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Partnership Regs Would Treat Disguised Payments For Services As Compensation, Not Capital Gain

NPRM REG-115452-14

The IRS has issued proposed partnership regs that would treat certain partnership arrangements as disguised payments for services, rather than as an interest in the partnership. As a result, the income received from the disguised payments would be compensation, taxed as ordinary income, rather than a distributive share of partnership income that could be capital gain.

- ***Take Away.*** "The genesis of these proposed regulations was the government's focus on management fee waivers by managers of private equity (and other) funds," Aaron Nocjar, partner, Steptoe & Johnson LLP, Washington, D.C., told Wolters Kluwer. "The perceived inequity was that such waivers were leading to inappropriate income character conversion and deferral. Unfortunately, the proposed regulations are not tailored to only that issue. Instead, the government has issued proposed regulations that apply much more broadly," Nocjar said.

Background

Payments from partnerships to partners for services include distributive shares under Code Sec. 704 and a transaction in which the partner renders services in a capacity other than as a partner, under Code Sec. 707(a). Partnership allocations determined by partnership income and made to a partner, as a partner, are treated as distributive shares. A fixed payment to a partner for services, determined without regard to partnership income, is a guaranteed payment under Code Sec. 707(c), rather than a distributive share.

Disguised payments for services

In 1984, Congress enacted an anti-abuse rule: Code Sec. 707(a)(2)(A). If a partner provides services to a partnership and receives a related allocation and distribution, the transaction is treated as a payment of fees to a nonpartner, rather than a distributive share of partnership income to a partner. Proposed Reg. §1.707-2(b) uses these elements to define a disguised payment for services. The partnership must apply this characterization when it determines the partners' distributive shares of partnership income.

- ***Comment.*** Congress granted Treasury and the IRS broad authority to treat transactions as disguised payments for services under this provision. "It is not too surprising that the government took such a broad approach [in the proposed regs] in light of the fact that the central statutory provision at issue had called for regulations to be issued well over 30 years ago," Nocjar said.

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IRS Revises Timeframe For Basket Option Contract, Basket Contract Disclosures

Notice 2015-47, amended; Notice 2015-48, amended

Recently-issued notices designating basket option contracts and basket contracts as reportable transactions have been amended by the IRS to extend the time for making disclosures. If a taxpayer is required to file a disclosure statement with respect to a transaction described in Notice 2015-47 or Notice 2015-48, after July 8, 2015, and prior to November 5, 2015, that disclosure statement will be considered to be timely filed if the taxpayer alternatively files the disclosure with the Office of Tax Shelter Analysis by November 5, 2015, the IRS explained.

- ***Take Away.*** As reportable transactions, both basket option contracts and basket contracts – along with substantially similar transactions – trigger disclosure requirements. *For more details see the July 16, 2015 issue of this newsletter.*

Background

In Notice 2015-47, the IRS announced that taxpayers engaged in basket option contract transactions in effect on or after January 1, 2011, must disclose the transactions for each tax year in which the taxpayer participated in the transactions, provided that the period of limitations for assessment of tax had not ended on or before July 8, 2015. In Notice 2015-48, the IRS announced that taxpayers engaged in basket transactions (and substantially similar transactions) entered into on or after November 2, 2006, and in effect on or after January 1, 2011, must disclose the transactions for each tax year in which the taxpayer participated in the transactions, provided that the period of limitations for assessment of tax had not ended on or before July 8, 2015.

Revised timeframe

For purposes of the transactions described in Notice 2015-47, the 90-day period provided in Reg. §1.6011-4(e)(2) for certain disclosures is extended to 120 days, the IRS explained in the amended notice. However, if, under Reg. §1.6011-4(e), a taxpayer is required to file a disclosure statement with respect to the listed transaction described in this notice after July 8, 2015, and prior to November 5, 2015, that disclosure statement will be considered to be timely filed if the taxpayer alternatively files the disclosure with the Office of Tax Shelter Analysis by November 5, 2015.

