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Inside this Issue

IRS Updates LB&I Directive On Repair Regs; Maintains Stand-Down Of Audits For Pre-2014 Years

◆ *LB&I -04-0313-001*

The IRS Large Business & International Division (LB&I) has updated its 2012 directive that generally instructs employees to discontinue audits of costs to maintain, replace or improve tangible property. The updated directive instructs LB&I employees not to begin examining those issues for tax years beginning on or after December 31, 2012 and before 2014. For examinations of tax years beginning on or after January 1, 2014, LB&I instructed its employees to apply the regs in effect and follow normal exam procedures.

■ ***CCH Take Away.*** "The directive retains the "stand-down" [of audit activity] for tax years beginning in 2012 and 2013. If the taxpayer did not file a Form 3115 [Application for Change of Accounting Method], the directive is telling exam teams not to audit 2012 or 2013," Eric Lucas, principal, KPMG LLP's Washington National Tax Practice, told CCH. "It's interesting that the directive did not extend the stand-down to 2014. For tax years beginning in 2014, it looks like the normal exam procedures will apply. It's hard to say whether LB&I will reissue the directive again to extend that date once the final regulations are issued," Lucas said.

Background

The IRS issued temporary regs (TD 9564) on the treatment of costs incurred for tangible property (the "repair regs"). The temporary regs originally applied to tax years beginning on or after January 1, 2012. Subsequently, the IRS delayed the temporary regs' effective date until January 1, 2014, so that it was clear that taxpayers did not have to comply with the regs before 2014. Taxpayers still have the option to apply the regs for 2012 and/or 2013. The IRS also indicated that it was likely to change portions of the temporary regs regarding the de minimis rules, routine maintenance, and dispositions under Code Sec. 168.

■ ***Comment.*** "Some clients decided to change their method of accounting under the temporary regs. Others have decided to wait, since the rules may change under the final regulations," Lucas said.

The IRS issued two revenue procedures (Rev. Proc. 2012-19 and Rev. Proc. 2012-20) to give taxpayers two years to file for automatic consent to change to the accounting methods permitted in the temporary regs. Under the delayed effective date of 2014, taxpayers may, but do not have to, change their method of accounting. The IRS instructed that it will issue final regs in 2013 that will likely be effective for taxable years beginning on or after January 1, 2014.

■ ***Comment.*** "Final regs are expected in late spring or summer of 2013," Lucas said.

Directives

The 2012 (LB&I-4-0312-004) and 2013 directives apply to the treatment of costs incurred to maintain, replace or improve tangible property, and to correlative issues

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Route to: _____ _____ _____ _____ _____

IRS Launches Opinion And Advisory Letter Program For Pre-Approved Code Sec. 403(b) Plans

◆ *Rev. Proc. 2013-22*

In much-anticipated guidance, the IRS has established a program for issuing opinion and advisory letters for Code Sec. 403(b) pre-approved plans (403(b) prototype plans and volume submitter plans), scheduled to begin June 28, 2013. Under the program, pre-approved plan sponsors may apply to the IRS for an opinion letter (for prototype plans), or advisory letter (for volume submitter plans). However, the IRS announced that it will not create a determination letter for individually designed 403(b) plans because of resource limitations.

■ ***CCH Take Away.*** "The new pre-approved 403(b) program provides welcomed reliance for plan sponsors for complying with the Code's 403(b) plan document requirements," Elizabeth Dold, principal, The Groom Law Group, Washington, D.C., told CCH. "Although the program requires the plan document to override the terms of the investment arrangements, which are not part of the review process, and does not (at least at this time) include an individual determination letter process, it is still an important first step towards a streamlined IRS approval process for 403(b) plans."

Program

The opinion and advisory letter program, the IRS explained, is intended to provide employers that maintain a 403(b) plan an alternative to adopting an individually designed plan to satisfy the written plan requirement of final regs issued in 2007. The IRS will issue an opinion or advisory letter as to whether the form of a 403(b) prototype plan or a 403(b) volume submitter plan meets the requirements of Code Sec. 403(b). An employer may satisfy the written plan requirement and obtain assurance that its plan meets the requirements of Code Sec. 403(b) by adopting a plan that has received an opinion or advisory letter.

