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Regs Allow Opt-In To New Partnership Audit Regime Before 2018

TD 9780, NPRM REG-105005-16

The IRS has issued temporary and proposed regs that provide the time, form, and manner of election for a partnership to opt in to the new partnership audit regime under the *Bipartisan Budget Act of 2015* (BBA). The election is available for partnerships that want the new audit regime to apply to a return filed for a partnership tax year that begins before January 1, 2018.

- ***Take Away.*** "The IRS needed to get guidance out so that people can get under the new regime," Travis Greaves, attorney, Caplin & Drysdale, Chartered, Washington, D.C., told Wolters Kluwer. "The regulations are a huge help; they clarify the timing and method for making the election."
- ***Comment.*** "The regulations don't say much about how the new regime works. They don't really clarify the methodology for calculating tax liability. We need to know what to expect," Greaves said. "Operating under TEFRA can be painful, but it is pain we know."
- ***Comment.*** "The regulations are the starting point for notice and comment from groups and practitioners. The hope is that Treasury will listen and will answer questions over the next few months. Nobody likes uncertainty. However, it is hard to say when more guidance will come. Unless people opt-in, the IRS doesn't need to implement the new law until 2018. It is not under pressure to issue guidance; my guess is it will not be rushing to issue guidance," Greaves said.

Background

Partnership audits are conducted under the rules provided in the *Tax Equity and Fiscal Responsibility Act of 1982* (TEFRA). Generally, under these rules, the IRS makes adjustments to partnership returns at the partnership level and then adjusts each partner's individual tax liability. The IRS then must collect the adjustment from the individual partners.

With the goal of facilitating the collection of tax after changes to the partnership's tax return, Congress revamped the partnership audit rules in the BBA, repealing the TEFRA rules, effective January 1, 2018, and providing a new partnership audit regime. Under the new regime, Code Sections 6221 and 6225 provide a general rule that adjustments to partnership income, gain, loss, deduction or credit are determined at the partnership level, and that any additional tax, referred to as the imputed underpayment, shall be collected from the partnership.

Effective date and election in

The new partnership audit regime applies to returns filed for partnership tax years beginning after December 31, 2017. The BBA authorizes a partnership to elect to apply

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Partnership Audit Regime

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the new regime to returns filed for partnership tax years beginning after November 2, 2015 (the enactment date of the BBA) and before January 1, 2018 (an "eligible tax year"). The temporary regs provide the procedures for the partnership election.

Code Sec. 6221(b) permits a small partnership (a partnership that issues 100 or fewer Schedules K-1, Partner's Share of Income, Deductions, Credits, etc.) to elect out of the new regime. The temporary regs provide that this "election-out" procedure shall not be available to a partnership that elects in to the new regime before 2018.

- ***Comment.*** "The IRS closed a loophole. The TEFRA rules have a small partnership exception for a partnership with 10 or fewer partners, while the new BBA audit regime allows small partnerships with 100 or fewer partners to elect out of the new rules," Greaves said. "The Temporary Regulations may be trying to prevent partnerships that do not qualify for TEFRA's small partnership exception from using the opt-in election under the BBA as a back door method to obtain a result similar to the TEFRA small partnership exception."

Exceptions

The regs provide exceptions to the definition of an eligible tax year to prevent the application of both the TEFRA rules and the BBA rules to the same partnership tax year. This could happen if, under the old rules, the tax matters partner (TMP) has filed a request for an administrative adjustment (AAR) under Code Sec. 6227(c) of the TEFRA rules. The regs also provide that an election is not valid if it frustrates the purposes of the law, including the collection of any imputed underpayment under Code Sec. 6225(a).

- ***Comment.*** "This provision is vague and reminiscent of some anti-abuse provisions. It is hard to imagine how an election could frustrate the purpose of the law; the regulations don't provide an answer," Greaves said.

Audit notice

Under the general rule, the election to opt-in must be made when the IRS first notifies the partnership in writing (a notice of selection for examination) that it has selected a partnership return (for an eligible tax year) for examination. Thus, generally, the partnership cannot elect-in to the new regime unless it receives the IRS notice. The election-in, once made, cannot be revoked unless the IRS consents.

An exception to the general rule allows a partnership to elect-in if the partnership wishes to file an AAR under the new regime. This election cannot be made before January 1, 2018 (although it will apply to a partnership tax year that begins before January 1, 2018).

30-day deadline

The partnership must make the election within 30 days of receiving the notice of selection for examination. The regs also provide a period of 30 days after a valid election-in and before the IRS mails a notice of administrative proceeding, for the partnership to file an AAR under Code Sec. 6227 of the new rules.

- ***Comment.*** "If the IRS selects a partnership for audit and the partnership is eligible to make an election into the BBA regime, it only has 30 days to ask in writing for the application of the new rules," Greaves said. "It is imperative that partnerships have procedures in place to notify partners of this election option if an audit is commenced in an eligible year. Thirty days could be challenging, especially for multi-tier partnerships. The tax matters partner must decide or must reach out to the partners."

Procedures

The partnership must make the election in writing and provide the election to the IRS individual identified in the notice of selection for exam. The statement must be dated and signed by the TMP. The partnership must represent that it is not insolvent, does not anticipate going into bankruptcy, and has sufficient assets to pay any imputed underpayment. The partnership must designate a partnership representative, the party under the BBA rules that fulfills the role played by the TMP under the TEFRA rules. The government expects to issue guidance regarding designation of a partnership representative.

- ***Comment.*** Even though the election rules are contained in the regs under §301.9100, which generally permit taxpayers to request extensions to regulatory deadlines to make an election, the temporary regs do not allow partnerships to request an extension of time under Reg. §301.9100-3 to elect in to the new audit regime.

References: FED ¶¶47,040, 49,710; TRC PART: 60,700.

