Proposed Regs Would Restrict Transfers Of Built-In Losses And Other Duplicated Loss Transactions

◆ NPRM REG-144468-05

The IRS has issued proposed partnership regs under Code Sections 704(c), 734, 743, and 755(c) to implement provisions added by the American Jobs Creation Act of 2004 that limit duplicated losses and inappropriate transfers of built-in losses between partners. The provisions apply to contributions to a partnership of property with a built-in loss, transfers of partnership interests by the contributor of the built-in loss property, and liquidating distributions to the partner who contributed the built-in loss property.

■ CCH Take Away. “The regulations are very comprehensive,” Paul Kugler, director, Washington National Tax Practice, KPMG LLP, Washington, D.C., told CCH. “The Jobs Act guidance was eagerly awaited. I think the regulations are very good. The rules work. There will still be some fine-tuning. Applying the framework of the Sec. 743 regulations, rather than merely cross-referencing them, was a good idea and enables people to more easily understand how the rules work,” Kugler said. “I was also pleased to see how comprehensive the preamble was. It is very helpful in understanding the regulations. This has not always been the practice,” he said.

■ Comment. “The issuance of the regulations was a long time coming and much welcomed,” Aaron Nocjar, partner, Steptoe & Johnson LLP, Washington, D.C., told CCH. “They attempt to simplify what can be very complicated analyses in partnership transactional planning.”

Jobs Act changes

Under Code Sec. 704(c)(1)(C), only the partner that contributed built-in loss property to a partnership can take the loss into account. Furthermore, the basis of the built-in loss property to the partnership is its fair market value at the time of contribution. Under Code Sec. 743, upon the transfer of a partnership interest, the partnership must adjust the basis of partnership property if the partnership has a substantial built-in loss (more than $250,000) immediately after the transfer. Under Code Sec. 734, a partnership must make similar adjustments on a distribution of partnership property if the distributee partner has a substantial loss (over $250,000). Code Sec. 755(c) challenges certain abusive transactions. It prevents a partnership from increasing the basis of depreciable assets while decreasing tax-free the basis of preferred stock of a corporate partner held by the partnership. The basis increase produces duplicated tax deductions at no economic cost.

Proposed regs

The proposed regs define a “section 704(c)(1)(C) basis adjustment” as the built-in loss associated with the property. If a partner receives a distribution of property in which another partner has this basis, the distributee partner does not take the basis adjustment into account. If the partner with the basis adjustment disposes of its
Corporate Inversion Regs Provide Limits On Ownership Of Stock In Surrogate Foreign Corporations

◆ **TD 9654, NPRM REG-121534-12**

The IRS issued final, temporary and proposed regulations to implement certain restrictions on corporate inversions under Code Sec. 7874. The regs identify stock of a foreign corporation that will be disregarded in determining whether it is a surrogate foreign corporation.

**CCH Take Away.** "In issuing these regulations, the IRS tightened the application of section 7874 in many respects as it relates to the ownership test to make section 7874 more likely to apply to a transaction," Joseph Calianno, partner, International Technical Tax Practice Leader, Grant Thornton, LLP, Washington, D.C., told CCH. “However, there was a recognition that, in some cases, the application of the section 7874 rules could be over-inclusive and, in these instances, there should be exceptions.”

**Background**

In a corporate inversion, a corporate group with a U.S. parent seeks to avoid U.S. taxes by incorporating a new foreign parent. Code Sec. 7874 imposes restrictions if the foreign parent is owned at least 60 percent by the shareholders of the former U.S. parent.

Code Sec. 7874(c)(2)(B) disregards stock sold in a public offering from the calculation of stock ownership. In Notice 2009-78, the IRS provided rules that disregard stock acquired through other means.

**Exclusion rule**

The temporary regs provide a new exclusion rule. The IRS believes that stock of the foreign acquiring parent that is transferred in exchange for property in a transaction related to the acquisition can also inappropriately reduce the ownership calculation, such as a private placement of stock for cash.

The exclusion rule excludes “disqualified stock” from the denominator of the ownership fraction, to prevent transactions designed to avoid the ownership threshold. The rule applies to a sale, distribution, exchange, or other stock disposition, even if the stock is transferred by another person, not the foreign corporation.

**Disqualified stock**

The temporary regs describe transactions that give rise to disqualified stock. A transfer of stock for property is disqualified stock only if the exchange increases the net assets (or decreases the liabilities) of the foreign corporation.

Disqualified stock includes stock of the foreign corporation that is transferred to a person other than the domestic entity, in exchange for nonqualified property. Nonqualified property includes cash or cash equivalents; marketable securities; disqualified obligations; and other property acquired with a principal purpose of avoiding Code Sec. 7874.

**Comment.** “The section 7874 regulations largely codify the definition of nonqualified property that was contained in Notice 2009-78 with certain modifications,” Calianno said. “For instance, in defining nonqualified property in the regulations, the IRS expanded on the definition that was included in the Notice to include disqualified obligations within the definition of nonqualified property, and identified three categories of disqualified obligations.”

A *de minimis* rule excepts from Code Sec. 7874 stock issued in exchange for nonqualified property if the former owners of the U.S. parent own minimal equity in the foreign acquiring corporation.

