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INSIDE THIS ISSUE

IRS Will Adopt Regs To Deter Conversion Of Pension Plan Annuities To Lump Sums

Notice 2015-49

The IRS has announced that it will issue regs to limit the ability of plan sponsors to offer lump sum options to pension plan participants currently receiving annuities benefits. The new rules generally take effect July 9, 2015, while allowing some conversions authorized before July 9.

- ***TakeAway.*** "Policy concerns take center stage with the IRS Notice -- using a very technical IRS regulation focused on mandatory distributions at age 70-1/2 to end a very popular method for plan sponsors to manage their pension costs through a lump sum window," Elizabeth Thomas Dold, Principal, The Groom Law Group Chartered, Washington, D.C., told Wolters Kluwer. "Although the Notice is limited to individuals already in pay status, and we don't anticipate any changes for plan terminations, it is clear that the agencies are taking a protective employee stance and are working hard to ensure lifetime benefits," Dold said.
- ***Comment.*** The IRS referred to these conversion programs as lump sum risk-transferring programs, "because longevity risk and investment risk are transferred from the plan to the retirees." The measure is consistent with other actions by the federal government to increase retirement security for pension plan participants by enabling them to take annuity benefits over their lifetime, rather than as a lump sum.

Background

In Notice 2015-49, the IRS stated that a number of defined benefit (DB) plan sponsors have amended their plans to provide a window for retirees currently receiving lifetime annuity benefits to elect to convert the annuity into a lump sum payable immediately. As part of the transfer of risk, the IRS noted, participants with the ability to accelerate distributions would receive smaller initial benefits, based on the actuarial cost of the acceleration.

- ***Comment.*** The IRS cited a 2015 Government Accountability Office (GAO) report stating that participants potentially face a reduction in their retirement assets when they accept a lump sum offer and an increased risk of outliving their assets. The GAO identified 22 plan sponsors who have offered lump sum windows in 2012 (generally before benefits began), involving almost 500,000 participants and lump sum payouts over $9.25 billion.

Under Code Sec. 401(a)(9) and the related regs, if a participant's entire interest under a qualified plan has not been distributed by the retired beginning date, the benefit must be paid over the life of the employee (or the employee and a designated beneficiary), in the form of periodic annuity payments. Generally, the form of the payments cannot be changed after they commence, and benefits must not increase.

- ***Comment.*** One exception allows a beneficiary to convert the survivor portion of an annuity, after the participant dies, but not while the employee is still living.

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IRS Designates "Basket Option Contracts," "Basket Contracts" As Reportable Transactions

Notice 2015-47, Notice 2015-48

The IRS has identified "basket option contracts" as a listed transaction and "basket contracts" as a transaction of interest. The designations are retroactive to transactions in effect on or after January 1, 2011 and apply to substantially similar transactions.

- ***TakeAway.*** In AM-2010-005, the IRS determined that the basket contract, although labeled as an option, lacks the essential economic and legal characteristics of an option. "An option only makes sense economically if the option holder's cost of failing to exercise is lower than the holder's potential liability had he or she instead entered into and breached a contract to buy or sell the underlying property." A contract that provides a taxpayer with dominion and control over a basket of securities, the opportunity for full gain and income, and substantially all of the risk of loss, provides to the taxpayer beneficial ownership of the securities for tax purposes, the IRS determined. Therefore, the taxpayer must currently recognize the trading gains, losses, income, or expense resulting from trading and holding the securities in the basket.
- ***Comment.*** The IRS advised taxpayers who have filed returns claiming the purported tax benefits of these transactions to take appropriate corrective action and ensure that their transactions are disclosed properly.

Background

The IRS reported that it has become aware of certain structured financial transactions (known as basket option contracts), where a taxpayer attempts to defer income recognition and convert short-term capital gain and ordinary income to long-term capital gain using a contract denominated as an option contract. In some cases, taxpayers are mischaracterizing a transaction as an option to avoid application of Code Sec. 1260, U.S. tax liability under Code Sections 871 and 881, and withholding and reporting obligations. In response, the IRS has designated basket option contracts and substantially similar transactions as listed transactions.

The IRS also reported that it has become aware of certain structured financial transactions (basket contracts) where a taxpayer attempts to defer income recognition and may attempt to convert short-term capital gain and ordinary income to long-term capital gain through a contract denominated as an option, notional principal contract, forward contract, or other derivative contract. Basket contracts (and substantially similar transactions) are now designated as transactions of interest.

- ***Comment.*** The IRS described some of the arguments it may use to challenge the purported tax treatment of these and substantially similar transactions.

Disclosure

Taxpayers engaged in basket option contract transactions in effect on or after January 1, 2011, must disclose the transactions for each tax year in which the taxpayer

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Annuities

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Proposal

Another exception allows plans to pay increased benefits that result from a plan amendment. Treasury and the IRS intend to amend Reg. Sec. 1.401(a)(9)-6, Q&A-14(a)(4) to limit this exception to benefit increases that increase the ongoing annuity payments, not to amendments that accelerate the annuity payments, even if the plan amendment also increases the annuity payments.

- ***Comment.*** The proposed amendments will not apply to lump-sum options available before a participant begins to receive benefits.

The amendments to the regs will take effect July 9, 2015. If the IRS issues a private letter ruling or determination letter on a plan that has a lump sum risk-transferring program, the ruling will include a caveat expressing no opinion on the tax consequences of the program.

The new regs will not apply to certain existing acceleration programs and plan amendments (identified as a pre-notice acceleration):

- Where the plan amendment was adopted or authorized before July 9, 2015;
- Where the IRS issued a ruling or determination prior to July 9, 2015;
- Where the plan notified participants of the program before July 9, 2015; or
- Where the plan and an employee representative entered into a binding agreement for the plan prior to July 9, 2015.

Information for participants

Notice 2015-49 does not discuss the information that a plan sponsor must provide

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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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Agencies Issue Final Regs To Implement ACA Preventive Services

TD 9726

The IRS and Departments of Labor (DOL) and Health and Human Services (HHS), the federal agencies that administer the *Affordable Care Act* (ACA), have issued final regs to implement the Supreme Court's decision providing an exemption to for-profit religious employers that object to providing insurance coverage for contraceptive services. At the same time, the regs require that employees with health insurance coverage have access to no-cost contraceptive services through the insurance plan's issuer or third-party administrator, consistent with ACA.

