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Inside this Issue

Draft Form Requires Entities To Certify FATCA Status Through Check-Boxes

◆ *Form W-8IMY (Draft dated August 13, 2012)*

To foster compliance under the Foreign Account Tax Compliance Act (FATCA), the IRS has released a draft of Form W-8IMY, Certificate of Foreign Intermediary, Foreign Flow-Through Entity, or Certain U.S. Branches for United States Withholding. The revised form generally requires foreign organizations to self-identify and self-certify their FATCA status.

■ ***CCH Take Away.*** "There are many different types of non-U.S. entity classifications under FATCA," Laurie Hatten-Boyd, tax principal, KPMG LLP, Seattle, told CCH. "Each has different requirements or responsibilities (regarding foreign accounts), including certification of FATCA status. This is a difficult form, but given the FATCA regime, I don't see how the IRS could have done this differently."

■ ***Comment.*** "For some of these (FATCA) entities, the form will be easy. For others it will not be completely clear," Julia Tonkovich, senior manager, Ernst & Young International Tax Services, told CCH. "We are going to see more complexity and more taxpayers struggling with the form."

U.S. payments

Form W-8IMY currently applies to payments of U.S.-source fixed or determinable annual or periodic (FDAP) payments, such as interest, dividends, rents or royalties, made to foreign intermediaries. The payments are subject to withholding under Chapter 3 (Code Secs. 1441–1446 and Code Secs. 1461–1464), Withholding of Tax on Nonresident Aliens and Foreign Corporations).

■ ***Comment.*** The existing Form W-8IMY "is provided by non-U.S. intermediaries that receive U.S. source payments made by a withholding agent on behalf of a non-U.S. investor (for example, dividends on U.S. stock owned by a foreign investor)," Hatten-Boyd said. "Generally, there is 30 percent withholding on the payment, unless reduced or eliminated by treaty."

■ ***Comment.*** "The entity providing Form W-8IMY is in effect telling the payor that "I'm receiving the payment but I'm not the beneficial owner,"" Lilo Hester, principal, Ernst & Young International Tax Services, Washington, D.C., told CCH.

The draft form retains the certifications required under Chapter 3, and includes FATCA certifications (under Chapter 4, Code Secs. 1471–1474) that must be made to avoid the 30 percent withholding under that regime. Intermediaries that receive U.S.-source payments on behalf of their accountholders will use the form to identify their status under both Chapters 3 and Chapter 4.

■ ***Comment.*** "FATCA imposes a 30 percent penal withholding tax on foreign financial institutions that refuse to identify and disclose foreign accounts owned by U.S. taxpayers," Hatten-Boyd said.

Continued on page 2

Route to: _____ _____ _____ _____ _____

LB&I Ends Tiered Issue Process; Pilots To Specialized Groups

◆ *LB&I-4-0812-010, Released August 17, 2012*

The IRS has announced that its Large Business & International (LB&I) Division is terminating the Tiered Issue Process to set exam priorities and manage exams. The new exam process is more decentralized and is intended to provide more authority to examination agents and teams to craft taxpayer-specific approaches to issues.

■ ***Reminder.*** "The vice grip of coordination has been released," George Hani, member, Miller & Chevalier, Washington, D.C., told CCH. "Many people felt that the tiered issue approach did not work in bringing cases to resolution. The intense coordination process worked well for tax shelters but did not work well for other issues. Taxpayers and government people are applauding," Hani said.

■ ***Comment.*** The (LB&I) memo provides that issues that were tiered "should be risk-assessed and examined in the same manner as any other issue in an audit." Hani said, "Exam teams should always be doing a risk assessment at the outset of the exam."

Tiered issues

The tiered issue process, initiated in 2006, "ensured consistency of treatment and uniform disposition of [tax shelter] and other types of cases," LB&I explained. The process identified certain issues as high risk and required the involvement of issue management teams to develop consistent approaches for resolving issues.

■ ***Comment.*** "The presence of a tiered issue was an obstacle [to case resolution]," Hani said. Examinations were subject to centralized control, and there was an inability to do a taxpayer-specific solution," he said.

