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Inside this Issue

Supreme Court Denies Review In Tax Cases...*477*

Accrued Benefits Taxable Income Upon Revocation Of ESOP's Exempt Status...*478*

Conservation Easement Agreement Provides Adequate Acknowledgment...*479*

Supreme Court Asks Administration To Respond To PPACA Challenge...*479*

ETI Exclusion Not Available To Reduce Subpart F Income...*480*

Substantial Variance Rule No Bar To Research Credit Claims...*480*

Financial Institution Must File Forms 1099-C Under Settlement Agreement...*481*

IRS Reminds Preparers Of RTRP Exam; Updates FAQs...*481*

IRS Treats Modified Corporate Transactions As F Reorgs...*482*

Tax Court Excuses International Organization Worker From Penalty...*482*

Tax Briefs...*483*

IRS Revises ITIN Procedures...*483*

IRS Updates Form 8027 E-Filing Instructions...*483*

Relief Expanded For Mississippi Disaster Victims...*484*

Practitioners' Corner: Sample 2012 Third Quarter Client Letter...*485*

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Pro-IRS Decisions In S Corp, Code Sec. 481 And Parsonage Cases Left Intact After Supreme Court Denies Review

◆ *U.S. Supreme Court Order List, October 1, 2012*

The U.S. Supreme Court has commenced its new term announcing that it will not review decisions by lower courts on a number of federal tax issues. The Court declined to review decisions involving S corp compensation, a Code Sec. 481 adjustment and the parsonage allowance.

■ ***CCH Take Away.*** The last term of the Supreme Court was highlighted by intense interest in the fate of the Affordable Care Act, which the Court upheld in *NFIB v. Sebelius, 2012-2* USTC *¶50,573*, Elizabeth Dold, principal, The Groom Law Group, Washington, D.C., told CCH. Looking ahead, the Supreme Court could take up the question of whether severance payments are subject to FICA taxes. "Last month, the Sixth Circuit Court of Appeals upheld the lower court's decision in *Quality Stores, 2012-2* USTC *¶50,551* holding that severance payments were not subject to FICA taxes." Additionally, the Supreme Court may take up the Defense of Marriage Act (DOMA), which prevents same-sex partners from filing returns using a married filing separately or jointly filing status because federal law does not treat same-sex partners as married for federal tax purposes, Dustin Stamper, manager, Washington National Tax Office, Grant Thornton, LLP, told CCH.

S corp compensation

Unlike a partnership, where a general partner's share of profits is subject to self-employment taxes, distributions to an S corp shareholder are not subject to FICA (Social Security) taxes. In *Watson, P.C., 2012-1* USTC *¶50,203*, the employee-owner of an S corp received $24,000 each year as compensation and the S corp paid FICA taxes on that amount. The S corp distributed approximately $200,000 to the employee-owner as a dividend. According to the IRS, the value of the employee-owner's services to the S corp was $91,000 and the S corp underpaid employment taxes.

The Eighth Circuit Court of Appeals found that the employee-owner was the primary rainmaker and the S corp had substantial income. The purported $24,000 in annual compensation was far below amounts paid to similarly-situated professionals. The Eighth Circuit concluded that a portion of the dividends paid to the employee-owner was compensation for services and the S corp was liable for unpaid taxes. Because the Supreme Court declined to review the case, the Eighth Circuit's decision is final.

Code Sec. 481

Under Code Sec. 481, a taxpayer changing its method of accounting for a particular year generally must take into account adjustments necessitated by the change, to prevent amounts from being duplicated or omitted. The adjustments are calculated as though the taxpayer had used the new method of accounting in all prior years, including closed years.

Continued on page 478

Route to: ______ ______ ______ ______ ______

Tax Court Finds Vested Accrued Benefits Included In Income Upon Revocation Of ESOP's Exempt Status

◆ *Yarish, 139 TC No. 11*

In a case of first impression, the Tax Court has found that the amount of a highly compensated employee's vested accrued benefits must be included in income upon revocation of an Employee Stock Ownership Plan's (ESOP) tax-exempt status. Code Sec. 402(b)(4)(A), the court held, requires that a highly compensated employee include in income the vested accrued benefit to the extent it has not been previously taxed.

■ ***CCH Take Away.*** The Tax Court upheld disqualification of the ESOP in *Yarish Consulting Inc., CCH Dec. 58,296(M).* The court found that the IRS did not abuse its discretion by retroactively revoking the ESOP's qualification.

Background

In 2000, the taxpayer organized an S corp to manage his several medical practices. The S corp sponsored an ESOP. The taxpayer, who was a highly compensated employee, participated in the ESOP. In 2004, the ESOP and the entire account balance was transferred to the taxpayer's individual retirement account (IRA). At that time, the taxpayer's account balance and vested accrued benefit in the ESOP was $2.4 million. None of that amount had been taxed to the taxpayer before the 2004 plan year.

The IRS retroactively disqualified the ESOP for the years 2000-2004. The IRS determined that the ESOP did not meet the requirements under Code Sec. 401(a) for failing to satisfy Code Sec. 410(b) and that the trust under the ESOP was not exempt from taxation under Code Sec. 501(a). The statute of limitations was closed for all years but 2004.

Court's analysis

The court found that Code Sec. 402(b) sets forth the consequences to participants in a plan under Code Sec. 401(a) when a trust associated with the plan is not exempt under Code Sec. 501(a). A special rule applies when the trust tax exemption does not apply due to a plan's failure to meet certain coverage or participation requirements under Code Sec. 410(b) or 401(a)(26). The special rule requires a highly compensated employee to include in income an amount equal to the vested accrued benefit of such employee (other than the employee's investment in the contract).

The taxpayer and the IRS disputed the meaning of the phrase "other than the employee's investment in the contract." According to the taxpayer, only the annual increase in his vested accrued benefit for 2004 was included in his income for that same year. The IRS countered that the entire amount of the vested accrued benefit was included in income for 2004.

The court found that "investment in the contract" is defined in Code Sec. 402. Under Code Sec. 402, employer contributions are treated as part of the "investment in the contract" to the extent they were previously included in income.

The taxpayer argued that the Code Sec. 72 definition should apply to Code Sec. 402(b)(4)(A). The court disagreed. The court found that nowhere in Code Sec. 72 or its regs is there any indication that the definition applies outside of Code Sec. 72.

The court also rejected the taxpayer's claim that "investment in the contract" under Code Sec. 402(b)(4)(A) should be interpreted in *pari materia* with Code Sec. 72. Statutes may be considered in *pari materia* when they relate to the same subject matter or have the same purpose. However, Code Sec. 72 and Code Sec. 402(b)(4)(A) serve different purposes. The purpose of Code Sec. 402(b)(4)(A), the court found, is to discourage highly compensated employees from participating in a plan that fails to satisfy certain coverage requirements. Code Sec. 72, in contrast, provides rules for taxation of distributions from annuity and similar contracts. Further, the court found that Code Sec. 402(b)(4)(A) was an exception to the general principle that amounts must be included in income for the tax year the accession to wealth occurs.

