IRS Releases Draft Form 8960 On Net Investment Income Tax; Final Regs Pending

**Background**

The 3.8 percent surtax on qualified net investment income under new Code Section 1411 has been effective generally for tax years beginning after December 31, 2012. Taxpayers and practitioners have been concerned over the complexities involved in determining liability for the NII surtax, particularly since the tax is already effective. Proposed regulations that were published on December 5, 2012 have been considered inadequate by many commentators. Final regulations have not yet been issued, although IRS officials have promised to issue them well in advance of the 2014 tax filing season.

**Comment.** Despite publication of the Notice and Request for Comments on Form 8960 in the July 29, Federal Register, the IRS did not make draft Form 8960 itself available until August 8. At the time of the Notice, an IRS spokesperson told CCH that the draft form had to undergo some “final adjustments” before being released.

**Single-page format**

Draft Form 8960 contains only 21 enumerated lines (33 if lines 4a-b, 5a-c, 9a-c, 18a-c and 19a-c are each counted separately). The draft form is divided into three parts: Part I—Investment Income; Part II—Investment Expenses Allocable to Investment Income and Modifications; and Part III—Tax Computation (within which separate computations are required for Individuals and Estates and Trusts).

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Net Investment Income
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The single-page format for Form 8960 apparently will not come without a price. Proper completion of draft Form 8960 requires both preliminary computations that will be transferred from other tax forms and schedules, and reference to the yet-to-be-published Instructions in which worksheets and other preliminary considerations are expected to be required.

Flow-through from other forms
IRS personnel had previously expressed their intention to make the NII surtax form a relatively simple, single-page form on which, to the extent possible, various components of net investment income will have already been computed at the back end on other forms and would be merely transferred onto the NII tax form. David Kirk, attorney-adviser, IRS Office of Associate Chief Counsel (Passthroughs and Special Industries) and a principal draftsperson on Chief Counsel (Passthroughs and Special Industries) and a principal draftsperson on which, to the extent possible, various components of net investment income will have already been computed at the back end on other forms and would be merely transferred onto the NII tax form. David Kirk, attorney-adviser, IRS Office of Associate Chief Counsel (Passthroughs and Special Industries) and a principal draftsperson on Chief Counsel (Passthroughs and Special Industries) and a principal draftsperson on Code Sec. 1411 regulations project, had earlier reported during the May 2013 American Bar Association’s Tax Section meetings that the NII surtax touches over 50 existing IRS forms and instructions that were being revised.

Comment. As an example of “back-door” computations done before an amount reaches the NII tax form, Kirk speculated at the time that NII adjustments for rental income might be made on Form 1040 Schedule E and then carried over as a single number onto the NII tax form. That intention appears to be reflected in draft Form 8960, with line 4a: “Rental real estate, royalties, partnerships, S corporations, trusts, etc. (Form 1040, Line 17; or Form 1041, line 5)” since Form 1040, line 17 carries the same title and instructs “Attach Schedule E” and Form 1041, line 5, instructs the same.

Reliance on Instructions
In addition to the preliminary work in determining net investment income done on other tax forms before reaching the NII Tax Form 8960, draft Form 8960 contains no less than 15 lines on which it instructs “(see instructions).” Some of those lines likely will require only quick reference to a chart or table in future Instructions (for example, line 14—“Threshold based on filing status (see instructions)”). The calculations behind others, such as Line 4b—“Adjustment for net income or loss derived in the ordinary course of a non-section 1141 trade or business (see instructions).” Line 5b—“Net gain or loss from disposition of property that is not subject to net investment income tax (see instructions);” and Line 9c—“Miscellaneous investment expenses (see instructions)” may require more complex directions or worksheets, given the issues that have surfaced surrounding them since proposed regulations were issued.

Comment. It is clear that a supplemental worksheet will be necessary before a taxpayer can populate Line 5c—“Adjustment from disposition of partnership interest or S corporation stock,” Nitti noted. “The proposed regulations require a detailed, time-consuming four-step process. Reflecting the result of this detailed computation as a single line item on the draft Form portends the development of a corresponding, additional worksheet.”

Preview of treatment by IRS?
In a “caution page” preceding the draft Form itself, the IRS warned that “no inference should be drawn from any particular line item regarding the treatment of such item in the final regulations.” It also advised that the draft form does not reflect consideration of comments submitted on the proposed regulations. Nevertheless, practitioners have been reading the tea leaves within draft Form 8960 to get a glimpse of how the IRS may treat certain issues within the final regulations. Within that search, two lines have drawn particular attention:

- Line 4a—“Rental real estate, …etc.” Speculation is that, by an intended omission, rental of personal property may be exempt from the NII surtax;
- Line 5a—“Net gain or loss from disposition of property.” The apparent inclusion of net losses within the sum of all three categories of net investment income under Code Section 1411(c)(1)(A) may signal a more flexible position taken by the IRS.

Comment. “Without question, the biggest eye opener on the draft Form is Line 5a. The proposed regulations separate net investment income into three categories, the third of which is ‘net gain attributable to the disposition of property,’ with some exceptions,” Nitti reported. “The regulations make it clear that this third category cannot produce a net loss that can be used to offset the other two categories of net investment income. The inclusion of the words ‘or loss’ on line 5a would seem to indicate a departure from this restriction, and raise the possibility that a net loss from the sale of property may be permitted to reduce a taxpayer’s net investment income from other sources such as interest, dividends, rent, or other passive income.”