- ***Take Away.*** The statute and federal regs provide an exemption from contraceptive coverage for religious nonprofit employers. In *Burwell v. Hobby Lobby Stores, Inc.*, 2014-2 USTC ¶50,341, the Supreme Court ordered that the Agencies provide a similar accommodation to for-profit religious employers. In *Wheaton College v. Burwell* (SCt. 2014), the Court ordered that the agencies provide an alternative process for religious employers to notify the government of their objection to providing contraceptive coverage. The final regs implement both of these requirements.

Background

The three federal agencies issued interim final regs in 2010 and 2011 that require health insurance plans to cover preventive services at no-cost, including contraceptive services, except for group health plans maintained by certain religious employers. The agencies issued regs in 2012 and 2013 that limited the definition of a religious employer to certain nonprofit organizations. The agencies also required employers to use DOL Form 700 to notify the federal government of their religious objections.

In 2014, after *Hobby Lobby*, the agencies issued proposed regs that expanded the definition of an "eligible organization" (entitled to a religious exemption) to "closely-held" for-profit employers. At the same time, following *Wheaton*, the agencies issued interim final regs to allow religious employers to ignore Form 700 and provide notice in writing to HHS through a simplified process.

The final regs finalize the interim regs on coverage of preventive services, the proposed regs defining religious organizations, and the interim regs requiring an eligible employer to provide notice of its objections. The regs on preventive services are not controversial, although the government received extensive comments on them.

Final regs

The final extend the contraceptive exemption to a for-profit entity that is not publicly traded, is majority-owned by a small number of individuals, whose owners object to contraceptive based on their religious beliefs. The owners must be closely-associated and personally identified with the organization, and be regarded as conducting personal business affairs through the entity.

The regs adopt a tax definition of a closely-held for-profit employer – more than 50 percent of the value of ownership interests must be owned directly or indirectly by five or fewer individuals. In a significant concession, the regs provide an exemption to entities with an "ownership structure that is substantially similar" to the 5/50 standard, such as an entity where six individuals own 49 percent, or a tiered entity where the ultimate stockholders have religious objections.

The agencies affirmed that eligible organizations must give notice of their objections to the federal government. The notice must provide the organization's name, the extent of its objections, the plan name and type, and contact information for any third-party administrator (TPA) or insurance issuer. HHS and DOL will contact TPAs and issuers, who remain responsible for providing contraceptive coverage without cost-sharing.

References: FED ¶47,022; TRC COMPEN: 45,228.

Annuities

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to participants regarding an option to accelerate benefits. GAO noted that although participants received some important information about the lump sum offer, plan sponsors "consistently lacked key information needed to make an informed decision."

GAO also pointed out that few plan sponsors informed participants of existing benefit protections provided by the PBGC for the annuity benefits provided by the plan, a key omission, GAO said, because many participants chose a lump sum because they feared a sponsor default.

References: FED ¶46,360; TRC RETIRE: 42,170.10.

Reportable Transactions

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participated in the transactions, provided that the period of limitations for assessment of tax had not ended on or before July 8, 2015. Similarly, taxpayers engaged in basket transactions (and substantially similar transactions) entered into on or after November 2, 2006, and in effect on or after January 1, 2011, must disclose the transactions for each tax year in which the taxpayer participated in the transactions, provided that the period of limitations for assessment of tax had not ended on or before July 8, 2015.

Material advisors. Material advisors who make a tax statement on or after January 1, 2011, with respect to basket option contract transactions in effect on or after January 1, 2011, have disclosure and list maintenance obligations under Code Sections 6111 and 6112. Similarly, material advisors who make a tax statement on or after January 1, 2011, with respect to basket transactions in effect on or after January 1, 2011, have disclosure and list maintenance obligations under Code Sections 6111 and 6112.

- ***Comment.*** Failure to make the required disclosures may trigger penalties, such as penalties under Code Sec. 6707A.

References: FED ¶¶46,358, 46,359; TRC FILEBUS: 9,458.05.

IRS Approves Transfers From Defined Contribution Plan To Defined Benefit Plan To Obtain Annuity Benefit

LTR 201527041

The IRS has determined that participants in a defined contribution (DC) plan who have terminated employment may make a one-time election to transfer their account balances to a defined benefit (DB) plan maintained by the same employer, and may immediately receive an annuity from the DB plan. The transfer of the account balance will not be taxable to the participant and will not be subject to an early distribution penalty.

- ***Take Away.*** The letter ruling cites Rev. Rul. 2012-4, which was part of an IRS/Treasury initiative to increase retirement payout options. Participants have greater flexibility to obtain lifetime annuity benefits, so that they will not outlive their retirement benefits. Rev. Rul. 2012-4 clarified that employees receiving a lump sum from their employer's 401(k) plan can use the lump sum to purchase an annuity from the employer's DB plan. The ruling is designed to give employees access to the DB plan's relatively low-cost annuity purchase rates.

Background

A county government maintains a DC plan and a DB plan. Each plan qualifies as a governmental plan under Code Sec. 414(d) and a qualified plan under Code Sec 401(a). The county intends to permit participants of the DC plan who have terminated employment to irrevocably elect to transfer their account balance to the DB plan. The participant would make the transfer before receiving any benefits from the DC plan. The amount transferred to the DB plan would be immediately annuitized and paid to the participant as a single life or joint and survivor annuity.

IRS analysis

The IRS ruled that, regardless of whether the participant has an existing benefit from the DB plan:

- The transfer of assets is permissible.
- The participant will not be taxable on the amount transferred under Code Sec. 72(t) (early distributions); 401(k), or 402, or under the constructive receipt doctrine.
- The annuity benefit will not be subject to the limitation on benefits under Code Sec. 415(b) on the amount transferred, unless the benefit is larger than that determined under Code Sec. 411(c).

The IRS concluded that the amounts transferred are eligible rollover distributions from one qualified plan to another, and the employee's elective transfer is a nontaxable direct rollover under Code Sec. 401(a)(31). The 415(b) limits do not apply to either employee contributions or rollover contributions. However, if the plan uses more favorable factors than the applicable interest rate and mortality table under Code Sec. 417(e), any additional annuity benefit derived from those factors would be included in the annual benefit subject to Code Sec. 415(b).

