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IRS Delays Uniform Basis Reporting Requirements For Estate Tax Property Until Late February 2016

Notice 2015-57

The IRS has delayed new uniform basis reporting requirements for estate tax property until February 29, 2016. The delay will give the IRS time to issue guidance so that executors, beneficiaries, and others can comply with the new reporting requirements.

- ***Take Away.*** Under the stepped-up basis rules of Code Sec. 1014, the basis of property acquired from a decedent generally is the property's fair market value, either at the date of death or six months later (the alternate valuation date). However, beneficiaries who receive estate property are not required to use the same value (and the same basis) reported by the estate. Because there has been no consistency requirement, the recipient could claim that the property's fair market value (and the basis) were higher than the estate tax value. Recent legislation imposed a consistency requirement, but left it to the IRS to prescribe reporting requirements and deadlines.

Background

Under Code Sec. 6018(a)(1), the executor of an estate must file an estate tax return where the gross estate at the death of a citizen or resident exceeds the basic exclusion amount for the year the individual died. Under Code Sec. 6018(b), an executor who cannot file a complete return must include in the return a description of property of the estate and the name of every person holding a legal or beneficial interest in it. Upon notice from the IRS, the beneficial shall file a return regarding the property. Under Code Sec. 1014(a), the basis of property acquired from a decedent or decedent's estate is the fair market value of the property.

New basis requirement

The Administration's 2016 budget proposals included a proposal to eliminate the inconsistency. In the *Surface Transportation Act of 2015* (signed into law by President Obama on July 31, 2015), Congress enacted Code Sec. 1014(f) and Code Sec. 6035 to impose the consistency requirement.

- ***Comment.*** The consistency requirement only applies to property that was includible in the gross estate and that increases estate tax liability.

Code Sec. 1014(f) requires that the basis of any property, as determined under Code Sec. 1014(a), shall not exceed the value determined for applying the estate tax. The value determined for the estate tax is either the final value determined for the estate tax, or the value reported under Code Sec. 6035. The final value is the value shown

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IRS Describes Filing Specifications For ACA Information Returns By Insurers And ALEs

www.irs.gov

Recently released draft instructions describe various electronic filing specifications for several information returns required by the *Affordable Care Act* (ACA). The draft instructions provide guidance on Forms 1094-B Transmittal of Health Coverage Information Returns; 1094-C Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns; 1095-B Health Coverage; and 1095-C Employer-Provided Health Insurance Offer and Coverage.

- ***Take Away.*** The first information returns required to be filed are for the 2015 calendar year. The IRS will not impose penalties under Code Sec. 6055 or Code Sec. 6056 for the first year of filing (returns and statements filed and furnished in 2016 to report offers of coverage in 2015) if reporting entities can show they have made good faith efforts to comply with the information reporting requirements.

Reporting

Code Sec. 6055, created by the ACA, provides that every provider of minimum essential coverage (MEC) must report coverage information by filing an information return with the IRS and providing a statement to individuals. Code Sec. 6056 requires applicable large employers (ALEs) to file information returns with the IRS, and provide statements to their full-time employees. The employer generally must provide information on the coverage (if any) offered to the employee, including the months for which MEC was available and for which the employee was covered under an employer-sponsored plan.

Draft instructions

Draft Publication 5165, Guide for Electronically Filing Affordable Care Act (ACA) Information Returns (AIR) for Software Developers and Transmitters (Processing Year [PY] 2015) describes communication procedures, transmission formats and validation procedures. The IRS also has issued draft instructions for general and program specific testing information for use with ACA Assurance Testing System (AATS) (Publication 5164, Test Package for Electronic Filers of Affordable Care Act (ACA) Information Returns). Software developers must pass all applicable test scenarios for the forms the software package supports, before the software packages are approved, the IRS explained.

In draft Publication 5223 (General Rules and Specifications for Affordable Care Act Substitute Forms 1095-A, 1094-B, 1095-B, 1094-C, and 1095-C), the IRS explained that for a substitute form or statement to be acceptable, it must conform to the official form or official specifications. The IRS will not allow substitute forms that include logos, slogans and advertisements as the recipient may not recognize the importance of the recipient copy for tax reporting purposes.

Reference: TRC HEALTH: 6,106.

Basis

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on the estate tax return and not contested by the IRS; the value prescribed by the IRS and accepted by the taxpayer; or the value determined by a court or agreement with the IRS.

New reporting requirements

Code Sec. 6035 requires executors that must file a return under Code Sec. 6018(a) or (b) to provide a statement of the property's value to the recipient and to the IRS. The executor must furnish the statement to both the IRS and the recipient that identifies the value of the property and provides any other information required by the IRS. The statement must be furnished by the earlier of the date that is 30 days after the due date of the estate tax return (including extensions), or that is 30 days after the return was filed. The statute authorizes the IRS to issue regulations to implement Code Sec. 6035.

Notice 2015-57

The new law applies to property for which a federal estate tax return is filed after July 31, 2015. For returns filed after July 31, 2015, the IRS delayed the requirement to file a statement under Code Sec. 6035 until February 29, 2016, if the statement would have been due before that date.

The IRS instructed executors and other persons required to file or furnish a statement under Code Sec. 6035 not to do so until it issues forms or other guidance to implement the reporting requirements. The IRS indicated that it expects to issue additional guidance under Code Sec. 1014(f) and 6035 and asked for comments.

- ***Comment.*** The new law added penalties for inconsistent estate tax basis reporting and for failures to file correct information returns and furnish correct statements.

References: FED ¶46,387; TRC SALES: 6,156.

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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Annuity Withdrawal Exceeded "Income On Contract" And Was Taxable, Tax Court Finds

Tobias, TC Memo. 2015-164

A married couple failed to persuade the Tax Court that their early distribution from an annuity should not be included in income. The amount of the distribution exceeded their "income on the contract." The court also upheld the Code Sec. 72(q)(1) penalty despite the wife's claim of being disabled.

