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IRS Launches Generous Worker Classification Settlement Program

◆ *IR-2011-95, Ann. 2011-64, www.irs.gov*

A new IRS program – the Voluntary Classification Settlement Program (VCSP) – will enable employers to voluntarily reclassify their workers for federal employment tax purposes and take advantage of a reduced penalty and audit protection. The IRS also released Form 8952, Application for Voluntary Classification Settlement Program, and Instructions, and posted frequently asked questions (FAQs) about the VCSP on its website.

■ ***CCH Take Away.*** Adam Lambert, CPA, executive director, Grant Thornton, LLP, New York, described the VCSP as the "deal of a lifetime." The reduced penalty is clearly the carrot of a carrot and stick approach, Lambert said. The VCSP also appears, at this time, to have no end date, Lambert observed.

■ ***Comment.*** Shortly before the IRS announced the VCSP, the agency and the U.S. Department of Labor (DOL) signed a new memorandum of understanding (MOU) to improve compliance with worker classification laws and regs (*see the September 22, 2011 issue of this newsletter for details*). Additionally, President Obama has proposed to authorize the IRS to issue general guidance on worker classification. *For details on the president's proposal, see the CCH Tax Briefing: White House Tax and Deficit Reduction Proposals on CCH's IntelliConnect and the CCH Tax Research Network.*

Eligibility

The VCSP is open to taxpayers currently treating their workers as independent contractors or other nonemployees and that want to prospectively treat the workers as employees. The taxpayer must have consistently treated the workers as nonemployees, and must have filed all required Forms 1099 for the workers for the three preceding calendar years ending before the date Form 8952 is filed. In the case of a taxpayer that has only been in business for two years, the filing requirement will be deemed satisfied if the taxpayer has provided Forms 1099 to workers for the time they worked for the taxpayer.

■ ***Comment.*** These provisions are similar to requirements under Section 530 of the *Revenue Act of 1978*. However there is no requirement that the employer consistently treated the workers as nonemployees for employment tax purposes for those tax periods and all prior tax periods after 1978 or that the employer had a reasonable basis for treating the workers as nonemployees. Section 530 provides three safe harbors establishing reasonable basis.

■ ***Comment.*** "In light of the legislative proposals over the last few years that threaten to severely restrict the existing 530 relief and the existing CSP relief programs available upon audit, this is a welcome step in the right direction for these historically difficult, facts and circumstances issues," Elizabeth Dold, principal, The Groom Law Group, Chartered, Washington, D.C., told CCH.

The taxpayer cannot currently be under audit by the IRS or DOL. A taxpayer previously

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Practitioners/Clients Try To Manage Uncertainty Over Tax Reform, Fate Of Expiring Incentives

Tax professionals cautioned that 2011 may end without resolution of outstanding tax issues during a webcast sponsored by the American Institute of Certified Public Accountants (AICPA) on September 23. The uncertainty complicates year-end 2011 and future tax planning, the practitioners said.

Tax proposals

President Obama has proposed new and expanded tax incentives to boost the economy and trim the nation's debt by eliminating or curbing other tax preferences, Mel Schwarz, CPA, JD, partner and director of tax legislative affairs, Grant Thornton, LLP, Washington, D.C., said. On September 12, 2011, President Obama proposed the American Jobs Act, followed by a deficit reduction plan on September 19, 2011.

Some of the President's proposals, such as tax credits to encourage hiring of unemployed military veterans, have bipartisan support, Schwarz said. However, the GOP has previously rejected the administration's proposals to limit the benefit of itemized deductions, certain above the line deductions, and exclusions to 28 percent for higher income taxpayers. Prior attempts to tax carried interest as ordinary income, another one of the President's proposals, have also failed in Congress, Schwarz said.

Extenders

Additionally, a host of temporary but popular tax incentives (known as extenders) are scheduled to expire after 2011. Peter Kravitz, CPA, director of Congressional and Political Affairs, AICPA, predicted that the fate of the extenders will be decided late in the year. While the extenders are popular, some lawmakers are resistant to extending them without corresponding offsets.

Joint committee

Kravitz predicted that Congress' Joint Select Committee on Deficit Reduction may play a role in tax reform. The joint select committee has been charged with reducing the federal deficit by at least $1.5 trillion over 10 years. The joint committee must present legislative language to Congress by November 23 for an up-or-down vote by December 23. No amendments can be offered, Kravitz explained.

Uncertainty

Clients are uncomfortable over all of the uncertainty, Martin M. Shenkman, CPA, Martin M. Shenkman, P.C., Paramus, N.J. cautioned. One concern, especially for higher income clients, is the fate of the federal estate tax, Shenkman noted during the webcast. President Obama has proposed to return the estate tax to its 2009 parameters after 2012.

Practitioners also need to watch for developments with the federal gift tax, Shenkman said. Clients may want to lock in at the current gift tax exemption before any possible changes take effect, he added.

VCSP

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audited by the IRS or DOL may be eligible for the VCSP if the taxpayer has complied with the results of that audit. Exempt organizations are eligible to participate in the VCSP unless they are under a Form 990 series examination.

Form 8952

Taxpayers will use form 8952 to apply to the VCSP. The IRS advised taxpayers to file Form 8952 at least 60 days from the date the taxpayer wants to begin treating its workers or class of workers as employees.

The IRS will review Form 8952 and verify the taxpayer's eligibility. If the taxpayer is accepted into the VCSP, the IRS will contact the taxpayer to enter into a closing agreement. The IRS will notify taxpayers if their VCSP application is rejected.

Audit protection and more

In exchange for agreeing to prospectively treat workers as employees for future tax periods, taxpayers:

- Will pay a percentage of the employment tax liability that may have been due on compensation paid to the workers for the most recent tax year, determined under the reduced rates of Code Sec. 3509(a).
- Will not be liable for any interest and penalties on the amount; and
- Will not be subject to an employment tax audit with respect to the worker classification of the workers being reclassified under the VCSP for prior years.

