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IRS Unveils Draft Form 3115, Application for Change in Accounting Method; December Final Release Anticipated

Draft Form 3115 (released July 16, 2015)

The IRS has released a much-anticipated draft version of Form 3115, Application for Change in Accounting Method. Slated for release in final form by December, new Form 3115 will be used to process many more accounting method changes than were required back in 2009 when current Form 3115 was issued. While the new draft generally follows the basic format of the current Form 3115, it makes some significant changes.

- **Take Away.** "The growing complexity in change-of-accounting method rules likely will be even more apparent when the new Instructions to new Form 3115 are released, which is expected in December 2015 as well," according to Eric Wallace, CPA, CCH instructor and author of CCH's TPR (Tangible Property Regulations) Certificate Training Program and his TPR Tools and Templates website. "The Instructions, which were 20 pages long when last revised in March 2012, are expected to grow even more lengthy as the IRS uses the Instructions, rather than Form 3115 itself, as the primary gatekeeper to what goes on the Form," Wallace added.
- **Comment.** At a recent IRS webinar dealing with the TPRs (i.e., the repair regulations), an IRS representative indicated that taxpayers will be permitted to continue using the current version of Form 3115 (rev. December 2009) to file accounting method changes for the 2014 tax year under the repair regulations even after the final version is released. This should come as good news to filers who would not need to re-prepare forms on which work has begun, or otherwise change procedures in the preparation of the form.

Background

Earlier this year, the IRS updated and made significant changes to the general Code Sec. 446(e) procedures to obtain advance and automatic consent to change a method of accounting for federal income tax purposes. The IRS also updated the comprehensive list of accounting methods to which the automatic change procedures apply (see Rev. Procs. 2015-13, 14 & 33). These revisions clarified and modified rules applicable to a change in a method of accounting in several dozen areas, including the many rules introduced by the "repair regulations" (TD 9636). Together, they now represent the principal "roadmap" to be consulted whenever a change of method of accounting may be involved.

What's new on draft Form 3115

Significant changes made to Form 3115 by the just-released draft version include, among other refinements (such as changing "advance consent requests" to "non-automatic change requests" throughout):

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Proposed Reliance Regs Would Assist E-Filing By Eliminating Requirement To File Code Sec. 83(b) Election With Return

NPRM REG-135524-14

The IRS has proposed regs to assist electronic filing of tax returns by eliminating the requirement that a taxpayer making a Code Sec. 83(b) election file a copy of the election with the taxpayer's return for the year of the Code Sec. 83 transfer. The regs would apply to property transferred on or after January 1, 2016, although taxpayers can rely on them for property transferred on or after January 1, 2015.

- **Take Away.** Code Sec. 83 requires a taxpayer making a Code Sec. 83(b) election to file the election with the IRS within 30 days after the date on which property is transferred to the taxpayer for services. In addition, Reg. §1.83-2(c) requires that the taxpayer submit a copy of the election with the individual's tax return for the year of the transfer. The IRS indicated that this additional procedure usually cannot be carried out electronically and prevents taxpayers from e-filing their income tax returns.

Background

Under Code Sec. 83, if property is transferred to a service provider or other person in connection with the performance of services, the value of the property (minus any amount paid) is included in the service provider's income when the property vests. The income is compensation income. Vesting generally requires that the property not be subject to a substantial risk of forfeiture (SRF). If property is subject to an SRF, its value is not taxed to the service provider (employee or independent contractor) until the property vests.

Once the property vests, any subsequent appreciation realized on the sale of the property is treated as capital gain, not as ordinary income. However, if the property is forfeited while it is nonvested, the forfeiture is treated as a sale or exchange at a loss, based on the amount paid for the property (not the amount included in income) over any amount realized on forfeiture. This loss is a capital loss.

Election

Code Sec. 83(b) allows the service provider to elect to treat nonvested property as if it were not subject to an SRF, provided the election is made and filed with the IRS within 30 days after the property is transferred. This election allows a service

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Draft Form 3115

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- Space on line 1 for listing multiple designated accounting change numbers (DCNs) for situations, such as the repair regulations, where different types of changes are allowed on the same Form 3115.
- New line 3 that asks specifically whether the taxpayer is including all information and statements required both on the Form and by the List of Automatic Changes.
- New line 7 that expands on the restrictions noted on current line 4 about filing a method change while under an IRS audit.
- New line 16 that requires the taxpayer, filing under either the advance or automatic consent procedures, to attach a full explanation of the legal basis supporting the proposed method for the item being changed. The taxpayer must include a detailed and complete description of the facts that explains how the law specifically applies to the applicant's situation and that demonstrates that the applicant is authorized to use the proposed method. All authority (statutes, regulations, published rulings, court cases, etc.) supporting the proposed method and a discussion of any contrary authorities must be included.
- New line 27 that reflects the previously announced $50,000 limit for the election to include an entire Code Sec. 481(a) adjustment in income in one year and the new partnership eligible acquisition election.
- New line 7h, Schedule E, relating to changes in depreciation method, that asks whether the property for which the change is made will be in a single asset account, multiple asset account, or a general asset account.
- **Comment.** Line 19 of the current version makes this new line 16 requirement applicable only to filers using the advance consent procedures. Repair regulations changes are made under the automatic consent procedures. The draft version will require the attachment of an additional statement to comply with line 19 even though the information required is essentially duplicative of information provided in other portions of the form or statements otherwise required to be attached.
- **Comment.** "The current Form 3115 issued in 2009 is required to be continued to be used until the new Form 3115 is finalized by the IRS," Wallace emphasized.

Reference: TRC ACCTNG: 21,104.05.