**References:** FED ¶¶47,009, 49,606; TRC INTL: 30,082.05.

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**Built-in Losses**

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partnership interest, the transferee does not succeed to the transferor partner’s basis adjustment.

**Comment.** “The rules require mandatory Sec. 734 and 743 adjustments in a tiered situation,” Kugler said. “The adjustments are required to be pushed down to where the property is. This may be difficult to implement; it is not clear that the lower-tier partnership would make the adjustment, absent the requirement to do so. The IRS requested comments on how to make this more administrable; it may be a challenge to balance administrability and the purpose of the statute.”

The rules on transfers of partnership interests do not apply if the partnership interest is transferred in a nonrecognition transaction under Code Secs. 381, 721, 351 or 731. Gifts do not qualify for this exception.

**Comment.** “The regulations allow transferees to retain the property’s basis in nonrecognition transactions,” Kugler said. “The legislative history only specifically covered Sec. 381 transactions. Thankfully, this was extended in the regulations to other provisions.”

**References:** FED ¶49,604; TRC PART: 45,112.
Divided Tax Court Finds Insurance Premiums Paid By Subsidiaries To Captive “Brother” Insurance Corporation Deductible

◆ Rent-A-Center, Inc., 142 TC No. 1

Insurance premium payments made by subsidiaries of a parent company to a brother captive insurance corporation within the same controlled group were deductible expenses, the Tax Court has found in a divided opinion. The captive insurer was not a sham, but was established for legitimate nontax reasons; and the insurance arrangement between the captive and subsidiaries met the two essential elements of insurance (risk shifting and risk distribution).

◆ CCH Take Away. In 1987 the Tax Court in Humana & Subs., 88 TC 197, CCH Dec. 43,666 rejected the brother-sister (balance sheet) theory of creating insurance tax treatment, Tom Jones, partner at McDermott Will & Emery LLP, Chicago, told CCH. He explained that even though the Sixth Circuit in Humana, CA-6, 89-2 USTC ¶9,453, had reversed this portion of the Tax Court’s ruling, the Tax Court had never officially ruled again on this brother-sister approach until now. “The Tax Court applied a facts and circumstances test in reviewing a captive’s proper tax treatment. For practitioners this may be frustrating: each case has to be analyzed anew, and there are no absolute rules. Nonetheless, under the facts of this case, a majority of the judges found favorably for the taxpayer on all counts.”

Background

The parent company controlled approximately 15 affiliated subsidiaries that owned and operated several thousand stores engaged in the rent-to-own business. Eventually the parent company became concerned over the growing insurance costs involved in obtaining coverage under workers’ compensation, automobile, and general liability insurance policies. It established the captive insurance company, a wholly owned subsidiary in Bermuda. The parent company paid insurance premiums related to the policies that insured the subsidiaries and their stores to the captive insurer. Some of the claims were reimbursed by the insurer.

Court’s analysis

The Tax Court majority found that creation of the captive insurer had several legitimate nontax purposes, including the reduction of overall insurance costs, supplying otherwise unavailable insurance coverage for the subsidiaries, and greater accountability and transparency relating to insurance costs. Second, the payments paid to the captive insurer were deductible insurance expenses. Insurance risk was present in the arrangement, and in fact involved three types of risk: worker’s compensation, automobile, and general liability. Furthermore, the risk shifted from the subsidiaries to the captive insurer, which was fully capitalized and financially capable of meeting its obligations, and which did not reduce the net worth of the subsidiaries by providing coverage payments on a policy.

Comment. The Tax Court also rejected the argument that the parent’s guaranty, signed to enable the captive to treat deferred tax assets as general business assets under Bermuda law, abrogated the risk shifting from the subsidiaries to the captive.

The insurance arrangement also resulted in the requisite risk distribution, the Tax Court found. The subsidiaries’ several thousand stores operated thousands of vehicles and employed tens of thousands, enabling the captive to achieve a sufficient number of statistically independent risks.

Comment. Judge Foley ignored Rev. Rul. 2002-90, which outlines specific requirements for brother-sister risk distribution, Jones told CCH. “According to the IRS ‘safe haven’ fact pattern, there must be at least 12 subsidiaries, each between five and 15 percent of the total risk,” he said. “Obviously, the parent in this case would never meet the IRS standard in the Revenue Ruling. Thus, the majority of the Tax Court implicitly rejected use of the IRS mechanical, entity-by-entity, too much risk concentration, percentage test.”

Dissents

Two judges dissented. The first stated the Tax Court majority had unnecessarily overruled the prior Tax Court ruling in Humana with respect to the brother-sister issue. The second stated that the amounts paid to the insurance company did not, under the facts and circumstances, constitute deductible “insurance” expenses.

References: CCH Dec. 59,801; TRC BUSEXP: 18,210.05.
Chief Counsel Concludes

Advertising Payments Could Qualify As DPGR Under Code Sec. 199, Chief Counsel Concludes

IRS Chief Counsel, in a memorandum to the Large Business & International Division, has concluded that vendor allowances paid to retailers for placing advertisements could qualify as domestic production gross receipts (DPGR), and would qualify for the nine percent domestic production activities deduction (DPAD) under Code Sec. 199. The vendor allowances were a separate item of gross income to the retailers, rather than a purchase price adjustment to the advertised merchandise, which would not be included in DPGR under Code Sec. 199.

