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HIGHLIGHTS

IRS issues final regs eliminating & modifying exceptions to coordination rule. IRS has issued final regs, generally adopting temporary regs issued in 2013, that eliminate an exception to the coordination rule between asset transfers and indirect stock transfers for certain outbound asset reorganizations. The final regs also modify another exception to that rule for Code Sec. 351 exchanges and make certain changes with respect to transfers of stock or securities by a domestic corporation to a foreign corporation in a Code Sec. 361 exchange.

CA 7 affirms; corporation's welfare benefit fund was a listed transaction. The Court of Appeals for the Seventh Circuit, affirming a district court opinion, has held that an S corporation participated in a 10-or-more employer welfare benefit fund that was the same as or substantially similar to the arrangement described in Notice 95-34, 1995-1 CB 309, a listed transaction, and thus was required to file a disclosure form with respect to the transaction.

Applying Supreme Court's standards, CA-11 finds no IRS bad faith and enforces summonses. The Court of Appeals for the Eleventh Circuit, affirming a district court case heard on remand, has applied standards provided by the Supreme Court and held that taxpayers who received IRS summonses did not make a showing of facts that gave rise to a plausible inference of improper motive on the part of IRS. Therefore, the Court held that the taxpayers could not examine an IRS employee's motives for issuing the summons and enforced the summons.

Residency and presence tests for 2015 foreign income/housing exclusions waived for Burundi. In a Revenue Procedure, IRS has waived the residency and presence tests that apply for purposes of the Code Sec. 911 foreign earned income and foreign housing cost exclusions with respect to certain U.S. individuals in Burundi, due to adverse conditions in that country beginning on May 14, 2015.

Blue Book on 2015 legislation explains "election out" of revised partnership audit rules. The staff of the Joint Committee on Taxation has published a "General Explanation of Tax Legislation Enacted in 2015," also known as the "Blue Book." This article highlights the Blue Book's guidance on an area of particular interest to practitioners: when "smaller" partnerships can elect out of the revised partnership audit rules enacted by the Bipartisan Budget Act of 2015.

IRS discusses application of residual profit-split method to outbound IP transactions. IRS has released a new international practice unit (IPU) illustrating the application of a specific transfer pricing method, the residual

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profit-split method (RPSM), to a transaction where a U.S. parent corporation (USP) licenses certain intangible property (IP) to its controlled foreign corporation (CFC) in exchange for royalty payments. Among other things, it explains to IRS examiners how to determine when the RPSM is the "best method" (i.e., the one that provides the most reliable measure of an arm's-length result) under the Code Sec. 482 rules.

No theft loss or bad debt deduction for taxpayer's seemingly bad investment. The Tax Court has held that a taxpayer's investments in and loans to a rather questionable business venture of an acquaintance did not qualify for a theft loss deduction because she didn't prove that her acquaintance made false representations. The taxpayer also did not qualify for a bad debt deduction because she didn't show that she lacked a reasonable chance of recovery.

Fraud penalties upheld against auto dealer who failed to report misappropriated funds. The Tax Court has determined that a former auto dealer and his wife failed to report funds that were misappropriated from various businesses that he was involved with, weren't entitled to claim pass-through losses in respect to entities in which he had no basis, and were liable for fraud penalties for each of the years at issue.

Sixth Circuit approves sale of home to satisfy one spouse's tax liability. The Court of Appeals for the Sixth Circuit, affirming a district court, has concluded that IRS could enforce its tax lien and sell the primary residence owned by the taxpayer and her tax-delinquent husband. The Court rejected the argument of the taxpayer, who did not owe any unpaid taxes, that the district court should have allowed IRS to sell only her husband's interest in the property.

Unresolved questions of fact surrounded purported alimony agreement including choice of law. The Court of Federal Claims denied both IRS's motion to dismiss for failure to state a claim for which relief could be granted, and the taxpayer's motion for summary judgment, in a refund suit. Although the taxpayer showed sufficient facts to plausibly allege that a 2007 payment was deductible alimony under the relevant law, there remained genuine disputes about the facts—not the least of which was whether the relevant law was that of New York or the United Kingdom (U.K.)—that could not be resolved without a trial.

Taxpayers' "rollover as business startup" account wasn't valid retirement plan. The Court of Federal Claims has denied taxpayers' claim for refund, rejecting their argument that their Individual Retirement Account (IRA) withdrawals were nontaxable distributions that were rolled over into a "Business Owners Retirement Savings Account," or BORSA—essentially, a variation of a "rollover as business startup" (ROBS) account. The Court found that, because there was no written plan in existence under which the IRA distributions were reinvested, the arrangement couldn't be a qualified trust under Code Sec. 401.

IRS must provide taxpayers a pre-assessment determination of responsible person penalty. The Court of Appeals for the Eleventh Circuit, vacating and remanding a Tax Court decision, has held that Code Sec. 6672(b)(3)(B)—which provides for an extension of the statute of limitations on assessment where the taxpayer protests IRS's preassessment determination of liability with respect to the responsible person penalty—in combination with regs, requires IRS to issue such a preassessment determination of liability.

Gift tax return filed as part of settlement can't escape late payment interest rules. The Tax Court has held that an estate's agreement to file a gift tax return and pay the gift tax due with that return, as part of a settlement with IRS that reduced IRS's proposed estate tax deficiency, did not prevent late payment interest from accruing with respect to the gift tax.

Estate wasn't insolvent on distribution date, so executor not liable for unpaid taxes. The Tax Court has held that amounts that state law required estate beneficiaries to contribute towards the estate's taxes had to be considered as estate assets for purposes of determining whether the estate was insolvent and that, as a result, the estate was not insolvent. Accordingly, the executor of the estate was not liable, under 31 USCS 3713(b), the federal priority statute, for the unpaid portion of the estate taxes imposed on the estate.

IRS correction; overpayment and underpayment rates increase 1% for second quarter, 2016. IRS has announced that the interest rates for tax overpayments and underpayments will increase by one percentage point for the second quarter of 2016.

Applicable Federal Rates for April. The Applicable Federal Rates for April 2016 have been released.

Disaster victims in Texas and Louisiana qualify for tax relief. IRS has announced on its website that victims of the severe storms, tornadoes, and flooding in counties of Texas that are designated as federal disaster areas qualifying for individual assistance, as well as additional victims of severe storms and flooding in parts of Louisiana that are also designated as federal disaster areas, have more time to make tax payments and file returns. Certain other time-sensitive acts also are postponed. This article summarizes the relief that's available and includes up-to-date disaster area designations and extended filing and deposit dates for all areas affected by storms, floods and other disasters in 2016.

Practice Alert: Important date approaching in 2016 for older clients with IRAs and qualified plan accounts. A critical date is approaching for many clients who attained age 70½ in 2015. By Apr. 1, 2016, these clients must commence making required minimum distributions (RMDs) from their regular IRAs. Also, a participant in a qualified retirement plan (e.g., 401(k) plan) must begin taking distributions by Apr. 1 of the calendar year following the later of the year in which he: (a) reaches age 70½, or (b) retires (except for 5% owners, who are subject to the same rules as IRA owners).

RIA Tax Watch 2016. FY 2017 budget introduced by House Budget Committee.

Washington Alert—Part I. House Appropriations Committee chairman rebuffs Treasury Secretary Lew's appeal for $1 billion IRS budget increase; IRS to conduct March 30 Affordable Care Act-related webinar addressing applicable large employers information return requirements; and Transactional Records Access Clearinghouse report says IRS auditing of big corporations plummets.

Washington Alert—Part II. TIGTA says it is making progress in battle against telephone scammers but warns taxpayers to stay on high alert; GAO reports claims for the small employer health insurance tax credit fall far short of expectations; and JCT publishes document on cash-flow and consumption-based approaches to taxation.

WG&L Journal Insights

EU succession Reg. can affect non-member state nationals. The ownership of assets in a European Union member state can implicate recent EU succession regulations, as discussed in this Estate Planning article.

Limit unwanted spousal asset rights in estate plans. Statutory spousal rights can thwart intended asset dispositions, but planning can reduce or eliminate the unwanted impact, as discussed in this Estate Planning article.

International estate planning for the domestic lawyer. This Estate Planning article discusses how knowing the questions to ask and forms to file helps practitioners service clients with estate planning issues that reach beyond U.S. borders.

Filing Form 709 beyond the basics of gift tax returns. This Estate Planning article discusses how a properly completed Form 709 can start the statute of limitations running and provide other advantages too, even if no tax is due with the return.

Dilemma for trustee when beneficiary has addiction. This Estate Planning article discusses how a trustee of a discretionary trust can be in a tough spot when determining distributions for a primary beneficiary who is addicted to drugs or alcohol.

District court in Santander upholds a STARS transaction, disagrees with other courts. In a well-reasoned opinion, the Massachusetts federal district court has broken the government's string of STARS transaction victories, which means the STARS saga is likely to continue, as discussed in this Journal of Taxation article.

Children with foreign accounts: unexpected tax, Schedule B, Form 8938, and FBAR issues. Parents must have a clear understanding of resolution options if they learn that their children had inadvertent foreign account noncompliance with the IRS, as discussed in this Journal of Taxation article.

Final regulations revise rules on grants to foreign charities by private foundations. This Journal of Taxation article discusses how the final regulations provide guidance to foundations in making a good faith determination that a foreign charity is the equivalent of a U.S. public charity and, therefore, that a grant to the charity will be considered a qualifying distribution under Section 4942 and not a taxable expenditure under Section 4945.

A fix too fast: anomalies in the new legislation on partnership tax audits. This Journal of Taxation article discusses how new rules providing for auditing and adjusting income tax liabilities of partnerships and partners. though riddled with apparent anomalies, nevertheless make it necessary for partnerships to review their partnership agreements.

IRS issues final regs eliminating & modifying exceptions to coordination rule

Reg § 1.367(a)-3, 03/18/2016; Reg § 1.367(a)-6, 03/18/2016; Reg § 1.367(a)-6T, 03/18/2016; Reg § 1.1248(f)-3, 03/18/2016; Reg § 1.6038B-1, 03/18/2016

IRS has issued final regs, generally adopting temporary regs issued in 2013, that eliminate an exception to the coordination rule between asset transfers and indirect stock transfers for certain outbound asset reorganizations. The final regs also modify another exception to that rule for Code Sec. 351 exchanges and make certain changes with respect to transfers of stock or securities by a domestic corporation to a foreign corporation in a Code Sec. 361 exchange.

Background on Code Sec. 367(a)(1)'s gain recognition rule. Subject to exceptions, if a U.S. person transfers property to a foreign corporation in connection with an exchange described in Code Sec. 332, Code Sec. 351, Code Sec. 354, Code Sec. 356, or Code Sec. 361 (i.e., certain exchanges that would otherwise be tax-free), the foreign corporation is not treated as a corporation for purposes of determining the extent to which gain is recognized on the transfer. (Code Sec. 367(a)(1)) As a result, certain transfers of property to a foreign corporation that would otherwise be tax-free are treated as taxable exchanges.

observation: The purpose of the Code Sec. 367(a)(1) rule is to prevent taxpayers from avoiding U.S. taxes by removing appreciated assets from the U.S. taxing jurisdiction.

Under current final regs, in order for an outbound transfer of stock and securities in a Code Sec. 361 exchange (essentially, an asset reorganization in which a corporation transfers assets in exchange for stock or securities) to avoid Code Sec. 367(a)(1)'s gain recognition rule, several conditions must be satisfied. Among those conditions are: Code Sec. 367(a)(5) (and any regs thereunder) must be satisfied, and any control group member (defined in Reg § 1.367(a)-7(f)) owning (with attribution) 5% or more of the stock of the transferee foreign corporation immediately after the transaction, by vote or value, must enter into a gain recognition agreement (GRA) with respect to the control group member's share of the gain, based on its ownership interest in the U.S. transfer. (Reg § 1.367(a)-3(e)) This is referred to as the "GRA requirement."

Background on the coordination rule. Certain outbound reorganizations followed by transfers to controlled corporations, and certain successive transfers of property to which Code Sec. 351 applies, constitute "indirect stock transfers" and are subject to gain recognition under Code Sec. 367(a)(1), unless an exception applies. (Reg § 1.367(a)-3(d)(1)) To avoid having these transactions be potentially analyzed and taxed as both stock and asset transfers, the coordination rule in Reg § 1.367(a)-3(d)(2)(vi)(A) generally provides that if, in connection with an indirect stock transfer, a U.S. person (U.S. transferor) also transfers assets to a foreign corporation (foreign acquiring corporation) in an exchange described in Code Sec. 351 or Code Sec. 361, Code Sec. 367 applies first to the asset transfer and then to the indirect stock transfer. In other words, Code Sec. 367(a) and Code Sec. 367(d) (which provides special rules for transfers of intangibles) apply to the transfer of assets before application of the indirect stock transfer rules of Reg § 1.367(a)-3(d). (Reg § 1.367(a)-3(d)(2)(vi))

The coordination rule, however, was subject to three exceptions. Two such exceptions provided that Code Sec. 367(a) and Code Sec. 367(d) don't apply to any assets transferred by a domestic acquired corporation to a foreign acquiring corporation in an asset reorganization that are re-transferred to a domestic corporation that is controlled by the foreign acquiring corporation (domestic controlled corporation). The first of these exceptions, the "Code Sec. 367(a)(5) exception," applied if: (i) the domestic controlled corporation's basis in the re-transferred property is no greater than the basis the U.S. transferor had in the property (the "basis comparison test"); and (ii) the conditions described in Reg § 1.367(a)-3(d)(2)(vi)(B)(1)(i) were satisfied. The second such exception, the "indirect domestic stock transfer exception," applied if (i) the basis comparison test was met; and (ii) the conditions in Reg § 1.367(a)-3(d)(2)(vi)(B)(1)(ii) were satisfied.

The third exception (the "Code Sec. 351 exception") applies if a U.S. person transfers assets to a foreign corporation in a Code Sec. 351 exchange, to the extent that such assets are transferred by such foreign corporation to a domestic corporation in another Code Sec. 351 exchange. (Reg § 1.367(a)-3(d)(2)(vi)(B)(2)) Like the Code Sec. 367(a)(5) and indirect domestic stock transfer exceptions, the basis comparison test must also be met in order for this exception to apply.

2013 temporary regs. In 2013, IRS issued temporary regs (TD 9615) that eliminated one of the two exceptions to the coordination rule between asset transfers and indirect stock transfers for certain out-

bound asset reorganizations. The temporary regs also modified the Code Sec. 351 exception so that it is consistent with the remaining outbound asset reorganization exception. The 2013 temporary regs also addressed the transfer of stock or securities by a domestic corporation to a foreign corporation in a Code Sec. 361 exchange, as well as modified, in various contexts, procedures for obtaining relief for failures to satisfy certain reporting requirements. (See Weekly Alert, 03/21/2013.) A portion of the 2013 temporary regs modifying the procedures for obtaining relief relating to reporting requirements was subsequently amended and removed by TD 9704 in November of 2014. (See Weekly Alert, 11/20/2014.)

New final regs. The new final regs largely adopt the 2013 temporary regs without change. In so doing, IRS rejected a commenter's request to liberalize the "basis comparison test," citing concerns that the coordination rule exceptions could be used to inappropriately reduce U.S. tax. by shifting gain or income to a foreign corporation. IRS noted that, even if that gain or income is subject to U.S. tax, the U.S. transferferor may nonetheless be able to use the foreign corporation's tax attributes to inappropriately reduce or offset that gain or income. (TD 9760)

Accordingly, the final regs:

. . . *Eliminate the Code Sec. 367(a)(5) exception.* IRS noted in TD 9615 that it had become aware of certain transactions involving outbound asset reorganizations and the repatriation of a foreign corporation's earnings and profits where taxpayers took the position that, under the Code Sec. 367(a)(5) exception, the transaction didn't require the recognition of gain or a dividend inclusion. IRS determined at that time that the Code Sec. 367(a)(5) exception was no longer appropriate and has now finalized its elimination. (The indirect domestic stock transfer exception, however, remains valid.)

. . . *Modify the basis comparison rule for the Code Sec. 351 exception.* The final regs adopt the modifications to the basis comparison rule in the Code Sec. 351 exception to provide that, for purposes of determining whether the domestic transferee's basis in the assets is not greater than that of the U.S. transferor, any increase in basis that results from gain recognized by the U.S. transferor with respect to such assets in the initial Code Sec. 351 exchange isn't taken into account. (Reg § 1.367-3(d)(2)(vi)(B)(1)(i)) This modification makes the basis comparison rule in the Code Sec. 351 exception consistent with the rule in the indirect domestic stock transfer exception.

. . . *Modify the GRA requirement for potential exclusion from Code Sec. 367(a)(5).* The GRA requirement is modified to provide that the 5% ownership threshold is determined by reference to the U.S. transferor's ownership of the transferee foreign corporation, rather than ownership of the transferee foreign corporation by control group members. (Reg § 1.367-3(e)(4)) Ownership is determined immediately after the U.S. transferor's transfer of the stock or securities to the transferee foreign corporation in the Code Sec. 361 exchange. (Reg § 1.367-3(e)(4))

If the U.S. transferor meets the 5% threshold, then two conditions must be satisfied in order to file a GRA: (i) each shareholder of the U.S. transferor that is a "qualified U.S. person" (i.e., any U.S. person except domestic partnerships or special corporate entities that are not subject to tax, (Reg § 1.367(e)-3(e)(vii))) and satisfies the 5% test must enter into a GRA unless the amount of gain that would otherwise be subject to the GRA is zero; and (ii) the U.S. transferor must recognize gain realized on the transferred stock or securities attributable to 10 shareholders that are not qualified U.S. persons or do not satisfy the 5% ownership threshold. (Reg § 1.367(e)-3(e)(iii))

. . . *Coordinate gain recognition rules.* IRS has finalized a conforming modification that was made by the temporary regs providing that previously deducted branch losses are to be reduced by any gain recognized pursuant to Code Sec. 367(a)(1) upon the transfer of the assets of the foreign branch to the foreign corporation. (Reg § 1.367(a)-6(e)(4).)

. . . *Reasonable cause.* IRS also finalized the procedures for requesting relief for failure to comply with any requirement under Reg § 1.1248(f)-2 (i.e., various reporting and other requirements relating to the requirement for U.S. stockholders to include in income a deemed dividend on the sale or exchange of stock in a foreign corporation if certain requirements are met) and how to establish reasonable cause for such failure. (Reg § 1.1248(f)-3(a)) Similar procedures are provided for failures to comply with any requirement of Code Sec. 6038B (which sets out reporting requirements for certain transfers from U.S. persons to foreign persons) and its regs. (Reg § 1.6038B-1(f)(3))

Effective dates. The final regs are generally effective on Mar. 22, 2016. However, the reasonable cause

procedures under Reg § 1.1248(f)-3(a) apply to distributions occurring on or after Apr. 17, 2013.

References: For transfers to foreign corporations, see Federal Tax Coordinator 2d and RIA's Analysis of Federal Taxes: Income at ¶ F-6000; U.S. Tax Reporter: Income at ¶ 3674; RIA's Tax Guide at ¶ 4925.

CA 7 affirms; corporation's welfare benefit fund was a listed transaction

Vee's Marketing, Inc., (CA7 3/14/2016) 117 AFTR 2d ¶ 2016-512

The Court of Appeals for the Seventh Circuit, affirming a district court opinion, has held that an S corporation participated in a 10-or-more employer welfare benefit fund that was the same as or substantially similar to the arrangement described in Notice 95-34, 1995-1 CB 309, a listed transaction, and thus was required to file a disclosure form with respect to the transaction.

Background. Under Code Sec. 6707A and Reg § 1.6011-4(a), a taxpayer must file a Form 8886, Reportable Transaction Disclosure Statement, if it "participated" in a "listed transaction." Reg § 1.6011-4(b)(2) provides that "[a] listed transaction is a transaction that is the same as or substantially similar to one of the types of transactions that IRS has determined to be a tax avoidance transaction and identified by notice, reg, or other form of published guidance as a listed transaction."

A taxpayer has "participated in a listed transaction" if the taxpayer's tax return reflects tax consequences or a tax strategy described in the published guidance that lists the transaction. A taxpayer also has participated in a listed transaction if the taxpayer knows or has reason to know that the taxpayer's tax benefits are derived directly or indirectly from tax consequences or a tax strategy described in published guidance that lists a transaction. (Reg § 1.6011-4(c)(3)(i)(A))

Code Sec. 419 limits the amount that a taxpayer may deduct for contributions to a welfare benefit plan. This limit does not apply to any welfare benefit plan which is part of a "ten-or-more employer plan" (except that it does apply to plans that maintain experience-rating arrangements for the individual employers). (Code Sec. 419A(f)(6))

Notice 95-34 provides that certain sets of transactions, including an employer joining a trust arrangement that purports to satisfy the requirements for the tax exemption in Code Sec. 419A(f)(6) for plans with contributions from 10 or more employers, do not meet those requirements. It says that these arrangements typically are invested in variable life or universal life insurance contracts on the lives of the covered employees, but require large employer contributions relative to the cost of the amount of term insurance that would be required to provide the death benefits under the arrangement.

Notice 95-34 notes a number of warning signs that should suggest caution, including plans in which the trust owns the insurance contracts; the trust administrator may obtain the cash to pay benefits, other than death benefits, by such means as cashing in or withdrawing the cash value of the insurance policies; most participants and their beneficiaries will receive their benefits (even though benefits may appear to be contingent on the occurrence of unanticipated future events); and the trust maintains separate accounting of the assets attributable to the contributions made by each subscribing employer. Thus, pursuant to formal or informal arrangements or practices, a particular employer's contributions or its employees' benefits may be determined in a way that insulates the employer to a significant extent from the experience of other subscribing employers.

Notice 95-34 does not identify the conduct that it discusses as a "listed transaction" or a "tax avoidance transaction." IRS had not introduced the concept of "listed transactions" when it issued that notice. However, Notice 2000-15, 2000-1 CB 826, includes Notice 95-34 as a listed transaction.

Facts. S corporation, Vee's Marketing, Inc., was owned by Scott Vee. Vee's Marketing enrolled in a plan promoted by CJA and Associates called CJA Trust, which was a 10-or-more multiple employer welfare benefit fund in which Vee's Marketing's payments into the fund would reduce the amount of Scott Vee's income subject to taxes and provide him term insurance plus a paid up $1 million of life insurance that could, if he wished, be used upon retirement for reimbursement of medical expenses. The money that participating employers paid into CJA Trust bought insurance for only their own employees; there was no pooled risk.

Vee's Marketing made its first contribution to the CJA Trust in December 2004, in the amount of $145,000, plus $1,250 for fees. CJA used $5,400 of the contribution to pay for one year of term insurance on Scott Vee's life; the remainder went into an account (i.e., the accumulation account) to fund Scott Vee's pre- and post-retirement death benefit.

On audit, IRS determined that Vee's Marketing was required to file a Form 8886 and assessed it $10,000 penalties for each of the tax years 2004 through 2007 under Code Sec. 6707A because it had not filed that form.

