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Final Regs Require U.S. Banks To Report Deposit Interest Paid To Nonresident Aliens

◆ *TD 9584, Rev. Proc. 2012-24*

In a controversial move, the IRS has finalized regs that require U.S. banks and other financial institutions to report to the agency interest on deposits paid to a nonresident alien (NRA). The requirement applies to payments to residents of any country having a tax information exchange agreement (TIEA) under which the United States will provide information, as well as receive it. The IRS also issued a companion revenue procedure that identifies countries that have a TIEA with the U.S. (and thus, for which reporting is required).

■ ***CCH Take Away.*** The regulations have been "extremely controversial," Eric Solomon, co-director, national tax department, Ernst & Young LLP, Washington, D.C., told CCH. The original 2001 regs, issued at the end of the Clinton administration, applied to all foreign persons, Solomon explained. U.S. banks were especially concerned about giving information to foreign governments, he said. The 2002 regs, issued by the Bush administration, scaled back the regs substantially, Solomon said. The 2011 proposed regs effectively reinstated the 2001 regs, he said.

■ ***Comment.*** Although the IRS has long contemplated this reporting, it took more decisive action after the Foreign Account Tax Compliance Act (FATCA) was enacted in 2010. The rules are an "important bookend" to FATCA, Solomon said.

Reporting

The reporting requirements will apply to interest payments made on or after January 1, 2013. Reporting will apply to commercial banks, savings institutions, credit unions, securities brokerages, and insurance companies. For administrative purposes, a financial institution may elect to report interest paid to all nonresident aliens, rather than having to determine whether the NRA lives in a country with an agreement with the U.S.

■ ***Comment.*** Although the regs require reporting, the Tax Code exempts the interest itself from income and is designed to encourage foreigners to deposit funds in the U.S.

Confidentiality and use

Reporting is only required for NRAs living in countries with a TIEA. Rev. Proc. 2012-24 provides two lists - a list of 78 countries that have TIEAs with the U.S., and a list of countries with which automatic exchanges are appropriate.

■ ***Comment.*** The IRS currently exchanges information automatically with only one country — Canada.

The IRS attempted to reassure financial institutions that it will not provide information to countries lacking appropriate safeguards for confidentiality and use. Although the IRS will require informa-

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Route to: ____________ ____________ ____________ ____________ ____________

IRS Intends To Apply Normal Retirement Age Rules To Governmental Plans

◆ *Notice 2012-29*

The IRS has announced plans for future guidance on the applicability of the normal retirement age (NRA) rules to governmental plans. The IRS intends to clarify that a governmental pension plan does not need a definition of "normal retirement age" to make in-service distributions to certain employees and would also provide a lower NRA for plans whose participants were substantially all qualified public safety employees.

■ ***CCH Take Away.*** "Notice 2012-29 did not indicate the timing of the release, although we anticipate the revised regulations to be issued within the two-year extension period," Elizabeth Dold, principal, The Groom Law Group Chartered, Washington, D.C., told CCH.

Background

Code Sec. 411(a)(8) defines NRA on which many of the qualification requirements of Code Sec. 401(a) pension plans are based. NRA is the earlier of: (1) the time the plan participant attains the normal retirement age under the plan, or (2) the later of: (a) the time the participant attains age 65, or (b) the fifth anniversary of the time the participant began participation in the plan. The definition under Code Sec. 411(a)(8), however, does not apply to governmental plans that satisfy requirements under Code Sec. 414(e)(2).

The IRS issued final regs in 2007 defining a pension plan's NRA to be an age that is not earlier than the earliest age reasonably representative of the typical retirement age for the industry employing the worker. An NRA of 62 years or older is deemed to satisfy this requirement (age 50 or older for public safety employees). The effective date of the 2007 regs has been delayed several times for governmental plans.

Proposed guidance

The IRS explained that proposed regs would provide that a governmental pension plan does not need a definition of NRA to make distributions to employees who have reached retirement or age 62 but have not yet left employment. Proposed regs would also allow an NRA of 50 under a governmental plan where substantially all of the participants are qualified public safety employees, whether or not the employees are covered by a separate plan.

Proposed guidance also would change the effective date for governmental plans to annuity starting dates that occur in plan years beginning on the later of (1) January 1, 2015 or (2) the close of the first regular legislative session of the legislative body with the authority to amend the plan that begins on or after the date that is three months after the date the final regs are published.

■ ***Comment.*** "Postponing the application to 2015 will provide an opportunity for government plans to understand the rules and where they exist. The guidance helps highlight that there are things that do apply to government plans and gives them an opportunity to comply before the effective date," Carl Mowery, managing director, Grant Thornton LLP, Chicago, told CCH.

References: FED ¶46,348;
TRC RETIRE: 15,056.

Deposit Interest

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tion on residents in treaty countries, it will not exchange the information automatically. Even if a TIEA is in effect, the IRS explained that it would not exchange information with a country that is not protecting the confidentiality of the information or is not using the information solely for tax enforcement.

■ ***Comment.*** The government is trying to get the balance correct, by showing its concern for financial institutions' fear that the information might not be used properly, Solomon said.

Regulatory objectives

The IRS indicated that the new reporting requirements are "essential" to the agency's efforts to combat offshore tax evasion. International cooperation depends significantly on the IRS's ability to reciprocate, the agency stated.

■ ***Comment.*** "This is a very significant development," Michael Mundaca, co-director of Ernst & Young's Americas Tax Center, said in a statement."In the Western hemisphere and beyond we are seeing growing capabilities and eagerness of governments to work together to combat tax evasion. This will significantly advance those efforts."

In connection with FATCA, the IRS is working on an alternative reporting system, under which foreign financial institutions will report information to their own governments, rather than directly to the IRS, and the foreign government will then provide the information to the IRS. *See the February 16, 2012 issue of this newsletter for details.*

The new rules will also make it more difficult for U.S. taxpayers with U.S. deposits to avoid U.S. taxes by falsely claiming to be nonresidents, the IRS explained.

