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IRS Seeks Comments On How New FASB/IASB Revenue Recognition Standards Impact Tax Accounting

Notice 2015-40

The IRS has requested comments on new converged financial accounting standards for recognizing income. The guidance issued in 2014 by the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) is intended to apply consistent principles for recognizing revenue, regardless of industry and/or geography. The IRS expressed concerns about a number of issues and asked if transition procedures would be helpful.

- **Take Away.** "The AICPA requested the government include this item on the priority guidance plan as it could have a significant impact on a number of taxpayers," Les Schneider, a member of the AICPA's Tax Methods and Periods Technical Resource Panel, told Wolters Kluwer. "Many taxpayers use the same accounting methods to recognize revenue for book and tax purposes so a change in the book method would, under the current procedural guidance, require a non-automatic accounting method change—which could be administratively burdensome. The AICPA appreciates the government issuing Notice 2015-40 and anticipates requesting that the government issue guidance that provides automatic consent for such method changes," Schneider added.

Background

In 2014, the FASB released Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers (Topic 606) and the IASB issued International Financial Reporting Standard (IFRS) 15, Revenue from Contracts with Customers. At that time, FASB explained that the new guidance aims to create a single, principle-based recognition framework. FASB set out five steps to apply the core principle: (1) Identify the contract with a customer; (2) Identify the performance obligations in the contract; (3) Determine the transaction price; (4) Allocate the transaction price to the performance obligations in the contract; and (5) Recognize revenue when (or as) the reporting organization satisfies a performance obligation.

- **Comment.** The new guidance is intended to replace numerous, industry-specific GAAP revenue recognition requirements, FASB explained. Additionally, FASB predicted the new guidance would provide more useful information to users of financial statements through improved disclosure.

Issues and comments

In Notice 2015-40, the IRS explained that the new revenue standards in ASU No. 2014-09 generate substantive and procedural issues, including whether the new standards are permissible methods of accounting for federal income tax purposes. The new revenue standards may affect the timing of income for tax accounting purposes for many taxpayers,

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IRS Modifies Accounting Method Change Procedures, Expands Some Automatic Consent Requirements

Rev. Proc. 2015-33

The IRS has made several modifications to Rev. Proc. 2015-13, the agency's comprehensive revenue procedure that taxpayers must follow to obtain a change in accounting method. Some of the changes clarify certain procedures; other changes expand the procedures for taxpayers to obtain automatic consent to change their account method.

- **Take Away.** Taxpayers seeking to change an accounting method under Code Sec. 446(e) must follow Rev. Proc. 2015-13, either to request advance IRS consent to change their method or to obtain automatic IRS consent to change a method. Taxpayers seeking automatic consent can find a list of eligible methods in Rev. Proc. 2015-14. Taxpayers generally prefer to use the automatic consent procedures.
- **Comment.** The changes in Rev. Proc. 2015-33 apply to Forms 3115 filed on or after January 16, 2015 for a year of change ending on or after May 31, 2014. These are the same dates as Rev. Proc. 2015-13.

Repair regs changes

Generally, Rev. Proc. 2015-13 applies to Forms 3115 filed on or after January 16, 2015 for a year of change ending on or after May 31, 2014. If a taxpayer is filing for an automatic change of accounting method for a tax year ending on or after May 31, 2014, and on or before January 31, 2015, existing provisions in Rev. Proc. 2015-13 allow taxpayers to use either Rev. Proc. 2011-14 or Rev. Proc. 2015-13 if the taxpayer files Form 3115 by the due date of the taxpayer's timely filed original return (excluding extensions) for the year of the requested change. Under existing procedures, taxpayers with tax years ending after January 31, 2015 cannot request an automatic change under the procedures of Rev. Proc. 2011-14.

The IRS noted that it issued final tangible property regs ("repair regs") in September 2013 and August 2014 that generally apply to tax years beginning on or after January 1, 2014. Rev. Proc. 2015-33 extends the transition rules for using Rev. Proc. 2011-14 to all taxpayers for their first tax year in which the final repair regs apply. Furthermore, taxpayers should provide a signed copy of an original Form 3115 to the IRS office in Ogden, Utah, rather than to the IRS National Office in Washington, D.C.

Other changes

Code Sec. 381. Among other changes, Rev. Proc. 2015-13 limits the automatic change procedures for certain liquidations or reorganizations to which Code Sec. 381(a) applies. These rules inadvertently exclude certain method changes other than changes to a principal method described in the regs under Code Sec. 381. Accordingly, Rev. Proc. 2015-13 is amended only to exclude changes to a principal method and not to exclude other changes.

References: FED ¶46,333; TRC ACCTNG: 21,104.

Tax Accounting

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such as taxpayers using the percentage of completion method; deriving income from the provision of services; engaging in bill and hold transactions for the sale of goods; accounting for sales and returns of goods; and earning income from warranties. Additionally, some industries may be more affected than others, such as construction and manufacturing, the IRS observed.

The IRS requested comments, on or before September 16, 2015, on:

- To what extent do the new standards deviate from the requirements of Code Sec. 451? How may they affect deferral of income?
- What industry and/or transaction-specific issues may arise as a result of the new standards that might be addressed in future guidance?
- What types of changes in methods of accounting do taxpayers anticipate requesting?
- Do taxpayers anticipate requesting changes in methods of accounting prior to the effective dates of the new standards?
- Should taxpayers be required to use the automatic consent accounting method change procedures or the advance consent procedures to request permission to change a method of accounting under the new standards, and why?
- Which accounting method changes under the new standards, if any, should be allowed using a cut-off method instead of a 481(a) adjustment, and why?
- Will advance or automatic consent procedures or other procedural guidance need to be modified and if so, how?
- What transition procedures may be helpful?
- What related accounting method changes do taxpayers anticipate requesting that may appropriately be made on a single Form 3115, Application for Change in Accounting Method?

Reference: TRC ACCTNG: 21,102.

