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IRS Issues Extensive Regs On Code Sec. 367 Transfers From U.S. To Foreign Corporations

◆ *TD 9614, TD 9615, NPRM REG-132702-10*

The IRS has issued final, temporary and proposed regs on transfers of assets by a U.S. corporation to a foreign corporation in certain nonrecognition transactions. One set of regs (TD 9614) applies to preserve corporate level gain under Code Sec. 367(a)(5) and is generally effective for transfers occurring on or after April 17, 2013. The other set of regs (TD 9615) makes changes to the coordination rule between asset transfers and indirect stock transfers in Reg. §1.367(a)-3(d), and applies to transactions occurring on or after March 18, 2013.

■ ***CCH Take Away.*** "The 367(a)(5) package is a complex set of regulations," Joseph Calianno, International Technical Tax Practice Leader, Grant Thornton LLP, Washington, D.C., told CCH. "Treasury and the IRS spent a lot of time looking at comments. The final regs largely reflect the proposed regs, with some changes," Calianno said.

Background

The IRS issued proposed regs in August 2008 on transfers of property by a U.S. corporation to a foreign corporation in an exchange described in Code Sec. 361(a) or (b), and on certain nonrecognition distributions of stock of a foreign corporation by a U.S. corporation. In TD 9614, the IRS adopted a portion of the 2008 proposed regs, with modifications, as final regs. In TD 9615, the IRS adopted another portion of the proposed regs as temporary regs.

In February 2009, the IRS issued final regs (TD 9446) under Code Sec. 367 on gain recognition agreements (GRAs). These final regs also addressed transfers of stock or securities by a U.S. corporation to a foreign corporation in a Code Sec. 361 exchange. In TD 9615, the IRS withdrew and revised the regs on Code Sec. 361 exchanges and reissued them as temporary regs.

TD 9614—inside gain

In the 2008 proposed regs, an exception to Code Sec. 367(a)(5) would ensure that any net gain realized by a U.S. transferor on a transfer of property (defined as inside gain) must be recognized as current by the U.S. transferor or must be preserved in the stock received by certain U.S. corporate shareholders of the U.S. transferor. To compute inside gain, the 2008 regs take into account certain liabilities of the U.S. transferor that would give rise to a deduction when paid.

Under the final regs, a deductible liability is limited to a liability assumed in a Code Sec. 361 exchange. The IRS rejected comments proposing that other attributes of the U.S. transferor should also be taken into account in computing inside gain (particularly net operating losses and foreign tax credits), because it would add complexity to the regs and to IRS audits of these transactions.

Special corporate entities

The IRS refused to exempt regulated investment companies (RICs), real estate investment trusts (REITs), and S corps

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IRS Finalizes Form 941 For 2013; Highlights New Additional Medicare Tax/Sunset Of Payroll Tax Holiday

◆ *2013 Form 941, Instructions*

The IRS recently announced the availability of final Form 941, Employer's Quarterly Federal Tax Return for 2013, and its Instructions. Revised Form 941 and its Instructions reflect the January 1, 2013 effective date of the 0.9 percent Additional Medicare Tax, expiration of the payroll tax holiday and other changes.

■ ***CCH Take Away.*** "Even though the IRS has made it easier for employers, an individual can be over or under-withheld based on his or her circumstances," Adam Lambert, CPA, Managing Director, Employment Tax Services, Grant Thornton, LLP, New York, told CCH. For example, a married person could have under-withheld if he or she files separately.

Background

The Additional Medicare Tax is imposed to the extent covered wages, compensation and/or self-employment income exceed threshold amounts ($200,000 for single individuals, $250,000 for married couples filing joint returns and $125,000 for married couples filing separately). Employers, however, must withhold Additional Medicare Tax from wages paid to an individual in excess of $200,000 in a calendar year, without regard to the individual employee's filing status or other wages/compensation.

Additional Medicare Tax

The IRS reminded employers that the Additional Medicare Tax, enacted by the *Patient Protection and Affordable Care Act* (PPACA) applies effective January 1, 2013. Employers must withhold a 0.9 percent Additional Medicare Tax from covered wages paid to an employee in excess of $200,000 in calendar year 2013.