Similarly, for purposes of the transactions described in Notice 2015-48, the 90-day period provided in Reg. §1.6011-4(e)(2) for certain disclosures is extended to 120 days. However, if, under Reg. §1.6011-4(e), a taxpayer is required to file a disclosure statement with respect to the transaction of interest described in this notice after July 8, 2015, and prior to November 5, 2015, that disclosure statement will be considered to be timely filed if the taxpayer alternatively files the disclosure with the Office of Tax Shelter Analysis by November 5, 2015.

- ***Comment.*** November 5, 2015 is 120 days after July 8, 2015.

References: FED ¶¶46,358, 46,359; TRC FILEBUS: 9,458.05.

Disguised Payments

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The proposed regs apply to a service provider who purports to be a partner, even if the regs' treatment requires the service provider not to be treated as a provider or the overall arrangement is not to be treated as a partnership. The regs characterize the arrangement at the time it is entered into. Although the definition requires both an allocation and a distribution, the IRS believes that an allocation includes an associated distribution.

Entrepreneurial risk

Whether an arrangement is a disguised payment for services depends on the facts and circumstances. The regs propose six nonexclusive factors for making this determination, five based on the legislative history. The proposed regs treat the first factor, the existence of significant entrepreneurial risk, as decisive, and claim that this treatment reflects Congress's view. Partners receive profits from a partnership based on its business success, while payments to third parties generally are not subject to this risk.

- ***Comment.*** "The proposed regulations follow somewhat the legislative history of section 707(a)(2)(A), which was written in 1984," Nocjar said. "However, the proposed regulations seem to elevate the central factor - entrepreneurial risk - from "the most important factor" to an exclusive superfactor with its use of presumptions, which seems to go beyond the words of the legislative history."

The regs describe arrangements that lack significant entrepreneurial risk. One example includes an allocation that is primarily fixed in amount and that is assured

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REFERENCE KEY

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

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IRS Announces Major Changes To EP Determination Letter Program

Ann. 2015-19

Effective January 1, 2017, the IRS will eliminate its staggered five-year determination letter remedial amendment cycles for individually designed plans, the agency has announced. Certain plans currently on the five-year cycle may be eligible for transition relief. The IRS also announced that effective July 21, 2015, it will not accept off-cycle determination letter applications, subject to certain exceptions.

- ***Take Away.*** "Determination letters are considered a vital component of our voluntary retirement system, and, as a result of these pending severe restrictions, heightened IRS qualification risks and uncertainty will fall on the shoulders of plan sponsors," Elizabeth Thomas Dold, principal, The Groom Law Group Chartered, Washington, D.C., told Wolters Kluwer. "Without these processes and related protections, employers face much greater exposure for errors and costly corrective measures/sanctions through the IRS correction program (EPCRS) - likely resulting in a mere shift of the resource/management burdens to other IRS programs. Ben Franklin's adage 'an ounce of prevention is worth a pound of cure' still stands true."
- ***Comment.*** Because of the elimination of the five-year remedial amendment cycles, the scope of the determination letter program for individually designed plans will be limited to initial plan qualification and qualification upon plan termination.

Background

Generally, plans may be amended retroactively during a remedial amendment period. In Rev. Proc. 2007-44, the IRS described procedures for issuing determination letters and the five-year remedial amendment cycle for individually designed plans. Generally, sponsors of individually designed plans may apply for determination letters once every five years. A determination letter application is filed off-cycle if it is submitted anytime other than during the last 12-month period of a plan's remedial amendment cycle.

Ann. 2015-19

As of January 1, 2017, the IRS will not accept determination letter applications based on the five-year remedial amendment cycles. Sponsors of Cycle A plans will continue to be permitted to submit determination letter applications during the period beginning February 1, 2016, and ending January 31, 2017.

Additionally, a sponsor of an individually designed plan will be permitted to

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Disguised Payments

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to be available. Another example includes an arrangement where the service provider waives its right to payment for future services in a nonbinding manner, or fails to timely notify the partnership of the waiver.