Comment. The arguments against reading too much into draft Form 8960 are twofold: (1) the IRS Forms and Publications division may have had to get only a “place-holder” draft form released at this time under its schedule for completing 2013 tax forms; and (2) the many “see Instructions” references can later likely remedy any apparent position now being taken on draft Form 8960 that may conflict with final regs.

Reference: TRC INDIV: 69,160.05.
ProposedRegsReflectRemovedDeadlineForRequestingEquitableInnocentSpouseRelief

**NPRM REG-132251-11**

The IRS has issued proposed regs reflecting its decision in Notice 2011-70 to remove a two-year deadline for requesting Code Sec. 6015(f) equitable innocent spouse relief. The IRS had provided transitional rules in Notice 2011-70 pending issuance of proposed regs.

**CCH Take Away.** “Most of what the IRS put into its proposed regulations merely elaborates on Notice 2011-70, with no surprises.” Carlton Smith, counsel, Roberts & Holland LLP, New York, told CCH. “Of some interest is the IRS’s putting into the regulations a reference to its 6015 relief reconsideration process. The IRS clarifies that a person can only formally seek equitable relief under 6015 once, and if the taxpayer seeks relief a second time, any IRS reconsideration is discretionary, and a disappointed taxpayer after a second request cannot then go to the Tax Court.”

Background

Taxpayers who file a joint return are each liable for the entire amount of tax shown on the return. Code Sec. 6015(f) provides that taxpayers who do not qualify for relief from joint and several liability under Code Sections 6015(b) and 6015(c) may request equitable relief.

Code Sections 6015(b) and 6015(c) impose by statute a two-year deadline (after the IRS’s first collection activity) for taxpayers to elect relief. Code Sec. 6015(f) does not impose a deadline. In regs issued in 2002, the IRS set a two-year deadline for requesting relief under Code Sec. 6015(f).

The Tax Court struck down the two-year deadline for requesting equitable innocent spouse relief in *Lantz, CCH Dec.* 57,784. The Seventh Circuit Court of Appeals reversed the Tax Court and upheld the two-year deadline, *Lantz, 2010-1 ustc §50,446*. The Third and Fourth Circuits also also upheld the two-year deadline.

However, under pressure from lawmakers, the IRS eliminated the two-year deadline in Notice 2011-70. Under transitional rules, the two-year deadline would not apply to any request for equitable innocent spouse relief filed on or after July 25, 2011 or any request already filed and pending with the IRS as of that date. Individuals whose requests for Code Sec. 6015(f) relief had been determined to be untimely were given the opportunity to reapply.

**Proposed regs**

The proposed regs would amend Reg. §1.6015-5 on the time and manner for requesting relief from joint and several liability. In accordance with Notice 2011-70, the proposed regs would remove the two-year deadline for requesting Code Sec. 6015(f) relief. The two-year requirement would be replaced with a requirement that a request for equitable innocent spouse relief must be filed with the IRS within the period of limitation in Code Sec. 6502 for collection of tax or the period of limitation in Code Sec. 6511 for a credit or refund of tax, as applicable to the specific request.

The proposed regs would also amend Reg. §1.66-4 to provide the same timing rules for requesting relief under Code Sec. 66(c). The latter provision allows a spouse in a community property state to obtain relief from taxes on community income of which the spouse reasonably had no knowledge.

**Other changes**

The IRS will consider any request submitted within the 10-year collection period, but it will not provide relief in the form of a credit or refund unless the applicable two-three year refund period is still open. The proposed regs would also provide that a requesting spouse may seek equitable innocent spouse relief (or request the application of Code Sec. 6015(b) or Code Sec. 6015(c)) as part of the collection due process hearing (CDP) procedures under Code Sec. 6320 and 6330. However, a requesting spouse may not seek Code Sec. 6015 relief during a CDP hearing if the IRS had previously ruled on the issue by making a final administrative determination.

**Effective date**

The proposed regs on deadlines would be effective July 25, 2011, the date that Notice 2011-70 was issued. Otherwise, the proposed regs will be effective when they are published as final regs.

References: FED 949,580; TRC INDIV: 18,052.10.

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**IRS Postpones August 30 Employee Furlough; September Furlough Possible**

The IRS has postponed its employee furlough day scheduled for August 30, 2013, citing successful cost-cutting efforts. However, an additional furlough day may still be required in September 2013, the IRS cautioned. “We still have more work to do on the budget and cost-savings, so we will reevaluate in early September and make a final determination as to whether we need another furlough day in September,” IRS Principal Deputy Commissioner Daniel Werfel said in a statement posted on the agency’s website. The cancellation of the August 30 furlough day ensures that all IRS offices will be open for business as usual, Werfel said.

**Comment.** Because of its reduced budget environment, the IRS had announced in April 2013 that there would be five furlough days scheduled throughout the summer: May 24, June 14, July 5, July 22, and August 30. The IRS previously canceled the July 22 furlough day.