■ ***Comment.*** The standard Medicare tax equals 1.45 percent of covered wages. The 1.45 percent employee-share of Medicare tax is matched by the employer. "There is no employer match for the Additional Medicare Tax," Lambert explained.

Employers, the IRS explained, are required to begin withholding Additional Medicare Tax in the pay period in which they pay wages in excess of $200,000 to an employee and continue to withhold it each pay period until the end of the calendar year. All wages that are subject to Medicare tax are subject to Additional Medicare Tax withholding if paid in excess of the $200,000 withholding threshold.

■ ***Comment.*** The IRS has added line 5d, Taxable wages & tips subject to Additional Medicare Tax withholding, to Form 941.

Employees cannot request additional withholding specifically for Additional Medicare Tax. Taxpayers anticipating they will owe Additional Medicare Tax, and who did not request additional income tax withholding, may need to make estimated tax payments.

Payroll tax holiday ends

The IRS also reminded taxpayers that the OASDI tax rate is 6.2 percent for both employers and employees for calendar year 2013. The payroll tax holiday, effective for calendar years 2011 and 2012, was not renewed by the *American Taxpayer Relief Act of 2012 (ATRA)* or other legislation and has expired. The Social Security wage base for calendar year 2013 is $113,700, up from $110,100 for calendar year 2012.

■ ***Comment.*** The payroll tax holiday reduced the employee-share of OASDI taxes from 6.2 percent to 4.2 percent (with a comparable benefit for self-employed individuals).

Reference: TRC PAYROLL: 66,600.

Code Sec. 367

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from Code Sec. 367(a)(5). The IRS stated that it remained concerned about this issue and about allowing special corporate entities to be members of the controlled group.

■ ***Comment.*** "It is unfortunate that the IRS and Treasury did not provide some type of exception or relief from the application from section 367(a)(5) when S corporations, RICs and REITs are transferring their assets to a foreign corporation in a section 361 transfer, given that these types of entities generally are not subject to corporate level tax," Calianno said. "From a policy perspective, it is not entirely clear why these types of entities should be subject to section 367(a)(5)."

TD 9615

The coordination rule provides that Code Sec. 367 applies first to the direct asset transfer and then to the indirect stock transfer, if both are part of a transfer from a U.S. person to a foreign corporation. There are three exceptions to this rule. The IRS indicated it had clarified and modified these exceptions to address policy concerns, such as transactions that may obtain tax-free repatriation of earnings.

The IRS said these concerns do not arise in transactions with unrelated parties, but do arise in transactions with affiliates that appear to be motivated by U.S. tax benefits. The temporary regs eliminated the Code Sec. 367(a)(5) exception.

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Reference Key

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

Tax Court Reverses Course: Gross Valuation Misstatement Penalty Cannot Be Avoided By Conceding On Grounds Unrelated To Valuation Or Basis

◆ *AHG Investments, LLC, 140 TC No. 7*

Departing from precedent, the Tax Court has held that an understatement of tax may be attributable to a valuation misstatement even when the IRS's determination of an underpayment of tax may also be sustained on a ground unrelated to basis or valuation. A taxpayer may not avoid application of the Code Sec. 6662(h) gross valuation misstatement penalty merely by conceding on grounds unrelated to valuation or basis, the court ruled.

■ ***CCH Take Away.*** "The Tax Court decision effectively concludes that the virtues of settlement, including by conceding the substantive issues to avoid the 40 percent penalty, are outweighed by the need for an expansive construction of the penalty's application," Mark Allison, member, Caplin & Drysdale, Chartered, New York, told CCH. "This is tantamount to treating the section 6662(h) as a strict liability penalty in line with the economic substance penalty under Code Sec. 6662(i). "

■ ***Comment.*** "Although the posture of certain cases may make it difficult, the Tax Court should try to develop a mechanism for taxpayers to undo their concessions," Matthew Lerner, partner, Steptoe and Johnson, LLP, Washington, D.C. told CCH. Many taxpayers relied on existing Tax Court precedent to assume their concessions would keep them out of a 40 percent penalty, he observed.

Background

The IRS issued a notice of final partnership administrative adjustment (FPAA) to a partner (other than the tax matters partner) in the taxpayer. The FPAA described 14 alternative grounds in support of the adjustments. The IRS also asserted 40 percent accuracy-related penalties for the portions of the underpayments of tax resulting from adjustments of partnership items attributable to a gross valuation misstatement.