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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Taxpayer Advocate Generally Approves IRS's Handling Of ACA; Urges IRS To Revisit FATCA Burden

IR-2015-97

National Taxpayer Advocate Nina Olson has told lawmakers that the IRS successfully implemented the *Affordable Care Act* (ACA) during the 2015 filing season but expressed concerns over the reach of the *Foreign Account Tax Compliance Act* (FATCA), the agency's customer service levels, and handling of identity theft cases. Olson made recommendations for improvements in her 2015 Mid-Year Report to Congress.

- **Take Away.** "Even using the practitioner priority line has become next to impossible," Barbara Nowotny, CPA, Barbara Nowotny, LLC, Bellaire, Texas, told Wolters Kluwer. "Wait times have doubled or tripled – and that's if you even get in the queue. More often, you reach a recording stating that IRS cannot answer any more calls that day."

ACA

The ACA generally requires individuals to carry minimum essential health coverage or make a shared responsibility payment, unless exempt. Payment is made when individuals file their federal income tax returns. Olson reported that 6.6 million returns reported owing a shared responsibility payment for 2014. However, some 300,000 individuals overstated their shared responsibility payment by $35 million (the average amount being $110 per return). Olson told lawmakers that many of these individuals did not owe a shared responsibility payment because they were eligible for an exemption.

- **Comment.** Olson recommended that the IRS issue refunds to these individuals without requiring them to file amended returns. Olson also reported that taxpayers claimed $7.7 billion in Code Sec. 36B premium assistance tax credits on 2014 returns. The average Code Sec. 36B credit amount was $3,000.

FATCA

As in past years, Olson expressed concerns over the broad sweep of FATCA and the compliance burdens it imposes on individuals and financial institutions. Olson again recommended that the IRS adopt a "same-country exception." This regulatory change would exclude from FATCA coverage financial accounts held in the country in which a U.S. taxpayer is a bona fide resident. The IRS, Olson reported, has not been receptive to this recommendation. Olson added she will continue to press for a FATCA structure that "gathers only the information actually needed by the IRS and burdens impacted parties as little as possible."

Customer service

As acknowledged by the IRS, customer service levels fell significantly during the 2015 filing season. Olson reported that the IRS answered only 37 percent of taxpayer calls, down from 71 percent during the 2014 filing season. "Courtesy disconnects" jumped from 544,000 in 2014 to 8.8 million this filing season, an increase of more than 1,500 percent. The IRS answered only 45 percent of calls from practitioners who called the IRS on the practitioner priority service line, and hold times averaged 45 minutes.

Identity theft

Tax-related identity theft continues to grow, Olson reported. At the end of May 2015, the IRS was working some 671,000 identity theft cases, reflecting a 69 percent increase from the same time last year. The frustration of taxpayers impacted by tax-related identity theft is exacerbated by the difficulty of contacting the IRS because of the low levels of customer service, Olson told lawmakers.

- **Comment.** During the 2015 filing season, the IRS stopped more than twice as many questionable returns as in the prior year, Olson reported. Yet at least one-third of the returns stopped by the agency turned out to come from legitimate filers. IRS data shows the false positive rate was 34 percent as of June 18, 2015, Olson noted.

References: FED ¶46,366; IRS: 3,058.

Sec. 83(b) Election

Continued from page 346

provider who expects to fulfill the vesting requirements and who expects the property to appreciate in value to include the value of the property in income when it is initially received, rather than wait until the vesting date.

Proposed regs

The IRS became aware that commercial software for filing income tax returns electronically often does not provide a means for submitting the Code Sec. 83(b) election to the IRS with the e-filed return. To comply with the requirement to submit the election to the IRS, the individual would have to file an income tax return on paper. This has become a barrier to e-filing of a return, the IRS noted.

The proposed regs would eliminate the requirement to file the election with the income tax return. The IRS stated that the statutory requirement to file the election with the IRS within 30 day after the transfer provides the IRS with the original Code Sec 83(b) election, and the IRS service center generates an electronic copy of the election. Therefore, there is no need for an additional filing requirement with the return, the IRS indicated.

- **Comment.** The IRS reminded taxpayers receiving property subject to Code Sec. 83 that they should keep a copy of any election and maintain records to show the original cost of the property, generally until the statute of limitations expires for the return on which the transfer is reported.

References: FED ¶49,656; TRC COMPEN: 18,304.

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Lower Interest Rate For Refunds To Corporations Applies To S Corp

Eaglehawk Carbon, Inc., Fed.Cl., July 16, 2015

The U.S. Court of Federal Claims has found that the lower interest rate that the IRS must pay on corporate refunds applies to S corps as well as C corporations. As a result, an S corp was entitled to overpayment interest of 0.5 percent on refunds over $10,000, instead of the three percent rate payable to individuals.

- **Take Away.** The taxpayer noted that Code Sec. 6621(c)(3), which provides for a different (in this case, higher) interest rate owed by corporations on underpayments, specifically applies to C corporations. However, Code Sec, 6621(a), which provides the rates for interest on overpayments, applies to "a corporation" and makes no distinction between C and S corporations. The Claims Court analyzed the provisions under various tools of statutory construction and concluded that they all supported the government's position, but ultimately it relied on the plain language of the statute.

Background

Several mining companies were small business corporations under Subchapter S of the tax code. The companies overpaid certain coal sales excise taxes for the years 1990-1996 and filed for refunds, plus interest, in 2009. The amount of the refunds ($6 million) was not in dispute.

Interest rates

Under Code Sec. 6621(a)(1), the overpayment interest rate is the federal short-term rate plus three percentage points for individuals, and plus two percentage points for corporations. For overpayments of tax by a corporation that exceed $10,000, the interest rate is increased by 0.5 percentage points, instead of two percentage points.

Under Code Sec. 6621(a)(2), the underpayment interest rate (for individuals) is the short-term rate plus three percentage points. Under Code Sec. 6621(c)(1), the underpayment rate on a "large corporate underpayment" is the short-term rate plus five percentage points. Code Sec. 6621(c)(3) defines a large corporate underpayment as any underpayment "by a C corporation for any taxable period," if the underpayment exceeds $100,000.

