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INSIDE THIS ISSUE

Regs Require Corporate Partner To Recognize Gain On Deemed Exchange Of Stock For Appreciated Property

TD 9722, NPRM REG-149518-03

The IRS has issued final, temporary and proposed regs that require a corporate partner of a partnership to recognize gain on the corporation's deemed exchange of appreciated property for its own stock using the partnership. The regs implement legislation enacted in 1986 and replace proposed regs that the IRS issued in 1992. The temporary regs apply to transactions occurring on or after June 12, 2015.

- ***Take Away.*** "I give kudos to the government for these regulations; they reflect a lot of work," Robert Crnkovich, principal, national tax, Ernst & Young LLP, Washington, D.C., told Wolters Kluwer. "Making the effective date prospective was a good policy call. So was providing the affiliated group exception. The regulations are quite complex. We're still absorbing their full impact on various fact patterns," Crnkovich said.

Background

In *General Utilities (1935)*, the Supreme Court held that a corporation can distribute appreciated property to its shareholders without recognizing gain. To override *General Utilities*, Congress enacted Code Secs. 311(b) and 336(a) to require the corporation to recognize gain on the distribution.

The IRS determined that corporations could use a partnership to postpone or avoid gain recognition. For example, a corporation could contribute appreciated property to a partnership. An unrelated partner contributes cash. The partnership buys stock of the corporate partner. The partnership then liquidates, distributing stock tax-free to the partner under Code Sec. 731(a) and the appreciated property to the other partner. This transaction enables the corporation to permanently dispose of the appreciated property without recognizing any gain.

Congress enacted Code Sec. 337(d) to authorize regs to prevent these transactions. The IRS issued proposed regs in 1992, containing a deemed redemption rule and a distribution rule. The new regs retain the deemed redemption rule but withdraw the distribution rule.

Redemption rule

Under the deemed redemption rule, the corporate partner recognizes gain at the time of any transaction with the economic effect of an exchange of appreciated property for the partner's stock. If a partnership engages in a Section 337(d) transaction, the corporate partner must recognize gain when it acquires or increases its interest in its own stock, an affiliate's, or that of a 50-percent parent, held by the partnership.

The regs apply to a "Section 337(d) Transaction," which may occur if:

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Proposed Regs Would Implement Code Sec. 732(f) To Prevent Tax Avoidance By Corporate Members Of Partnership

NPRM REG-138759-14

The IRS has issued proposed regs to implement Code Sec. 732(f) by requiring corporations that engage in certain gain elimination transactions to reduce the basis of their corporate assets or to recognize gain. The regs would, however, also provide relief from basis reduction or gain recognition by allowing consolidated group members that are partners in the same partnership to aggregate their bases in stock distributed by the partnership.

- ***Take Away.*** "The relief provision allowing aggregation of basis is a great policy call and absolutely the correct thing to do," Robert Crnkovich, principal, national tax, Ernst & Young LLP, Washington, D.C., told Wolters Kluwer. "I applaud the government for fixing a glitch in the rules."

Code Sec. 732(f) and regs

Congress enacted Code Sec. 732(f) because of concerns that a corporate partner of a partnership could negate the effects of a basis step-down in distributed property by applying the step-down against the basis of distributed stock. Therefore, the provision requires a basis reduction in the property of the distributed corporation. Otherwise, a partnership could increase the basis of its retained property under Code Sec. 734(b) without an equivalent basis reduction under Code Sec. 732 following a tax-free liquidation of the distributed property under Code Sec. 332. The proposed regs prevent these gain elimination transactions.

Enacted in 1999, Code Sec. 732(f) provides that if (1) a corporate partner receives a distribution from a partnership of stock in another corporation; (2) the corporate partner has control of the distributed corporation under Code Sec. 1504(a)(2) after the distribution; and (3) the partnership's basis in the stock immediately before the distribution exceeded the corporate partner's basis in the stock immediately after the distribution, the basis of the distribute property must be reduced by the excess. Thus, the code and regs ensure that any basis increase under Code Sec. 734(b) is offset and that gain is preserved for future recognition.

- ***Comment.*** Code Sec. 337(d) (see accompanying story on TD 9722 in this issue) and Code Sec. 732(f) share a common purpose of preserving corporate-level gains.

Relief provision

Code Sec. 732(f) generally applies on a partner-by-partner basis to determine whether gain is being eliminated. However, it is appropriate to allow consolidated group members owning interests in the same partnership to aggregate their bases in the partnership, so that one member does not have to reduce basis and recognize gain, while another partner increases basis by the same amount. The proposed regs provide relief in this situation.

References: FED ¶49,652; TRC PART: 33,162.10

Corporate Partner

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- A corporate partner contributes appreciated property to a partnership that owns its stock;
- A partnership acquires stock of the corporate partner;
- A partnership that owns stock of the corporate partner distributes appreciated property to another partner;
- A partnership distributes stock of the corporate partner to that partner; or
- A partnership agreement is amended to increase the corporate partner's interest in its own stock held by the partnership.

The regs include two rules to prevent duplicate recognition of gain. For the gain recognized on the deemed exchange, the corporate partner increases its basis in the partnership interest, and also increases its adjusted tax basis in the appreciated property.

Exceptions

The regs add an exception to gain recognition where all interests in the partnership are held by members of the affiliated group that includes the corporate partner. The regs also do not apply if the deemed exchange involves nonappreciated property or if the corporate partner receives property other than its own stock.

The regs provide de minimis and inadvertence exceptions to limit their scope. Under the de minimis rule, the regs do not apply to a corporate partner if:

- The corporate partner (plus related persons) own less than five percent of the partnership;
- The partnership holds corporate partner stock worth less than two percent of the partnership's gross assets; and
- The partnership never holds more than $1 million of stock in the corporate partner.

