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Proposed Regs Describe Application Of New Tax On Gifts And Bequests From Expatriates To U.S. Taxpayers

NPRM REG-112997-10

The IRS has issued proposed regs on a new tax under Code Sec. 2801 that applies to transfers of property from individuals who abandoned U.S. citizenship or residency and who later make a gift or bequest to U.S. taxpayers (individuals and domestic trusts). The tax applies to covered transfers of property on or after June 17, 2008, but does not have to be paid until the IRS issues final regs and new Form 708.

- ***Take Away.*** "The provision is a great disincentive for U.S. taxpayers to expatriate, unless the whole family moves," Ellen Harrison, partner, McDermott Will & Emery LLP, told Wolters Kluwer. "The provision is not tax neutral and is harsher than estate and gift taxes on U.S. taxpayers," she said. "There is no estate or gift tax exemption, except for the equivalent of one gift tax exclusion. There is no reduction in the amount of the gift if the donee pays the tax. And taxpayers cannot claim the tax for the year it accrues."
- ***Comment.*** The legislative history states that citizens and long-term residents have the right to relinquish their U.S. status and that the tax code should not be used to discourage these individuals. At the same time, Congress indicated, the tax code should not reward individuals who leave the United States. Because U.S. taxpayers are subject to estate tax on their worldwide assets, Congress determined it was appropriate to impose a tax on transfers from expatriates that would have escaped estate or gift tax.

Application of tax

In the *Heroes Earnings Assistance and Relief Tax Act of 2008*, Congress enacted Code Sec. 2801. The provision imposes a tax on U.S. citizens and residents who receive a bequest or gift from a U.S. expatriate (an individual who has left the United States and has relinquished U.S. citizenship or residency).

- ***Comment.*** A transfer of property is not a covered gift or bequest if the property is a timely reported taxable gift; is included in a timely reported gross estate; or would have been eligible for an estate or gift tax charitable deduction or marital deduction if the transferor were a U.S. person.

The tax applies to distributions on or after June 17, 2008 from an individual who expatriated on or after that same date. The tax applies to the receipt of a covered gift, defined as property acquired from an individual who is a covered expatriate, and to a covered bequest, defined a property acquired because of the death of a covered expatriate.

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Covered expatriate

Code Sec. 877A imposes an expatriation tax on gain from property held by "covered expatriates." Code Sec. 2801 adopts the definition in Code Sec. 877A of a covered expatriate, as an individual who, on the expatriation date:

- Had average annual net income tax liability over $124,000 (indexed for inflation) for the previous five years;
- Had net worth of at least $2 million (unindexed); or
- Failed to certify under penalties of perjury that he or she complied with all U.S. tax obligations for the prior five years.
- ***Comment.*** "How does the recipient of property know if the transferor is a covered expatriate?" Harrison said. "Family members may have some knowledge of income or assets, but not all will that information. Certification can be a problem. People may have expatriated and not filed the certification, even if they were not liable for taxes. Can someone go back and certify for a prior year? It's not clear. People expatriating may not have had tax advice and understood about the need to certify. Many people don't get tax advice when expatriating, or many not be able to afford it," Harrison said.

Trusts

A transfer to a domestic trust is a covered gift or bequest, and the trust is liable for the tax. A transfer to a foreign trust is not subject to the tax; however, a transfer from a foreign trust to a U.S. beneficiary or distributee (whether income or corpus) is taxable to the recipient.

A foreign trust may also elect to be treated as a U.S. trust and to be taxable when it receives the gift or bequest. The proposed regs describe the time and manner of making the election. The election will be made on Form 708, which the IRS will release once it issues final regs. The IRS will terminate the election if the trust fails to file Form 708 annually or to timely pay the tax. A trust may make a new election.

Power of appointment

The exercise, release or lapse of a covered expatriate's general power of appointment is a covered gift or bequest. An expatriate's grant of a general power of appointment over non-trust property is a covered gift or bequest when the power is exercisable and the transfer of property is irrevocable.

The value of the interest of a noncharitable U.S. beneficiary in contributions to a charitable remainder trust (CRT) is a covered gift or bequest. The trust is liable for the tax; however, its payment of the tax does not disqualify the trust as a CRT.

Liability

The U.S. citizen, resident or trust that receives the transfer is liable for the tax. A nonelecting foreign trust is not liable; instead, its U.S. beneficiaries are liable on trust distributions, to the extent the distribution is attributable to covered gifts or bequests to that trust.

Taxable amount

The proposed regs explain how to determine the amount of a distribution that is attributable to covered gifts and bequests. The amount is based on a ratio of covered and noncovered trust property and includes a portion of the income and appreciation on the trust's assets since the covered gifts and bequests to the trusts. The ratio must be redetermined after each contribution to the trust.

Tax rate

The tax applies to the total amount of covered gifts and bequests receiving during the year (by a recipient), reduced by the amount of the per-donee gift tax exclusion ($14,000 for 2015), and multiplied by the highest estate or gift tax rate in effect for the year. The tax is reduced by any estate or gift tax paid to a foreign country on the transfers.

The amount of the gift or bequest is the fair market value of the property on the date of receipt, without applying Code Sec. 2032 or 2032A. The proposed regs provide guidance for determining the date of receipt.

Reporting

Taxpayers will report and pay the tax using Form 708. The final regs will provide the due date for filing the form and paying the tax. U.S. recipients who have received a taxable transfer on or after June 17, 2008, and before the publication of final regs will have a reasonable period to file the form and pay the tax.

- ***Comment.*** "The tax has a great retroactive effect; enforcement may be an issue for prior years," Harrison said. "One break is that taxpayers will not owe interest because of the delayed reporting for prior years."

Under current law, a U.S. person who receives a gift or bequest from a foreign person must report the transfer on Form 3520. The IRS may use the information on Form 3520 to determine whether a U.S. citizen or resident received a covered gift or bequest.

