THE ELITE QUARTERLY – Taxation

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CPE for Enrolled Agents, CPAs, and Licensed Accountants

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We hope that you had a successful 2017 filing season. Many of you have renewed your newsletter subscriptions or special course offer for 2017 – we thank you very much! So far our "2017 EA Package" option remains the most popular option. Our "Special Offer" for our courses saves you $45. All eight of our courses have been updated for 2017. See pages 22 and 23 for details of all of our packages. Please also visit our website www.cpelite.com regularly to keep abreast of current tax developments at "Tax News." **As in the Spring 2017 newsletter this newsletter includes a "Special Topics" section.** This section reviews one or more popular tax provisions that affect many taxpayers each year. Testing online at our website is more convenient than ever. Thank you for being a customer – we appreciate your business! Here are the items in this newsletter.

What's Inside This Issue

INSTRUCTIONS – Read the content on pages 1-17, the quiz questions on pages 18-20, and the quiz instructions on page 21. Select the best answer for each quiz question and record the answers either on the answer sheet on page 21 or on-line at www.cpelite.com.

COURSE COMPONENTS, CONTENT LEVEL, AND LEARNING OBJECTIVES – The components of this newsletter are divided in order among IRS rulings, court decisions, Treasury items, Special Topics, and *An Elite Possibility* dealing with estate planning. The content level of the newsletter is an update of these items. For the IRS and Treasury Items, the learning objectives are:(1) Determine the vehicle deduction limitations for vehicles placed into service in 2017; (2) Know the notice relief requirements for "Qualified Small Employer Health Reimbursement Arrangements"; (3) Know the rules to elect to use the research tax credit against employer FICA taxes; (4) Determine whether employers are liable for unpaid taxes by a PEO; (5) Identify which taxpayer debts will be collected by private contractors; (6) Recognize differences and requirements between tips and service charges; and, (7) Know the IRS's efforts against identity theft. For each court ruling, the learning objectives are: (1) Differentiate the taxpayer's argument from the IRS's position; (2) Identify the factors used in the court's decision; and, (3) Recognize the decision reached by the court. For the special topics, the learning objectives are (1) Determine whether a taxpayer qualifies as a real estate professional under the passive activity loss rules; (2) Determine a taxpayer's tax home; and (3) Know the rules of the away from home requirement. For the Elite Possibility the learning objective is to determine which beneficiaries should be named beneficiaries to the taxpayer's IRAs. There are no prerequisites or additional materials needed nor is advance preparation required for our newsletters.

Key Terms in This Issue of THE ELITE QUARTERLY

[tem 2] Qualified small employer health reimbursement arrangement (QSEHRA): A health plan, exempt from the group health plan rules, that employers with less than 50 full-time employees may provide to eligible employees.

[tem 3] Qualified small business: A company which meets a set of requirements for satisfying certain provisions in the Code. For the election to apply to use research credits against employer FICA taxes, the company must be no more than five years old and have gross receipts below $5 million.

Key Terms - Continued

[tem 4] Professional Employee Organization (PEO): A firm that provides a service under which an employer can outsource employee management tasks, such as employee benefits, payroll and workers compensation, recruiting, risk/safety management, and training and development.

[tem 5] Private Collection Agency (PCA): A private contractor hired by the IRS to collect unpaid individual tax obligations that are not currently being worked by IRS collection employees and often were assessed by the tax agency several years ago.

[tem 6] Service charge: In contrast to tips, an amount that an employer requires a customer to pay.

[tem 10] Claim of Right Doctrine: This doctrine generally applies when a taxpayer reports an income item because the taxpayer appeared to have an unrestricted right to the income, even though the taxpayer may have to repay the amount in a future year.

[tem 12] Unauthorized disclosure: An IRS disclosure of a tax return or return information which is not authorized under Section 6103.

[tem 14] Identity theft tax refund fraud: An act that occurs when an individual uses another person's name and TIN to file a fraudulent return with false income and withholding documents to the IRS to receive a fraudulent tax refund.

[tem 15] Real estate professional: Under the passive activity loss rules, an individual or closely-held C Corporation who, if he (it) meets certain rules may use rental losses without limit to offset nonpassive income.

[tem 15] Material participation: Under the passive activity loss rules, a measure of whether a trade or business is subject to the rules. Excluded by meeting one of seven prescribed tests.

[tem 15] Grouping rules: Under the passive activity loss rules, rules that permit a taxpayer to group one or more of the taxpayer's activities as a single activity.

[tem 18] Away from home: A requirement to deduct travel business deductions. A taxpayer must be away from the taxpayer's tax home substantially longer than an ordinary day's work for which periods of rest are required to meet the demands of the job.

IRS

[ITEM 1] IRS PROVIDES VEHICLE LIMITATIONS FOR 2017 PURCHASES

In Revenue Procedure 2017-29 [3/24/17], the IRS specifies the inflation-indexed depreciation deduction limitations for owners of passenger vehicles and the income inclusion amounts for lessees of passenger vehicles first purchased or leased in calendar year 2017. There are separate limitations for trucks and vans. "Trucks and vans" refers to passenger vehicles built on a truck chassis, including minivans and sport utility vehicles that are built on a truck chassis. The limits for passenger automobiles placed in service in 2017 are: 2017 – $3,160; 2018 – $5,100; 2019 – $3,050; and, each succeeding year – $1,875. All four limits are the same as in 2016. For trucks and vans placed in service in 2017, the limits are: 2017 – $3,560; 2018 – $5,700; 2019 – $3,450; and, each succeeding year – $2,075. Except for the 2019 truck and van limit, which increased $100, the other limits are the same as in 2016. The "Protecting Americans from Tax Hikes Act of 2015" (PATH Act) extended bonus depreciation through 2019 but only extended the $8,000 increase in the first year vehicle limit for 2015-2017. For 2018, the increase is $6,400 and for 2019 it is $4,800. If taxpayers claim bonus depreciation in 2017, the first-year depreciation limitations are $11,160 for passenger automobiles and $11,560 for trucks and vans. **Note:** Use of the standard mileage rate in the first year limits the use of the immediate expensing election. Because of the annual depreciation limitations described above, the immediate expense deduction would not be available for most passenger automobiles. Certain sport utility vehicles, trucks, and vans with gross weights in excess of 6,000 pounds are not subject to the annual limitations and are entitled to an immediate expense deduction of up to $25,000 in the year of purchase. Vehicles with gross weights in excess of 14,000 pounds and certain exempt vehicles (such as passenger vehicles seating 10 or more passengers) may qualify for an immediate expense deduction of $510,000 in 2017 (inflation-adjusted) which was made permanent by the PATH Act.

[ITEM 2] IRS PROVIDES RELIEF FOR QUALIFIED SMALL EMPLOYER HEALTH REIMBURSEMENT ARRANGEMENTS

"Qualified Small Employer Health Reimbursement Arrangements" (QSEHRAs) were added by the *21st Century Cures Act (Cures Act)* on December 13, 2016. An employer generally with less than 50 full-time employees may provide a QSEHRA to eligible employees. After an eligible employee provides proof of coverage, payments or reimbursements may be made to the employee for medical care expenses incurred by the employee or his/her family members. Certain requirements must be satisfied. A QSEHRA is not treated as a group health plan, and so it is exempt from the group health plan rules. No salary reduction contributions may be made under a QSEHRA, and the amount of payments and reimbursements for any year may not exceed $4,950 ($10,000 for cases where reimbursements may be made for the employee's family members). Generally, an eligible employer must furnish a written notice to eligible employees at least 90 days before the beginning of a year for which the QSEHRA is provided. The written notice must include specified requirements under Section 9831(d)(4). There is a penalty for failing to timely furnish eligible employees with the required written notice. The penalty applies for years that begin after December 31, 2016. An employer that provides a QSEHRA to its eligible employees beginning in 2017 will not be treated as failing to timely file if the notice is furnished to employees no later than 90 days after the December 13, 2016, enactment date of the Cures Act (March 13, 2017). Recognizing that some employers may need additional guidance concerning the contents of the required notice, the IRS intends to issue guidance in the near future (not provided at June 15, 2017). In Notice 2017-20 [2/27/17], the IRS provides notice and penalty relief. For employers who provide QSEHRAs in 2017, the notice requirement is lifted until no earlier than 90 days following the issuance of the guidance. No penalties will be imposed for failure to provide the initial written notice before the extended deadline provided in the guidance. If an employer furnishes the QSEHRA notice before IRS guidance is issued, the employer may rely on a reasonable good faith interpretation of the Code to determine the contents of the notice.

[ITEM 3] IRS PROVIDES GUIDANCE ON USING RESEARCH TAX CREDITS AGAINST FICA TAXES

The PATH Act extended several provisions and made permanent many provisions, including the research tax credit under Section 41. One provision in the PATH Act that has not had a lot of coverage is an added provision to the research tax credit for small businesses. Specifically, a qualified small business may elect to use all or part of its research tax credit against the employer's share of FICA tax liability. For small businesses with taxable losses or little taxable income, this election would increase its current cash flow by applying part or all of the research tax credit against its FICA liability. In Notice 2017-23 [3/30/17], the IRS provides guidance on this election. There are two basic requirements to be a qualified small business. First, the gross receipts for the year must be less than $5 million. Second, the company did not have gross receipts for any taxable year preceding the 5-taxable-year period ending with such taxable year. In other words, the company has been in business five or less years. The maximum amount of the research tax credit that can be used each year against the employer FICA liability is $250,000. The election can be made for only five taxable years. If the business is part of a controlled group, the $250,000 maximum is allocated on the basis of each company's total research credit for the year. Form 6765 "Credit for Increasing Research Activities" is used to make the election. The election is made in Section D of the form. A qualified small business that elects to claim the payroll tax credit and files quarterly employment tax returns claims the payroll tax credit on its employment tax return for the first quarter that begins after it files the income tax return reflecting the election. For example, if a qualified small business files an income tax return on April 10, 2017, with a Form 6765 attached reflecting the payroll tax credit election, the qualified small business would claim the payroll tax credit on its Form 941, "Employer's Quarterly Federal ax Return," for the third quarter of 2017. Any unused credit could be claimed on its fourth quarter 941 return.

[ITEM 4] IRS FINDS EMPLOYER LIABLE FOR EMPLOYMENT TAXES NOT PAID BY PEO

Many companies contract a professional employee organization (PEO) to pay the wages of the company's employees, pay the applicable payroll taxes, and file the company's payroll tax returns. In Field Attorney Advice 20171201F, we are reminded of the importance of companies engaged in such contracts to monitor the activities of the PEOs and assure that the payroll taxes are being paid and the applicable payroll tax returns are being filed. The taxpayer operated a limousine transportation business and employed reservationists, fleet technicians, dispatchers, and chauffeurs. It also employed workers to perform services in accounting, administration, and marketing. The taxpayer entered into a contract with a PEO. Although the taxpayer was the common law employer of the employees, the contract referred to the workers as co-employees and the PEO was to perform the following duties: (1) administer the company's payroll, designated benefits and personnel policies and procedures related to the co-employees; (2) provide human resource administration; (3) furnish workers compensation covering the co-employees; and, (4) process and pay the wages of the co-employees. The agreement provided further that the company would fund the PEO at least one day before each payroll date, and the amount would cover the wages and any other charges with respect to the co-employees. The PEO was to pay the co-employees and payroll taxes as well as file the employment tax returns. No payroll taxes were paid and no payroll tax returns were filed. The taxpayer argued that it paid the PEO the requisite amount of payroll taxes so the PEO is obligated to pay the unpaid taxes. The taxpayer cited state law which requires every employee leasing company to assume responsibility for the payment of payroll taxes and collection of taxes from payroll on each covered employee. The IRS first indicated that state law does not supercede the Code and cannot relieve the actual employer of the obligation to pay taxes for which it is liable under the Code. As the taxpayer was responsible for the payment of wages, the IRS rejected the taxpayer's argument that the PEO was the statutory employer and was liable to pay the taxes. The IRS also ruled that the taxpayer was not entitled to relief treatment under Section 530, although it did concede that the taxpayer could be entitled to make interest-free adjustments for tax underpayments.