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Tax Court Denies Deductions Claimed On LILO/SILO Transactions, Based On Substance-Over-Form Doctrine

◆ John Hancock Life Insurance Co. (USA), 141 TC No.1

In a case of first impression, the Tax Court has applied the substance-over-form doctrine to conclude that an insurance company’s lease-in, lease out (LILO) and sale-in, lease out (SILO) transactions were not leases. The insurance company was not entitled to deduct depreciation, rental expenses, interest expenses, and transactional costs incurred in connection with the various transactions.

■ CCH Take Away. While the transactions did not lack economic substance, the Tax Court found that their substance was not the same as their form. The taxpayer lacked an ownership interest in the assets and could not deduct various expenses. The court found that several of the transactions closely resembled financing transactions and that the taxpayer should recognize original issue discount (OID). In other transactions, the taxpayer had at most a future interest and could not take current deductions against the property. Although the Second, Fourth, and Federal Circuits previously ruled against parties that have taken part in LILO and SILO transactions, the Tax Court had never examined the issue before.

Background

The insurance company engaged in several lease transactions between 1997 and 2001 to raise part of the cash flow it needed to meet its contractual obligations to policyholders. The transactions were either in the LILO form or the SILO form.

■ Comment. In a LILO transaction, generally a U.S. taxpayer leases assets from a foreign or domestic tax-exempt entity and then simultaneously sublets the same property back to the tax-exempt or tax-indifferent entity. A SILO transaction is similar, except that the initial lease extends beyond the remaining useful life of the property, and therefore a taxpayer would consider it a sale.

The parties chose to expedite the case by litigating only seven of the transactions, three LILOs and four SILOs. According to the IRS, the transactions lacked economic substance. The substance of the transactions was not consistent with their form because the insurance company had failed to acquire a leasehold interest in the LILO assets or an ownership interest in the SILO assets. The true substance of the transactions was a loan, the IRS argued.

Court’s analysis

The Tax Court found that the IRS bore the burden of proving lack of economic substance because it had failed to timely raise the economic substance argument in the pleadings. The IRS did not meet its burden.

■ Comment. The transactions took place before codification of the economic substance doctrine in the Health Care and Education Reconciliation Act of 2010. The Tax Court relied on the substance-over-form doctrine articulated in Frank Lyon Co., 78-1 ustc ¶9370, in which the U.S. Supreme Court held that “so long as the lessor retains significant and genuine attributes of the traditional lessor status, the form of the transaction adopted by the parties governs for tax purposes.”

The Tax Court found a lack of risk with respect to the three LILO transactions and one SILO transaction. Furthermore, there was a reasonable likelihood that the tax-indifferent entities would exercise their purchase options, ensuring that the insurance company would receive its expected return on its equity investments without any risk. Therefore, the transaction resembled an intricate loan from the insurance company to the tax-indifferent counterparties, and the taxpayer had OID income in these four transactions. The Tax Court also denied the insurance company’s deductions for rental expenses, interest expenses, and transaction costs with respect to the four transactions.

The Tax Court found that the substance of three of the SILO transactions was consistent with their form. However, because the insurance company had not acquired a present interest in the SILO assets, the Tax Court denied the insurance company’s deductions for depreciation and interest expenses.

References: CCH Dec. 59,597; TRC Sales: 3,154.

S Corp’s Payments To President Were Wages, Not Dividends Or Loan Repayments

◆ Glass Blocks Unlimited, TC Memo. 2013-180

Distributions made by an S corp to its president and sole shareholder were wages subject to employment taxes, not dividends or repayments on a loan, the Tax Court has found. Prior transfers by the president to the S corp were capital contributions, not loans.

■ CCH Take Away. The Tax Court also rejected the S corp’s claim that treating the distributions as wages would result in the payment of unreasonable compensation. Although reasonable compensation generally arises in the context of business deductions under Code Sec. 162, it can also apply to determine whether payments were wages or some other type of distribution. The Tax Court cited Watson, P.C., 2012-1 ustc ¶50,203, where a business paid its owner-employee an unreasonably small salary of $24,000 at the same time it

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District Court Finds Taxpayer Engaged In False Claims Act Lawsuit Was In A Trade Or Business

◆Bagley, DC-Calif., August 5, 2013

A federal district court has found that a taxpayer was engaged in a trade or business for purposes of Code Sec. 162(a) of litigating a lawsuit under the Federal Claims Act (FCA) against his former employer. The taxpayer’s litigation expenses in pursuing an FCA lawsuit as a qui tam relator could be deducted as ordinary and necessary expenses incurred for a trade or business.

■ CCH Take Away. The taxpayer documented his extensive work in pursuing the FCA litigation, Sharyn Fisk, partner, Hochman, Salkin, Retig, Toscher & Perez, P.C., Beverly Hills, Calif., told CCH. The taxpayer clearly showed that his activity had a profit motive and was conducted in a business-like manner, Fisk explained. Fisk and her colleague Barbara Lubin represented the taxpayer in the federal district court.

Background

The president of an S corp was its sole shareholder and only full-time employee. In 2007 and 2008, the president and his fiancée transferred personal funds to the S corp. In each of these years, the S corp paid approximately $31,000 to the president.


Court’s analysis

Before the Tax Court, the S corp claimed that the distributions to the president were repayments on loans and not wages subject to employment taxes. The S corp also argued that the distributions could not be recharacterized as wages because they would represent unreasonable compensation to the president.

