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INSIDE THIS ISSUE

Temporary Regs Expand Current Taxation Of CFC Transactions Involving Partnerships

TD 9733

The IRS has issued temporary and final regs that tighten the rules requiring current taxation of controlled foreign corporations (CFCs). The regs expand the definition of taxable U.S. property to encompass certain partnership transactions, and tighten the rules that exclude rent and royalty income from treated as Subpart F income (Code Secs. 951–964).

- **Take Away.** "The temporary regulations modify the anti-avoidance rules under Reg. §1.956-1T(b)(4) by broadening the scope of the rules to make it more likely that the regulation will apply to certain types of transactions," Joseph Calianno, partner and International Technical Tax Practice Leader, BDO USA, LLP, told Wolters Kluwer. "For instance, the rules expand the regulation to include transactions involving partnerships that are controlled by the CFC (new Reg. §1.956-1T(b)(4)(i)(C)). It is worth noting that, even prior to the revisions to Reg. §1.956-1T(b)(4) made by T.D. 9733, the IRS has been interpreting the anti-avoidance rules of Reg. §1.956-1T(b)(4) broadly to apply to certain transactions (see e.g., CCAs 201420017 and 201446020)," Calianno said.
- **Comment.** The regs generally apply to tax years of CFCs ending on or after the regs were published and to tax years of U.S. shareholders ending in which or with which those tax years end. The IRS stated that no inference is made for existing regs.

Background

A foreign corporation is a controlled foreign corporation (CFC) if more than 50 percent of the total combined voting power of all classes of the foreign corporation's voting stock, or more than 50 percent of the total value of the stock, is owned directly or indirectly by U.S. shareholders. A U.S. shareholder is a U.S. person that owns 10 percent or more of the total combined voting power of the foreign corporation.

The taxation of the income of a foreign corporation owned by U.S. shareholders is ordinarily deferred until the income is paid to the U.S. shareholder. However, a number of special rules under Subpart F impose current taxation on the activities of a CFC. U.S. shareholders are taxed on a CFC's investment of its earnings in U.S. property (based on the increase in the CFC's ownership of U.S. property. U.S. property includes tangible property located in the United States, stock of domestic corporations, obligations of U.S. persons related to the CFC, and intangibles used in the United States (Code Sec. 956).

- **Comment.** This prevents U.S. taxpayers from having both the benefit of deferred taxation of the CFC's earnings and the use of those earnings in the United States.

Anti-avoidance rule

Under Code Sec. 956(e) and Reg. §1.956-1T(b)(4), the IRS has authority to treat a CFC as indirectly holding investments in U.S. property that are acquired by any other foreign corporation controlled by the CFC, if a principal purpose for creating or funding the foreign

continued on page 430

Proposed Regs Would Extend Subpart F Taxation Of Deferred Income To Loans Made By CFCs To Partnerships

NPRM REG-155164-09

The IRS has issued proposed regs under Code Sec. 956 to extend the Subpart F rules to transactions involving a controlled foreign corporation (CFC) and a foreign partnership that has one or more partners who are U.S. shareholders of the CFC. The rules would impose taxation by treating an obligation of the foreign partnership as an obligation of its U.S. partners.

- **Take Away.** "In the preamble to the proposed regulations, the IRS and Treasury discuss Reg. §1.956-1(e)(2) as it relates to the operation of section 956 when multiple CFCs guarantee a single obligation of a U.S. person," Joseph Calianno, partner and International Technical Tax Practice Leader, BDO USA, LLP, told Wolters Kluwer. "Consider the following: A U.S. corporation with several CFCs receives a loan from a third party and each of its CFCs guarantees the U.S. corporation's loan. As currently written, the literal operation of Reg. §1.956-1(e)(2) could result, in certain instances, in the U.S. corporation having total income inclusions under section 951 that could exceed the aggregate unpaid principal amount of the obligation. See e.g., FSA 200216022. In this practitioner's opinion, having income inclusions under section 951 that exceed the aggregate unpaid principal amount of the obligation is not appropriate. The IRS and Treasury do state in the preamble, however, that they are considering whether to exercise their regulatory authority under section 956(e) to allocate the amount of the obligation among the relevant CFCs so as to limit the aggregate income inclusions to the unpaid principal amount of the obligation. Hopefully, the IRS and Treasury will exercise this authority in the near future," Calianno said.

Proposed regs

The current regs treat a CFC as indirectly holding investments in U.S. property that are acquired by any other foreign corporation controlled by the CFC, but do not address obligations of a foreign partnership that will be treated as U.S. property. When a U.S. shareholder can operate through a foreign partnership using deferred CFC earnings, the earnings are available to the U.S. shareholder. The U.S. shareholder could also access the earnings by taking a distribution from the partnership.

The proposed regs treat an obligation of a foreign partnership as an obligation of its partners, unless neither the lending CFC nor any person related to the CFC is a partner. The partner's share of the obligation would be based on its share of the partner's interest in partnership profits. The IRS is considering other methods to measure the partner's share of the obligation.

Pledges and guarantees

The proposed regs would clarify existing regs to provide that a CFC that is a pledgor or guarantor of an obligation of a U.S. person is treated as holding the obligation. The pledge and guarantee rules would apply to a CFC that guarantees an obligation of a foreign partnership that is treated as an obligation of a U.S. person. Thus, if an obligation of a foreign partnership is treated as an obligation of a U.S. person, and if a CFC guarantees the partnership obligation, the CFC will be treated as holding an obligation of a U.S. person. The indirect pledge or guarantee rules will apply to both domestic and foreign partnerships.

References: FED ¶49,666; TRC INTLOUT: 9,106.05.

CFC

Continued from page 429

corporation (through capital contributions or debt) is to avoid Code Sec. 956.

The temporary regs make several modifications to the anti-avoidance rule. The regs provide that the anti-avoidance rule can apply when a foreign corporation is funded by other amounts, in addition to capital contributions or debt. The regs add an example involving the funding of one CFC by another CFC that controls it. This example illustrates the application of the anti-avoidance rule when a principal purpose for funding the first CFC is to avoid the application of the rule to the CFC providing the funding (the "funding CFC"). The example indicates that the attributes associated with a Code Sec. 956 inclusion are taken into account when determining whether a principal purpose of the funding was to avoiding Code Sec. 956 by the funding CFC.

- **Comment.** The regs also modify the anti-avoidance rule so that it is self-executing, without the IRS being required to exercise its discretion under the rule.

