



FEDERAL TAX WEEKLY

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New IRS CI Chief Describes Enforcement Priorities, Launch Of Special Investigation Units

www.irs.gov

The new chief of IRS Criminal Investigations (CI), Don Fort, has announced some enforcement priorities for his team. CI will organize a new nationally coordinated investigations unit, which will focus on employment tax enforcement, international tax enforcement and other projects. CI also is organizing a dedicated international tax investigations group.

■ **Take Away.** “Since 2008, the government has criminally charged more than 160 U.S. taxpayers who maintained secret offshore bank accounts. During that same time period, the government has charged more than 50 enablers – foreign bankers, attorneys, investment advisors, and the like – who helped U.S. citizens set up and maintain secret foreign accounts,” Matthew Lee, Partner, Fox Rothschild LLP, Philadelphia, told Wolters Kluwer.

■ **Comment.** “This (nationally coordinated investigations unit) is really cutting edge for CI, and part of the future of IRS Criminal Investigation,” Fort told reporters at a news conference in Washington, D.C. “This particular unit is going to report directly to our frontline executives here in Washington, D.C. The goal of the unit is to really use all of the data that we have available to us to help identify and develop areas of noncompliance,” he said. Fort took over as CI chief in June after the departure of Richard Weber.

Background

In fiscal year (FY) 2016 (the most recent year for which statistics are available), IRS CI initiated 3,395 investigations. Of these, 1,963 were tax-related investigations and 1,432 were investigations of other financial crimes, the IRS reported. CI made 2,744 prosecution recommendations. CI obtained 2,672 convictions.

International

International tax compliance has been a top priority of the IRS. CI has reported seeing certain trends involving offshore accounts and noncompliance with the U.S. tax laws. Taxpayers attempt to use foreign accounts, credit/debit cards, trusts, corporations, partnerships, and other entities to commit criminal violations of U.S. tax laws as well as narcotics, money laundering and *Bank Secrecy Act* (BSA) violations. CI coordinates with INTERPOL, the Terrorist Finance Working Group (TFWG), the Financial Action Task Force (FATF), and the Organisation for Economic Co-operation and Development (OECD).

■ **Comment.** “This is something we have never done before,” Fort said. The international tax enforcement group will “leverage years of experience,” he said. Fort predicted that the international tax enforcement group will be operational by October 1, 2017 with an initial roster of around 10 agents. country, Fort said. “We have the framework set up; we need to identify the personnel,” he said.

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IRS Extends Phase-In Periods For Regs On Dividend Equivalent Payments

Notice 2017-42

The IRS has announced that it plans to delay the effective dates of certain provisions in final regs under Code Sec. 871(m). The IRS reported that it continues to evaluate the Code Sec. 871(m) regs and may consider possible actions that may reduce unnecessary burdens.

■ **Take Away.** Nonresident aliens and foreign corporations in general are withheld up to 30 percent (or a lower treaty rate) on non-trade or business U.S. sourced dividends that are not trade or business effectively connected. Code Sec. 871(m) expands the reach of withholding by including “dividend equivalents,” including instruments in the U.S. equity derivatives market.

Delta-one and non-delta-one transactions

The IRS intends to revise the effective/applicability date of the Reg. §1.871-15(d)(2) rules for determining specified notional principal contract (NPC) status on or after January 1, 2017, and the Reg. §1.871-15(e) rules for determining specified equity-linked instrument (ELI) status. These rules will not apply to any payment made with respect to any non-delta-one transaction issued before January 1, 2019, the IRS explained. This does not apply to any Code Sec. 871(m) transaction under Reg. §1.871-15(d)(1) regarding specified NPC status before January 1, 2017.

The periods for applying the enforcement standards provided by Notice 2016-76 are extended. The IRS explained that it will take into account the extent to which the taxpayer or withholding agent made a good faith effort to comply with the Code Sec. 871(m) regs in enforcing them for (1)

any delta-one transaction in 2017 and 2018, and (2) any non-delta-one transaction that is a Code Sec. 871(m) transaction under Reg. §§1.871-15(d)(2) or (e) in 2019.

Simplified standard

The period of the simplified standard in Notice 2016-76, which withholding agents apply to determine whether transactions entered into in 2017 are combined transactions under Reg. §1.871-15(n), is extended to include 2018.

Transactions entered into in 2017 and 2018 that are combined under the simplified standard will continue to be treated as combined transactions for future years and will not stop being combined transactions due to applying Reg. §1.871-15(n) or disposing of less than all of the potential Code Sec. 871(m) transactions that are combined under the rule. Transactions entered into in 2017 and 2018 that are not combined under the simplified standard will not become combined transactions due to applying Reg. §1.871-15(n) to these transactions in future years, unless a reissuance or other event causes the transactions to be retested to determine whether they are Code Sec. 871(m) transactions.

Additional relief

Treasury and the IRS intend to amend Reg. §1.871-15(q)(1) and (r)(3), and Reg. §1.1441-1(b)(4)(xxii)(C), so that a QDD will not be subject to tax on dividends and dividend equivalents received in 2017 and 2018 in its equity derivatives dealer capacity or withholding on dividends, including deemed dividends.

A QDD will be required to compute its Code Sec. 871(m) amount using the net delta approach beginning in 2019. This extends by one year the relief set forth in Rev. Proc. 2017-15, which provided that use of the net delta approach by one year would begin in 2018. A QDD will remain liable for tax under Code Sec. 881(a)(1) on dividends and dividend equivalents that it receives in any capacity other than as an equity derivatives dealer, and on any other U.S. source FDAP payments that it receives. A QDD also is responsible for withholding on dividend equivalents it pays to a foreign person on a Code Sec. 871(m) transaction, whether acting in its capacity as an equity derivatives dealer or otherwise.

References: FED ¶46,325;

TRC INTL: 3,558.