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 Acknowledges Theft Of More Than 100,000 Tax Transcripts From Online Application

Get Transcript Application: Questions and Answers; IRS Statement on the "Get Transcript" Application

More than 104,000 taxpayers are victims of a new identity theft scheme through which criminals used information previously stolen from outside sources to obtain unauthorized access to the IRS's online "Get Transcript" application. After discovering the scheme in mid-May, the IRS disabled the online application and is taking steps to alert affected taxpayers and to further investigate the perpetrators. The IRS estimated in the meantime that these criminal downloads might result in only 15,000 false tax return filings.

- **Take Away.** "At first blush, the amount of false returns created may seem like a statistically insignificant number, but this is a red herring," John Isaza, attorney, Rimon Law, Information Governance & Records Management practice, Los Angeles, told Wolters Kluwer. "The fact that hackers took data from other sources to create a very specific and targeted scheme means that we are now entering the next logical step after the data has been breached—mining for assets from vulnerable sites."

Background

The Get Transcript application enables taxpayers to obtain line-by-line tax return information going back five or more tax years. Criminals could use this specific tax return information to file false tax returns that appear similar to taxpayers' legitimately filed past-year returns. The false returns could then bypass the IRS's filters that flag suspicious returns by looking for anomalies in tax information.

According to recently released IRS FAQs, the Get Transcript application uses a multi-step process to check identities. First taxpayers must submit personal information including Social Security number, birth date, filing status and address. The second step poses certain "out of wallet" questions based on information that only the taxpayer should know.

The IRS detected the breach of the application in May while investigating a suspected denial-of-service attack on the application. After recognizing a large number of suspicious domains used to access an unexpectedly high volume of tax transcripts, the IRS determined that criminal organizations had attempted to access tax transcripts of approximately 200,000 taxpayers, and had been successful in an estimated 104,000 cases. The core tax filing system used by 150 million taxpayers was unaffected, the IRS said.

IRS actions

One of the IRS's highest priorities is to inform the taxpayers whose transcripts were downloaded (or nearly downloaded) that identity theft criminals have uncovered a large volume of their personal information. In addition to sending letters to these taxpayers, the IRS will provide free credit monitoring services to the taxpayers whose accounts were actually accessed.

- **Comment.** "The IRS can be expected to respond, to the best of its ability, to prevent any future breach," Charles Rettig, attorney, Hochman, Salkin, Rettig, Toscher & Perez, P.C., Beverly Hills, Calif., told Wolters Kluwer. "However, the public should be aware that these attacks are occurring through large criminal organizations located throughout the world."

Lawmakers have reacted to announcement of the breach with alarm. Senate Finance Committee Chair Orrin Hatch, R-Utah, requested a confidential briefing with IRS officials, to take place at press time, regarding the details of the data beach. "The Committee has an obligation to ensure that proper protections are in place and that such a breach is less likely in the future," wrote Hatch in a letter to IRS Commissioner John Koskinen. "A key concern of the Committee is the growing threat of stolen identity refund fraud to tax administration. This concern will only be amplified due to the recent IRS breach."

- **Comment.** On June 1, Sen. Kelly Ayotte, R-N.H., announced that the IRS has agreed to change its policy and will provide victims of identity theft with redacted copies of fraudulent returns filed in their names.

Reference: TRC IRS: 66,304.

IRS Makes Permanent Form 5500-EZ Late Filer Penalty Relief Program

Rev. Proc. 2015-32

The IRS has made permanent a pilot program targeting penalty relief to small businesses that file past due Form 5500-EZ retirement plan returns. The permanent program generally tracks the pilot program under Rev. Proc. 2014-32, with one notable difference being the addition of a filing fee.

- **Take Away.** "Making the program permanent, and adding a few simplifications regarding the use of the current Form 5500-EZ, is welcomed news for plan sponsors and administrators," Elizabeth Thomas Dold, principal, The Groom Law Group, Chartered, Washington, D.C., told Wolters Kluwer. "And the new filing fees are reasonable in light of the penalties faced for noncompliance, even though these fees result in a loss of a single batch filing for multiple plans."

Background

The IRS may assess penalties on plan sponsors and administrators who fail to timely file Form 5500 series returns for their retirement plans. Since 1995, various initiatives have reduced certain penalties in some cases. One initiative was the Rev. Proc. 2014-32

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IRS Updates FBAR Penalty Procedures To Improve Compliance; Nonwillfulness, Co-owned Accounts Addressed

SBSE-04-0515-0025, Interim Guidance for FBAR Penalties

Three IRS operating divisions (all but Wage and Investment) have issued interim guidance to improve the administration of the IRS's FBAR (Report of Foreign Bank and Financial Accounts) compliance program. The procedures, which are designed to ensure consistent and effective penalty administration, require that the IRS examiner consult with the division's FBAR coordinator after making a preliminary determination of penalties, and obtain the approval of the group manager.

- **Take Away.** Violations can be willful or nonwillful, can be excused for reasonable cause, or may be found not to have occurred. The burden is on the IRS to show that a violation occurred and, where applicable, that the violation is willful. The new procedures are effective immediately and apply to all open cases that consider a civil FBAR penalty.

  If a case warrants a criminal referral, the examiner must coordinate with a Fraud Technical Advisor.

- **Comment.** The FBAR statute establishes maximum penalties. It is up to the IRS to determine the appropriate penalty, based on the facts and circumstances.

Willful violations

For willful violations over multiple years, examiners must recommend a penalty for each year. The total penalty generally is limited to 50 percent of the highest aggregate balance of all unreported accounts during the years being examined. The total penalty will be allocated among all years, based on the ratio of the account balance for the year to the aggregate account balance. Examiners may recommend a penalty above or below 50 percent based on the facts and circumstances. The total penalty may not exceed 100 percent of the highest aggregate balance for the years being examined.

Nonwillful violations

Examiners generally will recommend one penalty for each year, regardless of the number of unreported accounts. The penalty for each year will be limited to $10,000. If warranted by the facts and circumstances, the examiner may assert a single penalty for one year only, or may assert separate nonwillful penalties for each year. An examiner will not recommend a penalty if the FBAR violations were due to reasonable cause and the violator later filed correct and complete FBARs.