Specialized practice groups

The new exam process involves specialized practice groups for domestic and interna-

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Draft Forms

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FATCA

Under FATCA, certain U.S. taxpayers with financial assets outside the U.S. must report those assets to the IRS. FATCA also requires foreign persons, such as foreign financial institutions (FFIs), to report information to the IRS about financial accounts held by U.S. taxpayers and by foreign entities in which U.S. taxpayers hold a substantial ownership interest.

■ ***Comment.*** The first reporting obligations for FFIs will begin in 2014 for 2013 accounts, Hatten-Boyd said. Reporting will encompass the name and address of the accountholder, as well as the balance in the account, she explained. By 2017, reporting will be required for account income and transactions.

Intermediaries

An intermediary is a person, generally a financial institution, that receives a payment from the U.S. payor on behalf of its account holder. The intermediary can be a qualified or nonqualified intermediary. A qualified intermediary (QI) agrees to withhold (or pass up withholding instruction) on the U.S. source payment; a nonqualified intermediary does not. The intermediary provides Form W-8IMY to the person making the payment.

■ ***Comment.*** Form W-8IMY refers to accounts, but these are accounts held by the intermediary. Using the form, the intermediary that is a QI does not identify accountholders to the payor, Hatten-Boyd explained. Instead, the QI either agrees to withhold or provides withholding instructions to the payor, indicating how much of a payment is subject to withholding and how much is not. Intermediaries will be acting under both Chapter 3 and Chapter 4, Hatten-Boyd said.

Expanded form

The draft Form W-8IMY has been expanded from two pages to seven pages. The draft form has a checklist of 20 types of entities identified under FATCA, plus a box for "other." The IRS did not issue instructions for the draft form.

■ ***Comment.*** The IRS may not be able to provide instructions until it issues final regs defining the different entities, Hatten-Boyd said.

One change to Form W-8IMY is the requirement, in Part I, Line 4, that the entity identify its Chapter 4 status under FATCA. A designated status includes participating or nonparticipating FFIs, active or passive nonfinancial foreign entities, and certain deemed-compliant and excepted entities.

In Parts VII to XXIII, the entity has to further certify through the use of checkboxes that it meets the requirements of its claimed status, including, in some cases, whether it is assuming primary withholding responsibility for payments subject to FATCA.

■ ***Comment.*** "The intergovernmental agreements (between the U.S. and other countries) are a huge part of FATCA and will drive FATCA compliance," Tonkovich said. "One big question is how a multinational group will categorize its members if some members of the group are covered by an intergovernmental agreement and some are not."

Reference: TRC INTL: 33,054.25

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 MAP-21 Adjusted Pension Funding Segment Rates

◆ *Notice 2012-55*

The IRS has issued adjusted pension funding segment rates to reflect the Moving Ahead for Progress in the 21st Century Act (MAP-21). Passed by Congress in July, MAP-21 provides for pension funding stabilization.

■ ***CCH Take Away.*** Before Notice 2012-55 was issued, some actuarial firms estimated what the rates would be, Louis Mazawey, principal, The Groom Law Group, Chartered, Washington, D.C., told CCH. "The good news is that the rates (in Notice 2012-55) are higher than anticipated, especially the third segment," he observed.

Background

Employers maintaining defined benefit plans generally are required to make a contribution for each plan year to fund plan benefits. The minimum required contribution for a plan year for a single-employer defined benefit plan generally depends on a comparison of the value of the plan's assets, reduced by any prefunding balance or funding standard carryover balance (net value of plan assets) with the plan's funding target and target normal cost.

■ ***Comment.*** Some in the business community lobbied for changes to the Pension Protection Act's (PPA) minimum funding rules (and benefit restrictions) to adjust for periods of abnormally low or extremely high interest rates so as to remove the distortions caused by the current low interest rate environment, Mazawey explained. MAP-21 adjusts the relevant interest rates for any period to the extent that the rate for that period is not within a specified range of the average "segment" rates for the preceding 25-year period (ending September 30 of the calendar year before the calendar year in which the plan year begins).