References: CCH Dec. 59,216;
TRC COMPEN: 15,106.05.

Supreme Court

Continued from page 477

In *Bosamia, 2011-2* USTC *¶50,688,* two S corps (A and B) were owned by a married couple. Because the two entities were related parties, Code Sec. 267(a)(2) would bar the entities from deducting payments owed to the other party from income until the related party included the payments in its income. From 1998 to 2003, A claimed accounts payable deductions for payments owed to B even though A never made any payments to B and B did not include the payments in income. The IRS determined that A could not claim deductions for the payments until B included the payments in income. When the IRS issued its notice of deficiency, the limitations period for the 1998-2002 tax years had expired.

The Fifth Circuit, affirming the Tax Court, held that disallowing a deduction under Code Sec. 267 constituted a change in accounting method. Under Reg. §1.446-1, a change in accounting method includes a change in the treatment of a material item, which the regs define as any item that involves the proper time for including an item in income or taking a deduction. The change involved a material item. Therefore, the IRS could under Code Sec. 481 increase the taxpayer's

Continued on page 479

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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*

Entire Conservation Easement Agreement Provides Adequate Acknowledgment

◆*RP Golf, LLC, TC Memo. 2012-282*

The Tax Court has found that a golf course's conservation easement agreement met the contemporaneous written acknowledgment requirement under Code Sec. 170, despite IRS protests that it lacked an explicit statement that no goods or services were exchanged for the agreement. When taken as a whole the agreement should be read to state that no goods or services were received in exchange for the contribution, the court found.

■ ***CCH Take Away.*** Code Sec. 170(f)(8)(A) requires that, for charitable contributions of $250 or more, no deduction is allowed unless the taxpayer substantiates the contribution by a contemporaneous written acknowledgment from the donee organization. The IRS has been insisting on the letter of the law, even in cases in which the evidence was clear that a contribution was made. In *Durden, TC Memo. 2012-140,* the Tax Court recently agreed with the IRS that a married couple's charitable contributions were not deductible because the written acknowledgments provided by their church initially forgot to recite the no services were provided and its follow up letter was no longer "contemporaneous." Taxpayers have been more successful, however, in proving that a contemporaneous written agreement "taken as a whole" can in effect "state" that no goods or services are received in return, although the IRS apparently has not yet backed off on pursuing litigation on this issue.

Background

The golf course and the donee, a local land trust, drew up and entered into an agreement for the exchange of conservation easement property. Although the agreement contained a detailed description of the property and the easement, it did not contain a specific clause stating that the land trust had not provided goods or services to the taxpayer in exchange for the easement.

Court's analysis

The Tax Court held that the agreement, taken as a whole met the substantiation requirements. The Tax Court found that the agreement:

- Stated the contribution was made in consideration of covenants and representations contained within the agreement;
- Did not include in its description of the consideration any other value other than the preservation of the property; and
- Stated that the agreement constituted the entire agreement between the parties.

The Tax Court relied on *Averyt v. Commissioner, CCH Dec. 59,121(M)*, and *Simmons v. Commissioner, CCH Dec. 57,934(M)*. As in *Simmons,* where the Tax Court had upheld the conservation easement, the agreement in this case was signed by a representative of the donee, was contemporaneous with the donation of the easement, and provided a detailed description of the property and the easement. Likewise, in *Averyt,* the Tax Court had upheld the conservation easement because, taken as a whole, the agreement—which was an unconditional gift, recited no consideration received in exchange for it, and stipulated that it constituted the entire agreement between the parties—stated that no goods or services were received in exchange for the contribution.

References: CCH Dec. 59,215(M); TRC INDIV: 51,462.

Supreme Court

Continued from page 478

income for deductions taken in closed years that would have otherwise allowed the taxpayer to take a duplicate deduction. Because the Supreme Court has declined to review the case, the Fifth Circuit's decision is final.

Parsonage allowance

In *Driscoll, 669 F.3d 1309 (2012),* the Eleventh Circuit reversed the Tax Court and found that an ordained minister and his spouse were not entitled to exclude from gross income under former Code Sec. 107 a parsonage allowance for a second residence. The Eleventh Circuit rejected the taxpayer's argument that Congress did not intend to limit the income exclusion under then applicable Code Sec. 107 to a minister's principal residence. Because the Supreme Court declined to review the case, the Eleventh Circuit's decision is final.

Reference: TRC LITIG: 9,210.

U.S. Supreme Court Asks Administration To Respond To Petition Challenging PPACA

The U.S. Supreme Court has directed the Obama Administration to respond to a petition for rehearing filed in a challenge to the Patient Protection and Affordable Care Act (PPACA). The Supreme Court had previously denied the taxpayer's petition after upholding the PPACA in *National Federation of Independent Business v. Sebelius, 2012-2* USTC *¶50,573.*

■ ***Comment.*** The taxpayer in this case (Liberty University) challenged Code Sec. 5000A's shared responsibility payment ("individual mandate") and Code Sec. 4980H's shared assessable payment on applicable large employers ("employer mandate"). The Supreme Court upheld Code Sec. 5000A in *NFIB* as a valid exercise of Congress' taxing power.

In 2010, the taxpayer filed suit to enjoin enforcement of the PPACA. The Fourth Circuit Court of Appeals found that the Anti-Injunction Act barred the suit. In July 2012, the taxpayer filed a petition for rehearing before the Supreme Court, arguing that *NFIB* had overruled the Fourth Circuit's decision. The Supreme Court instructed the federal government to respond to the petition within 30 days.

U.S. Supreme Court Order List, October 1, 2012.

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Extraterritorial Income Exclusion Not Available To Reduce U.S. Corporation's Subpart F Income, Chief Counsel Concludes

◆*CCA 201240019*

IRS Chief Counsel has determined that the extraterritorial income (ETI) exclusion under former Code Sec. 114 does not apply to the calculation of Subpart F income. Thus, the exclusion was not available to reduce the amount of a U.S. corporation's Subpart F income.

■ ***CCH Take Away.*** The ETI regime was enacted in 2000 to replaced the foreign sales corporation (FSC) regime. However, Congress repealed the ETI regime in 2004, after the World Trade Organization ruled that it was a prohibited export subsidy. The American Jobs Creation Act of 2004 enacted the Code Sec. 199 domestic production activities deduction to replace the ETI regime.

