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IRS Provides Significant Relief To Small Businesses For Implementing Repair Regs

◆ *Rev. Proc. 2015-20, IR-2015-29*

The IRS has substantially simplified the requirements for small businesses to adopt the "repair regs" for 2014. Small businesses can change their accounting methods automatically, without filing Form 3115 and without having to apply Code Sec. 481, the IRS explained.

■ ***Take Away.*** "This is very significant relief," George Manousos, partner, PricewaterhouseCoopers LLP, told Wolters Kluwer. "The regulations are voluminous. The government received a lot of comments on behalf of small business, regarding the perceived burden of implementing the regulations with a full Sec. 481 adjustment. Taxpayers are required to go back in time (as far back as their books would allow) and redo their analysis of prior years' repairs. The government did a lot for small business in the final regulations, but did not provide for a cutoff method. This relief allows small business to elect to implement the regulations on a cutoff basis," Manousos said.

■ ***Comment.*** The relief is available for the 2014 tax return that taxpayers will be filling out this tax season. "The IRS is pleased to be able to offer this relief to small business owners and their tax preparers in time for them to take advantage of it on their 2014 return," Commissioner John Koskinen said in a statement. "We especially appreciated the valuable feedback provided by the professional tax community on this issue."

■ ***Comment.*** Manousos agreed. "The timing is opportune. Taxpayers would have to file their return either March 15 or September 15 (with an extension). Getting this guidance out in the beginning of February has given small business plenty of time to comply with the regulations," he said.

Change of accounting method

The repair regs address whether costs incurred with respect to tangible property should be deducted or capitalized under Code Sections 162, 168 and 263. The final regs (TD 9636, September 2013) generally are effective for tax years beginning on or after January 1, 2014, although taxpayers can choose to apply them to 2012 or 2013. Many provisions require a taxpayer to change its method of accounting. Some provisions are elective from year to year and do not require a change of accounting method.

Under Rev. Procs. 2014-16 and 2014-54, the IRS provided automatic consent for taxpayers to change their accounting methods to comply with the repair regs. A taxpayer must file Form 3115 to request a change of accounting method and to obtain IRS consent, even if it is automatic. Taxpayers must apply Code Sec. 481, which requires them to calculate an adjustment to their treatment of the same items for prior years, before the year of change, so that there is no duplication of deductions or omission of income.

■ ***Comment.*** In the 2014 revenue procedures, the IRS provided reduced filing requirements for

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Repair Regs

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small taxpayers. These changes exempted filers from completing certain lines of Form 3115 but did not affect the detailed computation of any adjustment under Code Sec. 481.

AICPA request; IRS relief

The AICPA wrote to the IRS in October 2014 to express concern about the burden on small businesses, which under the final repair regs must change their methods of accounting for 2014. The organization also highlighted the burden on practitioners to meet their practice obligations under Circular 230 if small businesses could not comply with the regs. The AICPA proposed that small businesses be allowed to apply the repair regs prospectively, without having to calculate adjustments to prior-year tangible property costs under Code Sec. 481.

In Rev. Proc. 2015-20, the IRS responded to these concerns. A small business that is changing a method of accounting for tax years beginning on or after January 1, 2014, to comply with the repair regs, may make the change on a cutoff basis under Code Sec. 481, by taking into account only amounts paid or incurred, and dispositions, in their 2014 tax year.

■ ***Comment.*** Code Sec. 481 ordinarily requires taxpayers to account for treatment of the affected items in tax years prior to 2014, to avoid duplication of deductions or omission of income. The IRS relief effectively permits taxpayers to change their accounting methods prospectively, by only taking into account amounts paid or incurred, and dispositions, in taxable years beginning on or after January 1, 2014.

Furthermore, taxpayers may change their methods of accounting solely by filing a federal tax return, without filing a Form 3115 or separate statement. Under a transition rule, a qualifying taxpayer that previously filed Form 3115 for 2014 may withdraw the filed form on or before the due date of the taxpayer's timely filed return (including extensions).

■ ***Comment.*** "In the government's view, most taxpayers would need to file Form 3115, since the regulations are brand new," Manousos said. "Small businesses were concerned that having to file Form 3115 would be burdensome."

The relief is available to taxpayers that have one or more separate and distinct trade(s) or business(es), where the trade or business has either total assets under $10 million at the start of the 2014 tax year, or has average annual gross receipts of $10 million or less for the prior three tax years.

Audit protection

The government decided that taxpayers would not be entitled to audit protection for tax years before 2014. Also, taxpayers may not make a late partial disposition election for tax years before 2014.

■ ***Comment.*** It is in the government's discretion whether to provide audit protection, Manousos said. It does not depend on whether taxpayers can use a cutoff method or make a 481 adjustment when changing their accounting method. "Not providing audit protection is against the norm. But that type of taxpayer [small business] is not likely to have a material amount of changes [that would show up in an audit]. So this could be considered a small price to pay for the relief provided," he said.

De minimis safe harbor

Taxpayers can elect a *de minimis* safe harbor that requires them to deduct amounts paid to acquire or produce an item that costs $5,000 or less (by item or by invoice). The taxpayer must have an applicable financial statement (AFS) that treats the item's cost as a deductible expense for tax accounting purpose. The taxpayer also must have a written accounting procedure in place at the beginning of the tax year that requires expensing the item.

In the temporary regs, there was no safe harbor for a taxpayer without an AFS, a requirement that many small businesses could not satisfy. The final regs provided some relief, by allowing taxpayers without an AFS to deduct an item that cost $500 or less, provided the taxpayer had an accounting procedure in place (though it did not have to be written).

The AICPA requested that the IRS increase the *de minimis* safe harbor threshold for taxpayers without an AFS from $500 to $2,500, and index the amount for inflation. Under current law, businesses cannot deduct an item that costs greater than the $500 safe harbor unless they demonstrate that the deduction clearly reflects income, a subjective and difficult standard, the AICPA explained.

In Rev. Proc. 2015-20, the IRS requested comments (by April 21, 2015) on whether to increase the safe harbor above $500 for taxpayers without an AFS. The IRS asked commenters to specify an amount and to explain why that amount would be appropriate.

