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Lawmakers Deadlock Over Payroll Tax Cut, Pass IRS Budget, Punt Extenders

◆ *HR 3630, House Report 112-331*

House Republicans have rejected a two-month extension of the employee-side payroll tax cut, sending the fate of the payroll tax cut into limbo. In other developments, lawmakers also cut $305 million from the IRS's FY 2012 budget and, despite some last-minute maneuvering, failed to extend a package of so-called tax extenders, scheduled to sunset after 2011.

■ ***CCH Take Away.*** "The two-month extension (or one-sixth of the Social Security wage limit for 2012 ($18,350)) in the Senate bill means payroll processors have to track FICA wages on a reduced rate and cap the time limit as well as cap the wages associated with this," Adam Lambert, CPA, managing director, Grant Thornton, LLP, New York, told CCH. "For those individuals who exceed the cap before the two-month period, the key question is how do employers and payroll processors recapture that amount if this is ultimately extended at a later date," Lambert cautioned.

Payroll tax cut

The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 reduced the employee-share of OASDI taxes from 6.2 percent to 4.2 percent for calendar year 2011. Self-employed individuals also shared in the reduction. The 2011 employee-side payroll tax cut will expire after December 31, 2011.

After lengthy negotiations, Senate Democrats and Republicans on December 17 agreed on a two-month extension of the employee-side payroll tax cut. The Senate bill would extend the 4.2 percent rate on the employee-share of OASDI taxes through the end of February 2012 with a pro rata limitation on the amount of earnings eligible for the tax cut of $18,350. Self-employed individuals also benefit from the extension. The two-month extension would be paid for by increasing guarantee fees charged to mortgage lenders by Fannie Mae and Freddie Mac.

On December 20, the House approved a motion to go to conference on the payroll tax bill. House Republican leaders said they want to open negotiations with the Senate on a 12-month extension. Previously, the House had approved a 12-month extension of the payroll tax cut.

IRS budget

Congress has passed a $915 billion FY 2012 federal government spending bill. The new law appropriates $12.2 billion for Treasury for FY 2012, which includes $11.8 billion for the IRS. This represents $305 million less than the agency's FY 2011 budget.

■ ***Comment.*** In November, IRS Commissioner Douglas Shulman said that the agency would offer buyouts and early outs to certain employees to reduce operating expenses. CCH asked the IRS how many employees have accepted buyouts and early outs but did not receive a reply by press time.

Continued on page 2

Route to: ________ ________ ________ ________ ________

IRS Elaborates On FATCA Reporting For Individuals, Domestic Entities

◆ *IR-2011-117, TD 9567, NPRM REG-130302-10, www.irs.gov*

The IRS has issued much-anticipated guidance on reporting specified foreign financial assets under the *Foreign Account Tax Compliance Act (FATCA).* The guidance includes examples of who must file Form 8938, Statement of Specified Foreign Financial Assets, and describes taxpayers excused from reporting.

■ ***CCH Take Away.*** The guidance addresses many concerns unanswered in the draft instructions, Daniel Gottfried, partner, Rogin Nassau, LLC, Hartford, Conn., told CCH. "I was concerned that a convenience owner would be required to file Form 8938. In many instances of joint ownership, one individual actually owns the asset and another individual is a joint owner for convenience only. For example, elderly parents will often list their children as convenience owners of an asset so that the children can administer the asset in the event that the parents have health problems, and so the asset will ultimately pass outside of probate. U.S. tax law recognizes that in these instances, all tax responsibilities reside with the true beneficial owner and not the convenience owner." The temporary regulations, Gottfried explained, confirm that a person has an interest in an asset only if that person is, or would be, required to reflect tax attributes of that asset on their annual tax return. "Typically, a convenience owner would not report any tax attributes of the asset. "

Background

FATCA enacted Code Sec. 6038D, which generally requires certain U.S. taxpayers holding specified financial assets outside the United States to report them to the IRS. *FATCA* also requires foreign financial institutions to report directly to the IRS certain information about financial accounts held by U.S. taxpayers, or by foreign entities in which U.S. taxpayers hold a substantial ownership interest. The IRS has posted a final version of Form 8938 and Instructions on its website.