References: FED ¶¶47,022, 46,347;
TRC FILEBUS: 9,158.30.

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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*

Final Regs Characterize Gain On Distribution From Foreign Corporation As Dividend Under Code Sec. 1248(a)

◆ *TD 9585*

The IRS has issued final regs on the treatment of a distribution of property from a foreign corporation with respect to its stock under Code Sections 301 and 1248. The regs require that the distribution be treated as a dividend under Code Sec. 1248(a) in certain situations.

> ■ ***CCH Take Away.*** "These final section 1248 regulations, like the temporary regulations they replace, are designed to ensure that the earnings and profits of lower-tier foreign subsidiaries described in section 1248(c)(2) are taken into account when there is section 301(c)(3) gain," Joseph Calianno, partner and International Technical Tax Practice Leader, Grant Thornton LLP, Washington National Tax Office, told CCH. Calianno also noted that "Taxpayers always should consider the consequences of a deemed dividend under section 1248, including the sourcing and potential foreign tax credit consequences of the deemed dividend."

Background

Under the general rule of Code Sec. 1248(a), if a U.S. person (such as a domestic corporation) sells or exchanges stock in a foreign corporation, and the U.S. person owns (or is considered to own) 10 percent or more of the combined voting power of the foreign corporation when it was a controlled foreign corporation (CFC), then the gain recognized on the sale or exchange of the stock is included in the U.S. person's income as a dividend, to the extent of earnings and profits of the foreign corporation.

Code Sec. 301 applies to distributions of property with respect to stock. Under Code Sec. 301(c), the portion of the distribution that:

- Is a dividend (for example, a distribution out of earnings and profits (E&P) under Code Sec. 316) must be included in gross income;
- Is not a dividend must be applied against and reduce the adjusted basis of the stock (and is not taxable to that extent); and
- Is not a dividend, and that exceeds basis, must be treated as gain from the sale or exchange of property.

Code Sec. 1248 regs

In 2009, the IRS issued temporary and proposed regs providing that gain recognized under Code Sec. 301(c)(3) on the receipt of a distribution of property from a foreign corporation must be treated as gain from the sale or exchange of the stock of the foreign corporation. This ensured that some or all of the section 301(c)(3) gain would be characterized as a dividend under Code Sec. 1248(a) when the CFC making the distribution has lower-tier foreign subsidiaries described in section 1248(c)(2) with E&P. The regs also provided that the term "sale or exchange" includes a distribution that is treated as a redemption under Code Sec. 302(a) or a liquidation under Code Sec. 331(a).

> ■ ***Comment.*** The IRS indicated that the temporary regs preserved the policies underlying Code Sec. 367(b) (recognizing gain on certain transfers to foreign corporations), and ensured that the E&P of lower-tier foreign subsidiaries described in Code Sec. 1248(c)(2) are taken into account.

The final regs track the temporary regs relating to Code Sec. 1248, to ensure that lower-tier E&P is taken into account when gain is recognized on stock of a controlled foreign corporation. If the distributing corporation owned a lower-tier corporation with E&P, those earnings and profits could be used to characterize a portion of the distribution as a dividend to the U.S. corporation under Code Sec. 1248. The final regs also remove a reference to partial liquidations under Code Sec. 331(a)(2), which was no longer needed because of rules under Code Sec. 302. The final regs are effective April 24, 2012 and apply to distributions occurring on or after February 10, 2009.

Code Sec. 367

The 2009 regs also addressed the application of Code Sec. 367 to certain related-party stock transactions that are recharacterized under Code Sec. 304. As described in Notice 2012-15, the IRS will amend the regs under Code Sec. 367 to address these transactions and, consequently, will withdraw this portion of the temporary regs.

References: FED ¶47,023; TRC INTL: 30,308.

CRS Reviews Expiring Tax Provisions

The Congressional Research Service (CRS) has released a new report detailing the many tax provisions expiring after 2012. Extending these provisions, CRS noted, is estimated to cost $5.4 trillion between 2013 and 2022.

> ■ ***Comment.*** The House Ways and Means Committee is scheduled to hold a hearing on the so-called tax extenders, which expired after 2011. The hearing is expected to highlight which extenders enjoy bipartisan support to be renewed and which may be allowed to sunset permanently.

Bush-era tax cuts. CRS examined the Bush-era tax cuts, including lower individual income tax rates and reduced capital gains/dividends tax rates. The Bush-era tax rates also reduced estate tax liabilities by increasing the amount of an estate exempt from taxation and by lowering the estate tax rate.

Payroll tax cut. The two-percent employee-side OASDI payroll tax cut is scheduled to expire after December 31, 2012.

AMT patch. Increased exemption amounts and related-relief (the so-called AMT "patch") expired after 2011.

CRS Report, An Overview of Tax Provisions Expiring in 2012

IRS Issues Proposed Reliance Regs To Illustrate Program-Related Investments

◆ *NPRM REG-144267*

Recently released proposed reliance regs provide new examples illustrating investments that qualify as program-related investments (PRIs) under the private foundation rules. The charitable activities described in the new examples are based on published guidance and on financial structures described in private letter rulings, the IRS explained.

■ ***CCH Take Away.*** The proposed regs do not make any changes in the rules but add examples, which private foundations had requested, Ruth Madrigal with Treasury's Office of Tax Policy, told the Representing and Managing Tax-Exempt Organizations Conference in Washington, D.C. on April 19. "We heard that some foundations were hesitating to use PRIs," Madrigal noted, because the existing regs had not been updated in 40 years.

Background

Code Sec. 4944(a) imposes an excise tax on a private foundation that makes an investment that jeopardizes the carrying out of any of the private foundation's exempt purposes. Foundation managers who knowingly participate in the making of a jeopardizing investment are also liable for the tax. Moreover, Code Sec. 4944(b) imposes additional excise taxes on private foundations and foundation managers when investments are not timely removed from jeopardy.