IRS CI

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■ **Comment.** “The international tax enforcement group will examine a wide range of data and see where the data leads us in terms of other countries, other jurisdictions, and other individuals to best focus our efforts from a criminal investigation standpoint,” Fort said.

Employment taxes

As of June 30, 2016 (the most recent year for which statistics are available), some \$60 billion of federal employment taxes remained unpaid. The IRS also reported that employment tax evasion makes up some \$90 billion of the total tax gap, the difference between what taxpayers owe and what they pay.

Reference: TRC IRS: 66,454.

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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IRS Extends Voluntary Reporting Of Catastrophic Coverage Obtained On ACA Marketplace

Notice 2017-41

Health insurance issuers may, but are not required to, report on 2017 catastrophic coverage obtained through the ACA Marketplace, the IRS has announced. The announcement extends similar relief provided for reporting on 2015 and 2016 catastrophic coverage.

■ **Take Away.** Generally, catastrophic plans are available to individuals exempt from the shared responsibility requirement because they do not have access to affordable coverage or have experienced a hardship; or are under age 30. For 2017, the deductible for all catastrophic plans on the ACA Marketplace is \$7,150, the U.S. Department of Health and Human Services (HHS) has reported.

Background

The ACA generally requires individuals to have minimum essential health coverage or make a shared responsibility payment, unless exempt. An essential health benefits package provided by a qualified health plan in the individual or small group market, whether or not offered through the ACA

Marketplace, generally must (1) offer coverage for specific categories of benefits; (2) meet certain cost-sharing standards; and (3) provide certain levels of coverage.

The ACA allows Marketplaces to offer catastrophic plans to qualified individuals. This includes individuals qualifying for hardship exemptions, such as individuals whose plans have been cancelled who are unable to find another plan that is affordable.

■ **Comment.** Catastrophic plans do not qualify for cost-sharing under the ACA. Additionally, enrollees in catastrophic cannot claim the Code Sec. 36B credit for this coverage.

Reporting

The ACA requires issuers to report certain coverage (known as Code Sec. 6055 reporting). In 2016, the IRS issued proposed regs requiring issuers of catastrophic plans enrolled in through the ACA Marketplace to report catastrophic plan coverage. Reporting will be made on Form 1095-B, Health Coverage.

■ **Comment.** The IRS recently posted draft Form 1095-B for 2017. There are no changes to Form 1095-B.

The proposed reporting requirement would be effective beginning with coverage

for 2017 (for returns and statements filed and furnished in 2018). However, the IRS encouraged issuers to voluntarily report on 2016 catastrophic plan coverage (on returns and statements filed and furnished in 2017). The IRS also waived information reporting penalties for issuers that voluntarily reported on 2016 coverage.

Extension

The IRS reported that the proposed regs have not yet been finalized. As a result, the agency has extended the transition relief. Issuers of catastrophic plan coverage may, but are not required to, report on 2017 catastrophic plan coverage enrolled in through the ACA Marketplace (on returns and statements filed and furnished in 2018). Issuers also may rely on Notice 2017-41 to voluntarily report catastrophic plan coverage enrolled in through the ACA Marketplace for coverage years after 2017 to the extent final regs requiring issuer reporting of catastrophic plan coverage are not applicable, the IRS explained. Further, issuers that voluntarily report under Notice 2017-41 are not subject to information reporting penalties, the IRS explained.

References: FED ¶46,324; TRC HEALTH: 6,104.

IRS Alerts Tax Professionals To Growing Threat Of Ransomware

IR-2017-125, IR-2017-126

Ransomware is the latest cyberthreat confronting tax professionals, the IRS recently warned. Although the IRS is aware of a small number of ransomware attacks targeting tax professionals, the agency cautioned that ransomware attacks are growing.

■ **Take Away.** “Tax professionals face an array of security issues that could threaten their clients and their business,” IRS Commissioner John Koskinen said. “We urge people to take the time to understand these threats and take the steps to protect themselves. Don’t just assume your computers and systems are safe.”

Background

Ransomware is a type of malware. Tax practitioners may unknowingly open their computer systems to malware and ransomware. The IRS reported that the most common delivery method for malware is through phishing emails. The emails invite users to open an infected link or attachment. Ransomware infects computer systems and cybercriminals demand a ransom to release locked data on the system.

Preventing attacks

The IRS highlighted a number of steps tax professionals should take to guard against malware and ransomware. They include:

- Make sure employees are aware of ransomware and of their critical roles in protecting the organization’s data.
- Ensure that security patches are installed on operating systems, software and firmware.
- Back up data regularly and verify the integrity of those backups.
- Secure backup data.
- **Comment.** The IRS also warned tax professionals that cybercriminals are seeking to steal their passwords. This latest scam email often comes with a subject line of “Software Support Update,” the IRS explained.

Reference: TRC FILEIND: 18,052.

Appellate Court Finds Remuneration In Stock Exempt From RRTA Taxes

*Union Pacific Railroad Company, CA-8,
August 1, 2017*

Reversing a federal district court, the Court of Appeals for the Eighth Circuit has found that the *Railroad Retirement Tax Act* (RRTA) does not require payment of RRTA taxes on remuneration in stock. Similar, contract ratification payments were exempt from RRTA tax.

■ **Take Away.** The court noted that the Seventh Circuit recently held that payments in stock are a form of money remuneration because stock has become “practically equivalent to cash” (*Wisconsin Central Ltd.* 2017-2 USTC ¶50,295). Here, the Eighth Circuit found that even stocks with readily determinable share prices are not money because they are not mediums of exchange. “One cannot pay for produce at the local grocery store with stock....we do not think it is a medium of exchange,” the Eighth Circuit observed.

Background

The taxpayer was a rail carrier. In addition to a salary, qualified employees were paid in company stock. The taxpayer remitted RRTA taxes on the stock payments.