MAP-21

Under MAP-21, plan liabilities continue to be determined based on corporate bond segment rates, which are based on the average interest rates over the preceding two years. However, beginning in 2012 for purposes of the minimum funding rules, any segment rate must be within 10 percent (increasing to 30 percent in 2016 and thereafter) of the average of the segment rates for the 25-year period preceding the current year:

- If a segment rate determined for an applicable month under the regular rules is less than the applicable minimum percentage, the segment rate is adjusted upward to match that percentage.
- If a segment rate determined for an applicable month under the regular rules is more than the applicable maximum percentage, the segment rate is adjusted downward to match that percentage.

Under MAP-21, the applicable minimum and maximum percentages depend on the calendar year in which the plan year begins. The minimum and maximum percentages are:

- 90 percent and 110 percent for 2012;
- 85 percent and 115 percent for 2013;
- 80 percent and 120 percent for 2014;
- 75 percent and 125 percent for 2015; and
- 70 percent and 130 percent for 2016 and thereafter.

Notice 2012-55

The IRS has now released the first 25-year average segment rates and adjusted 24-month segment rates. Based on the calculation of equivalent rates for months before October 2005 and actual segment rates for later months, the averages, for the 25 years ending September 30, 2011, of the first, second, and third segment rates are: 6.15, 7.61, and 8.35 percent, respectively.

The IRS also described in Notice 2012-55 the 24-month average segment rates not adjusted under MAP-21, and adjusted 24-month average segment rates, for plan years beginning in 2012.

■ ***Comment.*** The IRS explained that the methodology used in Notice 2012-55 reflects a balance between the goal of a timely determination and publication of the 25-year average segment rates. The IRS also reported that it intends to issue more MAP-21 guidance in the near future.

References: FED ¶46,434; TRC RETIRE: 30,556.

District Court Nixes Accrual Method Taxpayer's Attempt To Currently Deduct State Taxes

◆ *Wells Fargo & Co., DC-Minn., August 10, 2012*

Despite a change in state law, a federal district court has found that an accrual method taxpayer could not deduct state taxes paid for the privilege of doing business in the state in the year the taxpayer argued that the all events test was satisfied. Code Sec. 461(d), the court observed, provides that if a state changes its tax laws after 1960—and, as a result of that change, the accrual date of the payment of state taxes is moved up—the change in the state law is ignored for purposes of federal tax law.

■ ***CCH Take Away.*** The taxpayer sought to deduct the taxes in Year 1 (the year in which the amount of the taxes are calculated) and not in year 2 (the year the taxes are paid). Since 1972, state law provided that corporation must pay taxes for the privilege of doing business in Year 2—and cannot have any part of its liability reduced—whether or not the corporation actually does any business in the state during Year 2. Because of Code Sec. 461(d), the taxpayer's ability to deduct the state taxes in Year 1 depended on state law as it existed before 1961.

Background

The taxpayer calculated its state tax liability on the basis of its income in Year 1 (even

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Failure To Timely File Proof Of Loss No Bar To Casualty Loss Deduction, Claims Court Finds

◆ *Ambrose, FedCl, August 3, 2012*

In a case of first impression, the Court of Federal Claims has found that a married couple's failure to provide timely proof of their loss to their insurance provider did not preclude them from deducting the loss under Code Sec. 165(h)(5)(E). The plain language of the statute merely requires a basic demand for compensation, the court held.

■ ***CCH Take Away.*** A casualty loss is a loss resulting from a fire, storm, or other casualty. For a casualty or theft loss sustained by a personal residence, the loss amount is its decline in value from the casualty or theft, or, if lesser, its adjusted basis, reduced by the amount of any insurance proceeds or other reimbursement received.

Background

In November 2002, the taxpayers' home was damaged by an appliance fire. Their insurance carrier contracted with a fire damage restoration company to repair the damage. On December 25, 2002, a second, larger fire destroyed the home. According to the insurer, the taxpayers failed to provide a proof of loss within the designated timeframe and the insurer denied their claim.

The taxpayers claimed a casualty loss of $168,000 on their 2007 return, which generated a $16,000 refund. The IRS disallowed the refund determining that the couple did not file a timely insurance claim as required under Code Sec. 165(h)(5)(E).

