



RECENT TAX NEWS – OUR FREE 1 HOUR NEWSLETTER

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2014 – 1 Hour of Free CPE Credit in Taxation – For New Customers Only.

CPE for Enrolled Agents, CPAs, and Licensed Accountants

Phone and fax # – 1-800-950-0273, e-mail – cpeliteinc@aol.com, web site – www.cpelite.com

For new customers only -- We are offering this newsletter which is worth one hour of CPE. It is **free**. It covers the following topics: (1) individual retirement accounts; (2) a compliance study involving the reporting of alimony income and deductions; (3) health savings accounts; (4) recordkeeping requirements; and, (5) the tax consequences of a settlement involving payments to qualified borrowers who lost their residence in foreclosure during a four-year period ending on December 31, 2011. Once you successfully complete the 5-question online quiz (see page 6) to this newsletter, you will receive a certificate of completion for one hour of CPE. Provide your PTIN, and we will electronically report your hour to the IRS. We invite you to become a 2014 subscriber to our 18-hour newsletter subscription and/or complete one or more of our eight 6-hour courses. We also offer a 2-hour “Special Edition” newsletter on ethics for enrolled agents. It will be available by mid-summer. For more information about our CPE materials, see pages 7-9 or visit our website www.cpelite.com. We encourage you to visit our website regularly to keep abreast of current tax developments at “Tax News.” Also, check regularly for company / product offerings. We will continue to update you through emails. Testing online at our website is very convenient. Thank you for trying out our free 1-hour newsletter. We hope you enjoy it and find it informative.

LEARNING OBJECTIVE AND CONTENT LEVEL – The primary learning objective of this newsletter is to make accounting and tax practitioners aware of IRS and Treasury items, and court decisions which are likely to have an impact on most tax practices. The content level of the newsletter material is an overview of these items.

PREREQUISITES – There are no prerequisites nor is advance preparation required for our newsletters.

TAX COURT DECIDES IRA ROLLOVER CONTRIBUTION ISSUES: IRS RESPONDS QUICKLY TO ONE OF THEM

In Bobrow [1/28/14], a married couple had three IRAs: (1) the husband’s traditional; (2) his rollover, and (3) the wife’s traditional. The issues in the case stem from IRA distributions and rollovers. Here are key dates in

the case: (1) 4/14/08 – husband receives two distributions totaling \$65,064 from his traditional IRA; (2) 6/6/08 – husband receives a \$65,064 distribution from his rollover IRA; (3) 6/10/08 – husband transfers \$65,064 from his individual checking account to his traditional IRA; (4) 7/31/08 – wife receives \$65,064 from her traditional IRA; (5) 8/4/08 – the couple transfer \$65,064 from their joint checking account to the husband’s rollover IRA; and, (6) 9/30/08 – wife transfers \$40,000 from their joint checking account to the wife’s traditional IRA. The Tax Court stated that Section 408 provides generally that any individual retirement plan distribution is included in the distributee’s gross income. However, the distribution is excludable from gross income if the entire amount is paid into a qualifying IRA, individual retirement annuity, or retirement plan no later than the 60th day after the distributee receives the distribution (“rollover contribution”). Partial rollover contributions for less than the full amount of the distribution also may be made into a qualifying retirement plan. A taxpayer is limited to one nontaxable rollover in a one-year period that begins on the day of the distribution. The husband stated that the one-year rule applies to each IRA, and not across all his IRAs. So, he argued that the distributions he received from his traditional and rollover IRAs were not taxable. His argument was based on an IRS private ruling and a Tax Court memorandum decision, both of which related to a taxpayer’s use of funds between the time he received them as an IRA distribution, and a later time when he repaid the funds to the IRA. The court agreed with the taxpayer that the use of the funds made was unimportant when they were only money, and not other property. But, it stated that the argument bore no relevance to the one-year rule. The IRS relied on two cases in which a taxpayer withdrew funds from IRA # 1 and deposited the funds into IRA # 2. Within one year of the first withdrawal, the taxpayer made two separate withdrawals from IRA # 2 and redeposited the funds back into IRA # 2. The court decided that the two later withdrawals were taxable rollovers, because the rollover exemption can be used only once during any one-year period, and the exemption applied to the first transfer from IRA # 1 to IRA # 2. The taxpayer argued against the IRS’s reliance on the two cases. He argued that the two cases apply only to the situation where the taxpayer takes multiple