Opinion and advisory letters

An application for an opinion letter for a 403(b) prototype plan may be filed by a prototype sponsor, by a mass submitter with respect to its mass submitter plan, or by a mass submitter on behalf of a word-for-word identical adopter or minor modifier of the mass submitter's plan. An application for an advisory letter for a 403(b) volume submitter specimen plan may be filed by a volume submitter practitioner, by a mass submitter with respect to its mass submitter plan, or by a mass submitter on behalf of a word-for-word identical adopter of the mass submitter's plan.

Determination letters

The IRS announced it is not establishing a determination letter program for 403(b) plans at this time. The extent of a plan sponsor's reliance on an opinion or advisory letter will depend in some cases on the type of pre-approved 403(b) plan that the sponsor adopts, the IRS explained.

Amendment

The IRS also described in Rev. Proc. 2013-22 procedures for the retroactive remedial amendment of plans to satisfy the requirements of Code Sec. 403(b) and the regs. The procedures permit the retroactive remedial amendment of 403(b) plans regardless of whether a plan is a pre-approved plan under the new program.

■ ***Comment.*** Rev. Proc. 2013-22 also describes duties of a pre-approved plan sponsor, scope of an opinion or advisory letter, employer reliance on an opinion letter, employer reliance on an advisory letter, maintenance of approved status, and more.

References: FED ¶46,355; TRC RETIRE: 69,060.

Repair Regs

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involving the disposition of property. The directives do not apply to audits of issues for which the IRS has provided specific guidance, apart from the regs.

■ ***Comment.*** "The new directive is pretty similar to the previous directive; there is not much difference," Lucas said. Lucas added he was surprised that the 2013 directive did not expand the scope to materials and supplies or de minimis expensing.

In both directives, LB&I instructed examiners and managers to cease audits and not begin any new audits for tax years beginning before January 1, 2012. LB&I instructed employees examining a return for a tax year beginning on or after January 1, 2012, but before January 1, 2014, to determine if the taxpayer has changed its method of accounting with respect to the issues, with or without filing a Form 3115, Application for Change in Accounting Method; and if yes, to perform a risk assessment regarding the method change. If no, the Option Period is still open and employees should not examine the issue.

■ ***Comment.*** "A risk assessment is a preliminary review," Lucas said. "Is the change material?" The IRS decides whether to examine the taxpayer's accounting method in more detail. It may decide not to

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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*

Supreme Court Agrees To Hear 40-Percent Gross Valuation Penalty Case; Concession Strategy In Shelter Litigation At Risk

◆ *Woods, S.Ct., certiorari granted, March 25, 2013*

The U.S. Supreme Court has granted the government's petition for certiorari to determine whether a taxpayer is liable for the 40 percent accuracy-related penalty for a gross valuation misstatement, where the case was decided on the grounds that the transaction lacked economic substance (*Woods, CA-5, 2012-2* USTC *¶50,657*). The taxpayer maintained that the 40 percent penalty cannot be imposed unless the taxpayer lost because of an overstatement of the basis or value of property.

■ ***CCH Take Away.*** In the inflated-basis tax shelter cases, involving transactions such as COBRA or Son of Boss, the taxpayer has claimed inflated deductions based on a very high tax basis, Matthew Lerner, partner, Steptoe & Johnson, LLP, Washington, D.C., told CCH. However, the taxpayer may lose the case on technical grounds (for example, economic substance—the parties failed to establish a partnership), rather than because of valuation, Lerner said. The issue is whether the taxpayer is still liable for the 40 percent gross valuation penalty or a 20 percent penalty for negligence or a substantial understatement of tax. Lerner pointed out that the 2011 IRS Chief Counsel Notice advised IRS attorneys not to accept concessions in tax-shelter cases without considering the impact on the application of the 40 percent gross valuation penalty.

■ ***Comment.*** Previously, the Tax Court had rejected the imposition of the 40-percent penalty in these cases, Lerner said. Recently, in *AHG Investments, CCH Dec. 59,485 (2013)*, the Tax Court reversed its position and held that the 40-percent penalty could apply, even though the taxpayer conceded the case on a ground unrelated to the value or basis of property. The decision creates a real problem for taxpayers who filed a tax shelter case in Tax Court and conceded the case on noneconomic grounds to avoid the 40 percent penalty, Lerner pointed out; their concession no longer protects them from the higher penalty.