Sometime later, the taxpayer requested refunds of the RRTA taxes paid on the stock payments. The IRS disallowed the refund. According to the IRS, employers that pay employment taxes under FICA are obligated to pay taxes on stock payments and its regs generally treat FICA and RRTA the same on this matter. A federal district court agreed and granted summary judgment in favor of the IRS. The taxpayer appealed to the Eighth Circuit.

Court's analysis

The court first found that RRTA tax is levied on an employee's compensation which is generally defined as any form of money remuneration paid to an individual for services rendered as an employee to one or more employers. FICA, the court found, levies a tax

on an employee's wages, which constitute all remuneration for employment. “FICA expressly mentions the cash value of remuneration not paid in cash, such as payments in property, whereas the RRTA does not, the court observed.” And the determiner ‘all’ qualifies ‘remuneration’ in FICA, appearing to make remuneration unlimited, whereas the word ‘money’ qualifies ‘remuneration’ under RRTA, the court added.

The court found that generally money means any currency, tokens, banknotes, or other circulating medium in general use as the representative of value. The court also noted an appellate court decision from the time when the RRTA was enacted had found that the word ‘money’ when taken in its ordinary and grammatical sense does not include corporate stocks.

Additionally, regs issued shortly after enactment of the RRTA provided that the term compensation means all remuneration in money, or in something which may be used in lieu of money (scrip and merchandise orders, for example), which is earned by an individual for services performed as an employee.

The appellate court also declined to interpret the RRTA to reach as far as the FICA because the two statutes share a similar purpose. Vague notions about the statutes' purposes, however, cannot be used to override their actual texts. The Eighth Circuit reversed the district court's decision granting summary judgment to the IRS.

Ratification payments

The taxpayer paid ratification payments to the employees when their unions ratified collective bargaining agreements. According to the taxpayer, the payments were not for services rendered and therefore were exempt from RRTA tax.

The appellate court found that the ratification payments were not made to employees for services rendered to the taxpayer. The taxpayer did not exercise control over whether a union ratifies a collective bargaining agreement, the court observed. Therefore, the ratification payments were exempt from RRTA tax.

*References: 2017-2 USTC ¶50,293;
TRC PAYROLL: 9,352.*

IRS Updates FAQs For Late FFI Agreement Renewals

The IRS has updated its online FATCA frequently asked questions with more information about renewing a foreign financial institution (FFI) agreements. The updated FAQs address late renewals.

Entities that are required to enter into an FFI agreement and that did so before January 1, 2017, were required to renew their FFI agreement by July 31, 2017, in the FATCA FFI Registration System if they want to remain on the FFI List.

On its website, the IRS explained that participating FFIs that missed the July 31, 2017 renewal deadline, and that have otherwise complied with the terms of the FFI agreement (including, since January 1, 2017, the current FFI Agreement) have until October 24, 2017, to renew the FFI agreement and continue to be treated as a participating FFI. If an entity required to renew the FFI agreement does not renew the FFI agreement by October 24, 2017, the registration status of the entity will be changed to “incomplete,” the IRS explained. The entity will no longer appear on the monthly FFI List beginning in November, and the entity will be considered a nonparticipating FFI as of January 1, 2017, the IRS added.

■ **Comment.** A participating FFI is an entity that enters into an FFI agreement where, among other things, it agrees to report with respect to its U.S. accounts. Generally, a nonparticipating FFI is subject to 30 percent withholding.

www.irs.gov; TRC INTL: 36,050.

Tax Court Strikes Down Losses From CARDS Transaction

*Curtis Investment Company, LLC,
TC Memo. 2017-150*

In consolidated cases, the Tax Court has again rejected purported losses from a CARDS transaction. The court found that no rational taxpayer would have entered into the transactions absent the tax benefits.

■ **Take Away.** The taxpayers in this case lived in different circuits. Therefore, the Tax Court looked

to how the Fourth Circuit and the Eleventh Circuit would answer the question of whether a transaction has economic substance.

Background

The taxpayers were part of a family business. The taxpayers sold some stock and were to realize significant gains. The taxpayers invested in a CARDS transaction. The IRS disallowed purported deductions

for capital losses or transaction costs as a result of the CARDS transaction.

■ **Comment.** A CARDS transaction typically has three stages: (1) loan origination; (2) loan assumption; and (3) loan operation, the court explained. The court found that the purpose of a CARDS transaction is to create an artificial substantial capital loss that offsets an unrelated capital gain.

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TIGTA Finds Potential Underreported Employment Tax Cases Not Being Worked

TIGTA Ref. No. 2017-40-038

The IRS may be missing out on recovering billions of dollars of uncollected employment taxes, the Treasury Inspector General for Tax Administration (TIGTA) recently reported. TIGTA reviewed the Combined Annual Wage Reporting (CAWR) Program, a document matching program that compares wage and withholding information reported by employers to the IRS to what was reported to the Social Security Administration (SSA).

■ **Take Away.** “The IRS’s method of allocating resources to discrepancy cases hinders its ability to reduce the billions of dollars that are owed but are not assessed or collected, known as the tax gap,” Treasury Inspector General for Tax Administration J. Russell George said. “The IRS needs to revise its case selection process to include cases with the highest potential tax assessment and expand the process to include cases that are currently excluded,” he added.

Background

The CAWR Program consists of two parts: IRS-CAWR and SSA-CAWR. The IRS-CAWR Program is designed to en-

sure that employers report the proper amount of taxes and tax withholding. The SSA-CAWR Program is designed to ensure that employees receive proper credit for covered earnings. TIGTA explained that a discrepancy case arises where the amount of wages and withholding reported by an employer to the SSA/IRS does not agree with the amount of wages and withholding the employer reported to the IRS on its employment tax return.

The IRS-CAWR Program identifies discrepancy cases to be worked two tax years behind the current tax year, TIGTA explained. This is intended to give employers time to file requisite forms. An automated process computes the total potential underreported tax for the discrepancy cases.

