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LB&I Examiners Told To "Stand Down" On Audits Of Capitalization Issues For Pre-2012 Tax Years

◆ *LB&I-4-0312-004*

The IRS's Large Business and International Division (LB&I) has issued a field Directive to its examiners and managers that they should cease conducting examinations of the repair versus capitalization issue for costs related to tangible property. The Directive, which follows the issuance of comprehensive temporary regs in late 2011, applies to both current examinations and new examinations of certain issues for tax years beginning before January 1, 2012.

■ ***CCH Take Away.*** "The transaction guidance and the Directive give taxpayers more flexibility to make the changes required under the regulations," Eric Lucas, principal, KPMG LLP's Washington National Tax Office, told CCH. "The regs are technically effective for tax years beginning in 2012, but LB&I will hold off its examinations for two years."

■ ***Comment.*** On the day that LB&I released the Directive, IRS Special Counsel Scott Dinwiddie told practitioners in Washington, D.C. that the IRS is "standing down from prior-year exam activity." Instead, LB&I is reserving examinations for issues arising under the most recent capitalization regulations, Dinwiddie said.

Background

At the end of 2011, the IRS issued comprehensive temporary regs on the capitalization of costs relating to tangible property (*see the January 5, 2012 issue of this newsletter for details*). The temporary regs are effective for tax years (or costs incurred in tax years) beginning on or after January 1, 2012.

The IRS recently issued two companion revenue procedures (Rev. Procs. 2012-19 and 2012-20) that provide automatic consent for taxpayers to change their accounting method(s) to a method permitted under the capitalization-repair temporary regs (*see the March 15, 2012 issue of this newsletter for details*). The revenue procedures waive certain limitations on obtaining automatic consent for taxpayers that change their accounting method for the first or second tax year beginning on or after January 1, 2012.

■ ***Comment.*** Under Rev. Proc. 2011-14, taxpayers that change their accounting method under the temporary regs beginning in 2012 would get audit protection for years before 2012.

■ ***Comment.*** "Generally, the regs are implemented with a [Code Sec.] 481 adjustment," Lucas said. "The 481 adjustment has the effect of making the regs retroactive."

Scope

The LB&I Directive applies to exam activity of positions taken by taxpayers on original returns for the following issues ("the Issues"):

- Whether costs incurred to maintain, replace or improve tangible property must be capitalized under Code Sec. 263(a); and

Continued on page 2

Route to: ____________ ____________ ____________ ____________ ____________

Senate-Passed Transportation Bill Contains Significant Tax Changes

◆ *Sen. 1813*

The Senate has passed a $109 billion highway bill with almost two dozen tax changes, affecting much more than just transportation. The Moving Ahead for Progress in the 21st Century Act (MAP-21) (Sen. 1813) includes restrictions on reverse Morris Trust transactions, parity for transit benefits, pension funding stabilization, new reporting rules for sales of life insurance policies, a delay in the worldwide allocation of interest method, and more. Despite last-minute negotiations, the Senate bill does not extend a host of expired tax extenders. MAP-21 passed the Senate by a vote of 74 to 22 on March 14.

■ ***CCH Take Away.*** Some of the revenue raising tax provisions in the Senate bill are unrelated to the underlying transportation spending bill, Dustin Stamper, manager, Washington National Tax Office, Grant Thornton, LLP, told CCH. "It is unclear whether these provisions will survive to reach enactment, as House Republicans may object to them," Stamper noted.

Tax evasion

The Patriot Act allows Treasury to take a range of measures against foreign financial institutions that engage in money laundering. The Senate bill would authorize Treasury to impose sanctions on foreign financial institutions if Treasury finds them to be "significantly impeding U.S. tax enforcement."

■ ***Comment.*** Sen. Carl Levin, D-Mich., who wrote the tax evasion language in the bill, explained in a statement, that Treasury could, for example, prohibit U.S. banks from accepting wire transfers or honoring credit cards from foreign banks.

