Wolters Kluwer

DECEMBER 17, 2015
ISSUE NUMBER 51

FEDERAL TAX WEEKLY

INSIDE THIS ISSUE

Happy Holidays!

Due to the holidays, the next issue of *Federal Tax Weekly* will be Issue No. 52, December 31, 2015. For breaking news, see *Federal Tax Day* on *CCH® IntelliConnect.* Happy Holidays to all!

IRS Provides Guidance To Retirement Plans, Health and Welfare Plans Reflecting *Obergefell*

Notice 2015-86

In question and answer format, the IRS has provided guidance to retirement plans and health and welfare plans on the Supreme Court's decision in *Obergefell, 2015-1* USTC *¶50,357,* which extended same-sex marriage nationwide. Because same-sex marriages have been recognized for federal tax law purposes since *Windsor, 2013-2* USTC *¶50,400,* the IRS explained that it does not anticipate any significant impact from *Obergefell* on the application of federal tax law to employee benefit plans.

- ***Take Away.*** "Notice 2015-86 provides some additional clarifications from the IRS regarding the treatment of same-sex spouses under tax-qualified plans and welfare plans," Todd Solomon, partner, McDermott Will & Emery, LLP, Chicago, told Wolters Kluwer. "While the Notice does not provide any surprises or obvious "to do's" for benefit plan sponsors, it is welcome in the sense that it specifically blesses many of the actions plan sponsors have already taken with respect to coverage of same-sex partners and application of the Section 125 change in status rules. "

Background

After the Supreme Court struck down Section 3 of the *Defense of Marriage Act* (DOMA) in *Windsor,* the IRS issued guidance for retirement and health and welfare plans in Notice 2014-19. The IRS also issued rev. Rul. 2013-17 announcing that the agency would take a place of celebration approach to same-sex marriage.

In June, 2015, the Supreme Court announced its ruling in *Obergefell.* The Court held that the Fourteenth Amendment requires a state to license a marriage between two people of the same sex. Further, states must recognize a marriage between two people of the same sex when their marriage was lawfully licensed and performed out-of-state.

Retirement plans

Some plan sponsors have asked for clarification of the application of *Obergefell* to certain changes to employee benefit plans, such as a discretionary expansion of benefits that is not required under the federal tax rules, the IRS reported. Concerning retirement plans, the IRS explained that a qualified retirement plan is not required to make additional changes as a result of *Obergefell.* Post-*Windsor* guidance required plans to adopt certain amendments.

However, a plan sponsor may decide to amend its plan following *Obergefell* to make certain optional changes or clarifications. Plan sponsors are permitted to make these amendments, which must comply with the applicable qualification requirements.

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Negotiations Continue On Extenders, Omnibus, ACA Taxes

At press time, negotiations continue over renewal of the tax extenders, an omnibus federal budget for fiscal year (FY) 2016, two excise taxes under the Affordable Care Act (ACA), and a trade bill with tax offsets. House and Senate leaders are aiming to have legislation passed and on its way to President Obama before December 18.

- ***Take Away.*** The uncertainty over late tax legislation impacts year-end tax planning. "Tax planning assumes the facts are what we know," Fred Slater, CPA, MS 1040, LLC, New York, told Wolters Kluwer. "Tax legislation over the past 15 years is not even predictable; trying to predict tax legislation is near impossible."

Extenders

More than 50 popular but temporary tax breaks for individuals and businesses expired after 2014. GOP leaders in the House and Senate have signaled their support for making permanent some business tax extenders, especially the research tax credit and Code Sec. 179 small business expensing. President Obama and many Democrats in Congress want to link any permanent extensions of business incentives to enhancements for individuals.

Omnibus

On December 11, Congress passed and President Obama signed a stop-gap bill to fund the federal government, including the IRS, for five more days. At this time, few details have emerged about the level of funding for the IRS in the omnibus spending bill.

ACA taxes

The extenders bill or the omnibus may include a delay in the start of the excise tax on so-called "Cadillac" health insurance plans under the ACA. Many lawmakers also want to repeal or "pause" the ACA's medical device excise tax.

- ***Comment.*** The excise tax on Cadillac plans is scheduled to take effect after 2017. A delay for as long as two years is reportedly being negotiated.

Trade bill

The Trade Facilitation and Trade Enforcement Act (HR 644) provides that if a return is filed more than 60 days after its due date, then the failure to file penalty may not be less than the lesser of $205 or 100 percent of the amount required to be shown as tax on the return.

For continuing coverage of the extenders, the IRS budget and other pending legislation, see Tax Day on IntelliConnect.

Plan Guidance

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Under *Windsor* and Notice 2014-19, a retirement plan fails to meet the Code Sec. 401(a) qualification requirements if it does not recognize the same-sex spouse of a participant as a spouse on and after June 26, 2013. However, a plan will not lose its qualified status if it also applies *Windsor* prior to June 26, 2013. A plan sponsor that has not yet made a retroactive amendment may do so now and the amendment will not cause the plan to lose its qualified status, the IRS explained.

Health and welfare plans

The federal tax treatment of health and welfare benefits provided to a same-sex spouse was addressed in Rev. Rul. 2013-17 and Notice 2014-1. Therefore, no changes to the terms of a health or welfare plan are required due to *Obergefell,* the IRS explained. If a health or welfare plan does offer benefits to the spouse of a participant, however, *Obergefell* could require changes to the operation of the plan to the extent that the decision results in a change in the group of spouses eligible for coverage under the terms of the plan.

- ***Comment.*** The IRS used the example of where a health or welfare plan provides that coverage is offered to the spouse of a participant as defined under applicable state law. The plan administrator determines that applicable state law has expanded to include same-sex spouses as a result of *Obergefell.* The terms of the plan would require coverage of same-sex spouses as of the date of the change in applicable state law.

