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Proposed Centralized Partnership Audit Regs Finally Released; Few Changes

NPRM REG-136118-15

The much-anticipated proposed regulations implementing the new centralized partnership audit regime under the *Bipartisan Budget Act of 2015* (BBA) have finally been released. The BBA regime replaces the current TEFRA (*Tax Equity and Fiscal Responsibility Act of 1982*) procedures beginning for 2018 tax year audits, with an earlier "opt-in" for electing partnerships. Originally issued on January 19, 2017 but delayed by a January 20, 2017 White House regulatory freeze, the re-proposed regs carry with them much of the same criticism leveled against them back in January, as well as several minor modifications.

- ***Take Away.*** "The release of these proposed regulations may satiate the relentless clamoring by some for "guidance" (although the regulations are merely proposed)," Michael Grace, Esq., consulting counsel, Wiley Rein LLP, and former IRS pass-throughs attorney, told Wolters Kluwer. "The proposed regulations do not and realistically could not have been expected to answer many practical questions that tax practitioners and clients must answer in preparing for the new rules," he added. Grace identified those issues to include:
  - Whether to elect out of the new rules (assuming a partnership's eligible);
  - Selecting a method of satisfying an imputed underpayment;
  - Allocating economic responsibility for an imputed underpayment among partners including situations in which partners' interests change between a reviewed year and the adjustment year; and
  - Indemnifications between partnerships and partnership representatives.

Scope

Under the proposed regs, to which Congress left many details to be filled in, the new audit regime covers any adjustment to items of income, gain, loss, deduction, or credit of a partnership and any partner's distributive share of those adjusted items. Further, any income tax resulting from an adjustment to items under the centralized partnership audit regime is assessed and collected at the partnership level. The applicability of any penalty, addition to tax, or additional amount that relates to an adjustment to any such item or share is also determined at the partnership level.

- ***Comment.*** Aside from the correction of certain typographical errors from the January-released regs, the re-proposed regs had the following "minor changes," as noted by an IRS spokesperson: the parenthetical "domestic or foreign)" was added to emphasize the application of the new regime to all partnerships required to file a return under Code Sec. 6031, the discussion in the preamble on section 6226 relating to push out elections for tiered partnerships has been changed; the "Special Analyses" section has been revised to address Executive Order 13789; and the Example 3 under §301.6225-1(f) involving certain netting rules has been deleted.

Election out

The BBA allows certain partnerships after 2017 to elect out of the new audit regime and be audited under the general rules applicable to individual taxpayers. Only an eligible partnership may

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Partnership Regs

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elect out of the centralized partnership audit regime. A partnership is an eligible partnership if it has 100 or fewer partners during the year and, if at all times during the tax year, all partners are eligible partners, as defined in Proposed Reg. §301.6221(b)-1(b)(3). A special rule applies to partnerships that have S corporation partners.

Proposed Reg. §301.6221(b)-1(c) provides the time, form, and manner for the partnership to make an election out of the centralized partnership audit regime. The election may be made only on a timely filed partnership return. The electing partnership must notify each partner within 30 days of making the election. For partnerships that elect out, the IRS will open deficiency proceedings at the partner level to adjust items associated with the partnership, resolve issues, and assess and collect any tax that may result from the adjustments.

- ***Comment.*** The IRS intends to carefully review a partnership's decision to elect out of the centralized partnership audit regime to ensure that the election out is not being used solely to frustrate IRS compliance efforts.

Consistent returns

A partner's treatment of each item of income, gain, loss, deduction, or credit attributable to a partnership must be consistent with the treatment of those items on the partnership return, including treatment with respect to the amount, timing, and characterization of those items. Under the proposed rules, the IRS may assess and collect any underpayment of tax that results from adjusting a partner's inconsistently reported item to conform that item with the treatment on the partnership return as if the resulting underpayment of tax were on account of a mathematical or clerical error appearing on the partner's return. A partner may not request an abatement of that assessment.

Partnership representative

The proposed regs require a partnership to designate a partnership representative, as well as provide rules describing the eligibility requirements for a partnership representative, the designation of the partnership representative, the representative's authority, determinations that a designation is not in effect, and IRS designations of a partnership representative. A non-partner is not prohibited from becoming a partnership representative.

The proposed regs coordinate the rules regarding notice of inconsistent treatment with situations where a partner is bound to the treatment of an item under Code Sec. 6223 as a result of actions taken by the partnership though its representative or of any final decision in a proceeding brought under the centralized audit provisions with respect to the partnership.

Imputed underpayment, alternatives and "push-outs"

Generally, if a partnership adjustment results in an imputed underpayment, the partnership must pay the imputed underpayment in the adjustment year. The partnership may request modification with respect to an imputed underpayment set forth in the notice of proposed partnership adjustment (NOPPA) under the procedures described in Proposed Reg. §301.6225-2.

The proposed regs provide that a partnership may elect under Code Sec. 6226 to "push out" adjustments to its reviewed year partners rather than paying the imputed underpayment determined under Code Sec. 6225. If a partnership makes a valid election in accordance with Proposed Reg. §301.6226-1, the partnership is no longer liable for the imputed underpayment. Rather, the reviewed year partners of the partnership are liable for tax, penalties, additions to tax, and additional amounts plus interest, after taking into account their share of the partnership adjustments determined in the final partnership adjustment (FPA). The proposed regulations provide rules for making the election, the requirements for partners to file statements with the IRS and furnish statements to reviewed year partners, and the computation of tax resulting from taking adjustments into account.

- ***Comment.*** Bipartisan technical corrections (HR 6439, Sen 3506) were introduced in December 2016 to allow a partner that is a partnership or S corporation to elect to either pay an imputed underpayment under rules similar to Code Sec. 6225 or flow the adjustments though the tiers. But according to the IRS, this would result in complexities, challenges, and inefficiencies similar to what occurred under TEFRA. As a result, the IRS has reserved this issue and is asking for comments in considering an approach for tiered partnerships regarding pushing the adjustments beyond the first tier partners.

