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Inside this Issue

IRS Updates FATCA FAQs; Number Of IGAs Increases As July 1 Nears

◆ *www.irs.gov*

The IRS has updated its online frequently asked questions (FAQs) about the *Foreign Account Tax Compliance Act* (FATCA). The FAQs discuss, among other topics, registration by foreign financial institutions (FFIs), responsible officers, foreign pension plans, and more.

■ ***CCH Take Away.*** "The 30 percent withholding in July is going to come as a surprise to many non-registered FFIs," Daniel Gottfried, partner, Hinckley, Allen & Snyder LLP, Hartford, Conn., told CCH. "Many smaller and middle-market FFIs are either waiting to see how the withholding impacts them, or are just closing their eyes and hoping that it will not happen. Of course, once they see a payment reduced by this withholding, they will have a renewed interest in FATCA registration."

■ ***Comment.*** The U.S. continues to negotiate intergovernmental agreements (IGAs) to implement FATCA. The Bahamas, Kuwait, the Philippines, and Slovakia, among other jurisdictions, have reported IGAs have been completed or are moving forward.

Registration

The IRS has developed an online FATCA registration portal. Financial institutions that are treated as Reporting Financial Institutions under a Model 1 IGA should register as Registered Deemed-Compliant Foreign Financial Institutions (RDCFFI). Financial Institutions that are treated as Reporting Financial Institutions under a Model 2 IGA should register as Participating Foreign Financial Institutions (Participating FFIs). Because of local law restrictions, some foreign financial institutions (FFIs) will need to register as a Limited FFI, the IRS noted.

Responsible officer

Generally, an FFI will select a Responsible Officer to facilitate compliance with FATCA. The Responsible Officer can authorize a point of contact (POC) to receive FATCA-related information and to take certain FATCA-related actions, the IRS explained. While the POC must be an individual, the POC does not need to be an employee of the financial institution.

Once the services of a POC are no longer needed, the Responsible Officer may log into the online FATCA account and delete the POC. This process revokes the POC's authorization. At this point, the Responsible Officer can input a new POC, or leave this field blank if the Responsible Officer no longer wants to have a POC, the agency explained.

Foreign pension plans

Generally, foreign pension plans are exempt from FATCA registration and withholding if they meet the requirements to be treated as a retirement fund under Reg. §1.1471-6(f), or under an IGA. A withholding agent is not required to withhold on a withholdable payment to the extent that the withholding agent can reliably associate the payment with documentation to determine the portion of the payment that is allocable to an exempt beneficial owner (in this case, a retirement fund) in accordance with the regs.

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Route to: ____________ ____________ ____________ ____________ ____________

IRS Developing Form 1023-EZ To Simplify Application Process For Small Charities

◆ *Draft Form 1023-EZ and Instructions*

The IRS is developing a draft of a simplified application (Form 1023-EZ) for small organizations who seek tax-exempt charitable status under Code Sec. 501(c)(3). The agency also has developed draft instructions for the proposed form.

■ ***CCH Take Away.*** "Neither the practitioner community nor the IRS wants to open the floodgates to 'automatic' 501(c)(3) status for smaller organizations, which are often the most confused (or ill-advised) as to 501(c)(3) limits and compliance mandates," Eve Borenstein, Borenstein and McVeigh Law Office LLC, Minneapolis, told CCH. "If the IRS is going to use a streamlined application form to confer such status, it will need to ramp up its existing educational efforts."

Background

An internal memo from Stephen Martin, acting director, EO Rulings and Agreements, dated February 28, 2014, discussed streamlined processing guidelines for EO cases. The memo stated that the IRS conducted an assessment of the EO application process and identified numerous problems, including inadequate technical tax law training.

The IRS developed and tested a draft Form 1023-EZ in October and November 2013. The streamlined form drastically reduced the information burden on both the IRS and taxpayers, by having taxpayers attest that they met the organizational and operational tests for tax-exempt status. The IRS concluded that the process was simplified, that correspondence with taxpayers was easier, and that the form accelerated case closings.

The draft form was dated February 19, 2014; the instructions were dated February 10, 2014. IRS made no announcement about the new form and instructions. However, the Treasury Department announced in the March 31 Federal Register that it was submitting the form to the Office of Management and Budget (OMB).

■ ***Comment.*** The OMB document states that comments must be furnished to the IRS by April 30. While practitioners were concerned that the IRS was proceeding without public input, it now appears that the comment deadline only concerns the paperwork reduction act and is not aimed at soliciting substantive comments on the form.

Form 1023-EZ

Charities that wish to be tax-exempt under Code Sec. 501(c)(3) must apply to the IRS on Form 1023, a 25-page form that the IRS estimates would take 101 hours for an organization to complete. Proposed Form 1023-EZ, Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code, is two pages long (as drafted) and is estimated to take 14 hours to complete.

Form 1023-EZ would be available to organizations with projected receipts of less than $200,000 in the next three years and with total assets of $500,000 or less. The organization could not be a successor to a revoked organization (other than automatic revocation for failure to file Form 990). The draft instructions provide an eligibility worksheet with 22 questions; organizations that answer "yes" to any question cannot use Form 1023-EZ.

In its submission to OMB, the IRS describes Form 1023-EZ as a simplified version of Form 1023 for organizations who meet certain criteria. The IRS indicated that it is introducing the EZ version as an alternative for recognition of exemption under Code Sec. 501(c)(3). The proposed form is a shorter, less burdensome version of Form 1023.

■ ***Comment.*** Unlike Form 1023, Form 1023-EZ does not ask for a narrative description of the organization's activities and does not require budget information.

References: TRC EXEMPT: 12,054.10.

FATCA

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Form W-8BEN-E

The IRS has posted final Form W-8BEN-E, Certificate of Status of Beneficial Owner for United States Tax Withholding and Reporting (Entities), on its website. Entities documenting their foreign status, chapter 4 status, or making a claim of treaty benefits (if applicable) should use Form W-8BEN-E, the agency explained.