- ***Take Away.*** Just before trial, the IRS moved to assert an accuracy-related penalty. The court granted the IRS's motion, finding that the couple had been given sufficient notice (two weeks) to address the penalty in post-trial briefing. The court ultimately upheld the accuracy-related penalty.

Background

In 2003, the taxpayer (who worked as a self-employed attorney) and his wife purchased a variable rate annuity (first annuity) for an initial investment of $228,800. The couple purchased the annuity with inherited securities they sold at a loss of $158,000. The couple subsequently made additional after-tax investments of $346,000 in the annuity. The couple surrendered the annuity in 2007. At that time, the value of the annuity was $794,000 (reflecting their investments and accrued earnings). The couple transferred the proceeds to a new variable annuity (second annuity).

In 2010, the couple withdrew $525,000 from the second annuity to purchase a residence. No tax was withheld. The second annuity issued a Form 1099-R, reporting the taxable amount as $186,000.

Court's analysis

The court first noted that an annuity is a contract to receive future periodic payments. The purchaser pays premiums that the annuity provider invests, generating income to cover the promised future payments. Gains on investments within an annuity are not taxed until the purchaser receives distributions.

Payments received under an annuity contract before the annuity starting date are included in the recipient's income, the court found. The "income-first" rule of Code Sec. 72(e) provides that payments received before the annuity starting date are included in gross income to the extent allocable to income on the contract. This amount is calculated by subtracting the recipient's "investment in the contract" from the cash value of the contract immediately before the distribution is received, disregarding any surrender charges.

Here, the court found that the taxpayers paid total premiums of $575,000 toward the first annuity. They made contributions and paid no premiums toward the second annuity. Therefore, their "investment in the contract" under the second annuity was $575,000 at the time of their withdrawal. Further, the couple had $186,000 of "income on the contract" (reflecting cash value of $761,000 minus their "investment in the contract" of $575,000). Because the amount of the withdrawal exceeded their "income on the contract," Code Sec. 72(e)(2)(B)(i) required that they include the latter amount in gross income for 2010. The balance of the distribution constituted a tax-free recovery of basis, the court found.

The court rejected the taxpayers' argument that the calculation should take into account their $158,000 loss when they sold securities to acquire the first annuity. Their "investment in the contract," which determined the amount taxable under Code Sec. 72(e)(2), was "the aggregate amount of premiums or other consideration paid for the contract," the court found.

Penalty

There is an exclusion from the 10 percent penalty under Code Sec. 72(q)(1) for distributions attributable to the taxpayer's becoming disabled. Here, the wife argued she was disabled at the time of the 2010 distribution. The court found that although her illness placed limits on her, the wife was not prevented from engaging in gainful activity and the exclusion did not apply.

References: Dec. 60,386(M); TRC RETIRE: 60,312.

IRS Incorrectly Abated Penalties In 42 Percent Of Cases, TIGTA Reports

The IRS Office of Appeals properly accepted the majority of cases in which the agency had previously denied the taxpayer's request for abatement and sufficiently documented the reasons for the penalty abatements in case files, according to a new report by the Treasury Inspector General for Tax Administration (TIGTA). However, 42 percent of the sampled penalty appeal cases were not abated in accordance with Appeals criteria because the operating divisions had not denied the abatement or because the case files did not support the abatement. Based on its sample, TIGTA estimated that, in fiscal year (FY) 2013, more than $39 million in penalty abatements did not comply with Appeals criteria.

TIGTA's sampling. TIGTA discovered in its sample that 70 cases involved the appeal of penalties in excess of $25,000. In four of the 70 cases, IRS Appeals abated more than $25,000 per case but a manager did not sign as reviewing and approving the case actions.

Recommendations. TIGTA recommended that Appeals provide training to its personnel on how to clearly document the reasons for abatement decisions. The IRS agreed with TIGTA's recommendations and indicated that it intends to provide additional training to employees who work penalty abatement cases.

TIGTA, Ref. No. 2015-10-059; TRC PENALTY: 3,304.

D.C. Circuit Affirms Tax Court's Jurisdiction Over IRS Determination Of Frivolous CDP Hearing Requests

Ryskamp, CA-D.C., August 14, 2015

Affirming the Tax Court, the Court of Appeals for the District of Columbia has found that an IRS determination of frivolousness falls within the category of determinations subject to judicial review. Code Sec. 6330(g), a divided court held, allows the Tax Court to review if the IRS has adequately identified why it deems a taxpayer's request to be frivolous, and whether that frivolousness assessment is facially plausible.

- ***Take Away.*** The Tax Court's scope of review is limited. Code Sec. 6330(g), however, precludes the Tax Court from reaching the merits of a purportedly frivolous position, the court explained. If the Tax Court sustains the IRS's determination of frivolousness, no further review is required, the court held.

Background

In 2011, the IRS informed the taxpayer that it intended to levy on his property to collect unpaid taxes. The taxpayer requested a CDP hearing, which the IRS rejected. The IRS determined that the taxpayer had presented only frivolous arguments for requesting a CDP hearing. The taxpayer filed an amended request for a CDP hearing and the IRS again rejected it as frivolous. The taxpayer next appealed to the Tax Court.

The Tax Court found that the IRS had sent the taxpayer a boilerplate letter that failed to explain the agency's reasons for denying his CDP hearing. This lack of explanation was an abuse of discretion and the court awarded summary judgment to the taxpayer. The court also directed the taxpayer to resubmit his arguments, which he did. Again, the IRS and the Tax Court rejected his arguments and the taxpayer appealed to the D.C. Circuit.