Administrative Adjustment Requests

Under Proposed Reg. §301.6227-1(a), a partnership may file an administrative adjustment request (AAR) with respect to one or more items of income, gain, loss, deduction, or credit, and any partner's related distributive share, for any partnership tax year. The partnership must determine whether the adjustments requested in the AAR result in an imputed underpayment for the reviewed year. If so, the partnership must take the adjustments into account and pay the imputed underpayment unless the partnership makes an election under Proposed Reg. §301.6227-2(c), in which case the reviewed year partners take the adjustment into account under rules similar to Code Sec. 6226.

References: FED ¶49,739; TRC PART: 60,700.

REFERENCE KEY

FED references are to ***Standard Federal Tax Reporter***
USTC references are to ***U.S. Tax Cases***
Dec references are to ***Tax Court Reports***
TRC references are to ***Tax Research Consultant***

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S Corp, ESOP Related Persons, Tax Court Finds

Petersen, 148 TC No. 22

The Tax Court, in a case of first impression, has held that an S corp and the participants in its employee stock ownership plan (ESOP) were related persons under Code Sec. 267(a)(2). The ESOP's stock was attributed to its participants/beneficiaries because the ESOP was a trust, the court found.

- ***Take Away.*** According to the court, the question of application of Code Sec. 267(a) to employers and ESOP participants had never before been raised before it. Because the issue was one of first impression, the court did not uphold penalties imposed by the IRS.

Background

The S corp maintained an ESOP for its employees. During 2009 and part of 2010, the ESOP trust owned 20.4 percent of the company. On October 1, 2010, the ESOP trust became the company's sole shareholder.

The S corp claimed deductions for the accrued but unpaid payroll expenses. The IRS disallowed deductions for the accrued but unpaid expenses to the extent they were attributable to employees who participated in the ESOP.

Court's analysis

The court first found that the S corp did business as an accrual basis taxpayer. Generally, an accrual basis taxpayer may deduct ordinary and necessary business expenses in the year when all events have occurred that establish the fact of the liability, the amount of the liability is set, and economic performance has occurred with respect to the liability.

However, the ESOP participants were cash basis taxpayers. The court found that when such expenses are owed to a related cash basis taxpayer, Code Sec. 267(a)(2) provides that the payor may deduct the expenses only for the tax year for which the amounts are includible in the payee's gross income.

Code Sec. 267, court explained, requires related persons to use the same accounting method with respect to transactions between themselves to prevent the allowance of a deduction without the corresponding inclusion in income. Code Sec. 267(c)(1) provides that stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust is considered as being owned proportionately by or for its shareholders, partners, or beneficiaries. That provision, however, does not define "trust," the court added.

Here, the court found that the entity holding the stock for the benefit of the ESOP participants was a trust in the ordinary sense of that word. The court noted that if the plan assets were not held by a trust, the ESOP could not qualify under ERISA. "The statutory scheme upon which the ESOP arrangement rests presumes that the stock held for the benefit of the ESOP participants will be owned by a trust," the court held.

The court rejected the business' argument that the ESOP was not a trust because the ESOP had participants and not beneficiaries. The court found that the employees were both participants and beneficiaries. The court also rejected the business' claim that the term trust for purposes of Code Sec. 267 should be limited to common law trusts. "The fact that ESOPs are creatures of statute rather than common law is irrelevant," the court held. Further, the court rejected the business' claim that the entity was not a trust under state law.

The court concluded that the ESOP was a trust under Code Sec. 267(c)(1). As a result the ESOP participants and the business were related persons for purposes of Code Sec. 267(b). Code Sec. 267(a), the court added, defers the business' deductions for the accrued but unpaid payroll expenses to the year in which such pay was received by the ESOP participants and included in their gross incomes.

References: Dec. 60,932; TRC ACCTNG: 12,150.

IRS Updates Online Account Tool With New Features

New features have been added to the IRS's online account tool. The tool assists taxpayers with basic account inquiries, such as information about their balance due and access to various payment options.

Background. The IRS unveiled the online account tool in 2016. At that time, the agency predicted that taxpayers who want to interact digitally with the IRS would take advantage of the tool.

Enhancements. New features allow taxpayers to view up to 18 months of tax payment history; view payoff amounts and tax balance due for each tax year; and obtain online transcripts of various Form 1040-series through Get Transcript. Users can also give feedback and suggestions for improvements on their experience with their online account.

- ***Comment.*** "We are constantly looking for ways to improve taxpayers' interactions with the IRS and adding these new features to the online account is an important step in that direction," said IRS Commissioner John Koskinen. "The IRS is committed to serving taxpayers in multiple ways and now taxpayers who want to interact digitally with us in a secure environment have access to even more helpful features," he added.

IR-2017-106; TRC INDIV: 18, 052.

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Chief Counsel Nixes Code Sec. 199 Deduction For Computer Software Fees

CCA 201724026

Chief Counsel has determined that certain fees in connection with online activities were for services for computer software rather than giving customers access to computer software for direct use. As a result, the taxpayer did not derive gross receipts for purposes of the Code Sec. 199 deduction, Chief Counsel concluded.

- ***Take Away.*** Chief Counsel's description of the facts and the taxpayer's business was heavily redacted. This leaves some uncertainty to the scope of application of Chief Counsel's analysis.

Background

The Code Sec. 199 deduction allows qualified taxpayers to deduct an amount equal to the lesser of a percentage of taxable income (adjusted gross income for individuals) or qualified production activities income (QPAI). A taxpayer's Code Sec. 199 deduction cannot exceed one-half (50 percent) of the W-2 wages paid by the taxpayer during the year. Domestic production gross receipts include gross receipts derived from the sale, exchange, lease, rental, license, or other disposition of qualified production property.

In 2015, the IRS issued proposed regs intended to clarify how to determine DPGR, and which also provided guidance on materials manufactured, produced, grown, or extracted (MPGE) for purposes of the deduction. Under the proposed regs, MPGE includes manufacturing, producing, growing, extracting, installing, developing, improving, and creating qualified production property (QPP), among other activities.