Reverse Morris Trust

Under a Reverse Morris Trust, a parent company spins-off a subsidiary, which merges into an unrelated company tax-free where the shareholders of the parent company control more than 50 percent of the voting rights and economic capital of the resulting merged company. The Senate bill would treat distributions of debt securities to the parent in reorganization transactions involving a spin-off in the same manner as distributions of cash or other property in the reorganization.

■ ***Comment.*** The Senate bill would apply to exchanges after the date of enactment, subject to a transition rule.

Transit benefits

The American Recovery and Reinvestment Act of 2009 and subsequent legislation provided parity in qualified transportation fringe benefits by temporarily increasing the monthly exclusion for employer-provided vanpool and transit pass benefits to the same level as the exclusion for employer-provided parking. Parity expired after 2011. The Senate bill would extend parity in transit benefits through 2012.

Pension funding

Under the Senate bill, plan liabilities would continue to be determined based on corporate bond segment rates. However, beginning in 2012 for purposes of the minimum funding rules, any segment rate must be within 10 percent (30 percent in 2016 and thereafter) of the average of

Continued on page 3

Capitalization

Continued from page 1

- Any correlative issues involving the disposition of structural components of a building or dispositions of other tangible depreciable assets.

■ ***Comment.*** The Directive does not apply to current examinations relating to costs for which the IRS has provided specific guidance (such as for the electric utility industry).

Tax years before January 1, 2012

For tax years beginning before January 1, 2012, the Directive instructs examiners to discontinue current activity with regard to the Issues, and not to begin any new exam activity with regard to the Issues. However, if a taxpayer applies for a change in accounting method (Form 3115) for a tax year not covered by the temporary regs, examiners are instructed to "risk assess" the Form 3115 and determine whether to examine it.

When discontinuing current exams, LB&I will inform taxpayers that the IRS "neither accepts nor rejects the position taken in the tax return." The taxpayer "will be allowed a two-year period to adopt the appropriate method of accounting provided in Rev. Proc. 2012-19 and 2012-20." If the taxpayer has not changed its accounting method in the first or second tax year beginning after December 31, 2011, the IRS may audit the repair expenses for tax years ending on or after January 1, 2012.

Subsequent years

If examining a return for a tax year beginning on or after January 1, 2012 but before January 1, 2014, and the taxpayer applied for a method change, the examiner should perform a risk assessment regarding the method change. If the taxpayer has not applied for a method change, it should be allowed to do so. For tax years beginning on or after January 1, 2014, the Directive instructs examiners to follow normal exam procedures.

Reference: TRC BUSEXP: 9,150.

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 Issues Proposed Regs Requiring Updated Information Where Nominee Applies For Employer Identification Number

◆*NPRM REG-135491-10*

Recently proposed regs would require persons with an employer identification number (EIN) to provide the IRS with updated information. The IRS explained that the goal of the regs is to ascertain correct ownership details for persons with an EIN.

■ ***CCH Take Away.*** "The proposed regs take an important first step to gather updated ownership information for EIN assignments to help facilitate tax compliance (and reduce abuses)," Elizabeth Dold, principal, The Groom Law Group Chartered, Washington, D.C., told CCH. "Importantly, they do not restrict the manner to obtain such information through the existing Form SS-4, which has historically not been viewed as an 'evergreen' form," Dold noted.

Background

EINs identify corporations, partnerships, nonprofit associations, estates of decedents, trusts and other entities, such as investment clubs. An EIN should also be used by a U.S. or foreign individual who is an employer or who is engaged in a trade or business as a sole proprietor. Any person required to furnish an EIN must apply for one with the IRS on a Form SS-4, Application for Employer Identification Number.

The IRS reported that some EIN applicants authorize certain individuals ("nominees") to act on their behalf. The IRS explained that the authority of these nominees to act on behalf of the EIN applicant is often temporary and expires after the application is processed.

Proposed regs

The proposed regs would require any person issued an EIN to provide updated information to the IRS in the manner and frequency required by forms, instructions, or other appropriate guidance, which the agency indicated it will issue in the near future. Along with ownership details, the proposed regs are intended to give the IRS additional information, including updated application information regarding the name and taxpayer ID number of the responsible party. The proposed regs cover persons who previously applied for an EIN by listing a person other than the applicant's responsible party.

