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National Taxpayer Advocate Questions Proposed Expansion Of IRS Math/Clerical Error Authority

www.irs.gov

National Taxpayer Advocate (NTA) Nina Olson has raised some concerns about the IRS's math and clerical error authority in a recent blog post. Olson noted that the White House has proposed to expand the IRS's math and clerical error authority to other errors.

- ***Take Away.*** "NTA Olson's comments are spot on," Alan Straus, CPA, LL.M., former chair of the New York State Society of CPAs Committee on Personal Financial Planning, told Wolters Kluwer. "Olson has clearly identified the potential problems with granting additional authority to the IRS in this area. I also believe she is correct in that the potential for problems will disproportionately effect poorer taxpayers who can least afford tax representation," he said.
- ***Comment.*** "NTA Olson is well versed in the inability of the IRS to perform accurately and timely," Fred Slater, CPA, a member of MS1040 LLC, New York, told Wolters Kluwer. "As Olson stated in her blog, the IRS is wrong more than half the time. To allow them to correct without allowing the taxpayers their normal rights is absurd. Congress wants to speed the process but this way is without merit," he said.

Background

When deficiencies are attributable to mathematical or clerical errors on a return, the IRS can assess the additional tax attributed to the mathematical or clerical error immediately and without resort to the deficiency procedures. However, the IRS must notify the taxpayer that additional tax is due and that the assessment has been or will be made. The IRS is expected to explain the source of the error. The notice is not considered to be a notice of deficiency, and as a result, the taxpayer has no right to petition the Tax Court.

Within 60 days after the notice of additional tax due is sent to the taxpayer, the taxpayer may request an abatement of an assessment based on mathematical or clerical errors. If the taxpayer requests an abatement, the IRS must abate the additional tax and cannot reassess it except in accordance with the deficiency procedures. During the 60-day period, the IRS is prohibited from collecting by levy or a proceeding in court.

Proposed expansion

The Trump Administration, Olson explained, has proposed to expand this authority where:

- The information provided by the taxpayer does not match the information in government databases;
- The taxpayer has exceeded the lifetime limit for claiming a deduction or credit; or

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IRS Announces Nonacquiescence In Tax Court Decision On Reverse Like-Kind Exchanges

AOD 2017-6

The IRS has announced its nonacquiescence in a Tax Court decision on reverse like-kind exchanges. The Tax Court handed down the decision last year (*Bartell Est., 147 TC No. 5, Dec. 60,669*).

- ***Take Away.*** The IRS provided a 180-day safe harbor for reverse like-kind exchanges in Rev. Proc. 2000-37. *Bartell*, which involved a 17-month period, took place before the effective date of Rev. Proc. 2000-37. However, Rev. Proc. 2000-37 specifically provided that "no inference is intended with respect to the federal income tax treatment of 'parking' transactions that do not satisfy the terms of the safe harbor provided in this revenue procedure, whether entered into prior to or after the effective date of this revenue procedure."

Background

The taxpayer in *Bartell* was a family business operating a cain or drug stores. The business entered into an agreement to purchase real property from a third party. The taxpayer assigned its rights in the purchase agreement to third-party exchange facilitator and entered a further agreement with the facilitator. Under that agreement, the facilitator would purchase the real property and the taxpayer have a right to acquire the real property from the facilitator. The facilitator purchased the real property on August 1, 2000, with bank financing guaranteed by the taxpayer. The real property was transferred from the facilitator to the taxpayer on December 31, 2001.

The IRS argued that the taxpayer owned the real property at the time of the exchange because the taxpayer and not the facilitator had all the benefits and burdens of ownership of the property. These included the capacity to benefit from any appreciation in the property's value, the risk of loss from any diminution in its value, and the other burdens of ownership, such as taxes and liabilities arising from the property.

Tax Court's ruling

The Tax Court explained that the "touchstone of Code Sec. 1031 is the requirement that there be an exchange of like-kind business or investment properties." The court also found that the Ninth Circuit Court of Appeals held in *Alderson, 63-2 ustc ¶9499*, that a party who takes title to replacement party for purposes of effecting a Code Sec. 1031 exchange is not required to assume the burdens and benefits of ownership to satisfy the exchange requirement. From the outset, the taxpayer had interposed a third-party exchange facilitator between itself and title to the replacement property in contemplation of a Code Sec. 1031 exchange, the court noted.

The Tax Court held that the intermediary should be treated as owner of the real property during the time it held title to the property. The court concluded that the transaction qualified for like-kind treatment under Code Sec. 1031.

Nonacquiescence

In AOD 2017-6, the IRS announced its nonacquiescence "relating to the holding that a taxpayer's sale and acquisition of business property qualifies as a like-kind exchange even though 17 months before the purported exchange, an accommodating party facilitating the transaction acquired title to the replacement property and the taxpayer acquired the benefits and burdens of ownership of the property."

References: FED ¶46,330; TRC SALES: 30,604.

Authority

Continued from page 373

- The taxpayer has failed to include with his or her return documentation that is required by statute.
- ***Comment.*** The Obama Administration made similar proposals to expand the IRS's math error authority in past years.

"Congress' original legislation back in 1926 was intended to limit the IRS's authority to summarily assess math errors to situations involving such unambiguous errors," Olson wrote. "Without adequate safeguards and Congressional oversight, however, significant expansion of the IRS's math error authority could permit the IRS to take property without adequate due process," she added.

Further, Olson noted that not every return that contains a typo or similar error contains an understatement. "The IRS should not automatically conclude that a taxpayer does not have a qualifying child just because the Taxpayer Identification Number (TIN) of the child listed on the return does not match a TIN in the IRS's database. Such mismatches can be typos," Olson wrote.

- ***Comment.*** Olson also cautioned that many taxpayers have trouble understanding math error notices. Olson added that unclear math error notices can jeopardize a taxpayer's rights to be informed, to challenge the IRS's position and be heard, and to appeal an IRS decision in an independent forum.

Reference: TRC IRS: 27,206.15.