■ **Comment.** TIGTA reported that the IRS software randomly selects the IRS-CAWR discrepancy cases that will be worked. The selections are made without any regard to the dollar amount of the IRS computed potential underreported taxes, TIGTA added.

TIGTA’s review

TIGTA reviewed some 140,000 IRS-CAWR Program discrepancy cases from

tax year (TY) 2013. TIGTA reported that the IRS did not work 83 percent of the cases. According to TIGTA, the unworked cases had a potential underreported total tax difference of more than \$7 billion.

TIGTA also reviewed the discrepancy cases worked by the IRS. TIGTA found that more than two-thirds resulted in total tax assessments of some \$64 million

■ **Comment.** TIGTA based its finding of \$7 billion on data as of April 2016 and acknowledged that the amount could be different from when the cases were initially identified as discrepancy cases.

■ **Comment.** TIGTA estimated that the IRS would need to devote 55 full-time equivalent (FTE) employees to work these cases.

SSA-CAWR cases

The IRS works all SSA-CAWR discrepancy cases, TIGTA reported. The IRS is required to work all SSA-CAWR cases under a settlement agreement dating to litigation from the 1980s.

■ **Comment.** TIGTA made a number of recommendations, including that the IRS evaluate the agreement with the SSA to determine if it could make changes.

Reference: TRC PAYROLL: 6,106.

AICPA Weighs In On Withdrawal Of Four Regulations

AICPA Comment Letter to IRS, August 2, 2017

In response to the IRS's invitation extended by Notice 2017-38, Implementation of Executive Order (EO) 13789 (Identifying and Reducing Tax Regulatory Burdens) (*see the July 13, 2017 issue of this newsletter*), the American Institute of CPAs (AICPA) has recommended the modification or withdrawal of four of the eight regulations on Notice 2017-38's list for reconsideration.

■ **Take Away.** Treasury and the IRS appear to intend to move quickly on deciding how to curtail this first group of eight regulations that have been labeled either overly complex or overreaching by many stakeholders. Comments on Notice 2017-38, issued on July 7, were requested by August 7, in anticipation of a final report to be sent by the Treasury to President Trump by September 18. That report will recommend "spe-

cific actions to mitigate the burden imposed by regulations identified in the interim report."

■ **Comment.** EO 13789 directed Treasury to review regs issued on or after January 1, 2016, that are significant in respect to contracting certain tax-policy goals. As such, significant is defined as all such regulations that: (1) impose an undue financial burden on U.S. taxpayers; (2) add undue complexity to the Federal tax laws; or (3) exceed the statutory authority of the IRS.

Recommendations

The AICPA recommends withdrawal of, or significant amendments to, the following regulations:

■ **REG-163113-02:** These estate tax valuation regs are overly broad and expand the breadth of Code Sec. 2704

"in a manner not contemplated by Congress," according to the AICPA. In addition to adding undue complexity, the proposed regs would unfairly treat family-owned businesses differently from similarly situated businesses without family ownership.

■ **TD 9790:** These debt-equity regs under Code Sec. 355 should be withdrawn or, at least, drastically reduced in their scope and complexity. Particularly onerous are existing documentation requirements, as well as the so-called "72-month per-se period."

■ **TD 9794:** Aspects of these regs regarding Code Sec. 987 qualified business units (QBUs) are sufficiently onerous according to the AICPA that they should be withdrawn and then reissued to include helpful portions. Complaints focused on the information required for QBUs and the lack of transition rules.

■ **TD 9803:** These final Code Sec. 367(d) regs are broad-reaching and burdensome on taxpayers, due to their complexity. In addition, the AICPA points out problems regarding their retroactive application, as well as being contrary to congressional intent related to recognition of gain on the transfer of goodwill or going concern value.

■ **Comment.** The AICPA made clear that it was not taking a position, either for or against, on the other four of the eight regs listed in Notice 2017-38. Those regs include:

■ **REG-129067-15:** "Proposed regs under Code Sec. 103 on definition of a political subdivision;"

■ **TD 9779:** "Temporary regs under Code Sec. 337(d) on certain transfers of property to regulated investment companies (RICs) and real estate investment trusts (REITs);"

■ **TD 9778:** "Final regs under Code Sec. 7602 on the participation of a person described in Code Sec. 6103(n);" and

■ **TD 9888:** "Temporary regs under Code Sec. 752 on liabilities recognized as recourse partnership liabilities."

References: Dec. 60,979(M);

TRC FILEBUS: 9,450.

Reference: TRC SALES: 51,056.05.

Transaction

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Court's analysis

The court first found that taxpayers may structure their transactions in a manner which decreases the amount of what otherwise would be their tax liabilities. "However, even if a transaction is in formal compliance with the tax Code, the economic substance of the transaction determines what is and what is not income to a taxpayer," the court held.

The court noted that it had examined other CARDS transactions by the same promoter. The other CARDS transactions were essentially the same as the CARDS transactions in these cases, the court added, so it looked to the economic substance test, with objective and subjective prongs, as it had in past CARDS transaction cases.

Here, the court found that the CARDS transactions failed the objective prong. The taxpayers had invested in the transactions to create tax losses, the court found. The taxpayers were aware that the transactions

would generate a tax loss and this was their motive. "There was no genuine profit motive for these CARDS transactions, and any testimony to the contrary is simply not credible," the court found.

Additionally, the court found that the CARDS transaction failed the subjective prong. The court rejected the taxpayers' argument that their business purpose for engaging in the transaction was to obtain proceeds for investment. Having a business purpose, the court explained, does not mean the reason for a transaction is free of tax considerations, but the purpose must be one that figures in a bona fide, profit-seeking business. The court found that the high financing costs and other factors showed that the investment motive was not credible.

The court also rejected the taxpayers' argument that they had acted in good faith because the CARDS transactions presented a novel issue. At the time the taxpayers had engaged in the transaction, the IRS had already taken a position unfavorable to CARDS transactions, the court found.