[ITEM 5] IRS ANNOUNCES THAT PRIVATE CONTRACTORS HAVE STARTED COLLECTING TAXES FOR THE IRS

A provision of the "Fixing America's Surface Transportation Act" passed in 2015 requires the IRS to use private collection agencies for the collection of outstanding inactive tax receivables. In IRS News Release 2017-74 [4/4/17], the IRS announced that it began sending letters to a relatively small group of taxpayers whose overdue federal tax accounts are being assigned to one of four private-sector collection agencies. The debts are unpaid individual tax obligations that are not currently being worked by IRS collection employees and often were assessed by the tax agency several years ago. Taxpayers being assigned to a private firm would have had multiple contacts from the IRS in previous years and still have an unpaid tax bill. The IRS will always notify a taxpayer before transferring their account to a private collection agency (PCA). First, the IRS will send a letter to the taxpayer and their tax representative informing them that their account is being assigned to a PCA and giving the name and contact information for the PCA. This mailing will include a copy of Publication 4518, "What You Can Expect When the IRS Assigns Your Account to a Private Collection Agency. " Once the IRS letter is sent, the designated private firm will send its own letter to the taxpayer and their representative confirming the account transfer. To protect the taxpayer's privacy and security, both the IRS letter and the collection firm's letter will contain information that will help taxpayers identify the tax amount owed and assure taxpayers that future collection agency calls they may receive are legitimate. The IRS also urges taxpayers to be on the lookout for scammers who might use this program as a cover to trick people. Taxpayers should remember that these private collection firms will only be calling about a tax debt the person has had – and has been aware of – for years and had been contacted previously in the past by the IRS. If taxpayers are unsure if they have an unpaid tax debt from a previous year – which is what the private collection firms will handle – they can go to IRS.gov and check their account balance: www.irs.gov/balancedue. If the account balance says zero, typically the taxpayer would not be getting a contact letter from the IRS or the private firm. The four private firms participating in this program are: (1) CBE Group of Cedar Falls, Iowa; (2) Conserve of Fairport, N.Y.; (3) Performant of Livermore, Calif.; and, (4) Pioneer of Horseheads, N.Y. The taxpayer's account will only be assigned to one of these agencies. **Note:** Taxpayers who owe $50,000 or less in combined tax, penalties and interest can use the Online Payment Agreement to set up a monthly payment agreement for up to 72 months. Taxpayers can choose this option even if they have not yet received a bill or notice from the IRS. With the Online Payment Agreement, no paperwork is required, there is no need to call, write or visit the IRS, and qualified taxpayers can avoid the filing of a Notice of Federal Tax Lien if one was not previously filed. Alternatively, taxpayers can request a payment agreement by filing Form 9465. This form can be downloaded from IRS.gov and mailed along with a tax return, bill, or notice.

[ITEM 6] IRS REVIEWS TIP AND SERVICE CHARGE DIFFERENCES AND REQUIREMENTS

In IRS Fact Sheet FS-2017-8 [4/25/2017], the IRS provides several reminders about tips and service charges. Tips include customer tips left through electronic settlement or payment (e.g., credit or debit card), tickets or other noncash tips of value, and tip amounts received from other employees paid out through tip pools or tip splitting. Four factors normally must be met for a payment to be a tip: (1) payment is made free from compulsion, (2) customer has unrestricted right to determine the amount, (3) payment is not the subject of negotiations or dictated by employer policy, and (4) generally customer has right to determine who receives the payment. Employees must report to their employer all cash tips received, except for tips from any month that total less than $20. Both directly and indirectly tipped employees must report tips to their employer. A "directly tipped employee" (for example, waiters and hair stylists) receives tips directly from customers, and includes one who after receiving the tips turns all of them over to a tip pool. An "indirectly tipped employee" (e.g., bussers and salon shampooers) is a tipped employee who does not normally receive tips directly from customers. Employers must retain employee tip reports, do employee withholding, and pay the employer's FICA share. Tips reported to the employer by the employee are included in Boxes 1, 5, and 7 of the employee's Form W-2. Any uncollected social security tax and Medicare tax are entered in Box 12. A service charge is an amount an employer requires a customer to pay. Service charges commonly added to a customer's check include a large dining party with automatic gratuity, banquet event fee, cruise trip package fee, and bottle service charges at nightclubs and restaurants. Generally, service charges are reported as non-tip wages paid to the employee. If the employer keeps a portion of the service charge, only the amount distributed to employees is non-tip wages to employees. Employers who distribute service charges to employees should treat them the same as regular wages for tax withholding and filing requirements. Distributed service charges are included in Boxes 1, 3, and 5 of the employee's Form W-2.

REVIEW QUESTIONS AND SOLUTIONS

1. Regarding the 2017 vehicle deduction limitations for vehicles placed into service in 2017, **which one** of the following statements **is false**?

   a. The 2017 limitations for passenger automobiles are the same as for vehicles placed into service in 2016.

   b. Assuming bonus depreciation is claimed, the 2017 maximum deduction for trucks and vans is $11,560.

   c. The 2017 immediate expense deduction for vehicles with gross weights less than 6,000 pounds is $25,000.

2. Regarding "Qualified Small Employer Health Reimbursement Arrangements (QSEHRAs)," **which one** of the following relief requirements was **not** provided in a recent IRS ruling?

   a. A delay is granted for when the required notice must be provided by employers who provide QSEHRAs in 2017.

   b. A QSEHRA is exempt from the group health plan rules.

c. There is penalty relief for employers who fail to provide the required QSEHRA notice before IRS guidance is provided.

3. Regarding the election to apply a company's research tax credit against part or all of its FICA tax liability, **which one** of the following companies **may make** the election in 2017?

   a. ABC corporation, which began business in 2014 and had gross receipts of $4,000,000 in 2017.

   b. LMN corporation, which began business in 2015 and had gross receipts of $6,000,000 in 2017.

   c. XYZ corporation, which began business in 2005 and had gross receipts of $3,000,000 in 2017.

Solutions

1. **"C" is the correct response**. The 2017 immediate expense deduction for vehicles with gross weights between 6,000 and 14,000 pounds is $25,000. At or below 6,000 pounds, the immediate expense deduction is limited by the first-year vehicle deduction limitations.

   "A" is an incorrect response. While one limit for trucks and vans increased from 2016 to 2017, none of the limits for passenger vehicles changed.

   "B" is an incorrect response. The 2017 first-year truck and van limitation of $3,560 is increased $8,000 for bonus depreciation to $11,560. *Revenue Procedure 2017-29.*

2. **"B" is the correct response**. This provision was in the law before the ruling was issued.

   "A" is an incorrect response. For employers who provide QSEHRAs in 2017, the notice requirement is lifted until no earlier than 90 days following the issuance of IRS guidance.

   "C" is an incorrect response. No penalties will be imposed for failure to provide the initial written notice before the extended deadline provided in IRS guidance. *Notice 2017-20.*

3. **"A" is the correct response**. The two primary requirements to qualify as a small business under this election are (1) the gross receipts for the year of the election is under $5 million, and (2) the company has been in business five years or less. ABC corporation meets both requirements.

   "B" is an incorrect response. LMN has gross receipts above $5 million so it fails requirement # 1.

   "C" is an incorrect response. XYZ has been in business more than five years so it fails requirement #2. *Notice 2017-23.*

COURT DECISIONS

[ITEM 7] TAX COURT WAIVES MISSED ROLLOVER REQUIREMENT FOR DEPRESSED TAXPAYER

In Trimmer [4/20/17], the taxpayer/husband retired from the New York police force on 4/30/11. He had secured a job as a security guard before retirement to supplement his police retirement income. Shortly after retirement, the job fell through, he could not find another position, and he did not have the option of returning to the police department. About 3 weeks after retirement, he began experiencing symptoms of major depressive disorder. He became antisocial, irritable, and uncommunicative with his wife and two sons, in stark contrast to his pre-retirement personality. His wife described him as "like a lost soul." On 5/27/11 and 6/10/11, at which time major depression had set in, he received checks from two separate retirement accounts. He deposited them into their joint bank account on 7/5/11, where they remained until 4/16/12. Still suffering from depression in Spring 2012, he went to their regular tax return preparer shortly before the 2011 return due date to have their 2011 return prepared. He gave the two Forms 1099-R for the retirement distributions to the preparer, who advised the taxpayer to put the distributions into an IRA, which he did on 4/16/12 after the couple's 2011 return had been filed on 3/29/12 (reporting the two distributions as nontaxable). In Summer 2012, his depression was in remission. On 12/16/13, the IRS issued the taxpayers a Notice CP2000, asserting the two distributions must be included in their 2011 taxable income, with imposition of the 10% Section 72(t) tax on the unreported income. The IRS advised the taxpayers if they disagreed with the proposed changes to respond by 1/14/14. The taxpayers requested an extension in a 3/27/14 letter, and the IRS extended the response date to 4/23/14. On 4/30/14, the taxpayers sent the IRS a letter detailing the situation, and contested the $39,963 the IRS said they owed. By 6/3/14 letter, the IRS center operations manager told the taxpayers not to worry about anything, and the IRS would contact the taxpayers within 60 days. Three days later on 6/6/14, the IRS denied the taxpayers relief from their 60-day retirement distribution requirement failure. The Tax Court stated that Section 402(c)(3)(B) provides for a hardship waiver exception if the failure to waive "would be against equity or good conscience including casualty, disaster, or other events beyond the reasonable control of the individual subject to such requirement." The taxpayer contended he qualified for the waiver because his failure to make timely rollovers was caused by his major depressive disorder during the relevant period. The IRS asserted the taxpayer did not qualify for the wavier provision because he failed to apply for relief pursuant to Revenue Procedure 2003-16. The procedure requires the taxpayer to make a private letter ruling request and pay the required fee. It does not provide that the IRS's Examination Division specifically has the authority to determine if the taxpayer qualifies for a waiver during the course of an examination of the taxpayer's return. The court found nothing in the procedure that limited the IRS examiner's ability to consider a hardship waiver during examination. The court noted that the IRS's "Internal Revenue Manual" gives the IRS authority to recommend the disposition of issues, including issues raised by the taxpayer. The court was struck by the IRS's not declining to consider the taxpayer's request in his 4/30/14 letter, and by its 6/3/14 letter to the taxpayer to not worry about doing anything. The court concluded the taxpayer had requested relief in his letter, the IRS had the authority to consider hardship waiver relief, and it denied the relief. The court then considered if the taxpayer qualified for a hardship waiver from the 60-day rollover requirement. The court accepted the testimony of a licensed master social worker that the taxpayer suffered from a major depressive disorder during the portions of 2011 and 2012 in which the retirement distributions were received and not rolled over by the taxpayers. It then considered if the IRS's failure to waive the 60-day requirement would be against equity or good conscience. The court noted that in its 2003 procedure, the IRS states that in determining whether to grant a waiver it will consider all relevant facts and circumstances, including (1) financial institution errors, (2) taxpayer inability to complete a rollover due to death, disability, hospitalization, incarceration, restrictions imposed by a foreign country, or postal error, (3) the use of the amount distributed, and (4) the time elapsed since the distribution occurred. The court decided the first factor was not applicable, and the third and fourth factors were favorable to the taxpayers – they never made any use of the two distributions except to deposit them into their joint bank account (and they profited from them in no meaningful way), and they completed the rollovers very soon after advised by their tax preparer. As to the second factor, the court found the husband suffered from major depressive disorder from around 5/21/11 until the summer of 2012. It concluded that his failure to meet the 60-day rollover requirement was attributable to his disability. It decided that he met the objective requirements for a hardship waiver under the 2003 procedure.