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 Unveils Procedures To Renew ITINs Post-PATH Act

IR-2016-100, Notice 2016-48, www.irs.gov

The IRS has announced procedures to renew Individual Tax Identification Numbers (ITINs) to reflect the *Protecting Americans from Tax Hikes Act of 2015* (PATH Act). The IRS also updated its online frequently asked questions (FAQs) about ITINs.

- ***Take Away.*** Only ITINs scheduled to expire at the end of the year and that need to be included on a U.S. tax return in 2017 should be renewed now, the IRS instructed. To assist taxpayers, the IRS has developed a rolling renewal schedule.

Background

Individuals filing a U.S. tax return are required to provide their taxpayer identification numbers on the return. Generally, a taxpayer identification number is the individual's Social Security number (SSN). In the case of individuals who are not eligible to be issued an SSN, but who still have a tax filing obligation, the IRS issues ITINs.

Under the PATH Act, any ITIN not used on a federal tax return for three consecutive tax years, either as the ITIN of an individual who files the return or as the ITIN of a dependent included on a return, will expire on December 31 of the third consecutive tax year of nonuse. This rule applies to all ITINs regardless of when the ITIN was issued. For ITINs issued before 2013, the PATH Act provides that ITINs will no longer be in effect according to a certain schedule, unless the ITIN has already expired due to nonuse for three consecutive years.

Unused ITINs

ITINs not used on a federal income tax return in the last three years (covering 2013, 2014, or 2015) will no longer be valid to use on a tax return as of January 1, 2017. ITIN holders in this group who need to file a tax return next year will need to renew their ITINs. The renewal period begins October 1, 2016.

Expiring ITINs

The first ITINs that will expire under the schedule are those with middle digits of 78 and 79. The renewal period for these ITINs begins October 1, 2016.

- ***Comment.*** A return with an expired ITIN will be processed and treated as timely filed, but it will be processed without any exemptions and/or credits claimed and no refund will be paid at this time, the IRS explained. After the ITIN is renewed, any exemptions and credits will be processed and any allowed refund will be paid.

Renewals

To renew an expiring ITIN, taxpayers must file Form W-7, Application for IRS Individual Taxpayer Identification Number, along with all required identification documents to the IRS. Updated Form W-7 and Instructions are expected to be available in September 2016, the IRS explained.

- ***Comment.*** "To reduce the paperwork burden on households where several people will need to renew their ITIN we created the family option. If any individual having an ITIN middle digit of 78 or 79 receives a renewal letter from the IRS, they can choose to renew the ITINs of all of their family members at the same time starting October 1, 2016," Debra Holland, Commissioner, IRS Wage and Investment Division, told reporters at a news conference announcing the ITIN procedures.
- ***Comment.*** Once an individual receives a SSN, he or she must use that number for tax purposes and discontinue using the ITIN. The IRS reminded taxpayers it is improper to use both the ITIN and the SSN assigned to the same person to file tax returns. It is the taxpayer's responsibility to notify the IRS so the agency can combine all of his or her tax records under one identification number

References: FED ¶¶46,381, 46,382; TRC FILEBUS: 12,106.

IRS Releases Interim Guidance For Certified Professional Employer Organizations

The IRS has issued interim guidance, on which taxpayers may rely, on the new voluntary certification program for professional employer organizations. The IRS announced that final regs will remove the previous ban on disregarded entities from becoming a Certified Professional Employer Organization (CPEO). The IRS also provided other clarifications.

Disregarded entities. The temporary regs prohibited disregarded entities from becoming a CPEO. The IRS announced that the final regs will not prohibit a business entity that is disregarded as separate from its owner from becoming a CPEO. However, the final regs will continue to require that a CPEO applicant or CPEO must be created or organized in the United States or under the laws of the United States or of any state. As a result, only domestic disregarded entities would be eligible to apply for certification, the IRS explained.

Sole proprietors. The IRS reported some stakeholder confusion over sole proprietors. The final regs will expressly allow sole proprietors to apply for certification as a CPEO, the IRS clarified.

Deadline. Under the interim guidance, the effective date of certification for a CPEO applicant that submits a complete and accurate application for certification on or before September 30, 2016, and is certified will be January 1, 2017. This treatment will apply even if the date of its notice of certification is after January 1, 2017, the IRS explained.

Notice 2016-49, FED ¶46,383; TRC PAYROLL: 3,058.05.

IRS Issues Proposed Regs On Restrictions On Liquidation Of Interests

NPRM REG-163113-02

The IRS has released proposed regs that treat certain transfers occurring within three years of death that result in the lapse of a liquidation right as transfers occurring at death for purposes of Code Sec. 2704(a). The proposed regs also address the definition of the term "applicable restriction" and describe a new class of restrictions ("disregarded restrictions").

- ***Take Away.*** The IRS had been working on the proposed regulations for over one year, Eileen Sherr, CPA, senior technical manager, AICPA, told Wolters Kluwer, and the estate planning community was very attentive. "The proposed regulations are far-reaching and likely will affect estate planning techniques involved with the valuation of family transfers of closely-held entities," Sherr said.
- ***Comment.*** The proposals are similar to ones discussed by the Obama Administration a few years ago, Sherr noted, but include some changes. The IRS has scheduled a hearing on the proposed regulations for December.

Background

Valuation rules in Code Sec. 2704 address how to value intra-family transfers of interests in corporations and partnerships subject to lapsing voting or liquidation rights and restrictions on liquidation. Code Sec. 2704(a)(1) generally provides that, if there is a lapse of any voting or liquidation right in a corporation or a partnership and the individual holding the right immediately before the lapse and members of the individual's family hold, both before and after the lapse, control of the entity, the lapse will be treated as a transfer by the individual by gift, or a transfer which is includible in the gross estate, whichever is applicable.