■ ***Comment.*** There is a split in the circuits. The Fifth and Ninth Circuits have denied the application of the 40-percent penalty in nonvaluation cases. However, most circuits, including the Eleventh Circuit (*Gustashaw, 2012-2* USTC *¶50,591*), the Federal Circuit (*Alpha I, L.P., 2012-1* USTC *¶50,401*), and others, have imposed the gross valuation misstatement penalty in these cases.

Background

The taxpayer was the tax matters partner for two general partnerships. In 1999, each partnership participated in a COBRA ("Current Options Bring Reward Alternatives") tax shelter. The partnerships

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Repair Regs

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examine the issue." In an exam, the IRS looks at whether the taxpayer has implemented the method of accounting correctly and is following the regs, Lucas said. "If the taxpayer is using an improper method, the IRS can change the taxpayer's method of accounting, going back to the earliest open year, and impose interest and penalties."

■ ***Comment.*** In the 2012 directive, LB&I indicated that it may or may not perform a risk assessment depending on whether the waiver period for the taxpayer to apply the revenue procedures has passed. In the 2013 directive, LB&I indicated that the issues should not be examined if the taxpayer has not filed a Form 3115.

Reference: TRC BUSEXP: 9,090.

2013 Returns And Refunds Show Drop From 2012

The IRS has reported that the number of individual returns filed so far this filing season is down 5.2 percent compared to the same time last year. The average refund amount also reflects a drop from 2012. Additionally, the IRS reported that refund delays for some taxpayers filing Form 8863, Education Credits, would be resolved shortly.

■ ***Comment.*** It has become customary for the IRS Commissioner to brief the press on the filing season at the National Press Club in Washington D.C. in April. This year, it appears that Acting Commissioner Steven Miller is not scheduled to speak at the National Press Club.

Returns and refunds. The IRS compared filing statistics for the week ending March 22, 2013 with the week ending March 23, 2012. As of March 22, 2013, the agency had received 80.4 million returns, compared to 89.4 million returns at the same time last year. The IRS processed 77.1 million returns as of March 22, 2013, compared to 81.9 million at the same time last year.

The average refund as of March 22, 2013 was $2,985 compared to $3,030 as of March 23, 2012. The IRS paid $187.7 billion in refunds as of March 22, 2013 compared to $200.9 billion at the same time last year.

Education credits. Some taxpayers have experienced delays in receiving refunds because of failing to complete all of Form 8863. The IRS indicated that many affected taxpayers would receive their refunds within two to four weeks.

www.irs.gov, TRC FILEIND: 15,204.

IRS Issues Proposed Reliance Regs On $500,000 Deduction Limit For Health Insurance Providers

◆ *NPRM REG-106796-12*

The IRS has issued proposed reliance regs on the $500,000 deduction limitation on compensation provided by health insurance providers. The limit under Code Sec. 162(m)(6) was enacted in the *Patient Protection and Affordable Care Act* (PPACA) and is designed to encourage providers to use some of their profits to reduce premiums rather than increase compensation, the IRS explained.

■ ***CCH Take Away.*** Taxpayers may rely on the proposed regs until the issuance of final regs. The IRS issued preliminary guidance on the deduction limit in Notice 2011-2, which also continues to apply under the proposed regs.

Compensation

Although the deduction limit generally applies to compensation (referred to as individual remuneration) earned in tax years beginning after December 31, 2012, it also applies to deferred compensation (referred to as deferred deduction remuneration) that is attributable to services performed in a taxable year beginning after December 31, 2009 and before January 1, 2013, and that becomes otherwise deductible in tax years beginning after December 31, 2012.

■ ***Example.*** In year one, an individual earns $400,000 in salary and is also credited $300,000 under a nonqualified deferred compensation plan. The employer can deduct the salary in the year earned and paid. The aggregated salary and deferred compensation earned in year one total $700,000, or $200,000 over the limit for year one. When the employer pays the $300,000 in deferred compensation in a subsequent year, the employer can only deduct $100,000 of the $300,000 payment. The remaining $200,000 is not deductible by the employer in any year.