[ITEM 8] GRANDMOTHER IS DENIED EXEMPTION FOR SUPPORTED GRANDCHILDREN

In Smyth [2/7/17], the taxpayer was a nursing assistant. In 2012, her adult son, his wife and their two young children (taxpayer's grandchildren) lived with her in her home. Her social security benefits and her wages made her gross income more than that of her son or his wife. She provided all the financial support for the household because neither her son nor his wife worked. Her son was dealing drugs, and his wife stayed home and took care of the two children. Her son told his mother he was not going to file his 2012 return. The taxpayer claimed the two grandchildren as dependents on her return. The IRS decided the children were not the taxpayer's "qualifying children," and denied the taxpayer the dependency exemption deductions. It increased her, tax by more than $5,000. Unknown to the taxpayer her son and wife did file a 2012 return. But, he prepared an amended return and deleted his claim of the dependency exemptions for the children. He gave a copy of his amended return to IRS counsel two weeks before the trial. The two children met the definition of "qualifying child" for both the taxpayer and her son and wife. But, only one person can claim the dependency exemption deduction for a qualifying child. The Code has tie-breaking rules for cases where a child is a qualifying child of more than one taxpayer. If the same child is a qualifying child of both the parent and someone else, only the parent can claim the child. If the parent does not claim the child, another taxpayer can claim the child if that taxpayer has a higher AGI than either parent. The issue in the case was who could claim the children as dependents. The IRS argued the taxpayer was not entitled to the dependency exemption deduction for the children because her son and wife claimed the children on their 2012 return. The taxpayer argued the IRS was wrong because her son and wife never filed an original 2012 return and, even if they did, they also filed an amended return releasing their claim to their children as their qualifying children. The Tax Court examined each argument, as the taxpayer had the highest AGI in the household for the 2012 tax year. *As to the original 2012 return*, the court found little evidence to support the taxpayer's argument that her son and wife did not file an original 2012 return. The IRS's audit program flagged her return for further investigation because it discovered that more than one taxpayer had claimed the same "qualifying child." It stated it highly likely that the taxpayer's return was chosen for review because her son and wife had already filed an original return claiming their two children as dependents, which was the case. Further, the taxpayer testified her son admitted filing a return to get a refund for his drugs, but presumably prepared an amended return to correct his previously filed original return. It found that her son and wife had filed an original 2012 return on which they claimed dependency exemptions for their two children. *As to the amended 2012 return*, the IRS considered if her son and wife actually **filed** an amended return. It decided that they had **prepared** an amended 2012 return. They delivered the prepared amended return to the IRS's counsel two weeks before trial. The court stated that the Code and regulations require that an original and amended return must be mailed to the correct IRS service center, or hand carried to any person assigned the responsibility to receive hand-carried returns in the local IRS office. It ruled that delivering the amended return to IRS counsel was not a proper "filing" of their return. The court held that the taxpayer was not entitled to a dependency exemption deduction, the earned income credit, the child tax credit, or "head of household" filing status to which she would have been entitled were her son to have filed an original return releasing the exemption deduction for each child, or "filed" an amended return relinquishing the exemption deductions. The taxpayer/grandmother lost more than $5,000 of tax benefits associated with the loss of the exemption deductions!

[ITEM 9] PENSION PLAN INCOME INTEREST IS NOT ASSET TO COMPUTE DEBT CANCELLATION INCOME INCLUSION

In Schieber [2/9/17], the taxpayer received a monthly payment from his state defined benefit pension plan after he retired. The payment was payable over his spouse's and his lives. In 2009, his mortgage lender cancelled $418,596 of debt secured by their principal residence. At the time of debt cancellation, the taxpayers' liabilities exceeded the fair market value of their assets by $293,308. The taxpayers argued that the amount of income reportable from the debt cancellation was $125,288 ($418,596 - $293,308). The IRS argued the amount of income reportable was the $418,596 of debt cancellation. The IRS insisted that the taxpayers' monthly pension payment was an asset. Both the IRS and the taxpayers agreed that were the pension payment an asset the taxpayers would not be insolvent, and $418,596 was the correct amount of the income inclusion. The issue in the case was whether the taxpayers' interest in the monthly payment was an asset in determining the amount of the taxpayers' insolvency. Section 108(a)(b)(B) excludes from gross income any amount that otherwise would be includible in gross income from debt cancellation, if the debt cancellation occurs when the taxpayer is insolvent. But, Section 108(a)(3) provides that the amount of the exclusion can not exceed the amount by which the taxpayer is insolvent. The court noted that the taxpayers could not convert their interest in the pension plan into a lump-sum cash amount, assign the interest, sell the interest, borrow against the interest, or borrow from the plan. The court stated that "assets" is not defined by the Code. It observed that it had decided in an earlier case (Carlson; 2001) that an asset exempt from creditors can give the taxpayer the ability to pay an immediate tax on income from the cancelled debt. The taxpayers asserted that they could not use their pension plan interest to immediately pay a tax liability because of the borrowing and other restrictions. They were entitled only to monthly payments. On the other hand, the IRS asserted that their right to receive monthly payments caused their plan interest to be considered an asset: the lack of any other rights did not matter. The Tax Court noted that the Carlson test was whether the asset gives the taxpayer the ability to pay an "immediate tax on income" from the cancelled debt, not to pay the tax gradually over time. It decided that the taxpayers' plan interest could not be used immediately to pay the income tax on cancelled-debt income, and was not an asset within the meaning of Section 108.

[ITEM 10] FIRST CIRCUIT RULES CLAIM OF RIGHT DOCTRINE DID NOT APPLY IN FRAUD CASE

In Robb Evans & Associates [3/3/2017], the petitioner was a court-appointed receiver acting on behalf of a class of defrauded persons (the plaintiffs) to collect judgments previously rendered against a network of interlocking corporations and their owners. The corporations held themselves out as skilled in improving credit ratings and trumpeted their ability to help financially strapped individuals by creating "debt management plans" for a fee. The plaintiffs eventually brought a class action suit against the owners and several of the corporations and judgments of $256 million and $259 million were entered against the owners and corporations, respectively. However, most of the money had vanished and the receiver was able to recoup less than $2.5 million. The receiver argued that under the "Claim of Right Doctrine" (Section 1341), the owners and corporations were due a refund for wrongfully including income they were not entitled to, and under the class-action judgment the refund should be paid to the receiver. Section 1341 works in the following manner. First an item was included in gross income for a prior taxable year (or years) because it appeared that the taxpayer had an unrestricted right to such item. Second, in the year of discovery, it is established that the taxpayer did not have an unrestricted right to the income. Third, in the year of discovery, the taxpayer claims a deduction for the amount of the income the taxpayer does not have an unrestricted right to receive. Generally, but not in this case, the amount is paid back. Fourth, the deduction either results in a lower tax in the year of discovery or generates a refund if there is an amended tax return for the year of discovery. In this case, the receiver filed a refund claim which was denied by the IRS on the basis that the first step did not apply. That is, it never appeared to the taxpayers that they had an unrestricted right to the funds because they were fraudulently obtained. Although a District Court agreed that the taxpayers never appeared to have an unrestricted right to the funds reported as income, it nonetheless concluded that, as a matter of equity, the fraudulent conduct of the owners should not be imputed to the receiver. It ruled that the IRS was obligated to honor the refund request. However, the First Circuit believed that the district court erred in refusing to follow Section 1341(a)'s unambiguous requirement that the taxpayer had an unrestricted right to the fraudulently-derived income. The First Circuit noted that nothing in the legislative intent justifies carving out a special exemption from the "unrestricted right" requirement for parties in either the receiver's or the underlying plaintiffs' position. It noted further that although Section 1341 was enacted to alleviate a perceived inequity, the inequity that the receiver deplores differs materially from the inequity that the statute was intended to correct. When a statute is aimed at addressing a particular inequity in the tax code, it does not follow that the statute may be interpreted to address every inequity attributable to the tax code. The First Circuit reversed the District Court in ruling that Section 1341 did not apply so the receiver was not allowed the refund requests pursuant to the Claim of Right Doctrine.

[ITEM 11] TAX COURT RULES WHETHER JUDGMENTS AGAINST TAXPAYER FOR S CORPORATION GUARANTEES CAN BE INCLUDED IN STOCK BASIS

In Phillips [4/10/17], the taxpayer was a 50% owner of an S Corporation which was engaged in developing and selling residential and commercial real estate. Like many real estate development businesses, it relied heavily on debt financing; its projects were encumbered at various times with aggregate debt of almost $191 million. The bulk of this debt was incurred by lower tier subsidiaries and was secured by mortgages encumbering the real estate properties. One of the major tax differences between partnerships and S Corporations is the effect of entity debt on the basis of the owner's interest. For partnerships, an owner's share of partnership debt is treated as a capital contribution and therefore it is included in the basis of the owner's partnership interest. That is why most taxpayers who invest in real estate activities which generate tax losses operate as a partnership. That is, the debt allocated to basis of the owner's partnership interest is used to allow tax losses to flow to the owner without being subject to the basis limitation. On the other hand, the debt of S Corporations is not included in the basis of the shareholder's stock. Historically, the logic of the disparate tax treatment is that generally partners are liable for the payment of partnership recourse debt in the event that the partnership is unable to make the debt payments. However, for corporations, shareholders generally are not liable for the debts of a corporation. With the advent of limited liability companies treated as partnerships and owner guarantees, whether by a partner or shareholder, the owner's risk with respect to the debts of the entity are fairly similar whether the entity is a partnership or S Corporation. That is, if an owner guarantees the debts of the entity, the owner is at risk of having to pay the debt whether the entity is a partnership or an S Corporation. Nevertheless, the tax difference between the two entities remains – partnership debt is included in the basis of the partner's partnership interest whereas S Corporation debt is not included in the basis of the shareholder's stock. With respect to shareholder guarantees, the guarantee is not included in the shareholder's basis until the debt is actually paid by the guarantor. What about judgments against the shareholder for guarantees of S Corporation debt? Is that included in the shareholder's stock basis at the time of the judgment? That is the issue in this case. Virtually all of the loans made to the S Corporation and its subsidiaries were guaranteed by the two shareholders. The nationwide downturn in the real estate market that began in late 2006 was especially severe in the S Corporation's region of operations. Starting in 2007 the company's business experienced a spiraling decline in sales, revenue, and cash flow from which it never recovered. This precipitated a default on virtually every loan owed by the company and its subsidiaries. The lenders sued for repayment, typically foreclosing on the property that secured the indebtedness. Because the real estate had declined so precipitously in value, the collateral was usually insufficient to satisfy these judgments. The lenders accordingly sued the guarantors, seeking enforcement of the personal guaranties to satisfy the deficiencies. Ten of these actions resulted during 2008-09 in final judgments, issued by Florida State courts, aggregating about $105 million against the taxpayer and the co-guarantors. As a result of these actions, the taxpayer increased her stock basis by about $1.5 million in 2008 and $30.2 million in 2009. With these basis increases the taxpayer's 2008 and 2009 tax returns generated additional losses of about $1.5 million in 2008 and $10.4 million in 2009. A 2009 NOL was carried back to her 2004 and 2005 tax returns generating substantial refunds. The IRS determined that the taxpayer was not entitled to any basis increase on account of her loan guarantees or the unpaid judgments against her. The Tax Court noted that the courts have consistently held that, in order for a taxpayer to acquire additional basis in an S corporation's indebtedness, there must be "an actual economic outlay by the taxpayer." It relied on a 1971 case (Perry) which ruled that before the taxpayer may increase her basis, "there must have occurred some transaction which when fully consummated left the taxpayer poorer in a material sense." The taxpayer argued that the judgments themselves demonstrate an "actual economic outlay" on the part of the taxpayer by showing that the lenders looked to her as a source of repayment. She relied on a 1985 11th Circuit case (Selfe), in which the shareholder was allowed a stock basis increase for loans originally made to the taxpayer and then transferred to a newly-formed S Corporation. In this case, the court found that the taxpayer was the primary obligor. The Tax Court distinguished the facts of the 11th Circuit case from the current case on several factors, including: (1) the current taxpayer was never the primary debtor on any of the loans; (2) she never pledged any of her personal assets as collateral for the loans; and, (3) there was no evidence that any of the lending banks looked to the shareholder as the primary obligor. The Tax Court ruled that the judgments against the taxpayer were not an economic outlay and could not be included in her stock basis until she made payments toward the judgments.