First district court case. In October of 2014, a district court held that Notice 95-34 was "published guidance" for purposes of the rules that require taxpayers to file a disclosure form if they participate in a listed transaction. (*Vee's Marketing, Inc. v. U.S., (DC WI 2014) 114 AFTR 2d 2014-6294*)

Second district court case. In a second district court case (*Vee's Marketing, Inc. v. U.S., (DC WI 2015) 115 AFTR 2d 2015-1873*; Weekly Alert, 05/28/2015), the district court found that Vee's Marketing failed to show that the CJA Trust wasn't the same or substantially similar to the arrangement described in Notice 95-34. The evidence showed that CJA Trust was an aggregation of separate plans maintained for individual employers that were experience-rated with respect to individual employers—that is, they were structured so as to assure each employer that its contributions would benefit only its own employees.

Appeals Court affirms. The Seventh Circuit has now affirmed the holding of the second district court case, noting that any benefit plan that allows Scott Vee to convert tax-free contributions to guaranteed payments for either himself or his beneficiaries was a listed transaction within the meaning of Notice 95-34.

References: For listed transaction (and reportable transaction) reporting requirements, see Federal Tax Coordinator 2d and RIA's Analysis of Federal Taxes: Income at ¶ S-4400; U.S. Tax Reporter: Income at ¶ 61,114; Tax Desk at ¶ 817,000; RIA's Tax Guide at ¶ 71807.

Applying Supreme Court's standards, CA-11 finds no IRS bad faith and enforces summonses

Clarke, (CA 11 3/15/2016) 117 AFTR 2d ¶ 2016-514

The Court of Appeals for the Eleventh Circuit, affirming a district court case heard on remand, has applied standards provided by the Supreme Court and held that taxpayers who received IRS summonses did not make a showing of facts that gave rise to a plausible inference of improper motive on the part of IRS. Therefore, the Court held that the taxpayers could not examine an IRS employee's motives for issuing the summons and enforced the summons.

Background. IRS may examine books, papers, records or other data, for purposes of ascertaining the correctness of any return, making a return if none has been made, determining the tax liability of any person, and collecting that liability. (Code Sec. 7602(a)(1)) IRS may issue a summons to the taxpayer or certain third parties it feels may be able to assist in determining the taxpayer's tax liability. (Code Sec. 7602(a)(2))

If a taxpayer does not comply with a summons, IRS may bring an enforcement action in district court. (Code Sec. 7402(b), Code Sec. 7604(a))

To have a summons enforced, IRS must make a 4-step prima facie showing that: (1) the investigation will be conducted pursuant to a legitimate purpose; (2) the inquiry may be relevant to the purpose; (3) the information sought is not already within IRS's possession; and (4) the administrative steps required by the Code have been followed. (*U.S. v. Powell, (S Ct 1964) 14 AFTR 2d 5942*) Once IRS makes its prima facie showing, the burden shifts to the party opposing the summons to either (1) disprove one of the four elements of IRS's prima facie case, or (2) convince the court that enforcement of the summons would constitute an abuse of the court's process.

Under the pre-2018 unified partnership audit (TEFRA) rules, the tax treatment of any partnership item (and the applicability of any penalty, addition to tax, or additional amount that relates to an adjustment to a partnership item) is generally determined at the partnership level. (Code Sec. 6221) If IRS decides to adjust any partnership items, it must notify the individual partners through a final partnership administrative adjustment (FPAA). (Code Sec. 6226)

Facts. The summons dispute in this case arose from an IRS examination of the tax returns of Dynamo Holdings Limited Partnership (Dynamo) for the 2005–2007 tax years. As its investigation proceeded, IRS persuaded Dynamo to agree to two year-long extensions of the usual 3-year limitations period for assessing tax liability. In 2010, with that period again drawing to a close, Dynamo refused to grant IRS a third extension. Shortly thereafter, IRS issued summonses to the taxpayers here, four individuals associated with Dynamo. None of the taxpayers complied with those summonses.

IRS instituted proceedings in district court to compel the taxpayers to comply with the summonses. IRS submitted an investigating agent's affidavit attesting to the *Powell* factors. In reply, the taxpayers pointed to

circumstantial evidence that, in their view, suggested the following "ulterior motives":

. . . First, the taxpayers asserted that IRS issued the summonses to punish Dynamo for refusing to agree to a further extension of the applicable statute of limitations. More particularly, they stated that immediately after Dynamo declined to grant a third extension, IRS, "despite having not asked for additional information for some time . . . suddenly issued" the summonses.

. . . Second, the taxpayers said that IRS decided to enforce the summonses, subsequent to IRS issuing an FPAA to Dynamo and Dynamo's filing suit in Tax Court, to evade the Tax Court's limitations on discovery and thus gain an unfair advantage in that litigation. In support of that charge, the taxpayers submitted an affidavit from the attorney of another Dynamo associate who had chosen to comply with a summons issued at the same time. The attorney reported that only IRS attorneys handling the Tax Court case, and not the original investigating agents, were present at the interview of his client.

In light of those submissions, the taxpayers asked for an opportunity to question the agents about their motives.

The district court denied that request. (*Clarke, (DC FL 2012) 111 AFTR 2d 2013-1697*) The Court of Appeals for the Eleventh Circuit reversed. (*Clarke, (CA11 2013) 111 AFTR 2d 2013-1700)*

But, the Supreme Court vacated and remanded the Appeals Court decision. (*Clarke (S Ct 2014) 113 AFTR 2d 2014-2483*; see Weekly Alert, 06/26/2014) It noted that every other Court of Appeals that has decided the issue—i.e., the First, Third, Seventh and Ninth Circuits—has rejected the Eleventh Circuit's view that a bare allegation of improper motive entitles a person objecting to an IRS summons to examine the responsible officials. It held that, where the issue is a summons's validity, a taxpayer is entitled to examine an IRS agent when he can point to specific facts or circumstances plausibly raising an inference of bad faith.

The Appeals Court then remanded to the district court, which found that none of the grounds on which the taxpayers challenged the IRS summons were improper as a matter of law. In addition, the district court found that none of the taxpayers' submissions showed facts giving rise to a plausible inference of improper motive regarding issuance of the summons. Accordingly, the district court denied the taxpayers' request for an evidentiary hearing and enforced the summonses. (*Clarke, (DC FL 2015) 115 AFTR 2d 2015-836*)

Appeals Court affirms latest district court holding and enforces the summons. The Appeals Court agreed with the district court's decision, on remand, that the taxpayers had not met the Supreme Court's standards for examining IRS's motives in issuing the summonses, and the Court therefore enforced the summonses.

As to the taxpayers' first argument (see Background above), the Court said that the taxpayers did not raise a plausible inference of improper motive. First, it said, the submission that the timeline of the issuance of the summonses supported an inference of retaliation by IRS required substantial conjecture that was both implausible and unsupported by the record. Further, none of the taxpayers' submissions suggested that the summonses were issued in bad faith anticipation of Tax Court proceedings rather than in furtherance of the IRS Agent's investigation.

The Court found the taxpayers' second argument unpersuasive because it ignored the taxpayers' statutory duty to comply with the summonses and overstated the impact of an FPAA on IRS's investigatory authority. Code Sec. 6230(h) provides, "Nothing in this subchapter [i.e., TEFRA] shall be construed as limiting the authority granted to the [IRS] under Code Sec. 7602." The issuance of an FPAA does not render a later summons illegitimate. (*Sugarloaf Funding, LLC, (CA 1 2009) 104 AFTR 2d 2009-6737*) Because neither the issuance of the FPAA nor the initiation of a challenge in the Tax Court affected IRS's investigatory authority under Code Sec. 7602, the taxpayers failed to rebut IRS's prima facie showing under *Powell* to bar enforcement of the summonses. The fact that IRS could conceivably attempt to introduce evidence from these summonses in the pending tax litigation did not rise to the level of an abuse of process contemplated by *Powell.* It was the domain of the Tax Court to control discovery in the pending tax litigation.

The Court also stated that issuing a summons only to retaliate against a taxpayer would be improper as a matter of law. And, it said that it would clearly be an improper purpose for IRS to issue a summons in bad faith outside a legitimate investigation, with the sole motive of circumventing Tax Court discovery. However, it said, given courts' deference to IRS's broad authority to investigate, the circumstances under which a taxpayer could successfully allege improper circumvention of tax discovery are exceptionally narrow.

References: For IRS's power to enforce summonses, see Federal Tax Coordinator 2d and RIA's Analysis of Federal Taxes: Income at ¶ T-1212; U.S. Tax Reporter: Income at ¶ 76,024; Tax Desk at ¶ 822,001; RIA's Tax Guide at ¶ 70051.

Residency and presence tests for 2015 foreign income/housing exclusions waived for Burundi

Rev Proc 2016-21, 2016-14 IRB

In a Revenue Procedure, IRS has waived the residency and presence tests that apply for purposes of the Code Sec. 911 foreign earned income and foreign housing cost exclusions with respect to certain U.S. individuals in Burundi, due to adverse conditions in that country beginning on May 14, 2015.

Background. Code Sec. 911(a) and Code Sec. 911(c)(4) allow a "qualified individual," as defined in Code Sec. 911(d), to exempt from taxation the individual's foreign earned income and the housing cost amount.

A qualified individual is an individual whose tax home is in a foreign country and who is either:

(1) a U.S. citizen (or, in certain situations, U.S. resident alien) who satisfies IRS that he has been a bona fide resident of one or more foreign countries for an uninterrupted period that includes an entire tax year (bona fide foreign residence test), or

(2) a U.S. citizen or resident who, during a period of 12 consecutive months, is present in one or more foreign countries for at least 330 full days (foreign physical presence test). (Code Sec. 911(d)(1))

Under certain circumstances, the time requirements of the foreign residence test and the foreign presence test may be waived. If these requirements are waived, the taxpayer is treated as having met the foreign residence requirement for the period during which he was a bona fide resident of the foreign country, or he will be treated as having met the foreign presence requirement for the period during which he was present in the foreign country. He will be so treated even though the relevant time requirement has not been met.

Three conditions must be met for the waiver to apply:

(1) The individual actually must have been a bona fide resident of, or present in, a foreign country for a period of time.

(2) Before he meets the time requirements for the foreign residence test or the foreign presence test, he must leave the foreign country during a period in which IRS determines, after consultation with the State Department, that individuals had to leave the foreign country because of war, civil unrest or similar adverse conditions in that country which prevented the normal conduct of business by those individuals.

(3) He must establish to IRS's satisfaction that he could reasonably have been expected to meet the time requirements but for the war, civil unrest or similar adverse conditions. (Code Sec. 911(d)(4))

Waiver of requirements for 2015. For 2015, IRS, in consultation with the Secretary of State, has determined that war, civil unrest, or similar adverse conditions precluded the normal conduct of business in Burundi beginning on May 14, 2015.

Accordingly, for purposes of Code Sec. 911(d)(1), an individual who left Burundi on or after May 14, 2015 will be treated as a qualified individual with respect to the period during which that individual was present in, or was a bona fide resident of, Burundi, if the individual establishes a reasonable expectation of meeting the requirements of Code Sec. 911(d) but for those conditions.

To qualify for relief under Code Sec. 911(d)(4), an individual must have established residency, or have been physically present, in Burundi on or before May 14, 2015 (i.e., the date that IRS determined that individuals were required to leave the country).

Individuals who establish residency, or are first physically present, in Burundi on or after May 14, 2015 will not be treated as qualified individuals under Code Sec. 911(d)(4).

References: For waivers of the time requirements for foreign residency or presence, see Federal Tax Coordinator 2d and RIA's Analysis of Federal Taxes: Income at ¶ O-1273; U.S. Tax Reporter: Income at ¶ 9114.03; Tax Desk at ¶ 191,511; RIA's Tax Guide at ¶ 30170.

Blue Book on 2015 legislation explains "election out' ' of revised partnership audit rules

The staff of the Joint Committee on Taxation (JCT) has published a "General Explanation of Tax Legislation Enacted in 2015," also known as the "Blue Book." It contains helpful explanations on 13 different laws carrying tax changes, and is especially valuable for its

coverage of many laws that were passed without a formal committee report or other "official" explanation of their tax provisions. This article highlights the Blue Book's guidance on an area of particular interest to practitioners: when "smaller" partnerships can elect out of the revised partnership audit rules enacted by the Bipartisan Budget Act of 2015 (P.L. 114-74, 11/2/2015).

Background. Under the currently applicable TEFRA unified partnership audit rules, the tax treatment of any partnership item (and the applicability of any penalty, addition to tax, or additional amount that relates to an adjustment to a partnership item) is generally determined at the partnership level. However, the unified audit rules don't apply to any partnership having 10 or fewer partners, each of whom is an individual (other than a nonresident alien), a C corporation, or an estate of a deceased partner, unless the partnership elects to have them apply. Simplified audit procedures apply to large partnerships with 100 or more partners that elect to be treated as electing large partnerships for reporting and audit purposes. Under these electing large partnership audit and adjustment procedures, IRS generally makes adjustments at the partnership level that flow through to the partners for the year in which the adjustment takes effect.

The Bipartisan Budget Act of 2015 (the Act) repealed the current TEFRA uniform partnership audit rules and replaced them with a streamlined single set of rules for auditing partnerships and their partners at the partnership level. (Code Sec. 6221:zz through Code Sec. 6241:zz)

observation: The addition of ":zz" to various citations in this article is for Checkpoint internal purposes only.

The new rules generally apply to partnership tax years that begin after Dec. 31, 2017. However, except for the election-out rules for smaller partnerships, covered below, partnerships may also elect (as directed by IRS) for the changes to apply to any return of the partnership filed for partnership tax years beginning after Nov. 2, 2015 (the Act's date of enactment) and before Jan. 1, 2018.

In general, under the new streamlined audit approach, any adjustment to items of income, gain, loss, deduction, or credit of a partnership for a partnership tax year (and any partner's distributive share of such adjustment) is determined at the partnership level. Similarly, any tax attributable to such adjustment is assessed and collected, and the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to any such item or share is determined, at the partnership level. (Code Sec. 6221(a):zz) For more details on the new partnership audit changes, see Weekly Alert, 11/05/2015.

Smaller partnerships' election out of new rules. Under new Code Sec. 6221(b):zz, similar to the current TEFRA rule excluding partnerships with 10 or fewer partners, partnerships with 100 or fewer qualifying partners can elect out of the new rules for any tax year. The Blue Book explains that if the election is made, the partnership and partners would be governed by the present-law deficiency procedures. (JCS-1-16, p. 58)

More specifically, the new partnership audit rules will not apply if all of the following apply:

(A) The partnership elects out for the tax year (Code Sec. 6221(b)(1)(A):zz);

(B) For that tax year, the partnership provides 100 or fewer statements under Code Sec. 6031(b):zz (i.e., Form 1065, Schedule K-1) with respect to its partners (Code Sec. 6221(b)(1)(B):zz);

(C) Each of the partners of the partnership is an individual, a C corporation, a foreign entity that would be treated as a C corporation were it domestic, an S corporation, or an estate of a deceased partner. (Code Sec. 6221(b)(1)(C):zz) According to the Blue Book, a C corporation partner that is a regulated investment company (RIC) or real estate investment trust (REIT) would not prevent the partnership from being able to elect out, as long as the applicable requirements are met. (JCS-1-16, p. 58)

(D) The election is made (in the manner set by IRS) with the partnership's timely filed return for the tax year and discloses the name and taxpayer identification number (TIN) of each partner of the partnership. (Code Sec. 6221(b)(1)(D):zz)

(E) And, the partnership notifies its partners of the election. (Code Sec. 6221(b)(1)(E):zz)

If a partner is an S corporation, the partnership will be treated as meeting the Code Sec. 6221(b)(1)(C):zz requirement, above, with respect to that partner only if the partnership includes (as IRS prescribes) a disclosure of the name and TIN of each person with respect to whom the S corporation must furnish a statement under Code Sec. 6037(b) (i.e., Form 1120S, Schedule K-1) for the tax year of the S corporation ending with or within the partnership tax year for which the election out is made. (Code Sec. 6221(b)(2)(A)(i):zz) These statements that the S corporation is required to furnish to its shareholders are treated as statements

furnished by the partnership for purposes of Code Sec. 6221(b)(1)(B):zz, above, relating to the 100-or-fewer statement rule. (Code Sec. 6221(b)(2)(A)(ii):zz)

The Blue Book provides the following example.

illustration (1): A partnership has 50 partners, 49 of which are individuals and one of which is an S corporation with 30 shareholders all of whom are individuals. Here, the partnership is treated as being required to furnish 80 statements: 49 statements for individual partners, plus one statement for the S corporation partner, plus 30 statements for individuals with respect to whom the S corporation must furnish statements. Thus, the partnership meets the 100-or-fewer-statements criterion for the partnership's eligibility to elect out. (JCS-1-16, p. 59)

Other persons as partners. Under Code Sec. 6221(b)(2)(C):zz, IRS may by regs or other guidance prescribe rules allowing the election of the small partnership exception where one or more partners isn't described in Code Sec. 6221(b)(1)(C):zz.

The Blue Book explains that this IRS guidance:

- will take into account, for purposes of applying the 100-or-fewer-statements requirement, each direct and indirect interest in the partnership of any person to which a statement (comparable to the partner statement under Code Sec. 6031(b):zz) is required to be furnished by any person;
- may also take into account any person with respect to which a comparable statement is *not* required to be furnished but which has an interest (direct or indirect) in the partnership; and
- will require the partnership to disclose to IRS the name and TIN of each person with respect to which a statement (comparable to the partner statement under Code Sec. 6031(b):zz) is required to be furnished and of other persons with an interest (direct or indirect) in the partnership. (JCS-1-16, pp. 59-60)

illustration (2): A partner of a partnership is a disregarded entity—such as a State-law limited liability company (LLC)—with only one member, a domestic corporation. IRS guidance may provide that the partnership can make the election if it includes (in the manner prescribed by IRS) a disclosure of the name and TIN of the disregarded entity and the corporation that is its sole member, and that each of them is taken into account as if each were a statement recipient in determining whether the 100-or-fewer statements requirement is met. (JCS-1-16, p. 60)

illustration (3): A partnership has 66 partners, 60 of which are individuals, one of which is an S corporation with 30 shareholders all of whom are individuals, and five of which are State-law LLCs that each have only one member, a domestic corporation. Here, under the Blue Book guidance, the partnership would be treated as being required to furnish 101 statements: 60 statements for individual partners, plus one statement for the S corporation partner, plus 30 statements for individuals with respect to whom the S corporation must furnish statements, plus 5 statements for each of the LLCs, plus 5 statements for each of the five LLCs' members that are domestic corporations. Thus, the partnership would not be able to elect out since it does not meet the 100-or-fewer-statements requirement.

Tiered partnerships. The Blue Book's final piece of guidance on the election out by "smaller" partnerships concerns tiered partnerships. Here, to the extent that additional rules will be consistent with prompt and efficient collection of tax attributable to the income of partnerships and partners, the Blue Book says IRS guidance may allow an election out in the case of a partnership (the first partnership) with one or more direct or indirect partners which are themselves partnerships.

Under any such IRS guidance, the sum of all direct and indirect partners (including each partnership and its partners) could not exceed 100 persons with respect to which a Code Sec. 6031(b):zz statement must be furnished, and each partner must be identified. That is, eligibility of the first partnership to make the election would require the first partnership to include (in the manner prescribed by IRS) a disclosure of the name and TIN of each direct partner of the first partnership and each indirect partner (including each partnership and its partners) in every tier, and would require that each will be taken into account in determining whether the 100-or-fewer-statements requirement is met. (JCS-1-16, p. 60)

References: For electing out of the post-2017 partnership audit procedures, see Federal Tax Coordinator 2d and RIA's Analysis of Federal Taxes: Income at ¶ T-2404; U.S. Tax Reporter: Income at ¶ 62,214.13; Tax Desk at ¶ 825,604.

IRS discusses application of residual profit-split method to outbound IP transactions

IRS has released a new international practice unit (IPU) illustrating the application of a specific transfer pricing method, the residual profit-split method (RPSM), to a transaction where a U.S. parent corporation (USP) licenses certain intangible property (IP) to its controlled foreign corporation (CFC) in exchange for royalty payments. Among other things, it explains to IRS examiners how to determine when the RPSM is the "best method" (i.e., the one that provides the most reliable measure of an arm's-length result) under the Code Sec. 482 rules.

Background on IPUs. In general, IPUs identify strategic areas of importance to IRS and can provide insight as to how IRS examiners may approach a particular issue or transaction on audit. However, they are not official pronouncements of law or directives and cannot be used, cited, or relied upon as such.

Background on Code Sec. 482. Code Sec. 482 provides the arm's-length standard for evaluating transfer pricing arrangements between related (i.e., controlled) parties. The pricing of such arrangements must reflect the pricing that would have occurred if the related parties had been unrelated (i.e., uncontrolled) taxpayers engaged in similar transactions under similar circumstances.

The Code Sec. 482 regs prescribe specified transfer pricing methods for determining the arm's-length terms on the transfer of tangible property, intangible property, service, and capital between affiliated taxpayers. In addition, they allow for the use of unspecified transfer pricing methods where the specified methods are not applicable.

There is no strict priority on the use of transfer pricing methods. Particular transaction types are also not assigned exclusively to a particular transfer pricing method. Instead, as noted above, the Code Sec. 482 regs prescribe a "best method" approach. (Reg § 1.482-1(c))

The Code Sec. 482 regs provide two categories of *specified* transfer pricing methods:

(1) Transactional-based methods that rely on comparisons to actual third-party transactions: (a) the comparable uncontrolled price (CUP) method, (b) the resale price method (RPM), and (c) the cost-plus method; and

(2) Profits-based methods that are appropriate when *both sides* of the controlled transactions own valuable non-routine IP (meaning that no reliable comparables for the IP exist): (a) the comparable profit-split method and (b) the aforementioned, RPSM.

New IPU on application of RPSM to outbound IP transactions. The new IPU focuses on the application of the RPSM to outbound transactions involving IP.

The IPU notes that the RPSM is discussed in Reg § 1.482-6(c)(3), Reg § 1.482-7 (as it pertains to cost sharing arrangements), and Reg § 1.482-9 (as it pertains to services). However, it caveats that Reg § 1.482-7 and Reg § 1.482-9 are beyond its scope and will not be addressed.

As stated in the IPU, the RPSM (like any other transfer pricing method) may only be used if, based on the facts and circumstances, it is the best method. According to the IPU, the following two factors are generally considered when identifying the best method:

- The degree of comparability between the controlled transaction and any uncontrolled (i.e., third-party) comparables, and
- The quality of data and assumptions.

As explained in the IPU, transactional-based and profit-based methods that use information that only benchmarks the profits of one controlled party (e.g., that party's operating profit or gross margin) may not be reliably used when both controlled parties, in the context of the controlled transaction, make significant nonroutine contributions (i.e., contributions for which it is not possible to identify a market rate of return). Thus, in such situations, the most reliable method could be the RPSM, which considers the functions, assets, and profitability of both controlled parties.