■ ***Comment.*** The rules do not apply to compensation attributable to services performed in tax years beginning before January 1, 2010, including deferred compensation attributable to services before 2010.

The deduction limit does not apply to compensation provided under a contract with a corporation or partnership. The IRS requested comments on how to address potential abuses from individuals forming small or single-member personal service corporations.

Application

The deduction limit applies to a covered health insurance provider in a tax year beginning after December 31, 2012. A health insurance issuer is a covered provider if the issuer receives premiums from providing health insurance and if at least 25 percent of the gross premiums received by the provider are from minimum essential coverage. Persons treated as a single employer under Code Sec. 414 are aggregated for applying the deduction limit, even if the group member is not a health insurance issuer.

■ ***Comment.*** Employers who self-insure their health insurance coverage are not covered providers.

Notice 2011-2 and the proposed regs provide a de minimis rule under the aggregation rules. A person is not a covered provider if the insurance premiums received by all members of the group are less than two percent of the gross revenue of all members of the group for the tax year.

Remuneration

The rules apply to all forms of remuneration, including deferred compensation, stock-based compensation, and involuntary separation pay, as well as earnings and changes in plan balances. The proposed regs provide extensive rules on the allocation of different forms of compensation to particular tax years.

References: FED ¶49,569; TRC COMPEN: 12,350.

Penalties

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claimed, and the IRS disallowed, ordinary losses of $13.4 million and short-term capital losses of $32.3 million. In 2010, a federal district court held that the losses claimed by the partnerships were properly disallowed because the transactions lacked economic substance.

The IRS also imposed three categories of accuracy-related penalties on the taxpayer: the 40-percent gross valuation misstatement under Code Sec. 6662(e); 20 percent for negligence under Code Sec. 6662(a) and (b)(1); and 20 percent for a substantial underpayment of tax under Code Sec. 6662(b)(2). The court held a separate proceeding on the penalty issues and asked the parties for briefs.

■ ***Comment.*** Lerner said there are questions of judicial economy involved in disposition of the penalty issues. "Do we now have to have a trial on whether economic substance is relevant," he queried. Lerner noted that the IRS directive instructed IRS attorneys to focus on the noneconomic substance grounds for attacking a shelter, if those are the better arguments.

The court denied the 40-percent penalty, but upheld the 20 percent penalty.

■ ***Comment.*** Lerner emphasized that, "Any time there's more than one potential penalty outcome [for example, zero, 20 or 40 percent], the question could come up—on what basis was the substantive tax issue decided?" Although the law was amended in 2010 to provide for a strict liability penalty for tax shelters, this penalty could be 20 percent for a transaction that lacks economic substance, but 40 percent if the taxpayer failed to disclose the transaction. "The taxpayer could be hit with either type of 40 percent penalty; it's the same kind of question," he said.

References: 2012-2 USTC ¶50,657; TRC PART: 60,558.

IRS Expands Law Enforcement Assistance Program Nationwide To Fight Identity Theft

◆ *IR-2013-34*

The IRS has announced that it is expanding and making permanent its identity theft Law Enforcement Assistance Program to cover all 50 states and the District of Columbia. The IRS added that since the start of 2013, it has worked with taxpayers to resolve and close more than 200,000 cases of identity theft.

■ ***CCH Take Away.*** "This is a very positive development," David Young, CPA, Young and Company CPAs LLP, Rochester, N.Y., told CCH. In many cases, identity thieves move quickly at the start of the filing season to file returns and taxpayers who have had their identities stolen do not learn of the fraudulent returns until they file their legitimate return, Young explained.

■ ***Comment.*** On March 28, Sen. Bill Nelson, D-Fla., announced that he intends to introduce legislation to reduce by half the time it takes the IRS to resolve and close identity theft cases, from 196 to 90 days. Nelson added that his bill will also impose new restrictions on the ability to use prepaid debit cards to commit tax fraud.

Background

The IRS explained that a taxpayer may suspect it is a victim of identity theft if he or she receives a letter from the IRS stating that the taxpayer filed more than one tax return or someone has already filed using the taxpayer's information. Identity theft may also have taken place where the taxpayer has a balance due, refund offset or has had collection actions for a year in which the taxpayer did not file a return. Taxpayers who have been victims of identity theft must complete Form 14039, Identity Theft Affidavit. The IRS will assign a special identity protection personal identification number (IP PIN) to the taxpayer.