The taxpayer sought partial summary judgment regarding the 40 percent gross valuation misstatement penalty. According to the taxpayer, the penalty did not apply as a matter of law because petitioner conceded the correctness of adjustments proposed in the FPAA on grounds unrelated to valuation or basis.

Court's analysis

The court looked to *McCrary, CCH Dec. 45,615*, *Todd I, CCH Dec. 44,294*, and the Court of Appeals for the Fifth Circuit's affirmation of *Todd I* in *Todd II, 852 F.2d 540 (1988)*. The Fifth Circuit in *Todd II* explained that the legislative history did not provide a method for calculating whether a given tax underpayment is attributable to a valuation overstatement. The Fifth Circuit applied the formula used by the Tax Court in *Todd I* from the *General Explanation of the Economic Recovery Tax Act of 1981* ("Blue Book") prepared by the Joint Committee on Taxation.

A majority of circuit courts of appeal, the Tax Court found, have adopted an alternative view. The Tax Court explained

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Code Sec. 367

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■ ***Comment.*** The IRS made the change because it perceived that taxpayers were using the transaction to repatriate earnings, Calianno said.

The 2008 proposed regs provide reasonable cause relief provisions under Code Sec. 367 and other provisions for taxpayers that fail to comply with certain requirements. The temporary regs eliminated a provision that treated a taxpayer as satisfying the reasonable cause standard if the IRS fails to respond within 120 days to a request for relief.

References: FED ¶¶47,014, 47,015, 49,567; TRC INTL: 30,056.

IRS Reminds Taxpayers To Claim 2009 Refunds; Appeal Of Loving Authorized

The IRS has announced that it has refunds totaling over $917 million for an estimated 984,400 taxpayers who did not file a federal income tax return for 2009. Individuals who may be due a refund must file a 2009 return no later than April 15, 2013.

■ ***Comment.*** The IRS also filed its reply to the reply filed by the plaintiffs in *Loving 2013-1* USTC *¶50,156.* The IRS again argued before the Court of Appeals for the District of Columbia Circuit that taxpayers will be irreparably harmed if the injunction against the return preparer oversight initiative is not stayed pending appeal. The IRS also told the court that the Solicitor General has authorized an appeal of the case to the D.C. Circuit.

Refunds. Code Sec. 6511 (a) provides that a claim for a tax refund must be filed within three years from the time the return was filed or two years from the time the tax was paid, whichever is later. For 2009 returns, the window for refunds closes on April 15, 2013.

■ ***Comment.*** Refunds will be applied to any amounts owed to the IRS or a state tax agency, and may be used to offset unpaid child support or federal debts, such as student loans.

IR-2013-29, TRC IRS: 36,052.05.

IRS Chief Counsel Allows Banks To Deduct—Rather Than Capitalize—Costs Associated With Sale Of Foreclosure Property

◆ *AM 2013-001*

The IRS Office of Associate Chief Counsel (Income Tax & Accounting) has determined that real estate acquired by banks through loan foreclosures is not property acquired for resale under Code Sec. 263A. As a result, the bank may deduct acquisition costs and certain indirect costs allocable to the property, and does not have to capitalize these costs.

■ ***CCH Take Away.*** "This is a huge win for the industry," Francisca Mordi, vice president and tax counsel, American Bankers Association, Washington, D.C., told CCH. "We've been working on this issue for a year. The only problem is that the IRS forced banks under audit to capitalize their expenses." The ABA has asked the IRS to provide an automatic change of accounting method, so that banks can deduct these costs, Mordi said, but it is not clear whether the IRS will act before 2012 returns are due.

■ ***Comment.*** AM 2013-001, which was issued February 22, 2013, contradicts IRS field attorney advice (FAA) 20123201F, issued June 18, 2012. Although AM 2013-001 did not discuss the FAA, Mordi said she was told that the FAA was "an old memo" and that it does not represent Chief Counsel's current position.

Background

In the ordinary course of its lending business, a bank lends money to purchasers of real estate. Each loan is secured by the property purchased. The bank sells many of the loans but retains a substantial portfolio of mortgage loans. When the borrower defaults on the loan, the bank will foreclose on the property, to mitigate any loss on the loan. This property is referred to as "other real estate owned" (OREO).

