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IRS Begins FATCA Information Exchange With Other Jurisdictions; Canadian Court Declines To Enjoin Disclosure

IR-2015-111; Hillis v. The Attorney General of Canada, September 30, 2015

The IRS has announced a milestone under the *Foreign Account Tax Compliance Act* (FATCA) by making an initial exchange of financial account information with foreign tax administrators. The exchange meets a key September 30 milestone, the IRS stated.

In a related development, the Canada Federal Court of Appeal declined to enjoin the Canada Revenue Agency (CRA) from disclosing account information of U.S. citizens living in Canada to the IRS. The opinion noted that the CRA was planning to disclose the information at the close of business on September 30.

- ***Take Away.*** While FATCA is under legal attack in both the United States and foreign jurisdictions, the IRS and foreign tax authorities are moving ahead to implement the law's reporting and disclosure regime. The exchange of tax information between governments is taking place under the authority of intergovernmental agreements (IGAs) negotiated by Treasury with foreign jurisdictions.

Background

FATCA generally requires foreign financial institutions (FFIs) to report to the IRS information about financial accounts by U.S. taxpayers (including foreign entities in which U.S taxpayers own a substantial interest). FFIs that fail to meet their disclosure obligations are subject to a 30 percent withholding regime on payments from the U.S. to their accounts.

To facilitate disclosure of foreign accounts the U.S. government has negotiated bilateral IGAs that enable the IRS to receive the foreign account information. Under a Model 1 IGA, foreign governments agree to collect their FFIs' U.S. account information and send it to the IRS. Most IGAs are Model 1 IGA, including Canada's. Under a Model 2 IGA, foreign governments agree to modify their laws to enable their FFIs to report U.S. account information directly to the IRS, without violating the jurisdiction's restrictions on disclosing financial information.

Exchange deadline

The IGAs provided that the first exchange of information had to take place by September 30, which imposed a deadline on the IRS to put the exchange process in place. To achieve the exchange of financial information, the IRS had to develop an information system that could receive, store, and transmit the information. The IRS also had to develop various legal and technical standards for the information system, and determine that the foreign

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District Court Denies Injunction To Stop Operation Of FATCA And FBAR Rules; Laws Appropriate To Curb Tax Evasion

Crawford v. Treasury, DC-Ohio, September 29, 2015

A federal district court has denied a request for a preliminary injunction to prevent Treasury and the IRS from enforcing the *Foreign Account Tax Compliance Act* (FATCA), the related intergovernmental agreements (IGAs) that supplant FATCA, and the Report of Foreign Bank and Financial Accounts (FBAR) requirement. The court concluded that the plaintiffs, who included Sen. Rand Paul, R-Ky., were unlikely to succeed on the merits, because they lacked standing and were not likely to suffer irreparable injury.

- ***Take Away.*** Significantly, the court denied the injunction because "the public interest is best served by keeping the statutory provisions … in place and enforceable." The court stated that the "FATCA statute, the IGAs, and the FBAR requirements encourage compliance with tax laws, combat tax evasion, and deter the use of foreign accounts to engage in criminal activity. A preliminary injunction would harm these efforts." Thus, the court's opinion provides an important basis for upholding the statutes when the lawsuit proceeds on the merits.
- ***Comment.*** To issue a preliminary injunction, a court must consider: the likelihood of plaintiff's success on the merits; whether the injunction will save plaintiffs from irreparable injury; whether an injunction will harm others, and whether the injunction will serve the public interest.

Basics

The five individuals in the lawsuit all lived abroad and either were U.S. citizens or have renounced U.S. citizenship. The lawsuit made six claims, challenging: the validity of four IGAs; the reporting requirements imposed on foreign financial institutions (FFIs) by the IGAs; the heightened reporting requirements for foreign bank accounts (information beyond the reporting of account's interest income, such as the account's value); the 30 percent withholding requirement on payments to FFIs and account holders who do not satisfy the FATCA reporting requirements; and the "excessiveness" of the penalty for willful violations of FBAR reporting.

Court's analysis

The court concluded that the plaintiffs are unlikely to prevail on the merits because they lacked standing. Sen. Paul, the court found, lacked standing. Paul argued that IGAs usurp Congress's power because they are not submitted for a vote, but this is a political dispute between institutions, not a private injury, the court found. Paul was not authorized to sue on behalf of the Senate. His legal remedy is to seek repeal of the laws through the legislative process, not a lawsuit.

The individuals also lacked standing. None is an FFI subject to 30 percent withholding, and none had alleged that he must report his accounts to the IRS, the court found. Some plaintiffs complained that their banks were harming them by denying their account applications, but if this is harm, it is caused by

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FATCA

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jurisdiction met its safeguards for handling the financial information, including confidentiality and cybersecurity issues. The IRS stated that it will only engage in a reciprocal exchange with foreign jurisdictions meeting these standards.

The IRS has now met this goal by the stated deadline, the agency reported. "Meeting the September 30 deadline is a major milestone in IRS efforts to combat offshore tax evasion through FATCA and the intergovernmental agreements," IRS Commissioner John Koskinen said in a statement. Meeting the deadline reflects a significant international collaboration and partnership with dozens of jurisdictions, according to the agency.

Canadian court ruling

In the Canadian lawsuit, two Canadian citizens who are U.S. citizens by birth argued that the CRA's provision of financial information to the IRS under the IGA between Canada and the U.S. could "cause them harm" and was illegal under the Canada–U.S Tax Treaty and other provisions of Canadian law.

The lower court stated that the application of the disclosure regime "could cause the appellants serious difficulties." However, the court of appeal concluded that the CRA's disclosure would not cause the individuals irreparable harm and was not grounds for an injunction at this time because, the CRA stated, there is no taxpayer information concerning the appellants in the information collected from financial institutions. Accordingly, the court declined to enjoin the CRA from disclosing the information, but agreed that the appeal will not be moot and may continue.

Reference: TRC FILEBUS: 9,108.