Law enforcement

The IRS launched the Law Enforcement Assistance Program as a pilot in Florida and subsequently expanded it to eight additional states. The Law Enforcement Assistance Program is now expanded nationwide.

The program provides for the disclosure of federal tax returns and return information associated with the accounts of known and suspected victims of identity theft with the express written consent of the victims. Before disclosing any tax information, victims are required to sign a waiver authorizing the release of information to the designated state or local law enforcement official pursuing the investigation. The IRS will provide law enforcement with the fraudulently filed return. The IRS explained that it will assist law enforcement in locating taxpayers and securing their consent.

■ ***Comment.*** "This program is an effective way for law enforcement to work with the IRS to pursue identity thieves and protect taxpayers. Expanding the program and making it permanent on a nationwide basis makes sense for victims as well as law enforcement and tax administration," Acting IRS Commissioner Steven Miller said in a statement.

IP PINs and other activity

The IRS reported that it has issued more than 770,000 IP PINs to taxpayers since the start of the 2013 filing season. The agency added that more than 200,000 identity theft cases have been closed since the beginning of 2013. Since October 2012, there have been more than 670 criminal identity theft investigations opened.

■ ***Comment.*** "Taxpayers whose identities have been stolen should immediately request an IP PIN and not wait until the filing season to contact the IRS," Young told CCH

Reference: TRC IRS: 66,304.

IRS Loses Bid To Stay Return Preparer Initiative Injunction; Government Files Appellate Brief

In a setback for the IRS, the Court of Appeals for the District of Columbia Circuit has rejected the government's request to stay a lower court's injunction of the agency's return preparer oversight initiative pending appeal *(Loving, 2013-1* USTC *¶50,156)*. As a result, the IRS cannot move forward with the initiative.

■ ***Comment.*** "We remain confident in our legal authority and remain committed to protecting taxpayers through implementing reasonable standards in this area. Our appeal of the original district court opinion is being actively pursued." the IRS announced after the decision.

Background. In *Loving,* the District Court for the District of Columbia enjoined the IRS from implementing its return preparer oversight initiative. The district court found that the IRS had overreached its authority to regulate practitioners. DOJ, on behalf of the IRS, asked the D.C. Circuit to stay the lower court's injunction pending appeal.

Stay denied. On March 27, in a one-page order, a panel of the D.C. Circuit held that the government had failed to satisfy the requirements for a stay pending appeal. The court did not elaborate on its reasoning.

DOJ files appellate brief. On March 29, DOJ filed its brief in the D.C. Circuit arguing that the district court had erred in declaring the return preparer initiative invalid. DOJ told the court that Congress granted broad authority to Treasury to regulate individuals who practice before the IRS and the return preparer initiative represented a reasonable construction of the authority granted to Treasury. DOJ added the initiative would improve the accuracy, completeness, and timeliness of returns prepared by paid return preparers.

Loving, No. 13-5061, March 27, 2013; TRC IRS: 3,204.30.

Latest IRS Data Book Reveals Drop In Overall Audit Rate; Increased Percentage Of Correspondence Audits

◆ *2012 IRS Data Book, IR-2013-32*

The IRS recently issued its annual Data Book for fiscal year (FY) 2012, which provides statistical information on examinations, collections and other activities. The IRS's comparison of FY 2012 data with FY 2011 data indicates a decrease in the percentage of returns being audited, possibly reflecting the IRS's shrinking budget environment.

■ ***CCH Take Away.*** "It is difficult to determine the actual impact on the overall tax enforcement efforts of the IRS associated with budget cutbacks. Historically, the IRS has been asked by Congress to do more with less resources and has, generally, been able to appropriately respond," Charles Rettig, partner, Hochman Salkin Rettig Toscher & Perez PC, Beverly Hills, Calif., and former chair of the IRS Advisory Council (IRSAC), told CCH. "The quality of examinations is often as important for tax compliance as the quantity of examination activity. Budget constraints and hiring freezes adversely impact the ability to have capable, experienced examining agents."

Returns/collections

During FY 2012, the IRS processed more than 237.3 million federal tax returns, paid out approximately 123.4 million refunds totaling more than $373.4 billion, and collected a net amount of $2.2 trillion.