■ ***Comment.*** "When discussing the new withholding obligations under FATCA, I like to show clients the old Form W-8BEN, which is one page and quite simple, and then show them the new Form W8-BEN-E, which is eight pages, and requires the payee to choose among eleven entity types for Chapter 3 purposes and thirty-one entity types for Chapter 4 purposes," Gottfried told CCH. "With that illustration, clients quickly figure out that FATCA made the world a much more complicated place, and that they need to take sufficient steps to complete the new Form W8-BEN-E or learn how to handle payables in light of W8-BEN-E's received from counterparties."

Reference: TRC INTL: 36,050.

Reference Key

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

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Tax Court Finds Good-Faith/State-Of-Mind Penalty Defense Waives Attorney-Client Privilege

◆ *Ad Investment 2000 Fund LLC, 142 TC No. 13*

Taxpayers' arguments in support of their affirmative defenses of good faith and state of mind to accuracy-related penalties put into contention their legal knowledge, understanding and belief, the Tax Court has held. As a result, the court held that the taxpayers' would sacrifice the attorney-client privilege to withhold the contents of opinion letters if they persisted in that defense.

■ ***CCH Take Away.*** "The decision is an important reminder of the consequences of injecting the taxpayer's knowledge and belief into a proceeding, whether or not relying on privileged information," Mark Allison, member, Caplin & Drysdale, Chartered, New York, told CCH. "The Tax Court has now made it clear, if it was at all ambiguous previously, that once the door is opened by the taxpayer the court will open it all the way."

Background

The IRS adjusted partnership items of the two partnerships and assessed Code Sec. 6662 accuracy-related penalties. In connection with the penalty determinations, the IRS determined that the adjustments of partnership items were attributable to a tax shelter (Son of BOSS) and the underpayments of tax resulting from the adjustments of partnership items were attributable to a substantial understatement of income tax, a gross valuation misstatement, or negligence or disregard of rules and regs.

The IRS moved to compel production of opinion letters from the taxpayers' legal advisor. The taxpayers countered that the opinion letters were protected by attorney-client privilege.

■ ***Comment.*** According to the IRS, the attorney-client privilege is waived when the client places otherwise privileged matters in controversy, which the taxpayers did in this case by relying on affirmative defenses to the penalties that turn on the partnerships' beliefs or state of mind.

Court's analysis

The Tax Court observed that the key point appeared to be whether each partnership reasonably believed that the tax treatment of partnership items was more likely than not the proper tax treatment. Regs generally provide that the belief requirement is satisfied if the taxpayer reasonably believed at the time the return was filed that the tax treatment of that item was more likely than not the proper treatment. A taxpayer may satisfy the belief requirement by either of two methods: self-determination or reliance on professional advice, the court found.

■ ***Comment.*** Under the first method, the court explained, the taxpayer analyzes the pertinent facts and authorities and, in reliance upon that analysis, reasonably concludes in good faith that there is a greater than 50-percent likelihood that the tax treatment of the item will be upheld if challenged by the IRS.

The IRS acknowledged that the taxpayers' arguments raised only the first method (self-determination) to show that the partnerships satisfy the belief requirement. However, the IRS argued that the taxpayers placed the opinions into controversy by relying on a reasonable cause, good-faith defense and by putting the partnerships' beliefs into issue. The opinions would be relevant because, if they contradicted the claimed self-determination, they could show that the self-determination was not reasonable; if consistent, they could show that the taxpayer made no self-determination.

The court found that the taxpayers' arguments that the partnerships satisfied the belief requirement by the first method put into dispute the partnerships' knowledge of the pertinent legal authorities. The taxpayers' arguments also put into contention the partnerships' understanding of the legal authorities and their application of the legal authorities to the facts. Additionally, the taxpayers' arguments put into contention the basis for the partnerships' belief that, if challenged, the tax positions would more likely than not

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Tax Court Will Not Revisit IRA Rollover Decision

A married couple was recently unsuccessful in their motion asking the Tax Court to reconsider *Bobrow, TC Memo 2014-21, CCH Dec. 59,823(M).* In *Bobrow,* the court held that a taxpayer could make only one nontaxable rollover contribution within each one-year period regardless of how many IRAs the taxpayer maintained.

Reconsideration. In a motion for reconsideration, the taxpayers argued that the court's interpretation of Code Sec. 408(d)(3)(B) was inconsistent with the IRS's published guidance. Publication 590, Individual Retirement Arrangements, applied the Code Sec. 408(d)(3)(B) limitation separately to each IRA.

■ ***Comment.*** The American College of Tax Counsel filed an Amicus Curiae Brief in support of the couple's motion for reconsideration. The American College of Tax Counsel argued, among other things, that the Tax Court should reconsider its decision to conform with Publication 590.

Court's order. The court reminded the taxpayers that the IRS's published guidance is not binding precedent. "Taxpayers rely on IRS guidance at their own peril," the court cautioned. If the taxpayers had argued Publication 590, the argument would not have served as substantial authority for the position taken on their return, the court concluded.

■ ***Comment.*** In March, the IRS announced it will revise Publication 590 and issue new proposed regs to reflect *Bobrow* (*Ann. 2014-15; see the March 27, 2014 issue of this newsletter for details*). The court noted that the IRS agreed to extend the relief in Ann. 2014-15 (allowing more than one rollover for IRA distributions before January 1, 2015) to the taxpayers in this case, thus reducing their tax liability and Code Sec. 6662 penalty.

Tax Court Order; TRC RETIRE: 66,702.

IRS To Revise Regs For U.S. Persons Owning PFIC Stock Through Tax-Exempt Organizations/Accounts

◆ *Notice 2014-28*

The IRS has announced its intention to amend the Code Sec. 1291 regs to provide guidance for U.S. persons owning stock of a passive foreign investment company (PFIC) (foreign mutual funds) through a tax-exempt organization or account. Generally, U.S. persons owning PFIC stock through a tax-exempt organization or account would not be treated as shareholders of the PFIC.