[ITEM 12] SECOND CIRCUIT LIMITS DAMAGES FOR UNAUTHORIZED DISCLOSURE OF RETURN INFORMATION

Consider two taxpayers who have filed their tax returns for 2016. Tax return #1 consists of W-2 wages for a single taxpayer and the standard deduction. Tax return #2 consists of an extensive tax return with W-2 wages, Schedule C income, several rental properties, capital gains and losses, and itemized deductions, including a substantial amount of charitable contributions. Mistakenly, the IRS discloses each tax return to a third party without the taxpayers' authorization. Are there penalties for the unauthorized disclosure and if so are the penalties a function of the amount of sensitive information that was disclosed? What if the disclosures concerned an IRS letter proposing several changes to a taxpayer's tax return? Are the damages here greater and should the penalty reflect these damages? These issues were addressed by the Second Circuit in Minda [3/24/17]. In 2009, an IRS employee prepared an examination report proposing changes to the 2007 federal income tax return filed jointly by the taxpayers. The report contained "dozens of items of return information," including the taxpayers' names, social security numbers, and detailed financial information. In 2010, the report was mistakenly mailed to an unrelated third party. The third party's lawyer notified the IRS and sent a copy of the notification to the taxpayers. An investigation of the matter concluded that the report was commingled with another report mailed to the unrelated third party. The taxpayers sought damages resulting from the unauthorized disclosure of their return information by filing an action in a District Court. Section 6103(a) provides that no U.S. employee shall disclose a return or return information except to the extent disclosure is authorized under the Code. Section 7431(a)(1) provides that if an employee of the United States knowingly, or by reason of negligence, discloses any return or return information with respect to a taxpayer in violation of any provision of Section 6103, the taxpayer may bring a civil action for damages against the United States in a U.S. District Court. Section 7431(c) limits the amount of damages to the greater of two amounts. The first amount is $1,000 for each act of unauthorized disclosure of a return or return information. The second amount is actual damages suffered by the taxpayer plus punitive damages in the case of willful disclosure if gross negligence. With respect to the second amount, the taxpayers acknowledged that they did not suffer any actual damages, although they sought punitive damages. The District Court ruled that no reasonable jury would find that the disclosure resulted from anything other than ordinary negligence. On appeal, the taxpayer argued that the IRS committed gross negligence by completely disregarding its duty to maintain taxpayer confidentiality. The Second Circuit noted that gross negligence requires conduct that is highly unreasonable and which represents an extreme departure from the standards of ordinary care. The act or omission must be of an aggravated character, as distinguished from the failure to exercise ordinary care. As the taxpayer provided no evidence of gross negligence, the Second Circuit denied punitive damages. With respect to the first amount, the taxpayer argued that the damage of $1,000 for each act of unauthorized disclosure should apply to each item of information contained in the report. The Second Circuit noted that the word "act" is not defined in the statute, and thus it is presumed to have its ordinary meaning. The statute refers to "each act of ... disclosure of a return or return information." A return, of course, will contain multiple items of information, and likewise "return information" clearly encompasses multiple items of information. Yet, Section 7431(c)(1)(A) treats the disclosure of either — "a return or return information" — as one act subject to one award of statutory damages of $1,000. Based on this analysis the Second Circuit concluded that the taxpayer's contention that each item of information constitutes a separate disclosure subject to a separate award of statutory damages contradicts this language. As a result, it affirmed the District Court and limited the damages to $1,000 to each taxpayer.

[ITEM 13] TAX COURT DETERMINES WHICH INNOCENT SPOUSE PROVISION APPLIES

The taxpayer was a registered nurse whose husband was employed with Publix Supermarkets for over 25 years. In 2009 he was fired from Publix, and in 2010 he began without his wife's knowledge liquidating his $200,000 of Publix stock to fund an extramarital affair. To prevent his wife from knowing about the stock liquidation (and also nearly all of their $200,000 in retirement savings), the husband directed their accountant to electronically file their 2010 joint return without the taxpayer's approval or review. The return did not report $4,874 in taxable dividends. In 2011, the taxpayer learned of the affair and separated from her husband and filed for divorce when she learned of the stock sales and family retirement savings liquidation. The divorce was finalized in 2013. When she filed her 2012 return shortly after the divorce became final, the IRS credited $1,570 of their 2010 joint liability (associated with the unreported dividends) against her $5,261 refund. She filed Form 8857, "Request for Innocent Spouse Relief," requesting relief from and a refund of the liability resulting from the unreported dividends. The IRS determined that the taxpayer was entitled to innocent spouse relief under Section 6015(c), but that she was not entitled to a refund. In Taft [4/18/17], the issue was whether Section 6015(c) relief applied to the taxpayer (in which case she was not entitled to a refund), or Section 6015(b) argued by the taxpayer applied, in which case refunds are allowed. The taxpayer must meet all five requirements under Section 6015(b). The case rested on the following two requirements, which the IRS insisted the taxpayer did not meet: (1) the requesting spouse must establish that in signing the return he/she did not know, and had no reason to know there was an understatement; and, (2) taking into account all of the facts and circumstances, it would be inequitable to hold the requesting spouse liable for the deficiency attributable to the understatement of tax on the return. As to the *reason to know* requirement, the court stated four factors that are used in making the determination: (1) requesting spouse's level of education, (2) requesting spouse's involvement in the family's business and financial affairs, (3) presence of expenditures that appear lavish or unusual when compared to the family's past levels of income, standard of living, and spending patterns, and (4) the culpable spouse's evasiveness and deceit concerning the couple's finances. The court found the following facts important: (1) the taxpayer, though she had an associate's degree in nursing, had no accounting or business background, and never had taken tax classes; (2) the couple maintained a great deal of independence from each other with respect to the family's financial affairs, e.g., each maintained a separate bank account that the other could not access, they refrained from opening or reviewing the other's mail, and her role in the family's financial affairs was limited to paying certain household expenses; (3) her husband made lavish and unusual expenditures in 2010 not for her benefit but with respect to his secret affair, and he concealed them from her – not until late 2011 did she learn of the affair and their wasted retirement savings; and, (4) her husband did not want her reviewing their 2010 return, directed the accountant to file it electronically without her signature or review, and when she inquired about it he brusquely stated that he "took care of it." The court decided that all four factors weighed in favor of the taxpayer. As to the *inequity* requirement, the court stated the material factors most often applied are (1) whether there has been a significant benefit to the spouse requesting relief, and (2) whether the failure to report the correct tax liability on the joint return resulted from concealment, overreaching, or any other wrongdoing by the other spouse. The court had little trouble finding it clearly would be inequitable to hold the taxpayer liable for the deficiency. Having found the taxpayer met the requirements of Section 6015(b), it ruled that she was entitled to relief from joint and several liability and a refund of the $1,570.

REVIEW QUESTIONS AND SOLUTIONS

4. In a recent Tax Court case dealing with a waiver from the 60-day rollover requirement for qualified retirement plan distributions, the court considered four factors in deciding if failure to grant a waiver would be against equity or good conscience. **Which one** of the factors did the court decide **was not** applicable?

   a. Taxpayer inability to make the rollover due to disability.

   b. The use of the amount distributed.

   c. A financial institution error.

5. In a recent Tax Court case, a grandmother lost more than $5,000 in tax benefits because she was denied a dependency exemption deduction for her two grandchildren that she supported. Which set of the following **contains all the benefits** that she lost?

   a. Earned income credit, child tax credit, "head of household" filing status.

   b. Earned income credit, child tax credit, foreign tax credit.

   c. Adoption tax credit, child tax credit, "head of household" filing status.

6. In a recent case involving the Claim of Right Doctrine, **which one** of the following statements **is true?**

   a. The District Court ruled that the taxpayers believed they had an unrestricted right to the funds reported as income.

   b. One requirement of Section 1341 is to establish that the taxpayer does not have an unrestricted right to the income in the year of discovery.

   c. Section 1341 allows the taxpayer to amend its tax return for the year it reported income if later it is established that it does not have an unrestricted right to the income.

7. Kathy White is the sole shareholder of Drews Inc., an S Corporation engaged in residential rental property. Anytime Drews Inc. acquires new property with debt financing, Kathy is required to guarantee the debt. As of December 31, 2016, Kathy's outstanding guarantees total $2 million. During 2016, two of the S Corporation's properties are in foreclosure. Judgments of $200,000 and $100,000 are issued against Kathy related to the loan guarantees in 2016, of which she paid $100,000. Based on a recent court case dealing with guarantees of S Corporation debt, how much of the S Corporation debt is included in Kathy's stock basis?

   a. $2,000,000.
   b. $ 300,000.
   c. $ 100,000.

8. Based on a recent case dealing with the innocent spouse provisions, **which one** of the following sets of items go together?

   a. Section 6015(b) – tax refund; Section 6015(c) – no tax refund.

   b. Section 6015(b) – no tax refund; Section 6015(c) – tax refund.

   c. Section 6015(b) – tax refund; Section 6015(c) – tax refund.

Solutions

4. **"C" is the correct response**. As no bank error was in the facts, the court decided this factor did not apply.

   "A" is an incorrect response. The court found the taxpayer/husband suffered from major depressive disorder that prevented his ability to make the rollover.

   "B" is an incorrect response. The court decided the taxpayers only deposited the distributions into their joint bank account, and they did not profit from them in any meaningful way. *Trimmer*.

5. **"A" is the correct response**. The grandmother lost all of the benefits listed.

   "B" is an incorrect response. The foreign tax credit was not an issue in the case.

   "C" is an incorrect response. The adoption tax credit was not an issue in the case. *Smyth*.

6. **"B" is the correct response**. In order to claim a deduction under Section 1341 for income reported in a prior year which the taxpayer believed he had an unrestricted right to receive, it must be established in the discovery year that the taxpayer does not have an unrestricted right to the income.

   "A" is an incorrect response. The District Court ruled that the taxpayers never appeared to have an unrestricted right to the funds reported as income. However, it concluded that as a matter of equity, the IRS was obligated to honor the receiver's refund request.

   "C" is an incorrect response. Section 1341 does not allow the taxpayer to amend a tax return in the year the taxpayer believed it had an unrestricted right to the income. Instead, the taxpayer claims a deduction in the year the taxpayer discovers he does not have an unrestricted right to the income item. *Robb Evans & Associates*.

7. **"C" is the correct response**. The Tax Court recently ruled that the judgments against the taxpayer were not an economic outlay and could not be included in the shareholder's stock basis until making payments toward the judgments. In this case, Kathy paid $100,000 of the judgments so that payment is included in her stock basis.

   "A" is an incorrect response. The courts have long established that shareholder guarantees of S Corporation debt are not included in the basis of the shareholder's stock.

   "B" is an incorrect response. In a recent case, the Tax Court ruled that the judgments against the taxpayer could not be included in the shareholder's stock basis until the judgments were paid. *Phillips.*

8. **"A" is the correct response**. Under Section 6015(b) relief tax refunds are allowed. On the other hand, under Section 6015(c) relief the taxpayer is not entitled to a refund.

   "B" is an incorrect response. Section 6015(b) relief provides for tax refunds, but Section 6015(c) does not.

   "C" is an incorrect response. Section 6015(c) does not provide for a tax refund. *Taft*.