Court's analysis

The court first noted that taxpayers may contest the methods used by the IRS to collect overdue taxes, including the imposition of a levy on a taxpayer's property. After a CDP hearing, a taxpayer may petition the Tax Court for review.

Generally, the Tax Code defines as frivolous any position that appears on the IRS's published list of frivolous positions or that otherwise reflects a desire to delay or impede the administration of federal tax laws. The court found that the IRS's roster of frivolous positions includes arguments such as compliance with the internal revenue laws is voluntary or optional; the taxpayer's income is not taxable because he is a citizen exclusively of a state (and not a United States citizen); only certain types of taxpayers are required to pay income taxes (such as federal government employees or corporations); and federal income taxes are unconstitutional.

Code Sec. 6330(g), the court found, does not strip the courts of jurisdiction to review the narrow question whether the IRS correctly determined that all of a taxpayer's arguments are frivolous. Code Sec. 6330 recognizes the Tax Court's jurisdiction to review a "determination under this section." A determination includes decisions under Code Sec. 6330(g) where the IRS concludes that a taxpayer's arguments are frivolous, the court held.

Dissent

The dissent would have found that Code Sec. 6330(g) stripped the Tax Court of jurisdiction over determinations of frivolousness by the IRS. Code Sec. 6330(g), the dissent stated, is a "closed door, not an invitation to come inside and engage in a little 'gate-keeping' review."

References: 2015-2 USTC ¶50,434; TRC IRS: 48,058.

IRS Reminds Employers To Distinguish Employees From Independent Contractors

Employers are responsible for correctly classifying workers as employees or independent contractors, the IRS recently reminded employers in a fact sheet. The IRS highlighted the factors for determining employee status or if a worker is an independent contractor.

- ***Take Away.*** The question of whether a worker is an employee or an independent contractor has taken on new life in today's "sharing economy." Court cases where individuals claim they are employees rather than independent contractors are pending.

Independent contractors are responsible for paying over federal employment and income taxes. In contrast, employers must withhold and pay over federal employment and income taxes on behalf of employees. Before an employer can determine how to treat payments for services, it must first know the relationship that exists between it and the person performing the services.

The IRS reminded employers that evidence of the degree of control and independence over a worker falls into three categories: behavioral, financial and the type of relationship. If, after reviewing the three categories of evidence, it remains unclear if a worker is an employee or an independent contractor, Form SS-8, Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding (PDF) can be filed with the IRS. The IRS will review the facts and circumstances and determine the worker's status.

If an employer classifies an employee as an independent contractor and the employer lacks a reasonable basis for doing so, the employer may be held liable for employment taxes for the worker. Where the employer had a reasonable basis, relief may be available (known as Section 530 relief).

FS-2015-21; TRC COMPEN: 3,050.

IRS Launches Early Interaction Initiative To Maintain Payroll Tax Compliance

www.irs.gov

The IRS has developed a new initiative to remind employers of their payroll tax obligations and to prevent the pyramiding of missed deposits. The Early Interaction Initiative will make expanded use of federal tax deposit alerts (FTD Alerts) to help taxpayers maintain payroll tax compliance.

- ***Take Away.*** Many employers use payroll service providers to file employment tax returns and make deposits. The *Tax Increase Prevention Act of 2014* instructs the IRS to create a certification program for payroll service providers (see the August 13, 2015 issue of this newsletter for details).

Background

There are two schedules for making deposits of payroll taxes: monthly and semiweekly. The timing and frequency of an employer's deposits for an employer that files Form 941 are determined on an annual basis based on its deposit history during a look-back period ending on June 30 of the preceding year. An employer is a monthly depositor for the entire calendar year if the aggregate amount of employment taxes reported for the look-back period is $50,000 or less. Employers that accumulate a tax liability of $100,000 or more on any day during a deposit period must deposit the tax by the next business day, whether the employer is a monthly or semiweekly schedule depositor.

The IRS routinely assigns FTD Alerts when records show a decline in an employer's payroll tax deposits. Field collection staff will contact the taxpayer to determine if there was a missed deposit and what actions may be taken to maintain payroll tax compliance.

New initiative

The IRS reported that it is working to issue FTD Alerts more quickly. When the IRS identifies a decline in payroll tax deposits, taxpayers will be contacted, in many cases, by letter. The letter will ask the taxpayer to contact the agency (by phone or letter) to explain any reason for the decrease in payroll tax deposits. Other FTD Alerts will be assigned to field collection staff with priority given to cases where the employer has preexisting delinquencies.

Field collection staff will work with taxpayers to return them to compliance as soon as possible. Cases will be closed, the IRS explained, if an employer has an explanation for the decline in payroll tax deposits, such as a reduction in workers.

Reference: TRC PAYROLL: 6,106.

Payments From Ex-Spouse Not Alimony; Tax Court Could Not Find Termination At Death

Crabtree, TC Memo. 2015-163

Reversing the IRS, the Tax Court has found that payments following a taxpayer's divorce did not constitute alimony. The court agreed with the taxpayer that the payments were excludible from income because the payments failed to satisfy the criteria for alimony under Code Sec. 71(b).

- ***Take Away.*** In *Mukheriee, TC Memo. 2004-98, Dec. 55,613(M),* the Tax Court explained that in Code Sec. 71(b)(1)(D), Congress recognized that payments would be for the support of the recipient. Congress intended to prevent the deduction of amounts that are in effect transfers of property unrelated to the support needs of the recipient spouse, the court noted.

Background

The taxpayer's marriage ended in 2006. The divorce agreement provided that the taxpayer's former husband would pay $5,200 monthly in alimony/child support for eight years as long as the taxpayer did not remarry. The agreement was silent as to whether the ex-husband's obligation would terminate upon the death of the taxpayer.