■ ***Comment.*** "This Chief Counsel Advice highlights the complexity involved with applying the intricacies of the Subpart F rules," Joseph Calianno, International Technical Tax Practice Leader, Grant Thornton LLP, Washington, D.C., told CCH.

Background

The taxpayer was a U.S. corporation and a U.S. shareholder of four subsidiaries that were each a controlled foreign corporation (CFC). The four CFCs were the only partners in a foreign partnership. The taxpayer manufactured personal property and sold it to the foreign partnership, which resold the property to unrelated foreign customers.

Each partner's share of the foreign partnership's sales income was treated as Subpart F income earned by the partner. This resulted in a Subpart F income inclusion to the taxpayer. The taxpayer claimed ETI exclusions when computing Subpart F income inclusions from the partners' income.

ETI regime

Under former Code Sec. 114, gross income did not include extraterritorial income, which was qualifying foreign trade income (QFTI), as determined under Subchapter N of the Tax Code. Under Sections 114 and 941-943, ETI was defined as gross income attributable to foreign trading gross receipts (FTGR). FTGR includes gross receipts from the sale, exchange, or other disposition of qualifying foreign trade property.

Subpart F

Code Sec. 951 requires that a U.S. shareholder of a CFC include its pro rata share of the foreign corporation's Subpart F income in gross income. However, former Code Sec. 951(c) provides that the foreign trade income of an FSC shall not be taken into account under Subpart F. A CFC's distributive share of partnership income that falls into a category of Subpart F income is treated as received directly by the CFC. However, in determining gross income and taxable income of a CFC, the provisions of Subpart N do not apply.

Chief Counsel's analysis

Code Sections 941-943, which define QFTI and FTGR, are a necessary prerequisite to applying the exclusion in Code Sec. 114, the Chief Counsel indicated. (A taxpayer can exclude QFTI from gross income.) Thus, the taxpayer must apply Code Sections 941-943 to determine whether it has QFTI and FTGR.

However, these provisions are located in Subchapter N, which does not apply for calculating a CFC's Subpart F income, the Chief Counsel noted. Thus, foreign base company sales income (which is included in Subpart F income), cannot be characterized as FTGR or QFTI. Therefore, an ETI exclusion cannot be claimed when determining a CFC's Subpart F income, and is not taken into account when determining a U.S. shareholder's Subpart F income inclusion, Chief Counsel stated.

The taxpayer disagreed with this analysis and raised several arguments. Since Chief Counsel concluded that Code Sections 941-943 do not apply, the ETI exclusion amount was zero.

Reference: TRC INTLOUT: 12,052.

Claims For Research Credit Not Barred By Substantial Variance Rule

◆*Bayer Corporation, DC-Pa., September 20, 2012*

A federal district court has allowed a corporation to pursue a refund claim for additional research credits under Code Sec. 41. The court denied the IRS's motion for partial summary judgment, which argued that the claim was barred by the substantial variance rule.

■ ***CCH Take Away.*** The IRS argued that the corporation had failed to describe all the business components (such as, products and inventions) for which it incurred qualified research expenses (QREs). The corporation used a cost center accounting system, which organized expenses by the activities performed, and did not track expenses for each individual business component.

Background

The corporation undertook research activities and filed refund claims for QRE credits. The IRS failed to act on the refund claims and the corporation filed suit in federal district court.

During the discovery phase of litigation, the IRS asked the corporation to describe each new or improved business component for which the corporation had incurred QREs. The corporation responded that this would be too burdensome, and offered a statistical sampling for the QREs.

Court's analysis

The IRS filed for partial summary judgment, asserting that the taxpayer's claim was barred by the substantial variance rule. This rule prohibits taxpayers from presenting claims in a refund suit that

Continued on page 481

Financial Institution Must File Forms 1099-C Under Settlement Agreement, IRS Determines

◆*LTR 201240001*

The IRS has determined that a financial institution must file Forms 1099-C, Cancellation of Debt, resulting from the write-off of balances and charges under a settlement agreement. According to the IRS, the discharge was the result of an identifiable event in Reg. §1.6050P-1(b)(2) and not by operation of state law.

■ ***CCH Take Away.*** IRS regs provide that a discharge of indebtedness occurs under certain identifiable events. One of these identifiable events (Reg. §1.6050P-1(b)(2)) occurs when a creditor makes a decision to discontinue collection activity and discharge the debt.

Background

A financial institution, providing checking, savings and other services, entered into a contract with a debt purchaser. The debt purchaser would apparently pursue collection of certain unpaid accounts.

A group of taxpayers (class members) subsequently filed a lawsuit alleging that the debt purchaser had violated certain consumer protection statutes. The financial institution and the class members reached a settlement, which provided for monetary payments to the plaintiffs. The financial institution also agreed to write off all remaining debt balances. Additionally, the settlement provided that all class members would be responsible for paying federal taxes due on the payments. After the settlement was negotiated, the financial institution requested a letter ruling from the IRS providing that it was not required to file information returns relating to the agreement.

IRS analysis

The IRS determined that under Reg. §1.6050P-1(b)(2)(F), an identifiable event exists when the applicable financial entity and debtor agree to discharge the indebtedness for less than full consideration. To establish consideration, there must be a performance or a return promised which has been bargained for by the parties.

Before the settlement, the court had found that there was a failure to send a pre-sale notice to each of the class members and/or that the pre-sale notices failed to comply with state law that the financial entity could collect any deficiency balances from the plaintiffs. The IRS determined that court's order did not convert the forgiveness of the debt from being entered into voluntarily to one forced by operation of state law. Therefore, Reg. §1.6050P-1(b)(2)(F) would apply.

The IRS further noted that under Reg. §1.6050P-1(b)(2)(G), a discharge of indebtedness exists where a creditor discontinues collection activity in response to a decision by the creditor or a defined policy of the creditor. Here, the IRS determined that the cancellation of indebtedness was not the result of any defined policy or business practice of the financial institution but rather its decision to discontinue collection action as part of settling the litigation. This decision by the financial institution would appear to fall under Reg. §1.6050P-1(b)(2)(G), the IRS observed. However, Reg. §1.6050P-1(b)(2)(F) applied and the financial institution had to satisfy the reporting requirements of Code Sec. 6050P, the IRS concluded.

Reference: TRC FILEBUS: 9,300.

Research Credit

Continued from page 480

"substantially vary" the legal theories or factual bases in the original claim.

The court found that the purpose of the substantial variance rule is to give the IRS notice of the nature of a refund claim and the specific facts upon which it was predicated. According to the court, the IRS had confused this requirement with a requirement to disclose all of the evidence supporting the claims.

The district court stressed that the corporation's use of the cost center accounting system was permitted. The IRS in its audits had never asked the corporation to list the business components relating to the claimed QRE credits. The corporation had provided the IRS with detailed spreadsheets identifying the claimed QRE credits, organized by the cost center where the related research activity had taken place.

