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MyRA Starter Roth IRA Now Available Nationwide; New Funding Options Offered

TDNR JL-10250

Treasury has announced the nationwide launch of the new myRA retirement savings account following the successful conclusion of its pilot program that began last December. The nationally available program has added several new payment features.

- ***Take Away.*** "The myRA savings option, which was recently rolled out by the federal government, should not have an impact on most benefit plan sponsors," Todd Solomon, partner, McDermott, Will & Emery LLP, Chicago, told Wolters Kluwer. "The myRA option will appeal most to workers whose employers do not offer a 401(k) plan or other retirement savings vehicle as it will give them an option to save larger amounts for retirement, without investment risk as the accounts are backed by government bonds."

Background

President Obama created the myRA program on January 29, 2014, by executive order and instructed Treasury to establish the program. In December 2014, Treasury initiated a pilot program with a small group of participating employers that offered employees the opportunity to set up contributions to a myRA via direct deposit from their paychecks.

myRA

As with the Roth IRA, individuals who fund a myRA during the 2015 tax year may contribute up to $5,500 to the account ($6,500 for individuals age 50 or older), unless their adjusted gross income (AGI) exceeds $116,000 (single filers and heads of household) or $183,000 (married joint filers). For 2015 the $5,500/$6,500 maximum contribution is reduced for individuals with income between $116,000 and $131,000 (single and head of household filers) or $183,000 and $193,000 (married joint filers). No contribution at all is allowed for single filers or head of household filers with income above $131,000 (or for married joint filers, $193,000) for 2015.

- ***Comment.*** myRA savers, like Roth IRA savers, can withdraw the money they *contribute* to the account without incurring income tax liability or penalties. Interest earned on the contributions, however, may be taxable and/or subject to a 10-percent addition to tax if the withdrawal is not a qualified distribution.

Contributions to the myRA will be invested in short-term securities backed by the U.S. Treasury and will earn interest at the same variable rate as securities invested in the Government Securities Fund available to federal employees. Funds will continue to earn interest until either the balance reaches the maximum of $15,000 or 30 years pass from the date the

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IRS Releases Revised Form 1042 (Withholding For U.S. Source Income) And Instructions For 2015

Draft Form 1042; Instructions for Form 1042

The IRS has released 2015 updates of Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons, and instructions for Form 1042. The updates incorporate several changes to address reporting under the *Foreign Account Tax Compliance Act* (FATCA).

- ***Take Away.*** Officials and practitioners have stressed that the goal of FATCA is not to add new withholding requirements, but to obtain information on foreign accounts with U.S. owners. Nevertheless, as FATCA-related requirements are phased in, the IRS needs to develop and update forms for reporting and withholding under FATCA.

Background

Chapter 3 of the Internal Revenue Code, Code Sec. 1441–1464, requires withholding agents to report and withhold 30 percent (or less if under treaty) of U.S. source payments (dividends, interest, etc.) made to foreign persons. Chapter 4, Code Sec. 1471–1474 (FATCA) requires withholding agents to withhold 30 percent of certain payments to foreign financial institutions and nonfinancial foreign entities that do not provide information on their U.S. accounts and their assets with substantial U.S. owners.

- ***Comment.*** The Form 1042 instructions define a withholding agent as any person required to withhold tax. Under FATCA, a withholding agent includes a participating foreign financial institution. A withholding agent must report its tax liability on Form 1042, for the amounts it is required to withhold and for the payments it made.

  Withholding agents are required to report amounts withheld on Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding. They must also furnish a copy of Form 1042-S to the IRS and to the recipient of the payment.

Changes

The updated instructions indicate that Form 1042 was modified in 2014 primarily for withholding agents to report payments and amounts withheld under FATCA, in addition to amounts reported under Chapter 3. Form 1042 added lines for reporting tax liability under Chapters 3 and 4, including separate status codes for withholding agents. The form further provides for a reconciliation of U.S. source payments that are withholdable payments under FATCA. Form 1042-S was also modified to accommodate reporting under FATCA.

- ***Comment.*** Because of the overlap between Chapters 3 and 4 to require withholding on foreign payments, the IRS is using existing forms developed for Chapter 3 reporting, where appropriate, and adding Chapter 4 requirements.

Section 1 of Form 1042 is used to report tax liability for the period (weeks, months for the calendar year) in which income was paid,

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MyRAs

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myRA was first funded, whichever event occurs first. At that point, the account owner will have the option of transferring the balance to a Roth IRA managed within the private sector. In the meantime, the myRA account owner pays no administrative fees.

- ***Comment.*** Treasury Secretary Jack Lew emphasized that the myRA was intended to jumpstart retirement savings rather than to wholly fund it. "We would never argue that $15,000 is adequate retirement savings, but you've got to go from $0 to $15,000 before you can get into the habit of really achieving your objectives," he said. "For people who are starting out at work or working at modest incomes, the idea of putting money away means they have to get over the hurdle of concern that they might lose their money, that they might have to pay fees, that it might be complicated. We want to take those obstacles away."

Funding options

Individuals in the pilot program could contribute to a myRA only through direct deposit of funds withheld from their paycheck. Treasury now allows working individuals to set up recurring or one-time contributions from their personal checking or savings account.

- ***Comment.*** Contributions may not, however, be made through a personal check sent directly to the myRA administrator.

In addition, taxpayers may now contribute a portion or all of their federal tax refund to a myRA account. The IRS had indicated on its draft 2015 Form 1040 that taxpayers may elect this option using Line 76, Amount refunded to you.

Reference: TRC RETIRE: 66,750.

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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Audits Of Individual Tax Returns Drop For Fifth Straight Year

Individual Exam Rate—FY 2015

Audit rates for individual returns declined for the fifth straight year and fell to its lowest level in a decade, the IRS announced. Audits dropped from 1.58 million in fiscal year (FY) 2010 to 1.23 million in FY 2015, a reduction of 350,000 audits or 22 percent.