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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Tax Court Limits Conservation Easement Deduction For Farmers Who Were Not "Qualified Farmers"

Rutkoske, 149 TC No. 6

Farmers who made a qualified conservation contribution through their limited liability company (LLC) had to limit their charitable contribution deduction to 50 percent of their contribution base. They were not entitled to a higher deduction limit as "qualified farmers" because the proceeds from the LLC's bargain sale of a conservation easement and subsequent sale of the underlying land were not income from a farming business.

- ***Take Away.*** The statute that increases the conservation contribution deduction for qualified farmers and ranchers is narrowly written. The Tax Court could not broaden it to encompass additional activities even if they were necessary for farming.

Background

The taxpayers were brothers who farmed several tracts of land, including a parcel they leased from their LLC. The LLC sold a conservation easement to a tax-exempt organization for far less than it was worth, and treated the difference between the sales price and the easement's value as a charitable contribution. The LLC later also sold the land.

The taxpayers each reported $877,000 in passed-through capital gain on the sale of the easement and the land, along with a $667,000 charitable contribution deduction for the contribution component of the easement.

The IRS relied on Code Sec. 170(b)(1)(E)(i) to limit each taxpayer's charitable donation deduction to 50 percent of his contribution base (adjusted gross income (AGI) less other charitable donations). However, the taxpayers argued that they were qualified farmers, so Code Sec. 170(b)(1)(E)(iv) should increase their deduction limit to 100 percent of their contribution bases.

Court's analysis

Under Code Sec. 170(b)(1)(E), a qualified farmer or rancher is an individual who derives at least 50 percent of gross income from a farming trade or business. Thus, the dispute centered on what constitutes gross income from farming.

The taxpayers claimed that the disposition of farmland, like the disposition of other farm assets, produces farming income. Thus, their farming income should include the $877,000 gain they each reported on the sale of the easement and land. This would make them qualified farmers because their farming income would greatly exceed 50 percent of their gross income.

The court recognized that the taxpayers were farmers, but concluded that they were not "qualified farmers." Code Sec. 170(b)(1)(E)(iv) defines farming by reference to the special valuation rules of Code Sec. 2032A(e)(5). This definition is limited to cultivating soil and raising, harvesting, and handling agricultural and horticultural commodities. Farming income must be derived from the sale of the commodities that these farming activities produce. Accordingly, proceeds from the disposition of farmland are not farming income, even though the acquisition and disposition of property is a necessary part of farming.

The court also discussed the fact that the LLC, rather than the taxpayers, actually sold the easement and land. First, the LLC did not affect the taxpayers' rights to the charitable contribution deductions. Since the LLC was taxed as a partnership, Reg. §1.703-1(a)(2)(iv) treated the LLC's donation of the easement as having been made directly by the taxpayers.

However, the LLC did affect the character of the sales proceeds because, under Code Sec. 702(b), income that flowed through from the LLC retained its character. The LLC was not in the farming business; it was in the business of leasing land to the taxpayers. Thus, the proceeds from its sale of the easement and the land were proceeds from the sale of real estate assets, not from farming. As a result, even if the taxpayers had been qualified farmers, the sales proceeds would not have been farming income.

References: Dec. 60,981; TRC INDIV: 51,364.

IRS Mailing ITIN Renewal Notices

Some one million taxpayers can expect to receive Individual Tax Identification Number (ITIN) renewal notices by mail, the IRS has announced. Renewal notices are being issued over a five-week period beginning this month.

Background. The *Protecting Americans from Tax Hikes Act of 2015* (PATH) Act generally provides that any ITIN not used on a federal tax return for three consecutive tax years expires on December 31 of the third consecutive tax year of nonuse. For ITINs issued before 2013, the PATH Act provides that ITINs will no longer be in effect according to a certain schedule, unless the ITIN has already expired due to nonuse for three consecutive years.

Renewals. ITINs with middle digits 70, 71, 72 or 80 are set to expire at the end of 2017. Affected taxpayers must renew their ITIN in order to file their federal income tax returns. Taxpayers may renew ITINs for their entire family at the same time even if family members have an ITIN with middle digits other than 70, 71, 72, 78, 79 or 80. Family members include the tax filer, spouse and any dependents claimed on the tax return.

- ***Comment.*** "We urge people who receive this letter to renew their ITIN as quickly as possible to avoid tax refund and processing delays next year," IRS Commissioner John Koskinen said. "Taking steps now and renewing early will make things go much more smoothly for ITIN holders when it comes time to file their taxes."

IR-2017-128; TRC FILEIND: 18,052.

Tax Court Finds Personal Lender In Business Of Lending

Owens, TC Memo. 2017-157

The Tax Court has found that an individual made loans from his personal funds continuously and regularly and did so with the purpose of making a profit. Therefore, the taxpayer was in the trade or business of lending money.

- ***Take Away.*** The taxpayer did not advertise his personal lending but was very well known-for lending money out of his own funds. The taxpayer's reputation brought borrowers to him, the court found.

Background

The taxpayer owned a money-lending business. Generally, the business provided short-term financing to investors who wanted to buy income-producing property and who needed quick financing to close a deal. Investors would then seek long-term financing from another lender. Loan terms were are typically for 18 months and have an interest rate of between seven and 11 percent. The business reflected the ebbs and flows of the real estate market.

The taxpayer also made loans from his personal funds. Generally, these were loans to borrowers deemed too risky for the business. Funds for the taxpayer's personal lending came from a trust, pension fund, and a family limited partnership. The taxpayer conducted his personal lending activities out of the same offices as the business

In 2002 and subsequent years, the taxpayer made personal loans to another individual. This individual's business eventually sought bankruptcy protection. According to the taxpayer, these personal loans create bona fide debts and those debts became worthless after the bankruptcy. The IRS countered that the taxpayer's personal lending did not amount to a trade or business.

Court's analysis

The court first found that a taxpayer must be involved in money lending with continuity and regularity for the activity to be treated as a trade or business. Generally, courts look to the total number of loans made; the time periods over which the loans were made; whether the loan activities were kept separate and apart from the taxpayer's other activities; whether the taxpayer sought out the lending business; the amount of time and effort expended in the lending activity; and the relationship between the taxpayer and his or her debtors.