A PRI is not considered a jeopardy investment. A PRI is an investment whose primary purpose is to accomplish a charitable, religious, scientific, or other qualified purpose (even if the purposes are carried out by noncharitable organizations) with no significant purpose either to produce income or capital appreciation or to accomplish legislative or political activity. The IRS issued regs with examples of PRIs in 1972.

Proposed regs

The new examples reflect current investment practices, the IRS explained. They illustrate that:

- An activity conducted in a foreign country furthers a charitable purpose if the same activity would further a charitable purpose if conducted in the United States;
- The charitable purposes served by a PRI are not limited to situations involving economically disadvantaged individuals and deteriorated urban areas;
- The recipients of PRIs need not be within a charitable class if they are the instruments for furthering a charitable purpose;
- A potentially high rate of return does not automatically prevent an investment from qualifying as program-related;
- PRIs can be achieved through a variety of investments, including loans to individuals, tax-exempt organizations and for-profit organizations, and equity investments in for-profit organizations;
- A credit enhancement arrangement may qualify as a PRI; and
- A private foundation's acceptance of an equity position in conjunction with making a loan does not necessarily prevent the investment from qualifying as a PRI.

■ ***Comment.*** International activities were one area where foundations had questions, Madrigal said.

The IRS explained that the new examples show that a PRI may accomplish a variety of charitable purposes, such as advancing science, combating environmental deterioration, and promoting the arts. The examples also demonstrate that an investment that funds activities in one or more foreign countries, including investments that alleviate the impact of a natural disaster or that fund educational programs, may further the accomplishment of charitable purposes and qualify as a PRI.

■ ***Comment.*** Taxpayers may rely on the examples before the proposed regs are finalized.

References: FED ¶49,528; TRC EXEMPT: 24,610.10.

Chief Counsel Determines Refund Claim Is Modification Of Earlier One; Amendment Is Timely

◆ *CCA 201216033*

IRS Chief Counsel has determined that a taxpayer's Form 843, Claim for Refund and Request for Abatement, was a permissible amendment to her timely filed 1040X amended return. The supplemental claim did not require the investigation of new matters and the IRS had not taken final action on the claim.

■ ***CCH Take Away.*** In this case, the three-year period under Code Sec. 6511(a) expired on April 17, 2007. The taxpayer's Form 1040X was timely received by the IRS and constituted a timely refund claim. The taxpayer's Form 843, however, was received by the IRS after the three-year period under Code Sec. 6511(a) had expired. Consequently, the Form 843 would be an untimely refund claim unless it would relate back to the timely refund claim on Form 1040X.

Background

In 2006, the taxpayer discovered that she had invested in a Ponzi scheme. The taxpayer filed an amended return for 2003. The IRS disallowed her refund claim. The taxpayer subsequently filed Form 843. A local taxpayer advocate asked the IRS National Office if the taxpayer's Form 843 was a permissible amendment to her timely filed Form 1040X.

■ ***Comment.*** When the taxpayer filed her 1040X she was seeking a refund as a result of improperly including a fictitious amount of interest on her original return. The

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Tax Court Finds Lawyer/Film Producer Is In Business For Profit; Greenlights Code Sec. 181 Election

◆ *Storey, TC Memo. 2012-115*

An attorney has persuaded the Tax Court that her documentary film production work was for profit and not a hobby. The court noted this case presented the first opportunity for it to review an election under Code Sec. 181.

■ ***CCH Take Away.*** Lee Storey, the taxpayer in this case, told CCH that the decision is a "huge victory for the arts" and has implications for other areas besides filmmaking. Storey said that the case appears to be the first time the Tax Court has addressed so extensively the making of documentaries as a business.

Background

In 2003, the taxpayer began taking filmmaking classes. Several years later, the taxpayer produced a 79-minute documentary film. The film won many accolades.

The IRS determined that the taxpayer had engaged in filmmaking without with the intent to make a profit. The IRS further determined that the taxpayer failed to make proper Code Sec. 181 elections.

■ ***Comment.*** Code Sec. 181 allowed taxpayers to deduct the production costs of a qualified film or television production that commenced after October 22, 2004 and before January 1, 2012. This special expensing rule expired after 2011 and is one of the many tax extenders currently being debated by Congress for renewal.

Court's analysis

The court structured its analysis around the factors in Reg. 1.183-2(b) to evaluate profit motive. The court first looked at the manner in which the taxpayer carried on the activity. The taxpayer had a business plan. She hired a bookkeeper and maintained separate accounts and a business credit card. The taxpayer also became skilled in filmmaking by attending classes and seeking the advice of experts. Additionally, the taxpayer spent many hours outside of her full-time job on the film. The court concluded that the taxpayer had engaged in filmmaking with the intent of realizing a profit.

The IRS argued that the taxpayer had failed to make the Code Sec. 181 election for the first tax year in which production costs were first paid or incurred. The court found that the language in the IRS regs is permissive and not mandatory. The regs describe a taxpayer timely making an election later than the year the production costs are first incurred because the taxpayer previously did not satisfy the reasonable expectation requirements, the court noted.

The court further found that the taxpayer's elections were imperfect. However, they were adequate under the doctrine of substantial compliance.

References: CCH Dec. 59,031(M); TRC BUSEXP: 3,054.

Refund

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IRS mistakenly disallowed the refund based on theft loss.

Chief Counsel's analysis

Chief Counsel first noted that Code Sec. 6511(a) provides that a refund claim must be filed within three years from the time the return was filed or two years from the time the tax was paid, whichever of the periods expires later, or if no return is filed, within two years from the time the tax was paid.

A supplemental claim may be considered an amendment to the original return, as opposed to an untimely, new claim, Chief Counsel observed. Two requirements must be satisfied. The supplemental claim must not require the investigation of new matters that would not have been disclosed by the investigation of the original claim. Further, the IRS must not have taken final action on the original claim by either rejecting or allowing the claim in whole or part.