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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TE/GE's 2016 Priorities Challenged By Budgetary Constraints

TE/GE News Conference, October 1, 2015

The IRS's work in the tax-exempt area, including employee plans, state and local governments, and tax-exempt bonds, is hamstrung by budget cuts, Sunita Lough, Commissioner, Tax Exempt/Government Entities (TE/GE) Division, recently told reporters in Washington, D.C. However, Lough emphasized that TE/GE remains "mission-focused" in describing the Division's anticipated work in fiscal year (FY) 2016.

- ***Take Away.*** Congress has not yet approved a FY 2016 budget for the IRS but in all likelihood funding will be reduced compared to FY 2015. House appropriators have endorsed an $838 million cut to the agency's FY 2016 budget; Senate appropriators have endorsed a $470 cut to the agency's FY 2016 budget. The current temporary stop-gap funding bill for the IRS and most federal agencies is scheduled to expire in mid-December.

Form 990

Following litigation earlier this year, the IRS agreed to provide electronically filed Forms 990 in a Modernized e-File (machine-readable) format. Machine-readable is not a format that the IRS has historically used to make Forms 990 available for public inspection. "The Form 990 process is moving forward very well," Lough said. Machine readable Form 990s should be available in early 2016, Lough predicted.

Knowledge Centers

TE/GE is developing knowledge libraries within Knowledge Centers. The libraries, Lough explained, contain technical resources for TE/GE personnel. The resources are searchable by key issue areas and resource type. In FY 2016, TE/GE will further develop and expand its Knowledge Center teams, Lough said.

2016 activities

Employee Plans. For FY 2016, Employee Plans (EP) will allocate examination resources to Specialty Program casework, Traditional Casework and Supplemental Casework. The Specialty Program encompasses EP Team Audit (EPTA)/Large Case, multiemployer plans, and 403(b)/457(b) plans. EP will also use the Employee Plans Compliance Unit to identify areas with the greatest potential for non-compliance in plan operation and form, Lough said.

Exempt Organizations. Exempt Organizations (EO) will focus its resources on five strategic issue areas in FY 2016: Exemption; Protection of Assets; Tax Gap; International; and Emerging Issues. EO's compliance strategy will also include oversight of tax-exempt hospitals with certain compliance issues related to the Affordable Care Act (ACA).

- ***Comment.*** The IRS announced in 2013 that it intended to revise the Code Sec. 501(c)(4) regulations and subsequently issued proposed regs. Lough noted that the IRS received more than 150,000 comments about the Code Sec. 501(c)(4) proposed

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Injunction

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the actions of third parties, even if there is a connection to FATCA. Complaints about invasion of privacy do not succeed because these involve bank records and information that the plaintiffs voluntarily provided. Depositors have no reasonable expectation of privacy. Some of the plaintiffs did not have bank accounts, and some d idnot live in countries that are currently subject to FATCA.

The plaintiffs' objected to FATCA's "heightened" reporting requirements for financial accounts, including the status of the account, its balance, and the income or loss or the account. Although this differed from the treatment of U.S. accounts, which only have to report interest, this did not violate equal protection of the laws under the Fifth Amendment, because U.S. citizens living in a foreign country are not a protected class, and the statute's treatment must only be rationally related to a legitimate government interest, the court found.

References: 2015-2 USTC ¶50,499; TRC FILEBUS: 9,108.

IRS Increases Number Of Countries With Which It Automatically Exchanges Tax Information

The IRS has added 16 countries to the list of countries with which it automatically exchanges tax information. Under the automatic exchange, the IRS provides information on the amount of deposit interest paid to nonresident aliens.

- ***Comment.*** The IRS's collection of the information is controversial among American banks, especially banks in Florida and Texas, since reporting applies to interest income that is nontaxable in the U.S. Banks claim that foreign depositors are not evading taxes in their own country, but have concerns about safety and security. Banks also claim they will lose business if the information is reported to the depositor's jurisdiction. U.S. banks have sued the IRS to overturn the reporting requirements, but have not been successful so far.

Exchanges. The IRS has income tax treaties and tax information exchange agreements with a number of countries. Rev. Proc. 2014-64 lists these countries. The IRS has also determined that it will have an automatic information exchange with some of these countries, to provide the information it receives on interest income paid to foreign taxpayers. Rev. Proc. 2014-64 also lists these countries.

Rev. Proc. 2015-50 supplements the automatic exchange list by adding 16 countries. While the revenue procedure does not mention the *Foreign Account Tax Compliance Act* (FATCA), the information provided by the IRS is an important part of its quid pro quo under FATCA.

Rev. Proc. 2015-50, FED ¶46,416; TRC FILEBUS: 9,158.12.

Taxpayer's Production Of "Unit Doses" Of Medications Qualifies For Code Sec. 199 Deduction

Precision Dose, Inc., DC-Calif., September 24, 2015

A federal district court has found that a taxpayer's production of "unit doses" of medications qualified for the Code Sec. 199 domestic production activities deduction. The production activities fell within the deduction's requirement that property be manufactured, produced, grown, or extracted (MPGE) by the taxpayer.

- ***Take Away.*** "The decision of the district court in *Precision Dose, Inc.* is another victory for taxpayers in their battle with the IRS over the definition of 'packaging, repackaging, labelling and minor assembly' activities that do not constitute production for purposes of Section 199," Andrea Mouw, National Tax Senior Manager, Accounting Methods, Eide Bailly LLP, Minneapolis, told Wolters Kluwer. "This case illustrates that the court's view of 'packaging, repackaging, labelling and minor assembly' differs from the view argued by the IRS in this case as well as the recent *Dean* decision and articulated in an example in the new proposed Section 199 regulations."
- ***Comment.*** The IRS issued proposed regs in August. *See the September 3, 2015 issue of this newsletter for details.*

Background

The taxpayer purchased medications in bulk. The taxpayer developed cups and syringes, worked with laboratories and vendors, conducted testing, and engaged in other activities to produce unit doses of the medications. The IRS determined that the taxpayer's activities were merely packaging, repackaging or labeling and not MPGE. The IRS denied the Code Sec. 199 deduction.

- ***Comment.*** A unit dose, the court explained, is a drug in a non-reusable container intended for administration as a single dose to a patient.