■ ***Comment.*** The IRS indicated in Rev. Proc. 2015-20 that the safe harbor and Code Sec. 179 expensing also already provide significant tax simplification for small businesses.

■ ***Comment.*** "The government received lots of comments on the de minimis safe harbor and was asked many times to go higher for taxpayers without an AFS," Manousos said. "The government will have to make a policy call. An AFS is significant. The government wants that book/tax tension so that there is no perceived abuse. If there is no AFS, the tax treatment may not clearly reflect income. Without an AFS, there is not as much comfort for the government," he said.

References: FED ¶¶46,252, 46,253; TRC BUSEXP: 9,099.

Reference Key

FED references are to *Standard Federal Tax Reporter*
USTC references are to *U.S. Tax Cases*
CCH Dec references are to *Tax Court Reports*
TRC references are to *Tax Research Consultant*

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IRS Finalizes Temporary Regs On Foreign Tax Credit Splitter Rules

◆ *TD 9710*

The IRS has issued final regs on foreign tax credit splitting events, just as temporary regs were set to expire. The final regs apply to foreign taxes paid or accrued in tax years ending after February 9, 2015. The temporary regs apply for prior years beginning on or after January 1, 2012; taxpayers may also apply the temporary regs to taxes paid or accrued in the first tax year ending after February 9, 2015.

■ ***Take Away.*** "The final regulations under section 909 maintain the same conceptual framework of the temporary regulations," Joseph Calianno, partner and International Technical Tax Practice leader, Grant Thornton LLP, Washington, D.C., told Wolters Kluwer. "Importantly, the final regulations did not add any additional arrangements to the list of splitter arrangements that were contained in the prior regulations. The final regulations did, however, address some areas of uncertainty that existed under the temporary regulations while clarifying certain items. Nevertheless, there are still several additional areas that need further guidance as it relates to the operation of the rules," Calianno said.

■ ***Comment.*** "As the discussion in the preamble relating to certain restructurings and dispositions indicates, taxpayers who are subject to section 909 need to carefully evaluate any restructuring or disposition to determine the impact of such transaction under section 909, including whether the restructuring or disposition could result in the permanent suspension of split taxes," Calianno said.

Background

Congress enacted Code Sec. 909 to address the inappropriate separation of foreign income taxes and the related income. In determining U.S. income taxes, if there is a foreign tax credit splitting event, the provision suspends the foreign tax credit until the year that the related income is taken into account. The rules also apply to partnerships at the partner level.

There is a foreign tax splitting event, for a foreign income tax, if the related income will be taken into account by a covered person. A covered person (with respect to the payor of the foreign tax) includes:

- An entity in which the payor owns at least 10 percent (by vote or value);
- Any person that owns at least 10 percent of the payor; or
- Any person related to the payor under Code Sec. 267(b) or 707(b).

In 2012, the IRS issued temporary and proposed regs (TD 9577; NPRM REG-132736-11) under Code Sec. 909. The temporary regs provided an exclusive list of splitter arrangements subject to the rules and removed consolidated group splitter arrangements from the list. The categories included were reverse hybrid structures, group relief or loss-sharing regimes, hybrid instruments, and partnership inter-branch payment arrangements. The temporary regs also provided interim mechanical rules for tracking taxes paid or accrued and the related income under a splitter arrangement.

■ ***Comment.*** In a reverse hybrid structure, the U.S. treats an entity as a corporation, while the foreign government treats it as a flow-through entity. Under a loss-sharing regime, the shared loss of a U.S combined group is used to offset the loss of another U.S. combined group. A hybrid instrument is treated as stock for U.S. tax purposes but as debt for foreign tax purposes.

Final regs

The final regs adopted the temporary and proposed regs without substantial modifications, maintaining the exclusive list of splitter arrangements while clarifying certain definitions. In response to a comment that the hybrid instrument category be expanded to apply if the instrument owner is not related to the issuer, the government said it was not appropriate to extend the splitter list at this time, but indicated it would consider this category and other potentially inappropriate arrangements.

The final regs made one clarification to the interim mechanical rules for tracking split taxes and related income, but otherwise did not address mechanical issues. The government recognized the need for mechanical rules and indicated that they will be addressed in future guidance.

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IRS Issues Proposed Guidance On Employee Consents To Support FICA Refund Claims

The IRS has issued a proposed revenue procedure describing employee consents to support *Federal Insurance Contributions Act* (FICA) and the *Railroad Retirement Tax Act* (RRTA) refund claims under Code Sec. 6402. The proposed revenue procedure permits, but does not require, the employee consent to be requested, furnished, and retained in an electronic format, as an alternative to a paper format. An employer may rely on the proposed procedure for employee consents requested before the date the final revenue procedure is published.

■ ***Comment.*** The guidance was issued in response to questions about what information must be provided in the employee's consent and whether such consent may be requested, furnished and retained in an electronic format.

Notice 2015-15. The IRS clarified that in addition to the employee's name, address and taxpayer identification number, a valid employee consent must identify the basis of the refund claim and be signed by the employee under penalties of perjury. The IRS also described what constitutes "reasonable efforts" to secure the employee's consent when consent cannot be obtained. Additionally, the IRS explained when an employer may request, furnish and retain employee consent in electronic format as an alternative to paper.

Notice 2015-15; FED ¶46,254; TRC IRS: 33,108.05.

IRS Will Disallow Most Severance-Pay FICA Refunds Based On *Quality Stores* Decision

◆ *Ann. 2015-8*

The IRS has announced that it will disallow claims for refunds of *Federal Insurance Contributions Act* (FICA) taxes paid with respect to severance payments that do not satisfy a narrow exclusion under Rev. Rul. 90-72. The action follows the Supreme Court's 2014 decision in *Quality Stores, 2014-1* USTC *¶50,228.* The Court held that supplemental unemployment benefits (SUB) payments made to terminated employees and not tied to the receipt of state unemployment benefits are wages for FICA tax purposes.