When determined to be the best method, the RPSM divides the operating profit from the relevant business activity between the two controlled taxpayers (the two related parties) in two conceptual stages.

(1) Each related party is first rewarded for routine contributions.

(2) Then, the residual profit or loss (i.e., the profit or loss after the reward for the routine activities is considered) is allocated between the related parties in proportion to the relative value of the parties's nonroutine contributions. When there is a residual profit, it is shared by the parties as a reward for their nonroutine contributions. When there is a residual loss, it is shared by the parties as a sharing of the risk that comes from developing and making nonroutine contributions.

For this purpose, routine contributions are contributions of the same or a similar kind made by uncontrolled taxpayers involved in a similar business activity for which it is possible to identify market returns. (Reg § 1.482-6(c)(3)(i)(A)) On the other hand, nonroutine contributions are contributions that are not accounted for as routine contributions (e.g., valuable IP not similar to that owned by uncontrolled taxpayers). (Reg § 1.482-6(c)(3)(i)(B)(1)) For this purpose, the functions performed, risks assumed, and resources employed by the controlled parties must be taken into account.

The IPU provides three examples of when the RPSM may be used:

- A sale of tangible goods, if the seller uses nonroutine manufacturing IP to make the goods, and another controlled party purchases and resells the goods using its nonroutine marketing IP;
- A license of IP, in which one controlled party licenses nonroutine manufacturing IP to a second controlled party, who then manufactures goods using those manufacturing IP and sells the goods using its own nonroutine marketing IP; and
- A commercial sale of a software product, if two controlled parties each contribute nonroutine software IP to manufacture the product, and the controlled parties share the revenue from the sales.

In these cases, the split of operating profit between the two controlled parties is determined under the RPSM. In other words, the RPSM would be used to determine the arm's length transactional price or value that results in that split of operating profit (e.g., arm's length price for the tangible goods sale, arm's length payment for the license, and arm's length split of third-party sales revenue).

The IPU provides four specific steps for IRS examiners to follow in determining whether the RPSM is the best method to evaluate a controlled transaction and in applying the RPSM to that transaction.

(1) Identify the routine and nonroutine contributions made by the parties. The IPU cautions that the RPSM should not be used if there are no nonroutine contributions or if only one controlled taxpayer is making nonroutine contributions.

(2) Determine if the RPSM is the best method. The RPSM is the best method only if it provides the most reliable measure of an arm's length result. As applied in practice, the RPSM generally uses internal data to allocate residual profit to the controlled parties based on their nonroutine contributions, which reduces this method's reliability. However, the RPSM can still be the best method, if the data necessary to apply other methods are incomplete or unreliable.

The IPU cautions that generally, the RPSM is used when both controlled parties have made *significant* nonroutine contributions. If only one party makes significant nonroutine contributions, then another transfer pricing method may be more reliable and the best method. Furthermore, even if the RPSM appears to be the best method, the reliability of the RPSM may be reduced if "the relevant business activity include[s] significant business activity that does not involve the controlled transaction at issue."

(3) Allocate income to the controlled parties based on routine contributions using market rates of return achieved by uncontrolled taxpayers engaged in similar activities. Such rates may be measured as operating profit achieved per some unit of asset or function (e.g., operating profit divided by operating assets (i.e., return on capital employed), operating profit divided by sales (i.e., operating margin), or gross profit divided by operating expenses).

The IPU cautions that, when determining the market rates of return for routine contributions, generally another transfer pricing method consistent with the methods listed in the Code Sec. 482 regs will be utilized.

(4) Allocate the residual profit or loss to the parties based on nonroutine contributions. The relative value of the nonroutine contributions allocated to the controlled parties may be measured by external market benchmarks, internal data (either capitalized costs of developing intangibles or actual recent expenditures).

The IPU cautions that not all IP and services provided using IP constitute nonroutine contributions, as some may be routine and thus can be valued by market data from uncontrolled transactions.

Finally, the IPU illustrates the application of the RPSM by using the example under Reg § 1.482-6(c)(3)(iii), which involves the license of IP by a USP to a CFC in exchange for royalty payments.

References: For the residual profit split method, see Federal Tax Coordinator 2d and RIA's Analysis of Federal Taxes: Income at ¶ G-4548; U.S. Tax Reporter: Income at ¶ 4824.04.

No theft loss or bad debt deduction for taxpayer's seemingly bad investment

Riley, TC Memo 2016-46

The Tax Court has held that a taxpayer's investments in and loans to a rather questionable business venture of an acquaintance did not qualify for a theft loss deduction because she didn't prove that her acquaintance made false representations. The taxpayer also did not qualify for a bad debt deduction because she didn't show that she lacked a reasonable chance of recovery.

Background. A theft loss is allowed in the year in which it is sustained (Code Sec. 165(a)), and taxpayers are considered to have sustained a theft loss in the year in which they discover it. (Code Sec. 165(e))

One of the elements that a taxpayer must prove in order to take a theft loss is that a theft occurred under the law of the jurisdiction where the loss occurred. (*Monteleone, (1960) 34 TC 688*) Under California law, the elements of the crime of theft by false pretenses are: (1) a false representation, (2) made with intent to defraud, (3) that causes the owner of property to part with it in reliance on the false representation. California law also requires that proof of false pretenses be corroborated if the claim "rests primarily on the testimony of a single witness that the false pretense was made."

A loss is allowed when a nonbusiness bad debt becomes worthless during a tax year. (Code Sec. 166(d)(1)(B)). A nonbusiness bad debt loss is sustained only when the debt has become totally worthless (i.e., there is no reasonable chance of recovery). (Reg § 1.166-5(a)(2))

Facts. The taxpayer, Ms. Riley, a California resident, had only a high-school education and little business knowledge. She divorced and received a large divorce settlement. At her job, she became acquainted with Mr. Nemirofsky, who told her he was starting a business, Exphand, based on an application that would allow television watchers to interact with television shows via their cell phones. From 2003-2008, Riley wrote checks to Nemirofsky or Exphand for over $1 million, in some cases receiving promissory notes and in other cases receiving nothing tangible in return. She testified that all of the checks were intended to be investments in or loans to Exphand.

Around 2006 or 2007, Riley noticed a change in Nemirofsky's standard of living. She testified that his house seemed to improve, he acquired a new Mercedes, and he began to wear nicer clothes. In 2010, Wendy Wallace, a friend of Riley's, began working for Nemirofsky. Riley claims to have learned from Wallace that things were not right at Exphand and that Nemirofsky had not used the money properly.

Riley began asking for her money back, and she hired an attorney, Nina Yablok, to assist her. Yablok wrote a letter to Nemirofsky in June 2010 to argue that he breached his fiduciary duties and disclosure obligations and request immediate repayment of $280,000 along with information about the future prospects of Exphand. Riley also consulted with the Fitzgerald law firm, where lawyers told her they would take her case against Nemirofsky on contingency, but she would need to pay $10,000 up front for expenses. She declined to retain the firm because of this retainer. Riley also told the FBI about Nemirofsky, but the government chose not to pursue the case. Riley and Nemirofsky remained in contact, speaking at least eight times in December 2013 alone. Riley testified that Nemirofsky had stated he wanted to return her money to her.

Riley reported a theft loss on her 2010 return, which IRS denied.

Taxpayer didn't prove a theft loss. The Court held that Riley did not prove that Nemirofsky made any false representation, let alone that he made such a representation with intent to defraud. Aside from the testimony described above, the only other evidence that she provided was a handwritten document purporting to show equity investors in Exphand; her name didn't appear on the list. The Court said that this didn't show any sort of fraud, given that she had testified that she had never received any documents or other indication that the amounts that she invested were specifically designated as equity. The Court also noted that Riley's testimony about Nemirofsky's new car and home improvements didn't prove that he lied about his use of the money.

And, taxpayer didn't prove the elements of a bad debt deduction. The Court then held that Riley did not show that she lacked a reasonable chance of recovery at the end of 2010. To the contrary, she testified that a law firm was willing to take her case on contingency; her decision not to pay $10,000 to retain the firm didn't affect this. She credibly testified that she remained in contact with Nemirofsky, and she claimed he wanted to repay her. She did not even suggest that Nemirofsky had insufficient funds to repay her. She never showed that any equity investment in Exphand was worthless.

References: For deduction for theft losses, see Federal Tax Coordinator 2d and RIA's Analysis of Federal Taxes: Income at ¶ M-2100; U.S. Tax Reporter: Income at ¶ 1654.351; Tax Desk at ¶ 367,001; RIA's Tax Guide at ¶ 17000. For bad debt deductions, see Federal Tax Coordinator 2d and RIA's Analysis of Federal Taxes: Income at ¶ M-2401; Federal Tax Coordinator 2d and RIA's Analysis of Federal Taxes: Income at ¶ M-2901; U.S. Tax Reporter: Income at ¶ 1664.300; Tax Desk at ¶ 320,501; RIA's Tax Guide at ¶ 17126.

Fraud penalties upheld against auto dealer who failed to report misappropriated funds

O'Neal, TC Memo 2016-49

The Tax Court has determined that a former auto dealer and his wife failed to report funds that were misappropriated from various businesses that he was involved with, weren't entitled to claim pass-through losses in respect to entities in which he had no basis, and were liable for fraud penalties for each of the years at issue.

Background. Code Sec. 6501(a) generally provides that a valid assessment of income tax liability may not be made more than three years after the later of the date the tax return was filed or the due date of the tax return. However, under one of several exceptions, Code Sec. 6501(c)(1) provides that the assessment period remains open indefinitely "in the case of a false or fraudulent return with the intent to evade tax." IRS bears the burden of showing the Code Sec. 6501(c)(1) applies.

IRS's burden of proof under Code Sec. 6501(c)(1) is the same as its burden to prove applicability of the Code Sec. 6663 civil fraud penalty, which applies if any part of any underpayment of tax required to be shown on a return is attributable to fraud. To satisfy that burden, IRS must show by clear and convincing evidence that (1) an underpayment of tax exists, and (2) the taxpayer intended to evade taxes known to be owing by conduct intended to conceal, mislead, or otherwise prevent the collection of taxes. (*Sadler, (1999) 113 TC 99*; *Parks, (1990) 94 TC 654*)

For this purpose, an underpayment is equal to the amount by which the tax imposed by the Code exceeds the amount shown as the tax by the taxpayers on their return for each of the years at issue. (Code Sec. 6664(a)) IRS may prove an underpayment by proving a likely source of unreported income or, if the taxpayer alleges a nontaxable source of income, disproving the nontaxable source. (*DiLeo, (1991) 96 TC 858*)

A net operating loss (NOL) is generally defined in Code Sec. 172(c) as the excess of allowable deductions over gross income. Taxpayers are entitled to an NOL deduction for the aggregate of NOL carrybacks and carryovers to the tax year. (Code Sec. 172(a))

A shareholder of an S corporation can directly deduct his or her share of entity-level losses. (Code Sec. 1366(a)) The losses cannot exceed the sum of the shareholder's adjusted basis in his stock and the shareholder's adjusted basis in any indebtedness of the S corporation to the shareholder. (Code Sec. 1366(d)(1)) The disallowed losses may be carried forward indefinitely and claimed when and to the extent that the shareholder increases his basis in the S corporation. (Code Sec. 1366(d)(2))

Facts. James O'Neal, Jr. (O'Neal) and Sally O'Neal were married in '67 and have four children.

. . . *Dealerships.* O'Neal, Jr. became involved with Arnold Palmer's automobile dealerships in '79. In '88 through '90, he, Palmer, and Mark McCormack, Palmer's business partner, were each one-third shareholders in five dealerships. O'Neal managed the dealerships' daily operations and, as early as '85, began siphoning money from the dealerships. When one dealership ran short on cash, he transferred money from another dealership to cover the shortfall, routing the transfers through his personal bank account and keeping some of the transferred funds for himself. On Oct. 15, '85, Mr. O'Neal signed a demand promissory note in favor of one of the dealerships showing that he had taken at least $287,000 from it.

In the spring of '89, an audit uncovered that O'Neal had taken more than $6 million from the dealerships. On Apr. 30, '89, O'Neal executed an agreement granting Palmer and McCormack a security interest in all of his assets, and on May 31, '89, he executed a demand promissory note to repay the $6 million he had taken. There was no evidence as to when payments were made on the demand note, although the dealerships' CPA indicated that they occurred in the early '90s. Also, Mr. and Mrs. O'Neal later transferred their home to Palmer and McCormack for $4 million (see below), but there was no indication that any money actually changed hands. O'Neal was removed from any ownership interests in the dealerships in '90.

. . . *Loans.* On July 2, '90—a time where the record was unclear as to whether O'Neal still had an owner-

ship interest in the dealership—he, Palmer, and McCormack executed a $10.4 million promissory note to personally guarantee one dealership's credit, which was treated as a contribution to capital made one-third by each. On Aug. 1, '92, O'Neal, Palmer, and McCormack executed an amended and restated note in favor of a bank for just over $10 million, which was an amendment and restatement of four loans previously made to them in '89 that were also treated as shareholder contributions to capital, one-third each. O'Neal never made any payments toward either of the loans, which were paid off by Palmer and McCormack.

. . . *Tax returns—'88-'90.* Mr. and Mrs. O'Neal reported NOLs on their '88, '89, and '90 income tax returns as follows: for '88, an NOL of $813,475 and an NOL carryforward of $568,352; for '89, an NOL of $4.5 million, an NOL carryover from prior years of $899,206, and an NOL carryforward of $5.3 million; and for '90, an NOL of $759,586, an NOL carryover from prior years of $5.4 million, and an NOL carryforward of $6.2 million. The NOLs claimed by petitioners for '88-'90 totaled $6.1 million and were purportedly attributable to flowthrough losses from the dealerships. An addendum to their '89 tax return titled "NOL" recites amounts of $34,896 for '85, $25,539 for '86, $122,028 for '87, and $716,743 for '88, totaling $899,206, despite the '88 tax return's reporting an NOL carryforward of only $568,352 and no NOL carryovers from prior years. They also did not report on their '88 or '89 income tax return any of the $6 million O'Neal had misappropriated from the dealerships.

. . . *BOH and APAG.* O'Neal formed Baker O'Neal Holdings, Inc. (BOH) with Patrick Baker in '93. Baker invested $400,000 in BOH and was its sole shareholder, and O'Neal was president from incorporation until Sept. 2, '98. American Public Automotive Group (APAG) was incorporated on Dec. 27, '95, and BOH was its sole shareholder. O'Neal similarly served as president from APAG's inception until Sept. 2, '98. BOH and APAG were organized to develop and operate auto dealerships. They raised capital through private investors but, instead of issuing stock, memorialized investments with promissory notes personally guaranteed by O'Neal and Baker. Almost $17 million in investor money was deposited into APAG's bank account from '95-'98, but by Apr. 1, '98, only $1.7 million remained. O'Neal, who never drew a salary, used BOH and APAG funds for his and Mrs. O'Neal's personal expenses (which they did knowingly to defeat creditors by not placing assets in their own names). In October of '95, O'Neal executed a demand promissory note in favor of BOH indicating that he had taken more than $3 million from '94 to '97. Throughout his involvement with BOH and APAG, O'Neal gifted funds for holidays, funded vacations, paid his children's educational expenses, drove company cars, and made real estate purchases unrelated to the business. Upon discovery of O'Neal's extensive personal use of BOH and APAG funds, his employment was terminated. BOH and APAG subsequently filed for bankruptcy and filed an adversary proceeding against Mr. and Mrs. O'Neal and three of their children. The court ultimately found that the children were fraudulent transferees and that Mrs. O'Neal knowingly participated in the scheme.

. . . *Tax crimes.* O'Neal was also investigated for tax crimes associated with his spending BOH and APAG funds. He was indicted by a grand jury on 49 counts of mail fraud, 30 counts of money laundering, and three counts of filing false income tax returns under Code Sec. 7207(1) for tax years '96, '97, and '98, and ultimately pled guilty to two counts of filing false returns under Code Sec. 7206(1) for '97 and '98. In a plea agreement, he agreed that money characterized as loans and money disguised as business expenses were instead income to him, resulting in approximately $6.6 million in unreported income from '95-'98.

. . . *Tax returns—'94-'98.* From '94 to '98 (the years at issue), Mr. and Mrs. O'Neal filed their income tax returns claiming relatively small amounts of wage income attributable to Mrs. O'Neal's work as a registered nurse, small amounts of taxable interest, $3,000 capital loss, and an NOL carryover (which started around $6.1 million and got slightly smaller each year and which related to losses originally reported on their '88-'90 returns) that reduced their taxable income each year to less than negative $6 million.

. . . *IRS notice of deficiency.* On Nov. 6, 2009, IRS issued a notice of deficiency to Mr. and Mrs. O'Neal for '94 to '98. The adjustments to income were based on the amounts O'Neal admitted to receiving as income in his plea agreement, and IRS also disallowed in full the O'Neals' NOL deductions carried forward from prior years.

Tax Court sides with IRS. The Tax Court first found that IRS was not barred by the statute of limitations from assessing taxes in this case, concluding that the returns for the years at issue were made fraudulently with the intent to evade tax. (Code Sec. 6501(c)(1))

The Court easily found that there were underpayments for each year because of the O'Neals' failure to

report income from their misuse of BOH and APAG funds, rejecting their contrary arguments that the amounts were loans and/or legitimate business expenses of the entities. And, while finding that O'Neal's admission in his plea agreement wasn't conclusive as to the precise understatement amounts, it did estop him for contesting that an underpayment existed for the years covered by it ('97 and '98).

The Court also found that the O'Neals weren't entitled to offset their income with NOL carryover deductions because they failed to show that they had sufficient basis in the dealerships to claim the losses. Notably, they didn't provide any evidence as to what, if any, financial contributions O'Neal made; their returns didn't reflect the $6 million that he misappropriated from the dealerships; and the reported NOLs were factually inconsistent with each other, in that the '89 and '90 returns showed larger carryover amounts than those reported on the '88 and '89 returns. It also concluded that his signing of various promissory notes didn't constitute indebtedness as there was no indication that the lenders actually looked to him as the primary obligor or that he made any economic outlay. Accordingly, the Court concluded that, since they had no basis, they weren't entitled to NOLs for '88-'90 or NOL carryovers in the years at issue.

The Court then considered the "badges of fraud" in evaluating where the O'Neals acted with fraudulent intent and concluded that they did. It found that the majority of the factors favored a finding of fraud for both Mr. and Mrs. O'Neal, including: a pattern of consistently underreporting income; inconsistent or implausible explanations for their behavior; concealment of assets or income; a general pattern of conduct showing an intent to mislead; lack of credibility; filing false documents; and failing to make estimated tax payments. Accordingly, the Court concluded that Mr. and Mrs. O'Neal were liable for the Code Sec. 6663 civil fraud penalty with respect to the entire amount of the underpayment for each of the years at issue.

References: For the penalty for civil fraud, see Federal Tax Coordinator 2d and RIA's Analysis of Federal Taxes: Income at ¶ V-2301 *et seq.*; U.S. Tax Reporter: Income at ¶ 66,634; Tax Desk at ¶ 865,000 *et seq.*; RIA's Tax Guide at ¶ 71644.

Sixth Circuit approves sale of home to satisfy one spouse's tax liability

U.S. v. Davis, (CA 6 3/9/2016) 117 AFTR 2d ¶ 2016-499

The Court of Appeals for the Sixth Circuit, affirming a district court, has concluded that IRS could enforce its tax lien and sell the primary residence owned by the taxpayer and her tax-delinquent husband. The Court rejected the argument of the taxpayer, who did not owe any unpaid taxes, that the district court should have allowed IRS to sell only her husband's interest in the property.

Background. Under Code Sec. 6331(a), IRS can levy on all property and rights to property of a taxpayer on which there is a federal tax lien, in order to collect delinquent taxes. As an alternative to a levy, IRS may bring a lien foreclosure suit under Code Sec. 7403, i.e., an action in federal district court, to reach the funds.

The Supreme Court, in *U.S. v. Rodgers, (S Ct 1983) 52 AFTR 2d 83-5042*, held that Code Sec. 7403 empowers a district court to enforce a tax lien by decreeing a forced sale of an entire property in which a delinquent taxpayer had an interest, even though a nondelinquent person also has an interest in the same property. The nondelinquent person is entitled to receive an appropriate portion of the sales proceeds. Under certain circumstances, the district court may use its discretion to disallow a request for the forced sale. This discretion should be exercised in the light of the following considerations:

. . . the extent to which government financial interests would be prejudiced by relegating it to forced sale of the partial interest actually liable for taxes;

. . . whether an innocent/nondelinquent third-party has a legitimate or legal expectation that his separate interest would not be subject to a forced sale by the delinquent taxpayer or his creditors;

. . . the likely prejudice to the third party, both in personal dislocation costs and in practical undercompensation; and

. . . the relative character and value of the nonliable and liable interests held in the property.

The term "practical undercompensation" refers to the Court's statement that "in practical terms financial compensation may not always be a completely adequate substitute for a roof over one's head." The Court suggested that this kind of undercompensation was

likely to arise in the case of a homestead interest (the type of interest at issue in *Rodgers*) where "the nature of the market for life estates or the market for rental property may be such that the value of a homestead interest, calculated as some fraction of the total value of a home, would be less than the price demanded by the market for a lifetime's interest in an equivalent home."

In *Rodgers,* the Supreme Court, without deciding the proper division of the sales proceeds, also suggested that one way of doing that division might me to value the nondelinquent owner's share actuarially based on that owner's remaining life expectancy at the time of sale. However, the Sixth (*U.S. v. Barr, (CA6 2010) 106 AFTR 2d 2010-5590*) and the Eighth (*U.S. v. Bachman, (CA8 1983) 52 AFTR 2d 83-5532*) Circuits have held that in the case of the judicial sale of property by the entirety, an equal division of the sales proceeds should be made, refusing to apply actuarial principles.

Facts. Ronald Davis, the sole owner of Dav-Tyre, Inc., did not pay federal employment taxes from 2008 to 2011. By 2013, Mr. Davis owed the government over $1 million in taxes, interest, and statutorily mandated penalties. IRS eventually filed a civil suit against Mr. Davis to reduce its tax assessments to judgment. IRS sought to enforce its tax liens through the sale of the Davises' primary residence. Though Mr. Davis's wife, Diane Davis, did not owe any unpaid taxes, IRS named her as a defendant in the action because she had an interest in the property which she and her husband held as a tenancy by the entirety. A tenancy by the entirety is an estate shared by husband and wife in a single ownership, and held in a single title; each has an undivided interest in the whole.

District court decision. The district court issued an order of sale authorizing IRS to sell the residence through an auction. As Mr. Davis conceded that he was liable for the over $1 million in unpaid federal employment taxes and penalties, the court granted IRS's motion for summary judgment reducing to judgment the tax assessments against Mr. Davis and enforcing the lien on his interest in the primary residence.

Mrs. Davis argued that a forced sale of the residence would leave her undercompensated because it would assume that she and her husband had equal interests in the property, notwithstanding her claim that she had a greater interest due to her longer life expectancy as a woman and the fact that she was in good health while her husband had heart disease and was diabetic. The district court noted that Mrs. Davis's argument that her longer life expectancy translated into a greater interest in the property was largely rejected by Sixth Circuit precedent.

