sen. Charles Grassley, R-Iowa, has written to IRS Commissioner John Koskinen, asking him to explain how and why the agency uses discretion to avoid terminating employees for willful violations of tax law. "Willful violation of tax law is a serious offense and the presumption is an employee guilty of the offense shall be terminated," Grassley wrote. "The Commissioner's discretion to mitigate the penalty of termination was intended to be a safety valve, not a tool to be used routinely to frustrate the intent of Congress." Grassley noted a report by the Treasury Inspector General for Tax Administration (TIGTA), which discovered that a major portion of employees found to have willfully violated tax law remain employed at the agency and received only minor punishments.

DOJ tax chief highlights refund fraud

Caroline Ciraolo, Acting Assistant Attorney General, Tax Division, recently highlighted her department's work to combat stolen identity refund fraud (SIRF). Ciraolo appeared before the House Judiciary Committee on May 19. SIRF crimes are different from the crimes typically addressed by the Tax Division, Ciraolo said. "While the typical criminal tax case may involve willfully filed false returns, evading the assessment of tax due and owing or the use of sophisticated financial schemes which invariably require lengthy in-depth investigations, SIRF crimes generally involve garden variety theft and fraud."

Continued from page 261

the IRS has provided taxpayers with the opportunity to verify their identity.

Now when the IRS receives a suspicious return, it will send a Letter 5071C or Notice CP01B to the taxpayer requesting him or her to either visit idverify.irs.gov or call the toll-free number listed on the header of the letter (1-800-830-5084) within 30 days. When the taxpayer does this, the taxpayer will encounter a series of questions asking for personal information, such as previous addresses. If the taxpayer fails to respond to the verification request or responds and answers a question incorrectly the IRS will flag the return as fraudulent and follow the prescribed procedures for resolving identity theft cases.

- ***Comment.*** The IRS strongly advised taxpayers to use the idverify.irs.gov website to avoid long telephone wait times.
- ***Comment.*** The IRS has stated that following a successful verification, the taxpayer's refund will be processed in *approximately* six weeks.

Resolving the case

After a tax return has been flagged with the special identity theft processing code, the IRS will assign the case to a tax assistor. TIGTA reported that the IRS assigns each case priority based first on its age and then by case type—for example, with cases nearing the statute of limitations placed first, followed by cases claiming disaster relief, and then identity theft cases.

Since Fiscal Year (FY) 2013, the IRS has supposedly limited tax assistors' case inventories to no more than 50 cases, a policy meant to ensure that assistors can manage their work load and prevent the lengthy periods where no progress was accomplished towards resolution. However, TIGTA reported that identity theft cases are frequently reassigned to multiple tax assistors, and there are often long lag times where no work is accomplished toward resolution.

National Taxpayer Advocate Nina Olson also noted in her recent "Identity Theft Case Review Report" on a statistical analysis of 409 identity theft cases closed in June 2014 that reassigned cases experienced longer periods of inactivity than those that were not reassigned. For more than 40 percent of the cases sampled in which the Taxpayer Advocate Service found a period of inactivity averaging 78 days. The burden of urging forward movement on the case fell largely on the taxpayer, who would be required to call the centralized telephone number for the Identity Protection Special Unit and explain (or re-explain) to whichever assistor was currently assigned to the case the circumstances behind the problem, Olson noted.

- ***Comment.*** Olson recommended in her FY 2015 Objectives Report to Congress that the IRS be required to assign an identity theft case to a single assistor who would serve as the sole point of contact between the IRS and the taxpayer.

Despite the 120-day resolution time cited by the IRS in response to her 2013 Annual Report to Congress, Olson reported that the average time to resolve an identity theft case was closer to 179 days. She added that cases with multiple issues (i.e. duplicate filing, notice, underreporting (AUR), and audit) required longer times to resolve than cases involving less complexity.

After resolution

The IRS has also created the Identity Protection Personal Identification Number (IP PIN) project, which is meant to prevent taxpayers from being victimized by identity thieves a second time after the IRS has resolved their cases and closed them. The IP PIN is a unique six-digit code that taxpayers must enter on their tax return instead of their Social Security number or taxpayer identification number (TIN) at the time they file their tax return. The IP PIN is only good for one tax year.

The IRS assigns an IP PIN to a taxpayer by sending him or her a Notice CP01A. Generally this Notice is issued in December in preparation for the upcoming filing season. The taxpayer then enters it into the appropriate box of his or her federal tax return (for example, Forms 1040, 1040A, 1040EZ or 1040 PR/SS). On paper returns, this box is located on the second page, near the signature line. When e-filing, the tax software or tax return preparer will indicate where the taxpayer should enter the IP PIN.

- ***Comment.*** The electronic filing identification number and IP PIN are different numbers.