■ ***Comment.*** The IRS reminded taxpayers that Form 8938 does not replace Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (FBAR).

Individuals

Generally, single individuals must file Form 8938 if they have an interest in one or more specified foreign financial assets and those assets have an aggregate fair market value exceeding either $50,000 on the last day of the tax year or $75,000 at any time during the tax year. The thresholds for married couples filing a joint return are higher ($100,000/$150,000, respectively). The thresholds are also higher for single individuals and married couples filing a joint return who reside outside of the U.S.

Domestic entities

Certain domestic entities must report specified foreign financial assets in the same manner as individuals. The regs apply to domestic entities formed or availed of for the purposes of holding, directly or indirectly, specified foreign financial assets. Such entities are referred to as specified domestic entities.

■ ***Comment.*** "The proposed regulations would require a domestic corporation or partnership to file Form 8938 if, in general, the entity is owned 80 percent or more by a single individual, and the entity has significant passive income or assets," Gottfried observed. "Although in this instance, there still could be significant minority owners (for example, 20 percent) to which the specified individual would owe fiduciary duties, at least by requiring 80 percent control, the IRS seems to recognize the big picture compliance issue."

Penalties

The IRS may impose a penalty of $10,000 for failing to file Form 8938, with an additional penalty of up to $50,000 for continued failure to file more than 90 days after notification. However, there is a reasonable cause exception. Failure must be due to reasonable cause and not willful neglect. Determinations will be made on a case-by-case basis. Taxpayers may also be liable for a 40 percent penalty on any understatement of tax attributable to nondisclosed assets.

References: FED ¶¶46,571, 47,061 49,512; TRC FILEBUS: 9,108.

Legislation

Continued from page 1

Extenders

The state and local sales tax deduction, higher education tuition deduction, research tax credit, and a host of other temporary incentives are scheduled to expire after December 31, 2011. The House payroll tax cut bill would extend 100 percent bonus depreciation through 2012. The Senate payroll tax cut bill does not extend any of the expiring tax extenders, despite last-minute negotiations to add some, especially energy tax incentives.

■ **Comment.** Senate Finance Committee Chair Max Baucus, D-Montana, predicted that Congress will take up the extenders in early 2012. "It is critical to pass these provisions early in the year to maximize their effect and provide certainty for the 2012 tax year," Baucus said in a statement.

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 Provides Guidance On Satisfying Continuity Of Interest Requirement For Corporate Reorganizations

◆ *TD 9565, NPRM REG-124627-11*

The IRS issued final and proposed regs on the continuity of interest (COI) requirement that must be satisfied to accomplish a corporate reorganization under Code Sec. 368. The regs provide additional guidance on the signing date rule.

■ ***CCH Take Away.*** The signing date rule provides some protection, to the parties to the transaction, that COI will be satisfied based on the value of the consideration offered by the acquiring corporation on a fixed date. The final regs expand slightly the signing date rule; the proposed regs would provide additional methods for satisfying the rule.

COI

COI is a nonstatutory requirement. It requires that a substantial part of the value of the proprietary interests (stock) in the target corporation be preserved in the reorganization. A proprietary interest in the target corporation is preserved if, in a potential reorganization:

- The interest is exchanged for a proprietary interest in the issuing corporation;
- The interest is exchanged by the acquiring interest for a direct interest in the target corporation enterprise; or
- The interest otherwise continues as a proprietary interest in the target corporation.

In 2007 temporary regs, the IRS determined that COI is preserved if the historic shareholders of the target corporation acquire and hold stock of the acquiring corporation that represents at least 40 percent of the value of the stock of the target corporation.

■ ***Comment.*** The IRS used to require that target shareholders hold 50 percent of the value of their stock. Court cases have recognized lower thresholds as satisfying COI.

Signing date rule

The signing date rule, adopted in 2005, provides that in determining whether a proprietary interest in the target corporation is preserved, the consideration (stock, cash, and/or other property) for the proprietary interests in the target corporation is valued on the last business day before the contract of reorganization becomes binding, provided that the consideration was fixed on the signing date. The IRS narrowed the definition of fixed consideration in 2007 temporary and proposed regs (providing for reliance on the proposed regs after the temporary regs sunset in 2010).