Appellate court decision. The Sixth Circuit concluded that the district court did not abuse its discretion by ordering the sale of the entire property.

The Court rejected Mrs. Davis's contention that she would suffer practical undercompensation from the sale of the entire property because she had a greater interest in the property than her husband. She argued that, although only eight months younger than her husband, the differences in their health, as well as her gender, supported a finding that she had a longer life expectancy than her husband. However, the Court found that even if she did have a longer life expectancy, she couldn't establish that that fact translates into a greater interest in the property.

In determining parties' respective interests for federal tax law purposes, the definition of underlying property interests is left to state law, and the consequences that attach to those interests is a matter left to federal law. In *Barr,* the Court observed that Michigan law dictated that spouses were entitled to equal interests in entireties property in every situation it had contemplated. Faced with an argument similar to the one Mrs. Davis raised here, the Sixth Circuit concluded that because Michigan law provided for equal division of property upon divorce or consensual sale, differences in life expectancy did not result in different survivorship interests.

Though the Court acknowledged that there might be circumstances where an actuarial valuation of survivorship interests was warranted—such as when determining the value of a life estate (which requires estimating the length of the measuring life)—*Barr* held that a tenancy by the entirety does not present such circumstances. Accordingly, the Sixth Circuit found that Mrs. Davis's argument that a longer life expectancy resulted in a greater interest in a property held in a tenancy by the entirety under Michigan law was foreclosed by the Court's precedent.

The Court also rejected Mrs. Davis's argument that the district court's order authorizing IRS's Property Appraisal and Liquidation Specialists (PALS) to sell the residence through an auction violated Code Sec. 7403(d) because that Code section "only permits sale by a receiver," concluding that her interpretation of Code Sec. 7403(d) was incorrect. Code Sec. 7403(d) only provides that a district court "may appoint a receiver," but does not require it to do so.

In addition, the Court rejected Mrs. Davis's argument that a sale by auction violated the Fifth Amendment's Just Compensation Clause because it would yield less than the fair market value of the residence. As stated in *Rodgers,* to the extent that third-party property interests are "taken" in the process, Code Sec. 7403 provides compensation for that "taking" by requiring that the court distribute the proceeds of the sale "according to the findings of the court in respect to the interests of the parties and of the United States." Thus, under *Rodgers,* so long as third-party interest holders were compensated as required by the statute, there was no Takings-Clause issue.

References: For forced sale of entire property in which nondelinquent person has an interest, see Federal Tax Coordinator 2d and RIA's Analysis of Federal Taxes: Income at ¶ V-5933.1; Federal Tax Coordinator 2d and RIA's Analysis of Federal Taxes: Income at ¶ V-5934; Tax Desk at ¶ 911,034.

Unresolved questions of fact surrounded purported alimony agreement including choice of law

Wolens v. U.S. (Ct Fed Cl 3/4/2016) 117 AFTR 2d 2016-904

The Court of Federal Claims denied both IRS's motion to dismiss for failure to state a claim for which relief could be granted, and the taxpayer's motion for summary judgment, in a refund suit. Although the taxpayer showed sufficient facts to plausibly allege that a 2007 payment was deductible alimony under the relevant law, there remained genuine disputes about the facts—not the least of which was whether the relevant law was that of New York or the United Kingdom (U.K.)—that could not be resolved without a trial.

Background. Generally, property settlements (or transfers of property between spouses) incident to a divorce do not give rise to deductions or recognizable income. (Code Sec. 1041) On the other hand, amounts received as alimony or separate maintenance payments are taxable to the recipient (Code Sec. 71(a)) and deductible by the payor in the year paid. (Code Sec. 215(a))

Under Code Sec. 71(a), gross income includes amounts received as alimony or separate maintenance payments. An alimony or separate maintenance payment is one that meets the following four requirements:

. . . the payment must be made under a divorce or separation instrument;

. . . the instrument must not designate the payment as not includable in the recipient spouse's gross income under Code Sec. 71 and not deductible by the payor spouse under Code Sec. 215;

. . . legally separated spouses under a decree of divorce or separate maintenance must not be members of the same household when the payments are made; and

. . . the payor's obligation to make the payment must end at the death of the payee spouse. (Code Sec. 71(b)(1))

Facts. Mr. Gary Wolens and Ms. Wolens were married in New York in '86. They later moved to London, England and resided there together through the time of their divorce on Jan. 24, 2006, which divorce was granted by order of the United Kingdom High Court of Justice, Family Division. Neither Mr. nor Ms. Wolens had established a domicile in the United Kingdom, nor did they domesticate their marriage under U.K. law. Mr. Wolens still claims domicile in New York.

The divorce decree issued by the High Court of Justice consisted of three sections: (1) the undertakings required of Mr. Wolens; (2) the agreements by both parties relative to the decree; and (3) the court's orders. The first section of the divorce decree required, among other things, that Mr. Wolens obtain life insurance in an amount sufficient to secure the payments owed to Ms. Wolens under Subparagraphs 5(c) through (e) of the third section of the decree; and make payments to Ms. Wolens under an interim financial arrangement until the payment date, except that, after the first "lump sum" payment specified in Subparagraph 5(a) of the decree, he would no longer be liable for the payment of £6000 per month under that arrangement. The second section stated, in relevant part, that the provisions of this order were to be in full and final satisfaction of all claims in any jurisdiction that either party may have against the other arising out of their marriage.

In the third section of the divorce decree, Paragraphs 1 through 4 governed the sale of the marital property and the division of the proceeds and associated chattels. Paragraph 5 ordered Mr. Wolens to pay five "lump sums" to Ms. Wolens as follows:

(a) £1,000,000 by 15 February 2006;

(b) £2,300,000 upon the payment date;

(c) £441,667 by 15 April 2007;

(d) £441,667 by 15 April 2008;

(e) £441,666 by 15 April 2009.

In the third section of the divorce decree, Paragraph 6 ordered the transfer of Mr. Wolens' interest in two individual retirement accounts and certain airline miles to Ms. Wolens. Paragraphs 7 through 9 pertained to Mr. Wolens' financial obligations with respect to his four children, including "periodical payments" of £12,500 per year for a specified time. Paragraph 10 stated:

> "Save as aforesaid... all of the claims of [Ms. Wolens] against [Mr. Wolens] and of [Mr. Wolens] against [Ms. Wolens] for any sort of provision in respect of this marriage shall stand dismissed and neither would be entitled to apply for an order under the Inheritance (Provision for Family and Dependents) Act 1975 even if, by the date of their death, the other party had become domiciled in England and Wales (neither being so domiciled at present)."

Mr. Wolens made the 2007 payment of £441,667 ($877,076) to Ms. Wolens pursuant to the third section of the divorce decree, Subparagraph 5(c). He did not report this payment as deductible alimony on his original 2007 U.S. tax return, but he later filed an amended return claiming a refund of $277,077 based on the payment in 2007, which he now reported as alimony. IRS disallowed the amended return.

Court looks at IRS's position. IRS contended that the 2007 payment wasn't deductible alimony because, under the terms of the divorce decree, Mr. Wolens would still have been obligated to make the 2007 payment, as well as all the payments specified in Paragraph 5 of the third section of the divorce decree, in the event of Ms. Wolens' death. IRS argued that the "save as aforesaid" exception set out in the third section of the divorce decree, Paragraph 10, operated to allow Ms. Wolens' estate to apply for an order to enforce the payment under the Inheritance (Provision for Family and Dependents) Act 1975 (the Inheritance Act). However, the Court found that the Inheritance Act states that a divorce decree can specify that, in the event of the death of one party, the other party isn't entitled to apply for an order under the Inheritance Act, and that Paragraph 10 of the Wolens divorce decree did just that—it prevented either party from bringing an action under the Inheritance Act even if, by the date of their death, the other party had become domiciled in England and Wales.

IRS also argued that under U.K. law, the 2007 payment, as well as the other payments specified in the third section of the divorce decree, Paragraph 5, should be considered lump-sum distributions of marital assets, and not alimony or maintenance payments. IRS asserted that lump-sum payments were intended to be distinct from "periodical payments," which were more typically associated with maintenance payments. There was precedent in the U.K. suggesting that because lump-sum payments were considered a division of assets, the obligation to make them did not terminate upon the payee spouse's death. IRS argued that Paragraph 5 was a division of marital assets achieved through a series of lump-sum payments created, in part, because Mr. and Ms. Wolens did not have sufficient liquidated assets available at the time of their divorce to make an immediate "clean break." However, the Court reasoned that, although IRS had shown that the term "lump sum" was typically associated in the U.K. with a division of marital assets, it hadn't established that this was the only reasonable interpretation of Paragraph 5. In particular, the Court found questions of fact arose regarding the operation of the provision in the first section of the divorce decree which stated that Mr. Wolens would cease to be liable for the "interim financial arrangements" related to his contribution to Ms. Wolens' costs of £6000 per month once he made the first lump-sum payment referred to Paragraph 5 of the third section of the divorce decree. The Court reasoned that it was possible that, as IRS argued, Paragraph 5 operated as a division of marital assets that replaced the need for the regular support payments specified in the first section of the divorce decree. On the other hand, it was also possible that the payments contemplated by Paragraph 5, or at least most of them, served as a continuation of these support payments, and so the 2007 payment was properly viewed as alimony.

IRS also pointed to the provisions in the first section of the divorce decree requiring Mr. Wolens to obtain life insurance to secure the obligations in Paragraph 5 of the third section of the divorce decree. IRS argued that because the decree inferentially addressed the continuation of payments upon Mr. Wolens' death, but did not mention termination of payments upon Ms. Wolens' death, no termination provision was intended with regard to Paragraph 5. However, the Court reasoned that it was also possible that the requirement in the first section of the divorce decree was meant to signify that the payments in Subparagraphs 5(c) through (e) of the third section of the decree were only meant to continue in the event of Mr. Wolens' death, but not meant to continue in the event of Ms. Wolens' death.

The Court found that, in the context of IRS's motion to dismiss, and based solely on the divorce decree and the facts alleged, IRS had failed to establish that Mr. Wolens could not plausibly state a claim for relief.

Court looks at the taxpayer's position. Mr. Wolens argued the Court should apply New York law and that under New York law, the 2007 payment would have terminated upon the death of Ms. Wolens because the payment was appropriately characterized as a maintenance payment and not an "equitable distribution" of assets. He pointed out that the Tax Court in *Leventhal, TC Memo 2000-92*, distinguished its earlier decision in *Megibow, TC Memo 1998-455*, which had found that a one-time payment was an equitable distribution, the obligation for which would not have terminated upon the payee spouse's death.

Court denies both parties' motions. The Court reasoned that whether New York law or the law of the U.K. was applied in this case, factual questions remain regarding the operation of Paragraph 5 of the third section of the divorce decree in conjunction with its other provisions, including those dealing with the responsibility of getting insurance and interim financial arrangements. Accordingly, there were genuine disputes of material fact at this time such that the Court couldn't determine whether the taxpayer was entitled to judgment as a matter of law.

References: For alimony payments includible in gross income, see Federal Tax Coordinator 2d and RIA's Analysis of Federal Taxes: Income at ¶ J-1413; U.S. Tax Reporter: Income at ¶ 714.01; Tax Desk at ¶ 198,502; RIA's Tax Guide at ¶ 19353.

Taxpayers' ' 'rollover as business startup' ' account wasn't valid retirement plan

Powell v. U.S., (Ct Fed Cl 3/16/2016) 117 AFTR 2d ¶ 2016-515

The Court of Federal Claims has denied taxpayers' claim for refund, rejecting their argument that their Individual Retirement Account (IRA) withdrawals were nontaxable distributions that were rolled over into a "Business Owners Retirement Savings Account," or BORSA—essentially, a variation of a "rollover as business startup" (ROBS) account. The Court found that, because there was no written plan in existence under which the IRA distributions were reinvested, the arrangement couldn't be a qualified trust under Code Sec. 401.

Background. In general, an IRA is a trust (or custodial account) created for the exclusive benefit of an individual or his beneficiaries on which no tax is paid on the income earned on contributions until the retirement savings are distributed. An IRA requires, among other things, a written plan and designation of an appropriate trustee. (Code Sec. 408(a), Reg § 1.408-2(b)) There is no immediate tax if distributions from an IRA are rolled over to another IRA or other eligible retirement plan (i.e., qualified trust, governmental Code Sec. 457 plan, Code Sec. 403(a) annuity, or Code Sec. 403(b) tax-shelter annuity). For the rollover to be tax-free, the amount distributed from the IRA generally must be recontributed to the IRA or other eligible retirement plan no later than 60 days after the date that the taxpayer received the withdrawal from the IRA. (Code Sec. 408(d)(3))

There are certain requirements for qualification which must be met by all qualified plans. In general, Code Sec. 401(a) prescribes the requirements which must be met for qualification of a trust forming part of a pension, profit-sharing, or stock bonus plan. One such requirement is that a plan be a definite written program. Failure to meet one of the Code Sec. 401(a) requirements disqualifies the plan.

IRS views a ROBS as a questionable, but not necessarily abusive, mechanism for individuals to use their existing retirement accounts as seed money for funding new businesses without first paying taxes on distributions from those retirement accounts. () IRS has stated that a ROBS may work as a legitimate tax planning entity but recommends assessment on a case-by-case basis through IRS determination letters. It outlines the steps generally to create a ROBS as follows:

(1) The individual creates a new corporation for the purpose of sponsoring a purportedly qualified retirement plan.

(2) The new corporation creates a qualified employee retirement plan and allows participants to invest the entirety of their retirement plan account balance in the corporation's stock.

(3) The individual becomes an employee of the corporation and enrolls in the plan.

(4) The individual either conducts a rollover or direct trustee-to-trustee transfer of funds from a qualified personal IRA or previous employer's Code Sec. 401 plan into the new corporate retirement plan.

(5) The individual directs his account balance in the qualified retirement plan to purchase stock of the newly formed corporation.

(6) The individual then uses the transferred funds to begin a business enterprise.

A "one-participant plan" is a retirement plan (that is, a defined benefit pension plan or a defined contribution profit-sharing or money purchase pension plan), other than an employee stock ownership plan (ESOP), that covers: (1) only an individual (or an individual and his or her spouse) who wholly owns a trade or business, whether incorporated or unincorporated; or (2) only the partners or the partners and their spouses. Such a one-participant plan with fewer than 100 participants is exempt from filing an annual return/report (other than for the final plan year to indicate that all assets have been distributed) if it has assets (either alone or in combination with one or more one-participant plans maintained by the employer) of $250,000 or less at the end of the plan year ().

Facts. James Clement Powell and Lucy Hamrick Powell, husband and wife, ran an energy business. They timely filed their 2004 joint federal tax return on which they listed $78,000 in IRA distributions as includible in income. They subsequently filed an amended 2004 return in which they claimed an overpayment of taxes based on the fact that they had purportedly rolled the $78,000 IRA distributions into another retirement account involved in commercial real estate investment, which they referred to as a "Business Owners Retirement Savings Account," or BORSA. IRS denied the refund claim, and the taxpayers sought relief in court.

IRS's requested from the Powells documentation on the existence of the IRA which allegedly received the distributions, and specifically sought its written plan and the identity of the trustee, which they failed to provide. At oral argument before the court, Mr. Powell conceded that there was no written agreement and no trustee. He admitted that they purchased the property in their individual capacities and held it individually until 2012, when it was sold to a corporation. The property had never been held in trust or in an IRA account. Mr. Powell's understanding was merely that any money withdrawn from an IRA and invested in a business still counted as being in an IRA.

The taxpayers also conceded that they did not follow the formal steps required for a ROBS. No corporation was created for purposes of running a qualified retirement plan. The entity which appeared to currently hold title to the property was created in 2012.

Parties' positions. The taxpayers argued that they had rolled over the $78,000 distribution into a valid retirement plan, making the distributions nontaxable. They argued that this other retirement account was a one-participant plan with less than $250,000 worth of assets which wasn't required to file an annual report until its final year of existence.

On the other hand, IRS argued that the taxpayers failed to show that the real estate investment in question met the requirements of a qualifying IRA under Code Sec. 408. And, even if their claims were construed to be based on a one-participant retirement plan, they failed to show evidence supporting the existence of such a plan.

Court's conclusion. The Court of Federal Claims held that the taxpayers weren't entitled to a refund. There wasn't a nontaxable rollover of the IRA distributions. Rather, the taxpayers withdrew money from their IRAs to purchase land in their individual capacities. The land was not purchased through or held by another IRA. As no IRA existed into which the taxpayers could have rolled the 2004 IRA distributions, IRS properly classified the distributions as income.

The Court agreed with IRS that, under Code Sec. 401 and its regs, one-participant retirement plans need written trust instruments and must meet certain other formalities. And while it may be true that one-participant plans with less than $250,000 worth of assets aren't required to file annual reports until their final year of existence, to be plans in the first place, such entities need trust instruments and a definite written program and arrangement. While the Powells may have had a business plan concerning the real estate purchased with the IRA distributions, there wasn't a written plan for an IRA through which the investment was made. With no written plan in existence under which the IRA distributions were reinvested, the arrangement could not have employed a qualified trust under Code Sec. 401.

The Court also noted that, because the corporation which currently held the investment property wasn't in existence when the IRA distributions were made and the proceeds reinvested, it couldn't have played a role in a ROBS transaction.

References: For ROBS, see Federal Tax Coordinator 2d and RIA's Analysis of Federal Taxes: Income at ¶ H-12250. For one-participant pension plans, see Federal Tax Coordinator 2d and RIA's Analysis of Federal Taxes: Income at ¶ S-3357; Tax Desk at

¶ 813,010. For qualification requirements for a qualified employee plan, see Federal Tax Coordinator 2d and RIA's Analysis of Federal Taxes: Income at ¶ H-5300; U.S. Tax Reporter: Income at ¶ 4014.05; Tax Desk at ¶ 286,001; RIA's Tax Guide at ¶ 8051.

IRS must provide taxpayers a pre-assessment determination of responsible person penalty

Romano-Murphy, (CA 11 3/7/2016) 117 AFTR 2d ¶ 2016-492

The Court of Appeals for the Eleventh Circuit, vacating and remanding a Tax Court decision, has held that Code Sec. 6672(b)(3)(B)—which provides for an extension of the statute of limitations on assessment where the taxpayer protests IRS's preassessment determination of liability with respect to the responsible person penalty—in combination with regs, requires IRS to issue such a preassessment determination of liability.

Background. Code Sec. 6672(a) imposes a 100% penalty, commonly referred to as the trust fund recovery penalty or the responsible person penalty, on "responsible persons" if they willfully fail to pay over to IRS the amount of taxes otherwise due. IRS must notify a taxpayer that he will be subject to an assessment (pre-assessment notice) before it can impose a penalty. (Code Sec. 6672(b)(1)) IRS must also wait 60 days from the date of the notice letter before making an assessment. (Code Sec. 6672(b)(2))

IRS has a 3-year statute of limitations for making assessments under Code Sec. 6672. The limitations period begins to run from the date of the filing of the tax return or the due date of the return, whichever is later. (Code Sec. 6501(a)) Where a taxpayer files a timely protest to IRS' pre-assessment notice, IRS has an additional 30 days, from when it makes a "final administrative determination" on the taxpayer's pre-assessment protest, to assess the taxpayer. (Code Sec. 6672(b)(3)(B))

Code Sec. 6330(a)(1) requires IRS to give a taxpayer written notice when IRS intends to levy upon the taxpayer's property. The notice must inform the taxpayer of the right to request an administrative (i.e., a collection due process, or CDP) hearing in the Appeals Office. If a taxpayer makes a timely written request and states the grounds for the requested hearing, he is entitled to a CDP hearing conducted by an impartial officer from the Appeals Office. (Code Sec. 6330(a)(3)(B)) The taxpayer may raise at the hearing challenges to the existence or amount of the underlying tax liability if he did not receive any statutory notice of deficiency for such tax liability or did not otherwise have an opportunity to dispute such tax liability. (Code Sec. 6330(c)(2)(B))

Facts. The taxpayer, Ms. Romano-Murphy, was the chief operating officer of NPRN, a business that was behind in paying its 2005 employment taxes. After unsuccessfully seeking full payment from NPRN, IRS sought to recover the remaining amount due from Romano-Murphy under Code Sec. 6672(a).

To that end, IRS sent Romano-Murphy a Letter 1153 (pre-assessment notice) informing her that, pursuant to Code Sec. 6672(a), she—as the chief operating officer of NPRN—was personally responsible for the company's unpaid trust fund taxes. It also informed her of her right to protest the proposed assessment.

Romano filed a timely protest with IRS. Due to some unexplained error, IRS did not forward Romano-Murphy's formal written protest to its Appeals Office, which exclusively handles taxpayers' pre-assessment protests under Code Sec. 6672(b). The Appeals Office, therefore, never considered the protest, and Romano-Murphy was not given a pre-assessment conference or a final administrative determination as to her protest.

On October 15, 2007, having failed to address or resolve her protest, IRS made an assessment against Romano-Murphy.

In August 2008, IRS served Romano-Murphy with notice of its intent to levy to collect the penalty for NPRN's outstanding trust fund taxes. In September 2008, Romano-Murphy filed a timely request for a CDP hearing to contest her liability under Code Sec. 6672(a).

Romano-Murphy received a CDP hearing with the IRS Appeals Office in February 2009. At the hearing, she disputed her liability under Code Sec. 6672(a) for the assessed penalty. The Appeals Office noted during the hearing that, although Romano-Murphy had filed a timely pre-assessment protest, IRS had never given her the opportunity to dispute her liability prior to making an assessment. Because the proposed assessment had never been reviewed, the Appeals Office conducted a post-assessment review of Romano-Murphy's challenges to liability and to the amount of the penalty.

IRS Appeals concluded that she was liable for the outstanding trust fund taxes.

Romano-Murphy sought review of the Appeals Office's determination in the Tax Court. The Tax Court held that Romano-Murphy was liable under Code Sec. 6672(a) for the penalty. (*Romano-Murphy, TC Memo 2012-330*; see Weekly Alert, 12/13/2012)

Romano-Murphy then filed a motion to vacate the Tax court's order. She argued that collection of a tax liability, pursuant to Code Sec. 6502, can only occur after an assessment has been made, and the assessment in her case was invalid because IRS had failed to give her a pre-assessment hearing and determination when she filed her timely protest, which was her right by law. This procedural error, Romano-Murphy argued, denied her due process and prejudiced her in a number of ways.

The Tax Court denied Romano-Murphy's motion to vacate.

Appeals Court says taxpayer was entitled to a pre-assessment determination. The Court of Appeals held that Romano-Murphy was entitled to a pre-assessment determination of her Code Sec. 6672 liability. IRS therefore erred in not providing her such a determination before making the assessment and issuing its notice of intent to levy. The Court disagreed with the Tax Court, which it said had, in effect, concluded that taxpayers have no statutory right to a pre-assessment hearing or to a final administrative determination of a pre-assessment protest.