The bank attempts to sell the property immediately, generally "as-is," without improvement. Bank regulators generally require the bank to give the borrower any sale proceeds that exceed the loan balance. The bank is not allowed to acquire property to resell for profit. The bank treats OREO as property primarily held for sale to customers in the ordinary course of its trade or business under Code Sec. 1221(a)(1); IRS Chief Counsel assumed this was the proper treatment.

Law

Code Sec. 263A requires a reseller to capitalize acquisition costs and certain indirect costs that are allocable to "property acquired for resale." This is real or personal property described in Code Sec. 1221(a)(1) that is acquired for resale. Code Sec. 1221(a)(1) property is property primarily held by a taxpayer for sale to customers in the ordinary course of a trade or business.

■ ***CCH Take Away.*** Thus, Chief Counsel stated, property acquired for resale under Code Sec. 263A must be both held primarily for sale to customers and acquired for resale.

Regs under Code Sec. 263A provide a "special rule" for banks that originate (and generally sell) loans—loan origination is not considered the acquisition of property for resale.

Conclusion

IRS Chief Counsel concluded that the bank was acting in its capacity as a lender, not as a traditional reseller of property. The bank's acquisition and sale of property securing its loans did not convert the bank into a reseller; these activities were an extension of the bank's loan origination activity.

The bank acquired the property only to recover funds it loaned to the borrower, Chief Counsel explained. It did not acquire the property to resell it at a profit, and it must return any excess proceeds to the borrower. Acquiring the property in an effort to mitigate loss on the loan is an extension of the bank's primary activity of originating loans. Thus, the property is not property acquired for resale under Code Sec. 263A.

■ ***Comment.*** Since the property is not acquired for resale, the bank's acquisition and indirect costs allocable to the property can be deducted and do not have to be capitalized under Code Sec. 263A.

Reference: TRC BUSEXP: 9,052.25.

Tax Court Reverses

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that these courts have held that an underpayment of tax may be attributable to a valuation misstatement even where the IRS's determination of an underpayment of tax may also be sustained on a ground unrelated to basis or valuation. Moreover, courts that follow the minority rule (the Fifth and Ninth Circuits) have suggested that the majority rule is erroneous, the court observed.

The Tax Court concluded that the IRS had met its burden of persuading the court to overrule the precedent established by *McCrary* and *Todd I*. "We depart from our precedent following the minority rule and side with the majority rule."

■ ***Comment.*** In CC-2012-001, Chief Counsel instructed its attorneys to oppose taxpayer concessions designed to avoid valuation misstatement penalties.

Judicial economy

The court noted that its ruling may improve judicial economy by discouraging taxpayers from engaging in tax-avoidance practices and using *McCrary* and *Todd I* to avoid penalties. However, its ruling could lead to more trials on questions of valuation.

■ ***Comment.*** "Stare decisis in the Tax Court appears to stand on weaker legs," Lerner told CCH.

References: CCH Dec. 59,485; TRC PENALTY: 3,110.25.

IRS Chief Counsel Denies Shorter Recovery Period For HVAC Units

◆ *CCA 201310028*

IRS Chief Counsel has determined that heating, ventilation, and air conditioning (HVAC) units installed outside a building are not qualified leasehold improvement property (QLIP). As a result, the taxpayer could not depreciate the units over 15 years; instead, they must be depreciated over 39 years.

■ ***CCH Take Away.*** Nonresidential real property generally must be depreciated over 39 years, using the straight-line method. Congress has provided temporary relief from the 39-year period for property that qualifies as QLIP, qualified restaurant property, or qualified retail improvement property. Here, the lessor of a building wanted to treat HVAC units it installed as 15-year property; Chief Counsel determined that this was not permissible under Code Sec. 168(k)(3).

Background

The taxpayer (lessee) leased a large, standalone commercial building used for retail sales. Under the lease, the lessee is responsible for improvements to the leased space. The taxpayer has replaced several HVAC units: some located on the building roof; some located on concrete slabs next to the building,

The units serve the leased space, which is occupied exclusively by the taxpayer. The units do not benefit a common area, are not part of the building's internal structural framework, and do not enlarge the building. Chief Counsel stated that the building is nonresidential real property under Code Sec. 1250. The taxpayer claimed that the replacement units are also nonresidential real property and are QLIP.