Recipient duty

The IRS stated that it is the responsibility of the recipient of a gift or bequest to determine whether the transferor is a covered expatriate and whether tax applies under Code Sec. 2801. Whether or not the IRS is able to disclose information about the transferor's status, the burden is still on the recipient to determine liability, and there is a rebuttable presumption that the tax applies.

Reference: TRC ESTGIFT: 60,256.

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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Questions Abound About HRA Excise Tax Liability; ACA Reporting

www.irs.gov, HR 2911, Sen. 1697

As employers continue to implement the *Affordable Care Act* (ACA), the role of health reimbursement arrangements (HRAs), especially for small employers, appears uncertain. Transition relief from excise taxes on stand-alone HRAs has expired, exposing small employers to significant excise tax liabilities unless Congress acts. At the same time, questions have arisen whether ACA information reporting requirements reach HRAs.

- ***Take Away.*** Bipartisan legislation has been introduced in the House and Senate (HR 2911; Sen. 1697) to provide permanent relief for small employers. "Under the legislation, small employers would be able to have stand-alone HRAs and reimburse expenses without violating the ACA's market reforms," Jeff Martin, CPA, senior manager, Washington National Tax Office, Grant Thornton, LLP, told Wolters Kluwer.

Excise tax liability

Many small businesses have traditionally provided a health benefit to their employees through HRAs. Following passage of the ACA, the IRS released Notice 2013-54, which described these arrangements as employer payment plans. Therefore, they are considered to be group health plans subject to the ACA's market reforms, including the prohibition on annual limits for essential health benefits and the requirement to provide certain preventive care without cost sharing.

Failure to comply with the ACA's market reforms triggers excise taxes under Code Sec.4980D. The excise tax reaches $100 per affected individual per day. Transition relief (Notice 2015-17) expired after June 30, 2015.

- ***Comment.*** The penalty is a self-assessed penalty, Martin explained. Employers will report the penalty when they file their 2015 returns.

Information reporting

Under Code Sec. 6055, every provider of "minimum essential coverage" must report coverage information by filing an information return with the IRS and furnishing 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 about the health insurance coverage the employer offered.

In August, the IRS released draft instructions for filing ACA information returns. The draft instructions cover 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.

In the draft instructions, the IRS explained that providers are not required to report the following minimum essential coverage that is supplemental to other minimum essential coverage: coverage that supplements a government-sponsored program, such as Medicare or TRICARE supplemental coverage; or coverage of an individual in more than one plan or program provided by the same plan sponsor (the plan sponsor is required to report only one type of minimum essential coverage). Coverage is not provided by the same plan sponsor if it is not reported by the same reporting entity. An insured group health plan and a self-insured health reimbursement arrangement (HRA) covering the employees of the same employer are not supplemental, the IRS explained.

- ***Comment.*** The draft instructions do not change the rules or regulations, Martin told Wolters Kluwer. "For applicable large employers (ALEs), if they have a fully insured plan, they are required to file Form 1095-C. If they have an HRA on top of that, they will have to complete Part III of Form 1095-C as well." Some small employers, Martin noted, may potentially have more of a burden. "If a small employer has a fully insured plan, the insurer will report information on Forms 1094-B and 1095-B, and the small employer has no reporting requirement. If, on top of the fully insured plan, the small employer has an HRA that results in a self-insured plan that triggers a reporting requirement, the small employer will also have to file Forms 1094-B and 1095-B," Martin said.

Reference: TRC HEALTH: 18,100.

House Has Standing to Challenge ACA Appropriations, District Court Finds

A federal district court has found that the U.S. House of Representatives has standing to challenge appropriations to implement the *Affordable Care Act* (ACA). However, the court found that the House did not have standing to pursue its challenge to the delay of the ACA's employer mandate.

- ***Comment.*** The court did not reach the merits of the case, leaving the merits for another day.

Background. The House argued that cost-sharing offsets under the ACA are not part of a permanent appropriation. Rather cost-sharing must be funded and re-funded. According to the House, Congress has not appropriated any funds for cost-sharing. Nonetheless, the Obama administration has spent public monies on that program. The House also argued that the administration's delay of the ACA's employer shared responsibility requirements (employer mandate) usurped Congress' legislative authority.

Court's analysis. The court found that the House had standing on the appropriations issue. The House had suffered a concrete, particularized injury. The role of the House would be meaningless, if the executive branch could circumvent the appropriations process and spend funds however it pleases, the court observed. However, the House's challenge to the delay of the employer mandate was too general to state a concrete, particularized harm.

U.S. House of Representatives v. Burwell, DC-D.C.; TRC HEALTH: 6,050.

Second Circuit Applies Economic Substance Doctrine To Disallow Foreign Tax Credits

Bank of New York Mellon Corp., CA-2, September 9, 2015

Expanding a split among the circuits, the Court of Appeals for the Second Circuit has found in consolidated cases that the economic substance doctrine can be applied to disallow foreign tax credits. It is entirely appropriate, the court held, to ask if a taxpayer's claim to foreign tax credits is tied to true business abroad resulting in actual out-of-pocket tax payments, or whether its claim derives from sham transactions devoid of a business purpose beyond exploiting differences among foreign tax codes.

- ***Take Away.*** The decision by the Second Circuit splits with ones by the Fifth (*Compaq Computer Corp., 277 F.3d 778 (2001)* and the Eighth Circuit (*IES Industries, Inc., 253 F.3d 350 (2001*). The Second Circuit found support for its analysis in the Federal Circuit's 2015 decision, *Salem Financial, Inc. (786 F.3d 932),* which reached a similar conclusion.
- ***Comment.*** Congress codified the economic substance doctrine in the *Health Care Reconciliation Act of 2010.* The transactions in these cases took place before codification of the economic substance doctrine.

Background

The taxpayers (A and B) both engaged in cross-border transactions. Taxpayer A borrowed funds at economically favorable rates below a benchmark rate (LIBOR) and invested the funds above LIBOR. Taxpayer B engaged in a transaction known as Structured Trust Advantaged Repackaged Securities (STARS). The taxpayers claimed that the transactions generated foreign tax credits, which could be used to offset unrelated income and reduce their U.S. tax liabilities. The IRS disallowed the foreign tax credits for both taxpayers.