There is a narrow exception to the final action rule, Chief Counsel noted. Disallowance will not constitute final action if the IRS did not fully consider all grounds for the refund and the taxpayer asks for "reconsideration" of those grounds.

■ ***Comment.*** This exception arose from a 1933 Supreme Court case *(Bemis Bros. Bag Co., 3 ustc ¶1063)* where the IRS denied a refund by rejecting one of three grounds stated in the claim, while overlooking two independent grounds. The taxpayer filed an amended claim, reiterating the grounds in the original claim. According to the Supreme Court, the claim as amended was timely.

Here, Chief Counsel determined that the taxpayer's Form 843 did not require investigation of new matters. The taxpayer's basis for the refund was the same grounds stated in her Form 1040X and her Form 843. Chief Counsel further determined that the agency's notice of claim of disallowance for 2003 was not a final action. The IRS had overlooked her grounds in the amended return.

Reference: TRC FILEIND: 18,150.

IRS Offers New Priority Service For Campus Correspondence Examinations

The IRS now provides practitioners with a priority phone number they can call with inquiries or other issues relevant to their clients currently undergoing a Campus Correspondence Examination audit. The CCE Practitioner Priority Service (CCE PPS) will address up to five clients per call and transfer or refer issues outside the CCE scope to the appropriate IRS functions. Prompts will direct the call to either the Small Business/Self Employed line or the Wage & Investment Examination line, depending on which is more appropriate. The number is (866) 860-4259.

DC Circuit Rejects Claim That Appeals Officers Are Appointments Clause "Inferior Officers"

◆ *Tucker, CA-DC, April 20, 2012*

Affirming the Tax Court, the Court of Appeals for the District of Columbia Circuit has rejected a taxpayer's claim that IRS Appeals officers at collection due process (CDP) hearings are "Officers of the United States" under the U.S. Constitution. Their appointments do not need to conform to the Constitution's Appointments Clause, the court held.

■ ***CCH Take Away.*** The U.S. Constitution, the court found, distinguishes between "principal" and "inferior" officers, and its requirements have no application to employees falling below the "officer" threshold. To be an "Officer of the United States" covered by Article II, a person must exercise significant authority under the laws of the United States. The main criteria for drawing the line between inferior officers and employees are the significance of the matters resolved by the officials, the discretion they exercise in reaching their decisions, and the finality of those decisions.

Background

In 2004, the IRS sent the taxpayer, a day trader, a Notice of Federal Tax Lien Filing due to his underpayment of income taxes from 1999 to 2003. The IRS informed the taxpayer that he had the right to a CDP hearing. The IRS Appeals Officer who conducted the CDP hearing recommended a partial installment plan. The taxpayer proposed an offer in compromise, which the Appeals Officer rejected. The Appeals Officer's manager also rejected the offer in compromise.

The taxpayer sought relief in the Tax Court. The court remanded the case to the IRS for a supplemental CDP hearing. A new Appeals Officer and her manager rejected the taxpayer's offer in compromise.

The taxpayer again appealed to the Tax Court. According to the taxpayer, a CDP hearing should only be conducted by, and a notice of determination issued by, an officer appointed by the President or the Secretary of the Treasury, in compliance with the Appointments Clause. The Tax Court rejected the taxpayer's argument.

■ ***Comment.*** When Congress enacted the CDP provisions in the IRS Restructuring and Reform Act of 1998, it employed the preexisting Office of Appeals and committed the new CDP function to that office, the Tax Court found. No position within Appeals is invested, in the CDP context, with the final decision-making power that may be exercised only by an officer of the United States, the Tax Court held.

Court's analysis

A taxpayer's tax liability is a significant matter. However, the discretion exercised by Appeals officers is highly constrained, the D.C. Circuit found. Appeals is subject to consultation requirements, to guidelines, and to supervision. For example, the court observed that Appeals officers must request legal advice from the agency's Chief Counsel on novel or significant issues. IRS regs and the Internal Revenue Manual impose guidelines on the types of settlements that Appeals may accept.

The court reiterated that Appeals does not hold trials. Appeals merely provides an opportunity for the taxpayer (and his/her counsel) to use argument and information to claim more favorable treatment than received from IRS employees encountered earlier in the process. The discretion involved in the decisions seems well below the level necessary to require an "officer," the court concluded.

Further, the court rejected the taxpayer's claim that the failure of Appeals to accept his offer in compromise was an abuse of discretion. Appeals did not err in including his day trading losses as dissipated assets. Additionally, IRS guidelines allow rejection of an offer in compromise if it is believed that the liability can be paid in full.

References: 2012-1 ustc ¶50,312; TRC IRS: 42,100.

U.S. Partnership's Depreciable Property Qualifies For Exception From Straight-Line Method

◆ *LTR 201216008*

The IRS has determined that a partnership's wind project that includes depreciable property will not be required to depreciate the property under the straight-line depreciation method. Instead, the property qualified under Code Sec. 168(g)(4)(G) for an exception to the use of the straight-line method.

■ ***CCH Take Away.*** The taxpayer did not fall within the literal terms of the exception, which is available to U.S. corporations. However, the IRS relied on its interpretation of the legislative history to conclude that a partnership owned solely by two U.S. corporations qualified for the exception.

Background

The taxpayer was a limited liability company (LLC). Two U.S. corporations were the members of the LLC. The taxpayer did not elect to be an association and, therefore, was taxable as a partnership. The taxpayer held an interest in another LLC, treated as a disregarded entity for federal taxes.

Thus, the assets of the latter LLC are treated as owned by the taxpayer. These assets include a wind project which consisted, in part, of depreciable property. The taxpayer represented that the wind project was located in a U.S. possession.