The Court cited several reasons for its conclusion:

. . . Although Code Sec. 6672 does not contain a subsection concerning a pre-assessment hearing or determination of liability, Code Sec. 6672(b)(3)(B) does presuppose that there will be a pre-assessment determination at some point if a taxpayer files a timely protest. It provides, in relevant part, that "if there is a timely protest of the proposed assessment," the 3-year statute of limitations for making an assessment "shall not expire before . . . "

The Court said that IRS read Code Sec. 6672 as allowing it unfettered discretion to resolve (or not resolve) timely pre-assessment protests filed by taxpayers after they receive notice of proposed assessments. IRS had said that the statute serves only to give the taxpayer notice of her proposed liability and speaks only about the possibility of an appeals process. In essence, the Court said, IRS maintained that it may simply ignore, disregard, or discard a taxpayer's timely protest to a Code Sec. 6672(b) pre-assessment notice if it so chooses.

But the Court said that courts try to interpret statutory text so as to give effect to every provision enacted by Congress. Therefore, it concluded that Code Sec. 6672(b)(3)(B) contemplates that there will be a pre-assessment determination of liability and notice thereof to the taxpayer if a timely protest has been filed. Statutory silence on the details as to how these procedures are to occur does not require courts to "shrug our collective shoulders" and let IRS act in an arbitrary fashion.

. . . Examples in Reg § 301.7430-3(d) provide that, when a pre-assessment protest is filed, the Appeals Office must make a determination of Code Sec. 6672 tax liability and notify the taxpayer of that determination in writing by following specific steps. First, the taxpayer "receives a . . . proposed assessment of trust fund taxes (Trust Fund Penalty) pursuant to Code Sec. 6672." Second, the taxpayer "requests and is granted Appeals Office consideration." (Reg § 301.7430-3(d), Example (7)). Third, the Appeals Office "considers the issues and decides to uphold [the] recommended assessment" or "upholds the [taxpayer's] position." (Reg § 301.7430-3(d), Example (5); Reg § 301.7430-3(d), Example (7)) Fourth, the Appeals Office "notifies [the taxpayer] of [its] decision in writing." Finally, IRS "assess[es] the taxes." (Reg § 301.7430-3(d), Example (7)).

. . . Previous Tax Court cases have held that a taxpayer has the opportunity to dispute his or her liability for a trust fund recovery penalty when he receives a Letter 1153. (*Bishay, TC Memo 2015-105*; *Giaquinto, TC Memo 2013-150*)

Appeals Court remands on question of whether IRS committed harmless error. IRS then argued that any error in denying Romano-Murphy a hearing or determination was harmless because she was subsequently able to challenge her liability and the amount of the penalty at the CDP hearing. Romano-Murphy contended that IRS's violation invalidated the assessment.

The Appellate Court then remanded that issue to the Tax Court. It noted that it is not a fact-finding tribunal; that the Tax Court did not address whether IRS' error, under the circumstances, required invalidation of any IRS action; and, more specifically, that the Tax Court did not make any findings concerning the prejudice that Romano-Murphy alleged that she suffered (e.g., that she had to pay more interest because interest accrues from the date of the assessment).

References: For responsible person penalty, see Federal Tax Coordinator 2d and RIA's Analysis of Federal Taxes: Income at ¶ V-1704; U.S. Tax Reporter: Income at ¶ 66,724; Tax Desk at ¶ 864,000; RIA's Tax Guide at ¶ 71612.

Gift tax return filed as part of settlement can't escape late payment interest rules

Estate of La Sala, TC Memo 2016-42

The Tax Court has held that an estate's agreement to file a gift tax return and pay the gift tax due with that return, as part of a settlement with IRS that reduced IRS's proposed estate tax deficiency, did not prevent late payment interest from accruing with respect to the gift tax.

Background. The estate tax is computed by first determining a tentative tax on the sum of the taxable estate and adjusted taxable gifts and then by reducing that tentative tax by the amount of gift tax that would have been payable on those gifts, using the rates in effect at the decedent's death. (Code Sec. 2001(b)) The term "adjusted taxable gifts" means the total amount of taxable gifts (within the meaning of Code Sec. 2503) made by the decedent after '76, other than gifts that are includible in the gross estate. (Code Sec. 2001(b)(2))

Code Sec. 2501(a) imposes a tax on the transfer of property by gift during the year. Interest accrues on a Federal gift tax liability at the rate specified by Code Sec. 6621 from the last date prescribed for payment until the date on which the tax is actually paid. (Code Sec. 6601(a)) Unless a statutory exception applies, the courts lack discretion to excuse a taxpayer from payment of interest. (*Johnson, (CA 6 1979) 44 AFTR 2d 79-5607*)

The mortality tables in Code Sec. 7520 cannot be used to determine the present value of an annuity, income interest, remainder interest or reversionary interest if an individual who is a measuring life for the interest is terminally ill at the time of the transaction. For these purposes, an individual who is known to have an incurable illness or other deteriorating physical condition is considered terminally ill if there is at least a 50% probability that the individual will die within one year. (Reg § 1.7520-3(b)(3))

Facts. On Jan. 1, 2003, Anthony La Sala (Anthony), then 93 years old, sold 99% of his wholly owned limited liability company, ALSF, to his daughter. ALSF's assets largely consisted of cash and marketable securities. In return for his ALSF shares, Anthony was to receive an annuity of $913,986 per year to be paid for the rest of his life. In determining this amount, he applied a discount of 50% to the values of the securities held by ALSF.

Anthony died 13 months later, having received one annuity payment. His estate filed a federal estate tax return which reported Anthony's 1% interest in ALSF as an asset of the estate. The return reported the sale of his 99% interest on Schedule I, Annuities. The estate took the position that Anthony's life expectancy exceeded one year when he sold the ALSF shares and that therefore, under the rules of Reg § 1.7520-3(b)(3), the private annuity transaction should be respected and the value of the 99% interest in ALSF would be excluded from the gross estate.

IRS audited the estate tax return and disagreed with the estate's application of Reg § 1.7520-3(b)(3) and with the discounts used for purposes of the sale of the ALSF shares to Anthony's daughter.

Before trial, the parties reached a basis of settlement. IRS conceded that Anthony, as of Jan. 1, 2003, was reasonably expected to survive for at least one year. The estate conceded that the fair market values of the securities held by ALSF were understated by the claiming of excessive discounts. And the parties agreed that, to the extent the value of the transferred 99% interest exceeded the consideration paid therefor—i.e., the value of the annuity—the excess constituted a taxable gift to Anthony's daughter for the tax year 2003.

In 2010, employing a 25% discount for valuing ALSF's securities, the parties calculated a gift tax liability for tax year 2003 of $235,207. Although interest on that gift tax liability would have been a deductible expense in computing the estate tax, neither the estate's nor IRS's calculations took account of any interest on the gift tax.

In September 2010, IRS requested that the estate execute and file a gift tax return (Form 709) to report the agreed gift tax liability. In October 2010, the estate executed and sent to IRS a Form 709 reporting a gift tax liability of $235,207. This gift tax return included the following notation: "The filing of this return is conditioned on the concurrent filing of a Decision with the U.S. Tax Court in Estate of Anthony La Sala, Docket No. 12409-08, reflecting an estate tax settlement reached by the Estate and the Internal Revenue Service."

The parties executed a decision document showing a recalculated estate tax deficiency of $160,176. This deficiency reflected the treatment of the 2003 gift as a prior taxable gift. The Tax Court on Oct. 27, 2010, entered a stipulated decision accordingly. That decision did not mention the 2003 gift tax liability because the notice of deficiency in the case at docket determined a deficiency in estate tax only. On Nov. 15, 2010, the estate sent IRS a check for $230,838, representing the estate tax due plus interest of $70,662, thus discharging the estate tax liability in full. On Nov. 18, 2010, the estate sent IRS a check for $235,207, representing the 2003 gift tax liability but without interest. On Jan. 3, 2011, IRS processed the Form 709 and assessed the gift tax plus interest.

The estate protested the assessment of interest on the gift tax and ultimately brought suit on that issue.

Court finds that interest accrued on the gift tax liability. The estate asked the Court to interpret the settlement to include, as an implied term, that no interest would be due on the 2003 gift tax liability, but the Court rejected its argument.

First, the estate argued that it did not have, under the settlement agreement, an actual delinquent gift tax liability for 2003. Rather, it claimed, the $235,207 figure was a mere "notational amount" that was used in calculating the estate tax deficiency and generating an overall settlement of the estate tax case. The estate asserted that it filed the Form 709, not to acknowledge an actual gift tax liability, but simply to create, at IRS's request, an account entry to which the $235,207 payment could be posted. In support of this argument, the estate cited its notation on the Form 709 that "the filing of this return is conditioned on the concurrent filing of a Decision with the U.S. Tax Court . . . reflecting [the] estate tax settlement."

But, the Court was not convinced. Through negotiations with IRS, the estate secured a settlement ensuring that the private annuity transaction would be respected. In exchange for that concession, the estate conceded that it had undervalued the securities held by ALSF and that, as a result, Anthony made a taxable gift. It was true that the 2003 gift, as a prior taxable gift, generated an input in calculating the estate tax. But it also established an independent gift tax liability for the tax year 2003; if that is not what the estate intended, it should not have signed a stipulation conceding that Anthony had made a taxable gift.

The Court said that the estate voluntarily filed a Form 709 reporting a gift tax liability for 2003. That this return was filed at IRS's request did not make it any less voluntary; the filing of this return was a necessary step in securing a settlement that the estate desired to secure. The appended notation that the filing of the gift tax return was conditioned on entry of a decision in the estate tax case did not render the Form 709 a "non-return." That notation simply indicated, correctly, that the estate's reporting of a 2003 gift tax liability had as a quid pro quo the concessions IRS made in the estate tax case.

The Court said that the estate's explicit concession that Anthony made a taxable gift in 2003 established a gift tax liability for that year. That concession was binding even though no gift tax liability was determined in the notice of deficiency commencing the estate tax case. Therefore, the estate owed interest on this gift tax liability, just as it would owe interest on any other tax liability not paid at the prescribed time.

The estate then argued that even if there was a delinquent gift tax liability for 2003, the settlement included an agreement that this liability would not bear interest. But, the Court said that there was nothing in the stipulation of settlement or the parties' subsequent correspondence addressing interest on the gift tax liability, much less evidencing a mutual understanding that no interest would be due. The IRS employee who handled the settlement negotiation had credibly testified to his belief that he lacked authority to waive interest and that he could never have gotten approval for a settlement that purported to waive interest. The Internal Revenue Manual, at pt. 35.8.2.5.1, provides, "The Service does not settle Tax Court cases by waiving statutory interest." Citing *Smith, TC Memo. 2009-33*, the Court said that "In a tax deficiency suit, deficiency interest is not at issue, and a settlement of the suit that makes no mention of interest should not be construed to somehow settle the issue of interest sub silentio."

Finally, the estate contended that upholding its liability for interest on the 2003 gift tax would be inequitable because it was prevented by the statute of limitations from claiming a deduction for that interest against the estate tax. The Court said that, although it had some sympathy for the estate's position, the responsibility for claiming deductions lies with the taxpayer. The estate's failure to claim a timely deduction for interest does not justify setting aside the statutory interest to which the Government is entitled.

References: For settlement agreements, see Federal Tax Coordinator 2d and RIA's Analysis of Federal Taxes: Income at ¶ T-1911.

Estate wasn't insolvent on distribution date, so executor not liable for unpaid taxes

Singer, TC Memo 2016-48

The Tax Court has held that amounts that state law required estate beneficiaries to contribute towards the estate's taxes had to be considered as estate assets for purposes of determining whether the estate was insolvent and that, as a result, the estate was not insolvent. Accordingly, the executor of the estate was not liable, under 31 USCS 3713(b), the federal priority statute, for the unpaid portion of the estate taxes imposed on the estate.

Background. Personal liability may be imposed upon a fiduciary of an estate in accordance with the federal priority statute, 31 USCS 3713(b). (Code Sec. 6901(a)(1)(B)) Under the federal priority statute, a fiduciary paying any part of a debt of an estate before paying a claim of the government is liable to the extent of the payment for unpaid claims of the government. (31 USCS 3713(b)) Personal liability can attach, to the extent of the distribution, if the government establishes three elements: (1) the fiduciary distributed assets of the estate; (2) the estate was insolvent at the time of the distribution or the distribution rendered the estate insolvent; and (3) the distribution took place after the fiduciary had actual or constructive knowledge of the liability for unpaid taxes. (*Coppola, (CA 2 1996) 77 AFTR 2d 96-2477*)

Insolvency within the meaning of 31 USCS 3713(b) is defined as having liabilities in excess of assets. (*United States v. Oklahoma, (S Ct 1923) 261 U.S. 253*)

Under New York law, with exceptions not applicable here, whenever a fiduciary has paid, or may be required to pay, Federal or State estate tax with respect to any property required to be included in the gross taxable estate, the amount of tax is to be equitably apportioned among the persons interested in the gross taxable estate. (N.Y. Est. Powers & Trust Law sec. 2-1.8(a))

Facts. Mr. Singer was the executor of the estate of Melvin Sacks; Mr. Sacks died in August '90. The estate was large and subject to estate tax, but many of the assets that were included in the gross estate were not probate property. For example, Mr. Sacks jointly owned property with persons that were not Mr. Sacks' spouse, and the gross estate included lifetime gifts made by Mr. Sacks. Mr. Sacks' will made no provision for the payment of estate tax.

On Dec. 21, '90, Singer filed a petition in the Surrogate's Court of the State of New York (surrogate's court) to obtain a restraining order over assets in brokerage accounts that Mr. Sacks owned jointly. Singer sought to restrain these assets since, at the time, it appeared that the probate estate would be insufficient to pay the claims of creditors, including Mr. Sacks' overdue Federal estate tax. The surrogate's court issued an order restraining the brokerage accounts. The assets in the brokerage accounts were still under the control of the surrogate's court at the time of the Tax Court trial.

In March '91, Singer filed a petition in the surrogate's court to disaffirm the transfer of jointly owned real property to the surviving joint owner. Singer stated therein that he sought to disaffirm the transfer for the benefit of the estate's creditors since the Sacks estate appeared to be insolvent.

Singer filed a Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, on behalf of the Sacks estate in November '91 but did not pay any of the tax shown as due. Thereafter, IRS issued an estate tax closing letter showing an unpaid liability of close to $2 million.

At several points throughout Singer's conduct as executor, he sought contribution toward the payment of the estate tax liability from those persons who had received property that was included in the gross estate for estate tax purposes. He reached settlements with two such beneficiaries, one for $87,500 and the other for $25,000.

In April '99, Singer made an application to the surrogate's court for the release of $753,321 from the brokerage accounts to enable the estate to pay $251,107 to one of the beneficiaries, $446,772 to IRS, and $171,587 to the New York Department of Taxation. The surrogate's court approved the release of funds.

IRS issued a notice of fiduciary liability to Singer on July 16, 2013, that determined that Singer was liable for $422,694 (i.e., $251,107 plus $171,587) of the estate's unpaid estate tax.

Tax Court determines estate was not insolvent, so executor wasn't liable for estate taxes. The only issue before the Tax Court was whether the estate was insolvent at the time of the distributions in question or those distributions rendered the estate insolvent. The Court concluded that there was no insolvency and that therefore Singer was not liable under Code Sec. 6901 and 31 USCS 3713(b).

IRS made several arguments that the Court rejected.

First it cited statements from Singer and third parties to the effect that the estate was insolvent at various times between the opening of the estate and the date of the distributions at issue. But the Court said IRS misinterpreted those statements. For example, in Singer's actions to restrain the brokerage accounts, he said noted that "the decedent's testamentary estate may be insufficient to pay the claims of creditors (including balances due the income tax authorities) and Federal and New York estate taxes." Similarly, in Singer's petition to the surrogate's court to disaffirm the transfer of the jointly owned real property, he stated: "The decedent's estate is insolvent; the assets of deceased, other than the assets for the recovery of which this action is brought, are insufficient to pay the debts of deceased." The Court said that when these statements are read in their proper context, it is clear Singer was referring only to the solvency of the *probate estate.* In fact, the primary impetus for Singer's actions with respect to the brokerage accounts and the real property was to secure assets that were under the control of joint owners so that those assets would be available to pay the estate's tax liabilities.

IRS then argued that the amounts owed by the beneficiaries for their share of the estate taxes were not collectible. But the Court pointed out the $87,500 and $25,000 that were already collected. And, it pointed out that 70% of the nonprobate property was property that had been jointly owned by Mr. Sacks and a Ms. Atwell, and the vast majority of the Sacks-Atwell assets were the brokerage account that was still under the control of the surrogate's court at the time of the Tax Court trial. So, the Tax Court concluded that the contribution rights owing from Ms. Atwell were surely not worthless.

IRS also argued that Singer could not escape liability by entering into agreements with third parties to pay the estate tax liability. For support, IRS cited *Coppola.* In that case, the executor of an estate had stripped it of all of its assets by dividing the family businesses, which formed the bulk of the estate, among various family members. In exchange for receipt of the business interests, the recipients signed an agreement to pay any estate taxes due in proportion to the value of the assets they had received. The Court of Appeals for the Second Circuit held that the executor was personally liable despite the existence of the agreement purporting to apportion estate taxes among the beneficiaries of the distribution. With respect to the personal liability of an executor, the arrangement for payment of unpaid taxes by a third party has no effect on the executor's liability for those taxes.

The Court here said that the agreement in *Coppola* was distinguishable from the facts at hand. *Coppola* didn't address whether the agreements affected the estate's solvency or dealt with the value of contribution rights from third parties. Additionally, Singer did not argue that the contribution rights should absolve him of liability but rather argued, rightly so, that they should be counted as assets of the estate when calculating the estate's solvency.

The Court then said that, in the Court of Appeals for the Second Circuit, to which an appeal in this case would lie, contingent subrogation and contribution rights must be valued as assets in determining solvency. Accordingly, when calculating the estate's assets, it was appropriate to include the value of any contribution rights from Ms. Atwell and the other beneficiaries and takers of non-probate property. Including those amounts, the Court found that the estate was not insolvent in Apr. '99 and that, therefore, Singer was not liable for the estate tax owed by the estate.

References: For fiduciary's personal liability for unpaid taxes, see Federal Tax Coordinator 2d and RIA's Analysis of Federal Taxes: Income at ¶ V-9605; U.S. Tax Reporter: Income at ¶ 69,014.

IRS correction; overpayment and underpayment rates increase 1% for second quarter, 2016

Rev Rul 2016-6, 2016-14 IRB; IR 2016-41, 03/16/2016

IRS has announced that the interest rates for tax overpayments and underpayments will increase by one percentage point for the second quarter of 2016.

observation: Earlier this week, IRS issued versions of the above Revenue Ruling and Information Release that provided that rates had not changed for the second quarter of 2016. It has now corrected those earlier documents..

observation: The interest rates for tax overpayments and underpayments had remained constant for eighteen quarters in a row (i.e., beginning Oct. 1, 2011 and ending on Mar. 31, 2016).

For noncorporate taxpayers, the rate for both underpayments and overpayments for the second quarter of 2016 will be 4%. The 4% rate also applies to

estimated tax underpayments for the second quarter in 2016.

For corporations, the overpayment rate for the second quarter of 2016 will be 3%. Corporations will receive 1.5% for overpayments exceeding $10,000. The underpayment rate for the second quarter of 2016 for corporations will be 4%, but will be 6% for large corporate underpayments.

Under Code Sec. 6621(b)(2)(B), the 3% rate that applies to estimated tax underpayments for the first calendar quarter in 2016, as provided in Rev Rul 2015-23, 2015-52 IRB, also applies to such underpayments for the first 15 days in April 2016.

Interest factors for daily compound interest for annual rates of 1.5%, 3%, 4% and 6% are published in Tables 56, 59, 61, and 65 of Rev Proc 95-17, 1995-1 CB 556.

References: For interest on tax overpayments, see Federal Tax Coordinator 2d and RIA's Analysis of Federal Taxes: Income at ¶ T-8002; U.S. Tax Reporter: Income at ¶ 66,214; Tax Desk at ¶ 807,001; RIA's Tax Guide at ¶ 70901. For interest on tax underpayments, see Federal Tax Coordinator 2d and RIA's Analysis of Federal Taxes: Income at ¶ V-1101; U.S. Tax Reporter: Income at ¶ 66,214; Tax Desk at ¶ 851,001; RIA's Tax Guide at ¶ 71566.

Applicable Federal Rates for April

Rev Rul 2016-9, 2016-14 IRB

The Applicable Federal Rates for April 2016 are reproduced below.

Table 1
Applicable Federal Rates (AFRs) for April 2016

	Period for Compounding			
	Annual	Semiannual	Quarterly	Monthly
		Short-Term		
AFR	.70%	.70%	.70%	.70%
110% AFR	.77%	.77%	.77%	.77%
120% AFR	.84%	.84%	.84%	.84%
130% AFR	.91%	.91%	.91%	.91%
		Mid-Term		
AFR	1.45%	1.44%	1.44%	1.44%
110% AFR	1.59%	1.58%	1.58%	1.57%
120% AFR	1.74%	1.73%	1.73%	1.72%
130% AFR	1.88%	1.87%	1.87%	1.86%
150% AFR	2.17%	2.16%	2.15%	2.15%
175% AFR	2.54%	2.52%	2.51%	2.51%
		Long-Term		
AFR	2.25%	2.24%	2.23%	2.23%
110% AFR	2.48%	2.46%	2.45%	2.45%
120% AFR	2.71%	2.69%	2.68%	2.68%
130% AFR	2.93%	2.91%	2.90%	2.89%

Table 2
Adjusted AFR for April 2016

	Period for Compounding			
	Annual	Semiannual	Quarterly	Monthly
Short-term adjusted AFR	.46%	.46%	.46%	.46%
Mid-term adjusted AFR	1.12%	1.12%	1.12%	1.12%
Long-term adjusted AFR	2.25%	2.24%	2.23%	2.23%

Table 3
Rates Under Section 382 for April 2016

Adjusted federal long-term rate for the current month	2.25%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months)	2.53%

Table 4
Appropriate Percentages Under Section 42(b)(1)
for April 2016

Under section 42(b)(2), the applicable percentage for non-federally subsidized new buildings placed in service after July 30, 2008, cannot be less than 9%.

Appropriate percentage for the 70% present value low-income housing credit	7.42%
Appropriate percentage for the 30% present value low-income housing credit	3.18%

Table 5
Rate Under Section 7520 for April 2016

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	1.8%

The latest AFRs are available at https://tax.thomsonreuters.com/products/brands/checkpoint/ria-wgl/afr-rates.

Disaster victims in Texas and Louisiana qualify for tax relief

IRS has announced on its website that victims of the severe storms, tornadoes, and flooding in counties of Texas that are designated as federal disaster areas qualifying for individual assistance, as well as additional victims of severe storms and flooding in parts of Louisiana that are also designated as federal disaster areas, have more time to make tax payments and file returns. Certain other time-sensitive acts also are postponed. This article summarizes the relief that's available and includes up-to-date disaster area designations and extended filing and deposit dates for all areas affected by storms, floods and other disasters in 2016.