A federal district court found, in the case of taxpayer A, that the economic substance doctrine applies to the foreign tax credit regime because Congress intended foreign tax credits to facilitate only "purposive" business transactions and foreign tax credits are to be included as a cost in the calculation of pre-tax benefit from cross-border transactions. In the case of taxpayer B, the Tax Court found, among other findings, that the STARS transaction lacked economic substance and that foreign tax credits but neither loan proceeds nor the tax-spread should be considered in the pre-tax tax analysis of economic substance.

Court's analysis

The Second Circuit found that the Supreme Court has long held that substance rather than form determines tax consequences. The economic substance doctrine, the court explained, stems from the concern that even if a transaction's form matches the dictionary definitions of each term used in a tax provision, it does not follow that Congress meant to cover the transaction and allow it a tax benefit. Additionally, the Second Circuit found that the economic substance doctrine gives courts a "second look" to ensure that particular uses of tax benefits comply with Congress' purpose in creating the benefit.

Congress' intent in creating foreign tax credits, the court found, was to prevent double taxation of taxpayers conducting business in the U.S. and abroad. The foreign tax credit is designed only for taxpayers who desire to engage in purposive activity, not sham transactions built solely around tax arbitrage.

The court looked at whether the taxpayers had objectively reasonable expectations of profit, apart from tax benefits, from the transactions, and whether the taxpayers had a subjective non-tax business purpose in entering the transactions. Here, the court found that the transactions were real insofar as money changed hands but they had little or no potential for economic return apart from the tax benefits.

- ***Comment.*** The Second Circuit characterized its approach to economic substance as "flexible" rather than a rigid two-step process with discrete prongs.

References: 2015-2 USTC ¶50,473; TRC INTLOUT: 3,100.

Expenses To Pursue Patent Infringement Claim Are Deductible Under Code Sec. 162

The IRS has concluded that a taxpayer's expenses for pursuing a patent infringement claim against another company are deductible expenses. Since the case did not involve a challenge to the taxpayer's legal title to the patent, the costs did not have to be capitalized under Code Sec. 263.

Background. The taxpayer entered into a license agreement with an affiliate for use of a patent to manufacture and sell products. The taxpayer claimed that another company manufactured products that infringed on the patent and filed a patent infringement claim against the company. None of the company's claims asserted that the affiliate lacked legal title to the patent.

IRS's analysis. A taxpayer must capitalize an amount paid to defend or perfect title to intangible property, if the other party challenges title. However, this rule does not require capitalization of amounts paid to protect property against infringement and to recover damages or protect profits. Here, the challenge did not involve whether the patent holder is the true owner of the patent.

LTR 201536006; TRC BUSEXP: 12,066.

IRS Finalizes Regs On Minimum Required Contributions For Single-Employer DB Plans

TD 9732

Final regulations have been released on the determination of minimum required contributions for single-employer defined benefit (DB) plans. The final regs generally track proposed regs issued in 2008 but with some modifications.

- ***Take Away.*** In the same guidance, the IRS discussed the excise tax for failure to satisfy the minimum funding requirements for DB plans. The guidance includes examples of when the excise tax would attach.

Background

Under the *Pension Protection Act of 2006* (PPA), an employer's contribution to a single-employer defined benefit plan for a plan year may not in the aggregate be less than the "minimum required contribution." The minimum required contribution applicable to plans in which plan assets (reduced by credit balances) are less than the funding target of the plan for the year is the sum of certain factors. If the value of a plan's assets (reduced by any credit balance) equals or exceeds the funding target (that is, 100 percent of the target liability), the minimum required contribution is the target normal cost of the plan for the plan year reduced (but not below zero) by the amount by which the plan's assets (reduced by a credit balance) exceed the funding target.

- ***Comment.*** The funding target of a plan is the present value of all benefits accrued or earned under the plan as of the beginning of the plan year. Benefits that are to be taken into account for purposes of the funding target include early retirement and similar benefits. However, benefits that have not accrued during the plan year are not included in a plan's funding target.

Final regs

The final regs clarify the rules for determining the amount of a minimum required contribution for a short plan year. If the plan terminates before the last day of the year, the IRS explained that the rules for short plan years apply for the year of termination by specifying that if a plan terminates before the last day of a plan year, the plan is treated as having a short plan year that ends on the termination date. The minimum required contribution is determined based on that short plan year. If a plan terminates before the date that would otherwise have been the valuation date for a plan year, the valuation date for the plan year must be changed so that it falls within the short plan year, the IRS explained.

The final regs also clarify the rules for providing a standing election to satisfy quarterly installments. A plan sponsor may provide a standing election in writing to the plan's enrolled actuary to use the funding standard carryover balance and the prefunding balance to satisfy any otherwise unpaid portion of a required installment. Any standing election to use the funding balances to satisfy quarterly installments remains in effect for the plan with respect to the enrolled actuary named in the election, unless the standing election is revoked or the plan's enrolled actuary is changed. However, a plan sponsor may suspend operation of a standing election for the remainder of a plan year by providing written notice to the enrolled actuary.

Additionally, the final regs provide rules for applying the liquidity requirements to a multiple employer plan. The IRS explained that the liquidity requirement is satisfied for the plan if it would be satisfied if the plan were a single-employer plan that is not a multiple employer plan. However, if the plan does not satisfy the liquidity requirement on this basis, then the liquidity requirement must be applied separately for each employer under the plan, as if each employer maintained a separate plan.

References: FED ¶47,032; TRC RETIRE: 30,502.

IRS Eliminates Appeals Arbitration Program; Only Two Cases Resolved In 14 Years

Rev. Proc. 2015-44

Citing lack of demand for its binding arbitration procedure, the IRS has announced that it will close its Appeals arbitration program at the end of September 2015. The IRS explained that during the entire 14-year period in which the program was in place, only two cases were resolved through binding arbitration.