Court's analysis

The plain test of the statute is of paramount importance, the court found. Courts may also consider the structure of the statute, canons of statutory construction, and the legislative history. A statute is ambiguous if it could yield two conflicting but reasonable interpretations.

Here, the court stated, the plain text was clear and unambiguous; only the government's interpretation was reasonable. An S corp is a corporation, as generally defined by the Tax Code; therefore the lower interest rate applies to their overpayments. The court also found that a reference in the overpayment statute to the underpayment statute did not include the latter's application to a C statute and could not be incorporated into the overpayment provisions.

Legislative history may be used to interpret a statute, but the legislative history must clearly evidence legislative intent to overcome the plain text. Here, the court observed, there was no clear statement of Congressional intent to exclude S corps from the overpayment language.

The taxpayers also argued that an S corp, as a passthrough entity, is more like an individual than a C corporation for tax purposes. The court found that although Congress could have reasonably exempted S corps from the corporate overpayment rates, it did not do so or indicate any intent to do so.

The court declined to follow the Tax Court's decision in *Garwood Irrigation (Dec. 56,500),* which concluded that the lower interest rate for large corporate overpayments did not apply to S corps. However, the same court applied the corporate overpayment rate of two percent, rather than the individual rate of three percent, to the initial portion of the overpayment. In any case, the Claims Court held that *Garwood* was not persuasive and had in fact not been followed in subsequent district court and appeals court decisions.

- **Comment.** The Claims Court also noted a 1998 IRS Chief Counsel opinion (expressed in a Program Manager Technical Assistance) concluding that the lower corporate overpayment rate applied to S corps.

References: 2015-2 ustc ¶50,387;
TRC PENALTY: 9,152.

Tax Court Reversal: IRS Concession In Innocent Spouse Case Not A Settlement Barring Litigation Costs

Knudsen, CA-9, July 15, 2015

Reversing the Tax Court, the Ninth Circuit Court of Appeals has found that the IRS's concession that a taxpayer was entitled to equitable innocent spouse relief was not a settlement barring litigation costs. The taxpayer had made a qualified offer, which the IRS rejected, and her offer exceeded her ultimate tax liability.

- **Take Away.** In Notice 2011-70, the IRS expanded the period of time in which taxpayers could request equitable innocent spouse relief. The IRS announced that it would no longer require taxpayers to submit requests for equitable relief within two years from the date that the agency took initial collection activity against the requesting spouse with respect to the joint tax liability at issue. IRS Chief Counsel subsequently instructed its attorneys to no longer argue in any docketed Tax Court case that the two-year deadline applied to equitable innocent spouse relief.

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IRS Greenlights HRA For Retiree Health Care Funded With Unused Sick Leave

LTR 201528004

The IRS has determined that a taxpayer's proposed Health Reimbursement Arrangements (HRAs) for retirees would not constitute wages and would not be subject to FICA or FUTA taxes or income tax withholding. The HRA would be funded by unused sick leave of eligible retirees.

- **Take Away.** In Notice 2013-54, the IRS explained that unless an HRA qualifies as an excepted benefit, it will be treated as violating market reforms under the *Affordable Care Act* (ACA), if it is not integrated with a group health plan, triggering an excise tax under Code Sec. 4980D. Transition relief from assessment of the excise tax in Notice 2015-17 has expired. However, a retiree HRA is treated as an excepted benefit.

Background

The taxpayer proposed to create a new medical benefit structure for retirees. The new structure would take the form of an HRA for the benefit of eligible retirees, their spouses, their registered domestic partners and their dependents (referred to as a "retiree HRA"). The retiree HRA would be funded by mandatory conversion of accumulated unused sick leave at retirement; no other contributions would be allowed. The retiree HRA would not pay claims for a registered domestic partner's medical expenses or reimburse a spouse's group health insurance paid with pre-tax dollars.

IRS analysis

The IRS first noted that under Code Sec. 106(a), the gross income of an employee does not include employer-provided coverage under an accident or health plan. Coverage provided under an accident and health plan to former employees and their spouses and dependents is excluded from gross income under Code Sec. 106.

Notice 2002-45, the IRS further explained, describes the tax treatment of HRAs. A tax-favored HRA is an arrangement that is paid for solely by the employer and not under a salary reduction election or otherwise under a Code Sec. 125 cafeteria plan; reimburses the employee for qualified medical care expenses incurred by the employee or by the employee's spouse or dependents; and provides reimbursements up to a maximum dollar amount with any unused portion of that amount at the end of the coverage period carried forward to subsequent coverage periods.

Further, the IRS noted that Code Sec. 3121(a) provides for FICA purposes (and Code Sec. 3306(b) provides for FUTA purposes), with certain exceptions, that the term wages means all remuneration for employment. However, the term wages does not include any payment made to or on behalf of an employee, or any of his or her dependents, for medical or hospitalization expenses.

Here, the IRS determined that the contributions of the taxpayer made to the retiree HRA on behalf of eligible retirees, spouses, and eligible dependents - used exclusively to pay for eligible medical expenses – would be excluded from the gross income of eligible retirees under Code Sec. 106. Taxpayer contributions made to the retiree HRA on behalf of eligible retirees, spouse and eligible dependents would not constitute wages and would not be subject to FICA or FUTA taxes or income tax withholding.

Reference: TRC HEALTH: 12,100.

Litigation Costs

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Background

The taxpayers were married from 1979 to 2008. The husband worked as an attorney and the wife worked at home. During their marriage, they filed joint returns. The couple reported tax liabilities for the years 1998 to 2001 but failed to make any payments. In 2008, the wife requested equitable innocent spouse relief, which the IRS denied. The wife also offered to settle the liability for $200. The IRS did not respond to her offer. Before trial, the IRS informed the wife that it would concede her entitlement to innocent spouse relief.