Code Sec. 199 deduction

The Code Sec. 199 deduction is calculated as a percentage of qualified production activities income. Domestic production gross receipts include gross receipts derived from the sale, exchange, lease, rental, license, or other disposition of qualified production property (QPP). The property also must be manufactured, produced, grown, or extracted (MPGE) by the taxpayer in whole or in significant part in the U.S.

Court's analysis

The court looked to the taxpayer's creation process for the unit doses and found that the taxpayer caused the unit doses to come into existence. The taxpayer's activities went beyond merely packaging, repackaging or labeling, the court found. While other entities made the drugs, a unit dose did not exist until the taxpayer completed its processes, the court found.

In *Dean, 2013-2* USTC*¶50,625,* another federal district court found that the production of gift baskets also went beyond merely packaging or repackaging and resulted in a distinct final product. The court in this case found that the taxpayer's activities in producing unit doses were analogous to the activities in *Dean*. Like the taxpayer in *Dean*, the taxpayer in this case engaged in a complex production process to create the unit doses. The result was a distinct final product, which qualified as MPGE for the Code Sec. 199 deduction, the court concluded.

- ***Comment.*** "With two separate district court decisions now contrary to the IRS' positon, the IRS may find it more difficult to successfully argue that taxpayers with similar activities are not engaged in production and not eligible for the deduction under Section 199," Mouw observed. "Additionally, the analysis in the case and the factors identified by the court as important for making this determination may prove to be more persuasive in future controversies between taxpayers and the IRS than the contrary example that Treasury and the IRS included in the new proposed regulations."
- ***Comment.*** The court rejected the IRS's argument that *Dean* was wrongly decided.

References: 2015-2 USTC ¶50,493; TRC BUSEXP: 6,160.

TE/GE

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regs, which it later put on hold. Lough declined to predict when the IRS may issue more guidance in this area.

FSLG. In FY 2016, the Federal, State and Local Governments (FSLG) function will continue to address compliance using outreach, education and examination activities. FSLG will invest its resources in areas that provide the greatest impact, Lough indicated. These include large entity examinations, Lough explained.

TEB. The FY 2016 work plan allocates 50 percent of resources within the TEB function to examination casework. Exam priority will be given to referrals, including whistleblower referrals, which have been determined to warrant examination resources, Lough reported. Resources will also be focused on the Voluntary Closing Agreement Program (VCAP). Additionally, TEB and Government Entities Compliance Services (GECS) are reinstituting a compliance check/soft letter program. Lough added that TE/GE is creating streamlined voluntary closing agreement programs with fill-in-the-blank sections. These will eliminate the need for drafting and negotiating when they apply, Lough predicted.

Reference: TRC EXEMPT: 12,054.

IRS Requests Comments On Types Of Property Qualifying For Code Sec. 48 Energy Credit; Future Regs Anticipated

Notice 2015-70

The IRS has requested comments on how to define certain types of property in upcoming regs on the Code Sec. 48 energy credit. The current regs under Code Sec. 48 were last updated in 1987, and since then many types of property were added to the Tax Code under Code Sec. 48(a)(3)(A).

- ***Take Away.*** "This is a welcome development," Greg Jenner, partner, Stoel Rives LLP, Washington, D.C., told Wolters Kluwer. "The current regulations were originally promulgated in the 1980s, which is virtually prehistoric when compared to current technologies. There is considerable uncertainty about how innovative technologies, such as power conditioning and storage, fit into section 48, and having a clearer understanding of where the lines are would be extremely beneficial for taxpayers and the government."

Background

Code Sec. 48(a)(1) provides that the energy credit for any taxable year is the energy percentage of the basis of each energy property placed in service during such taxable year. Code Sec. 48(a)(3)(A) sets forth the types of property qualifying as energy property for the energy credit. These include: certain solar energy property; certain equipment used to produce, distribute, or use energy derived from a geothermal deposit; qualified fuel cell property; qualified microturbine property; combined heat and power system property; qualified small wind energy property; and equipment using the ground or ground water as a thermal energy source.

The Tax Code further defines some of these terms under Code Secs. 48(c), and Reg. §1.48-9 provides further clarifications of these definitions. However, Code Sec. 48(a)(3)(A) was added after Reg. §1.48-9 was last updated. The IRS stated in Notice 2015-70 that it anticipates issuing regulations to further define the types of property listed under Code Sec. 48(a)(3)(A) for purposes of the energy credit.

Requested comments

The IRS requested comments specifically on how the following issues may be addressed in proposed regulations on the definition of certain types of property under Code Sec. 48:

- Whether property such as storage devices and power conditioning equipment may also be considered energy property in addition to property that produced electricity;
- Whether dual-use property should qualify for the credit and, if so, under what circumstances it should qualify;
- Comprehensive definitions of the property described in the notice; and
- The need for other energy-related definitions.
- ***Comment.*** Comments must be received by February 16, 2016.

References: FED ¶46,419;
TRC BUSEXP: 51,102.40.

Taxpayer Liable For COD Income; Contrary Representation By Lender Not Binding On IRS

Dunnigan, TC Memo. 2015-190

A taxpayer had cancellation of debt (COD) income although his lender had indicated on Form 1099-C, Cancellation of Debt, that he was not personally liable for the debt. The credit agreement between the taxpayer and the lender controlled, Tax Court has found. The court also found no "hardship" exception to the taxability of COD income, as claimed by the taxpayer.

- ***Take Away.*** In an attachment to his return, the taxpayer reported that he understood that the bank was not holding him personally liable for the unpaid loan because of his age and health. The taxpayer further stated that his local IRS office suggested he would fall under "hardship" rules for approval. The taxpayer did not elaborate in his note about these "hardship" rules.

Background

The taxpayer operated his appraisal business as a sole proprietor. In 2008, he obtained a business line of credit of $50,000 from a financial institution. The credit agreement provided that the taxpayer, both individually and on behalf of his business, jointly and severally promised to repay the loan. Unfortunately, the taxpayer was unable to repay the loan.