- ***Take Away.*** Discussing the impact of budget cuts and reductions in the agency's workforce, Commissioner John Koskinen told the AICPA National Tax Conference in Washington, D.C. on November 3 that the IRS "is especially concerned about the effect on audits." Koskinen said examination revenue has dropped from an average of $14.7 billion for FY 2005–2010 to an average of $10.5 billion for FY 2011–2015.
- ***Comment.*** Koskinen said that the IRS has lost 5,000 enforcement personnel since 2010, including revenue agents, revenue officers, and Criminal Investigation staff.

Examination results

For FY 2015, 146.8 million individual returns were filed and 1.23 million returns were audited, for an audit rate of 0.84 percent. Field audits declined from 291,000 in FY 2014 to 267,000 in FY 2015, while correspondence audits increased from 951,000 to 961,000. Examination revenue plummeted from $12.5 billion in FY 2014 to $7.3 billion in FY 2015.

Audit coverage was 1.11 percent for both FY 2010 and 2011, but has steadily declined since then. Examination revenue reached $16.9 billion in FY 2010, dropped from FY 2011 to FY 2013, and then rose back to $12.5 billion in FY 2014.

- ***Comment.*** Koskinen said that fewer employees doing compliance work means "leaving tax revenue on the table. In cutting the IRS budget, the government is forgoing billions just to achieve budget savings of a few hundred million dollars, since we estimate that every $1 invested in the IRS produces $4 in revenue."

Budget cuts

At the AICPA National Conference, Koskinen recounted that the biggest challenge facing the IRS a year ago was its budget situation. "Since then, our situation has gotten worse." For FY 2015, the IRS had $10.9 billion, its lowest funding level since 2008. Koskinen said that, as Congress has demanded, the IRS has worked to reduce costs and find efficiencies in its operations. "But there is a limit to how much we can do to find efficiencies. In 2015, we reached the point of having to make critical performance trade-offs" that have impacted service, enforcement and information technology.

Koskinen added that the risk is not just dollars and cents but the loss of voluntary compliance. "If people think they're not going to get caught if they cheat, or they're just fed up because they can't get the help they need from us to file their taxes, the system will be put at risk, and voluntary compliance is likely to suffer."

- ***Comment.*** The IRS has delayed "critical projects" in the information technology (IT) area because of funding restrictions, Koskinen said. The IRS still has old technology that it was using 50 years ago. Limited resources for taxpayer service and IT investments have hurt the IRS's ability to combat stolen identity refund fraud and to assist its victims, Koskinen added.

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Form 1042

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whether under Chapter 3 or 4, and regardless of whether the liability was satisfied by withholding or other payments by the withholding agent. Section 2 of Form 1042 provides for the reconciliation of payments of U.S. source income, taking into account income required to be withheld under FATCA and income required to be reported but not withheld upon under FATCA. Section 2 was optional for the 2014 form, but must be completed by all withholding agents for 2015.

As of 2015, the status codes under Chapters 3 and 4 for withholding agents are required, regardless of the types of payments reported on Form 1042. The status codes are extensive and are found in the instructions for Form 1042-S.

Reference:TRC INTL: 33,050.

Highway Bill With Tax Provisions Goes To Conference; Extenders Could Move With New Ways And Means Chair

The House and Senate have both approved multi-year highway and transportation spending bills including tax provisions. The bills now go to conference to iron-out differences. At the same time, the selection of a new leader of the House Ways and Means Committee could encourage movement on the expired tax extenders.

Highway bill. The House and Senate highway bills both would authorize the IRS to contract with private collection agencies for unpaid tax debts. The measure is similar to one in the *American Jobs Creation Act of 2004*. Both the House and Senate highway bills also provide for the revocation or denial of a passport in the case of certain unpaid taxes. The measure would authorize the government to deny the application for a passport if an individual owes more than $50,000 in unpaid federal taxes.

Tax extenders. New Ways and Means Chair Kevin Brady, R-Texas, said on November 5 that action on the extenders is a priority for him and the committee. Brady has been a proponent of making permanent a number of the tax extenders, most notably the research tax credit. Unless Congress acts, a host of business and individual tax incentives, which expired after 2014, will be unavailable for 2015.

Surface Transportation Reauthorization and Reform Bill (HR 22), Developing a Reliable and Innovative Vision for the Economy (DRIVE) Bill (HR 22)

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IRS Approves Restructuring Of S Corps That Will Become Partners In General Partnership

LTR 201544020

The IRS has issued a private letter ruling that approved a restructuring in which two S corporations will become partners in a general partnership. The ruling concluded that each S corp will continue to qualify as an S corp, as long as it does not have more than 100 shareholders.

- ***Take Away.*** In Rev. Rul. 94-43, the IRS approved an arrangement where three separate S corporations were partners in a general partnership. That ruling did not involve the type of restructuring described in the current ruling.

Background

X, Y, and Z are each incorporated under state law, and each elected to be treated as an S corp. X currently has close to 100 shareholders.

- ***Comment.*** Under Code Sec. 1361(b)(1)(A), an S corp cannot have more than 100 shareholders. This limit used to be as low as 10 shareholders.

The shareholders of X plan to restructure its business. As a result, X will become a general partnership. Y and Z together will own all the interests in X. The shareholders of X will become shareholders in either Y or Z, which will have and will be governed by identical boards of directors, as agreed under a shareholder voting agreement. The parties anticipate that Y and Z will issue additional shares to new shareholders over time.

The total number of shareholders in Y and Z may exceed 100. However, neither Y or Z will separately have more than 100 shareholders.

IRS analysis

In Rev. Rul. 77-220, the IRS denied S corp status to 30 individuals who formed three S corps and entered into the joint operation of a single business as a partnership. Rev. Rul. 770-220 concluded that the three corporations should be treated as a single corporation and that they were not entitled to S corp status.

In Rev. Rul. 94-43, the IRS reconsidered and revoked Rev. Rul. 77-220, concluding that the S corp elections of the separate corporations should be respected. The IRS concluded that the purpose for limiting the number of S corp shareholders was not avoided by the structure used in Rev. Rul. 77-220.

In the current ruling, the IRS concluded that Y and Z will continue to qualify as S corps, so long as neither one exceeds 100 shareholders each.