Reference: TRC RETIRE: 45,050.

Tax Court Denies Compensation Deduction To Corporation; Shares Transferred To Owner/Employee Not Subject To Code Sec. 83

QinetiQ U.S. Holdings, Inc., TC Memo. 2015-123

The Tax Court has found that shares transferred to an owner/employee of a corporation were for investment and were not subject to Code Sec. 83. Therefore, the corporation was not entitled to deduct the value of the shares as compensation.

- ***Take Away.*** The court concluded that the shares were not transferred in connection with the performance of services and that, even if they were, the shares were not subject to a substantial risk of forfeiture. Since there was no transfer for services, the employer was not entitled to a compensation deduction under Code Sec. 83. If the transfer had been for services, the shares would have vested in a prior year, because there was no substantial risk of forfeiture, and any deduction should have been taken in the prior year.

Background

Individual H formed an S corp in 2002; individual C joined the business in the same year. In December 2002, H paid $450 for 4,500 shares of the corporation's class A voting common stock (50.25 percent of the voting shares). C also paid $450, receiving 4,455 of the class A stock (49.75 percent of the voting shares) and 45 shares of class B nonvoting common stock. A director's resolution said that the stock was purchased for investment. In 2007, the corporation transferred additional shares of class B stock to both C and H.

H and C each entered into an employment agreement with the corporation that was silent on any stock transfer for services. From 2002 through 2007, H and C reported their shares of the corporation's earnings that were allocated to them as stockholders. The corporation did not report any portion of the stock value as wages and did not pay any employment taxes.

In September 2008, a director's resolution said that certain shares held by employees were subject to restrictive stock agreements providing for redemption of the stock at less than fair market value. The resolution said that the redemption option was a substantial

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Income From Hedging Transactions Not Included In REIT Gross Income Tests, IRS Rules

LTRs 201527012, 201527013

The IRS has concluded, in identical private letter rulings, that income earned by a real estate investment trust (REIT) from hedging transactions does not have to be included in gross income when applying the statutory gross income tests. The ruling applies to income from both "Original Hedges" and "Counteracting Hedges."

- ***Take Away.*** There are two gross income tests that require a REIT to earn a major portion of its gross income from real property and other qualified sources. Ninety-five percent of the REIT's income must stem from dividends, interest, rents from real property, and certain other items listed in Code Sec. 856(c)(2); 75 percent of the REIT's gross income must be derived from rents from real property and certain items listed in Code Sec. 856(c)(3). Since hedging income is not qualified income, excluding it from these calculations helps the REIT meet the two income tests.

Background

A REIT invests primarily in mortgages on real property and mortgage-backed securities. The mortgages generally are long-term debt with a fixed interest rate. The REIT seeks to hold a mortgage for a long period and to maintain a constant level of short-term financing on the mortgage. The taxpayer finances its mortgages with short-term borrowings, including repurchase agreements (repos).

- ***Comment.*** In a repo, the REIT sells mortgages to a counterparty and, simultaneously, agrees to repurchase the mortgages at a fixed date for a fixed price. A repo has a term of a specified number of days and an interest rate based on LIBOR.

At maturity, the REIT may choose to enter into a new repo, whose proceeds are used to repay the old repo. By rolling over a repo, at new rate of interest, the REIT in effect is using a long-term loan with a floating interest rate. The REIT also uses other types of financing with a floating interest rate.

Accordingly, the REIT is subject to the risk of changing interest rates on the debt it uses to carry its real estate assets. The taxpayer enters into various hedging transactions, such as interest-rate swaps, to hedge its risk of changing interest rates (Original Hedges). At times, the REIT needs to reduce the amount of its current hedging transactions. To do this, the REIT finds it more desirable to enter into a Counteracting Hedge, rather than terminate an existing hedge.

IRS analysis

A hedging transaction includes a transaction designed to manage the risk of interest rate changes. Income from a hedging transaction is not gross income for the 95 and 75 percent income tests, provided the transaction hedges debt incurred by the REIT to carry real estate assets. The transaction must be properly identified as a hedge on the day acquired. A hedging transaction includes a transaction entered into to offset another hedging transaction. The IRS ruled income from the REIT's Original and Counteracting Hedges may be excluded from gross income when applying the income tests for REITs.

- ***Comment.*** The IRS expressed no opinion on whether the taxpayer qualifies as a REIT under Code Sec. 856 and that the hedges qualify as hedging transactions under Code Sec. 1221(a)(7).

Reference: TRC RIC: 6,054.05.

Compensation Deduction

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risk of forfeiture. In October 2008, an outside corporation purchased all the shares of the S corp for $123 million and merged the two corporations. A director's resolution at the same time stated that class B shares granted to employees would vest immediately before the purchase and merger.

The acquiring corporation (the taxpayer) claimed a compensation deduction of $117 million. Consistent with this deduction, H and C reported their respective shares of this payment as wage income. The IRS challenged the compensation deduction. The taxpayer claimed that the stock transferred to C in 2002 was for the performance of services and did not vest until 2008.

Transfer for services

The taxpayer failed to prove that the transfer of stock to C in 2002 was in connection with the performance of services. H, C, and the S corporation all represented that C had outright unrestricted ownership of his stock. The corporation distributed income and losses to C as if he owned the shares as fully vested and outstanding stock. C also voted and signed corporate documents as an owner. In contrast to the agreements with C, when the corporation transferred stock to other employees for services, its restrictive stock agreements specifically stated that the transfers were made in consideration of employment.

Substantial risk of forfeiture

The Tax Court held that the "crux" of the matter was whether C's stock was subject to a substantial risk of forfeiture (SRF). The corporation's documents and the parties' actions demonstrated that the stock was transferred to C as fully vested and outstanding shares.

Property is not subject to an SRF if the employer is unlikely to enforce the forfeiture condition. The court concluded that because of H and C's close working relationship and C's substantial interest in the corporation, the corporation (owner H) was unlikely to enforce any forfeiture condition against C. Therefore, the risk of forfeiture was not significant, and the shares were fully vested on transfer.

References: Dec. 60,340(M); TRC COMPEN: 18,202.