■ ***Comment.*** The signing date rule addresses the concern that a decline in value of the issuing corporation's stock between the signing date and the closing date of the transaction may prevent the transaction from satisfying COI.

The final regs adopt the 2007 temporary regs with minor changes. The regs confirm that a contract of reorganization provides for fixed consideration if the contract provides the target shareholders with an election to receive stock, money, and/or other property at an exchange rate based on the value of the issuing corporation's stock on the signing date.

Proposed regs

The signing date rule is based on the principle that if the consideration is fixed, the target corporation shareholders are subject to the economic fortunes of the issuing corporation as of the signing date. However, if the contract does not provide for fixed consideration, the signing date value of the issuing corporation's stock is not relevant for determining whether a proprietary interest is preserved in the target.

The IRS decided to expand the signing date rule and to allow additional methods to satisfy it. The proposed regs would permit the consideration to vary if, between the signing date and the closing date, the value of issuing stock either declines (down to a floor price) or increases (up to a ceiling price). COI would be determined based upon the floor price or ceiling price. The proposed regs also permit the use of an average value for issuing corporation stock in some circumstances. The IRS requested comments on valuing the consideration on a date between the signing date and closing date, and on valuing different items on different dates.

References: FED ¶¶ 47,063,49,513; TRC REORG: 3,102.

IRS Extends Filing Dates For Certain Exempt Organizations

The IRS has announced that tax-exempt organizations with January and February filing due dates will now have until March 30, 2012 to file their annual returns. The extension is due to the unavailability of the Modernized eFile (MeF) system during those months.

Affected returns. The forms affected by the MeF system are: Forms 990, 990-EZ, 990-PF, and 1120-POL. However, only organizations with filing due dates within the suspension period of January 1, 2012 through February 29, 2012 are considered "affected organizations."

Additionally, the IRS clarified that the filing extension is not an extension of time in which organizations may pay their tax liabilities due within the suspension period. Such organizations must make timely payments either by making an estimated tax payment or filing a paper return.

Alternative options. The IRS will accept paper forms filed during the suspension period, or organizations may take advantage of the automatic extension and delay filing until no later than March 30, 2012.

Schedule H. The IRS also explained that Part V.B of the revised Form 990, Schedule H, is mandatory for the 2011 tax year. Hospital organizations required to file the 2011 Form 990 must complete all parts and sections of the form, with the exception of lines 1 through 7.

Notice 2012-4; FED ¶46,573; TRC EXEMPT: 12,252.15.

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Final Cost-Sharing Regs Address Issues Under Transfer Pricing Rules

◆ *TD 9568*

The IRS has issued final regs on methods to determine taxable income under a cost-sharing arrangement under the transfer pricing rules. The final regs address issues that have arisen in administering the current cost-sharing regs.

■ ***CCH Take Away.*** In a cost-sharing arrangement, the parties agree to share the costs of developing one or more intangible assets in proportion to their shares of reasonably anticipated benefits (RABs) from their individual use of the intangible.

Economic contributions

The regs provide guidance on identifying and providing compensation for all economic contributions by controlled (related) participants in a cost-sharing arrangement, in accordance with the arm's length standard. In a cost-sharing arrangement, the controlled participants make two types of economic contributions: cost contributions and platform contributions. The latter involve the provision of existing resources, capabilities or rights that will contribute to the development of the intangible assets.

The regs provide valuation guidance to determine the most reliable measure of arm's length results for these economic contributions, for the duration of development and exploitation activities under the cost-sharing arrangement. The regs apply an investor model to value each participant's net investment over the entire period of the cost-sharing arrangement.

Arm's length results

To measure the arm's length results of a cost-sharing arrangement, the regs adopted proposed regs that require assessing the potential application of the comparable uncontrolled transaction method (CUT). This method seeks to determine the results as if uncontrolled taxpayers had engage in the same transaction.