■ ***CCH Take Away.*** The IRS noted that neither the Tax Code nor regs provide guidance on the application of Code Sec. 1291 to a U.S. person that owns stock of a PFIC through a tax-exempt organization or account, other than an employees' trust that is exempt from tax (a section 401(a) trust). A U.S. person that is a beneficiary of a section 401(a) trust is not treated as an indirect shareholder with respect to any PFIC stock held by the trust for purposes of Code Sec. 1291.

Background

A shareholder of a PFIC who is a U.S. person is liable for U.S. tax liability as well as an interest charge based upon the value of tax deferral when such shareholder either disposes of PFIC stock or receives an excess distribution for the year. Code Sec. 1298(a) provides attribution rules that treat a U.S. person as the owner of PFIC stock that is owned by another person.

In 2013, the IRS clarified PFIC ownership determinations and revised reporting requirements in a package of regs (TD 9650, NPRM REG-140974-11, NPRM REG-113350-13). Generally, the term shareholder means any U.S. person that owns stock of a PFIC directly or indirectly. An indirect shareholder is a U.S. person that indirectly owns stock of a PFIC through domestic and foreign corporations, partnerships, S corps, estates, and trusts.

■ ***Comment.*** The *Hiring Incentives to Restore Employment Act of 2010* generally requires a U.S. person that is a shareholder of a PFIC to file an annual report.

Notice 2014-28

The IRS explained that application of the PFIC rules to a U.S. person treated as owning stock of a PFIC through a tax-exempt organization or account under Reg. §1.1298-1T(c)(1) would be inconsistent with the tax policies underlying the PFIC rules. The IRS used the example that applying the PFIC rules to a U.S. person that is treated as a shareholder of a PFIC through the U.S. person's ownership of an IRA that owns stock of a PFIC would be inconsistent with the principle of deferred taxation provided by IRAs. As a result, the IRS intends to amend the definition of shareholder in the Code Sec. 1291 regs to provide that a U.S. person that owns stock of a PFIC through a tax-exempt organization or account (as described in Reg. §1.1298-1T(c)(1)) would not treated as a shareholder of the PFIC.

■ ***Comment.*** The IRS noted the applicability of the guidance to U.S. persons that own stock of a PFIC through an organization or an account that is exempt from tax under Code Sec. 501(a) because it is described in sections 501(c), 501(d), or 401(a); a state college or university under Code Sec. 511(a)(2)(B); a plan described in Code Secs. 403(b) or 457(b); an individual retirement plan or annuity as defined in Code Sec. 7701(a)(37); or a qualified tuition program under Code Sections 529 or 530.

Effective date

Regs reflecting Notice 2014-28 would be effective for tax years of U.S. persons that own stock of a PFIC through a tax-exempt organization or account ending on or after December 31, 2013.

References: FED ¶46,320; TRC INTLOUT: 18,204.

Privilege Waiver

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succeed in the courts. The court concluded that if the taxpayers persisted in their defense, they would sacrifice the privilege to withhold the contents of the opinions.

■ ***Comment.*** If the taxpayers failed to produce the documents, the court indicated it would consider precluding the taxpayers from introducing beliefs and state of mind.

References: CCH Dec. 59,880; TRC IRS: 21,402.30.

IRS Reissues Corrections To Net Investment Income Tax Regs

The IRS has reissued two sets of corrections to final regs (TD 9644) published December 2, 2013 on the net investment income (NII) tax under Code Secs. 469 and 1411. Ann. 2014-18 describes corrections to the final regs. It includes a correction to clarify that the 500 hour safe harbor for real estate professionals to participate in rental real estate activities to applies separately to each activity, unless the taxpayer has elected to group the activities.

Ann. 2014-19 describes correcting amendments to the final regs. It includes a correction to Reg. §1.1411-4(f)(3)(iii) regarding the treatment of taxes described in Code Sec. 164, and a correction to Reg. §1.1411-4(h)(2) regarding the treatment of net operating losses under the NII tax rules.

■ ***Comment.*** *For insights into the reasoning behind these "corrections," see last week's issue of this newsletter.*

Ann. 2014-18, Ann. 2014-19; FED ¶¶46,324, 46,325; TRC FILEIND: 15,052.35.

IRS Field Audits Of Large Partnerships Less Than One Percent, GAO Reports

◆ *GAO Report No. GAO-14-379R*

IRS audits of large partnerships have not kept pace with the growth of this business entity, the Government Accountability Office (GAO) has reported. IRS field audit coverage of large partnerships was less than one percent in fiscal year (FY) 2012, showing little change from prior years.

■ ***CCH Take Away.*** "Auditing less than one percent of large partnership tax returns means the IRS is failing to audit the big money," Sen. Carl Levin, D-Mich., said in a statement. "It means over 99 percent of the hedge funds, private equity funds, master limited partnerships, and publicly traded partnerships in this country, some of which earn tens of billions each year, are audit-free," Levin added. GAO undertook the study at the request of Levin and Sen. John McCain, R-Ariz.

Background

For its study, GAO defined "large partnership" utilizing a combination of criteria for partner size and asset size. Generally, large partnerships are those that reported having 100 or more direct partners and $100 million or more in assets on Form 1065, U.S. Return of Partnership Income, or on Form 1065-B, U.S. Return of Income for Electing Large Partnerships. GAO also obtained data from the Business Return Transaction File (BRTF) on the number and characteristics of large partnerships that filed Form 1065 or a 1065-B for tax years 2002 through 2011.

GAO reported that the number of large partnerships with 100 or more direct partners and $100 million or more in assets increased from 720 in tax year 2002 to 2,226 in tax year 2011. Large partnerships also increased in terms of the average number of direct partners and average asset size. The number of businesses organized as large partnerships increased more than 200 percent, accounting for $2.3 trillion in assets and $68.9 billion in total net income by 2011, GAO reported

■ ***Comment.*** The IRS told GAO that although it accounts for a vast majority of the large partnerships, the Finance and Insurance group tends to account for a small percentage among all types of partnerships whereas the Real Estate and Rental group tends to account for a larger percentage. Among all partnerships in tax year 2011, almost 50 percent were in the Real Estate and Rental and Leasing group and nine percent were in the Finance and Insurance group.