Law

Nonresidential real property is Code Sec. 1250 property that is not residential rental property or property with a class life under 27.5 years. Under Code Sec. 168(e)(3), 15-year property includes QLIP. The property must be placed in service after October 22, 2004, and before January 1, 2014. Under Code Sec. 168(c), 15-year property is depreciated over 15 years, using the straight-line method.

■ ***Comment.*** Before the *American Taxpayer Relief Act of 2012* extended the QLIP provision, the property had to be placed in service before January 1, 2012.

Code Sec. 168(k)(3) and Reg. §1.168(k)-1(c) define QLIP as any improvement to the interior portion of a building which is nonresidential real property. The property must be installed by the lessee of that portion of the building; the lessee must occupy that portion exclusively; and the improvement must be placed in service more than three years after the building was placed in service. A QLIP does not include improvements that enlarge the building; any escalator or elevator; any structural component benefiting a common area; or the building's internal structural framework.

■ ***Comment.*** A structural component includes all components of a central air conditioning or heating system, as well as walls, floors, ceiling, plumbing, and fixtures. Chief Counsel stated that the units are structural components, but may have concluded that they do not benefit a common area.

Chief Counsel's analysis

Chief Counsel indicated that most of the requirements for QLIP were satisfied. However, the HVAC units did not qualify as QLIP because they were not improvements to an interior portion of the building. To interpret this provision, Chief Counsel looked at the plain meaning of the word "interior," including the dictionary definition. Interior means "being within the limiting surface or boundary: inside, inner—as opposed to exterior."

The statute is clear and unambiguous, according to the Chief Counsel; the improvement must be made to an inside or inner portion of the building. The HVAC units that are installed on the roof or next to the building are structural components, but they are improvements to the exterior of the building, not to the interior portion of the building.

Reference: TRC DEPR: 3,156.25.

State Fire Protection Fee Is Not Deductible As A Real Property Tax

◆ *CCA 201310029*

IRS Chief Counsel has determined that California residents may not deduct a state-imposed fire protection fee as real property tax under Code Sec. 164. According to Chief Counsel the fire protection fee is not a tax under federal or state law but rather a regulatory fee.

Background

California imposes a fire prevention fee on each structure within a state responsibility area. The state forestry and fire prevention office submits the names and addresses of taxpayers liable for the fee. The state board of equalization collects the fee.

Chief Counsel's analysis

California, Chief Counsel determined, requires two-thirds approval of both Houses of the State Legislature to raise taxes. The fire protection fee did not pass with a two-thirds vote but was approved by a simple majority.

Chief Counsel also determined that the fire protection fee was not levied at a like rate. Like rate requires that the rate must uniformly apply based upon an independent variable, such as property value or parcel or structure size, to be considered similar or like. Additionally, Chief Counsel determined that the fire protection fee was not imposed against all real property throughout the taxing authority's jurisdiction and was assessed only against specific property to provide a local benefit.

Reference: TRC INDIV: 45,156

Tax Court Finds Majority Of International Pro-Golfer's Endorsements Generated Royalties, Not Service Income

◆ *Garcia, 140 TC No. 6*

Sixty-five percent of the endorsement income received by an international golf pro, a non-U.S. citizen and resident of Switzerland, was properly allocable to royalties, the Tax Court has found. The golfer's royalties were not taxable under a U.S.–Swiss tax treaty. However the remainder of his endorsement income was properly allocable to personal services and was taxable in the U.S.

■ ***CCH Take Away.*** "The IRS's position has been that 100 percent of the value of an endorsement is personal services and zero of the amount is royalties. Going forward, the IRS is going to have to ask, is that right?" Thomas Linguanti, Baker & McKenzie LLP, Chicago, who served as lead counsel for the taxpayer in *Garcia*, told CCH. "Before, taxpayers were able to find common ground with the IRS and recognize some tangible value in the brand. But the IRS has taken a more extreme view in the last few years. In light of *Goosen, CCH Dec. 58,655*, and *Garcia*, the IRS is going to have to take a closer look at the facts."