Other factors

The other five factors are of secondary importance, and their weight depends on the particular case. The absence of one or more of these factors is not determinative. These other factors include whether:

- The service provider's partnership interest is transitory;
- The service provider receives an allocation and distribution in a time frame typical for payments to a nonpartner;
- The service provider became a partner to obtain tax benefits not available to a third party;
- The value of the service provider's interest is small compared to the allocation and distribution; or
- The arrangement provides for different allocations that are subject to varying levels of entrepreneurial risk.

Fee waivers

Examples 5 and 6 of Proposed Reg. §1.707-2(d) discuss fee waivers, where a partner agrees to forgo fees for services and to receive a share of future partnership income. In these examples, the arrangement reflects significant entrepreneurial risk by the service provider, who forgoes the right to fees before the service period begins and who executes a waiver that is binding, irrevocable, and clearly communicated to the other partners. The service provider will be allocated income from net profits that, at the time of the arrangement, are not likely to be available or reasonably determinable.

- ***Comment.*** "Another important aspect to this regulatory project is the statement in the preamble on the potential for any profits interest received by a partner in exchange for a management fee waiver to fall outside the safe-harbor provided in Rev. Proc. 93-27," Nocjar said. "It seems what the government is saying here is, even if your management fee waiver avoids section 707(a)(2)(A) and these regulations, the waiver may, nevertheless, result in ordinary compensation income."

Effective date

The regs would apply to arrangements entered into or modified after the publication of final regs. The IRS will characterize arrangements before that date based on the statute and the legislative history. The IRS believes that the proposed regs reflect Congress's intent on treating arrangements as disguised payments for services.

The IRS requested comments on whether allocations to service providers that lack significant entrepreneurial risk could ever be characterized as distributive shares, and on what fee waiver requirements would be binding and are administrable.

References: FED ¶49,657; TRC PART: 27,050 .

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IRS Issues Final Refund Claim Regs; Declines To Extend Them To Protective Claims

TD 9727

Recently issued final regs clarify the proper place to file a claim for credit or refund with the IRS. The final regs generally track proposed regs issued in 2011.

- ***Take Away.*** Although the regs appear on the surface to be housekeeping provisions, drilling down into the preamble describes areas where the IRS could have chosen to expand their scope but did not. The IRS declined to extend the regs to protective and informal refund claims and left unchanged the prohibition on refunds on equitable grounds.

Background

If a taxpayer is required to file a claim for a credit or refund on a particular form, the claim must be filed as mandated by the form and its instructions. Generally, a claim for a credit or refund must be filed with the IRS service center serving the internal revenue district in which the tax was paid. The proposed regs provided that taxpayers should file a claim for credit or refund with the same IRS service center where the taxpayer would file a return for the type of tax to which the claim relates.

Final regs

In the final regs, the IRS explained that the proper place to file a claim for a credit or refund is with the service center at which the taxpayer currently would be required to file a tax return for the type of tax to which the claim relates, irrespective of where the tax was paid or was required to have been paid. The final regs, like the proposed regs, also remove obsolete references and provisions in previous regs.

Protective and informal claims

Some commentator recommended that the final regs cover protective claims and informal claims. Although not provided for in the Tax Code, case law provides that protective claims may be filed to preserve a taxpayer's right to claim a refund when the taxpayer's right to the refund is contingent on future events and may not be determinable until after the statute of limitations expires. Case law also provides that a claim for refund that is technically deficient with respect to some formal claim requirement might nonetheless be a valid claim as long as it meets certain basic requirements. The IRS determined that protective claims and informal claims were outside the scope of the regs.

Equitable grounds

Some commentators recommended that the IRS amend the prohibition under Reg. §301.6402-2(b)(2) on refunds on equitable grounds. These commentators sought exceptions for innocent spouse relief and whether a levy may be released. The IRS declined to adopt the recommendations and the final regs make no changes to Reg. §301.6402-2(b)(2).