Cafeteria plans. If, as of the beginning of a plan year, a health or welfare plan offered under a Code Sec. 125 cafeteria plan does not permit coverage of same-sex spouses, and the terms or operation of the plan change during the plan year to permit coverage of same-sex spouses, the cafeteria plan may permit a participant to revoke an existing election and submit a new election, the IRS explained. If the terms of a cafeteria plan do not allow participants to make a change in election due to a significant improvement in coverage during the coverage period under an existing coverage option, the plan sponsor may amend the terms of the cafeteria plan to allow an election.

References: FED ¶46,470; TRC RETIRE: 9,050

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***

FEDERAL TAX WEEKLY, 2015 No. 51. FEDERAL TAX WEEKLY is also published as part of CCH Tax Research Consultant by Wolters Kluwer, 4025 W. Peterson Avenue, Chicago, IL 60646-6085. Editorial and Publication Office, 1015 15th St., NW, Washington, DC 20005.

IRS Launches Initiative To Help Employers Keep Current With Payroll Taxes

IR-2015-136

Employers that appear to have fallen behind in remitting payroll taxes will be contacted by the IRS under a new initiative. The new "Early Interaction Initiative" is intended to help employers stay in compliance with their payment and reporting obligations.

- ***Take Away.*** The IRS's general approach to tax collection, including payroll tax collection, is focused on voluntary compliance. In the past, the first attempt by the IRS to contact troubled employers was often made after the employment tax return was filed. The new initiative aims to advance the time of first contact to avoid the rapid accumulation of unpaid payroll taxes.

Background

Federal tax deposits are comprised of income tax withholding, Federal Insurance Contributions Act (FICA) taxes (Social Security and Medicare), and Federal Unemployment Tax Act (FUTA) taxes. Employers are required to match the amounts withheld from an employee's compensation for Social Security and Medicare taxes. Only the employer pays FUTA tax; it is not deducted from the employee's wages.

Employers are generally required to remit payroll taxes periodically through the Federal Tax Deposit system. The frequency of deposits depends on the amount of taxes due and the frequency of the employer's payroll.

- ***Comment.*** Employers that accumulate a tax liability of $100,000 or more on any day during a deposit period must deposit the tax by the next business day, whether the employer is a monthly or semiweekly schedule depositor.

Once an employer fails to remit payroll taxes, the IRS sends a series of notice letters. After the notice phase, the case may be assigned to collection personnel. The IRS can impose the Trust Fund Recovery Penalty (TFRP) for willful failure to collect, account for, or pay over employment taxes. The TFRP can be imposed on any individual who is responsible for collecting or paying withheld income and employment taxes, or for paying collected excise taxes, and who willfully fails to collect or pay them.

New initiative

The IRS explained that employers, especially those facing financial difficulties, sometimes inappropriately divert funds withheld from employees' pay for working capital or other purposes. As a result, employment tax liabilities can quickly grow beyond the employer's ability to satisfy its obligations. In other cases, miscommunication between an employer and its payroll processor may result in deposits not being timely made.

To help employers avoid these problems, the initiative will monitor deposit patterns and identify employers whose payments decline or are late. The IRS will contact these employers by letter asking the employer to discuss the situation with the agency. Some employers may receive automated phone messages from the IRS providing information and assistance. In other situations, an IRS revenue officer may contact some of these employers at their place of business.

Reference: TRC PAYROLL: 3,352.

IRS Reminds Applicable Large Employers Of ACA Reporting Deadlines

HCTT-2015-80

The IRS has reminded applicable large employers (ALEs) of *Affordable Care Act* (ACA) information reporting deadlines. Previously, the IRS encouraged ALEs to voluntarily report starting in 2015 for the 2014 plan year. Mandatory reporting begins in 2016 for the 2015 plan year.

- ***Take Away.*** Failure to file an information return reporting health insurance coverage or failure to include correct or complete information on a return is subject to the penalties for failure to file correct information returns, and for failure to furnish correct payee statements. The *Trade Preferences Extension Act of 2015,* signed into law by President Obama in June, revised the penalty structure, effective for information returns and payee statements required to be filed/furnished after 2015.
- ***Comment.*** ACA information returns are subject to Reg. §301.6011-2, which requires filers of 250 or more of any one type of information return to file electronically.

Background

Under Code Sec. 6055, every provider of "minimum essential coverage" must report coverage information by filing an information return with the IRS and furnishing a statement to individuals. Code Sec. 6056 requires ALEs to file information returns with the IRS, and provide statements to their full-time employees about the health insurance coverage the employer offered. Information to be reported to the IRS includes identification of the ALE, identification of full-time employees to whom an offer of coverage is made, and duration of the offer. Transition relief provides that employers do not have to file information returns with the IRS and furnish statements to their full-time employees until 2016 for the 2015 plan year.

- ***Comment.*** ALEs are required to report to the IRS, as well as to their full-time employees, regardless of whether the ALE actually offers health insurance coverage.
- ***Comment.*** Information reporting is needed for the administration of

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Mutual Insurance Policy Holders Had No Basis In Stock Issued on Demutualization; Amounts Received For Stock Were Taxable

Dorrance, CA-9, December 9, 2015

Reversing a federal district court decision, the Ninth Circuit Court of Appeals has concluded that a married couple was fully taxable on proceeds received for selling stock that they had received when a mutual insurance policy demutualized and issued stock. The district court had found that the taxpayers had basis in the stock and that a portion of the proceeds was nontaxable as a return of basis.

- ***Take Away.*** The Ninth Circuit analyzed the nature of the interests in a mutual insurance company and determined that the taxpayers only had rights as purchasers of insurance policies. They had no membership or ownership rights in the insurance companies themselves and therefore could not claim any basis in the stock received on demutualization.

Background

The taxpayers, husband and wife, purchased several insurance policies from five mutual insurance companies. They paid premiums of $15 million; the face value of their policies was just under $88 million. The companies subsequently demutualized, depriving the taxpayers of their membership rights in the companies. Instead, the companies issued stock to their policyholders. The taxpayers received stock valued at $1.8 million.