Under the inadvertence exception, the regs do not apply if (1) the partnership disposes of the corporate partner stock effectively in the same year acquired; and (2) the partnership

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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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Consolidated Return Regs Tackle Circular Basis Problem And Member Loss Allocations

NPRM REG-101652-10

The IRS has issued proposed regs to address two issues under Code Sec. 1502 (the consolidated return rules): the "circular basis problem" and the allocation of members' losses. The proposed rules for allocating member's losses are straightforward, while the circular basis rules are complex and may raise some concerns.

- ***Take Away.*** "The circular basis rules are the biggest element of the regulations," Andrew Dubroff, Co-Director, Mergers & Acquisitions, Ernst & Young LLP, Washington, D.C., told Wolters Kluwer. "The [basis] adjustment problem is an age-old problem and has been known for some time. The proposed solution provides some answers and achieves more precision, but at the expense of administrability," Dubroff said.
- ***Comment.*** "The circular basis issue is a very difficult problem," Dubroff said. "The government has done a lot of good thinking and is really trying to solve the problem. But in the real world, the circular basis problem does not happen that often. Other problems need answers," he said.

Circular basis—background

To prevent double inclusion of gain or loss in a consolidated group's income, the current regs adjust a member's basis in its subsidiary's stock to reflect those items. If the group includes a subsidiary's income or gains, basis is increased; if the group absorbs a subsidiary's deductions or losses, basis is reduced.

If a subsidiary has a loss in the same year that its stock is disposed of, the basis in the sub's stock is reduced, which affects the amount of gain or loss on the disposition of the stock. This in turn affects the amount of losses absorbed, triggering further basis adjustments and potentially eliminating the benefit of the sub's losses to the group.

The current regs require a tentative computation of consolidated taxable income (CTI) without gain or loss from the sub's stock. However, the regs do not prevent iterative computations in all cases.

- ***Comment.*** "The current regulations are not a complete solution. For example, they provide no relief in the brother-sister subsidiary case," Dubroff said. "The proposed regs seek to eliminate the circular basis problem in a broader class of transactions."

New regs

The proposed regs would limit the reduction in basis of the sub's stock. In some cases, the proposed regs would provide an alternative four-step computation of CTI. While the proposed regs could have some adverse results, the government indicated that the certainty provided by the proposed rules outweighs their potential harm.

- ***Comment.*** "The new rules will be hard to apply for larger consolidated groups and for midyear sales of a subsidiary's stock," Dubroff said. Determining CTI is complex and can be very challenging, he not—the new regulations require two calculations of CTI plus a potential third calculation with four steps.

Allocation of losses

The proposed regs would clarify how a group with a consolidated net operating loss (CNOL) determines the NOL amount to be allocated to a group member. Existing regs determine a fraction based on the member's separate NOL for the consolidated return year, compared to the combined NOLs of all group members for that year. The IRS noted that it can be unclear how to allocate a group's CNOL if the members have capital gains.

The proposed regs clarify that a member's losses are absorbed on a pro rata basis against other members' income. The regs would determine a member's loss without regard to capital gains or losses to apportion the CNOL to the member. This would be consistent with excluding capital gains and losses from a member's separate taxable income under Code Sec. 1502.

- ***Comment.*** "The allocation rules are very helpful clarifications," Dubroff said. "The government is trying to plug holes where there are ambiguities and anomalies in the law. The approach taken is what most people would have expected, but it helps to have clarity."

References: FED ¶49,650; TRC CCORP: 45,262.05.

IRS Launches Joint Effort To Combat Identity Theft Refund Fraud

IRS Commissioner John Koskinen unveiled at a June 11 press briefing a new joint effort with state tax administrators and companies handling tax preparation and software to combat identity theft refund fraud. The parties have agreed to several new initiatives to improve taxpayer authentication and detect refund fraud, share and assess information about fraudulent activity, and increase public awareness of the need to protect personal information.

The new program grew out of an IRS Security Summit convened in March 2015. Summit participants included IRS officials, state tax administrators, the CEOs of the leading tax preparation firms, software developers, and payroll and tax financial product processors. Discussions over the past three months resulted in the current agreement that leverages collective resources and efforts that, according to the IRS announcement, are designed "to prevent the increasing volume and sophistication of attempts to monetize stolen identity information through attacks on the tax system."

IR-2015-87; TRC IRS: 66,304.

Agencies Issue Final Regs On PPACA's Summary Of Benefits And Coverage

TD 9724

The IRS, along with the U.S. Department of Health and Human Services (HHS) and Labor (DOL), have issued final regs on the Summary of Benefits and Coverage (SBC) requirements under the Patient Protection and Affordable Care Act (PPACA). The agencies also released an updated glossary of terms for SBC purposes.

- ***Take Away.*** Revisions to coverage examples for SBCs are anticipated to be finalized by January 2016, the agencies reported. The revisions will apply to SBCs for coverage beginning on or after January 1, 2017.

Background

The PPACA generally requires group health plans and health insurance issuers to provide enrollees with an SBC. The SBC must describe certain plan benefits in a uniform format, using terminology understandable by the average plan enrollee. Besides the description of benefits, the SBC must describe exceptions, reductions, and limitations of the coverage; cost-sharing provisions of the coverage, including deductibles, coinsurance, and copayment obligations; and must include examples of coverage. Additionally, the PPACA requires the agencies to develop standards for a glossary of terms.

The agencies issued guidance in 2012 and have posted frequently asked questions (FAQs) on their websites. The agencies also have developed a set of SBC templates, instructions, an updated uniform glossary, and other materials.

Final regs

The final regs generally track previous guidance. The final regs clarify that generally health insurance plans and issuers must include an Internet web address where a copy of the actual individual coverage policy or group certificate of coverage can be reviewed and obtained. These documents must be easily available to plan participants and beneficiaries, the agencies explained. The PPACA requires that the SBC not exceed four pages, and the final regs explain that the SBC can be four double-sided pages. Additional guidance on length will be issued in the future, the agencies predicted.

- ***Comment.*** For the group market only, because the actual "certificate of coverage" is not available until after the plan sponsor has negotiated the terms of coverage with the issuer, an issuer is permitted to satisfy this requirement with respect to plan sponsors that are shopping for coverage by posting a sample group certificate of coverage for each applicable product.