New partnership rules

The temporary regs expand the current anti-avoidance rule to include transactions

continued on page 431

REFERENCE KEY

FED references are to ***Standard Federal Tax Reporter***
USTC references are to ***U.S. Tax Cases***
Dec references are to ***Tax Court Reports***
TRC references are to ***Tax Research Consultant***

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IRS Describes Participant Vote Requirement To Suspend Benefits Under MPRA

TD 9735, NPRM REG-123640-15

The IRS has issued temporary and proposed regs on the requirement for participants in a multiemployer defined benefit (DB) plan to vote on a proposed suspension of benefits. The temporary and proposed regs reflect the changes made by the *Multiemployer Pension Reform Act of 2014* (MPRA), which allows, in certain circumstances, the suspension of benefits.

- **Take Away.** After passage of the MPRA, plans are closely monitoring the law, according to a survey by the International Foundation of Employee Benefit Plans (IFEBP), Julie Stich, IFEBP director of research, told Wolters Kluwer. Approximately two-thirds of survey respondents reported their plans are in the green zone; 16 percent are in the endangered yellow zone and one percent is in the seriously endangered orange zone. Additionally, 14 percent are in the traditional critical status red zone, while six percent are in the new critical and declining status. "Half of funds reported that they have received questions from participants expressing concern about the law," Stich observed.
- **Comment.** "The *Pension Reform Act of 2006* (PPA) put tools in place to help plans in yellow and orange status," Stich told Wolters Kluwer.

Background

The MPRA created a new status for multiemployer DB plans: critical and declining status. Generally, a multiemployer DB plan is in critical status if, among other criteria, the plan is projected to become insolvent. Under the MPRA, a plan in critical or declining status asks Treasury for permission to suspend benefits. A suspension of benefits is the temporary or permanent reduction of any current or future payment obligation of the plan to any participant or beneficiary under the plan, whether or not in pay status at the time of the suspension of benefits.

The MPRA requires that the vote be administered by Treasury, in consultation with the U.S. Department of Labor (DOL) and the Pension Benefit Guaranty Corporation (PBGC). The three agencies will approve the ballot provided by the plan sponsor. Among other criteria, the ballot must include a statement opposing the proposed suspension of benefits. If a majority of plan participants and beneficiaries do not vote to reject the suspension, Treasury will authorize the suspension of benefits.

- **Comment.** A suspension will remain in effect until the earlier of the time when the plan sponsor provides benefit improvements or when the suspension expires by its own terms. If a suspension does not expire by its own terms, it continues indefinitely.

Voting procedures

The IRS explained that a vote to suspend benefits requires: (1) distribution of a package of ballot materials to eligible voters; (2) casting, collection and tabulation of ballots; and (3) determination that a majority of voters has voted to reject the proposed suspension of benefits. Eligible voters are all plan participants and all beneficiaries of deceased participants.

continued on page 432

CFC

Continued from page 430

involving partnerships controlled by the CFC. The IRS noted that a CFC may contribute cash to a partnership in exchange for a partnership interest. The partnership in turn lends the cash to the CFC's U.S. shareholder. The taxpayer claims that the CFC does not indirectly hold the entire obligation of the U.S. shareholder and that the CFC holds the obligation only to the extent of its interest in the partnership.

The temporary regs add Reg. §1.956-1T(b)(5) to address transactions where a CFC lends funds to a foreign partnership (or guarantees a loan to the foreign partnership), and the partnership the funds to a U.S. partner related to the CFC. Taxpayers have claimed that Code Sec. 956 does not apply, even though the CFC's earnings are effectively repatriated to a related U.S. partner. The new regs treat the partnership obligation as the obligation of the partner receiving the funds.

- **Comment.** The proposed regs issued simultaneously (NPRM REG-155164-09) include a similar partnership rule.

Rents and royalties

The existing Subpart F rules (Code Sec. 954) impose current taxation on "foreign personal holding company income," which includes rents and royalties (Code Sec. 954(c)(1)(A)). However, rents and royalties are not currently taxable if derived from an active trade or business and if paid by unrelated parties. The existing regs providing the exclusive rules for applying the active conduct tests.

The existing tests include an active development test and an active marketing test. Generally, the CFC's own officers and employees must perform the activities used to satisfy these tests; simply funding the activities of another company or of nonemployees, and collecting the resulting income, does not qualify. The temporary regs specifically incorporate the requirement for active participation by the CFC's officers and staff. Furthermore, costs of leasing and licensing expenses derived from cost-sharing and platform contribution transactions will not officers and employees to be treated as undertaking the activities themselves. However, the IRS has provided in the temporary regs that a CFC's employees and officers can perform the activities in more than one foreign country.

References: FED ¶47,030; TRC INTLOUT: 9,254.

IRS Issues Final Regs To Clarify Losses After Leg-Outs In Hedging Transactions With Foreign Currency Denominated Debt Instrument

TD 9736

The IRS has released final regs intended to clarify losses as a result of leg-outs in hedging transactions involving a foreign currency denominated debt instrument. The final regs adopt temporary regs issued in 2012 without substantive change.

- **Take Away.** The IRS explained that the temporary regs, and now the final regs, were issued with a limited purpose. That limited purpose is to clarify the application of the legging out rules under Reg. §1.988-5 to a particular fact pattern. The regs were not intended to be a more general revision, the IRS added.
- **Comment.** The final regs also update the existing examples and make minor wording changes to the temporary regulations for purposes of improving clarity. The IRS cautioned that these changes should not be interpreted as substantive changes to the temporary regulations.

Background

In 2012, the IRS issued temporary and proposed regs requiring taxpayers to recognize gains on foreign currency hedging transactions involving multiple hedges. In the temporary regs, the IRS explained that a taxpayer may fully hedge a fixed rate nonfunctional currency denominated debt instrument that it has issued with two swaps—a nonfunctional currency/dollar currency swap and a fixed for floating dollar interest rate swap. The effect of matching the currency swap with the foreign currency denominated debt is to create synthetic fixed rate U.S. dollar debt while the effect of the interest rate swap is to simultaneously transform the synthetic fixed rate U.S. dollar debt into synthetic floating rate U.S. dollar debt. Thus, assuming that the rules of §1.988-5(a) are otherwise satisfied, the taxpayer will have effectively converted the fixed rate foreign currency denominated debt instrument into a synthetic floating rate U.S. dollar denominated debt instrument.