In a subsequent year, they sold the stock for $2.25 million. They initially claimed a zero basis in the stock and reported the entire proceeds as gain. Subsequently, they claimed that they had no gain because the stock sale was a return on previously paid insurance premiums. The district court concluded that the taxpayers had a basis of $1.08 million and owed taxes on $1.17 million of proceeds. The IRS appealed.

- ***Comment.*** The IRS had issued a ruling that the demutualizations were tax-free reorganization and that taxpayers had no gain or loss from the receipt of stock.

Court's analysis

The primary issue was how to calculate the basis of stock received on demutualization. The taxpayers, in purchasing insurance, acquired policy or contractual rights, such as the death benefits, and mutual or membership rights. The premiums covered the contractual rights. The insurance companies did not treat the membership rights as having a cost and did not charge for these rights. The membership rights were not separate from the policy rights and could not be sold. Furthermore, after demutualization, the insurance premiums did not change, demonstrating that the insurance companies were not charging for the membership rights.

The IRS, in prior revenue rulings, and the insurance companies, on demutualization, told policyholders that the basis in their stock was zero. Even if the mutual rights had a value when stock was distributed, the policy holders did not pay anything to acquire these rights or to acquire the stock on the subsequent tax-free exchange, the Ninth Circuit found. The district court also erred when it estimated basis using the stock price at the time of demutualization, rather than calculating basis when the policies were acquired, according to the Ninth Circuit.

References: 2015-2 ustc ¶50,588; TRC SALES: 9,104.10.

ACA

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the Code Sec. 36B premium assistance tax credit and the employer-shared responsibility provisions of the ACA.

The new information returns and transmittal forms for the Affordable Care Act (ACA) are:

- Form 1094-B, Transmittal of Health Coverage Information Returns
- Form 1095-B, Health Coverage
- Form 1094-C, Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns
- Form 1095-C, Employer-Provided Health Insurance Offer and Coverage

Employers that offer employer-sponsored self-insured coverage use Form 1095-C to report about individuals that have minimum essential coverage under the employer plan, the IRS explained. Employers who are not ALEs but that sponsor self-insured group health plans must report information about employees (and their spouse and dependents) who enroll in the coverage to their employees, even though the employers are not subject to the employer shared responsibility provisions or the information reporting requirements for ALEs. In this case, these employers use Forms 1095-B and 1094-B.

Filing deadlines

The IRS reminded ALEs that Form 1095-C must be provided to employees by February 1, 2016. Forms 1094-C and Forms 1095-C are due to the IRS by February 29, 2016 (2016 is a leap year), if filing on paper, or March 31, 2016, if filing electronically. The filing deadlines for Forms 1094-B and 1094-C are the same.

AIR system

ACA information returns and transmittals are electronically filed through the ACA Information Returns (AIR) system. The IRS explained on its website that transmissions to AIR must be comprised of only one type of ACA information return and its associated transmittal. For example, a transmission must only contain: Form 1094-B and Form 1095-B or Form 1094-C and Form 1095-C. Each transmission must contain at least one Transmittal, either Form 1094-B or Form 1094-C.

Reference: TRC HEALTH: 6,106.

Tax Court Finds IRS Alternative Position Constituted Initial Determination For Penalty Purposes

Legg, 145 TC No. 13

Affirming the IRS, the Tax Court has concluded that the IRS properly determined the Code Sec. 6662(h) gross valuation misstatement penalty. The court found that a report prepared by an IRS examiner, which imposed the Code Sec. 6662(h) penalty as an alternative position, constituted an "initial determination" regarding the penalty.

- ***Take Away.*** Code Sec. 6751(b)(1) requires that no penalty be assessed "unless the initial determination of such assessment is personally approved (in writing) by the immediate supervisor of the individual making such determination." Additions to tax under Code Secs. 6651 (failure to file tax return or pay tax), 6654 (failure by individual to pay estimated income tax), 6655 (failure by corporation to pay estimated income tax) or any other penalty automatically calculated through electronic means are excepted from the requirement of Code Sec. 6751(b)(1), the court observed.

Background

The taxpayer contributed real property as a conservation easement to an organization. The taxpayer valued the real property at $1.4 million and claimed a charitable contribution of $184,000 on his 2007 return. The taxpayer also claimed carryover charitable contribution deductions for 2008, 2009, and 2010 on the conservation easement value.

The IRS disallowed the taxpayer's claimed charitable contribution deduction. The IRS also determined that the taxpayer was liable for a 20 percent accuracy-related penalty under Code Sec. 6662(a) or, alternatively, the 40 percent accuracy-related penalty for a gross valuation misstatement under Code Sec. 6662(h).

- ***Comment.*** The report prepared by the examiner concluded that the taxpayer was "subject to the Accuracy Related Penalty-Gross Valuation Misstatement pursuant to Section 6662 for the tax year 2007." The court found that the examination report, however, calculated the proposed penalties using the 20 percent rate.

IRS Appeals agreed that accuracy-related penalties should be imposed. Appeals explained that imposing 40 percent gross valuation misstatement penalties should be the IRS's primary position because the value of the conservation easement reported on the returns exceeded more than 200 percent of the correct value. Appeals further explained that imposing 20 percent accuracy-related penalties should be the IRS's alternative position. The IRS ultimately determined 40 percent gross valuation misstatement penalties. The taxpayer and the IRS reached a settlement over all issues except the penalty.

Court's analysis

The court first found that the term "initial determination" is not defined under the statute or regs. Looking to the dictionary definition, the court noted that the word "initial" has to "do with, indicating, or occurring at the beginning." According to the IRS, its examiner made an initial determination that the 40 percent penalties were appropriate, concluding in the examination report that the taxpayer was liable for the penalty. The court agreed with the IRS.

- ***Comment.*** Congress, the court explained, created Code Sec. 6751(b) to ensure that taxpayers understood the penalties that the IRS imposed upon them. Before enactment of Code Sec. 6751, the IRS was not required to describe how penalties were computed. The court highlighted a Congressional report prior to passage of the *IRS Restructuring and Reform Act of 1997* that underscored that penalties should only be imposed where appropriate and not as a bargaining chip.