- ***Comment.*** X, by converting to a general partnership, obviously terminated its S corp status. The ruling did not discuss this. The IRS did state that it was not expressing any opinion about the tax consequences of the steps of the restructuring.

Reference:TRC SCORP: 304.10.

D.C. Circuit Denies Rehearing In Challenge To Reporting Of Nonresident Interest Income

In a *per curiam* order, the Court of Appeals for the District of Columbia Circuit has turned down a request for rehearing *en banc* by two bankers' associations that had challenged IRS regs (TD 9584) requiring U.S. banks to report interest income earned by nonresident aliens on U.S. bank accounts. The order leaves intact the court's August 14, 2015, decision by a three-judge panel that dismissed the challenge as premature. In the August decision (*2015-2* USTC *¶50,436*), one of the three judges dissented, but the November 5 order stated that no judge asked for a vote on whether to rehear the case.

The court's prior decision concluded that the lawsuit was premature and was barred by the *Anti-Injunction Act* (AIA) and the *Declaratory Judgment Act.* The AIA bars lawsuits that would prevent the collection of a tax. The court indicated that the banks can challenge the regs by failing to report the income, paying a penalty, and then suing for a refund. The banks can also request Supreme Court review.

- ***Comment.*** Some commentators have said that the D.C. Circuit's decision is inconsistent with *Direct Marketing Association*, where the Supreme Court concluded that the *Tax Injunction Act* (a law similar to the AIA) did not bar a challenge to state tax reporting requirements.

Florida Bankers Association, November 5, 2015, 2015-2 USTC ¶50,551; TRC FILEBUS: 9,158.

Audit Coverage

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Taxpayer service

Koskinen said that taxpayer service during the 2015 filing season by phone and in person was "far worse" than desired. On some days, telephone response rates dropped below 40 percent, and long waits were typical for both phone and in-person service. Practitioners are suffering the same impacts, he said. Service will get worse if there are budget cuts, and will not improve if the budget is the same, Koskinen predicted.

The IRS could restore the telephone response rate to 70 percent if Congress provided an additional $300 million, Koskinen said. The IRS would improve the system by using "virtual holds," where the agency gets callers' numbers and calls them back in order. This service would cost an additional $45 million; Koskinen has asked Congress for funds.

Filing season

The IRS will face several challenges for the 2016 filing season. One is to implement provisions in the *Affordable Care Act* (ACA), especially provisions that took effect in 2015, such as the employer mandate. Another challenge is the potential for late legislation that

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Tax Court Limits Deductions For Physician's "Mobile Office"

Cartwright, TC Memo. 2015-212

The Tax Court has found that an on-call physician at a hospital could deduct some, but not all, of his deductions for depreciation and Code Sec. 179 expensing for a motor home used as a "mobile office." The court was not persuaded that the taxpayer used his motor home nearly 100 percent for business purposes.

- ***Take Away.*** The taxpayer and the IRS agreed there was business use of the motor home but disagreed as to the extent. According to the IRS, the taxpayer used the mobile home for business purposes 19.42 percent of the total mileage for 2008 and 22.23 percent of the total mileage for 2009. The taxpayer countered that the mobile home served as a mobile office for nearly 100 percent of the time while performing on-call duties at the hospital. The court agreed with the IRS.

Background

The taxpayer practiced medicine as an orthopedic surgeon. The taxpayer was an on-call physician and surgeon at a hospital, where he was required to work a 24-hour period three days a month from Friday through Sunday. In the event of a medical emergency, the taxpayer was required to arrive within one hour. In certain instances he was instructed to respond to pages within 20 minutes and "stat" pages within five minutes.

In 2008, the taxpayer purchased a motor home. The taxpayer would drive the motor home to the hospital and park it there so he could rest and sleep when not on duty. The taxpayer did not see patients in the motor home but he would review charts and records, and do medical research.

On his 2008 and 2009 returns, the taxpayer reported business expense deductions and Code Sec. 179 expensing related to use of the motor home. The IRS disagreed with the taxpayer's calculations of his business use of the motor home, determining that its use was primarily personal.

Court's analysis

The court first found that ordinary and necessary business expenses may be deducted under Code Sec. 162(a). Ordinary means that which is normal, usual, or customary in the type of business in which the taxpayer is engaged. A necessary expense is one that is "appropriate and helpful" to the taxpayer's business. Additionally, Code Sec. 167(a) allows as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear of property used in a trade or business. Where property is used for business and personal purposes, the allowable deduction is measured by the percentage of business use, the court observed.

The court found that the evidence showed the taxpayer used the mobile home for business purposes only 27 days in 2008 and 36 days in 2009. The taxpayer used the mobile home for nonbusiness purposes on the remaining days. The court upheld the IRS's determinations that the taxpayer used the mobile home for business purposes 19.42 percent for 2008 and 22.23 percent for 2009.

Penalties

The court also upheld the accuracy-related penalty for substantial understatement of tax. The taxpayer could not show that he acted with reasonable cause and in good faith in assessing his proper tax liability, the court found.

References: Dec. 60,440(M); TRC INDIV: 39,052.

IRS Extends Safe Harbor Deduction For Distressed Homeowners Receiving Government Assistance

A safe harbor for distressed homeowners receiving financial assistance under certain federal programs has been extended through 2017, the IRS has announced. The IRS also extended penalty relief related to information reporting. Notice 2015-77 amplifies Rev. Proc. 2011-55 and Notice 2013-7.

Background. The federal government's HFA Hardest Hit Fund and Emergency Homeowners Loan Program provide federal funding to states to assist distressed homeowners. Funding is generally available in states where either housing prices declined more than 20 percent from peak prices or the unemployment rate equals or exceeds the national average. Funds may be used for a variety of purposes, including mortgage modifications, principal reduction programs, second lien reductions, and assistance to unemployed borrowers.

- ***Comment.*** The programs may provide, for example, one year of payments to the mortgage lender to assist unemployed or underemployed borrowers with their first mortgage or a one-time payment to satisfy some or all of any past due amounts, subject to certain monetary caps.