Limitations period

For the first three years under the program, taxpayers are subject to a special six-year statute of limitations, rather than the usual three years that generally applies to payroll taxes. A taxpayer may refuse to extend the limitations period or to limit the extension to particular issues. However, the IRS will not execute the closing agreement in these cases.

■ ***Comment.*** The distinction between employee and independent contractor have new importance if Congress enacts President Obama's proposed American Jobs Act, which would reduce the employee and employer-share of OASDI taxes for 2012. *For details, see the CCH Tax Briefing: American Jobs Act on CCH's IntelliConnect and the CCH Tax Research Network.*

References: ¶¶46,486, 46,487; TRC PAYROLL: 3,050.

Reference Key

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

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IRS Reminds Preparers Of PTIN Renewals; Issues Guidance On Testing, Suitability Checks And Continuing Education

◆ *IR-2011-96, Notice 2011-80, NPRM REG-116284-11*

Preparer tax identification numbers (PTINs) must be renewed on a calendar-year basis, the IRS has reminded tax professionals. The IRS also issued more guidance on competency testing, fingerprinting and suitability checks, and continuing education requirements for registered tax return preparers.

■ ***CCH Take Away.*** The IRS previously described some of the areas to be tested on the registered tax return preparer examination *(see the September 15, 2011 issue of this newsletter for details).* The IRS is expected to post additional materials, including a candidate information bulletin and what to expect on testing day on its website.

PTINs

A PTIN must be obtained by all tax return preparers who are compensated for preparing, or assisting in the preparation of, all or substantially all of any U.S. federal tax return, claim for refund, or other tax form, subject to certain exceptions. The IRS launched an online PTIN system in 2010. PTIN renewals for 2012 are expected to begin in October 2011, the IRS predicted on its website.

Additionally, the IRS has been issuing provisional PTINs to preparers who are expected to take the registered tax return preparer examination. The IRS anticipates that competency testing will begin in the fall of 2011. To give individuals time to prepare for the examination, and not to disrupt the 2012 filing season, the IRS intends to continue issuing provisional PTINs until at least April 18, 2012. Provisional PTIN holders must take the registered tax return preparer examination before December 31, 2013.

Preparer examination

The IRS intends to charge a user fee of $27 to take the registered tax return preparer examination. The amount represents the government's costs for overseeing the examination and does not include any fees charged by the testing administrator. The user fee must be paid each time the individual takes the examination. The total fee may reach between $100 and $125, the IRS advised.

Suitability checks

The IRS is not currently conducting fingerprint checks as part of the PTIN application process. However, certain applicants may be fingerprinted in the future as part of suitability checks, the IRS reported. The IRS intends to charge a user fee of $33 to be fingerprinted. The amount represents the government's cost for processing the fingerprints and does not include any fees charged by the vendor. The total fee is projected to range from $60 to $90 for fingerprinting.

■ ***Comment.*** Individuals who have already been fingerprinted as part of the PTIN, acceptance agent or authorized e-file provider programs will not need to be re-fingerprinted, the IRS advised. A PTIN holder, acceptance agent or authorized e-file provider residing and employed outside of the U.S. will not need to be fingerprinted.

The IRS is not requiring attorneys, certified public accountants, enrolled agents, enrolled retirement plan agents, and enrolled actuaries to be fingerprinted at this time. However, these practitioners must answer all of the suitability questions asked on the PTIN application.

Continuing education

Registered tax return preparers must satisfy continuing education requirements on a calendar-year basis. The 15-hour continuing education requirement for registered tax return preparers will begin in 2012. Provisional PTIN holders, because they intend to become registered tax return preparers, are subject to the same continuing education requirements, the IRS explained.

■ ***Comment.*** Continuing education requirements for individuals who initially become a registered tax return preparer after January 31st will be prorated for the initial registration year.

References: FED ¶¶46,489, 46,490; TRC IRS: 3,204.

IRS Requires Church Plans To Give Notice To Participants In Connection With Letter Ruling Requests

◆ *Rev. Proc. 2011-44*

The IRS is now requiring church organizations that apply for a letter ruling, regarding the status of the church's retirement plan under Code Sec. 414(e), to give notice to plan participants and other interested persons. Interested persons receiving notice will then have an opportunity to comment on the ruling request to the IRS within 60 days.

■ ***CCH Take Away.*** Church plans described in Code Sec. 414(e) are not subject to major ERISA requirements, such as funding, participation and vesting. Instead, they are subject to pre-ERISA requirements. The IRS's new notice requirement applies to plans that do not make the election and therefore are not covered by ERISA. The IRS considered the lack of ERISA protections to be important and deserving of comment by affected persons.

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IRS FAQs Describe Tax Treatment Of Registered Domestic Partners In Community Property States

◆ *www.irs.gov*

The IRS has posted frequently asked questions (FAQs) on its web site outlining the tax treatment of registered domestic partners in community property states. The FAQs discuss filing status, tax credits and more.

■ ***CCH Take Away.*** On September 19, 2011, 74 members of the House, Democrats and Republicans, asked the IRS to take administrative action to ease the filing process and reduce unnecessary burdens for registered domestic partners. The lawmakers noted that registered domestic partners in community property states face additional complexities. The IRS addressed some of these issues in the online FAQs.

Background

In 2010, the IRS issued CCA 2010021050. The IRS observed that by 2007, California had extended full community property treatment to registered domestic partners. Applying the principle that federal law respects state law property characterizations, the IRS determined that the federal tax treatment of community property should apply to California registered domestic partners. Consequently, for tax years beginning after December 31, 2006, California registered domestic partners must report one-half of community income, whether received in the form of compensation for personal services or income from property, on his or her federal income tax return.

The IRS explained in the FAQs that registered domestic partners must each report half of the combined community property earned by the partners. A partner who has income that is not community property must report that separate income.