The transfers by the president to the S corp were capital contributions and not bona fide loans, the Tax Court found. The court considering a nonexclusive list of 13 factors described in Calumet Industries, Inc., CCH Dec. 46,872 (1990). These factors included: the names given to the evidence of indebtedness; the absence of a fixed maturity date or other characteristics of a loan; the parties’ intent; and the risks to the parties making the advances.

There were no written agreements or promissory notes supporting the argument that the transfers were loans, the Tax Court stated, and the S corp did not report the 2008 transfer as a loan on that year’s return. There was no evidence that the president required interest for the use of the transferred funds, that the S corp provided any security on the loan, or that the parties had created a fixed repayment schedule. The Tax Court found that because the expectation of repayment depended solely on thesuccess of the S corp’s business, the transfers of funds were a capital contribution, not a loan.

The Tax Court also found unpersuasive the S corp’s argument that the distributions to the president, if recharacterized as wages, would be unreasonable compensation to the president. The taxpayer understated the hours worked and the value of the president’s services, the court concluded. In fact, the president’s efforts had generated all of the S corp’s sales and income for the 2007 and 2008 tax years.

References: CCH Dec. 59,600(M);
TRC PLANIND 9,102.
IRS Counsel Denies Deduction For Costs Of Stock Offering

IRS Counsel, in field attorney advice within the IRS’s Large Business & International Division, has concluded that a taxpayer who incurred costs for a planned stock offering had to capitalize the costs. The taxpayer could not deduct the offering costs where the offering was terminated but the taxpayer followed up with a related offering to sell the same stock.

**CCH Take Away.** The taxpayer maintained that it abandoned the first stock offering and then engaged in another offering that was separate from the first. The IRS rejected this analysis, concluding that the second offering was a continuation of the first offering and that expenses of both offerings should be capitalized.

### Background

The taxpayer and two other parties adopted a plan of reorganization. The plan provided that the ownership interest in one party would be sold to the public through a stock offering; the second party would convert from one type of corporation to a fully public corporation; and the third party would cease to exist.

The taxpayer filed an S-1 registration statement with the Securities and Exchange Commission for the proposed sale of common stock to the public and for other transactions. Subsequently, the stock offering in connection with the conversion was postponed.

**Comment.** The taxpayer claimed that the offering had been abandoned but that, for the public’s perception, this was described as a postponement.

The taxpayer then adopted a new plan of conversion and reorganization and filed another S-1 with the SEC. The Forms S-1 were “structurally and formulaically” similar, with certain quantitative differences, the IRS explained.

### Taxpayer’s position

The taxpayer deducted various costs paid for the offering including legal, investment banking, printing, and audit. In response to an IRS inquiry, the taxpayer conceded that some of the costs — state tax opinion, regulatory filing fees, and appraisal — had future value.

The taxpayer maintained that the first offering was in fact terminated, noting that all subscription orders were cancelled, all subscription proceeds were returned, and there was an absence of any plans for a future offering. The taxpayer indicated that most of the offering’s expenses would not have any future value.

IRS Counsel concluded that the taxpayer did not abandon its public offering. The taxpayer fully intended to complete the stock offering at a later date. The second plan was a continuation of the first plan, the IRS concluded. Even if the taxpayer terminated the first plan, this was not an abandonment of the transaction. The two plans were mutually exclusive alternatives for converting one of the entities and for completing a single transaction. The plans were not independent transactions.

### Applicable law

Under Reg. §1.263(a)-5(a), a taxpayer must capitalize an amount paid to facilitate a reorganization of the capital structure of a business entity, including costs incurred to prepare for a public offering of stock. Reg. §1.165-1(b) requires that to be deductible, a loss must be evidenced by a closed and completed transaction and fixed by an identifiable event. Therefore, under Rev. Rul. 73-580, restructuring costs are deductible when the proposed transaction is abandoned.

If a taxpayer investigates and pursues several separate transactions, costs allocable to an abandoned transaction are deductible even if some transactions are completed. A loss may be allowed even if the taxpayer later proceeds with a separate transaction.

However, if a taxpayer considers two exclusive alternatives in pursuing a single transaction, no loss is allowed unless the entire transaction is abandoned. The costs of pursuing an abandoned alternative must be capitalized as part of the cost of the completed alternative.

### IRS counsel analysis

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The IRS concluded that in cases that allowed the costs of one plan to be deducted, the taxpayers explored transactions that were clearly distinct from the transaction in which the taxpayer ultimately engaged. The results of those proposed transactions were separate and distinct. That was not the situation here.

**Reference:** TRC BUSEXP: 39,100.
HHS Clarifies Requirements For Marketplaces To Verify Income Of Taxpayers Applying For Health Insurance Cost Reductions

The U.S. Department of Health and Human Services (HHS) recently issued guidance on the steps that health insurance marketplaces (also known as exchanges) will take to verify the income of individuals applying for benefits to help pay the cost of health insurance obtained through the exchange. These benefits include the Code Sec. 36B premium assistance tax credit provided by the IRS and cost-sharing reductions provided by HHS.  

**CCH Take Away.** At press time, the IRS finalized its rules for disclosing return information to marketplaces for the Code Sec. 36B credit and other purposes. See next week’s issue of this newsletter for details.