In this matter, the taxpayer engaged in cerain online activities. These activities generated revenues, including Fee X and Fee Y. The taxpayer treated these fees as DPGR and eligible for the Code Sec. 199 deduction.

Chief Counsel's analysis

Chief Counsel first noted that there are times where a taxpayer allows customers access to online software, but the taxpayer does not derive gross receipts from that access because the online software is only enabling the provision of services rather than direct use of the software. The facts here reflected that scenario.

Chief Counsel determined that Fee X and Fee Y were not charged for customers' direct use of computer software. The taxpayer provided access to the software needed for customers to participate in online activities, Chief Counsel added.

"When computer software enables a customer to participate in a taxpayer's service, those gross receipts are considered derived from an online service," Chief Counsel determined. "Once characterized as a service, there are also no gross receipts attributable to any computer software that enables participation in the service. Taken a step further, there should also be no gross receipts attributable to any components of computer software that enables participation in the service," Chief Counsel concluded.

- ***Comment.*** Chief Counsel noted several examples in the regs in its analysis, including Example M. In that example, M is an internet auction company that produces computer software within the United States that enables its customers to participate in internet auctions for a fee. Under the regs, gross receipts derived from online auction services are attributable to a service and do not constitute gross receipts derived from the disposition of computer software. M's activities constitute the provision of online services. Therefore, M's gross receipts from the internet auction services are non-DPGR, the IRS explained.

Reference: TRC BUSEXP: 6,160.20

Chief Counsel Determines Employer, Not PEO, Liable For Unpaid Payroll Taxes

CCA 201724025

IRS Chief Counsel has determined that an S corp and not a professional employer organization (PEO) was liable for unpaid federal employment taxes. Chief Counsel rejected the taxpayer's argument that the PEO was the statutory employer of the workers with sole responsibility for paying over federal employment taxes.

- ***Take Away.*** The taxpayer did not dispute that it was the common law employer of the workers and it had responsibility to pay the underlying tax liabilities on wages it paid to employees. The taxpayer however, argued that it paid the requisite amount of wages, the employer share of FICA and the proper amount of FUTA taxes to the PEO, and the PEO was solely responsible for the payment of the employment taxes at issue.
- ***Comment.*** Chief Counsel noted that it has issued memoranda based on similar facts advising that "a taxpayer is not in control of the payment of wages if the payment of wages is contingent upon, or proximately related to, the taxpayer having first received funds from its clients."

Background

The S corp engaged the services of a PEO for accounting, marketing and administrative workers. The taxpayer did not file Form 940 or Form 941. The taxpayer also did not file Form W-2, Wage and Tax Statement, for any of the workers. On its federal return, the taxpayer claimed deductions for "employee leasing."

The IRS informed the taxpayer that the PEO had not paid over any payroll taxes.

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Tax Court Rejects Substance Over Form Argument In Sale Of Partnership Interests

Watts, TC Memo. 2017-114

Two brothers, owners of a long-time business, failed to persuade the Tax Court that they gave up proceeds from the sale of that business to incentivize the majority owner to sell to a certain bidder. The court rejected their substance over form argument. The court also found that the brothers did not abandon their partnership interests.

- ***Take Away.*** The brothers had relied on their accountant of more than 30 years for advice. The court found that their reliance on the accountant was reasonable and ruled the brothers were not liable for penalties imposed by the IRS.

Background

The brothers agreed to sell their business. A partnership was formed to facilitate the sale of the business. The purchaser obtained 80 percent of the partnership and had preferred interests. Over time, the number of common interests changed hands. The ownership stake of one brother decreased while the ownership stake of another brother increased.

Eventually, the majority owner decided to sell its investment in the partnership. A buyer was found. The agreement provided a nominal purchase price of $85 million, to be adjusted upon closing, reflective of closing costs, expenses, and partnership's final working capital and indebtedness. At the closing, the buyer paid $87 million for all of partnership. Approximately $43.8 million of that amount came in the form of payments of the partnership debts. The brothers did not receive any proceeds from the sale.

According to the brothers, they agreed to give up any proceeds from the sale to incentivize the majority owner to sell to a certain buyer. Two bidders had come forward. The brothers were opposed to one potential buyer fearing, among other things, job losses for their employees.

For federal tax purposes, the brothers reported that they had disposed of their interests in the partnership but that they had received no cash proceeds from the disposition. The brothers treated the disposal of their partnership interests as an abandonment, generating an ordinary loss. The IRS disagreed. At trial, the brothers raised their substance over form argument.

Court's analysis

The court first found that when the form of a transaction does not coincide with the economic reality, the substance of the transaction rather than its form should determine the tax consequences. Taxpayers may assert substance-over-form arguments; however, they may face a higher than usual burden of proof.

The brothers, the court found, argued that they were entitled to a pro rata share of the cash proceeds from the sale. The court found that their argument was contrary to the words of the original agreement. That agreement had provided the majority owner with a priority payment for its interests in the event of an exit transaction. The court concluded that the brothers failed to show they were entitled to any cash proceeds from the sale. The brothers could not have offered nonexistent proceeds to incentivize the majority owner to sell to a certain bidder.

The court next found that partnership interests may be abandoned. Here, the court found no evidence of abandonment. Ordinary abandonment losses may arise only when the partner was not personally liable for the partnership's recourse debts or was limited in liability and otherwise not exposed to any economic risk of loss for the partnership's nonrecourse liabilities. However, the disposal of the partnership interest did not fall within these narrow exceptions, the court found. The brothers did not show how their actions "constituted an intentional and overt manifestation of abandoning their partnership interests," the court concluded.

References: Dec. 60,936(M); TRC PART: 39,050

Payroll Taxes

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The PEO also failed to file the requisite payroll tax forms.

Court's analysis

The court found that if a common law employer does not have control of the payment of wages, the term employer means the person having control of the payment of wages. A key inquiry is to determine if a PEO was in control of the payment of wages.