The wife moved for litigation costs as the prevailing party. The Tax Court found that the IRS's concession was an offer to settle the dispute, an offer which the wife had accepted, and denied her litigation costs.

Court's analysis

The Ninth Circuit first found that the wife claimed she should be deemed to qualify as a prevailing party because of her qualified offer. Under Code Sec. 7430(c)(4)(E)(i), a party is treated as the prevailing party if the liability of the taxpayer is equal to or less than the liability of the taxpayer which would have been so determined if the government had accepted a qualified offer of the party. However, this provision is inapplicable to any judgment issued pursuant to a settlement.

The Ninth Circuit agreed with the Tax Court that a settlement is a contract. The formation of a contract generally requires a bargain in which there is a manifestation of mutual assent to the exchange and a consideration. In this case, the Ninth Circuit found no negotiations had taken place between the taxpayer and the IRS. Rather, the IRS unilaterally conceded the case. The taxpayer's offer had been for $200; her ultimate tax liability was zero. The Ninth Circuit remanded the case to the Tax Court for a determination of reasonable litigation costs, including attorney's fees.

References: 2015-2 ustc ¶50,383; TRC LITIG: 3,154.05.

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IRS Reminds Retirement Plans Of July 31 Filing Deadline; Notes Penalty Relief Program

IR-2015-96

The IRS has issued a reminder to retirement plan sponsors and administrators that, in most cases, the plan must file a return each year by the end of the seventh month following the close of the plan year. For calendar year taxpayers, the 2014 return is due July 31, 2015.

- **Take Away.** The IRS also encouraged eligible plans that failed to file a return for a prior year to take advantage of the IRS's penalty relief program for small business pension plans. In Rev. Proc. 2015-32, the IRS extended and made permanent a pilot relief program that was set to expire June 2, 2015.

Background

Funded retirement plans generally must file Form 5500, Annual Return/Report Of Employee Benefit Plan. These forms include Form 5500; Form 5500-EZ, Annual Return of One-Participant Retirement Plan; and Form 5500-SF, Short Form Annual Return/Report of Small Employee Benefit Plan. Forms 5500 and 5500-SF must be filed electronically; Form 5500-EZ must be filed on paper.

- **Comment.** Plans can get a filing extension on Form 5558, Application of Extension of Time to File Certain Employee Plan Returns.

Penalty relief

Small businesses that fail to file Form 5500 can face penalties as high as $15,000 per return. However, under the Late Filer Penalty Relief Program, the penalty is $500 per delinquent return, and the maximum penalty is $1,500 per plan. The IRS encouraged program applicants to include multiple late returns in a single submission. However, delinquent returns for multiple plans must be submitted separately, since the maximum penalty applies per plan.

Under the pilot program, participants did not owe a penalty. The permanent program added the penalty relief program. The IRS reported that it received about 12,000 late returns since the pilot program began in June 2014.

The program is available to owner-spouse plans for 100 percent owners, for plans of business partnerships, and certain foreign plans. Plans that include employees can seek relief under the U.S. Department of Labor's Delinquent Filer Voluntary Compliance Program.

Reference: TRC RETIRE: 78,052.10.

AFRs Issued For August 2015

Rev. Rul. 2015-16

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

Applicable Federal Rates (AFR) for August 2015

Short-Term	**Annual**	**Semiannual**	**Quarterly**	**Monthly**
AFR	.48%	.48%	.48%	.48%
110% AFR	.53%	.53%	.53%	.53%
120% AFR	.58%	.58%	.58%	.58%
130% AFR	.62%	.62%	.62%	.62%
Mid-Term				
AFR	1.82%	1.81%	1.81%	1.80%
110% AFR	2.00%	1.99%	1.99%	1.98%
120% AFR	2.18%	2.17%	2.16%	2.16%
130% AFR	2.36%	2.35%	2.34%	2.34%
150% AFR	2.74%	2.72%	2.71%	2.70%
175% AFR	3.20%	3.17%	3.16%	3.15%
Long-Term				
AFR	2.82%	2.80%	2.79%	2.78%
110% AFR	3.10%	3.08%	3.07%	3.06%
120% AFR	3.39%	3.36%	3.35%	3.34%
130% AFR	3.67%	3.64%	3.62%	3.61%

Adjusted AFRs for August 2015

	Annual	**Semiannual**	**Quarterly**	**Monthly**
Short-term adjusted AFR	.48%	.48%	.48%	.48%
Mid-term adjusted AFR	1.58%	1.57%	1.57%	1.56%
Long-term adjusted AFR	2.82%	2.80%	2.79%	2.78%

The Code Sec. 382 adjusted federal long-term rate is 2.82%; the long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months) is 2.82%; the Code Sec. 42(b)(2) appropriate percentages for the 70% and 30% present value low-income housing credit are 7.53% and 3.23%, respectively, however, the appropriate percentage for non-federally subsidized new buildings placed in service after July 30, 2008, and before January 1, 2015, shall not be less than 9%; and the Code Sec. 7520 AFR for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest is 2.2%.

References: FED ¶46,367; TRC ACCTNG: 36,162.05.

Welfare Benefit Plan Was Split-Dollar Life Insurance; Owner/Employees Taxed, Employers Denied Deductions

Our Country Home Enterprises, Inc., 145 TC No. 1

The Tax Court has concluded that a purported welfare benefit plan used by several companies and their owner/employees was in substance a split-dollar life insurance policy. The court rejected the employers' deductions for payments to the "employee benefit programs" and held that the employees who benefited from the policies received a taxable economic benefit.