The court found that the taxpayer's personal lending activities were continuous and regular. Over a period of 14 years, the taxpayer made some 66 loans exceeding $24 million. The taxpayer, the court found, credibly testified that he personally took on these loans in many cases where the business would not have done so.

The court also found that the taxpayer credibly testified that he generally spent 50 hours weekly at work. The taxpayer also testified that did not distinguish the time the time he spent on personal lending from other activities. "On the facts of this case, we find, as we have in similar cases, that the taxpayer had no need to bill specific hours on his personal lending," the court held.

Next, the court looked to whether the taxpayer's loans to the bankrupt individual were bona fide debt. The court explained that a bona fide debt is one that "arises from a debtor-creditor relationship based upon a valid and enforceable obligation to pay a fixed or determinable sum of money." Again, the court looked to several factors, including the names given to the certificates evidencing the indebtedness; the presence or absence of a maturity date; enforceability; and the intent of the parties.

The court found that the loans were called promissory notes, which showed a general intent to create a genuine debt. The promissory notes carried maturity dates. The taxpayer had a right to enforce payment on the promissory notes. Further, the taxpayer and the individual intended for their relationship to be one of lender and borrower.

References: Dec. 60,988(M); BUSEXP: 48,052.

Remote Network Takeovers Are Emerging Threat To Tax Professionals

The IRS has warned tax professionals that remote takeovers of computer networks are emerging as a threat. The IRS reported learning of multiple incidents of remote takeovers in the past year.

- ***Comment.*** The IRS previously warned that some preparers have noticed larger than expected refunds for clients with bank account numbers changed. Some preparers have also discovered that new accounts are being set up in their systems without their authorization.

Cybercriminals have attacked and secretly infiltrated computer systems of tax professionals, the IRS reported. Cybercriminals seek to exploit weak security settings or use malware to gain access to a network. Once inside a network, they access client information, file fraudulent returns using that information, and pocket refunds.

The IRS cautioned that wireless networks, including mobile phones, modems and router devices, are particularly vulnerable. A printer with a factory-issued password can easily be accessed, and the cybercriminals can see return information stored in its memory. The IRS recommended that users replace factory password settings with strong passwords.

- ***Comment.*** "Many tax professionals think 'this can't happen to me' but it does," Carol Campbell, Director, IRS Return Preparer Office, said on social media.

IR-2017-127; TRC FILEIND: 18,052.

IRS Issues Guidance On Stock Distributions Made By Publicly Offered REITs And RICs

Rev. Proc. 2017-45

The IRS has announced that it will treat stock distributions made by a publicly offered real estate investment trust (REIT) or regulated investment company (RIC), in a transaction that satisfies certain requirements, as a distribution of property under Code Secs. 301 and 305(b). The IRS explained that a publicly offered REIT or RIC must make a distribution to its shareholders with respect to its stock and, pursuant to the declaration of the distribution, each shareholder must have a cash or stock election with respect to part or all of the distribution.

- ***Take Away.*** A publicly offered REIT is a REIT that is required to file annual and periodic reports with the Securities and Exchange Commission (SEC), the IRS explained in Rev. Proc. 2017-45. A publicly offered RIC is a RIC whether the shares are continuously offered under a public offering, regularly traded on an established securities market, or held by or for no fewer than 500 persons during the tax year.
- ***Comment.*** Rev. Proc. 2017-45 is effective with respect to distributions declared on or after August 11, 2017.

Rev. Proc. 2017-45

The IRS explained that if a publicly offered REIT or a publicly offered RIC makes a distribution of stock in a transaction that is described in Rev. Proc. 2017-45, the IRS will treat the distribution of stock as a distribution of property to which Code Sec. 301 applies by reason of Code Sec. 305(b).

According to Rev. Proc. 2017-45, the value of the stock received by any shareholder in lieu of cash will be considered to be equal to the amount of cash for which the stock is substituted. The calculation of the number of shares to be received by a shareholder is determined based on a formula that (1) utilizes the market price of the shares; (2) is designed so that the value of the number of shares to be received in lieu of cash corresponds closely to the amount of cash to be received under the declaration; and (3) uses data from a period of no more than two weeks ending as close as practicable to the payment date.

- ***Comment.*** For purposes of Rev. Proc. 2017-45, if a shareholder participates in a dividend reinvestment plan, the stock received by that shareholder under the dividend reinvestment plan is treated as received in exchange for cash received in the distribution.

References: FED ¶46,334; TRC RIC: 6,104.25.

Tax Court Finds Partnership Was A Sham; Designed To Facilitate Son-of-BOSS Transactions

BCP Trading and Investments, LLC, TC Memo. 2017-151

The Tax Court has found that a purported partnership was a sham, organized for tax avoidance and to facilitate Bond and Options Sales Strategy (Son of BOSS) transactions. The court upheld the IRS's determination to disallow the purported losses of the partnership.

- ***Take Away.*** While there are different varieties of Son-of-BOSS deals, what they have in common is the transfer of assets encumbered by significant liabilities to a partnership with the goal of inflating basis in that partnership, the court observed.

Background

The IRS determined that the taxpayer was a sham, which had been organized "solely for purposes of tax avoidance by artificially overstating basis in the partnership interest of its purported partners." According to the IRS, the taxpayer lacked a genuine profit motive. The IRS disregarded the taxpayer for tax purposes, thereby eliminating a purported $14 million loss.

Court's analysis

The court first found that while the partnership appeared to satisfy the statutory requirements, there was no operating agreement or actual operations. Further, there was no indication of a mutual combination for the purpose of conducting an ongoing enterprise. To be a bona fide partner for tax purposes, a party must have a meaningful stake in the success or failure of the enterprise. Here, the partners did not intend to join together to undertake business, and they were not partners in the purported partnership, the court found.

Further, the court found that the partnership did not engage in any business activity. The only business that the partnership conducted was the sale of option pairs used to buy $2 million in foreign currency, the court found.

The court disregarded the partnership. As a result, the partnership's activities were treated as engaged in directly by the purported partners.