Here, the court found that the PEO had not assumed legal responsibility for payment of the wages to the employees. The contract between the taxpayer and the PEO required that the taxpayer pay an amount equal to the wages with respect to the workers in advance of the next payroll date to the PEO. To ensure that the PEO would not be responsible for payment of wages to these workers, the taxpayer also had to provide a security deposit or letter of credit naming the PEO as beneficiary in the amount as determined by the PEO to cover the wages. Additionally, the PEO could terminate the contract immediately without notice and taxpayer would be responsible for payment of all wages and taxes. The court held that the PEO acted merely as a conduit for paying over employment taxes.

The court further found that a taxpayer may qualify for Section 530 (*Revenue Act of 1978*) relief. That provision generally provides that workers will not be deemed to be employees or employment taxes, unless the taxpayer had no reasonable basis for treating workers as other than employees. Section 530 was inapplicable. The taxpayer's liability for the employment taxes did not involve a question of whether the workers are employees or nonemployees, the court explained.

Reference: TRC PAYROLL: 6,254.05.

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Treasury Requests Input For Regulatory Reform Task Force

Treasury Department Notice

The Treasury Department has requested recommendations for regs that can be eliminated, modified, or streamlined to reduce burdens. The request reflects Executive Order (EO) 13777 signed by President Trump earlier this year.

- ***Take Away.*** Wolters Kluwer had asked the IRS earlier this year if and when it would establish a regulatory reform task force. Now, it appears that the IRS's activities will be reviewed by the overall Treasury regulatory reform task force. Wolters Kluwer asked Treasury for details about the composition of the regulatory reform task force, such as who will serve on the task force, but did not receive a response by press time.

Background

In EO 13777, the President directed federal agencies to convene regulatory reform task forces. The Treasury regulatory reform task force "will evaluate existing regs and make recommendations to prioritize their possible repeal, replacement, or modification, consistent with applicable law," the department explained. "EO 13777 encouraged agencies to seek input from small businesses, state and local governments, trade associations, and other stakeholders significantly affected by regs," Treasury added.

Input

Treasury invited stakeholders to identify regs that should be modified or eliminated to reduce burdens. Commentators, if possible, should provide available data and an explanation of regulatory costs and compliance burdens. Comments are requested by July 31, 2017. Treasury noted that comments submitted under Notice 2017-28 for the 2017-2018 IRS Priority Guidance Plan will be shared with the regulatory reform task force.

Other Executive Orders

In addition to EO 13777, President Trump signed EO 13771 shortly after taking office. EO 13771 generally requires federal agencies to identify for elimination two prior regulations for every one new regulation issued going forward.

The Office of Management and Budget (OMB) has explained that EO 13771 applies to significant regulatory actions an agency issues between noon on January 20, 2017 and September 30, 2017 and to those agencies required to submit significant regulatory actions to OMB's Office of Information and Regulatory Affairs (OIRA) for review. IRS Commissioner John Koskinen has discussed certain "subregulartory" items, which appear to encompass revenue procedures and news releases, along with some postings on the IRS website.

- ***Comment.*** Last year, the Government Accountability Office (GAO) told Congress that tax regs are generally

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AFRs Issued For July

Rev. Rul. 2017-14

The IRS has released the short-term, mid-term, and long-term applicable interest rates for July 2017.

Applicable Federal Rates (AFR) for July 2017

Short-Term	**Annual**	**Semiannual**	**Quarterly**	**Monthly**
AFR	1.22%	1.22%	1.22%	1.22%
110% AFR	1.34%	1.34%	1.34%	1.34%
120% AFR	1.47%	1.46%	1.46%	1.46%
130% AFR	1.60%	1.59%	1.59%	1.58%
Mid-Term				
AFR	1.89%	1.88%	1.88%	1.87%
110% AFR	2.08%	2.07%	2.06%	2.06%
120% AFR	2.27%	2.26%	2.25%	2.25%
130% AFR	2.45%	2.44%	2.43%	2.43%
150% AFR	2.84%	2.82%	2.81%	2.80%
175% AFR	3.32%	3.29%	3.28%	3.27%
Long-Term				
AFR	2.60%	2.58%	2.57%	2.57%
110% AFR	2.86%	2.84%	2.83%	2.82%
120% AFR	3.12%	3.10%	3.09%	3.08%
130% AFR	3.38%	3.35%	3.34%	3.33%

Adjusted AFRs for July 2017	**Annual**	**Semiannual**	**Quarterly**	**Monthly**
Short-term adjusted AFR	0.91%	0.91%	0.91%	0.91%
Mid-term adjusted AFR	1.40%	1.40%	1.40%	1.40%
Long-term adjusted AFR	1.93%	1.92%	1.92%	1.91%

The Code Sec. 382 adjusted federal long-term rate is 1.93%; the 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) is 2.04%; the Code Sec. 42(b)(2) appropriate percentages for the 70% and 30% present value low-income housing credit are 7.52% and 3.22%. The Code Sec. 7520 AFR for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest is 2.20%. The Code Sec. 7872(e)(2) blended annual rate is 1.09 percent.

References: FED ¶46,300; TRC ACCTNG: 36,162.05.

Tax Court Finds Lack Of Profit Motive In Auto Racing Business

Stettner, TC Memo. 2017-113

An automobile racing enthusiast lacked an actual profit motive in running his business, the Tax Court has held. The taxpayer genuinely enjoyed racing but his pattern of losses reflected the lack of a profit motive, the court held.

- ***Take Away.*** The business in this case was the taxpayer's second attempt at racing. Some years earlier, the taxpayer had established a racing business but closed it after several years of losing money.

Background

In 2011, the taxpayer organized an automobile racing business using funds from his retirement plan. The taxpayer participated in 18 to 22 races each year. At the time he organized the business, the taxpayer was unemployed and generally spent more than 40 hours every week on racing. In time, he obtained employment and spent some 20 hours every week on the activity. The IRS ultimately determined that the racing activity was not engaged in for profit.