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FinCEN Extends Deadline For Certain FBAR Filers

Treasury's Financial Crimes Enforcement Network (FinCEN) has announced another extension of time to report certain Report of Foreign Bank and Financial Accounts (FBAR) filings. The extension is available to individuals with signature authority over, but no financial interest in, certain types of accounts. The deadline is unchanged for all other individuals with an FBAR filing obligation.

- ***Comment.*** The *Surface Transportation Act of 2015* changed the due date for FBAR filers to April 15, applicable for FBARs for tax years beginning after December 31, 2015.

Background. A U.S. person is required to disclose on FINCen Form 114 (commonly referred to as the FBAR) any financial interests in, signature authority over, or other authority over foreign financial accounts if the aggregate value of the accounts exceeds $10,000 at any time during the calendar year. The FBAR must be received by Treasury for each calendar year on or before June 30 of the succeeding year. In late 2014, FInCEN issued Notice 2014-1 to extend the filing date for FinCEN Form 114 (FBAR) for individuals with signature authority over, but no financial interest in, one or more foreign financial accounts to June 30, 2016.

Extension. FinCEN reported that it continues to receive questions about Notice 2014-1. In response, FinCEN decided to extend the filing due date to April 15, 2017, for individuals whose filing due date for reporting signature authority was previously extended by Notice 2014-1. This extension applies to the reporting of signature authority held during the 2015 calendar year, as well as all reporting deadlines extended by previous FinCEN notices.

FinCEN Notice 2015-1; TRC FILEBUS: 9,104.

Transfer Of Stock In Family Business To Trust For Children Was Taxable Gift; No Gift Tax Return Kept Limitations Period Open

***Redstone*, TC Memo. 2015-237**

The Tax Court has found that an individual's transfer of stock to trusts for his children was a taxable gift worth $2.5 million. The court concluded that the taxpayer's transfer was motivated by donative intent with respect to his family and was not made for full and adequate consideration or in the ordinary course of business.

- ***Take Away.*** The court distinguished the circumstances of the taxpayer's transfer (which was not required by litigation or a settlement agreement), from a similar transfer of stock by his brother, which was required to resolve litigation and to settle a genuine dispute as to the brother's stock ownership.

Background

The taxpayer, his father (M), and his brother (E) each owned all of the shares in a family holding company that operated a business. Although each individual owned had received 100 shares in the company, the M had in fact contributed 48 percent of the assets owned by the company, while taxpayer and E each contributed approximately 26 percent of the stock. M subsequently transferred 50 shares to trusts for his grandchildren, and exchanged the other 50 shares for preferred stock in the company.

E sought to redeem his 100 shares and sued the company for the proceeds when the taxpayer and his father refused to do. To settle the dispute, the parties agreed to redeem 66 2/3 shares of the E's stock for $5 million. E agreed to transfer the other 33 1/3 share to trusts for his children. These shares were valued at $2.5 million. Subsequently, in 1972, the taxpayer also decided to transfer 33 1/3 shares of his stock to trusts for his children. The taxpayer was not required to take these actions under the settlement of E's lawsuit.

In 2006, one of E's children sued M and the taxpayer for additional stock and cash under the earlier agreement. This suit was eventually dismissed. At trial, the taxpayer testified that he transferred his own shares to his children's trusts voluntarily, as an outright gift, not as a result of litigation.

- ***Comment.*** The taxpayer stated that his accountant had advised him that no gift tax return was required for his transfer.

In 1974, the IRS asked the taxpayer for information on contributions he made to the 1972 presidential campaign. After obtaining the information, the IRS concluded that the taxpayer was not required to file a gift tax return. In 2010, the IRS learned of taxpayer's 1972 transfer of his stock, opened an audit, and claimed that the taxpayer should have a filed a gift tax return.

Court's analysis

The Tax Court found that the taxpayer's 1972 transfer of 33 1/3 shares to trusts for his children was a gift and that the taxpayer should have filed a gift tax return. The shares were worth $2.5 million, reflecting the parties' 1972 arm's-length agreement that placed a $5 million value on the 66 2/3 shares redeemed by E.

The court rejected taxpayer's arguments that the statute of limitations had closed, that the taxpayer was not entitled to dismissal on the basis of laches (delay), and that the IRS had violated the restriction in Code Sec. 7605(b) against a second audit of taxpayer's books and records.

Although the taxpayer's transfer was made in 1972, the statute of limitations never started to run because the taxpayer did not file a gift tax return. It was not clear that the IRS's earlier actions were in fact an examination of taxpayer's books and records; in any case, the taxpayer agreed to the examination and effectively waived any rights under Code Sec. 7605(b).

However, the court rejected the IRS's claims of fraud and additions to tax. There was no evidence of fraud and no liability for additions to tax, because the taxpayer had relied in good faith on advice from qualified tax professionals that there was no gift tax liability.

References: Dec. 60,467(M); TRC ESTGIFT: 3,068.

IRS Releases Annual List Of Cumulative Changes In Plan Qualification Requirements

The IRS has released its 2015 Cumulative List of changes in plan qualification requirements. The 2015 Cumulative List is to be used by plan sponsors and practitioners submitting determination letter applications for plans during the period beginning February 1, 2016, and ending January 31, 2017.

- ***Comment.*** Plans using this Cumulative List will primarily be single employer individually designed defined contribution plans and single employer individually designed defined benefit plans that are in Cycle A. Generally, an individually designed plan is in Cycle A if the last digit of the employer identification number of the plan sponsor is 1 or 6.

Notice 2015-84; FED ¶46,201; TRC RETIRE: 51,102.05.

Penalty

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Here, the examiner's report described why the taxpayer was liable for a penalty. The taxpayer could not claim that he did not understand why the penalty was imposed, the court found. Additionally, the examiner's manager signed-off on the report as required by statute. Further, the court found that the examiner's calculation of the penalty at 20 percent rather than 40 percent did not nullify the initial determination.

References: Dec. 60,464; TRC PENALTY: 3,110.25.