New FAQ

In a new FAQ, HHS described procedures for both federally-run and state-run exchanges. For applicants whose data shows household income that is more than 10 percent below IRS data, federal exchanges will attempt to verify the information for 100 percent of applicants, to determine eligibility for cost reduction benefits. CMS explained that HHS will exercise enforcement discretion for 2014 to allow state exchanges, in these circumstances, to verify information based on a statistically-significant sample of applicants, rather than 100 percent.

**Income verification**

An applicant’s eligibility and level of cost reduction benefits depends on the applicant’s household income amounting to between 100 percent and 400 percent of the federal poverty level. Applicants must provide their projected household income. The exchange will seek to verify household income based on information from the IRS and the Social Security Administration (SSA), or from a credit-reporting service that receives wage information from employers.  

**Comment.** Individuals providing income information may receive advance payments of cost-reduction benefits for 90 days while the exchange verifies the information. The 90-day period may be extended for good faith.

The IRS will reconcile advance payments of the Code Sec. 36B credit when taxpayers file their annual income tax returns. The agency will seek to recover overpayments and provide refunds when appropriate, subject to statutory limits.

**Reference:** TRC IRS: 9,254.50.

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**HHS FAQs on Marketplaces and Income Verification**

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**CRS Describes Tax Consequences Of Supreme Court’s Windsor Decision**

**CRS, 7-5700**

The Congressional Research Service (CRS) has described some of the tax consequences from the U.S. Supreme Court’s decision in E.S. Windsor, 2013-2 ustc §50,400, which struck down Section 3 of the Defense of Marriage Act (DOMA). According to CRS, the Windsor decision is expected to affect a married same-sex couple’s filing status and their opportunity to take advantage of some tax credits.

**CCH Take Away.** It is unclear if the IRS will take a state of domicile approach or state of celebration (of marriage) approach in its expected post-DOMA guidance. Some federal agencies, including the U.S. Department of Homeland Security, have announced they will recognize a same-sex couple’s marriage based on the law of the place of celebration.

**Filing status**

CRS reported that as a result of the Windsor decision, married same-sex couples are expected to file their taxes in the same manner as married opposite-sex couples; either married filing joint returns or married filing separate returns. In some cases marriage will decrease a couple’s overall tax liability. In other cases it will increase it, an effect that is often called the “marriage penalty.” Couples with greater disparity between their incomes are likely to experience a “marriage bonus.” This occurs most frequently among couples where one spouse earns less than five percent of the family’s total income, CRS reported.

**Comment.** CRS noted that the application of Windsor could be only prospective, and, therefore not affect previous years’ filing status.

**Tax credits**

Marital status also affects the operation of many tax credits, CRS reported. Combined income could either place the joint filers within a credit’s phase-out range or above it so that they are no longer eligible for the credit. CRS noted that tax credits subject to income limitations include:

- Earned income credit (EIC);
- Child and dependent care credit;
- Child tax credit;
- Various education tax credits; and
- Adoption credit.

**Nontaxable employee compensation**

The Windsor decision is also expected to affect whether certain forms of employee compensation are nontaxable, CRS reported. Married opposite-sex couples are not taxed on the portion of health insurance premiums the employer pays for the opposite-sex spouse. This treatment, CRS observed, is likely to be extended to married same-sex couples.

**Comment.** For more information on the Supreme Court’s decision in Windsor, see the CCH Briefing: 2013 Supreme Court Strikes Down DOMA (June 27, 2013) on CCH IntelliConnect.

**Reference:** TRC FILEIND: 3,202.
Internal Revenue Service
The IRS and the Treasury have released the 2013-2014 Priority Guidance Plan. Also released was the fourth-quarter update to the 2012-2013 Priority Guidance Plan.

Deductions
A couple’s loss deductions related to their bull breeding activity were disallowed because they did not materially participate in the activity. They were liable for the substantial understatement penalty. They did not show that they had reasonable cause or that they acted in good faith.

Bankruptcy
The IRS did not violate the bankruptcy discharge injunction by attempting to collect post-petition tax assessments that were classified as a general unsecured debt. The debtor’s plan did not contain any specific language regarding the treatment of non-dischargeable debts.

Income
An individual was required to include the full amount of a disability insurance payment in her income in the year it was received. Her argument that amounts she should have received in prior years were excludable was rejected because she was a cash method taxpayer. The taxpayer failed to show that she was entitled to business expense deductions in excess of those allowed by the IRS. Finally, she was liable for additions to tax for her failure to timely file a return and failure to pay the tax shown on the substitute for return prepared by the IRS.

Anti-Injunction Act
An individual’s complaint seeking a preliminary injunction prohibiting the state (Michigan) department of retirement services from complying with an IRS levy was dismissed for lack of subject matter jurisdiction. The Anti-Injunction Act prohibits, except in limited circumstances, injunctive relief pertaining to the assessment or collection of taxes.

Refund Claims
Untimely refund claims filed by two couples and three corporations were disallowed for lack of subject matter jurisdiction.

Summons
An individual’s petition to quash a third-party summons issued to a bank in connection with the IRS’s efforts to collect the individual’s tax liability was dismissed for lack of subject matter jurisdiction. The individual was not entitled to notice of the summons under Code Sec. 7609(c)(2)(B)(i) and, therefore, lacked standing to bring a petition to quash.