However, a cost-sharing arrangement may benefit from a controlled group's unique competitive advantages. There may not be any comparable uncontrolled transactions. In this case, the regs consider the results that controlled taxpayers could have realized by choosing a "realistic alternative." This analysis constructs a CUT that may more reliably reflect the actual contributions to the CSA than can be derived from third-party transactions.

Other provisions

The regs resolve issues raised under 1995 regs. If a controlled participant devotes an existing resource or capability for the benefit of another controlled participant, the regs require an arm's length charge for this platform contribution. An example is the contribution of a particular research team's experience and expertise. The IRS intends that research tools be treated as platform contributions.

The IRS also clarified that taxpayers should not update determinations of RABs using information later obtained. However, the regs do not limit the IRS's use of subsequent information to determine cost-sharing arrangement allocations.

Additionally, the IRS indicated it will continue to study the valuation of stock-options and other stock-based compensation.

References: FED ¶47,064;
TRC INTL: 15,152.

IRS Adds Differential Income Stream As Consideration In Assessing Best Method For Cost-Sharing Arrangement

◆ *TD 9569, NPRM REG-145474-11*

The IRS has issued new guidance implementing the use of the differential income stream to assess a cost-sharing arrangement. The new guidance augments final cost sharing regs issued in TD 9568.

■ ***CCH Take Away.*** When the IRS issued final cost sharing regs in TD 9568, the agency reserved guidance on discount rates.

Background

The IRS reported that some taxpayers have been taking unreasonable positions in applying the income method by using low licensing discount rates and high cost sharing discount rates. These taxpayers, according to the IRS, fail to sufficiently consider the appropriate interrelationship of the discount rates and projections.

New guidance

The IRS provided guidance in the final regs on comparing the financial projections associated with the cost-sharing alternative discounted at the rate appropriate for the cost sharing alternative with the financial projections associated with the licensing alternative discounted at the rate appropriate for the licensing alternative, and evaluating reliability considerations associated with such a comparison.

The temporary regs provide guidance on evaluating results of application of the income method. The IRS explained that the temporary regulations add a new provision, which provides that an analysis under the income method that uses a different discount rate for the cost-sharing alternative than for the licensing alternative will be more reliable the greater the extent to which the implied discount rate for the projected present value of the differential income stream is consistent with reliable direct evidence of the appropriate discount rate applicable for activities reasonably anticipated to generate an income stream with a similar risk profile to the differential income stream.

The IRS has also proposed a new specified application of the income method in Reg. §1.482-7(g)(4)(v), which provides that the determination of the arm's- length charge for the payment can be derived by discounting the differential income stream at an appropriate rate. The differential income stream approach to determining payments depends on reliably determining the discount rate associated with the differential income stream.

References: FED ¶¶47,006, 49,514;
TRC ACCTNG: 30,056.

IRS Provides Temporary Relief For IRA Owners Entering Into Broker Indemnification Agreements

◆*Ann. 2011-81*

The IRS has announced temporary relief for owners of individual retirement accounts (IRAs) who enter into indemnification agreements with brokers, which could result in a prohibited loan transaction. The agency's action comes shortly after the U.S. Department of Labor (DOL) issued an advisory opinion.

■ ***CCH Take Away.*** Richard Matta, principal, The Groom Law Group, Chartered, Washington, D.C., told CCH that DOL's advisory opinion has implications beyond IRAs. "Indemnification is not limited to IRAs," Matta explained. By issuing the advisory opinion, DOL calls other indemnities into question, Matta observed.

Background

Code Sec. 4975(c)(1)(B) generally prohibits the direct or indirect lending of money or other extension of credit between a plan and a disqualified person. A plan includes an IRA and a disqualified person includes a fiduciary. An IRA owner who self-directs investments attributable to his or her IRA is a fiduciary and subject to Code Sec. 4975.

In October 2011, DOL issued Advisory Opinion 2011-09A. In that opinion, the owner of an IRA directed a trust company to open a futures trading account with a broker for purposes of the owner self-directing the investment of assets attributable to the account. The broker required an indemnification agreement from the IRA owner to engage in futures trading.