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AFRs Issued For May 2014

◆ *Rev. Rul. 2014-13*

The IRS has released the short-term, mid-term, and long-term applicable interest rates for May 2014.

Applicable Federal Rates (AFR) for May 2014

Short-Term	Annual	Semiannual	Quarterly	Monthly
AFR	.33%	.33%	.33%	.33%
110% AFR	.36%	.36%	.36%	.36%
120% AFR	.40%	.40%	.40%	.40%
130% AFR	.43%	.43%	.43%	.43%
Mid-Term				
AFR	1.93%	1.92%	1.92%	1.91%
110% AFR	2.12%	2.11%	2.10%	2.10%
120% AFR	2.31%	2.30%	2.29%	2.29%
130% AFR	2.52%	2.50%	2.49%	2.49%
150% AFR	2.90%	2.88%	2.87%	2.86%
175% AFR	3.39%	3.36%	3.35%	3.34%
Long-Term				
AFR	3.27%	3.24%	3.23%	3.22%
110% AFR	3.59%	3.56%	3.54%	3.53%
120% AFR	3.93%	3.89%	3.87%	3.86%
130% AFR	4.25%	4.21%	4.19%	4.17%

Adjusted AFRs for May 2014

	Annual	Semiannual	Quarterly	Monthly
Short-term adjusted AFR	.33%	.33%	.33%	.33%
Mid-term adjusted AFR	1.41%	1.41%	1.41%	1.41%
Long-term adjusted AFR	3.27%	3.24%	3.23%	3.22%

The Code Sec. 382 adjusted federal long-term rate is 3.27%; the long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months) is 3.36%; the Code Sec. 42(b)(2) appropriate percentages for the 70% and 30% present value low-income housing credit are 7.60% and 3.26%, respectively, however, the appropriate percentage for non-federally subsidized new buildings placed in service after July 30, 2008, and before January 1, 2014, shall not be less than 9%; and the Code Sec. 7520 AFR for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest is 2.4%.

References: FED ¶46,326; TRC ACCTNG: 36,162.05.

Dependency Exemption Not Controlled By Court-Filed Conciliation Agreement; Trumped By Changed Circumstances

◆ *Harris, TC Memo. 2014-69*

The Tax Court has upheld a taxpayer's claim to the dependency exemption after finding that his child spent the greater number of nights during the calendar year with him. A state-court filed conciliation agreement entered into when the child was a toddler did not reflect the actual time he spent with each parent as he grew older.

■ ***CCH Take Away.*** Testimony at trial was critical to show how much time the child spent with each parent. The court went into significant detail about the rearing of the child, school activities and sports.

Background

The taxpayer and another individual had a child. The taxpayer and this person never married and lived separately. In 2003, when the child was two years old, a conciliation agreement and stipulated order was filed in state court reflecting that both parents agreed to share custody of their child. The agreement, however, was silent as to the dependency exemption; nor did it set out detailed guidelines on how time with the child was to be split throughout the year. Both individuals claimed the dependency exemption for the child for 2010 and 2011.

Court's analysis

The court first found that under Reg. §1.152-4(d)(1), the custodial parent is the parent with whom the child resides for the greater number of nights during the calendar year and the noncustodial parent is the parent who is not the custodial parent. A child is treated as residing with a parent for a night if the child sleeps at the residence of that parent or if the child sleeps in the company of the parent, when the child does not sleep at a parent's residence. A child may be treated as a qualifying child of the noncustodial parent if, among other requirements, the custodial parent releases the claim to the exemption for the child and the noncustodial parent attaches the release to the return.

■ ***Comment.*** The IRS has developed Form 8332 for this purpose. Taxpayers may use an equivalent document if it meets the requisite requirements.

Here, the court found that the conciliation agreement suggested that the child's mother should be treated as the custodial parent. However, testimony at trial revealed that the conciliation agreement did not reflect the time actually spent by the child with each of his parents in 2010 and 2011.

The court found that the child slept at the taxpayer's residence or in the company of the taxpayer for a greater number of nights in 2010 and 2011 than the child slept at the mother's residence or in her company. The court concluded that the taxpayer was entitled to the dependency exemption for 2010 and 2011.

References: CCH Dec. 59,882(M); TRC FILEIND: 6,150.

GAO

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Audit coverage

GAO discovered that IRS had data on two categories of large partnership return audits. GAO found that the number of completed field audits of large partnership returns increased from 11 in fiscal year (FY) 2007 to 31 in FY 2013. The number of audits closed through the IRS campus function increased from 42 to 143 over the same period.

The field audit coverage rate for large partnerships was 0.8 percent in FY 2012, declining from 0.9 percent in FY 2011 and 2.2 percent in FY 2010, GAO reported. The campus function audit rate for large partnerships was 7.1 percent in FY 2012, rising from 2.0 percent in FY 2011.

■ ***Comment.*** GAO explained that campus function audits are mainly an administrative support function used by IRS. Campus function audits generally do not entail a review of the books and records of the taxpayer return in question, as do audits completed in the field. The IRS told GAO that the number of indirect partners of a partnership has more of an impact on IRS's campus function than on the field audits.

■ ***Comment.*** In comparison, GAO found that the audit coverage rate for corporations with $100 million or more in assets was 27.1 percent in FY 2012.

Reference: TRC PART: 60,650.

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78 Percent Of 2014 Refunds Already Issued, IRS Reports; Online Tracking Available

The IRS has issued a reminder to taxpayers who have not yet received their tax refunds that a taxpayer may check the status of his or her refund using the Where's My Refund? tool, available at www.irs.gov and via the IRS2Go 4.0 smartphone app. The refund tracking tool updates taxpayer information within 24 hours after receipt of a taxpayer's e-filed return or within four weeks after receiving a paper return.

Filing season statistics. The IRS reported that as of April 11, 2014 it had received nearly 113 million tax returns and issued more than 85.26 million tax refunds, totaling approximately $234.55 billion.