Court's analysis

The court first found that taxpayers may not deduct expenses incurred in connection with activities not engaged in for profit, such as activities primarily carried on as sport, as a hobby, or for recreation, to offset taxable income from other sources. An activity is engaged in for profit if the taxpayer has an actual, honest profit objective, even if it is unreasonable or unrealistic. Determining profit motive is based on all the facts and circumstances, the court added.

The court also found that a business-like operation would have a business plan. Here, the taxpayer did not have a written business plan for the racing business, only a mental one, the court found. "Failure to keep adequate books and records and the lack of a written business plan indicate that petitioners did not conduct the business in a business-like manner nor in a manner similar to those of other profitable racing activities," the court held.

The court acknowledged that the taxpayer had more than 20 years of engagement in racing. This experience, the court noted, is a way to gain expertise in an activity. The court also acknowledged that the taxpayer devoted substantial time to racing, especially during the period when he was unemployed.

However, the court found that the taxpayer had never won a race during the tax years in dispute. The profits the taxpayer earned were from the sale of used parts and cars, an annual sponsorship payment, and minimal race prize money. The court concluded that the taxpayer did not have an actual and genuine profit objective in operating his business.

- ***Comment.*** Code Sec. 183(d) provides that an activity is presumed to be engaged in for profit if the activity produces income in excess of deductions for any three of the five consecutive years which end with the tax year. The taxpayer appeared to assert that the business had shown profits for 2013-2015 but the court found that the business had losses for 2014 and 2015.

References: Dec. 60,395(M); TRC BUSEXP: 15,150.

TAX BRIEFS

Jurisdiction

An individual's refund claims were dismissed for lack of jurisdiction. The individual's claim for the first year was dismissed as untimely. The only tax the individual paid for the tax year at issue was withholding from her wages and those amounts were considered paid more than two years before she filed her refund claim. The individual's claim for the second year was timely; however, the individual failed to produce any evidence that she was entitled to claim the American Opportunity Tax Credit. Therefore, she was not entitled to a refund for the second year.

Fallen, DC Md., 2017-1 USTC ¶50,248; TRC IRS: 36,052.10

Income

An individual, who received a settlement payment from her employer, could not exclude the payment from gross income because the payment was not for personal physical injury or physical sickness. In addition, the individual was also liable for an accuracy-related penalty because she did not make a good-faith effort to assess her correct tax liability.

Devine, Jr., TC, CCH Dec. 60,933(M), FED ¶48,047(M); TRC INDIV: 33,402.15

Deductions

An individual, who sold insurance as an independent contractor at a company, was liable for self-employment tax because the termination payments he received were dependent on his length of service at the company; penalties were imposed. The taxpayer was also not entitled to a business expense deduction or an interest expense deduction because the taxpayer made no attempt to distinguish between the personal and business use of those expenses.

Geneser, TC, CCH Dec. 60,931(M), FED ¶48,045(M); TRC INDIV: 63,100

Anti-Injunction Act

A tax protestor's complaint for injunctive relief, damages, refund and prosecution of the criminal acts alleged was dismissed. The individual failed to establish that the government waived its sovereign immunity or that jurisdiction was proper. Further, to the extent individual's claims were based on her argument that she was not required to pay income tax they were dismissed as frivolous.

Cox, DC Hawaii, 2017-1 USTC ¶50,247; TRC IRS: 45,152

Partnerships

A federal district court properly determined that the IRS timely issued final partnership administrative adjustment (FPAA) to an individual and his single-member limited liability company (LLC). The individual argued that his consents to extend the limitations period were invalid because he relied

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Tax Briefs

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on the man who originally sold him the BLIPS investment strategy when he agreed to extend the limitations period. However, the facts did not support the inference that the tax shelter seller's potential conflict infected every extension of the limitations period that the taxpayer personally signed.

Sixty-Three Strategic Investment Funds and Presido Growth LLC, CA-9, 2017-1 USTC ¶50,254; TRC PART: 60,352

A partnership was not entitled to a charitable contribution deduction for its donation of a conservation easement on a warehouse because neither the use restriction nor the conservation purpose of the easement was protected in perpetuity as of the donation date. The partnership executed a deed granting a façade easement on the warehouse to a conservation trust; however, the deed was not recorded until a later tax year.

Ten Twenty Six Investors, TC, CCH Dec. 60,937(M), FED ¶48,051(M); TRC INDIV: 51,364.25

Foreclosures

A limited liability company (LLC) that lost its quiet title claim to property purchased from a foreclosure sale had its appeal partly dismissed as moot. Following entry of the district court judgment, the LLC's escrow agent paid off all the liens on the property, including the IRS lien. Therefore, the title was no longer clouded. Further, to the extent the LLC had a damages claim, the government had not waived its sovereign immunity.

Neighborhood Improvement Projects, LLC, CA-9, 2017-1 USTC ¶50,252; TRC IRS: 51,158.15

False Tax Returns

An individual was properly convicted of conspiracy to defraud the government and aiding in the preparation of materially false income tax returns. Contrary to the individual's argument, the government presented sufficient evidence for a rational jury to find that the individual acted willfully and with specific intent to defraud the IRS.

Rodrigues, CA-9, 2017-1 USTC ¶50,253; TRC IRS: 66,052

Liens and Levies

The IRS's levy of funds from an individual's individual retirement account (IRA) constituted a taxable distribution; therefore, the IRS's deficiency determination was proper because the individual failed to report the distribution on his return. The individual did not dispute that the distribution was made and IRA distributions are generally included in a recipient's income.

Joseph, CA-9, 2017-1 USTC ¶50,250; TRC INDIV: 6,052

Refund Claims

Married individuals were not entitled to a refund of the taxes that were erroneously assessed for a subsequent year because the incorrect year on the assessment was a typographical error and the taxpayers were not misled by that error. The taxpayers understood when the payment was made that the taxes, penalties and interest were owed and they paid the amount while the assessment period for that year was still open.

Habenicht, FedCl, 2017-1 USTC ¶50,249; TRC IRS: 33,052

Whistleblower Award Claims

An individual's whistleblower award claim was dismissed for lack of jurisdiction because the information that formed the basis for the claim was provided before the enactment of Code Sec. 7623(b). Even accepting the individual's representations about his post-enactment submissions, the information was not "new information" that gave the court jurisdiction to consider his claim.