DOL noted that a class exemption (PTE 80-26) would allow parties in interest or disqualified persons with respect to employee benefit plans to make certain loans and extensions of credit to plans. However, the rules are narrow. DOL determined that an indemnification agreement required for the IRA to engage in futures trading would not fall under PTE 80-26.

IRS action

Pending further action by DOL and until issuance of further guidance by the IRS, the IRS will provide temporary relief for affected IRA owners. The IRS will determine the tax consequences of an IRA examination without taking into account the possible existence of a Code Sec. 4975 prohibited transaction in connection with any indemnification agreement described in DOL Advisory Opinion 2011-09A or "guarantee"or pledge described in earlier DOL Advisory Opinion 2009-03.

■ ***Comment.*** "Hopefully, DOL will clarify that typical indemnification agreements do not result in prohibited extensions of credit," Matta noted. DOL may withdraw the advisory opinion or limit its use to specific facts.

References: FED ¶46,567; TRC RETIRE: 48,200.

IRS Aims To Reduce Processing Time For EP Determination Letters

◆ *Ann. 2011-82*

The IRS has announced new changes to the Employee Plans (EP) determination letter procedures to reduce processing time. The changes described in Ann. 2011-82 will appear in Rev. Proc. 2012-6, scheduled to be issued in early 2012.

■ ***CCH Take Away.*** "While we appreciate the need to reduce the processing time for determination letters, restricting the ability to obtain determination letters for pre-approved plans raises concerns about the level of document production needed in the event of an audit," Elizabeth Dold, principal, The Groom Law Group, Chartered, Washington, D.C. told CCH. "Moreover, eliminating Schedule Q results in a loss of valuable plan qualification protections, particularly for innovative benefit designs and M & A transactions. "

Background

There are two types of pre-approved plans: Master and Prototype (M&P) and Volume Submitter (VS) plans. Adopters of pre-approved plans apply for a determination letter using Form 5307, Application for Determination for Adopters of Master or Prototype or Volume Submitter Plans, to ensure the choice of elections in the Adoption Agreement meets the requirements of Code Sec. 401(a). Additionally, plan sponsors may elect to expand the scope of a determination letter application by completing Schedule Q (Form 5300), Elective Determination Requests, and submitting data demonstrating compliance with coverage and nondiscrimination requirements.

Form 5307 applications

On or after May 1, 2012, the IRS will not accept determination letter applications filed on Form 5307 by adopters of VS plans that have not made an any changes to the terms of the pre-approved VS specimen plan (except to select options under the plan) or by adopters of M&P plans. The IRS explained that these VS and M&P adopters may rely on the advisory or opinion letter issued with respect to the VS or M&P plan to the extent provided in Section 19 of Rev. Proc. 2011-49.

Coverage and nondiscrimination

The IRS also reported it will not consider the demonstration requests reflected on Schedule Q in its review of the plan. This change is effective for applications filed on or after February 1, 2012, for plans under a five-year remedial amendment cycle and May 1, 2012 for terminating plans and plans under a six-year remedial amendment cycle.

■ ***Comment.*** The IRS also intends to clarify when a determination letter must be filed on Form 5300 in certain cases.

References: FED ¶46,574; TRC RETIRE: 9,022.

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IRS Rejects Use Of Recurring Item Exception To Accelerate Deductions

◆ *Rev. Rul. 2012-1*

The IRS issued a revenue ruling that denies the use of the recurring item exception to deduct an expense that accrues over two tax years for financial statement purposes. The ruling applies to two situations: payments to lease property and payments to obtain services.

- ***CCH Take Away.*** The recurring item exception allows taxpayers to deduct an expense in the earlier year if the expense is not a material item or if the earlier accrual better matches the expense with the related income. The IRS concluded that the expenses did not satisfy the exception and should be accrued over the entire one-year period.

Background

A corporation using the accrual method of accounting files its income tax return on a calendar year. On July 1, 2011, the corporation leases property for one year for its business. The corporation pays $50,000, the entire lease liability, on July 1, 2011.

The corporation also enters into a one-year service contract with a maintenance company, which will inspect and clean the property monthly and provide ordinary repair and maintenance services. The corporation pays $2,400, the entire contract liability, on July 1, 2011.