■ ***Comment.*** The regs would apply to all taxpayers possessing an EIN after the date the regs are finalized.

References: FED ¶49,525; TRC FILEBUS: 12,106.20.

Senate Bill

Continued from page 2

the segment rates for the 25-year period preceding the current year.

Life insurance reporting

The Senate bill would require information reporting on the sale of an existing life insurance policy. Information reporting would not apply to the initial sale of a life insurance policy by a life insurance company to an individual. Reporting would apply if the policy owner sells the policy to a third party.

Worldwide interest expense allocation

The American Jobs Creation Act of 2004 provided that a worldwide affiliated group could make a onetime election to determine the foreign source taxable income of the group by allocating and apportioning the domestic members' interest expense on a worldwide basis as if all members of the group were a single corporation. Subsequent legislation delayed implementation of this provision to tax years beginning after 2020. The Senate bill would further delay the implementation date to tax years beginning after 2021.

Individuals

An individual with $50,000 or more (indexed for inflation) of "seriously delinquent tax debt" may be subject to denial of a U.S. passport under the Senate bill. The government could also revoke the individual's passport upon reentry to the U.S.

Additional provisions

The Senate bill would also:

- Extend the temporary increase in small issuer exception to tax-exempt interest allocation rules for financial institutions;
- Provide for 100 percent continuous levy on payments to Medicare providers and suppliers;
- Clarify IRS levy authority for Thrift Savings Accounts;
- Expand ability of small issuers to sell bank-qualified bonds;
- Provide alternative minimum tax relief (AMT) on private activity bonds;
- Allow state infrastructure banks to issue Transportation and Regional Infrastructure bonds (TRIPs);
- Eliminate volume cap for water sewage and water facility project private activity bonds;
- Provide special depreciation and amortization rules for highway and related property subject to long-term leases;
- Extend highway excise taxes;
- Dedicate "gas guzzler tax" on certain heavy vehicles to Highway Trust Fund;
- Reduce the Leaking Underground Storage Tank Trust Fund tax; and
- Impose excise taxes on businesses operating roll-your-own cigarettes.

Failed amendments

At the eleventh hour, several tax-related amendments to MAP-21 failed to pass the Senate. They included proposals to:

- Extend individual, business and energy tax extenders;
- Fund a corporate income tax rate cut with repeal of certain energy tax preferences; and
- Require inherited IRAs to be distributed within five years.

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Agencies Propose Revisions To Preventive Health Services Regs

◆*ANPRM RIN-1210-AB44*

The IRS, the U.S. Department of Health and Human Services (HHS) and Department of Labor (DOL), recently announced that they intend to propose changes to regs on preventive health services under the Patient Protection and Affordable Care Act (PPACA). In an Advanced Notice of Proposed Rulemaking (ANPRM), the agencies described draft proposals to implement the changes and requested comments on the proposals.

■ ***CCH Take Away.*** In 2011, the agencies issued final interim regs for preventive health services, including well-woman visits, support for breast-feeding equipment, contraception, and domestic violence screening, to be covered without cost sharing in new health plans starting in August 2012. The ANPRM, a spokesperson for HHS said in a statement, "is intended to provide individuals with access to recommended preventive services including contraceptives without cost sharing, while ensuring that non-profit religious organizations are not forced to pay for, provide, or facilitate the provision of any contraceptive service they object to on religious grounds."

Background

The PPACA generally requires certain health plans to cover and eliminate cost sharing for various preventive services. The agencies previously issued regs to require private health plans to cover preventive services for women without charging a co-pay. The agencies also provided an exemption for group health plans established or maintained by certain religious employers with respect to contraceptive services.

ANPRM

In the ANPRM, the agencies explained that they intend to propose changes to accommodate the objections of non-exempt, non-profit religious organizations to covering contraceptive services. Generally, group health plans sponsored by certain religious employers (and any group health insurance coverage provided in connection with such plans) are exempt from the requirement to offer coverage of contraceptive services that would otherwise be required for plan years beginning on or after August 1, 2012. A second set of organizations qualifies for a temporary enforcement safe harbor: group health plans sponsored by non-exempt, non-profit organizations, that, consistent with any applicable state law, do not, on or after February 10, 2012 cover some or all forms of contraceptives due to the organization's religious objections to them (and any group health insurance coverage provided in connection with such plans).