- **Take Away.** The employers were all closely-held companies that entered into the Sterling Benefit Plan (the Plan) to provide benefits to their owner/employees without current taxation and in excess of those obtainable through pension plans. In Notice 2007-83, IRS identified similar arrangements using trusts and cash value life insurance policies as tax avoidance transactions.
- **Comment.** The Tax Court's opinion applied to seven consolidated cases involving three employers and five owner/employees. Another 40 cases agreed to be bound by the court's decision.

Background

The Plan was established as a welfare benefit plan that paid death, medical and disability benefits. The employers made contributions in their discretion. They also set the terms of the plan and the amount of benefits for each participating employee. The Plan maintained individual personal accounts for each participant, and employees could direct investments of the accounts.

The Plan purchased various life insurance products, including cash-value policies, to fund benefits payable to employees. The increase in a policy's cash value was added to the employee's personal account. The employee designated the beneficiaries of the Plan's benefits and the life insurance benefits. In some cases, the Plan was designated as the beneficiary of the insurance policy, but the primary participants in the Plan were the owner/employees. The Plan's terms ensured that the employees would be vested in their benefits.

- **Comment.** As an example of the arrangement, one corporation deducted $1.05 million it contributed to the Plan. The IRS denied the deductions and determined that the employee/owner realized income of $3 million. The Plan purchased a life insurance policy on the employee with a face amount of $6.9 million.

Holdings

The Tax Court concluded that:

- The Plan and its trust were not an employee welfare benefit plan.
- The employers' participation in the Plan was a compensatory split-dollar life insurance arrangement for the benefit of particular employees. The life insurance policies were not group-term life insurance.
- The employers were not entitled to any deductions for the payments that funded the policies.
- The employees had to recognize income for their benefits in the life insurance policies.

Analysis—the arrangement

The court held that the arrangement between the employer (the owner of the life insurance contract) and the employee (as nonowner) was a compensatory arrangement that should be treated as a split-dollar life insurance contract under Reg. §1.61-22(b). The arrangement was for services, the employer paid the premiums, and the employee had an interest in the cash value of the insurance contract.

The court noted that although the Plan was designated as the beneficiary of each policy and its life insurance benefit, the employee ultimately determined the beneficiary of the policy, by instructing the Plan who should receive the proceeds. The employee was assured of receiving the entire amount paid under the policy or of receiving the policy itself.

Analysis—deduction and income

Because the life insurance policies were compensatory split-dollar arrangements, any deduction for their cost had to comply with Reg. §1.83-6(a)(5). The deduction

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Social Security Urges Same-Sex Couples To Apply For Benefits Following *Obergefell*

The Social Security Administration (SSA) has encouraged spouses, divorced spouses, and surviving spouses of a same-sex marriage to apply for benefits in light of the Supreme Court's decision in *Obergefell, 2015-2 USTC 50,357.* The SSA reported that it is working with the U.S. Department of Justice (DOJ) to analyze the decision and provide instructions for processing claims.

Background. After the U.S. Supreme Court struck down Section 3 of the Defense of Marriage Act (DOMA) in *Windsor, 2013-2 ustc 50,400,* the IRS adopted a place of celebration approach to same-sex marriage. SSA, however, did not take the same approach. Since 2013, SSA has looked to the laws of the state of the number holder's (NH's) domicile to determine whether SSA could recognize the marriage. If the NH is alive, SSA would look to the NH's domicile at the time of application or while the claim is pending a final determination. If the NH has died, SSA would look to the NH's domicile at the time of his or her death.

Obergefell decision. The Supreme Court in *Obergefell* held that same-sex couples have a constitutional right to marry in all states. Consequently, more same-sex couples will be recognized as married for purposes of determining entitlement to Social Security benefits or eligibility for Supplemental Security Income (SSI) payments, SSA explained.

SSA Statement, www.ssa.gov; FILEIND: 3,202.

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TAX BRIEFS

Interest Rates

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

Notice 2015-50, FED ¶46,365; TRC RETIRE: 15,304.10

Deductions

A married couple's charitable contribution deduction and two business expense deductions were properly disallowed. An S corp made the charitable contributions at issue and the couple failed to show that the husband bore the economic burden of the contributions. Additionally, the couple failed to show that the business expense deductions were ordinary and necessary.

L. Zavadil, CA-8, 2015-2 USTC ¶50,385; TRC INDIV: 51,050

Two related limited partnerships were each denied a deduction for the charitable contribution of a conservation easement. Further, transfers of property in exchange for contributions to the partnerships were actually disguised sales, with the proceeds being includible in the partnerships' gross income. Finally, gross valuation misstatement penalties applied.

Bosque Canyon Ranch, L.P., TC, CCH Dec. 60,348(M), FED ¶48,058(M); TRC INDIV: 51,364.05

Income

Married individuals established that some purportedly unreported income was nontaxable loan proceeds. However, they were taxable on the remainder. Deductions were disallowed in part as unsubstantiated, although depreciation was allowed. Additionally, an accuracy-related penalty applied based on both negligence and substantial understatement of tax.

Holden, TC, CCH Dec. 60,349(M), FED ¶48,059(M); TRC INDIV: 6,052

Jurisdiction

The court lacked jurisdiction over an individual's wrongful levy claim under Code Sec. 7426 because the individual was not a third party with respect to her own tax liability. Further, the individual's request for an order restraining the IRS from levying her income and property was barred by the Anti-Injunction Act.

Komlo, DC Pa., 2015-2 USTC ¶50,384; TRC IRS: 45,152

Liens and Levies

A federal tax lien against an individual who had outstanding tax liabilities and raised only frivolous arguments in opposition to the IRS's collection action was properly sustained and the sanction for maintaining frivolous proceeding was properly imposed. The individual proposed no collection alternative and failed to raise any other cognizable challenge to the propriety of the lien. Further, the individual knew or should have known that his arguments could subject him to the delay penalty.