Electronic filing

The IRS reported that some commentators recommended that the final regs provide for electronic filing, when available. The IRS explained that although the final regs do not expressly refer to electronic filing, the final regulations instruct taxpayers to file a claim for credit or refund in a manner consistent with forms, form instructions, publications, and other guidance on the IRS website. To the extent that electronic filing is or becomes available for filing a claim for credit or refund, it will be described elsewhere, for example, in forms, form instructions, publications, or the IRS website, the agency added.

More clarifications

The final regs also respond to requests for clarification in cases where claims for a credit or refund of penalties are not related to any tax for which a return is required. The IRS explained that in the case of an assessable penalty that is unrelated to a particular tax, the notice containing or issued along with demand for payment provided the proper address for filing a claim for credit or refund. Taxpayers should follow these instructions, the IRS explained.

- ***Comment.*** Generally, the final regs are effective for claims for credit or refund filed after July 23, 2015.

References: FED ¶47,023; TRC IRS: 33,150.

Determination Letters

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submit a determination letter application for a plan on initial plan qualification and for qualification upon plan termination. A sponsor will also be permitted to submit a determination letter application in certain other limited circumstances.

- ***Comment.*** The IRS reported that future guidance will describe the certain other limited circumstances.

Transition period

Because of the elimination of the five-year remedial amendment cycles, the extension of the remedial amendment period (Section 5.03 in Rev. Proc. 2007-44) will not be available after December 31, 2016. The IRS intends to extend the remedial amendment period for individually designed plans to a date that is expected to end no earlier than December 31, 2017.

Comments requested

The IRS asked for comments on a number of issues related to the elimination of the five-year remedial amendment period. These include what changes should be made to the remedial amendment period that would otherwise apply to individually designed plans under Code Sec. 401(b) and what guidance should be issued to assist plan sponsors that want to convert an individually designed plan into a pre-approved plan.

References: FED ¶46,368; TRC RETIRE: 51,050.

Tax Court Concludes Consolidated Group Must Reduce Attributes For Consolidated NOLs

Marvel Entertainment, LLC, 145 TC No. 2

In a case of first impression, the Tax Court has concluded that a consolidated group of corporations that excluded cancellation of debt (COD) income under Code Sec. 108 had to reduce the consolidated net operating losses (CNOLs) of the entire group, rather than just the NOLs of the four group members that had COD income. As a result, the group had a smaller NOL to carry over to future years and had to recognize additional income.

- ***Take Away.*** Under Code Sec. 108(a)(1)(A), the consolidated group could exclude its COD income from gross income because the group was in bankruptcy. Code Sec. 108(b) requires "the taxpayer" to reduce its attributes for the amount excluded. NOLs must be reduced first. It was unclear whether the taxpayer required to reduce attributes was the entire group or was limited to the four corporations with COD income. Based on the Supreme Court's decision in *United Dominion, 2001-1* USTC *¶50,430*, the Tax Court concluded that the CNOLs of the entire group had to be reduced.

Background

As part of a bankruptcy reorganization, four members of the taxpayer's consolidated group realized COD income of $171 million for the tax year ending October 1, 1998. At that time, the group had a CNOL of $187 million. On that year's consolidated return, the taxpayer reduced the share of CNOLs that was attributable to the four corporations realizing COD income, equal to approximately $90 million. The group calculated that its remaining CNOLs equaled $97 million.

The group carried its CNOLs forward into 2003 and 2004. The IRS determined that the group should have reduced its CNOLs by the entire $171 million amount excluded from income, which would have resulted in a CNOL of $16 million, instead of $97 million.

Court's analysis

The court stated that the issue was whether the NOL subject to reduction in 1998 was the group's entire CNOL (a single-entity approach), or the portion of the CNOL allocable to each group member (a separate entity approach). The court noted that under Code Sec. 172(e), the relevant law was the law that applied in 1998, not the law for the later years to which the NOLs were carried. The IRS argued that the consolidated group members cannot apply the separate entity approach unless specifically authorized in the consolidated return regs under Code Sec. 1502.