distributions from one IRA, and not to his situation where he takes a single distribution from each IRA that he maintains. The court rejected the taxpayer's position that the one-year applies with respect to each of a taxpayer's IRAs. It concluded that the one-year rule applies across all of a taxpayer's IRAs. It decided that the June 6 distribution that the taxpayer received from his rollover IRA was fully includible in his gross income. **Compliance Conflict:** On page 25 of IRS Publication 590, the IRS by both statement and example provides that the one-year rule applies to each taxpayer IRA, not across all of his IRAs. **Note:** In recent IRS guidance, Announcement 2014-15 [3/20/14], the IRS states that it will issue new proposed regulations and revise Publication 590 to reflect the Tax Court's decision in Bobrow. **Compliance Pointer:** Trustee-to-trustee transfers between IRAs do not trigger the Section 408 one-year limitation. With respect to the wife's 7/31/08 distribution from her traditional IRA, the court stated that the 9/30/08 partial contribution of \$40,000 to her traditional IRA was not within the 60-day period, as it was made on the 61st day after the 7/31/08 distribution. The taxpayers asserted that the wife had requested before September 30 that their bank transfer \$65,064 from their joint checking account to the wife's traditional IRA. They argued that their failure to meet the 60-day rollover deadline was due to bank delays. The taxpayers failed to provide documentation to support their bank delay argument. Because of the documentation failure, the court refused to grant them relief from the 60-day requirement available under one of two methods for relief in Revenue Procedure 2003-16 (hardship, and automatic approval under certain circumstances). The court also decided that the wife's distribution was subject to the Section 72(t) 10% premature distribution penalty as she was not at least 59 ½ at the time of the July 31, 2008, distribution to her from her traditional IRA.

TIGTA REPORTS LARGE GAP BETWEEN ALIMONY DEDUCTIONS AND ALIMONY INCOME REPORTED ON 2010 TAX RETURNS

The Treasury Inspector General of Tax Administration (TIGTA) in Audit Report # 2014-40-022 [3/31/2014], reports the results of an investigation of 567,887 tax returns for 2010 where taxpayers claimed alimony deductions totaling more than \$10 billion on their returns. For 266,190 (47%) of the returns, the following discrepancies were noted: (1) the amount deducted by the payer differed from the amount reported by the recipient (222,895 cases or 84% of the total discrepancies); (2) the recipient failed to report any of the alimony received even though the recipient was required to file a tax return (36,795 cases or 14% of the discrepancies); and, (3) the recipient's taxpayer identification number (TIN) provided on the payer tax return was either missing or not valid, so the TIGTA

could not determine whether the income was reported by the recipient (6,500 cases or 2% of the discrepancies). These discrepancies resulted in more than \$2.3 billion in alimony deductions claimed without the corresponding income being reported by the recipient. Based on the results of completed IRS examinations, the TIGTA estimated that noncompliance with regard to those returns not selected for examination totals more than \$351 million in unreported tax resulting from an erroneous deduction or unreported income. Other findings by the TIGTA include the following: (1) for taxpayers who did not report a valid TIN, the IRS failed to assess penalties of nearly \$325,000; (2) the IRS has no processes or procedures to address the alimony reporting compliance gap; and, (3) the TIGTA questioned three of the seven filters that the IRS uses to identify tax returns with the highest risk of alimony noncompliance. TIGTA recommended that the IRS evaluate current examination filters to ensure that potentially high-risk tax returns are not inappropriately excluded from examination and develop a strategy to address the significant alimony compliance gap. This strategy should include determining the net benefit of using soft notices as an alternative approach to address this issue, as well as actions the IRS plans to take with regard to individuals who continue to misreport alimony deductions and/or income. TIGTA also recommended that the IRS revise processes and procedures to verify that all tax returns include a valid recipient TIN when an alimony deduction is claimed, and correct errors in IRS processing instructions to ensure that a penalty is accurately assessed on all tax returns on which a valid recipient TIN is not provided.