Kanofsky, CA-3, 2015-2 USTC ¶50,381; TRC IRS: 51,056.25

Employment Taxes

A former president of a corporation was a responsible person for purposes of the trust fund recovery penalty with respect to underpaid employment taxes. The former president acted willfully because he knew of the unpaid employment taxes and failed to make payment when funds were available. The corporation paid its creditors instead of meeting its tax obligations. The individual acknowledged that he was primarily concerned with preserving shareholder value instead of meeting the tax obligations.

Wheeler, DC Ky., 2015-2 USTC ¶50,382; TRC PAYROLL: 6,306.05

The IRS was entitled to foreclose on and sell a married couple's property to satisfy their trust fund recovery penalty for unpaid employment tax liabilities. The couple did not have a statutory right to redeem the property and the couple did not show they were entitled to redemption on equitable grounds.

Nipper, DC N.M., 2015-2 USTC ¶50,380; TRC IRS: 45,160

Tax Crimes

A sentence of probation imposed upon an individual who pleaded guilty to evading taxes using an undisclosed foreign bank account was proper. No statute required the sentencing court to impose a sentence of imprisonment; in fact, the law the individual violated, Code Sec. 7201, allows a sentencing court to impose just a fine.

Warner, CA-7, 2015-2 USTC ¶50,379; TRC IRS: 66,462.15

Split-Dollar

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equals the income recognized by the employee under Reg. §1.61-22(g) or equals the fair market value of the contract if it is transferred to the employee. Here, the policy was not transferred and the employees did not recognize any income.

The court found that each owner/employee must include in income (as compensation) all of the economic benefits provided by the Plan through the insurance policies. The value of the economic benefits included the cost of current life insurance protection; the cash value that the employee has access to; and any other economic benefit provided.

Penalties

The court held the parties liable for the 20 percent accuracy-related penalty under Code Sec. 6662(a) for significantly underreporting income. The court also found that the parties were liable for the 30 percent penalty for failing to adequately disclose a reportable transaction. Only one penalty applies to the same underpayment.

Further, the parties failed to show reasonable cause for the understatements of income. They relied on persons who promoted or sold the arrangement, and did not demonstrate reliance on any impartial legal advisors.

References: Dec. 60,344; TRC COMPEN: 48,156.05.

PRACTITIONERS' CORNER

Navigating the ACA's Employer Shared Responsibility Requirements And Reporting

Applicable large employers (ALEs) are subject to the Affordable Care Act's shared responsibility rules, popularly known as the "employer mandate." Wolters Kluwer has several resources now available on IntelliConnect to assist practitioners in understanding the ACA's employer shared responsibility requirements. These include a Briefing: Employer Shared Responsibility Payments and Reporting under the Affordable Care Act, along with Affordable Care Act: Law, Regulatory Explanation & Analysis 2015. This Practitioners' Corner highlights key excerpts from the Briefing.

Applicable Large Employers

An employer qualifies as an applicable large employer (ALE) for a calendar year if it averaged 50 or more full-time and full-time equivalent employees during the prior year. Sole-proprietors, partners, 2% plus S corporation shareholders, real estate agents, direct sellers, and independent contractors are not employees for these purposes. A full-time employee averages at least 30 hours of service per week, or has 130 hours or more of service during the month. A fulltime equivalent employee (FTE) is a combination of part-time employees. The FTE count is determined by adding the number of hours of service of employees who are not full-time employees (but not more than 120 hours per employee) for the month, and then dividing by 120.

- **Comment.** FTEs are used solely for determining ALE status, and are not used for determining shared responsibility payments.
- **Comment.** Transition rules apply for the 2015 plan year so that employers with fewer than 100 (instead of 50) full-time employees are not applicable large employers, the offer of coverage does not have to include dependents, and an employer is considered to have offered coverage if it offers it to 70 (instead of 95) percent of its full-time employees.

ALE status is determined by aggregating controlled group employers. Individual employer members of the aggregated ALE group are known as Applicable Large Employer Members (ALEMs). Shared responsibility payment and reporting duties are applied to each ALEM separately. A single employer ALE is treated as an ALEM for these purposes.

Play or Pay Decision

If an ALEM decides to "play" by offering coverage rather than pay shared responsibility assessments, there are two routes it can go. It can offer low-cost coverage to at least 95% (70% for 2015) of its full-time employees, which will mean no liability for failing to offer coverage, but some risk of shared responsibility liability for not offering affordable coverage or coverage providing minimum value to all of its full-time employees. Or it can pay more for insurance coverage, and offer coverage that meets affordability and minimum value standards to all of its full-time employees in which case it will be insulated from shared responsibility liability altogether.

"The IRS has provided two methods for using hours of service to determine full-time status: the monthly measurement method, and the look-back safe harbor measurement method. These methods provide minimum standards for the identification of full-time employees."

Code Sec. 4980H(a) Liability

Payments for Not Offering Coverage Under Code Sec. 4980H(a): if an ALEM fails to offer its full-time employees and (after 2015) their dependents the opportunity to enroll in minimum essential coverage for any calendar month, and it has at least one full-time employee that has obtained subsidized coverage through a Marketplace an Exchange for that period, a shared responsibility payment may be imposed based on the full-time employee count of the ALE of which the ALEM is a member.

Code Sec. 4980H(b) Liability

The shared responsibility payment under Code Sec. 4980H(b) for offering coverage that does not meet affordability or minimum value standards is the product of: (a) the number of the full-time employees receiving a premium tax credit or cost-sharing subsidy certification for the purchase of health insurance through a state or federal health exchange for the month, times (b) an amount equal to 1/12 of $3,000 for any month (i.e. $250 per month). After 2014, the $3,000 amount is adjusted for inflation. The payment under Code Sec. 4980H(b) is assessed only if the ALEM is not assessable under Code Sec. 4980H(a) for failing to offer coverage to its full-time employees. The payments under Code Sec. 4980H(b) are capped so they can never exceed what the ALEM would owe under Code Sec. 4980H(a).

