THE ELITE QUARTERLY – Taxation

Published by **CPElite**,[T.M.] Inc.
The Leader in Continuing Professional Education Newsletters

Volume XXVI, Number 3, Fall 2017 Issue – 4 Hours of CPE Credit (Taxation)
CPE for Enrolled Agents, CPAs, and Licensed Accountants
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We hope that you had a wonderful summer. If you have not renewed your newsletter subscription for 2017, you may still do so. As in our 2017 Spring and Summer newsletters, this newsletter includes a "Special Topics" section. This section reviews the hobby loss provisions and the innocent spouse relief provisions – two areas where there is significant litigation. 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 item, Special Topics, and *An Elite Possibility* dealing with vacation homes and repair and maintenance (R&M) days. The content level of the newsletter is an update of these items. For the IRS and Treasury Items, the learning objectives are: (1) Identify factors in a company / PEO relationship that are important in determining who is responsible for paying employment taxes; (2) Know about key items in the NTA's 2017 midyear report; (3) Recognize increased cybercriminal efforts aimed at tax professionals; (4) Know what ITINs need to be renewed; (5) Determine the proper date for certain actions by taxpayers in Presidentially-declared disaster areas; (6) Know the HSA inflation-adjusted amounts for 2018; and, (7) Identify the IRS's selection criterion for discrepancy cases under the CAWR program and determine whether the IRS is obtaining the highest return in its selection process. 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. The learning objectives for the Special Topics sections are: (1) Know the rules to determine if an activity is a non-for-profit activity; and, (2) Identify the factors used to determine innocent spouse relief. The learning objective for the Elite Possibility is to know how to document R&M days and whether travel days qualify as R&M days. 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

[Item 1] PEO (Professional Employer Organization): The name commonly used to reference businesses that market their ability to assist employers with ministerial tasks associated with the reporting and payment of employment taxes.

[Item 3] Spear phishing: Cybercriminal emails sent to tax professionals that identify the sender as a friend, customer, or company.

[Item 4] Individual taxpayer identification numbers (ITINs): ITINS are used by people who have tax filing or payment obligations under U.S. law but who are not eligible for a social security number.

[Item 5] Postponement period: The period in which certain actions of the taxpayer have been granted an extension to take action because the taxpayer's area where he lives was declared a Presidentially-declared disaster area.

Key Terms - Continued

[Item 6] High-deductible health plan: A health plan which is eligible for the health savings account provisions because it meets the minimum annual deductible amounts and the maximum annual out-of-pocket amounts for self-only coverage and family coverage plans.

[Item 7] ERISA: An acronym for the provisions in the Employee Retirement Income Security Act. These provisions generally obligate private employers offering pension plans to adhere to an array of rules designed to ensure plan solvency and protect plan participants.

[Item 9] Meal expense de minimis fringe exception: One of the exceptions to the general rule that 50% of meal expenses are deductible. The exception permits a full deduction for meal expenses that meet the exception.

[Item 9] Revenue/operating cost test: One of the requirements that an employer must meet to qualify for the meal expense de minimis fringe exception. For this requirement, revenue derived from the employer's eating facility must at least equal the facility's direct operating costs.

[Item 10] Constructive receipt doctrine: Constructive receipt occurs when income is credited to an individual's account, set apart for him, or otherwise made available so he may draw upon it. Income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

[Item 12] Section 267 related party rules: Rules under which, if parties have a specified relationship, certain payor deductions are delayed until the payee reports the item in income.

[Item 13] Reasonable prospect of recovery: One of two terms that are investigated before determining the year in which a theft loss is deductible. The loss is not deductible until determining the amount of recovery.

[Item 13] Reasonable certainty: The second term that is investigated before determining the year in which a theft loss is deductible. Some courts have combined both terms when determining the amount of recovery, if any.

[Item 14] Combined Annual Wage Reporting (CAWR) Program: A program which compares the employee wage and withholding information reported to the IRS on employment tax forms to withholding documents filed with the Social Security Administration.

[Item 15] Not-for-profit activity (NFPA): Any activity other than a trade or business or income-producing activity which has a profit motive.

[Item 15] Rebuttable presumption for a NFPA: A presumption that if an activity's gross income exceeds its deductions for 3 out of 5 (2 of 7 for a horse activity) years, the burden is on the IRS to prove that the activity is a NFPA.

[Item 17] Innocent spouse provisions: Section 6015, which provides three alternatives to seek relief from tax due on a joint return.

[Item 17] Erroneous items: Either (1) gross income not reported by the taxpayer's spouse or (2) improper deductions, credits, or property basis claimed by the taxpayer's spouse.

[Item 18] Form 8857: The required form to file when seeking innocent spouse relief.

[Item 18] Informal claim doctrine: A doctrine which permits a taxpayer to avoid the statute of limitations if the taxpayer filed a written refund request that was sufficient to apprise the IRS that a refund is being claimed.

[Item 20] Vacation home: A provision which limits the deductions for rental property to its rental income. Rental property is a vacation home if the taxpayer uses the residence for personal use the greater of 14 days or 10% of the days rented.

[Item 20] Repair and maintenance (R&M) days: Days that the owner stays at his rental property and engages in repair and maintenance. These days do not count as personal use days for purposes of determining whether the vacation home limits apply.

IRS

[ITEM 1] IRS DETERMINES WHETHER COMPANY OR PEO IS RESPONSIBLE FOR WORKER EMPLOYMENT TAX OBLIGATIONS

In Chief Counsel Advice Memorandum 201724025, the IRS considered if an S Corporation that contracted with a third party to perform its employment tax obligations is the statutory employer responsible for employment tax obligations unpaid by the third party. The corporation hired workers to perform various services. When it filed its Form 1120S, it claimed no deductions for officer compensation, salaries, or wages. Rather, it claimed deductions for "Employee Leasing" for its entire workforce. It had entered into a contract with a third party professional employer organization (PEO). Under the contract, the corporation assumed the responsibility for the day-to-day supervision and control of the workers. At least one business day before each payroll date, the corporation paid an amount at least equal to all wages, salaries, taxes, and all other payments to be paid with respect to the workers. The corporation was required to provide a security deposit or procure a letter of credit naming the PEO beneficiary in the amount determined by the PEO to cover wages, salaries, taxes, and all payments to be paid with respect to the workers. The PEO could terminate the contract, immediately without notice, upon the occurrence of the corporation's failure to pay any invoice in full in the amount and at the time specified when due, or any breach or default of the contract by the corporation. In the event of termination for any reason, the corporation was responsible for payment of all wages, salaries and employment-related taxes. The PEO's duties included administering the corporation's payroll, processing and paying wages to the individuals, and filing all Forms 940 and 941 and furnishing Forms W-2. The contract referred to the workers as "co-employees." But, the corporation conceded that it was the common law employer of the workers, and it had the right to direct and control them in all aspects of the employment relationship. For the years at issue, the corporation filed no Forms 940 or 941 and issued no Forms W-2, and it took no steps to verify that the PEO had done so. The corporation learned on audit that the PEO had failed to remit the employment taxes to the government.

The issue was whether the corporation met its employment tax obligation since it paid the amounts in question to the PEO, and thus was not liable for the unremitted employment taxes. The corporation acknowledged that as the common law employer, it had the responsibility to pay the underlying tax liabilities on wages it paid to the workers. The corporation asserted it paid the requisite amount of wages and associated employment taxes to the PEO, and further that the PEO is solely responsible for the payment of the employment taxes. The IRS stated that if the common law employer does not have control of the payment of wages (and FICA and FUTA taxes), the term employer means the person who does have control of the payment of those items. Based on the provisions in the contract that the corporation had with the PEO, the IRS concluded the PEO was not in control of the payment of wages because the PEO did not assume legal responsibility for paying the wages to the employees. The IRS ruled that the PEO was a mere conduit in making payroll, and so the corporation was responsible for paying the underlying tax liabilities.

[ITEM 2] NATIONAL TAXPAYER ISSUES 2017 MID-YEAR REPORT

The National Taxpayer Advocate (NTA) is required by the Code to issue 2 reports annually to Congress. In IR-2017-113 [6/28/17] the IRS covers her 2017 mid-year report. The report contains a review of the 2017 filing season, her identification of the issues the Taxpayer Advocate Service (TAS) will address during FY 2018, and the IRS's responses to each of the 93 administrative recommendations she made in her 2016 year-end report to Congress. For the 2017 filing season, she praised the IRS for its reducing the incidence of identity theft, implementing new accelerated Form W-2 reporting requirements, and matching Forms W-2 against tax returns that claim refunds. She shows continuing concern about the IRS's budget allocation between enforcement activities (over 60%) versus taxpayer outreach and education (about 4%). The IRS processed nearly 130 million returns during the 2017 filing season, 90% of which were filed electronically. The IRS answered 79% of telephone calls it received on calls routed to telephone assistors on its "account management lines," up from 72% in FY 2016. The time taxpayers spent on hold declined to 6.5 minutes from 11.1 minutes from FY 2016. But, the IRS service on its "compliance telephone lines" was not so successful. The calls on those lines are largely from taxpayers seeking to make payment arrangements. On those lines, the IRS answered only 40% of the calls (down from 76% in FY 2016), and wait times went from 11 minutes in FY 2016 to 47 minutes in FY 2017. For FY 2018, the IRS plans to focus on 13 priority issues, some of which are: private debt collection implementation, U.S. Passport revocations and denials, transparency in its Offshore Voluntary Disclosure Programs, options to improve the administration of the EITC, tax compliance barriers for ITIN holders, and its policies regarding levies on retirement accounts.

[ITEM 3] IRS ISSUES TWO RELEASES ON PHISHING WARNING

In IR-2017-111 [6/23/17], the IRS warns of new phishing emails that target tax professionals. The emails purport to be from a tax software education provider, and seek extensive amounts of sensitive preparer data. The IRS does not know of the origin of the email, but states it is unusual in that it seeks a large amount of specific client data. It reminds tax professionals that legitimate businesses and organizations never ask for usernames, passwords, or sensitive data in emails. In both IRS releases discussed here, the IRS notes that it, state tax agencies, and the tax industry are making inroads on individual tax-related identity theft, and so cybercriminals are increasingly targeting tax professionals, looking for real client data so they can better impersonate the taxpayer when filing fraudulent returns for refunds. The fake email begins: "In our database, there is a failure, we need your information about your account. In addition, we need a photo of the driver's license, send all the data to the letter." Then, the cybercriminal requests 13 specific pieces of information, for example, Eservices username, EIN number, and prior years AGI. The IRS requests that anybody who receives the scam email contact it at phishing@irs.gov.