The bank issued Form 1099-C, Cancellation of Debt, in 2009. The bank indicated on the form (box 5) that the taxpayer was not personally liable for repayment of the debt. The taxpayer did not report the cancellation of debt income on his 2009 return.

Court's analysis

Cancellation of debt income, the court explained, may be realized without a taxpayer's personal liability for a debt. The taxpayer's credit agreement with the bank expressly provided that he was individually and severally liable for repayment. The credit agreement, the court found, was in direct opposition to the indication on Form 1099 (box 5).

The court further found no "hardship" exception to the taxability of discharge of indebtedness income. The closest analogy, the court observed, would be in bankruptcy or insolvency, but the taxpayer was not bankrupt or insolvent.

References: Dec. 60,416(M);
TRC INDIV: 66,058.

Second Circuit Upholds Tax Court; Wholesaler's Stamp Tax Costs Not Exempt From UNICAP Rules

City Line Candy & Tobacco Corp., CA-2, September 30, 2015

The Second Circuit has upheld the Tax Court's decision that a cigarette wholesaler and reseller did not qualify for the small reseller exception from Code Sec. 263A. Accordingly, the wholesaler had to capitalize the costs of cigarette stamp taxes and include the costs in inventory, rather than deduct them when incurred.

- ***Take Away.*** The IRS recently amended its regulations under Code Sec. 263A to include the capitalization of indirect costs that "are determined by reference to the number of units of property sold," language that could have been helpful for the IRS. However, these revised regulations were not effective during the events at issue.

Background

A corporation was engaged in the wholesale selling of cigarettes in New York where under state law, all resellers and wholesalers of cigarettes must pay for and affix a state-issued tax stamp on all cigarette boxes offered for sale. The price of the tax stamp was included in the final sale price.

The Tax Court upheld the IRS's determination that the corporation could not immediately deduct the cost of the tax stamps from its gross receipts, but was required to capitalize them under Code Sec. 263A as indirect costs allocable to property acquired for resale that directly benefit or are incurred by reason of resale activities. Therefore the corporation's gross receipts exceeded the $10 million threshold for qualifying for the small reseller exception to the uniform capitalization (UNICAP) rules.

Court's analysis

The Second Circuit affirmed the Tax Court: the cost of the tax stamps must be included in the corporation's gross receipts, which placed its gross receipts over the $10 million threshold for qualifying for the "small reseller exception" to the UNICAP rules. The cost of the tax stamps was subject to the UNICAP rules, the Second Circuit also affirmed. The cost was an indirect cost under the definition laid out in Reg. §§1.263A-1(e)(3)(i)(A) and 1.263A-1(e)(3)(ii)(L), and indirect costs properly allocable to property produced that directly benefits or is incurred by reason of the performance of production activities must be capitalized. Even if the tax stamps had been a direct cost, Code Sec. 263A(a)(2)(A) requires the capitalization of direct costs as well, the Second Circuit found.

Neither was the cost of the stamps a deductible selling expense under Reg. §1.263A-1(e)(3)(iii)(A). Rather, the Second Circuit noted (citing *Robinson Knife, 2010-1* USTC *50,300,* that "the regulations specifically list [taxes] as" an example of indirect costs that must be capitalized.

The Second Circuit found that *Robinson Knife* provided only two limitations on the requirement that indirect costs be capitalized. Costs could be deducted if they were calculated as a percentage of sales revenue from certain inventory, and were incurred only upon sale of such inventory. Here the corporation's costs for the tax stamps were not calculated as a percentage of sales revenue: the tax was assessed per cigarette package.

The Second Circuit further found that the costs were incurred as soon as the corporation offered the cigarettes for sale, and not when it sold them. Allowing an immediate deduction for costs associated with future sales created "precisely the kind of temporal mismatch Section 263A seeks to avoid," the Second Circuit found.

The Second Circuit also noted that Code Sec. 263A, as interpreted by *Robinson Knife*, requires capitalization of costs that are a "but-for cause" of the taxpayer's production or sales activity. The Second Circuit found that the stamp costs satisfied this test.

Reference: TRC BUSEXP: 9,056.

IRS Grants Drought-Stricken Farmers And Ranchers Additional Time To Replace Livestock

The IRS has provided an extended period for farmers and ranchers, forced to sell livestock due to drought, to replace the livestock and defer tax on any gains from the forced sales. Farmers and ranchers whose drought sale replacement period was scheduled to expire on December 31, 2015, will now have until the end of their next tax year.

Background. If a sale or exchange of livestock is treated as an involuntary conversion and is solely on account of drought, flood, or other weather-related conditions, the replacement period ends four years after the close of the first tax year in which any part of the gain from the conversion is realized. Code Sec. 1033(e)(2)(B) authorizes the IRS to extend the replacement period.

Extension. The one-year extension of the replacement period generally applies to capital gains realized by eligible farmers and ranchers on sales of livestock held for draft, dairy or breeding purposes due to drought. Because the normal drought sale replacement period is four years, this extension immediately impacts drought sales that occurred during 2011, the IRS explained. Because of previous drought-related extensions affecting some of these localities, the replacement periods for some drought sales before 2011 are also affected.

- ***Comment.*** Sales of other livestock, such as those raised for slaughter or held for sporting purposes, and poultry are not eligible for the relief, the IRS explained.

IR-2015-110, Notice 2015-69; FED ¶¶46,414; 46,415; TRC FARM: 3,206.10

Taxpayer Not In Business Of Lending; No Deduction For Unpaid Loan To Company In Bankruptcy

Cooper, TC Memo. 2015-191

A taxpayer was not in the business of lending and could not take a business bad debt deduction for an unpaid loan, the Tax Court has held. Moreover, the taxpayer failed to show that the loan was worthless in the year claimed in order to claim a deduction for nonbusiness bad debt.

- ***Take Away.*** The taxpayer described his lending activities as "hard-money loans," and lent money to people who might otherwise have had difficulty obtaining cash. Typically, these were short-term loans at high interest rates.

Background

The taxpayer owned a number of businesses. The taxpayer also would make loans to friends and acquaintances. The taxpayer often did not require borrowers to complete any kind of loan application. Neither did he perform credit checks or verify collateral. According to the taxpayer, he spent between 120 and 200 hours in his lending activities during the years in dispute.