The taxpayer did not report the payments as alimony on her 2010 return. According to the taxpayer, the payments did not constitute alimony and were excludible from her gross income.

Court's analysis

Code Sec. 71(b), the court found, defines alimony as any payment in cash that satisfies certain conditions. One condition is that a payment constitutes alimony only if there is no liability to make any such payment for any period after the death of the payee spouse.

Here, the taxpayer's agreement did not specify if the ex-husband's payment obligation would terminate upon the taxpayer's death. The court looked to the language of the agreement and found that the agreement obligated the ex-husband to pay a certain amount for a continued eight year period. The agreement did not suggest that the eight year period would be shortened by the taxpayer's death, the court noted. Further, the agreement provided that the ex-husband's payment obligation would terminate if the taxpayer remarried.

The court concluded that the ex-husband's payment obligation not terminate in the event of his death. The payments did not constitute alimony because the divorce agreement did not eliminate the liability of the payor to make payments after the death of the payee.

- ***Comment.*** The court also looked to state law (Delaware) but found it ambiguous.

References: Dec. 60,385(M); TRC INDIV: 21,206.05.

Information Reporting Not Required For Payments By Court Clerks, Chief Counsel Determines

CCA 201533012

IRS Chief Counsel has determined that court clerks need not issue a Form 1099 when the court sends a debtor's garnished funds to a creditor's attorneys. Form 1099 is also not required to be furnished to an attorney who is refunded his or her client's money at the end of a case. Additionally, no Form 1099-S, Proceeds From Real Estate Transactions, would need be issued on real estate foreclosure transactions.

- ***Take Away.*** Chief Counsel characterized as a "close call" the question of whether a judge in the exercise of his or her judicial duties in collection actions would be subject to information reporting responsibilities under the "middleman regs." The issue of who should report payments under the middleman regs would be obviated if the court order of distribution or order to disburse garnished personal earnings provided that defendants were responsible for information reporting requirements, Chief Counsel noted. Chief Counsel did not elaborate further on the issue in this CCA.

Background

Among their duties, the clerks of court account for all monies collected and disbursed. The clerks collect garnishment proceeds and forward them to the creditor. The clerks also return certain court fees paid by litigants and are involved in certain foreclosure actions.

Chief Counsel's analysis

Chief Counsel determined that the clerks were not payors. The clerks did not perform management or oversight functions. Likewise, the clerks did not have a significant economic interest in the payment. The monies were distributed by order of court and the clerks had no discretion in making the payments.

Chief Counsel also determined that the clerks would not be required to issue a Form 1099 to an attorney whose client's money has been refunded at the end of a case. A deposit made and returned to a taxpayer generally does not constitute an accession to wealth. The clerk's office would not know if the taxpayer who made the deposit took a deduction and received a tax benefit for the amount deposited. Additionally, no Form 1099 would need to be issued on foreclosure real estate transactions.

Reference: TRC FILEBUS: 9,206.

AFRs Issued For September 2015

Rev. Rul. 2015-19

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

Applicable Federal Rates (AFR) for September 2015

Short-Term	Annual	Semiannual	Quarterly	Monthly
AFR	.54%	.54%	.54%	.54%
110% AFR	.59%	.59%	.59%	.59%
120% AFR	.65%	.65%	.65%	.65%
130% AFR	.70%	.70%	.70%	.70%
Mid-Term				
AFR	1.77%	1.76%	1.76%	1.75%
110% AFR	1.95%	1.94%	1.94%	1.93%
120% AFR	2.12%	2.11%	2.10%	2.10%
130% AFR	2.30%	2.29%	2.28%	2.28%
150% AFR	2.66%	2.64%	2.63%	2.63%
175% AFR	3.10%	3.08%	3.07%	3.06%
Long-Term				
AFR	2.64%	2.62%	2.61%	2.61%
110% AFR	2.90%	2.88%	2.87%	2.86%
120% AFR	3.16%	3.14%	3.13%	3.12%
130% AFR	3.44%	3.41%	3.40%	3.39%

Adjusted AFRs for September 2015

	Annual	Semiannual	Quarterly	Monthly
Short-term adjusted AFR	.45%	.45%	.45%	.45%
Mid-term adjusted AFR	1.52%	1.51%	1.51%	1.51%
Long-term adjusted AFR	2.64%	2.62%	2.61%	2.61%

The Code Sec. 382 adjusted federal long-term rate is 2.64%; 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)(1) appropriate percentages for the 70% and 30% present value low-income housing credit are 7.51% and 3.22%, 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 ¶46,386; TRC ACCTNG: 36,162.05.

D.C. Circuit Dismisses, As Premature, Bankers' Challenge To Regs Requiring Reporting Of Interest Income Earned By Nonresident Aliens

Florida Bankers Association, CA-D.C., August 14, 2015

The Court of Appeals for the D.C. Circuit dismissed a lawsuit by two bankers' associations that challenged IRS regs (TD 9584) that require U.S banks to report to the IRS interest income (above $10) earned by nonresident aliens on accounts held by the banks. The court concluded that the lawsuit was premature and was barred by the *Anti-Injunction Act* (AIA) and the *Declaratory Judgment Act.*

- ***Take Away.*** The court stated that the banks could still challenge the interest-reporting regs. The issue was when - not if - a bank may challenge the regs. The court indicated that a bank could decline to submit a required report, pay the penalty, and sue for a refund, and a court could consider the legality of the regs. Here, the bankers' lawsuit, if successful, would have invalidated the reporting requirement prematurely and restrained the collection of the tax in violation of the AIA.

Background

The IRS adopted the regs in 2012, and they took effect in 2013. A federal district court upheld the regs on the merits and rejected the bankers' challenge to the regs (*2014-1* USTC *¶50,133*).