In IR-2017-117 [7/7/17], the IRS warns tax professionals to increase their computer security and to beware of their inbox, referring specifically to successful email scams dubbed spear phishing that identify the sending party as a friend, customer, or company. It states that there is the danger of exposing taxpayer data to theft by opening an infected link or attachment, or disclosing usernames and passwords to critical accounts. The cybercriminals also want to steal preparers' e-Services passwords, electronic filing ID numbers, centralized authorization numbers, and PTINs. The IRS points out that from January - May, 2017, 177 tax professionals or firms reported data thefts involving client information for thousands of people. It notes that tax practitioners are reporting 3 - 5 data thefts weekly involving client information. The Anti-Phishing Work Group (APWG) reports 1.2 million phishing attacks in 2016, a 65% increase from 2015. The APWG sees 92,564 unique phishing attacks monthly, a 5,753% increase over the last 12 years. Phishing.org reports more than 100 billion spam emails are being sent daily, more than 85% of all organizations have been targeted by phishing attempts, and phishing damages have exceeded $1 billion. A 2017 Verizon report found that 95% of successful phishing attacks include some sort of malware software installation that allows thieves to export data or take control of systems. Verizon found 81% of hacking efforts used either stolen passwords or accessed weak passwords.

[ITEM 4] IRS REMINDS TAXPAYERS ABOUT ITIN RENEWAL APPLICATIONS

In IR-2017-109 [6/21/17], the IRS reminds affected taxpayers that it is accepting renewal applications for

2018 for Individual Taxpayer Identification Numbers (ITINs). ITINS are used by people who have tax filing or payment obligations under U.S. law but who are not eligible for a social security number. Taxpayers with ITINs that have not been used on a federal tax return at least once in the last 3 consecutive years expire December 31, 2017. ITINs with the middle digits 70, 71, 72, or 80 also expire December 31, 2017, and need to be renewed even if the taxpayer has used the ITIN in the last three years. Those taxpayers also have the option to renew ITINS for their entire family at the same time, even if family members have ITINs with other numbers. Individuals with ITINs with middle digits of 78 and 79 expired last year, and those taxpayers can renew at any time to file for 2017. The IRS is sending the CP-48 Notice this summer to affected taxpayers. To renew an ITIN, a taxpayer must complete Form W-7 and submit all required documentation. Taxpayers submitting Form W-7 do not have to attach a federal tax return, though they still must note on Form W-7 a reason for needing an ITIN. There are 3 ways to submit Form W-7: (1) mail it to the IRS along with original identification documents or copies certified by the agency that issued them; (2) work with Certified Acceptance Agents (CAAs) authorized by the IRS to help them apply for an ITIN; and, (3) call and make an appointment at a designated IRS Taxpayer Assistance Center.

[ITEM 5] IRS CLARIFIES DISASTER AREA RELIEF PROVISION FOR TAX PAYMENTS

IRC Section 7508A grants the Treasury the authority to postpone certain deadlines by reason of Presidentially-declared disaster or terroristic or military actions. Under the Treasury regulations, an affected taxpayer is eligible for postponement of time to perform an act until the last day of the relief period if the affected taxpayer is required to perform a tax-related act by a due date that falls within the postponement period. In Chief Counsel Advice 201723023, the IRS clarifies whether the late payment penalty applies to a taxpayer who filed an extension to file her 2015 tax return. The disaster occurred on August 11, 2016 and the postponement period to take certain actions was postponed until January 17, 2017. The taxpayer was able to file her 2015 tax return on or before January 17, 2017 (the end of the postponement period). That is because the due date of the 2015 tax return after filing a valid extension is October 15, 2016 and that date falls in the postponement period. However, the failure to pay penalty begins on April 15, 2016, well before the beginning of the postponement period so the failure to pay penalty and accrual of interest begin on April 15, 2016 and includes the postponement period until the tax is paid.

[ITEM 6] IRS ISSUES HSA INFLATION-ADJUSTED AMOUNTS FOR 2018

In Revenue Procedure 2017-37 [5/4/17], the IRS reports annual inflation adjustments related to health savings accounts (HSAs) for 2018. The maximum deduction for 2018 contributions for coverage under a high-deductible health plan is $3,450 for self-only coverage (up $50 from 2017) and $6,900 for family coverage (up $150 from 2017). The high-deductible health plan for 2018 must have an annual deductible that is not less than $1,350 (up $50 from 2017) for self-only coverage and $2,700 (up $100 from 2017) for family coverage. The 2018 annual out-of-pocket expense maximums are $6,650 (up $100 from 2017) for self-only coverage and $13,300 (up $200 from 2017) for family coverage.

REVIEW QUESTIONS AND SOLUTIONS

1. Recently the IRS ruled that a company that leased workers from a Professional Employer Organization (PEO) was responsible for paying employment taxes with respect to workers it leased from the PEO. **Which one** of the following responses **was not** a fact in the ruling?

   a. The PEO paid the employment taxes timely.

   b. The corporation hired the workers to perform various services for it.

   c. The corporation was contractually obligated to provide a security deposit or procure a letter of credit naming the PEO as beneficiary for the amount the PEO determined was necessary to cover payments made with respect to the workers.

2. **Which one** of the following **was not** in the National Taxpayer Advocate's recent 2017 mid-year report?

   a. For the 2017 filing season, she praised the IRS for matching Forms W-2 against tax returns that claimed refunds.

   b. The IRS electronically processed 76% of the returns filed during the 2017 filing season.

   c. On its account management lines, the time that taxpayers spent on hold declined over 4 minutes from FY 2016 to FY 2017.

3. **Which one** of the following plans **will qualify** as a high deductible health plan in 2018?

   a. A plan with a $1,400 annual deductible for self-only coverage and an annual out-of-pocket expense maximum of $7,000 for self-only coverage.

   b. A plan with a $3,000 annual deductible for family coverage and an annual out-of-pocket expense maximum of $12,000 for family coverage.

   c. A plan with a $2,600 annual deductible for family coverage and an annual out-of-pocket expense maximum of $13,000 for family coverage.

Solutions

1. **"A" is the correct response**. The PEO did not pay the employment taxes on the workers.

   "B" is an incorrect response. The corporation hired the workers to perform various services, and then leased the workers from the PEO.

   "C" is an incorrect response. One of the provisions in the contract between the company and the PEO was that the corporation was required to provide a security deposit or procure a letter of credit naming the PEO beneficiary in the amount determined by the PEO to cover wages, salaries, taxes, and all payments to be paid with respect to the workers. *Chief Counsel Advice Memorandum 201724025*.

2. **"B" is the correct response**. The IRS electronically processed 90% of the returns filed during the 2017 filing season.

   "A" is an incorrect response. This was one of three IRS areas the National Taxpayer Advocate praised the IRS for its 2017 filing season.

   "C" is an incorrect response. Wait time spent on the IRS's account management lines declined from 11.1 minutes in FY 2016 to 6.5 minutes in FY 2017. *IR-2017-113*.

3. **"B" is the correct response**. In this plan, the annual deductible is at least $2,700 for family coverage and the annual out-of-pocket expenses may not exceed $13,300 for family coverage.

   "A" is an incorrect response. This plan violates the annual out-of-pocket expense maximum of $6,650 for self-only coverage.

   "C" is an incorrect response. This plan violates the annual deductible minimum of $2,700 for family coverage. *Revenue Procedure 2017-37.*

COURT DECISIONS

[ITEM 7] SUPREME COURT DETERMINES WHETHER ERISA APPLIES TO PENSION PLANS OF CHURCH-AFFILIATED COMPANIES

Chapter 18 of Title 29 deals with the Employee Retirement Income Security Act (ERISA). Passed in 1974, these provisions generally obligate private employers offering pension plans to adhere to an array of rules designed to ensure plan solvency and protect plan participants. Church plans (as defined in Section 1002(33)) are specifically exempt from the ERISA rules. Section 1002(33)(A) defines a church plan as a plan established and maintained for its employees by a church or by a convention or association of churches which is exempt from tax. In 1980, Congress added Section 1002(33)(C)(ii)(II), which provides that the term employee of a church or a convention or association of churches includes an employee of an organization which is exempt from tax and controlled by or associated with a church or a convention or association of churches. In 2013, a former employee of a non-profit healthcare entity filed a class action alleging that his former company failed to comply with various ERISA obligations. The most serious allegation was that, as of the end of 2011, the pension plan was underfunded by more than $70 million. The healthcare entity runs a variety of facilities, including a hospital, and employs over 2,800 people. Though it is not a church, it has ties to the Roman Catholic Diocese in New Jersey. The entity claimed that it qualified for ERISA's church plan exemption and was not required to comply with the ERISA provisions the former employee claimed it had violated. A District Court ruled that the healthcare entity could not establish an exempt church plan because it was not a church. The Third Circuit agreed. The Seventh and Ninth Circuits affirmed similar decisions and the Supreme Court granted certiorari. In Advocate Health Care Network et al. [6/5/17], the Supreme Court reversed all three appellate court decisions in ruling that a plan maintained by a church-affiliated nonprofit entity qualifies as a church plan. As such, the plan is exempt from the ERISA rules. The current and former employees of the healthcare entities argued that a plan of a church-affiliated organization must have been established by a church to qualify for the church-plan exemption. They focused on Section 1002(33)(A) defining church plan and the language "a plan **established and maintained** by a church for its employees." The Supreme Court countered that the 1980 amendment added a new category of church plans under Section 1002(33)(C)(ii)(II) and that only requires that the organization be a nonprofit entity which is controlled by or associated with a church. It used the following logic to arrive at its conclusion. Premise 1 (Section 1002(33)(A)): A plan established and maintained by a church is an exempt church plan. Premise 2 (Section 1002(33)(C)(ii)(II)): A plan established and maintained by a church includes a plan maintained by a principal-purpose organization. Deduction: A plan maintained by a principal-purpose organization is an exempt church plan. Or, as one court put the point without any of the ERISA terminology: "If A is exempt, and A includes C, then C is exempt." On this basis, the Supreme Court ruled that a plan by a church-affiliated organization qualifies as a "church plan," regardless of who established it. It accordingly reversed the judgments of the three Courts of Appeals. **Note:** In a concurring opinion, while Justice Sotomayor agreed with the court's interpretation of the relevant statutory text, she expressed concern that scores of employees of many church-affiliated organizations which operate like large businesses might be denied ERISA's protections. She prompted Congress to take action on this decision.