Jurisdiction

Because the taxpayer was subject to audit under TEFRA, the court's jurisdiction at the partnership level was limited to partnership items. Once a petition is filed, the court explained, it has jurisdiction to determine partnership items as well as jurisdiction to determine the allocation of those items among the partners and any penalty that relates to an adjustment of a partnership item.

- ***Comment.*** The member clients also challenged the validity of various statute-of-limitations extensions under Code Sec. 6229. The court found that the extensions were valid.

References: Dec. 60,982(M); TRC BUSEXP 30,168.

DOL Proposes Further Delay For Full Implementation Of Fiduciary Rule

www.dol.gov

The U.S. Department of Labor (DOL) has proposed to extend the phased-in implementation period for the fiduciary rule to July 1, 2019. The phased-in implementation period is currently scheduled to run through January 1, 2018.

- ***Take Away.*** In February, President Trump directed DOL to examine whether the fiduciary rule may "adversely affect the ability of Americans to gain access to retirement information and financial advice." The President instructed DOL to prepare an updated economic and legal analysis concerning the likely impact of the final rule.

Background

In 2016, DOL issued rules, under which generally anyone who provides investment advice to plans, plan sponsors, fiduciaries, plan participants, beneficiaries and individual retirement accounts (IRAs) and IRA owners must either: (1) avoid payments that create conflicts of interest, or (2) comply with the protective terms of an exemption issued by the DOL. For a communication to be covered investment advice, there must be a recommendation to a plan, plan fiduciary, plan participant and beneficiary, or IRA owner for a fee or other compensation, direct or indirect, as to the advisability of buying, holding, selling or exchanging securities or other investment property. This coverage extends to recommendations as to the investment of securities or other property after being rolled over or distributed from a plan or IRA.

Earlier this year, DOL extended the applicability date of the fiduciary rule from April 10, 2017 to June 9, 2017. Certain provisions of the fiduciary rule became applicable in June, including the definiton of who is a fiduciary. DOL provided for a phased implementation period ending on January 1, 2018 for certain other provisions, including the best interest contract exemption.

- ***Comment.*** During the phased implementation period, DOL explained that it will not pursue claims against fiduciaries who are working diligently and in good faith to comply with the fiduciary duty rule and exemptions, or treat those fiduciaries as being in violation of the fiduciary duty rule and exemptions.

Proposed extension

Now, DOL has announced that it intends to extend the phased-in implementation period from January 1, 2018 to July 1, 2019. DOL explained that it had submitted the proposed extension to the federal Office of Management and Budget (OMB) for approval.

- ***Comment.*** In March, the IRS issued Ann. 2017-4 explaining that the agency would not apply Code Sec. 4975, which provides excise taxes relating to prohibited transactions, and related reporting obligations with respect to any transaction or agreement to which the DOL's temporary enforcement policy described in DOL FAB 2017-01, or other subsequent related enforcement guidance, would apply.

Casual Gambler Cannot Deduct Losses Above-The-Line

Viso, TC Memo. 2017-154

A taxpayer was not engaged in the trade or business of gambling. Therefore, the taxpayer could not deduct his gambling losses against his gambling winnings above-the-line, the Tax Court has reiterated. For nonprofessional gamblers, losses are itemized deductions, which means they are deductible only from adjusted gross income, and only if the taxpayer foregoes the standard deduction, the court found.

- ***Take Away.*** Professional gamblers, who pursue wagering as a full-time activity and not as a hobby, may treat their gambling losses as trade or business expenses, deductible from gross income to arrive at adjusted gross income. However, the language in Code Sec. 165(d) limiting gambling losses to gambling gains, controls over the language in Code Sec. 162 allowing broader deductions for trade or business expenses. As a result, loss deductions for both professional and nonprofessional gamblers are all limited to the amount of gambling gains, and excess losses and expenses cannot be carried over to other tax years.

Background

The taxpayer regularly bet on sports teams and other gambling activities. In 2013, the taxpayer had some $7,000 in gambling losses and $5,000 in gambling winnings. The taxpayer did not report his gambling losses and winnings on his return.

Court's analysis

The court first noted that taxpayers engaged in the trade or business of gambling may deduct their gambling losses against their gambling winnings above-the-line as a trade or business expense in arriving at adjusted gross income. However, a different rule applies to taxpayers not engaged in the trade or business of gambling. In that case, gambling losses are allowable as an itemized deduction, but only to the extent of gambling winnings.

Here, the taxpayer did not claim to be in the trade or business of gambling. Therefore, the taxpayer could not deduct his gambling losses against his gambling winnings above-the-line, the court held. Moreover, the taxpayer had claimed the standard deduction and he had not changed his election to claim the standard deduction. The court found that the taxpayer could not take an itemized deduction for his gambling losses to offset his gambling winnings.

References: Dec. 60,985(M); TRC BUSEXP: 30,256.

Appellate Court Upholds Transferee Liability; IRS Not Required To Exhaust Remedies

Kardash, CA-11, August 4, 2017

The Court of Appeals for the Eleventh Circuit has held that the IRS was not required to exhaust remedies against a business before proceeding against the taxpayer as a transferee. State law did not require exhaustion for liability to exist, the court found.

- ***Take Away.*** The court appeared to sympathize with the taxpayer, noting that he was a victim of fraud conducted by his friends and coworkers. In perpetrating that fraud, however, the majority shareholders had transferred funds from the business to the taxpayer that rightly belonged to the IRS, and state law required that the taxpayer pay those funds back.

Background

The taxpayer owned part of a construction business. The business enjoyed steady growth and substantial revenues until the housing market downturn in 2007. Unknown to the taxpayer, the majority shareholders in the business had regularly stolen cash from the business and failed to pay federal income tax. Eventually, the IRS issued a notice of deficiency.

The IRS determined that the taxpayer had received two sets of payments from the business: "Advance Transfers" of $250,000 and $300,000 in 2003 and 2004 respectively, and "Dividend Payments" of approximately $1.5 million, $1.9 million, and $57,500 in 2005, 2006, and 2007. According to the IRS, the payments were actually or constructively fraudulent transfers under state law, *Florida Uniform Fraudulent Transfer Act* (FUFTA), because the business did not receive any value from the taxpayer in exchange and the business was insolvent or the transfers led to the businesses' insolvency.