Retirement Plans
For pension plan years beginning in August 2013, the IRS has released the 30-year Treasury weighted average interest rate, the permissible range of interest rates used to calculate current plan liability and to determine the required contribution under Code Sec. 412(1) for plan years through 2013, and the current corporate bond yield curve and related segment rates for the purpose of establishing a plan’s funding target under Code Sec. 430(h)(2).

Innocent Spouse Relief
An individual was eligible to elect relief from joint and several liability under Code Sec. 6015(c) because he and his spouse were no longer married. He satisfied all requirements for relief on the portion of the deficiency allocable to his spouse, and the IRS failed to prove that the husband knew of the omitted income when he signed the return.

Statute of Limitations
An individual’s claim seeking damages for the government’s failure to release its lien and for unauthorized collection actions was time-barred. The individual had a reasonable opportunity to discover the essential elements of a possible cause of action several years before the suit was filed.
Taking The Pulse Of Tax Reform

When Congress returns to Washington on September 9th following a five-week recess, a groundswell of calls for tax reform must vie with an otherwise packed agenda during the final days of the 1st session of the 113th Congress. Work on immigration reform, agriculture and nutrition programs, and, most pressing, replacement the 12 unfinished annual spending bills with a temporary continuing budget resolution (CR) to keep the government operating after September 30, will all reduce the time left in 2013 to consider tax reform. Conflict over these pending matters may also chip away at the spirit of bipartisan cooperation needed to fast track any ongoing effort to pass the first comprehensive reform of the federal Tax Code since the Tax Reform Act of 1986. Yet, other signs point to momentum building toward tax reform that could provide the “win-win” for both sides of the aisle to point to in an otherwise gridlocked Congressional session.

Assessing the odds for tax reform

Chances look good for actual passage of at least an overall agreement on the scope of comprehensive tax reform this year, with passage of specific tax legislation sometime in 2014. An even more accelerated pace may be possible if passage is tied directly to a budget compromise. Likely legislative vehicles for passage could be an eventual long-term CR, a year-end tax extenders package or the debt ceiling bill, even though the President has signaled his unwillingness to negotiate over nation’s debt limit. Whether or how this supercharged effort to revamp the Tax Code will cross the finish line will largely be determined by a bipartisan coalition of lawmakers on the House Ways and Means Committee and the Senate Finance Committee.

The general experience and, therefore, comfort level of current members of Congress in dealing with tax matters should also not be discounted in helping to move tax reform along quickly once negotiations take hold, according to interviews with lawmakers and tax lobbyists. Tax legislation has never been overly resistant to political headwinds, particularly if it involves reform of the Tax Code for the first time in nearly three decades. But those now in Congress have already gained a facility with dealing with the Tax Code in deciding the fate of corporate and individual tax incentives in annual tax extenders bills that pass Congress and major tax measures like the American Taxpayer Relief Act of 2012 that passed on New Year’s Day.

Revenue neutrality

Despite any temporary slowdown caused by the IRS controversy, the main sticking point for progress on tax reform is a fundamental difference over revenue neutrality. Differing prescriptions for tax revenue were already on display earlier this year in the budget resolutions adopted by the Republican controlled House and the Senate, which is controlled by Democrats. Continuing disagreements have led to the inability of lawmakers to reach a so-called grand bargain with the White House to lower the federal budget deficit through a mix of spending cuts and tax hikes. They also resulted in lawmakers being unable to replace the government wide budget sequestration enacted as part of the Budget Control Act of 2011.

The House GOP’s tax reform plans were unveiled in The Path to Prosperity: A Responsible, Balanced Budget, the House Republican Fiscal Year 2014 Budget Resolution. The GOP budget proposed $4.6 trillion in spending cuts over 10 years, with no new tax revenues. It also called for reforming that Tax Code without raising any new tax revenues and included three main reform goals: simplifying the code, making tax laws fairer, and reducing the time and effort need for compliance. In the Democratic-controlled Senate, lawmakers approved a FY 2014 budget resolution called the Foundation for Growth: Restoring the Continued on page 391

Comment. One test of bipartisanship is the ongoing controversy surrounding the IRS’ extra scrutiny of applications for tax-exempt status by conservative organizations. The House Oversight and Government Reform Committee and the Ways and Means Committee have held a series of hearings delving into the IRS’s targeting of Tea Party groups. Those partisan hearings have forced frustrated lawmakers onto different sides of the issue. GOP allegations of White House culpability for the IRS scandal are increasing, just as the effort to build a consensus for tax reform is ramping up.
Congress in recess, tax reform discussions continue

Congress has officially left Washington, D.C. for its annual August recess, which will last from August 2 to September 9, 2013. When lawmakers return they will have a full agenda of pressing budget, statutory debt, and domestic policy issues. Work on immigration reform, a farm bill, and tax reform is pending. See the Practitioner’s Corner in the issue for details on possible tax reform and work being done on it during the August recess. The most intense legislative action will center on efforts to replace 12 unfinished annual spending bills with a temporary continuing budget resolution (CR) that will keep the government operating after the end of the current fiscal year on September 30.