[ITEM 8] DISTRICT COURT RULES IRS MAY NOT CHARGE FEES FOR ISSUING PTINS

Back in 2010, the IRS and Treasury attempted to regulate both credentialed and uncredentialed tax return preparers. In accordance with newly issued regulations in 2010, the IRS established a new

"registered tax return preparer" designation, requiring individuals other than attorneys, enrolled agents, and CPAs to: (1) pass a one-time competency exam, (2) pass a suitability check, and (3) obtain a PTIN. Since 2010, there has been a user fee for each year a tax preparer renews his or her PTIN. In 2014, the D.C. Circuit Court affirmed the Loving decision by agreeing with a lower court that the regulations in Circular 230 applied only to individuals who were able to "practice" before the IRS and that the preparation and signing of tax returns did not constitute such practice. As a result, the first two items of the 2010 IRS initiative no longer are required after this decision. In Steele et al. [[6/1/17], the plaintiffs went after the third prong of the initiative – PTINs and the required user fee. The D.C. District Court first considered whether the IRS has the authority to require PTINs. Section 6109(a)(4), which was enacted prior to the 2010 regulations, provides that a tax preparer must furnish an identifying number on returns prepared by the preparer. Section 6109(d) provides further that an individual's social security number shall be used as the identifying number except as otherwise specified under Treasury regulations. The court first found that the IRS was authorized to issue regulations requiring the exclusive use of PTINs. The court relied on two prior Supreme Court cases (Chevron, 1984 and State Farm, 1983) to determine whether the Treasury overstepped its authority in its interpretation of the law. Under Chevron, if the intent of Congress is clear, that is the end of the matter; for the court, as well as the Treasury, must give effect to the unambiguously expressed intent of Congress. If the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the regulations are based on a permissible construction of the statute. As Section 6109(d) precisely gives the Treasury the authority to require an identifying number other than the preparer's social security number, the decision is clear under Chevron – the Treasury has the authority to require a PTIN. Under State Farm, the analysis focuses on whether the Treasury's actions are arbitrary or capricious. The court ruled that the Treasury was justified in requiring PTINs for a number of reasons. It noted that the IRS explained the need to identify tax return preparers in order to maintain oversight, and stated that the use of a single identifying number was critical to such effective oversight. In addition, it agreed with the IRS that the use of a single number would "enable the IRS to accurately identify tax return preparers, match preparers with the tax returns and claims for refund they prepare, and better administer the tax laws with respect to tax return preparers and their clients." The District Court reached a different decision on the IRS's authority to impose user fees for PTINs. Under the Independent Offices Appropriations Act of 1952 (IOAA), government agencies may prescribe regulations establishing the charge for a service or thing of value provided by the agency. The IRS indicated that PTINs provided a service or a thing of value on two levels – (1) it allowed tax professionals to prepare tax returns for clients, and (2) it protected the confidentiality of the preparer's social security number. The District Court rejected both of these positions. First, it noted that after Loving anyone can obtain a PTIN as there are no criteria to become eligible to prepare tax returns. Second, the confidentiality justification is mentioned only briefly in the regulations requiring the use of PTINs. It is not discussed in the regulation specifically addressing user fees. The District Court ruled that the IRS may not charge fees for issuing PTINs and the regulations requiring payment of fees for PTINs are unlawful. **Note:** PTIN registration and renewal were suspended on June 2. The IRS resumed the issuance of PTINS, without charge, on June 21, 2017.

[ITEM 9] HOCKEY TEAM'S MEAL EXPENSES ARE FULLY DEDUCTIBLE

The taxpayers owned the Boston Bruins National Hockey League ice hockey team franchise through an S Corporation. The team played ½ of its 82 regular season games away from home, and also played preseason games, and possible postseason games. As part of its business model, the team's goal was to win as many hockey games as possible. For the 2009 and 2010 tax years, between 20 - 24 players and other team personnel (e.g., coaches, medical personnel, and athletic trainers) traveled to every Bruins away game. The team had contracts with away city hotels for sleeping accommodations, and meal rooms where pregame meals and snacks were served to all traveling employees. All food was available to all employees, and certain meals were mandatory for players. The Bruins used the away hotels for lodging, meals, meetings, and other team-related activities, for example medical treatment, physical therapy, and conditioning training. The issue in Jacobs [6/26/17] was whether the meal expenses were fully deductible as asserted by the taxpayers, or 50% deductible as asserted by the IRS. The Tax Court considered if Section 274(n)1) limited the meal deductions to 50% of the meal expense, or whether the meal expense was subject to the Section 274(n)(2)(B) exception and fully deductible as a de minimis fringe. The court analyzed 6 requirements for the cost of the meals to be fully deductible. First, it considered if the meals were provided on the same terms to each member of a group of employees. It concluded that, in that pregame meals were provided to all traveling hockey employees, they were provided on a nondiscriminatory basis, and met this requirement. Second, it considered if the eating facility were owned or leased by the employer. It concluded that, though the team/hotel contract was not denominated as a lease, the substance of the team's contract with each hotel was the team's paying for the right to use and occupy the hotel meal rooms. Thus, the second requirement was met. Third, the court considered if the eating facility were operated by the employer. It concluded that, per Treasury regulations, since the employer/team contracted with another to operate an employee eating facility, the facility is considered to be operated by the employer for purposes of the de minimis rules. Fourth, it considered if the eating facility were located on or near the business

premises of the employer. The court considered the employee's duties and the nature of the employer's business. It concluded that with the traveling hockey team's employees' performance of significant business duties at away city hotels, and the unique nature of the Bruins' business, the away city hotels were part of the team's business premises. Fifth, the court considered if the eating facility met the "revenue/operating cost" test in the Code and regulations. For this requirement, revenue derived from the eating facility must at least equal the facility's direct operating costs. The regulations provide that this requirement is met if the meals are furnished for the convenience of the employer, and furnished on the employer's business premises. The convenience part is satisfied if meals provided without charge to the employee are furnished for a substantial noncompensatory business. The court stated that the substantial noncompensatory purpose was met because the meals were provided to players for nutritional and performance reasons (conducive to the team's goal of winning games), and to other employees so they could better meet their busy schedule. So, this requirement was met. Sixth, it considered if the meals were furnished during, before, or after the employee's workday. The IRS conceded this requirement was met. The court concluded that the taxpayers' provision of pregame meals and snacks to the team's traveling employees at away city hotels qualified as a de minimis fringe and the meal and snack costs were fully deductible.

[ITEM 10] 7TH CIRCUIT INTERPRETS CONSTRUCTIVE RECEIPT RULES FOR IRA DISTRIBUTION

The taxpayer had an IRA with Merrill Lynch (ML). In summer 2011, he requested that ML use his IRA money to buy a privately held financial corporation's stock. For unclear reasons ML would not buy the shares. The taxpayer called ML and initiated a $50,000 wire transfer from his IRA directly to the corporation. The wire transfer occurred on 10/7/11. On 11/28/11, the corporation issued a stock certificate titled "Raymond McGaugh IRA FBO Raymond McGaugh" and mailed it to ML. ML said it received the certificate in early 2012, though the corporation claimed it sent it earlier. When ML received the certificate, it did not retain it, and tried to send it to the taxpayer twice in February 2012. Both times the US Postal Service returned it to ML. The second time it was marked as refused. Then ML sent it to the taxpayer a 3rd time via FedEx, and it was returned. The shares never were deposited into the taxpayer's IRA, and the location of the shares still is unknown. The IRS contends the taxpayer possesses the certificate, and the taxpayer denies the allegation. ML ultimately characterized the wire transfer as a taxable distribution, and issued the taxpayer a Form 1099-R. The taxpayer claimed he never received the Form 1099-R. On 3/17/14, the IRS issued the taxpayer a notice of deficiency for $13,538 of tax on the $50,000 distribution for 2011. The taxpayer filed suit against the IRS, insisting that it was an error. The Tax Court agreed with the taxpayer, and the IRS appealed to the 7th Circuit. The core issue in McGaugh [6/26/17] was whether the taxpayer had made a taxable withdrawal from his retirement account. The IRS's position was that, though the taxpayer never physically received any cash or other assets from his IRA during 2011, he took a distribution because he constructively received the IRA proceeds. The IRS's primary argument was that the taxpayer constructively received funds from his IRA when he directed ML to wire funds at his discretion to the corporation. The 7th Circuit stated that the record revealed no evidence that the taxpayer was in constructive receipt of assets from his IRA. The court stated it was clear the taxpayer constructively received no stock, as the certificate never was in his physical possession during 2011. The court stated he had no control over the corporation's shares. The certificate was not issued in the taxpayer's name, and when the taxpayer requested a replacement certificate from the corporation, it refused to issue one without first receiving indemnification from ML. The court noted that if the taxpayer had directed a distribution to a third party, the IRS's argument that it would be taxable might be acceptable. But, the taxpayer bought stock, a prototypical, permissible IRA transaction. The court found no evidence that the taxpayer orchestrated the purchase for the benefit of the corporation, or for any reason other than because he wanted to obtain the stock to be held in his IRA. The 7th Circuit found no evidence that the taxpayer constructively received funds, either in ordering ML to wire the funds, or in any other respect. It upheld the Tax Court in ruling the taxpayer did not actually or constructively receive any assets from his IRA during his 2011 tax year, and so took no 2011 distribution from his IRA.