SFC Unveils Working Groups' Tax Reform Reports

Senate Finance Committee, July 8, 2015

Business, individual, international, and retirement/pension tax reform proposals were reviewed in recently-released bipartisan reports by the Senate Finance Committee (SFC). The reports, which were the culmination of many months of work, did not make concrete proposals for tax reform. However, the reports did draw attention to tax reform and could help encourage movement of tax legislation, including a package to renew the so-called tax extenders.

- ***Take Away.*** "The reports as a whole show that comprehensive tax reform is still a long way off," Dustin Stamper, Director, Washington National Tax Office, Grant Thornton, LLP, told Wolters Kluwer. "Each working group did a good job discussing options for reforming different parts of the Tax Code, but in the end they could not find much agreement on actual concrete proposals or detailed recommendations."
- ***Comment.*** At press time, the SFC is reportedly trying to add the tax extenders to its July schedule (with July 21 being discussed as a target date). Some 50 extenders, including the state and local sales tax deduction, higher education tuition deduction, and research tax credit, expired after 2014. Moving the extenders out of the SFC would be the first step to getting them to the Senate floor for a vote, possibly after Congress' August recess.

Background

SFC Chair Orrin Hatch, R-Utah, and ranking member Ron Wyden, D-Ore., launched the five tax reform working groups earlier this year. The five working groups reviewed a number of previous tax reform proposals, including the 2012 Framework for Business Tax Reform from President Obama, a comprehensive Tax Code overhaul prepared by then Ways and Means Chair Dave Camp, and others.

Business tax reform

Thirty-one industrialized nations have lowered their corporate tax rates since 2001, the business reform group noted. The U.S. corporate tax rate has remained unchanged. Various proposals to reduce the rate have stalled, primarily because of disputes over how to, or whether to at all, recoup the lost revenue. "Reducing the corporate rate as part of revenue-neutral tax reform requires roughly $100 billion of base broadening for each point of rate reduction." Offsets that have failed to win support include repeal of the last-in, first-out (LIFO) method of accounting, repeal of the Code Sec. 199 domestic production activities deduction, and others.

The business tax reform group also noted that the Code Sec. 41 research tax credit has been extended 16 times since it was first enacted in 1981, often on a retroactive basis after the credit had expired. "Yet it is likely that very few businesses that conduct research and experimentation expect the credit will not be reinstated. To say that the credit is a temporary provision of the tax code is to state something that may be technically accurate, but does not actually reflect reality."

A number of energy tax incentives also are temporary. Their temporary nature provides taxpayers with little certainty, the working group noted. "As a result, taxpayers may choose to forgo the investments these provisions are meant to encourage."

Individual tax reform

Like business tax reform, individual tax reform has been hindered over disagreements about revenue raisers, the working group reported. A one percentage point across-the-board rate reduction would cost $690 billion over 10 years. "Difficult choices would need to be made if even a modest reduction in rates were to be achieved while continuing to raise similar amounts of revenue." Revenue could be generated by reducing or eliminating, for example, the home mortgage interest deduction, the child tax credit, and the Code Sec. 36B premium assistance tax credit.

- ***Comment.*** Eliminating the home mortgage deduction and the Code Sec. 36B credit would generate some $700 billion in revenues, the working group estimated.

The individual working group also reviewed education tax incentives and ob-

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IRS Delays Deadline For Energy Credit Standards Imposed On Certain Small Wind Turbines

The IRS has delayed the deadline that had been set for certain small wind energy property to meet the performance and quality standards necessary to qualify for the Code Section 48 energy credit. Notice 2015-4, published last January, set standards for small wind energy property acquired or placed in service (in case of property self-constructed, reconstructed, or erected by the taxpayer) after February 2, 2015. Notice 2015-51 delays that February 2, 2015 deadline to December 31, 2015, in the case of small wind turbines having a rotor swept area of more than 200m. Those turbines are subject to the performance and quality standards set by the International Electrotechnical Commission (IEC).

- ***Comment.*** Treasury and IRS explained that they were delaying the IEC standards deadline until December 31, 2015, based upon complaints that the manufacturers of certain property were unable "to immediately complete the certification process relating to the performance and quality standards as set forth in IEC with respect to mid-size turbines currently available for sale." For smaller turbines with a rotor sweep of 200m or less, the February 2, 2015 deadline did not change. Those turbines are subject to a standard set by the American Wind Energy Association (AWEA). Both deadlines apply only to wind turbines with nameplate capacities of not more than 100kW.

Notice 2015-51; FED ¶46,364; TRC BUSEXP: 51,102.30.

Boycott Countries

The current list of countries that may require participation in, or cooperation with, an international boycott is as follows: Iraq, Kuwait, Lebanon, Libya, Qatar, Saudi Arabia, Syria, United Arab Emirates and Yemen.

Boycott Notice, FED ¶46,357; TRC INTL: 21,050

Alimony

A large payment made by an attorney to his former spouse under a divorce agreement was a property settlement, not alimony, and was not deductible by the taxpayer. The Tax Court also imposed the accuracy-related penalty. Under state (Florida) law, any lump-sum alimony was a property settlement and not deductible alimony for federal income tax purposes.

Muniz, TC, CCH Dec. 60,342(M), FED ¶48,052(M); TRC INDIV: 21,106

Income

An attorney was guilty of tax evasion because he willfully attempted to evade paying tax. Intentionally attempting to place assets outside of the government's reach, with or without misleading or concealing, violated the statute. Moreover, making false statements to the IRS also constituted an affirmative act of evasion.

Boisseau, DC Kan., 2015-2 USTC ¶50,375; TRC IRS: 66,154

The Tax Court properly held that the amount paid to an individual for his participation in a medical research study was not excludable from his gross income as a gift or as compensation for an injury or sickness. There was no evidence that the payment was a gift or that he suffered from any physical injury or sickness on account of the study.

O'Connor, CA-9, 2015-2 USTC ¶50,364; TRC INDIV: 33,102

A request for reimbursement of amounts paid to the IRS as a result of nominee tax liens on the taxpayers' property for taxes allegedly owed by their lessee was dismissed. The taxpayers had failed to properly comply with the rules governing a third-party's challenge of another's tax liability.