References: 2012-2 USTC ¶50,596; TRC IRS: 33,202.05.

IRS Reminds Preparers Of Registered Tax Return Preparer Exam Deadline; Updates FAQs

The IRS Return Preparer Office recently sent letters to more than 300,000 preparers, reminding them about the Registered Tax Return Preparer (RTRP) examination, the agency announced on a social media site. The IRS also updated its frequently asked questions (FAQs) about the RTRP exam on its website.

Letters. All tax return preparers who prepare Form 1040 series returns for compensation must take the RTRP unless they are certified public accountants (CPAs), enrolled agents (EAs), attorneys, or certain supervised preparers, subject to some exceptions. The IRS reminded preparers that the deadline for taking the RTRP exam is December 31, 2013. The IRS encouraged preparers to act soon to ensure their first choice for date, time and location.

FAQs. The RTRP exam is administered by a third-party under contract with the IRS at testing centers nationwide.

In the updated FAQs, the IRS reminded preparers that they must bring one unexpired government-issued identification that includes the individual's name, photo and signature. The first and last names on the government-issued identification must be identical to the first and last names the individual provided to the IRS when registering for the RTRP exam.

www.irs.gov; TRC IRS: 3,204.

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IRS Treats Modified Corporate Transactions As Tax-Free F Reorgs

◆*LTR 201239003*

In a supplemental private letter ruling, the IRS has approved a modified corporate transaction as tax-free "F" reorganizations under Code Sec. 368(a)(1)(F), followed by a sale of assets to a third party. In its prior ruling, the IRS had approved an F reorganization and a sale of stock to the public.

■ ***CCH Take Away.*** The supplemental ruling explains that the original proposed transaction was modified for purportedly valid business reasons. In an F reorganization, a corporation changes its name, form or place of organization. In this ruling, the transaction changed the location of a foreign subsidiary from one country to another, through the mechanism of transferring an existing corporation's stock to a new corporation. The ruling also ensured that a sale of stock following the transaction will be treated as an unrelated transaction that does not jeopardize the reorganization.

Revised transaction

A parent corporation owned a domestic subsidiary (DSub). DSub and two foreign corporations (designated as the "incorporators") together owned a foreign subsidiary (FSub). Other shareholders in FSub were redeemed by FSub or bought out by DSub. The incorporators subscribed to stock in two new foreign companies, TopCo1 and TopCo2.

First reorganization

In the first reorganization, the incorporators transferred FSub stock to TopCo1 in exchange for TopCo1 stock. FSub then became a disregarded entity (owned by TopCo1).

The IRS ruled that the first reorganization qualified as an F reorganization, with TopCo1 and FSub being the parties to the reorganization. No gain or loss was recognized by FSub on the distribution of TopCo1 stock to its shareholders, and no gain or loss was recognized by FSub's shareholders on the receipt of TopCo1 stock in exchange for FSub stock.

Second reorganization

In the second reorganization, the incorporators transferred their TopCo1 stock to TopCo2, in exchange for TopCo2 stock. TopCo1 became a disregarded entity.

The IRS ruled that the second reorganization also qualified as an F reorganization, with TopCo2 and TopCo1 being the parties to the reorganization. No gain or loss was recognized by TopCo1 on the distribution of TopCo2 stock to its shareholders, and no gain or loss was recognized by TopCo1's shareholders on the receipt of TopCo2 stock in exchange for TopCo1 stock.

■ ***Comment.*** TopCo1 was supplanted by TopCo2. In effect, FSub became a new corporation, TopCo2.

Post-reorganization steps

After the F reorganizations, a third party acquired TopCo1 stock for cash. TopCo2 used the cash to redeem the shares held by the two foreign corporations that were incorporators of FSub. Some cash was distributed to DSub, the remaining incorporator that holds TopCo2 stock. The IRS ruled that the sale of TopCo1's stock was treated as a sale of TopCo1's assets by TopCo2.

■ ***Comment.*** Thus, the sale of TopCo1 assets following the reorganizations was treated as an unrelated transaction that did not jeopardize the F reorganizations. The IRS approved this result in Rev. Rul. 96-29. Otherwise, similar transactions (not F reorgs) would be reviewed under the step transaction doctrine.

Reference: TRC REORG: 24,300.

International Organization Worker Excused From 20 Percent Penalty For Reasonable Cause

◆*Chien, TC Memo. 2012-77*

The Tax Court has concluded that an individual was not liable for the 20-percent accuracy-related penalty for failing to pay self-employment taxes. The taxpayer conceded that she owed the taxes, however, under circumstances peculiar to workers for certain public international organizations, she had enough reasonable cause for confusing her status as self-employed rather than employee.

■ ***CCH Take Away.*** Code Sec. 3121(b)(15) provides that salary received from certain public international organization is not wages and is subject to self-employment taxes. Here, the taxpayer was never directly informed that she was liable for self-employment taxes. In light of her inexperience, her failure to pay self-employment taxes was reasonable.

Background

The taxpayer's employer, the International Monetary Fund (IMF), gave her a Form W-2 showing her salary and no withholding for income taxes or Social Security taxes. When an IRS employee delivered a slide presentation to IMF employees, the taxpayer missed most of the presentation, which was not mandatory. The slides advised that U.S. citizens who are employees of international organizations owe self-employment tax. The taxpayer testified credibly at trial that even after reading the slides, she did not understand the difference between income tax and self-employment tax.

Court's analysis

Code Sec. 6662(a) imposes an accuracy-related penalty for underpayment of tax due to negligence or disregard of rules and regulations. The penalty does not apply if there was reasonable cause and the taxpayer acted in good faith.

The court found that the taxpayer failed to understand her liability because of her inexperience. She also relied on IRS instructions for Form 1040, which indicated that she was not self-employed. The taxpayer made an honest mistake in applying the instructions, the court concluded.

References: CCH Dec. 59,210(M); TRC PENALTY: 3,108.15.

Tax Briefs

International

The government's claim that the tax basis of a foreign national couple's U.S. property was its purchase price as a matter of law and, therefore, the couple was not entitled to a refund, was rejected.

Yiu, DC N.J., 2012-2 USTC ¶50,594; TRC SALES: 6,352.05.

Tax Crimes

Six individuals were properly convicted of and sentenced for tax evasion, fraud, and conspiring to impede and impair IRS functions. Ample evidence existed that the individuals knew that the trust scheme was fraudulent.

Vallone, CA-7, 2012-2 USTC ¶50,593; TRC IRS: 66,306.

Income

Using the bank deposits method, the IRS established that an individual was liable for tax on unreported income from a purported religious ministry from which she obtained money.