Based on *United Dominion (2001)*, the court agreed with the IRS. The Supreme Court, ruling for the taxpayer and against the government, concluded that the 1998 Code and regs for consolidated groups provided only one definition of NOL – the consolidated NOL. The concept of a separate NOL did not exist for a consolidated return. There were no regs providing for a separate entity approach.

- ***Comment.*** The Tax Court stated that Supreme Court decisions are generally retroactive. Therefore, a 2001 decision could be applied to the 1998 tax year.

The Tax Court cited legislative history to obtain insight into the general purpose of Code Sec. 108(b). Congressional intent is to provide a fresh start, by deferring but eventually collecting income realized from the discharge of debt. To attain deferral, attribute reduction must be applied to the CNOL as a whole and not to some lesser portion attributable to the debtor members of the consolidated group.

- ***Comment.*** The IRS eventually issued Reg. §1.1502-28, which takes a hybrid approach by first reducing the tax attributes of the member entity, then its subsidiaries, and finally the attributes of the consolidated group as a whole. These regs were not issued until 2003 and do not apply to the 1998 tax year.

References: Dec. 60,351;
TRC CONSOL: 41,200.

Third Circuit Holds Required Records Doctrine Mandates Production Of Foreign Account Records

Chabot, CA-3, July 17, 2015

The Third Circuit Court of Appeals has found that foreign bank account records fell within the required records exception to the Fifth Amendment. The Third Circuit affirmed the lower court's enforcement of IRS summonses for the bank records.

- ***Take Away.*** The Third Circuit joins six other circuits in holding that the required records exception applies. "The voluntary choice to engage in an activity that imposes record-keeping requirements under a valid civil regulatory scheme carries consequences, perhaps the most significant of which is the possibility that those records might have to be turned over upon demand, notwithstanding any Fifth Amendment privilege," the court observed.

Background

In 2010, the IRS received information that a couple had undisclosed assets in a foreign account. The IRS issued several administrative summonses for documents. The couple declined to produce the documents or to appear before the IRS, asserting their Fifth Amendment privilege. A federal district court enforced the summonses, find-

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Taxpayer's Change In Treatment Of Settlement Payments Was Accounting Method Change, Claims Court Finds

Greiner, FedCl., July 22, 2015

The Federal Claims Court has agreed with the IRS that a taxpayer's change in treatment of settlement payments was a change in accounting method for which consent was required. The taxpayer did not obtain consent and the court granted summary judgment to the IRS.

- ***Take Away.*** The taxpayer, the court found, did not fall within exceptions under Code Sec. 446 for a change in accounting method without IRS consent. These included that the taxpayer merely sought to correct his original reporting; there was no change in method because there was no inconsistent reporting of a specific material item; and there was no effect on the timing of income.

Background

The taxpayer served as CEO of a corporation. In 2004, the corporation merged with another business. The taxpayer was entitled to payments under an "earned out buy out" program, which he reported as ordinary income. Post-merger litigation resulted in the end of the earned out buy out payments. Instead, the taxpayer received a share of a settlement amount. The taxpayer initially reported these amounts as ordinary income but later filed amended returns to treat the payments as capital gain.

Court's analysis

The court observed that to change accounting methods, taxpayers generally must secure consent from the IRS, subject to certain exceptions. Consent is also required for changes from an impermissible method to a permissible one. The adoption of an accounting method is generally manifested by its first use on a return.

Here, the court found that in 2004, the taxpayer could have reported the earn-out income as payments that were actually received under the open transaction principles or report the earn-out income under the closed transaction rule, by estimating and reporting the fair market value of the earn-out right. The taxpayer used an open transaction approach and did not report an estimated fair market value of the earn-out right in 2004, but reported income associated with the earn-out right only when and as payments were received. The taxpayer, the court found, maintained this approach for six years.

The taxpayer's amended returns, however, moved to the closed transaction approach. The shift to the closed transaction approach reflected a change in method of accounting, the court held. The taxpayer never sought or obtained consent from the IRS to change accounting method, the court concluded.