In 2006, the taxpayer loaned $750,000 to a friend who owned a construction business. This loan was in writing and included a collateral guaranty. However, no lien was recorded. The borrower sought bankruptcy protection in 2008. The taxpayer did not file a proof of claim with the bankruptcy court against the bankruptcy estate. In 2010, the taxpayer filed an amended return on which he claimed a business bad debt deduction for the loan to the construction company, which the IRS disallowed.

Court's analysis

The court first found that under Code Sec. 166, taxpayers may deduct any debt that becomes worthless within the tax year. The taxpayer must show a bona fide debt based on a debtor-creditor relationship. Taxpayers must treat nonbusiness bad debts as losses from the sale or exchange of a short-term capital asset and can deduct the debt only for the year in which the debt becomes wholly worthless. Business bad debts give rise to deductions that can be offset against ordinary income.

To determine if a taxpayer is in the business of lending, courts look to a number of factors, such as the (1) The total number of loans made; (2) the time period over which the loans were made; (3) the adequacy and nature of the taxpayer's records; (4) whether the loan activities were kept separate and apart from the taxpayer's other activities; (5) whether the taxpayer sought out the lending business; (6) the amount of time and effort expended in the lending activity; and (7) the relationship between the taxpayer and his debtors.

Here, the court found that lending was secondary to the taxpayer's other activities. The taxpayer worked full-time and traveled extensively for the businesses he owned. The taxpayer also failed to conduct his lending practices with typical business formalities, the court found. The taxpayer did not perform credit checks or verify collateral. Promissory notes were executed only for five of the 12 loans he made. The court was also not persuaded that the taxpayer spent as many hours as he claimed on lending activities. Additionally, the court found that the taxpayer did not keep adequate business records. The records produced at trial were not contemporaneous and were constructed after the fact. There was no record of any Form 1099-C, Cancellation of Debt.

The court further found that the taxpayer did not treat the $750,000 loan to the construction company as worthless in the years in dispute. The taxpayer treated the loan as worthless in 2010, when he filed an amended return. Therefore, the taxpayer could not deduct the loan as a nonbusiness bad debt.

References: Dec. 60,417(M); TRC BUSEXP: 48,152.

TAX BRIEFS

Jurisdiction

An Internet company and its officers were not entitled to dismiss the government's tax collection action based on *res judicata*, issue preclusion or the statute of limitations. The taxpayers failed to show that the government could not establish tolling of the limitations period. Further, the government's action was not barred by issue preclusion. The company failed to show that the prior court made a final determination on whether the statute of limitations was tolled while the company's assets were in receivership.

Today.com Incorporated, DC Ariz., 2015-2 USTC ¶50,500; TRC IRS: 30,208.10

The Tax Court had jurisdiction over a Notice of Final Partnership Administrative Adjustment (FPAA) that was issued to the partner of a terminated partnership. The FPAA was not a prohibited second notice because it was not issued to the same partnership for the same tax years and made materially different adjustments to items of income and expense. Moreover, the adjustments the IRS made were not merely computational. The IRS's description of the adjustments to basis, depreciation and loss simply notified the taxpayer of the reason for the adjustments.

American Milling, LP, TC, Dec. 60,418(M), FED ¶48,128(M);TRC PART: 60,250

The Tax Court lacked jurisdiction to determine that a married couple's currently not collectible (CNC) account status should have been retroactive, invalidated a Notice of Federal Tax Lien (NFTL) filing and entitled them to a refund. Further, the Ap-

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peals officer (AO) did not abuse her discretion sustaining the NFTL. The taxpayers failed to show that the NFTL impeded their sale of the property.

Shenk, TC, Dec. 60,419(M), FED ¶48,129(M); TRC IRS: 48,052.10

A married couple's untimely refund claim was dismissed for lack of subject matter jurisdiction. The couple's claim was filed outside the three-year limitations period.

J. Haskett, DC Fla., 2015-2 USTC ¶50,492; TRC LITIG: 9,052

Summonses

A federal district court's denial of a hedge fund's petition to quash an IRS third-party summons issued to a bank in connection with an investigation of the fund's tax liability was vacated in part. The government established its *prima facie* case under *Powell*, which the fund failed to rebut, but the court's failure to consider and expressly rule on the fund's privilege claim was error and the case was remanded for further proceedings.

Highland Capital Management, L.P., CA-2, 2015-2 USTC ¶50,497; TRC IRS: 21,108

Deductions

Married taxpayers were not entitled to deduct the contribution of a conservation easement because they failed to subordinate the mortgage to the easement at the time of the gift.

Minnick, CA-9, 2015-2 USTC ¶50,494; TRC INDIV: 51,364.05

Liens and Levies

The government was entitled to reduce to judgment an individual's federal income tax liabilities and a federal tax lien attached to mineral royalties payable to the individual. However, the individual's attorney had a superpriority lien for professional services to the extent his services helped to make funds available for tax collection.

Leathers v. Leathers, DC Kan., 2015-2 USTC ¶50,495; TRC IRS: 45,158

Refund Claims

A pharmaceutical company was entitled to claim deductions for domestic production activities and, therefore, it was entitled to refunds for the two tax years at issue. The company engaged in a complex production process that it applied to drugs and containers to produce unit doses, which otherwise did not exist. *T.J. Dean*, DC Calif. 2013-2 USTC ¶50,625.

Precision Dose, Inc., DC Ill., 2015-2 USTC ¶50,493; TRC BUSEXP: 6,160

Collection Due Process

An IRS Appeals officer's (AO) determination to proceed with a levy to collect a defunct, disregarded entity's unpaid employment taxes resulting from disallowed Advanced Earned Income Tax Credits (AEIC) for one tax period was an abuse of discretion but the taxpayer's liability for two prior years was sustained. The Tax Court had jurisdiction to review the IRS Appeals officer's determination even though the determination notice was mailed to and the case was instituted in the name of a defunct, disregarded entity.