Hovind, TC, CCH Dec. 59,214(M), FED ¶48,228(M); TRC INDIV: 6,054.

Deductions

An individual who purchased a van that he used for his daily commute to work was not entitled to a deduction for the depreciation of his van or for his claimed vehicle mileage expenses absent adequate substantiation.

Park, TC, CCH Dec. 59,212(M), FED ¶48,226(M); TRC BUSEXP: 24,502.

Liens and Levies

An individual's action seeking damages for the government's alleged unlawful collection actions and for failure to release liens was dismissed for failure to exhaust his administrative remedies. The government's judgment lien had priority over a bank's mortgage lien: the abstract of judgment lien was recorded first.

J.R. Malouf, DC Mass., 2012-2 USTC ¶50,603; TRC IRS: 45,114.

Refund Claims

An individual's action seeking abatement and a refund of the trust fund recovery penalty was not stayed while the government pursued a collection action against him for the same penalty. Code Sec. 6331(i)(4)(A) prohibits the government from filing a collection action for any unpaid divisible tax while a refund suit regarding the same taxpayer and tax is pending.

Thomas, DC Wis., 2012-2 USTC ¶50,604; TRC IRS: 45,158.

An individual's refund claim based on a claimed theft-loss deduction for a failed investment was denied. The individual failed to demonstrate that the investment company had the criminal intent to deprive him of his investment money under state (Ohio) law.

Labus, DC Ohio, 2012-2 USTC ¶50,597; TRC INDIV: 54,104.

A deceased taxpayer's estate was properly denied tax refunds arising from a claimed capital loss deduction and a net operating loss carryback because it was time barred.

Gonzales, CA-9, 2012-2 USTC ¶50,592; TRC BUSEXP: 30,168.

Collection Due Process

A married couple sufficiently raised the issue of their liability for additions to tax at the collection due process (CDP) hearing to provide the settlement officers an opportu-

Continued on page 483

IRS Implements Streamlined ITIN Application Requirements For Foreign Students And Noncitizens On Extension

The IRS has announced on its website that it is implementing streamlined procedures for issuing Individual Taxpayer Identification Numbers (ITINs) to foreign students studying in the U.S. and noncitizen taxpayers under extension.

■ ***Comment.*** The IRS's administration of the ITIN program has come under fire. The Treasury Inspector General for Tax Administration (TIGTA) recently urged the IRS to tighten its procedures for verifying an ITIN applicant's background information.

Students. The streamlined procedures for foreign students apply to participants in the Student Exchange Visitors Program (SEVP). These are individuals admitted to the U.S. under an F, J or M visa who receive taxable scholarship, fellowship or other grants reportable by the school on Form W-2 or Form 1042-S. The IRS explained that SEVP participants will need a letter from their educational institution verifying their status.

Noncitizens on extension. The IRS is also implementing special procedures for noncitizens who have an approved tax year 2011 extension to file their completed returns. Qualified taxpayers will be allowed to have their original documents certified by a Certifying Acceptance Agent (CAA) or a SEVP-approved institution. The ITINs issued to qualified noncitizens are temporary, expiring one year from the extended return due date (October 15, 2013).

www.irs.gov, TRC FILEBUS: 12,106.204.

IRS Updates Form 8027 E-Filing Instructions

The IRS has issued revised specifications (Rev. Proc. 2012-37) for electronically filing Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips, for tax year 2012 and tax years prior to 2012. Form 8027 is used by large food or beverage establishments to report their gross receipts from food or beverage operations and tips reported by employees.

Rev. Proc. 2012-37, FED ¶46,488; TRC PAYROLL: 3,406.25.

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Tax Briefs

Continued from page 483

nity to consider the issue and the taxpayers' arguments and evidence relating to it.

Fielder, TC, CCH Dec. 59,218(M), FED ¶48,232(M); TRC LITIG: 6,450.

Deficiencies and Penalties

An individual who fraudulently underreported income from the business he operated and overstated deductions by the business was liable for the Code Sec. 6663(a) fraud penalty for both tax years at issue and the Code Sec. 6651(a)(1) addition to tax for failing to timely file his return for one of the tax years at issue.

Jenkins, TC, CCH Dec. 59,217(M), FED ¶48,231(M); TRC PENALTY: 6,104.

The executive director of a nonprofit organization was a responsible person liable for trust fund recovery penalties assessed against him. The individual knew that the organization was not paying its payroll taxes during the quarters for which he was assessed and during that time he authorized payments to other creditors.

Zarate, DC Tex., 2012-2 USTC ¶50,595; TRC PAYROLL: 6,306.05.

Married individuals were liable for accuracy-related penalties for failure to pay self-employment tax because they failed to show that they acted reasonably and in good faith. The husband did not give their return preparer all necessary information; they did not investigate his advice that they did not owe tax, and so did not act in good faith.

Diaz, TC, CCH Dec. 59,213(M), FED ¶48,227(M); TRC PENALTY: 3,116.

An individual's petition challenging a deficiency assessed by the IRS was not timely filed. While the notice was not sent to his last known address, a copy had been sent to his former address where he had lived with his wife. The notice was valid, and the taxpayer was deemed to have actually received it with ample time to file a timely petition.

Sarkissian, TC, CCH Dec. 59,211(M), FED ¶48,225(M); TRC LITIG: 6,106.

The Tax Court properly determined that a tax shelter investor was liable for the 40-percent gross valuation misstatement penalty with respect to a claimed tax loss that resulted from a Custom Adjustable Rate Debt Structure (CARDS) transaction. The individual's tax underpayment resulted from his overstated basis in foreign currency.

Gustashaw, Jr., CA-11, 2012-2 USTC ¶50,591; TRC PENALTY: 3,110.20.

Bankruptcy

A Chapter 13 debtor was not entitled to strip-off an IRS lien from his property because it was unsupported by collateral value pursuant to section 506(d) of the Bankruptcy Code.

In re Ryan, BC-DC Ill., 2012-2 USTC ¶50,606; TRC IRS: 57,106.15.

A debtor was entitled to exempt from the bankruptcy estate a variable annuity she purchased with funds from her 401(k) plan. The annuity was a qualified individual retirement annuity.

In re M. Kiceniuk, BC-DC N.J., 2012-2 USTC ¶50,605; TRC RETIRE: 66,050.

A bankruptcy court's order denying debtors' claims for exemption of a post-petition tax refund from their bankruptcy estate was reversed. The trustee failed to object to the plan. Therefore, the provisions of section 1325(b) were not at issue when the bankruptcy court ruled on the trustee's objection to the exemptions.

Matos, BAP-1, 2012-2 USTC ¶50,601; .Santiago, BAP-1, 2012-2 USTC ¶50,602; TRC IRS: 57,156.