The taxpayer argued that the IRS had failed to exhaust all reasonable collection efforts against the business before pursuing transferee liability against him. The taxpayer also argued that the payments were part of his compensation. The Tax Court ruled against the taxpayer and he appealed to the Eleventh Circuit.

Court's analysis

The appellate court first looked to the history of Code Sec. 6901 and its predecessor statute. Before these statutes were passed, the rights of the government as creditor, depended upon state statutes or legal theories developed by the courts for the protection of private creditors, as in cases where the debtor had transferred his or her property to another, the court found. Code Sec. 6901 was intended to allow the government to avoid complicated suits against transferees in state and federal courts, the court explained.

The court further found that when Code Sec. 6901's predecessor statute was passed some 90 years ago, few state or federal laws existed governing transferee liability. Where they did exist, however, the IRS was free to utilize them to proceed against the transferees of a delinquent taxpayer.

Under FUFTA, transferee liability is not dependent upon the creditor proving that all remedies have been exhausted against the transferor, the court found. Because state law did not require exhaustion for liability to exist, the court held that the IRS was not required to exhaust remedies against the business before proceeding against the taxpayer as a transferee.

The court also found that the taxpayer failed to show that the payments were part of his compensation. The business had expressly declared the payments to be dividends, the court noted. The court concluded that the payments were dividends for which the business did not receive reasonably equivalent value.

References: 2017-2 USTC ¶50,300; TRC IRS: 30,124.

TAX BRIEFS

Internal Revenue Service

The IRS has provided the domestic asset/liability percentages and domestic investment yields needed by foreign life insurance companies and foreign property and liability insurance companies to compute their minimum effectively connected net investment income under Code Sec. 842(b) for tax years beginning after December 31, 2015.

Rev. Proc. 2017-44, FED ¶46,333; TRC INTL: 3,400

For pension plan years beginning in August 2017, the IRS has released the 30-year Treasury bond weighted average interest rate, the unadjusted segment rates, the adjusted rates and the minimum present value segment rates.

Notice 2017-43, FED ¶46,332; TRC RETIRE: 30,556

The IRS has corrected a revenue procedure that provided the specifications for the private printing of red-ink substitutes for the 2017 revisions of information returns, preparing acceptable substitutes of the official forms, and using official or acceptable substitute forms to furnish information to recipients. The procedure covers Forms 1096, 1097-BTC, 1098 series, 1099 series, 3921, 3922, 5498 series, W-2G, 1042-S and 8935. Rev. Proc. 2017-39, I.R.B. 2017-26, 1286, is amended.

Announcement 2017-10, FED ¶46,331; TRC FILEBUS: 12,052.10

Delegation Orders

Authority to grant relief to taxpayers affected by disasters, terrorist or military actions was delegated to the Chief, Facilities and Organizational Support, the Human Capital Office, and the Small Business/Self-Employed Division in a delegation order

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issued by the IRS commissioner. The order, which supersedes Delegation Order No. 25-11 (Rev. 2), is effective July 24, 2017.

CDO No. 25-11 (Rev. 3), FED ¶46,329; TRC FILEBUS: 15,110

The IRS Deputy Commissioner for Services and Enforcement has delegated his authority waive some pension plan excise taxes. The order supersedes Delegation Order 7-7, dated November 7, 2007, and is effective from July 13, 2017.

CDO No. 7-7 (Rev. 1), FED ¶46,328; TRC IRS: 12,358

The IRS Deputy Commissioner for Services and Enforcement has delegated his authority to approve and deny applications for certification as a Certified Professional Employer Organization (CPEO), to propose denial of certification and issue notices of proposed denial of certification, to suspend CPEOs, propose revocation of certification and to lift suspension and withdraw proposed revocation of an existing CPEO's certification. He delegated the authority to the Small Business/Self-Employed (SB/SE) Director, Examination Legislative Program Coordination.

CDO No. 25-19, FED ¶46,327; TRC IRS: 12,358

Summons

The president of a company with delinquent payroll taxes was not entitled to quash a summons directed to the company's bank. The IRS satisfied the "Powell" factors, which the individual failed to rebut. Moreover, the individual's tax protestor arguments regarding the IRS's authority to issue the summons were summarily dismissed.

Cooper, DC Neb., 2017-2 USTC ¶50,303; TRC IRS: 21,052

Deductions

A psychiatrist was not entitled to deduct various unsubstantiated business expenses related to her medical practice. The taxpayer failed to show that the expenses were related to her medical practice. Moreover, the taxpayer's correct filing status was determined to be married filing separately for two tax years because there was no evidence that the taxpayer was not married at the end of those tax years. Accuracy-related penalties, penalties for failure to file timely tax returns and fraud penalties were imposed.

Knowles, TC, CCH Dec. 60,983(M), FED ¶48,097(M); TRC BUSEXP: 24,806

Anti-Injunction Act

A *pro se* individual's suit challenging the IRS's collection of her income taxes and a related tax lien was dismissed. The court did not have jurisdiction over her claims because the Anti-Injunction Act prohibits suits attempting to restrain tax collection. Such suits may not be brought in "any court" by "any person." Further, the Declaratory Judgment Act specifically divested the court of jurisdiction over any of the individual's claims to declaratory relief.

Lafferty v. Smith, DC Wash., 2017-2 USTC ¶50,298; TRC LITIG: 9,254

Litigation and Administrative Costs

A design business was not entitled to litigation and administrative costs that were incurred before it made a qualified offer. Although the taxpayer was a "prevailing party," the government's position was substantially justified. Therefore, the qualified offer rule applied.

C1 Design Group, LLC, DC Ida., 2017-2 USTC ¶50,302;

Religious-Employer Exemption

A nonprofit, nonreligious, pro-life organization was not entitled to an injunction granting it the religious-employer exemption or prohibiting the government from applying the contraception mandate to the organization or its insurer in a way that required them to maintain coverage for services that contradicted its moral or religious beliefs or that penalized them for not offering such coverage. The organization was not entitled to the religious-employer exemption because it was not a religious employer.