Filing status

The IRS reiterated in the FAQs that registered domestic partners and same-sex couples married under state law cannot file their federal income tax returns using a married filing jointly (or separately) status. Registered domestic partners and married same-sex couples, the IRS explained, are not spouses as defined by federal law.

■ ***Comment.*** The *Defense of Marriage Act,* enacted in 1996, defines spouse as a person of the opposite sex for federal purposes.

Because registered domestic partners are not spouses under federal law, one partner may itemize deductions if the other partner claims a standard deduction. Other provisions in the Tax Code that may apply to spouses, such as the passive loss rules for rental real estate activities, do not apply to registered domestic partners because they are not married under federal law, the IRS observed.

Schedule C

Schedule C income that is community property should be reported by registered domestic partners, the IRS explained. Half of the income, deductions and net earnings of a business operated by a registered domestic partner must be reported by each domestic partner on Schedule C (or Schedule C-EZ). Each registered domestic partner would owe self-employment tax on half of the net earnings of the business, the IRS added.

■ ***Comment.*** The IRS noted that employment tax rules prohibit spouses from treating net earnings as community property. Registered domestic partners, however, are not spouses under federal law.

Various credits

Community property laws are not taken into account in determining earned income for purposes of the dependent care credit, the earned income credit, the Making Work Pay credit, and the refundable portion of the child tax credit, the IRS explained. However, community property laws are taken into account in determining adjusted gross income (or modified adjusted gross income) for these credits.

Reference: TRC INDIV: 24,162.

Church Plans

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Church plans

A church plan is a plan established and maintained by a church for its employees or their beneficiaries. The plan could also be established by a convention or association of churches. The plan can include employees of tax-exempt organizations under Code Sec. 501(a) that are associated with the church, convention or association.

The church is subject to the requirements that pre-date the enactment of ERISA. It can also be subject to state law requirements. A church plan does not have to obtain a ruling as to its status, although other agencies may require an IRS ruling. However, it can choose to request an IRS letter ruling that it is exempt under Code Sec. 501(a), even though it is not qualified under ERISA and Code Sec. 401(a).

Notice

The IRS decided that “interested persons” in a non-ERISA church plan should be given notice and an opportunity to comment if the plan requests an IRS ruling that it is exempt. An interested person is a plan participant, beneficiary, or alternative payee, and an employee organization representing plan participants. If the plan covers more than one employer, other contributing employers are also interested persons.

■ ***Comment.*** The IRS did not provide any other guidance on what issues are relevant.

Effective date

Rev. Proc. 2011-44 supplements the IRS’s basic letter ruling procedures for retirement plans in Rev. Proc. 2011-4. The notice requirement is effective for all ruling requests received after September 26, 2011 and for ruling requests pending with the IRS as of September 26, 2011.

References: FED ¶46,488;
TRC IRS: 12,230.10.

IRS Memo Addresses Use Of Schedule UTP For Audits Of CAP Program Taxpayers

◆ *IRS LB&I Memorandum, released September 13, 2011*

Large Business & International (LB&I) Commissioner Heather Maloy has issued guidance to members of IRS Compliance Assurance Process (CAP) teams on how to use Schedule UTP (Uncertain Tax Positions) when reviewing returns filed by corporations in the CAP Program. The guidance is an early indication of how the IRS will use the information provided in Schedule UTP.

■ ***CCH Take Away.*** Large corporations under the jurisdiction of LB&I must file Schedule UTP with their 2010 returns, disclosing their uncertain tax positions. The requirement applies to corporations that issue an audited financial statement in which they recorded reserves for uncertain tax positions taken on their federal income tax return. In a previous memo, LB&I announced that it would collect and hold all returns with Schedule UTP until it developed procedures for using Schedule UTP in the audit process. The new memo indicates that the IRS will release the return and Schedule UTP to IRS CAP teams.

■ ***Comment.*** Corporations in the CAP program agree to disclose tax issues to the IRS before they file their income tax return, and to work with the IRS to resolve the issues before an audit.

Centralized handling

In a May 11, 2011 memorandum to LB&I employees, Maloy said that the division is preparing to integrate Schedule UTP into its examination process, in particular to screen and assess the value of the information and to use the information to guide selection and examination of issues. However, until guidance is developed, LB&I decided it would centrally collect and hold all 2010 returns with UTP schedules. Examination teams were not to question taxpayers about the Schedule UTP. The memo stressed that it is imperative that use of the UTP information be consistent with the expectations and framework set forth by the IRS.

Release to CAP teams

Now, LB&I has begun to issue guidance on how its employees should use Schedule UTP. The initial guidance applies only to 2010 returns for CAP taxpayers that were in CAP in 2010.

LB&I directed that 2010 tax returns that include a Schedule UTP will be released to CAP teams shortly after filing. The team should follow existing CAP guidance for reviewing the return. Teams should also compare the issues listed on Schedule UTP to the list of taxpayer disclosures made during the CAP year.

Comparing disclosures

Teams are instructed how to proceed in various circumstances:

- The taxpayer files a Schedule UTP but does not disclose any issues;
- Schedule UTP describes an issue that was disclosed to the team and is unagreed or under examination;
- Schedule UTP describes an issue that was disclosed, and the team decided not to pursue it;
- Schedule UTP describes an issue that was not disclosed during the CAP year;
- The taxpayer disclosed an issue to the team but failed to file a Schedule UTP;
- The taxpayer filed Schedule UTP but was expected to disclose additional items in light of the reserves on its financial statements; and
- The financial statements reflect an increase in reserves but the taxpayer did not file a Schedule UTP.

In the last two circumstances, Maloy instructed teams not to ask the taxpayer about the makeup of the reserves and to merely confirm the taxpayer's treatment of Schedule UTP. In some situations, the team should consult with the Director, Field Operations to determine what action to take. In other situations, the team should again confirm the taxpayer's reporting or request that the taxpayer file a new or revised Schedule UTP, Maloy explained.

LB&I is developing a process for CAP teams to provide feedback about their use of Schedule UTP, but has not finalized the process. Teams with questions or comments were directed to consult the CAP Technical Advisor.