**CCH Take Away.** “Retailers have been claiming the Sec. 199 deduction for their retail flyers,” George Manousos, partner, PricewaterhouseCoopers LLP, Washington, D.C., told CCH. “Their position is that the advertising revenue from their vendors can qualify as DPGR. IRS Exam has argued that retailers are not eligible for the “advertising exception,” and that advertising flyers are not an “other similar printed publication.” This memorandum clearly resolves the issue of whether an advertising flyer is an “other similar printed publication,” Manousos said.

**Background**

Vendors manufacture or supply products that they sell to retailers at the wholesale level. The vendors and the retailers enter into advertising arrangements that require the retailers to produce printed advertisements of the vendors’ products in advertising flyers. The retailers are responsible for all aspects of producing and distributing the flyers, and bear the upfront cost of the flyers.

**Comment.** “Most retailers don’t print the flyers themselves. The situation is analogous to the ADVO decision (TC, 2013, CCH Continued on page 41

**References:** FED ¶49,605; TRC ESTGIFT: 45,204.
IRS Finalizes Regs Allowing Ordinary Deduction For Certain Zero Coupon Bonds

◆ _TD 9653_

The IRS has finalized temporary regs issued in 2013 that allow an ordinary deduction for bond premiums when a zero coupon bond, acquired at a premium and with a negative yield, is sold, retired or otherwise disposed of. The final regs generally track temporary and proposed regs issued in 2013.

■ _CCH Take Away._ Zero coupon bonds generally do not pay interest during the life of the bonds and are purchased at a discount from their face value. When a zero coupon bond matures, holders of these bonds generally receive one lump sum equal to the initial investment plus the imputed interest.

Background

Under Code Sec. 171, a bondholder may generally amortize bond premium by offsetting the qualified stated interest with the bond premium allocable to the same accrual period. If the bond premium exceeded the stated interest, the holder could deduct the excess bond premium. However, the deductible amount would be limited by net interest on the bond from prior accrual periods. Any amount that could not be deducted would be carried forward as bond premium to the next accrual period, the IRS explained.

In the case of a zero coupon bond, there is no qualified stated interest. As a result, the bond premium would always exceed the stated interest and would be required to be carried forward. Before the issuance of the 2013 temporary regs, the bond holder, upon the sale, retirement or other disposition of the bond, would be entitled to a capital loss for the excess bond premium that is carried forward.

Final regs

At the time the IRS issued the temporary regs, it explained that the amount of bond premium carryforward should be treated as a bond premium deduction under Code Sec. 171(a)(1) rather than as a capital loss for the holder when the bond is sold, retired, or otherwise disposed. The temporary regs provided a specific rule for the treatment of a bond premium carryforward determined as of the end of the holder's final accrual period for any taxable debt instrument for which the holder had elected to amortize bond premium. The bond premium carryforward would be treated as an ordinary deduction.

The IRS reported that it received no comments on the temporary regs. The final regs adopt the temporary regs without substantive change.

Effective date

The temporary regs generally applied to a bond acquired on or after January 4, 2013; however, the IRS permitted taxpayers to apply them to bonds acquired before January 4, 2013. The final regs carry the same effective date.

References: _FED_ ¶47,008; _TRC DEPR:_ 21,202.

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**DPGR**

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Dec. 59,670). The retailer needs to have the benefits and burdens of ownership during the printing of the flyers, if the retailer is using a third-party printer,” Manousos said. The retailers receive allowances from the vendors for providing advertising services. The allowances typically are provided in the following manner:

■ The vendor makes direct payments to the retailer;

■ The vendor reduces the amount owed by the retailer for prior purchases; or

■ The vendor may issue a credit to the retailer for future purchases.

Allowances

Payments made by vendors to retailers as an inducement to purchase merchandise are treated as adjustments to the cost of the merchandise purchased, and are not gross income. The treatment of a payment, allowance or rebate depends on the parties’ intention and purpose. If an allowance is contingent upon the purchaser’s performance of services, then the allowance is not a trade or other discount; it is a separate item of gross income.

■ _Comment._ “It’s critical for retailers to understand the character of the revenue from vendors. That’s a big to-do for retailers. This is a factual determination, based on the contract between the retailers and the vendors,” Manousos said.

**Code Sec. 199**

DPGR means gross receipts from the lease, rental, sale, license, exchange or other disposition of qualifying production property. Generally, DPGR does not include advertising income and product-placement income, because the receipts are derived from providing a service. However, advertising-related income is DPGR if the advertising is placed in newspapers, magazines, phone books, periodicals, or “other similar printed publications,” assuming the publications otherwise qualify under Code Sec. 199.

Treatment of the allowances in this case depends on the facts and circumstances. If the purpose and intent of the allowance is to compensate the retailer for advertising services, then the allowance is a separate item of gross income, and may be included in DPGR, if the retailers’ flyers come under the advertising exception.

Examples

Chief Counsel provided three examples on the issue. In the first two examples, the purpose and intent of the allowances is to compensate the retailer for advertising services. Therefore, the income is DPGR. In the third example, the allowance is not DPGR.