Entities

Under the proposed regs, a corporation is any business entity described in Reg. §301.7701- 2(b)(1), (3), (4), (5), (6), (7), or (8), an S corp within the meaning of Code Sec. 1361(a)(1), and a qualified subchapter S subsidiary within the meaning of Code Sec. 1361(b)(3)(B). Generally, a partnership would be any other business entity within the meaning of Reg. §301.7701-1(a), regardless of how the entity is classified for federal tax purposes.

Control

The proposed regs, the IRS explained, are intended to clarify that control of a limited liability company (LLC) or of any other entity or arrangement that is not a corporation, partnership, or limited partnership would constitute the holding of at least 50 percent of either the capital or profits interests of the entity or arrangement, or the holding of any equity interest with the ability to cause the full or partial liquidation of the entity or arrangement. For purposes of determining control, under the attribution rules of Reg. §25.2701-6, an individual, the individual's estate, and members of the individual's family are treated as holding interests held indirectly through a corporation, partnership, trust, or other entity, the IRS explained.

Lapse

The proposed regs would narrow the exception in the definition of a lapse of a liquidation right to transfers occurring three years or more before the transferor's death that do not restrict or eliminate the rights associated with the ownership of the transferred interest. The exception limiting applicable restrictions to limitations that are more restrictive than the limitations that would apply in the absence of the restriction under local law generally applicable to the entity would be removed.

More provisions

The proposed regs also remove the exception in Reg. §25.2704-2(b) that limits the definition of applicable restriction to limitations that are more restrictive than the limitations that would apply in the absence of the restriction under the local law generally applicable to the entity. Additionally, the proposed regs provide for a new class of restrictions that would be disregarded ("disregarded restrictions."). The proposed regs also aim to coordinate the amendments with marital and charitable deductions.

Reference: TRC ESTGIFT: 18,608.

Taxpayer's "Egregious History Of Noncompliance" Was Adequate Basis To Reject Offer In Compromise

The Eighth Circuit Court of Appeals has affirmed the Tax Court's decision upholding the IRS's rejection of a taxpayer's $500,000 offer in compromise as settlement for his $15 million tax liability. The appeals court rejected the taxpayer's argument that the Tax Court lacked jurisdiction and that the IRS abused its discretion.

Background. The IRS determined that the taxpayer, an investment consultant, failed to timely file his income tax returns during the years in issue, and when he did file, he did not pay the liability due. The IRS rejected his proposed offer in compromise, citing his history of noncompliance and failure to report any income or pay any taxes for several years.

Court's analysis. On appeal, the taxpayer argued that the Tax Court lacked jurisdiction to review the IRS's supplemental notice of determination. The court found that the taxpayer presented no authority to support his position. In addition, the court found that it was not abuse of discretion for the IRS to reject the offer in compromise. The taxpayer failed to point to any evidence to support his claim that the IRS miscalculated the value of his assets. In addition, his continued failure to report all his income and pay his tax liability was an adequate basis to reject his offer in compromise.

Hauptman, CA-8, 2016-2 USTC ¶50,368; TRC IRS: 42,120.

Second Circuit Declines To Enforce Summons; Production Of Documents Would Be Self-Incriminating

Greenfield, CA-2, August 1, 2016

The U.S. Court of Appeals for the Second Circuit has declined to enforce an IRS summons requiring an individual to produce bank records and other documents relating to offshore accounts. Reversing a district court decision, the appeals court found that production of the documents would be self-incriminating, and that no exception existed to the 5th Amendment privilege.

- ***Take Away.*** The taxpayer was accused of tax evasion, after a leak of bank records indicating that he (and many others) maintained secret offshore accounts in Liechtenstein that held over $2 million in assets. While production of documents could be self-incriminatory, a court can order disclosure if the existence of the documents, the taxpayer's control of the documents, and their authenticity were a "foregone conclusion." The appeals court found that the government failed to satisfy the requirements for this doctrine, and remanded the case to the district court.

Background

In 2008, an employee of a Liechtenstein financial institution (LGT) leaked thousands of bank documents, many involving secret accounts. The taxpayer, one of the individuals implicated by the disclosures, did not report the existence of his offshore accounts or the income earned by the accounts.

The taxpayer lived in New York and owned a successful business. The leaked documents included a 2001 LGT memo on a meeting with the taxpayer; a 2001 account statement for a Liechtenstein foundation owned by taxpayer and set up in 1992; a 2001 LGT account information form for the foundation and two entities apparently owned by the foundation; and other 2001 LGT documents on these entities. One of the LGT memos indicated that the LGT accounts previously were held in a Hong Kong trust owned by taxpayer's father that had over $30 million in assets.

In 2013, the IRS began an audit of taxpayer's 2005 and 2006 returns. The IRS issued a summons for records from tax years 2001-2006 relating to the LGT accounts, other foreign assets of the taxpayer, and taxpayer's foreign travel. A federal district court ordered enforcement of the summons in February 2015. The taxpayer appealed.

Law

In *Fisher, 425 U.S. 391 (1976)*, the Supreme Court found that the act of producing records could be self-incriminatory, because compliance with a subpoena concedes the existence of the documents, their possession or control by the taxpayer, and the taxpayer's belief that the documents were authentic and were those described in the subpoena. Production could also violate the 5th Amendment if the government did not have prior knowledge of the documents or their existence, because of the government's derivative use of the documents in a chain of potentially incriminatory evidence.

However, under the "foregone conclusion" doctrine, compliance with a subpoena was an act of "surrender," not testimony, if the documents' existence, control by the taxpayer, and authenticity were a foregone conclusion. The government must demonstrate its prior knowledge of the documents "with reasonable particularity."

Court's analysis

The Second Circuit found that the government failed to establish with reasonable particularity the existence, control and authenticity of the sought documents as of their creation in 2001. Furthermore, even if the government could satisfy the foregone conclusion doctrine as of 2001, it failed to demonstrate that the documents remained in the taxpayer's control through the years to 2013, the date of the summons.