■ ***Comment.*** The temporary enforcement safe harbor applies for plan years beginning on or after August 1, 2012, and before August 1, 2013.

The agencies also intend to seek comments on possible approaches to having a third-party administrator fund contraceptive coverage without using funds provided by the religious organization. The third-party administrator could use revenue that is not already obligated to plan sponsors, such as drug rebates or other sources, the agencies observed. Alternatively, the third-party administrator could separately arrange for contraceptive coverage. In this case, an additional independent entity other than a third-party administrator would be needed, the agencies noted.

Additionally, the agencies intend to propose an accommodation for religious organizations that are non-profit institutions of higher education with objections to contraceptive coverage with respect to the student health insurance plans that they arrange. Student health insurance coverage is defined as a type of individual market health insurance coverage offered to students and their dependents under a written agreement between an institution of higher education and an issuer.

■ ***Comment.*** HHS issued a final student health coverage rule on March 16, 2012.

Comments

The agencies requested comments on accommodation, third-party administration and related areas. Comments should be submitted to the agencies on or before June 19, 2012.

References: FED ¶46,320;
TRC COMPEN: 45,228.

No Credit Given For Employer's Failure To Withhold On The Exercise Of NQSOs

◆*McLaine, 138 TC No. 10*

The Tax Court has found that a taxpayer/employee was liable for over $1.6 million in unpaid taxes due on the exercise of nonqualified stock options (NQSOs). The taxpayer was not entitled to a credit for taxes that the employer was supposed to withhold, since there was no evidence that the employer actually paid any withholding taxes to the IRS.

■ ***CCH Take Away.*** Code Sec. 31 allows a credit to the employee for amounts withheld by the employer on the employee's income. The taxpayer failed to demonstrate that the employer had in fact withheld any income tax on the employee's stock option income. A concurring opinion would have held that even if the employer had paid the nonwithheld taxes in a later year, the employee was not entitled to a credit under Code Sec. 31.

Background

The taxpayer was hired by a corporation as a senior officer. After the taxpayer left the employer in 1998, he exercised (in 1998 and 1999) nonqualified stock options received from the company. He received option proceeds of more than $8 million for the 1999 exercise. The plan required him, upon notification, to pay to the company amounts necessary to satisfy federal tax withholding requirements. The taxpayer knew that no taxes had been withheld and he received no notice of amounts due to the company.

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Tax Court Rebuffs Owner's Attempt To Depreciate Apartment Complex Costs As Personal Property

◆*AmeriSouth XXXII, LTD., TC Memo. 2012-67*

The Tax Court has agreed with the IRS that many assets in an apartment complex were depreciable as residential property written off over 27.5 years. The court rejected the taxpayer's claims that certain assets could be depreciated as personal property.

■ ***CCH Take Away.*** Cost segregation studies, which have grown in popularity over recent years, have helped many building owners accelerate overall depreciation deductions reportedly by up to 15 percent or more through reclassifying certain building components as personal property. While there is clear value to use of these studies in many situations, there are also limits to what may be reclassified as personal property. The Tax Court in this case, for example, viewed what is considered structural components within a residential complex as very broad, leaving little room for the taxpayer to separate out certain items for faster depreciation.

Background

The taxpayer, doing business as a limited liability company (LLC), purchased an apartment complex. The complex occupied 16 acres and contained more than 40 buildings with 366 apartments. The apartments had dishwashers and garbage disposals. Some apartments had hookups for washing machines and dryers with their own plumbing and electrical connections. Many of the apartments had molding and chair rails. Some kitchens and living rooms had built-in shelving.

The taxpayer undertook a $2 million renovation of the complex. The taxpayer replaced, among other items, kitchen cabinets and countertops, vent hoods, and sinks. The taxpayer decided to depreciate many parts by themselves and not as part of the buildings to which they were attached. The IRS disagreed.

■ ***Comment.*** Depreciating these parts separately accelerated depreciation and resulted in lower taxes.