[ITEM 11] EMPLOYER MISSTEP RESULTS IN IRA DISTRIBUTION PROBLEM

The taxpayer was an administrator and compliance officer at a nursing and rehabilitation center. In July 2012, she took a leave of absence. Her leave was unpaid except for accrued sick, personal, and vacation leave covering about 5 weeks. Her leave started 7/30/12, and she returned to work 10/12/12. On 7/27/12 she entered into a loan agreement with Mutual of America (MOA) to borrow $40,000 from her Section 401(k) plan with the center, to be repaid through anticipated biweekly payments of $341.79. Also on that day she formally entered into a loan repayment payroll deduction agreement, under which the center was required to deduct from her salary the amounts to make the loan repayments and remit them to MOA. The biweekly payroll deductions were to begin with her first billing statement after 8/10/12. Were a payment missed, the taxpayer could pay the delinquent amounts up to the last day of the calendar month after the month the delinquent payment was due (cure period). Were she to become delinquent and not pay delinquent payments within the cure period, the entire loan amount would be in default and considered a plan distribution to her. During her leave of absence, she received paychecks from the center of $2,181 on 8/10, 8/24, and 9/7 of 2012, and $2,328 on 10/19/12. Her first $341.79 loan payment

was due 8/24/12. The center failed to deduct and remit the required loan repayments. The taxpayer was unaware of this failure until she returned from her leave. Then, she made a $1,000 loan repayment on 11/20/12, increased this amount by $500 through 7/15/13, and continued to make $341.79 payments until the loan was repaid fully on 7/9/14. On 7/16/14, MOA confirmed by letter to the center and the taxpayer the loan was repaid in full. MOA issued the taxpayer a Form 1099-R for 2012 showing a taxable distribution of $40,065 and made it available online, but the taxpayer did not access or review it. The taxpayer did not report a distribution on her 2012 return. On 10/6/14, the IRS issued the taxpayer a notice of deficiency for 2012, determining she received a taxable retirement plan distribution subject to income tax and the Section 72(t) 10% additional tax. In Frias and Salomon [7/11/17], the Tax Court stated that a loan from a qualified employer plan is not treated as a distribution if specified Code requirements are met, one of which is substantially level amortization (at least quarterly) of the loan to repay it within 5 years. A deemed plan distribution occurs for failure to make the required payments. A deemed distribution does not occur, however, if the plan participant makes a delinquent payment within the cure period. The IRS argued that the taxpayer's loan amount became a deemed distribution when she failed to make the first payment due on 8/24/12, and did not cure the failure by the end of the following month. The taxpayer argued since she was on leave without pay beginning 7/30/12, the substantially level amortization requirement did not apply. She contended that she qualified for an exception to the requirement because she was considered to be on leave without pay. The IRS contended that since she received pay for about 5 weeks, she did not meet this exception. The court noted that Treasury regulations exempt a participant from the requirement if the participant is on a bona fide leave of absence for no longer than a year, either without pay or with pay that is less than the required installment payments under the requirement. It found that she received compensation payments (the accrued leave) during the 5-week period that were greater than the required installment payments, so she was required to make the 2012 August and September payments. Since she did not, the substantially level amortization payment requirement was violated, and she received a deemed distribution of the plan balance and accrued interest. The Section 72(t) 10% tax also applied.

[ITEM 12] CORPORATION'S DEDUCTION FOR PAYROLL EXPENSES DELAYED: ITS ESOP AND OWNERS ARE RELATED

A closely-held S Corporation uses the accrual method of accounting for federal income tax purposes. The corporation had accrued but unpaid expenses for wages and vacation pay for its cash-basis employees at the end of 2009 and at the end of 2010. The wage expenses were paid by January 31 of the following year, the vacation pay by December 31 of the following year. About 89% of the wage amounts (94.5% of the vacation pay amounts) was attributable to employees who participated in the corporation's employee stock ownership plan (ESOP) maintained for its participating employees. During each year, some or all of the corporation's stock was owned by the related ESOP trust. For its 2009 and 2010 tax years, the corporation deducted the accrued but unpaid payroll expenses. The shareholders claimed flowthrough deductions for their share of the expenses on their individual returns. Generally, an accrual basis taxpayer deducts its business expenses when the all events test is met and economic performance has occurred. The IRS invoked Section 267, and disallowed the corporation current deductions to the extent they were attributable to employees who participated in the ESOP. The IRS allowed the corporation deductions for expenses in the next year the accrued expenses were paid. In Petersen and Johnstun [6/13/17], the Tax Court addressed the issue of whether the corporation and its employees who were ESOP participants were related persons under Section 267(a)(2), in which case the corporation's deductions for accrued payroll expenses were deferred until the wages were includible in the ESOP's beneficiaries' incomes. The court examined Section 267 in several respects. It stated that Section 267 requires related persons to use the same accounting method with respect to transactions between them to prevent the allowance of a current deduction without the current inclusion in income of that amount. It considered if Section 267(b) covered the taxpayers in this case. It concluded that 267(e) deems S Corporations and their shareholders to be related persons, regardless of how much stock each shareholder individually owns. The court also noted that Section 267(c)(1) provides that stock owned, directly or indirectly, by or for a trust, is considered to be owned proportionately by or for its beneficiaries. It concluded that if the ESOP participants constructively owned stock of the S Corporation as trust beneficiaries, the S Corporation and its employees, no matter their percentage ownership, were Section 267 related persons. The court examined if the ESOP were a "trust" within the meaning of Section 267(c)(1). It noted that Section 267 does not define the term "trust." It examined the documents that created the ESOP. It found that two documents were involved in creating the trust: a plan agreement and a trust instrument. It concluded that the entity holding the S Corporation's stock for the benefit of the ESOP participants was a "trust" in the ordinary sense of the word, and so was a trust under Section 267(c)(1). It ruled that the S Corporation's stock held by the ESOP trust was owned proportionately by the trust's beneficiaries, that is the corporation's employees who participated in the ESOP. Thus, the ESOP participants and the corporation were related persons under Section 267(b). It held that the corporation's deductions for the accrued but unpaid payroll expenses were deferred to the year in which such pay was received by the ESOP participants and includible in their gross income. Any accrued wages attributable to employees not participating in the ESOP are deductible in the year accrued unless the employee was a shareholder of the S Corporation.

[ITEM 13] FEDERAL CIRCUIT CONSIDERS TIMING OF THEFT LOSS DEDUCTION FROM INVESTMENT SCAM

In Adkins [5/8/17], the taxpayer was victimized by a "pump-and-dump" scheme where an investment company engaged in the following practices: (1) purchasing stock in a company; (2) encouraging its customers to do the same after pumping the stock; (3) selling stock in the company at the artificially increased price for a profit; and, (4) leaving its customers holding stock worth significantly less due to the aforementioned transactions. At their peak in 2000, the taxpayer's investments were valued at $3.6 million. By the end of 2001, they were worth less than $10,000. Discovering he had been the victim of fraud, he submitted a statement of claim to the National Association of Securities Dealers ("NASD") in support of arbitration in February 2002. Because the principals of the investment company were about to be indicted, the taxpayer's lawyers suggested that the arbitration claim be left open in the event that proceedings in the criminal matter revealed pertinent information. While three of the principals pleaded guilty to committing securities fraud in 2004, proceedings against other principals in the company continued from 2005 to 2009. While the criminal proceedings were pending, in 2006, the taxpayer attempted to recoup some of his losses by claiming a theft loss under Section 165. He claimed a loss of over $2.1 million for the 2004 taxable year with excess refund portions carried back over the three previous years. The IRS denied the loss and the taxpayer filed suit in the Claims Court. The court ruled that the taxpayer was not entitled to a theft loss for the 2004 taxable year because he had not "ascertained with reasonable certainty that they would not receive reimbursement of their losses." On appeal to the Federal Circuit, the taxpayer made several arguments against the Claims Court, although the Federal Circuit only considered the first two. First, the taxpayer argued that the Claims Court did not properly apply the regulations for determining the proper year of the theft loss. Second, the court incorrectly required abandonment of the arbitration claim. Regarding the first argument, any loss arising from theft is treated as sustained during the taxable year in which the taxpayer discovers the loss. However, the regulation provides that if in the year of discovery there exists a claim for reimbursement with respect to which there is a *reasonable prospect of recovery*, no portion of the loss is deductible until the taxable year in which it can be ascertained with *reasonable certainty* whether or not the reimbursement will be received. A previous Claims Court decision noted that other courts have combined the *reasonable prospect of recovery* standard with the *reasonable certainty* standard. It disagreed and ruled that the terms are distinct and the standards to be applied are different. Specifically, the *reasonable prospect of recovery* standard tolerates a greater probability of recovery than the *reasonable certainty* standard. The Claims Court denied the loss deduction on the basis the taxpayer did not satisfy the more stringent standard. The taxpayer argued that the terms are two sides of the same coin – a reasonable prospect for recovery is the inverse of reasonable certainty that there will be no recovery. The Federal Circuit agreed with the taxpayer by citing opinions in other circuits that apply a single standard. Otherwise, the court noted that good-faith efforts to recover losses in the year of discovery will be pushed to later years, dissuading taxpayers from these efforts. With respect to the second argument, the Federal Circuit reasoned that a taxpayer may rely on the date that his arbitration or lawsuit for the loss was settled, abandoned, or adjudicated. In the case of abandonment, because no dated court order or settlement agreement exists, the plaintiff must be able to provide some other form of "objective evidence" as to when abandonment occurred. Even though the taxpayer left the arbitration claim open, neither he nor his attorneys took further action after 2004. The Federal Circuit ruled that the Claims Court improperly required abandonment of the arbitration claim. It then remanded the case back to the Claims Court for it to determine if abandonment occurred in 2004. We will keep an eye on the outcome of this case.

REVIEW QUESTIONS AND SOLUTIONS

4. In a recent Supreme Court case which ruled whether a pension plan by a church-affiliated organization qualifies as a church plan, **which one** of the following statements **is false**?

   a. The pension plan maintained by the church-affiliated organization must be established by the church.

   b. Church pension plans are exempt from the ERISA rules.

   c. The District Court ruled that the healthcare entity could not establish an exempt church plan because it is not a church.