Reference: _TRC BUSEXP:_ 6,162.15.
**District Court Upholds Expanded Reporting Of Nonresident Alien Bank Accounts**

**Florida Bankers Association, DC-D.C., January 13, 2014**

A federal district court has upheld regs (TD 9584) that require U.S. banks to report interest income earned by nonresident aliens from the banks. The court granted the government’s motion for summary judgment and rejected the bankers’ challenge to the regs. The court found that the IRS “reasonably concluded that the regulations will improve U.S. tax compliance, deter foreign and domestic tax evasion, impose a minimal reporting burden on banks, and not cause any rational actor—other than a tax evader—to withdraw his funds from U.S. accounts.”

**CCH Take Away.** The decision enables the IRS to collect information on the income and assets of foreign taxpayers and to exchange that information with foreign countries. This will play an important role in the implementation of the Foreign Account Tax Compliance Act (FATCA), which requires foreign governments (and foreign financial institutions) to provide information to the IRS on certain assets held in their countries by U.S. citizens.

**Background**

In 2012, the IRS issued final regs that require U.S. banks to report information about accounts earning more than $10 of interest held by nonresident aliens. The regs took effect in 2013. The regs as proposed would have required reporting of accounts of foreign taxpayers in any of the 196 countries worldwide. The final regs narrowed this by requiring reporting only for residents of countries that have tax treaties or tax information exchange agreements (TIEAs) with the United States.

Although the income being reported is not taxable in the U.S., the regs will have a significant impact on the IRS and Treasury’s implementation of FATCA. The regs were controversial. U.S. banks holding accounts of foreign taxpayers argued that the reporting requirements would push customers to close their accounts.

**Court upholds regs**

The Florida and Texas Bankers Associations challenged the regs under the Administrative Procedure Act (APA) and the Regulatory Flexibility Act. They argued that the IRS should not move to comply with its treaty obligations and deter tax cheats if banks would be harmed. The court found that the IRS’s decisions were both reasonable and supported by the evidence:

- While the IRS did not know how much money was involved (and that was one purpose of the regs), it made a reasonable estimate of no more than $400 billion, and it reasonably determined that the regs would not impact the decisions of most nonresidents.
- The expansion of reporting from one country (Canada) to additional countries with TIEAs was not arbitrary or capricious.
- The IRS could impose the reporting requirements and did not have to rely on its summons power on a case-by-case basis. The IRS wanted to be in a position to exchange information reciprocally with treaty partners, automatically in some cases.
- The IRS devoted a majority of the regs’ preamble to rebutting claims of substantial capital flight that would harm banks. The IRS addressed privacy concerns (that the information disclosed might be misused by the foreign government) by describing the safeguards in place for account information.
- The IRS reasonably concluded that the regs were needed now, although they might not have been in 2001 when earlier regs were withdrawn. The U.S. has constructed a network of international agreements for which the reporting requirements are essential.

**References:** 2014-1 ustc ¶50,133; TRC FILEBUS: 9,158,12.

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**IRS Chief Counsel Nixes Bonus Depreciation Deduction For Taxpayer’s Construction Project**

In field attorney advice, IRS Chief Counsel determined that a taxpayer’s construction project was ineligible for 50 percent bonus depreciation. The taxpayer could not show that it began qualified construction on the project within the statutory periods during which bonus depreciation was allowed, after 2007 and before 2014.

**Comment.** Fifty percent bonus depreciation generally expired after December 31, 2013 (with exceptions for certain transportation and other property). President Obama may propose extending bonus depreciation in his fiscal year (FY) 2015 budget proposals.

**No turnkey project.** The taxpayer, a hotel owner and operator, acquired an adjacent building and engaged an architect and building contractor to convert the property into a casino. According to the taxpayer, the project was provided under a turnkey contract and final acceptance of project did not occur until the contractor completed all work required for final acceptance. IRS Chief Counsel disagreed. Chief Counsel determined that the agreements among the taxpayer, the architect and the contractor were traditional design-bid-build (DBB) contracts. Further, partial legal title passed to the taxpayer prior to completion of the project and the taxpayer was able to take possession of the released properties.

**Safe harbor not met.** Although a safe harbor rule can allow a taxpayer to determine when physical work of a significant nature begins (generally after more than 10 percent of costs have been incurred), the taxpayer here could not show when the costs of any separately identifiable properties were incurred. Additionally, the taxpayer failed to demonstrate which, if any, properties had met the all events and economic performance requirements.

FAA 20140202F; TRC DEPR: 3,602.
Internal Revenue Service
The IRS has supplemented the schedules of prevailing state-assumed interest rates and applicable federal interest rates set forth in Rev. Rul. 92-19, 1992-1 CB 227, for tax years beginning after December 31, 2012.

Rev. Rul. 2014-4, FED ¶46,240; TRC ACCTNG: 36,162.05.

International
Updated by the IRS on January 13, 2014.
Guidance has been issued to foreign financial institutions (FFIs) entering into an FFI agreement with the IRS under Code Sec. 1471(b) and Reg. §1.1471-4 to be treated as participating FFIs.


Tax Crimes
A federal district court’s restitution order that exceeded the tax loss from a tax return preparer’s offense of conviction was reversed. The individual did not agree to pay restitution beyond the amount attributable to the offense of conviction and the restitution statute, 18 USC §3663, does not authorize restitution orders compelling payment to the IRS for a Title 26 offense unless agreed to by the parties in a plea agreement.