If nonwillful violations meet the mitigation thresholds, examiners should use the mitigation guidelines in the Internal Revenue Manual, The penalty for each year will be limited to $10,000. Higher or lower amounts may be asserted based on the facts and circumstances. If the mitigation thresholds are not met, examiners should assert a separate penalty for each account and for each year. The total penalty should not exceed 50 percent of the highest aggregate balance of the unreported accounts.

Co-owned accounts

Examiners must make a separate determination for each co-owner of an account, regarding the existence of a violation and the co-owner's willfulness. If a penalty is asserted, it must be based on the co-owner's percentage ownership of the accounts' highest balance. If the ownership percentage cannot be determined, the examiner may divide the penalty equally among the co-owners.

Other procedures

Counsel review of proposed penalties is no longer required unless the examiner proposes penalties for willfulness. Counsel will advise whether a violation occurred, whether the violation was willful, and whether the proposed penalty is within the statutory limits.

- **Comment.** The IRS also provided a checklist of documents for each FBAR examination case.

Reference: TRC FILEBUS: 9,104.

Form 5500-EZ

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pilot program. The pilot program was generally available to small business plans that only cover the owner and the owner's spouse. Some foreign plans were eligible.

Permanent program

The permanent program makes several changes to the pilot program. Under the permanent program, all submissions must include a payment. The payment for each submission is $500 for each delinquent return for each plan, up to a maximum of $1,500 per plan.

The pilot program provided that multiple returns for multiple plans could be included in a submission. Because the permanent program requires a payment based on the number of delinquent returns for each plan, the permanent program requires that delinquent returns for each plan must be submitted separately, the IRS explained.

The permanent program provides that the applicant must submit the delinquent return on the Form 5500-EZ that applied for the plan year for which the return was delinquent. For returns for plan years prior to 1990, the applicant may use a current-year Form 5500-EZ filled out with the beginning and ending dates for the plan year for which the return was delinquent.

Effective date

Rev. Proc. 2015-32 is effective June 3, 2015 and is intended to be of indefinite duration, the IRS reported. However, the IRS noted that Rev. Proc. 2015-32 could be modified from time to time or ended.

References: FED ¶46,331; TRC RETIRE: 78,052.10.

IRS Updates Guidance To Regulated Investment Companies For Treatment Of Capital Gain Dividends

Notice 2015-41

The IRS has issued guidance to regulated investment companies (RICs or mutual funds) on the treatment of capital gains dividends distributed to the RIC's shareholders. The guidance updates two existing notices on the tax treatment of capital gain dividends to reflect enactment of the *Regulated Investment Company Modernization Act of 2010*.

- **Take Away.** The RIC Modernization Act made two significant changes for deferring capital losses arising after October 31. It made the deferral of losses elective for all purposes (for computing taxable income and for determining the maximum amounts distributable as capital gain dividends). The Act also allowed the deferral of net short-term capital losses arising after October 31.

Background

A RIC that has a net capital gain for the year may distribute capital gain dividends to its shareholders. A capital gain dividend is treated by the shareholders as gain from the sale or exchange of a capital asset held more than a year—in effect, as long-term capital gain. If the RICs net capital gains exceed the distribution to shareholders, the excess is known as undistributed capital gains. Each shareholder must also include in income its designated share of the undistributed amounts.

Prior to the RIC Modernization Act, a RIC, in computing its capital gain dividends, was required to disregard net capital losses arising after October 31 of the tax year. Instead, these losses were treated as arising on the first day of the next tax year. However, in computing its taxable income, a RIC had the option (rather than a requirement) to disregarded and defer post-October net capital losses and net long-term capital losses.

Notice 97-64 set out a "designation rule" that allows a RIC to designate and allocate its capital gain distribution as a 20 percent, 25 percent, or 28 percent rate gain distribution ("designation rule"). The notice also sets out a "bifurcation adjustment" that requires a RIC to bifurcate its tax year into pre-November and post-October portions and to net capital gains and losses separately for each portion. This prevents post-October losses from changing the characterization of pre-November gains.

Notice 2015-41

Notice 2015-41 modifies the designation rule to require (rather than merely permit) a RIC that reports capital gain dividends or undistributed capital gains to designate a rate group (20, 25 or 28 percent gains or small business stock taxed at a reduced rate under Code Sec. 1202). RICs may designate on IRS Form 1099-DIV or Form 2439. The forms lack a designation for 20 percent rate gains. The IRS explained that capital gains reported in the total on the form but not reported in one of the component boxes are deemed to be designated as 20 percent gains.

Notice 2015-41 provides that Sec. 4 of Notice 97-64 still applies to require shareholder reporting of the appropriate capital gain rates for their capital gain distributions and to require limitations on the designation of capital gains dividends. Notice 2015-41 also points out that the RIC Modernization Act replaced the mandatory deferral adjustment in Sec. 6 of Notice 97-64 with an elective deferral regime. A RIC can elect to treat any portion of a post-October 31 loss (long-term or short-term) as arising on the first day of the following tax year, for all purposes of the Code (for computing taxable income and capital gain dividends).

The bifurcation adjustment described in Sec. 6 of Notice 97-64 still applies in certain circumstances. If the RIC makes a bifurcation adjustment, then it must net its capital gains and losses as if pre-November and post-October portions of its tax year were separate tax periods.

Capital loss carryovers

Previously, capital loss carryovers from a prior year were treated as arising ratably over the tax year, rather than on the first day of the tax year. Under the RIC Modernization Act, they are treated as arising on the first day of the tax year to which they are carried. This is important because post-October losses are subject to deferral, and the amount deferred will depend on whether some of the losses are allocated to the period before November 1.

References: FED ¶46,330; TRC RIC: 3,252.