IRS UPDATES HSA LIMITATIONS

In Revenue Procedure 2014-30 [4/23/14], the IRS reports annual inflation adjustments related to health savings accounts (HSAs) for 2015. The maximum deduction for 2015 contributions is \$3,350 for self-only coverage (up \$50 from 2014) and \$6,650 for family coverage (up \$100 from 2014). The high-deductible health plan must have an annual deductible that is not less than \$1,300 for self-only coverage (up \$50 from 2014) and \$2,600 for family coverage (up \$100 from 2014). The 2015 annual out-of-pocket expense maximums of \$6,450 for self-only coverage and \$12,900 for family coverage increased by \$100 and \$200, respectively, from 2014. The deduction limit is increased by \$1,000 for an eligible individual who is age 55 or older. To qualify for a Health Savings Account, the insurance plan must be a high-deductible health plan (HDHP) that satisfies the minimum annual deductible and out-of-pocket expenses limitations specified for the tax year. Generally, the HDHP may not provide benefits for any year until the minimum deductible for that year is

satisfied. There is a safe harbor for the absence of a deductible for preventive care. An HDHP may provide preventive benefits without a deductible, or a deductible less than the general limit. The Affordable Care Act contains a requirement that group health plans and health insurance issuers that offer group and individual health coverage provide benefits for certain preventive health services without imposing cost-sharing requirements. The IRS has clarified that the Affordable Care Act requirement for group health plans and health insurance issuers will not cause an otherwise qualified HDHP to fail to qualify as an HDHP.

PENALTY EMPHASIZES IMPORTANCE OF ADEQUATE RECORDS

For 2009, the taxpayer reported no income and \$65,524 of business expenses on his Schedule C. The IRS disallowed all \$5,309 of the car and truck expenses portion with respect to the SUV he used in his real estate sales business. The taxpayer had two documents supporting his car and truck expenses. On a mileage chart was a handwritten list of places the taxpayer alleged he had driven. He showed no business purpose nor mileage traveled or amount of each trip expense. On a second document was a printed list of his purported 2009 SUV expenses for fuel, insurance, parts, registration, and service. It included an amount for each entry, and a handwritten note on the document stating “mileage for 2009, 11,135.” In the Tax Court’s summary opinion [[Chapin](#); 4/3/14], it stated taxpayers are required to maintain sufficient records to establish the amount and purpose of any ordinary and necessary business deduction. Additional substantiation is necessary for “listed property” (Section 280F), such as passenger automobiles. Substantiation is necessary either through (1) adequate records, or (2) sufficient evidence that verifies the taxpayer’s statement as to (1) expense amount, (2) time and place of travel, and (3) business purpose of the expense. Noting that a contemporaneous log is not required, it stated that if the taxpayer subsequently reconstructs his expenses, corroborative evidence with a high degree of probative value to support a reconstruction not made at or near the time of the expenditure is necessary. The court noted that the taxpayer’s records were reconstructions of the business places he traveled and the vehicle expenses he incurred. He however did not provide any corroborating receipts or other records that substantiated the two documents. Neither document identified a business purpose nor showed mileage. The court disallowed the taxpayer’s vehicle expense deduction. It stated that a 20% underpayment accuracy penalty applies if the taxpayer is negligent or disregards rules or regulations, or substantially understates his income tax (larger of 10% of the tax required to be shown on the return, or \$5,000). The taxpayer must prove that he had reasonable cause or substantial authority (Section 6662).