Campbell, CA-5, 2014-1 ustc ¶50,140; TRC IRS: 66,204.

An individual was properly convicted of conspiracy to defraud the government of payroll and income taxes and endeavoring to obstruct and impede the IRS. The court rejected the individual’s claim that evidence against him should be suppressed because armed IRS agents searched his home in violation of Code Sec. 7608(b). The agents carried a valid warrant.

Adams, CA-1, 2014-1 ustc ¶50,135; TRC IRS: 66,306.

The IRS’s motion for partial summary judgment in a case that involved the issue of whether an individual’s admission

Frivolous Arguments
The Tax Court properly upheld a notice of deficiency against a pro se individual and imposed sanctions for instituting proceedings merely for delay. The individual made only frivolous, tax protestor arguments.

Young, CA-5, 2014-1 ustc ¶50,130; TRC PENALTY: 6,816.05.

An individual was liable for a frivolous return penalty for the tax year because he filed a zero return. Further, the IRS’s determination to proceed with the collection actions was proper. The individual was provided with a Collection Due Process hearing that complied with all applicable requirements and the IRS settlement officer did not abuse his discretion in sustaining the filed notice of federal tax lien and levies.

Shirley, TC, CCH Dec. 59,811(M), FED ¶47,926(M); PENALTY: 3,260.

Liens and Levies
Federal tax liens attached to three properties held by a married couple’s nominees and alter egos because the couple was the true owner of the properties even though the nominees and alter egos held legal title to the properties. All of the transfers were

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Supreme Court Takes Up Taxation Of Supplemental Unemployment Benefits (SUB) Payments
The U.S. Supreme Court heard oral arguments in Quality Stores, 2012-2 ustc ¶50,551 on January 14. The U.S. Department of Justice (DOJ), arguing on behalf of the IRS, urged the justices to overturn the Sixth Circuit’s decision that supplemental unemployment benefits (SUB) paid to the taxpayer’s terminated employees were not wages for purposes of FICA tax.

Comment. The justices asked both the taxpayer and the government some challenging questions, Adam Lambert, CPA, Managing Director, National Practice Leader—Employment Tax Services, Grant Thornton LLP, New York, told CCH. No matter how the Court decides, the decision will have significant impact on employers and individuals who receive these types of payment, Lambert observed.

Background. After ceasing its business operations, the taxpayer’s terminated employees received SUB payments. The taxpayer paid FICA tax on the payments but later sought a refund. A federal district court and the Sixth Circuit ruled in favor of the taxpayer, finding that the payments made by the taxpayer to its former employees were within the Code Sec. 3402(o)(2) exception to wages for supplemental unemployment compensation benefits and were not taxable for purposes of FICA tax. DOJ appealed to the Supreme Court, which granted certiorari.

Supreme Court. Before the Supreme Court, DOJ urged the justices to look to the FICA statute and not Code Sec. 3402(o), which the government argued is limited to income tax withholding provisions. The taxpayer argued that the SUB payments were not remuneration for services under FICA and the Sixth Circuit’s analysis was correct.

In re Quality Stores, 2012-2 ustc ¶50,551; TRC PAYROLL: 3,178.
Tax Briefs

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shams and the transferee entities did not have any interest in the properties.
Booth, DC Calif., 2014-1 ustc ¶50,137; TRC IRS: 48,106.10.

Refund Claims

A married couple’s refund claim was barred by the look-back period in Code Sec. 6511(b)(2)(A) because they did not pay any taxes within the three-year period directly preceding the filing of their refund claim.
Ebeyer, FedCl, 2014-1 ustc ¶50,131; TRC IRS: 36,052.05.

Collection Due Process

An individual owed income tax on non-employee compensation that was reported by the service recipients on Forms 1099-MISC, Miscellaneous Income, and W-2, Wage and Tax Statement. The taxpayer owed additions to tax for failing to file on time and failure to pay estimated taxes.
Estes, TC, CCH Dec. 59,810(M), FED ¶47,925(M); TRC IRS: 51,056.

Deficiencies and Penalties

A married couple who engaged in a tax shelter transaction did not file a qualified amended return (QAR) before the IRS began its investigation of the transaction and, therefore, was liable for an accuracy-related penalty. Contrary to the taxpayers’ arguments, the QAR filing period under Reg. §1.6664-2(c)(3)(ii) terminated when the IRS first contacted the tax shelter’s promoter concerning liability under Code Sec. 6700 for an activity with respect to which the couple had claimed a tax benefit.
Bergmann, CA-9, 2014-1 ustc ¶50,136; TRC PENALTY: 3,122.

Bankruptcy

A bankruptcy court properly determined the damages it awarded to an individual for the IRS’s violation of the discharge injunction. The individual was only entitled to recover expenses for IRS violations occurring within the two-year period before she filed her administrative damages claim and the amount of attorney’s fees awarded was governed by Code Sec. 7430.
Kovaec, CA-7, 2014-1 ustc ¶50,139; TRC LITIG: 3,154.

Partnerships

A Final Partnership Administrative Adjustment (FPAA) issued to a lower-tier partnership (FTAP) issued to a lower-tier partnership that included adjustments directly attributable to partnership flow-through items from the top-tier partnership was timely. The top-tier partnership and the IRS executed Form 872-I, Extension Agreements, which contained language limiting the deficiency assessment to partnership flow-through items attributable to the top-tier partnership.
Candyce Martin 1999 Irrevocable Trust, CA-9, 2014-1 ustc ¶50,134; TRC PART: 60,550.