Reference: TRC IRS: 18,106.

IRS Amends Final Code Sec. 6050W Regs For Certain Insurance Companies

The IRS has announced its intention to amend final regs under Code Sec. 6050W addressing merchant payment card reporting. The amendments impact certain insurance companies.

Background. Code Section 6050W generally requires information reporting on payment card transactions. A payment settlement entity must report payments made to merchants for goods and services in settlement of payment card and third-party payment network transactions. The IRS issued final Code Sec. 6050W regs in 2010.

Final regs. The final regs provide that a healthcare network generally is outside the scope of section 6050W because a healthcare network does not enable the transfer of funds from buyers to sellers. The IRS reported that questions arose about application of the regs to certain insurance arrangements.

IRS amendment. In response, the IRS has decided to amend the final regs to provide that an insurance company or an affiliate administering a self-insured arrangement on behalf of an employer or other entity on a cost-plus basis, or under an Administrative Services Only (ASO) plan or an Administrative Services Contract (ASC) plan, will not be treated as a third party settlement organization.

Notice 2011-78, FED ¶46,491; TRC FILEBUS: 9,320.

District Court Knocks Out S Corp Tax Shelter Based On Presence Of Second Class Of Stock

◆ *Santa Clara Valley Housing Group, Inc., DC-Calif., September 21, 2011*

A federal district court has found that a tax shelter known as the S Corporation Charitable Contribution strategy (SC2) violated the requirements for an S corp by creating a second class of stock, and should be treated as a C corp. As a result, the corporation's income was taxable at the corporate level and could not be passed-through to a tax-exempt organization.

■ ***CCH Take Away.*** Although the transaction was an abusive tax shelter, the court analyzed the S corp regs to determine that the S corp's status terminated (and it was a taxable C corp), rather than using tax shelter doctrines, such as sham or lack of economic substance.

Background

The taxpayers set up an S corp with 100 voting shares and 900 nonvoting shares. The taxpayers "donated" the nonvoting shares to a pension fund, a tax-exempt entity. Shareholders, all related, were issued warrants to purchase 10 shares of nonvoting stock for each share of nonvoting stock held.

■ ***Comment.*** The warrants were issued to protect the taxpayers' equity interests in the S corp while they engaged in the SC2 strategy, in case the charitable donee refused to sell the shares back.

Over four years, the S corp earned $114 million in ordinary income, most of it allocated to the 90 percent interest held by the pension fund, which paid no taxes on the income. The S corp distributed $200,000 to the pension fund, less than 2 / 10 of one percent of the income allocated. After four years, the pension fund sold the nonvoting shares back to the taxpayers for $1.6 million, approximately 1.5 percent of the income.

■ ***Comment.*** The theory of the tax shelter was that the S corp could then distribute the accumulated income to the original shareholders either tax-free or as long-term capital gains under the S corp rules.

IRS theories

The IRS challenged the transaction based on two theories. It contended the transaction lacked substance and that the S corp's income should be allocated to the taxpayers, not the pension fund. Alternatively, the IRS contended that the warrants should be treated as a second class of stock, that the corporation's S corp status terminated, and that the corporation was taxable as a C corp on the $114 million of income. Both parties filed for partial summary judgment on the second theory.

Court's analysis

The court granted partial summary judgment to the IRS. It held that the warrants were a second class of stock and that the corporation's S corp status terminated.

Under Reg. §1.1361-1(*l*)(4), the court noted, an instrument or obligations is treated as a second class of stock if (1) the instrument is equity or results in the holder being treated as the owner of stock under general tax principles, and (2) a principal purpose of issuing the instrument is to circumvent the distribution rights of the outstanding stock. The court concluded that the warrants were issued to protect the taxpayers' equity interests by allowing them to retain ownership of 90 percent of the stock, even though 90 percent of the shares had been transferred to the pension fund.

References: (to be reported); TRC BUSEXP: 54,230.

Chief Counsel Determines Tax Court Lacks Jurisdiction To Review Another Year's Tax Liability In CDP Case

◆ *CC-2011-021*

IRS Chief Counsel has determined that the Tax Court does not have jurisdiction, in reviewing a collection due process (CDP) case, to determine the taxpayer's tax liability from a different year. As a general matter, the court cannot review a taxpayer's claim that he or she made an overpayment and that the overpayment should be used to pay the tax owed for the CDP period.

■ ***CCH Take Away.*** IRS Appeals holds a CDP hearing to determine whether the IRS has taken the proper steps to use a lien or levy to collect taxes. Appeals (and the Tax Court on review) would not ordinarily look at the taxpayer's underlying liability, unless the taxpayer had no opportunity to dispute that liability. Chief Counsel was concerned that taxpayers were claiming that a tax liability from another year was "relevant" to the CDP determination and should be adjudicated because funds from the other year could be used to pay the CDP liability.

No jurisdiction

Chief Counsel reiterated that the Tax Court cannot determine an issue of the tax liability from a year that was not before the court (and had not been before the IRS). Chief Counsel also determined that the Tax Court, as a prepayment forum, had no jurisdiction to hear a taxpayer's *refund* claim from another year, even if the taxpayer argued that the refund could be used to pay the tax owed for the CDP year.

However, Chief Counsel stated that the availability of an overpayment from a non-CDP

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Internal Revenue Service

An individual could not contest the amount of income or expenses to which he stipulated with the IRS, and so could not claim deductions to which the IRS had not agreed. Further, he was liable for self-employment tax based on the increase in his income arising from the stipulation. Finally, the taxpayer was subject to an accuracy-related penalty because he did not act reasonably or in good faith and his entire underpayment was attributable to negligence.

Williams, TC, CCH Dec. 58,763(M), FED ¶48,183(M); TRC LITIG: 6,612.05.

In related cases, petitions filed by partners other than the tax matters partner for readjustment of final partnership administrative adjustments (FPAAs) were not timely filed. The assertion that the original FPAAs were not delivered to or received by the tax matters partner was not determinative, as the validity of a properly mailed FPAA is not contingent on actual receipt by the tax matters partner.