The final regs, the agencies explained, also help prevent unnecessary duplication in cases where a group health plan utilizes a binding contractual arrangement where another party assumes responsibility to provide the SBC; where a group health plan uses two or more insurance products provided by separate issuers to insure benefits with respect to a single group health plan; and where the SBC for student health insurance coverage is provided by another party (such as an issuer that provides coverage for student enrollees and covered dependents of an institution of higher education). Additionally, the agencies clarified that a qualified health issuer (QHI) must disclose on the SBC whether non-excepted abortion services as well as excepted abortion services are covered or excluded.

References: FED ¶47,020; TRC COMPEN: 45,228.

IRS Updates And Broadens Procedures For Pre-Approved Plans; Extends Remedial Cycle Application Deadline

Rev. Proc. 2015-36

The IRS has updated and expanded the scope of procedures for retirement plans to obtain opinion and advisory letters on the acceptability of pre-approved plans. The procedures apply to master and prototype (M&P) and volume submitter (VS) plans under Code Sections 401(a) (qualified plans), 403(a) (annuities), and 4975(e)(7) (employee stock ownership plans or ESOPs). The IRS also extended the deadline from June 30, 2015, to October 30, 2015, for submitting on-cycle applications for opinion and advisory letters for pre-approved defined benefit (DB) plans for the plans' second six-year remedial amendment cycle. The extension applies to mass submitter lead and specimen plans, word-for-word identical plans, and DB non-mass submitter plans.

- ***Take Away.*** Rev. Proc. 2015-36 updates and supersedes Rev. Proc. 2011-49. Under the prior procedures, the IRS would not issue opinion and advisory letters for ESOPs and applicable defined benefit plans (hybrid plans) governed by Code Sec. 411(a)(13)(C). In the latest procedures, the IRS has expanded the program for pre-approved plans to include ESOPs and hybrids.

Pre-approved plans

Master and prototype plans are retirement plans that are designed for adoption in essentially the same form by several unrelated employers. They are not the same as individually designed plans. The IRS issues opinion letters to a sponsor or mass submitter on M&P plans without regard to the facts of the individual employers that adopt the plans.

Volume submitter plans consist of a plan document and a trust or custodial account, but can also include an adoption

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IRS Provides Eligible Form 8966 Filers With Extension/Waiver Of Electronic Filing

www.irs.gov

In updated frequently asked questions (FAQs) on its website, the IRS has provided an extension of time to file Form 8966, FATCA Report, for Tax Year (TY) 2014 for eligible filers. In the same FAQs, the IRS announced that eligible filers may request a waiver from filing Form 8966 electronically for TY 2014.

- ***Take Away.*** An extension of time to file TY 2014 Form 8966 does not automatically provide a waiver from the requirement to file the form electronically, the IRS explained. Similarly, waiver from electronic filing of Form 8966 for TY 2014 does not automatically provide an extension of time to file the form. Requests for extension/waiver may be submitted to the IRS together.

Background

The *Foreign Account Tax Compliance Act* (FATCA) generally requires foreign financial institutions (FFIs) to report to the IRS information about financial accounts held by U.S. taxpayers, or by foreign entities in which U.S. taxpayers hold a substantial ownership interest. When a foreign financial institution (FFI) enters into an agreement with the IRS, it is treated as a participating FFI (PFFI). A PFFI files Form 8966 to report certain information with respect to U.S. accounts, accounts held by recalcitrant account holders, accounts held by nonparticipating FFIs, and other accounts.

Extension

An additional 90 day extension of time to file Form 8966 for TY 2014 will be automatically approved for eligible filers that submit a request, the IRS explained. Filers should use the template (on the IRS website) entitled Request for Additional Extension of Time to File Form 8966 for Tax Year 2014. The deadline for submitting requests is June 29, 2015.

Waiver

Filers seeking a waiver from filing Form 8966 electronically for TY 2014, should use the template (on the IRS website) entitled Request for Waiver From Filing Form 8966 Electronically for Tax Year 2014. The deadline for submitting requests is August 13, 2015.

Limitations

Not all filers of Form 8966 may be eligible for extension and/or waiver, the IRS noted. In some cases, an intergovernmental agreement (IGA) between the U.S. and a foreign jurisdiction may preclude any extension of time to file. For example, the IRS explained that entities located in a Model 1 IGA jurisdiction and reporting on behalf of themselves (or any entities that are reporting on behalf of another entity that is located in a Model 1 IGA jurisdiction) may not request an extension of time to file Form 8966 from the IRS because they must report directly to the Model 1 jurisdiction's tax authority.

Reference: TRC INTLOUT: 36,050.

Pre-Approved Plans

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agreement. A VS plan is a sample plan that the practitioner's clients may adopt on an identical or substantially identical basis. A master plan is made available by the plan sponsor with a single funding medium for the use of all adopting employers. A prototype plan involves a separate funding medium for each adopting employer.

An employer adopting an M&P plan may rely on the plan's opinion letter without having to obtain a separate determination letter, provided that: the plan sponsor has a valid opinion letter; the employer follows the terms of the plan; and the plan doesn't favor highly compensated employees. The favorable opinion letter is the equivalent of a favorable determination letter.

Rev. Proc. 2015-36

In Rev. Proc. 2015-36, the IRS reduced the required number of adopting employers to qualify as a sponsor (M&P practitioner) from 30 to 15. Sponsors can request opinion letters under the M&P program for ESOPs and cash balance plans. VS practitioners can request advisory letters for ESOPs and cash balance plans. Rev. Proc. 2015-36 spells out required provisions that ESOPs and cash balance plans must include for getting pre-approval.

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Eighth Circuit Affirms Payment Of Wages From IRA-Owned LLC Was Prohibited Transaction

Affirming the Tax Court, the Court of Appeals for the Eighth Circuit has found that compensation paid to taxpayer from his IRA-owned limited liability company (LLC) was a prohibited transaction. By directing the LLC to pay him a salary, the taxpayer had engaged in a prohibited transaction.