Court's analysis

The court first noted that Code Sec. 168(e)(2)(A)(i) defines residential rental property as any building or structure if 80 percent or more of the gross rental income from such building or structure for the tax year is rental income from dwelling units. Residential rental property is depreciated over 27.5 years via straight line.

The court found that the water-distribution system, which included water and fire lines, fire hydrants, and trenching and backfill, was an integral part of the plumbing and air conditioning systems. As a result, the water-distribution system had to be depreciated over 27.5 years.

Sinks, the taxpayer argued, should be treated a personal property because they are easy to remove. The court found that Reg. 1.48-1(e)(2), specifically lists sinks as structural components. Similarly, interior windows and chair rails were structural components. Built-in shelves in the kitchens and living rooms in the apartments also were integral parts.

The court did find that duplex outlets, which were four-feet above the ground in the kitchens and intended to accommodate refrigerators, were personal property. The same was true with respect to 220-volt outlets in the kitchens because they are used solely for powering stoves.

The court also disagreed with the IRS that venting connected to clothes dryers served the function of ventilating the apartments. The vents expelled hot air and carbon monoxide related to operation of the dryers. The vents extended directly from the dryers to the outside of the building and had no connection to the apartments' general ventilation system.

■ ***Comment.*** Vent hoods above stoves, however, were integral components of the building and had to be depreciated over 27.5 years, the court found.

References: CCH Dec. 58,975(M); TRC DEPR: 3,156.35.

Stock Options

Continued from page 4

The taxpayer paid $1.6 million to the IRS and owed another $1.6 million in income taxes. The taxpayer claimed the $1.6 million payment was made in 2000; IRS records indicated it was made in 2001. The IRS assessed the unpaid taxes, plus additional amounts for failure to pay estimated taxes and income taxes, plus interest.

The taxpayer had a collection due process (CDP) hearing. The hearing officer rejected the taxpayer's alcoholism defense against payment of the taxes, and sustained the amounts due for collection. The taxpayer's representative discussed an offer-in-compromise and an installment agreement but never followed through by making an offer or providing financial information to the IRS.

Court's analysis

The Tax Court found no evidence in the IRS's records or actions that the employer ever paid any taxes on behalf of the employee. The court found that IRS Form 4340 (employment tax transcript of account) was a reliable indicator of the taxpayer's outstanding liability, and that there was no evidence of any irregularity.

Because there was no payment, the taxpayer was not entitled to a Code Sec. 31 credit. The court noted that *Whalen, TC Memo. 2009-37, CCH Dec. 57,740(M)*, left open the possibility of a credit for a later payment of nonwithheld taxes, but indicated it did not have to resolve that issue in this case.

The taxpayer failed to show good cause, such as hardship, for failing to pay the taxes. The taxpayer was negligent because he received over $8 million in proceeds but failed to set aside funds to pay the full tax liability. Moreover, the taxpayer's defense of alcohol incapacitation was not convincing, since he had engaged in numerous responsible actions during the time he claimed to be impaired.

References: CCH Dec. 58,977; TRC INDIV: 57,306.

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Tax Court Finds Taxpayers Must Reside In Home To Exclude Foster Care Payments

◆ *Stromme, 138 TC No. 9*

The Tax Court has found that state payments made to a married couple's foster care group home operating out of their second home were taxable. The taxpayers had spent considerable time at the foster care home, but the court concluded that they resided in another home for purposes of the exclusion.

- ***CCH Take Away.*** Prior case law found that payments to a foster care home used as a residence were excludable, but did not explicitly state that a residence must be the taxpayer's principal residence. Nevertheless, the taxpayers argued that the foster care home had been their principal residence.

Background

Code Sec. 131 provides that qualified foster care payments are excludable from income when (1) paid by either a state (or political subdivision thereof); and (2) which are paid to the foster care provider for caring for a qualified foster individual in the foster care provider's home (or represents a difficulty of care payment). The IRS argued that the foster care home was not the taxpayer's principal place of residence and, therefore, the state payments they received and used for its operation were taxable.

Court's analysis

The court found that there was ample evidence that the foster care home was not the taxpayers' residence. According to the court, the couple commuted to and performed chores at the foster care home but resided in another home.