Han Kook LLC I-I, TC, CCH Dec. 58,758(M), FED ¶48,178(M); Han Kook LLC I-D, TC, CCH Dec. 58,759(M), FED ¶48,179(M); TRC PART: 60,550.

Jurisdiction

An individual's untimely refund claim was dismissed for lack of subject matter jurisdiction. The claim was barred by the limitations period in Code Sec. 6511(a) since he filed it more than three years after filing his return and more than two years after paying his taxes.

McGuigan, DC N.Y., 2011-2 USTC ¶50,635; TRC LITIG: 9,056.

Two individuals' amended complaint seeking to set aside a jeopardy assessment and levy, to recover the levied amount and to obtain damages was properly dismissed for failure to state a claim and for lack of subject matter jurisdiction. They failed to exhaust their administrative remedies prior to filing suit.

Galvez, CA-11, 2011-2 USTC ¶50,634; TRC IRS: 45,114.

An individual's refund suit was dismissed for lack of subject matter jurisdiction because she did not file her suit within two years from the mailing date of the IRS's disallowance notice. The individual failed to rebut the IRS's evidence that established that she was provided with notice of disallowance.

Breland, DC N.Y., 2011-2 USTC ¶50,632; TRC LITIG: 9,058.05.

Summons

IRS summonses issued to two banks during an IRS investigation of an individual's claimed residence in the U.S. Virgin Islands (USVI) were enforced. The summonses were issued for the legitimate purpose of determining whether he was a *bona fide* resident of the USVI, reported all income on his USVI returns, used controlled entities to conceal or transfer funds or distribute U.S. income to him and the information sought was relevant to determining those issues.

Day, DC Colo., 2011-2 USTC ¶50,636; TRC IRS: 21,300.

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IRS Extends Livestock Replacement Period For Drought-Affected Localities

New guidance has been released on the extension of the replacement period under Code Sec. 1033(e) for livestock sold on account of drought in specified localities in the U.S.

Drought. If livestock, other than poultry, are held by the taxpayer for draft, breeding or dairy purposes, any sale or exchange solely because of drought, flood or other weather-related conditions is an involuntary conversion to the extent it exceeds sales or exchanges that would have occurred under the taxpayer's normal business practices. For tax years with respect to which the due date for returns, without extensions, is after December 31, 2002, the replacement period is four years in areas designated as eligible for assistance by the federal government. The IRS may further extend this replacement period on a regional basis.

Localities. In Notice 2011-79, IRS has updated a list of counties in the U.S. for purposes of the extended livestock replacement period. The affected counties are located in Alabama, Arizona, Arkansas, California, Colorado, Delaware, Florida, Georgia, Hawaii, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana (parishes), Maryland, Minnesota, Mississippi, Missouri, Nebraska, New Jersey, New Mexico, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, Tennessee, Texas, Virginia (counties and independent cities), and West Virginia.

Notice 2011-79, FED ¶46,485; TRC FARM: 3,206.10.

IRS Adds To/Updates Disaster Relief Designations/Extensions

The IRS has updated its designations of regions where tax relief is available in the form of filing and/or payment extensions, accelerated casualty loss deductions, or other special consideration:

Tropical Storm Lee. The IRS has expanded designations/updates for Tropical Storm Lee victims to include the counties of Chemung and Schenectady in New York.

Texas wildfires. The IRS has expanded designations/updates for wildfire victims to include the counties of Cass, Gregg, Grimes, Marion, Montgomery, Walker, and Waller in Texas.

FED ¶¶46,472, 46,479; TRC FILEIND: 15,204.25.

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Income

A partnership's claim to Code Sec. 988 ordinary losses stemming from the receipt of Swiss francs was disallowed because the partnership failed to establish the partnership's basis in the francs and the transaction underlying the partnership's receipt of the francs lacked economic substance. The partnership omitted income for one of the tax years at issue and the period of limitations with respect to that year had not expired. Also, the partnership's income for two of the tax years at issue was self-employment income. Further, the partnership was not allowed to deduct certain other expenses. Finally, the partnership was liable for the 40-percent accuracy-related penalty for gross valuation misstatement and the 20-percent accuracy-related penalty for negligence, substantial understatement of tax or substantial valuation misstatement.

Rovakat, LLC, TC, CCH Dec. 58,761(M), FED ¶48,181(M); TRC FILEBUS: 3,052.25.

Deductions

An individual who had no principal place of work because his work was always temporary had a business justification for treating his personal residence as his tax home, and his residence was so treated for purposes of deducting expenses incurred while away from home. He substantiated payment of some expenses and was allowed those deductions, but he offered little substantiation for the other claimed deductions, which were denied. An accuracy-related penalty was imposed.

Lyseng, TC, CCH Dec. 58,762(M), FED ¶48,182(M); TRC INDIV: 36,050.

An individual who claimed losses for a business in which he offered high-performance glider flight instruction and glider plane rides engaged in the activities with an intent to make a profit. The individual held himself out as a glider instructor and actively promoted his business through a web site to secure clients. Unreimbursed employee expenses were not deductible. Penalties were applied.

Weller, TC, CCH Dec. 58,760(M), FED ¶48,180(M); TRC INDIV: 36,056.

Liens and Levies

Federal tax liens had priority over an attorney's excess fees because they were not attributable to procuring a settlement for a tax-debtor corporation. The attorney's one-third contingency fee for procuring the settlement was afforded super-priority status under Code Sec. 6323(b)(8). However, the additional fees he claimed were not entitled to priority status because his security interest was not perfected when the tax lien was filed.

W.T. Mechanical, Inc., DC Ill., 2011-2 USTC ¶50,631; TRC IRS: 48,150.