Court's analysis

The Tax Reform Act of 1986, the court found, denies a deduction for any loss covered by insurance unless the individual files a timely insurance claim with respect to such loss. According to the IRS, the taxpayers did not make a timely insurance claim because they made a personal decision not to file the proof of loss on a timely basis. The court observed that the statute does not define "files a timely insurance claim."

■ ***Comment.*** Before enactment of Code Sec. 165 (h)(5)(E), some courts allowed taxpayers to deduct casualty losses even though they had failed to file insurance claims, the Claims Court noted

The plain meaning of the word "claim," the court found, encompasses a demand for something as rightful or due. It does not require details specific enough to permit the liable party to evaluate and quantify its liability. The court concluded that requiring a taxpayer to file a timely claim does not mean that she must file with her insurer anything more than what qualifies, under the policy, as a basic demand for compensation.

References: 2012-2 USTC ¶50,518; TRC REAL: 3,110.20.

Deductions

Continued from page 3

though the taxes were paid for the privilege of conducting business in Year 2). According to the taxpayer, as an accrual method taxpayer, it should be able to deduct the state taxes on the returns it files for Year 1.

All events test

Code Sec. 461(a) provides that the amount of any deduction or credit must be taken for the tax year that is the proper tax year under the method of accounting the taxpayer uses to compute taxable income. Reg. §1.461-1(a)(2)(i) provides that, under an accrual method of accounting, a liability is incurred, and is generally taken into account for federal income tax purposes, in the taxable year in which (1) all the events have occurred that establish the fact of the liability, (2) the amount of the liability can be determined with reasonable accuracy, and (3) economic performance has occurred for the liability.

Court's analysis

The taxpayer argued that the Supreme Court's application of the all events test in *Hughes Properties, Inc., 476 U.S. 593 (1986)* controlled in this case despite Code Sec. 461(d). The court disagreed.

In *Hughes Properties*, the Supreme Court held that a casino operator could deduct amounts guaranteed for payment of progressive slot machine jackpots that had not yet been won by casino patrons. According to the Supreme Court, the taxpayer had a fixed obligation to pay the guaranteed amounts, and that the identification of the eventual recipients of the progressive jackpots was inconsequential. The court found that the obligation of the casino in *Hughes Properties* was materially different from the obligation of the taxpayer under state law as it existed before 1961.

Under pre-1961 state law, a business would never become liable to pay for the privilege of operating in Year 2 unless it actually operated in Year 2, the court found. The corporation's liability (its obligation to pay taxes for the privilege of conducting business in the state in Year 2) was contingent on its actually conducting business in the state in Year 2.

■ ***Comment.*** The district court noted that other courts have interpreted pre-1961 state law to require that the deduction be taken in Year 2.

Reference: 2012-2 USTC ¶50,521; TRC INDIV: 45,112.15.

LB&I Ends

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tional issues. These groups are designed to provide exam teams with technical advice to manage their cases. "LB&I views [the groups] as a better mechanism for balancing the need for consistency with the recognition that there is no "one size fits all" approach to examining and resolving issues," LB&I stated in the memo.

■ ***Comment.*** "Issue practice groups do not have any authority over examiners," Hani said. "My impression is that it will be up to the exam team to reach out to the issue teams, but no requirement to do so," he said. "Coordination is nothing new; it will be interesting to see how the new era of coordination is implemented."

Reference: TRC IRS 3,106.

Tax Court Finds Masonry Workers Are Employees Of S Corp, Not Independent Contractors

◆ *Atlantic Coast Masonry, Inc., TC Memo. 2012-233*

An S corp engaged in masonry subcontracting misclassified its workers as independent contractors, the Tax Court has held. Applying the common law worker classification test, the court found that the majority of factors favored employee status.

■ ***CCH Take Away.*** "States and the federal government have really stepped up enforcement of worker misclassification," Douglas Hass, attorney, Franczek Radelet, P.C., Chicago, told CCH. Construction is among the main industries where state and federal governments have focused their worker misclassification investigations, Hass said. "Other industries receiving increased governmental scrutiny include hospitality, janitorial, technology, and home health care."