- ***Take Away.*** Although Appeals arbitration is being eliminated, the IRS has indicated that taxpayers may still be eligible to request mediation for unresolved issues that remain after completion of settlement discussions in IRS Appeals. The mediation procedures are set forth in Rev. Proc. 2014-63.

Background

Code Sec. 7123(b)(2) required the IRS to establish a pilot program by which a taxpayer and the IRS Office of Appeals may jointly request binding arbitration for any issue unresolved at the conclusion of Appeals procedures (or following unsuccessful attempts to enter into a closing agreement under Code Sec. 7121 or a compromise under Code Sec. 7122). To comply with Code Sec. 7123, on January 18, 2000, IRS Appeals established a two-year pilot program offering binding arbitration procedures to certain taxpayers with cases involving a limited set of factual issues. The IRS formally established the program in late 2006 when it published the procedures in Rev. Proc. 2006-44.

The initial program was limited to certain factual issues. Eventually, IRS Appeals extended its arbitration procedures to cover offers-in-compromise (OIC) and trust fund recovery penalty (TFRP) cases for taxpayers whose appeals were being considered in one of eight cities (Atlanta, Chicago, Cincinnati, Houston, Indianapolis, Louisville, Phoenix, and San Francisco).

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Sixth Circuit Upholds Imposition Of General Statute Of Limitations To S Corp/ESOP Excise Tax Situation

Law Office of John H. Eggertsen P.C., CA-6, September 8, 2015

The Sixth Circuit Court of Appeals, in a divided opinion, has upheld the Tax Court's application of the statute of limitations under Code Sec. 6501 to a case involving an S corp's liability for the Code Sec. 4979A excise tax. Although the Tax Court had initially applied the statute of limitations under Code Sec. 4979A and found it had expired, the Tax Court did not abuse its discretion by later granting the IRS's motion to reconsider and applying the unexpired statute of limitations under Code Sec. 6501, the Sixth Circuit found.

- ***Take Away.*** Under Code Sec. 4979A(e)(2)(D), the limitations period starts from the later of the allocation or ownership giving rise to the tax, or the date the IRS has notice of the allocation or ownership. Code Sec. 6501 generally provides the IRS with three years from the date the return is filed to assess a tax. The court concluded that the taxpayer never filed the return needed to trigger the running of the statute.

Background

An individual established a law firm that elected S corp treatment and then created an employee stock ownership plan (ESOP) into which he transferred all his shares in the S corp. Congress later imposed a 50-percent excise tax under Code Sec. 4979A on the amount involved in this type of narrow stock allocation arrangement between an S corp and ESOP that failed to provide broad-based employee coverage.

After the IRS assessed the Code Sec. 4979A excise tax, the issue proceeded to the Tax Court. Initially the Tax Court found that the limitations period under Code Sec. 4979A applied and had expired. The IRS subsequently filed a motion for reconsideration, arguing that Code Sec. 6501 applied to this case. The Tax Court granted the motion and ruled in the IRS's favor, finding that the statute of limitations under Code Sec. 6501 applied and had not been triggered because the S corp and ESOP had not filed Form 5330, Return of Excise Taxes Related to Employee Benefit Plans.

Court's analysis

The Sixth Circuit first found that the S corp was liable for the excise tax under Code Sec. 4979A because the ESOP had a nonallocation year. Second, the Sixth Circuit found that the statute of limitations under Code Sec. 6501 had never been triggered because the law firm failed to file the requisite return: Form 5330. No exception to this rule requiring the filing of a return to trigger the period applied to this case, the Sixth Circuit found.

Finally, the Sixth Circuit held that the Tax Court had not abused its discretion in granting the IRS's motion to reconsider which statute of limitations to apply. It was not relevant whether the IRS had forfeited its right to argue that the Code Sec. 6501 limitations period should apply: the Tax Court had granted the motion in order to correct its own mistake, not the IRS's. Furthermore, the doctrine of judicial estoppel did not apply: The doctrine does not usually apply to shifting legal arguments, but to shifting factual arguments, the Sixth Circuit found.

- ***Comment.*** The dissent would have considered applying judicial estoppel. The dissent noted that, "Judicial estoppel has been applied in numerous instances where a party reversed itself on an issue of law."

References: 2015-2 USTC ¶50,468; TRC RETIRE: 75,454.10.

Tax Court Finds Lender Failed To Rebut Presumption Of Identifiable Event; COD Not Included In Income

A taxpayer did not have to recognize discharge of indebtedness income as a result of defaulting on her automobile loan, the Tax Court has found. The lender failed to rebut the presumption that an identifiable event took place discharging the taxpayer's debt in a year prior to the year in dispute.

Background. In 1999, the taxpayer financed the purchase of an automobile. The taxpayer subsequently defaulted on the loan. Five collection agencies worked the account without success. In 2011, the lender reported that the outstanding balance was discharged by filing Form 1099-C with the IRS. The taxpayer's copy of Form 1099-C was returned to the lender as undeliverable, address unknown. The taxpayer did not report any income from the discharge of the debt on her 2011 return.

Court's analysis. The court acknowledged that the lender had engaged the services of five collection agencies but found the evidence did not show what, if any, collection activities took place. Significant collection activities, the court found, require more than routine mailings and similar actions. As a result, the taxpayer did not have any discharge of indebtedness for 2011 and no related income.

Clark, TC Memo. 2015-175; Dec. 60,398(M); TRC SALES: 12,154.20.

Arbitration Program

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Closure

Effective from the publication of Rev. Proc. 2015-44 in the Internal Revenue Bulletin, the Appeals arbitration program will be closed. The IRS explained that the reason for this program closure was the general lack of demand for arbitration. The program had not proved a successful tool for settling disputes without litigation.

References: FED ¶46,396; TRC IRS: 24,300.

No Aggregation Of Poker Tournament Multiple Buy-Ins, Chief Counsel Determines

FAA 20153601F

Multiple buy-ins in a poker tournament are not identical wagers, Chief Counsel has determined in field attorney advice (FAA). Therefore, multiple buy-ins should not be aggregated for purposes of Code Sec. 3402(q) withholding and reporting requirements.