IRS Provides Tax Filing/Payment Relief For Oklahoma Storm Victims

The IRS has postponed certain deadlines and will abate certain penalties and interest for taxpayers who reside or have a business in the parts of Oklahoma that have been declared a federal disaster area due to severe weather that took place beginning on May 5, 2015. Individuals and businesses in the following counties may qualify for relief: Cleveland, Grady and Oklahoma. The relief postpones until August 31, 2015, many deadlines falling on or after May 5, 2015 and on or before August 31, 2015.

- **Comment.** At press time, President Obama had declared certain parts of Texas a federal disaster area. While the IRS has not yet announced filing relief at press time, such relief is expected.

HOU-04-2015, FED ¶46,332; TRC FILEIND: 15,204.25.

IRS Change To Timing Of Income Was Change Of Accounting Method, Despite Partnership's Election To Adjust Basis Of Property

CCA 201521012

IRS Chief Counsel has determined that the IRS's proposed change to the timing of partnership income was a change in accounting method and that it was appropriate to require taxpayer to make an adjustment under Code Sec. 481(a) to recognize income. Chief Counsel rejected the taxpayer's argument that the proposed accounting method change would create a permanent difference in income because of the taxpayer's election to adjust the basis of its assets under Code Sec. 754.

- **Take Away.** A change in an accounting practice is a change of accounting method if the accounting treatment merely affects the timing of income and does not permanently affect the taxpayer's lifetime taxable income. When the IRS on audit proposes a change in accounting method, it can require the taxpayer to make a Code Sec. 481 adjustment that requires the taxpayer to recognize additional income because of the accounting method change.

Background

The taxpayer, a partnership, engages in basket transactions in which it purchases and disposes of positions in securities on a daily basis. In a typical transaction, the taxpayer pays 10 percent of the notional amount in the basket, and a bank provides the remaining 90 percent.

The contract between the taxpayer and the bank describes taxpayer's investment as a premium that gives it the option to receive a cash settlement from the bank when the contract expires. The taxpayer defers recognition of any tax consequences from the securities traded within the basket transaction (gains, losses, income and deductions) until the contract expires or terminates. Until then, the parties treat the bank as the owner of the securities.

The IRS determined that the taxpayer did not merely hold an option in the basket. Instead, the taxpayer owned the securities underlying the basket transaction and was not entitled to defer gains and losses. The IRS proposes to change the taxpayer's accounting method to require the taxpayer to recognize gains and losses at a much earlier time. The IRS intends to impose a Code Sec. 481(a) adjustment to require the taxpayer to recognize additional income resulting from the proper treatment of the transactions.

The partnership redeemed the interests of several partners. The distributions exceeded each partner' basis in its interest and the partners recognized gain under Code Sec. 731. Since the partnership had a Code Sec, 754 election in effect, it increased its basis in its assets under Code Sec. 734(b), to account for the gain. If the taxpayer had recognized gain on the basket transactions rather than defer the gain, it would have recognized income earlier and increased the partners' basis in their interests, The partners being redeemed would have had less income and the adjustment under Code Sec. 734(b) would have been smaller.

Chief Counsel's analysis

The partnership asserted that the IRS's proposed change would create a permanent difference in its lifetime taxable income because the Code Sec. 734(b) adjustments would have been reduced. Therefore, the proposed change would not be a change of accounting method and there would be no Code Sec. 481(a) adjustment.

When a withdrawing partner recognizes gain under Code Sec. 731, the partnership can elect to increase the basis of its property to eliminate timing distortions. However, the election does not affect the total income recognized by all partners over the life of the partnership. Chief Counsel concluded that whether a partnership has a change in accounting method does not depend on whether the partnership has made an election under Code Sec. 754. The proposed change in treatment of the basket transactions would be a change in accounting method, and it would be appropriate to require the partnership to recognize gain on a Code Sec. 481(a) adjustment.

Reference: TRC ACCTNG: 21,152.

Real Estate Partnership Did Not Abandon Intent To Develop Property; Gain From Sale Ordinary

A real estate partnership held property for development and not investment, the Tax Court has found. The court rejected the partnership's argument that the sale of the property produced capital gain because its intent to develop the property had been abandoned.

- **Comment.** The partnership held the property for approximately 10 years before the property was sold. During this time, the local real estate market for mixed-use projects such as undertaken by the partnership had significantly slowed. Nonetheless, the court found that the partnership, while suspending development of the property, did not abandon those plans.

Court's view of intent. The court acknowledged that, under a question-of-fact analysis, the unsolicited nature of the sale as well as lack of repeated sales activity indicated capital gain may have been the appropriate treatment. However, more compelling, according to the court, was the fact that the property had been initially acquired for development purposes and the taxpayers continued to hold the property primarily to develop it until the offer was presented.

Fargo, TC Memo. 2015-96, Dec. 60,310(M); TRC INDIV: 48,400.

Incorrect But Similar Return Filed With IRS Can Start Running Of Statute Of Limitations

FAA 20152101F

The IRS has concluded, in field attorney advice, that a taxpayer who filed the wrong employment tax return may have filed a valid return, in some circumstances, that triggers the running of the statute of limitations for the IRS to assess taxes. The IRS applied the doctrine of substantial compliance to evaluate whether the return was valid.

- **Take Away.** The limitations period (generally three years) for the IRS to make an assessment of taxes generally begins when the taxpayer files a valid return. Under the doctrine of substantial compliance, as expressed in *Beard, 82 TC 766 (1984), Dec. 41,237*, courts look to see whether a document satisfies four requirements: provides sufficient data to calculate tax liability; purports to be a return; is an honest and reasonable attempt to satisfy the tax law; and is executed under penalties of perjury. An incorrect form that satisfies these requirements can be a valid return.
- **Comment.** The IRS noted that a timely return is deemed to be filed on April 15 of the succeeding calendar year. Thus, the three-year period of limitations for a valid return starts running on April 15, not on the actual filing date.

IRS analysis

An employer paying wages must file Form 941 quarterly to report and pay employment taxes, such as FICA tax and income tax withholding. Employers with annual employment tax liability of $1,000 or less may instead file Form 944 and pay the taxes annually instead of quarterly.