Stidham, DC Va., 2015-2 USTC ¶50,376; TRC IRS: 48,204.15

Deductions

A divorced individual was not entitled to a loss deduction for transferring property to her ex-husband as the transfer was incident to their divorce. Pursuant to a written agreement modifying their divorce settlement, the taxpayer transferred the property to her ex-husband in lieu of her required alimony payments within one year of their divorce. Moreover, while the taxpayer and her husband agreed that the transferred property would replace the taxpayer's alimony obligation, the property did not qualify as alimony under Code Sec. 71 because it was not cash or a cash equivalent.

Mehriary, TC, CCH Dec. 60,343(M), FED ¶48,053(M);TRC INDIV: 21,050

Liens and Levies

An individual's claim against her retirement plan administrator and two of its employees for complying with an IRS levy and remitting the individual's entire monthly retirement allowance was dismissed. The plan administrator had statutory immunity from any liability for complying with the IRS levy under Code Sec. 6332.

Caudle v. Colandene, DC Va., 2015-2 USTC ¶50,373; TRC IRS: 51,060.05

Jurisdiction

The Court of Federal Claims lacked subject matter jurisdiction over an individual's claim for refund of gift taxes and estate taxes paid with respect to his parents' property. The individual previously filed a refund petition in the Tax Court regarding the same issue for the same tax year. Further, his refund claims were also dismissed

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Ninth Circuit Upholds Denial Of Medical Marijuana Dispensary's Business Deductions

The Court of Appeals for the Ninth Circuit has affirmed the Tax Court's denial of business deductions to a medical marijuana dispensary. Although the use and sale of medical marijuana was legal under state law, the use and sale of marijuana remains prohibited under the federal law and Code Sec. 280E prohibited the taxpayer's business deductions, the court found.

Background. The taxpayer operated a medical marijuana dispensary where customers could purchase marijuana and consume it on the premises. The taxpayer purchased the marijuana from licensed medical marijuana suppliers. The taxpayer reported some $600,000 in business expenses for 2004 and 2005. The IRS disallowed the deductions and Tax Court agreed.

Court's analysis. Code Sec. 280E, the court found, precludes deductions for business expenses where the amount paid or incurred during the tax year was for the purpose of carrying on any trade or business consisting of trafficking in controlled substances. Here, the taxpayer's only income-generating activity was from the sale of marijuana. The taxpayer offered food and beverages to customers along with games and movies, but these activities were provided to customers at no cost.

- ***Comment.*** In *Californians Helping to Alleviate Medical Problems, 123 TC 173 (2007), Dec. 56,935,* the taxpayer provided medical marijuana and counseling and caregiving services. The Tax Court found that the counseling services constituted the taxpayer's primary business purpose and the secondary purpose was to provide medical marijuana. In the case before the Ninth Circuit, the taxpayer occasionally provided counseling services.

Olive, 2015-2 USTC ¶50,377; TRC BUSEXP: 3,100.

Tax Briefs

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for lack of jurisdiction because he failed to file an administrative claim for refund prior to filing the suit. Moreover, his claims were barred under the limitations period in Code Sec. 6511.

Widtfeldt, FedCl, 2015-2 USTC ¶50,370; TRC IRS: 36,052.05

An individual's request for an order compelling the IRS to conduct an investigation of a taxpayer identified on his Form 211, Application for Award for Original Information, and to reconsider his award claim was dismissed for lack of subject matter jurisdiction. The Tax Court was the proper forum for the individual's appeal of the IRS's final determination regarding his second and third submissions.

Meidinger, DC Fla., 2015-2 USTC ¶50,369; TRC IRS: 63,060.05

A federal district court in New York lacked subject matter jurisdiction over a corporation's claim for refund of income taxes paid to the Virgin Islands. The court rejected the corporation's argument that it had jurisdiction under 28 U.S.C. § 1346(a)(1), which provides that federal district courts have original jurisdiction over civil actions against the United States for the recovery of any internal revenue tax. The Internal Revenue Code does not adopt or incorporate section 1346 and, therefore, it was not incorporated into the Virgin Islands' mirror code.

Hess Oil Virgin Islands Corp. v. the Government of the United States Virgin Islands, DC N.Y., 2015-2 USTC ¶50,367; TRC LITIG: 9,052

Innocent Spouse

A separated individual was not entitled to innocent spouse relief under Code Sec. 6015(b), (c), or (f) because the unemployment compensation income that the individual failed to report was attributable to him and not to his former spouse.

Agudelo, TC, CCH Dec. 60,341(M), FED ¶48,051(M); TRC INDIV: 18,056.05

Penalties

A frivolous appeal penalty was imposed on an individual who claimed his wages were not subject to federal income taxation. Assessment of tax deficiencies and penalties was properly sustained.

Stanley, CA-8, 2015-2 USTC ¶50,366; TRC COMPEN: 6,050

FOIA

An individual's Freedom of Information Act (FOIA) request for all IRS records pertaining to her was dismissed for lack of subject matter jurisdiction because she failed to exhaust her administrative remedies. The individual failed to make a valid FOIA request.

Kalu, DC D.C., 2015-2 USTC ¶50,374; TRC IRS: 9,502

The IRS adequately searched for documents in response to a Freedom of Information Act (FOIA) request. The IRS identified all recordkeeping systems that could have contained the requested documents and searched them thoroughly.

Judicial Watch, Inc., DC D.C., 2015-2 USTC ¶50,368; TRC IRS: 9,502

IRS Announces Disaster Relief For Wyoming Storms/ Floods; Expands Texas Relief

The IRS has announced disaster relief for victims of severe storms and flooding that began on May 24, 2015, in parts of Wyoming. President Obama has declared Johnson and Niobrara counties as federal disaster areas. Certain federal tax deadlines falling on or after May 24, 2015, and on or before August 31, 2015, have been postponed to August 31, 2015.

Texas. The IRS also announced that it has expanded disaster relief related to severe storms, tornadoes, straight-line winds and flooding that began on May 4, 2015, in parts of Texas. The expanded disaster relief covers Angelina, Erath, Frio, Jim Wells, Montgomery, and Trinity counties in Texas.

DEN-2015-41, HOU-05-2015; FED ¶¶46,334, 46,361; TRC FILEIND: 15,204.25.