Real Alternatives, Inc., CA-3, 2017-2 USTC ¶50,301; TRC HEALTH: 9,114.20

Default Judgment

The government was entitled to reduce to judgment an attorney's taxes, penalties, interest and other charges for the tax years at issue. The IRS's tax transcripts were presumptively valid and created a *prima facie* case of liability, which the taxpayer failed to rebut.

Wales, DC N.Y., 2017-2 USTC ¶50,299; TRC LITIG: 9,256

Collection Due Process

An IRS Settlement officer (SO) did not abuse his discretion by sustaining a lien and a levy to collect a real estate professional's tax liabilities. The taxpayer had a history of noncompliance and the SO properly concluded that she could pay a far larger proportion of her outstanding liabilities than either her offer in compromise or her installment agreement provided.

Dykstra, TC, CCH Dec. 60,987(M), FED ¶48,101(M); TRC IRS: 36,052.05

An IRS settlement officer (SO) did not abuse his discretion by sustaining a levy to collect a tax protestor's outstanding tax liability. The individual's contradictory testimony claiming that a notice of deficiency was not sent to his last known address was rejected. The IRS also produced an incomplete USPS Form 3877, Certified Mail List, and a copy of the notice of deficiency each showing the individual's last known address. The individual was subject to a delay penalty.

Fleming, TC, CCH Dec. 60,986(M), FED ¶48,100(M); TRC IRS: 51,056.20

Deficiencies and Penalties

An individual was liable for deficiencies and additions to tax because he had wilfully neglected to timely file returns and timely pay his tax liability without any reasonable cause. He was further liable for a delay penalty for failing to pay heed to the Court's warning and persistently asserting frivolous contentions.

Blair, TC, CCH Dec. 60,984(M), FED ¶48,098(M); TRC PENALTY: 3,050.

The 50-percent owner and CEO of a tool and design company was liable for the trust fund recovery penalty. The individual was a responsible person who acted willfully because he ignored three separate red flags that should have caused him, as a reasonable person, to oversee the taxes.

Hartman, DC Mich., 2017-2 USTC ¶50,297; TRC PENALTY: 3,150

Available Credits And Deductions For Back-To-School Expenses

As the nation heads back to school, the tax benefits associated with educational expenses should not be overlooked. This Practitioners' Corner provides an overview of the tax benefits connected with a variety of educational expenses. Following the overview, this article's focus turns to the availability of tax benefits for educational expenses related to education up through grade 12. *For further details on education expenses, see Wolters Kluwer's Intelliconnect, the Tax Research Consultant, and Answer Connect.*

General rules

Educational expenses are nondeductible personal expenses unless a deduction or credit is carved out somewhere in the Internal Revenue Code. Carve-outs exist when expenses qualify under a number of provisions.

Code Sec. 162 business expenses. Educational expenses may qualify as business expenses under Code Sec. 162 if they are related to current employment and do not qualify the taxpayer for another job or profession. If an employer pay for education, it will be treated as compensation unless the employee would otherwise be entitled to a deduction or otherwise be able to exclude payments from income, for example, if they qualify as a statutory fringe benefit.

Code Sec. 222 above-the-line deduction. As an above-the-line deduction for higher education under Code Sec. 222 (but only up through 2016, unless extended by Congress), the deduction for qualified tuition and related expenses can be taken even if the taxpayer does not itemize deductions where it would be subject to a two-percent floor. Qualified tuition and related expenses are the same as they are for purposes of the Hope and Lifetime Learning credits. No deduction is allowed under this provision if the taxpayer or any other person takes a Hope Scholarship Credit (American Opportunity Tax Credit) or Lifetime Learning Credit with respect to the student.

The maximum deductible amount is $4,000 for taxpayers with adjusted gross income not exceeding $65,000 ($130,000 for joint filers). Taxpayers whose income exceeds that limit but does not exceed $80,000 ($160,000 for joint filers) may deduct up to $2,000 in qualified expenses.

- ***Comment.*** The above-the-line deduction for qualified tuition and related expenses officially ended on December 31, 2016. The expectation, however, is that unless there is a complete restructuring of education benefits under tax reform legislation, Congress will extend these benefits in an "extenders" package, retroactively to include 2017 and forward to cover at least 2018 expenses.

> *"...the availability of tax benefits for educational expenses related to education from pre-school up through grade 12."*

Code Sec. 25A education tax credits. Higher education expense may be eligible for the American Opportunity Tax Credit (AOTC), with a cap of $2,500 per year for the first four years of college higher education under Code Sec. 25A, or for the Lifetime Learning credit under Code Sec. 25A with a $2,000 annual cap for a broader range of educational pursuits. Both credits phase out above certain income levels.

Code Sec. 67 miscellaneous itemized deduction. As a work-related expense under Code Sec. 67, education expenses may be deductible as a miscellaneous itemized deduction, subject to its 2 percent overall floor. Education costs incurred to improve the employee-student's skills or to satisfy continuing education requirements may be deductible. If the costs are not reimbursed by the employer, a deduction may be available as the cost of producing income. The deduction can be claimed on Form 1040, Schedule C by self-employed persons. Employees may claim the deduction for unreimbursed education expenses only if they itemize deductions on Schedule A. The deduction is subject to the 2 percent-of-adjusted-gross-income limit that applies to most miscellaneous itemized deductions.

- ***Comment.*** Tuition, training, and similar costs associated with entering a new line of work are not deductible.

Code Sec. 221 student loan interest. An eligible taxpayer can deduct qualified interest on a qualified student loan for an eligible student's qualified educational higher-education expenses at an eligible institution. The amount of the deduction is limited, and it is phased out for taxpayers whose modified adjusted gross income (AGI) exceeds certain thresholds. For tax years beginning in 2017, the $2,500 maximum deduction for interest paid on qualified education loans is reduced when modified AGI exceeds $65,000 ($135,000 for joint returns), and is completely eliminated when modified AGI reaches $80,000 ($165,000 for joint returns).