- ***Take Away.*** Payers must provide players with Form W-2G, Certain Gambling Winnings, which is also filed with the IRS. The payer must issue the form based on the type of gambling, the amount won and other factors. Income tax withholding is required at a flat rate of 25 percent of more than $5,000 from wagering pools, among other types of gambling activities, if the winnings are at least 300 times the wager.

Background

To participate in a poker tournament, players pay a buy-in amount. In exchange for the buy-in, players receive tournament chips. Once a player bets all of his or her tournament chips, the player is eliminated from game play. An eliminated player can re-enter during an alternate period by purchasing an additional buy-in at the same price. The player who is the last one remaining in the event with tournament chips wins the first place prize. Additionally, the top 10 percent of players in each tournament field receive cash prizes.

- ***Comment.*** Each additional buy-in had the effect of increasing the wagering pool and potential prize amounts.

Chief Counsel's analysis

Chief Counsel first noted that the IRS determined in Rev. Proc. 2007-57 that poker tournament sponsors must withhold and report on payments of more than $5,000 (after reducing the payment by the amount of the wager) made to a winning payee in a tax year by filing an information return. For purposes of Code Sec. 3402(q), winnings subject to withholding include proceeds of more than $5,000 from a wager placed in a sweepstakes, wagering pool, or lottery. Poker tournaments, Chief Counsel explained, are treated as a wagering pool. Chief Counsel further noted that amounts paid with respect to identical wagers are treated as paid with respect to a single wager for purposes of calculating the amount of proceeds from a wager.

Here, players in the tournament could buy-in to the tournament as many times as they wanted after they lost their initial buy-in, as long as the tournament had not advanced past the alternate period. Each time they purchased an additional buy-in, Chief Counsel observed that the tournament advanced and the circumstances that must occur for players to win changed. Therefore, the additional buy-ins were not identical wagers and should not be aggregated for the purpose of determining whether the reporting and withholding thresholds have been met, Chief Counsel concluded.

Reference: TRC PAYROLL: 3,404.

TAX BRIEFS

Disaster Relief

The IRS has added the Kentucky counties of Breathitt, Fleming, and Perry to its list of federal disaster areas where certain victims of severe storms, tornadoes, straight-line winds, flooding, landslides and mudslides that took place beginning on July 11, 2015 in parts of Kentucky may qualify for tax relief from the IRS.

Kentucky Disaster Relief Notice Updated (KY-2015-13), FED ¶46,383; TRC FILEIND: 15,204.25

Income

An individual was required to include his IRA distributions in his gross income for the tax year at issue. The taxpayer's arguments that these distributions should not be subject to tax because he did not receive the funds or received any benefit therefrom were rejected; he constructively received the IRA distributions to satisfy his legal obligations. Further, the IRS settlement officer (SO) did not abuse his discretion in sustaining the notice of federal tax lien (NFTL) since the taxpayer did not offer any collection alternatives during the course of the CDP hearing .

Rodrigues, TC, Dec. 60,401(M), FED ¶48,111(M); TRC RETIRE: 42,550

Married individuals, who lent money to a business that financed insurance premiums, received unreported interest income for the year at issue and were liable for a substantial understatement penalty. The facts of the case weighed in favor of finding a debtor-creditor relationship, with the taxpayers' receiving regular payments of interest income.

Friedman, TC, Dec. 60,400(M), FED ¶48,110(M); TRC INDIV: 12,106

Deductions

The IRS correctly disallowed a semiretired patent attorney's deduction of portfolio losses realized inside his Individual Retirement Account (IRA) and imposed the substantial understatement penalty. Distributions from an IRA trigger income tax consequences and the taxpayer may not use losses realized within the IRA to offset his income.

Fish, TC, Dec. 60,399(M), FED ¶48,109(M);

Married individuals who incorporated their business were not entitled to claim the cor-

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poration's business deductions for the two years at issue on their Forms 1040, Schedule C. Further, the taxpayers were conditionally liable for substantial understatement penalties, depending on post-trial computations.

Rochlani, TC, Dec. 60,397(M), FED ¶48,107(M); TRC BUSEXP: 12,156.20

Deficiencies and Penalties

A married couple's claim for refund of trust fund recovery penalties was dismissed. The individuals were responsible persons liable for the trust fund recovery penalty under Code Sec. 6672 and their failure to pay the taxes was willful because they paid employees instead of the government.

Hasbun, DC Fla., 2015-2 USTC ¶50,466; TRC PAYROLL: 6,306

Summonses

An IRS summons requiring an individual to appear, testify and produce documents in connection with the collectability of his tax liability was ordered enforced. The government established its *prima facie* case for summons enforcement, which the individual failed to rebut.

Rexrode, DC Tex., 2015-2 USTC ¶50,470; Kaebel, DC Tex., 2015-2 USTC ¶50,471; TRC IRS: 21,300

Refund Claims

A couple was not entitled to refund of taxes paid pursuant to a partnership audit settlement because their return was not timely filed and they failed to show that they requested an additional extension and that it was granted.

Kalantari, DC Calif., 2015-2 USTC ¶50,467; TRC FILEIND: 15,302

Litigation Costs

A married couple was not entitled to reasonable litigation costs because the government's position was substantially justified. Therefore, the IRS's interpretation was substantially justified within the meaning of Code Sec. 7430(c)(4)(B)(i) and the taxpayers were not the prevailing party within the meaning of Code Sec. 7430(c)(4)(A).

Mikel, TC, Dec. 60,396(M), FED ¶48,106(M); TRC LITIG: 3,154.05

Default Judgment

The government's motion to default married taxpayers was granted. The couple refused to provide discovery or participate in pretrial conferences with the IRS, ignored court orders and failed to appear at trial. Further, based on facts deemed to be admitted, the government's burdens of production and proof were satisfied and a judgment was entered against the taxpayers.

Hill, TC, Dec. 60,395(M), FED ¶48,105(M); TRC LITIG: 6,656.15

False Tax Returns

An individual was properly convicted and sentenced for filing false refund claims and tax evasion. However, the sentencing court's restitution order was erroneous since it required him to pay more in restitution to the IRS than the actual loss caused by his false refund claim. Therefore, the restitution order was vacated and remanded.