Extension. After the program was launched, the IRS provided a safe harbor generally allowing qualified participants to deduct certain payments made to the mortgage servicer, HUD or a state financing agency on the home mortgage. The safe harbor was scheduled to expire after 2015. Notice 2015-77 extends the safe harbor through 2017.

Information reporting. The IRS generally will not assert information reporting penalties against a mortgage servicer that reports on Forms 1098 payments received under these programs. Notice 2015-77 extends that relief through 2017.

Notice 2015-77; FED ¶46,445; TRC INDIV: 33,354.

Audit Coverage

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requires the IRS to reprogram its systems. Congress has not yet passed extenders legislation that would apply to 2015. Koskinen said that the IRS may need to postpone the start of the 2016 filing season if Congress does not act on the extenders before December.

Reference: TRC IRS: 3,052.

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District Court Allows Trust To Deduct Fair Market Value Of Donated Properties

***Green*, DC-Okla., November 4, 2015**

In a motion for summary judgment, a federal district court has held that a trust could deduct the appreciated value of properties donated to charitable organizations. The court found that the fair market value standard should apply to the charitable deductions because Code Sec. 642 does not provide a different valuation standard.

- ***Take Away.*** The court appeared to make a distinction between deductions that are provided by legislative grace and statutes regarding charitable deductions, which are not matters of legislative grace, but rather "expressions of public policy." The court noted the Tenth Circuit's decision in *Bonfils Trust, 115 F.2d 788 (1940)*, holding that the purpose of Code Sec. 642 is to encourage charitable gifts so as to further and not hinder their beneficent purpose.
- ***Comment.*** To qualify for a deduction under Code Sec. 642, a contribution must be authorized by and made under an estate or trust instrument; sourced from and traceable to gross income; and for a purpose specified in Code Sec. 170(c). The IRS and the taxpayer agreed that these requirements had been met concerning the contributions made by the trust to the various charitable organizations. However, the IRS and the taxpayer disagreed over the proper valuation of the donated properties.

Background

In 1993, two individuals created a trust to distribute funds to charitable organizations. The trust provided that a distribution could be made only when the purposes of the distribution and the charity were as described in Code Sec. 170(c). The trust was also a limited partner in another enterprise (HL). The trust received significant distributions from its interest in HL, which it reported on its returns.

In 2003, an entity (G) owned by the trust purchased land and buildings in Virginia for $10.3 million. The funds for the purchase came from a distribution from HL to the trust. One year later, G donated a portion of the property to a charitable organization.

G also purchased a building in Oklahoma. Again, the funds for the purchase came from a distribution from HL to the trust. G donated the building to a charitable organization. Similarly, G purchased real property in Texas with funds from HL and donated that land to a charitable organization.

Court's analysis

The court first found that Code Sec. 642(c)(1) generally allows a trust to deduct contributions to qualified charitable organizations. Code Sec. 170, the court found, pertains to charitable deductions by individuals and corporations. Code Sec. 170 defines and categorizes qualifying charities and, based upon the particular charity, limits the amount of a taxpayer's adjusted gross income which can be deducted in a single year. Code Sec. 170 also distinguishes between charitable contributions of cash and property other than money, and values the latter at the fair market value at the time of contribution.

The court found that this limiting language under Code Sec. 170 is absent from Code Sec. 642. Rather than place limiting language in Code Sec. 642, Congress specified a deduction without limitation.

The court further rejected the IRS's argument that any capital appreciation must not be considered in the valuation of the donated property because appreciation constitutes unrealized gains. This approach, the court found, would require it to read a limitation into the statute where none existed.

The fair market value standard, the court found, was as close to a generalized valuation standard as there is in the Tax Code. Congress did not provide a different standard of valuation in Code Sec. 642. The court concluded that Congress sought to authorize in Code Sec. 642 a deduction without limitation and fair market value is the appropriate standard for the donated property.

References: 2015-2 USTC ¶50,549; TRC ESTGIFT: 45,252.45.

Gross Receipts From Contract With Broadcast Network Are Not Domestic Production Gross Receipts

A sports team's share of gross receipts resulting from a broadcast contract between a sports league and a network for the tax years at issue did not qualify as domestic production gross receipts (DPGR) under Code Sec. 199, IRS Chief Counsel has concluded. The taxpayer was not the producer of the game broadcasts.

Background. A sports league, on behalf of all teams in the league (including the taxpayer), entered into a contract with the network. The contract gave the network the collective rights to produce and broadcast the games played between the teams.

Chief Counsel's analysis. The network, not the taxpayer was the producer of the qualified film for DPGR purposes. The taxpayer's primary activity relating to broadcasts was playing the games. It was the network's activities that converted the live sporting events into a qualified film.

- ***Comment.*** To qualify as DPGR under Code Sec. 199 and its regs, the taxpayer's gross receipts from the contract with the network must be directly derived from the disposition of a qualified film produced by taxpayer. Only the producer of the game broadcasts can claim DPGR from the disposition of those game broadcasts.

CCA 201545018; TRC BUSEXP: 6,106.15.

TAX BRIEFS

Internal Revenue Service

The IRS has extended the comment period for proposed regulations relating to extensions of time to file information returns on forms in the W-2 series (except Form W-2G) (NPRM REG-132075-14, I.R.B. 2015-35, 288; TAXDAY, 2015/08/13, I.1). Written or electronic comments and requests for a public hearing must be received by January 11, 2016.

Notice of Extension of Comment Period (REG-132075-14), FED ¶46,444; TRC FILEBUS: 15,104.25

The IRS Commissioner has delegated authority to accept, reject, return, terminate or acknowledge withdrawals, of offers in compromise to various IRS officials based on the amount of the offer, whether the offer is based on doubt as to collectibility or doubt as to liability and the type of tax involved. The authority in the delegation order may not be redelegated and is effective October 28, 2015. Any authority previously exercised consisted with the delegation order is affirmed and ratified. CDO No. 5-1 (Rev. 3) is superseded.