As the U.S. dollar declines in value relative to the foreign currency in which the debt instrument is denominated, the taxpayer disposes of the interest rate swap while keeping the currency swap in existence. The taxpayer takes the position that the disposition of the interest rate swap allows it to treat the debt instrument as having been terminated on the date of disposition and claims a loss on the debt instrument without taking into account the offsetting gain on the remaining component of the hedge. Thus, the taxpayer claims the transaction generates a net loss. The IRS deemed this result as inappropriate.

Final regs

Under the final regs, when a taxpayer identifies multiple hedges as being part of a qualified hedging transaction, and the taxpayer terminates at least one but less than all of the hedges (including a portion of one or more of the hedges), the taxpayer must treat the remaining hedges as having been sold for fair market value (FMV) on the date of disposition of the terminated hedge.

The IRS reported that it received one comment in response to the temporary regs. The commentator suggested the regs were not needed because the taxpayer position considered in the regs was inconsistent with Code Sec. 988(d) and the economic substance of the transaction. The IRS determined that the regs are necessary to clarify the Code Sec. 988(d) integration rules.

The same commentator called for aligning the hedge integration regime under Code Sec. 988 with the approach taken in regs under Code Sec. 1275. The IRS explained that

continued on page 433

Suspension of Benefits

Continued from page 431

Under the temporary regs, the plan sponsor cannot distribute the ballot package. The temporary regs permit Treasury to designate a service provider to facilitate administration of the vote, including distributing the ballot package, collecting the ballots and tabulating the votes. The plan sponsor will provide a list of eligible voters. Ballot packages will be delivered to eligible voters by the U.S. Postal Service. A supplemental copy of the mailed ballot package may be sent by an electronic communication to eligible voters who have agreed to receive electronic notifications.

- **Comment.** The plan sponsor is responsible for paying all costs associated with printing, assembling, and distributing the ballot package, including postage.

All votes, the IRS explained, must be collected and tabulated using an automated voting system under which each eligible voter must furnish a unique identifier in order to cast a vote. The system will record votes by having voters access a website or by having voters call a toll-free number.

- **Comment.** There is no provision in the temporary regs for the use of paper ballots.

Votes will be certified within seven days after the end of the voting period. Treasury will either certify that a majority of all eligible voters has voted to reject the suspension or, if a majority of eligible voters did not vote to reject the suspension, issue a final authorization to suspend benefits.

- **Comment.** A model ballot may be released at a future date, the IRS indicated.

Effective dates

The temporary regs apply on and after June 17, 2015. The temporary regs are scheduled to expire on June 15, 2018.

References: FED ¶¶47,029, 49,665; TRC RETIRE: 57,212.20.

Proposed Regs Require Inpatient Hospitalization/Physician Services To Meet ACA's Minimum Value

NPRM REG-143800-14

Newly proposed regs provide that employer-sponsored plans that fail to provide substantial coverage for inpatient hospitalization or physician services do not provide minimum value under the *Affordable Care Act* (ACA). The proposed regs include transition relief for eligible employer-sponsored plans.

- **Take Away.** The U.S. Department of Health and Human Services (HHS) previously issued guidance explaining that so-called "skinny plans," which fail to provide inpatient hospitalization or physician services, do not meet minimum value under the ACA. The IRS's proposed regs reflect the approach taken by HHS.
- **Comment.** The IRS withdrew, in part, NPRM REG-125398-12 and replaced the withdrawn portion with the proposed regs.

Background

Under the ACA, an eligible employer-sponsored plan provides minimum value only if the plan's share of the total allowed costs of benefits under the plan is at least 60 percent. Minimum value applies to all eligible employer-sponsored plans, including self-insured plans and insured plans in the large group market.

In 2013, HHS and the IRS issued guidance which, among other things, allowed group health plans to determine their minimum value percentage by using HHS's MV Calculator. Some employers claimed that plans without coverage of inpatient hospital services provided minimum value by adopting a benefit package that, based on standardized actuarial assumptions used in the calculator, would offset the absence of spending on inpatient hospital coverage with increased spending on other benefits. HHS ultimately determined that the quantitative test for minimum value was not exclusive. In Notice 2014-69, the IRS announced that it intended to propose regs on minimum value and inpatient hospitalization or physician services.

- **Comment.** If an applicable large employer (ALE) fails to offer affordable minimum essential coverage that provides minimum value to its full-time employees (and their dependents), the ALE may be liable for a Code Sec. 4980H shared responsibility payment.

Proposed regs

The proposed regs, the IRS explained, incorporate the substance of the HHS guidance on skinny plans. An eligible employer-sponsored plan provides minimum value only if the plan's share of the total allowed costs of benefits provided to an employee is at least 60 percent and the plan provides substantial coverage of inpatient hospital and physician services.

Transition relief

The proposed regs are effective for plan years beginning after November 3, 2014. However, the IRS included transition relief in the proposed regs. For purposes of the employer shared responsibility requirement under Code Sec. 4980H(b), the changes to the minimum value regulations do not apply

continued on page 434

Leg-Outs

Continued from page 432

greater alignment between the hedge integration regimes under Code Sec. 988 and Code Sec. 1275 would be beyond the scope of the guidance project and unnecessary to achieve the purpose of the regs. Other recommendations by the same commentator also were not adopted by the IRS.

- **Comment.** The final regs apply to leg-outs within the meaning of Reg. §1.988-5(a)(6)(ii) occurring on or after September 6, 2012.

Reference: FED ¶47,031; TRC INTLOUT: 21,054.05.

IRS Reminds Individuals To Report Life Events To Health Insurance Marketplaces; May Impact Code Sec. 36B Credit Eligibility

Individuals who obtain health insurance through the Affordable Care Act (ACA) Health Insurance Marketplace must advise the Marketplace of changes in certain circumstances, the IRS has reminded taxpayers. Any life event, the IRS noted, may impact an individual's eligibility for the Code Sec. 36B premium assistance tax credit.

Coverage and credit. Individuals who obtain coverage through the Marketplace may qualify for the Code Sec. 36B credit to help offset the cost of coverage. When individuals apply for coverage in the Marketplace, the Marketplace estimates the amount of the Code Sec. 36B credit. Eligibility for the Code Sec. 36B credit is determined, among other criteria, by the relationship of the taxpayer's household income to the federal poverty level (FPL). The credit may be paid in advance to the insurance provider.