Background

An S corp hired workers to perform masonry services. The workers provided their own tools and were free to seek employment as masonry workers with other businesses. However, one of the S corp owners always delivered instructions to the workers prior to commencement of the project and many workers worked exclusively for the S corp. Also the workers worked a required eight-hour day; they could be fired at will; and they received weekly cash payments based on their productivity.

The S corp failed to file Form 1120S, U.S. Income Tax Return for an S Corporation, for the 2004, 2005, and 2006 tax years. The S corp did not issue Forms 1099-MISC, Miscellaneous Income, to its masonry workers until after receiving notice that the IRS had selected it for an employment tax examination. The IRS determined that the taxpayer owned more than $700,000 in employment taxes.

Section 530 relief

Generally, employers must withhold income taxes, withhold and pay Social Security and Medicare taxes, and pay unemployment tax on wages paid to an employee. Employers do not generally have to withhold or pay any taxes on payments to independent contractors

Certain employers that have misclassified workers may be eligible for relief under Section 530 of the Revenue Act of 1978 if they can show that:

- They did not treat the workers as employees;
- They consistently treated the individuals as non-employees on all tax returns; and
- They had a reasonable basis for not treating the individuals as employees.

■ ***Comment.*** "Courts seem to be taking the position that if you have not complied with the Form 1099 requirements, you are not likely to receive any relief under the (IRS) Voluntary Classification Settlement Program or the Section 530 safe harbor," Hass told CCH. "I am not aware of any cases where the requirement was waived."

Court's analysis

The common law test describes a number of factors to determine if a worker is an employee or independent contractor. The factors include the degree of control exercised by the principal, whether the principal can discharge the workers, and the permanency of the relationship.

The court found that the S corp possessed a degree of control over the workers indicating an employer–employee relationship: the S corp had the authority to instruct the masons on the job; it had the right of approval as to the quality of their work; and it set the hours and pay and paid workers on a weekly basis. The court also found that workers had no opportunity for profit or loss, no matter whether the project was completed under or over-budget; the S corp had the right to discharge workers at will; and the workers were an essential part of the S corp's normal operations. The freedom of the masons to work elsewhere was one factor that weighed in favor of independent contractor status.

The court also refused to grant Section 530 relief to the S corp because of its failure to file Forms 1099-MISC. Additionally, the court upheld penalties, finding that the S corp had not shown reasonable cause for its failure to file timely returns or make employment tax deposits.

References: CCH Dec. 59,160(M); TRC COMPEN: 3,102.

TIGTA Discovers Errors By IRS Appeals In CDP Cases

The Treasury Inspector General for Tax Administration (TIGTA) has uncovered errors by the IRS Appeals in collection due process (CDP) cases. The errors impact the type of hearing offered to the taxpayer, the termination of the collection statute of limitations, and the documentation of Appeals' officers impartiality in the CDP hearing process.

■ ***Comment.*** The number of collection-related hearings continues to increase, to over 50,000 hearings a year. TIGTA studied a sample of 140 cases. While the number of sample errors is not high, the totals project to thousands of erroneous cases, according to TIGTA.

Background. The IRS uses liens and levies to collect taxes. After receiving notice, a taxpayer has 30 days to request a CDP hearing. If the request is late, the IRS may grant an equivalent hearing (EH). Taxpayers can appeal a CDP hearing decision to the Tax Court, but cannot appeal EH decisions.

TIGTA's report. TIGTA reported that Appeals made errors that favored taxpayers, by granting CDP hearings instead of EH hearings, and granting EH hearings where no hearing was required. TIGTA also discovered that in some cases the IRS computed inaccurate statutes of limitations, giving itself additional time to collect the liability.

TIGTA Ref. No. 2012-10-077; TRC IRS: 48,058.

GAO Reviews Possible Tax Avoidance Advantage Of Foreign-Controlled Domestic Corporations

◆ *GAO-12-743*

The Government Accountability Office (GAO) recently cautioned that the foreign-controlled domestic corporation (FCDC) ownership structure could facilitate a tax avoidance or evasion advantage. However, GAO added that a lack of information makes determining how corporate groups become foreign-owned infeasible at this time.