CDO No. 5-1 (Rev. 4), FED ¶46,442; TRC IRS: 42,054

Jurisdiction

A company's claim for refund of taxes, penalties and interest alleged to have been erroneously assessed and collected was properly dismissed for lack of subject matter jurisdiction. The company failed to exhaust its administrative remedies by timely filing an informal or formal refund claim with the IRS prior to filing suit.

Rollock Company, CA-3, 2015-2 USTC ¶50,543; TRC LITIG: 9,052

A married couple's amended complaint seeking damages against the IRS and its employees for an allegedly unauthorized collection action was properly dismissed for failure to state a claim. The couple failed to prove that the government waived its sovereign immunity or that it consented to be sued for damages.

Good, CA-3, 2015-2 USTC ¶50,542; TRC IRS: 45,114

A couple's untimely refund claim was dismissed for lack of subject matter jurisdiction. The couple failed to show timely mailing, an informal refund claim or equitable tolling. In addition, the mitigation provisions under Code Secs. 1311-1314 did not toll the limitations period because the denial of the refund claim did not create any inconsistency between successive tax years and the denial did not fall within the seven circumstances of adjustment under Code Sec. 1312.

Meinhold, DC Colo., 2015-2 USTC ¶50,540; TRC IRS: 30,302

IRPAC Issues 2015 Annual Report; Makes Recommendations

The IRS Information Reporting Program Advisory Committee (IRPAC) has released its 2015 annual report and recommendations. This year's recommendations included introducing penalty relief for certain information return filers that experience mismatches of names and taxpayer identification numbers (TINs), creating a searchable database of IRS frequently asked questions (FAQs), and improving implementation of the *Foreign Account Tax Compliance Act* (FATCA).

TIN Matching. IRPAC recommended that the IRS introduce special relief from penalty assessments for filers of non-wage information returns who do not currently have access to the TIN Matching Program. The penalty relief would be for information return filers who encounter name-TIN mismatches.

FAQs. IRPAC also recommended that IRS create an archived, searchable database for FAQs that have been modified or deleted from the IRS's website (www.irs.gov). The advisory board explained that because these FAQs are sometimes changed and the old versions are removed, many information reporters must print out hard copies of the FAQs as they appear on the website, complete with date stamps to support any position taken in reliance on an FAQ.

FATCA. The International Reporting and Withholding subgroup of IRPAC made numerous recommendations for how the IRS could better implement FATCA. These included a request for clarification of certain regulatory provisions; modifications to the instructions for Form 1042-S and substitute Form 1042-S payee statements; new instructions for the treaty claims section of Form W-8BEN-E; and clarifications and limitations in regard to a new reportable item the IRS has added to the 2016 draft Form 1042-S.

2015 IRPAC Public Report, October 28, 2015.

Deductions

An individual was not entitled to deduct certain business expenses as they were mostly unsubstantiated. Further, he was liable for the negligence penalty under Code Sec. 6662(a).

Smith, TC, Dec. 60,442(M), FED ¶48,152(M); TRC BUSEXP: 3,102

Liens and Levies

Federal tax liens were not extinguished by the issuance of a property tax deed to a third-party purchaser because the IRS was not properly notified of the property tax sale. To extinguish the liens, Code Sec. 7425 requires the purchaser to give the IRS notice no less than 25 days prior to the sale as prescribed in IRS Publication 786. Therefore, even though the IRS had actual notice of the sale, the notice of sale was ineffective and the liens were not divested.

Mendoza v. Cisneros, DC Colo., 2015-2 USTC ¶50,544; TRC IRS: 45,160

Collection Due Process

An IRS settlement officer's (SO) determination to sustain a Notice of Federal Tax Lien (NFTL) and a levy to collect an Indian tribe's federal income tax liabili-

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ties for six tax years was not an abuse of discretion. The NFTL complied with IRS administrative procedures, was not prematurely filed and any mistakes constituted harmless error. The taxpayer requested an installment agreement and withdrawal of the NFTL. However, the taxpayer provided no evidence that withdrawing the lien would facilitate payment of its tax liability and failed to submit the financial information necessary for the SO to consider an installment agreement.

Miccosukee Tribe of Indians of Florida, TC, Dec. 60,444(M), FED ¶48,154(M); TRC IRS: 51,056

An IRS settlement officer (SO) did not abuse her discretion by rejecting an individual's offer in compromise (OIC). Even excluding the taxpayer's "dissipated assets" from his RCP, the SO did not abuse her discretion by rejecting the OIC because his disposable income significantly exceeded his total OIC.

Chandler, TC, Dec. 60,443(M), FED ¶48,153(M); TRC IRS: 51,056.25

An IRS settlement officer (SO) did not abuse her discretion by relying on TXMOD transcripts to verify an individual's assessments; the frivolous return penalty and delay sanctions were not imposed. Absent a showing by the taxpayer of an irregularity in the IRS's assessment procedure, it is not an abuse of discretion for an appeals officer to rely on a TXMOD computer transcript of account to comply with Code Sec. 6330(c)(1). Moreover, the IRS failed to show that an individual filed a frivolous tax return; therefore, the individual was not liable for the frivolous return penalty.

Martens, TC, Dec. 60,441(M), FED ¶48,151(M); TRC LITIG: 6,816.10

Tax Assessments

A married couple's tax liabilities were properly reduced to judgment. Since the couple did not allege that the Forms 4340 were incorrect or otherwise invalid, the government was not required to also submit Forms 23C in order to validate the assessments.

Basile, CA-3, 2015-2 USTC ¶50,541; TRC IRS: 27,202

Employment Taxes

The IRS has reminded business owners of the importance of understanding the various types of employment-related taxes they may be required to deposit and report. The IRS has answered common employment-tax queries posed by business owners on topics such as worker classification, voluntary classification settlement program, fringe benefits, officer compensation and backup withholding and information return penalties. A business is always required to secure a Taxpayer Identification Number (TIN) from any individual who will receive payments. Certain reportable payments to individuals are subject to backup withholding when a payee's TIN is missing or incorrect on an information return. The IRS also noted that information return penalties apply to the failure to file correct information returns, including 1099-MISC, W-2 and Schedule K-1.