Law and analysis

Under Code Sec. 168(g)(1)(A), tangible property used outside the U.S. must be

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Taxpayer Meeting "All Events" Test Can Deduct Estimated Reimbursements Before Making Payments

◆ *Field Attorney Advice 20121602F*

IRS Chief Counsel has concluded that a taxpayer met the "all events" test for deducting payments that it made to reimburse wholesaler/distributors for sales below their acquisition cost. Chief Counsel also determined that the taxpayer was entitled to use the recurring item exception for taking a deduction.

- ***CCH Take Away.*** Economic performance does not apply to recurring items of expense. Therefore, taxpayers can make payments with a reasonable period after the close of the tax year or 8 ½ months after the close of the tax year. Chief Counsel concluded that the taxpayer was entitled to its deduction even though economic performance had not yet occurred.
- ***Comment.*** Although the taxpayer was entitled to a deduction, the Chief Counsel determined that further examination was needed to determine if the amount claimed by the taxpayer was appropriate.

Background

The taxpayer was a pharmaceutical company. The taxpayer negotiated discounted prices that are administered through its wholesalers/distributors through a chargeback program. The discounts were initially absorbed by the wholesaler/distributors, who accepted a selling price below their cost for the drugs. The taxpayer was obligated to pay chargeback reimbursements to the wholesaler/distributors, who submitted a chargeback reimbursement request to the taxpayer. The taxpayer deducted an estimate of its reimbursement liability, based upon historical pricing data and other information.

Chief Counsel's analysis

Under the all events test, a liability is deductible when it is fixed and it can be determined with reasonable accuracy. The liability is established when the event fixing liability occurs or payment is unconditionally due. Here, the event fixing liability had occurred; the event is the drug sale at a price below acquisition cost. The submission of a reimbursement form is a ministerial demand for payment and did not affect the timing of the deduction.

Economic performance generally occurs as payment is made, with respect to a rebate, refund or similar payment. If the payments are made within the appropriate period, then economic performance is satisfied. In the case of the taxpayer's rebates, Chief Counsel concluded that the recurring item exception was satisfied. Furthermore, the taxpayer can satisfy economic performance by making a payment within 8½ months of the end of the year.

Reference: TRC ACCTNG: 12,104.10.

Tax Briefs

Internal Revenue Service

The IRS has issued updated requirements for preparing and submitting substitute Forms W-2c, Corrected Wage and Tax Statement, and Forms W-3c, Transmittal of Corrected Wage and Tax Statements.

Rev. Proc. 2012-22, FED ¶46,349; TRC FILEBUS: 12,052.10.

Documents subpoenaed by the IRS from a third-party administrator in connection with an audit of several welfare benefit plans were not protected by attorney-client privilege or the work product doctrine. The documents were not created in anticipation of pending or impending litigation and the documents were disclosed to others not in the attorney-client relationship, which waived the privilege.

Servicemaster of Salina, Inc., DC Kan., 2012-1 USTC ¶50,310; TRC IRS: 21,402.

A married couple was liable for the unpaid taxes, penalties, and interest assessed against them. Although the check they submitted to the IRS was for the correct amount of tax, only a part of that amount was actually transferred. The couple was liable for the balance because under state (Pennsylvania) law, payment by check is a conditional payment accomplished only when the funds are actually received by the payee.

Zarra, CA-3, 2012-1 USTC ¶50,309; TRC IRS: 45,160.

A stipulated decision was not vacated on the basis of mutual mistake. To the extent that the taxpayers or their counsel misunderstood the terms of a stipulated decision document sent by the IRS counsel, the misunderstanding was a unilateral mistake, which does not provide grounds for vacating a decision.

Farner, TC, CCH Dec. 59,027(M), FED ¶48,041(M); TRC LITIG: 6,952.15.

International

The Tax Court did not abuse its discretion by denying the U.S. Virgin Islands' (USVI) motion to intervene in a deficiency proceeding between an alleged USVI resident and the IRS

McHenry, CA-4, 2012-1 USTC ¶50,305; TRC LITIG: 6,180.

Jurisdiction

The U.S. Court of Federal Claims lacked subject matter jurisdiction over a married couple's suit seeking refunds for several tax years.

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Waltner, CA-FC, 2012-1 USTC ¶50,308; TRC IRS: 33,150.

A federal district court had jurisdiction over the government's action seeking to reduce to judgment a married couple's unpaid federal tax liabilities and to foreclose federal tax liens on their property. The First Amendment did not require the government's claims to be heard in an ecclesiastical court because the determination of the couple's tax liability did not involve a question of church doctrine or hierarchy.

Augustine, DC Minn., 2012-1 USTC ¶50,307; TRC LITIG: 9,256.

Summons

An IRS summons was ordered enforced because individual advanced only tax-protestor arguments. The individual's claims that he was not obligated to pay taxes for tax years at issue because he was a nonresident alien and a noncitizen national and that the work he performed, and for which he was compensated, was not employment as defined by the Internal Revenue Code were rejected.

Amabile, DC Pa., 2012-1 USTC ¶50,304; TRC IRS: 21,300

Deductions

The denial of a self-employed individual's claimed deductions for travel expenses, meals and entertainment expenses, automobile expenses, software expenses, cell phone expenses, legal and professional fees, business use of residences, insurance premiums, contract labor and other expenses resulted in her substantially understating her tax liability. She was liable for the accuracy-related penalty because she substantially understated her income tax and her tax underpayment was attributable to negligence. The reasonable cause exception did not apply.

Ong, TC, CCH Dec. 59,030(M), FED ¶48,044(M); TRC BUSEXP: 12,054.10.

Anti-Injunction Act

An individual's action seeking to enjoin the IRS from assessing taxes that he claimed were previously paid was dismissed. The Anti-Injunction Act barred his suit for the purpose of restraining the assessment or collection of taxes and none of the exceptions to the Act applied.

Widtfeldt v. Nebraska State Bar Association, DC Neb., 2012-1 USTC ¶50,306; TRC IRS: 45,152.