Out of that 85.26 million, approximately 69.92 million refunds were issued by direct deposit, representing a small .3-percent increase from this time last year. The IRS also estimated that the 85.26 million refunds constitute approximately 78 percent of all the refunds it will issue in 2014.

IR-2014-54; TRC FILEIND: 15,052.45.

Entrepreneur Cannot Deduct Bad Debts From Intra-Family Transfers; Expenses For Mother/Brother Not Trade Or Business Losses

◆ *Alpert, TC Memo. 2014-70*

The Tax Court has found that a taxpayer's transfers to two trusts were not bona fide loans, and the trusts' failure to repay the taxpayer did not result in a deductible nonbusiness bad debt. Neither could the taxpayer deduct amounts paid on behalf of his mother and disabled brother in connection with a purported indemnification agreement.

■ ***CCH Take Away.*** The Tax Court reasoned that it was justified in applying a heightened level of scrutiny to the question of whether the trust transfers and indemnification agreement were valid loans or business losses. It stressed that "the transactions in question must be viewed in light of the fact that many of the parties to these transactions with petitioner are related to him or are under his control." The Tax Court cited several cases including *Clark, 18 T.C. 780, CCH Dec. 19,113,* and *Goldstein, T.C. Memo. 1980-273, CCH Dec. 37,099(M),* as precedent for the application of rigid scrutiny to intra-family transfers.

Background

The taxpayer established two irrevocable trusts for the benefit of his sons. From 1995 to 2000 he made numerous transfers of funds into the trusts. On his 2006 return the taxpayer characterized his transfers into the trusts as loans that had become worthless when they were not repaid.

In 2000, the taxpayer also made unauthorized investments of his mother's funds in his company's stock, which then significantly declined in value. As a result, the taxpayer orally promised his mother in 2001 (and later by letter), to indemnify her and her estate for any losses from the stock price decline and to pay for her support and for that of his disabled brother. For 2006 he claimed a deduction for trade or business losses under Code Sec. 165(c)(2) for these expenses.

Court's analysis

Only bona fide debt that becomes worthless qualifies for the deduction under Code Sec. 166, the Tax Court found. The taxpayer's transfers into the trusts were not bona fide loans; therefore the "losses" from the trusts' failure to repay the transfers were not deductible. The transfers were documented solely by the execution of two promissory notes, which merely reflected the cumulative amounts already transferred as of their date of execution. Further, the Court found no evidence of any repayment plan or demand by the taxpayer for repayment.

Similarly, the Tax Court found that the taxpayer's testimony did not show credible evidence that he had contracted to indemnify his mother against any pre-2000 stock losses. As to the losses he claimed related to the 2000 tax year stock purchases, the Tax Court found that they were not connected with a trade or business and therefore were not deductible under Code Sec. 165(c)(2).

Finally, the Tax Court found that the taxpayer was liable for the Code Sec. 6662(a) accuracy related penalty, because he had not shown reasonable cause for claiming the disallowed deductions. The mere fact that a CPA prepared his tax return did not prove that the CPA had provided advice on which he had reasonably relied in good faith.

References: CCH Dec. 59,883(M); TRC BUSEXP: 48,152.

IRS Clarifies Injured Spouse's Deadline For Filing Form 8379

The IRS has issued a clarification to its internal procedures relating to the time period for filing of Form 8379, Injured Spouse Allocation. The revised language deletes previous references to a "statute of limitations" period and states that the applicable time periods for filing Form 8379 are:

With the jointly filed Form 1040 or 1040X, as an attachment; and controlled by that Form 1040 deadline, or

If Form 8379 is filed separately from a taxpayer's jointly filed Form 1040 or Form 1040X, then within two years from the date of a refund offset to pay for federal tax debts or within six years from the date of a refund offset to pay for Treasury Offset Program (TOP) debts.

The IRS further clarified to its personnel that if it should offset a refund claimed on a Form 1040 or Form 1040X to a federal tax debt or TOP debt, it will not issue a Notice of Claim Disallowance, "as nothing is being disallowed."

WI-21-0414-0696; TRC IRS: 33,102

IRS Announces 2014 Nationwide Tax Forums

The IRS has announced the opening of registration for its 2014 Nationwide Tax Forums to enrolled agents, certified public accountants, certified financial planners and other tax professionals. This year's Tax Forums, 3-day programs held at various locations during July and August, feature more than 40 separate seminars and workshops presented by government officials and expert practitioners, who will cover recent federal and state tax issues. Preregistration prices are $225; on-site registration is $355. For further details, see *http://www.irstaxforum.com.*

IR-2014-55; TRC IRS: 3,204.10.

Tax Briefs

Internal Revenue Service

A corporation's action against the IRS for the alleged wrongful disclosure of its tax return information was dismissed because the IRS's statement that the corporation's investment program was a Ponzi scheme did not violate Code Sec. 6103. The government established that the Ponzi scheme disclosure directly impacted the participants' tax liabilities and, contrary to the corporation's assertion, the government was not required to justify the disclosure by proving that a participant in the program actually incurred a deductible Ponzi scheme loss.

Emerging Money Corp., DC Conn., 2014-1 USTC ¶50,257; TRC IRS: 9,354.

Summons

A petition to quash an IRS third-party summons issued to a bank in connection with the examination of the tax refunds deposited in an individual's account held with the bank was dismissed. The government established its *prima facie* case for enforcement under *Powell* and the individual failed to show that the summons was issued in bad faith or was an abuse of process.

Charles, DC Mich., 2014-1 USTC ¶50,259; TRC IRS: 21,300.

Refund Claims

A partnership that won its refund suit against the IRS was not entitled to maintain a cross-appeal to preserve its argument that Code Sec. 6229 would also have precluded the IRS from assessing additional tax. Since the Code Sec. 6229 argument was an alternative ground to support the Claims Court's decision it was not the proper basis for a cross-appeal.

BASR Partnership, CA-FC, 2014-1 USTC ¶50,258; TRC LITIG: 9,254.