District Court Finds Some Requested Documents Beyond Taxpayer's Control

Liu, DC-Calif.

A federal district court has found that a taxpayer did not possess certain documents sought by the IRS because the records were either beyond his control or no longer existed. The court utilized a “sliding scale” test. The taxpayer had challenged the IRS’s summons for these documents on several grounds.

■ **Take Away.** An IRS summons imposes a duty to retain possession of summoned documents pending a judicial determination of the enforceability of the summons, the court found. The party resisting enforcement bears the burden of producing credible evidence that he does not possess or control the documents sought.

Background

In 2014, the IRS served the taxpayer a summons. An IRS agent subsequently met with the taxpayer, who declined to answer certain questions. In 2015, the IRS served a second summons. The IRS sought to compel the production of documents related to a company in Hong Kong, another company in Malaysia and a third business in the British Virgin Islands. The taxpayer provided some documents but not all of the requested documents. The IRS subsequently moved for a court order to compel cooperation with the summons.

Court’s analysis

The court first noted that under *Powell*, 64-2 USTC ¶9858 and *Clarke*, 2014-2 USTC ¶50,370, the government must show that:

- The investigation will be conducted for a legitimate purpose;
- The material being sought is relevant to that purpose;
- The information sought is not already in the IRS’s possession; and
- The IRS complied with all the administrative steps required by the Tax Code.

■ **Comment.** The court had previously found that the government had established prima facie case under *Powell*. The IRS did not possess the records sought. The material was relevant to the agency’s investigation. The court also found that the IRS had complied with all the administrative steps.

“The burden is minimal because the statute must be read broadly in order to ensure that the enforcement powers of the IRS are not unduly restricted,” the court observed. Grounds for challenging a summons include showing a failure to satisfy the *Powell* requirements.

Abuse of process, such as bad faith use of the procedure to harass or pressure the taxpayer regarding other disputes, is also recognized as grounds to invalidate the summons.

The taxpayer argued that he did not possess, control, or have custody of any of the documents sought. The IRS countered that the taxpayer had an obligation to retain the documents.

According to the court, it is unclear exactly what a taxpayer must show to meet his or her burden of demonstrating a lack of possession, custody, or control of the requested documents. “However,

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National Taxpayer Advocate: IRS Allowable Living Standards Not Realistic

In a recent post on the Taxpayer Advocate Service (TAS) site, National Taxpayer Advocate Nina Olson made the case that the IRS’s standards for assessing a taxpayer’s ability to pay an outstanding deficiency is significantly out of date just as the IRS’s Allowable Living Expense (ALE) standards now play a larger role in many types of collection cases. ALEs cover common expenses such as food, clothing, transportation, housing and utilities.

The National Taxpayer Advocate makes several points in the case that current ALE standards are unrealistic when measured against contemporary needs:

- “Taxpayer averages” used for ALEs do not reflecting what any particular taxpayer may be facing in terms of expenses;
- ALEs need to be more weighted toward income levels, recognizing for example that higher income taxpayers pay less of a percentage of their income on housing than do lower-income taxpayers;
- ALE standards are outdated in not recognizing certain additional expenses that have become family necessity, including digital technology access, child care, and retirement savings;
- ALE standards do not reflect the decreasing cash reserves with which the typical household in the middle third finds themselves for emergencies, dropping from \$17,000 in 2004 to \$6,000 in 2014; and
- ALE standards for 2016 and 2017 have decreased for some expense amounts based upon the IRS’s false belief that expenses are going down.
- **Comment.** Olson reported that the IRS’s decrease in some expense categories over the past two years was done despite both the IRS’s general lack of available data and its agreement with the Taxpayer Advocate in 2007 that “the allowance amount for any ALE category cannot be decreased unless something economic changes significantly, such as a major sustained recession or depression.”

www.irs.gov; TRC IRS: 42,106.

TAX BRIEFS

Treasury

The Treasury Department has published a current list of countries that may require participation in, or cooperation with, an international boycott. The list is as follows: Iraq, Kuwait, Lebanon, Libya, Qatar, Saudi Arabia, Syria, United Arab Emirates and Yemen.

*Boycott Notice, FED ¶46,323;
TRC INTL: 21,050*

Disaster Relief

Victims of severe storms and flooding that began on June 22, 2017, in parts of Michigan may qualify for tax relief from the IRS. The president has declared the counties of Bay, Gladwin, Isabella, and Midland Counties, and the Saginaw Chippewa Tribe within Isabella County federal disaster areas. Individuals who reside or have a business in these counties may qualify for tax relief. The IRS has postponed certain deadlines for taxpayers who reside or have a business in the disaster area. Certain deadlines falling on or after June 22, 2017, and before October 31, 2017, have been postponed to October 31, 2017.

*Michigan Disaster Relief Notice (MI-2017-01),
FED ¶46,326; TRC FILEIND: 15,204.25*

Jurisdiction

A married couple's claims for unauthorized collection damages were dismissed for lack of jurisdiction. The couple failed to exhaust their administrative remedies. To exhaust their administrative remedies, the couple

was required to file an administrative claim before filing suit. The administrative claim must be sent in writing to the area director of the area in which the taxpayer resides.

*Wroblewski, et al., DC Calif., 2017-2 USTC
¶50,296; TRC IRS: 45,114*

Deductions

An independent contractor, who was a courier, could not deduct contract labor and repair and maintenance expenses because he failed to substantiate the expenses. Further, the taxpayer could not deduct depreciation for the vehicle he used in his courier business because the taxpayer did not own the vehicle.

*Drah, TC, CCH Dec. 60,979(M),
FED ¶48,093(M); TRC BUSEXP: 24,8026*

TIGTA

The IRS properly identified and reported 20 instances of confirmed purchase card misuse and two instances of purchase card misuse pending final agency action, according to a report by the Treasury Inspector General for Tax Administration (TIGTA). TIGTA's report assessed the Service's implementation of, and compliance with, the Government Charge Card Abuse Prevention Act of 2012 (Charge Card Act) for the period October 1, 2016, through March 31, 2017.