Background

The taxpayer entered into a multiple-year contract with a sponsor under which the sponsor acquired image rights to the taxpayer's name and likeness for worldwide marketing purposes. The taxpayer also agreed to provide certain personal services, such as wearing and using the sponsor's merchandise. The original agreement did not specify which portion of sponsor's payments to the taxpayer were royalties and which portion were for personal services. Later the original agreement was amended to provide that 85 percent of the payments were for royalties, and 15 percent were for personal services.

The taxpayer performed some of these services within the U.S. In addition, the taxpayer established an LLC in Delaware and assigned it his image rights. The LLC received his royalty payments under the sponsor's endorsement agreement and then paid a portion of these to a second LLC established in Switzerland.

Court's analysis

The Tax Court found that the payments made by the firm to the taxpayer were properly allocated 65 percent to royalties and 35 percent to personal services. The court distinguished the taxpayer's situation from that of a U.K. golfer's in *Goosen*, where the Tax Court had ruled that a 50–50 split was appropriate due to the higher value of that taxpayer's personal services. The taxpayer had a better golf record than the taxpayer in *Garcia* and was required to make more personal appearances and play at more tournament engagements.

Further, the court found that in *Garcia* the taxpayer's "cool" and "Maverick" personality were more valuable to the endorsement firm for marketing purposes than his personal services, which he delivered through personal appearances, tournament obligations, and usage of the firm's equipment and sportswear. Under the circumstances, the payments under the endorsement agreement were aptly more heavily weighted towards an allocation to royalties for usage of the taxpayer's name and likeness to sell products.

The Tax Court concluded that the royalty payments were not taxable because Article 12 of the U.S.–Swiss Tax Treaty specifically provides that royalties are not taxable and that royalties include payments for image rights because they are "gains derived from the alienation of any such right or property which are contingent on the productivity, use, or disposition thereof."

Finally, the Tax Court held that the taxpayer's income from personal services was taxable U.S. source income. The taxpayer had initially conceded taxability of this income, and only raised the issue in a post trial opening brief.

References: CCH Dec. 59,484; TRC INTL: 3,350.

Tax Court Rejects Flight Attendant's Claim For Foreign Earned Income Exclusion

The Tax Court has reiterated that a U.S. taxpayer is allowed the foreign earned income exclusion only with respect to wages earned while in or over foreign countries and not for wages earned in international airspace or in or over the U.S. The court further found that flight-time percentages stipulated applied to all of the taxpayer's compensation.

Background. The taxpayer, a U.S. citizen, was employed as a flight attendant based out of Hong Kong. During 2007, the taxpayer worked 16 flights between Hong Kong and San Francisco (and 16 return flights); 14 flights between Hong Kong and Chicago (and 14 return flights); and many other flights within Asia.

The taxpayer's employer provided her with pay statements that allocated her 2007 wages between U.S. taxable income and Hong Kong taxable income. On her 2007 return, the taxpayer reported $41,000 as "other" income and claimed the same amount as her foreign earned income exclusion.

Court's analysis. The court found that the taxpayer had excluded 100 percent of her wages as foreign earned income but only a percentage of her flight time occurred within or over foreign countries. The foreign income exclusion, the court had previously held, is available only with respect to wages earned while in or over foreign countries. The court also rejected the taxpayer's argument that wages allocable to nonflight time were 100 percent foreign earned income.

Rogers, TC Memo. 2013-77, CCH Dec. 59,482(M); TRC EXPAT: 12,208.10.

Tax Briefs

Summons

IRS third-party summonses issued to two banks as part of an investigation into the employment tax liability of two entities were quashed because the IRS failed to comply with Code Sec. 7609(a)(1). The IRS failed to provide the responsible person with notice of the summonses at least 23 days before the date specified on the summonses for the production of the records.

Jewell, DC Okla., 2013-1 USTC ¶50,222; TRC IRS: 21,106.

Income

An individual who failed to file tax returns for the tax years at issue was determined to have unreported income and interest income after his income was reconstructed using the bank deposits method. His claimed business expenses were disallowed and he was liable for additions to tax for failing to timely file his returns, failing to pay tax shown on substitute returns and failing to pay estimated tax.

Cox, TC, CCH Dec. 59,480(M), FED ¶47,998(M); TRC ACCTNG: 3,052.05.