Distributions To Shareholders In REIT Conversion Taxable

LTR 201550017

The IRS has determined that stockholders who may elect to take a distribution from a C corporation in either cash or stock are treated as receiving a distribution of property under Code Sec. 301. The amount of the distribution will be equal to the amount of cash received plus the amount of cash that could have been received instead of any stock actually distributed.

- ***Take Away.*** Under Code Sec. 305(a), a distribution of stock by a corporation to its shareholders with respect to the corporation's stock is tax-free. However, under Code Sec. 305(b), the distribution is treated as a distribution of cash, where the shareholder could have elected to receive either cash or stock. Here, the IRS determined that distributions of stock to shareholders were taxable as distributions of property, because the shareholders could elect either stock or cash.

- ***Comment.*** The C corporation intended to convert to a real estate investment trust (REIT). To qualify as a REIT, a corporation cannot retain any earnings and profits (E&P) accumulated in a year that the corporation was not a REIT.

Background

A corporation with Class A and Class B common stock, and convertible debt, intends to elect to be treated as a REIT, effective on the first day of Year 1. Prior to the end of Year 1, the corporation will distribute to its shareholders all of its E&P accumulated for periods ending prior to Year 1. Prior to any distributions, the corporation will relocate its jurisdiction of ownership to a different state. The corporation represents that this will be a tax-free "F" reorgization.

The corporation will make the E&P distributions as a combination of cash and common stock. Shareholders can elect to receive their distribution as either all cash or all common stock. Class A stockholders will receive Class A stock; class B stockholders will receive Class B stock. If a shareholder fails to make a valid election, the shareholder will be deemed to elect all cash.

IRS analysis

The IRS determined that any distributions of stock would be treated as distributions of property under Code Sec. 301. The amount of the distribution of stock would be equal to the amount of money that the shareholder could have received instead. Provided that the corporation distributions cash to its shareholders, then any adjustments to the conversion ratios of the convertible debt required as a result of the distribution would be deemed to be distributions under Code Sec. 301 (under Code Sections 305(b)(2) and 305(c)), to the holders of convertible debt.

Reference: TRC CCORP: 6,054.

PMTA Addresses Eligibility Of Look-Back Interest For Netting

PMTA 2015-016

The IRS has reviewed in Program Manager Technical Advice (PMTA) whether look-back interest itself is eligible for interest netting. The IRS also reviewed if interest netting may be available to any underpayment or overpayment interest from look-back interest.

- ***Take Away.*** Under Code Sec. 6621(d), interest is eligible for netting only if it is payable under subchapter A and allowable under subchapter B on equivalent underpayments and overpayments by the same taxpayer.

Background

Under Code Sec. 460(a), taxable income from any long-term contract is determined under the percentage-of-completion (PCM) method as modified in Code Sec. 460(b). Under this provision, a taxpayer using PCM to account for income from long-term contracts is required to pay or is entitled to receive interest on the amount of tax liability deferred or accelerated under that method of accounting.

In the event a contract price is overestimated – or contract costs are underestimated – the taxpayer is entitled to interest as a result of the acceleration of the tax liability. This is known as look-back interest.

IRS analysis

The IRS first reviewed where look-back interest is owed by a taxpayer. In this scenario, the IRS determined that the look-back interest is treated under the Code as additional tax. The look-back interest itself would not be eligible for netting, the IRS concluded. However, because an underpayment could result from look-back interest, any interest arising from the underpayment would be eligible for netting because it would be interest payable under subchapter A.

The IRS also reviewed where look-back interest is owed to a taxpayer. The IRS explained that a claim for credit or refund of look-back interest that was not previously paid by the taxpayer is treated as a general, non-tax claim against the government and is not an overpayment because it is not an amount that was previously paid by or collected from the taxpayer. If the taxpayer had previously paid the look-back interest, interest arising from look-back interest owed to the taxpayer would be eligible for interest netting. The look-back interest would be an overpayment, and interest on the overpayment is interest allowable under subchapter B.

Reference: TRC IRS: 33,302.05.

TAX BRIEFS

Jurisdiction

An individual's action seeking a refund of back taxes citing his status as a taxpayer and punitive damages was dismissed for lack of subject matter jurisdiction. The individual had failed to prove that the government waived its sovereign immunity or consented to be sued.

Zammit, DC Mich., 2015-2 USTC ¶50,592; TRC LITIG: 9,254.05

A couple's complaint against the IRS for failure to release tax liens against their property and for damages was dismissed for lack of subject matter jurisdiction. The couple had failed to exhaust their administrative remedies by filing a claim with the IRS before bringing a damages action as required by Code Sec. 7432. Further, the couple did not allege a basis for jurisdiction as to their claim seeking release of the liens.

Galluzzo, DC N.J., 2015-2 USTC ¶50,590; TRC IRS: 48,210.10

A federal district court lacked subject matter jurisdiction over an individual's counterclaims seeking a refund of erroneously or illegally assessed or collected taxes, penalties and interest and to quiet title to real and personal property. The individual had previously filed the same claims and sought the same relief for the same tax years, the dismissal of which was affirmed (CA-10, 2015-2 USTC ¶50,441). Therefore, the individual's claims were barred by the Tenth Circuit's mandate.

LNV Corporation, DC Colo., 2015-2 USTC ¶50,587; TRC LITIG: 3,050

Summonses

The government's petition to enforce an administrative summons issued to a corporation in connection with the corporation's tax liabilities was ordered enforced. The district court found that the government established its *prima facie* case for summons enforcement under *Powell*. The corporation failed to rebut this presumption by showing that the summons was issued in bad faith or that enforcement would result in an abuse of process. The corporation's claim that the IRS's engagement of a law firm as a private contractor to assist the IRS in examination of the corporation's taxes amounted to the IRS's bad faith or improper purpose was without merit.