Ref. No. 2017-30-047

The IRS did not issue the required notification letters by June 30, 2015, to taxpayers without minimum essential coverage un-

der the Affordable Care Act (ACA) for tax year 2014, the Treasury Inspector General for Tax Administration (TIGTA) reported. In March 2016, the IRS's ACA Program Management Office had coordinated with the Department of the Treasury and the Centers for Medicare and Medicaid Services to develop the notification letters and identify taxpayers to whom the letter would be mailed.

Ref. No. 2017-43-052

Letter Rulings

Two publicly traded corporations that retained stock pursuant to certain transactions did not do so for the principal purposes of tax avoidance.

LTR 201731003, LTR 201731004

A nonqualified deferred compensation plan adopted by a township for the benefit of its employees was an eligible deferred compensation plan.

LTR 201731009

In each of two cases, a REMIC's right to receive an allocable share under a settlement agreement arose from mortgage loans and its status as a REMIC. Therefore, the REMIC's right to receive an allocable share was not an asset newly acquired after its startup date.

LTR 201731001, 201731002

A private foundation's procedures for awarding scholarships were approved.

LTR 201731018

Documents

Continued from page 367

the taxpayer's responsibilities surely go further than a pro forma demand and cursory search for records, or a self-serving affidavit, lacking detailed facts and any supporting evidence," the court observed.

Some appellate courts, the court found, have held that it is within the district court's discretion to simply determine whether the facts show that the

taxpayer does, or does not, possess the relevant documents. Other appellate courts have required the party resisting enforcement bear the burden of producing credible evidence of non-possession, operating on a sliding scale. "The more the government's evidence suggests the defendant possesses the documents at issue, the heavier the defendant's burden to successfully demonstrate that he does not."

Utilizing the sliding scale test, the court agreed with the taxpayer that he did not

have possession of the requested documents because the non-produced records were either beyond his control or no longer existed. Advisory letters from law firms within the foreign jurisdictions, explained that non-beneficial owners, such as the taxpayer, would have no legal right to compel production of the documents. The court held it could not compel the taxpayer to produce documents that he did not have in his possession or control.

*References: 2017-2 USTC ¶50,294;
TRC IRS: 21,056.*

PRACTITIONERS' CORNER

AICPA's Recommendations Remind Congress Of Vast Scope Of Tax Reform, Simplification

The American Institute of CPAs (AICPA) recently made recommendations on the taxation of individuals, business taxation, tax administration and a number of other topics to Congress. "We need a tax system that is administrable, stimulates economic growth, has minimal compliance costs, and allows taxpayers to understand their tax obligations. These features of a tax system are achievable if principles of good tax policy are considered in the design of the system," the AICPA told lawmakers. *This Practitioners' Corner highlights some of the AICPA's recommendations for tax simplification and reform.*

■ **Comment.** The AICPA's tax technical resource panels have been working on a variety of proposals, Annette Nellen, CPA, Chair, Tax Executive Committee, told Wolters Kluwer. Some topics have been discussed for many years, Nellen explained, such as the alternative minimum tax (AMT). When the Senate Finance Committee (SFC) recently asked for recommendations for tax reform, the Tax Executives Committee drew on this breath of knowledge to submit proposals, Nellen said.

Individual taxation

The AICPA reminded lawmakers that requiring taxpayers to compute income for regular tax and alternative minimum tax (AMT) purposes contributes to the complexity. "Congress should apply a simplified rate structure with only one set of rules, as opposed to the current system, which arguably includes three different taxation systems (regular tax, AMT, and net investment income (NII) tax)," the AICPA told Congress. Similarly, the AICPA called on lawmakers to use a consistent definition of taxable income, without the use of any phase-outs.

Information returns

The AICPA alerted lawmakers about the growing number of corrected and delayed information returns. "Taxpayers receiving corrected Forms 1099 are obligated to file amended tax returns in order to report the corrected amounts. This process compresses the tax filing season and causes time-consuming and expensive efforts for corrections that often result in insignificant differences," the AICPA observed.

"The AICPA reminded lawmakers that the majority of businesses are structured as pass-through entities such as, partnerships, S corporations, or limited liability companies."

The current safe harbor under Code Sections 6721 and 6722 only applies to issuers of information returns. "In the interest of effective tax administration, the AICPA recommends adding a de minimis safe harbor for recipients of corrected information returns such that small changes do not require the filing of amended Forms 1040, 1041, 1065, 1120-S or 1120."

Self-employed individuals

The AICPA recommended full deductibility of health insurance costs in calculating the self-employment tax for self-employed individuals. Employees receive this deduction for their health insurance costs while self-employed individuals are not allowed a deduction in determining their net income subject to these taxes. The AICPA called for consistent treatment among all taxpayers.

Small businesses

The AICPA reminded lawmakers that the majority of businesses are structured as pass-through entities such as, partnerships,

S corporations, or limited liability companies. "If Congress, through tax reform, lowers the income tax rates for C corporations, all business entity types should also receive a rate reduction," the AICPA recommended.

At the same time, Congress should continue to encourage, or more accurately, not discourage, the formation of sole proprietorships and pass-through entities. "These business structures provide the flexibility and control desired by many business owners that

is not available within the more formal corporate structure," the AICPA told lawmakers.

Education

As in past years, the AICPA recommended simplification of education tax incentives. The American Opportunity Tax Credit (AOTC) and lifetime learning credit should be replaced with one new or revised credit. The credit should be allowable on a per student rather than a per taxpayer basis, which the AICPA predicted would potentially generate a larger tax benefit per family. Further, the new or revised credit should be available for six-years of post-secondary education, including graduate-level and professional degree courses.