Hesser, CA-11, 2015-2 USTC ¶50,469; TRC IRS: 66,058.05

Tax Crimes

An individual was properly convicted of conspiracy to defraud the government and filing false tax returns for the tax years at issue. However, the sentence imposed was vacated and the matter was remanded for the sentencing court to recalculate the tax loss.

Hough, CA-11, 2015-2 USTC ¶50,472; TRC IRS: 66,202

FOIA

An individual's Freedom of Information Act (FOIA) claim seeking a corporate income tax return and Form 2553, Election by a Small Business Corporation, of a printing company was dismissed for lack of subject matter jurisdiction. The IRS's search revealed that the company did not file a corporate tax return for the year requested and the individual failed to show that the IRS possessed the document and improperly withheld it.

Powell, DC Mich., 2015-2 USTC ¶50,474; TRC IRS: 9,502

SFC Set To Move Return Preparer Regulation Bill

At press time, the Senate Finance Committee (SFC) is expected to approve bipartisan legislation to give the IRS express authority to regulate all paid tax return preparers. The bill has the support of SFC Chair Orrin Hatch, R-Utah, and SFC ranking member Ron Wyden, D-Ore.

Background. In *Loving, 2014-2 USTC ¶50,175,* the Court of Appeals for the District of Columbia Circuit struck down the IRS's Registered Tax Return Preparer (RTRP) program. The court held that the RTRP program exceeded the agency's authority to regulate return preparers under existing regs.

- ***Comment.*** After the RTRP program was discontinued, the IRS launched the Annual Filing Season Program (AFSP). Return preparers who voluntarily satisfy the AFSP's continuing education and other requirements receive a Record of Completion. AFSP participants, however, do not have unlimited practice rights before the IRS unless the preparer is also a CPA, attorney or EA. The IRS continues to seek legislation expressly authorizing the regulation of return preparers.

SFC bill. The SFC bill would override Loving and provide the IRS with authority to regulate paid tax return preparers. The bill specifies that preparation of tax returns for compensation is subject to regulation. The bill also authorizes the IRS to revoke preparer tax identification numbers (PTINs) for failure to comply with regulations. The SFC is scheduled to mark up the bill on September 16.

- ***Comment.*** "I am confident this is legislation that the committee can get behind on a bipartisan basis, and I look forward to continuing to find ways to protect taxpayers from identity theft and fraud," Wyden said in a statement.
- ***Comment.*** The SFC bill would end the AFSP.

Chairman's Mark of a Bill to Prevent Identity Theft and Tax Refund Fraud; TRC IRS: 3,200.

PRACTITIONERS' CORNER

First Look At 2015 Year-End Tax Planning

As fall approaches and calendar year 2015 winds down, it is a good time for individuals and businesses to consider what steps they can take to reduce their tax bills for 2015. Tax law developments in 2015 can affect, for example, the deduction of costs and expenses, the treatment of contributions to tax-favored accounts, and the inclusion of certain benefits in income. Traditional year-end planning techniques for investments are also important. This Practitioners' Corner reviews some of the 2015 developments in Congress and the IRS for taxpayers to consider.

Tax legislation

While many taxpayers wait for Congress to act on the now-expired tax extenders, legislation already passed or likely to be approved before year-end opens some additional year-end tax planning opportunities. The extenders are among the most widely used incentives, but taxpayers should not ignore possible tax planning strategies in other bills and new laws. As January 1, 2016 draws closer, taxpayers will have a better indication which pending tax bills will be enacted into law. In the meantime, taxpayers should consider how new tax laws and pending proposals may affect their year-end tax planning.

Tax extenders. While lawmakers debate comprehensive tax reform, the clock is ticking on the fate of the tax extenders. The *Tax Increase Prevention Act of 2014* (TIPA) only extended the popular tax breaks for 2014. The expired extenders include the state and local sales tax deduction, higher education tuition deduction, transit benefits parity, research tax credit, the work opportunity tax credit, and many others.

The extenders are likely to be renewed for 2015 if not longer. They may be renewed in a package, as in past years, but some, such as the research credit, could be renewed as stand-alone legislation, in an effort to make them permanent.

Stand-alone bills. The *American Research and Competitiveness Bill of 2015* (HR 880), which passed the House earlier this year, would simplify and make permanent the research tax credit. The House bill provides no revenue offsets, however, and President Obama has promised to veto the measure. In April, the House passed the *State and Local Sales Tax Deduction Fairness Bill* (HR 622), which would permanently extend the deduction for state and local sales taxes. The White House also said it would veto HR 622, stating that the cost of the measure is not offset and would add to long-term deficits. The lack of support from the President and the cost of these stand-alone bills make a short-term renewal of the extenders in a package much more attractive.

"While many taxpayers wait for Congress to act on the now-expired tax extenders, legislation already passed or likely to be approved before year-end opens some additional year-end tax planning opportunities."

Education. Early in 2015, momentum was building to make Code Sec. 529 college saving plans more taxpayer-friendly, and the House approved HR 529. The bill would allow the purchase of a computer to be considered a qualified expense. Another provision provides tax and penalty relief where a student may have to withdraw from school for illness or other reasons. Under current law, any refunds from the college are subject to immediate taxation and a 10 percent tax penalty. The bill eliminates this tax and penalty if the refund is redeposited in a Sec. 529 account. The Senate has yet to take up the House bill, but reforming 529 plans has enjoyed bipartisan support in the past.

Public safety officers. Two new laws impact tax planning for public safety officers. The *Don't Tax Our Fallen Public Safety Heroes Act* clarifies that both federal and state benefits for public safety officers fallen or injured in the line of duty are treated the same in the tax code and are not taxable. The *Defending Public Safety Employees' Retirement Act* affects retirement planning. Generally, taxpayers who receive an early distribution from a qualified retirement plan are subject to a 10 percent penalty, unless an exemption exists. The *Defending Public Safety Employees' Retirement Act* expands the exemption to include certain federal law enforcement officers, federal firefighters, customs and border protection officers, and air traffic controllers.