Situation 1. An employer that is required to file Form 944, but instead timely files four quarterly Forms 941, has filed a valid return because the forms provide sufficient information to calculate the tax, assuming the other conditions of *Beard* have been satisfied.

Situation 2. An employer that is required to file Form 944 but instead timely files Form 941 for the first two quarters of the year, and then files nothing for the rest of the year, has not filed a valid return. The employer's employment tax liability for the third and fourth quarters may not be equal to the amounts reported for the first two quarters and are not sufficient to determine the employer's annual tax liability. The Forms 941 may also fail to be honest and reasonable attempts to satisfy the tax law.

Situation 3. An employer is required to file Form 941 for all four quarters of the tax year but instead files Form 944. The form can meet the *Beard* formulation and be treated as a valid return, assuming the four requirements of *Beard* are met.

Reference: TRC FILEBUS: 12,054.05.

TAX BRIEFS

Internal Revenue Service

The Commissioner has delegated the authority to grant extensions of time to file income tax and estate tax returns.

CDO No. 25-4 (Rev. 1), FED ¶46,327; TRC EXCISE: 18,266

The IRS has reminded businesses in U.S. territories that they must file Form 8300, Report of Cash Payments Over $10,000 Received in a Trade or Business, when they engage in cash transactions in excess of $10,000.

IR-2015-81, FED ¶46,325; TRC FILEBUS: 9,322.05

Jurisdiction

The Tax Court properly dismissed for lack of subject matter jurisdiction an individual's petition challenging a deficiency assessment. The individual actually received the notice of deficiency; therefore, the notice was valid.

Sarkissian, CA-9, 2015-1 USTC ¶50,318; TRC LITIG: 6,106

Charges brought against an individual for corrupt interference with the administration of the tax laws was not barred by statute of limitations. Congress expressly included the Code Sec. 7212 offenses within the six-year limitations period, and the structure of Code Sec. 6531 made it apparent that the parenthetical language in Code Sec. 6531(6) was not limiting.

Huante, DC Tex., 2015-1 USTC ¶50,311; TRC IRS: 66,356

Summons

An individual's amended petition to quash third-party summonses issued by the IRS to banks in which the individual held personal accounts was dismissed. The government presented a *prima facie* case for summons enforcement satisfying the *Powell* factors and the individual failed to show that the summonses were not issued in good faith or that they were an abuse of process.

Martin, DC Calif., 2015-1 USTC ¶50,319; TRC IRS: 21,300

The IRS was not entitled to enforce a summons to a corporation to produce two memoranda prepared by its tax department lawyers that were used to support a worthless stock deduction. The documents were protected by the attorney-client privilege and the work-product doctrine: the documents contained legal analysis, were prepared by the corporation's tax department lawyers and were provided confidentially only to personnel who needed legal advice. There was no support for the IRS's contention that the outside law firm was hired to

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provide nonprivileged valuation services rather than legal advice.

Sanmina Corporation, DC Calif., 2015-1 USTC *¶50,312; TRC IRS: 21,402*

Deductions

A corporation was not entitled to refund of payments made for failure to file Form 8886, Reportable Transaction Disclosure Statement, with respect to deductions it claimed for contributions to a welfare benefits plan. The corporation's attempt to claim deductions by joining a trust arrangement that satisfied the requirements for the tax exemption under Code Sec. 419A(f)(6) was a tax strategy described as a listed transaction in Notice 95-34, 1995-1 CB 309, and Reg. §1.6011-4. The corporation failed to prove that the trust in which it participated was not the same or substantially similar to the arrangement described in Notice 95-34.

Vee's Marketing, Inc., DC Wis., 2015-1 USTC *¶50,314; TRC FILEBUS: 3,052*

Frivolous Arguments

A married couple's tax-protestor arguments that a federal district court lacked jurisdiction over an IRS suit to reduce assessments to judgment and foreclose on liens on certain property were dismissed as frivolous. The couple failed to show a legitimate argument to support a finding of fraud, misrepresentation or misconduct by the government, and therefore, there was no basis for relief from judgment.

Green, DC Okla., 2015-1 USTC *¶50,315; TRC LITIG: 9,256*

False Tax Returns

Two individuals involved in an investment fraud were properly convicted and sentenced for filing false tax returns for the three tax years at issue. There was sufficient evidence that the individuals knew the payments they received were reportable income, not loans. During the investigation, one of the individuals characterized the payment as a fee. Moreover, neither individual listed the payment as a loan on their personal financial statements.

McGinn, CA-2, 2015-1 USTC *¶50,313; TRC IRS: 66,202*

A 60-month sentence imposed upon the branch manager of a bank for filing false tax returns and embezzlement was substantively reasonable. The individual's argument that the sentencing court failed to take into consideration that she had no prior criminal history before imposing the sentence was without merit. The individual was an educated person who used her training and sophistication to defraud elderly customers of her bank. She also failed to demonstrate how sentence disparities in several cases she cited rendered her sentence unreasonable.

Niehaus, CA-6, 2015-1 USTC *¶50,310; TRC IRS: 66,202*

Liens and Levies

An individual's action against the government seeking to release IRS liens and levies on his Social Security and pension benefits was properly dismissed for lack of jurisdiction. The IRS was empowered to levy on the individual's Social Security and pension benefits pursuant to the first sentence of Code Sec. 6331(a). Since the individual was an income earner, he was liable to pay taxes.

O'Donnell, CA-7, 2015-1 USTC *¶50,317; TRC IRS: 51,060*

Collection Due Process

The Tax Court had jurisdiction to review an Appeals officer's Collection Due Process (CDP) hearing determination. The individual's corporation had filed for bankruptcy; however, the automatic stay did not apply to the individual. The individual's liability for the trust fund recovery penalty (TFRP) was separate and distinct from the corporation's payroll tax obligation and there was no evidence that the individual would be indemnified by the corporation if she was forced to pay the TFRP. Therefore, the individual was not included within the scope of the corporation's bankruptcy stay.