Refund Claims

A veteran's claim for refund of taxes was dismissed for lack of subject matter jurisdiction. Code Sec. 6511(d) as amended by the Heroes Earnings Assistance and Relief Tax Act of 2008 (P.L. 10-245) did not apply because he sought refunds for tax years that began more than five years prior to the date of the Department of Veteran's Affairs determined that part of his income was nontaxable.

S. Noret, DC Calif., 2012-1 USTC ¶50,311; TRC IRS: 36,052.05.

Deficiencies and Penalties

An individual was liable for a deficiency in income tax for all years at issue. He conceded that he earned the income that led to the notices of deficiency and objected only to the denial of the deductions. He was subject to an addition to tax for failure to file and was subject to the accuracy-related penalty.

Rinehart, TC, CCH Dec. 59,028(M), FED ¶48,042(M); TRC FILEIND: 9,052.

Offer-in-Compromise

Interest and penalties on tax liabilities covered by the installment agreement were not waived. The IRS employee who negotiated the installment agreement did not have the authority to abate interest and penalties. The Appeals officer's improper rejection of the taxpayers' offer-in-compromise (OIC) because they failed to provide required financial information was harmless error. Although they submitted their OIC based on doubt as to liability and, therefore, were not required to provide any financial information, rejection of their offer was warranted in any event.

Watchman, TC, CCH Dec. 59,029(M), FED ¶48,043(M); TRC IRS: 51,056.

Tax Shelters

Motions to reconsider or vacate were denied in a case involving a program dealing in distressed receivables that was without economic substance. The use of a subjective intent, totality-of-the-circumstances test to determine the existence of a partnership was proper. The step-transaction doctrine was applied to collapse the steps of the shelter program into a single sale of receivables for money. Because the transfer of receivables occurred within two years of payment, the transaction was presumed to be a sale. Finally, the imposition of a gross valuation misstatement penalty was proper.

Superior Trading, LLC, TC, CCH Dec. 59,026(M), FED ¶48,040(M); TRC PART: 27,058.

Field Attorney Advice

In Field Attorney Advice, IRS Chief Counsel determined that a trust satisfied its entitlement to a refund claim. The refund claim was valid and consistent with the terms of the prior closing agreement. The government could deny the trust's refund on the grounds that the individual partners did not pay a related liability. As long as the trust's position would be consistent with the terms of the closing agreement, the mitigation provisions would apply and the claim could be allowed.

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Partnership

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depreciated under the alternative (straight-line) depreciation method. Under Code Sec. 168(g)(4)(G), an exception to this rule applies to property owned by a U.S. corporation or U.S. citizen, if the property is used predominantly in the U.S. possession.

After examining the legislative history of the predecessor of Code Sec. 168(g)(4)(G), the IRS concluded that the exception can apply to a U.S. person, including a domestic partnership. The IRS determined that the exception applies to a domestic partnership where all the partners are U.S. corporations. Therefore, the exception applied to the taxpayer, a U.S. partnership with two U.S. corporations as its sole partners.

■ ***Comment.*** The exception also requires that the corporations not be entitled to benefits under Code Sections 931 or 933, and not have an election in effect under Code Sec. 936. The taxpayer represented that it satisfied these conditions.

Reference: TRC DEPR: 6,102.

JCT Describes Retirement Savings Reform Proposals Reviewed By Ways And Means Committee

Proposals to reform retirement savings plans were highlighted during a recent hearing by the House Ways and Means Committee. The April 17, 2012 hearing was the latest in a series of tax reform hearings held by the Ways and Means Committee. In advance of the hearing, the Joint Committee on Taxation (JCT) summarized the tax treatment of current-law retirement savings plans and described some recent reform proposals.

■ ***Comment.*** "As the Committee considers tax reform, there are three important principles to keep in mind when evaluating tax-favored retirement vehicles: simplification, increased participation, particularly lower and middle income taxpayers and whether the tax benefits are effective and properly targeted," Ways and Means Chair Dave Camp, R-Mich., said before the start of the hearing. Ranking Member Sander Levin, D-Mich., said "the basic structure of our current system should be preserved and this structure should not be repealed to pay for tax reform." The Committee's GOP leaders have not indicated if they will introduce legislation based on the hearing or to what extent retirement savings plans might be part of comprehensive tax reform in 2012 or 2013.

Tax-favored retirement plans

The JCT explained that the Tax Code provides for a number of tax-favored employer-sponsored retirement plans, including qualified retirement plans and annuities (Code Sec. 401(a) and Code Sec. 403(a)), tax-deferred annuities (Code Sec. 403(b)), governmental eligible deferred compensation plans (Code Sec. 457(b)), Savings Incentive Match Plan for Employees (SIMPLE), individual retirement accounts (IRAs) (Code Sec. 408(a)), and simplified employee pensions (SEPs) (Code Sec. 408(k)). Generally, contributions, earnings on contributions, and benefits are not included in gross income until amounts are distributed. In many cases, distributions can be rolled over to another plan for further deferral of income inclusion.

Tax-favored treatment carries certain requirements, JCT observed. There are minimum participation, vesting, exclusive benefit and minimum funding requirements. These requirements generally have parallels under ERISA. Some qualified plan requirements limit tax benefits, such as the limit on compensation taken into account under a plan and limits on contributions and benefits.

Qualified retirement plans, JCT observed, traditionally have been of two general types: defined benefit (DB) plans and defined contribution (DC) plans. In a DB plan, benefits are determined under a plan formula and paid from general plan assets, rather than individual accounts. In a DC plan, benefits are based on a separate account for each participant, to which are allocated contributions, earnings and losses. Some qualified retirement plans are referred to as hybrid plans because they have features of both a defined benefit plan and a defined contribution plan; for example, cash balance plans are defined benefit plans, but plan benefits are defined by reference to a hypothetical account balance, the JCT noted.

Reform proposals

The White House and Congress have made many proposals to reform, expand or otherwise change individual and employer-sponsored savings arrangements. The JCT examined several of these proposals.