■ ***Comment.*** "Just because IRS auditors find there are additional taxes due in their opinion doesn't mean it is necessarily ever collected," Susan Long, professor, Syracuse University and co-director, Transactional Records Access Clearinghouse (TRAC) told CCH. "When you speak about revenue, it is a more complicated picture to look at, since there may be appeals contesting the amount as well as issues of collectability once the amount is finally determined. But I don't think anyone debates that if IRS had more auditors it would be able to raise more money than those auditors cost."

Individual returns. More than 146.2 million individual income tax returns were filed during FY 2012, representing a 1.8 percent increase from the number of returns filed in FY 2011. Individual income tax withheld and tax payments, combined, totaled nearly $1.4 trillion before refunds, which amounted to almost $322.7 billion.

Nearly 81.0 percent of individual income tax returns were filed electronically in FY 2012, the IRS reported. This represented an increase from the 77 percent of individual tax returns that were e-filed in FY 2011. Much of this increase likely results from increased e-filing among paid tax return preparers, who filed more than 75.1 million tax returns electronically in FY 2012 (up from 71 million in FY 2011).

Business returns. The IRS processed nearly 2.3 million returns and collected almost $281.5 billion in taxes, before refunds, from corporations in FY 2012. Partnerships and S corps filed an additional 8.2 million returns.

Examinations

Individual examinations. Individual taxpayers collectively were audited at a 1.0 percent rate over the FY 2012 period, based on 1,481,966 audited returns (down from 1,564,690 in FY 2011) out of the 143,399,737 returns that were filed (up from 140,837,499 in FY 2011). This rate represents a small decrease from the 1.1 percent of returns covered in FY 2011.

■ ***Comment.*** As usual, both correspondence and field audits were counted within the statistics. Correspondence audits accounted for 75.7 percent of all individual audits for FY 2012 (up slightly from 75 percent in FY 2011), while in-person audits were 24.3 percent of the total, representing a slight decrease from 25 percent in FY 2011.

■ ***Comment.*** "The number of correspondence audits went down four percent for individuals," Long noted. With correspondence audits, the IRS can do many more with a lower-cost examiner since each takes little time, she said. However,

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Tenth Circuit Finds Bankruptcy Petition Does Not Stay Appeal From Tax Court

In a recent decision, the Court of Appeals for the Tenth Circuit has joined four other circuits in finding that the filing of a bankruptcy petition does not operate as a stay of a taxpayer's appeal of a case from the Tax Court. As a result, the split among the circuits has widened.

Background. The taxpayer appealed an adverse Tax Court decision to the Tenth Circuit. While the appeal was pending, the taxpayer sought bankruptcy protection.

Court's analysis. Bankruptcy Code Sec. 362(a)(1) provides that the filing of a bankruptcy petition operates as a stay of the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case. The Tenth Circuit found it was an open question in the circuit whether a proceeding is considered initiated by the debtor when he files a petition in Tax Court or whether the Tax Court proceeding is a continuation of the proceeding initiated against the debtor when the IRS begins the administrative process of determining that there is a deficiency. The Tenth Circuit held that a petition filed in Tax Court is an independent judicial proceeding initiated by a debtor in bankruptcy; not the continuation of an administrative proceeding against the debtor.

Schoppe, CA-10; 2013-1 USTC ¶50,246; TRC BUSEXP: 3,200.

Tax Briefs

Internal Revenue Service

The IRS has issued its fourteenth annual report on advance pricing agreements (APAs) and the APA Program. The report describes the experience, organizational structure, and activities of the APA Program during calendar year 2012.

Announcement 2013-17, FED ¶46,353; TRC INTL: 15,200.

International

The IRS has released a copy of the competent authority (CA) agreement between the United States and Norway clarifying the treaty between the two countries with respect to offshore activities. The agreement clarifies when a resident of a state that operates tugboats and similar vessels in the other state in connection with offshore activities will be exempt from tax in that other state. The agreement lists specific activities that these vessels can undertake and remain exempt from tax.

Announcement 2013-16, FED ¶46,356; TRC INTL: 18,138.