Riggs, TC, Dec. 60,312(M), FED ¶48,022(M); TRC IRS: 51,056.15

Tax Assessments

The government was entitled to reduce to judgment unpaid federal tax liabilities assessed against an individual. The government submitted Form 4340, Certificates of Assessments and Payments and Other Specified Matters, which was presumptive proof of valid assessments against the individual and he failed to overcome that presumption. Contrary to his arguments, the IRS was not required to exhaust administrative remedies prior to filing the suit.

Batchelor, DC Va., 2015-1 USTC *¶50,316; TRC IRS: 45,158*

Log Of Documents Insufficient To Sustain Attorney-Client Privilege, Tax Court Holds

In consolidated cases, the Tax Court has found that a log of privileged communications was insufficient for purposes of attorney-client privilege. Because the log lacked sufficient detail, the court could not assess if the privilege had been properly claimed.

Background. The IRS served a subpoena on the taxpayer's attorney for various documents. The attorney countered that the documents were privileged and provided the IRS with a log. The log contained references to some 2,000 communications, mostly emails.

Court's analysis. The court found that it generally requires submission of a privilege log whenever a party asserts the attorney-client privilege over a large number of documents. The log must establish, as to each document, each element of the claimed privilege, the court added. However, if a log provides no information whatever about the subject of the allegedly privileged communications, the log is inadequate.

Here, the log did not state the subject of any email; did not describe the contents of any email; and did not describe the purpose for which any email was created. The log also did not include any facts indicating that any particular communication was intended to be confidential, the court found.

Pacific Management Group, TC Memo. 2015-97, Dec. 60,311(M); TRC LITIG: 6,754.

PRACTITIONERS' CORNER

Spring 2015 SOI Bulletin Highlights Impact Of 2013 Tax Law Changes

The IRS Statistics of Income (SOI) Division recently released its Spring 2015 Bulletin, which contains preliminary data gleaned from the more than 145 million individual income tax return filed for the 2013 tax year. The 2013 tax year saw a number of important tax changes, including the expiration of the Bush-era tax cuts, imposition of the new Additional Medicare tax and net investment income (NII) tax, an increase in the top long-term capital gains tax rate, and more. The preliminary data for 2013 reveal a corresponding increase in tax liability across all tax brackets and a slight decrease in the amount of charitable contributions deducted. This Practitioners' Corner summarizes the tax law changes that took place in 2013 and reviews the IRS's preliminary data for the returns filed for that year.

Tax changes for 2013

After much debate and uncertainty during 2012, both houses of Congress passed the *American Taxpayer Relief Act of 2012* on January 1, 2013, and President Obama signed the bill into law the following day. Among other measures, the American Taxpayer Relief Act allowed the Bush-era tax cuts to sunset after 2012 for single individuals with incomes over $400,000 and married taxpayers with incomes over $450,000. Essentially, this meant that individuals with incomes above the $400,000/$450,000 thresholds paid more in taxes for 2013 because of a higher 39.6 percent income tax rate. The American Taxpayer Relief Act also increased the net capital gain and qualified dividends tax rate for higher-income taxpayers.

Beginning in 2013, the 15-percent maximum tax rate percent on net capital gain and qualified dividends was increased to 20 percent for higher-income taxpayers who are also subject to the 39.6-percent marginal tax rate. Also beginning in 2013, for certain higher-income taxpayers with adjusted gross income over the threshold rates ($150,000 for married filing separately, $250,000 for single, $275,000 for head of household, and $300,000 for married filing jointly), the amount of itemized deductions was limited by the so-called "Pease limitation."

"The preliminary data for 2013 reveal a corresponding increase in tax liability across all tax brackets and a slight decrease in the amount of charitable contributions deducted."

- **Comment.** The Pease limitation, named after the member of Congress who sponsored the original provision, reduces the total amount of a higher-income taxpayer's otherwise allowable itemized deductions by three percent of the amount by which the taxpayer's adjusted gross income exceeds an applicable threshold.

In addition to the changes made by the American Taxpayer Relief Act, new taxes imposed under the *Patient Protection and Affordable Care Act* became effective at the beginning of 2013. As a result, many higher-income taxpayers became subject to the additional medicare tax and/or the net investment income tax in 2013. For 2013, the 0.9 percent additional medicare tax applied to Medicare wages, railroad retirement compensation, and self-employment income that exceeds $125,000 for married filing separately, $250,000 for married filing jointly, and $200,000 for single or head of household.

The 3.8-percent net investment income (NII) tax was also imposed on either the excess of the taxpayer's modified adjusted gross income over the threshold ($125,000 for married filing separately, $250,000 for married filing jointly, and $200,000 for single or head of household.) or on the taxpayer's net investment income, whichever amount was smaller.

Tax liability

The IRS's preliminary data indicate that total tax liability for the 2013 tax year rose to $1.29 trillion owed by 98.8 million returns, up from just under $1.24 trillion owed by 96.9 million returns filed for 2012. Total tax liability increased for all income categories, but taxpayers with adjusted gross income between $200,000 and $250,000 experienced the sharpest percent change in tax liability: an increase of 10.55 percent from 2012 to 2013 (calculated from the $70.69 million owed for 2012 versus the $78.13 million owed for 2013), the IRS reported. Increased liability resulted from several factors, namely the drastic increase in capital gains distributions during 2013 (see below for more details) and the introduction of the health care taxes.

- **Comment.** Comparisons were made between the preliminary data for 2013 to the preliminary data for 2012. The IRS noted that even though final estimates for Tax Year 2012 are available in Publication 1304, Individual Income Tax Returns Complete Report, 2012, a comparison of the preliminary estimates for Tax Year 2013 to final estimates could yield misleading results.