Collection Due Process

An individual's petition for review of a Collection Due Process (CDP) determination to proceed with a levy was properly dismissed for failure to state a claim upon which relief could be granted. The individual was precluded from challenging her underlying tax liability and her vaguely worded claims of arbitrary persecution and bias during the administrative process were not supported by the record.

Gossage, CA-11, 2011-2 USTC ¶50,629; TRC IRS: 48,058.15.

Deficiencies and Penalties

A corporation's founder/director was not entitled to a refund of the trust fund recovery penalty the IRS levied from his retirement account. He was a responsible person who willfully failed to pay the company's taxes because he knew that the taxes were not being paid and paid other creditors with the company's unencumbered funds, including himself.

Jenkins, FedCl, 2011-2 USTC ¶50,630; TRC PAYROLL: 6,306.05.

Bankruptcy

A debtor's objection to an IRS's proof of claim that arose from the IRS's disallowance of an earned income credit for the tax year at issue was rejected. The IRS established its *prima facie* case for its claim by providing an account transcript, and the debtor failed to rebut the IRS's *prima facie* case.

In re Krause, BC-DC Tenn., 2011-2 USTC ¶50,633.

CDP

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period as a source of payment may be raised as a relevant issue before the IRS or the Tax Court when the IRS has already agreed that the taxpayer is entitled to the overpayment. The Appeals Officer (AO) may verify that an overpayment exists and determine whether the overpayment may be credited against the CDP period liability, under the statute of limitations. The Tax Court then has jurisdiction to review the AO's determination under an abuse of discretion standard, Chief Counsel explained.

Reference: TRC IRS: 51,056.25.

Practitioners’ Corner: Early Year-End Tax Planning Worth A Look

As the third quarter of 2011 comes to a close, it’s not too early to think about year-end tax planning. Both individuals and businesses can take actions to reduce their taxes. As always, any action must make economic sense as well as fulfill tax planning requirements.

This year is different from 2010 in some respects. At this time last year, it appeared that individual tax rates might increase in 2011 because of the timetable then in place for the sunset of the Bush-era tax cuts. The long-term tax situation remains in flux after 2012, but thanks to the *Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (2010 Tax Relief Act)*, there is some certainty for the next 15 months. The picture after 2012 is unclear, with President Obama proposing to let tax rates increase for the two highest income groups, and the Republicans continuing to oppose the administration.

The Bush-era tax cuts remain in effect through the end of 2012, so there is no difference in the rates that generally apply in 2011 and 2012. Thus, there is no advantage (other than the time value of money or keeping within a constant tax bracket) to moving income and deductions between 2011 and 2012. Individual tax rates are not scheduled to rise until 2013, if at all. The 15 percent maximum rate for net long-term capital gains and qualified dividend income also will not rise until 2013. However, there is always last-minute year-end planning that involves shifting income to a later year, by accelerating deductions and deferring income.

Individuals

Certain individual extenders are slated to expire after 2011, with no guarantee at this time that they will be extended by Congress into 2012. The above-the-line tuition and fees deduction for higher education, which can be as high as $4,000 and is a significant benefit, is one example of a tax break that may not return in 2012. Another important benefit scheduled to expire after 2011 is the deduction for mortgage insurance premiums. This allows taxpayers to deduct certain premiums paid for qualified mortgage insurance, subject to phase-out based on the taxpayer’s income.

“Both individuals and businesses can take actions to reduce their taxes.”

The following benefits are also among those scheduled to expire after 2011 (not an exhaustive list):

- The state and local sales tax itemized deduction in lieu of the state income tax deduction;
- The teacher’s $250 classroom expense above-the-line deduction;
- The exclusion from income of distributions of up to $100,000 from an IRA if made directly to charity;
- Parity of transit benefits;
- The nonbusiness energy credit for qualified energy efficiency improvements and residential energy property expenditures, which used to be $1,500 but is $500 for 2011;
- Higher limits for charitable contributions of appreciated property for conservation purposes. The donor can deduct up to 50 percent of adjusted gross income, rather than the 20-percent or 30-percent limits that normally apply to donations of appreciated capital gain property.

AMT

The alternative minimum tax (AMT) has been patched through 2011; that is, the exemption has been increased and other relief provided. Generally, the patch (the increase) is extended from year to year, but it is possible that Congress will not adopt a patch for 2012 and let the exemption sink to prior levels (or perhaps to one less generous to every tax expense as one eye is now cast toward the deficit). For 2011, the exemption amounts are $48,450 for individual taxpayers; $74,450 for married taxpayers filing jointly and surviving spouses; and $36,225 for married couples filing separately. Without the patch, the exemption amounts would drop, respectively, to $33,750, $45,000, and $22,500. No one likes the AMT, but so far the loss of revenue from abolishing the tax is considered too difficult to replace. Eliminating the AMT remains a target of comprehensive individual tax reform.

- ***Comment.*** Dealing with the AMT may take additional planning, but it could make sense as the year-end gets closer to realize AMT income in 2011 (such as capital gain income), when the patch is higher.

IRAs

Contributions to an individual retirement account (IRA) are an important above-the-line deduction that reduces adjusted gross income. Individuals can also reduce their taxable wages by mak-

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Washington Report

by the CCH Washington News Bureau

Obama continues push for jobs act

President Obama continued his push for Congress to pass his proposed tax incentives and revenue raisers on a swing through western states. Speaking in Washington state on September 25, President Obama said the tax cuts and revenue raisers in the proposed bill, along with tax and offset provisions in his deficit reduction plan, would trim the federal budget deficit and encourage job creation. "The reform we are proposing is based on a simple principle: Middle-class folks should not pay higher tax rates than millionaires and billionaires. Warren Buffett's secretary should not pay a higher tax rate than Warren Buffett," the president said.

Previously, House Speaker John Boehner, R-Ohio, told reporters that concerns have been noted by members of both political parties in Congress about the payroll tax break proposed by President Obama. "There is a real question as to what it means to the entitlement programs that those payroll taxes support," Boehner said. He added that lawmakers also question "the real economic impact of payroll tax deductions and credits and whether it really does, in fact, help the economy." President Obama has proposed to reduce the employee-share of OASDI taxes to 3.1 percent for calendar year 2011 and provide payroll tax cuts to employers.