During the August recess, Sen. Max Baucus, D-Mont., chair of the Senate Finance Committee; and Rep. Dave Camp, R-Mich., chair of the House Ways and Means Committee, are continuing their multi-city tax reform tour. On August 19 and 20 the lawmakers are scheduled to visit two separate technology companies in San Francisco and the Silicon Valley area. The West Coast trip is the third stop in a series of trips across the nation to promote tax reform.

Online disclosure authorization feature to be retired September 2

The IRS has announced on its website that it is delaying the planned retirement of the Disclosure Authorization (DA) and Electronic Account Resolution (EAR) applications from e-Services until September 2, 2013. Previously, the IRS had announced that due to low usage rates it would retire the two applications on August 11, 2013. However, the IRS requires additional time to complete the transition to a new web portal. In the meantime, DA and EAR users will have an additional three weeks to use both electronic products. After September 2, 2013, former DA users will need to complete paper Form 2848, Power of Attorney and Declaration of Representative, or paper Form 8821, Tax Information Authorizations, and mail or fax it to the location listed on the form’s instructions, the IRS explained.

Private equity funds petition for rehearing of First Circuit pension case

Funds affiliated with a private equity firm have filed a petition with the First Circuit Court of Appeals for a rehearing of several issues decided in Sun Capital Partners III LP, et. al, CA-1, July 24, 2013, in which the First Circuit found that the funds were not mere investors, but were in a trade or business of managing the distressed business in which they had invested for the purposes of the Employee Retirement Income Security Act (ERISA). As a consequence, the equity funds were potentially liable to a multiemployer pension fund for a substantial share of the vested, but unfunded benefits, owed by the distressed company.

The funds argue in their petition that the First Circuit should apply the law in Whipple, 63-1 ustc §9466, to avoid the confusion that they state will come about from the court’s current “investment plus” analysis. Second, the funds argue that the First Circuit had not conducted a thorough-enough analysis of whether or not the fund’s general partner (GP) provided management services as an agent for the fund.

The funds also argue that the First Circuit had overlooked important principles of agency law and created conflicts with its own prior decisions. Finally, the funds argue that the First Circuit should remand the case to the district court to determine whether there had been any fee offset.

Legislation targets cruise line tax “loophole”

Sen. John “Jay” Rockefeller, D-WVa., chair, Senate Commerce, Science and Transportation Committee, is currently working to close a tax loophole that he claims allows the cruise ship industry to escape paying federal taxes. The “loophole” allows the companies to register as foreign-owned corporations that do not pay much in U.S. corporate taxes while still earning billions of dollars from U.S. passengers, Rockefeller said in a statement.

Rockefeller recently introduced Sen 1449, a bill to provide that income attributable to certain passenger cruise voyages beginning or ending in the U.S. shall be treated as effectively connected with the conduct of a trade or business within the U.S. Rockefeller also introduced Sen 1450, a bill to impose an ad valorem excise tax on certain passenger cruise voyages.

Advocacy groups report small pass-throughs taxed higher than C corps

A new study released by two small business advocacy groups indicates that individuals and pass-through businesses pay significantly higher marginal tax rates than C corporations. The report states that effective tax rates vary by the type of business entity and industry, but that small businesses and sole proprietorships face the highest tax burdens. For example, the Patient Protection and Affordable Care Act (PPACA) and the American Taxpayer Relief Act of 2012 increased the top marginal rate for individuals and pass-through businesses to 44.7 percent, the study shows. Quantria Strategies, LLC prepared the report on behalf of the National Federation of Independent Business (NFIB) and the S Corporation Association.
Practitioners’ Corner
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Promise of American Opportunity. The Senate budget called for $975 billion in new revenues, $975 billion in spending cuts, and a $100 billion investment in jobs and infrastructure over the next 10 years. Its tax reform principles were to maintain progressivity, in part, through tax credits for middle- and low-income families. Democrats also called for closing the tax gap, ending off-shore tax abuse, shutting down inefficient business tax loopholes, and reducing tax rates only if revenue and progressivity goals can be reached.

Comment. The issue of revenue neutrality might lose its importance as the U.S. economy appears to be improving and the federal deficit is slowly dropping. Recent economic reports show that the housing market is recovering in some major cities while the unemployment rate has fallen to 7.4 percent, the lowest level since the Great Recession. According to recent Congressional Budget Office estimates, the budget deficit will shrink to $642 billion in 2013 because tax revenues are rising faster than spending.

Public and private meetings
The most notable example of bipartisanship is the cooperation between Ways and Means Chair Dave Camp, R-Mich., and Senate Finance Chair Max Baucus, D-Mont. Together, they have embarked on a multi-city tour to sell the idea of tax reform to the American public. The third stop on the trip will be a visit to Silicon Valley in mid-August where they hope to tie technological innovation to tax reform.

Behind those public appearances, lawmakers have quietly been meeting each week to build consensus for action. Camp has held closed door meetings with individuals and groups on his committee, including a meeting with the so-called New Democrats who are said to be open to the idea of reform without new tax revenues. In addition, Camp has released a series of major discussion drafts targeting areas of concern in the Tax Code and given the public an opportunity to comment on possible changes.

House developments. Camp’s tax reform discussion drafts dealt with small businesses, financial products and international taxation. Camp has maintained that the drafts were not intended to be final legislation. Moreover, specific provisions in the drafts should not be considered as revenue raisers since they may be included in a larger bill that will be revenue neutral.