Collection Due Process

After a Collection Due Process hearing, an IRS settlement officer (SO) did not abuse her discretion in rejecting a taxpayer's offer-in-compromise. The proposed offer was well below the amount the SO had determined was the taxpayer's reasonable collection potential.

Buchanan, TC, CCH Dec. 59,881(M), FED ¶47,997(M); TRC IRS: 42,120.

Alimony

An individual's payments to his ex-spouse were child support rather than alimony, and so not deductible by the taxpayer. The "spousal maintenance" payments were made pursuant to a divorce decree, and the obligation terminated on the death of either party, the remarriage of the taxpayer's ex-spouse, or the graduation from high school of the youngest child. A payment subject to contingencies involving a child must be considered to be child support, which is not deductible. However, the taxpayer reasonably relied on his CPA in preparing his return and was not liable for an accuracy-related penalty.

Johnson, TC, CCH Dec. 59,879(M), FED ¶47,995(M); TRC INDIV: 21,102.

Tax Credits

For calendar year 2013, the nonconventional source fuel credit is available only for fuel produced from coke or coke gas. In case of facilities producing coke or coke gas, the nonconventional source fuel credit is $3.59 per barrel-of-oil equivalent.

Notice 2014-25, FED ¶46,323; TRC BUSEXP: 54,508.05.

The IRS has published the inflation adjustment factors and reference prices to be used in computing the renewable electricity production credit for calendar year 2014. The inflation adjustment factors and references prices apply to sales in calendar year 2014 of kilowatt hours of electricity produced in the United States or a U.S. possession from qualified energy resources, and to 2014 sales of refined coal and Indian coal produced in the U.S. or one of its possessions.

Credit for Renewable Electricity Production, Refined Coal Production, and Indian Coal Production, and Publication of Inflation Adjustment Factors and Reference Prices, FED ¶46,322; TRC BUSEXP: 54,550.

Employment Tax

The ex-CEO and ex-CFO of a corporation were jointly and severally liable for the corporation's unpaid withholding taxes because they were responsible persons during the periods at issue and paid other creditors before the government despite knowing that the taxes were outstanding. The CEO, a stockholder, was a responsible person because he was involved in the day-to-day affairs of the business, had the authority to hire and fire employees and controlled the corporation's financial affairs, including paying vendors, employees and payroll taxes. The CFO was responsible because he determined which bills to pay first and had access to all of the corporation's financial records. Despite knowing that the taxes were outstanding, they continued to use unencumbered funds to pay creditors other than the government.

Schiffmann, DC R.I., 2014-1 USTC ¶50,256; TRC PAYROLL: 6,306.05.

Practitioners Highlight Problems At IRS Exempt Organizations Division

"IRS Commissioner John Koskinen, speaking recently on the 501(c)(4) crisis, stressed the importance of restoring public trust in the IRS."

The IRS's Exempt Organizations (EO) Division has been highly visible the last 12 months, since then-EO Director Lois Lerner made a public apology for EO's inappropriate focus on conservative political organizations. The Division has faced heavy criticism, not only from Congressional Republicans but from President Obama and other Democrats.

Several former IRS officials, all current EO practitioners, recently discussed problems facing EO, at a program of the D.C. Bar. The officials included Marc Owens, member, Caplin & Drysdale, Chartered, who spent 25 years with IRS Exempt Organizations, the last ten as its director; T.J. Sullivan, partner, Drinker Biddle & Reath LLP, an EO healthcare specialist who spent eight years at the IRS; and Paul Streckfus, founder and editor of the EO Tax Journal, and a former EO staff member. This Practitioners' Corner takes a closer look at the comments of these officials and at the state of EO. (The PC also uses some information provided by Owens in a March 2014 analysis of EO.)

History

Owens observed that the history of exempt organizations and their regulation by the IRS has itself tracked certain scandals and high profile events over time—charities competing against for-profit businesses (leading to the taxation of unrelated business income); "massive resistance" and the use of nonprofit schools to avoid school desegregation; religious credentials provided by mail-order ministries to avoid serving in Vietnam; the use of EOs to funnel money to Nicaraguan rebels in the Iran/Contra scandal during the Reagan administration; and the use of EOs as a mechanism for campaign funding. But Owens noted that concerns about the abuse of exempt organizations go even further back; they can be dated to the year 1601, when Britain enacted the Statute of Charitable Uses to address the "misemployment of lands, goods and stocks of money" by charity.

In the *Tax Reform Act of 1969*, Congress strengthened the IRS's oversight role by imposing excise taxes on private foundations and their accumulation of assets. But EO (as well as Employee Plans (EP)) differs from other IRS concerns; it is not a revenue-producing area, and therefore is not "central" to the IRS, Sullivan noted. To ensure that the IRS devoted time and resources to EOs, Congress in 1974 mandated the position of Assistant Commissioner (EP/EO), to police EOs and to oversee the IRS's EO activities, Owens said.

EO staffing

The developments of 1969-1974 generated a dramatic increase in IRS's staffing of EO, Owens said. There were other developments, he noted: the creation of assistant regional commissioners (EP/EO) to oversee field operations, and the establishment of a "key district" system in the IRS National Office audit division to better focus audit resources. But it has been downhill since 1978, Streckfus said. Because IRS's oversight of EOs does not raise revenue, it has been easy for IRS commissioners to "loot" EO to shift resources to other IRS functions, he said. Owens observed that IRS staffing and resources have fallen or remained stagnant.

■ ***Comment.*** IRS Commissioner John Koskinen observed that the IRS has approximately 90,000 employers, but only about 800 in the EO division. Owens, citing an IRS report, noted a slow decline in staffing, from 900 employees in 2010 to 876 in 2012.

Moreover, as employees hired in the 1960s and '70s became eligible to retire after 30 years, there has been a wave of retirements, with a corresponding loss of experience and institutional knowledge, Owens said. Sullivan and Streckfus agreed. The situation has become "very bad" in the last 15 years, Sullivan said; the current IRS staff, no matter how capable, lacks historical knowledge of developments in EO law. Streckfus observed that the IRS has appointed many managers that lack EO experience since Owens left.