Code Secs. 135, 530, 529: U.S. savings bonds, Coverdell Education Savings Accounts, and Qualified Tuition Programs. Tax-free appreciation of qualified savings under any of these vehicles can be realized if paid for higher-education costs. Only Coverdell Education Savings Accounts, however, may be used to cover elementary and secondary school education *(see further details, below).*

Code Sec. 72 withdrawals. Withdrawals from Individual Retirement Accounts (IRAs) before the owner reaches age 59 1/2 can avoid the 10 percent early withdrawal penalty if paid for qualified higher education expenses. Ordinary income is still realized on withdrawal.

Code Sec. 21 child-care credit. Education expenses for a child under age 14 may count toward costs eligible for the

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WASHINGTON REPORT *by the Wolters Kluwer Washington News Bureau*

Social Security wage base likely to increase for 2018

The Social Security Administration's Board of Trustees recently released is annual report. The Board estimated that the Social Security wage base for 2018 will be $130,500. The Social Security wage base for 2017 is $127,200.

Social Security's Old-Age, Survivors, and Disability Insurance (OASDI) program limits the amount of earnings subject to taxation for a given year. This limit changes each year with changes in the national average wage index. The Social Security Administration will announce the official wage base for 2018 before year-end.

Koskinen discusses customer service, regulation of preparers

IRS Commissioner John Koskinen spoke at the National Association of Tax Professionals (NATP) National Conference in Washington, D.C. on August 8. Koskinen discussed customers service, his push for authority to regulate practitioners and the budget appropriations process.

"I have spent my term as Commissioner trying to make Congress and the public realize that the tax filing season does not happen automatically or by accident," Koskinen said. "It happens because our employees spend months beforehand preparing for it, and then making sure it goes smoothly."

Koskinen responded to audience members who expressed concerns regarding IRS taxpayer services. He noted that a lack of resources is largely to blame for IRS shortcomings in taxpayer services.

"I have warned Congress that if we continued to get budget cuts, our level of service would go down to an unacceptable level," Koskinen said. "I told Congress that it's a simple algorithm, if we have the money, we hire people and they answer the phone; if we don't have enough money, we don't have enough people, and we don't answer the phone enough."

Congress did allocate an additional $290 million in funding for taxpayer services in 2016 and 2017, Koskinen noted. He noted that the average wait time for people calling the IRS's direct number during the 2017 filing season was eight minutes.

Although the IRS has been able to get to around 73 percent level of taxpayer service with the additional funding, it is still significantly below where the IRS would like to be, according to Koskinen. "Those delays are not acceptable, and, at some point, my hope is that Congress will come to recognize that."

Koskinen also spoke of the important role return preparers play in the filing process, and he reiterated the IRS's goal to have the authority to require a certain set of standards for each preparer. "The IRS has been pushing for several years to ensure every tax return preparer has minimum qualifications," he said.

IRS updates CbC reporting jurisdiction status table

The IRS has updated its online Country-by-Country (CbC) Reporting Jurisdiction Status Table to reflect additional competent authority arrangements. The update reflects the addition of Australia (signed August 1, 2017); Belgium (signed July 20, 2017); Brazil (signed July 20, 2017); Isle of Man (signed July 20, 2017); and Jamaica (signed July 20, 2017).

IRS regs generally require U.S. multinational entities to report certain financial information on a CbC basis. The report will be exchanged under bilateral competent authority arrangements negotiated between the U.S. and foreign jurisdictions. On its website, the IRS reports that it is entering into competent authority arrangements for the exchange of CbC reports with jurisdictions that have a legal instrument allowing for the automatic exchange of information with the U.S. and that the U.S. has determined have both appropriate safeguards to ensure that the information received remains confidential and is used solely for tax purposes.

TIGTA reviews IRS compliance with extension rules

The IRS complied with the legal requirements for extending the assessment statute, according to the Treasury Inspector General for Tax Administration (TIGTA). TIGTA is required by law to annually determine whether the IRS has complied with Code Sec. 6501(c)(4)(B), which requires the IRS to provide notice to taxpayers of their rights to decline to extend the assessment statute of limitations or to request that any extension be limited to a specific period of time or specific issues. However, seven of the 60 closed taxpayer audit files reviewed by TIGTA did not contain documentation to indicate whether taxpayers were properly notified of their rights as required by the IRS's internal procedures.

In addition, TIGTA's review of 44 taxpayer audit files that had authorizations for third-party representation found that six of the taxpayer audit files did not contain documentation to support that the taxpayers' representatives were provided with the required notifications. TIGTA did not make any recommendations because the IRS has taken sufficient actions to remind employees of their responsibilities to properly notify taxpayers and their representatives.

SSA sees continuing scams

The Social Security Administration (SSA) has reported that criminals continue to pose as SSA employees to trick individuals into revealing personal financial data. Typically, con artists call individuals and relate that they are due a 1.7 percent cost-of-living adjustment (COLA) increase of their Social Security benefits. The SSA imposter then asks the victim to verify their personal information to receive the increase. SSA has asked that individuals receiving these calls report them to its Office of Inspector General at *oig.ssa.gov/report.*

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child care credit for gainful employment *(see further details, below)*.

Coverdell ESAs

Two education savings entities let individuals pay for education on a tax-favored basis: a Coverdell Education Savings Account (Coverdell ESA or ESA) under Code Sec. 530 and a qualified tuition program (QTP, also referred to as a Code Sec. 529 plan).

Distributions from Coverdell ESAs and QTPs are not included in the income of the donor or the beneficiary, as long as they do not exceed the beneficiary's adjusted qualified education expenses (AQEE). AQEE generally are limited to out-of-pocket expenses for which the taxpayer is not reimbursed from any other source, unless the reimbursement has to be included in income.

Contributions to a Coverdell ESA must be made in cash, and before the designated beneficiary attains the age of 18, unless the beneficiary has special needs. They are not deductible by the donor (although some states may offer a tax benefit). The aggregate contributions to a single ESA (or to multiple ESAs for the same beneficiary) cannot exceed $2,000 for the tax year. This amount is not adjusted for inflation. Amounts can be rolled over from one Coverdell ESA to another for the benefit of the same beneficiary, or for another beneficiary who is a member of the beneficiary's family. Such rollovers are not counted as contributions. For individual donors, this $2,000 limit is also phased out as income increases.