Tax Reform

Continued from page 338

served that the number of education credits and deductions could be ripe for streamlining and consolidation. "Complexities associated with multiple incentives make it difficult for taxpayers to take into account the value of the incentives in budgeting for college expenses, while income-related phaseouts create both computational and transactional complexity for taxpayers."

The sequence of return filing dates complicates a taxpayer's ability to prepare an accurate return, the individual working group explained. The information that a taxpayer is required to assemble with respect to all income-generating investments or activities may not be available until shortly before, after or contemporaneous with the taxpayer's filing date, the working group explained.

- ***Comment.*** The working group acknowledged that reordering the due dates for filing income tax returns so that both partnerships and S corps file before C corporations and individuals may reduce the need for routine use of extensions, but did not endorse a specific proposal.

International reforms

The international working group reviewed options for moving from a worldwide tax system to a territorial tax system. "Every other G-7 country has adopted some form of territorial system - and all of these countries have lower corporate tax rates than the U.S. This means that no matter what jurisdiction a U.S. multinational company is competing in, it is competing at a disadvantage," the working group observed.

Retirement/pension reforms

The savings and investment working group identified three key goals for retirement savings/pension reforms: increasing access to tax deferred retirement savings; increasing participation and levels of savings; and discouraging leakage while promoting lifetime income. While the working group did not endorse any specific proposals, its members emphasized that tax reform must include retirements savings/pension reforms.

Sample Client Letter On 2015 Second Quarter Federal Tax Developments

The second quarter of 2015 brought many tax developments from Washington, the IRS and the courts. Wolters Kluwer has prepared a Second Quarter 2015 Federal Tax Developments client letter. Practitioners can email this letter to clients to alert them to some of these important recent developments.

This letter includes references to Federal Tax Weekly. Practitioners can refer to Federal Tax Weekly for more information about these developments, but should delete the references in their communications with clients.

Re: Important 2015 Second Quarter Federal Tax Developments

Dear Client:

During the second quarter of 2015, there were many important federal tax developments. This letter highlights some of the more significant developments for you. As always, contact our office if you have any questions.

Tax legislation

In June, President Obama signed two trade bills that included tax provisions affecting individuals and businesses. The *Trade Preferences Extension Act of 2015* renews the health care tax credit (HCTC), provides that taxpayers must possess a valid information return (Form 1098-T, Tuition Statement) to claim the tuition and fees deduction, the American Opportunity Tax Credit, and the Lifetime Learning credit, overhauls the penalty structure for information returns, limits the child tax credit for taxpayers who elect to exclude from gross income for a tax year any amount of foreign earned income or foreign housing costs, and includes a corporate estimated tax shift. The *Bipartisan Congressional Trade Priorities and Accountability Act of 2015* provides certain federal public safety officers with an exemption from the 10-percent penalty on early distributions from a qualified retirement plan. *Federal Tax Weekly No. 27, July 2, 2015; Federal Tax Weekly No. 28, July 9, 2015.*

In April, President Obama signed the *Medicare Access and CHIP Reauthorization Act of 2015,* also known as the "doc fix" bill. The new law, among other measures, provides the IRS with enhanced levy authority to collect unpaid taxes from Medicare providers. *Federal Tax Weekly No. 17, April 23, 2015.*

"The second quarter of 2015 brought many tax developments from Washington, the IRS and the courts."

Affordable Care Act

In a 6 to 3 decision, the U.S. Supreme Court held in June that the Code Sec. 36B premium assistance tax credit is not limited to enrollees in state-run Health Insurance Marketplaces (previously referred to as Exchanges). Enrollees in federally-facilitated Marketplaces may also claim the credit, if eligible, the Supreme Court held. Writing for the majority, Chief Justice John Roberts explained that Code Sec. 36B allows tax credits for insurance purchased on any Marketplace created under the Affordable Care Act (ACA). The dissent would have struck down the IRS regulations as contrary to the language of the ACA. *King, SCt. June 25, 2015, Federal Tax Weekly No. 27, July 2, 2015.*

Same-sex marriage

Two years after the U.S. Supreme Court first addressed same-sex marriage, the Court held in June that the Fourteenth Amendment requires a state to license a marriage between two people of the same sex. Further, states must recognize a marriage between two people of the same sex when their marriage was lawfully licensed and performed out-of-state. In light of this decision, states that did not recognize same-sex marriage will presumably have to treat married same-sex married couples the same as married opposite-sex couples for tax filing purposes. *Obergefell, SCt., June 26, 2015, Federal Tax Weekly No. 27, July 2, 2015.*

ABLE accounts

The IRS released proposed reliance regulations on the establishment, funding, distribution, and reporting of ABLE Accounts under the *Achieving a Better Life Experience (ABLE) Act of 2014* in June (NPRM REG-102837-15). The ABLE Act, signed into law by President Obama in late 2014, created tax-favored savings accounts for qualified individuals with disabilities (who became disabled before age 26) for tax years beginning after December 31, 2014. *Federal Tax Weekly No. 26, June 25, 2015.*

Partnerships

The Treasury Inspector General for Tax Administration (TIGTA) reported in May that although the IRS has taken steps to improve the process for auditing partnership businesses and decrease the no-change rate, it lacks the ability to measure the amount of additional tax assessed as a result of partnership audit adjustments (TIGTA Report No. 2015-30-004). Without this data, the IRS cannot adequately plan the proper level of examination coverage for partnership returns, TIGTA explained. TIGTA noted that since fiscal year (FY) 2010, the IRS has failed to assess taxable partners with approximately $14.5 million in taxes, interest, and penalties resulting from audits of partnership returns. *Federal Tax Weekly No. 19, May 7, 2015.*

The IRS issued proposed regulations under Code Sec. 7704(d)(1)(E) intended to clarify the qualifying income of a publicly traded partnership (PTP) in May (NPRM REG-

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WASHINGTON REPORT *by the Wolters Kluwer Washington News Bureau*

House vote on IRS FY 2016 budget uncertain

At press time it is unclear when the House will take up the IRS's fiscal year (FY) 2016 budget. House Majority Leader Kevin McCarthy, R-Calif., had previously indicated that the House would vote on the agency's FY 2016 budget during the week of July 13. However, the House did not vote on the Interior Department's FY 2016 budget bill during the week of July 6 as scheduled, potentially moving the IRS FY 2016 budget bill to another week. On June 17, the House Appropriations Committee had approved a FY 2016 appropriations bill to provide $10.1 billion to fund the IRS. The bill represents a cut of approximately $838 million to the agency's budget, compared to FY 2015.