Change in circumstances. Changes in circumstances that an individual should report to the Marketplace include: changes in income; marriage or divorce; birth or adoption of a child; moving out of the area served by the current Marketplace plan; starting a job with health insurance; and gaining or losing your eligibility for other health care coverage. Notifying the Marketplace about changes in circumstances allows the Marketplace to update the information used to determine an individual's expected amount of the Code Sec. 36B credit, the IRS explained.

IRS Health Care Tax Tip 2015-54; TRC HEALTH: 3,300.

Chief Counsel Determines No Deduction For Partially Worthless Debt; Taxpayer Did Not Charge Off Amounts

FAA 20153501F

IRS Chief Counsel has determined that a taxpayer was not able to deduct partially worthless debt. The taxpayer had not charged off the amounts on its books. The taxpayer's reserve account did not qualify for a current deduction.

- **Take Away.** In *International Proprietaries, 18 TC 133 (1952)*, the Tax Court held that setting up a reserve for bad debts does not meet the charge-off requirements. In that case, the taxpayer had increased its reserve account for bad debts, which decreased its balance sheet assets, and credited surplus, which decreased its net income on its books.

Background

The taxpayer loaned money to other entities. After a turndown in the economy, some borrowers defaulted on their loans. The loans were generally secured by real estate. Some of the mortgages on the real properties were subject to foreclosure. In other cases, there were short sales and other modifications.

Chief Counsel's analysis

Chief Counsel first noted that under Code Sec. 166(a)(2), the IRS may allow a taxpayer to claim a partial bad debt deduction for a debt recoverable only in part, in an amount not in excess of the part charged off within the tax year. The amount which has become worthless shall be allowed as a deduction under Code Sec. 166(a)(2) but only to the extent charged off during the tax year.

Chief Counsel explained that the purpose of the charge-off requirement is to perpetuate evidence of a taxpayer's election to abandon part of the debt as an asset. An increase in a general reserve account does not constitute the required charge off. The taxpayer's intent to abandon the charged-off portion of the debt must be reflected in its books and records.

Here, Chief Counsel determined that the taxpayer had created an allowance and a provision for losses anticipated in the future (should the property go into foreclosure, be sold, etc.). An allowance and/or a provision is nothing more than a reserve, Chief Counsel explained.

- **Comment.** According to Chief Counsel, the taxpayer's case was not distinguishable from *International Proprietaries*. Chief Counsel highlighted that a taxpayer must eliminate the debt as an asset on its books in order to comply with the statutory requirements of charge-off.

Chief Counsel distinguished the Tax Court's decision in *Brandtjen, 34 TC 416 (1960),* which had found in favor of the taxpayer. Chief Counsel explained that in *Brandtjen*, entries in the taxpayer's books were described in words indicating a sustained loss, and not an anticipated future loss. In contrast, the taxpayer's books in this case indicated that the entries were in the nature of a reserve for an anticipated future loss and not a sustained loss. Additionally, the Tax Court found sufficient indicia of a sustained loss.

- **Comment.** The taxpayer in *Brandtjen* titled its account in the nature of a reserve, but the Tax Court found that the taxpayer had used sufficiently descriptive and contemporaneous language in its books, in describing the entries made to the account. In the instant case, the taxpayer not only titled its accounts in the nature of a reserve, so too was the contemporaneous explanation accompanying its journal entries.

Reference: TRC IRS: 30,052.

IRS Allows Disclosure Of FFI Database, But Not Form 2848

The IRS Chief Counsel considered opening up disclosure of otherwise protected data in two circumstances recently. In one, efficient FATCA administration was deemed an appropriate reason to allow access to a database on foreign banks; in the other, however, a Form 2848, Power of Attorney and Declaration of Representative, was deemed protected even when the underlying tax return had become a matter of public record.

Tax administration. The disclosure of information within a database on foreign financial institutions to an IT (FFI) vendor for the purpose of demonstration was authorized by Code Sec. 6103(k)(6), because the disclosures were appropriate and helpful to the IRS's official duties (identifying noncompliance with FATCA). However, Chief Counsel further cautioned that only information necessary for purposes of the demonstration be considered available.

Public record exception. With respect to disclosure of Form 2848, the public record exception, whether return information has been disclosed within a Tax Court petition or at trial, would not apply. That form was not gathered with respect to the taxpayer's liability under the Code. Nevertheless, if the Form 2848 is disclosed to the State Bar, Chief Counsel's office advised that the TIN and the tax years and tax matters at issue should be redacted; but that "the safest course" would be to ask the taxpayer to consent to the disclosure of the Form 2848.

CCA 201536023; CCA 201536019; TRC IRS: 9,206.15, IRS: 9,252.

Minimum Value

Continued from page 433

before the end of the plan year beginning no later than March 1, 2015 to a plan that fails to provide substantial coverage for in-patient hospitalization services or for physician services (or both), provided that the employer had entered into a binding written commitment to adopt the noncompliant plan terms, or had begun enrolling employees in the plan with noncompliant plan terms, before November 4, 2014. For this purpose, the plan year is the plan year in effect under the terms of the plan on November 3, 2014, the IRS explained.

References: FED ¶49,664; TRC HEALTH: 3,310.

IRS Updates FATCA FAQs With Clarifications For Disregarded Entities, Branches

www.irs.gov

The IRS has posted updated frequently asked questions (FAQs) about the *Foreign Account Tax Compliance Act* (FATCA). The updated FAQs clarify registration requirements for disregarded entities and branches.

- **Take Away.** To implement FATCA, the U.S. has negotiated intergovernmental agreements (IGAs) with foreign jurisdictions. There are two types of IGAs: Model 1 IGA and Model 2 IGA. The majority of IGAs are Model 1 agreements, where financial institutions report information about U.S. account holders to their respective governments, which in turn will relay the information to the U.S. The U.S. reciprocates with similar information about the jurisdiction's account holders.

Background

FATCA generally requires withholding agents to withhold tax on certain payments to foreign financial institutions that do not agree to report certain information to the IRS about their U.S. accounts. Financial institutions (FIs) may report information about account holders through the IRS's FATCA Registration System.

Financial institutions also receive a Global Intermediary Identification Number (GIIN), which they use for identification purposes with withholding agents and tax administrators. A separate GIIN is issued to the financial institution to identify each jurisdiction where the FI maintains a branch that is participating or registered deemed-compliant.