Microsoft Corporation, DC Wash., 2015-2 USTC ¶50,591; TRC IRS: 21,302

Summary Judgment

An individual was entitled to summary judgment with respect to a refund claim for the sum she paid to the IRS to remove a lien placed on her property, based on her ex-husband's tax debt for the tax year at issue. The court found that the taxpayer had pursued the proper procedures in requesting a certificate of discharge, but the IRS effectively prevented her from satisfying the conditions necessary to obtain one. Further, the IRS did not provide the taxpayer with the necessary information to make a deposit or post a bond in satisfaction of Code Sec. 6325(b)(4). However, the district court denied summary judgment with respect to a claim for damages for the IRS's failure to release the lien on the property under Code Sec. 7432(a).

Streeter, DC Mass., 2015-2 USTC ¶50,589; TRC LITIG: 9052

Income

The CEO and majority shareholder of a family-owned corporation had unreported income from a constructive dividend and was liable for the accuracy-related penalty. The corporation paid his personal expenses and there was no evidence that the payments were meant to be part of the taxpayer's compensation. The taxpayer was liable for the accuracy-related penalty based on substantial understatements of income tax due to negligence. The taxpayer diverted corporate funds to pay personal expenses while improperly deducting those expenses at the corporate level.

Schank, TC, CCH Dec. 60,465(M), FED ¶48,175(M); TRC CCORP: 6,302

Deductions

Members of a limited liability company (LLC) that donated conservation easements on operating golf courses were not entitled to deductions for qualified conservation contributions because the easements did not comply with the "conservation purposes" requirement of the statute. The taxpayers contended that the two easements were "protected natural habitat;" however, the easements did not act as a "wildlife corridor" or "sink" for any species. However, the LLC members reasonably relied on professional advice and, therefore, the court did not impose any accuracy-related penalty.

Atkinson, TC, CCH Dec. 60,466(M), FED ¶48,176(M); TRC INDIV: 51,364

Tax Crimes

The former CEO of an investment firm was sentenced to 27-months imprisonment and one year of supervised release for filing false tax returns. Combining the adjusted offense level with the individual's criminal history resulted in a sentencing guidelines range of 27-33 months. The individual's request for probation was rejected because he failed to present any mitigating explanation for his relevant offense conduct. Therefore, the low-end guidelines sentence with one-year supervised release was sufficient to comply with the purpose of punishment, the court concluded.

Hochstedler, DC Ind., 2015-2 USTC ¶50,586; TRC IRS: 66,202

Two individuals involved in a tax fraud scheme to obtain "early withdrawal of Social Security benefits" were properly convicted and sentenced for making false, fictitious, or fraudulent claims and for conspiring to defraud the government. Any errors were harmless. In addition, one individual's claim that his sentence was procedurally and substantively unreasonable was rejected. The tax loss was properly calculated and the individual was not entitled to a two-level minor-participant reduction.

McGuire, CA-6, 2015-2 USTC ¶50,585; TRC IRS: 66,058.20

PRACTITIONERS' CORNER

Year-End Tax Planning Strategies Available For 2015

As 2015 comes to an end, individuals and businesses still have time to take advantage of traditional planning strategies and new opportunities. Taxpayers can take steps both to reduce their 2015 taxes and to start looking at their 2016 taxes. This Practitioners' Corner looks at both traditional and new techniques for taking action as the calendar year comes to a close.

Extenders

Every year, there are a number of tax provisions that Congress must consider whether to extend for the current year and for future years. This year, Congress continued to discuss comprehensive tax reform, but no action is looming. Congress is also considering whether to make permanent certain extenders provisions, such as the research credit, but concerns about revenue costs have stalled developments.

Current extenders provisions expired at the end of 2014; the latest proposals would extend most, if not all, provisions retroactively for 2015 and for a second year, through 2016. Although these provisions have not yet been enacted at press time, taxpayers can generally rely on their extension for another year or two. If Congress is unable to take action in 2015, it is still likely to approve the extenders provisions early in 2016, effective for 2015, so taxpayers should proceed to act as if the provisions have been extended.

Individuals. For individuals, important extenders include the state and local sales tax deduction (as an alternative to claiming the state and local income tax deduction); the higher education tuition and fees deduction; the teachers' classroom expense deduction ($250, with the potential of being indexed for inflation), and the residential energy property credit. Certain deductions are noteworthy because they are "above the line"; thus qualifying taxpayers can take a deduction even if they claim the standard deduction and do not itemize their deductions.

179 expensing. Extenders provisions are an important aspect of year-end planning for business. Depreciation and "expensing" are key provisions for businesses to reduce their tax liability by taking action before the year expires. Code Sec. 179 expensing has been around for years, but the key is the "enhanced" caps set by Congress for taking write-offs. For 2014 and prior years, businesses could write off $500,000 in qualifying expenditures, with reductions not applicable until expenditures exceeded $2 million. If enhanced caps are not extended for 2015, the limits would fall to $25,000 and $200,000 respectively.

- ***Comment.*** Code Sec. 179 expensing is available for new and used tangible property that is depreciable under Code Sec. 1245 and that is purchased for use in a trade or business. Qualifying property also includes off-the-shelf computer software and certain real property. It is crucial that the property not just be acquired but that it is placed in service by the end of the year.

Bonus depreciation. Businesses can claim bonus depreciation of 50 percent through 2014, and the provision is up for extension through 2015 (and 2016). Bonus depreciation can be elected on the 2015 tax return filed in 2016, as long as the property is purchased and placed in service in 2015. Unlike Section 179 "expensed" property, bonus depreciation can only be claimed if the property is new when placed in service.

- ***Comment.*** Another benefit for taking depreciation and placing property into service is the half-year convention. Even though property is placed in service late in the tax year, the half-year convention allows the taxpayer to claim a full six-months' worth of depreciation in the first year, whether or not bonus depreciation is available or is claimed.

"As 2015 comes to an end, individuals and businesses still have time to take advantage of traditional planning strategies and new opportunities."

Repair regs safe harbor

The "repair regs" for tangible personal property include a very beneficial safe harbor provision for deducting items that have a small cost. The *de minimis* safe harbor allows taxpayers to deduct small dollar expenditures to acquire, produce or improve property. The provision is an election, not an accounting method, so taxpayers can elect to apply the safe harbor one year and decide not to apply it the next year, without having to file for a change in accounting method.