FS-2015-25, FED ¶46,443; TRC COMPEN: 3,050

Tax Crimes

An individual was properly convicted of tax evasion and failing to file tax return. The district court properly excluded from evidence the substance of cases, government publications and other materials allegedly supporting the individual's belief that she did not have a duty to pay taxes. Further, the court did not misstate the law or mislead the jury by giving the pattern jury instruction.

Montgomery, CA-11, 2015-2 USTC ¶50,546; TRC IRS: 66,154

False Tax Returns

A tax return preparer was properly convicted and sentenced for preparing materially false tax returns. The individual's argument that he misunderstood the nature of the First-Time Homebuyer Credit was without merit. The evidence showed that the Forms 5405, First-Time Homebuyer Credit and Repayment of the Credit, which were attached to the tax returns claiming the credit, contained false information. Considering the preparer's experience as a tax preparer with two national tax preparation companies, a reasonable juror could conclude that the preparer had read and understood the form's instructions.

James, CA-3, 2015-2 USTC ¶50,539; TRC IRS: 66,058.05

Anti-Injunction Act

A federal district court lacked subject matter jurisdiction over an individual's complaint seeking declaratory and injunctive relief from the collection of his federal income taxes. The Anti-Injunction Act barred the individual's suit because he sought to require the IRS to remove tax liens and database entries listing the tax he owed and to enjoin the IRS from engaging in activities that would pressure him to pay taxes.

O'Hara, DC Md., 2015-2 USTC ¶50,545; TRC IRS: 45,152

Bankruptcy

A Chapter 7 debtor's adversary proceeding seeking a preliminary injunction prohibiting the IRS from levying his retirement account in order to collect his alter-ego taxes was dismissed. The Anti-Injunction Act (AIA) generally prohibits injunctive relief pertaining to the assessment or collection of taxes and the debtor failed to show that the extraordinary remedy of an injunction was appropriate.

In re Horstemeyer, BC-DC S.C., 2015-2 USTC ¶50,547

IRS Affirms Requirement That Each Person Representing Taxpayer Must Sign Practice Declaration

The IRS has affirmed, in Chief Counsel Advice, that every person who represents a taxpayer before the IRS must sign the practice declaration in Part II of Form 2848, Power of Attorney and Declaration of Representative. One taxpayer representative cannot sign the declaration on behalf of another representative.

In the practice declaration, the representative swears under penalties of perjury that the person is not suspended from practice before the IRS; the person is subject to Circular 230; and the person is authorized to represent the taxpayer.

CCA 201544024; TRC IRS: 3,208.05.

PRACTITIONERS' CORNER

Proposed Code Sec. 7704 Regs On Publicly Traded Partnerships Violate Statute?—Opponents Weigh In

Publicly traded partnerships (PTPs) allow small investors to invest in oil and gas exploration, real estate development, and other activities without requiring the substantial investments often required for partnerships whose interests are not publicly traded. This allows PTPs to raise capital from individual investors who could not otherwise afford to invest in nontraded partnerships.

PTPs have been around since 1981. Congress and the Treasury Department became concerned that PTPs were eroding the corporate income tax base. In 1987, Congress enacted Code Sec. 7704, which requires that publicly-traded partnerships satisfy a 90-percent qualifying income test to be treated as a partnership, rather than a corporation.

The IRS issued proposed regs (NPRM REG-132634-14) in May 2015 to identify activities that would and would not produce qualifying income. Witnesses at a recent IRS hearing strongly criticized the regs for inappropriately restricting activities that would generate qualifying income, contrary to the statute and legislative history. This Practitioners' Corner discusses the hearing and the proposed regs.

PLRs and regs

Qualifying income generally is passive income, such as interest and dividends. In addition, under Code Sec. 7704(d)(1)(E), activities that produce qualifying income also include the exploration, development, mining or production, processing, refining, transportation and marketing of minerals and natural resources. Since the law's enactment, the IRS has never issued regs under Code Sec. 7704(d)(1)(E). Instead, the IRS addressed questions as to qualifying income under Code Sec. 7704(D)(1)(E) through the private letter ruling (PLR) process.

The IRS noted that the demand for PLRs had increased from five or less through 2008 to more than 30 requests in 2013. Because of the increased interest in this provision, the IRS issued proposed the regs.

Qualifying income

The IRS stated that the activities listed in Code Sec. 7704(d)(1)(E) represent different stages in the extraction of minerals or natural resources and the eventual offering of products for sale. Each of these stages involves various types of operations, the IRS stated in the preamble to the regs.

"Witnesses strongly criticized the regs for inappropriately restricting activities that would generate qualifying income, contrary to the statute and legislative history."

The proposed regs take a controversial approach by providing an exclusive list of operations that comprise Code Sec. 7704(d)(1)(E), developed in part by consulting IRS engineers. The IRS indicated that this list may be expanded by published guidance. The proposed regs thus identify specific activities that are undertaken by an exploration and development company, a mining and production company, a refiner or processor, or a transporter or marketer of a mineral or natural resource.

Holly Porter, chief of the branch responsible for the regs in the office of the Associate Chief Counsel (Passthroughs and Special Industries), said that the IRS wants to understand the science behind the regs and wants to get to the right answer. If the current exclusive list is too narrow, she indicated that the IRS could work with the industry to expand the list to cover other appropriate activities.

Steve Bender of Westlake Chemical Partners (Westlake), a PTP, said that the industry starts with a natural resource and processes it into a natural resource product. Different natural resources that produce various end products, such as natural gas and natural gas liquids (NGLs), should be treated as qualifying income.

The regs define development as an activity that makes substances accessible. The regs would approve fracturing for oil and natural gas ("fracking") as a development technique that produces qualifying income. While not discussed at the hearing, fracking has become a controversial technique that some groups blame for harming water quality and the environment.

Processing and refining

For processing and refining, the proposed regs take a different approach. Instead of describing activities in general, the regs provide industry-specific rules. The regs provide that activities are processing or refining if done to purify, separate, or eliminate impurities. The regs also impose a consistency requirement with the MACRS classification class life used for depreciating the assets.