Who gets relief. Only taxpayers considered to be affected taxpayers are eligible for the postponement of time to file returns, pay taxes and perform other time-sensitive acts. Affected taxpayers are those listed in Reg § 301.7508A-1(d)(1) and thus include:

. . . any individual whose principal residence, and any business entity whose principal place of business, is located in the counties designated as disaster areas;

. . . any individual who is a relief worker assisting in a covered disaster area, regardless of whether he is affiliated with recognized government or philanthropic organizations;

. . . any individual whose principal residence, and any business entity whose principal place of business, is not located in a covered disaster area, but whose records necessary to meet a filing or payment deadline are maintained in a covered disaster area;

. . . any estate or trust that has tax records necessary to meet a filing or payment deadline in a covered disaster area; and

. . . any spouse of an affected taxpayer, solely with regard to a joint return of the husband and wife.

What may be postponed. Under Code Sec. 7508A, IRS gives affected taxpayers until *the extended date (specified by county, below)* to file most tax returns (including individual, estate, trust, partnership, C corporation, and S corporation income tax returns; es-

tate, gift, and generation-skipping transfer tax returns; and employment and certain excise tax returns), or to make tax payments, including estimated tax payments, that have either an original or extended due date falling on or after *the onset date of the disaster (specified by county, below),* and on or before *the extended date.*

IRS also gives affected taxpayers until *the extended date* to perform other time-sensitive actions described in Reg § 301.7508A-1(c)(1) and Rev Proc 2007-56, 2007-34 IRB 388, that are due to be performed on or after *the onset date of the disaster,* and on or before *the extended date.* This relief also includes the filing of Form 5500 series returns, in the way described in Rev Proc 2007-56, Sec. 8. Additionally, the relief described in Rev Proc 2007-56, Sec. 17, relating to like-kind exchanges of property, also applies to certain taxpayers who are not otherwise affected taxpayers and may include acts required to be performed before or after the period above.

The postponement of time to file and pay does not apply to information returns in the W-2, 1098, 1099 or 5498 series, or to Forms 1042-S or 8027. Penalties for failure to timely file information returns can be waived under existing procedures for reasonable cause. Likewise, the postponement does not apply to employment and excise tax deposits. IRS, however, will abate penalties for failure to make timely employment and excise deposits, due on or after *the onset date of the disaster,* and on or before *the deposit delayed date (specified by county, below),* provided the taxpayer made these deposits by *the deposit delayed date.*

Affected areas and dates for storms, floods and other disasters occurring in 2015 (or in 2014, with extended dates going into 2015) that are federal disaster areas qualifying for individual assistance, as published on IRS's website, are carried below.

observation: Effective for disasters declared in tax years beginning after Dec. 31, 2007, the term "federally declared disaster" replaced the previously used 'presidential disaster area" term (see Code Sec. 1033(h)(3), as amended by Sec. 706(d)(1), Div. C, P.L. 110-343, 10/03/2008). The new term is substantially the same as the definition of "presidentially declared disaster" under former law. (TD 9443, 01/4/2009, see Weekly Alert, 01/22/2009)

Arkansas: The following are federal disaster areas qualifying for individual assistance on account of severe storms, tornadoes, straight-line winds and flooding that took place beginning on Dec. 26, 2015: Benton, Carroll, Crawford, Faulkner, Jackson, Jefferson, Lee, Little River, Perry, Sebastian, and Sevier counties.

For these Arkansas counties, the onset date of the disaster was Dec. 26, 2015, the extended date is May 16, 2016 (which includes the 2015 income tax returns normally due on Apr. 18, the Jan. 15 and Apr. 18 deadlines for making quarterly estimated tax payments, the Feb. 1 and May 2 deadlines for quarterly payroll and excise tax returns, and the special Mar. 1 deadline for farmers and fishermen who choose to forgo making estimated tax payments). The deposit delayed date was Jan. 11, 2016.

California: The following are federal disaster areas qualifying for individual assistance on account of the Valley and Butte fires that took place beginning on Sept. 12, 2015: Calaveras and Lake counties.

For these California counties, the onset date of the disaster was Sept. 12, 2015, the extended date was Jan. 15, 2016 (which includes the Sept. 15 estimated tax deadline, the 2014 corporate and partnership returns on extension thru Sept. 15, and the Oct. 15 deadline for those who received an extension to file their 2014 return). The deposit delayed date was Sept. 28, 2015.

Louisiana: The following are federal disaster areas qualifying for individual assistance on account of severe storms and flooding that took place beginning on Mar. 8, 2016: Allen, Ascension, Beauregard, Bienville, Bossier, Caddo, Calcasieu, Caldwell, Claiborne, De Soto, Grant, La Salle, Livingston, Madison, Morehouse, Natchitoches, Ouachita, Richland, St. Tammany, Tangipahoa, Union, Vernon, Washington, Webster, West Carroll, and Winn parishes.

For these Louisiana parishes, the onset date of the disaster was Mar. 8, 2016, and the extended date is July 15, 2016 (which includes 2015 income tax returns normally due on April 18, the April 18 and June 15 deadlines for making quarterly estimated tax payments, and a variety of business tax deadlines including the May 2 deadlines for quarterly payroll and excise tax returns). The deposit delayed date was Mar. 23, 2016.

Mississippi: The following are federal disaster areas qualifying for individual assistance on account of recent storms that took place beginning on Dec. 23, 2015: Benton, Coahoma, Marshall, Monroe, Panola, Prentiss, Quitman, and Tippah counties.

For these Mississippi counties, the onset date of the disaster was Dec. 23, 2015, and the extended date is May 16, 2016 (which includes the 2015 income tax returns normally due on Apr. 18, the Jan. 15 and Apr. 18 deadlines for making quarterly estimated tax payments, and a variety of business tax deadlines including the Feb. 1 and May 2 deadlines for quarterly payroll and excise tax returns and the special Mar. 1 deadline for farmers and fishermen who choose to forgo making estimated tax payments). The deposit delayed date was Jan. 7, 2016. (IR 2016-2, 01/07/2016)

Missouri: The following are federal disaster areas qualifying for individual assistance on account of recent storms that took place beginning on Dec. 23, 2015: Barry, Barton, Camden, Cape Girardeau, Cole, Crawford, Franklin, Gasconade, Greene, Hickory, Jasper, Jefferson, Laclede, Lawrence, Lincoln, Maries, McDonald, Morgan, Newton, Osage, Phelps, Polk, Pulaski, Scott, St. Charles, St. Francois, St. Louis, Ste. Genevieve, Stone, Taney, Texas, Webster, and Wright counties.

For these Missouri counties, the onset date of the disaster was Dec. 23, 2015, and the extended date is May 16, 2016 (which includes 2015 income tax returns normally due on April 18, the Jan. 15 and Apr. 18 deadlines for making quarterly estimated tax payments, and a variety of business tax deadlines including the Feb. 1 and May 2 deadlines for quarterly payroll and excise tax returns and the special March 1 deadline for farmers and fishermen who choose to forgo making estimated tax payments). The deposit delayed date was Jan. 7, 2016. (IR 2016-9, 01/22/2016)

South Carolina: The following are federal disaster areas qualifying for individual assistance on account of severe storms and flooding that took place beginning on Oct. 1, 2015: Bamberg, Berkeley, Calhoun, Charleston, Clarendon, Colleton, Darlington, Dorchester, Fairfield, Florence, Georgetown, Greenville, Greenwood, Horry, Kershaw, Lee, Lexington, Marion, Newberry, Orangeburg, Richland, Spartanburg, Sumter and Williamsburg counties.

For these South Carolina counties, the onset date of the disaster was Oct. 1, 2015, and the extended date was Feb. 16, 2016 (which includes the Oct. 15 deadline for those who received an extension to file their 2014 return). The deposit delayed date was Oct. 16, 2015.

Texas: The following are federal disaster areas qualifying for individual assistance on account of severe storms, tornadoes, straight-line winds and flooding that took place beginning on Oct. 22, 2015: Bastrop, Brazoria, Caldwell, Cameron, Comal, Galveston, Guadalupe, Hardin, Harris, Hays, Hidalgo, Liberty, Navarro, Travis, Willacy, and Wilson counties.

For these Texas counties, the onset date of the disaster was Oct. 22, 2015, and the extended date was Feb. 29, 2016. The deposit delayed date was Nov. 6, 2015.

Texas: The following are federal disaster areas qualifying for individual assistance on account of severe storms, tornadoes, and flooding that took place beginning on Mar. 7, 2016: Jasper, Newton, and Orange counties.

For these Texas counties, the onset date of the disaster was Mar. 7, 2016, and the extended date is July 15, 2016 (which includes the 2015 income tax returns normally due on April 18, the April 18 and June 15 deadlines for making quarterly estimated tax payments, and a variety of business tax deadlines including the May 2 deadlines for quarterly payroll and excise tax returns). The deposit delayed date was Mar. 22, 2016.

References: For postponement of tax deadlines due to disasters, see Federal Tax Coordinator 2d and RIA's Analysis of Federal Taxes: Income at ¶ S-8500; U.S. Tax Reporter: Income at ¶ 75,08A4; Tax Desk at ¶ 570,306; RIA's Tax Guide at ¶ 1944.

Important date approaching in 2016 for older clients with IRAs and qualified plan accounts

A critical date is approaching for many clients who attained age 70½ in 2015. By Apr. 1, 2016, these clients must commence making required minimum distributions (RMDs) from their traditional IRAs. (Lifetime distributions need not be taken from Roth IRAs at any age.) (Code Sec. 408A(c)(5)) A participant in a qualified retirement plan (e.g., 401(k) plan) must begin taking distributions by Apr. 1 of the calendar year following the later of the year in which he: (a) reaches age 70½, or (b) retires (except for 5% owners, who are subject to the same rules as IRA owners). A qualified plan may provide that the required beginning date for all employees (including non-5% owners) is Apr. 1 of the calendar year following the calendar year in which the employee attains age 70½. (Code Sec. 401(a)(9)(C); Reg § 1.401(a)(9)-2, Q&A 2(e))

How to calculate the RMD. If the IRA account balance is not distributed in full to its owner by the

required beginning date, the RMD for each year from IRAs or individual accounts under a qualified defined contribution plan is found by dividing the account balance as of the end of the preceding year by the life expectancy factor from a uniform table in Reg § 1.401(a)(9)-9, Q&A 2. This table is used in all cases, except where the account's designated beneficiary is (a) the account owner's spouse and (b) more than 10 years younger than the owner. In this instance, the joint life and last survivor life expectancy table in Reg § 1.401(a)(9)-9 Q&A 3 is used. (Reg § 1.401(a)(9)-5, Q&A 4(a))

caution: The Apr. 1 required beginning date is critical because failure to begin RMDs could expose the taxpayer to a penalty tax equal to 50% of the difference between the amount that should have been withdrawn and the amount that was withdrawn. (Code Sec. 4974) However, the penalty may be waived if the shortfall in the distribution was due to reasonable error, and reasonable steps are being taken to remedy it.

Attainment of age 70½. A taxpayer attains age 70½ as of the date that is six months after the 70th anniversary of his birth.

observation: A taxpayer attained age 70½ in 2015 if he was born after June 30, '44, and before July 1, '45.

Multiple IRAs. If your client has several traditional IRAs, the RMD amount is calculated separately for each IRA. However, the RMD amounts for the separate IRAs may be totaled and the aggregated RMD amount may be paid out from any one or more of the IRA accounts. (Reg § 1.408-8, Q&A 9) Roth IRAs aren't included.

illustration: Jack has two separate IRAs. The RMD for IRA-A is $18,000 and the RMD for IRA-B is $10,000. Jack may take his total $28,000 RMD from either IRA-A or IRA-B, or take distributions from both as long as the total IRA payout for the year is $28,000.

caution: Many financial institutions automatically place each year's IRA-RMD in a separate non-IRA account. This procedure avoids the risk of penalties for insufficient distributions. A taxpayer who wants to take his RMD from another IRA should notify the trustees of the IRAs from which he does not want to withdraw in order to avoid an amount being automatically withdrawn from them.

caution: RMDs from inherited IRAs must be figured separately from required minimum distributions from IRAs in the taxpayer's own name.

Multiple qualified plans. The amount of each RMD must be calculated and paid separately for each qualified plan. Therefore, the RMD for one qualified plan account cannot be aggregated with the RMD from another plan and distributed from one plan. If an employee's interest in a plan is divided into separate accounts, however, they generally are aggregated for RMD purposes. Note that under Reg § 1.401(a)(9)-8, Q&A 2, separate accounts in a qualified plan aren't aggregated in certain situations after the death of the account owner.

Tax planning for clients who attain age 70½ in 2016. In general, the first distribution year is the year in which the IRA or qualified plan account owner attains age 70½. (Reg § 1.401(a)(9)-5, Q&A 1(b)) The taxpayer may postpone the first RMD until the second distribution year (i.e., make the first RMD by Apr. 1 of the second year). But those who do that still must take a distribution for the second distribution year, resulting in two distributions in a single year. Clients attaining age 70½ in 2016 should consider taking their first year's RMD during 2016, rather than waiting until 2017. Doing so may avoid a bunching-of-income problem in 2017.

illustration: Anna attains age 70½ in 2016 and her aggregated RMD for all her IRAs for that year is $35,000. For simplicity, assume her aggregated IRA-RMD for 2017 also will be $35,000. If Anna waits until March of 2017 to take the $35,000 RMD for her first distribution year (2016), she will have to withdraw another $35,000 from her IRAs by the end of 2017. Both amounts will be included on her 2017 return and could cause loss of tax breaks.

Consequences of delay. Delaying taking the first year's RMD until the second distribution year could have one or more of the following effects:

(1) All or part of the first distribution may be taxed at a higher rate than it would have been taxed at if distributed in the first year.

observation: Taxpayers may have an additional tax incentive—namely, *state* tax savings—for not waiting until the second distribution year to take their first year's RMD. By waiting, they could lose part or all of the benefits of a state pension/retirement income exclusion for the first distribution year.

(2) It could cause some or all of the taxpayer's qualified dividends and/or net capital gains to be taxed at 15% rather than 0%.

(3) More of the account owner's social security benefits may be subject to tax.

(4) The resulting increase in the account owner's adjusted gross income (AGI) for the second distribution year may cause a reduction in deductions and/or credits subject to an AGI floor, such as the deduction for medical expenses, the deduction for casualty losses, and the personal exemption phaseout (PEP) and the itemized deduction (Pease) limitations.

(5) It could trigger a 3.8% surtax on the account owner's net investment income. This surtax applies to the lesser of (1) net investment income or (2) the excess of modified adjusted gross income (MAGI) over the threshold amount ($250,000 for joint filers or surviving spouses, $125,000 for marrieds filing a separate return, and $200000 for other taxpayers). For surtax purposes, investment income does not include distributions from IRAs or qualified plans. But MAGI does income distributions from IRAs or qualified plans, including, of course, RMDs.

When it may be advisable to delay taking the first distribution until the second distribution year. In some situations, it may be advisable for the IRA or qualified plan account owner to delay taking the first distribution from a traditional IRA or qualified plan account until the second distribution year. Here are some key examples:

. . . The account owner expects to be in a lower tax bracket in the second distribution year. This could result from his having lower taxable income from other sources in the second tax year.

. . . The account owner expects that taking two distributions in the same year won't cause any part of the total distribution to be taxed at a higher rate than it would be taxed at if the distributions were taken in separate years. By deferring the first distribution to the second distribution year, the distributee can continue to earn tax-deferred income for a longer period of time.

. . . If the account owner expects to have less income from other sources in the second distribution year, deferring the first distribution to that year may enable him to avoid or minimize AGI limitations in the first distribution year without causing any increase in those limitations in the second distribution year. For example, suppose an IRA owner continues to work until after age 70½ and has unreimbursed business expenses in the year he retires. By delaying taking the first distribution until the second distribution year, AGI for the year of retirement will be reduced, and more of the unreimbursed business expenses may be deductible as a miscellaneous itemized deduction.

. . . Taking the first year's RMD will cause the taxpayer's MAGI to exceed the threshold amount that triggers the 3.8% surtax on NII, but deferring the distribution until the following year will not have the same effect because his income from other sources will be much lower.

caution: Taxpayers considering a rollover from a regular IRA to a Roth IRA should keep in mind that RMDs cannot be part of the rollover.

Qualified charitable distributions and RMDs. Taxpayers who are age 70½ or older may make tax-free distributions to a charity directly from an Individual Retirement Account (IRA) of up to $100,000 per year. (Code Sec. 408(d)(8)) These distributions, called qualified charitable distributions, aren't subject to the charitable contribution percentage limits since they are neither included in gross income nor claimed as a deduction on the taxpayer's return.

Qualified charitable distributions should be considered by better-off, charitable-minded taxpayers who don't need to withdraw money from their retirement plans, but must anyway because of the RMD rules. Reason: Although such distributions aren't included in the taxpayer's gross income, they are taken into account in determining his RMD for the year. For example, if a taxpayer's IRA-RMD for the year is $80,000, and he makes a $50,000 qualified charitable distribution from the IRA, another $30,000 withdrawal from the IRA will satisfy the year's RMD requirement.

For a Client Letter on the advantages of accelerating RMDs from qualified plans and traditional IRAs, see FTC Client Letters at ¶ 1303.

RIA Tax Watch 2016

. . . House Budget Committee introduces FY 2017 budget. On March 15, the House Budget Committee introduced its Fiscal Year 2017 budget proposal, "A Balanced Budget for a Stronger America," which would cut nearly $7 trillion from the federal budget over 10 years, in part by repealing all of the Affordable Care Act and reforming the tax Code. The budget proposal calls for a major overhaul of the tax Code, with a lowering of rates and a consolidation of tax brackets. In addition, it would repeal the alternative minimum tax and transition away from a world-

wide tax system. The budget resolution faces strong opposition from a large bloc of Republicans, the Freedom Caucus, who have stated they will not support the budget's $1.07 trillion level for discretionary spending. Senate Majority Leader Mitch McConnell (R-KY) has also stated that he has no intention of bringing a budget resolution to the floor as Congress passed a 2-year budget package in 2015.

Washington Alert —Part I

. . . Despite a Capitol Hill appearance by Treasury Secretary Jacob Lew on March 16, it seems unlikely that a $1 billion increase in funding for IRS contained in the Obama administration's fiscal year (FY) 2017 budget request will take place. The budget request supports a key administration priority of making "strategic investments in the IRS to provide the level of customer service and privacy protections that Americans expect and deserve," Lew told the House Appropriations Subcommittee on Financial Services and General Government. At current levels, IRS is "severely underfunded," he contended. "A sustained deterioration in taxpayer services combined with diminished enforcement capacity could create serious long-term risk for the U.S. tax system," Lew said. However, his arguments were quickly rebuffed by Rep. Harold Rogers (R-KY), chairman of the full appropriations committee. The administration should operate within the limits of the bipartisan budget agreement, Rogers said, adding that IRS must prioritize spending as other federal agencies must do. He also said he was "very disappointed" that the IRS budget proposal eliminates three particular administrative provisions that have been enacted with bipartisan support for several years. "Since the IRS'targeting and spending scandals, appropriations bills have included prohibitions against: targeting U.S. citizens for exercising their First Amendment rights, targeting groups for regulatory scrutiny based on their ideological beliefs, and making videos without advance approval," Rogers said.

. . . IRS will conduct a webinar on March 30 titled "Affordable Care Act: Applicable Large Employers Information Return Requirements." (e-News for Tax Professionals 2016-10) Topics that will be covered include the following: information on filing responsibilities for applicable large employers, private insurers, software developers, transmitters and government program providers; rules for government entity designation, third party and multiple employer plans; filing extensions granted for 2015; and transition relief for 2015. There will be a live question and answer session with IRS subject matter experts. Certificates of completion are being offered and it is possible to earn one continuing education credit. To register, go to https://www.webcaster4.com/Webcast/Page/445/13498.

. . . Total IRS revenue agent audit hours aimed at larger corporations, which are those with a minimum of at least $250 million in assets, dropped by 34% from FY 2010 to FY 2015, according to a new report released by the Transactional Records Access Clearinghouse (TRAC) based at Syracuse University. (IRS Auditing of Big Corporations Plummets) In the same period, the resulting additional taxes uncovered by agents that have been lost to the government fell by 64% from $23.7 billion to $8.5 billion, the report said. "Unless there has been a dramatic improvement in the way big corporations complied with complex requirements of the tax laws over the FY 2010-2015 period, this would mean that the potential loss to the government now amounts to at least $15 billion per year," the TRAC said. The report also took a close look at what were described as "the absolute giants of the business world," meaning those with $20 billion or more in assets. This revealed "declines in audit attention that were even sharper," the report said. The revenue agent audit time for this group in the FY 2010-2015 period was off by 47%. The recommended additional taxes dropped by 71%, from $13.4 billion to $3.9 billion. The report can be found at http://trac.syr.edu/tracirs/latest/416/.

Washington Alert —Part II

. . . Despite progress in ongoing efforts to end the scourge of telephone scammers pretending to be from IRS and threatening taxpayers, the end is not yet in sight, J. Russell George, the Treasury inspector general for tax administration (TIGTA), said on March 16. He advised taxpayers "to stay on high alert through the end of the 2016 tax filing season." According to George, TIGTA's counteroffensive consists of a number of elements – using an autodialer to call the scammers to advise them that their activity is criminal and to cease and desist; working with telephone companies to shut down the telephone numbers used to perpetrate these crimes; publishing telephone numbers associated with the criminal activity on the Internet; and engaging in widespread outreach efforts to educate taxpayers about the scam. The four-part

strategy is producing results, he said. "Where the perpetrators used to be able to get a victim every 40-50 calls, now they must make 300-400 attempts to claim a victim," George added. Additional details can be found at https://www.treasury.gov/tigta/press/press_tigta-2016-07.htm.

. . . Claims of the small employer health insurance tax credit (also known as the small business health care tax credit) have remained lower than was initially estimated by government agencies and small business groups, according to March 22 testimony delivered on Capitol Hill by James McTigue, director, strategic issues, for the Government Accountability Office (GAO). (GAO-16-491T) This has limited the effect of the credit on expanding health insurance coverage via small employers, he told a House Small Business Committee panel. As described by McTigue, the credit was created by the Affordable Care Act to help eligible small employers – businesses or tax-exempt entities – provide health insurance for employees. "In 2012, GAO reported that selected estimates of the number of employers eligible ranged from about 1.4 million to 4 million," he added. Claims for the credit totaled $541 million in 2014, in stark contrast to initial estimates of $2 billion by the Congressional Budget Office and the Joint Committee on Taxation. Among the reasons for the lower-than-expected claims for the credit cited by McTigue were the following: the maximum amount of the credit is not an effective incentive; few small employers qualify for the maximum credit; the credit can only be claimed for two consecutive years after 2013; and the cost and complexity involved in claiming the credit "was significant." His prepared testimony can be found at http://gao.gov/assets/680/675969.pdf.