Accrual method

Under the accrual method, a liability can be deducted in the year that:

- All the events have occurred to establish the liability;
- The amount can be established with reasonable accuracy; and
- Economic performance has occurred.

If the liability is for the use of property, economic performance occurs over the period the taxpayer can use the property. If the liability is an insurance, warranty or service contract, economic performance occurs when the liability is paid. This rule applies where the other party agrees to replace or repair the property in specified circumstances.

Conclusions

The corporation accrues the liability over the period of the lease for financial accounting, and uses the property to generate income over the period of the lease. Thus, accruing the liability over the lease period is a better match.

The IRS concluded that, like the lease, the recurring item exception did not apply to the service contract and that the liability had to be accrued over the one-year period of the contract.

References: FED ¶46,570; TRC ACCTNG: 12,104.10.

AFRs Issued For January

◆ *Rev. Rul. 2012-2*

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

Applicable Federal Rates (AFR) for January 2012

	Annual	Semiannual	Quarterly	Monthly
Short-Term				
AFR	.19%	.19%	.19%	.19%
110% AFR	.21%	.21%	.21%	.21%
120% AFR	.23%	.23%	.23%	.23%
130% AFR	.25%	.25%	.25%	.25%
Mid-Term				
AFR	1.17%	1.17%	1.17%	1.17%
110% AFR	1.29%	1.29%	1.29%	1.29%
120% AFR	1.40%	1.40%	1.40%	1.40%
130% AFR	1.53%	1.52%	1.52%	1.52%
150% AFR	1.77%	1.76%	1.76%	1.75%
175% AFR	2.06%	2.05%	2.04%	2.04%
Long-Term				
AFR	2.63%	2.61%	2.60%	2.60%
110% AFR	2.89%	2.87%	2.86%	2.85%
120% AFR	3.15%	3.13%	3.12%	3.11%
130% AFR	3.42%	3.39%	3.38%	3.37%

Adjusted AFRs for January 2012

	Annual	Semiannual	Quarterly	Monthly
Short-term adjusted AFR	.38%	.38%	.38%	.38%
Mid-term adjusted AFR	1.50%	1.49%	1.49%	1.49%
Long-term adjusted AFR	3.47%	3.44%	3.43%	3.42%

The Code Sec. 382 adjusted federal long-term rate is 3.47 the long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months) is 3.55%; the Code Sec. 42(b)(2) appropriate percentages for the 70% and 30% present value low-income housing credit are 7.44% and 3.19% respectively, however, the appropriate percentage for non-federally subsidized new buildings placed in service after July 30, 2008, and before December 31, 2013, shall not be less than 9%; the Code Sec. 7520 AFR for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest is 1.4% and the deemed rate of return for transfers during 2012 to pooled income funds that have been in existence for less than 3 taxable years is 1.8%. *TRC ACCTNG:* 36,162.05.

Final Regs Apply Subpart F To CFC Income Involving Branches

◆ *TD 9563*

The IRS issued final regs that clarify the application of Subpart F income that is foreign base company sales income (FBCSI). This income is generated when a controlled foreign corporation (CFC) has sales income from a transaction involving a related party.

■ ***CCH Take Away.*** Income of a CFC that manufactures property is deferred from U.S. taxes until the income is brought back into the U.S. Other CFC income, such as income from a sale of personal property to a branch in another country, is taxable as FBCSI. The final regs clarify the application of Subpart F when a CFC uses a sales branch located in another country. The regs also apply if purchase and sale activities are conducted by multiple branches or if multiple branches manufacture items sold by the CFC.

FBCSI

Code Sec. 954(d)(2) applies the FBCSI rules to a CFC that has a branch outside the CFC's country of incorporation. This branch rule applies if the CFC carries on purchasing, selling or manufacturing activities through the branch, and if these activities have substantially the same tax effect as if the branch were a wholly-owned subsidiary of the CFC.

The branch and the remainder of the CFC are treated as separate corporations for determining the CFC's FBCSI. This transforms sales by the branch into sales between related parties and converts the branch's income from sales to unrelated parties into FBCSI.