Disregarded entities

The IRS explained that a disregarded entity in a Model 1 IGA must register as an entity separate from its owner, provided that the disregarded entity is treated as a separate entity for purposes of its reporting to the applicable Model 1 jurisdiction. A disregarded entity that is a Model 2 IGA (or that is in a jurisdiction without an IGA) must be registered as a branch of its owner rather than as a separate entity.

Branches

A branch that is in a Model 2 IGA jurisdiction (or that is in a jurisdiction without an IGA) must be registered as a branch of its owner rather than as a separate entity, the IRS clarified. If a branch incorrectly registered separately, the IRS instructed the financial institution to revise its own registration to include the branch by the end of the 2015 calendar year.

- **Comment.** A branch of a financial institution in a Model 1 IGA jurisdiction must be registered as a branch of its owner and not as a separate entity.

Reference: TRC FILEIND: 9,100.

IRS TEB Voluntary Closing Agreement Procedures To Be Updated For FY 2016

Internal Revenue Manual (IRM) 7.2.3, IRM 4.81.6

The IRS Tax Exempt Bonds (TEB) function has announced several changes to its tax-exempt bonds Voluntary Closing Agreement Program (TEB VCAP) that will become effective in fiscal year (FY) 2016. The changes will be reflected in revised IRM sections 7.2.3 and 4.81.6, both of which will be published in the near future.

- **Take Away.** The program changes are designed to assist the IRS in meeting its goal of resolving VCAP requests within six months of receipt, Karen Skinder, acting program manager, IRS Tax Exempt Bonds Compliance and Program Management, said during a September 3, 2015 webinar, sponsored by the agency.

Background

The IRS TEB VCAP program is designed for issuers of certain tax-advantaged bonds that have discovered noncompliance with outstanding bonds that is not otherwise correctible. The program enables such issuers to correct the noncompliance problems so that they do not jeopardize the bonds' tax-exempt status. Resolution through VCAP generally results in more favorable treatment for an issuer than would have been provided if the violation had been discovered during an IRS examination.

FY 2016 updates

Form 14429, Tax Exempt Bonds Voluntary Closing Agreement Program Request, which is currently not a requirement for application to the TEB VCAP program, will be a mandatory part of the submission, effective from the start of FY 2016. Second, TEB VCAP applicants will now be required to submit a completed model agreement containing language approved by IRS Chief Counsel and that is generally used in VCAP agreements. Third, six months after the program updates become effective, the TEB function will no longer provide relief previously extended for certain determinations of resolution amounts related to violations discovered through implemented written post-issuance compliance procedures. Finally, six new resolution standards will be added to the IRM sections relating to VCAP. Four relate to tax-exempt bonds, and two pertain to direct-pay bonds.

In addition, the IRS stated that the TEB function is also working on several specialized closing agreement templates—such as for certain TEFRA violations—that will be published in the form of announcements in the Internal Revenue Bulletin. They will be formatted similarly to the automatic revocation Announcement 2015-2, published at the end of 2014.

Another development is that the IRS TEB has prepared a "Welcome to VCAP" letter that it hopes to begin using within the next few months. The letter will confirm to the issuer that a VCAP case has been reviewed and assigned and will provide the contact information of the person handling the request should the issuer have immediate questions.

TAX BRIEFS

IRS

Effective January 1, 2016, the IRS will not accept any check payment for an amount greater than $99,999,999.00, which is the maximum amount that the Federal Reserve banks can process. Fourteen checks over this limit were received this past season. After January 1, 2016, two or more checks will be required if a taxpayer owes more than the maximum processible amount. The IRS recommends taxpayers use Fed Wire to make tax payments.

Announcement 2015-23

Jurisdiction

A *pro se* litigant's complaint challenging the constitutionality of the Patient Protection and Affordable Health Care Act (P.L. 111-148) (PPACA) and seeking a refund of his shared responsibility payment (SRP) was dismissed for lack of subject matter jurisdiction and for failure to state a claim. The calendar year had not yet ended at the time the individual filed his refund claim and he failed to show that he paid in full the SRP for the year.

Lipiec, DC Mich., 2015-2 USTC ¶50,465; TRC INDIV: 42,550

An individual's petition for redetermination of his tax liability was dismissed for lack of jurisdiction. A challenge to an IRS deficiency notice may not be brought in federal district court unless the taxpayer first pays the deficiency in full.

Ford, DC V.I., 2015-2 USTC ¶50,462; TRC LITIG: 6,106

An individual's damages claim against the IRS for offsetting his past-due child support obligation with his tax refund was dismissed for lack of subject matter jurisdiction. Code Sec. 6402(g) expressly prohibits such suits.

Mitchell, DC Va., 2015-2 USTC ¶50,460; TRC IRS: 33,302

Liens and Levies

Federal tax liens against a couple's residence held as tenants by entirety were foreclosed and the property was ordered sold. Code Sec. 7403 explicitly allows the IRS to sell not only the tax debtor's property or interest in property, but the e ntire property, even property held as a tenancy by the entirety by a tax debtor and nonliable spouse.

Staton, DC Hawaii, 2015-2 USTC ¶50,463; TRC IRS: 45,160

Shareholders

The Tax Court's determination that a corporation's shareholders were not liable as transferees for taxes owed by the corporation for the sale of its assets was vacated and remanded. The Tax Court applied the incorrect standard when it determined that the subsequent stock sale was a legitimate transaction whose form must be respected.

Slone, CA-9, 2015-2 USTC ¶50,457;

Return Preparers

An individual was permanently enjoined from acting as a federal tax return preparer, advising or assisting in the preparation or filing of any federal tax returns or promoting and selling any abusive tax shelter scheme. He displayed a complete disregard for the laws and without a permanent injunction he would likely continue to promote and administer the false 1099-OID scheme.

Hinz, DC Ohio, 2015-2 USTC ¶50,459; TRC IRS: 6,200

Tax Crimes

An individual's sentence for tax evasion was vacated and the case was remanded for resentencing because the sentencing court imposed additional conditions of supervised release without explanation. All discretionary conditions, whether standard, special or invented require findings.

R.D. Falor, CA-7, 2015-2 USTC ¶50,464; TRC IRS: 66,462

An individual was properly convicted and sentenced for identity-theft refund fraud using his electronic filer identification number (EFIN). The sentencing court properly found that the individual's identity theft refund fraud scheme impacted 50 victims and, therefore, the four-level enhancement was proper.