Innocent Spouse Relief

An individual was barred by the doctrine of res judicata under Code Sec. 6015(g)(2) from litigating her entitlement to equitable relief from joint and several liability under the innocent spouse provisions of Code Sec. 6015(f).
Haag, TC, CCH Dec. 59,812(M), FED ¶47,928(M); TRC LITIG: 6,130.35.

Constitutional Issues

Constitutional challenges raised by a corporation and its founder/employee to the employer mandate imposed by the Patient Protection and Affordable Care Act (PPACA) (P.L. 111-148) were dismissed. Assuming that the PPACA was a revenue bill, it did not violate the Origination Clause (Art. I, §7, cl.1), which requires revenue bills to originate in the House of Representatives. In addition, the corporation’s claim that the PPACA violated the Takings Clause of the Fifth Amendment because it compelled private individuals and entities to make payments to other private entities, without a public use and without just compensation, was rejected.

Dependency Exemption

A married individual who had claimed head of household status and had filed a separate return from that of his wife was barred from filing a joint return, and as a result was also barred from claiming the earned income credit. In addition, the taxpayer failed to substantiate that two children for whom he claimed the dependency exemption and the child tax credit were qualifying children.
Ibrahim, TC, CCH Dec. 59,809(M), FED ¶47,924(M); TRC INDIV: 57,452.

District Court Rejects Challenge To Code Sec. 36B Premium Assistance Tax Credit

In a recent decision upholding a key provision of the health care law, a federal district court has rejected arguments that the Code Sec. 36B premium assistance tax credit is only available to individuals who obtain health coverage through a federally-facilitated Marketplace.

**Background.** When an individual applies for coverage in a Marketplace (previously known as an Exchange), the Marketplace estimates the individual’s eligibility for the Code Sec. 36B credit. The credit, which is linked to household income in relation to the federal poverty line, may be paid in advance directly to the insurer to be applied to monthly premiums. Alternatively, eligible taxpayers may claim the credit on their returns.

The IRS issued final regs on the Code Sec. 36B credit in 2012. In this case, the taxpayers argued that the IRS regs are contrary to the Patient Protection and Affordable Care Act (PPACA), which they claimed authorized tax credits only for individuals who obtain coverage through a state-run Marketplace.

**Court’s analysis.** The court found that Congress intended to make the Code Sec. 36B credit available to individuals who obtain coverage in both state-run Marketplaces and federally-facilitated Marketplaces. Congress intended to give states flexibility as to whether or not to establish or operate Marketplaces but lawmakers did not want to limit availability of the credit only to state-established Marketplaces. Even if the PPACA was ambiguous, the IRS regs were a permissible construction of the statute, the court concluded.

AICPA Award Winner Discusses Tax Reform, Changes In Tax And Accounting Profession, Education, And More

Annette Nellen, JD, CPA, the recipient of the 2013 Arthur J. Dixon Memorial Award given by the Tax Division of the American Institute of Certified Public Accountants (AICPA), recently discussed with CCH, a part of Wolters Kluwer, some of the changes in the tax and accounting profession, tax and accounting education, and some challenges facing young CPAs. Nellen also described some proposals for federal tax reform and simplification.

Nellen is a tax professor and director of San José State University’s graduate tax program in San Jose, Calif. For more than 20 years, Nellen has been a dedicated volunteer for the AICPA. Nellen now serves on the AICPA Tax Executive Committee and the Tax Reform Task Force. Nellen also maintains the 21st Century Taxation website and blog. Additionally, Nellen has testified before many Congressional committees. Nellen was presented the Arthur J. Dixon Memorial Award at the AICPA’s Fall Tax Division Meeting in National Harbour, Md., in November, 2013. The award honors Arthur J. Dixon, a CPA who was chair of the AICPA’s Tax Executive Committee from 1977 to 1980 and posthumously won the first award named in his honor. The award was established by the AICPA after Dixon’s death in 1981 to honor outstanding CPAs in the area of taxes.

CCH community

Congratulations on receiving the AICPA’s 2013 Arthur J. Dixon Memorial Award. Can you describe when you began serving on various AICPA committees and what motivated you to become involved in serving the practitioner community?

Nellen. I became active in the AICPA in 1993 and since then have been in a wide range of activities. The AICPA is always looking at ways to better serve the CPA community and also to improve the tax system. This is my second time serving on the AICPA Tax Executive committee, which is composed of a dedicated group of professionals.

Tax reform

CCH. You currently serve on the AICPA Tax Executive Committee and Tax Reform Task Force. Can you share some federal tax reform ideas and proposals that have been discussed in the committees? How would you gauge prospects for federal tax reform in 2014?

Nellen. The AICPA has continually called for simplification of the tax system. There are numerous provisions in the Tax Code that can be simplified, such as the variety of education incentives, with their multiple definitions; the “kiddie” tax could be made more transparent; and deadlines could be simplified,” Annette Nellen, CPA, the recipient of the 2013 Arthur J. Dixon Memorial Award, given by the Tax Division of the American Institute of Certified Public Accountants (AICPA), told CCH.