. . . The Joint Committee on Taxation (JCT) on March 21 published a document titled "Background on Cash-Flow and Consumption-Based Approaches to Taxation." (JCX-14-16) The document is divided into four parts which provide the following – an overview of the proposals and issues; a summary of the present-law federal tax system; a general description of four tax systems that adopt a cash-flow and consumption-based approach to taxation: the value-added tax, the flat tax, the X-tax, and the national retail sales tax; and an analysis of the proposals and a general discussion of cash-flow and consumption-based approaches to taxation. The last part also evaluates the proposals in the context of four criteria that economists have used to examine the effectiveness of tax systems: efficiency, equity, simplicity, and administration. The document, which was prepared for a hearing of the House Ways and Means Subcommittee on Tax Policy, can be found at https://www.jct.gov/publications.html?func=startdown%26id=4880. For a more in-depth discussion of the document and hearing, see Weekly Alert.

— *WG&L Digests* —

EU succession Reg. can affect non-member state nationals.

On 8/17/2015, the EU Succession Regulation (Regulation No 650/2012 of 7/4/2012) (the "Regulation") came into effect in 25 European Member States (the "Member States"). The United Kingdom, Denmark, and Ireland have chosen to opt-out and are not directly bound by the Regulation, as is the case with non-EU Member States such as Switzerland. Moreover, nationals of non-Member States, such as the U.S. and Canada, may still be affected by the Regulation depending on the location of their assets or their habitual residence. This article illustrates some of the more common interactions between non-Member State nationals, non-Member States, and the Regulation. (M. Michaels and J. Crivellaro, 43 Estate Planning, No. 4, 40 (April 2016).)

Limit unwanted spousal asset rights in estate plans.

Remarriage automatically creates rights, powers, and benefits for each new spouse -- often to the detriment of the other spouse's heirs. This article considers ways to reduce claims against assets of the new spouse. These techniques are largely "state specific," so engaging competent local counsel is a vital element in making and implementing these decisions. (J.J. Scroggin, 43 Estate Planning, No. 4, 30 (April 2016).)

International estate planning for the domestic lawyer.

As the iconic Disney Theme Park ride repeatedly states, "it's a small world after all." And in an increasingly international society, the world is getting even smaller. It is now fairly common for the average trusts and estates client to have connections to countries outside of the U.S. From a U.S. client who owns foreign assets or who is a beneficiary of a foreign trust to a nonresident alien (NRA) who owns U.S.-source assets, a failure by the practitioner to identify and plan

around potential international estate planning issues may result in large tax bills that could otherwise have been avoided by using the strategies discussed in this article. The purpose of this article is to make estate planners who focus primarily on domestic issues cognizant of the international estate planning considerations and techniques that cannot be ignored in our ever-globalized society. The article begins by highlighting some of the latest developments in international estate planning and then continues by exploring some of the more important international estate planning questions that every trusts and estates practitioner should consider. (M. T. Meltzer, M. S. Schwartz, and S. R. Weissbart, 43 Estate Planning, No. 4, 13 (April 2016).)

Filing Form 709 beyond the basics of gift tax returns.

Since 2013, the gift tax filing threshold has been $14,000, making it relatively apparent that if a client made a gift in excess of $14,000 to any one person (other than a spouse) in 2013 or any year thereafter, the client probably had to file a federal gift tax return (Form 709). Less obvious are the various elections, allocations, and disclosures reported on Form 709 that provide additional reasons to file gift tax returns, some of which are mandatory and some of which are elective. This article explores some of those less obvious issues that may arise when preparing a Form 709. (S. Bieber and S. J. Chang, 43 Estate Planning, No. 4, 3 (April 2016).)

Dilemma for trustee when beneficiary has addiction.

A discretionary trust is a trust document drafted in such a way that the trustee has discretion in deciding when and how much income or principal is to be distributed to the named beneficiaries. The main responsibility given to the trustee is to distribute income and principal in accordance with the provisions of the trust agreement, taking into consideration the intent of the settlor and the best interest of the beneficiaries. A discretionary trust suggests an effort by the trust creator to perpetuate the core values that are important to him or her by vesting the trustee with discretionary power to make or withhold distribution to and among the class of beneficiaries named. This article discusses the dilemma for the trustee of a discretionary trust when a primary beneficiary, or one or more of a group of primary beneficiaries, has an addiction to drugs or alcohol. Conflict arises when a primary beneficiary requests funds from the trustee and the trustee is unwilling to exercise his or her discretion to comply with the beneficiary's request. (E. O Dea and R. Whitman, 43 Estate Planning, No. 4, 27 (April 2016).)

District court in Santander upholds a STARS transaction, disagrees with other courts.

In *Santander Holdings USA, Inc., 116 AFTR2d 2015-6795 (DC Mass., 2015)*, a Massachusetts federal district court concluded that the STARS transaction entered into by Santander should be respected, and Santander was entitled to its claimed foreign tax credits, notwithstanding that other courts had reached the opposite conclusion. The district court specifically addressed the decisions from each of the other courts and indicated where, in the court's view, the other courts had erred in their analyses. From a purely logical standpoint, the district court's opinion is a tour de force, and its step-by-step legal analysis demolished the government's arguments. Moreover, the district court strongly attacked the use by the IRS and other courts of "Section I Don't Like It" as a basis for application of the tax laws. However, it remains to be seen whether this opinion will be sustained on appeal, particularly in light of the decisions of the other courts of appeal that have considered identical transactions. (R.M. Lipton, 124 Journal of Taxation 127 (March 2016).)

Children with foreign accounts: unexpected tax, Schedule B, Form 8938, and FBAR issues.

The goal of most parents is to make the lives of their children better than their own. Methods for reaching this lofty aspiration abound, but most entail establishing some degree of financial security for the children. Parents open different types of accounts for their children, such as those for covering college expenses, facilitating receipt of monetary gifts from relatives on birthdays and holidays, and creating a fund to be released to the children upon graduation, adulthood, marriage, or some other future contingency. Unfortunately, this type of laudable behavior can trigger U.S. tax problems for children when the financial accounts are located outside the United States. This article describes a typical scenario triggering unintentional violations, examines the thorny tax and information-reporting requirements for children and parents,

and analyzes the options that children have for resolving problems with the IRS. (H.E. Sheppard, 124 Journal of Taxation 134 (March 2016).)

Final regulations revise rules on grants to foreign charities by private foundations.

With the ever-increasing popularity of international grant-making by private foundations, the issuance of final regulations provides welcome guidance to foundations in making a good faith determination that a foreign charity is the equivalent of a U.S. public charity and, therefore, that a grant to such a charity will be considered a qualifying distribution under Code Sec. 4942 and not a taxable expenditure under Code Sec. 4945. Although the final regulations eliminate the long-standing rule allowing an affidavit of a foreign charity to ordinarily serve as the basis for making such a determination, they expand the class of qualified tax professionals on whose advice a private foundation can rely to attorneys, CPAs, and enrolled agents, which includes organizations employing qualified tax practitioners and having an equivalency determination repository that can offer cost-effective equivalency determination services. The final regulations do not affect the availability of an alternative method for a private foundation to make a grant to a foreign charity by exercising expenditure responsibility and requiring the grantee to maintain the grant funds in a separate fund dedicated to charitable purposes pending their use, which may, under certain circumstances, be a more viable and less expensive alternative to making a good faith determination that the foreign charity is the equivalent of a public charity under U.S. tax law. This alternative method also allows for the grant to be treated as a qualifying distribution and not a taxable expenditure. (R. L. Fox, 124 Journal of Taxation 108 (March 2016)).

A fix too fast: anomalies in the new legislation on partnership tax audits.

Title XI of the Bipartisan Budget Act of 2015 (H.R. 1314, P.L. 114-74, 11/2/15, referred to herein as the "Act") significantly changed the provisions of the Code that provide for auditing and adjusting income tax liabilities of partnerships (which formerly did not have income tax liabilities) and partners. It accomplished this by completely rewriting Subchapter C of Chapter 63 of the Code. The story of Title XI of the Act is of interest in itself. In October 2015, legislators in Congress who were struggling to complete a budget agreement decided they needed some additional revenue to achieve an acceptable level of satisfaction. What became Title XI was at that time being worked on by others in Congress as a stand-alone provision, so a draft was available to the legislators working on the budget deal. Recognizing that the draft comprised provisions that would be scored as generating revenue, the budget-seeking legislators grabbed it. They corrected some parts of the draft that they considered blatant errors, but there seems to be general agreement that the draft included in the actual legislation was sub-optimal (though necessary to achieve the broader purpose of enacting a budget). Some anomalous features of the statute are described in this article. At least some of them might have been revised before enactment had there been sufficient time, and some might be considered for a technical corrections bill. (M. G. Wasserman, 124 Journal of Taxation 118 (March 2016)).

In Brief

Here are the latest developments, in Code Section order.

Code Sec. 61

Unreported income—loans; disguised business expenses—proof.

Auto corp. pres./husband and registered nurse/wife had unreported income from monies taken/transferred from husband's corps. and used for personal/family expenses. Argument that funds were really loans was meritless and belied by facts that taxpayers, who kept lavish lifestyle even though they never drew salaries from corps. and were heavily indebted to creditors during years at issue, didn't have any fee agreements with corps. themselves or any written loan agreement, promissory note, fixed repayment schedule or other evidence supporting loan argument. Moreover, amounts they sought to disguise as business expenses, such as amounts used to buy family farms, had no relation to corps.' businesses. (*James T. O'Neal, Jr., et ux. v. Commissioner, (2016) TC Memo 2016-49, 2016 RIA TC Memo ¶ 2016-49*)

Code Sec. 165

Theft loss deductions—proof of theft—failed investments—net operating loss carrybacks—capital vs. ordinary loss—nonbusinsess bad debts; worthless securities—time for deduction—collection due process.

In CDP case involving IRS's administrative determination to proceed with lien for year at issue, taxpayer was denied claim to apply to that year's liabilities NOL carryback from later year's theft loss deduction for purported investment payments she made to friend or his co. Taxpayer failed to prove theft actually occurred under California law where she offered only her own testimony, claiming that friend made false statements, that she was equity investor in his co., and that his increasingly lavish lifestyle was suspicious, but didn't call him or another relevant individual to testify, didn't contradict record evidence that most of her payments were to him personally rather than to his co., and didn't otherwise show he had intent to defraud her. Also, while failure to prove such intent wouldn't preclude her from taking nonbusiness bad debt or worthless securities deduction instead, either of those would give rise only to capital loss that couldn't be carried back to year at issue. And in any event, taxpayer didn't establish no reasonable prospect of recovery to support those deductions for year stated; in fact, record showed that law firm agreed to take on case against friend that year, that taxpayer was still in touch with friend, and that she believed he wanted to repay her. (*Kaylan J. Riley v. Commissioner, (2016) TC Memo 2016-46, 2016 RIA TC Memo ¶ 2016-46*)

Abandonment losses—nuclear decommissioning funds—construction and decommissioning of independent spent fuel storage installation costs.

Costs associated with construction and decommissioning of independent spent fuel storage installation used for decommissioning of nuclear plant were deductible abandonment losses under Code Sec. 165 and constituted nuclear decommissioning costs within meaning of Code Sec. 468A and Reg § 1.468A-1(b)(6), and can be paid out of nuclear decommissioning fund. (IRS Letter Ruling 201612003)

Code Sec. 172

Net operating loss deductions—specified liability losses—years to which losses may be carried—nuclear decommissioning costs.

Nuclear power generating facility operator's yearly liability to make payments imposed by state law for storage of spent nuclear fuel at nuclear power plant located in state, and that was contingent on plant being in operation for that year, didn't arise until plant was operating for that year. (Chief Counsel Advice 201612013)

Net operating loss carryovers—S corps.—basis—closely owned entities—proof.

Auto corp. pres./husband and registered nurse/wife were denied claim to carryover to years at issue millions of dollars in alleged NOLs stemming from prior years in which husband was manager of, and siphoned funds from, auto dealership S corps. in which he was shareholder: taxpayers failed to prove they had sufficient basis in S corps. to support loss claims where they made only general and self-serving allegations of having contributed significant funds to S corps., but didn't offer any specific amounts or documentation corroborating same. (*James T. O'Neal, Jr., et ux. v. Commissioner, (2016) TC Memo 2016-49, 2016 RIA TC Memo ¶ 2016-49*)

Code Sec. 215

Alimony deductions—written separation agreement—pretrial order—involuntary payments—obligations terminating on death—state law.

Taxpayer was entitled to alimony deduction for monthly payments he made to unemployed ex-wife before divorce judgment was final and pursuant to pretrial order, requiring parties to "maintain status quo" as to various items that included ex-wife's spending money. Order qualified as written instrument incident to decree of divorce or separate maintenance under Code Sec. 71(b). Moreover, payments weren't designated in order as not being deductible by payor or not includible in payee's income or received while spouses were members of same household. And since payments were made to maintain couple's financial status quo until divorce judgment entered, they were considered periodic alimony under Alabama law that terminated on death. (*Barry M. Anderson v. Commissioner, (2016) TC Memo 2016-47, 2016 RIA TC Memo ¶ 2016-47*)

Code Sec. 355

Distribution of stock and securities of controlled corp.—continued ownership of remainder stock—tax avoidance.

Distributing parent's continuing ownership of remainder stock until its disposition within 5 years of initial external distribution won't be in pursuance of plan that has tax avoidance as one of its principal purposes under Code Sec.

355(a)(1)(D)(ii). (IRS Letter Ruling 201612012)

Code Sec. 367

Foreign corps.—outbound transfers—exceptions to coordination rule.

IRS has issued final regs addressing indirect stock transfers and coordination rule exceptions for certain outbound asset reorgs. Temporary regs, issued in TD 9615 (3/19/2013), were removed. (TD 9760)

Code Sec. 408

IRAs—Roth IRAs—inherited IRAs—surviving spouse—rollovers.

Under Code Sec. 408(d)(3), taxpayer/surviving spouse will be treated as payee or distribute proceeds from decedent's IRA and Roth IRA, and IRA and Roth IRA won't be treated as inherited IRAs with respect to taxpayer. Also, taxpayer was eligible to roll over proceeds from IRA and Roth IRA into respective IRA and Roth IRA set up and maintained in her own name, as long as rollover occurred within 60 days after she received proceeds. (IRS Letter Ruling 201612001)

IRAs—waiver of rollover requirement—medical condition of taxpayer.

Pursuant to Code Sec. 408(d)(3)(I), IRS waived 60-day rollover requirement where taxpayer's failure to timely roll over funds was due to her health issues. So, contribution was considered rollover contribution, provided all other requirements of Code Sec. 408(d)(3) were met. (IRS Letter Ruling 201612016)

IRAs—waiver of rollover requirement—taxpayer's intentions; reliance on spouse.

Pursuant to Code Sec. 408(d)(3)(I), IRS declined to waive 60-day rollover requirement where taxpayer/husband failed to establish that he intended to rollover distribution into IRA where he used stated amount in non-IRA account as checking account for living expenses. But, IRS waived 60-day rollover requirement regarding taxpayer/wife's failure to timely roll over funds from her IRA due to her reliance on her husband in financial matters. So, wife's contribution was considered rollover contribution, provided all other requirements of Code Sec. 408(d)(3) were met. (IRS Letter Ruling 201612017)

IRA distributions—rollovers—qualified plans—definite written plan—refunds—summary judgment.

Pro se married energy co. executives' refund claim, alleging that IRS erroneously categorized as income IRA distributions which they allegedly rolled over into another IRA for commercial real estate investment, was denied on summary judgment: taxpayers didn't provide any written plan for new IRA or trustee's name or otherwise show that new IRA actually existed; and in fact, real estate purchased with distributions was never held in any IRA account or trust, but rather was purchased and held by taxpayers in their individual capacities. Also, to extent they were claiming "rollover as business startup" treatment, such failed due to above and fact that they admittedly didn't follow applicable steps for same. (*Powell v. U.S., Ct Fed Cl, 117 AFTR 2d ¶ 2016-515*)

Code Sec. 501

Exempt orgs.—exempt status—final adverse determinations.

IRS issued final adverse determination revoking Code Sec. 501(c)(7) org.'s exempt status, effective stated date, where org. consented to revocation via signed Form 6018-A. (IRS Letter Ruling 201612014)

Code Sec. 911

Citizens or residents of U.S. living abroad—residency waiver due to adverse conditions in foreign country.

IRS listed one country that has qualified for waiver of residency requirements under Code Sec. 911(d)(4) due to adverse or dangerous conditions in 2015, including date of departure. Taxpayers will be considered to have satisfied requirements of Code Sec. 911(d)(1) if they leave foreign country during period for which Secy. of Treasury, after consultation with Secy. of State, determines that individuals should leave due to war or civil unrest that precluded normal conduct of business and taxpayers show that, but for adverse conditions, they could reasonably have been expected to meet eligibility requirements. (Rev Proc 2016-21, 2016-14 IRB , U.S. Tax Reporter: Income at ¶ 86,136)

Code Sec. 953

Ins. income—election by foreign ins. co. to be treated as domestic corp.—extensions.

Foreign ins. co. was granted 60-day extension from date this letter was issued to make Code Sec. 953(d) election to be treated as domestic corp. for tax purposes, beginning on first day of stated tax year, where taxpayer acted reasonably and in good faith and govt.'s interests wouldn't be prejudiced. (IRS Letter Ruling 201612007)

Code Sec. 1001

Gain on stock sales—to whom taxable; actual seller—closely held corps.—substance vs. form—sale agreements—intent.

Taxpayer/closely owned holding co. was required to report in income gain on sale of sub.'s stock. Taxpayer's argument that transaction was, in substance, sale by its shareholders of its own stock rather than sub.'s stock was barred by *Danielson* rule since agreement effecting transaction was unambiguous and clearly required sale of sub.; or, even if *Danielson* rule didn't apply, overall evidence belied taxpayer's position and showed that sale was in both form and substance of sub.'s stock. Alternative argument that parties to agreement made mutual mistake such that reformation was required also failed due to lack of proof that there was in fact any mistake as to which entity was seller and whose stock was being sold. Although taxpayer's shareholders may have intended to sell taxpayer rather than sub. and although purchaser may have been amenable to same, those facts were irrelevant and didn't change terms or substance of agreement they actually reached. (*Makric Enterprises, Inc. v. Commissioner, (2016) TC Memo 2016-44, 2016 RIA TC Memo ¶ 2016-44*)

Capital gains—ordinary income vs. capital gain—intellectual property—licenses, sublicenses, sales, assignments and other dispositions—summary judgment.

IRS was denied summary judgment that proceeds of transfer, involving intellectual property rights in chemical compound that taxpayer/pharmaceutical co./licensee made under amended agreement with sublicensee, were taxable as ordinary income, vs. capital gain as taxpayer argued. Although taxpayer's original agreement with sublicensee was clearly sublicensing agreement, whether amendment's effect was just to accelerate license fees and royalty payments as IRS claimed, or whether amendment terminated and effectively resulted in sale of substantially all of taxpayer's rights in compound as taxpayer argued, wasn't clear from contract's face and instead depended on material fact issues that weren't determinable on summary judgment. (*Mylan Inc. And Subsidiaries v. Commissioner, (2016) TC Memo 2016-45, 2016 RIA TC Memo ¶ 2016-45*)

Code Sec. 1274

Applicable federal rate tables.

IRS provided various applicable federal rate tables for April 2016. (Rev Rul 2016-9, 2016-14 IRB , U.S. Tax Reporter: Income at ¶ 86,135)

Code Sec. 1361

S corps.—election to treat sub. as QSub—extensions.

S corp. was granted 120-day extension from date this letter was issued to file Form 8869 to elect to treat sub. as QSub, effective stated date, where taxpayer acted reasonably and in good faith and granting relief wouldn't prejudice govt.'s interests. (IRS Letter Ruling 201612011)

Code Sec. 1362

S corps.—inadvertent terminations—ineligible shareholders.

Corp. will continue to be treated as S corp. from stated date and thereafter, where termination of corp.'s S status was inadvertent under Code Sec. 1362(f) due to ineligible shareholder, provided that election was valid and not otherwise terminated under Code Sec. 1362(d). (IRS Letter Ruling 201612002)

Code Sec. 1502

Consolidated returns—intercompany transactions—matching rule—basis—gains—exclusion from income.

Intercompany gains from 1st and 2nd intercompany transactions won't be reflected in basis of any of subs.' assets, other than stock of distributed members. And, 1st and 2nd intercompany gains would be redetermined to be excluded from gross income under Reg § 1.1502-13(c)(6)(ii)(D). (IRS Letter Ruling 201612006)

Code Sec. 2010

Unified credit against estate tax—portability election—deceased spousal unused exclusion—extensions.

Decedent's estate was granted 120-day extension from date this letter was issued to make Code Sec. 2010(c)(5) portability election to take into account DSUE amount where taxpayer acted reasonably and in good faith and granting relief wouldn't prejudice govt.'s interests. (IRS Letter Ruling 201612004)

Unified credit against estate tax—portability election—deceased spousal unused exclusion—extensions.

Decedent's estate was granted extension until stated date to make Code Sec. 2010(c)(5) portability election to take into account DSUE amount where taxpayer acted reasonably and in good faith and granting relief wouldn't prejudice govt.'s interests. (IRS Letter Ruling 201612005)

Unified credit against estate tax—portability election—deceased spousal unused exclusion—extensions.

Decedent's spouse/executor was granted 120-day extension from date this letter was issued to make Code Sec. 2010(c)(5) portability election to take into account DSUE amount where taxpayer acted reasonably and in good faith and granting relief wouldn't prejudice govt.'s interests. (IRS Letter Ruling 201612008)

Unified credit against estate tax—portability election—deceased spousal unused exclusion—extensions.

Decedent's estate was granted 120-day extension from date this letter was issued to make Code Sec. 2010(c)(5) portability election to take into account DSUE amount where taxpayer acted reasonably and in good faith and granting relief wouldn't prejudice govt.'s interests. (IRS Letter Ruling 201612009)

Unified credit against estate tax—portability election—deceased spousal unused exclusion—extensions.

Decedent's estate was granted 120-day extension from date this letter was issued to make Code Sec. 2010(c)(5) portability election to take into account DSUE amount where taxpayer acted reasonably and in good faith and granting relief wouldn't prejudice govt.'s interests. (IRS Letter Ruling 201612010)

Code Sec. 4945

Private foundations—grant-making procedures—taxable expenditures.

Exempt private foundation's procedures for awarding educational grants to facilitate introduction of international art professionals to artists and art professionals living and working in stated country comply with Code Sec. 4945(g)(3) requirements, and expenditures made in accordance with those procedures won't be taxable. (IRS Letter Ruling 201612015)

Code Sec. 6011

Return requirements—Tax Time Guide.

As part of series of ten daily tax tips, IRS described help and information that is provided through IRS online tools. (IR 2016-43 , U.S. Tax Reporter: Income at ¶ 86,131)

Return requirements—Tax Time Guide.