■ ***Take Away.*** "This anticipated announcement is important because it first clarifies that Revenue Ruling 90-72 continues in effect (providing limited relief from employment taxes for certain payments linked to state unemployment compensation), and second that no action is needed by employers who filed refund claims (including protective claims) and appeals prior to the Supreme Court's decision, as those actions will be denied (unless Rev. Rul. 90-72 is satisfied)," Elizabeth Thomas Dold, principal, The Groom Law Group Chartered, Washington, D.C., told Wolters Kluwer.

Background

In *Quality Stores,* the Supreme Court found that FICA defines wages as all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash. Further, in reversing the Sixth Circuit, the Court found that the term "employment" encompasses any service, of whatever nature, performed . . . by an employee for the person employing him. Severance payments, the Court held, are remuneration. Severance payments are made to employees only. It would be contrary to common usage to describe as a severance payment, remuneration provided to someone who has not worked for the employer, the Court observed.

■ ***Comment.*** The decision by the Sixth Circuit had created a split among the circuits. In 2008, the Federal Circuit held that severance payments were wages for FICA and tax purposes in *CSX Corp., 2008-1* USTC *¶50,218.*

Refund claims

The IRS reported that before the Supreme Court's decision in *Quality Stores,* it had received FICA refund claims (along with claims for refunds of *Federal Unemployment Tax Act* (FUTA) and Railroad Retirement taxes (RRTA) paid with respect to severance payments). The IRS disallowed these claims and many taxpayers appealed to IRS Appeals. Action on these appeals was suspended pending the Supreme Court's decision in *Quality Stores.*

Rev. Rul. 90-72

In Rev. Rul. 90-72, the IRS determined that SUB payments must be linked to the receipt of state unemployment compensation and must not be received in a lump sum to be excluded from the definition of wages for FICA purposes. In *Quality Stores*, the Supreme Court did not address whether the exclusion from FICA taxes set forth in Revenue Ruling 90-72 for certain payments linked to state unemployment benefits is consistent with the broad definition of wages under FICA. Therefore, the IRS explained that Rev. Rul. 90-72 continues to be in effect.

■ *Comment.* Rev. Rul. 90-72 revoked the portion of Rev. Rul. 77-347 that had concluded that SUB pay does not have to be tied to state unemployment benefits to receive nonwage treatment for purposes of FICA and FUTA taxes.

Ann. 2015-8

As a result of the Supreme Court's holding in *Quality Stores,* the IRS will disallow all claims for refund of FICA or RRTA taxes paid with respect to severance payments that do not satisfy the narrow exclusion in Rev. Rul. 90-72. The IRS will also disallow all claims for FUTA tax refunds. This treatment, the IRS explained, applies to all pending refund claims before the IRS. No further action will be taken on these claims, the IRS reported.

References: FED ¶46,248; TRC PAYROLL: 3,178.

Foreign

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Additional changes

Changes regarding loss-sharing arrangements included:

- A clarification that references to income of a U.S. combined group refers to income for purposes of foreign law, not U.S. law; and
- A modification that a usable shared loss is a shared loss that could be used in foreign law to offset income in a prior foreign tax year, as well as in the current year. However, it does not include a loss that could be carried forward.

Other changes included:

- Two new examples to clarify how to determine the related income with respect to split taxes from a reverse hybrid splitter;
- A clarification that an actual payment of an accrued amount does not prevent the instrument from being a splitter arrangement; and
- A clarification that split taxes are unsuspended only when the related income is taken into account by the payor Code Sec. 902 corporation as a result of a distribution or inclusion out of earnings and profits, or from a combination of the payor 902 corporation and the covered person in a Code Sec. 381 transaction.

References: FED ¶47,008; TRC INTLOUT: 3,302.

Code Sec. 475 Does Not Preclude Application Of Code Sec. 7701(g), Chief Counsel Determines

◆ *CCA 201507019*

IRS Chief Counsel has determined that Code Sec. 7701(g) applies to the determination of gain or loss under Code Sec. 475. Further, decisions by the Supreme Court require a dealer in securities determining year-end mark-to-market gain or loss on securities to include in the amount realized the amount of nonrecourse indebtedness to which the securities are subject.

■ ***Take Away.*** Chief Counsel noted that Code Sec. 7701(g) was enacted to reflect the rationale in *Tufts, 461 U.S. 300 (1983).* If a tax benefit, Chief Counsel explained, is claimed and allowed for debts incurred under nonrecourse obligations, the taxpayer must treat the transfer of these obligations as part of the consideration for a sale of the property.

Background

Partnership X served as a traditional holding company for Partnership Y. X also held a majority interest in Partnership Z. The partnerships Y and Z (the Partnerships) engaged in the business of originating and purchasing mortgage loans on the open market and issuing notes to investors as mortgage-backed securities in exchange for cash. The partnerships were not personally liable for the payment of the notes, and the notes were nonrecourse liabilities to which the mortgage securities were subject. The receipt of cash was treated by Y and Z as nontaxable loan proceeds.

■ ***Comment.*** The partnerships conceded that the notes were nonrecourse liabilities to which the securities were related.

Y sold some of its mortgage securities subject to nonrecourse liabilities to X. In calculating its amount realized on the sale, Y included the amount of nonrecourse liabilities. X included the amount of nonrecourse liabilities in calculating its basis in the purchased securities.

Chief Counsel's analysis

Chief Counsel first noted that Code Sec. 475(a) generally requires a dealer in securities to use a mark-to-market method of accounting for securities it holds. Under Code Sec. 475(a)(2), any security not held as inventory and which is held at the end of the year is treated as if it had been sold at fair market value on the last business day of the year, and any gain or loss is recognized. Code Sec. 7701(g), Chief Counsel further explained, provides that in determining the amount of gain or loss (or deemed gain or loss) with respect to any property, the fair market value of the property is treated as being not less than the amount of any nonrecourse indebtedness to which the property is subject.

Code Sec. 475 does not contain any language precluding the application of Code Sec. 7701(g). As a result, Chief Counsel concluded that the partnerships had to treat the fair market value of the securities as being not less than the amount of nonrecourse indebtedness to which the securities were subject.