The AICPA also noted that many taxpayers are confused by the higher education tuition and fees deduction and the student loan interest deduction. Taxpayers also have experienced confusion defining education expenses. The AICPA proposed to create a uniform definition for all education-related tax provisions. This uniform

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Trump nominates two individuals to serve on Tax Court

President Trump has nominated Elizabeth Ann Copeland and Patrick Urda to serve as judges on the U.S. Tax Court. Copeland currently is a partner at Strasburger & Price LLP, San Antonio, Texas. Urda is currently counsel to the deputy assistant attorney general in the U.S. Department of Justice (DOJ) Tax Division.

Bipartisan bill addresses corporate transparency

Sen. Marco Rubio, R-Florida, and Sen. Ron Wyden, D-Oregon have introduced the Corporate Transparency Act of 2017. The lawmakers explained that their bill would require the beneficial owners of U.S.-based shell corporations to appropriately disclose their identities.

"We must work to ensure that law enforcement has the basic information, tools, and authorities at its disposal to identify and disrupt illicit activities affecting our communities and our national security, whether its human trafficking, health care fraud, transnational corruption, or terrorism financing," Rubio said. "Criminals have been able to hide behind shell companies to finance terrorism, launder money and defraud the government at the expense of American taxpayers," Wyden said.

Senator says IRS plans drought relief

Sen. Heidi Heitkamp, D-North Dakota, recently announced that the IRS intends to provide tax relief to ranchers who have suffered losses because of weather conditions. Heitkamp said that many ranchers have had to sell their livestock at lower prices because of a lengthy drought. According to Heitkamp, IRS Commissioner John Koskinen has indicated that he would let North Dakota ranchers know they are eligible for capital gains tax deferrals.

IRS plans e-Services outage

The IRS has announced a complete outage of all e-Services tools, including Registration, Transcript Delivery System (TDS), and Taxpayer Identification Number (TIN) Matching, from 6:00 p.m. ET, Thursday, August 17, 2017 until 6:00 a.m. ET, Monday, August 21, 2017. All applications also will be offline and resume August 22, 2017, except for state users. The scheduled outage will allow a complete transition of e-Services to a new platform that will improve the look and feel of applications and complete a multi-year technical upgrade, the agency explained.

IRS seeks stay in PTIN case

The IRS has asked a federal district court to stay its injunction barring the agency from charging a user fee for preparer tax identification numbers (PTINs). In *Steele, 2017-1 USTC ¶50,238*, the court found that the IRS may require the use of PTINs. Although the IRS may require the use of PTINs, the agency may not charge fees for PTINs because this would be equivalent to imposing a regulatory licensing scheme and the IRS does not have this regulatory authority, the court held.

Individuals who are compensated for preparing, or assisting in the preparation of all or substantially all of any U.S. federal tax return, claim for refund, or other tax form submitted to the IRS, generally must obtain a PTIN. There are exceptions for preparers of certain forms and returns.

DOJ announces five individuals indicted in \$9 million refund scam

The U.S. department of Justice (DOJ) has announced that five individuals have been charged with conspiring to submit fraudulent claims for tax refunds. According to the indictment and information provided to the court, the individuals filed fraudulent tax returns with the Internal

Revenue Service (IRS) that included fake income, false dependents and bogus education expenses. "As a result of filing these fraudulent returns, the defendants are alleged to have stolen more than \$9 million in tax refunds," DOJ reported. The indictment alleges that the defendants directed the IRS to send the refunds to addresses and bank accounts that they controlled. According to the indictment, they forged endorsements and cashed or deposited the refund checks at financial institutions and businesses in California.

FinCEN asks for comments on Form 8300

Treasury's Financial Crimes Enforcement Network (FinCEN) has requested comments on its proposed renewal without change to the collection of information through Form 8300, Report of Cash Payments Over \$10,000 Received in a Trade or Business. Generally, any person in a trade or business who, in the course of the trade or business, receives more than \$10,000 in cash or foreign currency in one or more related transactions to report it to FinCEN and provide a statement to the person. FinCEN requested comments by October 2, 2017.

Multistate Tax Commission unveils voluntary disclosure program

The Multistate Tax Commission (MTC) has developed a voluntary disclosure program for taxpayers with back tax liabilities in multiple states to negotiate settlements by entering into voluntary disclosure agreements. Taxpayers, the MTC explained, will use a uniform procedure coordinated through the MTC. The types of taxes that can be covered in a voluntary disclosure agreement include corporate taxes, employer taxes, franchise taxes, and other business activity taxes. In exchange for entering into an agreement, the jurisdiction waives, in part or in total, certain penalties and provides other relief.

Practitioners' Corner

Continued from page 369

definition should include tuition, books, fees, supplies and equipment.

Disaster relief

In the past, Congress has responded to some disasters with temporary tax relief. The AICPA urged Congress pass permanent tax legislation that would take effect immediately when a declaration of a federal disaster occurs. The AICPA recommended that permanent disaster relief waive individual casualty loss limitations, allow a five-year carryback period for net operating losses (NOLs) attributable to a disaster event, increase Code Sec. 179 expensing limits, and allow a housing exemption for displaced individuals, among other changes.

Under current law, the IRS's authority to grant deadline extensions is limited to taxpayers affected by federally-declared disasters. The AICPA recommended that Congress authorize the IRS to postpone certain deadlines in response to state-declared disasters or state of emergencies.

■ **Comment.** Making these provisions permanent would offer taxpayers assurance of relief and ensure that the treatment of taxpayers is consistent for all federal disasters, Nellen told Wolters Kluwer.

Interest expense deduction

The AICPA urged Congress to retain the interest expense deduction. Abolishment would effectively eliminate the benefit of a valid business expense for many small businesses, as well as many professional services firms, the AICPA predicted. "If a limit on the interest expense deduction is paired with a proposal to allow for an immediate write-off of acquired depreciable property, it is important to recognize that this combination adversely affects professional service firms and small businesses while offering larger manufacturers, retailers, and other asset-intensive businesses a greater tax benefit."