Employers that paid Federal Insurance Contributions Act (FICA) taxes for foreign contract workers employed in garment factories in the Commonwealth of the Northern Mariana Islands (CNMI) were not entitled to a refund of those taxes. The CNMI was within the United States with respect to employment for FICA tax purposes. Further, section 606(b) of the covenant states that laws of the United States pertaining to Social Security contributions and benefits were applicable to the CNMI.

American Pacific Textile, Inc., DC N.M.I., 2013-1 USTC ¶50,241; TRC PAYROLL: 9,054.

Jurisdiction

The Tax Court properly dismissed for lack of subject matter jurisdiction a corporation's petition challenging the IRS's offset of its excise tax overpayments against penalties assessed under Code Sec. 6721 for failure to file correct information returns and Code Sec. 6722 for failure to file correct payee statements. The petition was untimely.

Apex Oil Company, Inc., CA-8, 2013-1 USTC ¶50,244; TRC LITIG: 6,106.10.

Summons

An IRS summons directing an individual to appear, testify and produce documents relating to an investigation of her federal tax liabilities was ordered enforced. The individual failed to rebut the government's *prima facie* case for enforcement under *Powell*.

Van Liew, DC Tex., 2013-1 USTC ¶50,243; TRC IRS: 21,300.

Deductions

Married individuals were denied deductions for expenses associated with their attempted rental of their farmhouse for the years at issue, as they did not operated a real estate rental business and did not hold the building for the production of income. However, although the IRS demonstrated negligence, the taxpayers acted reasonably in reliance on a tax professional and were not subject to accuracy-related penalties.

Meinhardt, TC, CCH Dec. 59,492(M), FED ¶48,010(M); TRC BUSEXP: 12,060.

A corporation that was a wholesale distributor of animal health products was limited in the amount of its deductions for reasonable compensation for its officers and certain employees and its deduction for reasonable rent paid to a related party base. Equitable recoupment did not apply to allow any excess tax paid by shareholders to offset their corporation's tax liability.

K & K Veterinary Supply, Inc., TC, CCH Dec. 59,491(M), FED ¶48,009(M); TRC COMPEN: 9,000.

Liens and Levies

A state court order halting an IRS levy of a delinquent taxpayer's retirement and college savings accounts and seeking recovery of previously levied funds was vacated. The individual failed to demonstrate that the government had waived its sovereign immunity or consented to be sued or that he was entitled to recovery of the already levied funds. The individual also failed to prove that he intended to irrevocably transfer the money in the plans to his children, or that funds in the accounts were not his property.

M.F. Taylor v. Taylor, DC N.Y., 2013-1 USTC ¶50,245; TRC IRS: 45,152.

The IRS Appeals Office did not abuse its discretion when it refused to consider the same claim that an individual raised in his lien hearing request as he had raised at the hearing following a levy. The settlement officer may have erred in concluding that

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IRS Changes Phone Number To Check Voluntary Correction Program Submissions

The IRS has changed the telephone number in "Appendix D, Acknowledgment Letter," attached to Rev. Proc. 2013-12, that taxpayers can use to check the status of a Voluntary Correction Program (VCP) submission. As of March 27, 2013, taxpayers must call (626) 927-2011 to inquire about the status of a VCP submission sent to the IRS.

■ ***Comment.*** The VCP enables plan sponsors to identify and correct retirement plan failures in advance of an audit and allows the retirement plan to continue qualifying for tax benefits.

Ann. 2013-21; TRC RETIRE: 51,450.

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the taxpayer was challenging his underlying liability; however, it was a harmless error.

S. Cohen, TC, CCH Dec. 59,493(M), FED ¶48,011(M); TRC IRS: 24,054.

Refund Claims

An individual's complaint seeking to carry back a net operating loss to offset his tax liability for two tax years, which would result in tax refund, could not be dismissed for lack of subject matter jurisdiction. The individual sent faxes and letters to the IRS on many occasions over a period of years seeking to apply the carryback loss and the IRS responded by requesting the individual to provide additional information. Therefore, the individual had filed an informal refund claim.

McKenzie, DC Pa., 2013-1 USTC ¶50,242; TRC LITIG: 9,102.05.

Deficiencies and Penalties

An individual who was liable for underreported income as set out in a notice of deficiency was not liable for fraud penalties relating to the underreported income but was liable for the accuracy-related penalty. The bank deposits method was properly used to reconstruct his income. The individual's ex-wife was entitled to innocent spouse relief.