“...”

Tax and accounting education

CCH. In addition to your service to the AICPA, you are an educator. What trends have you seen emerge in recent years in tax and accounting education? The AICPA recently launched an online community to...

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President signs omnibus spending bill

President Obama on January 17 signed a $1.1 trillion spending bill for fiscal year (FY) 2014 following Senate passage of the Consolidated Appropriations Act, 2014 (HR 3547) on January 16. The omnibus appropriations bill sets spending levels for all federal agencies, including the IRS, which will see its budget cut to $11.3 billion, or roughly $526 million below the FY 2013 level. The bill also appropriates a supplemental $92 million for the improvement of taxpayer services, enforcement, and operations support. The bill specifically states the IRS should not use any portion of this amount for implementation of the Patient Protection and Affordable Care Act (PPACA).

IRS Free File now available

IRS Free File, the brand-name software for taxpayers earning $58,000 or less, is now available at IRS.gov/freefile. Taxpayers can complete and e-file tax returns and the Free File companies will hold them until January 31, when the IRS will begin accepting returns.

As previously announced, the IRS delayed the filing season due to critical system testing following the federal government closure in October 2013. “Many tax preparers and tax software companies are now open for return preparation, including Free File. If you plan to get a head start on your taxes, remember to e-file. Electronic filing will allow software companies to hold your return and to automatically send it to the IRS on January 31. There is absolutely no advantage to filing by paper,” said IRS Commissioner John Koskinen.

As January 31 approaches, Koskinen reminded taxpayers that IRS.gov has a range of information and services to help taxpayers prepare their tax returns. “Free File is just one of the many services available through IRS.gov to help people with their taxes,” Koskinen said. “Additional services include Where’s My Refund for timely updates on refunds, YouTube videos with quick tax tips, and many other ways of getting information.”

IRS conference spending drops

Despite spending an estimated $49 million for 225 conferences during the three-year period between 2010-2012, annual conference spending at the IRS dropped from $38 million in FY 2010 to $5 million in FY 2012. Treasury Inspector General for Tax Administration (TIGTA) J. Russell George, who testified on January 14 before the Senate Homeland Security and Governmental Affairs Committee about IRS conference spending, attributed the reduction of spending in part to enhanced policies and controls that include Department of the Treasury and Office of Management and Budget guidelines.

George specifically addressed spending at an August 2010 management conference held in Anaheim, California, which reportedly cost $4.1 million and garnered excessive negative media attention, leading to an investigation by TIGTA. He stated that some of the key findings for the Anaheim conference include the IRS not having effective controls to track and report the cost of the conference and the use of two event planners that were not under contract with the IRS and had no incentive to negotiate a favorable room rate. The two planners requested 25 or more VIP suite upgrades and received a total of $133,000 in commissions from the hotels. Other examples of questionable spending include planning trips costing $35,000 and two video productions shown at the conference.

Lawmakers take aim at child care credit abuses

Senate Budget Committee ranking member Jeff Sessions, R-Ala, is urging the House and Senate Appropriations Committees to offset some $6 billion in cuts to military retirees by reforming the child tax credit in order to end fraud and abuse. Sessions recently said he believes there are millions of people seeking the tax credit who are not entitled to it. Rep. Sam Johnson, R-Tex., on January 10 also urged Senate Majority Leader Harry Reid, D-Nev., to bring an end to illegal immigrants receiving the $1,000 child tax credit through verification of Social Security numbers. Johnson re-introduced a bill in February 2013 (HR 556) to end unqualified payments. The nonpartisan Joint Committee on Taxation (JCT) estimated Johnson’s bill would save approximately $24.4 billion.

Senate Finance approves more nominations

The Senate Finance Committee on January 15 approved the nominations of Tamara W. Ashford to serve as a judge on the U.S. Tax Court and Judge L. Paige Marvel to serve a second term on the U.S. Tax Court. The committee also unanimously approved the nomination of Sarah Bloom Raskin to be deputy secretary of the Treasury Department. The nominations must receive confirmation from the full Senate before the appointments are final.

Camp seeks to postpone 501(c)(4) regs

House Ways and Means Committee Chairman Dave Camp, R-Mich., has introduced the Stop Targeting of Political Beliefs by the IRS Bill of 2014 (HR 3865), a bill to stop the Treasury and IRS from issuing or finalizing proposed regulations that he said would restrict the First Amendment rights of Code Sec. 501(c)(4) tax-exempt organizations. Camp’s legislation, introduced on January 14, is the result of an ongoing committee investigation into extra IRS scrutiny leveled at conservative groups seeking nonprofit status. Camp said the proposed regulations, which were released in November 2013, should not go into effect as final regs for at least a year. “It is premature to publish new rules before getting all of the facts,” Camp said in a written statement.
CRS Highlights Changes Made By America Invents Act To Patenting Of Tax Strategies

◆ CRS, January 15, 2014

A new report by the Congressional Research Service (CRS) describes the impact of the Leahy-Smith America Invents Act (America Invents Act) on tax strategy patents. The America Invents Act was passed by Congress and signed into law by President Obama in 2011 as part of a comprehensive overhaul of the patent system.