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WASHINGTON REPORT *by the Wolters Kluwer Washington News Bureau*

Obama signs public safety officers tax relief bill

President Obama signed the *Don't Tax Our Fallen Public Safety Heroes Act* on May 22, which clarifies federal law to ensure that both federal and state benefits for public safety officers fallen or injured in the line of duty are treated the same in the Tax Code. Under the legislation, neither would be subject to federal income tax. The bill was introduced by House Ways and Means Committee members Erik Paulsen, R-Minn., Bill Pascrell, D-N.J., and Rep. Dave Reichert, R-Wash. Companion legislation approved by the Senate was introduced by Sens. Kelly Ayotte, R-N.H., and Jeanne Shaheen, D-N.H.

SFC tax reform working groups get extension

Senate Finance Committee (SFC) working groups on tax reform will have more time to analyze current tax law and examine policy trade-offs and available reform options within each group's designated topic areas. The SFC, which formed the groups in January to spur comprehensive tax reform efforts in the 114th Congress, will decide on a new timeline. The SFC tax reform working groups are: Individual Income Tax; Business Income Tax; Savings and Investment; International Tax; and Community Development and Infrastructure.

"After receiving valuable feedback from our working groups it is prudent to allow additional time so that they can continue their work. These bipartisan working groups will use this extended time to finalize their recommendations for tax reform and produce in-depth analyses of options and potential legislative solutions," SFC Chair Orrin Hatch, R-Utah, and Ranking Member Ron Wyden, D-Oregon, said in a statement.

House GOP leader outlines June agenda

House Majority Leader Kevin McCarthy, R-Calif., said on May 29 that lawmakers will continue working on the annual appropriations process in June in a memo to GOP lawmakers. The House is expected to approve a fiscal year (FY) 2016 funding bill for the IRS. McCarthy added that the House is expected to take up trade legislation, which includes a number of tax provisions. The Senate trade package would extend the Health Coverage Tax Credit (HCTC) through 2019 for qualified individuals and their families. The HCTC was not extended as part of last year's tax extenders package (the *Tax Increase Prevention Act of 2014*). Another provision in the Senate trade package would deny a U.S. passport (or renewal of a passport) to an individual who has a seriously delinquent tax debt.

Medical device excise tax. At press time, the House Ways and Means Committee is expected to approve legislation to repeal the Code Sec. 4191 medical device excise tax. The full House could take up the bill in June.

Bill would modify ITIN application process

Senate Finance Committee member John Cornyn, R-Tex., and House Ways and Means member Sam Johnson, R-Texas, recently reintroduced the Individual Taxpayer Identification Number (ITIN) Reform Bill. The bill would generally require first-time applicants to submit an ITIN application in-person at an IRS Taxpayer Assistance Center or other authorized location. Individuals seeking an ITIN would need to provide original documentation establishing their identity and foreign status. Additionally, new ITINs would have a time limit with an option to renew.

FIFA corruption scheme involves tax evasion/failure to report bank accounts

Fourteen high-ranking officials of the Fédération Internationale de Football Association (FIFA) and its continental confederation have been named as defendants in a massive 47-count indictment filed in a New York district court, the U.S. Attorney's office has announced. Charges include conspiracies to commit racketeering, wire fraud, and money laundering in connection with bribes meant to influence, among other things, the location of the World Cup and large media and marketing deals.

FIFA has formed an enterprise with six constituent continental confederations, including the Confederation of North, Central American and Caribbean Association Football ("CONCACAF"), and other organizations for the principal purpose of regulating and promoting soccer worldwide. Responsibilities include creating and enforcing uniform standards and rules, organizing international competitions, and commercializing the media and marketing rights associated with international soccer.

The IRS Criminal Investigation Division played a major role in the investigation leading up to the indictment. The conspirators allegedly hid illicit funds in offshore accounts located in tax shelter jurisdictions. Five counts of the indictment were for willfully aiding and assisting in, and procuring, counseling and advising the preparation and presentation of false and fraudulent U.S. tax returns. In other words, for misstating taxable income and for failing to report a financial interest in a foreign bank account.

Swiss banks enter into agreement with DOJ

The U.S. Department of Justice (DOJ) announced on May 28 that four banks reached a resolution under the department's Swiss Bank Program. The banks are Société Générale Private Banking (Lugano-Svizzera); MediBank AG; LBBW (Schweiz) AG; and Scobag Privatbank AG.

The Swiss Bank Program, DOJ explained, provides a path for Swiss banks to resolve potential criminal liabilities in the U.S. Under the program, banks are required to make a complete disclosure of their cross-border activities; provide detailed information on an account-by-account basis for accounts in which U.S. taxpayers have a direct or indirect interest; and cooperate in treaty requests for account information."Today's agreements reflect the Tax Division's continued progress towards reaching appropriate resolutions with the banks that self-reported and voluntarily entered the Swiss Bank Program," Acting Assistant Attorney General Caroline Ciraolo said in a statement.

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Income tax. For 2013, the 39.6-percent top marginal tax rate became effective for certain high-income taxpayers. The preliminary data list the highest income category as tax returns reporting $250,000 or more in adjusted gross income, meaning the data for the highest-income taxpayers includes both taxpayers who are and are not subject to this tax rate. The IRS's data show that taxpayers in this income category reported $182 billion less in adjusted gross income (less deficit) for 2013 than they did for 2012 (the only income category to experience such a decrease). However, the tax returns in this income category reported approximately $15 billion more in total income tax owed for 2013.

- **Comment.** The decrease in AGI for 2013 among tax returns reporting AGI of $250,000 or more resulted from lower amounts of certain items of income including: ordinary and qualified dividends, IRA distributions, pensions and annuities, and partnership net income, the IRS reported. Taxpayers in this income category also reported higher amounts of partnership net loss and estate and trust net loss for 2013. They also claimed higher amounts of certain adjustments, such as contributions to a health savings account and the deduction for self-employed health insurance.

More tax returns reported income of $250,000 or greater for 2013. Due to this increase, the average amount of income tax owed per tax return decreased for 2013 to approximately $168,900 (down from approximately $172,015 per return for 2012), even though the total amount of reported income tax owed increased.

- **Comment.** Although it is difficult to determine how much of this increase in income tax liability was attributable to the 39.6-percent marginal tax rate, the IRS itself has stated that, "the larger percentage increase in total income tax and total tax liability relative to AGI and taxable income coincided with the new higher marginal tax rates for ordinary income . . . and certain capital gain income."