Background. The taxpayer formed the IRA-owned LLC with himself as the general manager. The taxpayer received $10,000 in 2005 to compensate him for serving as general manager. The IRS determined that the taxpayer had engaged in a prohibited transaction. The Tax Court agreed with the IRS.

Court's analysis. The Eighth Circuit found that the taxpayer had caused his IRA to invest most of its value in the LLC with the understanding that he would receive compensation. The taxpayer engaged in the indirect transfer of the income and assets of the IRA for his own benefit, the court concluded.

Ellis, CA-8, June 5, 2015; 2015-1 USTC ¶50,328; TRC IRS: 66,454.

IRS Issues Final Regs On Estate Tax Portability Election

TD 9725

Final regs issued by the IRS describe and clarify the estate tax portability election. The final regs generally track previous guidance issued in 2012.

- ***Take Away.*** The estate of a decedent survived by a spouse makes the portability election by timely filing a complete and properly prepared estate tax return. The IRS reiterated that the question of whether an estate tax return is complete and properly prepared is to be determined on a case-by-case basis.

Background

The *Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010* provided that portability was available to estates of decedents dying after December 31, 2010 and before January 1, 2013, if survived by a spouse. The *American Taxpayer Relief Act of 2012* made portability permanent for estates of decedents dying after December 31, 2012.

Final regs

The final regs clarify the availability of an extension of time under Reg. §301.9100-3 to elect portability. The IRS explained that an extension of time to elect portability will not be granted under Reg. §301.9100-3 to any estate that is required to file an estate tax return because the value of the gross estate equals or exceeds the threshold amount described in Code Sec. 6018, but may be granted under the rules in Reg. §301.9100-3 to estates with a gross estate value below that threshold amount and not otherwise required to file an estate tax return.

- ***Comment.*** The IRS announced transitional relief regarding the availability of an automatic extension of time for executors of certain estates under the filing threshold of Code Sec. 6018(a) to file an estate tax return to elect portability of an unused exclusion amount. The IRS reported that it has received requests to make the transitional relief permanent and is considering those requests.

The final regs also reiterate that only the executor of the decedent's estate may file the estate tax return and make the portability election. Additionally, the final regs clarify changes to the application of the portability rules to qualified domestic trusts (QDOTs); the inclusion of a rule allowing a surviving spouse who becomes a U.S. citizen after the death of the deceased spouse to take into account the DSUEA of such deceased spouse; and explain that eligibility for credits against the tax imposed by Code Sec. 2001 does not factor into the computation of the DSUEA.

Reference: TRC ESTGIFT: 51,000.

IRS Reminds Taxpayers With Foreign Financial Assets Of FBAR/FATCA Obligations

IR-2015-86

In advance of the June 30, 2015, deadline for certain taxpayers to file Form 114, Report of Foreign Bank and Financial Accounts (FBAR), the IRS has issued a reminder of the tax reporting obligations associated with holding foreign financial assets. The IRS addressed FBAR reporting and compliance under the *Foreign Account Tax Compliance Act* (FATCA).

- ***Take Away.*** "Many of the same U.S. Persons subject to FATCA or FBAR should also be aware that they may be required to also prepare and file appropriate Forms BE-10, Survey of U.S. Direct Investment Abroad, with the Department of Commerce, Bureau of Economic Analysis (the "BEA")," Zion Levi, partner, Dearson, Levi & Pantz PLLC, Washington, D.C. told Wolters Kluwer. Generally, Forms BE-10 are now required from U.S. Persons if, at any time during fiscal year 2014, they owned or controlled, directly or indirectly, 10 percent or more in any business enterprise (whether incorporated or otherwise) located outside of the U.S. or any non-U.S. real property that produced income. Generally, the deadline for Forms BE-10 is either May 29, 2015, or June 30, 2015, depending upon circumstances and whether an extension is granted. For all U.S. Persons required to file for the first time, the BEA has extended the deadline to June 30, 2015. "Civil and criminal penalties may apply for noncompliance," Levi added.

FBAR

Generally, taxpayers with an interest in, or signature or other authority over, foreign financial accounts whose aggregate value exceeded $10,000 at any time during 2014 must file Form 114 with the Financial Crimes Enforcement Network (FinCEN) by June 30, 2015. FinCEN is a bureau of the Treasury Department.

FATCA

In general, federal law requires U.S. citizens and resident aliens to report any worldwide income, including income from foreign trusts and foreign bank and securities accounts. In most cases, affected taxpayers need to complete and attach Schedule B to their tax returns.

Certain taxpayers subject to FATCA reporting requirements must also complete and attach to their tax return Form 8938, Statement of Specified Foreign Financial Assets. Generally, U.S. citizens, resident aliens and certain nonresident aliens must report specified foreign financial assets on this form if the aggregate value of those assets exceeds certain thresholds. Taxpayers who do not have to file an income tax return for the tax year do not have to file Form 8938, regardless of the value of their specified foreign financial assets.

Thresholds. Generally, if the total value of an unmarried taxpayer's foreign financial assets is at or below $50,000 at the

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Internal Revenue Service

The IRS has cancelled a hearing on proposed regulations for determining AFR adjustments for tax-exempt obligations (NPRM REG-136018-13, I.R.B. 2015-11, 759). The hearing was scheduled for June 24, 2015.

Notice of Cancellation of Hearing,, NPRM REG-136018-13, FED ¶46,341; TRC ACCTNG: 36,162.05

The IRS has published the nonconventional source fuel reference price for calendar year 2014. The reference price for calendar year 2014 is $87.39.

Notice 2015-45, FED ¶46,340; TRC BUSEXP: 54,508.05

Filing Requirements

A married individual, who filed a head-of-household return, was not barred from subsequently filing a joint return for the same tax year because he did not file a separate return. Contrary to the Tax Court's finding, the Tax Code exclusively uses the phrase "separate return" to mean "married filing separately." Therefore, the individual's head of household return did not constitute a separate return under Code Sec. 6013(b)(1).