TREASURY

[ITEM 14] THE TIGTA ISSUES REPORT ON IRS EFFORTS AGAINST IDENTITY THEFT

In Report 2017-40-017 [2/7/17], the Treasury Inspector General for Tax Administration (TIGTA) reports on its audit of the IRS's efforts to defend against identity theft and to identify areas that require additional effort. Identity theft tax refund fraud occurs when an individual uses another person's name and TIN to file a fraudulent return with false income and withholding documents to the IRS to receive a fraudulent tax refund. In 2014 the IRS published its first "Identity Theft Taxonomy" to measure its efforts to defend against identity theft and identify areas that require additional effort. The TIGTA audit was initiated to assess the effectiveness of the IRS's continued efforts to detect and prevent identity theft, measure undetected identity theft, and coordinate identity theft information with other government agencies and tax industry partners. Efforts implemented by the IRS to assist with its overall detection and prevention efforts include: (1) convening a "Security Summit" for collaborative efforts of IRS officials, Chief CEOs of leading tax preparation firms, software developers, payroll and tax financial product processors, and State Departments of Revenue; (2) obtaining early submission of Forms W-2 – a voluntary program in which 18 payroll providers were requested to submit Forms W-2 directly to the IRS by January 31, 2016; (3) using verification codes on Form W-2 to improve efforts to validate income and withholding information; and, (4) obtaining leads of potential identity theft tax returns from State tax agencies and tax industry partners. The TIGTA found that there have been continued reductions in the volume of undetected potentially fraudulent tax returns. It noted that false reporting of wages and withholding continues to account for the largest amount of undetected potentially fraudulent tax return refunds. However, it believes that the passage of legislation to accelerate the reporting of Forms W-2 (beginning for Tax Year 2016 employers were required to submit third-party income and withholding information (Forms W-2 and returns or statements required to report nonemployee compensation)) on or before January 31 of the following tax year should enable the IRS to significantly reduce the number of undetected fraudulent tax returns. The TIGTA found that using State lead data during tax return processing can improve identity theft detection efforts. Finally, the TIGTA found that the accuracy of the IRS's Identity Theft Taxonomy quantification for both protected revenue (prevention of fraudulent tax refunds from being issued) and unprotected revenue (issuance of fraudulent tax refunds) could be improved. The TIGTA recommended that the IRS expand the use of its identity theft models, develop a process to use State lead data, and update the Identity Theft Taxonomy used to quantify unprotected and protected revenue. The IRS agreed with all of the TIGTA's recommendations.

REVIEW QUESTION AND SOLUTION

9. **Which one** of the following **was** a TIGTA finding in a recent audit of the IRS's efforts to defend against identity theft?

   a. There have been continued reductions in the volume of undetected potentially fraudulent tax returns.

   b. The use of State lead data during tax return processing does not improve identity theft detection efforts.

   c. The accuracy of the IRS's Identity Theft Taxonomy quantification with respect to the issuance of fraudulent tax returns does not need improvement.

Solution

9. **"A" is the correct response**. The TIGTA found that there have been continued reductions in the volume of undetected potentially fraudulent tax returns.

   "B" is an incorrect response. The TIGTA found that using State lead data during tax return processing can improve identity theft detection efforts.

   "C" is an incorrect response. The TIGTA found that the accuracy of the IRS's Identity Theft Taxonomy quantification for unprotected revenue (issuance of fraudulent tax refunds) could be improved. *TIGTA Report 2017-40-017*.

========== SPECIAL TOPICS ============

RENTAL REAL ESTATE AND PASSIVE ACTIVITY LOSS RULES

Under Section 469, the principal passive activities are a trade or business in which the taxpayer does not materially participate, and any rental activity. To materially participate, the taxpayer must be involved in the operations of the activity on a regular, continuous, and substantial basis. There are seven tests for material participation. Generally, any rental activity is automatically passive, without regard to participation. One exception is a rental activity for a "real estate professional." In the first section of this "Special Topic," we provide a summary of the real estate professional rules, including the material participation tests. In the next two sections, we provide two recent court cases where taxpayers, one self-employed and one an employee, satisfied both the real estate professional rules and the material participation tests, thereby allowing immediate deductions for their current rental real estate losses.

[ITEM 15] *BASIC REVIEW OF THE REAL ESTATE PROFESSIONAL RULES*

A "real estate professional" is a taxpayer who meets two personal services tests. First, more than one-half of the taxpayer's personal services in trades or businesses during the tax year are performed in real property trades or businesses in which the taxpayer materially participates. Second, the taxpayer performs more than 750 hours during the taxable year in real property trades or businesses in which the taxpayer materially participates. Participation may be substantiated by any reasonable means, including use of appointment books, calendars, or narrative summaries. For a joint return, either spouse must separately satisfy the two tests. However, one spouse can count the other spouse's participation in an activity to satisfy the material participation requirement. For a closely-held C Corporation, the two tests are met if more than 50% of the corporation's gross receipts for the tax year are derived from real property trades or businesses in which the corporation materially participates. Personal services performed as an employee are not treated as performed in a real property trade or business, unless the employee owns more than 5% of the employer. Taxpayer material participation in an activity is met by satisfying any of seven participation tests: (1) more than 500 hours, (2) substantially all of the participation in the activity of all individuals (including non-owners), (3) more than 100 hours and taxpayer's participation is not less than participation of any other individual (including non-owners), (4) more than 100 hours in an activity, taxpayer does not materially participate under any other test, and total participation in all such activities is more than 500 hours, (5) taxpayer materially participated in the activity for any five of the previous ten tax years, (6) activity is a personal service activity, and taxpayer materially participated in the activity for any three preceding tax years, and (7) based on all the facts and circumstances, taxpayer participated in the activity on a regular, continuous, and substantial basis (taxpayer must participate more than 100 hours to avail himself of this test). A "real property trade or business" is any of the following: real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business. So, the taxpayer must materially participate in any rental real estate activity whose losses he wishes to qualify for use under the real estate professional rule. While generally each rental activity is treated as a separate activity, the taxpayer may elect to treat all interests in rental real estate as one activity. Regulation 1.469-9(g)(3) and Revenue Procedure 2010-13 provide grouping rules in this case. The taxpayer must attach a statement to the return with his tax return for the tax year that identifies the names, addresses, and EINs, if applicable, for the rental activities that are being grouped as a single activity. If the taxpayer adds a new rental activity to a previous grouping, he must file a written statement with his tax return for that year containing the same information for the added rental (as well as others in the group). Revenue Procedure 2011-34 provides that a late grouping election may be made if the taxpayer meets the requirements specified in the procedure.

[ITEM 16] TAX COURT RULES SELF-EMPLOYED DENTIST IS A REAL ESTATE PROFESSIONAL

In Zarrinnegar [2/13/17], the taxpayer and his wife were dentists who worked at their joint dental practice in shifts: she worked 9 - 2:30 Mondays, Wednesdays, Thursdays, and Fridays, and some Saturdays, and her husband worked 2:30 - 6:00 Mondays, Wednesdays, Thursdays, and Fridays. His real estate business consisted of his real estate brokerage activity and four rental properties that they owned and he managed. His wife did not participate in the real estate business. He spent hundreds of hours on brokerage-related activities (e.g., brokers' tours and open houses), and significant time managing the four rental properties. He spent over 1,000 hours on the real estate business each year at issue in the case. The taxpayers reported substantial income from their dental practice, and they reported losses from the real estate business for the three tax years at issue in the case. The IRS disallowed the real estate business losses, contending they were passive activity losses, and not deductible under the general passive activity loss disallowance rule of Section 469(a). The Tax Court observed that, while the general rule for passive activities permits a deduction for a business activity only if the owner materially participates in the activity, rental activities are per se passive, regardless of how much the owner participates in the rental activity. But, the court noted the real estate professional rule excepts the taxpayer from the general rule if the taxpayer meets the two personal services tests. Brokerage and rental real estate businesses are real property trades or businesses. The court noted that, for a joint return, the two requirements are met only if either spouse separately meets the two tests. The court examined only the husband's activities. The court first examined if the husband materially participated with respect to the rental properties and the brokerage business. It noted that each rental property must be examined unless the taxpayer makes the grouping election, which he had not made. The court considered if the husband met any one of the seven tests that satisfies material participation. It focused on the test that provides for material participation if the individual's participation constitutes substantially all of the participation in the activity of all individuals, including individuals who do not own interests in the activity. The IRS conceded the husband's participation in each rental activity met this test, and so the husband met the material participation requirement. Secondly, the court examined if the husband met the two requirements under the real estate professional rule. It looked at the hours he spent in both his dental practice and his real estate business (brokerage and rental activities). It found his testimony credible that he worked at his dental practice on average 14 hours per week and, using 52 weeks a year if he worked every week, it arrived at 728 hours for his dental practice hours. The court felt this conclusion was supported strongly by the manner in which he documented his real estate businesses hours. For each of the three tax years, he produced logs that were prepared contemporaneously. He testified credibly and at great length about the logs' contents, being able to recall extensive details relating to the log entries. Several other witnesses provided credible testimony that tended to corroborate the husband's logs and testimony. The logs showed he spent more than 1,000 hours per year on real estate activities. Given the husband's credible support for working more than 1,000 hours in real estate, and less than 1,000 hours in his dental practice, the Tax Court ruled he met the requirements for a real estate professional, and allowed the husband's losses from the real estate activities.

[ITEM 17] STOCK BROKER (A LONG-TIME EMPLOYEE) SATISFIED REAL ESTATE PROFESSIONAL RULES

In Windham [4/24/17], the taxpayer was a *stock broker* for more than 30 years, and for the tax year at issue she was employed by Wells Fargo in its brokerage department. She managed a number of individual accounts with total assets of about $70 million. Generally she worked at her brokerage office from 12:30 p.m. until the U.S. markets closed each weekday. She was compensated on the basis of her production. Her calendar reflected that she did not work in her brokerage office on 9 holidays for the year, and on days that she worked she would stay about 1 ½ hours in her office after the markets closed at 3 p.m. to do volunteer work on charities in which she was involved. She also owned 12 rental properties (one of which was an apartment attached to her personal residence) and a 50% interest in a vacant lot. She did administrative tasks associated with the properties during the morning hours before she went to her brokerage office. She managed all aspects of her rental properties, including vetting potential tenants, collecting rent, evicting tenants, and negotiating, hiring, and overseeing contractors and repairmen who worked on her rental properties. She showed some of her properties for sale to potential buyers. She documented her participation hours in all properties except the apartment attached to her residence. She participated more than 100 hours for three of the properties (107.5, 104.5, and 103), less than 100 hours for all other properties, and a total of 901.25 hours (which included 12 hours on the vacant lot). In 2010 she withdrew $182,025 from her retirement accounts to meet her rental real estate business requirements, reporting $148,893 of the withdrawal in her 2010 taxable income. On her 2010 Form 1040, she reported $285,437 of Wells Fargo income, the $182,025 retirement distribution, and a Schedule C $307,933 loss from her rental properties. She did not make a grouping election. The IRS determined that her rental real estate activity loss was passive and could not offset her Wells Fargo wage income. The Tax Court determined first if the taxpayer materially participated in her rental real estate activities. It stated that each of her real estate interests was treated as a separate activity. As the taxpayer made no grouping election, the court examined each of her rental real estate properties separately for her material participation. For the 3 properties in which she participated more than 100 hours, the court found her testimony credible as to the number of participation hours. The court ruled that the taxpayer met the 7th test, the "facts and circumstances" test, and she materially participated in those activities. The court then examined the other 8 properties in which she participated less than 100 hours. It noted that the only one of the other 6 tests to be considered was whether her participation for each activity constituted substantially all of the participation in the separate activities of all individuals, including individuals who are not owners in the property. The court noted she ran her real estate activities by herself, handling all aspects of the business from collecting rent to overseeing the work of repairmen. She met prospective buyers and handled problems with utility and service companies. It noted that she did not perform all of the necessary repairs to the properties, but she hired multiple contractors and repairman to handle those repairs. With the repairs made and number of different individuals involved in the repairs, no one individual participated to the extent that the taxpayer did. It ruled that she met the substantial participation test, and therefore materially participated in all the other activities except the vacant lot (while she documented her 12 hours of participation in the lot, she failed to prove that her participation constituted substantially all of the participation in the activity). Having ruled the taxpayer materially participated in 10 of the 12 real rental estate activities, it next turned to whether she was a "real estate professional." It stated that the 750-hour requirement was easily dispensed of, as she performed 889.25 hours of services in the rental real estate trade or business in which she materially participated. Based on court-accepted testimony that she went into her brokerage office for 2 ½ hours a day five days a week, took no vacations in 2010, and that the U.S. stock markets were closed on 9 days in 2010 when she did not work, the court arrived at 577.5 hours of stock brokerage work in 2010. It ruled that she met the "real estate professional" test requirement of working more than ½ of her personal hours in a real estate trade or business. The court ruled that she was a real estate professional, and her real estate losses were not limited by the Section 469 passive activity loss rules.