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AICPA Unsuccessful In Challenging IRS Annual Filing Season Program

A federal district court has found that the American Institute of Certified Public Accountants (AICPA) lacked a proper cause of action under which to challenge the IRS's Annual Filing Season (AFS) Program. The court dismissed the case.

Background. In July 2014, the AICPA challenged the IRS over its institution of the AFS Program, citing that the IRS lacked authority to create a program that provided recorded credentials to unenrolled preparers who participated in the program. The AICPA brought its claim under the *Administrative Procedure Act* on behalf of its members. The AICPA contended that the AFS Program caused its members harm under a theory of competitive injury by way of brand dilution. The AICPA argued that by providing unlicensed tax return preparers with credentials, the IRS was diluting the value in the credentials of its CPA members.

District Court. The court found , after considering the AICPA members' interests, that the AICPA's grievance was not within the "zone of interests" protected by the *Administrative Procedure Act.* The court reasoned that Congress' goal in enacting limitations on practice before the IRS was to safeguard consumers, and not the interests of the preparers themselves. According to the court, the AICPA did not offer any reason to think that AICPA member interest in getting more revenue through the elimination of the brand diluting effect of the AFS program would serve Congress's concern for protecting consumer wellbeing.

American Institute of Certified Public Accountants v. IRS, DC-D.C.; TRC IRS 3,200.

Tax Court Interprets "Collected Proceeds" Expansively For Whistleblowers

Whistleblower 21276-13W, 147 TC No. 4

Criminal fines and civil forfeitures are "collected proceeds" for calculating whistleblower awards under Code Sec. 7623(b), the Tax Court has held. The court rejected the IRS's arguments to limit collected proceeds to amounts assessed and collected under Title 26.

- ***Take Away.*** "The court's decision is a straightforward reading of the statutory language and Congress' intention for whistleblowers to be rewarded," Shayne Stevenson, partner, Berman Sobol Shapiro LLP, Seattle, told Wolters Kluwer. "The court recognized that Congress did not exclude specific categories of recovery from the definition of 'collected proceeds'," Stevenson explained.

Background

The whistleblowers, a married couple, sought an award from the IRS under Code Sec. 7623(b). The IRS Whistleblower Office rejected their claim, determining that the additional tax, penalties, interest or other proceeds had been collected before the couple/petitioners filed their claim. The Tax Court found that Form 211 is not required to be filed with the Whistleblower Office before the whistleblower supplies information to other parts of the IRS or other government agencies to be eligible for an award under Code Sec. 7623(b).

The whistleblowers and the IRS subsequently agreed that the couple were eligible for an award; and the award would be 24 percent of the collected proceeds. However, the IRS and the whistleblowers could not agree on the amount of the collected proceeds.

- ***Comment.*** The IRS collected some $74 million from the taxpayer, comprising tax restitution of $20 million; criminal fines of $22 million; civil forfeitures of $15 million; and relinquishment of all claims to $16 million previously forfeited.

Court's analysis

The court first looked to the language of Code Sec. 7623(b). This provision, added to the Tax Code by Congress in 2006, generally provides that a whistleblower will receive an award at least 15 percent but not more than 30 percent of the collected proceeds, including penalties, interest, additions to tax, and additional amounts.

According to the IRS, only those proceeds assessed and collected under a provision of Title 26 may be used to pay a whistleblower award. The whistleblowers countered that the entire amount collected from the taxpayer constituted collected proceeds.

The court found that the term collected proceeds was not defined by statute. The term proceeds, the court found, is a word of great generality and encompasses what is produced by or derived from something (as a sale, investment, levy, or business) by way of total revenue: the total amount brought in.

Congress could have limited a whistleblower's award to taxes and other amounts assessed and collected by the IRS under Title 26. Congress did not, the court observed. Instead, lawmakers chose to use expansive language.

The court rejected the IRS's argument that criminal fines cannot be treated as collected proceeds. The term collected proceeds encompasses the total amount brought in by the government, including criminal fines. Similarly, the term collected proceeds encompasses civil forfeitures, the court held.

- ***Comment.*** The decision, Stevenson predicted, will encourage more whistleblowers to come forward.

References: Dec. 60,664; TRC IRS: 63,060.05.

Summons

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The court agreed with the government that it knew that an LGT account existed as of 2001 and that LGT issued documents such as bank statements. The government also knew that the taxpayer controlled the documents as of 2001, because he had a power of attorney regarding the accounts.

However, the government failed to demonstrate that it was a foregone conclusion that it could authenticate the documents without the taxpayer. It was speculative that either a bank employee or the original leaker of the documents would be available to testify as to their authenticity; these methods were not practicable.

- ***Comment.*** The court did agree with the lower court that the taxpayer's passport and related travel documents were authentic as of 2001.

The main problem, according to the court, was that even if producing the documents in 2001 did not violate the 5th Amendment, the act of producing the documents *today* (emphasis in the original) would be self-incriminatory. Production would indicate that the documents remained in the taxpayer's control and that the assets and accounts were still active, potentially triggering audits for later years.

The government had to establish current control of the documents in some other manner. The court would infer the taxpayer's continued possession of the documents if there were no indication that they were transferred or destroyed and if the interval were short between the original date of possession and the date of the IRS summons. Here, there were significant intervening events that could result in a lack of control, such as the dissolution of some of the entities, the death of taxpayer's father (the assets' original owner), or even the taxpayer's destruction of the records. Furthermore, the interval between original control and the date of the summons was extremely long (more than a decade), negating an inference of continued control, even for taxpayer's passport and related travel documents.

- ***Comment.*** The court indicated it would not foreclose the possibility that the government could develop a better record for each requirement in connection with a future summons.

References: 2016-2 USTC ¶50,367; TRC IRS: 21,052.