References: 2015-2 USTC ¶50,399; TRC ACCTNG: 33,100.

Records

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ing that the required records exception applied and the Fifth Amendment did not preclude production of the documents.

Court's analysis

The Third Circuit first found that the *Bank Secrecy Act* (BSA) generally requires taxpayers to keep records and file reports (the FBAR) of their foreign financial transactions. The required records doctrine prevents individuals, who possess records the government requires them to maintain as a result of voluntary participation in certain regulated activities, from asserting their Fifth Amendment privilege.

- ***Comment.*** In *Gross, 68-1* USTC *¶15,801,* the U.S. Supreme Court outlined three factors to determine if the required records doctrine applies: the government's inquiry must be essentially regulatory; information is to be obtained by requiring the preservation of records of a kind which the regulated party has customarily kept; and the records must have assumed public aspects.

The court rejected the couple's argument that the BSA is essentially criminal, not regulatory. The information sought under the BSA is used for a variety of purposes, not just for criminal prosecution, the court found.

Further, the court found that the requested materials constituted records customarily kept. Because the personal information is compelled in furtherance of a valid regulatory scheme, the information assumes a public aspect, the court concluded.

References: 2015-2 USTC ¶50,388; TRC IRS: 21,414.

Tax Court Nixes Cost Sharing Regs Under Code Sec. 482

At press time, the Tax Court has found regs under Code Sec. 482, which require controlled parties entering into qualified cost-sharing agreements (QCSAs) to share stock-based compensation (SBC) costs, were arbitrary and capricious. The court held Reg. §1.482-7(d)(2) invalid.

According to the court, the IRS's determination that the regs were consistent with the arm's-length standard was unreasonable. It found that the IRS, in issuing the final regs, failed to support its belief that unrelated parties would share SBC costs with any evidence in the administrative record, failed to articulate why all QCSAs should be treated identically, and failed to respond to significant stakeholder comments. *For details and analysis of the Tax Court's decision, see next week's issue of this newsletter.*

Altera Corporation and Subsidiaries, 145 TC No. 3

C Corp That Became QSub Owes Taxes For LIFO Recapture

FAA 20153001F

The IRS has determined, in Field Attorney Advice (FAA), that a C corporation that used last-in first-out (LIFO) inventory accounting had to take a LIFO recapture amount into income when an S corp acquired the C corp and the S corp elected to treat the C corp as a qualified subchapter S subsidiary (QSub). The IRS also concluded that the C corp cannot use consolidated net operating losses (CNOLs) to reduce the LIFO recapture amount.

- ***Take Away.*** A C corp that uses LIFO inventory accounting and then elects to become an S corp must include a LIFO recapture amount in income for the last year before the S corp election took effect. Recapture also applies when a C corp transfers LIFO inventory to an S corp in a nonrecognition transaction. The FAA is significant because it extends LIFO recapture treatment to an C corp that was acquired by an S corp and was the subject of a QSub election.
- ***Comment.*** A S corp can elect to treat a wholly-owned domestic corporation as a QSub. A QSub is not treated as a separate corporation; its assets, liabilities, income and deductions are treated as items of the S corp.

Background

On Date 1 (the merger closing date), the taxpayer, a C corp, merged into a corporation owned by an S corp. The C corp survived as a subsidiary of the S corp. The merger did not terminate the C corp's tax year or its consolidated group. On Date 2 (the date immediately following the closing date), the S corp elected to treat the taxpayer and its subsidiaries as QSubs. Thus, the C corp became a QSub and was no longer treated as a C corp.

The taxpayer filed a short period consolidated return for the period ending on Date 1 and reported an NOL on that return. The taxpayer initially did not report any LIFO recapture amount, but subsequently agreed to file a separate, single-transaction return for Date 2 on a non-consolidated basis. On the return, the taxpayer reported the LIFO recapture amount and paid 25 percent of the tax owed (to be spread over four years), plus interest, penalties, and a late-filing penalty.