- ***Comment.*** Excess contributions are subject to a six-percent excise tax, and the earnings on them are included in the beneficiary's income, so mistakes in calculating total contributions for one year can be costly.
- ***Comment.*** Coverdell ESAs (formerly known as education IRAs) resemble traditional IRAs in many ways. IRAs even offer limited educational benefits, because IRA distributions that are used to pay qualified higher education expenses are not subject to the 10-percent penalty on early distributions. However, ESAs are generally a better vehicle for education expenses for two reasons. First, ESA distributions used for education expenses are entirely excluded from the beneficiary's income, while IRA distributions used for higher education expenses are taxed like other IRA distributions. Second, excludable ESA distributions can be used for qualified elementary, secondary, and college education costs, while penalty-free IRA distributions can be used only for higher education expenses.

Qualified elementary and secondary school expenses. For purposes of excludable distributions from an ESA, qualified elementary and secondary school expenses (kindergarten through grade 12), include the following costs:

- expenses for tuition, fees, academic tutoring, services for beneficiaries with special needs, books, supplies, and other equipment that are incurred in connection with the designated beneficiary's enrollment or attendance at a public, private or religious school;
- expenses for room and board, uniforms, transportation, and supplementary items and services (including extended day programs) that are required or provided by the school in connection with enrollment or attendance; and
- expenses for the purchase of computer technology or equipment or internet access and related services that will be used by the beneficiary and the beneficiary's family during any of the years the beneficiary is in school. This category does not include software designed for sports, games or hobbies unless it is predominantly educational in nature *(Code Sec. 530(b)(2),(3))*.

Gift-tax consequences

A donor receives an unlimited gift tax exclusion for a donee's medical care and tuition expenses paid by the donor directly to a provider or to an institution (Code Sec. 2503(e)). Contributions to qualified state tuition programs and Coverdell ESAs do not qualify for the unlimited exclusion. In any case, no unlimited exclusion is permitted for amounts paid for books, supplies, dormitory fees, board, or other similar expenses which do not constitute direct tuition costs.

A qualifying educational organization is one which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on. Such definition appears to include grades K through graduate school. Parents, who have a duty to support children as minors, are not considered to make a gift to their child whether or not paid directly to a school.

Dependent care credit

For purposes of the child and dependent care credit, a restriction applies to employment-related expenses that are incurred for services outside the taxpayer's household. These expenses are creditable only if incurred for the care of:

- a dependent of the taxpayer who is under the age of 13 at the time the expense is incurred and for whom the taxpayer is entitled to a dependency exemption; or
- any other qualifying individual who regularly spends at least eight hours each day in the taxpayer's household item.

As a result, a portion of the cost of sending a child to boarding school can qualify as an employment-related expense, although the earned income limitation on the parents for taking the credit may the value of that credit minimal at best in most cases *(Reg. §1.21-1(d)(12), Example 2)*.

Reg. 1.21-1(d)(5) provides that expenses for a child in nursery school, pre-school, or similar programs for children below the level of kindergarten are for the care of a qualifying individual and may be employment-related expenses. Expenses for a child in kindergarten or a higher grade are not for the care of a qualifying individual. However, expenses for before- or after-school care of a child in kindergarten or a higher grade may be for the care of a qualifying individual.

Amount of credit. The maximum amount of eligible expenses is $3,000 for taxpayers with one qualifying individual, and $6,000 for taxpayers with two or more qualifying individuals. Applying the applicable percentage to the maximum amount of eligible employment-related expenses, the maximum credit is $1,050 if there is one qualifying child or dependent, and $2,100 if there are two or more qualifying children or dependents.

COMPLIANCE CALENDAR

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.

August 25

Employers deposit Social Security, Medicare, and withheld income tax for August 19, 20, 21, and 22.

August 30

Employers deposit Social Security, Medicare, and withheld income tax for August 23, 24, and 25.

September 1

Employers deposit Social Security, Medicare, and withheld income tax for August 26, 27, 28, and 29.

September 7

Employers deposit Social Security, Medicare, and withheld income tax for August 30, 31, and September 1.

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 from the perspective of research assistance (not legal advice) by our Wolters Kluwer Tax Research Consultant Helpline (1-800-344-3734).

Q Assume taxpayer had an unsecured claim for compensation from "ABC," a C corporation that entered Chapter 7 bankruptcy. In return for being unsecured, he received a small interest in the ABC Corporation Liquidation Trust. If he receives a cash distribution in settlement of his claim from the liquidation trust is it compensation to him subject to withholding or just ordinary income? Or if another party offers to buy his unsecured claim, would be received compensation or does the character of the income change?

A Rules to which these particular facts and circumstances may be applied are found in: *TRC PAYROLL: 3,174, Back Pay and Settlement Awards as Wages Subject to Withholding; COMPEN: 100, Fundamental Concepts: Compensation and Benefits; PLANRET: 3,204.10, Economic Benefit Doctrine—Income Inclusion; ACCTNG: 6,104.10, Notes; COMPEN: 6,106, Payment in Notes for Services as Taxable Compensation; PAYROLL: 3,250, Nonqualified Deferred Compensation Subject to Withholding; COMPEN: 12,000, Overview—Taxation of Compensation to the Recipient and Deductibility to the Payer; and COMPEN: 12,102, Constructive Receipt of Compensation.*

Q Under what circumstances is a loan to an equity method investment entity classified as an equity contribution, not a loan?

A Explanations on debt vs. equity classification many be found in several of our tax products. In AnswerConnect, this topic is covered in "Corporate Debt-Equity Considerations and Section 385 Regulations." *In TRC, debt-equity classification is discussed at CCORP: 3,300, Corporate Debt-Equity Classification, through CCORP: 3,312, Problem Areas for Debt/Equity Classification. In FED, there is an explanation of debt vs. equity at ¶17,351, Debt-Equity Guidelines (under Code Sec. 385).* Alternatively, search for "debt-equity" (or "debt equity") or "385 regulations" to find relevant results in both AnswerConnect and IntelliConnect.