Comprehensive tax reform. In January 2015, the Senate Finance Committee (chaired by Sen. Orrin Hatch, R-Utah, with Sen. Ron Wyden, D-Oregon, as ranking member) took the lead on federal tax reform with the formation of working groups to study comprehensive tax reform. The SFC created five working groups: (1) Individual income tax; (2) Business income tax; (3) Savings and investment; (4) International tax; and (5) Community Development and Infrastructure. Six months later, the working groups released their reports. The working groups did not, however, make any proposals for tax reform. Instead, the working groups described various approaches to tax reform, many which had been put forward in past years.

Strategy. After release of the SFC report, enthusiasm for tax reform appeared to wane. Comprehensive tax reform before year-end 2015 is a non-starter and the outlook in 2016, a presidential election year, is murky at best. As a result, traditional year-

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WASHINGTON REPORT *by the Wolters Kluwer Washington News Bureau*

Tax extenders, highway bill wait for action in Congress

Since returning from their August recess, lawmakers have made little progress on two tax fronts: the tax extenders and tax provisions in a multi-year highway and transportation funding package. Both measures are likely to be on the back-burner through the end of September.

Extenders. In July, the Senate Finance Committee approved the Tax Increase Prevention Act of 2015, extending many of the extenders and enhancing some of the incentives. House Ways and Means Chair Paul Ryan, R-Wis., however, has yet to determine when the committee will take-up a similar package. Before the August recess, the House approved several stand-alone bills extending some of the expired provisions.

In a September 10 letter, a coalition of more than 2,000 organizations told Congress that failure to extend the tax incentives amounts to a tax increase on businesses and individuals. Delaying approval of the tax extenders "will inject instability and uncertainty into the economy and weaken confidence in the employment marketplace. Acting promptly on this matter will provide important predictability necessary for economic growth," the group emphasized.

Highway bill. Before the August recess, the Senate approved a multi-year highway bill, the Developing a Reliable and Innovative Vision for the Economy (DRIVE) Bill (Sen 1647). The Senate bill is funded for three years with tax-compliance measures and revenue for the remaining three years to be determined by the next Congress. House lawmakers are expected to complete a long-term highway funding measure in either September or October and the two chambers aim to go to conference by late October to reconcile their respective multi-year bills.

House panel examines definition of small business under ACA

The House Energy and Commerce Subcommittee on Health held a hearing on September 8 to review the Protecting Affordable Coverage for Employees (PACE) Bill (HR 1624). The bill would amend the *Affordable Care Act* (ACA) to redefine a small employer as one with 50 or fewer employees and give states the option to expand the definition to include employers with up to 100 employees. Companion legislation (Sen 1099) has also been introduced in the Senate.

Historically, an employer with 50 or fewer employees was considered a "small employer" and could purchase health insurance coverage in the small-group market, supporters of the PACE bill explained. The ACA revised the threshold upward, redefining a small employer as those employers with 100 or fewer employees. Currently, states must implement the expanded definition for plan years beginning in 2016.

Rep. Joe Pitts, R-Pa., said the bill was needed as the new requirements could lead some employers with 51-to-100 employees to self-insure to avoid higher premiums. "If that happens, this could result in adverse selection in the small group pool and higher premiums for employers with 1-to-50 employees. Unless this current law is reversed, the disruption in the marketplace will be significant," Pitts said.

However, Rep. Frank Pallone, D-N.J., countered Pitts, saying the bill was premature. "I don't know if this is the best approach," Pallone said. He added that lawmakers should work to strengthen the ACA.

Lawmakers review ACA's impact on health care market

The health care market has recently witnessed historic levels of mergers and acquisitions, with much of the consolidation having been accelerated by implementation of the *Affordable Care Act* (ACA), witnesses told members of the House Judiciary Subcommittee on Regulatory Reform, Commercial and Antitrust Law on September 10. In the commercial market for private coverage there has been a contraction in the number of carriers offering health plans, Scott Gottlieb M.D., a resident fellow at the American Enterprise Institute, testified before lawmakers. About 50 new health carriers have entered the commercial market since 2008, Gottlieb explained. "Half of these are not-for-profit co-op plans that the ACA subsidizes," Gottlieb said.

Compliance with the IRS is also a factor for the changing health care marketplace. Among the many issues confronting hospitals that merge is uncertainty about how the IRS will view payments from tax-exempt hospitals to nontax-exempt physicians working together in clinically integrated arrangements, testified Richard Pollack, president and CEO, American Hospital Association.

IRS holds hearing on MPRA regs

The IRS held a hearing on temporary and proposed regs under the *Multiemployer Pension Reform Act of 2014* (MPRA) in Washington, D.C. on September 10. Proponents and opponents of the MPRA testified about the temporary and proposed regs.

The International Brotherhood of Teamsters (IBT) recommended that the IRS reconsider the prohibition on contingent phasing-in of suspensions of benefits and permit contingent phase-in of the final rules. "We advocate this position because we believe contingent phase-in of suspension of benefits is more consistent with and in fact better complements Code Sec. 432(e)(9)(D), which requires that aggregate suspensions of benefits be reasonably estimated to achieve, but not materially exceed, the level that is needed to avoid plan insolvency."

In related news, opponents of the MPRA urged Congress to repeal the law at a news conference. Sen. Bernie Sanders, I-Vermont; and Reps. Marcy Kaptur, D-Ohio and Tim Ryan, D-Ohio, have introduced the Keep our Pension Promises Act. Their bill would roll-back the MPRA. "Retirees have worked hard all of their lives to achieve the American dream. Now they are faced with unprecedented and unfair cuts to the pensions that they have earned, "Karen Friedman, executive vice president, Pension Rights Center, said. Friedman predicted that if the Keep Our Pension Promises Act is not passed, benefits could be cut for as many as one million retirees in 2016.