Importantly, the regs would not treat an activity as processing or refining if it causes a physical or chemical change in the mineral or natural resource, or transforms it into a new or different mineral product, including manufactured products. The production of plastics and similar petroleum derivatives does not generate qualifying income.

- ***Comment.*** In its written comments, the Master Limited Partnership Association (MLPA) stated that the legislative history to the 1987 legislation provides that natural resources include oil, gas or products thereof. Oil and gas products include methane, butane, propane, and similar products recovered from petroleum refineries

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WASHINGTON REPORT *by the Wolters Kluwer Washington News Bureau*

Brady selected to chair House Ways and Means Committee

Rep. Kevin Brady, R-Tex., has been selected as chair of the House Ways and Means Committee, succeeding former chair Paul Ryan, R-Wisc., who stepped down to become House speaker. Brady was selected by the House Republican Steering Committee. Brady was elected to the House in 1996 and is currently serving his tenth term in Congress.

Ways and Means ranking member Sander Levin, D-Mich., said in a statement that "Kevin Brady has been a vigorous and hardworking member during all of his 14 years on the committee. I look forward, as do my Democratic colleagues, to working with Kevin as the new chair as we seek bipartisan action on the big issues within the committee that will impact American families and our nation's economy."

Senate Finance Committee Chair Orrin Hatch, R-Utah, released a statement following the selection of Brady, saying the Ways and Means Committee and the Senate Finance Committee have a long history of collaborating to pass legislation that falls under the control of the two panels. "As a long-serving member of the Ways and Means Committee, Kevin brings a wealth of necessary experience to write, negotiate, and ultimately make pro-growth laws that will enhance opportunities for American families and job creators," Hatch said.

Highway bill with tax offsets clears House

House lawmakers on Nov. 5 approved by a margin of 363 to 64, a six-year highway bill, the Surface Transportation Reauthorization and Reform Bill (HR 22). The measure now moves to conference to reconcile differences between the House and Senate's separate bills.

The House bill contains two revenue offsets that also appear in the Senate's long-term transportation bill, the Developing a Reliable and Innovative Vision for the Economy (DRIVE) Bill (HR 22). Both bills would only fund the Highway Trust Fund for three years, with further funding to be resolved by the next Congress.

The first tax-related provision calls for the revocation or denial of a U.S. passport in the case of certain unpaid taxes. The measure would authorize the government to deny the application for a U.S. passport if an individual owes more than $50,000 in unpaid federal taxes. The provision is expected to bring in $398 million over 10 years.

Congress last authorized the IRS to outsource some tax collection in the *American Jobs Creation Act of 2004.* According to the IRS, it placed approximately $1.8 billion in tax debts with private agencies for collection over three years.

The second provision calls for the IRS to use private debt collection agencies to collect some unpaid taxes. The measure is estimated to raise more than $2 billion over 10 years. Eleven House Democrats sponsored an amendment to remove the provision from consideration in the highway bill, but the amendment failed. Opponents have said they will try to have the provision removed in conference.

Hearing examines waiver of anti-terror provisions in Tax Code

Congress can use the Tax Code to help counter potential terrorism, witnesses told House lawmakers on November 4. The House Ways and Means Oversight Subcommittee held a hearing on presidential authority to waive anti-terror provisions in the Tax Code with respect to Iran.

The Tax Code currently requires U.S. companies to immediately pay taxes on any income derived from Iran by foreign subsidiaries. However, the law currently gives the president the authority to waive these tax provisions and allow beneficial tax treatment for business conducted in Iran.

Peter Roskam, R-Ill., noted that U.S. companies get two benefits on their worldwide business income: foreign tax credits and deferral. However, under current law, no foreign tax credit or deferrals may be claimed by a U.S. company doing business in Iran. Roskam said one of the relief measures the president may provide to Iran while implementing his nuclear agreement is to waive these provisions, which work to discourage U.S. companies from doing business there. Roskam added that he has asked the administration if it plans to waive these rules in light of the nuclear agreement, but the president has not responded.

Jim Walsh, MIT Security Studies Program, told lawmakers that, while the president has the authority to issue waivers, "it is premature to judge whether such authority will be exercised or speculate as to the scope of any possible relief." As far as potential policy consequences, Walsh said he believed that any Tax Code-related relief "will have little or no effect on Iran's sponsorship of terrorism."

Bipartisan bill would reform rules for vehicle donations

Rep. Linda Sanchez, D-Calif., and Rep. Todd Young, R-Indiana, have introduced a bill to revise the rules for charitable donations of motor vehicles. The proposed CARS Act would allow donors who wish to claim a deduction amount between $500 and $2,500 the opportunity to do so, provided they obtained a valuation from an authorized online valuation service and the charitable organization verifies the physical condition of the vehicle.

"Today, charities and organizations are struggling to meet the needs of our communities with fewer resources and staff to carry out their missions. By making this simple change to the charitable automobile donation process, the proposal will make it easier for people to donate their cars to charities that provide these critical services," Sanchez said in a statement.

"Thousands of charities rely on the donation of cars as a key fundraising tool. Our bill makes a simple change to spur these donations after years of decline, in the hope we can restore a critical resource charities use to make a difference in their communities," Young added.

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or field facilities. Oil, gas or products thereof are not intended to encompass oil or gas products produced by additional processing, such as plastics or similar petroleum derivatives.

Many PTPs are involved in the production of natural gas liquids (NGLs). Natural gas includes methane and NGLs. The latter are components of natural gas that are separated from the gas as liquids at a field facility or gas processing plant. NGLs are naturally occurring elements in natural gas and include propane, butane, and ethane. They are produced from gas wells or are associated with the production of crude oil. The prominence of NGLs has grown with the development of shale gas exploration and fracking.

Regs inconsistent

Several witnesses testified that the proposed regs violate the statute because they treat certain activities involving crude oil production as generating qualifying income, while similar activities involving natural gas production do not generate qualifying income. Bender and Dave Witte of Westlake testified that NGLs are natural resources and should be treated a generating qualifying income under Code Sec. 7704(d)(1)(E). NGLs are produced by "cracking," a process that does not involve the manufacturing of end products such as plastics, they noted.