- ***Comment.*** The interest-reporting regs are controversial. The interest paid to nonresident aliens is not taxable in the U.S. The regs enable the IRS to collect information on the income and assets of foreign taxpayers and to exchange that information with foreign countries that have tax treaties or tax information exchange agreements with the U.S. This will play an important role in the implementation of the *Foreign Account Tax Compliance Act* (FATCA), which requires foreign governments and foreign financial institutions to provide information on foreign accounts of U.S. taxpayers.

Court's analysis

The D.C. Circuit vacated the district court decision (apparently as a premature decision on the merits), instead of upholding it. The result was the same for now; the court dismissed the bankers' challenge, but left the door open to a subsequent challenge of the regs.

The appeals court dismissed the lawsuits because of the AIA and the Declaratory Judgment Act. Both statutes bar lawsuits to restrain the assessment or collection of a "tax." Under Code Sec. 6671, the reference to a tax also includes a penalty imposed by the tax code, such as the "penalty" owed by a bank that fails to report the interest it pays to a nonresident alien.

- ***Comment.*** The court cited the Supreme Court's decision on the Affordable Care Act, *NFIB v. Sebelius, 2012-2* USTC *¶50,423,* which concluded that the "individual mandate" imposed by the ACA was still a tax.

The court also rejected the bankers' argument that they were not challenging the collection of a tax but were seeking relief from a regulatory mandate that exists separately. The court concluded that the AIA cannot be sidestepped by this argument, and again found support in various Supreme Court decisions that rejected challenges to the regulatory aspect of a regulatory tax.

References: 2015-2 USTC ¶50,436;

TAX BRIEFS

Internal Revenue Service

The IRS has provided the domestic asset/liability percentages and domestic investment yields needed by foreign life insurance companies and foreign property and liability insurance companies to compute their minimum effectively connected net investment income under Code Sec. 842(b) for tax years beginning after December 31, 2013.

Rev. Proc. 2015-42, FED ¶46,388;

The IRS has scheduled a public hearing on a proposed regulation addressing when a foreign insurance company's income is excluded from the definition of passive income for the passive foreign investment company (PFIC) rules (NPRM REG-108214-15, I.R.B. 2015-23, 1035). The hearing is scheduled for Friday, September 18, 2015, at 10:00 a.m. in the IRS Auditorium, Internal Revenue Service Building, 1111 Constitution Avenue, NW., Washington, D.C. 20224.

Notice of Hearing (REG-108214-15), FED ¶46,384; TRC INTLOUT: 18,202.10

Summonses

An individual's petition to quash an IRS third-party summons issued to a bank seeking records in connection with the individual's accounts was denied. The IRS was not precluded from issuing the summons even though a Justice Department referral had been made because it related to different tax years.

Stadmueller, DC Calif., 2015-2 USTC ¶50,440; TRC IRS: 21,108

Income

A married couple was required to include in gross income unreported retirement plan distributions and were liable for an additional tax for the early distribution and an accuracy-related penalty. There is no exception under Code Sec. 408 for distributions used to defray ordinary living expenses following the loss of a job or other misfortune.

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Adams, TC, CCH Dec. 60,384(M), FED ¶48,094(M); TRC RETIRE: 42,550

A dentist and his practice were properly held liable for unpaid income and employment taxes and his practice and real property held by his nominee were properly ordered sold. The district court did not commit reversible error in finding that title to the property was held by the dentist's nominee.

De Beck, CA-5, 2015-2 USTC ¶50,435; TRC IRS: 51,158

Deductions

An individual was not engaged in a profit-seeking trade or business and he failed to substantiate his claimed business expenses; therefore, he was not entitled to deduct them.

Pouemi, TC, CCH Dec. 60,383(M), FED ¶48,093(M); TRC BUSEXP: 3,100

Exemptions

An individual failed to report income for the tax year at issue, but was allowed a dependent exemption for his common law spouse. The individual stipulated that he received the income and his claim that only federal government employees received taxable wages was frivolous. However, the individual was entitled to a dependent exemption for his common law spouse because the evidence supported his claim to the dependency exemption, which the IRS failed to refute.

Shimanek, TC, CCH Dec. 60,387(M), FED ¶48,097(M); TRC FILEIND: 6,152

Default Judgment

An individual, who failed to respond to request for admissions, answer discovery requests, comply with court orders or appear at trial, was defaulted and the IRS's deficiency determinations, based on reconstruction of the individual's income were sustained. Penalties for failure to pay estimated taxes and the tax liability shown on a return were imposed.

Putnam, TC, CCH Dec. 60,382(M), FED ¶48,092(M); TRC IRS: 66,106.20

Liens and Levies

A married couple's amended complaint claiming refund of taxes, penalties and interest for the tax years at issue, return of levied property, release of tax liens, and damages for the IRS's failure to release the liens was properly dismissed. The couple's amended complaint contained only conclusory allegations that they had satisfied their tax liabilities and that the liens were legally unenforceable without providing any evidence.

Hook, CA-10, 2015-2 USTC ¶50,441; TRC IRS: 48,202

The government was entitled to reduce to judgment an individual's outstanding tax liabilities and enforce its tax liens by selling the tax debtor's property. However, the government's liens did not take priority because a bank filed its lien on the property first.

Plummer, DC N.C., 2015-2 USTC ¶50,439; TRC IRS: 45,158

Refund Claims

A limited liability company's (LLC's) action claiming due process violations, seeking to quiet title and a refund was dismissed for lack of subject matter jurisdiction. Since the LLC did not obtain a certificate of discharge from the IRS and then file a refund claim, the government had sovereign immunity.