Senate approves trade bill with enhanced HCTC

The Senate on September 22 approved the *Trade Adjustment Assistance Extension Bill (HR 2832),* which contains an expanded health care tax credit (HCTC) for workers who have lost their employer-provided coverage due to a trade-related layoff. The proposed HCTC would subsidize 72.5 percent of the cost of health care premium assistance, which provides qualified displaced workers with retroactive payments to help cover the up-front costs of obtaining health insurance coverage and provides coverage for the worker's spouse and dependents. The HCTC is currently 65 percent.

JCT chief testifies about business tax reform

The top tax analyst in Congress recently told lawmakers that Congress should consider targeting tax reform legislation at business income, rather than type of entity. Joint Committee on Taxation (JCT) Chief of Staff Thomas Barthold testified before the Joint Select Committee on Deficit Reduction on September 22. Barthold said that taxing businesses based on whether they are organized as a C corporation or a pass-through entity would simply cause taxpayers to restrict their entity choice to achieve the lowest tax rate. Barthold released a chart of the most costly business tax expenditures.

SFC leaders endorse permanent research tax credit

Senate Finance Committee Chair Max Baucus, D-Mont., and ranking member Orrin Hatch, R-Utah, said on September 20 that Congress should make permanent the research tax credit. The lawmakers called it a necessary incentive for U.S. industry to remain competitive in the global marketplace. The *Greater Research Opportunities With Tax Help Bill of 2011 (GROWTH Act) (Sen 1577)* would simplify and update the research credit by raising the value of the alternative simplified credit from 14 percent to 20 percent of average qualifying research expenses and allowing the traditional credit to expire at the end of 2011. "Development and innovation here at home boosts our economy and creates jobs. Making the research and development tax credit permanent will provide certainty and help spur economic growth for generations to come," Baucus said.

IRS releases draft 2011 Form 940

The IRS has released a draft version of Form 940, Employer's Annual Federal Unemployment Tax (FUTA) Return for 2011. FUTA authorizes the IRS to collect a federal employer tax to fund state workforce agencies. In 1976, Congress enacted a 0.2 percent FUTA surtax on top of the regular 6.0 percent FUTA tax rate. The most recent extension of the FUTA surtax expired after June 30, 2011.

Employers pay FUTA tax annually by filing Form 940. The 2011 Form 940, the IRS explained, reflects the 6.2 percent FUTA rate for the first six-month period of 2011 and the 6.0 percent FUTA tax rate for the second half of 2011.

Employers that timely pay state unemployment tax receive an offset credit of up to 5.4 percent. However, the offset credit is reduced in states which have unpaid loans from the federal government to pay unemployment benefits. As of September 22, 2011, 27 states and the U.S. Virgin Islands have borrowed federal monies to pay unemployment benefits. States that do not make repayments by November 2, 2011 risk a reduction in their offset credit.

IRS customer services lags, TIGTA reports

The Treasury Inspector General for Tax Administration (TIGTA) recently reported that call demand and limited resources continue to keep the level of service below 80 percent for toll-free telephone calls from taxpayers to the IRS. TIGTA reported that the IRS received approximately 80-million attempts to call the IRS toll-free telephone lines. Approximately 75 percent of taxpayers who wanted to speak to an IRS customer service representative were able to do so, TIGTA found. In addition, TIGTA reviewed the IRS's real-time message system that informs taxpayers of the expected wait time to reach an IRS customer service representative. TIGTA found that the IRS's message system was accurate in estimating the wait time for a customer service representative.

Practitioners' Corner

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ing a salary-reduction contribution to an employer-sponsored retirement plan such as a 401(k) plan. The IRA contribution limits are $5,000 for individuals under 50 and $6,000 for individuals older than 50, who can make catch-up contributions. It is better to make a contribution each year if possible. For some taxpayers, the contribution is fully deductible; for other taxpayers (such as those in another retirement plan), the deduction is reduced or disallowed.

Converting an IRA to a Roth IRA was more important for 2010 because the income realized from the conversion in 2010 could be split between 2011 and 2012. This is not the case for a 2011 conversion; all income must be recognized in the year of the conversion. Nevertheless, it is important to consider whether to convert a traditional IRA to a Roth IRA, since distributions from a Roth IRA are nontaxable. Furthermore, those who converted in 2010 and elected not to recognize the income on their 2010 returns must remember to include half of that conversion income into estimates of 2011 income for tax planning purposes.

Businesses

Some important business tax benefits are slated to expire (or drop in value) after 2011. For businesses, the two most important benefits are 100 percent bonus depreciation and Code Sec. 179 expensing, whose threshold and limits keep changing from year to year.

Bonus depreciation

One hundred percent bonus depreciation is scheduled to drop to 50 percent for 2012 and terminate after 2012. (These deadlines are extended one year for property with a longer production period and certain transportation property.) The status of bonus depreciation is uncertain; in the American Jobs Act, President Obama has proposed to extend 100 percent bonus depreciation through 2012. However, while this proposal would normally get broad support, the president has proposed to pay for the extension with other tax increases, which the Republicans are likely to oppose.

To qualify for bonus depreciation, property must satisfy place-in-service date and acquisition date requirements. An asset is placed in service when it is (i) in a condition or state of readiness on a regular, ongoing basis (ii) for a specifically assigned function (iii) in a trade or business.

The acquisition date rules are different for the 100 percent and 50 percent rates. For 100 percent bonus depreciation (the 2011 rate), property is acquired when the taxpayer pays or incurs its cost. For an accrual-basis taxpayer, this occurs when property is provided. "Provided" is usually defined as the delivery of the property, but it could be when title passes. For 50 percent property (the 2012 rate), property is acquired when the taxpayer takes physical possession on control of the property.