The regs should define processing as a process that involves oil, gas and NGLs, Bender testified. Crude oil as extracted contains NGLs; both crude oil refining and steam cracking (natural gas) create physical and chemical changes and produce products that are essentially the same, Witte said. Most oil refineries now include steam cracking and create identical products.

Under the statute, qualifying income must be derived from minerals or natural resources. Natural gas and natural gas liquids fit within these terms but are improperly excluded by the proposed regulations, Randall Fowler of Enterprise Products Partners, L.P., testified. The regulations limit qualifying products to those produced by (oil) refineries; this is not consistent with the statute, legislative history, or Congressional intent, Robert McNamara of Andrews Kurth, LLP (Houston) testified.

The statute does not define refining or process, Angela Richards of Andrews Kurth said. There are no industry-specific limitations. The regs incorrectly define processing and refining as the transformation into a new substance. The proposed regs rewrite the statute and are an "extreme, unwarranted" departure from the IRS's "long-standing interpretation," as expressed in the PLRs, Richards said.

- ***Comment.*** Linda Carlisle of Miller and Chevalier, speaking on her own behalf, told Wolters Kluwer that a major problem with the proposed regs was their definition of processing and refining. The definition discriminated against natural gas activities, by limiting processing to physical processes that purified, separated, or eliminated impurities. This definition creates problems for natural gas, ores and timbers, compared to the treatment of oil. For petroleum, there is a different, much broader definition of qualifying activities that includes chemical transformation. This distinction is not sanctioned by the statute, she said. As a consequence, she said, if crude oil is converted into olefins (a chemical compound used in processing and manufacturing), the income qualifies; but if natural gas is converted into olefins (the exact same substance), the income does not qualify.

Grandfathering

Westlake is in a particularly difficult position under the proposed regs, Bender said, because it obtained a PLR in 2013 that treated its natural gas and NGL production activities as generating qualifying income. The proposed regs essentially revoke the PLR. After the proposed regs were issued, Westlake's net worth dropped by $1 billion, he said.

The proposed regs would treat existing PLRs as continuing in effect for 10 years after the IRS issues final regs. Witnesses testified that 10 years was insufficient for companies to recoup their investment and to make a profit. Carlisle, testifying on behalf of the MLPA, said that it was unprecedented for the IRS to revoke a PLR where there was change in the facts or the law, and no erroneous statements of fact. Any existing PLR should be permanently grandfathered, she said, rather than limited to 10 years.

Other witnesses, such as Timothy Vail of G2X Energy, Inc., also said that a 10-year transition period is not sufficient. Master limited partnerships (MLPs), as many PTPs are known, need substantial time to plan refining facilities, attract investors and raise capital, to build a facility and to start to make money. Facilities can cost as much as $2 billion, Vail said.

Greg Dalton of OCI Partners, LP, said that after receiving a favorable PLR in 2013, the company invested $2 billion in a new methanol facility. The PLR remains correct and Congress has not changed the law, Dalton said. The IRS should honor previously issued PLRs and should amend the proposed regulations so that qualifying income can be derived from natural gas activities, including the production of methanol, the witnesses said.

Exclusive list

Carlisle criticized the IRS's regulatory approach that would include an exclusive list of activities that produce qualifying income. When Congress enacted the statute, it did not limit activities to predetermined processes. Technologies inevitably change; for example, fracturing has become a standard technique that was not used in 1987. An exclusive list would create uncertainties and would not be useful for MLPs that depend on the public market to raise capital. MLPs need to know if an activity produces qualified income well in advance of production by a new facility. Carlisle recommended that the regulations develop broad principles with definitions of each qualifying activity, and provide examples of operations that satisfy and do not satisfy the definition.

Ryan Carney of Vinson & Elkins testified that Congress intended the law to apply broadly. An exclusive list would be narrowly construed and creates a presumption that new processes do not produce qualifying income. Other witnesses said that an exclusive list would create uncertainty for taxpayers who already have a PLR and who cannot determine whether their activities are permitted. James Chenoweth of Baker Botts also expressed concerns about the application of the grandfathered rulings if any circumstances change.

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COMPLIANCE CALENDAR

November 16
Employers deposit Social Security, Medicare, and withheld income tax for November 7, 8, 9, and 10.

November 18
Employers deposit Social Security, Medicare, and withheld income tax for November 11, 12, and 13.

November 20
Employers deposit Social Security, Medicare, and withheld income tax for November 14, 15, 16, and 17.

November 25
Employers deposit Social Security, Medicare, and withheld income tax for November 18, 19, and 20.

November 30
Employers deposit Social Security, Medicare, and withheld income tax for November 21, 22, 23, and 24.

December 2
Employers deposit Social Security, Medicare, and withheld income tax for November 25, 26, and 27.

TRC TEXT REFERENCE TABLE

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

ACCTNG 33,152.05	528	FILEBUS 9,108	501	IRS 6,106.05	526
ACCTNG 36,162.05	517	FILEBUS 9,158	540	IRS 9,400	528
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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 Is a taxpayer entitled to claim the $500,000 exclusion from gain on the sale of a principal residence if he has rented out his former home for the past three years?

A One of the requirements for using the principal residence gain exclusion is that the selling taxpayer must have used the property as his or her principal residence for periods aggregating two out of the past five years prior to the sale. *See TRC REAL: 15,156.10 for more information.*

Q Is an employer's check payment to the beneficiary of a decedent taxable to the beneficiary or is it a gift?

A Generally any amount transferred by or for an employer to, or for the benefit of, an employee is not covered by the general rule that excludes gifts from gross income. In some circumstances, the argument can be made that the transfer is for the benefit of the beneficiary rather than the decedent (and is, therefore, a gift). A number of factors are used to determine if a payment made in a business setting is a nontaxable gift. The intention of the transferor involves a question of fact and is the most important factor to be considered. *See TRC COMPEN: 48,206 for more information.*