A debtor could exempt from her bankruptcy estate only $5,000 of the amount she deposited into an IRA because the funds were not "retirement funds," but were her share of the equity in the marital home.

In re Ahmed, DC Mich., 2012-2 USTC ¶50,600; TRC RETIRE: 66,800.

Innocent Spouse Relief

A divorced wife was entitled to partial innocent spouse relief where she prepared and filed the couple's joint return for the year at issue. The couple had been living separate and apart during the 12 months prior to the wife's election of innocent spouse relief, and she lacked actual and clear awareness of her husband's unreported income.

Harrington, TC, CCH Dec. 59,219(M), FED ¶48,233(M); TRC INDIV:18,056.

Res Judicata

A quiet title action filed by the beneficiaries of two trusts to properties upon which federal tax liens had been foreclosed in a previous litigation was properly dismissed because the complaint was barred by the principle of *res judicata*.

Carey, CA-9, 2012-2 USTC ¶50,599; TRC LITIG: 9,254.10.

Bank Secrecy Act

The government's forfeiture complaint pleaded sufficient facts to support its claim that an individual intended to evade or violate the Bank Secrecy Act's anti-structuring and currency transaction reporting (CTR) provisions.

Two Hundred Twenty-Five Thousand Three Hundred Dollars ($225,300.00) in U.S. Funds from Firstbank (Jackson, TN) Account #86476002 in the Name of Norene Pumphrey, DC Tenn., 2012-2 USTC ¶50,598; TRC FILEBUS: 9,316.05.

IRS Announces Additional Relief For Mississippi Disaster Victims

The IRS has designated five additional counties in Mississippi where qualifying taxpayers may claim relief from certain tax-related deadlines following Hurricane Isaac. Disaster relief in the form of extended filing deadlines and abated interest and penalties is now available in Copiah, Franklin, Jefferson, Jones and Lamar.

Extended due date. Affected taxpayers have until January 11, 2013 to file certain returns and pay any taxes due. This applies to corporations that previously obtained an extension until September 17, 2012 to file their 2011 returns and individuals who received a similar extension until October 15, 2012. It also includes the estimated the third quarter of 2012 tax payment, otherwise due September 17, 2012.

LA/MS-2012-14; TRC FILEBUS: 15,110.

Practitioners' Corner

Sample Client Letter On 2012 Third Quarter Federal Tax Developments

The third quarter of 2012 brought many tax developments from Washington, the IRS and the courts. CCH has prepared a Third Quarter 2012 Federal Tax Developments client letter. Practitioners can email or mail this letter to clients to alert them to some of the important tax developments during the third quarter of 2012.

This letter includes references to CCH's Federal Tax Weekly. Practitioners can refer to CCH Federal Tax Weekly for more information about these developments but should delete the CCH references in their communications with clients.

Re: Important 2012 Third Quarter Federal Tax Developments
Dear Client:

During the third quarter of 2012, there were many important federal tax developments. This letter highlights some of the more significant developments for you. As always, please give our office a call or email if you have any questions.

Legislation

Bush-era tax cuts. The House and Senate passed competing tax bills before their August recess to extend the Bush-era tax cuts, which are scheduled to expire after 2012. The House bill, the Recession Prevention and Job Protection Act (HR 8), would extend the Bush-era tax cuts for all taxpayers through 2013. The Senate bill, the Middle Class Tax Cut Act (Sen. 3412) would extend the Bush-era tax cuts on incomes up to $200,000 for single individuals and $250,000 for families. These bills could serve as frameworks for an extension of the Bush-era tax cuts in the lame-duck Congress before year-end. *CCH Federal Tax Weekly No. 30, July 26, 2012; CCH Federal Tax Weekly No. 31, August 2, 2012.*

Tax extenders. The Senate Finance Committee approved legislation, the Family and Business Tax Certainty Act, to extend many popular but temporary tax incentives that expired at the end of 2011. These provisions, known as tax extenders, include the state and local sales tax deduction, the higher education tuition deduction, the research tax credit, and many more. The full Senate did not take up the bill before recessing in September but could during the lame-duck session before year-end. *CCH Federal Tax Weekly No. 34, August 23, 2012.*

> *"The third quarter of 2012 brought many tax developments from Washington, the IRS and the courts."*

Payroll tax holiday. The payroll tax holiday, which reduced the employee-share of OASDI taxes from 6.2 percent to 4.2 percent through 2012 and provided a comparable benefit to self-employed individuals, is scheduled to expire after 2012. At this time, it is unclear if the payroll tax holiday will be extended into 2013. *CCH Federal Tax Weekly, No. 34, August 23, 2012.*

MAP-21. Congress passed and President Obama signed in July the Moving Ahead for Progress in the 21st Century Act (MAP-21). The new law provides pension funding stabilization, enhances the ability of employers to transfer excess pension assets to fund retiree health benefits, authorizes phased retirement for federal employees, and expands the definition of tobacco manufacturer to include businesses operating roll-your-own cigarette machines. The IRS issued MAP-21 guidance about pension stabilization in August and September. *CCH Federal Tax Weekly No. 28, July 12, 2012; CCH Federal Tax Weekly No. 34, August 23, 2012.*

Small business. Legislation to provide a 10 percent tax credit to small businesses that add payroll in 2012 failed to pass in the Senate in July. The Small Business Jobs and Tax Relief Act (Sen. 2237) would also have extended 100 percent bonus depreciation through 2012. *CCH Federal Tax Weekly No. 29, July 19, 2012.*

Identity theft. The House passed the Stopping Tax Offenders and Prosecuting (STOP) Identity Theft Act (HR 4362) in August. The STOP Act directs the U.S. Attorney General to bring more perpetrators of tax return identity theft to justice and take into account the need to concentrate efforts in areas of the country where the crime is most frequently reported. *CCH Federal Tax Weekly No. 32, August 9, 2012.*

Foreign accounts

The Treasury Department released model intergovernmental agreements to implement the Foreign Account Tax Compliance Act (FATCA). The agreements aim to implement FATCA's reporting and disclosure requirements for foreign financial institutions (FFIs) through a government-to-government approach. The agreements were developed by the U.S., France, Germany, Italy, Spain, and the United Kingdom. *CCH Federal Tax Weekly No. 31, August 2, 2012.*

In related news, the IRS began implementing new streamlined filing compliance programs for qualified nonresident U.S. taxpayers who have not filed income tax returns and statements of financial

Continued on page 487

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Washington Report

by the CCH Washington News Bureau

Tax policy at center of presidential debate on domestic issues

President Obama and Governor Mitt Romney traded barbs on federal tax policy during the October 3, 2012 presidential debate in Denver. The President said Romney's policies would involve a $5 trillion tax cut that would benefit the wealthy at the expense of middle class Americans. In response Romney accused the President of furthering policies that taxed the middle class even as gasoline, food, and health care prices were rising.