Code Sec. 179 expensing

Code Sec. 179 expensing is another valuable benefit. Expensing is capped at a high level of $500,000 for 2011, dropping to $125,000 for 2012 and to $25,000 for years after 2012 (adjusted for inflation). For 2012, that limit is projected to be $139,000. The cap is reduced for qualifying property purchases that exceed $2 million for 2012, dropping to $500,000 for 2012 (inflation-adjusted to $560,000) and $200,000 for years after 2012. Both of the 2011 figures are the highest ever for this benefit.

Under the *Small Business Jobs Act of 2010,* a taxpayer can elect to expense up to $250,000 (of the $500,000 deduction limit) for qualified real property, for 2011. This category includes qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property. The *2010 Tax Relief Act* did not extend this treatment into 2012; however, it did extend the treatment of off-the-shelf computer software as qualifying property if placed in service in 2011 or 2012.

For businesses considering an investment in depreciable property, the payoff is definitely greater for a 2011 investment. Taxpayers taking advantage of expensing should apply it to assets that would otherwise have the longest recovery periods. Remember, also that while bonus depreciation applies only to new property, Code Sec. 179 property can be either new or used.

Other 2011 benefits

Other important benefits are scheduled to expire or decrease after 2011. A major benefit to many businesses, also in 2011, is the 20 percent research tax credit. This credit has been extended from year to year, although Congress sometimes renews the credit late in the new year and makes it retroactive, adding further uncertainty to tax planning. The credit has never been permanent, but President Obama has now proposed that it be permanent.

Another significant benefit is the 100 percent exclusion for small business stock, which applies to stock acquired through 2011. The normal exclusion is 50 percent, although Congress has also adopted a 75 percent rate in recent years. The stock must be acquired in 2011, be held for at least five years, and satisfy other requirements to benefit from the 100 percent exclusion when eventually sold.

Special charitable deduction provisions for contributions of food, books, and computer equipment to schools also apply through 2011 only. Several business extenders are also scheduled to terminate at the end of 2011. These include the work opportunity tax credit (WOTC), brownfields remediation, the Indian employment credit, and the 15-year recovery period for certain qualified improvements to realty.

Conclusion

Year-end tax planning has become more complex, with many significant provisions scheduled to expire at the end of 2011, but with no firm signal from Washington yet on which of them may be extended at the eleventh hour. Taxpayers with drops in income also must consider whether they can take advantage of the available tax benefits or use particular strategies like carryovers of net operating losses or carryforwards of unused capital losses from past years. With all these variables, it is worthwhile to start planning before the end of the year.

Compliance Calendar

■ **September 30**
Employers deposit Social Security, Medicare, and withheld income tax for September 24, 25, 26, and 27.

■ **October 5**
Employers deposit Social Security, Medicare, and withheld income tax for September 28, 29, and 30.

■ **October 7**
Employers deposit Social Security, Medicare, and withheld income tax for October 1, 2, 3, and 4.

■ **October 11**
Employees who received $20 or more in tips during October report them to their employers.

■ **October 13**
Employers deposit Social Security, Medicare, and withheld income tax for October 5, 6, and 7.

■ **October 14**
Employers deposit Social Security, Medicare, and withheld income tax for October 8, 9, 10, and 11.

TRC Text Reference Table

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.

ACCTNG 36,162.05	442	INDIV 24,162	452	IRS 57,158	432
BUSEXP 6,104.30	440	INDIV 36,056	456	IRS 57,900	432
BUSEXP 9,060	428	INDIV 57,454.10	419	IRS 63,060	431
BUSEXP 33,106	432	INTL 3,400	431	IRS 66,058.15	443
BUSEXP 51,708	443	IRS 3,204	452	IRS 66,154	443
BUSEXP 55,850	432	IRS 12,230.10	452	LITIG 6,126	443
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COMPEN 3,050	419	IRS 21,108	443	LITIG 6,130	432
COMPEN 36,250	438	IRS 21,300	431	LITIG 9,056	455
COMPEN 36,300	431	IRS 27,154	419	LITIG 9,058.05	455
COMPEN 45,228	432	IRS 30,308.05	444	LITIG 9,260	443
DEPR 3,604	430	IRS 36,052.05	444	PART 27,058	416
DEPR 15,106	418	IRS 45,114	455	PAYROLL 9,000	425
ESTRST 12,054	427	IRS 45,160	444	PAYROLL 6,306.05	456
ESTRST 39,310	439	IRS 48,058.15	456	PAYROLL 3,050	450
EXCISE: 9,102.05	428	IRS 48,150	456	PAYROLL 6,306.05	444
FILEBUS 9,104	440	IRS 51,056.15	420	REORG 21,056	417
FILEBUS: 9,320	453	IRS 51,056.25	454	SCORP 404.05	430
FILEBUS 9,485	426	IRS 51,158	431	SALES 3,302.35	442
FILEBUS 12,302	431	IRS 57,060	444	SALES 33,064.20	416
FILEIND 15,205.25	444	IRS 57,106.10	420	SALES 45,252	441

Monthly Quizzer

The following questions (with answers at the bottom of the column) will help you review some of the more important developments in CCH Federal Tax Weekly during the past month.

Q The IRS Offshore Voluntary Disclosure Initiative (OVDI) was extended to:

(a) August 3, 2011
(b) September 9, 2011
(c) September 30, 2011
(d) October 17, 2011

Q President Obama signed a bill denying a patent for any strategy for reducing, avoiding, or deferring tax liability. *True or False?*

Q The IRS Fresh Start Initiative applies to:

(a) Taxpayers suffering economic hardship
(b) Worthless stock deductions
(c) The treatment of goodwill
(d) The sale of annuities

Q In his recent deficit reduction plan President Obama proposed instituting the so-called "Buffett" rule *True or False?*

Answers:

Q1. *(b), See Issue #35, page 401.*
Q2. *True, See Issue #37 page 426.*
Q3. *(a), See Issue #36, page 414.*
Q4. *True, See Issue #38, page 437.*