■ ***Comment.*** Chief Counsel, however, did not limit its holding strictly to statutory construction. Even if Code Sec. 7701(g) did not apply to Code Sec. 475, Chief Counsel reasoned that the Partnerships' omission of the nonresource indebtedness in determining the amount realized under Code Sec. 475(a)(2) would fail to follow the symmetrical approach endorsed by the Supreme Court in *Crane* (331 US 1) and *Tufts* (461 U.S. 300): if a tax benefit is claimed and allowed from debts incurred under nonrecourse obligations, the taxpayer must then treat the transfer of those obligations as part of the consideration for a sale of the property.

Reference: TRC SALES: 45,350.

Updated Guidance On Adequate Disclosure Of Return Positions Released

The IRS has released updated procedures describing income tax return disclosures for purposes of certain accuracy-related penalties and preparer penalties. The updated procedures apply to income tax returns filed for a tax year beginning in 2014, or for returns filed in 2015 on 2014 tax forms for short years beginning in 2014, the agency reported.

Background. The IRS regularly updates guidance identifying circumstances under which the disclosure on a taxpayer's income tax return with respect to an item or position is adequate for the purpose of reducing the understatement of income tax under Code Sec. 6662(d) and for the purpose of avoiding the Code Sec. 6694(a) preparer penalty relating to understatements due to unreasonable positions. Form 8275, Disclosure Statement, is used by taxpayers and preparers to disclose items or positions, except those taken contrary to a reg, that are not otherwise adequately disclosed on a return. Form 8275 is filed to avoid the portions of the accuracy-related penalty due to disregard of rules or to a substantial understatement of tax for a non-tax shelter item if the return position has a reasonable basis. Form 8275 is also used for disclosures relating to preparer penalties for understatements due to unreasonable positions or disregard of rules.

Update. The IRS explained that the updated procedures in Rev. Proc. 2015-16 are editorial and not substantive. Generally, the taxpayer must provide all required information and money amounts must be verifiable. The IRS identified various forms, and lines on those forms, which must be completed.

Rev. Proc. 2015-16; FED ¶46,251; TRC PENALTY: 3,108.05.

Notice Of Deficiency Prerequisite To CDP Hearing; Underlying Deficiency Addressed In CDP Hearing Not Binding

◆ *Ding, TC Memo. 2015-20*

The Tax Court has denied the IRS's motion to dismiss a taxpayer's challenge to her underlying tax liabilities, even though the matter had advanced past the collection due process (CDP) hearing stage. A genuine dispute of material fact existed as to whether the taxpayer, who had been out of the country for a protracted period of time, had actually received the notice of deficiency.

■ ***Take Away.*** The Tax Court also noted, however, what would be the likely outcome if a notice of deficiency had been received: any decision made by the Appeals Officer regarding the underlying deficiency would not be binding on the IRS under Code Sec. 6330(c)(2)(B).

Background

The IRS proposed tax deficiencies on the taxpayer for three tax years. During much of the examination period, the taxpayer was out of the country, but she entrusted her affairs to a CPA and her sister, to whom she gave power of attorney. The IRS claimed that it sent a Notice of Deficiency to the taxpayer's New Jersey residence. It sent the Notice of Federal Tax Lien and other documents to the sister's post office box.

The matter progressed through a timely-filed Form 12153, Request for a Collection Due Process or Equivalent Hearing, and was handed over to an Appeals Officer, who decided to allow a challenge to the underlying tax liabilities, given the unusual circumstances surrounding any deficiency notice and a subsequent Letter 950. The Appeals Officer's offer to reduce the deficiency by 54 percent, however, was rejected by the taxpayer's representative because an installment agreement was not also offered. Now before the Tax Court, the IRS moved for summary judgment, arguing the taxpayer was precluded from challenging her tax liabilities because she had received and not responded to the notice of deficiency.

Court's analysis

The court denied the IRS's motion for summary judgment. The IRS's pleadings included a tracking number indicating that the IRS had sent a notice of deficiency to the taxpayer's New Jersey address. The court, nevertheless, held that there remained a genuine dispute of fact as to whether the notice of deficiency, if mailed to the taxpayer's "last known address," was actually received by her.

The court went on to speculate, however, that if the taxpayer had received the notice of deficiency, it would preclude her from disputing her underlying tax liabilities, even though the Appeals Officer had permitted her representatives to raise those liabilities, and even though the IRS actually adjusted them, during the CDP process. Citing *Behling, 118 TC 572 (2002),* and Reg. §301.6320-1(e)(3), Q-E11, the court stated that, in this situation, any adjustment to the taxpayer's underlying tax liability will not be considered part of the notice of determination that is reviewable by the Tax Court.

References: Dec. 60,225(M); TRC IRS: 51,056.25.

IRS Grants Extension To Recharacterize Roth IRA Conversion; Fraud Concealed Commodity Pool Losses

◆ *LTR 201506015*

The IRS has determined that a taxpayer was entitled to an extension of time to elect to recharacterize an amount converted from his traditional IRA to a Roth IRA. The taxpayer was unaware, until after the reharacterization deadline, that the company in which his assets had been invested fraudulently misrepresented the value of the investments.

■ ***Take Away.*** The election to recharacterize and the transfer of the assets generally must both take place on or before the due date (including extensions) of the tax return for the year for which the contribution was made for the first IRA. Reg. §301.9100-3 provides, however, that if a taxpayer acted reasonably and in good faith, but was nevertheless late with a recharacterization election, the taxpayer may seek an extension for making the election. Reg. §301.9100-3(b)(1) lists factors, including fraud, that would indicate that a taxpayer acted reasonably and in good faith.

Background

At the end of December 2010, the taxpayer rolled over the assets in his traditional IRA to a Roth IRA. In January 2011, on the advice of his financial advisor he invested part of this amount in a company, which in turn invested its assets in a second company that lost the assets by investing in a commodity pool. The U.S. Commodity Futures Trading Commission (CFTC) filed an emergency action in federal district court to freeze the second company's assets. After learning that his Roth IRA assets were practically worthless, the taxpayer promptly requested a ruling for an extension of time to recharacterize the rollover.

IRS analysis

The IRS granted the taxpayer a 60-day extension of time to recharacterize the Roth IRA contribution as a contribution to a traditional IRA. The taxpayer, the IRS determined, had acted reasonably and in good faith, and he satisfied three of the factors listed under Reg. §301.9100-3(b)(1). The IRS noted that the taxpayer had not known that the value of the rolled over assets had declined because the second company had provided false statements to its investors until after the deadline.