The IRS also announced that it will invite approximately 1.7 million taxpayers to voluntarily opt into the IP PIN program where the IRS has identified certain indicators of identity theft on their tax accounts. Eligible taxpayers will generally receive a Notice CP01F inviting them to create an online account, verify their identities, and obtain an IP PIN.

- ***Comment.*** Another way into the IP PIN program is available to certain taxpayers who filed 2013 federal income tax returns with addresses in Florida, Georgia, and the District of Columbia. These areas have the highest per-capita percentage of tax-related identity theft. As such, the IRS will allow taxpayers residing in these areas to request an IP PIN through a special pilot program.

Taxpayers who have been assigned an IP PIN, but who have lost or misplaced it cannot electronically file their tax returns until they have located it. Previously such taxpayers had no way to retrieve their IP PIN and had to file on paper. Their tax returns would be subject to additional screenings and delays. Beginning on January 14, 2015, however, taxpayers who had lost their IP PINs were able to retrieve them by accessing their online accounts and providing the IRS with specific personal information and answer a series of questions to verify identity. Taxpayers could also contact the Identity Protection Specialized Unit to receive a replacement IP PIN, although the IRS warned that using a replacement IP PIN would result in additional refund processing delays.

COMPLIANCE CALENDAR

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.

June 12
Employers deposit Social Security, Medicare, and withheld income tax for June 6, 7, 8, and 9.

June 15
Individuals, partnerships, passthrough entities and corporations make the second installment of 2015 estimated quarterly tax payments.

U.S. citizens or resident aliens living and working (or on military duty) outside the United States and Puerto Rico must file Form 1040 and pay any tax, interest, and penalties due.

TRC TEXT REFERENCE TABLE

The cross references at the end of the articles in Wolters Kluwer 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.

ACCTNG 15,200	199	FILEIND 15,200	259	IRS 66,304	188
ACCTNG 36,162	209	FILEIND 15,204.25	234	NOL 36,150	243
ACCTNG 36,162.05	259	HEALTH 3,302	208	PART 3,254.05	233
BUSEXP 9,099	207	HEALTH 3,308	206	PART 60,052	219
BUSEXP 9,104.30	220	HEALTH 6,050	219	PENALTY 3,106.05	211
BUSEXP 33,506	197	HEALTH 9,114.25	244	PENALTY 3,106.10	258
BUSEXP 54,200	247	INDIV 6,354.05	195	PENALTY 3,108	242
BUSEXP 55,850	243	INDIV 12,108	246	PENALTY 3,110.25	245
CCORP 30,054	254	INDIV 42,452.05	224	PENALTY 3,116	220
CCORP 39,252.10	253	INDIV 51,052	235	PENALTY 9,052	221
COMPEN 45,218	194	INDIV 60,108.05	222	PLANRET 3,206.30	221
COMPEN 45,354	245	INDIV 60,156	236	REAL 15,054	258
CONSOL 15,060	257	INTL 18,000	255	REORG 18,050	229
DEPR 15,160	232	INTL 33,050	217	RETIRE 66,450	260
ESTGIFT 51,060.10	232	INTL 36,050	244	RETIRE 66,502	222
EXCISE 6,162.15	257	INTLOUT 9,256	198	RETIRE 78,052.10	218
EXCISE 6,164.05	208	INTLOUT 18,202.10	205	SALES 3,154	241
EXEMPT 3,354	223	IRS 3,200	256	SALES 6,100	246
EXEMPT 12,252.15	231	IRS 30,054	196	SALES 45,254.05	234
EXPAT 12,152	198	IRS 36,050	209	SALES 51,358	260
EXPAT 12,208.10	211	IRS 36,052.10	197	STAGES 6,228	223
FILEBUS 12,106.05	256	IRS 51,056.25	210		
FILEBUS 15,054	231	IRS 51,060	196		

MONTHLY QUIZZER

The following questions (with answers at the bottom of the column) will help you review some of the more important developments in Wolters Kluwer Federal Tax Weekly during the past month.

Q1. The IRS issued proposed regs to clarify oil, gas and other income as qualifying income for publicly traded partnerships, describing activities such as:
(a) Exploration
(b) Processing
(c) Transportation
(d) All of the above

Q2. Certain small businesses that failed to timely file retirement plan returns (in the Form 5500 series) were given until June 2, 2015, to take advantage of a special one-year penalty relief program and file their returns. *True or False?*

Q3. A medical doctor failed to persuade the Tax Court that the cost of flying lessons was a deductible ______ expense.
(a) Charitable
(b) Educational
(c) Transportation
(d) None of the above

Q4. One way the IRS suggested that taxpayers could prepare for the 2016 filing season was to maintain accurate and organized tax records, such as home loan documents or financial aid documents, throughout 2015. *True or False?*

Answers:

Q1. *(d), See Issue #20, page 233.*
Q2. *True, See Issue #19, page 218.*
Q3. *(b), See Issue #19, page 222.*
Q4. *True, See Issue #18, page 212.*