■ ***CCH Take Away.*** Senate Finance Committee Chair Max Baucus, D-Mont., requested GAO to identify if there are tax advantages to the FCDC ownership structure and describe the number, size and type of these FCDCs. GAO told Baucus and other lawmakers that "very little is known about the foreign parents of corporations with a majority of their operations in the U.S."

Background

Income earned by a foreign corporation from its foreign operations generally is subject to U.S. tax when such income is distributed to a U.S. person that holds stock in such foreign corporation. Accordingly, a U.S. person that is a shareholder of a foreign corporation generally is not subject to U.S. tax on the income earned by the foreign corporation until that income is distributed to the shareholder as a dividend. However, a variety of anti-deferral regimes apply to subject the U.S. shareholder to U.S. tax on that income even if the income is not actually distributed to the shareholder.

■ ***Comment.*** United States shareholders of controlled foreign corporations (CFCs) are required to include in gross income currently their pro rata share of certain income of the CFC (referred to as subpart F income), without regard to whether the income is distributed by the CFC to its shareholders in the year the income is earned. Subpart F income includes foreign base company income, including foreign personal holding company income (such as dividends, interest, annuities and other specified passive income), and certain insurance income.

Under Code Sec. 482, the IRS may adjust the income, deductions, credits, or allowances of commonly controlled taxpayers to prevent evasion of taxes or to clearly reflect their income. Code Sec. 482 regs generally provide that prices charged by one affiliate to another, in an intercompany transaction involving the transfer of goods, services, or intangibles, yield results that are consistent with the results that would have been realized if uncontrolled taxpayers had engaged in the same transaction under the same circumstances.

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AFRs Issued For September 2012

Rev. Rul. 2012-24

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

Applicable Federal Rates (AFR) for September 2012

Short-Term	Annual	Semiannual	Quarterly	Monthly
AFR	.21%	.21%	.21%	.21%
110% AFR	.23%	.23%	.23%	.23%
120% AFR	.25%	.25%	.25%	.25%
130% AFR	.27%	.27%	.27%	.27%
Mid-Term				
AFR	.84%	.84%	.84%	.84%
110% AFR	.92%	.92%	.92%	.92%
120% AFR	1.01%	1.01%	1.01%	1.01%
130% AFR	1.09%	1.09%	1.09%	1.09%
150% AFR	1.26%	1.26%	1.26%	1.26%
175% AFR	1.48%	1.47%	1.47%	1.47%
Long-Term				
AFR	2.18%	2.17%	2.16%	2.16%
110% AFR	2.40%	2.39%	2.38%	2.38%
120% AFR	2.62%	2.60%	2.59%	2.59%
130% AFR	2.84%	2.82%	2.81%	2.80%

Adjusted AFRs for September 2012

	Annual	Semiannual	Quarterly	Monthly
Short-term adjusted AFR	.23%	.23%	.23%	.23%
Mid-term adjusted AFR	.95%	.95%	.95%	.95%
Long-term adjusted AFR	2.80%	2.78%	2.77%	2.76%

The Code Sec. 382 adjusted federal long-term rate is 2.80%; 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 3.02%; the Code Sec. 42(b)(2) appropriate percentages for the 70% and 30% present value low-income housing credit are 7.35% and 3.15%, 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 1.0%.

References: FED ¶46,437; TRC ACCTNG: 36,162.05.

Shareholder's Hardship Loan Is Taxable Income; Intent Found Through Subsequent Acts

◆ *Todd, CA-5, Aug. 16, 2012*

Affirming the Tax Court, the Fifth Circuit Court of Appeals has found than an advance on a life insurance policy to a taxpayer, who was the sole shareholder of a corporation that participated in a death-benefits-only plan, was a taxable distribution and not a bona fide loan. The parties failed to persuade the court that they intended the loan to be repaid.

■ ***CCH Take Away.*** The central question of whether a transaction is a nontaxable bona fide loan hinges on whether the parties intended that the borrowed funds be repaid.