Whistleblower 19860-15W, TC, CCH Dec. 60,934(M), FED ¶48,048(M); TRC LITIG: 6,104

Tax Assessments

A married couple's convictions for various tax-related offenses stemming from their failure to pay income taxes for over twenty years were affirmed. There was sufficient evidence of willfulness to support their convictions. In addition, the husband's 97-month sentence was substantively reasonable because the district court was not required to conform his sentence to those imposed in similar cases.

Joling, CA-9, 2017-1 USTC ¶50,251; TRC IRS: 66,052

IRS Warns Of New Phone Scam

The IRS has warned taxpayers of a new scam linked to the Electronic Federal Tax Payment System (EFTPS). The IRS reports the scam is being seen nationwide. In this latest iteration of impersonating an IRS agent, the con artist claims that certified letters were sent but were returned as undeliverable. The scammer threatens arrest if a payment is not made immediately through a prepaid debit card. The con artist also tells the victim that the card is linked to the EFTPS system when, in fact, it is controlled by the scammer.

- ***Comment.*** "This is a new twist to an old scam. Just because tax season is over, scams and schemes do not take the summer off. People should remember that the first contact they receive from IRS will not be through a random, threatening phone call," Commissioner John Koskinen said.

The EFTPS is an automated system offered by the U.S. Treasury and does not require the purchase of a prepaid debit card, the IRS explained. In addition, taxpayers have several options for paying a real tax bill and are not required to use a specific one.

IR-2017-107; TRC IRS: 12,350.

Regulations

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exempt from OIRA review based on an agreement between the Treasury Department and OMB. This agreement, dating back to 1983, "exempts regulations issued by IRS from further analysis and review unless [the regulations] were legislative and major under Executive Order 12291."

In April, President Trump signed EO 13789. This EO instructs Treasury to reevaluate all significant tax regulations issued on or after January 1, 2016, with the purpose of revising or eliminating those that do not comply with specified policy standards regarding undue compliance costs, complexity, or overreaching of IRS's authority. EO 13789 requires Treasury to submit an interim report on its findings to the President within 60 days, followed up by a full report within 150 days.

PRACTITIONERS' CORNER

Expert Comments On Re-proposed Centralized Partnership Audit Regime

Upon release of the re-proposed centralized partnership audit regulations (NPRM REG-136118-15), Wolters Kluwer sat down with Michael Grace, Esq, CPA, Wiley Rein LLP, Washington, DC, for his immediate impressions of the regulations and their practical implications. Grace has represented domestic and foreign companies in a broad range of tax transactional, planning, and controversy matters spanning numerous industries. He has represented partnerships and partners in TEFRA examinations. At the IRS Office of Chief Counsel (National Office) in Washington, Grace played a significant role legislatively developing and administratively interpreting the Passive Activity Limitations and associated rules.

General impressions

Wolters Kluwer: What are your overall impressions regarding the re-proposed centralized partnership audit regulations?

Michael Grace: Not since the Tax Reform Act of 1986 have I witnessed such incessant clamoring for "guidance" interpreting amendments of the Code affecting partnerships. The proposed regulations may sate these demands (although the regulations are merely proposed). They also may help practitioners overcome apprehension that they could not advise clients without more detail from the Government. The proposed regulations do not and realistically could not have been expected to answer many practical questions that tax practitioners and clients now should be trying to answer in preparing for the new rules. (*See the lead article in this week's newsletter for a list of these questions.*)

Definitions

Wolters Kluwer: Within the "Definition - Items of income, gain, loss, deduction, or credit" (Prop. Reg. §301.6221(a)-1(b)(1)), do some terms require further clarification?

Michael Grace: The proposed regulations' reference to "the character, timing, and source of the partnership's activities, including whether the partnership's activities are active or passive," needs some work. Distinctions between active and passive activities have relevance under IRC Sections 469 and 1411. However, whether an activity conducted through a partnership is active or passive mostly depends on a particular partner's relationship to the activity.

"Before a partnership elects to push an imputed underpayment out to its partners, the parties should appreciate the detailed nature of the information the partnership must provide …."

Scope of rules

Wolters Kluwer: Within the "Scope of Rules" that coordinate with other provisions within the Internal Revenue Code (Prop. Reg. §301.6221 (a)-1(d)), do you notice any pitfalls for practitioners and their clients?

Michael Grace: Nothing in the Centralized Partnership Audit Rules precludes the IRS from adjusting an item in order to determine taxes other than income taxes. For example, the IRS without examining a partnership under the centralized rules could adjust a partner's share of income subject to the Section 1411 Net Investment Income Tax (imposed under Chapter 2A). As another example, the IRS outside the centralized rules could examine a partnership's employment taxes on its employees (imposed under Chapter 25).

Election out

Wolters Kluwer: Within the "Election Out" provisions (Prop. Reg. §301.6221(b)-1), were there any particular restriction that may send up a red flag for some partnerships?

Michael Grace: Many will find it disappointing that a partnership having even one tax disregarded entity as a partner (e.g., a single member LLC) cannot elect out of the Centralized Partnership Audit Rules. Partnerships and partners should consider this disadvantage when deciding to follow the trend toward owning partnership interests through disregarded entities.

Consistency requirements

Wolters Kluwer: Were the examples presented in "Notification to the IRS of Inconsistent Treatment" Prop. Reg. §301.6222-1(c)) helpful?

Michael Grace: Two examples helpfully illustrate the potential consequences of a partner's notifying the IRS of having treated an item inconsistently with its treatment on the partnership's return.

In Example 1, the partner's own income tax return treats two items inconsistently with the partnership's return: a deduction and an item of capital gain. The partner reports to the IRS the inconsistent treatment of the deduction but not that of the capital gain. The IRS without separately examining the partner's return may assess and collect the underpayment of tax resulting from adjusting the capital gain as a mathematical or clerical error.