5. For a recent case dealing with the amount of the taxpayer's deduction for meal expenses, **which one** of the following statements **is false**?
   a. The de minimis fringe benefit exception was examined by the Tax Court in determining the amount of the taxpayer's meal expense deduction.

   b. The Tax Court decided that 50% of the taxpayer's meal expenses were deductible.

   c. The meals were furnished during, before, or after the employee's workday.

6. A taxpayer requests his IRA trustee to purchase a company's shares for his IRA, and initiates a wire transfer to do so. The trustee receives the stock certificate for the shares, but the shares never are deposited to the IRA, and the location of the shares is unknown. The IRA trustee issues the taxpayer a Form 1099-R characterizing the transaction as a taxable distribution. Based on a recent case on the constructive receipt rules, **which one** of the following statements **is true**?

a. Since the taxpayer did not constructively receive IRA funds, the distribution is not taxable.

b. The 7th Circuit recently held that the taxpayer had orchestrated the purchase for the benefit of the corporation, and so was in constructive receipt of the funds wired.

c. The 7th Circuit noted that the taxpayer had directed a distribution to a third party, a transaction different from an IRA purchase of assets by an IRA trustee for a taxpayer's IRA.

7. For a recent case involving an S Corporation and its ESOP, **which one** of the following statements **is false**?

a. The Code section that applied required the corporation to defer its deduction for accrued but unpaid expenses until the employee included the amount in gross income.

b. A corporate employee who participated in the S Corporation's ESOP was related to the corporation regardless of how much company stock he owned through the ESOP.

c. The court ruled that whether a corporation employee participated in the ESOP or not, he was related to the corporation.

8. During 2014, a taxpayer's stock portfolio suffered severe losses. In 2015, it was discovered that the losses were due to fraud committed by the taxpayer's stock broker. In 2017, the taxpayer settled his claim against the stock broker for a fraction of his losses. Based on a recent case involving stock fraud, in which year may the taxpayer deduct the losses due to the fraud as a theft loss deduction?

a. 2014.
b. 2015.
c. 2017.

Solutions

4. **"A" is the correct response**. The Supreme Court noted that the ERISA amendment, which expanded the definition of church plans for church affiliated organizations, did not require the affiliated church to establish the plan. It may be established by a church-affiliated organization.

"B" is an incorrect response. Pension plans established by a church have been exempted from the beginning of the ERISA rules.

"C" is an incorrect response. The District Court focused on Section 1002(33)(A), which contained the "establish by the church" language, when it ruled that a healthcare entity plan was not exempted from the ERISA rules. *Advocate Health Care Network et al.*

5. **"B" is the correct response**. The court agreed with the taxpayer that 100% of the taxpayer's meal expenses were deductible.

"A" is an incorrect response. The Tax Court examined the various requirements for the de minimis fringe benefit exception, and agreed with the taxpayer that the taxpayer met this exception.

"C" is an incorrect response. This was the 6th requirement examined by the Tax Court. Both the IRS and the taxpayer agreed the taxpayer met this requirement. *Jacobs*.

6. **"A" is the correct response**. The 7th Circuit found no evidence that the taxpayer constructively received funds, either in ordering ML to wire the funds, or in any other respect. So, the distribution was not taxable.

"B" is an incorrect response. The court found no evidence that the taxpayer orchestrated the purchase for the benefit of the corporation, or for any reason other than because he wanted to obtain the stock to be held in his IRA.

"C" is an incorrect response. The court noted that if the taxpayer had directed a distribution to a third party, the IRS's argument that it would be taxable might be acceptable. But, the taxpayer bought stock, a prototypical, permissible IRA transaction. *McGaugh*.

7. **"C" is the correct response**. The court ruled that only the corporation's employees who participated in its ESOP were related to the corporation.

"A" is an incorrect response. Section 267 basically put the accrual basis corporation on the cash basis, same as its cash basis employees, so that it could not deduct the accrued expenses until it paid the amounts to its employees.

"B" is an incorrect response. If the employee owned corporate stock through the corporation's ESOP, he was related to the corporation regardless of the size of his stockholding in the corporation. *Petersen and Johnstun*.

8. **"C" is the correct response**. Generally, the theft loss from securities fraud is deductible in the year of discovery unless there is a reasonable certainty that some or all of the loss may be recovered. In that case, it is not deductible until the taxable year in which it can be ascertained with reasonable certainty whether such reimbursement will be received, which in this case is 2017.

"A" is an incorrect response. 2015 is the year the theft loss is discovered. However, the

amount of loss was not finalized until it was settled in 2017.

"B" is an incorrect response. While the theft occurred in 2014, the amount of the actual loss from the theft was not finalized until it was settled in 2017. *Adkins.*

TREASURY

[ITEM 14] TIGTA ASSESSED WHETHER THE IRS-CAWR PROGRAM SELECTS MOST PRODUCTIVE CASES

The Combined Annual Wage Reporting (CAWR) Program consists of two parts: SSA-CAWR and IRS-CAWR. The purpose of the SSA-CAWR Program is to ensure that employees receive proper credit for covered earnings for purposes of determining the amount of social security benefits. The purpose of the IRS-CAWR Program is to ensure that employers report the proper amount of wages and federal tax withholdings (FICA, Medicare, and federal income tax). The program compares the employee wage and withholding information reported to the IRS on employment tax forms to withholding documents filed with the Social Security Administration (SSA). In TIGTA Report Number 2017-40-038 [7/26/17], the Treasury Inspector General for Tax Administration (TIGTA) investigated whether the IRS-CAWR Program's document matching process accurately identifies and selects the most productive discrepancy cases. A discrepancy case is identified when the amount of wages and withholding reported by an employer on Forms W-2/W-3 submitted to the SSA or Forms 1099-R or W-2G submitted to the IRS do not agree with the amount of wages and withholding the employer reported to the IRS on its employment tax return. The TIGTA found that of the 137,272 IRS-CAWR discrepancy cases identified by the IRS for the 2013 taxable year, 23,184 cases (17%) were worked by the IRS. For these cases, 18,667 (81%) resulted in total tax assessments of $64 million. The remaining discrepancy cases that were not worked had a potential underreported total tax difference of more than $7 billion. The TIGTA estimated that it would take about 55 full-time equivalent employees costing about $2.7 million to address these cases. The TIGTA found that the discrepancy case selection processes do not ensure that priority is given to working discrepancy cases with the highest potential tax assessment. If the IRS had selected the 23,184 auto-generated cases with a higher average assessment potential to work, it would have selected cases with more than $128 million in assessment potential. It also stated that the IRS could further increase its return on investment by including prior year discrepancy cases when working current year discrepancy cases for the same employer. The TIGTA's analysis found that 3,137 of the discrepancy cases identified in taxable year 2013 also had discrepancy cases in taxable year 2012, with potential underreported tax totaling more than $448 million for taxable year 2012. The TIGTA made several recommendations, including the following: (1) the IRS should evaluate the current agreement and workload processes with the SSA, as required, and ensure that it is expending resources to work the most productive IRS-CAWR cases; (2) revise its case selection criteria to include auto-generated cases with the highest potential tax assessment; (3) coordinate with the Information Technology organization to review and prioritize programming enhancements; and, (4) take actions necessary to implement the proposed upgrade to include prior year discrepancy cases when current year discrepancy cases are selected for the same employer. The IRS agreed with all of the recommendations except the fourth one listed above. However, the IRS indicated that it will consider employers that have a prior year discrepancy case as part of the selection criterion for current year cases.

SPECIAL TOPICS

HOBBY LOSS RULES

This special topic reviews the basic rules for hobbies, and other activities not engaged in for profit by the taxpayer. We also discuss a recent case dealing with whether an automobile racing enthusiast had a profit motive for his automobile racing activities.

ITEM [15] BASIC REVIEW OF THE HOBBY LOSS RULES

Section 183 contains the rules for individuals, trusts, estates, or S Corporations that engage in a not-for-profit activity (NFPA, or hobby). A NFPA is any activity other than a trade or business or income-producing activity which has a profit motive. There is a rebuttable presumption (in which case the burden is on the IRS to prove that an activity is a NFPA) that an activity is not a NFPA if the activity's gross income exceeds its deductions for 3 out of 5 consecutive taxable years. The presumption is 2 out of 7 years if the activity consists in major part of breeding, training, showing, or racing horses. A determination as to whether the rebuttable presumption applies will not be made before the close of the 4th taxable year (6th year for a horse activity) after the taxable year in which the taxpayer first engages in the activity if the taxpayer makes a proper election on Form 5213. If an activity is subject to the NFPA loss rules, deductions are limited to the gross income from the activity. First, deductions that otherwise are allowable without regard to whether the activity is a NFPA are taken. Examples of the first category are property taxes and interest that are deductible on Schedule A. Second, deductions that do not affect a property's basis and otherwise are allowable if the activity were engaged in for profit are taken. Examples of this category are business expenses deductible on Schedule C other than cost recovery deductions. Finally, cost recovery deductions with respect to property used in the activity if it were engaged in for profit are taken. Disallowed deductions are not permitted to be used in another taxable year.