Identifying Full-Time Employees

The IRS has provided two methods for using hours of service to determine full-time status: the monthly measurement method, and the look-back safe harbor measurement

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SFC prepares two year extenders package

At press time, the Senate Finance Committee (SFC) is expected to mark up a two-year extension of tax provisions that expired at the end of 2014. The two-year extension is estimated to cost $95 billion over 10 years. "This markup will give the committee a timely opportunity to act on extending a number of expired provisions in the tax code that help families, individuals and small businesses," SFC Chair Orrin Hatch, R-Utah, said. The extenders package includes individual and business incentives, such as the state and local sales tax deduction, teachers' classroom expense deduction, research credit, Work Opportunity Tax Credit (WOTC), Indian employment credit, New Markets Tax Credit, a number of energy incentives, transit benefits parity, and more.

House approves highway bill with tax provisions

House lawmakers on July 15 approved the Highway and Transportation Funding Bill of 2015, Part II (HR 3038), which would fund and extend the authorization for highway and transit programs through December 18, 2015. The final vote was 312 to 119. The measure is paid for by increased tax compliance rules, which cover $5 billion of the bill's $8.1-billion total cost. The bill, which was introduced by House Ways and Means Chair Paul Ryan, R-Wisc., and House Transportation and Infrastructure Committee Chair Bill Shuster, R-Pa., calls for modifications to mortgage reporting requirements, estate inheritance reporting and tax return due dates. The bill impacts filing deadlines, including modifications to the due date of the FBAR (FinCEN Form 114).

The bill faces an uncertain future in the Senate, however, as Senate Majority Leader Mitch McConnell, R-Ky., plans to propose a multi-year bill of two-to-four years. At press time, McConnell's proposal reportedly would use increased tax compliance rules and other undisclosed tax offsets that have received positive feedback from Senate Democrats. McConnell said he was "fairly optimistic" that the Senate could take up and pass a highway bill before the end of July, when the Highway Trust Fund runs out of money.

At the same time, House Democrats introduced a long-term transportation bill, funded in part by cracking down on corporate tax inversions. The Generating Renewal, Opportunity, and Work with Accelerated Mobility, Efficiency, and Rebuilding of Infrastructure And Communities Throughout America (GROW AMERICA) Act would authorize President Obama's six-year transportation plan, providing $478 billion over that period to rebuild infrastructure. The tax provision raises $41 billion by tightening restrictions on corporate tax inversions, limiting the ability of U.S. companies to avoid U.S. taxation by moving their mailing address overseas.

Koskinen updates lawmakers on ACA implementation

IRS Commissioner John Koskinen has told lawmakers that some 76 percent of taxpayers reported they had minimum essential health coverage on their 2014 federal income tax returns. Koskinen wrote to lawmakers on July 17.

The Affordable Care Act requires individuals to carry minimum essential health coverage or make a shared responsibility payment, unless exempt. Koskinen also reported that some 12 million taxpayers claimed an exemption from the individual mandate. Approximately 7.5 million taxpayers reported a total of $1.5 billion in individual shared responsibility payments. Payments were generally relatively small, with the average payment around $200. About 40 percent of these payments were $100 or less and about 95 percent of these payments were $500 or less.

Koskinen also reported that some 300,000 taxpayers reported a shared responsibility payment when they should have claimed a health care coverage exemption. The IRS intends to send letters to these taxpayers, informing them about available exemptions and note that they may benefit from amending their return. The IRS is also working with tax software companies to help address this issue going forward.

Bills would revise Tax Code language for *Obergefell* decision

On July 16, House Ways and Means Committee ranking member Sander Levin, D-Mich., introduced the Equal Dignity for Married Taxpayers Bill to clarify equal treatment for all married couples under the Tax Code. Senate Finance Committee ranking member Ron Wyden, D-Ore., along with the Democratic caucus, introduced an identical measure in the Senate on July 9. The bills would update the Tax Code to make it consistent with the Supreme Court's recent decision that same-sex couples have a constitutional right to marry (*Obergefell, 2015-1* USTC *¶50,357*). "As the Supreme Court recently ruled in favor of marriage equality, my bill would effectuate this equality to all married couples under our country's Tax Code, providing them with the fairness, dignity, and basic rights we all deserve," Levin said in a statement. Wyden said that the bill ensures that the nation's tax law properly reflects the landmark civil rights decision, offering equal treatment to all married taxpayers.

FinCEN acts to curb tax refund fraud

Treasury's Financial Crimes Enforcement Network (FinCEN) recently issued a Geographical Targeting Order (GTO) to curb tax refund fraud. The GTO, issued in coordination with the IRS, requires check-cashing entities to obtain and record additional identifying information about customers cashing tax refund checks over $1,000. The GTO applies to the following counties in Florida: Miami-Dade and Broward.

U.S. and Vietnam sign tax treaty

The United States and Vietnam have signed a new income tax treaty. Among other provisions, the treaty provides for reductions in withholding taxes on cross-border payments of dividends, interest and royalties. The treaty now goes to the Senate.

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method. These methods provide minimum standards for the identification of full-time employees. Employers may always treat additional employees as eligible for coverage, subject to compliance with any nondiscrimination or other applicable requirements

Under the monthly measurement method, an ALEM determines each employee's status as a full-time employee by counting the employee's hours of service for each calendar month. Special rules apply for offering coverage to an employee who qualifies for the first time for an offer of coverage, and for employees who return after a leave of absence. The look-back method uses standard measurement periods to determine employee status, and associated stability periods during which the employees are treated in accordance with their status as so determined.