Ryan discusses short, long-term tax reform

House Ways and Means Committee Chair Paul Ryan, R-Wisc., said recently that he is looking for short-term solutions as a down payment on more comprehensive tax reform. Ryan also pointed out, however, that there is no sure thing when it comes to tax reform.

While Ryan was short on specifics, he praised the efforts of Sens. Charles Schumer, D-N.Y., and Rob Portman, R-Ohio, who put out a plan for international tax reform as part of the Senate Finance Committee's working groups on tax reform. Schumer and Portman touched on several aspects of international taxation reform that Ryan felt pointed the way to accomplish that goal. Ryan also lauded the concept of a "patent" or"innovation" box, saying it was a good means to get a lower tax rate for corporations. A patent box is a tax incentive designed to encourage companies to make profits from their patents by reducing the tax paid.

IRS telephone impersonation scam grows

The IRS telephone impersonation scam is pervasive and growing, a senior official with the Treasury Inspector General for Tax Administration (TIGTA) told reporters at a news conference in Washington, D.C. on July 8. Criminals use fake names, provide bogus IRS badge numbers and alter caller ID numbers to make it look like the IRS is calling. "Through July 6, 2015, we logged over 591,000 contacts from telephone impersonation calls," the official said.

Intended victims are threatened with imprisonment or deportation if they do not make immediate payment of purported tax debts. "Criminals are so aggressive. They catch people off guard," the official noted. Often, criminals demand payment by prepaid debit cards. "Use of these prepaid cards makes it difficult to track the criminals," the official added.

The typical loss is between $5,000 and $7,000, the official said. "We had one reported loss of $500,000 but this amount was not confirmed." The telephone impersonation scam has claimed some 4,000 victims nationwide, according to the official. Several states have reported spikes in the in recent months, including Pennsylvania and Virginia.

According to TIGTA, criminals will sometimes call a second or third time claiming to be from a law enforcement agency in an attempt to make the first call appear legitimate. In some cases, intended victims have reported to the IRS and TIGTA that criminals knew their Social Security numbers. Individuals can report IRS impersonation calls to TIGTA by going to its website or calling (800) 366-4484. The IRS and the Federal Trade Commission are also tracking telephone impersonation scams and identity theft schemes.

The news conference was held on the same day that TIGTA and the U.S. Attorney's Office for the Southern District of New York announced that an individual had been sentenced to 14 years in prison for a call center fraud scheme. The scheme collected more than $1 million by impersonating IRS and other government officials.

TIGTA reviews IRS seizures

The Treasury Inspector General for Tax Administration (TIGTA) has reviewed the IRS's compliance with the legal requirements of the *IRS Restructuring and Reform Act of 1998* (RRA '98) when conducting seizures of taxpayers' property. RRA '98 amended the Tax Code to provide requirements for seizures, from notice to the taxpayer through the sale or redemption of the property.

TIGTA reviewed 50 of the 425 seizures conducted in the year ending June 30, 2014. TIGTA identified 28 instances where the IRS did not comply with requirements. For example the sale of seized property was not always properly advertised; and the amount of the liability for which seizures were made was not always correct on the notice of seizure provided to taxpayers.

TIGTA made two recommendations, which the IRS accepted. The first recommendation was to revise the Internal Revenue Manual guidelines for advertising the sale of seized property. The second recommendation was to remind employees of the steps to be followed when revising fair market values affecting minimum bids.

U.S. and India sign agreement to implement FATCA

The U.S. and India signed an intergovernmental agreement (IGA) on July 9 to implement the *Foreign Account Tax Compliance Act*. "The signing of this agreement is an important step forward in the collaboration between the U.S. and India to combat tax evasion," the U.S. government said in a statement. The IGA was signed in India.

Foreign financial institutions (FFIs) in India will be required to report tax information about U.S. account holders directly to the Indian Government which will, in turn, relay that information to the IRS. The IRS will provide similar information about Indian account holders in the United States. This automatic exchange of information is scheduled to begin on September 30, 2015.

Continued from page 341

132634-14). The guidance provides an exclusive list of the qualifying activities that make up the exploration, development, mining or production, processing, refining, transportation, and marketing of minerals or natural resources. The IRS also described when support activities are treated as qualifying activities. *Federal Tax Weekly No. 20, May 14, 2015.*

Pension plans

In June, the IRS issued temporary and proposed regulations and a revenue procedure describing how multiemployer defined benefit (DB) plans in critical and declining status may apply for suspension of benefits (TD 9723, NPRM REG-102648-15, Rev. Proc. 2015-34). The guidance reflects changes made by the *Multiemployer Pension Reform Act of 2014* (MPRA). The MPRA, which was signed into law by President Obama in late 2014, created a new status for multiemployer DB plans: critical and declining status. *Federal Tax Weekly No. 26, June 25, 2015.*

Individuals

The U.S. Supreme Court held in May that the state of Maryland must give full credit for out-of-state income taxes. Maryland residents who earned pass-through income from an S corporation that earned income in several states had not been allowed to claim a full income tax credit against county taxes on their Maryland income tax return for taxes paid to those other states. Writing for the majority, Justice Samuel Alito explained that the dormant Commerce Clause precludes states from discriminating between transactions on the basis of some interstate element. *Comptroller of the Treasury of Maryland v. Wynne, SCt., May 18, 2015, Federal Tax Weekly No. 21, May 21, 2015*

The IRS Statistics of Income (SOI) Division released its Spring 2015 Bulletin, which contains preliminary data gleaned from the more than 145 million individual income tax returns filed for the 2013 tax year. The IRS reported that 2013 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. *Federal Tax Weekly No. 23, June 4, 2015.*

Charitable contributions

In April, the Tax Court denied a charitable deduction for donations of household items made in batches of less than $250. The taxpayers unsuccessfully argued that the donations did not require a contemporaneous written acknowledgment because they were made in batches below the $250 threshold. The court found it implausible that taxpayers had made the purported donations on nearly 100 distinct occasions in one year. *Kunkel, TC Memo. 2015-71, Federal Tax Weekly No. 16, April 16, 2015.*