In Example 2, the partner's income tax return reports an ordinary loss from a partnership at a higher amount than the partnership had reported. The partner notifies the IRS of the inconsistent treatment. Based on the notification, the IRS separately examines the partner's return. In examining the partner's return, the IRS not

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WASHINGTON REPORT *by the Wolters Kluwer Washington News Bureau*

SFC asks stakeholders for tax reform recommendations

The Senate Finance Committee (SFC) Chair Orrin G. Hatch, R-Utah, on June 16 posted a letter asking tax stakeholders for recommendations on tax reform. In particular, Hatch is asking for feedback on how to improve the individual, business and international sides of the tax code. Written feedback and proposals should be sent via email to *taxreform2017@finance.senate.gov* by July 17, 2017.

"After years of committee hearings, public statements, working groups, and conceptual exercises, Congress is poised to make significant steps toward comprehensive tax reform," Hatch said. "As we work to achieve those goals, it is essential that Congress has the best possible advice and insight from experts and stakeholders," he added.

"The only way to pass lasting, job-creating tax reform that's more than an economic sugar-high is for it to be bipartisan," SFC ranking member Ron Wyden, D-Ore., has said. "Tax reform is not a haphazard exercise, throwing together a set of bullet points in the wake of a critical op-ed written by campaign advisors. It takes a lot of careful consideration to write a bipartisan tax reform bill, and I know because I've written two of them.""

Lawmakers explore small business tax reform

The Senate Small Business and Entrepreneurship Committee held a hearing on June 14 examining the prospects of tax reform and the removal of barriers to small business growth. Mark Mazur, former Treasury assistant secretary for tax policy, testified before the committee along with Annette Nellen on behalf of the American Institute of Certified Public Accountants (AICPA).

Lawmakers focused in particular on the increased burdens and costs of tax compliance experienced by small businesses. "Tax compliance costs are 67 percent higher for small businesses," Committee Chair James Risch, R-Idaho, said during opening statements. Likewise, ranking member Jeanne Shaheen, D-N.H., criticized the current tax code for being "too long and too complex." Shaheen added, "Small businesses spend 2.5 billion hours complying with IRS rules."

According to Nellen, current federal tax law hinders growth for small businesses and the economy. The complexity of tax compliance for small businesses requires that more time and money be dedicated toward complying with tax laws, rather than business and job growth, she noted. "The AICPA has consistently supported tax reform simplification efforts because we are convinced such actions will significantly reduce small businesses' compliance costs and fuel economic growth," she said.

Mazur also testified that small businesses generally have a larger per-unit cost of tax compliance than larger businesses. One particular area that adds to the complexity of complying with the tax code is accrual accounting, he noted. Mazur suggested a possible solution to simplify tax compliance that would allow a dollar threshold to be set where firms and smaller amounts of gross receipts could use a more simplified method of cash accounting.

Sound tax policy is based on three distinct variables: efficiency, equity and simplicity, according to Mazur. Achieving all three, however, requires managing potential conflict and necessary trade-offs, he noted. Nellen weighed in on the factors needed to achieve an ideal tax system for small businesses. "Our tax system must be administrable, support economic growth, have minimal compliance costs, and allow taxpayers to understand their tax obligations," she testified.

Nellen also advocated making tax provisions permanent, rather than temporary. There has been talk on Capitol Hill that a lack of lawmaker consensus and revenue neutrality on a tax reform bill could lead to the implementation of temporary tax cuts instead of true reform. Temporary tax law changes cause confusion and increased complexity for small businesses, according to Nellen.

Ways and Means approves bipartisan nuclear production tax credit

The House Ways and Means Committee approved a bipartisan measure on June 15 that would amend Code Sec. 45J to modify the credit for production from advanced nuclear power facilities. HR 1551 is sponsored by Reps. Tom Rice, R-S.C., and Earl Blumenauer, D-Oregon.

According to Rice, the passing of this legislation is an urgent matter to maintain nuclear facilities." If these nuclear facilities close, it would cost 12,000 jobs," Rice said. "It will also promote the development of the smaller scale, very efficient technology which could have broad application and is worth our pursuing," Blumenauer said.

Acting DOJ Tax Division chief testifies

Acting Assistant Attorney General David Hubbert, DOJ Tax Division, told lawmakers recently that the Division has some 6,000 cases pending in various stages of litigation. "The Division's civil appellate attorneys handle about 650 civil appeals, about half of which are from decisions of the U.S. Tax Court," Hubbert told the House Judiciary Committee. The Division authorizes between 1,300 and 1,600 criminal tax investigations annually, he added. Hubbert said that the Division is currently operating under a $107 million budget. President Trump has requested the same amount for fiscal year (FY) 2018, Hubbert said.

Departments post new ACA-related FAQ

The Treasury Department, along with the U.S. Departments of Health and Human Services (HHS) and Labor (DOL), has posted a new online FAQ about the *Affordable Care Act* (ACA). FAQ 38 discusses mental health parity. The departments explained that the ACA, the *21st Century Cures Act* and the *Mental Health Parity and Addiction Equity Act of 2008* have certain disclosure requirements. The departments are seeking comments on how to improve disclosure. The departments are requesting comments on a model form, treatment of certain disorders and certain state requirements.

Continued from page 293

only may correct the partner's share of the partnership loss but also adjust other items having nothing to do with the partner's interest in the partnership.

Partnership representatives

Wolters Kluwer: There has been a lot written lately about revising partnership agreements to designate a partnership representative under the new regime. Does "Partnership Representative" (Prop. Reg. §301.6223-1) assist in such designations?

Michael Grace: The proposed regulations helpfully prescribe the circumstances under which a legal entity may serve as partnership representative. Under the TEFRA Rules, many partnerships have become accustomed to having an entity serve as tax matters partner. Under the proposed regulations, a partnership must designate a partnership representative separately for each taxable year. The IRS apparently wants current information about the person authorized to act for and bind a partnership.

Practitioners should not assume that they can adequately update existing agreements merely by substituting "partnership representative" for "tax matters partner." Compared to a tax matters partner, a partnership representative has broader authority, and partners have fewer rights than under the TEFRA Rules.