Little Italy Oceanside Investments, LLC, DC Mich., 2015-2 USTC ¶50,438; TRC LITIG: 9,100

Tax Crimes

A 71-month sentence imposed upon an individual for obstructing and impeding the IRS from collecting taxes and for passing bad checks with intent to defraud was vacated and remanded. Since the "tax loss" reflects the tax revenue that the government was owed but did not receive due to the individual's criminal conduct, the tax loss could not exceed the $5.3 million the IRS claimed he owed.

Black, CA-7, 2015-2 USTC ¶50,442; TRC IRS: 66,306

A doctor was properly convicted and sentenced for tax evasion and for structuring a currency transaction in violation of 31 U.S.C. §5324(a)(3). The government properly charged the doctor with structuring by alleging that he engaged in a series of currency transactions under $10,000 for the purpose of evading the reporting requirement.

Sperrazza, CA-11, 2015-2 USTC ¶50,437; TRC FILEBUS: 9,104

IRS Publishes Interest Rates Used To Calculate Value Of Farm Land For Estate Tax

The IRS has published the annual effective interest rates used by estates to value land that is used for farming. The new rates may be used by estates that value farmland as of a date in 2015.

- ***Comment.*** Code Sec. 2032A provides a special election for executors to value farmland at a reduced rate when determining the value of the gross estate. The farmland must satisfy the requirements for qualified real property under Code Sec. 2032A(b) and Code Sec. 2032A(c).

The rates represent the interest rates on new loans under the Farm Credit System and range from 4.17 to 5.21 percent for 2015. The ruling identifies four Farm Credit System Bank Territories and the states within each territory. The territories include all 50 states plus the District of Columbia.

Valuation method. The special use valuation for farmland is determined under Code Sec. 2032A(e)(7)(A). The calculation includes three steps:

- Calculate the excess average gross cash rental for comparable farmland in the same locale, over the average annual state and local real estate taxes (if deductible) for comparable farmland;
- Find the average annual effective interest rate for Farm Credit Bureau loans for the year that the land is valued.
- Divide the excess gross cash rental determined in the first step by the interest rate determined in the second step.

Rev. Rul. 2015-18; TRC ESTGIFT: 36,252.

PRACTITIONERS' CORNER

SFC's Individual Income Tax Working Group Explores Approaches To Tax Reform

On January 15, 2015, to coincide with the kickoff of a series of tax reform hearings, Senate Finance Committee (SFC) Chair Orrin Hatch, R-Utah, and ranking member Ron Wyden, D-Ore., announced the formation of bipartisan tax reform working groups. After five hearings on the topic, committee members on July 8, 2015 submitted their reports. All of the SFC's white papers describe in great detail possible approaches to many thorny tax reform issues. This Practitioners' Corner highlights some of the insights and approaches of the report prepared by the SFC individual income tax working group.

- ***Comment.*** The SFC reported that it received more than 1,400 recommendations for tax reform, reflecting the level of interest in the subject. The individual income tax working group received the most recommendations for tax reform among all the working groups.
- ***Comment.*** The white papers include a focus on individual income tax and offer policy options and recommendations for the SFC to consider as part of comprehensive tax reform. Earlier in the year Hatch had said that many of the committee members believe that tax reform is "no longer optional." Moreover, Hatch called tax reform "essential" to help jump-start a lagging economy. "In my view, we should minimize tax provisions that stand in the way of efficiently utilizing resources," Hatch said.

Individual income tax

The report from the individual income tax working group, co-chaired by Sens. Charles Grassley, R-Iowa, Mike Enzi, R-Wyo., and Debbie Stabenow, D-Mich., addressed tax administration --including identity theft -- and simplification proposals, as well as tax incentives for higher education.

The working group also acknowledged that because individual tax reform presents difficult challenges, it is an important undertaking for the sake of assisting individual taxpayers. They noted that for many taxpayers, filing their taxes is one of the "primary direct interactions" they have with the federal government. "While much of the Tax Code may seem abstract to the vast majority of taxpayers, millions of taxpayers interact with the individual side of the Tax Code," asserted the group in its report. "In addition, the working group affirmed that the government has a duty to make complying with tax laws as simple and understandable as possible in order that taxpayers are able to make sense of their tax obligations while paying only the amount of tax that is owed."

"As the Tax Code stands now, the working group called it 'frustratingly complex' for the average individual."

Complexity

As the Tax Code stands now, the working group called it "frustratingly complex" for the average individual. "Taxpayers face confusion in terms of which deductions or credits they might be able to take, uncertainty in terms of whether beneficial expiring provisions will be in effect, and a system of tax administration that creates unnecessary difficulties and risk of identity theft," they declared.

The working group further noted that complexity of the Tax Code may result in some taxpayers deferring decisions on making charitable gifts which provide beneficial monetary resources to groups and affiliations that serve communities. "Taxpayers may leave credits and deductions on the table that could help make it easier for them to attend college or vocational school and secure the opportunity to better provide for themselves and their families," they stated. Moreover, they maintained that taxpayers face "too much confusion" in the process of filing their taxes, which could lead to unintended consequences by making them victims of crime by having their personal information compromised. The working group added that taxpayers should have "confidence" that the tax system protects their private information, and allows reasonable access to the IRS for basic questions.

- ***Comment.*** "Getting help from the IRS is often impossible," the working group observed. IRS customer service plummeted this past filing season, with a huge number of so-called "courtesy disconnects."