Start-up expenses

Current law provides immediate expensing of start-up expenses up to \$5,000. Previ-

ously, Congress temporarily enhanced the \$5,000 amount. The AICPA recommended that lawmakers permanently increase the \$5,000 amount (and the phase-out amount) with inflation adjustments. The larger dollar amounts will better encourage entrepreneurship. "Higher dollar amounts also reflect the costs for legal, accounting, investigatory, and travel that are frequently incurred when starting a new business," the AICPA observed.

Retirement plans and savings

Many taxpayers are confused by the number of retirement plans, the AICPA told lawmakers. "There are more than a dozen tax-favored, employer-sponsored retirement planning vehicles. Each plan type is subject to different rules pertaining to plan documents, eligibility, contribution limits, tax treatment of contributions and distributions, availability of loans, portability, nondiscrimination, reporting and disclosure, which causes unnecessary complexity and confusion."

The AICPA reminded Congress that taxpayers can make larger contributions to employer-sponsored plans than to IRAs or Roth IRAs. "Because tax-preferred retirement plans are a large source of retirement savings for many workers, it is important that the rules governing them are as simple as possible."

The AICPA recommended that Congress limit the number of contributory retirement plans. "A suggested approach is to eliminate SIMPLE IRAs and amend the rules of SEPs to allow for salary reduction contributions, as previously permitted. In addition, Congress could eliminate the SIMPLE 401(k) plan because while the fees are similar to that of a 401(k) plan, the 401(k) plan is favored since it is more flexible." The AICPA also recommended eliminating the top-heavy rules, creating a uniform attribution rule, and creating a uniform definition of owners, among other changes.

Required minimum distributions

The AICPA recommended several changes to the required minimum distribution (RMD) rules. RMDs should be required only from retirement accounts greater than \$500,000. Additionally, the age at which participants are required to begin taking distributions from 70 ½ to 80. "An increase in

the age requirement will provide incentive for retirement plan account holders to save longer which will help retirement savings to last over longer lives," the AICPA predicted.

AMT

The AICPA discussed the history and impact of the AMT and recommended its repeal. "The AMT was created to ensure that all taxpayers pay at least a minimum amount of tax on their economic income. However, businesses suffer a heavy burden because they often do not know whether they are affected by the AMT until they file their tax federal income tax returns."

Taxpayers must make a separate computation of their income, expenses, allowable deductions, and credits under the AMT system, the AICPA explained. This separate calculation is required for all components of income including business income for sole proprietors, partners in partnerships and shareholders in S corporations.

Identity theft

Tax-related identity theft, the AICPA told lawmakers, continues to victimize individuals and businesses. The AICPA recommended a single point of IRS contact for victims of identity theft. Efficiencies will result as the single point of contact will identify areas of duplication and areas causing delays, the AICPA predicted. As in past years, the AICPA proposed that Congress make it a felony offense for a person to use a stolen identity to file a return.

Mobile work force

The AICPA has long advocated for passage of mobile workforce legislation. Generally, this legislation would provide a uniform national standard for non-resident state income tax withholding and a de minimis exemption from the multi-state assessment of state non-resident income tax. The legislation also would provide a 30 day de minimis threshold before income tax withholding is required. "The current situation of having to withhold and file many state nonresident tax returns for just a few days of work in various states is too complicated for both small businesses and their employees," the AICPA told lawmakers.

COMPLIANCE CALENDAR

■ August 10

Employers who deposit quarterly employment tax timely, file Form 941 for the second quarter of 2017 if the second quarter employment taxes were previously deposited timely, properly and in full.

Employees who received \$20 or more in tips during July report them to their employers.

■ August 11

Employers deposit Social Security, Medicare, and withheld income tax for August 5, 6, 7, and 8.

■ August 15

Employers for whom the monthly deposit rule applies, deposit employment taxes

and nonpayroll withholding payments for July.

■ August 16

Employers deposit Social Security, Medicare, and withheld income tax for August 9, 10, and 11.

■ August 18

Employers deposit Social Security, Medicare, and withheld income tax for August 12, 13, 14, and 15.

■ August 23

Employers deposit Social Security, Medicare, and withheld income tax for August 16, 17, and 18.

FROM THE HELPLINE

The following questions have been answered recently from the perspective of research assistance (not legal advice) by our Wolters Kluwer Tax Research Consultant Helpline (1-800-344-3734).

Q Assume a taxpayer has 12+ real estate properties exclusively rented short-term using AirBnB type agencies. Are these reported as Ordinary Business income or Rental Activity income? Does a 7-day rule judge when it's Rental or Business activity?

A The distinction between business income (Schedule C) and rental income (Schedule E) depends on the services the landlord/host provides, rather than the extent of the rental activities. If the landlord/host provides only basic services and amenities (heat, light, cleaning public areas, trash collection, etc.), rental income is normally reported on Schedule E as income from a rental activity. If the landlord/host provides more extensive services for the tenant's convenience (for instance maid service for the tenant's room, meals, etc.), the rental income is normally reported on Schedule C as business income. Most taxpayers prefer using Schedule E, because Schedule C income is generally subject to self-employment tax.

The seven-day rule is part of the Code Sec. 469 passive activity loss (PAL) rules – specifically, Temporary Reg. §1.469-1T(e)(3)(ii)(A). These rules apply if the rental activity is a business (that is, if the income is reported on Schedule C). A rental business is presumed to be passive and, thus, subject to the PAL rules that limit loss deductions from passive activities. However, if the average rental period is seven days or less, the activity is not treated as a rental and, thus, it is not subject to the PAL rules. This rule presumes that such short rental periods generally require the landlord/host to provide tenant-specific services that make the activity more like a business and less like a rental. For instance, a traditional hotel or motel is generally treated like any other business, rather than as a rental activity that is subject to the PAL rules. *See TRC BUSEXP: 33,106.10 and BUSEXP: 12,158.*

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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