Scott Labor, LLC, TC, Dec. 60,420(M), FED ¶48,130(M); TRC PART: 3,102

Trust Fund Taxes

An individual's unpaid income and withholding tax liabilities were reduced to judgment. The individual was a responsible person and he willfully failed to pay over the withheld taxes to the government. He had a duty to use all available unencumbered funds to pay the back payroll taxes.

Crews, III, DC S.C., 2015-2 USTC ¶50,498; TRC PAYROLL: 6,306.05

IRS Reminds Taxpayers On Extension Of Approaching October 15 Deadline

The IRS has reminded taxpayers on extension of the October 15 deadline to file returns. The IRS encouraged taxpayers on extension to file their returns electronically. Qualified individuals may be eligible to use FreeFile.

Tax incentives. The IRS reminded taxpayers on extension not to overlook tax incentives for education, such as the American Opportunity Tax Credit, incentives for families, such as the earned income credit, and incentives for retirement, such as the saver's credit. Additionally, the Tax Increase Prevention Act of 2014 renewed the health care tax credit (HCTC) for 2014. Taxpayers who intend to claim the HCTC for 2014 must first file an original 2014 tax return without claiming the HCTC, even if they have no other filing requirement. They can then file an amended return when the IRS issues further HCTC guidance, the agency explained.

Payment plans. Individuals who owe $50,000 or less in combined tax, penalties and interest can use the Online Payment Agreement to set up a monthly payment agreement for up to 72 months or request a short-term payment plan. Taxpayers can choose this option even if they have not yet received a bill or notice from the IRS. Taxpayers can also request a payment agreement by filing Form 9465.

IR-2015-109; TRC FILEBUS: 15,100.

IRS Issues Computational Factors For Enhanced Oil Recovery Credit/Marginal Production

Enhanced oil recovery credit. The IRS has announced that the Code Sec. 43 enhanced oil recovery credit once again is completely phased out for 2015. The inflation adjustment factor for calendar year (CY) 2015 is 1.6245. The reference price for 2014 ($87.39) exceeds the product of $28 multiplied by the inflation adjustment factor for CY 2014 (which is $45.49) by $41.90. The GNP implicit price deflator to be used for calendar year 2015 is 108.407.

Marginal properties. The IRS also issued the applicable percentage under Code Sec. 613A for determining percentage depletion for marginal properties for the 2015 calendar year. Because the reference price determined under Code Sec. 45K(d)(2)(C) for the 2014 calendar year is $87.39, the applicable percentage for marginal production for taxable years beginning in calendar year 2015 is 15 percent.

Notice 2015-64, Notice 2015-65, FED ¶¶46,417, 46,418; TRC BUSEXP: 54,554.15.

Preparing To File ACA-Required Forms 1095-C And 1094-C For 2015

This year, for the first time, large employers and small employers that offer self-insured group health coverage are subject to the requirement under the *Affordable Care Act* (ACA) to report certain information about the health coverage they offered to their employees during 2015. Many employers, at the IRS's urging, already reported this information at the beginning of 2015 with respect to coverage offered in 2014. However, information reporting was merely voluntary for calendar year 2014. For 2015, all applicable large employers (and self-insured employers) must report health coverage information on Forms 1095-C, Employer-Provided Health Insurance Offer and Coverage, and 1094-C, Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns (or Forms 1095-B, Health Coverage, and 1094-B, Transmittal of Health Coverage Information Returns), or face stiff penalties.

- ***Comment.*** Small employers who are not subject to the requirement to either offer affordable minimum essential coverage or make the employer shared responsibility payment, but who nonetheless offer self-insured health coverage will report such coverage on Forms 1095-B and 1094-B (the forms generally used by health insurance issuers and carriers to report health coverage information). Applicable large employers who offer self-insured group health plans, on the other hand, will generally report the information on coverage offered to full-time employees on Form 1095-C, Part III. Large self-insured employers who also offer coverage to employees who were not full-time employees for all 12 months of the year may report such coverage on Form 1095-B instead of Form 1095-C.

Purpose of filing

The IRS will use the information provided on Form 1095-C (or Form 1094-C) to determine whether the employer offered health coverage that meets the requirements of the Affordable Care Act. An employer that does not must generally make the employer shared responsibility payment under Code Secs. 4980H(a) or (b). Forms 1095-B and 1094-B are transmittal documents that relay information to the IRS about the employer filing the Forms 1095-C or 1094-C, the number of forms being filed, and more.

"The IRS will use the information provided on Form 1095-C (or Form 1094-C) to determine whether the employer offered health coverage that meets the requirements of the Affordable Care Act."

Form 1095-C (or Form 1094-C) must also be issued to each covered employee. Employees, as individuals, are required to obtain affordable health coverage either through an employer or a Health Insurance Exchange or other sponsor. Those who do not may be subject to the individual shared responsibility payment. Individuals who do not receive an offer of affordable minimum coverage from their employer and who obtain coverage through an Exchange may be eligible for a premium tax credit to offset the cost of coverage. Therefore, the information on Form 1095-C is a vital tool the IRS uses to determine which individuals qualify for the premium tax credit.

Because the information provided on Forms 1095-C and 1094-C provides the basis for the IRS's implementation of the Affordable Care Act, the IRS imposes potentially hefty penalties on employers who are required to file them and fail to do so. The penalty for failure to file an information return generally is $250 for each required return not filed (the total penalty amount is capped at $3,000,000).

- ***Comment.*** For 2015 reporting, the IRS will not impose penalties on a filer for reporting incorrect or incomplete information if the filer can show that it made good faith efforts to comply with the reporting requirements.