Conclusions

The IRS determined that:

- LIFO recapture applies on a QSub election as well as an S corp election. Therefore, the taxpayer owed a LIFO recapture amount.
- A taxpayer reporting a LIFO recapture amount cannot file a return as part of a consolidated group. Therefore, consolidated NOLs cannot be used to offset a LIFO recapture amount.
- The taxpayer's short-period consolidated return was a proper return.
- The single-transaction return was a valid and necessary return to report the LIFO recapture amount. The IRS can assess the LIFO recapture taxes reported on this return.
- Although there was an erroneous refund, the taxpayer did not owe any interest because it did not cash the refund check.

Reference: TRC SCORP: 352.35.

Chief Counsel Will Assist Exam Team's Challenge To Taxpayer's Interpretation of Anti-Abuse Rules

CCA 201530020

IRS Chief Counsel has determined that it will assist IRS Exam's challenge of a corporate transaction where a newly-formed U.S. subsidiary corporation acquired property in exchange for stock of its parent and is attempting to limit the treatment of the amount received from a deemed distribution as a taxable dividend or repatriation of earnings. The subsidiary claims that only the current earnings and profits (E&P) of the acquiring corporation should be counted in characterizing the distribution of the property. IRS Exam intends to assert that the accumulated E&P of the target corporation must also be taken into account in determining the amount of the deemed distribution that is a dividend.

- ***Take Away.*** The IRS views these transactions as an abusive device to repatriate earnings from a foreign subsidiary to a parent without tax liability. In 2011 regs, the IRS required adjustments based on a deemed distribution. The IRS also imposed a deemed contribution rule, but subsequently became concerned that taxpayers were exploiting the latter rule to avoid U.S. taxes. The IRS also became concerned that taxpayers were abusing the "priority" rule in Code Sec. 367(b).

Anti-abuse rules

The IRS issued final regs in 2011 that targeted triangular reorganizations involving a foreign parent or subsidiary, where the subsidiary transfers property to the parent in exchange for parent stock. The subsidiary then uses the parent stock to acquire a target's stock or assets. The final regs were designed to prevent taxpayers from asserting that the sub's transfer of property to the parent was a purchase, not a distribution.

In Notice 2014-52, the IRS announced that it will amend the 2011 regs to remove the deemed contribution rule. The IRS also announced that taxpayers were interpreting the anti-abuse rule in the 2011 regs too narrowly, and that it planned to revise the regs. The anti-abuse rule will be "clarified" so that a sub's acquisition of its parent's stock in an exchange for a note can trigger gain under the rule. Furthermore, the E&P of a corporation may be taken into account whether or not the corporation was related to the parent or subsidiary before the triangular reorganization.

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TAX BRIEFS

Disaster Relief

Victims of severe storms, tornadoes, straight-line winds and flooding in parts of Texas, which began on May 4, 2015, may qualify for relief. The IRS has updated previously released disaster relief to include Hood, Madison, Red River, Shelby, Wharton counties in Texas.

Texas Disaster Relief Notice (HOU-05-2015), FED ¶46,334; TRC FILEIND: 15,204.25

Refunds

A voluntary employee benefits association's (VEBA) refund claim was untimely and the mitigation provisions did not apply. Therefore, the VEBA's refund claim was denied. The mitigation provisions under Code Secs. 1311 through 1314 did not apply to the VEBA's refund claim because the IRS did not maintain an inconsistent position. The IRS did not change its longstanding position on the issue until the federal circuit's decision in *Fisher*, CA-FC, 2010-1 USTC ¶50,289, required it to do so.

Illinois Lumber and Material Dealers Association Health Insurance Trust, CA-8, 2015-2 USTC ¶50,396; TRC IRS: 30,306.35

Summonses

An individual's petition to quash an IRS summons to appear, testify and produce documents in connection with his tax liabilities was dismissed and the summons was ordered enforced. The claims raised in his counterclaim were already adjudicated in *R. Singh*, DC Calif., 2015-1 USTC ¶50,268, which was previously dismissed.