However, the Tax Court did not uphold the accuracy-related penalty for underpayments. The taxpayers acted in good faith and with reasonable cause in excluding the payments, especially where the case law was ambiguous. The court also took into account that the taxpayers maintained good records and had consulted a tax professional before excluding the payments.

Concurring opinions

The first concurring judge stated that a "home" was where one resides, but was not necessarily the "principal" home.

The second judge stated that the Tax Court did not need to rule on the issue of whether a taxpayer could have two homes: the parties disputed only whether the foster care home had been the taxpayers' principal residence. The second concurring opinion reasoned that if the statutory language were ambiguous, however, then the court should narrowly construe it for income exclusions.

References: CCH Dec. 58,976; TRC INDIV: 33,252.

AFRs Issued For April 2012

◆ *Rev. Rul. 2012-11*

The IRS has released the short-term, mid-term, and long-term applicable interest rates for April 2012.

Applicable Federal Rates (AFR) for April 2012

	Annual	Semiannual	Quarterly	Monthly
Short-Term				
AFR	.25%	.25%	.25%	.25%
110% AFR	.28%	.28%	.28%	.28%
120% AFR	.30%	.30%	.30%	.30%
130% AFR	.33%	.33%	.33%	.33%
Mid-Term				
AFR	1.15%	1.15%	1.15%	1.15%
110% AFR	1.27%	1.27%	1.27%	1.27%
120% AFR	1.38%	1.38%	1.38%	1.38%
130% AFR	1.51%	1.50%	1.50%	1.50%
150% AFR	1.74%	1.73%	1.73%	1.72%
175% AFR	2.02%	2.01%	2.00%	2.00%
Long-Term				
AFR	2.72%	2.70%	2.69%	2.68%
110% AFR	2.99%	2.97%	2.96%	2.95%
120% AFR	3.27%	3.24%	3.23%	3.22%
130% AFR	3.54%	3.51%	3.49%	3.48%

Adjusted AFRs for April 2012

	Annual	Semiannual	Quarterly	Monthly
Short-term adjusted AFR	.22%	.22%	.22%	.22%
Mid-term adjusted AFR	.95%	.95%	.95%	.95%
Long-term adjusted AFR	3.04%	3.02%	3.01%	3.00%

The Code Sec. 382 adjusted federal long-term rate is 3.04%; the long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months) is 3.26%; the Code Sec. 42(b)(2) appropriate percentages for the 70% and 30% present value low-income housing credit are 7.44% and 3.19%, respectively, however, the appropriate percentage for non-federally subsidized new buildings placed in service after July 30, 2008, and before December 31, 2013, shall not be less than 9%; and the Code Sec. 7520 AFR for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest is 1.4%.

References: FED ¶46,319; TRC ACCTNG: 36,162.05.

Tax Briefs

Jurisdiction

A federal district court properly found that it lacked subject matter jurisdiction over an individual's quiet title suit challenging the IRS tax liens. However, a quiet title action was not the proper way to challenge the underlying merits of the assessment.

Tinnerman, CA-11, 2012-1 USTC *¶50,243; TRC LITIG: 9,254.05.*

An individual's action seeking a refund and damages against the IRS was dismissed for lack of subject matter jurisdiction and for failure to state a claim upon which relief could be granted. The individual's overpayment was allowed by the IRS and properly applied as credit against her outstanding tax liability for the tax year at issue.

Crigler, FedCl, 2012-1 USTC *¶50,240; TRC LITIG: 9,052.*

Tax Crimes

The co-owner of a retail carpet chain's petition for rehearing *en banc* of the Sixth Circuit's affirmance of the district court's denial of his motion for judgment of acquittal after his conviction for attempted tax evasion, conspiracy to defraud and signing a false tax return was denied. The petition was circulated to all the active judges, none whom voted for rehearing. All of the issues raised in the petition were fully considered in the original decision.

Rozin, CA-6, 2012-1 USTC *¶50,237; TRC IRS: 66,306.*

An individual's conviction for failure to file returns was proper and he was not entitled to a new trial because of prosecutorial misconduct. The individual failed to show that the prosecutor's improper comments changed the outcome of his trial.