Reference: TRC RETIRE: 66,764.

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Internal Revenue Service

The IRS has released a fact sheet providing information on a taxpayer's right to pay only the amount of tax legally due, and to have the IRS apply all tax payments properly. This is one of several taxpayer rights that are grouped into ten categories and are discussed in IRS Publication 1, Your Rights as a Taxpayer.

FS-2015-7, FED ¶46,247; TRC IRS: 12,350

The IRS has provided the maximum face amount of qualified zone academy bonds (QZABs) that may be issued for each state for calendar year 2014. Allocations to the District of Columbia and other U.S. possessions are also included.

Notice 2015-11, FED ¶46,246; TRC BUSEXP: 55,810

International

The IRS made unauthorized disclosures of various taxpayers' return information to the Japanese National Tax Administration (NTA) and, therefore, the taxpayers were entitled to statutory damages. The IRS sent a Simultaneous Examination Proposal (SEP) to the NTA that contained information that the IRS's international examiner knew to be false. Therefore, the IRS knowingly disclosed false return information to the NTA.

Aloe Vera of America Incorporated, DC Ariz., 2015-1 USTC ¶50,192; TRC IRS: 9,350

Income

Funds that an individual received from the company she worked for and other sources and deposited into her bank accounts were partially income, but mostly nontaxable amounts received by the taxpayer as a conduit. The amount found to be earned by the taxpayer was subject to self-employment tax. The taxpayer was subject to an accuracy-based penalty based on negligence. The taxpayer failed to establish that she acted reasonably and in good faith.

Na, TC, CCH Dec. 60,226(M), FED ¶47,936(M); TRC INDIV: 6,052

Deductions

An individual was entitled to deduct expenses incurred by her model airplane shop, which was run with a profit objective. However, the taxpayer could not deduct expenses associated with her rental of rooms in a residence to other individuals. Accuracy-related penalties were imposed based on negligence and a failure to show reasonable cause.

Savello, TC, CCH Dec. 60,229(M), FED ¶47,939(M); TRC BUSEXP: 27,102

A police officer was not entitled to deduct unreimbursed employee business expenses that consisted of vehicle expenses, transportation expenses, travel expenses and clothes and equipment expenses. The expenses were not related to his on-duty work as a police officer. He was liable for the accuracy-related penalty under Code Sec. 6222 for an underpayment attributable to negligence or disregard of rules and regulations.

Peterson, TC, CCH Dec. 60,228(M), FED ¶47,938(M); TRC BUSEXP: 24,804

Refund Claims

Whether an insurance company was entitled to a refund depended on (1) whether the taxpayer was a bona fide partner in a *bona fide* partnership; and (2) whether the taxpayer correctly adjusted its outside basis in the partnerships to reflect the distribution of previously taxed income (PTI). Questions of fact precluded resolution of the issues without trial.

Principal Life Insurance Company and Subsidiaries, et al., FedCl, 2015-1 USTC ¶50,184; TRC INTLOUT: 9,356

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IRS Highlights PPACA Changes On Form 1040

As the filing season moves forward, the IRS continues its outreach about important changes to individual income tax returns, reflecting new requirements under the *Patient Protection and Affordable Care Act* (PPACA). The IRS also reviewed some of the tax incentives renewed by the Tax Increase Prevention Act of 2014 (TIPA).

- ***Comment.*** The IRS has ramped-up its outreach about the PPACA, expecting many questions from taxpayers. At February 11 hearing, IRS Commissioner John Koskinen told lawmakers that the filing season is "going well" but cautioned that the agency lacks enough telephone assistors to answer all the calls from taxpayers as call volume climbs.
- ***Comment.*** Unless exempt, individuals must carry minimum essential health coverage or make a shared responsibility payment. The IRS reminded individuals to report their coverage status on their 2014 return (Line 61 on Form 1040). Individuals who claim an exemption musty file Form 8965, Health Coverage Exemptions, and attached it to their return.

Premium tax credit. Individuals who obtained coverage through the Health Insurance Marketplace may have qualified for advance payments of the Code Sec. 36B premium assistance tax credit. Advance payments of the credit must be reconciled with amount of the actual credit. The IRS has developed Form 8962, Premium Tax Credit.

Extenders. TIPA extended many temporary individual incentives through 2014. These include the state and local sales tax deduction, higher education tuition deduction, Code Sec. 25C residential energy credit, and the teachers' classroom expense deduction.

Fact Sheet 2015-9; TRC FILEIND: 15,200.

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Frivolous Arguments

An individual's complaint alleging standard tax-protestor claims and that the IRS intentionally pursued an unlawful collection action against him and his wife was properly dismissed for failure to state a claim and lack of jurisdiction. The individual's claims against the various IRS officials he named as defendants were properly dismissed because he failed to allege sufficient facts to support a claim under Code Sec. 7433 and his claims against the government were barred by sovereign immunity.

Bullock, Sr., CA-3, 2015-1 USTC ¶50,190; TRC IRS: 45,114

The Court of Federal Claims properly dismissed a couple's claim for abatement of a frivolous return penalty for lack of subject matter jurisdiction and held that the couple was not entitled to tax refund for the tax years at issue. There was no allegation or proof that the couple paid the disputed penalty in full prior to filing suit. Further, the IRS could apply the couple's overpayments to the outstanding penalty under Code Sec. 6402.

Diamond, CA-FC, 2015-1 USTC ¶50,189; TRC IRS: 33,302

Trust Fund Penalty

Both the chief financial officer (CFO) and a director of a corporation were responsible persons jointly and severally liable for the trust fund penalty. However, the director was not entitled to contribution from the CFO under Code Sec. 6672(d) until he had paid his proportionate share of the outstanding liability.

Happy v. McNeil, DC Tex., 2015-1 USTC ¶50,186; TRC IRS: 6,306.05

A certified public accountant (CPA) was not entitled to an award of fees and costs under Code Sec. 7430, for time he spent defending his license before a state (North Carolina) board or administratively challenging the trust fund penalty assessed against him. However, the CPA's claim for fees and costs incurred for the present judicial action was not dismissed. The government's concession of the case was but one factor in determining whether the government's overall position was substantially justified.