Objective standards are used, taking into account all facts and circumstances. A reasonable expectation of profit is not required. But, the facts and circumstances must indicate that the taxpayer entered into the activity, or continued it, with the objective of making a profit. In determining whether an activity is engaged in for profit, greater weight is given to objective facts than to the taxpayer's statement of intent. No one factor is determinative. There are 9 factors prescribed by Treasury regulations, but other factors may be taken into account. It is not intended that a determination of hobby status is to be made on the basis that the number of factors (whether one of the 9, or other factors) indicating a lack of profit objective exceeds the number of factors indicating a profit objective (and vice versa). The 1st factor is the *manner in which the taxpayer carries on the activity*. The fact that the taxpayer carries on an activity in a businesslike manner and maintains complete and accurate books and records indicates a profit motive. A change of operating methods, adoption of new techniques, or abandonment of unprofitable methods in a manner consistent with an intent to improve profitability shows a profit motive. The 2nd factor is *the taxpayer's or his advisors' expertise*. The taxpayer's preparing for the activity by extensively studying accepted business, economic, and scientific practices, consulting with an expert regarding such practices, and carrying on the activity in accordance with such practices show a profit motive. The 3rd factor is *the taxpayer's time and effort expended in carrying on the activity*. The taxpayer's devoting much of his personal time and effort to carrying on an activity may indicate an intention to derive a profit, as well as his withdrawing from another occupation to devote most of his energy to the activity. The 4th factor is *the expectation that assets used in the activity may appreciate in value*. Profit encompasses appreciation in the value of assets used in the activity. The 5th factor is *the taxpayer's success in carrying on other similar or dissimilar activities*. The taxpayer's converting similar activities in the past from unprofitable to profitable may indicate that he is engaged in the present activity for profit, even though it currently is not profitable. The 6th factor is *the taxpayer's history of income or losses with respect to the activity*. A series of losses during the initial or start-up phase of an activity may not indicate lack of profit motive. But, unexplained continuing losses beyond the period which is customarily necessary to make the activity profitable may indicate lack of profit motive. Losses sustained from unforeseen or unfortunate circumstances beyond the taxpayer's control, for example weather damages or involuntary conversions, would not indicate lack of a profit motive. The 7th factor is *the amount of occasional profits, if any, which are earned*. Criteria in determining the taxpayer's intent for this factor are the amount of profits in relation to the amount of losses incurred, and in relation to the amount of the taxpayer's investment and the value of the assets used in the activity. The 8th factor is *the taxpayer's financial status*. The taxpayer's having insubstantial income or capital from sources other than the activity may indicate the activity is engaged in for profit. The 9th factor is *the taxpayer's personal pleasure or recreation from the activity*. The presence of personal motives in carrying on an activity may indicate absence of a profit motive, especially where there are recreational or personal elements for the taxpayer from the activity.

ITEM [16] TAX COURT CONSIDERS IF AUTO RACER HAS PROFIT MOTIVE

The taxpayer formed a racing company and reported losses of about $20,000 and $16,500 on Schedule C for his first 2 years (2006 and 2007). He stopped operating the company for 2008 - 2010. In 2009 he filed a Chapter 7 bankruptcy petition, admitting the filing was attributable in part to his racing losses. Unemployed in 2011, he withdrew part of his Section 401(k) and used the withdrawal to start another racing company. He believed that his nearly 20 years of racing experience together with reading periodicals and online resources and consulting with successful drivers would provide him the necessary expertise to operate a profitable racing business. He spent 40-60 hours a week in 2011, and 15-20 hours a week in 2012 (he became gainfully employed) in his new racing business. He had no written company business plan, did not maintain a separate bank account for it, and paid the company's expenses out of his personal checking account. For 2011 - 2015, he reported the following profit (loss), respectively: ($62,769), ($16,016), $3,840, $4,638, and $3,158. His company's gross income consisted of race prize money, proceeds from sales of used parts and cars, and sponsorship payments (only one sponsor gave him cash, $1,200 annually). The other sponsors gave him a 10% discount for parts he purchased from them. For each of years 2013 and 2014, he paid more for car parts than total expenses that he reported on his Schedules C, resulting in "actual" net losses for those years rather than the reported net profit. He purchased tools from his employer (where he worked as a mechanic) which he claimed as Schedule A itemized deductions of $18,978 and $14,303 for 2014 and 2015, respectively. His wages as a mechanic for those 2 years were $18,696 and $36,899. On October 14, 2013, the taxpayer timely filed Form 5213 requesting that the IRS postpone a determination as to whether the rebuttable presumption applies that the activity was engaged in for profit. The IRS found that after adjusting the taxpayer's 2013 and 2014 reported Schedule C profits for car parts not reported on Schedule C, there were net losses for those years, and so he did not have net profit for 3 of the preceding 5 years. The IRS denied the presumption that his company was engaged in profit. The IRS disallowed his 2011 Schedule C deductions in accordance with Section 183. In Stettner [6/14/17], the issue was whether the taxpayer's 2011 racing activity was a NFPA under Section 183. The Tax Court stated that evidence from years afer the year at issue is relevant to the extent it creates inferences regarding the taxpayer's requisite profit objective in earlier years. The court agreed with the IRS that, while the taxpayer filed a

timely Form 5213, he had "actual" net losses for 2013 and 2014 from his racing activity, thus did not produce gross income exceeding deductions for 3 of the preceding 5 years, and so was not entitled to the presumption that his racing company was engaged in for profit. The court then examined the 9 factors in the regulations. The court concluded factor # 1 favored the IRS. It found the business was not conducted in a businesslike manner as there was no written business plan, and he did not keep adequate books and records. Also, the taxpayer did not change operating methods, adopt new techniques, or abandon unprofitable methods that contributed to his first racing company's failure. It concluded factor # 2 was neutral. It found his 20-plus years of car racing experience were a valuable way to gain expertise. But, it found no credible evidence that the "regularly successful" drivers he consulted made a profit in car racing or were anything other than mere hobbyists. It concluded factor # 3 favored the taxpayer. It found he spent significant personal time and effort preparing his cars for racing events based on his 40-60 hours per week before becoming gainfully employed, and 15-20 hours per week thereafter. The court found this factor taxpayer-favorable even though he enjoyed racing and derived much pleasure from it. The court concluded factor # 4 favored the IRS. It found significant the taxpayer's acknowledgment that assets used in racing rarely, if ever appreciate, and therefore he had no expectation that the activity's assets would appreciate. It concluded factor # 5 favored the IRS. It found very important the fact that the taxpayer had operated a prior racing company nearly identical to his second racing company and had losses in both years from that prior company. The court concluded factor # 6 favored the IRS, finding important reported net losses for 2011 and 2012, "actual" net losses for 2013 and 2014, and questions about the accuracy of reported profits for 2015. This history caused the court to be skeptical the company would realize profit on the activity's entire operation. It concluded factor # 7 favored the IRS. It found important no evidence that he ever won a race during 2011 - 2015, most of his profits consisted of proceeds from the sale of used parts and cars, and that his initial investment was substantial, yet he had no net profit during any year from 2011 - 2014, and minimal net profit if reported accurately for 2015. The court concluded factor # 8 favored the taxpayer, finding he was not employed when he started his second racing company, and he withdrew a portion of his Section 401(k) plan to fund his initial company investment. The court concluded factor # 9 favored the IRS. It found there was no question the taxpayer enjoyed and obtained pleasure from his car racing activity, evidenced by his 20-plus years of racing experience. The court ruled the taxpayer's deductions for the activity's expenses were subject to the Section 183 limitation, concluding 6 of the 9 factors favored the IRS, 2 the taxpayer, and 1 was neutral.

INNOCENT SPOUSE RELIEF PROVISIONS

While there may be multiple advantages of spouses electing to file a joint return, both spouses are jointly and severally liable for the joint federal income tax liabilities on the return. Under Section 6015, there are three ways in which a current or former spouse may obtain relief from tax, interest, and penalties if the taxpayer's spouse improperly reported items or omitted items on the joint return. In the first section of this "special topic," we provide a basic review of the three methods to obtain relief in the innocent spouse relief provisions. It is important to adhere to the deadlines and complete the proper tax forms when requesting relief or a review by the Tax Court. In the second section, two recent cases that deal with timeliness for filing deadlines and the filing of proper forms are summarized.

[ITEM 17] BASIC REVIEW OF THE INNOCENT SPOUSE PROVISIONS

The three ways to obtain tax relief under the innocent spouse provisions are contained in Subsections 6015(b), (c), and (f). Under Section 6015(b) there are four requirements all of which must be satisfied to gain tax relief. First, the requesting spouse (taxpayer) had filed a joint return with his or her spouse. Second, there is an understated tax on the return that is due to erroneous items of the taxpayer's spouse (or former spouse). Erroneous items are either (1) gross income not reported by the taxpayer's spouse, or (2) improper deductions, credits, or property basis claimed by the taxpayer's spouse. Third, the taxpayer can show that when she signed the joint return she did not know, and had no reason to know, that the understated tax existed. Fourth, taking into account all the facts and circumstances, it would be unfair to hold her liable for the understated tax. Importantly, Form 8857 must be filed no later than two years after the date on which the IRS first attempted to collect the tax from the taxpayer. With respect to the third item, the IRS will consider all facts and circumstances in determining whether the taxpayer had reason to know of an understated tax due to an erroneous item. The facts and circumstances that are considered include, but are not limited to the following: (1) the nature of the erroneous item and the amount of the erroneous item relative to other items; (2) the couple's financial situation; (3) the requesting spouse's educational background and business experience; (4) the extent of the requesting spouse's participation in the activity that resulted in the erroneous item; (5) whether the requesting spouse failed to inquire about items on the return or omitted from the return that a reasonable person would question; and, (6) whether the erroneous item represented a departure from a recurring pattern reflected in prior years' returns. Concerning the equity or fairness issue in this subsection, the Treasury regulations provide examples of four items that the IRS will address. First, and perhaps most importantly, is whether the taxpayer received a significant benefit, either directly or indirectly, from the understated tax. A "significant benefit" is subjective in nature and is defined as any benefit in excess of normal support. It does not include any sharing of the tax savings as that is the

fourth item. Items two and three deal with marital status – whether the spouse deserted the taxpayer or whether the couple is divorced.

Section 6015(c) deals with partial relief where the understated tax on the joint return is allocated between the taxpayer and the spouse. The taxpayer either must (1) be divorced or legally separated from the spouse with whom he or she filed the joint return for the year relief is requested, or (2) not be a member of the same household during the 12-month period ending on the date the taxpayer files Form 8857. Generally, no relief may be granted to any part of understated tax due to an erroneous item of which the taxpayer had actual knowledge. However, if the taxpayer had actual knowledge of the erroneous item, relief may be granted if (1) the taxpayer was victim of spousal abuse or domestic violence, and (2) the taxpayer did not challenge the treatment of any items because he or she was afraid the spouse would retaliate against the taxpayer.