Wolters Kluwer: Some practitioners had voiced concerns earlier about the broad scope of the partnership representative's authority, when compared to that of the tax matters partner under TEFRA. How does "Partnership Representative's Authority to Bind Partnership" (Prop. Reg. §301.6223-2) address those concerns?

Michael Grace: Users should be cautioned that a partnership representative acting within the scope of the authority granted under the rules has the sole authority to bind the partnership in an examination by the IRS. Nothing in the new rules prevents a partnership from subjecting a partnership representative to oversight or review by, for example, a managing partner or a committee of partners. However, requirements that a partnership representative consult with partners, other internal review processes, state law, and disagreements by the partnership or particular partners do not prevent the partnership representative's actions from binding the partnership. Several examples describing realistic situations reinforce this point.

Modification of imputed payments

Wolters Kluwer: What restrictions might be unstated within "Modifications of Imputed Underpayments" (Prop. Reg. §301.6225-2)?

Michael Grace: Under the general rule of a partnership's satisfying an imputed underpayment, partners economically bear the underpayment based on their interests in the partnership for the adjustment year. This result may prove undesirable especially if since the reviewed year (to which the underpayment relates) partners have come or gone or partners' interests otherwise have changed. Economically distorted resorts can be mitigated by partners amending their own returns for the reviewed year. Under the proposed regulations, however, this technique will be respected only if a partner files an amended return not only for the reviewed year but also for any "modification year." In complicated partnerships having numerous carryover items, identifying modification years and computing adjustments on amended returns may prove challenging. Twice in the preamble, however, the proposed regulations invite public comment on ways to simplify the amended return process.

"Push outs"

Wolters Kluwer: Concerns have also been voiced lately over the extent to which "push outs" of partnership underpayments may be available. What relief is available in "Push-Out Election - Statements Furnished to Partners and Filed with the IRS" (Prop. Reg. §301.6226-2)?

Michael Grace: Before a partnership elects to push an imputed underpayment out to its partners, the parties should appreciate the detailed nature of the information the partnership must provide not only the partners but also the IRS. Note also that a partnership must elect push-out within 45 days after the date of the notice of final partnership adjustment. See IRC Section 6226 and Section 301.6226-1(c)(3). However, the proposed regulations somewhat reduce administrative burdens by providing a safe harbor for calculating the share of the imputed underpayment for which a push-out partner must be responsible.

In general, the Push-Out Election operates as an all or nothing proposition. In other words, if the partnership makes the election, then the partners themselves must completely satisfy an imputed underpayment; the partnership has no liability for it. However, the proposed regulations provide some flexibility. A partnership can elect to push-out a "specific imputed underpayment" to partners while the partnership itself satisfies a "general imputed underpayment." The partnership's general imputed underpayment also could be modified by, for example, particular partners filing amended returns. In other words, in some situations, a combination of methods may be used to satisfy an imputed underpayment.

Even if a partnership elects to push-out an imputed underpayment to its partners, only the partnership itself may seek judicial review of the underlying examination adjustments. A partnership's making a push-out election does not grant partners any rights to seek judicial review of the underlying adjustments.

Multi-tiered arrangements

Wolters Kluwer: What clarity has been gained under the proposed regulations for multi-tiered arrangements within "Push-Out Election – Passthrough Partners" (Prop. Reg. §301.6226-3(e))?

Michael Grace: The proposed regulations preamble acknowledges the private sector's desire to push adjustments through tiers of partnerships to the ultimate owners, but it describes various administrative concerns with that outcome. The proposed regulations reserve the issue but invite public comment on it. It would seem possible to reconcile the IRS' apparent apprehension about possibly losing track of persons ultimately responsible for an imputed underpayment with the private sector's desire to push an imputed underpayment through vertical tiers of partnerships. Organizations of tax professionals and other persons can help by suggesting specific rules.

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COMPLIANCE CALENDAR

June 23

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

June 28

Employers deposit Social Security, Medicare, and withheld income tax for June 21, 22 and 23.

June 30

Employers deposit Social Security, Medicare, and withheld income tax for June 24, 25, 26 and 27.

July 6

Employers deposit Social Security, Medicare, and withheld income tax for June 28, 29, and 30.

July 7

Employers deposit Social Security, Medicare, and withheld income tax for July 1, 2, 3, and 4.

TRC TEXT REFERENCE TABLE

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

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FROM THE HELPLINE

The following questions have been answered recently by our Wolters Kluwer Tax Research Consultant Helpline (1-800-344-3734). (Note: Our Helpline provides research assistance, not legal advice.)

Q Is there a way to get the actual 1031 basis calculations within AnswerConnect? If so, please provide details on what, if anything is needed to be added to AC2 and how to find. Thanks so much

A For explanations about basis in a 1031 exchange, search Answer Connect for "like-kind basis" (without the quotation marks). Then, in the left-hand window of the search results page, click on Topics or Explanations. A worksheet that calculates basis along with other amounts is available (search like-kind, and then, in the left-hand window of the search results page, click on Tools—the first hit should be Worksheet, Code Sec. 1031 (Like-Kind) Exchange Calculations.

Q Can an LLC make a charitable gift of a mutual fund or ETF to a private foundation and have it qualify as a gift of appreciated stock – whereas it could take the fair market value of the stock as a deduction on its tax return? Also, would the private foundation record that donation at cost or fair market value (in other words, would the cost basis to the foundation be at the original cost basis in the hands of the LLC)?

A An LLC is subject to the same rules for the charitable contribution of appreciated property under Code Sec. 170(e) and Reg. §1.170A-4 as other taxpayers. (However, if the LLC is taxed as a partnership it may not claim the deduction but instead passes it through to its partners on their Schedule K-1s). For a discussion of contributions of appreciated capital gain property to a private foundation). *See TRC INDIV: 51,208.* There are no special rules for tax purposes regarding a charitable organization's basis in appreciated property received. The organization's basis is determined under Code Sec. 1015 (*TRC SALES: 6,100*).