Carriker, DC N.C., 2015-1 USTC ¶50,185; TRC LITIG: 3,154.10

Liens and Levies

The government was entitled to reduce a married couple's tax liability to judgment and to foreclose its tax liens and sell their real property to satisfy the liability. The tax liens arose upon all the couple's property when they failed to pay the assessed taxes despite the government's notice and demand.

Azarian, DC Tex., 2015-1 USTC ¶50,182; TRC IRS: 45,158

Refund Claims Collection Due Process

An IRS Appeals officer's determination not to withdraw a Notice of Federal Tax Lien (NFTL) filed against a married couple was not an abuse of discretion. The AO properly determined that the NFTL was not premature and that withdrawing it would not facilitate collection of the taxpayers' liabilities even though filing the lien resulted in the husband's security clearance being suspended.

Bateman, TC, CCH Dec. 60,227(M), FED ¶47,937(M); TRC IRS: 42,120

Tax Assessments

The government was not entitled to reduce to judgment a married couple's alleged federal income tax liability for four of the tax years at issue. When the couple filed their return was an issue of fact because if the couple timely filed their return the IRS's collection action was time barred.

Maris, DC Nev., 2015-1 USTC ¶50,183; TRC IRS: 30,052

Deficiencies and Penalties

An individual and his corporation were properly held liable penalties for fraudulently underpaying taxes for three tax years. There were several badges of fraud in the record to support a finding of fraudulent intent including, concealed assets, underreported income, and false statements to the IRS.

California Radomes, Inc., CA-9, 2015-1 USTC ¶50,191; TRC PENALTY: 6,104

Bankruptcy

A Chapter 13 debtor's objection to the IRS's claim for criminal restitution assessments was rejected. Since Code Sec. 6501(c)(11) provides that the IRS can assess criminal restitution at any time the assessment was not barred by the statute of limitations. In addition, the IRS's claim was not barred by the doctrine of *res judicata* and collateral estoppel because the assessment was related to but separate from the criminal restitution ordered.

In re Jara, BC-DC Tex., 2015-1 USTC ¶50,188; TRC IRS: 57,062

In a Chapter 7 proceeding, IRS liens attached to a debtor couple's home were stripped off. The government's argument that it had a partially secured claim against the couple's personal property and, therefore, its claim was partially secured was rejected.

In re Gonzon, BC-DC Fla., 2015-1 USTC ¶50,187; TRC IRS: 57,104

IRS Reminds Employers Of Differences Between Tips And Service Charges

The IRS recently reminded employers of key differences between tips and service charges (also known as auto-gratuities). Service charges added to a bill or fixed by the employer that the customer must pay, when paid to an employee, constitute non-tip wages and are subject to Social Security tax, Medicare tax and federal income tax withholding.

Service charges versus tips. Service charges, the IRS noted, are common in the restaurant and hospitality industries. Common examples are a large party charge at a restaurant, a room service charge at a hotel, and luggage assistance charge at a hotel. These charges are not optional. In contrast, tips are made free from compulsion and the customer has the right to determine the amount and who receives the payment.

Fact Sheet 2015-8; FED ¶46,249; TRC PAYROLL: 3,154.

Final Instructions Flesh Out Employer Reporting Under PPACA

The IRS recently posted final instructions for important new forms applicable large employers and health insurance issuers/carriers will use for reporting health insurance coverage. The final Instructions cover new Form 1094-B, Transmittal of Health Coverage Information Returns; Form 1095-B, Health Coverage; Form 1094-C; Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns; and Form 1095-C, Employer-Provided Health Insurance Offer and Coverage.

■ ***Comment.*** The IRS reminded applicable large employers and health insurance issuers/carriers that Forms 1094-B, 1094-C, 1095-B, and 1095-C are not required to be filed for 2014. However, in preparation for the first required filing of these forms (that is, filing in 2016 for 2015), employers and others may voluntarily file in 2015 for 2014.

Reporting

Employer reporting under Code Sec. 6056, and insurer reporting under Code Sec. 6055, is needed for the administration of Code Sec. 4980H and the Code Sec. 36B premium assistance tax credit. Code Sec. 6056 requires reporting on employers offering coverage (including contact information and the number of full-time employees); and for each full-time employee, information about the coverage (if any) offered to the employee, by month, including the lowest employee cost of self-only coverage offered. Code Sec. 6055 requires reporting on the entity providing coverage, including contact information; and which individuals are enrolled in coverage, with identifying information and the months for which they were covered. The IRS issued final regulations in 2014 in TD 9661.

Form 1095-B is used to report information to the IRS and to taxpayers about individuals who are covered by minimum essential coverage. Form 1094-B is the transmittal form that must be filed with the Form 1095-B. Self-insured employers that are applicable large employers, and therefore are also subject to the information reporting requirements for offers of employer-sponsored health insurance coverage, must combine reporting under both provisions by filing a single information return, Form 1095-C, and transmittal, Form 1094-C. Self-insured employers that are not applicable large employers use Form 1095-B and the transmittal Form 1094-B to meet the information reporting requirements for providers of minimum essential coverage.

"Employer reporting under Code Sec. 6056, and insurer reporting under Code Sec. 6055, is needed for the administration of Code Sec. 4980H and the Code Sec. 36B premium assistance tax credit."

Employer shared responsibility

Applicable large employers generally are required to make a shared responsibility payment under Code Sec. 4980H if they do not provide minimum essential coverage, among other criteria (known as the "employer mandate"). There are two types of Code Sec. 4980H liability:

Section 4980H(a) liability. The employer does not offer coverage at all or offers coverage to fewer than 95 percent (70 percent in 2015) of its full-time employees (or a combination of full-time and part-time employees that is equivalent to 95 percent of full-time employees) and their dependents the opportunity to enroll in minimum essential coverage and one or more full-time employees is certified to the employer as having received a Code Sec. 36B premium assistance tax credit.