Mui, TC, CCH Dec. 59,490(M), FED ¶48,008(M); TRC ACCTNG: 3,152.

Tax Credits

State and local housing credit agencies that allocate low-income housing tax credits and states and other issuers of tax-exempt private activity bonds have been provided with a listing of the proper population figures to be used when calculating the 2013 calendar-year population-based component of the state housing credit ceiling under Code Sec. 42(h)(3)(C)(ii), the 2013 calendar-year private activity bond volume cap under Code Sec. 146, and the 2013 exempt facility bond volume limit under Code Sec. 142(k)(5).

Notice 2013-15, FED ¶46,357; TRC BUSEXP: 54,220.10.

Retirement Plans

The IRS has issued frequently asked questions (FAQs) regarding required minimum distributions (RMDs) from retirement plans. Among the subjects covered by the FAQs are types of plans that must make RMDs, calculation of the RMD, RMDs where there are multiple accounts, additional withdrawals and consequences of not taking a timely RMD.

Required Minimum Distribution FAQs, FED ¶46,358; TRC RETIRE: 42,150.

IRS Data

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more in-depth issues require face-to-face time, and the audit rate for these types of examinations decreased in FY 2012, she explained.

Examination coverage: individuals

The following audit statistics taken from the FY 2012 Data Book (and contrasted with FY 2011 statistics) reflect a decrease in the audit rate especially in proportion to adjusted gross income (AGI) level:

- No AGI: 2.67% (3.42% in 2011)
- Under $25,000: 1.05% (1.22% in 2011)
- $25,000 to $50,000: 0.70% (0.73% in 2011)
- $50,000 to $75,000: 0.64% (0.83% in 2011)
- $75,000 to $100,000: 0.64% (0.82% in 2011)
- $100,000 to $200,000: 0.85% (1.00% in 2011)
- $200,000 to $500,000: 1.96% (2.66% in 2011)
- $500,000 to $1 million: 3.57% (5.38% in 2011)
- $1 million to $5 million: 8.90% (11.80% in 2011)
- $5 million to $10 million: 17.98% (20.75% in 2011)
- $10 million and over: 27.37% (29.93% in 2011)

Examination coverage: business returns

For individual income tax returns that include business income (other than farm returns), the 2012 audit rate based upon business income (total gross receipts) decreased from FY 2011. However, the IRS appears to continue to devote more attention to individual small business returns than individual nonbusiness returns within the same income categories.

- Gross receipts under $25,000: 1.2% (1.3% in 2011)
- Gross receipts $25,000 to $100,000: 2.4% (2.9% in 2011)
- Gross receipts $100,000 to $200,000: 3.6% (4.3% in 2011)
- Gross receipts over $200,000: 3.4% (3.8% in 2011)

The difference in audit rates between returns with and without business income, as measured by total positive income of at least $200,000 and under $1 million, appears to support the IRS's tendency toward auditing business returns: 3.7 percent for returns with business income versus 2.8 percent without in FY 2012. The gap in these audit rates has increased from FY 2011 when the IRS audited 3.6 percent of returns with business income versus 3.2 percent without.

Examination coverage: small corporations and others

For small corporations showing total assets of $250,000 to $1 million, the audit rate for FY 2012 increased to 1.7 percent, up from 1.6 percent in 2011; for small corporations with total assets between $1 million and $5 million, the rate increased to 2.1 percent, up from 1.9 percent in 2011; and for small corporations with assets between $5 million and $10 million, the rate remained 2.6 percent, the same as in 2011.

For larger corporations showing total assets of $10 million to $50 million, the audit rate for FY 2012 decreased to 10.5 percent, down from 13.3 percent in 2011. The audit rate of large corporations at the top end, whose assets ranged between $5 billion and $20 billion, was 45.4 percent, down from 50.5 percent in 2011, but comparable with the 45.3 audit rate for the same category in FY 2010.

For S corps and partnerships, the overall FY 2012 audit rate was 0.5 percent (a slight increase from 0.4 percent in 2011), in contrast to an overall 1.6 percent rate for corporations (1.5 percent in 2011).

References: FED ¶46,354; TRC IRS: 9,402.