Background

The taxpayer was the sole shareholder, director, and president of a corporation that entered into an agreement with a welfare benefit fund for a death-benefits-only plan. The taxpayer then took out life insurance policies to fund the death benefits owed by the welfare benefit fund to each of the corporation's employees. The taxpayer subsequently claimed financial hardship and took a $400,000 distribution from the plan. The welfare benefit fund did not secure the $400,000 loan or create a repayment schedule until several months after making the distribution. The taxpayer never made payments on the note.

■ ***Comment.*** The plan provided death benefits up to eight times an employee's annual salary with a cap at $6 million.

Tax Court's decision

The Tax Court used a common law test to determine whether a bona fide loan existed. These factors, laid out in *Welch, CA-9, 2000-1* USTC *¶50,258,* include:

- Whether the promise to pay is evidenced by a note or other instrument;
- Whether interest was charged;
- Whether a fixed schedule for repayments was established;
- Whether collateral was given to secure payment;
- Whether repayments were made;
- Whether the borrower had a reasonable prospect of repaying the loan and whether the lender had sufficient funds to advance the loan; and
- Whether the parties conducted themselves as if the transaction were a loan.

The Tax Court found that although the death-benefit plan could serve as security for the loan and the taxpayer had a reasonable prospect of repaying the purported loan, the majority of the evidence weighed against existence of a bona fide loan. The Tax Court found that the parties had failed to comply with the terms of the promissory note, the interest rate charged was below-market, there were no payments made by the taxpayer or attempts at collection by the lender, the purported alternative payment method of relying on the death benefit was inadequate because the benefit was contingent, and the parties did not conduct themselves as if the transaction were a loan.

Fifth Circuit's analysis

The Fifth Circuit upheld the Tax Court's decision and found the advance was taxable. The promissory note on the loan and the repayment schedule were only adopted after the fact, in contravention of the welfare benefit fund's policies. This suggested an attempt at formality merely to achieve a desired tax result, the Fifth Circuit found.

Reference: 2012-2 USTC ¶50,525; TRC INDIV: 6,056.

GAO

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GAO's study

Studies of this corporate structure, GAO reported, have been limited to studies of corporations that inverted. In an inversion, a corporate group with a U.S. owner generally creates a new foreign corporation in a low tax country that becomes the foreign owner of the corporate group to reduce the group's tax liabilities, GAO explained.

GAO further reported that Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business, fails to provide reliable information about U.S. sales or other indicators of the U.S. share of worldwide operations. The IRS does not define "principal country(ies) where business is conducted" on Form 5472 and taxpayers can claim more than one country as a principal location where business is conducted.

Reference: TRC INTL: 3,754.

Dormant LLC Can Treat Entity Classification Election As Its First

The IRS has ruled that a "completely dormant" limited liability company could make a classification election after its date of formation. The election will not be considered a change of classification that would require a 60-day wait period or permission from the IRS.

Background. X was formed as a limited liability. Initially, X had no assets, liabilities, income or deductions. Subsequently, Y merged into X, which elected to be an association taxable as a corporation. The election was effective on the date of the merger.

IRS analysis. The IRS noted that a noncorporate entity can elect its federal tax classification and can change its classification. An entity that changes its classification has to wait 60 months before it can change its classification again. However, an election by a newly-formed entity that is effective on the date of formation is not a change of classification.

The IRS determined that X's election to be a corporation was an initial classification election, not a change. Thus, the 60-month waiting period was not triggered.

■ ***Comment.*** An initial election is not a change, but the regs specify that the election be effective on the date of formation. X's election was made after its date of formation. However, the IRS treated X as a newly-formed entity because of its lack of activity.

LTR 201233007; TRC STAGES: 24,150.

Tax Briefs

International

The competent authorities of the U.S. and Belgium have agreed that additional taxes established by Belgium municipalities and conurbations on the Belgium income tax are covered under Article 2 of the U.S.-Belgium tax convention.

Announcement 2012-30, FED ¶46,436; TRC INTL: 18,138.

Foreign citizens were not entitled to litigation and administrative costs despite the IRS conceding that their wages from employment at foreign embassies in the U.S. were exempt from taxation, because the IRS's initial position that their wages were not exempt under Code Sec. 893(b) was substantially justified.

Da Silva, TC, CCH Dec. 59,162(M), FED ¶48,176(M); TRC LITIG: 3,154.