As part of series of 10 tax tips, IRS reminded taxpayers that they can maximize their tax benefits and get useful tips for preparing their 2015 returns by consulting free comprehensive tax guide available on IRS.gov. (IR 2016-44 , U.S. Tax Reporter: Income at ¶ 86,132)

Return requirements—Tax Time Guide.

As part of series of ten daily tax tips, IRS described online tools taxpayers could use to help choose qualified tax preparers. (IR 2016-46)

Reportable transactions—what constitutes listed transaction—welfare benefit plan arrangements and contributions—penalties for failure to include reportable transaction information with return—refunds.

District court properly denied onion brokering S corp. refund of penalties imposed for failing to file Forms 8886, reporting its participation in purported multiemployer welfare benefit plan transaction: when considering overall facts and circumstances, including that contributions exceeded cost of term life ins. and that plan was "experience rated," plan was sufficiently similar to transactions described in Notice 95-34, 1995-1 CB 309 Notice 95-34, 1995-1 CB 309 to require taxpayer to provide listed transaction notice to IRS on Form 8886. (*Vee's Marketing, Inc. v. U.S., CA 7, 117 AFTR 2d 2016-989*)

Code Sec. 6035

Basis information to persons acquiring property from decedent—transitional relief.

IRS issued temporary regs to provide that those required to file statement under Code Sec. 6035(a) *before* 3/31/2016 need not do so *until* 3/31/2016. This reiterates relief stated inNotice 2016-19, 2016-9 IRB 362, which recommended that executors and other persons wait to prepare statements until further guidance was issued. (TD 9757 , U.S. Tax Reporter: Income at ¶ 86,129)

Code Sec. 6321

Bankruptcy court procedure—prepetition liens—lien priority—homeowners' association lien vs. tax lien—choateness doctrine—superpriorities.

In Chap. 11 case involving taxpayer's sale of lien property, IRS's lien was found to have priority over competing homeowners' association's lien, save for small amount set out in association's notice, because remaining portion of association's lien, purporting to apply to future defaults, was inchoate both when association's own notice was recorded and when IRS's lien was recorded. Arguments that choateness doctrine was obsolete or that Code Sec. 6323 exceptions prevented IRS from exercising its superpriority rights were unavailing, especially since association's lien was limited under California law to amounts specifically identified in association's notice and attached accounting, with uncertain future assessment amounts not being included. Or even if such could be included under California law, Code

Sec. 6323(a) would clearly only give priority to assessments that accrued before IRS filed its lien. (*In Re: Guajardo, Bktcy Ct CA, 117 AFTR 2d ¶ 2016-517*)

Code Sec. 6330

Collection due process—review of administrative determination—prior opportunity to dispute underlying liabilities—estate and gift taxes—summary judgment.

Tax Court properly granted IRS summary judgment in CDP case: IRS correctly determined that taxpayer wasn't entitled to use case to relitigate deceased mother's estate's liability; and he didn't identify any basis for reversal. Court also properly dismissed as duplicative 2 more actions taxpayer filed. (*Widtfeldt v. Comm., CA 8, 117 AFTR 2d 2016-968*)

Collection due process—review of administrative determination—collection alternatives—installment agreements—special circumstances—hearings.

Tax Court properly upheld IRS's administrative determination to reject installment agreement proposal and proceed with levy against convicted tax evader/sole owner of 2 corps., for liabilities stemming from his failure to report as income corps.' payments of his legal and professional fees in his earlier criminal case and other litigation. Taxpayer's argument that settlement officer misunderstood her discretion to approve payment plan was meritless; alternative argument that he had special circumstances excepting him from requirement to liquidate his retirement account and life ins. policies wasn't properly raised during hearing, and so couldn't be considered here; and claim that officer improperly considered his tax evasion conviction was unsupported. Also, officer's refusal to give taxpayer face-to-face hearing was reasonable when considering such hearings weren't matter of right and that taxpayer's failure to comply with his tax obligations made him generally ineligible for collection alternative. (*Boulware v. Comm., CA Dist Col, 117 AFTR 2d 2016-969*)

Code Sec. 6402

Confidentiality and disclosure of return information—identity theft and fraud prevention.

IRS announced Top Ten Identity Theft Prosecutions for fiscal year 2015, provided statistical recap of investigations and incarcerations, and outlined enforcement efforts. (IR 2016-45 , U.S. Tax Reporter: Income at ¶ 86,133)

Code Sec. 6501

Limitations periods on assessments—suspensions and extensions—fraud.

Limitations periods didn't bar assessments against auto corp. pres./husband and registered nurse/wife for decades-old tax debts for various years, for which they filed fraudulent returns omitting husband's income and claiming millions of dollars in loss carryovers: Code Sec. 6501(c)'s open-ended fraud period applied. (*James T. O'Neal, Jr., et ux. v. Commissioner, (2016) TC Memo 2016-49, 2016 RIA TC Memo ¶ 2016-49*)

Code Sec. 6651

Failure to timely file returns penalties—burden of proof and production—reasonable cause.

Failure to timely file returns penalty was upheld against auto dealership manager/husband and registered nurse/wife for pre-1999 year: although it was unclear if examination for subject year commenced before Code Sec. 7491(c)'s effective date and thus whether burden of production on IRS applied, to extent it did, IRS met same with proof taxpayers didn't file until years after return's due date; and taxpayers didn't offer any reasonable cause for same. (*James T. O'Neal, Jr., et ux. v. Commissioner, (2016) TC Memo 2016-49, 2016 RIA TC Memo ¶ 2016-49*)

Code Sec. 6662

Accuracy-related substantial understatement penalties—burden of proof and production—reasonable cause; good faith—reliance on professional.

Accuracy-related substantial understatement penalty was upheld against taxpayer/closely owned holding co. for year for which it failed to report gain from sale of its sub.'s stock in income: IRS met its burden of production on penalty's applicability with proof that understatement was greater of 10% of tax required to be shown on return or $10,000; and taxpayer failed to establish reasonable cause for same where, although it used return preparer for subject year's return, and although preparer failed to report sale gain on basis of erroneous assumption that sale was of taxpayer itself rather than sub., preparer was told that assumption was correct by taxpayer's CFO, but CFO didn't read sale agreement himself, consult counsel, or otherwise take reasonable steps to verify correctness of that assumption. Fact that CFO may in turn have relied on erroneous advice from investment banker or possibly CEO wasn't excuse. (*Makric Enterprises, Inc. v. Commissioner, (2016) TC Memo 2016-44, 2016 RIA TC Memo ¶ 2016-44*)

Code Sec. 6663

Fraud penalties—unreported income; losses—clear and convincing evidence—criminal convictions.

Fraud penalties were upheld against auto corp. pres./husband and registered nurse/wife for decades-old tax debts for various years, for some of which husband had been convicted of filing false returns and in respect to which couple filed fraudulent returns omitting husband's income and claiming millions of dollars in unsupported loss carryovers: IRS showed by clear and convincing evidence that taxpayers had underpayments for each year that were attributable to fraud. Evidence included that taxpayers consistently understated husband's income in significant amounts that dwarfed relatively small amounts they reported from wife's job; that husband gave inconsistent explanations for same ; and that wife's claims of being unaware were implausible, especially when considering she knew they were insolvent due to outstanding judgments from past years when husband had engaged in similar conduct with other business. (*James T. O'Neal, Jr., et ux. v. Commissioner, (2016) TC Memo 2016-49, 2016 RIA TC Memo ¶ 2016-49*)

Code Sec. 7402

Actions by U.S.—default judgment—conduct hindering tax law enforcement—injunctions—employment taxes.

Govt. was granted default judgment in employment tax injunction suit against pizzeria corp. and its owner: judgment was supported by overall factors, including that govt. would be prejudiced absent judgment, set out and sufficiently pled meritorious claim, and wasn't seeking monetary relief; that there was likely no dispute concerning material facts; and that taxpayers' neglect wasn't excusable. So, injunction was entered prohibiting them from failing to withhold and pay over to IRS employment taxes, including federal income and FICA taxes, and ordering them to segregate and deposit taxes in appropriate bank, to provide IRS with affidavits of compliance, to timely pay all outstanding liabilities, to not assign any property or make other disbursements before paying taxes, and to notify IRS of any future employment tax conduct with new or presently unknown entity. (*U.S. v. Evnol, Inc., DC CA, 117 AFTR 2d ¶ 2016-516*)

Code Sec. 7403

Collection actions—motion to dismiss—frivolous claims—interlocutory appeals.

Taxpayer's repeat motions to dismiss govt.'s collection complaint were denied: motions, which repeatedly referred to and sought to challenge prior orders that rejected taxpayer's frivolous anti-tax theories, were in substance reconsideration motions that were untimely and meritless. Also, leave to file interlocutory appeal was denied based on above and since appeal wouldn't advance case's ultimate termination. (*U.S. v. Balice, DC NJ, 117 AFTR 2d 2016-985*)

Collection actions—motions to dismiss—frivolous claims—mandamus.

Taxpayer's mandamus petition, seeking to vacate district court orders denying repeat motions to dismiss govt.'s collection action that he filed on grounds govt. was constitutionally prohibited from collecting and enforcing income tax, was denied: mandamus relief wasn't appropriate since taxpayer could pursue his claims on appeal. (*U.S. v. Balice, CA 3, 117 AFTR 2d 2016-986*)

Collection actions—lien foreclosure—appointment of counsel.

Magistrate judge denied without prejudice, and with leave to renew, pro se taxpayer's application to have pro bono counsel appointed to represent her in suit govt. filed against her and husband, seeking to enforce lien on property held in her name to collect on prior judgment for her and husband's joint liabilities for various years: counsel appointment wasn't warranted at this stage in proceedings where it couldn't be determined if taxpayer's defense, challenging validity of prior judgment and arguing she and husband weren't legally married, was "likely to be one of substance." Moreover, she had not been completely without counsel, in that she had been consulting with both her husband and his brother who were attorneys. (*U.S. v. Schwartz, et al., DC NY, 117 AFTR 2d 2016-964*)

Collections actions—lien foreclosure; sale—jointly owned property—equity.

Wife's objection to order authorizing govt. to sell by auction her and husband/taxpayer's home, to satisfy his back taxes, was denied. Her underlying argument that auction sale violated Code Sec. 7403's just compensation requirement mistakenly relied in part on Supreme Court case that addressed distribution of proceeds of, not methods to be used for, sale. And there was nothing in record or other authority that would otherwise make auction sale impermissible under Code Sec. 7403 or require district court to guarantee that wife would receive FMV. However, since govt. didn't object to use of realtor, order was amended to allow wife opportunity to do so, provided she completed sale within 120 days and did so in arm's length transaction. But, if property didn't sell in that time, govt. would be allowed to proceed per original order's terms. Wife's alter-

nate request to stay same pending appeal was unavailing given above plus facts that she didn't have substantial likelihood of success on merits; that she was already being given chance to conduct private/realtor sale and wouldn't suffer irreparable injury absent stay; and that in contrast, allowing stay would both harm govt. and contravene public interest. (*U.S. v. Davis, DC MI, 117 AFTR 2d 2016-956*)

Code Sec. 7407

Return preparer penalties—injunctions.

Permanent injunction was entered barring return preparer and those acting with him from acting as preparers or assisting in preparation or filing of returns or other related tax forms or documents for others; representing others before IRS; owning, managing, controlling, working for, profiting from, or volunteering for return preparation business; seeking permission or authorization to file returns with PTIN, EFIN, or any other IRS service or program for filing returns; using, maintaining, renewing, obtaining, transferring, selling, or assigning PTIN or EFIN; and engaging in conduct designed or intended to obstruct or delay IRS investigation or audit. (*U.S. v. Sanchez, DC CA, 117 AFTR 2d ¶ 2016-518*)

Code Sec. 7421

Actions against IRS employees—mandamus—Anti-Injunction and Declaratory Judgment Acts—removal and remand.

Married taxpayers' mandamus petition against IRS agent and others, seeking order compelling IRS to furnish them with verifiable tax return, verified and signed assessments, affidavit of collector, and lawful notice of distraint and/or instrument substantiating that IRS had valid claim for years at issue, was dismissed as to IRS: AIA and DJA barred requested relief since taxpayers were essentially attempting to prevent IRS from collecting their back taxes. Also, since remainder of claims went to state law, district court declined to exercise supplemental jurisdiction and remanded suit back to state court. (*Harvey, Jr. v. Unknown Agent of the IRS, et al., DC LA, 117 AFTR 2d 2016-967*)

Code Sec. 7422

Refund actions—jurisdiction—full payment—divisible taxes—tax shelter promoter penalties—due process—Declaratory Judgment and Anti-Injunction Acts.

Tax shelter promoter's complaint for Code Sec. 6707 penalty refund was dismissed due to his failure to meet jurisdictional full payment prerequisite to suit. Arguments that Code Sec. 6707 penalty was analogous to excise taxes and/or Code Sec. 6672 or Code Sec. 6700 penalties for purposes of divisible tax exception to full payment rule were belied by facts that Code Sec. 6707 penalty was predicated on single act of failing to register tax shelter and calculated based on aggregate of entire amount of tax shelter investment, and as such didn't qualify as divisible tax. Fact that IRS considered underlying investments when determining total penalty amount didn't in itself mean penalty was divisible. Also, promoter's alternative due process argument didn't provide jurisdictional basis for suit; claim that penalty was already satisfied via other jointly and severally liable promoters' payments that IRS had not properly allocated was unsupported; and DJA and AIA barred any claims for declaratory or injunctive relief. (*Pfaff v. U.S., DC CO, 117 AFTR 2d 2016-981*)

Refund actions—motions—withdrawal of attorney—discovery and scheduling deadlines.

Taxpayer's motions for withdrawal of his attorney and to suspend discovery and scheduling deadlines in his refund suit were denied: taxpayer and his attorney neither demonstrated good cause for attorney's withdrawal, nor showed why taxpayer should be permitted to seek new counsel and postpone his discovery obligations 1 day before answers to govt.'s discovery requests were due, where they didn't explain motions' timing, show any efforts to secure new counsel, or support claim that attorney had conflict of interest. (*Elieff v. U.S., DC CA, 117 AFTR 2d 2016-965*)

Code Sec. 7602

Summons enforcement—procedure.

Govt. was granted petition to enforce IRS summons on taxpayer individually and as pres. of his medical corp., compelling him to appear before revenue officer and provide testimony and produce documents described in summons. Also, he was warned that failure to comply with this order could result in contempt finding and arrest. (*U.S. v. Phipps, DC VT, 117 AFTR 2d 2016-987*)

Summons enforcement—procedure.

Govt. was granted petition to enforce IRS summons on taxpayer, who didn't appear at show cause hearing until after it ended: petition and revenue agent's declaration established sufficient basis for enforcement. (*U.S. v. Ottimo, DC FL, 117 AFTR 2d 2016-964*)

Code Sec. 7609

Third-party summons enforcement—legitimate purpose—bad faith; improper purpose—limitations periods on assessments—suspensions and extensions—partnership items.

District court remand decision, denying summoned parties/respondents' request for evidentiary hearing and enforcing IRS summonses issued in connection with examination of partnership liabilities, based on findings that respondents failed to present specific facts or circumstances that would plausibly raise inference of improper purpose for summonses, under standard set out in recent Supreme Court decision, was affirmed. Although court erred in determining that summonses issued solely for retaliation against partnership for not extending assessment period or to circumvent Tax Court discovery in related case weren't issued for improper purposes as matter of law, facts showed that its decision to exclude additional evidence was appropriate in light of proceeding's summary nature and that it correctly found that respondents failed to show that summonses weren't issued in furtherance of IRS's investigation. Argument that issuance of FPAA foreclosed IRS's legitimate need for summoned information failed where neither FPAA nor Tax Court petition affected IRS's investigatory authority under Code Sec. 7602. (*U.S. v. Clarke, CA 11, 117 AFTR 2d ¶ 2016-514*)

Code Sec. 7623

Awards to whistleblowers—eligibility—collected proceeds; additional amounts—penalties for failure to file report of foreign bank and financial accounts.

In Code Sec. 7623 case involving award claim by whistleblower who was allegedly involved in investigation of Swiss banker that ultimately led to U.S. taxpayer pleading guilty to filing false return and agreeing to pay FBAR penalty substantially in excess of $2 million, plus small amount of restitution for unpaid tax on income derived from undisclosed Swiss accounts, IRS was granted summary judgment that FBAR penalties didn't qualify as "additional amounts" for purposes of Code Sec. 7623(b)(5)(B)'s $2 million eligibility threshold; rather, when considering that additional amounts was term of art under IRC and taking into account longstanding case law interpreting same, it was clear that such referred to penalties set forth in chap. 68, subchap. A. And FBAR penalties clearly weren't among penalties enumerated therein or "assessed, collected, and paid in same manner as taxes" under Code Sec. 6665. Whistleblower's contrary arguments, to interpret additional amounts to mean other sums of money or that Code Sec. 7623(b)'s "collected proceeds" language was otherwise broad enough to include FBAR penalties, even though they were paid under Title 31 and even if they didn't qualify as tax, penalties, interest, additions to tax, or additional amounts under Title 26, were rejected accordingly. Alternative policy arguments to treat FBAR penalties same as tax because of close connection between FBAR regime and tax enforcement were also unavailing. (*Whistleblower 22716-13W v. Commissioner, 146 TC No. 6*)

Code Sec. 7802

Organization of IRS—Guidance Priority List.

IRS is seeking public input on tax issues that need to be addressed through various types of administrative guidance and should be included on 2016-2017 Guidance Priority List, which reflects guidance to be issued between 7/1/2016 and 6/30/2017. Comments should be submitted by 5/16/2016 for possible inclusion on original 2016-2017 list, while later received comments will be considered for future updates. (Notice 2016-26, 2016-14 IRB , U.S. Tax Reporter: Income at ¶ 86,138)

Judicial proceedings

District court procedure—in forma pauperis—tax protesters—refunds—appeals.

District court certified that pro se married tax protesters' appeal from adverse decision in their refund suit wasn't taken in good faith, and accordingly denied their motion to proceed in forma pauperis on appeal: no reasonable person could find appeal to have any merit where taxpayers were basing same on frivolous argument that they didn't owe tax because their income was from private vs. govt. employers. (*Gillespie v. IRS, DC WI, 117 AFTR 2d 2016-988*)

Tax crimes—criminal contempt—false returns and erroneous refunds—constitutional claims—jury instructions.

Taxpayer's conviction for felony criminal contempt under 18 USCS 401(3) for violating injunction order in prior civil case, which barred her and husband from filing future frivolous returns and required them to file amended returns for years for which they had submitted such returns that resulted in erroneous refunds, was affirmed. Argument that conviction should be vacated because underlying injunction order was itself unconstitutional was unavailing under collateral bar rule. Alternate arguments that district court erred in its instructions to jury re-

garding injunction order or by failing to give specific unanimity instruction were similarly unavailing when considering above plus fact that even if court should have given unanimity instruction, any resulting error was harmless since taxpayer didn't contest that she committed underlying acts/that she didn't file properly amended returns for stated years and filed another frivolous return for later year. 6th Amendment claim that her right to self-representation was violated when standby counsel failed to ask her questions as she had instructed was also unavailing. (*U.S. v. Hendrickson, CA 6, 117 AFTR 2d 2016-971*)

Tax crimes—criminal contempt—false returns and erroneous refunds—U.S. Sentencing Guidelines.

Taxpayer's sentence for felony criminal contempt under 18 USCS 401(3) for violating injunction order in prior civil case, which barred her and husband from filing future frivolous returns and required them to file amended returns for years for which they had submitted such returns that resulted in erroneous refunds, was affirmed: sentence was properly based on U.S.S.G.'s tax loss computation provision for offenses involving improper refund claims and was procedurally reasonable. Contrary to taxpayer's claims that contempt offense was wholly unrelated to erroneous refund claims at issue in underlying civil case, her filing failures and erroneous refund claims were all part of same course of conduct. Alternate arguments, such as that amount of erroneous refund set out in injunction order was itself illegitimate, were also unavailing. (*U.S. v. Hendrickson, CA 6, 117 AFTR 2d 2016-971*)

Tax crimes—conspiracy to defraud U.S.; false claims—U.S. Sentencing Guidelines—enhancements.

Mother's sentence for conspiring to defraud U.S. and making false claims, incident to refund scheme run out of her home with her adult children/co-conspirators, was reversed and remanded due to district court's non-harmless error in applying organizer and leader enhancement: although defendant owned house where IRS obtained relevant evidence and although she subscribed to internet service used for submitting false returns, there was no evidence that she planned scheme, organized or directed co-conspirators, or otherwise controlled commission of offense. But, sophisticated means enhancement was proper where supported by evidence that scheme employed multiple bank accounts and P.O. boxes, that subject returns were filed with false addresses and no preparer listed, and that hundreds of returns claiming significant refunds were involved, which showed that conduct in this case was "notably more intricate" than "garden-variety conspiracy." Additional enhancement, for offense involving 50 or more victims, was also proper. (*U.S. v. Laws, CA 8, 117 AFTR 2d ¶ 2016-513*)

Tax crimes—conspiracy to defraud U.S.; false claims—evidence—motions to suppress and for acquittal.

Co-conspirators/siblings' convictions for conspiring to defraud U.S. and making false claims, incident to refund scheme they conducted with their mother out of her home, were affirmed. 1 defendant's suppression arguments, regarding statements he made to IRS agent at mother's home while search was being executed, failed in face of evidence he wasn't in custody at time he made subject statements; another defendant's acquittal motion and claim of insufficient evidence was belied by fact that evidence showed she prepared significant number of false returns that claimed improper first-time homebuyer credit for persons who she knew weren't entitled to same; and 3d defendant's acquittal motion was belied by evidence that refund which flowed from false return sister prepared for him, as well as other false refunds, were deposited in accounts he owned or controlled. (*U.S. v. Laws, CA 8, 117 AFTR 2d ¶ 2016-513*)

Practice before IRS—Joint Board for Enrollment of Actuaries.

IRS issued amendment intended to conform 1975 regs that established Joint Board for the Enrollment of Actuaries with changes made in 1981 to bylaws governing membership of said Board. (TD 9749 , U.S. Tax Reporter: Income at ¶ 86,127)

Tax crimes—corrupt interference with tax law administration; fictitious instruments—U.S. Sentencing Guidelines—tax loss.

Taxpayer's sentence for obstructing tax law administration under Code Sec. 7212 and presenting govt. with fictitious instruments with intent to defraud under 18 USCS 514(a)(3), relating to his multiple attempts to use false checks or bills of exchange to extinguish multimillion dollar tax debts, was vacated and remanded for resentencing due to nonharmless errors in district court's tax loss computations. Errors included that court misinterpreted applicable U.S.S.G. provision requiring it to compute tax loss IRS incurred or could have incurred rather than general loss. However, court was entitled to include penalties and interest in tax loss calculations where taxpayer's

conduct was tantamount to Code Sec. 7201 and Code Sec. 7203 conduct. Court also correctly determined that it shouldn't consider alleged audit errors and unclaimed deductions that taxpayer didn't prove. (*U.S. v. Black, CA 7, 117 AFTR 2d 2016-947*)