Ibrahim, CA-8, 2015-1 USTC ¶50,334; TRC FILEIND: 18,056.05

Income

The Eighth Circuit has affirmed the Tax Court's application of the six-year period of limitations under Code Sec. 6501(e)(1) where the taxpayer omitted gross income from a taxable Employee Stock Ownership Plan (ESOP) distribution into his traditional IRA. The amount of the 2003 plan distribution exceeded 25 percent of the taxpayer's gross income for the year.

Heckman, CA-8, June 10, 2015, 2015-1 USTC ¶50,333; TRC IRS: 30,150.

Deductions

An individual who was involved in "dressage," the breeding and showing of horses in a particular format, was not engaged in the activity for profit and could not deduct related expenses. The taxpayer was entitled to half of the her claimed deduction for legal expenses and all of her claimed deduction for interest expenses. An accuracy-related penalty was not proved by the IRS.

McMillan, TC, Dec. 60,325(M), FED ¶48,035(M); TRC BUSEXP: 3,054

The Tax Court properly held that a corporate taxpayer could not deduct capital losses generated from a paired-option transaction that lacked economic substance. The taxpayer was also denied a deduction for professional fees because it failed to prove that such expenses were ordinary and necessary business expenses. Since the paired-option transaction lacked economic substance, the costs associated with it could not be deducted as business expenses.

Humboldt Shelby Holding Corporation, CA-2, 2015-1USTC ¶50,329; TRC BUSEXP: 3,100

Frivolous Arguments

The Tax Court correctly concluded that an individual, who raised only frivolous arguments regarding her tax liability, was liable for tax as determined by the IRS and also additions to tax. The IRS settlement officer did not abuse her discretion in excluding the testimony of the individual's representative because he persistently raised only frivolous arguments. Finally, the appeals court imposed sanctions on the individual for bringing a frivolous appeal.

Carlson, CA-9, 2015-1 USTC ¶50,332; TRC LITIG: 3,152

Refund Claims

A married couple's claim for refund of tax paid on excess IRA contributions they failed to withdraw was dismissed. The couple failed to file their complaint within two years of receiving notice of the claim's disallowance. The couple sent a letter to the IRS that set forth in detail their request for a refund of "late-payment penalty" and "late-filing penalties" on returns filed for the years at issue, including that the filing delay was due to reasonable cause. Therefore, the letter constituted an informal refund claim.

Wu, DC Ill., 2015-1 USTC ¶50,336; TRC LITIG: 9,050

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International Filers

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end of the tax year, there is no reporting requirement for the year, unless the total value was more than $75,000 at any time during the tax year. The threshold is higher for individuals who live outside the United States and for married taxpayers.

- ***Comment.*** The FATCA Form 8938 requirement does not replace or otherwise affect a taxpayer's obligation to file an FBAR, the IRS reminded taxpayers.

Reference: TRC FILEBUS: 9,108.20.

Reversing District Court, Eleventh Circuit Rejects Res Judicata And Upholds IRS Claims Against Estate

The Eleventh Circuit Court of Appeals, reversing a federal district court, has rejected a taxpayer's claim of res judicata and upheld the IRS's assessment of additional income taxes. The Eleventh Circuit also upheld the IRS's denial of a double deduction against income taxes and estate taxes.

The district court applied res judicata. Res judicata applies if both cases involve the same cause of action—a rights and duties test—and the same facts, the appeals court stated. Here, the cases involved two different tax liabilities and two different causes of action: a corporate income tax and transferee liability in one case; an individual's income taxes from capital gains and interest income in the other case. Therefore, the two cases were factually distinct, the court held.

Batchelor-Robjohns, CA-11, June 5, 2015, 2015-1 USTC ¶50,330; TRC LITIG: 3,050.

Tax Briefs

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Collection Due Process

A Collection Due Process (CDP) hearing determination was remanded to Appeals for the Appeals officer to reconsider his determination to reject a taxpayer's collection alternative, which would have reinstated a terminated partial payment offer-in-compromise (OIC). The case was remanded to Appeals to reconsider its determination not to reinstate the OIC agreement and to provide a full explanation of its reasons for its determination.

Quality Software Systems Inc., TC, Dec. 60,323(M), FED ¶48,033(M); TRC IRS: 42,152

An IRS settlement officer did not abuse her discretion in upholding a levy action against a corporation. The corporation, and its sole shareholder and officer as its representative, did not raise any relevant issues or defenses to the collection action, nor did they offer any collection alternatives. The IRS prepared substitutes for return using the bank deposits method to reconstruct the corporation's income for the tax years in which it had not filed tax returns. The corporation was liable for additions to tax for for failure to timely file tax returns, failure to timely pay tax, and failure to pay estimated income tax.

Epitome Systems, Inc., TC, Dec. 60,324(M), FED ¶48,034(M); TRC FILEBUS: 6,052.05

A settlement officer (SO) properly sustained a proposed levy against an individual who failed to provide financial information or propose a collection alternative at his Collection Due Process (CDP) hearing. There was no basis for the individual's assertion that the IRS was barred from trying to collect the tax due while his case was on appeal because he failed to file an appeal bond.

S. Natkunanathan, TC, Dec. 60,322(M), FED ¶48,032(M); TRC LITIG: 6,966

Bankruptcy

A debtor couple's self-directed individual retirement account (IRA) was not exempt from their bankruptcy estate. The IRA lost its tax-exempt status under Code Sec. 408 before the debtors filed for bankruptcy because the husband directed the IRA to engage in prohibited transactions with disqualified persons.

In re Kellerman, BC-DC Ark., 2015-1 USTC ¶50,331; TRC RETIRE: 48,204

Transferee Liability

The Tax Court erred in holding that the IRS could not impose the tax liability of a defunct broadcasting company on its shareholders as transferees. Therefore, the case was remanded to the Tax Court to apply proper legal standard laid down under the two-prong test in *Stern*, SCt, 58-2 USTC ¶9594.