Guinn, CA-11, 2012-1 USTC *¶50,236; TRC IRS: 66,152.*

Income

An arbitrator's award for wrongful termination from employment on account of a disability was not excludable from gross income. The arbitration award made no mention of physical injury and the taxpayer failed to allege such an injury in his complaint or show it at trial. However, the taxpayer acted reasonably and in good faith and so was not subject to an accuracy-related penalty.

Neri, TC, CCH Dec. 58,981(M), FED ¶47,995(M); TRC INDIV: 33,402.10.

An individual who purchased stock that became valueless was not entitled to a refund of the income tax paid when he received the stock. The taxpayer had acquired a beneficial ownership interest in the shares, which were transferable and not subject to a substantial risk of forfeiture. Therefore, the taxpayer was required to recognize gross income in the amount by which the fair market value of the shares exceeded the exercise price paid for them.

Sheedy, TC, CCH Dec. 58,979(M), FED ¶47,993(M); TRC COMPEN: 18,502.

An individual was liable for tax on the unreported income determined by the IRS. The IRS was not required to produce reasonable verification of the information returns on which it had based its claims and did not err in calculating the individual's taxes using a single filing status. However, the IRS failed to carry its burden of proof as to why the individual was not entitled to three dependency exemptions. He was liable for both the Code Sec. 6651(a)(1) addition to tax and the frivolous position penalty.

Parker, TC, CCH Dec. 58,974(M), FED ¶47,988(M); TRC IRS: 66,152.15.

Deductions

The IRS has changed the date of a public hearing on proposed regulations relating to the deduction and capitalization of expenditures related to tangible property (NPRM REG-168745-03). The public hearing has been rescheduled for May 9, 2012, at 10:00 a.m.

Notice of Hearing, FED ¶46,317; TRC ACCTNG: 12,100.

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Tax Court Rejects Treatment Of Foreign Distributions As Return Of Capital

A taxpayer could not unilaterally treat distributions from Canadian entities as nontaxable return of capital, the Tax Court has held. The taxpayer's Form 1099-DIV confirmed that the distributions were dividends, the court found. The taxpayer's independent computation of available earnings and profits (E&P) was inadequate.

Background. The taxpayer owned shares in Canadian entities through a brokerage account. In 2007, the taxpayer received distributions. The taxpayer claimed the distributions were returns of capital and not dividends. The taxpayer disregarded the Form 1099-DIV he received.

Court's analysis. The court found that Reg. §1.316-1(a)(1) provides that the term dividend includes a distribution of property made by a foreign corporation to its shareholders. The court further found that the taxpayer failed to show that the Canadian entities did not have sufficient current or accumulated E&P from which a dividend distribution could be made.

Audited financial statements of the entities merely served as a starting point for the calculation of E&P for tax purposes, the court observed. It also found that the financial statements of the Canadian entities did not purport to compute the entities' E&P under U.S. tax principles. Additionally, news releases from the entities stated that the distributions were dividends, effectively requiring the taxpayer to shoulder the contrary position as part of the taxpayer's burden of proof.

■ ***Comment.*** The court also upheld the Code Sec. 6662(a) accuracy-related penalty.

Juha, TC Memo. 2012-68, CCH Dec. 58,978(M); TRC FILEBUS: 9,154.

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Tax Briefs

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A Custom Adjustable Rate Debt Structure (CARDS) transaction entered into by an individual to produce tax losses for his S corporation lacked economic substance, and as a consequence, the claimed loss deduction was denied. The individual was also liable for a 40-percent accuracy-related penalty for gross valuation misstatement.

Crispin, TC, CCH Dec. 58,980(M), FED ¶47,994(M); TRC SALES: 3,154.

FOIA

The IRS properly withheld documents responsive to an attorney's Freedom of Information Act (FOIA) request because disclosure would seriously impair the collection, assessment, or enforcement of the tax laws and, therefore, were exempt.

Shannahan, CA-9, 2012-1 USTC ¶50,239; TRC IRS: 9,502.