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end planning that balances income, deductions and credits between this year and next is relatively straightforward. However, taxpayers should be alert to several possible wild cards. Although an extenders package is expected to be passed eventually by Congress, it may only cover 2015, with 2016 relief delayed for possible consideration with tax reform.

Investment planning

The wild swings in the stock markets lately have added not only a degree of volatility to investments but also to related tax strategies. Taking inventory of gains and losses at this time to map out a year-end buy, sell or hold strategy later makes particular sense. Investors should note that immediate losses in the stock markets do not necessarily translate into tax losses. The fact that assets purchased several years ago may still yield taxable gains because of low basis, and the existence of the wash-sale rule if a stock is purchased within 30 days before or after a sale, should be considered in assessing current tax positions.

Taxpayers overall should also remember the new, higher tax rate environment that is now in its third year. Not only is the top rate now 39.6 percent for ordinary income (and short-term capital gains) but the rate for long-term capital gains and qualified dividends increased from 15 to 20 percent. Furthermore, a 3.8 percent net investment tax applies to taxpayers with income above a non-inflation-adjusted threshold ($250,000 for married taxpayers filing jointly; $125,000 for married taxpayers filing separately; and $200,000 for all other taxpayers).

Retirement planning

Retirement planning should be a year-round concern, but focus is usually intensified at year end. Although most IRA contributions for a particular year may be made until the filing date for that year, other deadlines are at year end, such as contributions to 401(k) plans and Roth conversions and reconversions. Required minimum distributions for retirees and those over age 70 1/2 also generally carry a year-end distribution date beyond which a penalty applies. One exception allows an individual turning age 70 1/2 to delay starting distributions until April 1 of the year following the year in which the individual turns 70 1/2.

One strategy for consolidating IRAs ended this year. Following *Bobrow, TC Memo. 2014-21*, the IRS ended a 2014 grace period and announced in Announcement 2014-32, that, effective for rollover distributions received on or after January 1, 2015, a taxpayer is now limited to one 60-day rollover per year for all IRA accounts under the tax code rather than one 60-day rollover per year for each IRA account. Unlimited trustee-to-trustee transfers, however, are still allowed.

Repair-capitalization rules

Small business in particular has relied on the generous Section 179 deductions—now up for renewal within extenders legislation—to gain an immediate write-off for equipment, rather than follow depreciation schedules. The extenders package application for 2014 set the Code Sec. 179 dollar limit at $500,000 for 2014 with a $2 million overall investment limit. Absent Congressional action, however, the dollar limit reverts to a lower $25,000/$200,000 level in 2015.

One alternative now available to many businesses is the de minimis safe harbor threshold amount under the final "repair regs" for taxpayers. Currently, a de minimis safe harbor under the repair regs allows taxpayers to deduct certain items cost $5,000 or less (per item or invoice) and that are deductible in accordance with the company's accounting policy reflected on their applicable financial statement (AFS). IRS regulations also provide a $500 de minimis safe harbor threshold for taxpayers without an applicable financial statement. The American Institute of Certified Public Accountants (AICPA) asked the IRS in early 2015 to raise the threshold amount from $500 to as much as $2,500, but the IRS has not yet acted on that request.

Routine service contracts

Accrual basis taxpayers also have a new tool to use in year-end planning. Rev. Proc. 2015-39 provides a safe harbor under which accrual-basis taxpayers may treat economic performance as occurring on a ratable basis for ratable service contracts. The IRS also indicated that additional safe harbors may be developed. This new safe harbor may be particularly useful in connection with regular services that extend into 2016. Taxpayers meeting the safe harbor for ratable service contracts may take a full deduction in the current 2015 tax year for certain 2015 payments, even though services may not be performed until 2016.

ABLE accounts

Families of individuals facing significant disabilities should consider contributions before year-end to A Better Life Experience (ABLE) account. States are now enacting enabling legislations, which along with federal law, will allow ABLE accounts to be set up for qualified individuals with disabilities (who became disabled before age 26) for tax years beginning after December 31, 2014. Contributions in a total amount up to the annual gift tax exclusion amount, currently $14,000, can be made to an ABLE account on an annual basis, and distributions are tax-free if used to pay qualified disability expenses.

Conclusion

Year-end tax planning is important for taxpayers to consider and act on. Changes in the tax law can provide opportunities for both individuals and businesses to reduce their potential tax bill for 2015, by taking appropriate actions by the end of the calendar year. This Practitioners' Corner has pointed out some of the developments that taxpayers should keep in mind as the end of 2015 approaches.

COMPLIANCE CALENDAR

■ 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.

■ September 30
Employers deposit Social Security, Medicare, and withheld income tax for September 23, 24, and 25.

■ October 2
Employers deposit Social Security, Medicare, and withheld income tax for September 26, 27, 28, and 29.

■ October 7
Employers deposit Social Security, Medicare, and withheld income tax for September 30, October 1, and 2.

TRC TEXT REFERENCE TABLE

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

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FROM THE HELPLINE

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

Q What are the initial questions that an individual must ask before claiming a foreign income tax credit for foreign tax withheld?

A First ask whether the foreign taxes are creditable income taxes under Code Sec. 901. A creditable income tax includes a tax that is paid in lieu of an income tax, such as a withholding tax, under Code Sec. 903. *See TRC INTLOUT: 3,112.* Second, note that taxpayers claiming a foreign tax credit have the burden of proving that the foreign taxes were not only withheld, but were paid. In the absence of direct evidence, acceptable secondary evidence may be provided Code Sec. 905(b) and Reg. §1.905-2(b). *See TRC INTLOUT 3,256.*

Q Should an employer include amounts paid to an employee to reimburse him for his tuition for work-related post-graduate courses on the employee's Form W-2 for the tax year?

A If the courses help to maintain or improve job skills or provide education necessary to meet the employer's requirements and the courses are job-related, the education expenses are either (1) excludable by the employee if paid directly to the educational institution by the employer; or (2) deductible by the employee as business expenses if reimbursed by the employer. Rev. Rul. 76-71 provides that reporting is not required if the reimbursement equals the cost. *See TRC COMPEN: 36,552.*