Slone, CA-9, 2015-1 USTC ¶50,335; TRC IRS: 30,124

Retirement Plans

For pension plan years beginning in June 2015, the IRS has released the 30-year Treasury bond weighted average interest rate, the unadjusted segment rates, Highway and Transportation Funding Act of 2015 (HATFA) (P.L. 113-159) adjusted rates, the Moving Ahead for Progress in the 21st Century (MAP-21) Act (P.L. 112-141) adjusted rates, and the minimum present value segment rates.

Notice 2015-42, FED ¶46,338; TRC RETIRE: 15,304.10.

Corporate Partner

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did not distribute the stock to the corporate partner or a controlling corporation.

Distributions of stock

The regs eliminate the distribution rule but extend the deemed redemption rule to certain distributions to the corporate partner of its stock. The regs deem that 100 percent of the distributed stock goes to the corporate partner and that a reduced interest in other partnership property is allocated to other partners. The regs do not apply if Code Sec. 732(f) applies to the distribution (see related story in this issue).

It is unclear under existing law whether a corporate partner receiving a distribution of its own stock has basis in that stock. The regs require the partnership and the corporate partner to determine the basis of other distributed property and any retained partnership interest using the partnership's basis in the distributed stock.

References: FED ¶¶47,019, 49,651; TRC CCORP: 21,400.

IRS Extends Disaster Relief To More Oklahoma Counties

The IRS has updated its May 27, 2015, notice granting tax relief to victims of severe storms, tornadoes, straight-line winds and flooding that took place beginning on May 5, 2015 in parts of Oklahoma. The June 15, 2015, update provides that the previously announced relief is now extended to certain individuals who reside or have a business in Beckham, Caddo, Canadian, Marshall, McIntosh, Seminole and Wagoner counties.

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

Pre-Approved Plans

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Remedial amendments

The IRS provides a system of cyclical amendment periods for retirement plans to update their provisions. Every pre-approved plan must be submitted to the IRS for a new opinion or advisory letter every six years. The second remedial amendment cycle for pre-approved DB plans extends from February 1, 2013, to January 31, 2019.

The submission period for sponsors and VS practitioners to seek opinion and advisory letters during the second cycle was scheduled to end June 30, 2015. In Rev. Proc. 2015-36, the IRS further extended the submission deadline to October 30, 2015. Plan sponsors must follow the 2012 Cumulative List of Changes in Plan Qualification Requirements.

References: FED ¶46,337; TRC RETIRE: 51,100.

PRACTITIONERS' CORNER

Can Summer Camp Costs Qualify For A Tax Credit?

Now that summer 2015 is officially here and the main filing season is out of the way, tax planning may be far from your mind. However, typical summer traditions can yield tax benefits. For example, when school lets out for the summer, some parents may decide to send their young children to summer camp. Whether parents do this to supplement their children's education, enhance their athletic skills, provide social opportunities, or simply to get them out of the house, some working parents may be able to deduct certain expenses associated with the cost of sending children to day camp. This Practitioners' Corner will discuss the child care and dependent credit under Code Sec. 21, particularly in the context of summer day camp.

Child care and dependent credit basics

A taxpayer, who incurs expenses to obtain day care for child under age 13 so that the taxpayer and his or her spouse can be gainfully employed (or look for gainful employment), may be able to claim the child care and dependent tax credit on Form 1040, (line 49), Form 1040A (line 31), or Form 1040NR (line 47). Taxpayers may also claim the credit for expenses paid for care for certain other qualifying individuals, such as physically or mentally incapacitated dependents.

Taxpayers who qualify for the child and dependent care tax credit must claim it by completing and filing Form 2441, Child and Dependent Care Expenses, along with their tax returns.

- ***Comment.*** Taxpayers may not claim the credit if they file a Form 1040EZ, Income Tax Return for Single and Joint Filers With No Dependents, or Form 1040NR-EZ.

A taxpayer who qualifies may claim a credit in an amount between 20 to 35 percent of employment-related child care expenses. Such expenses can include the cost of sending a child to day camp, something that can run up a hefty bill of more than $100 or $500 per week.

In general, to claim the child and dependent care credit, the taxpayer must meet the following requirements:

- The taxpayer must live with the child(ren) or qualifying person(s) for more than half of the tax year;
- The child and dependent care expenses must be incurred to allow the taxpayer to work or look for work. (If the taxpayer or the spouse is a stay-at-home parent, unfortunately, the child care costs are nondeductible);
- The taxpayer must have income from work during the year. (The amount of the employment-related expenses taken into account in calculating the child and dependent care credit may not exceed the lesser of the taxpayer's earned income or the earned income of his spouse if the taxpayer is married at the end of the tax year);
- The taxpayer must have made payments for child and dependent care to someone the taxpayer or his spouse could not claim as a dependent. If the person to whom payments were made was the taxpayer's child, the child must have been 19 or over by the end of the year;
- If married, the taxpayer must file a joint return (unless an exception applies);
- The taxpayer must include the taxpayer identification number of the qualifying individual on the return;
- The taxpayer must provide specified information regarding service providers, including the name, address and taxpayer identification number (TIN) of the provider (no TIN is required if the provider is a tax-exempt organization);
- A taxpayer must substantiate any child and dependent care credit claimed by providing adequate records or other sufficient evidence of work-related expenses, etc.

"Some working parents may be able to deduct certain expenses associated with the cost of sending children to day camp."

Summer camp costs

Because day camp is comparable to day care, the IRS allows taxpayers to factor in the costs of sending a child to day camp when determining the amount of the child and dependent care credit they may claim. The cost of sending a child to a day camp may be a work-related expense, even if the camp specializes in a particular activity, such as computers, music, football, or soccer. Furthermore, taxpayers are not required to seek out the least expensive day camp option in order to claim the credit. The IRS regs provide that "the manner of providing care need not be the least expensive alternative available to the taxpayer."