District Court Denies Attorney's Fees, Costs To Taxpayer Who Was Prevailing Party

Appelbaum, DC-N.C., July 27, 2016

A federal district court has rejected a taxpayer's motion for attorney's fees and costs even though the taxpayer was the prevailing party in a trust fund recovery penalty case. The court concluded that the government was substantially justified in the positions it took during the case.

- ***Take Away.*** There were two significant issues: whether the taxpayer received proper notice of the liability asserted by the IRS, and whether the taxpayer was a responsible party who was liable for unpaid employment taxes. Even though the taxpayer was successful on the significant issues in the litigation, the court found that the government's positions could be justified by the factual evidence and by the law. The court found that a reasonable person could have agreed with the positions taken by the government

Background

In the prior proceeding, the IRS sought a trust fund recovery penalty from the taxpayer under Code Sec. 6672. Less than 10 days before trial, the taxpayer made a claim that he had not received proper notice of the IRS's claim. The court found that the IRS had not mailed the required notice, Letter 1153. Therefore, the government violated the notice requirements of Code Sec. 6672(b)(1) and was not entitled to recover any amounts from the taxpayer.

- ***Comment.*** The IRS uses Letter 1153 to explain that its efforts to collect employment or excise taxes due from the business named on the letter have not resulted in full payment of the liability and that the IRS proposes to assess a penalty against the individual named on the letter.

The court also found that the government had the burden of proving, by the preponderance of evidence, that it satisfied the notice requirements, and it failed to do so. Finally, the court found that the statute of limitations had expired and that the government could not take action after losing the case.

Court's analysis

The taxpayer satisfied two of the requirements under Code Sec. 7430 to recover costs. The taxpayer substantially prevailed in the case, since the IRS sought $3.8 million and recovered nothing. The taxpayer satisfied the net worth requirement, since his net worth did not exceed $2 million. But he was not entitled to costs because the government's position was substantially justified. The IRS provided statements that it generated and sent Letter 1153. The taxpayer's claim of nonreceipt was subject to dispute. The IRS also had 13 pieces of circumstantial evidence that suggested the taxpayer was a responsible party.

References: 2016-2 USTC ¶50,365; TRC LITIG: 3,154.

TAX BRIEFS

Internal Revenue Service

The Commissioner's authority to approve and determine whistleblower awards under Code Sec. 7623 has been delegated.

CDO No. 25-7 (Rev. 3), FED ¶46,379; TRC IRS: 63,060.05

International

The current list of countries that may require participation in, or cooperation with, an international boycott is as follows: Iraq, Kuwait, Lebanon, Libya, Qatar, Saudi Arabia, Syria, United Arab Emirates and Yemen.

Boycott Notice, 2016FED ¶46,380; TRC INTL: 21,050

Deductions

The district court properly held that real estate professionals can only deduct losses from rental real estate activities from their income if they materially participate in those rental activities. Married individuals sought to deduct losses from rental properties they owned, arguing that the wife's status as a real estate professional rendered the real estate losses nonpassive *per se,* and so deductible under Code Sec. 469, regardless of material participation by the taxpayer. The appellate court examined the applicable statutory and regulatory language, as well as the holding by the Tax Court in *Perez,*, TC, Dec. 58,358(M), and concluded that real estate professionals were not exempted by Congress from the requirement that a taxpayer show material participation in order to deduct losses from a real estate investment.

Gragg, CA-9, 2016-2 USTC ¶50,370; TRC BUSEXP: 33,106.40

A married couple's expenses related to the rental of their personal residence were limited by Code Sec. 280A for the tax year at issue. In addition, the taxpayers were not entitled to other deductions in excess of amounts determined because they failed to provide proper substantiation. The taxpayers were also liable for failure to file and negligence penalties.

Szanto, TC, CCH Dec. 60,663(M), FED ¶48,079(M); TRC BUSEXP: 27,050

An electrical contracting company officer, who was not liable for the Trust Fund Recovery Penalty, was not entitled to litigation costs or attorney's fees. Although the individual was a prevailing party and met the net worth requirement, the government was substantial-

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ly justified in proceeding on its claim against the individual.

Appelbaum, DC N.C., 2016-2 USTC ¶50,365; TRC LITIG: 3,154

Self-Employment Taxes

A U.S. citizen, who performed services in the U.S. as an employee of an international quasi-governmental agency, was liable for self-employment taxes for the year his bankruptcy case was open. Contrary to the taxpayer's argument, the bankruptcy estate was not liable for the individual's tax liability because the payments he received from the international organization were not wages for employment tax purposes, but earnings from self-employment. Since the self-employment tax is not a tax on taxable income, it is not the tax imposed on the bankruptcy estate by Code Sec. 1398(c)(1) and there is no other provision that imposes self-employment tax on the estate. Therefore, the estate was not liable for the individual's self-employment taxes.

Sisson, TC, CCH Dec. 60,661(M), FED ¶48,077(M); TRC INDIV: 63,100

Tax Law Violations

A married couple was held in civil contempt for violating a permanent injunction that, among other things, precluded them from committing further violations of the tax laws. Despite the appointment of a receiver, the couple failed to timely file tax returns timely pay their taxes or timely make payroll tax deposits and the couple failed to justify their noncompliance with the court's orders.

Baker Funeral Home, Ltd., DC Pa., 2016-2 USTC ¶50,369; TRC LITIG: 9,256

An attorney's conviction and sentence for tax evasion were affirmed. The court rejected the individual's argument that his partnership draws were not "salary or wages" subject to the levy. Moreover, the trial court properly refused to dismiss the levy counts based on the statute of limitations. The extended period of limitations applied.