Singh, DC Calif., 2015-2 USTC ¶50,395; TRC IRS: 21,108

Liens and levies

A landlord's suit attempting to recoup rent his tenant paid directly to the IRS in compliance with a levy was dismissed. Under Code Sec. 6332(e), the tenant was required to comply with the levy and was discharged from any liability to the landlord once he turned over the landlord's property to the IRS.

Burgess v. Mineni, DC Calif., 2015-2 USTC ¶50,394; TRC IRS: 51,060.05

Income

A payment received by a software engineer that equaled the value of his stock incentive plan when his employer was acquired was ordinary income because the plan did not qualify as an incentive stock option plan. In addition, penalties were imposed on the taxpayer for failure to timely file his return.

Stout, TC, CCH Dec. 60,352(M), FED ¶48,062(M); COMPEN: 27,108.10

Tax Crimes

An individual was properly convicted of tax evasion and the 51-month sentence imposed upon him was reasonable. The four letters from his church that were found during a search of the individual's residence were properly admitted into evidence and the sentence imposed was within the applicable guidelines range and was afforded a presumption of reasonableness that the individual failed to rebut.

Ross, CA-6, 2015-2 USTC ¶50,397; TRC IRS: 66,154

An individual was properly convicted of tax evasion; however, her sentence was vacated because the trial court erroneously increased her base offense level for obstruction of justice. Although the trial court erroneously increased the individual's base offense level for obstruction of justice, her refusal to disclose her unreported income during the investigation could not serve as the basis for an obstruction of justice enhancement.

Kupfer, CA-10, 2015-2 USTC ¶50,390; TRC IRS: 66,154

Bankruptcy

A debtor couple's objection to the priority asserted by the IRS over Code Sec. 72(t) exaction for an early withdrawal from the debtors' Individual Retirement Account (IRA) was sustained because the amount was neither income tax nor penalty compensating the government for actual pecuniary loss under section 507(a)(8) of the Bankruptcy Code. The exaction was enacted to deter debtor's inappropriate use of retirement savings, rather than support the government.

In re Bradford, BC-DC Ga., 2015-2 USTC ¶50,393; TRC RETIRE: 42,552

A bankruptcy court reconsidered and revised its previous ruling and held, instead, that the IRS's setoff violated the debtors' confirmed Chapter 12 plan and the refunds had to be returned to the debtors. The Supreme Court's ruling in *Hall*, SCt, 2012-1 USTC ¶50,345, did not apply retroactively to the debtors' confirmed plan.

In re Legassick, BC-DC Iowa, 2015-2 USTC ¶50,391; TRC IRS: 57,058

FOIA

The IRS properly withheld documents responsive to Freedom of Information Act (FOIA) requests filed by a corporation and an individual having substantial ownership in the corporation. The only document responsive to the corporation's FOIA request was a draft revenue agent report (RAR), which was protected by the deliberative process privilege.

B&P Company, Inc., DC Ohio, 2015-2 USTC ¶50,392; TRC IRS: 9,502

FinCEN

The Financial Crimes Enforcement Network (FinCEN) has issued a final rule, pursuant to Section 311 of the USA PATRIOT Act, which imposes "special measure five" against FBME Bank Ltd.

FinCEN Final Rule RIN 1506-AB27, FED ¶47,024; TRC FILEBUS: 9,324

Sec. 367 Regs

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Exam challenge

In Notice 2014-52, the IRS described some of the changes as clarifications, not modifications or new regs, so that the IRS could apply the changes to both past and current transactions. Exam is planning to challenge the taxpayer's application and interpretation of the anti-abuse rule from the 2011 regs. Chief Counsel affirmed that it supports Exam's application of the anti-abuse rule in Reg. §1.367(b)-10(d) and will assist in the case if requested by Exam and challenged by the taxpayer.

Reference: TRC INTL: 30,308.30.