Reg. §1.21-(1)(d)(6) provides that the cost of sending your child to an overnight camp, however, is *not* considered a work-related expense. Similarly, summer school and tutoring programs are not considered to be for the care of a qualifying individual and the costs are not employment-related expenses.

The regs under Code Sec. 21 provide two examples intended to outline the distinction between a summer day camp for which expenses are deductible and a tutoring program, for which expenses are nondeductible. They state: To be gainfully employed, Nina sends her 9-year old child to a summer day camp that offers computer activities and recreational activities such as swimming and arts and crafts. The full cost of the summer day camp may be for deductible care. In contrast, to be gainfully employed, Olivia sends her 9-year old child to a math tutoring program for two hours per day during the summer. The cost

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WASHINGTON REPORT *by the Wolters Kluwer Washington News Bureau*

House appropriators propose cut to IRS FY 2016 budget

The House Appropriations Subcommittee for Financial Services and General Government on June 11 approved a fiscal year (FY) 2016 funding bill of $10.1 billion for the IRS, representing a cut of $838 million below FY 2015 and $2.8 billion below President Obama's budget request. The bill also designates $2.2 billion for improvements to taxpayer services. The FY 2016 IRS funding bill now goes to the full House Appropriations Committee for consideration. The National Treasury Employees Union (NTEU), which represents IRS employees, urged lawmakers not to cut the agency's budget for FY 2016. NTEU President Colleen Kelley predicted that additional reductions in funding would impair the agency's ability to undertake its core activities. GOP lawmakers countered that the agency has adequate resources to focus on its core activities of tax collection and taxpayer services.

Senate approves public safety officer retirement bill

The Senate has approved the Defending Public Safety Employees' Retirement Bill (HR 2146), which would allow federal public safety officials to access retirement savings at the age of 50 after 20 years of service without the application of any penalty. The bill was approved in the House on May 12 by a vote of 407 to 5. Senate lawmakers approved the legislation by unanimous consent. Under current law, a penalty is generally added on top of normal tax amounts taken out of retirement accounts before the age of 59-1/2. In 2006, Congress recognized that state and local public safety officials should be able to access their accounts without penalty at age 50 because many of them are eligible to retire at earlier ages due to the hazardous nature of their work. An amendment in the Senate by Sen. Pat Toomey, R-Pa., made a technical timing change that will require the measure to return to the House for final approval.

Concerns raised over final Code Sec. 174 regs

The American Institute of Certified Public Accountants (AICPA) recently expressed concern about how IRS examiners may interpret some provisions of final regs under Code Sec. 174. The AICPA urged the IRS to provide audit protection to taxpayers making accounting method changes for mischaracterized Code Sec. 174 expenditures.

"There has always been some uncertainty for taxpayers making certain types of method changes for the treatment of 174 expenses, " Joe Stoddard, partner, Eide Bailly LLP, National Tax Office, told Wolters Kluwer. "The comments by the AICPA reflect the need for additional guidance and clarity for the procedures for making these method changes, especially in light of the regulations recently finalized with respect to pilot models."

The IRS issued final regs under Code Sec. 174, on the deduction for research and experimentation expenditures in 2014. The final regs addressed the treatment of amounts incurred in the development of products, including inventions, pilot models, and patents. The final regs retained the so-called shrinking-back rule. The IRS explained that the shrinking-back rule is designed to ensure a deduction where a product's basic design specifications have been established, but there is uncertainty for certain components of the product. To avoid confusion with the shrinking-back rule of Code Sec. 41, the IRS changed the name of the rule to Application of section 174 to components of a product.

The AICPA expressed concerns that IRS examiners potentially could misapply the shrinking-back rule in the final regs to exclude from Code Sec. 174 eligibility certain expenditures, such as those related to integration testing activities. According to the AICPA, taxpayers seeking to correct prior mischaracterizations of research and experimentation expenditures should treat these corrections as accounting method changes effected with a Code Sec. 481(a) adjustment. Additionally, the AICPA recommended that taxpayers should receive audit protection incident to the filing of a method change request to correct the mischaracterization of research and experimentation expenditures incurred in tax years prior to the year of change.

"The proposed changes and guidance requested by the AICPA would be of particular significance to taxpayers that incur significant supply expenses for building prototypes, including companies in the manufacturing, equipment, aerospace and defense, automotive, and similar industries," Stoddard noted. "Other companies that have mischaracterized 174 expenses in the past would also benefit from additional guidance in this area."

Boustany sees international issues driving tax reform

Lawmakers cannot address tax reform without considering international issues, House Ways and Means Committee member Charles Boustany, R-La., told an audience attending the 26th Annual Legislative Seminar sponsored by the law firm of BakerHostetler on June 10 in Washington, D.C. "What is driving U.S. tax reform is international taxation and we know that our Tax Code has become very outdated relative to our foreign counterparts causing U.S. based companies to lose their competitive edge in worldwide business markets," Boustany said. "I would submit that we cannot just look at tax reform here in America without considering what's happening globally."

Hatch, Ryan urge Treasury to engage Congress on OECD project

Senate Finance Committee Chair Orrin Hatch, R-Utah, and House Ways and Means Committee Chair Paul Ryan, R-Wisc., recently called on Treasury Secretary Jack Lew to work with Congress to ensure the international tax proposals being considered by the Organisation for Economic Co-operation and Development (OECD) are beneficial to American workers and job creators. The OECD is working on a Base Erosion and Profit Sharing plan (BEPS). "As your BEPS discussions continue and proposals are considered, we strongly encourage you to continue engagement with us and to solicit input from the tax writing committees," Hatch and Ryan wrote to Lew.

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of the tutoring program is not for care.

- ***Comment.*** According to the IRS, the question of whether or not an expense qualifies for the dependent care credit depends on the nature and primary purpose of the services provided and is primarily a question of fact. In order for an expense to qualify in full for the dependent care credit, any portion of the expense for purposes other than care must be minimal or insignificant and inseparable from the portion of the expense for care. If a significant portion of the expense is for purposes other than care, an allocation must be made as to which portion of the costs are for deductible care and which portion of the costs are for other purposes. An expense that is primarily for a purpose that is not care, such as education, does not qualify for the dependent care credit.