The repair regs provide a threshold of $5,000 for taxpayers with an applicable financial statement (AFS). Initially, the threshold was only $500 for taxpayers without an AFS. However, after hearing from taxpayers and tax professional associations, the IRS raised the threshold for taxpayers without an AFS to $2,500. While the increased threshold is not effective until 2016, the IRS, at the same time, announced that it would not challenge use of the $2,500 threshold in a tax year after 2011 and before 2016.

- ***Comment.*** Although taxpayers do not have to change their accounting method, they must adopt a policy to deduct amounts up to the threshold under their financial accounting (or "book") policy for the year. Generally, this policy must be adopted by the end of the tax year, for application to the succeeding tax year.

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Lawmakers seek to finalize extenders, omnibus

At press time, discussions are ongoing among Congressional Democrats and Republicans and the Obama administration over the size of a tax extenders bill. Lawmakers also are finalizing a fiscal year (FY) 2016 omnibus spending bill. "We want to get it right, we don't want to rush this omnibus appropriations," House Speaker Paul Ryan, R-Wisc., told reporters. House Minority Leader Nancy Pelosi, D-Calif., said that the extenders should not be linked to the omnibus. "I wouldn't vote for an omnibus-extenders bill," Pelosi told reporters.

Some GOP lawmakers have been working to repeal or delay the medical device excise tax and the excise tax on so-called "Cadillac" health insurance plans. According to Congressional staffers, lawmakers are debating a two-year delay in the excise tax on high dollar health plans and a "pause" in the medical device excise tax. The White House previously signalled its opposition to repealing both the excise tax on high dollar health plans and the medical device excise tax. The White House has not indicated its position on delaying the taxes.

On December 11, the House passed a trade bill, the Trade Facilitation and Trade Enforcement Act, which includes two tax-related provisions. The Trade Act would make permanent the temporary moratorium on states and localities taxing Internet access and also provides that if a return is filed more than 60 days after its due date, then the failure to file penalty may not be less than the lesser of $205 or 100 percent of the amount required to be shown as tax on the return. The increased penalty would be effective for returns required to be filed after calendar year 2015. *For continuing coverage of the extenders, omnibus and other year-end tax legislation, see Tax Day on IntelliConnect.*

Bill would nix proposed regs for charities

Sen. Pat Roberts, R-Kansas, has introduced legislation to prevent the IRS from moving forward with final regs that give charitable organizations an alternative method of substantiating contributions through direct reporting. "The rule would provide the IRS detailed information on who is making donations to particular charities," Roberts said in a statement. "There is no assurance that the agency will stop at this voluntary rule and move to make such reporting mandatory."

According to the IRS, there have been misunderstandings and inaccuracies about the proposed regs. Recently, the IRS clarified that the proposed regs would not impose mandatory changes to current rules on how charities substantiate contributions. "Charities could continue doing things as they do now," the agency explained in a statement.

Senate approves church pension plan bill

The Senate on December 11 approved the Church Plan Clarification Act of 2015 (Sen. 2308). The bipartisan measure addresses controlled group rules, grandfathered defined benefit (DB) plans, automatic enrollment, certain transfers, and more of church pension plans. "Many church plans date back to the 18th century. While their unique structures have been recognized by the law, our modern, complicated tax system has not always been accommodating," Sen. Ben Cardin, D-Md., said in a statement. "Our bill will make important reforms to ensure financial security for those who have devoted their lives to faith," Sen. Rob Portman, R-Ohio, added. The House has not taken up a companion bill (HR 4085) on church pension plans.

Grassley lauds reinstatement of private tax collection

Iowa Republican Sen. Charles Grassley said on December 8 that he welcomed passage of the Fixing America's Surface Transportation (FAST) Act, which directs the IRS to contract with private collection agencies to collect some tax debts. "This provision requires the IRS to once again use private contractors to collect overdue taxes that the IRS is not attempting to collect. These are taxes that are owed and not in dispute," Grassley said.

White House announces IRS Oversight Board nominations

The White House has announced that President Obama intends to nominate Alan Kreczko and James White to serve on the IRS Oversight Board. The Board is an independent body charged with overseeing the IRS in its administration, management, conduct, and direction. Board members are appointed by the President and confirmed by the Senate for five-year terms.

Kreczko is a special adviser to the chief executive officer of the Hartford Financial Services Group. Kreczko also has worked for the U.S. State Department and the National Security Council. White has worked at the Government Accountability Office (GAO) and also as an adjunct faculty member at George Mason University, Fairfax, Virgina.

FinCEN highlights enforcement work

Jennifer Shasky Calvery, director of Treasury's Financial Crimes Enforcement Network (FinCEN), highlighted the agency's enforcement activities at a recent meeting of law enforcement professionals. "On average, we receive approximately 55,000 electronically filed BSA reports from more than 80,000 financial institutions and 500,000 individual foreign bank account holders each day," she said.

FinCEN is working with its international and law enforcement partners to combat global cyber threats, Shasky Calvery added. "In recent years, law enforcement has seen an increase in phishing cases against middle to high-value business targets. These are instances where cyber criminals obtain and replicate an enterprises' wire transfer information and send the authenticated data to the compromised company's financial institution. The financial institution then wires the funds to an overseas bank account that the criminals control," she explained.

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Retirement-related planning

Taxpayers may want to consider a number of different provisions in anticipation of retirement, at the point of retirement, or after retirement. Active employees should consider making contributions to an employer-sponsored plan, using elective salary deferrals, particularly if an employer will match the contribution. These plans include 401(k) plans, 403(b) tax sheltered annuities, and 457 state, local and tax-exempt plans. For 2015, the elective salary deferral limit for these plans is the lesser of $18,000 or 100 percent of compensation.

IRAs. Employees and other taxpayers should also consider making contributions to individual retirement accounts (IRAs), whether traditional or Roth IRAs. Contributions to traditional IRAs may be deductible, but payouts of deductible contributions (and earnings) will be taxable. Contributions to a Roth IRA are not deductible, but payouts of qualifying contributions and earnings will not be taxable. Contributions to a traditional IRA can be made up the filing deadline (without extensions) for 2015 returns.