Regulations provide separate rules for ongoing employees, new full-time employees who are not seasonal, and new employees who are variable hour, seasonal or part-time. Special rules apply for new variable, seasonal or part-time employees as they transition to ongoing employees. Special rules are also provided for employees rehired after termination or resuming service after an absence. The lookback method and the monthly method may be used concurrently for different categories of employees.

- **Comment.** The look-back method is relatively complex and inflexible compared to the monthly method, and it can result in the employer having to offer coverage to an employee for some time after the employee is no longer otherwise qualified for an offer of coverage under the plan. However, the look-back method provides stability and a degree of certainty. Employees that average near 30 hours per week will not simply be popping into and out of coverage eligibility. Also, employers may tailor their lookback rules for greater flexibility by using shorter periods, or lean towards stability with longer periods.

Code Sec. 6055 Reporting

Code Sec. 6055 provides that every provider of "minimum essential coverage" must report coverage information by filing an information return with the IRS and furnishing a statement to individuals. Generally, providers are insurers, carriers, or government agencies providing coverage, but they can include any employer with a self-insured plan. Health coverage provider reporting is done through two forms: Form 1094-B (a pure transmittal form, used to identify the reporting entity and transmit Forms 1095-B), and Form 1095-B (statements furnished to individuals with a copy sent to the IRS).

- **Comment.:** Beginning on January 1, 2014, individuals are required to either maintain minimum essential coverage for every month in the calendar year, claim an exemption, or pay a penalty. For 2014, the individual shared responsibility payment is the greater of: one percent of household income that is above the tax return filing threshold for the individual's filing status; or the individual's flat dollar amount, which is $95 per adult and $47.50 per child, limited to a family maximum of $285, but capped at the cost of the national average premium for a bronze level health plan available through the Marketplace in 2014. For 2015, the payment is the greater of two percent of household income that is above the tax return filing threshold for the individual's filing status; or the flat dollar amount, which is $325 per adult and $162.50 per child, subject to certain ceilings. The information on these forms is used by the IRS to confirm that the individual has satisfied the individual shared responsibility provisions of ACA.

ALEMs will definitely be subject to Code Sec. 6056, but may also be subject to Code Sec. 6055. However, ALEMs will not file Forms 1094-B/1095-B. Entities subject only to Code Sec. 6055 who will report on 1094-B/1095-B are: Small employers not subject to the employer shared responsibility provisions sponsoring self-insured group health plans; and Health insurance issuers or carriers who provide individual market coverage, coverage for employees of small employers who obtain coverage through the SHOP, and coverage provided through fully insured plans sponsored by employers.

Code Sec. 6056 Reporting

Code Sec. 6056 requires ALEs to file information returns with the IRS, and provide statements to their full-time employees about the health insurance coverage the employer offered. An ALE may be a single entity or may consist of a group of related entities (such as parent and subsidiary or other affiliated entities) treated as a single employer under Code Secs. 414(b), 414(c), 414(m), or 414(o). Each entity is known as an ALEM.

For each of its full-time employees, the ALEM is required to file a return with the IRS and furnish a statement to the employee reporting on whether an offer of health coverage was or was not made to the employee. If an offer was made, the ALEM must report the required information about the offer. Therefore, even if an ALEM does not offer coverage to any, or only some, of its full-time employees, it must file returns with the IRS and furnish statements to each of its fulltime employees to report information specifying that coverage was or was not offered.

Code Sec. 6056 reporting serves two purposes:

- Each ALEM with full-time employees is the entity responsible for filing and furnishing statements with respect to its full-time employees under Code Sec. 6056. For example, if a corporation is made up of a controlled group of twelve ALEM subsidiaries, each ALEM would file separately from each other, and only for the full-time employees that work for that subsidiary. This is consistent with the manner in which any potential assessable payments under Code Sec. 4980H will be calculated and administered.
- It allows the employees who receive the statements to determine if they are actually eligible for the premium tax credit under Code Sec. 36B. The advanceable and refundable Code Sec. 36B premium tax credit helps individuals afford health insurance coverage purchased through an Exchange. An employee is not eligible for the premium tax credit if the employee is offered affordable minimum essential coverage under an employer-sponsored plan that provides minimum value, or if the employee enrolls in an employer-sponsored plan that provides minimum essential coverage.

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COMPLIANCE CALENDAR

■ **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.)

■ **August 5**
Employers deposit Social Security, Medicare, and withheld income tax for July 29, 30, and 31.

■ **August 7**
Employers deposit Social Security, Medicare, and withheld income tax for August 1, 2, 3, and 4.

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 "Tax Research Consultant" Helpline (1-800-344-3734).

Q A few years ago the IRS changed the instructions related to the self-employed health insurance deduction to make it clear that Medicare premiums could be deducted as self-employed health insurance. But are Medicare premiums of a spouse of a taxpayer that owns his/her own business deductible?

A All Medicare premium payments paid by or on behalf of a self-employed individual can be taken into account for purposes of the deduction if all other requirements are met. This includes Medicare premiums made on behalf of the self-employed individual's spouse, dependent, or child (i.e. an individual who is under age 27 at the end of the tax year, but is not a dependent). See Letter Ruling 201228037; TRC COMPEN: 45,250.

Q When is the 130 percent AFR applicable and to what Code section would it be applied?

A The 130 percent Applicable Federal Rate (AFR) is utilized in two places:

- Reg. §1.482-2(a)(2)(iii) provides a safe harbor for an arm's-length interest rate charged on loans between members of a group of controlled entities (130 percent of the AFR is the upper limit). See INTL: 15,108.15 for an explanation of the safe harbor.
- Reg. §1.679-4(c) providing the definition of a qualified obligation in determining whether a transfer by a U.S. person to a foreign trust is for fair market value (130 percent of the AFR is the upper limit of yield to maturity). See TRC INTL: 30,252.05 for an explanation.