Married individuals who attempted to avoid taxation by creating a church were liable for tax on income as determined by the IRS using the bank deposits method of income reconstruction. They were also subject to self-employment tax, since they did not seek exemption, and to penalties for failure to file returns or to pay estimated tax.

Gardner, TC, CCH Dec. 59,472(M), FED ¶47,990(M); TRC ACCTNG: 3,150.

Deductions

An individual's claimed deductions arising from his not-for-profit horse-breeding activity for the tax years at issue were disallowed. As a result of his claimed deductions being disallowed, he substantially understated and underpaid his tax and, in the absence of reasonable cause, was liable for the accuracy-related penalty.

Dodds, TC, CCH Dec. 59,481(M), FED ¶47,999(M); TRC BUSEXP: 15,106.

A cofounder of an animal rescue organization was not allowed a charitable contribution deduction due to lack of proper substantiation. In the course of making the contributions, she failed to properly substantiate the charitable contributions even though she was both the donor and the recipient.

Villareale, TC, CCH Dec. 59,479(M), FED ¶47,997(M); TRC INDIV: 51,454.

An individual was denied deductions claimed with regard to a restaurant business and rental real estate expenses because of lack of substantiation. The taxpayer's expensing of the cost of vehicles purportedly used for business purposes, but not proved as such, was recaptured. Finally, the taxpayer was subject to accuracy-related penalties.

Castillo, TC, CCH Dec. 59,477(M), FED ¶47,995(M); TRC BUSEXP: 3,200.

In the absence of adequate substantiation, an individual who was an employee for a portion of the tax year and self-employed for the remainder of the tax year at issue could not deduct any unreimbursed employee expenses, nor could he deduct any trade or business deductions on his Schedule C above the amounts the IRS had already allowed.

Rehman, TC, CCH Dec. 59,476(M), FED ¶47,994(M); TRC BUSEXP: 3,100.

Liens and Levies

An IRS settlement officer's determination to sustain a Notice of Federal Tax Lien (NFTL) to collect individual taxpayers' unpaid federal income tax liabilities for five tax years at issue was not an abuse of discretion where only frivolous arguments were made by the taxpayers and all procedural and legal requirements had been satisfied. A frivolous position penalty was not imposed.

Satkiewicz, TC, CCH Dec. 59,478(M), FED ¶47,996(M); TRC IRS: 48,056.20.

Refund Claims

An individual was not entitled to credit for a tax overpayment because he failed to show that he did not receive the refund check sent to him by the IRS or to provide any evidence to support his challenge to the

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IRS To Develop Bilateral Safe Harbors For Transfer Pricing Issues

The IRS has announced that it is developing a model memorandum of understanding (MOU), intended for use between Competent Authorities on certain transfer pricing issues. The IRS requested comments on bilateral safe harbors with regard to arm's-length compensation for routine distribution functions that are frequently an issue in transfer pricing cases.

The IRS further explained that in 2012 the Organisation for Economic Co-operation and Development (OECD) issued a discussion draft on safe harbors, which included draft sample memoranda of understanding on certain "low risk" functions in manufacturing, marketing and distribution, research and development, and other services. The IRS directed that comments should be highly specific to the issues at hand, and may include proposed text for draft model agreements involving routine distribution functions.

■ ***Comment.*** The IRS recently completed reorganization of its advance pricing agreement (APA) program into the larger Advanced Pricing and Mutual Agreement (APMA) program. The reorganization is meant to promote more efficient review of advance pricing agreements and other transfer pricing issues.

IR-2013-30; TRC INTL: 15,306.

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reliability of the IRS's records. The IRS's records did not show a hold was placed on the refund or that the individual requested the IRS to apply the overpayment to his existing liabilities.

Wright, TC, CCH Dec. 59,473(M), FED ¶47,991(M); TRC IRS: 33,410.

Deficiencies and Penalties

A married couple was not entitled to a refund of penalties for failure to timely pay tax and failure to pay estimated tax imposed after an IRS audit reclassified their securities losses as capital. The IRS properly declined to fully abate the penalties for the tax years at issue even though it abated the couple's penalties for a prior year because each tax year is treated separately and the Internal Revenue Manual does not have the force of law.

Christman, FedCl, 2013-1 USTC ¶50,225; TRC PENALTY: 3,050.