Section 6015(f) is an equitable relief provision if relief is not available under Subsections 6015(b) or (c). Under this provision, the IRS has the discretion to grant equitable relief to a requesting spouse when, considering all of the facts and circumstances, it would be inequitable to hold the requesting spouse jointly and severally liable for the tax understatement. In addition to have filed a joint return and not qualifying for relief under the other two provisions, there are several other requirements to obtain relief under this provision. As for the other two subsections, Form 8857 must be timely filed. The taxpayer and spouse must not have transferred assets to one another as part of a scheme to defraud the IRS, or to another third party such as a business partner or creditor. Similarly, property must not have been transferred from the spouse to the taxpayer for the main purpose of avoiding tax. The taxpayer must not knowingly have participated in the filing of a fraudulent joint return. The final requirement is that the income tax liability from which the taxpayer is seeking relief is an item of the taxpayer's spouse or an unpaid tax resulting from the spouse's income. The IRS will consider all facts and circumstances in determining whether it is unfair to hold the taxpayer liable for all or part of the unpaid income tax liability or deficiency, and whether full or partial equitable relief should be granted. Many of the same factors used in granting relief under Subsections 6015(b) and (c) are used in Subsection 6015(f). For example, the IRS will consider the taxpayer's marital status, the taxpayer's financial ability to pay, and whether the taxpayer knew or had reason to know of the erroneous items which lead to the tax understatement. In addition, spousal abuse of the taxpayer may result in certain factors weighing in favor of relief when otherwise the factor may have weighed against relief.

Form 8857 must be timely filed under all three subsections (no later than two years after the date on which the IRS first attempted to collect the tax from the taxpayer). Another timeliness issue deals with a petition for review by the Tax Court. In this case, the taxpayer may request the Tax Court to review the taxpayer's request for relief if a petition is filed no later than the 90th day after the date the IRS mails its final determination letter to the taxpayer. If no determination letter is received, the ninety-day period begins six months after the taxpayer filed Form 8857.

[ITEM 18] 9TH CIRCUIT WEIGHS IN ON TIMELINESS OF FILING FORM 8757

In Palomares [5/31/17], the taxpayer sought innocent spouse relief from her joint and several liability for an unpaid joint return filed by her then-husband. In July 2008, a volunteer attorney helped her file Form 8379, which requests injured spouse relief. She should have filed Form 8857, which requests innocent spouse relief. By the time she corrected this mistake years later by filing Form 8857, the statute of limitations to request refunds for her 2006 and 2007 overpayments had expired. These refunds were applied to tax due from a previous return which she filed jointly with her former spouse. The taxpayer argued that her Form 8379 was an "informal claim" for innocent spouse relief and, as a result, the time between her filing the Form 8379 and Form 8857 should be tolled. The Tax Court disagreed, and ruled that Form 8379 was insufficient to put the IRS on notice that the taxpayer was seeking a refund on the basis of a request for Section 6015 relief from joint and several liability. The Ninth Circuit applied the "informal claim doctrine" which permits a taxpayer to avoid the statute of limitations of Section 6511(a) if the taxpayer filed a written refund request that was sufficient to apprise the IRS that a refund is being claimed, and specifies the tax and the year or years for which the refund is being sought sufficiently so that the IRS can investigate the claim. It reversed the Tax Court by holding that the filing of Form 8379 fairly apprised the IRS that she was seeking innocent spouse relief for two reasons. First, the IRS had been crediting tax overpayments, which were associated with returns she filed separately, to liability on the tax return that she filed jointly. The only form of relief that made any sense under these circumstances was innocent spouse relief. Second, in responding to the taxpayer's Form 8379, the IRS informed the taxpayer that to request innocent spouse relief she should file a Form 8857, not a Form 8379. Next, the Ninth Circuit indicated that, based on the evidence presented to the Tax Court, the equities clearly weigh in favor of granting the taxpayer relief under the informal claim doctrine. She spoke little to no English during the relevant period. She was the subject of domestic abuse. She was not responsible for the deficient payment. And her improper filing of the Form 8379 was the result of incorrect advice from a volunteer attorney. Because Form 8379 sufficiently gave notice to the IRS that she was seeking a refund on the ground that she was an innocent spouse, and the equities clearly weighed in her favor, the Ninth Circuit ruled that the Tax Court should have granted her relief by letting her Form 8379 toll the limitations period until the Form 8857 was filed.

[ITEM 19] 3RD THIRD CIRCUIT DETERMINES WHETHER TAXPAYER TIMELY FILED A PETITION TO THE TAX COURT TO REVIEW THE IRS'S DENIAL OF INNOCENT SPOUSE RELIEF

In Rubel [5/9/17], the taxpayer was not as fortunate as the taxpayer in the above case. On January 4, 2016, the IRS sent the taxpayer three notices of its final determination denying her requests for relief for tax years 2006 through 2008. On January 13, 2016, the IRS sent her a similar denial for the 2005 tax year. The determinations notified her that, if she disagreed with the IRS's decision, she could file a petition with the Tax Court to review the denial for relief within ninety days from the date of the determination. Accordingly, the IRS informed the taxpayer that she needed to file a petition with the Tax Court by April 4, 2016 for the 2006 through 2008 tax years and by April 12, 2016 for the 2005 tax year. The taxpayer sent additional information to the IRS on March 3, 2016. The IRS once again denied her request and reminded her that her time to petition the Tax Court began to run when the IRS issued her its final determination on January 4, 2016, and ends on April 19, 2016. Note that this was in error as the actual deadlines were April 4 and 12, 2016. The taxpayer mailed a petition challenging the IRS's determinations to the Tax Court on April 19, 2016. The IRS moved to dismiss the petition because it was not made within 90 days of the notices of final determination. The taxpayer argued that the March 3, 2016 letter started a new ninety-day period for filing a petition and, in any event, that the IRS should be equitably estopped from relying on the statutory deadline because the March 3 letter contained erroneous information. The Tax Court agreed with the IRS and dismissed the petition for lack of jurisdiction. The Third Circuit indicated that the issue in this case is whether the 90-day deadline is a jurisdictional requirement or a claims-processing statute. If it is a claims-processing statute, the taxpayer's failure to comply with it may be subject to waiver, forfeiture, and equitable tolling. However, if it is jurisdictional, the taxpayer's failure to comply with it deprives the Tax Court of the authority to hear the case, even if equitable considerations would support extending the prescribed time period. The Third Circuit noted that the Supreme Court has historically found that filing deadlines in tax statutes are jurisdictional because allowing case-specific exceptions and individualized equities could lead to unending claims and challenges and upset the IRS's need for "finality and certainty." It also noted that the context of the provision supports that the statute is jurisdictional – the granting of the jurisdiction and the time limit for activating that jurisdiction are located with the same provision. It affirmed the Tax Court's dismissal of the taxpayer's petition for lack of jurisdiction.

REVIEW QUESTIONS AND SOLUTIONS

9. **Which one** of the following **is not** a factor in the regulations used to determine if a taxpayer engages in an activity for a profit?

   a. The taxpayer's time and effort expended in carrying on the activity.

   b. The amount of occasional profits, if any, which are earned.

   c. The number of owners of the activity.

10. Under the innocent spouse relief provisions of Section 6015, **which one** of the following statements **is true**?

    a. Form 8857 must be filed no later than two years after the due date of the tax return for the year the taxpayer is seeking innocent spouse relief.

    b. It is unlikely that innocent spouse relief will be granted if the taxpayer seeking relief significantly benefitted from the spouse's reporting or lack of reporting of the erroneous items.

    c. A taxpayer may receive innocent spouse relief under Section 6015(c) even if the taxpayer is living with his or her spouse on the date Form 8857 is filed.

11. Concerning two recent cases dealing with the innocent spouse provisions, **which one** of the following statements **is false**?

    a. The Tax Court had ruled that the taxpayer who filed Form 8379 rather than Form 8857 was insufficient to put the IRS on notice that the taxpayer was seeking relief from joint and several liability

    b. Taxpayers who seek the Tax Court's review of an innocent spouse case must file the petition no later than the 90th day after the date the IRS mails its final determination letter to the taxpayer.

    c. Because the IRS had informed the taxpayer of the improper date to petition the Tax Court for a review of her case, the Third Circuit ruled that her petition was timely.

Solutions

9. **"C" is the correct response**. This is not one of the nine factors in the regulations.

   "A" is an incorrect response. This is the 3rd factor in the regulations.

   "B" is an incorrect response. This is the 7th factor in the regulations. *Basic Review of the Hobby Loss Rules*.

10. **"B" is the correct response**. If the taxpayer receives a significant benefit from the reporting of erroneous items (beyond normal support), it is likely that the IRS will not find it inequitable or unfair to reject innocent spouse relief.

"A" is an incorrect response. Form 8857 must be filed no later than two years after the date on which the IRS first attempted to collect the tax from the taxpayer, not two years after the filing due date of the tax return.

"C" is an incorrect response. Under Section 6015(c), the taxpayer must either be divorced from her former spouse or not be a member of the same household during the 12-month period ending on the date she files Form 8857. *Special Topics – Basic Review of the Innocent Spouse Provisions.*

11. **"C" is the correct response**. Although the IRS's second reminder about the dates to file a petition for a Tax Court review was incorrect, the Third Circuit affirmed the Tax Court's dismissal of taxpayer's petition.

"A" is an incorrect response. The Tax Court ruled that filing Form 8379 was insufficient to put the IRS on notice that innocent spouse relief under Section 6015 was requested.