"The White House and Congress have made many proposals to reform, expand or otherwise change individual and employer-sponsored savings arrangements."

Mandate automatic enrollment payroll deduction IRA. President Obama has proposed mandatory automatic enrollment payroll deduction IRA programs. An employer that does not sponsor a qualified retirement plan, SEP, or SIMPLE IRA plan for its employees (or sponsors a plan and excludes some employees) would be required to offer an automatic enrollment payroll deduction IRA program with a default contribution to a Roth IRA of three percent of compensation under which three percent of compensation is deducted from each employee's cash wages and contributed to an IRA unless the employee makes an affirmative election of no IRA contribution or elects a different contribution amount. An employer would not be required to offer the program if the employer has been in existence less than two years or has 10 or fewer employees. The proposal includes other provisions designed to limit administrative burdens and ERISA liabilities on employers, such as allowing all contribu-

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Washington Report

by the CCH Washington News Bureau

House passes small business tax cut bill

On April 19, the House passed the Small Business Tax Cut Bill (HR 9) by a vote of 235 to 173. The legislation would provide a 20-percent tax cut for small businesses with up to 500 employees and would cost an estimated $46 billion in 2013. "This bill will help small businesses to re-invest, hire new workers, or provide a raise to an employee," Chair Dave Camp, R-Mich., said.

Democrats argued that businesses would receive the tax cut whether or not they had added new hires and that the cuts would result in an even more regressive small business tax regime. "Five out of every six dollars will go to people making more than $200,000 a year. That's not a small-business bill," Sen. Harry Reid, D-Nev., stated at an April 19 press conference.

Reid also discussed a counterproposal to extend the tax provision to allow small businesses to write off 100-percent of their major expenses from 2012 and to create a 10-percent income tax credit on new payroll in 2012.

Highway funding receives 90-day extension

The House voted 293 to 127 on April 18 to pass the Surface Transportation Extension Bill of 2012, Part II (HR 4348), which extends for 90 days the current highway funding and excise fuel taxes, including those on diesel fuel and certain alcohol fuels. The House bill also would authorize the Keystone XL oil pipeline project.

House Democrats would prefer that the House pass the bipartisan version of the highway reauthorization legislation, the Moving Ahead for Progress in the 21st Century Act (Sen 1813), passed in the Senate on March 14. The Senate bill includes several tax provisions, such as stabilization of interest rates for pension funding purposes along with revenue raisers.

Ways And Means approves child tax credit limits

On April 18, the House Ways and Means Committee approved limits on the Additional Child Tax Credit program, which would require taxpayers to provide their Social Security numbers to obtain the credit. The refundable credits were meant to help low-income individuals with families reduce their tax burden, but they have also become a popular vehicle for tax fraud according to the IRS.

"The legislation will help deter abuse and fraud that costs taxpayers billions of dollars by preventing those without Social Security numbers, including illegal immigrants who are currently ineligible to work in the United States, from receiving checks from the IRS in the form of the refundable child tax credit," Chair Dave Camp, R-Mich., said. He estimated that the bill would save $7.6 billion over 10 years.

Rep. Sander Levin, D-Mich., criticized the measure. He stated the limits would prevent three million children from receiving credits in 2013.

Tax Gap requires funding, internal reform

The IRS is in need of additional funding to effectively fight identity theft and narrow the tax gap between what is owed by taxpayers and what is actually paid, officials from the IRS, Treasury and Government Accountability Office (GAO) testified before the House Oversight and Government Reform Subcommittee on Government Organization, Efficiency, and Financial Management on April 19. However, they urged the IRS to take steps to modernize its internal systems and procedures in order to address the issues at hand. Suggestions for internal IRS improvements included performing more complete research into compliance, more targeted return selection, and establishing a reliable third-party document-matching program.

Experts emphasize tax reform should not harm retirement benefits

Experts at an April 17 House Ways and Means Committee hearing testified that the current framework for tax-favored retirement savings provides many valuable incentives for both employers and employees to make retirement contributions. While experts agreed that there could be improvements, they stressed that no action should be taken that would discourage employers from sponsoring retirement plans for their workers.

Judy Miller, chief of actuarial issues and director of retirement policy for the American Society of Pension Professionals and Actuaries, testified, "Any short-term revenue gain that might be derived from changes in the retirement savings incentives is largely illusory because when a worker saves less money today, it will mean smaller distributions and less tax revenue when the individual retires."

Social media use increases along with telephone wait time

The Treasury Inspector General For Tax Administration (TIGTA) recently reported that more people are using social media such as Facebook and Twitter to communicate with the IRS. The IRS is also communicating with taxpayers through video-sharing sites and podcasts. The increased use of Internet communication may be the result of decreasing telephone service quality. For the 2012 filing season, the IRS achieved only 66-percent level of service, and wait times averaged 16 minutes, TIGTA found.

LB&I receives new appointment

On April 19, Richard McAlonan was named as the new IRS Large Business and International (LB&I) Division's new Advanced Pricing and Mutual Agreement Director. McAlonan formerly worked in the Office of Associate Chief Counsel (International).

Practitioners' Corner

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tions to be made to a single IRA trustee or custodian designated by the employer.

- ***Comment.*** "Automatic enrollment and automatic escalation strategies hold great promise for increasing DC plan coverage and also increasing contributions to those plans," the American Benefits Council told the Ways and Means Committee. "In particular, studies show that automatic enrollment has a notable impact on the participation of lower income, younger and minority workers." The Council told the Committee that "more employers are adopting these designs every year, but accelerating those trends is important." Tools to accelerate the growth of automatic enrollment designs include "creation of new and simpler nondiscrimination testing safe harbors, removal of the existing limit on auto escalation in existing safe harbors and tax credits to employers that adopt automatic enrollment and escalation features."
- ***Comment.*** Rep. Richard Neal, D-Mass., has introduced the Automatic IRA Act of 2012 (HR 4049). The bill would generally require certain employers that do not maintain qualifying retirement plans or arrangements to make available to their eligible employees a payroll deposit IRA. Employees would be able to opt out of participation. The bill would also provide a tax credit to small employers (no more than 100 employees) to offset a portion of the costs associated with establishing an automatic IRA arrangement.