Tax rate disparity

The tax paid by the branch on a hypothetical amount of branch income is compared to the hypothetical tax that would result if the branch were a resident of the CFC's country and earned its imputed income there. If the tax rate disparity is too great, the branch is treated as a subsidiary corporation.

For a sales or purchase branch, the test is applied by comparing the rate of tax imposed on income from the branch's activities with the tax rate that would apply if the income were earned by the remainder of the CFC. For a manufacturing branch, the test is applied by comparing the tax rate on the CFC's purchase and sales activities with the tax rate that would apply in the country where the manufacturing branch is located.

Final regs

The IRS issued temporary and proposed regs at the end of 2008. The final regs adopt the proposed regs with several clarifying changes. The regs apply to tax years of CFCs beginning after June 30, 2009, the date the temporary regs took effect. The IRS is considering additional FBCSI guidance.

References: FED ¶47,062; TRC INTLOUT: 9,108.

Tax Briefs

Internal Revenue Service

IRS Chief Counsel has issued an action on decision recommending nonacquiescence to the Tax Court's decision in *W. Norris*, 102 TCM 26, Dec. 58,694(M), TC Memo. 2011-161. According to the IRS, the Tax Court's approach in evaluating the evidence employed an artificial and rigid system of scoring in place of a consideration of the taxpayer's entire course of conduct. The IRS also reported that the Tax Court's decision to "weigh all the factors equally" was wrong because strong evidence of only a few factors can be enough to prove fraudulent intent.

AOD-2011-05, 2011FED ¶46,569; TRC IRS: 30,052.

Jurisdiction

An educational consultant's claim for refund of taxes paid by her employer pursuant to a settlement with the IRS was untimely under Code Sec. 6511 and, therefore, her claims were dismissed for lack of subject matter jurisdiction. The limitations period was not tolled under Code Sec. 6511(d) because her employment status was changed from independent contractor to employee.

L. Stabiner, DC N.J., 2011-2 USTC ¶50,758; TRC IRS: 36,052.05.

Tax Crimes

A motion for rehearing filed by a nightclub owner, who was convicted of, and sentenced for, willful tax evasion, was properly denied. The $1.9 million seized from his safe was properly included in the tax loss calculation notwithstanding his repayment of those funds to his corporations. The tax loss is the total loss that would have resulted had the offense been successfully completed and is not reduced by any payment subsequent to the commission of the offense.

Khanu, CA-DC, 2011-2 USTC ¶50,754; TRC IRS: 66,154.

Summons

An IRS summons was ordered enforced because the government established a *prima facie* case for enforcement that was not rebutted. The summons was issued in good faith and for a legitimate purpose, the documents sought were relevant to that purpose and the IRS did not already have them, all requisite administrative steps had been followed and no Justice Department referral for criminal prosecution had been made.

Canul, DC Calif., 2011-2 USTC ¶50,757; TRC IRS: 21,308.

Income

An individual shareholder of a closely held S corporation was required to include in his gross income the exercise of his option in the tax year at issue. The stock was transferred to the individual shareholder in connection with the performance of his services because

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the S corporation granted the option with the intent of securing the shareholder's participation in the day-to-day management of the S corporation. The S corporation was entitled to deduct $36 million paid to the individual shareholder as reasonable compensation. The business of the corporation expanded due to the individual shareholder's participation in its management.

Davis, TC, CCH Dec. 58,831(M), FED ¶48,251(M); TRC COMPEN: 18,502.

Deductions

Deductions claimed by a married couple for cost of goods sold, rent, legal fees, insurance and commissions allegedly incurred for corporations they owned were not properly substantiated and they could not establish that those expenses were ordinary and necessary.

F.A. Blake, DC Mich., 2011-2 USTC ¶50,760; TRC BUSEXP: 3,100.

Liens and Levies

Tax assessments against an individual were reduced to judgment and federal tax liens on real property held by the individual's nominee trust were properly foreclosed and the sale proceeds applied to his tax debt. Form 4340, Certificate of Assessments and Payments, established the individual's tax liability and the district court properly held that the trust created for the benefit of his children was the individual's nominee.

Burnett, III, CA-5, 2011-2 USTC ¶50,755; TRC IRS: 45,160.