Section 4980H(b) liability. The employer offers to all, or at least 95 percent, of its full-time employees (or a combination of full-time and part-time employees that is equivalent to 95 percent of full-time employees) (70 percent in 2015) and their dependents the opportunity to enroll in minimum essential coverage under an eligible employer-sponsored plan and one or more full-time employees is certified to the employer as having received a Code Sec. 36B premium assistance tax credit or cost-sharing reduction.

■ ***Comment.*** Minimum essential coverage includes employer-sponsored coverage, such as group health insurance coverage for employees under a governmental plan; a plan or coverage offered in the small or large group market within a state; a grandfathered health plan offered in a group market; a self-insured group health plan for employees; COBRA coverage; and retiree coverage.

For Code Sec. 4980H(a) liability, the IRS explained on its website that the annual payment will be $2,000 (indexed for infla-

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Washington Report

by the CCH Washington News Bureau

Wyden, Paul say time is ripe for tax reform

Sen. Ron Wyden, D-Ore., ranking member of the Senate Finance Committee (SFC), said on February 12 that he and SFC Chair Orrin Hatch, R-Utah, share the view that it is time for comprehensive tax reform. "The building blocks are there," he said. Wyden spoke at the Tax Council Policy Institute's 16th Annual Symposium on the globalization of tax policy and implications for U.S. economic growth and investment in Washington, D.C.

Pro-growth tax reform can help raise revenue, according to Wyden. "The Tax Code must be more progressive, a principle espoused by former President Reagan, and must promote fairness," he said.

Wyden called the current Tax Code "an economic straitjacket" that is getting tighter. "We need a modern Tax Code that is simpler and more efficient, that makes the U.S. more competitive in global markets." The Tax Code distorts the market and drives business decisions, he said. Instead of focusing on growth, business spends too much time trying to figure out ways around the Tax Code. Wyden said the corporate tax should help corporations compete internationally. Lowering rates will help corporations compete with the rest of the world.

The need to address extenders provisions on a permanent basis is another reason to try to move quickly on tax reform, Wyden said. As 2015 moves forward, there will be lines for tax reform and lines for extenders, the latter will be people who are skeptical of tax reform happening, he noted. The *Tax Increase Prevention Act of 2014* (TIPA) extended many of the extenders through 2014.

At a separate event, House Ways and Means Chair Paul Ryan, R-Wisc., echoed some of Wyden's comments. "Tax reform is a 2015 thing for sure and I think it's got to be done by the end of the summer," Ryan said. "If we keep dragging this out we're not going to get there."

House approves small business tax reform bill and more

On February 13, the House passed the America's Small Business Tax Relief Act of 2015 (HR 636). The bill provides for a $500,000 dollar limit and a $2 million investment limit for Code Sec. 179 expensing, adjusted for inflation after 2015. The bill also extends the rules for off-the-shelf computer software and qualified real property. One day earlier, the House approved the Fighting Hunger Incentive Act of 2015 (HR 644). The bill makes permanent the tax deduction for charitable contributions of food inventory along with other enhancements. At this time, it is unclear if the Senate will take up the bills.

Ways and Means moves tax reform bills

The House Ways and Means Committee on February 12 approved legislation to make permanent the state and local tax deduction, the research tax credit and to expand Code Sec. 529 college savings plans. "The point of all three is to make people's lives easier. It's to give them more certainty about the future," Ways and Means Chair Paul Ryan, R-Wisc., said. "Making these incentives permanent would allow businesses and families to plan for the future—without any fear of expirations or extensions," he added.

House Speaker John Boehner, R-Ohio, backed the Ways and Means Committee action, pointing out the 529 bill to strengthen college savings accounts. "The President tried to tax these accounts, but we're working to expand them, which means more savings and less debt for our students. And I think you can expect this bipartisan bill on the floor very soon," Boehner predicted.

SFC marks up 17 tax bills

The Senate Finance Committee on February 11 unanimously approved 17 noncontroversial tax bills ranging from a bill to modify the excise tax on cider to a bill to exclude from gross income certain clean coal power grants. Senate Finance Committee Chair Orrin Hatch, R-Utah, said that he and ranking member Ron Wyden, D-Ore., laid out several criteria for bills to be considered. All of the bills had to fall within the jurisdiction of the committee. Second, they had to have bipartisan support and be noncontroversial to both sides. Third, they had to have little or no budgetary impact and any bill scored as losing revenue had to have an acceptable offset. "While this may be the first markup of this kind, it shouldn't be the last," Hatch predicted.

The bills will give teachers, transit employees and fire fighters more control over their savings for healthcare; help level the playing field and cut red tape for producers of craft beer, cider, wine and distilled spirits; encourage foreign investment in the U.S. and promote agricultural research; and give relief to military members when they have to relocate, according to Wyden. None of the changes will add to the deficit.

Industry group seeks delay of Code Sec. 871(m) regs

The International Swaps and Derivatives Association (ISDA) recently asked Treasury to modify the effective date of anticipated Code Sec. 871(m) regs. ISDA told Treasury that its members are concerned that application of the regs to payments made prior to January 1, 2017 and to certain instruments may make compliance very challenging. The regs, ISDA explained, generally would impose U.S. witholding tax with respect to dividend equivalent payments made on or after January 1, 2016 on a notional principal contract (NPC) that is considered a specified NPC or an equity-linked instrument (ELI) that is considered a specified ELI.

Practitioners' Corner

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tion beginning in 2015) for each full-time employee (without regard to whether each employee received a premium tax credit), after excluding the first 30 full-time employees from the calculation. The IRS will determine this payment on a month-by-month basis. For Code Sec. 4980H(b) liability, the IRS explained that the annual payment will be $3,000 (indexed for inflation beginning in 2015) for each full-time employee who received the premium tax credit. The IRS will determine this payment on a month-by-month basis.

The Obama administration previously announced that no shared responsibility payments will be assessed for 2014. Additionally, the IRS provided transition relief for 2015 in TD 9655. For 2015, employers with at least 50 but fewer than 100 full-time employees, including full-time equivalent employees, may be eligible for transition relief for the employer shared responsibility requirement. The IRS imposed a number of requirements that employers must satisfy before they may be eligible for the transition relief.