The 2013 "crisis"

In May 2013, EO Director Lois Lerner, speaking at a conference of the American Bar Association's Section of Taxation, apologized for EO's inappropriate targeting of conservative political organizations seeking tax exempt status under Code Sec. 501(c)(4) (social welfare organizations). In response to the criticism that followed this disclosure, EO focused "entirely" on (c)(4) organizations, Owens said, while other EO responsibilities, including the processing of 501(c)(3) (charity) applications, "ground to a halt."

Although a backlog had been building, this shift in focus led to a larger, unprecedented backlog of as much as 80,000

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Washington Report

by the CCH Washington News Bureau

Bill would increase safe harbor for tangible property costs

Sen. John Hoeven, R-N.D., and Sen. Maria Cantwell, D-Wash., a member of the Senate Finance Committee, recently introduced the Farm and Small Business Expensing Tax Relief Act, which would increase to $5,000 the current $500 safe harbor limit for tangible property costs in the new tangible property repair regulations (T.D. 9636). The increase in the safe harbor election would more closely reflect the actual cost of items, lawmakers proposed. In addition, the measure would eliminate the applicable financial statement criteria and sets out a current IRS definition of small business as $10 million or less in gross receipts.

NTEU criticizes renewed interest in privatizing tax collection

The National Treasury Employees Union (NTEU) has urged Congress not to partially privatize tax collection, an idea currently under consideration by some House and Senate lawmakers. Some lawmakers have proposed requiring Treasury to contract with private collection agencies (PCAs) to collect unpaid taxes.

"Between 2006 and 2009, the IRS contracted with private collection agencies to collect taxes with dismal results," the NTEU cautioned. "While the program was projected to bring in up to $2.2 billion in unpaid taxes it instead resulted in a net loss of almost $4.5 million to the federal government, after subtracting $86.2 million in program administration costs and more than $16 million in commissions to the private collection agencies."

"I can say in very clear terms that private tax collection does not save or generate any money for the federal government," NTEU President Colleen Kelley said in a statement. "It costs a lot of money and risks the privacy of taxpayer information."

Tax-exempt controversy continues

On April 15, the Republican National Committee (RNC) filed a lawsuit against the IRS for withholding records sought last year through the RNC's 2013 Freedom of Information Act (FOIA) request. In May 2013, the RNC sought to review documents and correspondence related to criteria used for reviewing and approving Code Sec. 501(c)(4) applications. However, the IRS requested several extensions and has yet to turn over the information. RNC Chair Reince Priebus called the delay "unacceptable and inexcusable."

In related news, several former IRS officials speaking at a bar association panel program discussed the recent backlash that the IRS Office of Exempt Organizations (EO) has suffered since the revelation last year that it had inappropriately delayed review of several applications for tax-exempt status under Code Sec. 501(c)(4). The former officials admitted that EO has been plagued by serious and long-standing problems, including lack of transparency. Other issues included severe backlogs in case processing, leadership failures, and loss of experienced personnel.

Government studies estimate lower-than-expected federal PPACA costs

In new report, the Congressional Budget Office (CBO) and Joint Committee on Taxation (JCT) issued an estimate that the cost to the federal government for implementing the insurance coverage provisions of the *Patient Protection and Affordable Care Act* (PPACA) will be lower than originally projected. Both agencies now project a net cost of $36 billion for 2014, which is $5 billion less than the previous projection for the year. Similarly, the CBO report projected a total cost of $1,383 billion for the 2015–2024 period, which is $104 billion less than the February projection.

The lower estimate stems partly from the lower premium payment rates for plans offered through Marketplaces, CBO reported. This, in turn, decreases the cost of federal subsidies to insured taxpayers. "Subsidies and related spending for insurance obtained through the exchanges constitute the largest share of the costs of the PPACA's coverage provisions," CBO noted.

GAO recommends more oversight of paid return preparers

The Government Accountability Office (GAO) recently urged Congress to consider granting the IRS authority to regulate paid tax return preparers. Earlier this year, the Court of Appeals for the District of Columbia Circuit struck down the IRS's registered tax return preparer (RTRP) program as exceeding the agency's statutory authority. The IRS had required unenrolled preparers to complete competency testing and satisfy continuing education requirements.

In a study, GAO discovered significant preparer errors during undercover site visits to 19 randomly selected preparers. Refund errors in the site visits varied from giving the taxpayer $52 less to $3,718 more than the correct refund amount. Only two of 19 preparers calculated the correct refund amount, GAO reported.

GAO noted that paid preparers who understate a taxpayer's tax liability due to willful or reckless conduct can be subject to a penalty. In 12 of 19 cases, paid preparers did not record additional side income not reported on Form W-2s. Three preparers used a preparer tax identification number (PTIN) that did not belong to them and one used a fake PTIN, GAO reported.

"Undoubtedly, many paid preparers do their best to provide their clients with tax returns that are both fully compliant with the tax law and cause them to neither overpay nor underpay their federal income taxes. However, IRS data, which more broadly track compliance, show preparers made serious errors, similar to the findings from our site visits," GAO told Congress.

Practitioners' Corner

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cases, Owens said. There is now anecdotal evidence that EO is taking steps to address the backlog, Owens said, but it is unclear whether these steps are having an effect.

Koskinen, speaking recently on the 501(c)(4) crisis, stressed the importance of restoring public trust in the IRS, "which was shaken by the management problems … with regard to the determination process. As a result of the inappropriate use of an organization's name alone as the criterion for setting its application aside for special treatment, doubt has been cast by some on the independence of the IRS."

Koskinen also discussed the service of former IRS Commissioner Randolph Thrower, who led the IRS from 1969 to 1971. "Thrower held firm against attempts being made at that time [by the Nixon administration] to politicize the agency. His refusal to let politics compromise the IRS is an important reminder to all IRS commissioners of what our mission is. I intend to follow his example."