The court noted that there would have to be further IRS / taxpayer computations to determine if there was substantial understatement, so it considered the IRS’s alternative argument that the taxpayer was negligent for failure to maintain records to support the deductions that he claimed for “listed property” (Section 274). The taxpayer could have argued reasonable cause or good faith for his record failure. Instead he stated “no one keeps records in accordance with the ‘IRS code.’” The Tax Court upheld the 20% accuracy penalty on the amount of the tax underpayment (Section 6662). **Note:** IRS Publication 463, Chapter 5, contains a sample “Daily Business Mileage and Expense Log” and a sample “Weekly Traveling Expense and Entertainment Record” useful for recordkeeping.

TAX CONSEQUENCES OF RECEIPT OF NATIONAL MORTGAGE SETTLEMENT PAYMENT ARE SPECIFIED

In Revenue Ruling 2014-2 [12/18/13], the IRS considers the treatment of the amount a taxpayer receives under the National Mortgage Settlement (NMS) due to foreclosure on the taxpayer’s principal residence. Under settlement agreements between the federal government and the District of Columbia and all states except Oklahoma, five mortgage servicers paid about \$1.5 billion into a settlement fund for payments to qualified borrowers who lost their residence in foreclosure between January 1, 2008, and December 31, 2011. Borrowers receive about a \$1,400 payment because the mortgage servicer mishandled the borrower’s loan application or made errors in the foreclosure process. Payments began in Summer 2013. In the case of a deceased borrower who qualified, the payment is made in the borrower’s name. The IRS considers seven different fact patterns where payment is received and there is gain or loss on a single-unit or multiple-unit home (e.g., one unit used as a principal residence, and another unit used as rental property), there is gain on the home that is more or less than prior depreciation, and the borrower died before receiving the payment. The amount realized by the borrower on disposition of the property is the fair market value of the property. The IRS states that the NMS payment is an additional amount realized on foreclosure of the borrower’s principal residence. The IRS states that the payment is intended to compensate the borrower for loss of a principal residence, not for loss on other property. Finally, the IRS states that a taxpayer who receives a deceased borrower’s NMS payment stands in the borrower’s shoes, and any gain not excluded from gross income under Section 121 is income in respect of a decedent. Two examples from the ruling are provided here. **Example 1:** At foreclosure, the taxpayer’s residence has a \$125,000 fair market and a \$230,000 basis. The \$105,000 loss

is reduced to \$103,600 because of the \$1,400 NMS payment that the borrower receives. None of the loss is deductible. **Example 2:** In 2000, the taxpayer buys a home for \$155,000, financing \$130,000 with a recourse, first-lien mortgage loan secured by the home. He uses part of his home as an office, claiming \$10,000 of depreciation to 2009. In 2009, when the basis of the home is \$145,000 and it is worth \$149,000, the lender forecloses on it. The lender later sells the home for \$149,000. The loan balance at the time of foreclosure is \$175,000 (there were subsequent refinancings), which is satisfied from the \$149,000 sales proceeds. The taxpayer receives a \$1,400 NMS payment in 2013. The taxpayer's gain on foreclosure of the home is \$5,400 ($\$149,000 + \$1,400 - \$145,000$). Generally, under Section 121, all \$5,400 would be excludable from the taxpayer's gross income. However, since it is less than the \$10,000 of depreciation taken, all \$5,400 is reportable in the taxpayer's gross income.