Employers

Form 1095-C is filed and furnished to any employee of an applicable large employer who is a full-time employee for one or more months of the calendar year. Applicable large employers must report that information for all twelve months of the calendar year for each employee. Form 1094-C is the transmittal form that must be filed with the Form 1095-C.

In the case of an applicable large employer that offers health coverage through an employer-sponsored self-insured health plan, the applicable large employer must complete Form 1095-C, Parts I, II and III, for any employee who enrolls in the health coverage, whether or not the employee is a full-time employee for any month of the calendar year. If the employee who enrolled in self-insured coverage is a full-time employee for any month of the calendar year, the employer must also complete Part II, the IRS explained.

■ ***Comment.*** If an employer is offering health coverage to employees in another manner, such as through an insured health plan or a multiemployer health plan, the issuer of the insurance or the sponsor of the plan providing the coverage is required to furnish the information about their health coverage to any enrolled employees, and the employer should not complete Form 1095-C, Part III, for those employees, the IRS explained.

Streamlined reporting. Employers that self-insure have a streamlined way to report for purposes of Code Sec. 6055 reporting and Code Sec. 6056 reporting. The top half of Form 1095-C includes information needed for Code Sec. 6056 reporting; the bottom half includes information needed for Code Sec. 6055 reporting.

Qualifying offers. The IRS has developed a simplified reporting method for employers that provide a "qualifying offer" to any of their full time employees, as an alternative to reporting monthly, employee-specific information on those employees. A qualifying offer is an offer of minimum value coverage that provides employee-only coverage at a cost to the employee of no more than about $1,100 in 2015 (9.5 percent of the federal poverty level), combined with an offer of coverage for the employee's family.

■ ***Comment.*** Employers certifying that they have made a qualifying offer to at least 95 percent of their full-time employees (plus an offer to their families) will be able to use an even simpler alternative reporting method for 2015. They may use the simplified reporting method for their entire workforce, including for any employees who do not receive a qualifying offer for the full year.

Filing. Applicable large employers must file Form 1095-C by February 28 if filing on paper or March 31 if filing electronically of the year following the calendar year to which the return relates. The IRS explained that for calendar year 2015, Form 1095-C is required to be filed by February 29, 2016, or March 31, 2016, if filing electronically.

■ ***Comment,*** Form 1095-C is subject to the requirements to file returns electronically. Filers of 250 or more information returns must file the returns electronically. The 250-or-more requirement applies separately to each type of return and separately to each type of corrected return, the IRS explained. Form 1094-C is also subject to the requirements to file returns electronically.

An applicable large employer must furnish a Form 1095-C to each of its full-time employees by January 31 of the year following the year to which the Form 1095-C relates. The first Forms 1095-C are due to individuals by February 1, 2016, the IRS explained. Before providing statements to employees electronically, the employer must obtain affirmative consent from the employee to furnish the form in this manner.

■ ***Comment.*** IRS regs authorize filers of Form 1095-C to truncate the Social Security number (SSN) of an individual (the employee or any family member of the employee receiving coverage) on Form 1095-C statements furnished to employees by showing only the last four digits of the SSN and replacing the first five digits with asterisks or "Xs." However, truncation of SSNs is not allowed on forms filed with the IRS.

Health insurers/carriers

Health insurance issuers or carriers must file Form 1095-B for most health insurance coverage, including individual market coverage and insured coverage sponsored by employers. Health insurance issuers will also file Form 1094-B to report coverage for employees of qualified employers that obtain coverage through the Small Business Health Options Program (SHOP). However, insurance issuers or carriers will not file Form 1095-B to report coverage in individual market qualified health plans that individuals enroll in through Health Insurance Marketplaces. Instead, the Marketplace reports this coverage, using Form 1095-A, Health Insurance Marketplace Statement. Additionally, health insurance issuers will not file Form 1094-B to report coverage under Medicaid, Medicare or the Children's Health Insurance Program (CHIP) provided through health insurance companies, the IRS explained.

■ ***Comment.*** Individuals who obtained health insurance coverage through the Marketplace in 2014 should have already received Form 1095-A from the Marketplace for use in preparing their 2014 tax returns.

Compliance Calendar

■ February 20
Employers deposit Social Security, Medicare, and withheld income tax for February 14, 15, 16, and 17.

■ February 25
Employers deposit Social Security, Medicare, and withheld income tax for February 18, 19, and 20.

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

■ March 2
Businesses file information returns for certain payments made during 2014. These payments include, *but are not limited to*: cash payments for fish; compensation for workers who are not considered employees; dividends and other corporate distributions; interest; rent; royalties; profit-sharing distributions; retirement plan distributions; and original issue discount.

■ March 4
Employers deposit Social Security, Medicare, and withheld income tax for February 25, 26, and 27.

■ March 6
Employers deposit Social Security, Medicare, and withheld income tax for February 28, March 1, 2, and 3.

TRC Text Reference Table

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

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From the Helpline

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

Q Can a self-employed taxpayer establish an SEP-IRA and make contributions both to it and to his traditional IRA?

A Yes. The SEP-IRA is generally governed by the same rules as traditional IRAs. Thus, an employee can make traditional IRA contributions of up to $5,500 (in 2014 and 2015, $6,500 if the catch-up limits apply) to the SEP-IRA. However, any dollars contributed to the SEP-IRA will reduce the amount the participant can contribute to other IRAs for the year.

The limits on contributions by self-employed individuals are governed by the employer rules for making contributions to SEP-IRAs on behalf of employees. However, self-employed individuals can make independent contributions to their SEP-IRAs under the IRA contribution rules, including the $1,000 catch-up contribution. *See TRC RETIRE: 63,306.*

Q Is a construction allowance paid to a lessee by the lessor taxable to the lessee?

A It depends. Qualified construction allowances that are paid by lessors to tenants, who use the allowance for constructing or finishing the interior of their leased retail space, may be excluded from the tenants' incomes. A qualified construction allowance is any amount paid by the lessor to the lessee in cash or in the form of a rent reduction under a short-term lease of retail space for 15 years or less; for the purpose of constructing or improving qualified long-term real property for use in the lessee's trade or business at that retail space; and to the extent that the allowance does not exceed the amount spent by the lessee for the construction or improvement. *See TRC SALES: 42,262.05.*