Health care taxes. The IRS reported that for 2013 almost 3.1 million returns were subject to the net investment income tax. The amount of net income tax liability reported totaled nearly $11.7 billion. Nearly 93 percent of the taxpayers who incurred liability for the net investment income (NII) tax reported adjusted gross income of $250,000 or more. These approximately 2.86 million taxpayers reported $11.58 billion in net investment tax (NII) liability. The IRS also reported that the 182,470 tax returns reporting adjusted gross income between $200,000 and $250,000 were liable for $73.2 million in net investment income tax.

Preliminary data also show that nearly 2.88 million taxpayers were liable for a total of $6.64 billion in additional medicare tax for 2013. Eighty-two percent of tax returns with liability for this tax reported adjusted gross income of $250,000 or more. Nearly 13 percent of tax returns reported adjusted gross income between $200,000 and $250,000. The 370,051 taxpayers with adjusted gross income in this category owed more than $88.5 million in additional medicare tax, the IRS reported.

Capital gains. Although payments of ordinary and qualified dividends decreased from 2012 to 2013, capital gain distributions increased by nearly 157 percent between 2012 and 2013 (up from $17.6 billion for 2012 to more than $45.2 billion for 2013). The increase came as a result of large gains in the stock market during 2013. The amount of capital gains reported on tax returns with $250,000 or more in adjusted gross income increased by nearly $9 billion (from $6.9 billion for 2012 to $15.9 billion for 2013).

The increase in capital gains distributions also likely pushed many taxpayers into higher tax brackets, which could explain in part the overall increase in tax liability between 2012 and 2013. For example, the preliminary data for 2013 indicates that there were 233,198 more taxpayers in the $250,000 and up income category who reported capital gains distributions than there were for 2012. The corresponding increase in taxpayers for the $200,000 to $250,000 income category was 145,041 for 2013. In fact, there was an across-the-board increase in the number of tax returns reporting capital gains distributions in all income categories.

Itemized deductions

The total amount of itemized deductions claimed decreased from the 2012 level by approximately $45.52 billion for the 2013 tax year (representing a 4.2-percent decrease), the IRS reported. The largest percent change decrease among all itemized deductions registered in the amount of home mortgage interest deducted. Tax returns filed for 2013 reported a home mortgage deduction totaling approximately 10.2 percent less than what was reported for 2012. The next largest decrease hit the deduction for medical and dental expenses. Tax returns deducted just under $1.03 billion less for Schedule A medical and dental expenses for 2013 than for 2012.

Also a factor contributing to the decrease of itemized deductions reported for 2013 was the Pease limitation, the IRS reported. The amount of itemized deductions claimed on tax returns reporting adjusted gross income of $250,000 or more declined by 9.54 percent from 2012 to 2013. The amount claimed by tax returns reporting between $200,000 and $250,000 in adjusted gross income also declined by 5.58 percent from 2012 to 2013.

Charitable contributions. The deduction for charitable contributions, which some tax policy analysts had predicted would be negatively impacted by the reintroduction of the Pease limitation, declined by 0.1 percent, according to the IRS's preliminary data for 2013. Charitable contributions totaled approximately $179.05 billion for 2012 and $178.95 for 2013. Charitable giving actually increased slightly for 2013 among tax returns in the following income categories: $200,000 to $250,000; $100,000 to $200,000; and $30,000 to $50,000, the IRS added.

- **Comment.** The Spring 2015 SOI bulletin also covered noncash contributions reported by taxpayers during the 2012 tax year. The IRS reported a marked increase in corporate stock donations for the 2013 tax year, something it attributed to the eagerness of taxpayers to donate before the Pease imitation on itemized deductions kicked in for 2013.

COMPLIANCE CALENDAR

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.

June 17

Employers deposit Social Security, Medicare, and withheld income tax for June 10, 11, and 12.

June 19

Employers deposit Social Security, Medicare, and withheld income tax for June 13, 14, 15, and 16.

June 24

Employers deposit Social Security, Medicare, and withheld income tax for June 17, 18, and 19.

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.

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CONFERENCES

June 18: Wolters Kluwer hosts a two-hour program “Partnership Distributions: Tax Rules and Implications,” featuring a review of the tax rules that apply to distributions of money or property from a partnership to a partner. Visit *www.krm.com/cch* or call (800) 775-7654 to register.

June 25: The AICPA presents the 2015 NYU Federal Real Estate and Partnerships Tax Conference in Washington, D.C. Topics will cover the latest developments, recent legislation, cases and rulings affecting real estate and partnership tax transactions. For more information or to register, visit *www.cpa2biz.com*.

July 7–9: The IRS hosts the first of its five Nationwide Tax Conferences in National Harbor, Md. featuring updates and insights from IRS leaders and experts. Other dates and locations include: Denver (July 28–30); San Diego (August 11–13); Atlanta (August 25–27); and Orlando (September 1–3). For more information, visit *www.irstaxforum.com*.

July 13–17: The Tax Executives Institute presents its 2015 U.S. International Tax Course in Atlanta. The program will cover topics including the sourcing of income and expenses under Code Sec. 861, the foreign tax credit, earnings and profits, subpart F, transfer pricing, foreign currency issues, FATCA, and inbound and outbound transactions under Code Sec. 367. To register, visit *www.tei.org*.

July 13–24: The NYU School of Professional Studies hosts its summer institute in taxation in New York for new professionals as well as attorneys and accountants seeking to refresh their knowledge and to learn about new developments in legislation and regulations. In-depth sessions will cover state and local taxation, partnerships, consolidated returns, trusts and estates, federal wealth tax, and international taxation. For more information, visit *www.scps.nyu.edu*.

July 20–23: The National Association of Tax Professionals (NATP) presents “Jazzed in New Orleans,” a conference featuring programs on individual, passthrough, and corporate taxation. For more information or to register, visit *www.natptax.com*.