TRAVEL EXPENSES AND THE "AWAY FROM HOME" REQUIREMENT

In the first section of this "Special Topic," we provide a basic review of the "away from home" requirement for qualifying for the travel expense deduction. In the second section, we discuss a recent court case involving the away from home requirement.

[ITEM 18] BASIC REVIEW OF THE AWAY FROM HOME REQUIREMENT

The major components of the travel expense deduction are transportation costs, and meals and lodging costs. If a taxpayer qualifies for this deduction, a "windfall" may be realized if the per diem rate for meals or the mileage rate for automobiles exceeds the actual out-of-pocket costs. One of the major requirements of qualifying for the travel expense deduction is that the taxpayer must be away from the taxpayer's tax home substantially longer than an ordinary day's work for which periods of rest are required to meet the demands of the job. The taxpayer does not have to be away all day as long as the rest period is adequate (e.g., a short nap is considered inadequate rest). Tax home generally refers to the taxpayer's primary business location. If the taxpayer has no principal place of business, the taxpayer's principal residence is considered the tax home. If a taxpayer has two or more places of business, it is necessary to determine the primary job location. Factors which should be considered include: (1) total time ordinarily spent working in each area; (2) degree of business activity in each area; and, (3) relative amount of income earned from each area. In some cases, a taxpayer may not have either a principal job location or a principal residence. For this situation, the IRS states that a tax home will be where the taxpayer regularly lives providing the following three requirements are satisfied: (1) some work is performed at the designated tax home; (2) living expenses are duplicated; and, (3) the taxpayer has not abandoned the area in which both his historical place of lodging and his main home are located. If only one factor is satisfied, the taxpayer's tax home is where he works. If the taxpayer moves from one job to another job, maintains no fixed home, and the jobs are not associated with any particular business locality, each place the taxpayer works becomes the taxpayer's tax home. Thus, no deduction is allowed for travel expenses. For example, assume Henry Rogers is an outside salesperson with a sales territory covering several states. His employer's main office is Newark, where he meets with his employer on an occasional basis. Henry lives in his married sister's house in Dayton a few weeks a year but does not conduct business in this area. Only the third condition is satisfied (for Dayton). As a result, Dayton is not considered Henry's tax home. Therefore, he is not considered to be away from home and he may not deduct travel-related expenses. If two of the three conditions are met, the determination of whether the taxpayer has a tax home depends on the unique facts and circumstances of each situation. For example, assume Jack Sanders is an outside salesperson and sells tax software to accounting and tax firms who prepare tax returns in the Carolinas. He spends about 50% of the year traveling to major cities in North and South Carolina. Because about 30% of his clients reside in the Charlotte area, Jack decided to buy a home there. He is from Ohio. He generally stays in hotels when he is out of town. He meets the first (work performed at designated home) and second (duplication of expenses) tests but does not meet the third test (family lives there). If two of the three conditions are met, whether the taxpayer has a tax home depends on the facts and circumstances of each case. In this particular case, it appears that he has a good chance of obtaining the travel expense deduction for the hotel costs. The time away from home must be temporary. If it is considered indefinite rather than temporary, the taxpayer is considered having moved to a new business location and none of the expenses qualifies for the travel deduction. If the period of employment in the new location exceeds one year, the taxpayer is not treated as being temporarily away from home during any period of employment. The IRS, in Revenue Ruling 93-86, provides three situations which help to clarify this rule. In Situation 1, the expected duration was 6 months and the actual stay was 10 months. This case is fairly clear cut. Since the expected and actual stays were less than one year, the entire period is considered temporary. In Situation 2, the expected duration was 18 months but the actual stay was 10 months. Even though the actual stay was less than 12 months, the entire period is considered indefinite because the taxpayer reasonably had expected the stay to exceed 12 months. In Situation 3, the taxpayer expected to complete the assignment in 9 months. After 8 months however, the taxpayer was asked to stay another 7 months for a total stay of 15 months. The IRS ruled that the first 8 months are considered temporary. After this time, it no longer was expected that the assignment would be completed in 12 months. Thus, the last 7 months were ruled indefinite.

[ITEM 19] FOREIGN STUDENTS DENIED TRAVEL EXPENSES CLAIMED AGAINST THEIR SUMMER WORK INCOME

Consider three foreign exchange students who are participating in the U.S. Department of State Summer Work Travel Program (program). They came to the United States for no more than four months over the summer to participate in cultural exchange, travel domestically, and work in temporary or seasonal jobs. All three students were full-time students in the country in which they resided and only one of the students held a part-time job in their country while also attending school. None of the students worked after returning to their country. Each student sought to deduct expenses paid in connection with the program, including the costs of airfare, program and visa fees, travel, health insurance, and meals and entertainment. Section 162 allows a deduction for business travel expenses for ordinary and necessary business expenses while traveling "away from home." They argued that since they were required to maintain residences abroad, their work in the U.S. was considered "temporary" and that they were away from home for purposes of Section 162. They likened their situation to that of the taxpayer in a 5^{th} Circuit case (Le Blanc) who, being a justice of the Louisiana Supreme Court and thus required to retain his lifelong home in his district while working in New Orleans, was allowed to deduct as a traveling expense his rental of an apartment in New Orleans. The IRS countered that each student had a principal place of business in the U.S. at the location of their respective summer jobs, and therefore their tax homes were in the U.S., not their home countries. The IRS also noted that pursuing an education full time does not constitute a trade or business under Section 162. In a regular Tax Court decision, the Tax Court in Liljeberg et al. [3/16/17] first noted that whether the business-related expenses were deductible rested on whether the taxpayers were away from home. A taxpayer may in certain cases claim his personal residence as his tax home when his absence is temporary. However, the court noted that a temporary absence alone does not make a taxpayer's personal residence his tax home. The taxpayer must have a business reason to maintain a distant, separate residence. The Tax Court agreed with a court case cited by the IRS (Hantzis; 1981) where a law student who lived in Boston with her husband during the school year could not deduct her traveling expenses when she took a summer job in New York. In this case, the First Circuit held that the temporary employment doctrine does not, however, purport to eliminate any requirement that continued maintenance of a first home have a business justification. Rather, this rule has no application where the taxpayer has no business connection with his usual place of residence. The First Circuit concluded that a taxpayer who pursues temporary employment away from the location of his usual residence, but has no business connection with that location, is not "away from home" for purposes of Section 162(a)(2). The Tax Court found the facts of the Hantzis case to be similar to the current case in that the students' lack of business connections with their respective home countries leads to the conclusion that they could not have been away from home. It therefore denied the taxpayers' claimed deduction for travel and living expenses paid in connection with their participation in the work program.

REVIEW QUESTIONS AND SOLUTIONS

10. For two recent Tax Court cases dealing with the real estate professional rule under the passive activity loss rules, **which one** of the following statements **is false**?

    a. The "substantial participation" test was used to determine material participation for some or all of the rental real estate properties in both cases.

    b. The court determined if the taxpayer met the two personal services tests before it determined if the taxpayer materially participated in the rental real estate activities.

    c. The taxpayer was required to document hours in all personal service activities in both cases.

11. According to the IRS, **which one** of the following factors **is least important** in determining the taxpayer's tax home (primary job location) in cases where a taxpayer has two places of business?

    a. How close the offices are to the taxpayer's principal residence.

    b. The total time spent working in each area.

c. The degree of business activity in each area.

Solutions

10. **"B" is the correct response**. In both cases, the Tax Court decided material participation in rental real estate activities before ruling on the two personal services tests.

    "A" is an incorrect response. The "substantial participation" test was the only test used in the dentist case. It and the "facts and circumstances" test were used in the stock broker case.

    "C" is an incorrect response. The court examined documented hours for both real estate and non-real estate activities in both cases. *Zarrinnegar and Windham*.

11. **"A" is the correct response**. The IRS considers three factors in determining a taxpayer's tax home when a taxpayer has two or more places of business. The taxpayer's residence is considered if the taxpayer has no principal place of business. Otherwise, it generally has no effect on determining the taxpayer's tax home.

    "B" is an incorrect response. This is factor #1 that the IRS considers in determining the taxpayer's tax home.

    "C" is an incorrect response. This is factor #2 that the IRS considers in determining the taxpayer's tax home. *Special Topics – Travel Expenses and the "Away from Home" Requirement*.

[ITEM 20] AN ELITE POSSIBILITY

When a taxpayer establishes an IRA, generally the taxpayer designates one or more beneficiaries of the IRA. As time goes by, taxpayers may become complacent about who was named the beneficiary of the account. IRAs do not go through probate. As a result, the taxpayer's representative has no flexibility to reduce income taxes to the beneficiaries of a taxpayer's estate by distributing a decedent's taxable IRAs to the beneficiaries in the lower tax brackets. This can result in significant losses in the after-tax value of IRAs to the decedent's beneficiary. With proper planning, these value reductions can be minimized. The example below illustrates the importance of periodically reviewing the named beneficiaries' current tax situation.

Twenty-five years ago, the mother named her son the sole beneficiary of her Roth IRA and her daughter the sole beneficiary of her traditional IRA. At the time, her son was 30 and earning a moderate salary and her daughter was in college. Currently, the value of the Roth IRA is $450,000 and the value of the traditional IRA is $400,000 with a tax basis of zero. The bulk of the mother's remaining assets are her house, cash, and stocks and bonds. The mother's will provides that all of her remaining assets are to be distributed equally after adjusting for any difference in the values of the IRAs which pass directly to the son and daughter. So in this example, whoever receives the traditional IRA will receive $50,000 more of the remaining assets. The mother has experienced several health issues and her long-term prognosis is not good. The son, now age 50, has had a modest career and is expected to have a 15% marginal tax rate for the foreseeable future. The daughter has been very successful and has a marginal tax rate of 45% when considering her federal and state tax rates. However, she does have some immediate cash flow concerns with three children, including two in college. If the mother would pass on in the near future, both the son and daughter would make sizable distributions from the IRAs over the next few years. Since Roth IRA distributions are nontaxable, the son would incur no tax cost form his IRA distributions. On the other hand, for each $10,000 distribution received from the traditional IRA by the daughter, there would be immediate tax costs of $4,500. This significantly reduces the after-tax value of the traditional IRA. In this case, the mother's representative should consider having the mother reverse the beneficiaries of the IRAs. The will could be modified to "compensate" the son for changing his IRA bequest from a Roth IRA to a traditional IRA by changing the amount of allocation of the remaining assets. By reducing the overall income tax consequences to the two beneficiaries, the after-tax value of the estate would be increased and both beneficiaries would be better off. To put it simply, by transferring low basis assets to the taxpayer in the lower tax bracket and compensating the beneficiary for doing this, both parties can benefit. If there are other beneficiaries such as grandchildren in the zero tax bracket, even more savings could be realized by distributing low basis assets to beneficiaries in the lowest tax brackets.