Raising revenues

While tax reform should aim to make the Tax Code fairer and reduce complexity for individual taxpayers, at the same time, tax reform should also help ensure that the tax code provides adequate revenue for the federal government, but not to excess. The members of the working group said that the goal of individual income tax reform would be a broader base, along with lower rates of tax. Base broadening measures could either substantially reduce, or eliminate, many popular and widely used deductions, credits, and exclusions from income. However, the working group granted that if tax reform aims for overall revenue reduction, there are those who believe that the cost could be alleviated by reducing federal spending. "Indeed, the overall level of revenue needed to fund the government is a broad, over-arching

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WASHINGTON REPORT *by the Wolters Kluwer Washington News Bureau*

Taxpayers file suit over IRS data breach

Two individual taxpayers have filed a lawsuit against the IRS stemming from the breach of the IRS's Get Transcript app earlier this year (Welborn v. IRS, DC-D.C.). The IRS recently announced that the data breach was larger than originally believed and the agency has expanded its outreach to affected taxpayers. According to the IRS, there were 610,000 attempts to gain access to the Get Transcript information, with about 330,000 of those attempts successfully getting through verification measures. The Get Transcript application was shut down in May.

According to the complaint, the IRS had received, but not acted on numerous reports that its systems did not have adequate security…and it had actual knowledge that cybercriminals were engaged in ongoing efforts to hack the IRS systems. "Despite this knowledge, the IRS deliberately and intentionally decided not to implement the security measures needed to prevent the subject data breach." The plaintiffs allege that the IRS violated the *Privacy Act of 1974* and the *Administrative Procedure Act;* and requested damages for their current and future losses and injunctive relief. The plaintiffs also sought to have the court certify the case as a class action.

IRS levies follow legal guidelines, TIGTA finds

The IRS is generally protecting taxpayers' rights when issuing systemic and manual levies in cases for which additional assessments were not included in the levy, according to a new report by the Treasury Inspector General for Tax Administration (TIGTA). TIGTA reviewed statistical samples of systemic and manual levies issued by the Automated Collection System (ACS) and the Integrated Collection System (ICS) and determined that controls ensured that most taxpayers were given notice of their Collection Due Process (CDP) rights at least 30 calendar days prior to the levies' issuance. An additional review of statistical samples of taxpayers' cases that were worked in ACS determined that 40 percent of taxpayers with systemic and 20 percent of taxpayers with manual levies did not receive a new notice of intent to levy after an additional assessment was made on a tax period listed on the levy.

The IRS advised TIGTA that computer programming changes to correct this problem were made for fiscal year 2014 levies. However, TIGTA's review identified other systemic problems of which the IRS was not aware.

DOL projects FUTA credit reduction states

The U.S. Department of Labor (DOL) recently posted an update to potential 2015 FUTA credit reductions. Eight states and the U.S. Virgin Islands have potential credit reductions, DOL reported. The eight states are California, Connecticut, Indiana, Kentucky, New York, North Carolina, Ohio, and South Carolina.

The FUTA tax rate is six percent on the first $7,000 of wages subject to FUTA. Employers may receive a FUTA credit of 5.4 percent for payment of state unemployment insurance tax. However, the credit may be reduced where states have made loans from the Federal Unemployment Trust Fund and have outstanding loan balances on January 1 for two consecutive years, and do not repay the full amount of the loans by November 10 of the second year.

The FUTA credit reduction rate is 0.3 percent for the first year the state is a credit reduction state and an additional 0.3 percent for each year thereafter that the state has not repaid its loans. Additional offset credit reductions may apply to a state beginning with the third and fifth years if a loan balance is still outstanding and certain criteria are not met.

More banks enter DOJ's Swiss Bank Program

Bank Zweiplus and Banca dello Stato del Cantone Ticino have reached resolutions under the U.S. Department of Justice (DOJ) Swiss Bank Program. The announcement brings the number of banks participating in the Swiss Bank Program to more than 30.

Under the Swiss Bank Program, banks are generally required to advise DOJ that they had reason to believe that they had committed tax-related criminal offenses in connection with undeclared U.S.-related accounts. However, banks under criminal investigation cannot participate in the program. According to DOJ, Bank Zweiplus will pay a penalty of $1.089 million. Banca Stato will pay a penalty of $3.393 million.

"The vigorous pursuit of unreported income in hidden offshore accounts is one of our top priorities," Richard Weber, chief, IRS-Criminal Investigation (CI), said in a statement. "Through our coordinated efforts with DOJ we now have significantly more information about the institutions and individuals involved in offshore tax evasion," he added.

Individual pleads guilty to filing 3,000 false returns

An Alabama resident has pleaded guilty in federal court to filing more than 3,000 false tax returns for 2012 and 2013, the U.S. Department of Justice announced on August 19. The bogus returns claimed more than $7.5 million in income tax refunds. The defendant obtained IRS electronic filing identification numbers in the names of sham businesses and stolen identities that included personal information.

In related news, an individual in Florida pleaded guilty to filing false returns using information improperly obtained from a medical services provider. The false returns used personal information of patients of the medical services provider and directed that the refunds be deposited into accounts controlled by the individual or others working with the individual.

U.S. - St. Vincent and the Grenadines sign FATCA agreement

The Treasury Department has announced that the U.S. has reached an intergovernmental agreement (IGA) with the Caribbean island nation of St. Vincent and the Grenadines to implement the provisions of the Foreign Account Tax Compliance Act (FATCA). The intergovernmental agreement is a Model 1 IGA.

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question that needs to be answered," they concluded. The working group further acknowledged that there are important questions to be answered about how the benefits and difficulties should be distributed under the Tax Code. Moreover, the group also affirmed that reform of the individual side of the tax code should result in a tax system that "at a minimum should be at least as progressive as the current system."

Pass-through entities

The report of the individual income tax working group affirmed that in individual tax reform, there is the need to address pass-through entities, which make up more than 90 percent of all businesses nationally. "There is no question that making sure that pass-through entities are treated fairly is an essential part of the tax reform process, especially as tax reform looks to eliminate tax benefits for businesses and lower corporate tax rates, " the group explained. Among the possible options that could be considered to ensure pass-through entities are treated equitably, including changes to the individual statutory rates, would be to provide enhanced tax expenditures to certain businesses, and either a special rate or deduction applied to business income.