Jurisdiction

The Court of Federal Claims lacked subject matter jurisdiction over an individual's claims for tax refund and damages. The individual had already filed petitions in the Tax Court for the tax years at issue and failed to pay the tax liability in full for one of the tax years prior to filing suit.

Smith, CA-FC, 2012-2 USTC ¶50,515; TRC INDIV: 18,052.20.

Tax Crimes

There was sufficient evidence to convict an individual of willfully filing false tax returns because he knowingly deducted personal expenses and understated his taxable income. The individual's challenge to the credibility of his bookkeeper's testimony was an argument for the jury that the jury resolved against him.

VanArsdale, CA-6, 2012-2 USTC ¶50,513; TRC IRS: 66,202.

Summons

An IRS summons directing an individual to appear, testify and produce documents was ordered enforced. The government established its *prima facie* case for enforcement under *Powell*, which the individual failed to rebut.

Bates, DC Calif., 2012-2 USTC ¶50,517; TRC IRS: 21,300.

An IRS summons directing an individual to appear, testify and produce documents relating to an investigation into his liability for the trust fund recovery penalty was ordered enforced. The government established its *prima facie* case for enforcement under *Powell*, which the individual failed to rebut.

P. Le, DC Calif., 2012-2 USTC ¶50,516; TRC IRS: 21,300.

Deductions

An S corporation owned by a CPA was denied travel expense deductions and depreciation on his home. In addition, the income the taxpayer received from insurance policies equalled its gross receipts since the policies were not a material product to which direct costs could be allocated. The payments that he received from his company were executive compensation, not rental payments. Finally, the taxpayer was liable for an accuracy-related penalty.

Perry, TC, CCH Dec. 59,164(M), FED ¶48,178(M); TRC BUSEXP: 3,200.

Frivolous Arguments

An individual was not entitled to dismissal of the government's complaint seeking to reduce to judgment federal tax assessment against the individual and to foreclose tax liens upon her property. Her arguments were dismissed as frivolous.

Berryman, DC Colo., 2012-2 USTC ¶50,514; TRC IRS: 45,160.

An airline pilot who raised only tax protestor arguments had unreported compensation income for the tax years at issue because the payments he received from his employer were compensation for services rendered. He was liable for the Code Sec. 6651(a)(1) addition to tax as well as for the frivolous argument penalty,

Nelson, TC, CCH Dec. 59,159(M), FED ¶48,173(M); TRC IRS: 30,152.05.

Collection Due Process

An IRS settlement officer (SO) did not abuse his discretion in rejecting an individual's proposed offer in compromise as a collection alternative and continuing with collection proceedings. Further, the SO did not abuse his discretion in using national and local standards to determine the taxpayer's "reasonable collection potential," rather than the taxpayer's actual housing and utility expenses.

Clarke, TC, CCH Dec. 59,165(M), FED ¶48,179(M); TRC IRS: 51,056.25.

An IRS settlement officer did not abuse her discretion in denying an individual's request for an installment agreement and determining to continue collection proceedings against that individual. He failed to file a return for a later tax year, precluding application of an installment agreement.

I.L. Starkman, TC, CCH Dec. 59,163(M), 2012FED ¶48,177(M); TRC IRS: 51,056.25.

An IRS settlement officer did not abuse her discretion by denying an individual's requests for an installment agreement and to place his tax liability in currently not collectible status. The financial information he filed demonstrated that he had sufficient assets to pay his tax liability. The settlement officer allowed a 120-day extension for the individual to file loss carryback paperwork from one year to resolve the tax liability of the tax year at issue.

E.E. Curran, TC, CCH Dec. 59,161(M), FED ¶48,175(M); TRC IRS: 51,056.15.

Retirement Plans

The IRS has provided specifications for filing Form 8955-SSA, Annual Registration Statement Identifying Separated Participants with Deferred Vested Benefits, with the Internal Revenue Service/Information Returns Branch (IRS/IRB) electronically through the FIRE (Filing Information Returns Electronically) System.

Rev. Proc. 2012-34, FED ¶46,435; TRC RETIRE: 78,052.20.