Form 1095-C

Applicable large employers—those who had 50 or more full-time equivalent employees on average during a consecutive six-month period during 2014—must provide the following information on Form 1095-C:

- Identifying information for employer and employee such as name, address, Social Security Number, Employer Identification Number (Part I);
- The months for which health coverage was offered (Part II, Line 14);
- The employee's share of the monthly premium for lowest-cost self-only minimum value coverage (Part II, Line 15);
- The months, if any, for which the employer met the requirements for relief from the Code Sec. 4980H employer shared responsibility requirements; and
- The months for which the employee was enrolled in coverage (Part III—to be completed only by employers that offer coverage through employer-sponsored self-insured health plans).
- ***Comment.*** After ALEs report 2015 coverage in 2016 (with ALE status

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WASHINGTON REPORT *by the Wolters Kluwer Washington News Bureau*

PACE Act heads to President for signature

At press time, President Obama is expected to sign the Protecting Affordable Coverage for Employees Act (PACE) (HR 1624), which amends the definition of small businesses and protects them from possible increases in health care premiums under the *Affordable Care Act* (ACA). The House approved the measure on September 28, by voice vote, and the Senate followed on October 1, also by voice vote.

Currently under the ACA, the definition of the state-based small group markets is scheduled to change in 2016 from 50 to include employers with up to 100 employees. This change would require many small and mid-sized businesses to be subject to different rating rules and requirements, with the potential of increasing the health insurance premiums for small businesses and their employees. The PACE Act keeps the one to 50 definition in place, but gives states the option of expanding the definition of small employer to cover employers with up to 100 employees. The measure was sponsored in the Senate by Sens. Jeanne Shaheen, D-N.H., and Tim Scott, R-S.C. Rep. Brett Guthrie, R-Ky., sponsored the bill in the House. The PACE Act is backed by a coalition representing small and mid-sized businesses, including the U.S. Chamber of Commerce, the National Retail Federation, the National Restaurant Association, and the National Federation of Independent Business.

ACA bills move forward in House

On September 28, the House approved the Equitable Access to Care and Health (EACH) Bill (HR 2061), which would exempt certain religious groups, such as Christian Scientists, from the individual mandate under the Affordable Care Act (ACA). The measure would extend current religious exemptions to individuals who rely solely on a religious method of healing and for whom the acceptance of medical health services would be inconsistent with their religious beliefs. A companion bill (Sen 352) has been introduced in the Senate, but has not been acted upon by the Senate Finance Committee.

On September 29, the House Ways and Means Committee approved legislation calling for repeal of the ACA's individual and employer mandates, as well as the medical device tax, and the so-called "Cadillac plan" tax. The measure would repeal these provisions of the ACA under the "reconciliation" process.

Senate Finance Committee examines EIC overpayments

With improper payments government-wide estimated to be more than $124 billion, and the latest estimate for the annual net tax gap at $385 billion, Senate Finance Committee Chair Orrin Hatch, R-Utah, held a hearing on October 1 to examine solutions addressing overpayments of the Earned Income Credit (EIC), as well as with Medicare and Medicaid, whose oversight is conducted by the committee. The Government Accounting Office (GAO) has reported for several years that the federal government is unable to determine the full extent to which improper payments occur and reasonably assure that actions are taken to reduce them.

"Reducing the tax gap would raise revenue that could be put toward a host of purposes, but there are no easy fixes to this problem," GAO Comptroller Gene Dodaro said. The GAO found that, in fiscal year 2014, the IRS reported program payments of $65.2 billion for the EIC. The IRS estimated that 27.2 percent, or $17.7 billion, of these program payments were improper. Dodaro told lawmakers a root cause of EIC noncompliance is that eligibility is determined by taxpayers themselves or their tax return preparers and that IRS's ability to verify eligibility before issuing refunds is limited.

OCED releases BEPS proposals

The Organisation for Economic Co-operation and Development (OECD) has released final recommendations on measures to address base erosion and profit shifting (BEPS) by multinational corporations. The BEPS project aims to provide governments with proposals for closing gaps in existing international tax rules that allow corporate profits to escape taxation or to be artificially shifted to low-tax environments.

"The measures we are presenting today represent the most fundamental changes to international tax rules in almost a century," OECD Secretary-General Angel Gurría said in a statement. "These measures will render BEPS-inspired tax planning structures ineffective," Gurría said. The BEPS measures will be presented and discussed at an October 8 meeting of the G20 finance ministers and a November meeting with G20 leaders.

House Ways and Means Chair Paul Ryan, R-Wisc., questioned the OECD's proposals, saying they will have a significant impact on U.S. corporations doing business abroad. Ryan said the details require close review.

Feedback important in LB&I reorganization, expert says

Practitioner and taxpayer feedback in response to the IRS's recent announcement that it will reorganize its Large Business & International (LB&I) Division is essential if the rollout of the new division structure is going to work, industry practitioners said during an October 1 webcast hosted by KPMG LLP. "The IRS is looking for feedback here," Sharon Katz-Pearlman, national principal in charge, Tax Controversy Services and Tax Dispute Resolution Services, KPMG LLP, said.

The new structure generally means migrating from the current Coordinated Industry Case (CIC) examinations to an environment in which the division plans to apply a more targeted, nuanced approach to identifying and addressing compliance risk. The new structure will also involve operations being organized around nine practice areas (PAs), four of which will be organized geographically. The remaining five practice areas will be organized by subject matter and will include: passthrough entities; enterprise activities; cross-border activities; withholding and international individual compliance; and treaty and transfer pricing operations.

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based on the number of full-time equivalent employees they had during 2014), ALE status will determined by the average number of full-time equivalent employees an employer had for the whole 12 calendar month period preceding the year for which health coverage must be reported. The temporary transition relief available for determining ALE status for 2015 enabled some employers to escape ALE status by choosing the six-month period of 2014 most favorable to them.

Social Security Numbers. To properly implement the ACA provisions, the IRS must be able to match the Form 1095-C against the individual's tax return with its corresponding income information. Consequently SSNs (or Taxpayer Identification Numbers if there is no SSN) are required on all Forms 1095-C, and employers are required by the regulations to make reasonable efforts to obtain them. This is especially important for self-insured employers who may not have previously obtained the SSNs for all their employees' dependents covered under their plans.

Plan year v. tax year

If an ALE has a health coverage plan year that is not based on the calendar year starting with January (for example, the renewal date begins in October), the ALE is still required to report coverage information for all 12 months of 2015. The information provided will be pulled from multiple plan years.

- ***Comment.*** The IRS recently revised Form 1095-C to include an optional box in Part II in which form filers may indicate the first month of the plan year. The IRS has stated that it anticipates the box will be mandatory in future years.