Wanland, Jr., CA-9, 2016-2 USTC ¶50,363; Wanland, Jr., CA-9, 2016-2 USTC ¶50,364; TRC IRS: 66,052

Collection Due Process

An IRS Appeals officer did not abuse his discretion by rejecting an individual's offer in compromise. The individual's argument that the Tax Court lacked jurisdiction over the supplemental notice of determination was rejected. The court retained jurisdiction over the case because there are no additional requirements to be met before the Tax Court can exercise jurisdiction over supplemental notices. Moreover, the individual did not point to any evidence to support his contention that the Appeals officer miscalculated his collection potential or that his reasonable collection potential equaled the amount of his offer.

Hauptman, CA-8, 2016-2 USTC ¶50,368; TRC IRS: 42,120

Tax Assessments

A widow, who was the executor of her deceased husband's estate, was personally liable for the decedent's tax liability under the federal priority statute. The widow distributed virtually all of the estate's assets to herself, the estate was insolvent at the time of the transfers because the unpaid tax liabilities far exceeded the value of the estate's assets and the widow was aware of the unpaid taxes when she affected the transfers.

McNicol, CA-1, 2016-2 USTC ¶50,366; TRC IRS: 60,202

Deficiencies and Penalties

The IRS properly used the bank-deposits method to reconstruct a disbarred attorney's unreported income and the fraud penalty was imposed. The individual did not dispute that he received the deposits identified in the IRS's bank deposits analysis. Further, as part of his guilty plea for filing a false tax return, the individual admitted that he failed to report Schedule C gross receipts totaling approximately $800,000. The individual's intentional filing of a false return, reporting an amount of income he knew to be false, was a strong indicator of fraudulent intent.

Schwartz, TC, CCH Dec. 60,662(M), FED ¶48,078(M); TRC PENALTY: 6,104

As Phone Scams Surge, IRS Warns Taxpayers To Be Cautious

The IRS has warned taxpayers of automated phone scam telephone calls and new tactics from scammers demanding tax payments on gift cards. The summer months have seen a surge in the frequency of these calls.

- ***Comment.*** "Scammers are evolving and using more and more automated calls in an effort to reach the largest number of victims possible," IRS Commissioner John Koskinen said in a statement. "Taxpayers should remain alert for this summer surge of phone scams."

Scam logistics. The IRS explained that the fake, automated calls claim to be a taxpayer's final warning before legal action is taken, often with threats to arrest, deport, or revoke the driver's license of the victim for failure to pay. Once a victim calls back, impersonators demand payments on iTunes and other gift cards to settle tax bills.

Reminder. The IRS reminded taxpayers that it will never demand immediate payment over the phone, nor call about a tax obligation without having first mailed a bill. Taxpayers who receive these fraudulent calls should contact the Treasury Inspector General for Tax Administration (TIGTA) and/or the Federal Trade Commission.

- ***Comment.*** Phone scams have been increasing in number and type, the IRS reported. Along with these payment by gift card scams, criminals are also demanding payment for a nonexistent "federal student tax," soliciting W-2 information from payroll professionals, pretending to be from the tax preparation industry, and purporting to "verify" return information over the phone. All of these are scams, the IRS warned.

IR-2016-99, TRC IRS: 12,350.

PRACTITIONERS' CORNER

Wolters Kluwer Interview: New Partnership Audit Rules

The *Bipartisan Budget Act of 2015* (BBA), enacted November 2, 2015, significantly changes the treatment of partnership audits by the IRS. The BBA provisions—generally effective for tax years after December 31, 2017, but with an immediate opt-in election available—replace the audit procedures in Code Secs. 6221 through 6241 previously established by the *Tax Equity and Fiscal Responsibility Act of 1982* (TEFRA). The new rules require adjustment of all items of income, gain, loss, deduction, or credit at the partnership level, making the partnership liable for any resulting underpayment of tax.

Wolters Kluwer Tax & Accounting sat down recently with Travis Greaves, Attorney, Caplin & Drysdale, Washington, D.C., to discuss the potential impact of the new audit rules on partnerships and tax practitioners.

Wolters Kluwer: What do you consider to be the most pressing issues that should be of immediate concern to partnerships and their partners?

Travis Greaves: There are a number of issues that partnerships should immediately consider. Current partners need to decide whether to amend their current partnership agreement given the new rules. Even though the new rules will not apply until 2018, it will no doubt take time for the partnership to get all partners on board with a new agreement. A number of issues flow from drafting the new agreement, including the partnership's ability to take on new partners and new investments, and who will be the partnership representative and what powers they should have. It's important that partnerships work with attorneys to ensure that the agreements are drafted properly and address all the new issues.

Wolters Kluwer: Given that mandatory implementation of the new audit rules is first effective for audits of 2018 tax year returns, likely not taking place much before 2020, is it too early to start planning now for these new audit rules?

Greaves: No, it's not too early to start planning for the new rules. Current partnerships need to consider amending agreements and consulting with current partners.

"The Bipartisan Budget Act of 2015 (BBA), enacted November 2, 2015, significantly changes the treatment of partnership audits by the IRS. The BBA provisions— generally effective for tax years after December 31, 2017, but with an immediate opt-in election available—replace the audit procedures in Code Secs. 6221 through 6241 previously established by the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA).

This will take time. Partnerships shouldn't wait for the commencement of an audit to address these issues.

Wolters Kluwer: Who should opt-in to application of the new audit rules for the 2015 tax year and later returns?

Greaves: Good question; those partnerships looking to negotiate with the IRS under the new regime may prefer to opt-in. The IRS is still developing guidance on the new rules, and some partnerships may find that a lack of guidance may benefit them (i.e. the guidance under TEFRA isn't helpful to the partnership). In this instance, the partnership may choose to opt-in when audited and negotiate with the IRS for a better deal given the agent doesn't have guidance to rely upon. The Temporary Regulations (TD 9780) effective August 5, however, clarify that a partnership may not elect into the new audit regime and then elect out of the new rules under the small partnership exception of Code Sec. 6221(b).[*These new regulations are discussed in this week's newsletter.*]

Wolters Kluwer: Audit adjustments will now be assessed in the year the audit concludes rather than in the year under audit. Is there concern that newly admitted partners could be subject to consequences of a prior-year audit?