****REVIEW QUESTIONS AND SOLUTIONS****

1. Regarding a recent Tax Court case on IRA rollover contributions, **which one** of the following statements **is false**?
 - a. After the IRS revises its Publication 590, the IRS and the court's decision will agree on the application of the one-year rule to rollover contributions.
 - b. The court ruled against the taxpayer's position that the one-year rule applies to each of a taxpayer's IRAs.
 - c. The taxpayer transferred property other than cash between his IRAs.
2. In a recent TIGTA investigation of tax returns with alimony deductions, what was the percentage of tax returns on which the TIGTA found IRS discrepancies?
 - a. 84%.
 - b. 47%.
 - c. 14%.
3. Regarding health savings accounts, **which one** of the following statements **is true**?
 - a. The 2015 annual out-of-pocket expense maximums for self-only coverage is \$6,650.
 - b. The 2015 minimum annual deductible for self-only plans is \$2,600.
 - c. Generally, a high-deductible health plan may not provide benefits for any year until the minimum deductible for that year is satisfied.
4. Based on a recent Tax Court decision dealing with the deduction for car and truck expenses, **which one** of the following statements **is true**?
 - a. Documentation of car and truck expenses is not the same as documentation of other business expenses.
 - b. A contemporaneous log is required to document car and truck expenses.
 - c. Reasonable cause or good faith is not a defense against the substantial income tax understatement accuracy penalty of Section 6662.
5. A qualified borrower receives a \$1,400 NMS payment after foreclosure on his principal residence. At foreclosure, his basis in the residence was \$150,000, and it was worth \$100,000. **How much** is his loss, **and how much** of the loss **is reported** on his tax return?
 - a. \$50,000 loss; no reportable loss.
 - b. \$48,600 loss; no reportable loss.
 - c. \$48,600 loss; \$48,600 reportable loss

Solutions

1. **"C" is the correct response.** Only cash was involved in all of the distributions and rollovers from the taxpayers' IRAs.
"A" is an incorrect response. The court ruled against the taxpayer's position that the one-year rule applies to each of a taxpayer's IRAs. In IRS Publication 590, the IRS provides that the one-year rule applies to the same IRA, not all IRAs. However, the IRS has announced it will change Publication 590 to agree with the Tax Court's decision.
"B" is an incorrect response. The court concluded that the one-year rule applies across all of a taxpayer's IRAs. It decided that a distribution made less than two months earlier from another of the taxpayer's IRAs caused the latter IRA distribution to be taxable. *Bobrow*.
2. **"B" is the correct response.** Of the 567,887 tax returns where taxpayers claimed alimony deductions, 266,190 (47%) of them had discrepancies.

"A" is an incorrect response. 84% was the percentage of total discrepancies where the amount deducted by the payer differed from the amount reported by the recipient.

"C" is an incorrect response. 14% was the percentage of total discrepancies where the recipient failed to report any of the alimony received even though the recipient was required to file a tax return. *TIGTA Audit Report # 2014-40-022.*

3. **"C" is the correct response.** Other than a safe-harbor exception for preventive care, the individual is responsible for all medical costs until the annual deductible is reached.

"A" is an incorrect response. \$6,650 is the maximum 2015 deduction for family coverage. The 2015 annual out-of-pocket expense maximums for self-only coverage is \$6,450.

"B" is an incorrect response. \$2,600 is the 2015 minimum annual deductible for family coverage plans. *Revenue Procedure 2014-30.*

4. **"A" is the correct response.** Additional substantiation is necessary for "listed property" (Section 280F), such as passenger automobiles.

"B" is an incorrect response. While a contemporaneous log is not required, if the taxpayer subsequently reconstructs his expenses, corroborative evidence with a high degree of probative value to support a reconstruction not made at or near the time of the expenditure is necessary.

"C" is an incorrect response. In addition to reasonable cause and substantial authority, reasonable cause or good faith is a defense against the penalty. *Chapin.*

5. **"B" is the correct response.** The \$50,000 loss (\$150,000 - \$200,000) is reduced by the \$1,400 NMS payment. As the loss is on the principal residence, there is no deduction.

"A" is an incorrect response. The loss without regard to the NMS payment is reduced by the amount of the NMS payment.

"C" is an incorrect response. As the loss is on the principal residence, none of the loss is reported on the tax return. *Revenue Ruling 2014-2.*

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***** QUIZ QUESTIONS *****

To test on-line, go to www.cpelite.com. From the middle section on our home page, click on the button '1 Hr Free Newsletter' and follow the instructions on the screen.