An individual's motion for relief from a prior order denying his wrongful levy claim under Code Sec. 7426 was denied because his claim was barred by the statute of limitations. Although the individual's claim arose when he was a minor, there is no provision in Code Secs. 6532 or 7426 that provides for the equitable tolling of the limitations period because of a claimant's minority; therefore, the individual's claim was barred by the statute of limitations because it was filed more than nine months after the levy.

Volpicelli, DC Nev., 2011-2 USTC ¶50,753; TRC IRS: 51,156.20.

Two banks' claims to tax lien foreclosure sale proceeds had priority over the goverment's interest to the extent that post-refinance interest had accrued on the banks' mortgages between the refinancing and the foreclosure sale. The banks were entitled to the same rights as the original mortgagors to the extent they were granted the lien priority of the original mortgagors. Therefore, they were entitled to the same interest that would have accrued on the original mortgage prior to foreclosure.

Cabansag, DC Calif., 2011-2 USTC ¶50,752; TRC IRS: 48,154.

Collection Due Process

A corporation waived its right to appeal the preponderance of the evidence standard used by the Tax Court to uphold the IRS's collection action because the issue was raised for the first time on appeal. The IRS's determination of the corporation's tax liability was presumptively correct and the corporation had the burden of proving that the IRS was wrong by a preponderance of the evidence.

535 Ramona, Inc., CA-9, 2011-2 USTC ¶50,759; TRC IRS: 48,058.25.

The IRS could continue collection proceedings against an individual who was not entitled to dispute the underlying tax liability at a Collection Due Process (CDP) hearing because he had previously received a notice of deficiency for each of the relevant tax years. The taxpayer and his wife introduced no evidence of irregularities in the mailing of the notices except their own self-serving testimony.

Kamps, TC, CCH Dec. 58,832(M), FED ¶48,252(M); TRC IRS: 51,056.

Bankruptcy

A foreclosure sale purchaser failed to show by clear and convincing evidence that the IRS acted in bad faith when it sold its right of redemption to the purchaser. At the time the IRS released its right of redemption, the bankruptcy court had not yet rejected the IRS's arguments that its liens were valid despite an error in the taxpayer's name, and the IRS had every reason to believe its redemption claim was made in good faith.

Road and Highway Builders, LLC, FedCl, 2011-2 USTC ¶50,756; TRC IRS: 51,308.15.

Innocent Spouse

A individual was entitled to Code Sec. 6015(f) relief from joint and several liability for 30 percent of the underpayments that were attributable to her former husband's items of income. Although she did not satisfy all three requirements for safe harbor relief, an application of the facts and circumstance test favored granting her partial relief.

Waldron, TC, CCH Dec. 58,833(M), FED ¶48,253(M); TRC INDIV: 18,058.15.

Retirement Plans

The IRS has published the 2011 Cumulative List of Changes in Plan Qualification Requirements (2011 Cumulative List). The 2011 Cumulative List informs plan sponsors and practitioners of issues the IRS has specifically identified for review when determining whether individually designed single-employer plans filing in Cycle B have been properly updated.

Notice 2011-97, 2011FED ¶46,568; TRC RETIRE: 51,052.20.

IRS Finalizes Preparer EIC Due Diligence Regs

The IRS has issued final regs on the paid preparer earned income credit (EIC) due diligence requirements. The final regs generally track proposed regs issued in October 2011.

Nonsigning preparers. The final regs clarify that the due diligence requirements and the penalty for failure to comply with them apply to nonsigning preparers. Individuals who prepare a return but do not submit it directly to the IRS may satisfy their due diligence obligation by providing Form 8867, Paid Preparer's Earned Income Credit Checklist, to the taxpayer or the signing tax return preparer for submission with the return, the IRS explained.

Firms. The final regs also clarify application of the due diligence requirements and the penalty for failure to comply with them to firms.

Penalty. The 2011 U.S.-Korea Trade Agreement increased the EIC due diligence penalty from $100 to $500. The final regs reflect the increased penalty.

TD 9570, FED ¶47,005; TRC IRS: 57,266.10.