Variste, CA-11, 2015-2 USTC ¶50,461; TRC IRS: 66,202

FOIA

The IRS failed to conduct an adequate search for documents responsive to an organization's Freedom of Information Act (FOIA) request. Therefore, the case was remanded to the IRS to conduct an adequate search for records responsive to the organization's FOIA request and to release any reasonably segregable nonexempt information to the requestor.

Cause of Action, DC D.C., 2015-2 USTC ¶50,458; TRC IRS: 9,502

Bankruptcy

An individual's tax debts were not discharged in bankruptcy; therefore, his tax liabilities were reduced to judgment and tax liens on his property were foreclosed.

Dew, Jr., DC S.C., 2015-2 USTC ¶50,456; TRC IRS: 45,160

Over- And Underpayment Interest Rates Remain Same For Fourth Quarter 2015

The IRS has announced that the interest rates on overpayments and underpayments of tax for the calendar quarter beginning October 1, 2015 will remain unchanged.

The rates will be:

- 3 percent for overpayments, in cases other than corporations;
- 2 percent for overpayments in the case of a corporation (except 0.5 percent for the portion of a corporate overpayment exceeding $10,000); and
- 3 percent for underpayments (except 5 percent for large corporate underpayments).

- **Comment.** The Tax Code provides that the rate of interest on over- and underpayments of tax is to be determined on a quarterly basis. The interest rates for the fourth quarter 2015 are computed by using the federal short-term rate based on daily compounding determined during July 2015.

IR-2015-106; Rev. Rul. 2015-17; FED ¶¶46,396, 46,397; TRC PENALTY: 9,152.

PRACTITIONERS' CORNER

IRS Data For 2013 Show Decline In Reported Individual/ Partnership Income

The IRS Statistics of Income (SOI) Division has issued its final report (*2013 Individual Income Tax Returns Complete Report (Publication 1304)*) on the approximately 147 million individual income tax returns filed for tax year (TY) 2013. The report reiterates the preliminary data issued in June: For 2013, tax liability increased due to the 39.6-percent top marginal income tax rate, the top 20-percent capital gains rate, net investment income (NII) tax, and Additional Medicare tax that all became effective that year. The IRS also published statistics on 2013 partnership returns, which break down income, loss and other data by specific industrial sector. The indicate an overall decrease in net income among all partnerships between 2012 and 2013, but an increase within certain industrial sectors such as real estate rental and arts and entertainment. Partnerships within the health care sector largely saw their income decrease from 2012 to 2013, with some exceptions. This Practitioners' Corner reports on the IRS's individual and partnership data.

Individual income statistics

Tax liability for TY 2013 increased despite a 0.1-percent decrease in both adjusted gross income (AGI) and taxable income. (*For a report on the preliminary statistics, see the June 4, 2015 issue of this newsletter*). The increase in tax liability, the IRS reported, was attributable to the NII tax, the Additional Medicare tax, and the increase in the top capital gains tax rate and the top marginal income tax rate, all of which became effective in 2013.

- **Comment.** The *American Taxpayer Relief Act of 2012* allowed the Bush-era tax cuts to sunset after 2012 for single individuals with incomes over $400,000 and married taxpayers with incomes over $450,000. Individuals with incomes above the $400,000/$450,000 thresholds paid more in taxes for 2013 because of a higher 39.6-percent income tax rate. The *American Taxpayer Relief Act* also increased the net capital gain and qualified dividends tax rate for higher-income taxpayers. Effective January 1, 2013, the maximum tax rate on qualified capital gains and dividends rose from 15 to 20 percent for taxpayers whose incomes exceeded the thresholds set for the 39.6 percent rate (the $400,000/$450,000/$425,000 thresholds discussed above). The maximum tax rate for all other taxpayers remains at 15 percent; and a zero-percent rate continues to apply to qualified capital gains and dividends to the extent income falls below the top of the 15- percent tax bracket.
- **Comment.** The *American Taxpayer Relief Act of 2012* did not extend the payroll tax holiday that was available to qualified individual individuals in 2012. Effective January 1, 2013, the employee-share of Social Security increased from 4.2 percent to 6.2 percent (its rate before enactment of the payroll tax holiday). The net result was that all individuals who receive wages (and self-employed individuals) saw less take-home pay in 2013.

Adjusted gross income reported for individual returns decreased by $6.5 billion from 2012 to 2013, according to the IRS. Reported AGI for 2012 was $9.10 trillion; for 2013 it was $9.09 trillion. Similarly taxable income decreased slightly for 2013. Taxable income reported for 2012 was approximately $6.394 trillion; for 2013 it was $6.388 trillion. The decrease possibly reflected the decrease in reported net capital gain and other investment income, as many higher income taxpayers had accelerated such income into 2012 to avoid the higher top capital gains tax and top marginal tax rate.

- **Comment.** However, the IRS's SOI Summer bulletin featured an article on higher-income individual tax returns finding there were 5.3 million tax returns reporting $200,000 or more of income for 2012. This is actually lower than the 5.56 million returns reporting the same income for 2013, according to Publication 1304.

"For 2013, tax liability increased due to the 39.6-percent top marginal income tax rate, the top 20-percent capital gains rate, net investment income tax, and additional Medicare tax that all became effective that year."

Overall tax liability reported by individual tax filers for 2013, however, increased from approximately $1.25 trillion to $1.31 trillion, which is similar to what the IRS reported in its preliminary data tables issued this past June. Preliminary data indicated that total tax liability for TY 2013 had risen to $1.29 trillion owed by 98.8 million returns, up from just under $1.24 trillion owed by 96.9 million returns filed for 2012. With a few exceptions, the total dollar amount of most claimed credits against tax increased for 2013. For example, the child care credit, the credit for the elderly or disabled, the American Opportunity Tax Credit and Lifetime Learning credits, the Code Sec. 25C residential energy credit, and the foreign tax credit all increased. Thus, the increased tax liability for 2013 was mainly the result of the increased top

continued on page 439

WASHINGTON REPORT *by the Wolters Kluwer Washington News Bureau*

Congress returns after August recess

Lawmakers have returned to Capitol Hill after their August recess. One of the first items on the House's agenda is a markup of legislation to revise the reach of the Affordable Care Act's employer shared responsibility requirements (employer mandate). Both the House and Senate must reach an agreement to fund the IRS and the entire federal government. Current funding for the federal government will expire after September 30, 2015.