Greaves: Yes, that's a big concern. That's the reason why partnerships should revise their agreements before the new rules go into effect.

Wolters Kluwer: What steps might partners want to take to indemnify themselves against adjustments arising in periods before their ownership?

Greaves: A new partner may demand a tax indemnity from the selling partner and/or from the partnership for tax adjustments made to a period before the new partner acquired his or her partnership interest. Alternatively, a new partner may require the selling partner to put money in an escrow account, which would remain open until the tax year was past the statute of limitations.

Wolters Kluwer: How should partnership agreements be drafted or amended to in-

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WASHINGTON REPORT *by the Wolters Kluwer Washington News Bureau*

Schumer urges passage of Olympic medals bill

Sen. Charles Schumer, D-N.Y., recently called on the House to take up the United States Appreciation for Olympians and Paralympians Bill (Sen 2650). The Senate approved the bill, co-sponsored by Sen. John Thune, R-S.D., by unanimous consent on July 12. If enacted, U.S. Olympians and Paralympians would be permitted to exempt the value of their medals and monetary prizes from their taxable income. The bill would have a negligible effect on federal revenue and would not affect taxes on any potential endorsement or sponsorship income earned by Olympic athletes, according to Schumer.

TIGTA reviews IRS's implementation of Charge Card Act

The IRS properly identified and reported some instances of confirmed purchase card misuse and four instances of purchase card misuse pending final agency action, according to the Treasury Inspector General for Tax Administration (TIGTA). TIGTA reviewed the agency's implementation of, and compliance with, the *Government Charge Card Abuse Prevention Act of 2012* (Charge Card Act) for the period October 1, 2015, through March 31, 2016.

The purchase card misuse cases reported by the IRS collectively totaled almost $4,000, TIGTA found. TIGTA also reviewed the IRS's current charge card guidance and determined that policies and controls had been established and designed to mitigate the risk of fraud and inappropriate travel and purchase card practices, including controls that address centrally billed travel card accounts. In addition, TIGTA reviewed the final version of the Fiscal Year (FY) 2016 Department of the Treasury Charge Card Management Plan and determined that it had been updated to comply with the requirements in the Charge Card Act.

Treasury official discusses proposed earnings-stripping regs

The earnings-stripping regs under Code Sec. 385 are a priority, a Treasury official said on August 2, but the government is not wedded to issuing final regulations by a particular date. Doug Poms, Treasury deputy international tax counsel, said that the government will issue the final regs when it is ready. In the meantime, the government is carefully considering all the comments received on the proposed regulations and the final regulations will reflect the government's thinking on the issues commentators have raised, Poms reported. Poms spoke at a webinar sponsored by BDO USA, LLP.

Treasury and the IRS issued the proposed regs in April under the debt-equity provisions of Code Sec. 385. The government issued the regs primarily to attack earnings-stripping transactions between related corporations. Poms said that the government's concerns go well beyond inversions and encompass a broad range of transactions. Corporations are generating huge deductions by simply transferring debt to a related company without any new investment. The government needed to put out rules and looked at Code Sec. 385 to do this, he explained.

NTA schedules public forum in Ohio

National Taxpayer Advocate (NTA) Nina Olson will hold a public forum to discuss IRS taxpayer service on August 16 in Parma, Ohio. The forum will feature an invited panel of local business representatives and tax professionals. This is the latest in a series of public meetings the NTA is hosting about the IRS's Future State plan.

In her recent report to Congress, Olson recommended that the IRS seek comments from taxpayers and tax professionals, including their thoughts on the extent to which taxpayers will continue to need telephone and in-person assistance, so the Future State plan will better reflect taxpayers' needs and preferences as they work to comply with the Tax Code. The public events are a part of that recommendation: a series of events around the country to seek comments and suggestions regarding what taxpayers want and need from the IRS to help them comply with their tax obligations.

Associate chief counsel for transfer pricing selected

IRS Chief Counsel on August 5 announced the selection of Kenneth Wood as deputy associate chief counsel (Transfer Pricing and International Programs) in Washington, D.C., effective August 22. In an internal message to employees, Chief Counsel William Wilkins noted that Wood has 35 years of an "extraordinary mix of inside government and outside government experience."

GAO reviews Treasury's approach state innovation waivers under ACA

The Government Accountability Office (GAO) recently reviewed how Treasury and the U.S. Department of Health and Human Services (HHS) will handle waivers to allow for state innovation in providing health insurance under the *Affordable Care Act* (ACA). The ACA provides that states may seek federal approval to waive certain requirements, including requirements related to health insurance exchanges. Treasury and HHS share responsibility for reviewing and approving waivers. To receive approval, states are required to meet statutory criteria that the waiver provides coverage to at least a comparable number of state residents as would have received coverage without the waiver, that the coverage is at least as comprehensive and affordable as it would be in the absence of the waiver, and that the waiver will not increase the federal deficit. GAO found that Treasury and HHS are in the process of developing procedures for coordinating their approach to waivers. Treasury told GAO that the Departments are taking a flexible approach to setting procedures in recognition they may need to evolve.

Practitioners' Corner

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clude considerations now relevant under the new audit regime? Should drafting be delayed until the IRS releases guidance to clarify some of the provisions?

Greaves: Assuming the partnership isn't electing into the new regime, it may be worth waiting until the IRS releases its guidance to finalize the agreement. However, partnerships should start now with wrestling with issues such as who will be the partnership representative because it will take time to get everyone on board. In terms of how they should be drafted, primary considerations are (1) who can be a partner and how many partners to admit (this affects the partnership's ability to opt-out); (2) the partnership representative selection process, and whether the partnership representative will be compensated, indemnified, etc.; (3) each partner's rights in an audit proceeding; (4) the process for requesting information from individual partners during an audit; (5) the treatment of former partners; and (6) what happens if the partnership dissolves.