The members of the individual working group also recognized that due to its impact on the economy, the tax treatment of pass-through businesses must be addressed irrespective of determining whether any proposed treatment is "fair." They further acknowledged that there was some disagreement among the group about whether changes can address just pass-through entities as an initial step in a larger process or whether they must be addressed within the context of revising the entire Tax Code.

Education incentives

The working group highlighted the many education tax incentives and their complex and often overlapping rules. "The existence of these numerous tax incentives for education may mean that more taxpayers are able to take advantage of one or more education incentives. However, understanding the tax benefits provided by the different provisions, the various eligibility requirements, the interactions between different incentives and provisions within each incentive, and the record-keeping and reporting requirements may be time consuming and confusing for taxpayers," the working group said.

Consolidation, the working group noted, is often promoted as the solution to reducing complexity. However, the various incentives have differing credit percentages applied to different base amounts of qualifying expenses. "The complexities associated with multiple credits make it difficult for taxpayers to take into account the value of the credits in budgeting for college expenses."

- ***Comment.*** Under current law, the higher education tuition deduction has expired after 2014. The deduction is likely to be extended in a tax extenders bill before year-end. The American Opportunity Tax Credit (an enhanced version of the Hope credit) is also temporary and under current law is scheduled to expire after 2017.

The working group also looked at the tax treatment of federal Pell grants. These grants to eligible students are generally treated as a scholarship, and are excluded from taxable income, if the proceeds are allocated towards tuition and fees. The grants are included in taxable income if deemed used for other purposes, such as room and board. Any Pell Grant amount that is deemed to be treated as a scholarship will reduce the amount of tuition paid, for purposes of computing a taxpayer's AOTC or Lifetime Learning credit. Several proposals have been made to exclude the entirety of Pell Grant amounts from a taxpayer's income, without regard to the use of those proceeds, among other reforms.

Return filing

The working group indicated that the order in which income tax returns and information returns are due constitutes a problem that complicates and, in some instances, diminishes tax compliance. Lawmakers found two different problems with due dates: the sequence of information provided to taxpayers complicates return preparation, and second, limitations on access to information on returns by the IRS during the processing of income tax returns can "hamper the IRS' ability to deter and detect" fraudulent claims for refund.

Another problem the working group found is that the sequence of due dates may require dependence on extensions of due dates for filing. When information is received near the tax due date, it may contribute to errors on original returns that later require amendment. They suggested that reordering the due dates for filing income tax returns so that both partnerships and S corporations file before C corporations and individuals may reduce the need for routine use of extensions.

- ***Comment.*** The working group released its report before passage of the *Surface Transportation Act of 2015. For details of the changes made to a number of return filing deadlines by the Surface Transportation Act of 2015, see the Practitioners' Corner in the August 20, 2015 issue of this newsletter.*

Identity theft

The working group highlighted a pilot program recently instituted by IRS for cooperation with local authorities. On its website, the IRS describes the Identity Theft Victim Disclosure Waiver Process, as a program developed by the IRS to permit greater cooperation with state and local law enforcement. "Under this process, federal tax returns and return information associated with the accounts of known and suspected victims of identity theft is made available to non-federal law enforcement officers with the express written consent of those victims." Before disclosing any tax information, the IRS requires that victims sign a waiver authorizing the release of information to the designated state or local law enforcement official pursuing the investigation. The working group said the process is now being implemented throughout the U.S.

COMPLIANCE CALENDAR

■ September 2

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

■ September 4

Employers deposit Social Security, Medicare, and withheld income tax for August 29, 30, 31, and September 1.

■ September 10

Employers deposit Social Security, Medicare, and withheld income tax for September 2, 3, and 4.

Employees report tips of $20 or more earned during August.

■ September 11

Employers deposit Social Security, Medicare, and withheld income tax for September 5, 6, 7, and 8.

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 21,104.05	345	FILEBUS 9,206	410	IRS 24,054	397
ACCTNG 21,302.10	373	FILEBUS 9,458.05	358	IRS 33,150	360
ACCTNG 33,100	362	FILEBUS 15,104.25	393	IRS 36,106	396
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COMPEN 48,156.05	351	INTL 15,052.05	362	PENALTY 3,304	407
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EXCISE 24,310	398	IRS 3,058	347	RETIRE 78,052.10	350
FARM 9,050	373	IRS 3,200	387	SALES 6,156	405
FILEBUS 9,108	384	IRS 18,054	385	SALES 39,000	383
FILEBUS 9,158	411	IRS 21,414	361	SCORP 352.35	363

MONTHLY QUIZZER

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

Q1. The *Surface Transportation Act,* signed into law by President Obama on July 31, shifts the due date for the FBAR (Report of Foreign Bank and Financial Accounts, FinCEN Form 114) from June 30 to:

(a) April 1 with a maximum extension of a six-month period ending October 1
(b) April 15 with a maximum extension of a six-month period ending October 15
(c) April 30 with a maximum extension of a six-month period ending October 31
(d) April 30 with no maximum extension

Q2. Final and temporary regs remove the automatic extension of time to file most forms in the W-2 series. *True or False?*

Q3. Final regs provide rules for determining a taxable beneficiary's basis in a term interest in a charitable remainder trust (CRT) upon the sale or other disposition of all interests to the extent that basis consists of a share of adjusted uniform basis. The final regs:

(a) Make no modifications to the proposed regs
(b) Delay the effective date of the regs until January 1, 2025
(c) Prevent the IRS from applying legal arguments available before issuance of the final regs to contest the claimed tax treatment
(d) All of the above

Answers:

Q1. *(b), See Issue #32, page 369.*
Q2. *True, See Issue #34, page 393.*
Q3. *(a), See Issue #34, page 397.*