The government was entitled to foreclose its liens on property held by a corporation as an individual's nominee/alter-ego and to sell the property to satisfy the individual's tax shelter promoter penalties. Under state (Illinois) law, the corporation was the individual's nominee or alter-ego because he retained control of the property.

Cohen, DC Ill., 2013-1 USTC ¶50,224; TRC IRS: 45,160.

The sole owner of a law practice, who failed to file federal income tax returns for the tax years at issue, was liable for additions to tax for fraudulently failing to file his federal income tax returns, failing to timely pay tax; and failing to make the required estimated tax payments.

Cryer, TC, CCH Dec. 59,474(M), FED ¶47,992(M); TRC PENALTY: 6,054.

Bankruptcy

A bankruptcy court properly held that a debtor willingly participated in fraudulently transferring real property from her ex-husband's name to hers through a sham divorce to shield the property from the IRS. The debtor knew of her husband's tax debt before the property was transferred because she obtained innocent spouse relief after she was denied a car loan due to IRS liens against her and her husband.

Schaudt, DC Ill., 2013-1 USTC ¶50,226; TRC IRS: 57,150.

A debtor's tax liabilities were not discharged in bankruptcy because he failed to file his tax return for one of the tax years at issue and willfully evaded the payment of his tax liability for the remaining tax years. The debtor failed to show that the tax return for one tax year was sent to the government via certified or registered mail with return receipt requested. The debtor's verbal offer to pay only his taxes, but not the accrued interest and penalties, without a serious and persistent effort to resolve his tax liability, demonstrated a conscious and intentional decision to not pay his outstanding tax liability.

In re F.C. Meyer, BC-DC N.Y., 2013-1 USTC ¶50,223; TRC IRS: 57,150.

Alimony

Family support payments made by a husband to his wife under two support orders by a state (California) court were alimony rather than child support. The husband was entitled to deduct the entire amount of the payments for the year at issue. He was not liable for the accuracy-related penalty, since he had no underpayment of tax.

DeLong, TC, CCH Dec. 59,475(M), FED ¶47,993(M); TRC INDIV: 21,206.05.

Innocent Spouse Relief

An individual was not entitled to equitable spouse relief under Code Sec. 6015(f). Three of the eight factors of section 4.03 of Rev. Proc. 2003-61, 2003-2 CB 298-299, weighed against granting relief to the taxpayer. She failed to prove that she was divorced, legally separated or living apart from her husband when she requested the relief; she had actual knowledge of his income; and she had reason to know that he would not pay his tax liabilities.

Williamson, TC, CCH Dec. 59,483(M), FED ¶48,001(M); TRC INDIV: 18,058.

Costs and Fees

A delinquent taxpayer's ex-wife was the prevailing party in a quiet title action against the government; therefore, she was entitled to attorney's fees and costs under Code Sec. 7430. The government's positions were not substantially justified and the individual's challenge to the levy was an administrative proceeding; therefore, she was also eligible to recover the costs incurred in preparing and submitting her administrative claims.

Filicetti, DC Ida., 2013-1 USTC ¶50,227; TRC LITIG: 3,154.

Tax Court Holds Waiver Of Right To Partition Should Be Disregarded In Valuation Of Fractional Interests In Art

The Tax Court has found that a decedent's agreement by which he waived his right to institute a partition action with respect to some of the works of art should be disregarded under Code Sec. 2703(a).

Background. The decedent and his spouse invested in artwork over the course of 30 years. Some of the artwork was included in a grantor retained income trust (GRIT) created by the couple and some items were not. The decedent's spouse predeceased him. The decedent disclaimed a portion of his spouse's interests in the artwork. The decedent and his children executed an agreement which provided that none of the non-GRIT artwork could be sold without unanimous consent. The IRS determined that the decedent's interests covered by the agreement should be valued without regard to the restrictions in the agreement.

Court's analysis. The Tax Court found that the restrictions on transferability in the agreement were restrictions on the right to sell or use property under the meaning of Code Sec. 2703(a). This provision, the found, generally provides that the value of any property for estate, gift or generation-skipping transfer (GST) tax purposes, is determined without regards to any restriction on the right to sell or use the property. The court concluded that the restrictions should not be taken into account for purposes of valuation.

Elkins, Jr., Est., 140 TC No. 5, CCH Dec. 59,471; TRC VALUE: 21,200.