CCH Take Away. Tax strategy patents were included in the America Invents Act but were not the focus of the legislation. When Congress was debating the law, the American Institute of Certified Public Accountants (AICPA) worked to include tax strategy patents. The AICPA told lawmakers that tax strategy patents limit the ability of taxpayers to utilize fully interpretations of tax law intended by Congress. Tax strategy patents also complicate the provision of tax advice by professionals and create a new burdensome level of compliance and cost borne by taxpayers. Additionally, just because a patent has been issued, it does not guarantee that the underlying strategy is valid under the Tax Code, the AICPA cautioned.

Background

Before passage of the America Invents Act, the U.S. Patent Office had granted patents to reportedly more than 130 tax strategies. The U.S. Patent Office did not review tax strategies for any potential abuses of the federal tax laws. The IRS also did not review applications for tax strategy patents.

Comment. The AICPA gave lawmakers examples of tax strategy patents, including a patent on calculating the savings of converting an IRA to a Roth IRA; a patent on the treatment of stock options when they are put in a certain kind of trust; a patent for engaging in certain tax-deferred real estate exchanges; a patent for analyzing college savings plans; a patent for investing long-term assets of tax-exempt charities; and a patent on hedging liabilities associated with a deferred-compensation plan.

America Invents Act

The America Invents Act denies a patent for any strategy for reducing, avoiding, or deferring tax liability. A tax liability includes liability for a tax under any federal, state or local law, or the law of any foreign jurisdiction. The America Invents Act also authorizes the U.S. Patent Office to seek assistance from Treasury and the IRS to ensure that patents do not infringe on the ability of others to interpret the law, and that implementing those interpretations remains in the public domain. The law does not apply to tax software used solely for preparing a tax return or other tax filing, or to any product or system used solely for financial management. The latter must be severable from any tax strategy and cannot limit the use of any tax strategy.

CRS report

In its report, CRS noted that under the America Invents Act, “unless a tax strategy patent claimed an additional component that met the novelty and non-obviousness requirements—such as new computer hardware—then the invention could not be patented.” CRS explained that “this provision does not apply to that part of an invention used solely for preparing a tax or information return or other tax filing.” Additionally, the America Invents Act “stipulated that the tax strategy patent provision does not apply to a method, apparatus, technology, computer program product, or system used solely for financial management, to the extent it is severable from any tax strategy or does not limit the use of any tax strategy by any taxpayer or tax advisor.”

Practitioners’ Corner

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help young CPAs establish connections with their peers, exchange ideas and advance their careers. What challenges and opportunities do you see for individuals entering the profession today?

Nellen. Compared to 10 years ago, students are seeking more exposure to international tax and multi-state tax issues. Individuals entering the CPA profession today are also looking for a work-life balance. In our MST program at San José State University, we offer a course about how to pursue a career path that balances work and life in different periods of life.

The interest in maintaining a work-life balance appears much greater than, for example, 20 years ago, which reflects, I think, a societal shift.

Return preparer regulation

CCH. The U.S. Court of Appeals for the District of Columbia Circuit is currently considering the fate of the IRS’s return preparer oversight initiative (Loving, 2013-1 ustc §50,156). When the IRS launched the return preparer initiative several years ago it predicted that approximately 700,000 unenrolled preparers would become Registered Tax Return Preparers (RTRPs). Subsequent information from the IRS appears to show that the agency’s initial estimate was too high. Do you think the IRS overreached with the return preparer initiative?

Nellen. The AICPA provided comments to the IRS on the return preparer oversight program. One concern was to provide an exemption for certain supervised preparers. From an educational perspective, it would have been challenging for students to obtain an internship before becoming CPAs if they had to pass the RTRP examination first. In the recent Loving hearing, it appeared that the appeals court was grilling the government over the statutory authority to implement the RTRP program. If the government is unsuccessful in its appeal, Congress will need to tweak the law to expressly allow the IRS to regulate all return preparers.
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.

Employers deposit Social Security, Medicare, and withheld income tax for January 25, 26, 27, and 28.

Employers deposit Social Security, Medicare, and withheld income tax for January 29, 30, and 31.

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

Employees who received $20 or more in tips during January report them to their employers using Form 4070.

The following questions have been answered recently by our “CCH Tax Research Consultant” Helpline (1-800-344-3734).

Taxpayers are a same-sex married couple who lived in Virginia throughout the year. How does the Supreme Court decision in U.S. v. Windsor affect their federal filing status for 2013?

They must file their federal tax returns using the married filing jointly (or separately) status if they were validly married in a state or foreign jurisdiction that recognizes same-sex marriage. Shortly after the Supreme Court’s decision in Windsor, the IRS ruled that same-sex couples who were legally married in a jurisdiction that recognizes same-sex marriages will be treated as married for all federal tax purposes, even if the couple lives in a jurisdiction that does not recognize the validity of same-sex marriages. See TRC FILEIND: 3,202.

Are payments from a dental medicine practice paid to a former partner to retain her goodwill after her withdrawal from the business excludable as gifts?

Transfers from employers to employees are generally not excludable as gifts, no matter what their motivation. Although proposed regulations provide for some exceptions, to fit within one such exception, the employee must show that the transfer was not made in recognition of the employee’s employment. However, this issue is similar to a Tax Court case in which payments for goodwill made by a law firm to a departing attorney were found to be compensation. See TRC COMPEN: 6,352.