IRS delays

Sullivan and Owens recounted problems they had dealing with EO on applications for tax-exempt charitable status under Code Sec. 501(c)(3). With EO's focus on applications from Sec. 501(c)(4) organizations, there have been long delays in handling other applications. Sullivan submitted a Form 1023 for a health clinic in March 2013. Unbeknownst to the practitioners and the public, the IRS decided to sit on all hospital Forms 1023, pending guidance on community health needs assessment (CHNA) requirements under Code Sec. 501(r). The IRS would not even acknowledge this suspension. At the same time, the IRS cut way back on its expedited handling of applications. Sullivan said this treatment was particularly outrageous; taxpayers need action on their applications, so that they can properly manage their organization's operations.

The IRS was just assigning cases from April 2012 when Sullivan submitted the application in March 2013. After the IRS denied expedited handling, Sullivan filed in court for a declaratory judgment on the application's status. Only at that point did the IRS address the application. The court filing occurred December 4; the IRS informed Sullivan January 9 that it would approve the application.

Owens had a similar experience. After constant IRS delay and ignoring of an application, Owens filed for a judicial determination of an organization's status. Again, the IRS finally reviewed the application after being sued, and it soon approved the application for tax-exempt status.

> ■ ***Comment.*** Streckfus said that EO had lots of "chefs," not just Lois Lerner, and that EO needed unity of command. He also commented that the oversight by Congress has not been helpful, because Congress's goal has been to find a scapegoat, not to uncover and fix EO's problems.

Other EO problems

Meanwhile, other factors were exacerbating the problems at EO, including sequestration and the government shutdown in October 2013, Owens said. Another factor was a new law that automatically revoked the tax-exempt status of organizations that failed to file a Form 990 (exempt organization annual information return) for three consecutive years. Hundreds of thousands of organizations had their status revoked. Many of these organizations had gone out of existence, but for those in existence, this was a real crisis, especially for those nonprofit organizations that had issued tax-exempt bonds. EO had to develop procedures and review thousands of applications for reinstatement. This was an unnecessary drain on EO's resources, Owens said; these were primarily small organizations with no money and no problems; there was no reason to address the lack of filings.

Current challenges include a continuation of EO's historic aversion to openness, Owens said. EO used to publish a phone list, so that practitioners knew who to contact, but it does not anymore. EO fails to disclose new procedures adopted internally and has not provided a fiscal year 2014 workplan to discuss its goals and projects for the coming year. (An EO official said there would be a 2015 workplan.) There has been a dramatic decline in technical advice requests from the field to the National Office, proceedings where taxpayers could present their case to the National Office, the source of EO guidance. Now, technical advice is essentially nonexistent. Less taxpayer involvement leads to bad decisions, Owens said.

> ■ ***Comment.*** Streckfus believes that the IRS Chief Counsel reinvents its procedures and relabels advice provided to the field, so that it does not have to include taxpayers in the proceedings. Chief Counsel will not provide information that should be in the public domain, he insisted.

Another problem is the influx of political money into tax-exempt organizations that are not Sec. 527 political organizations. The IRS has proposed new regs under Code Sec. 501(c)(4) (NPRM REG-134417-13) to limit their political activities, but organizations of all stripes have complained that the regs would go too far. The IRS has received more than 150,000 comments and will have huge demands on its time to address this rulemaking. Koskinen has said that the proceedings will not be resolved before 2015 at the earliest, and that the IRS may need to repropose the regs after reviewing comments and holding a hearing.

Reorganization

Koskinen has stated that his goal is to find problems quickly, fix them promptly, make sure they stay fixed, and be transparent in the process. After the 2013 crisis, there are new officials at EO, as well as Koskinen. The new management team includes Sunita Lough, TE/GE Commissioner; Tamera Ripperda, EO Division Director; and Stephen Martin, director, EO Rulings and Agreements. Owens said it is unclear how this new leadership will affect EO's direction. At the same time, EO functions are being reorganized, with many tasks and personnel shifting from EO to Chief Counsel. EO will implement the changes by October 1, 2014; the impact, again, is unclear.

Compliance Calendar

April 25
Employers deposit Social Security, Medicare, and withheld income tax for April 19, 20, 21, and 22.

April 30
Employers deposit Social Security, Medicare, and withheld income tax for April 23, 24, and 25.

May 2
Employers deposit Social Security, Medicare, and withheld income tax for April 26, 27, 28, and 29.

May 7
Employers deposit Social Security, Medicare, and withheld income tax for April 30, May 1, and 2.

May 9
Employers deposit Social Security, Medicare, and withheld income tax for May 3, 4, 5, and 6.

May 14
Employers deposit Social Security, Medicare, and withheld income tax for May 7, 8, and 9.

TRC Text Reference Table

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

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Monthly Quizzer

The following questions (with answers at the bottom of the column) will help you review some of the more important developments in CCH Federal Tax Weekly during the past month.

Q Foreign Financial Institutions treated as Reporting Financial Institutions under a Model 1 FATCA intergovernmental agreement should register with the IRS as which of the following?

(a) Withholding Agents
(b) Qualified Intermediaries
(c) Registered Deemed-Compliant Foreign Financial Institutions
(d) PFICs

Q The maximum inflation-adjusted limitation for purposes of calculating deductible foreign *housing expenses* for 2014 is $90,200. *True or False?*

Q The IRS reiterated in Notice 2014-19 that qualified retirement plan operations must reflect the outcome of which U.S. Supreme Court ruling from June 2013 relating to same-sex marriage?

(a) *E.S. Windsor*
(b) *WFC Corporation*
(c) *In re Quality Stores*
(d) None of the above

Q Reversing the Sixth Circuit Court of Appeals, the U.S. Supreme Court has held that supplemental unemployment benefits (SUB) payments made to terminated employees and not tied to the receipt of state unemployment benefits are wages for FICA tax purposes. *True or False?*

Answers:

Q1. *(c), See Issue #17, page 193.*
Q2. *False, See Issue #16, page 187.*
Q3. *(a), See Issue #15, page 171.*
Q4. *True, See Issue #14, page 157.*