Note: For those readers who have a greater interest in this topic, we provide below one possible arrangement where both the son and daughter benefit by reversing the beneficiaries of the two IRAs. Determining the tax savings requires several calculations. Assume that it was agreed among the parties that on the basis of orderly IRA distributions, the after-tax values of the Roth and traditional IRAs were $450,000 and $220,000 ($400,000 x 55% (100%-45%)) respectively, before the beneficiary change and $450,000 and $340,000 ($400,000 x 85% (100%-15%)) respectively, after the change. Also, assume that the before- and after-tax value of the mother's remaining assets are $500,000. So the current before-tax value of the estate is $1,350,000 ($450,000 + $400,000 + $500,000). Before the change, upon the death of their mother, each child would receive assets with a before-tax value of $675,000 ($450,000 + $225,000 for the son and $400,000 + $275,000 for the daughter). However, the daughter's estimated after-tax value of her share of assets is only $495,000 ($220,000 for the traditional IRA and $275,000 for her share of the remaining assets). The son's estimated after-tax value is $675,000 ($450,000 for the Roth IRA and $225,000 for his share of the remaining assets). The daughter is receiving $50,000 more of the remaining assets to make up for the difference in the before-tax value of the IRAs. By simply switching the beneficiaries of the two IRAs, $120,000 ($340,000 - $220,000) of income tax savings to the beneficiaries would be realized. This savings could be shared in amounts agreed to by all parties. If the beneficiaries of the two IRAs were reversed, the son rather than the daughter would receive $50,000 more of the other assets. Assume the family agreed that the son would also receive $90,000 of the tax savings (payable out of the remaining assets) and the daughter would receive $30,000. As a result, the son's after-tax value would equal $705,000 ($340,000 for the traditional IRA, $275,000 of his share of the remaining assets, plus an additional $90,000 of the remaining assets for the tax savings). The daughter's after-tax value would increase from $495,000 to $585,000 ($400,000 for the Roth IRA and $185,000 for her share of the remaining assets ($275,000 - $90,000 transfer to the brother for the shared tax savings). Although her after-tax value of her share of the assets is still less than her brother's share ($585,000 versus $705,000), this change has increased her after-tax share by $90,000 ($585,000 versus $495,000) while her brother's share increased $30,000 ($705,000 versus $675,000). Note that the combined after-tax value increase of $120,000 ($90,000 + $30,000) is equal to the before-tax value of the traditional IRA ($400,000) times the difference in the marginal tax rates between the daughter and son (45% - 15%).

REVIEW QUESTION AND SOLUTION

12. Assume a taxpayer has a Roth IRA and a traditional IRA. With respect to income tax and estate tax planning, **which one** of the following statements **is false**?

   a. IRAs do not go through probate.

   b. Once a taxpayer names beneficiaries to his or her IRAs, the beneficiaries should not be changed unless the beneficiary dies before the taxpayer.

   c. One way to increase the after-tax value of the estate is to bequest traditional IRAs to beneficiaries in the lower tax brackets.

Solution

12. **"B" is the correct response**. As illustrated in the *Elite Possibility*, the taxpayer or his or her tax professional should periodically review the named beneficiaries' current tax situation and modify the beneficiaries to the taxpayer's IRAs to maximize the after-tax value of the taxpayer's estate, Generally, higher marginal tax rate beneficiaries should inherit Roth IRAs and lower marginal tax rate beneficiaries should inherit traditional IRAs.

    "A" is an incorrect response. Because IRAs do not pass through probate, the planning related to increasing the after-tax value of IRAs is done when the IRA beneficiaries are named.

    "C" is an incorrect response. As noted above, lower marginal tax rate beneficiaries should inherit traditional IRAs and be "compensated" by receiving additional property that passes through the estate. *An Elite Possibility.*

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

*Place your answers to the following 20 Multiple Choice Questions on the enclosed answer sheet (**page 21**).*

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1. What is the maximum passenger vehicle deduction **in 2018** (Year 2) for vehicles placed into service in 2017?

   a. $ 5,100.
   b. $ 5,700.
   c. $11,160.

2. Regarding the notice requirement for "Qualified Small Employer Health Reimbursement Arrangements (QSEHRA)," **which one** of the following statements **is true**?

   a. Generally, an eligible employer must furnish a written notice to eligible employees at least 90 days before the beginning of a year for which the QSEHRA is provided.

   b. For employers who provide QSEHRAs in 2017, the notice requirement is lifted until no earlier than 50 days following the issuance of IRS guidance.

   c. An employer may not furnish the required QSEHRA notice before IRS guidance is issued.

3. Regarding the election to apply a company's research tax credit against part or all of its FICA tax liability, **which one** of the following statements **is false**?

   a. The maximum amount of the research tax credit that can be used each year against the employer FICA liability is $250,000.

   b. Only qualified small businesses may make this election.

   c. The election can be made during the company's first 10 taxable years.

4. In an IRS ruling involving a taxpayer's use of a professional employee organization (PEO) to pay its payroll taxes and file its payroll tax returns, **which one** of the following statements **is true**?

   a. Although the PEO filed the taxpayer's payroll tax returns, none of the taxpayer's payroll taxes were paid by the PEO.

   b. State law cannot relieve the actual employer of the obligation to pay taxes for which it is liable under the Code.

   c. The IRS ruled that the PEO was considered the statutory employer of the taxpayer's workers.

5. In a recent IRS announcement involving tax collections by private collection agencies (PCAs), **which one** of the following statements **is false**?

   a. The PCAs will be attempting to collect only IRS tax debts that have been outstanding for a number of years.

   b. There are ten PCAs participating in the program.

   c. The PCAs will not contact taxpayers until the IRS notifies taxpayers that their accounts are being transferred to a PCA.

6. Regarding a recent IRS fact sheet on tips and service charges, **which one** of the following statements **is false**?

   a. A service charge is an amount an employer requires a customer to pay.

   b. A busser is an example of a "directly tipped employee."

   c. Generally, service charges are reported as non-tip wages.

7. For a recent case on a waiver from the 60-day rollover requirement for qualified retirement distributions, **which one** of the following statements **is true**?

    a. The taxpayers requested waiver relief from the requirement in a formal IRS letter ruling.

    b. The court was not bothered that the taxpayers had profited substantially from the retirement distributions.

    c. The court accepted the testimony of a licensed master social worker that the taxpayer suffered from a major depressive disorder.

8. For a recent case involving who was entitled to claim children as dependents, **which one** of the following statements **is false**?

    a. Neither the grandmother nor the parents claimed the parents' children as dependents on their original returns.

    b. The parents did not claim the children as dependents on a **prepared** amended return.

    c. The court ruled the parents did **not file** an amended return.

9. For a recent case involving the amount of the taxpayer's insolvency when debt on their principal residence was cancelled, **which one** of the following statements **is true**?

    a. The taxpayers argued that their pension plan interest could be used to pay an immediate tax liability.

    b. The IRS argued that the taxpayers' monthly pension payment was an asset in determining the amount of the taxpayers' insolvency.

    c. The Tax Court ruled that the taxpayers' pension plan interest was an asset within the meaning of Section 108.

10. For a recent case, what was a major reason the First Circuit denied the receiver the refund requests pursuant to the Claim of Right Doctrine?

    a. The taxpayers never had an unrestricted right to the funds.

    b. The taxpayers never reported the income that was fraudulently obtained.

    c. There was no inequity to the taxpayer since they committed fraud.

11. In a recent case involving loan guarantees by shareholders of an S Corporation, **which one** of the following statements **is true**?

    a. The yet to be paid judgments against the taxpayer resulting from the loan guarantees were considered by the Tax Court to be economic outlays at the time of the judgments.

    b. Several of the banks considered the shareholder to be the primary obligor of the loans to the S Corporation.

    c. The Tax Court ruled that the judgments against the taxpayer resulting from the loan guarantees are not included in the stock basis of the shareholder until the judgments are paid.

12. In a recent case where the IRS made an unauthorized disclosure of the taxpayers' joint tax return, what was the amount awarded to the taxpayers by the Second Circuit?

    a. $1,000 per taxpayer.

    b. $1,000 for each item on the tax return that was disclosed.

    c. $100,000 for punitive damages.

13. For a recent innocent spouse case, **which one** of the following **was** a conclusion of the Tax Court?

    a. Only two of the four factors applied to the taxpayer in determining that she did not have reason to know of an understatement on their tax return.

    b. The court had substantial difficulty in finding it inequitable to hold the taxpayer liable for the deficiency attributable to the understatement of tax on her former husband's and her 2010 joint return.

    c. Section 6015(b) applied to the taxpayer and she was entitled to a refund.

14. Based on a recent TIGTA report on IRS efforts to defend against identity theft, **which one** of the following statements **is false**?

    a. The IRS has **not** published an "Identity Theft Taxonomy" to measure its efforts to defend against identity theft.

    b. The IRS has obtained leads of potential identity theft tax returns from State tax agencies.

    c. The IRS agreed with the TIGTA recommendation to expand the use of its identity theft models.

15. Regarding the real estate professional rule, **which one** of the following statements **is false**?

    a. A real estate financing business is **not** a "real property trade or business."

    b. The taxpayer must attach a statement to the tax return providing specified information if the taxpayer wishes to treat all rental real estate as one activity.

    c. One of the personal services tests to meet the real estate professional rules is that the taxpayer performs more than 500 hours during the tax year in real property trades or businesses.

16. For a recent case in which the Tax Court found that a dentist was a real estate professional, **which test** did the court apply in deciding that the dentist materially participated in each of his rental activities?

    a. He participated more than 500 hours in each rental activity.

    b. His participation was substantially all of the participation of all individuals in each rental activity.

    c. Based on all the facts and circumstances, he participated on a regular, continuous, and substantial basis in each rental activity.

17. For a recent case in which the Tax Court found that a stock broker was a real estate professional, **which test(s)** did the court apply in deciding that the stock broker materially participated in her rental activities?

    a. Both the "facts and circumstances" and the "substantial participation" tests.

    b. Only the "facts and circumstances" test.

    c. Only the "substantial participation" test.

18. Regarding the "away from home" requirement applicable to business travel deductions, **which one** of the following statements **is true**?

    a. Tax home generally refers to the taxpayer's principal residence.

    b. For travel to be considered temporary, the expected stay out of town must not exceed six months.

    c. If a taxpayer has two or more places of business, the relative amount of income at each location or area is a factor which is used to determine the primary job location.

19. In a recent case involving foreign exchange students and the travel expense deduction, **which one** of the following statements **is false**?

    a. The IRS argued that the students' tax homes were in the U.S. where they worked.

    b. Because the students were at temporary locations, the Tax Court ruled that they satisfied the away from home requirement.

    c. None of the students worked in their home country upon returning from the work travel program in the U.S..

20. Assume that Jane Smith is in ill health and is not expected to survive the year. She has three children who are beneficiaries of her estate with combined federal and state marginal income tax rates as follows: child #1 - 15%; child #2 - 30%; and, child #3 - 45%. The value of Jane's estate is around $200,000 with the bulk of her assets held in nearly equal amounts in the following asset categories: (1) stocks; (2) a Roth IRA; (3) a traditional IRA with a stock basis of zero; and, (4) cash and CDs. Based on the primary objective of maximizing the after-tax returns of the beneficiaries, which child should be the named beneficiary of the **traditional IRA**?

    a. Child # 1.
    b. Child # 2.
    c. Child # 3.

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QUIZ INSTRUCTIONS AND ANSWER SHEET – SUMMER 2017, VOLUME XXVI, NUMBER 2, TAXATION

(**LATEST RECOMMENDED COMPLETION DATE: WITHIN ONE YEAR OF PURCHASE**)

There are 20 quiz questions which are on pages 18-20 of the newsletter. Choose the best answer based on the limited facts of each question, and record your answer below. Indicate your responses in the newsletter for your personal records and **complete the "Newsletter Evaluation" below.**

You must score 70% to receive continuing professional education credit for the newsletter. After you successfully complete the quiz, your quiz results, a complete set of solutions, and a certificate of completion will be mailed to you within 10 working days of our receipt of your answer sheet. If a score of less than 70% is achieved, you may retake the quiz without additional cost. The **completion date** that you specify on your answer sheet below **will be** the date placed on your certificate. We appreciate your business and hope that you are satisfied with the newsletter.