ACA. The House Energy and Commerce Committee is scheduled to mark up the Protecting Affordable Coverage for Employees Act (HR 1624) The bill amends the ACA to include employers with 51 to 100 employees as applicable large employers for purposes of ACA Health Insurance Marketplaces. States have the option to treat these employers as small employers. Currently under the ACA, employers with 51 to 100 employees are treated as small employers, but before January 1, 2016, states have the option to treat them as large employers. Under ACA, health insurance offered in the small group market must meet certain requirements that do not apply to the large group market, including the requirement to cover the essential health benefits.

IRS budget. House and Senate appropriators have voted to reduce the IRS's budget for fiscal year (FY) 2016 but by differing amounts. The Senate Appropriations Subcommittee on Financial Services and General Government on July 22 approved $10.475 billion for the IRS for FY 2016, a cut of $470 million, or four percent, below the FY 2015 enacted level. The House on June 17 approved $10.1 billion to fund the IRS for FY 2016, representing a cut of approximately $838 million, compared to FY 2015.

On September 2, Senate Finance Committee ranking member Ron Wyden, D-Ore., predicted that budget cuts will impair IRS enforcement activities. "Cutting enforcement spending, such as by performing fewer audits, will embolden tax cheats and increase deficits, heaping a new burden onto the backs of honest taxpayers," Wyden said.

Medical device excise tax. Senate Finance Committee Chair Orrin Hatch has long advocated for repeal of the ACA's medical device excise tax and may try to move legislation this Fall. In January, Hatch and 10 other senators introduced the Medical Device Access and Innovation Protection Bill (Sen 149). Opponents of the tax have had more success so far in the House. In June, the House approved the Protect Medical Innovation Bill of 2015 (HR 160), which would repeal the medical device excise tax.

Warner asks Treasury, IRS about "sharing economy"

Sen. Mark Warner, D-Va., has asked Treasury Secretary Jack Lew and IRS Commissioner John Koskinen to describe the growth and taxation of the so-called "sharing economy." Warner wrote to the officials on September 1. According to Warner, a significant number of individuals are involved in some form or another in the sharing economy. These include self-employed individuals, part-time workers, temporary employees, and on-call workers.

"We know that millions of Americans are eagerly participating in this dynamic new economy, but we don't have good information on the extent of that participation or the possible policy ramifications," Sen. Warner said. "In a 21st century economy, we need new and better information so we can understand the potential policy ramifications when more people, whether by personal choice or economic necessity, are making a living with no connection to a single employer and without access to the safety net benefits and worker protections typically provided through traditional full-time employment."

Swiss bank pays $10.354 million penalty for facilitating tax evasion

The U.S. Department of Justice (DOJ) has announced that Swiss bank Schroder & Co. Bank AG, has resolved its potential criminal liabilities under the DOJ's Swiss Bank Program. Schroder Bank will pay a penalty of $10.354 million, one of the largest penalties paid to date by banks under the DOJ's Swiss Bank Program. Since August 1, 2008, Schroder Bank had 243 U.S.-related accounts with approximately $506 million in assets under management, the DOJ reported.

"The cumulative penalties the Swiss Bank Program has generated to date are extraordinary," Chief Richard Weber of IRS-Criminal Investigation (IRS-CI) said in a statement. "However, a significant element of the program is the highly-detailed account and transactional data that has been provided to the IRS specifically for law enforcement purposes. We will continue to use this information to vigorously pursue U.S. taxpayers who may still be trying to illegally conceal offshore accounts, ensuring we are all playing by the same rules."

The Swiss Bank Program, which was announced on August 29, 2013, provides a path for Swiss banks to resolve potential criminal liabilities in the United States. In the past months, several banks have resolved their criminal liabilities through the program.

HHS posts guidance on essential health benefits, nondiscrimination

The U.S. Department of Health and Human Services (HHS) recently posted information on essential health benefits benchmark plans. The Affordable Care Act requires non-grandfathered health plans in the individual and small group markets to cover essential health benefits which include items and services in 10 benefit categories. HHS provided for plan years 2014–2016 information on each benchmark plan in the 50 states and the District of Columbia. HHS also provided information on proposed 2017 benchmark plans.

In related news, HHS released proposed rules on nondiscrimination. Section 1557 of the ACA extended civil rights protections banning sex discrimination to health programs and activities. The proposed rules bar discrimination based on gender identity. HHS also issued guidance on communicating with individuals with disabilities and individuals with limited English language proficiency.

Continued from page 437

marginal tax rate, the Additional Medicare tax, the net investment income tax, and the 20-percent top capital gains tax rate.

For 2013, the IRS reported that taxpayers owed $37.6 billion more in taxes attributable solely to the marginal income tax rates than they had owed for 2012. More than 890,000 tax returns reported $613 billion in income subject to the top 39.6-percent marginal income tax rate. The 39.6-percent rate, on its own, generated $242.7 billion in tax for 2013.

- **Comment.** Overall tax owed is computed across all rates. The IRS reported that the tax returns with income tax imposed at the top marginal rate generated nearly $382.5 billion in tax computed from all tax rates.

Investment income

More than three million tax returns filed for 2013 owed $16.5 billion in net investment income. Less than one percent of these returns reported income of $10 million or more, but these returns were responsible for more than 31 percent of the amount of net investment income tax. Tax returns reporting between $1 million and $10 million in income owed 37 percent of the net investment income tax; these tax returns represented 9.5 percent of all returns reporting net investment income tax liability.

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

Nearly three million returns reported $6.27 billion owed in Additional Medicare tax. The largest number of returns reporting the tax fell within the $200,000 to $500,000 income category. The Additional Medicare tax is imposed on salary and wage income ($872 billion for this category of tax filers for 2013; as opposed to $619 billion in salary and wage income on all returns reporting income of $500,000 or more). Ostensibly much of the income reported by tax returns showing the highest levels of income stems from investments rather than salaries, and therefore is not subject to the Additional Medicare tax.

- **Comment.** For 2013, the 0.9 percent Additional Medicare tax applied to Medicare wages, railroad retirement compensation, and self-employment income that exceeded $125,000 for married filing separately, $250,000 for married filing jointly, and $200,000 for single or head of household.

The top 20-percent rate for capital gains income reported on tax returns that were also subject to the top marginal income tax rate did not increase the amount of capital gains tax reported by individuals for 2013. Net capital gains income decreased from 2012 to 2013, possibly because many taxpayers had accelerated capital gains income into 2012. However, 2013 saw a marked increase in capital gains distributions from mutual funds, which likely pushed many taxpayers into higher tax brackets.