President Obama stated that he would lower the corporate tax rate to 25 percent, close loopholes allowing U.S. companies to take business expense deductions for the cost of moving operations overseas, provide more tax breaks for small businesses, and create tax incentives to boost clean energy production.

Romney pledged that he would lower tax rates for both corporations and individuals, but by eliminating certain tax deductions, credits, and exemptions, he would completely avoid a $5 trillion tax cut or any addition to the deficit. "My number-one principal is there will be no tax cut that adds to the deficit," he said. Romney did not, however, list any specific provisions that he would strip from the tax code to pay for the proposed rate cuts.

The President charged that Romney's plan was unrealistic and unspecific. "The fact is that if you are lowering the rates the way you describe, Governor, then it is not possible to come up with enough deductions and loopholes that only affect high-income individuals to avoid either raising the deficit or burdening the middle class," Obama said.

The debate was the first of three planned televised presidential debates leading up to the 2012 election. The next presidential debate will air on October 16, 2012, 9:00-10:30 p.m. Eastern Time and will focus on foreign policy.

House Democrats urge pre-election action to avoid fiscal cliff

House Democrats called on their GOP counterparts to return to Washington, D.C. and finish work on must-pass legislation addressing the nation's looming fiscal crisis, as well as Medicare, agriculture, domestic violence and postal reform. House Minority Leader Nancy Pelosi, D-Calif., and 14 other House Democrats, recently said GOP lawmakers should not wait for a lame-duck session after the November elections to address the expiring Bush-era tax cuts, budget sequestration and defense cuts planned for 2013.

Budget experts release non-partisan corporate tax reform report

The Committee for a Responsible Budget (CRFB), a Washington D.C-based bipartisan, nonprofit organization, recently released a report entitled "Reforming the Corporate Tax Code." The CRFB explained that reducing the corporate tax rate to 28 percent would cost about $750 billion through 2022, while reducing the top tax rate to 25 percent could likely cost close to $1.1 trillion. To offset the costs, the CRFB proposed eliminating many of the narrowly-focused provisions which benefit only one or a few industries. Other provisions that could be eliminated include the domestic production activities deduction, the research & experimentation tax credit, or many of the provisions in the Tax Code allowing for accelerated depreciation.

The CRFB also suggested that the U.S. move from its current international taxation system to a "worldwide system" by repealing deferral of taxation. Worldwide income would instead be taxed when it is earned rather than after it is repatriated. "This approach would have the added potential of generating substantial revenue for tax rate or deficit reduction, although a territorial system could also raise revenue depending on how it was designed," the CRFB stated.

Wall Street whistleblower earns $2 million reward

The IRS has awarded $2 million to a Wall Street whistleblower who exposed a corporation's multimillion dollar tax-evasion scheme, the whistleblower's lawyers announced on October 4.

According to the law firm, Phillips & Cohen LLP, Washington, D.C., the whistleblower had exposed an alleged tax-avoidance scheme. The precise amount of the government's recovery is not known, but the taxpayer's filings reflect a $383-million write-down of a deferred tax asset that the company deducted from its taxable income. "The chances of getting caught for this complex type of tax scheme were highly unlikely unless a whistleblower alerted the IRS to the sophisticated practice," Erika Kelton of the firm said in a statement.

IRS officers contacting represented taxpayers directly, TIGTA reports

The Treasury Inspector General for Tax Administration (TIGTA) recently reported that in some instances IRS revenue officers deviated from procedures by directly contacting taxpayers with representatives during the collection process. The IRS has a number of policies and procedures in place to help ensure that taxpayers are afforded the right to designate a qualified representative to act on their behalf when dealing with IRS personnel in a variety of tax matters. Nevertheless TIGTA found that some revenue officers had contacted the taxpayer directly on the initial or subsequent contact in the collection investigation, rather than the authorized representative; had not sent copies of taxpayer correspondence to the authorized representative; or had not allowed the taxpayer enough time to obtain a representative.

TIGTA made several recommendations. In response IRS officials are planning to issue a memorandum reinforcing the need for field collection personnel to follow the established procedures.

Practitioners' Corner

Continued from page 485

accounts. The program is open to taxpayers who have lived abroad since 2009 and who have not filed U.S. income tax returns; and whom the IRS deems to be "low-risk." *CCH Federal Tax Weekly No. 36, September 6, 2012.*

The Fourth Circuit Court of Appeals found in July that a taxpayer's failure to file an *FBAR* (Form TD F 90-22.1, Report of Foreign Bank and Foreign Accounts) was willful and upheld significant penalties (*Williams, CA-4, July 20, 2012*). According to the court, the taxpayer's conduct showed he deliberately failed to file the FBAR and the IRS properly imposed two $100,000 penalties. *CCH Federal Tax Weekly No. 31, August 2, 2012.*

Worker classification

The Tax Court held in July that farm workers engaged by an S corporation were employees and not independent contractors (*Twin Rivers Farm, TC Memo. 2012-184*). The court found that the S corporation exercised sufficient control over the activities of the workers to treat the workers as employees. As a result, the S corporation was liable for employment taxes on remuneration paid to the workers. *CCH Federal Tax Weekly No. 12, July 12, 2012.*

In August, the Tax Court found that masonry workers were employees of an S corporation and not independent contractors (*Atlantic Coast Masonry, Inc., TC Memo. 212-233*). The S corporation instructed the masons how to perform their work, set the hours and rate of pay, and had the right to discharge workers. All of these factors evidenced that the S corporation was their employer. *CCH Federal Tax Weekly No. 34, August 23, 2012.*

Per diem rates

The IRS issued the simplified per diem rates that taxpayers can use to reimburse employees for expenses incurred during business travel after September 30, 2012. The simplified "high-low" per diems for 2013 remain unchanged from 2012 at $242 for high-cost localities and $163 for all other localities. *CCH Federal Tax Weekly No. 40, October 4, 2012.*

Health care

The Patient Protection and Affordable Care Act (PPACA) generally will require large employers to pay a penalty starting in 2014 if they fail to offer minimum essential health coverage to qualified employees or if the coverage is deemed unaffordable. The IRS issued interim guidance about the PPACA's employer shared responsibility payment. *CCH Federal Tax Weekly No. 37, September 13, 2012.*

Dependency exemption

The Tax Court upheld in July the IRS's determination that a married couple residing in Israel were not entitled to dependency exemption deductions because their children were not U.S. citizens during most of the relevant tax years (*Carlebach, 139 TC No.1*). The court found that the IRS's regulations requiring U.S. citizenship for the dependency exemption were valid. *CCH Federal Tax Weekly No. 30, July 26, 2012.*