ANSWER SHEET

4 HOURS OF CPE: FEDERAL TAX LAW UPDATE

DELIVERY METHOD - SELF STUDY

Please record your answers below to the quiz questions. **Customers** should mail to the address below which coincides with the zip code indicated below. FOR NONSUBSCRIBERS, please be sure to include your check for $40 or supply the credit card information below.

CUSTOMERS WITH ZIP CODES BELOW 56000	**CUSTOMERS WITH ZIP CODES ABOVE 55999**
CPElite T.M. P.O. Box 721 White Rock, SC 29177-0721	**CPElite** T.M. P.O. Box 1059 Clemson, SC 29633-1059

1.	______	5.	______	9.	______	13.	______	17.	______
2.	______	6.	______	10.	______	14.	______	18.	______
3.	______	7.	______	11.	______	15.	______	19.	______
4.	______	8.	______	12.	______	16.	______	20.	______

COMPLETE FOR NEWSLETTER CREDIT

NAME (Circle Mr./Ms.) ____[PLEASE PRINT]

ADDRESS ____

E-MAIL ADDRESS ________________________________ **PHONE NUMBER** _________________________
(*Note: We do not share or sell email addresses*)

PRE-PAID SUBSCRIPTION # (Not Applicable to First-Time Subscribers) ______________________________

SIGNATURE ____ **COMPLETION DATE** ___________________

PURPOSE OF CPE ___________________________ **PTIN (if applicable**) ______________________________

(Indicate whether credit is for Enrolled Agent, CPA, or other purpose. For CPAs and licensed accountants, please indicate the state where you are licensed. If you have a PTIN, please provide it for IRS reporting purposes).

NEWSLETTER EVALUATION (Answer Yes, No, or N/A)

1. The stated learning objective was met. _______ 2. Handout or advance preparation materials were satisfactory._______ 3. The materials were accurate._______ 4. The materials were relevant and contributed to the achievement of the learning objective._______ 5. If applicable, prerequisite requirements were appropriate.______ 6. The time allotted to the learning activity was appropriate._______7. Additional Comments

____

CP<u>Elite</u>,T.M. Inc.
In a Class By YourselfT.M.
ORDER FORM

2017 Purchase Options - with online testing available at no extra charge:

Option 1 - ***2017 Unlimited CPE Online Package*** – up to 66 hours of CPE - $175. ***Courses available by PDF format only, with quizzes*** **online.** Includes four quarterly 4-hour issues of *The Elite Quarterly – Taxation* (plus 2 hour Ethics issue for enrolled agents) and all eight ***courses available in PDF format****.* The 2017 courses must be completed by December 31, 2017, under this option.

Option 2 – **2017 EA Package** - 24 hours of CPE – $155. This satisfies the average annual continuing education requirement for Enrolled Agents. Includes four quarterly 4-hour issues of The Elite Quarterly – Taxation (plus 2 hour Ethics issue for enrolled agents) and **one** course by mail or PDF format. ****Make course selection below**.

Option 3 – ***2017 Annual Subscription to The Elite Quarterly*** – 18 hours of CPE - $135. Includes four quarterly 4-hour issues of *The Elite Quarterly – Taxation* (plus 2 hour Ethics issue for enrolled agents).

Option 4 – ***Single Quarterly newsletter*** - 4 hours of CPE credit - $40.

Option 5 – ***Special Course Offer*** - 20 hours of CPE – $135. Choose any 3 of our 8 courses. Plus you receive the 2 hour Ethics issue for enrolled agents **free**! ***Courses available by PDF format only, with quizzes*** **online. **Make course selections below.**

Option 6 – ***Individual Course(s)*** - We offer eight 6-hour courses updated annually. ****Make course selection(s) below**.

Course Information and a description of each course is on page 24. We offer eight 6-hour courses which have been updated for 2017. For Options 2, 5, and 6, indicate the course(s) you are ordering by checking the box(es) below Option 6. **Quarterly Newsletter & Ethics Information is on page 23**. The CPE hours listed are based on 50 minutes of completion time per CPE hour. For questions, please e-mail us at cpeliteinc@aol.com, or call us at 1-800-950-0273.

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1. CHOOSE YOUR OPTION -- Described Above and on Next Page

Option 1 - 2017 Unlimited CPE Online Package - Up to 66 hours of CPE: **Enter $175**
(Includes Newsletters, Ethics, and any of our 8 courses in PDF format only) ____________

Option 2 - 2017 EA Package - 24 hrs of CPE **select ONE course below: Enter $155 ____________

Option 3 - 2017 Annual Subscription - 18 hours of CPE: Enter $135 ____________

Option 4 - Quarterly Newsletter submitted as single issue (4 hrs of CPE): Enter $40 ___________

Option 5 - Special Course Offer - 20 hrs of CPE **select 3 courses below: Enter $135 ___________

Option 6 - Individual 6-hour Course(s) **select below - $10 per CPE hour (# of courses checked times $60) ___________

<u>Select Courses for Options 2, 5, and 6</u>

**Course # 1 ☐ 2 ☐ 3 ☐ 4 ☐ 5 ☐ 6 ☐ 7 ☐ 8 ☐ Delivery - PDF ☐ Or Mail ☐ On-line Testing - Yes ☐ No ☐

2. AMOUNT DUE: Total of all Options (Payable by Check to **CP<u>Elite</u>**T.M. Inc. or VISA, MC, Discover below) $___________

PLACE ORDER one of 4 ways – At our website www.cpelite.com (first-time online customers – Click 'Order Now' Tab, existing online customers – log in to your account), phone or fax 1-800-950-0273, or by mail.

For mail and fax orders, please complete the credit card information below for VISA [ ] Mastercard [ ] Discover [ ] (check one)

Credit Card # ____Expiration Date _______________________________

Name____ Signature____

Phone______________________ Address____

To order by mail - **CP<u>Elite</u>**, T.M. Inc.. **Customers with Zip Codes below 56000** -- Address to P.O. Box 721, White Rock, SC 29177-0721. **Customers with Zip Codes above 55999** -- Address to P.O. Box 1059, Clemson, SC 29633-1059. **To order by phone or fax** using your Discover, Mastercard, or VISA, call or fax: 1-800-9500-CPE. Please have your credit card information available. **To order on the internet** visit our web site at www.cpelite.com, then click the 'Order Now' Tab. We appreciate your business!

CPE CREDIT INFORMATION

Contact us by E-mail (cpeliteinc@aol.com), phone or Fax (1-800-950-0273)

SIX CPE CREDIT OPTIONS - DETAILS BELOW

OPTION 1 - ***2017 Unlimited CPE Online Package - up to 66 hrs***

OPTION 2 - ***2017 EA Package - 24 hrs***

OPTION 3 - ***2017 Annual Subscription Package -18 hrs***

OPTION 4 - ***Single Newsletter - 4 hrs***

OPTION 5 - ***Special Course Offer - 20 hrs***

OPTION 6 - ***Individual Course(s) - 6 hrs per course***

OPTION 1 – ***2017 Unlimited CPE Online Package*** – up to 66 hours of CPE - $175. *Courses available in PDF format in your online account or emailed by request. Quizzes online.* Covers four quarterly 4-hour issues of *The Elite Quarterly – Taxation* (including Ethics issue for enrolled agents) and all eight ***courses.*** Refer to page 24 for course descriptions. The 2017 courses must be completed by December 31, 2017, under this option.

OPTION 2 – ***2017 EA Package*** - 24 hours of CPE – $155. This satisfies the average annual continuing education requirement for Enrolled Agents. Includes four quarterly 4-hour issues of The Elite Quarterly – Taxation issued 4 times per year (plus 2 hour Ethics issue for enrolled agents) and **one** 6-hour 2017 course by mail or PDF format. Make course selection for option 2 on the order form on page 22.

OPTION 3 – ***2017 Annual Subscription to The Elite Quarterly*** – 18 hours of CPE - $135. For those wishing to complete only newsletters for CPE credit. Includes four quarterly 4-hour issues of *The Elite Quarterly – Taxation* issued 4 times per year (plus 2-hour Ethics issue for enrolled agents).

OPTION 4 – ***Single Quarterly Newsletter*** – Select Option 4 on the order form, and enclose your check for $40 payable to **CPElite,**T.M. or provide your credit card authorization.

OPTION 5 – ***Special Course Offer*** – Choose 3 of our courses for a total of $135. Plus you receive the 2 hour Ethics issue for enrolled agents **free** – A total savings of $65. Make course selection for option 5 on the order form on page 22.

OPTION 6 – ***Individual Course(s)*** - We offer eight 6-hour CPE credit courses which are updated annually. Each course costs $60 under this option. Make course selection for option 6 on the order form on page 22.

ENROLLED AGENTS – Our CPE newsletters and courses qualify for EA's. Our "ethics" newsletter satisfies the 2-hour ethics component for EA's.

CPAs AND LICENSED ACCOUNTANTS – Our newsletters and courses conform to the enhanced AICPA/NASBA Standards for providers of continuing professional education. We are a NASBA-approved QAS Learning Provider.

CPE INFORMATION – Each newsletter and course contains 5 quiz questions per CPE hour. You must score at least 70% to receive CPE credit. **Online testers** see **ONLINE TESTING** below. Otherwise, place your answers to the quiz questions on the answer sheet (page 21) and remit payment if you have not purchased one of our packages. You specify the date you complete the quiz on your answer sheet. **You must complete the material for CPE credit within one year from the purchase date.** Our materials are also available for download at www.cpelite.com.

ONLINE TESTING – **Current online testers** – Go to www.cpelite.com, and log in to your account. New customers CLICK "Online Testing Available" at our website for instructions. **Our online testing system is integrated into our website.**

HOW TO ORDER – Order at our website at www.cpelite.com, by clicking the "Order Now" Tab, **otherwise:**

1. Complete the newsletter
2. Fill in the answer sheet
3. Complete order form/select payment option
4. Enclose payment
5. Mail, fax, or email the answer sheet and order form

Questions? E-mail us at cpeliteinc@aol.com. Or, call us at 1-800-950-0273, or for more information regarding administrative policies such as complaint and refund, please contact our offices at 1-800-950-0273.

We are the leader in continuing professional education newsletters!

A DESCRIPTION OF CPElite'sT.M. CPE MATERIALS

The recommended CPE hours for our newsletters are based on length of written material, level of difficulty, and input from reviewers and pilot testers. Each hour of credit specified below is based on a 50-minute hour per CPE hour. The content level of materials is an update [U] for our newsletters and basic [B] for each course. **Notes:** There are no prerequisites nor is advanced preparation required for our products. The learning objectives of each CPE product are provided below and on page 24. All our materials are available for download and on-line testing.

NEWSLETTERS

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

To make practitioners aware of recent tax developments in legislation, the IRS, judicial decisions, and the Treasury. The four issues typically are available on-line, by email, or mail by the following dates: May 1, July 15, September 15, and November 30. Each issue costs $40. An annual subscription to all four issues costs $135. The 2-hour ethics issue for enrolled agents is included in the subscription.

[2] ETHICS FOR ENROLLED AGENTS – Recommended CPE Credit – 2 Hours per issue [U]

To provide recent developments affecting tax professionals which satisfy the ethics and professional conduct component required for enrolled agents only. The 2017 issue costs $20 and is **free to annual subscribers** to *The Elite Quarterly* and Option 5 orders.

THE ELITE QUARTERLY NEWSLETTER
Published by CPElite,T.M. Inc.
P.O. Box 721, White Rock, 29177-0721 or
P.O. Box 1059, Clemson, SC 29633-1059

Change Service Requested

***** 4 HOURS OF SELF-STUDY CPE CREDIT INSIDE *****

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The leader in "continuing professional education newsletters" for tax professionals

(Visit us at www.cpelite.com or Call us at 1-800-950-0273)

COURSES – Field of Study: Federal Tax

[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.