The IRS's response to an individual's requests under the Freedom of Information Act (FOIA) was inadequate. Regarding the first request, the IRS was required to provide a *Vaughn* index and all responsive documents for *in camera* review. Also, the IRS was required to allow the individual to refine his second request so that it reasonably described the sought documents.

Leonard, DC N.J., 2012-1 USTC ¶50,238; TRC IRS: 9,502.

Liens and Levies

A mortgage lien had priority over federal and state tax liens and judgment creditors' claims to the proceeds of the judicial sale of a tax debtor's residential real property. The government failed to demonstrate that the individual executed a note and trust deed intending to defraud his creditors thereby rendering the note and the deed invalid under state (California) law.

Lang, DC Calif., 2012-1 USTC ¶50,247; TRC IRS: 48,158.10.

Tax assessments against a married couple were reduced to judgment; however, the government was not entitled to foreclose the federal tax liens on the couple's real properties. The Form 4340, Certificate of Assessments and Payments, was presumptive proof of valid assessments against the couple, which they failed to rebut, but issues of fact remained regarding the couple's transfer of their property to a trust.

Lipari, DC Ariz., 2012-1 USTC ¶50,245; TRC IRS: 45,158.

The Tax Court properly upheld an IRS Appeal's officer's determination to proceed with a levy to collect a retired federal employee's tax liability and frivolous return penalties. The individual's nondisabilty annuity from the Civil Service Retirement System (CSRS) was taxable income and, because it was not listed as exempted under Code Sec. 6334(a)(6), it was not exempt from an IRS levy.

McNeil, CA-10, 2012-1 USTC ¶50,235; TRC IRS: 51,060.05.

Collection Due Process

A federal district court denied an individual's request to reconsider its decision to reduce his unpaid taxes, penalties, fees, and interest to judgment. The court considered all of the individual's arguments, allowed him ample time to respond to the government's motions and allowed him ample latitude in filing briefs and motions of his own. Therefore, the individual was not denied due process. Moreover, his arguments were meritless.

Hiatt, DC Wash., 2012-1 USTC ¶50,242; TRC LITIG: 9,256.

Tax Assessments

The government was entitled to reduce to judgment federal income tax liabilities assessed against a married couple and payroll tax liabilities assessed against the husband and his sole proprietorship law firm. The Form 4340, Certificate of Assessments and Payments, was presumptive proof of a valid assessment; which the couple failed to rebut.

Lebeau, DC Calif., 2012-1 USTC ¶50,244; TRC IRS: 45,114.

Deficiencies and Penalties

The chairman of the board of a nonprofit corporation was a responsible person liable for the trust fund recovery penalty assessed against him in connection with the corporation's unpaid withholding taxes. The individual knew that the withholding taxes were not being paid; however, the corporation continued to pay other creditors, to meet payroll, and to repay the individual's loans to the corporation.

Bunch, DC Tenn., 2012-1 USTC ¶50,246; TRC PAYROLL: 6,308.

An individual's underreported income and underpaid income tax were due to fraud on his part. As a result, he could not avail himself of the three-year statute of limitations. Further, he was liable for the 75-percent fraud penalty.

Scott, TC, CCH Dec. 58,973(M), FED ¶47,987(M); TRC PENALTY: 6,102.

Tax-Exempt Status

The IRS has obsoleted Announcement 2010-19, I.R.B. 2010-14, 529, which described procedures for certain charitable trusts that classified themselves as private foundations to be reclassified as Type III supporting organizations. The IRS updated the procedures for an organization to obtain a determination regarding its foundation status in Rev. Proc. 2012-10, I.R.B. 2012-2, 273.

Announcement 2012-12, FED ¶46,318; TRC EXEMPT: 21,202.

Tax Shelters

The government was entitled to an injunction under Code Sec. 7408 against the head minister of a church who was promoting an abusive tax shelter. The head minister knew or should have known that the statements he made were false because under Rev. Rul. 77-290, assignment or transfer of compensation for personal services to the church did not relieve a taxpayer of his federal income tax liability.

Hartshorn, DC Utah, 2012-1 USTC ¶50,241; TRC LITIG: 9,256.