Wolters Kluwer: Certain partnerships will be permitted to elect-out of the new rules by filing such election annually with the partnership's tax returns. What are the "pros and cons" of this election and procedure?

Greaves: The "pros" of this election procedure are (1) avoids additional interest charge that applies on "push-out" K-1; (2) makes it difficult for IRS to audit all partners; and (3) takes burden off of partnership representative. The "cons" of this election procedure are (1) inconsistent results for different partners; (2) increased costs because each partner may need to hire representation for their own audit; and (3) difficult to maintain election because people want to own interest through a partnership, which requires using the new partnership audit rules. Partnerships should work on gathering consensus up front.

Wolters Kluwer: What are the potential benefits and drawbacks for a partnership that elects to pay the imputed underpayment?

Greaves: A major drawback is that current year partners have to pay at the highest marginal tax rate for the reviewed year. A benefit is that the partnership has 270 days from the date the IRS issued the FPA to rebut the imputed underpayment, whereas if the partnership relies on the adjusted Schedules K-1 process, the partnership has only 45 days from the date the IRS issued the FPA to issue the adjusted Schedules K-1. Moreover, the adjusted Schedule K-1 process requires partners to pay a 2% higher interest rate than that paid under the imputed underpayment method.

Wolters Kluwer: The new rules are supposed to streamline audits and create new efficiencies for the IRS. What about new burdens on the taxpayer side –partnerships and their tax advisors?

Greaves: The new rules shift a number of burdens from the IRS to the partnership and partnership representative. First, the new rules remove the IRS's obligations to provide notice to partners other than the partnership representative; thus, that burden may shift to the partnership and the partnership representative. Second, while the new rules help the IRS avoid entering into settlement agreements with multiple parties, they push that burden to the partnership and/or partnership representative to ensure any settlement is legally approved under the terms of the partnership agreement. Finally, the IRS TEFRA unit used to process settlement adjustments for each of the partners, but under the new rules the burden is on the partnership and/or partnership representative to ensure partners file amended returns to reduce the imputed underpayment amount.

Wolters Kluwer: What is the most notable consequence and benefit of the new partnership audit rules?

Greaves: The overall administrative burden on the IRS should be reduced (assuming most partnerships do not elect out) and the quantity of partnership audits should increase while the quality of such audits is also improved. Hopefully the new rules will also decrease the time it takes for a partnership case to move from exam to IRS Appeals.

Wolters Kluwer: What additional guidance from the IRS may be helpful for partnerships complying with the new audit rules?

Greaves: The IRS needs to issue additional guidance and modify existing forms to implement the new partnership audit rules. Some additional guidance would be helpful on the following topics: Impact of certain types of partners on eligibility of partnership to opt out of the new audit rules. For example, (1) does the presence of a single person grantor trust prevent a partnership from opting out of the new rules; (2) does the IRS look at the nominal owner of the partnership interest or the beneficial owner of the partnership interest; and (3) do spouses who own interests in the same partnership count as two partners for the 100 partner limit?

Role of Partnership Representative. For example, (1) what happens if a partnership representative resigns during an audit, or (2) what is the procedure for a partnership to give notice to the IRS of a change of partnership representative?

Wolters Kluwer: What initial developments can tax practitioners expect to see moving forward as the IRS rules and filing requirements become effective in 2017?

Greaves: Additional IRS guidance and the publication of draft forms related to the opt-out election, the revised K-1 procedures and the Administrative Adjustment Request rules.

Wolters Kluwer: How can tax practitioners best prepare clients for the implementation of the new partnership audit rules?

Greaves: Tax practitioners should advise clients that these rules have a significant impact on how partnership agreements should be drafted. Existing partnerships should prepare to amend their agreements now because it may take time to obtain the agreement of all the partners. Partnerships may want to engage counsel to begin drafting new provisions and to send informational notices to partners of forthcoming changes to the partnership agreement.

COMPLIANCE CALENDAR

August 15
Employers for whom the monthly deposit rule applies, deposit employment taxes and nonpayroll withholding payments for July.

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

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

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

TRC TEXT REFERENCE TABLE

The cross references at the end of the articles in Wolters Kluwer Federal Tax Weekly (FTW) are text references to 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 "Wolters Kluwer Tax Research Consultant" Helpline (1-800-344-3734).

Q The U.S. has negotiated intergovernmental agreements with foreign jurisdictions under the *Foreign Account Tax Compliance Act* (FATCA). Is it correct that these agreements will expire after 2016?

A On January 1, 2017, certain jurisdictions that have not brought their Intergovernmental Agreement (IGAs) into force will no longer be treated as if they have an IGA in effect for purposes of FATCA, Treasury and the IRS have announced. Each jurisdiction with an IGA that is not yet in force and that wished to continue to be treated as having an IGA in effect must provide, by December 31, 2016, a detailed explanation of why the jurisdiction has not yet brought the IGA into force and a step-by-step plan that the jurisdiction will follow in order to sign the IGA and bring it into force, including expected dates for achieving each step. *See TRC INTL: 36,050.*

Q Before recessing, the House passed bipartisan Small Business Health Care Relief Bill (HR 5447) to allow small businesses to continue using pre-tax dollars to give employees a defined contribution for health care expenses and allow employees to use Health Reimbursement Arrangement (HRA) funds to purchase health coverage on the individual market. What is the status of this bill?

A The Senate recessed for an extended summer break before taking any action on the bill. The bill has bipartisan support in the Senate and is expected to be taken up before year-end, subject to the calendar set out by the Senate majority leader.