1. In a recent case, the Tax Court decided that a taxpayer's rollover contribution to his IRA was taxable because:
 - a. the taxpayer received distributions from two different IRAs within one year from the date of the distribution from the first IRA.
 - b. the contribution was done through a trustee-to-trustee rollover.
 - c. before the Tax Court decision, the IRS in its Publication 590 provides that the rollover distribution is taxable.
2. Regarding a recent TIGTA investigation of tax returns with alimony deductions, **which one** of the following statements **is true**?
 - a. The TIGTA was satisfied with all of the filters that the IRS uses to identify tax returns with the highest risk of alimony noncompliance.
 - b. Most of the taxpayers claiming alimony deductions failed to report the recipient's taxpayer identification number on the taxpayer's tax return.
 - c. The TIGTA reported that more than \$2.3 billion in alimony deductions were claimed without the corresponding income being reported by the recipient.
3. What is the maximum deduction for contributions to a **family** health savings account for 2015 assuming the taxpayer is less than age 55?
 - a. \$3,350.
 - b. \$6,650.
 - c. \$6,550.
4. Regarding a recent Tax Court decision dealing with a taxpayer's deduction of expenses for an SUV he used in his real estate sales business, **which one** of the following responses **is false**?
 - a. The court denied the car and truck expenses deduction.
 - b. The court imposed the accuracy penalty.
 - c. The court denied the car and truck expenses deduction, and imposed no accuracy penalty.
5. **Which one** of the following **is not** an IRS conclusion in a recent ruling on the National Mortgage Settlement payment?
 - a. The NMS payment is treated as an additional amount realized with respect to the borrower's principal residence.
 - b. If a taxpayer receives a deceased borrower's NMS payment, the treatment of the payment to the recipient depends on the recipient's marital status.
 - c. The payment is treated as compensating the borrower for loss of his or her principal residence.

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[1] **THE ELITE QUARTERLY** – Recommended CPE Credit – 4 Hours per issue [O]

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COURSES

- [1] INCOME ITEMS AND PROPERTY TRANSACTIONS.** Recommended CPE Credit: 6 HRS [B]
To provide an explanation of (1) selected income items affecting individual income taxpayers, including social security income, alimony, and scholarships, and (2) common property transactions involving individual income taxpayers, such as capital gains, sale of personal residence, and like-kind exchanges.
- [2] ABOVE-THE-LINE DEDUCTIONS.** Recommended CPE Credit: 6 HRS [B]
To provide an explanation of (1) expenses commonly deducted by Schedule C taxpayers, including travel, transportation, and home office deductions, and (2) and common above-the-line deductions.
- [3] ITEMIZED DEDUCTIONS.** Recommended CPE Credit: 6 HRS [B]
To provide an explanation of medical expenses, taxes, residence interest, charitable contributions, nonbusiness casualty and theft losses, miscellaneous itemized deductions, and the standard deduction.
- [4] RATES, CREDITS AGAINST TAX, AND SPECIAL ISSUES.** Recommended CPE Credit: 6 HRS [B]
To provide an explanation of the tax rate structure, selected credits (including the earned income tax credit and the education credits), estimated tax payments, and selected special issues (including filing status and exemptions).
- [5] PARTNERSHIP TAXATION – PART I.** Recommended CPE Credit: 6 HRS [B]
To provide an explanation of (1) the tax implications of formation, including gain or loss, basis of partnership interest, and basis of partnership assets after formation and (2) general reporting procedures of partnership items.
- [6] PARTNERSHIP TAXATION – PART II.** Recommended CPE Credit: 6 HRS [B]
To provide an explanation of the special topics involving partnership operations and the tax implications of sales of partnership interests, partnership distributions, and redemptions of a partner's interest.
- [7] S CORPORATION TAXATION – PART I.** Recommended CPE Credit: 6 HRS [B]
To provide an explanation of (1) considerations in being an S Corporation, (2) requirements and election to be an S Corporation, (3) elections and operations, (4) shareholder basis issues, and (5) reporting and compliance.
- [8] S CORPORATION TAXATION – PART II.** Recommended CPE Credit: 6 HRS [B]
To provide detailed coverage of S Corporation shareholder basis issues, and an explanation of loss limitation issues, distributions made by an S Corporation to its owners, and S Corporation shareholder changes and income taxes.