- **Comment.** For 2013 more than 843,000 tax returns reported $270 billion in capital gains income taxable at the top 20-percent rate. This 20-percent rate generated $54 billion in tax for 2013. Total tax generated on capital gains income for 2013 was more than $81.7 billion (for both the 15-percent and 20-percent rates). This represented a decrease from the $96.7 billion generated by the 15-percent capital gains rate in 2012 (before the 20-percent rate was effective). Tax returns reporting $10 million or more in capital gains income generated a total of $28.5 billion in capital gains tax, 30 percent less than the $40.8 billion in capital gains tax generated for this same category of tax returns for 2012.

Partnerships

The IRS posted several new tables containing statistics for partnerships from the 2013 tax year, classified by industry and size of total assets. The statistics indicate that for 2013, partnerships across all industrial sectors reported $9 billion less in total net income minus loss than they had for 2012, reflecting a nearly 1.2-percent decrease. Income for 2013 was $768.8 billion; for 2012 reported partnership income was $777.9 billion. Certain sectors, however, reported increased income that corresponds to reports on domestic economic improvement for 2013. For example, net income from the construction of buildings increased for 2013 from $2.5 billion to 4.8 billion, a 48-percent change from income reported in 2012 and also nearly double the income reported by the industry for 2007 before the economic slowdown set in.

The real estate rental and leasing industry reported increased income for 2013, particularly with regard to the rental of nonresidential buildings. Net income for 2013 exceeded $61.6 billion. For 2012 the amount was $53.1 billion.

Income from oil and gas extraction increased by $1.84 billion for 2013. This appears to support the White House's assertion in December 2013 that during 2013 the U.S. had become the largest producer of oil and gas in the world and was producing more oil domestically than it imported. The increased production was likely attributable to the growth of hydraulic fracturing.

Reported partnership income from the retail industry also increased slightly for 2013, from $10.3 billion reported for 2012 to $10.5 billion for 2013. Notably, electronics and appliance retailers experienced increased income for 2013. Other specialty retailers such as furniture stores and building and garden materials stores reported higher net partnership income for 2013. Motor vehicle parts retailers, clothing stores, and sporting goods stores, however, reported lower income or net losses for the year.

- **Comment.** Industries reporting a decline in 2013 partnership income from 2012 included the financial services sector and the health care services sector. Partnerships within the health care sector reported income for 2013 that was $0.4 billion less than income reported for 2012. Within the health care sector, however, outpatient care centers and social assistance services reported slightly higher net income for 2013.

COMPLIANCE CALENDAR

September 11
Employers deposit Social Security, Medicare, and withheld income tax for September 5, 6, 7, and 8.

September 15
Corporations deposit the third installment of estimated tax for 2015.

Individuals make the third installment of 2015 estimated tax.

Monthly depositors deposit Social Security, Medicare, and withheld income tax for August.

Corporations and S corporations with 6-month extensions file 2014 Forms 1120 and 1120S and pay tax due.

Partnerships with 5-month extensions file 2014 Form 1065.

September 16
Employers deposit Social Security, Medicare, and withheld income tax for September 9, 10, and 11.

September 18
Employers deposit Social Security, Medicare, and withheld income tax for September 12, 13, 14, and 15.

September 23
Employers deposit Social Security, Medicare, and withheld income tax for September 16, 17, and 18.

September 25
Employers deposit Social Security, Medicare, and withheld income tax for September 19, 20, 21, and 22.

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 21,302.10	373	HEALTH 9,302	375	IRS 48,058	408
ACCTNG 33,100	362	INDIV 6,364.10	424	LITIG 3,104.35	385
ACCTNG 36,162.05	410	INDIV 6,368	394	PART 9,050	381
BUSEXP 6,100	417	INDIV 21,206.05	409	PART 24,112.10	371
BUSEXP 18,200	398	INDIV 36,054	399	PART 27,050	357
BUSEXP 18,808	388	INDIV 48,400	383	PART 60,500	422
BUSEXP 31,100	386	INTL 15,052.05	362	PAYROLL 6,106	409
COMPEN 3,050	408	INTL 15,052.05	372	PENALTY 3,252.10	419
COMPEN 36,354	386	INTL 15,210	395	PENALTY 3,304	407
CONSOL 41,200	361	INTL 15,306.05	395	PENALTY 9,152	436
ESTGIFT 36,252	412	INTL 24,300	420	PENALTY 18,100	420
ESTGIFT 45,208	397	INTLOUT 9,106.05	430	REAL 6,156.33	421
EXCISE 24,310	398	INTLOUT 9,254	429	RETIRE 30,556	376
FILEBUS 9,158	411	INTLOUT 21,054.05	432	RETIRE 30,650	421
FILEBUS 9,206	410	IRS 9,206.15	434	RETIRE 57,212.20	431
FILEBUS 15,104.25	393	IRS 9,402	422	RETIRE 60,312	407
FILEIND 9,100	435	IRS 18,054	385	RETIRE 78,052.10	350
HEALTH 3,300	433	IRS 24,054	397	SALES 6,156	405
HEALTH 3,310	433	IRS 30,052	434	SALES 39,000	383
HEALTH 6,106	406	IRS 36,106	396	SCORP 352.35	363

FROM THE HELPLINE

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

Q May the soon-to-be ex-husband of a divorcing married couple who no longer resides in the primary residence, but continues to make the mortgage payments pursuant to an oral agreement, deduct the mortgage interest from his income?

A A taxpayer must be liable for the mortgage to deduct interest payments. The fact that a married couple is in the process of getting divorced or separated does not alter this rule. Furthermore, even after there is a property settlement from a divorce and the taxpayer no longer has an interest in the home, he generally may still deduct the mortgage interest if he is obligated to pay it under the settlement. *See TRC INDIV: 48,206.10.*

Q Is an increase in tax on a return due to an advance premium tax credit adjustment a tax that is deductible on Form 1040, Schedule A, as a deductible tax?

A The additional tax due to reconciliation of an advance premium tax credit is a federal income tax, as indicated by Code Sec. 36B(f)(2), which describes the tax as an increase in the tax "imposed by this chapter" (referring to the income tax chapter). Federal income, excess profits, and all inheritance, estate and gift taxes are specifically nondeductible. *For extended coverage of deductible taxes, see TRC INDIV: 45,000.*