Minimum distribution requirements. Most retirement arrangements (other than Roth IRAs) require that participants begin to take annual payments of benefits in the year they turn age 70 1/2. While distributions generally must be made at the end of the calendar year, distributions for the first year can be delayed until April 1 of the succeeding year. However, the disadvantage of the latter approach is that the participant will receive two distributions in first year of payments (a delayed payment for the first year and the required payment for the second year).

Charitable donations. Another extender provision allows taxpayers age 70 1/2 who are facing required minimum distributions to take a tax-free distribution from their IRA and contribute the funds to a tax-exempt organization. This has the advantage of reducing the taxpayer's gross income and also ensures that the taxpayer will receive a tax benefit from the charitable contribution, whether or not the taxpayer otherwise itemizes deductions and claims a deduction for charitable contributions.

Health insurance. The "individual mandate" is in effect and requires a payment from individuals who do not carry health insurance that qualifies as minimum essential coverage, unless exempt. Many employees receive health coverage from their employer, and most employer policies satisfy the minimum essential coverage requirements. Individuals without adequate coverage may be required to pay a two percent penalty, unless they qualify for an exemption (or dollar minimum, at $325 per adult and capping at $975, is higher). Retiring and retired employees who no longer receive benefits from an employer should pay attention to whether they qualify for Medicare or are enrolled in coverage that satisfies the individual mandate.

ABLE accounts/gift tax

Code Sec. 529A ABLE accounts are tax-favored accounts maintained for beneficiaries who are blind or disabled. The accounts are analogous to qualified tuition plans under Code Sec. 529. Contributions (which must be in cash) to an account are not deductible, but income accrues tax-free in the account, and may be distributed to the beneficiary tax-free if the distribution is used to pay qualified expenses. Contributions can be made up to the amount of the annual exclusion for gifts ($14,000 for 2015; $28,000 for a married couple). However, multiple individuals can contribute to the same account.

Since contributions are limited and the gift tax exclusion does not carryover, it is worthwhile to make the maximum contribution by the end of the year. The gift tax exclusion is also an important device for estate-planning and for income-splitting, allowing donors to make a contribution to one or more persons, especially children or other relatives. The combined contribution for married couples takes on added importance because of Supreme Court decisions requiring that the federal government and the states recognize the validity of same-sex marriages.

Other considerations

Code Sec. 199 deduction. Code Sec. 199 provides business taxpayers with a manufacturing (domestic production activities) deduction of nine percent of qualified production activities income (QPAI). The deduction cannot exceed 50 percent of the W-2 wages paid by the company to its employees for services allocable to the company's domestic production gross receipts (DPGR). A business that is in jeopardy of violating this threshold may want to increase its W-2 wages paid for services provided in 2015. One mechanism for achieving this would be to pay a bonus to an owner-employee.

Year-end payments. It is not necessary to pay cash to make a payment with the goal of attaining a deduction or other tax benefit for 2015. Taxpayers can write a check or can charge an item by credit card and treat these actions as payments. It does not matter, for example, when the recipient receives a check mailed by the payor, when a bank honors the check, or when the taxpayer pays the credit card bill, as long as done "in due course". The same treatment applies for a gift – sending a check is treated as a payment and will qualify for the current year gift tax exclusion.

Capital losses. Cashing out stocks with a built-in loss can be a simple means of providing a loss to be taken against current ordinary income. The law allows individuals to deduct up to $3,000 of additional losses, whether net long-term or short-term capital gain; losses above $3,000 can be carried over and deducted in succeeding years. If the investment is still economically attractive, taxpayers can buy the same stock more than 30 days before or after they sell shares in the same company. This avoids the wash sale rules, which would disallow the loss.

Conclusion

These are just a sample of the year-end tax benefits that are available to taxpayers who take action before January 1, 2016 (or later in some cases). Taxpayers still have time to take advantage of year-end tax planning strategies to maximum their tax benefits for 2015.

COMPLIANCE CALENDAR

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

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

■ **December 28**
Employers depositor Social Security, Medicare, and withheld income tax for December 19, 20, 21 and 22.

■ **December 30**
Employers depositor Social Security, Medicare, and withheld income tax for December 23, 24, and 25.

■ **January 4, 2016**
Employers depositor Social Security, Medicare, and withheld income tax for December 26, 27, 28 and 29.

■ **January 6**
Employers depositor Social Security, Medicare, and withheld income tax for December 30 and 31.

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 Are charities now required to report to the IRS all donations of $250 or more?

A No. Taxpayers must obtain a contemporaneous written acknowledgment from the charitable organization indicating the amount of the cash and a description of any property contributed, whether the charity provided any goods or services in exchange, and, if so, its value. Proposed regs (NPRM REG-138344-13) that would allow a charity to use an alternative method of direct reporting to the IRS are optional and, in any case, not available until final regs are released. Sen. 2370 has been introduced to prevent the IRS from moving forward with this option, in large part because of concerns regarding the privacy of donors' Social Security numbers, as well as the additional burdens eventually placed on charities.*See TRC INDIV: 51,050.*

Q When hotel guests complete their stay, their deposits are recognized as income. The hotel has not been taking the deposit by no-shows into income since their requests for refunds for are accommodated. Assume that the hotel wants to change to the deferred method of reporting income from deposits (it appears they can use automatic change number 84). Can the hotel take the Code Sec. 481(a) adjustment into income ratably over a four-year period?

A The net adjustment required because of change in accounting methods generally must be included in the year of change. However, a taxpayer is permitted to spread certain adjustments over a period of years so as to avoid the pyramiding of income in a single year. For requests filed after May 14, 1997, the adjustment may be spread ratably over four years. For further information, see *TRC: ACCTNG: 21,152, ACCTNG: 21,154, ACCTNG: 21,158, ACCTNG: 21,158.05, and ACCTNG: 21,162.05.*