Self-insured employers

An employer that offers health coverage through an employer-sponsored self-insured health plan must complete Form 1095-C, Parts I, II, and III, for any employee who enrolls in the health coverage. This requirement applies regardless of whether or not the employee is a full-time employee for any month of the calendar year. However, self-insured employers who offer coverage to employees that were not full-time employees for all 12 months of 2015 have the option of reporting such coverage on Form 1095-B instead.

- ***Comment.*** If the employee who enrolled in self-insured coverage was not a full-time employee for all 12 calendar months of 2015, the employer must complete Form 1095-C, Parts I and III. On Part II, the employer must enter code "1G" on Line 14 in either the "All 12 Months" column or—if such coverage was not offered for all 12 months—then in each separate monthly box. Code 1G indicates that the employer made an offer of coverage to employee who was not a full-time employee for any month of the calendar year. The self-insured employer may leave Part II, lines 15 and 16 blank.
- ***Comment.*** An employer that offers employer-sponsored self-insured health coverage, but is not an applicable large employer subject to the employer shared responsibility provisions under section 4980H, should not file Forms 1094-C and 1095-C, but should instead file Forms 1094-B and 1095-B to report information for employees who enrolled in the employer-sponsored self-insured health coverage.

Form 1094-C

A Form 1094-C is a transmittal form that must be filed when an employer files one or more Forms 1095-C. The form requires the filer to provide identifying information on the organization offering coverage and to report whether the filer offered coverage to at least 70 percent of its full-time employees and their dependents during 2015.

- ***Comment.*** This lower 70-percent threshold is effective only for 2015. After 2015, the threshold increases to 95 percent of full-time employees.

The filer must also provide the total number of Forms 1095-C issued to employees; the total number of full-time employees the employer had each month; whether the employer is a member of an aggregated applicable large employer group, and whether the employer is eligible for certain transition relief from the Code Sec. 4980H employer shared responsibility payment.

Code Sec. 4980H transition relief. For 2015, certain employers that are required to make an assessable payment under Code Sec. 4980H(a) or (b) because they either did not provide affordable health coverage to all their full-time employees or did not offer health coverage with minimum value, may be eligible for certain transition relief that can remove the requirement to make a payment or reduce the payment amount (depending on the size of the employer). Such employers must report their eligibility for this transition relief on Form 1094-C, line 22, box C.

For applicable large employers with 50 to 99 full-time equivalent employees, any penalty owed under Code Secs. 4980H(a) or (b) for the 2015 calendar year will be waived. (If the employer has a non-calendar-year plan, the penalty will not apply for the portion of the 2015 plan year that falls in 2016.) For applicable large employers with 100 or more full-time employees, for 2015, the IRS has increased the number of employees an employer may subtract from its total number of full-time equivalent employees for purposes of calculating the penalty under Code Sec. 4980H(a).

- ***Comment.*** An employer eligible for transition relief from Code Sec. 4980H's requirements is still subject to the Forms 1094-C and 1095-C reporting requirements for 2015 with respect to its full-time employees.

Filing deadline

Forms 1094-C and 1095-C are considered timely filed if they are properly addressed and mailed on or before the due date, which for the 2015 year falls on February 29, 2016 (for paper filers) or March 31, 2016, for employers filing electronically.

The employer has an earlier deadline for furnishing a copy of the Form 1095-C to each of its full-time employees. The deadline is generally January 31 of the year following the year to which the Form 1095-C relates. In other words, for 2015 the first Forms 1095-C must be provided to individuals by February 1, 2016. An employer is required to obtain affirmative consent from the employee to furnish a statement electronically. Otherwise the statement must be provided on paper.

COMPLIANCE CALENDAR

October 9
Employers deposit Social Security, Medicare, and withheld income tax for October 3, 4, 5, and 6.

October 13
Employees report tips of $20 or more earned during September.

October 15
Individuals with automatic 6-month extensions to file their 2014 income tax returns must file Form 1040, 1040A, or 1040EZ, and pay any tax, interest, and penalties due.

Electing large partnerships that obtained a 6-month extension for filing the 2014 calendar year return (Form 1065-B) must now file the return.

Employers deposit Social Security, Medicare, and withheld income tax for October 7, 8, and 9.

October 16
Employers deposit Social Security, Medicare, and withheld income tax for October 10, 11, 12, and 13.

October 21
Employers deposit Social Security, Medicare, and withheld income tax for October 14, 15, and 16.

October 23
Employers deposit Social Security, Medicare, and withheld income tax for October 17, 18, 19, and 20.

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

Q A company's fiscal year (FY) ended on June 30, and it took bonus depreciation for the second half of 2013, but did not take it for the first six months of 2014. Now that Congress has extended the law to allow bonus depreciation for 2014, should the company amend the old return or make changes to the next return?

A If the taxpayer has not filed a return for its FY ending 6/30/2015, then the taxpayer should first file an amended return for its FY ending 6/30/2014 and claim bonus depreciation for the assets that were placed in service in 2014 prior to the extension of bonus depreciation. However, if the taxpayer has filed its return for its FY ending 6/30/2015, then it has adopted an accounting method by filing two "incorrect" returns: one return for the FY ending 6/30/2014 on which bonus depreciation was not claimed and another return for the FY ending 6/30/15 on which bonus depreciation was claimed on some of the assets that should have been claimed on the first return. If two incorrect returns were filed the taxpayer must file an accounting method change to claim the bonus depreciation through a Code Sec. 481(a) adjustment. *For more information, see TRC DEPR: 15,304.15.*

Q A taxpayer owned property that he used for a trade or business, but then withdrew it and later sold it. Is it a business asset for tax purposes?

A Property used in a trade or business, and then withdrawn from use, does not change its status merely because of the withdrawal. Similarly, property not originally used in the trade or business may be converted to an asset substantially so used by the time of its sale, exchange or involuntary conversion, so that it qualifies for the capital gain/ordinary loss rule. The intent of the taxpayer at the time of the sale, exchange, or involuntary conversion governs. *See TRC SALES: 21,106.15 for more information.*