Commuting expenses

In July, the Tax Court held that a taxpayer's travel expenses to five temporary work sites were not exceptions to the general rule treating commuting expenses as nondeductible personal expenses (*Saunders, TC Memo. 2012-200*). The temporary work sites could not be considered outside of the metropolitan area where the taxpayer resided. *CCH Federal Tax Weekly No. 30, July 26, 2012.*

Audits

The Treasury Inspector General for Tax Administration (TIGTA) urged the IRS to improve its audits of S corporations. According to TIGTA, more than 60 percent of S corporations were closed without any changes to the returns. The IRS told TIGTA that it intends to analyze S corporation files to better identify which returns from S corporation exams to select for audit. *CCH Federal Tax Weekly No. 31, August 2, 2012.*

Severance payments

In September, the Court of Appeals for the Sixth Circuit held that supplemental unemployment benefits (SUB) payments are not wages for purposes of FICA taxes (*Quality Stores, CA-6)*. The court declined to give deference to prior IRS rulings, which had reached a contrary result. *CCH Federal Tax Weekly No. 37, September 13, 2012.*

Fast track settlement

The IRS announced in September that its temporary fast-track settlement program for taxpayers in the Tax Exempt and Government Entities (TE/GE) Division is now permanent. Fast-track settlement uses alternative dispute resolution techniques to help taxpayers and the IRS come to an agreement. *CCH Federal Tax Weekly No. 36, September 6, 2012.*

Aircraft

The IRS issued final regulations on an employer's deduction for entertainment or recreational use of employer-owned aircraft. The final regulations describe fixed and variable costs, two alternative methods for allocating costs and include many examples. *CCH Federal Tax Weekly No. 32, August 9, 2012.*

ITINs

The Treasury Inspector General for Tax Administration (TIGTA) warned in August that individual taxpayer identification numbers (ITINs) are vulnerable to identity theft. The IRS created ITINs in 1996 for provide an identification number to individuals without a Social Security number. TIGTA urged the IRS to more closely monitor the documents that taxpayers provide when they apply for an ITIN to identify problems. *CCH Federal Tax Weekly No. 33, August 16, 2012.*

Medical loss ratio rebates

The first round of medical loss ratio rebates were issued in mid-2012. If an insurance company spends less than 80 percent of premiums on medical care (or less than 85 percent in the large group market), it must rebate the portion of premium dollars that exceeded this limit. Whether a rebate is taxable depends on a number of variables. *CCH Federal Tax Weekly No. 33, August 16, 2012.*

If you have any questions about these or any other federal tax developments, please contact our office.

Sincerely yours,

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Compliance Calendar

■ **October 12**
Employers deposit Social Security, Medicare, and withheld income tax for October 6, 7, 8, and 9.

■ **October 15**
Individuals who received an automatic 6 month extension to file a 2011 calendar year income tax return must file and pay tax, interest, and any penalties due.

Electing large partnerships that received an automatic 6 month extension to file a 2011 calendar year income tax return must file Form 1065-B, U.S. Return of Income for Electing Large Partnerships.

Monthly depositors must deposit Social Security, Medicare, and withheld income tax for September.

■ **October 17**
Employers deposit Social Security, Medicare, and withheld income tax for October 10, 11, and 12.

■ **October 19**
Employers deposit Social Security, Medicare, and withheld income tax for October 13, 14, 15, and 16.

■ **October 24**
Employers deposit Social Security, Medicare, and withheld income tax for October 17, 18, and 19.

■ **October 26**
Employers deposit Social Security, Medicare, and withheld income tax for October 20, 21, 22, and 23.

TRC Text Reference Table

The cross references at the end of the articles in CCH Federal Tax Weekly (FTW) are text references to CCH Tax Research Consultant (TRC). The following is a table of TRC text references to developments reported in FTW since the last release of New Developments.

ACCTNG 12,102.20	421	COMPEN 48,150	423	IRS 30,152.40	445
ACCTNG 21,300	431	EXEMPT 24,410	455	IRS 33,202.05	480
ACCTNG 15,210.10	429	FILEBUS 9,300	481	IRS 36,056.25	411
ACCTNG 36,106.05	458	FILEBUS 9,316	468	IRS 42,120	466
BUSEXP 3,100	422	FILEBUS 12,106.204	483	IRS 63,202	419
BUSEXP 9,104.20	420	FILEBUS 15,110	484	LITIG 9,210	477
BUSEXP 12,150	470	FILEBUS 15,104.05	467	NOL 15,202	442
BUSEXP 24,912.05	465	INDIV 30,100	447	PART 60,352.25	445
BUSEXP 48,110	457	INDIV 36,056	430	PAYROLL 3,178	434
BUSEXP 54,150	433	INDIV 51,462	479	PAYROLL 3,406.25	483
BUSEXP 54,164	469	INTL 3,558.25	419	PENALTY 3,108.15	482
BUSEXP 54,158.10	458	INTLOUT 12,052	480	PENALTY 3,110.25	470
BUSEXP 54,906	467	INTLOUT 21,154.05	433	REAL 3,056.05	418
BUSEXP 57,304.20	422	IRS 3,200	441	REORG 24,300	482
CCORP 21,050	436	IRS 9,256	434	RETIRE 15,304.10	446
CCORP 27,106	456	IRS 12,104	444	RIC 3,252	468
COMPEN 15,106.05	478	IRS 12,350	459	SALES 27,064.25	471
COMPEN 45,232	432	IRS 21,256	420	SALES 30,108	456
COMPEN 45,352	423	IRS 24,106	417		

From the Helpline

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

Q A U.S. single member LLC is owned by an Italian corporation. What are the U.S. filing requirements, and who must file?

A By default, a single member LLC that does not elect to be treated as a corporation is treated as a disregarded entity. Thus, the foreign corporation would be required to file Form 1120-F, U.S. Income Tax Return of a Foreign Corporation, with respect to the income of the single member LLC. In general, a foreign corporation is required to file Form 1120-F if the foreign corporation has income that is effectively connected with its U.S. trade or business, has U.S. source income, or is claiming a treaty exemption or other Tax Code exemption. *See TRC FILEBUS: 3,066.15.*

Q A self-employed individual leased an automobile, which he used for business purposes approximately 30 percent of the time. He claimed 100 percent of the lease payments as a business expense deduction. Can he do this?

A Generally no. A taxpayer who leases an automobile in connection with his trade or business may deduct the portion of the lease payments that is allocable to the business use of the automobile. In addition, operating expenses actually paid by a lessee-taxpayer may be deducted to the extent they are allocable to business use. For additional assistance, see *TRC BUSEXP: 3,100 and BUSEXP: 24,508.*