Expand the saver's credit. President Obama has proposed to make the retirement savings contribution credit, known as the saver's credit, fully refundable and for the saver's credit to be deposited automatically in an employer-sponsored retirement plan account or IRA to which the eligible individual contributes. In addition, in place of the current credit ranging from 10 percent to 50 percent for qualified retirement savings contributions up to $2,000 per individual, the White House proposal would provide a credit of 50 percent of such contributions up to $500 (indexed for inflation) per individual. The income threshold for eligibility would be increased to $65,000 for married couples filing jointly, $48,750 for heads of households, and $32,500 for singles and married individuals filing separately, with the amount of savings eligible for the credit phased out at a five-percent rate for AGI exceeding those levels.

Limit the value of exclusions and deductions for pretax employee contributions to defined contribution plans and IRAs. President Obama has proposed to limit the rate at which taxpayers with taxable income in excess of a threshold amount benefit from all itemized deductions, certain exclusions from AGI, as well as certain above-the-line deductions. In general, the White House proposal would limit the benefit of the specified provisions for individuals to 28 percent of the amount of the deduction or the exclusion. The exclusions and deductions under the proposal that are limited to 28 percent of their value include the exclusion or above-the-line deduction for pretax employee contributions to defined contribution plans and contributions to traditional IRAs, as well as the exclusion for employer-provided health insurance (and the deduction for the cost of health insurance for self-employed individuals) and the exclusion for tax-exempt state and local bond interest.

Consolidate some plans. The JCT also reviewed two retirement proposals from the Bush administration: Consolidating traditional and Roth IRAs into a single type of account (Retirement Savings Accounts). LSAs (Lifetime Savings Accounts) could be used to save for any purpose with an annual limit for contributions of $2,000. The JCT explained that the tax treatment of RSAs and LSAs would be similar to the current tax treatment of Roth IRAs (contributions would not be deductible, and earnings on contributions generally would not be taxable when distributed). Additionally, President Bush proposed to consolidate various current-law employer-sponsored retirement arrangements under which individual accounts are maintained for employees and under which employees may make contributions into a single type of arrangement called an employer retirement savings account (ERSA).

- ***Comment.*** The American Society of Pension Professionals and Actuaries (ASPPA) told the Ways and Means Committee that the large number of plans with different rules and criteria does not reduce the effectiveness of the incentives in increasing retirement savings. "Consolidating all types of DC plans into one type of plan would not be simplification," the ASPPA cautioned. "It would disrupt savings, and force state and local governments and nonprofits to modify their retirement savings plans and procedures."

More proposals. The JCT did not discuss the February 2012 proposals by Treasury and the IRS to broaden retirement payout options. Treasury and the IRS issued a comprehensive guidance package designed to increase the number and availability of retirement payout options, including proposed regs to encourage DB plans to offer a split option to avoid participants having to make a "cash or annuity" decision upon retirement and proposed regs to promote deferred longevity annuities. *See the February 9, 2012 issue of this newsletter for details.*

The JCT also did not review a recent legislative proposal to require distributions of inherited IRAs within five years. Generally, holders of IRAs and 401(k)-type accounts are required to begin taking taxable distributions from those accounts once they reach age 70½. However, distributions can be stretched over years if the holder leaves the account to a very young beneficiary. When the account holder dies, the taxation of the account is then spread over the life of the beneficiary. An early version of the Senate's Moving Ahead for Progress in the 21st Century Act (MAP-21) would have required the retirement savings accounts to be treated, for tax purposes, as distributed within five years of the death of the account holder, unless the beneficiary is the account holder's spouse, a disabled or chronically ill individual, a minor child or someone within 10 years of the account holder's age. The inherited IRA provision was dropped from the final version of MAP-21 as passed by the Senate.

Compliance Calendar

■ April 27
Employers deposit Social Security, Medicare, and withheld income tax for April 21, 22, 23, and 24.

■ May 2
Employers deposit Social Security, Medicare, and withheld income tax for April 25, 26, and 27.

■ May 4
Employers deposit Social Security, Medicare, and withheld income tax for April 28, 29, 30, and May 1.

■ May 9
Employers deposit Social Security, Medicare, and withheld income tax for May 2, 3, and 4.

■ May 10
Employees who received more than $20 in tips during April report them to their employers using Form 4070.

■ May 11
Employers deposit Social Security, Medicare, and withheld income tax for May 5, 6, 7, and 8.

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.

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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 **1**. The IRS announced that using which form to report interests in the income, expenses, and assets of joint ventures and other partnerships in which they have an ownership interest was optional for filers of 2011 Form 990, Return Of Organization Exempt From Income Tax?

(a) Form 1099-MISC
(b) Form 1065, Schedule K-1
(c) Form W-2
(d) None of the above

Q **2**. The IRS extended the deadline for taxpayers to request refunds of telephone excise taxes paid on long distance-telephone communications billed between February 28, 2003 and August 1, 2006. *True or False?*

Q **3**. What is the name of the U.S. Supreme Court case on the constitutionality of the *Patient Protection and Affordable Care Act?*

(a) *Lawrence v. Texas*
(b) *Marbury v. Madison*
(c) *Department of Health and Human Services v. Florida*
(d) None of the above

Q **4**. All Code Sec. 501(c)(3) organizations are prohibited from directly or indirectly participating in, or intervening in, any political campaign on behalf of or in opposition to any candidate for elective public office. *True or False?*

Answers:

Q1. *(b), See Issue #16, page 181.*
Q2. *True, See Issue #15, page 171.*
Q3. *(c), See Issue #14, page 159.*
Q4. *True, See Issue #13, page 153.*