In addition, Camp also organized lawmakers on his committee into 11 bipartisan working groups to review and propose reforms to the Tax Code in the following areas including Charitable/Exempt Organizations; Debt, Equity and Capital; Education and Family Benefits; Energy; Financial Services; Income and Tax Distribution; International; Manufacturing; Pensions/Retirement; Real Estate and Small Business/Passthroughs. In May, the Joint Committee on Taxation released a summary of present law and suggestions for reform submitted to the 11 Tax Reform Working Groups.

Senate developments. Just like the House Ways and Means Committee chairman, Baucus has been exploring various options for tax reform with Senate lawmakers on the Finance panel as well as meeting with all members, individually. He also plans to hold 10 meetings with Finance panel members.

Since the spring, Baucus has issued more than a half dozen bipartisan discussion papers on tax reform. Discussion papers have covered a range of issues throughout the Tax Code, including: examining the tax treatment of small businesses and corporate investment; families and children; education expenditures; different types of income and tax structures; international taxation; charitable giving and tax-exempt organizations.

One of the drafts included a non-exhaustive list of tax reform options suggested by witnesses at the committee’s 30 hearings on tax reform, bipartisan commissions, tax policy experts, and members of Congress. In order to facilitate discussions, the draft set aside the question of whether revenue should be used to lower tax rates, cut the deficit, or a combination of the two approaches.

Comment. Baucus had planned to introduce a tax reform bill by August, but has since moved the deadline back to sometime in the Fall. He has refrained from setting an exact date, but emphasized his determination to get a bill out of his committee by the end of 2013. His effort to pass legislation has already generated a raised eyebrow from Senate Majority Leader, Harry Reid, D-Nev., who told senators that he wants Baucus to include a revenue target in the tax reform legislation. As majority leader, Reid has the power to stop tax reform from being considered on the Senate floor.

Blank-slate approach
In order to build bipartisan support for tax reform, Baucus and Finance Committee ranking member Orrin Hatch, R-Utah, adopted a blank slate approach to generating ideas. They invited senators to consider the Tax Code as a completely blank document, and to make their cases for including tax provisions in the legislation that they believe are essential. The effort faltered initially, until Baucus and Hatch offered 50 years of confidentiality to any senator who made a proposal. Baucus said 18 senators declined to make any written submission, but he would talk with them privately.

Tax reform legacy
Another reason for the growing momentum for a rewrite of the Tax Code is the upcoming retirement of both of its major champions. Baucus, 71, said he will not seek reelection in 2014. Camp, 60, is considering a bid to replace retiring Sen. Carl Levin, D-Mich., in 2014. These influential Congressional leaders see tax reform as a legacy to their years of service. They seem determined to succeed before they leave Capitol Hill in their present positions. Also to be considered is the need for members of Congress to defacto the label of a “do-nothing” Congress to their tenure, with tax reform in which “legislative accounting” may show more winners than losers an opportune vehicle for forward progress.

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The cross references at the end of the articles in CCH Federal Tax Weekly (FTW) are text references to CCH 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.

| August 15 | Exempt organizations with a fiscal year ending on March 31, 2013 file their Form 990 or Form 990-EZ. |
| August 16 | Employers deposit Social Security, Medicare, and withheld income tax for August 10, 11, 12, and 13. |
| August 21 | Employers deposit Social Security, Medicare, and withheld income tax for August 14, 15, and 16. |
| August 23 | Employers deposit Social Security, Medicare, and withheld income tax for August 17, 18, 19, and 20. |
| August 28 | Employers deposit Social Security, Medicare, and withheld income tax for August 21, 22, and 23. |
| August 30 | Employers deposit Social Security, Medicare, and withheld income tax for August 24, 25, 26, and 27. |

**A taxpayer rented out his vacation beach front property for a total of approximately 45 days during the current tax year. The taxpayer himself recently used the property for just over two weeks during July. May the taxpayer deduct expenses such as utilities related to the rental?**

Yes, but these deductions may be subject to limits. The treatment of deductions that may be taken in connection with the rental of a residence or vacation home depends on a number of factors, including number of days the unit is rented at fair rental value and whether or not the taxpayer uses the property as a personal residence.

Here, since the property had been rented out for more than 15 days during the tax year rental deductions are limited by Code Sec. 280A(d)(1), not to exceed the amount by which the gross income derived from such activity exceeds the deductions otherwise allowable for the property, such as interest and taxes. See TRC BUSEXP: 27,102 and BUSEXP: 27,300.

**A taxpayer wants to temporarily borrow from regular Individual Retirement Account (IRA). How long does he have to repay the withdrawal before the 10-percent early withdrawal penalty is applied to the distributions?**

A 60-day exception may apply when Code Sec. 72(t) would otherwise impose a 10-percent additional tax on early distributions from qualified retirement plans, including IRAs. The additional tax, as well as any underlying income tax due on the distribution, can be avoided if the amount distributed from the taxpayer’s IRA is rolled over into another IRA or back into the same IRA within 60 days. In any case, a rollover is allowed only once in a 12-month period. See TRC RETIRE: 66,506 and RETIRE: 66,700.