Other deductible costs. Amounts paid for clothing, schooling and entertainment are not considered qualified expenses for purposes of calculating the child care and dependent credit. However, if these amounts are incident to and cannot be separated from the cost of caring for the qualifying person, the regs provide that these expenses can be counted toward the credit for qualified dependent care. This means that costs to purchase clothing, horseback riding chaps, soccer cleats, football padding, violin strings, or other gear that may be used by the child while at the day camp are nondeductible because they are technically personal in nature and not for the well-being of the child. However, if the day camp provides a lunch and snacks to the children attending the day camp, the regs provide that the cost of this lunch and the snacks may be included in the cost of care for the child if they are incidental to and inseparably a part of the care.

The cost of transporting a qualifying individual to a place where care is provided is not generally a qualifying expense, unless it is provided by a dependent care provider. If a day camp takes a child or qualifying person to or from the day camp location, that transportation is for the care of the child. This includes transportation by bus, subway, taxi, or private car.

An expense incurred for the care of a child or a dependent sometimes can be treated as a medical expense or as a child/dependent care expenses. Any part of an expense that is used for the credit cannot be taken into account when computing the medical expense deduction. Conversely, an amount that is taken into account for purposes of the medical expense deduction cannot be treated as an employment-related expense for credit purposes. For most taxpayers, using the expenses for the credit will produce greater tax benefits than using them for the medical expense deduction.

Forfeited amounts. A taxpayer may include the cost of fees paid to an agency to get the services of a day camp provider, including deposits and application fees. However, if the taxpayer changes his or her mind and either does not send the child to day camp or selects another program, any forfeited deposit will not be considered "for the care of a qualifying person" and will therefore become nondeductible.

Credit amount

The amount of the child care and dependent credit is subject to a cap calculated as a percentage of the taxpayer's employment-related expenses, as well as a dollar limit. A maximum credit of 35 percent of employment-related expenses is available to taxpayers with adjusted gross income (AGI) of $15,000 or less. The credit percentage is reduced by one percentage point for each $2,000 of adjusted gross income, or fraction thereof, above $15,000. The minimum credit percentage is 20 percent, and it applies to taxpayer with AGI in excess of $43,000.

In addition, the maximum amount of eligible expenses that may be used to calculate the final credit amount is $3,000 for taxpayers with one qualifying individual, and $6,000 for taxpayers with two or more qualifying individuals. Therefore, the maximum credit amount is $1,050 for taxpayers claiming expenses for one child and $2,100 for taxpayers claiming expenses related to two or more children.

- ***Comment.*** Any child care benefits provided by an employer will reduce dollar-for-dollar the amount of expenses a taxpayer may use to calculate the credit.
- ***Comment.*** The child care and dependent credit is nonrefundable, meaning that if the taxpayer already has no tax liability for the year in which he or she incurred qualified expenses for purposes of the credit, he or she will receive no tax benefit from claiming the credit.

What lies ahead for the tax credit

The cost of childcare can be pricey. As such, lawmakers including President Obama, Sen. Bob Casey, D-Pa., and Sen. Patty Murray, D-Wash., have called for certain enhancements to the child and dependent care credit. In his March 2015 State of the Union Address, President Obama proposed tripling the maximum child and dependent care credit for families with children under five. The maximum credit would be $3,000 per child. In addition, the maximum credit amount would be available to families with incomes up to $120,000.

Senator Casey endorsed the President's proposed enhancements. In addition, Casey's plan would make the credit refundable so that families making less than $20,000 a year (and who generally have no income tax liability) would be able to reap a benefit from their childcare costs in the form of a higher tax refund. Senator Murray's plan would go a step further and make the increased credit available to all qualifying families with children under 13. None of these proposals, however, has seen serious discussion within any of the Congressional committees, let alone the House or Senate floor.

COMPLIANCE CALENDAR

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.

June 26

Employers deposit Social Security, Medicare, and withheld income tax for June 20, 21, 22, and 23.

June 30

U.S. persons with financial interests in or signature authority over foreign financial accounts generally must electronically file FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR) if, at any point during the 2014 calendar year, the aggregate value of the accounts exceeds $10,000. FinCEN has announced some limited exceptions.

July 1

Employers deposit Social Security, Medicare, and withheld income tax for June 24, 25, and 26.

July 6

Employers deposit Social Security, Medicare, and withheld income tax for June 27, 28, 29, and 30.

July 8

Employers deposit Social Security, Medicare, and withheld income tax for July 1, 2, and 3.

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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FROM THE HELPLINE

The following questions have been answered recently by our "Wolters Kluwer Tax Research Consultant" Helpline (1-800-344-3734).

Q Are there any circumstances under which a C Corp may use the cash-basis method of accounting?

A Yes. Although generally Code Sec. 448 provides that a regular (C) corporation may not use the cash-basis method of accounting, there are exceptions. Exceptions to the prohibition for corporations are allowed for farming businesses and qualified personal service corporations. In addition, corporations and partnerships are excepted if the entity or its predecessor satisfies the $5 million gross receipts test for prior tax years. An entity meets the $5 million gross receipts test for any prior tax year if the average annual gross receipts for the three tax years ending with the prior tax year do not exceed $5 million. *See TRC ACCTNG: 6,050.*

Q Who is a "material advisor" for purposes of reporting a listed transaction to the IRS?

A Code Sec. 6111(b)(1) defines a material advisor as any person who: (1) provides any material aid, assistance, or advice with respect to organizing, managing, promoting, selling, implementing, insuring, or carrying out any reportable transaction; and (2) directly or indirectly derives gross income for the advice or assistance in excess of a threshold amount.

For returns due after October 22, 2004, a penalty is imposed on material advisors who fail to properly file the required information returns. The penalty is imposed if: (1) the material advisor fails to file the required return on or before the date it is due; or (2) the material advisor files a false or incomplete information return. *See TRC PENALTY: 3,254.05.*