Broker reporting

Responding to requests from taxpayers, the IRS announced in June that it would move the effective date for reporting certain information by brokers on transfers of debt instruments by six months to January 1, 2016 (TD 9713, Correcting Amendments). Previous guidance provided for a June 30, 2015 effective date. *Federal Tax Weekly No. 24, June 11, 2015.*

Transferee liability

The Tax Court in April rejected the IRS's two-step approach to determine transferee liability under Code Sec. 6901. The court reiterated that Code Sec. 6901 requires an independent basis under state law, contrary to the IRS's approach. *Stuart, Jr., 144 TC No. 12, Federal Tax Weekly No. 15, April 9, 2015.*

Rents

In April, the Tax Court upheld the IRS's recharacterization of rents as nonpassive. The Tax Court found that income from the rental of commercial real estate that the taxpayers claimed as passive income for tax years 2009 and 2010 should be recharacterized as nonpassive under Reg. §1.469-2(f)(6). The court rejected the taxpayers' argument that Code Sec. 469 does not apply to S corporations. *Williams, TC Memo. 2015-76, Federal Tax Weekly No. 17, April 23, 2015.*

Spinoffs

In May, the IRS Office of the Associate Chief Counsel (Corporate) indicated it is reevaluating whether it will continue to issue private letter rulings (PLRs) on Code Sec. 355 spinoffs where the corporation being spun off owns minimal assets in an active trade or business (ATB). The issue is one of avoiding double taxation on the distribution of appreciated passive assets. *Federal Tax Weekly No. 22, May 28, 2015.*

Repair regulations

In May, several tax professional associations urged the IRS to revisit the de minimis safe harbor threshold amount under the final repair regulations for taxpayers without an applicable financial statement (AFS). For acquisitions of tangible property, a de minimis safe harbor allows taxpayers to deduct certain items. The safe harbor applies to items that cost $5,000 or less (per item or invoice) and that are deductible in accordance with the company's AFS. IRS regulations also provide a $500 de minimis safe harbor threshold for taxpayers without an applicable financial statement. *Federal Tax Weekly No. 18, April 30, 2015*

Estate tax

The IRS released final regulations on the estate tax portability election in June (TD 9725). 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. *Federal Tax Weekly No. 25, June 18, 2015.*

Tax scams

After the end of the 2015 filing season, the IRS announced that some 104,000 taxpayers had been victims of a new identity theft scheme. Criminals obtained taxpayer information through the IRS's online "Get Transcript" application. After discovering the scheme in mid-May, the IRS disabled the online application and alerted affected taxpayers. *Federal Tax Weekly No. 23, June 4, 2015.*

If you have any questions about these or other federal tax developments, please contact our office.

Sincerely,

COMPLIANCE CALENDAR

■ July 17

Employers deposit Social Security, Medicare, and withheld income tax for July 11, 12, 13, and 14.

■ July 22

Employers deposit Social Security, Medicare, and withheld income tax for July 15, 16, and 17.

■ July 24

Employers deposit Social Security, Medicare, and withheld income tax for July 18, 19, 20, and 21.

■ July 29

Employers deposit Social Security, Medicare, and withheld income tax for July 22, 23, and 24.

■ July 31

Employers deposit Social Security, Medicare, and withheld income tax for July 25, 26, 27, and 28.

Issuers and plan sponsors subject to the Patient-Centered Outcomes Research Institute (PCORI) Trust Fund fee use Form 720 for the 2nd quarter to report and pay it. Other Form 720 liabilities for that quarter should be reported on the same form.

Form 941, Employer's Quarterly Federal Tax Return, due for the second quarter of 2015.

Employers that maintain an employee benefit plan, such as a pension, profit-sharing, or stock bonus plan, file Form 5500 or 5500-EZ for calendar year 2014. (Employers that use the fiscal year as the plan year file the form by the last day of the seventh month after the plan year ends.)

TRC TEXT REFERENCE TABLE

The cross references at the end of the articles in Wolters Kluwer Federal Tax Weekly (FTW) are text references to Tax Research Consultant (TRC). The following is a table of TRC text references to developments reported in FTW since the last release of New Developments.

ACCTNG 6,228	281	FILEBUS 9,108.30	306	IRS 60,052	318
ACCTNG 24,256.20	282	FILEBUS 9,252	278	IRS 66,304	291
ACCTNG 36,162.05	306	FILEBUS 9,458.05	334	IRS 66,454	293
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CCORP 21,400	323	FILEIND 15,204.25	340	PART 3,254.05	283
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COMPEN 45,228	335	INDIV 30,550	301	REORG 27,050	282
ESTGIFT 51,000	294	INTL 30,082	277	RETIRE 42,170.10	333
ESTTRST 36,100	305	INTLOUT 36,050	293	RETIRE 45,050	336
EXEMPT 3,154	316	IRS 3,118	280	RETIRE 51,100	295
EXEMPT 3,300	327	IRS 3,200	304	RETIRE 57,212	302
EXEMPT 12,252	324	IRS 18,306	305	RETIRE 66,750	325
FILEBUS 6,106.20	320	IRS 27,212	307	RIC 6,054.05	337
FILEBUS 9,108.20	294	IRS 33,402	317	SALES 51,150	316

FROM THE HELPLINE

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

Q What is the effect on basis of S corporation distributions of retained earnings?

A Retained earnings is a financial accounting concept calculated under GAAP or IFRS. Earnings and profits is similar but determined under the Code and regs, which provide slightly different rules. Code Sec. 1368 generally governs the tax treatment of S corporation distributions to shareholders; for S corporations that have accumulated earnings and profits, the ordering rules under Code Sec. 1368(c) apply to determine the tax outcome of the distribution. Code Sec. 1367 provides for certain adjustments to S corporation stock basis, and under Code Sec. 1367(a)(2)(A), basis is decreased by distributions that are not includable in the shareholder's income by reason of Code Sec. 1368. *See TRC SCORP: 410.05 and 450, 454 and 458.*

Q Can a contribution to an Individual Retirement Arrangement be based on deferred compensation?

A No. Code Sec. 219 limits the deduction for IRA contributions to compensation includible in the individual's gross income for the tax year. Code Sec. 219(f)(1) states that compensation "does not include any amount received as deferred compensation." *See TRC RETIRE: 66,206.*