"B" is an incorrect response. As noted in this case, there are no exceptions to file the petition no later than the 90th day after the date the IRS mails its final determination letter to the taxpayer. *Palomares and Rubel.*

[ITEM 20] AN ELITE POSSIBILITY

Like the hobby loss provisions discussed above in the Special Topics section, the business deductions allocated to a "vacation home" are limited to the gross income derived from renting the vacation home during the year. A taxpayer's second home which is rented out during part of the year is considered a vacation home if the taxpayer uses the residence for personal use the greater of 14 days or 10% of the days rented. A day will not be considered a personal use day by the taxpayer if the taxpayer is engaged in repair and maintenance on a substantially full time basis for that day. This is the case even if other individuals who are on the premises on that day are not so engaged. A recent Tax Court case deals with repair and maintenance days. While there was little doubt in the outcome of the case, the case provides some helpful do's and don't's in documenting repair and maintenance days. This issue's Elite Possibility reviews this case and offers some additional guidance and planning tips regarding repair and maintenance days. In Cooke [5/1/17], the taxpayer, an attorney in Alaska, became a 50% owner in an LLC in 2007. One month later, the LLC purchased the former home of NBA basketball star Larry Bird in Indiana for $787,500. He and the other 50% LLC owner converted the property into a bed and breakfast (B&B). It opened in June 2008 and a series of managers for the B&B resided in an apartment on the property. During the tax years at issue, 2010 and 2011, the B&B operation was discontinued and the property was offered for sale. Caretakers resided at the property during this time and several offers to rent the property while it was for sale were declined for various reasons. During 2010, the taxpayer made three trips to the Indiana property and resided there for at least a part of 26 days. Four trips were made to the property in 2011 for a total of 33 days. The LLC incurred losses of about $134,000 in 2010 and $128,000 in 2011. The IRS denied the losses on the basis that the owners of the property used the property for personal use more than 14 days. The taxpayer contends that he engaged substantially full time in repair and maintenance (R&M) activities during every day he was at the property. He also argued that the days that he spent traveling from and back to Anchorage should not be counted as personal use days for the Indiana property because the principal purpose of each trip during the tax years in issue was to perform repairs and maintenance. The taxpayer relied on his logbooks to establish that he engaged in R&M activities during his trips to the Indiana property. His testimony did not provide specific details about the R&M activities that he performed. He testified that he did some work on the grounds of the Indiana property. No other witnesses testified to verify that the taxpayer conducted repairs and maintenance during his trips to the Indiana property. From his testimony and the logbooks, there was no evidence of disrepair of the Indiana property and no specific details of what was done to improve it. Furthermore, since it was not rented during 2010 and 2011 aside from the taxpayer's own visits, there was no specific use for which to repair and maintain the property. The taxpayer documented that his "business activity" included traveling to visit with past vendors and business contacts, meetings with the resident caretaker and other service providers for the property, and discussions with the local real estate agent. The Tax Court argued that while these activities may constitute business activity under other Code sections, they are not the repairs and maintenance contemplated by Section 280A(d)(2). The court noted that the logbooks did not provide sufficient information to determine how much time the taxpayer spent on repairs and maintenance versus other activities that do not except his use of the property from use "for personal purposes" under Section 280A(a). Even when records appear to corroborate a specific repair or maintenance activity on a specific day reported in the logbooks, the court concluded it could not determine whether the taxpayer's time spent on repairs and maintenance on that day amounted to engagement on a substantially full-time basis. The court ruled that the taxpayer had not met his burden of proof, and that he used the Indiana property for personal purposes for more than 14 days during each of 2010 and 2011. This resulted in the court's denial of the LLC losses. So what have we learned from this case? Documentation of R&M days is a must if the taxpayer stays at his rental home for personal use the greater of 14 days or 10% of the days rented. For clients who rent a beach house or mountain home and use it during the off season, tell them to bring their pressure washer, paint brush, hammer, and other tools when they are residing there. While the taxpayer is pressure washing the decks, porches, carport, and mildew on the home's exterior, the taxpayer's family can enjoy

the use of the property and not have that day count as a personal use day. As long as the taxpayer works on the property for a significant part of the day (six hours or more should be safe), that day will count as a R&M day and the taxpayer can use the rest of the day for recreation. If the taxpayer is ambitious and a "handy person," 10-15 days each year should be able to count as R&M days assuming the property is rented a significant amount of time during the year. R&M activities include a thorough cleaning of the home after the rental season, painting the walls and ceilings, repairing or replacing counters, floors, or other minor repairs, and pressure washing. The logs should specify the particular R&M tasks conducted each day and the number of hours worked each day. Before and after pictures should be taken and receipts should be kept for the cost of repairs (cleaning materials, paint and paint brushes, gas for the pressure washer, etc.). Whether a travel day to the property counts as a R&M day depends on whether the stay was primarily for pleasure or repairs and maintenance. For example, if the taxpayers stay at their beach house for one week and 5 of the 7 days qualify as R&M days, the travel days count as a R&M day. Tell your clients that if they conduct repairs and maintenance while they stay at their rental home and adequately document their R&M days, they can have their cake and eat it too – enjoy their rental property while avoiding the vacation home limitations.

REVIEW QUESTION AND SOLUTION

12. Based on a recent court case and this issue's Elite Possibility about repair and maintenance (R&M) days by owners staying at their rental property, **which one** of the following statements **is true**?

    a. Although the taxpayer maintained logs, there was no evidence that the property was in disrepair.

    b. No more than 14 days may qualify as R&M days each year.

    c. If a taxpayer resides at her rental property for 15 days, it will automatically be considered a vacation home for tax purposes.

Solution

12. **"A" is the correct response**. Neither the taxpayer's testimony nor his logs provided any details of the repairs conducted by the taxpayer.

    "B" is an incorrect response. There is no statutory limit on the number of R&M days under the vacation home provisions. The 14 day use is part of the personal use provision for determining whether the rental home is a vacation home.

    "C" is an incorrect response. In order to be considered a vacation home, personal use by the owner of the rental property must exceed the **greater** of 14 days or 10% of the days rented. So if the rental days are at least 150 days, the taxpayer can have 15 personal days without being subject to the vacation home limitations. *An Elite Possibility and Cooke.*

INDEX

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

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

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1. In a recent IRS ruling dealing with a professional employer organization (PEO), **which one** of the following **was not** important in determining who was responsible for paying employment taxes on workers the company leased from the PEO?

   a. The PEO hired the workers to work for the company.

   b. Before the payroll date, the company paid to the PEO an amount that included the taxes with respect to the workers.

   c. The PEO did not assume legal responsibility for paying wages to the workers.

2. **Which one** of the following statements about the National Taxpayer Advocate's 2017 mid-year report **is false**?

   a. She reports that IRS telephone response effectiveness was about the same for its account management lines and its compliance telephone lines.

   b. The IRS plans to focus on options to improve the administration of the EITC in FY 2018.

   c. She is concerned about the IRS's budget allocation between enforcement activities and outreach and education.

3. For two recent IRS releases related to cybercriminals, **which one** of the following statements **is true**?

   a. Both releases deal with the efforts of cybercriminals that are aimed at tax professionals.

   b. The cybercriminal emails do not target specific information.

   c. One report states that 2016 phishing attacks increased 177% over 2015 phishing attacks.

4. **Which one** of the following ITIN numbers **does not** expire December 31, 2017?

   a. An individual with an ITIN having a middle digit 72.

   b. An individual with an ITIN that has not been used on a federal tax return at least once in the last 3 consecutive years.

   c. An individual with an ITIN having a middle digit 78.

5. Jane files a valid extension for her 2016 tax return on the last eligible day (April 18, 2017). On July 27, 2017, her town was declared a disaster area as a result of tornado damage. Taxpayers in the disaster area are allowed until December 15, 2017 to file their 2016 return. If the taxpayer winds up owing taxes on her 2016 return and wishes to avoid the failure to pay penalty, by what day must she pay the taxes due?

   a. April 18, 2017 (the 15th is a Saturday and the 17th is a holiday).

   b. October 16, 2017 (the 15th is on a Sunday).

   c. December 15, 2017.

6. **Which one** of the following **is not** the correct health savings account amount for 2018?

    a. The maximum deduction for 2018 contributions for coverage under a high-deductible health plan is $6,900 for family coverage.

    b. The high-deductible health plan for 2018 must have an annual deductible that is not less than $1,350 for self-only coverage.

    c. The 2018 annual out-of-pocket expense maximum is $6,550 for self-only coverage.

7. Recently, the Supreme Court determined whether a pension plan by a church-affiliated organization qualifies as a church plan. Which court was the only one to conclude that it qualifies?

    a. District Court.

    b. Third Circuit Court of Appeals.

    c. Supreme Court.

8. Concerning a recent case involving PTINs and PTIN fees, **which one** of the following statements **is false**?

    a. The IRS may continue to require PTINs.

    b. The court ruled that a PTIN constitutes a service because it protects confidentiality of a tax preparer's social security number.

    c. The IRS no longer is allowed to charge user fees for PTINs.

9. For a recent case dealing with whether meal costs were a de minimis fringe, **which one** of the following statements **is false**?

    a. The court concluded that the meals were provided on a non-discriminatory basis.

    b. The taxpayer asserted that the meal costs were 50% deductible.

    c. The court concluded that away city hotels were considered part of a hockey team's business premises.

10. For a recent case in which the taxpayer requested his IRA trustee buy a financial corporation's shares for his IRA, **which one** of the following statements **is true**?

    a. When the IRA trustee received the stock certificate for the shares, the trustee did not deposit the certificate into the taxpayer's IRA.

    b. The taxpayer personally sent his own funds rather than IRA funds directly to the corporation to buy the shares.

    c. The IRA trustee never sent the taxpayer a Form 1099-R.

11. Regarding a recent Tax Court case dealing with a taxpayer's violation of the "substantially level amortization" requirement for repaying qualified plan loans, **which one** of the following statements **is true**?

    a. The taxpayer made good on missed loan repayments within the required cure period.

    b. The taxpayer argued since she was on leave without pay during a time when loan repayments were required, she was not subject to the amortization requirement.

    c. Since the taxpayer received only accrued sick, personal, and vacation leave during her leave of absence, she was not subject to the amortization requirement.

12. An accrual basis, calendar year S Corporation has 7 employees who own no direct ownership in the S Corporation stock. Four of the employees participate in the corporation's ESOP. Three of the 4 ESOP participants each owns 10% of the ESOP, and the other participant owns 3%. At the corporation's 2016 year-end, it has accrued wages of $3,000 for each of the 7 employees. Based on a recent case, **how much** of the accrued wages may the S Corporation **deduct in 2016?**

    a. $12,000.

    b. $9,000.

    c. $-0-.

13. Regarding a recent Federal Circuit case involving a theft loss deduction, **which one** of the following statements **is true**?

    a. The Federal Circuit ruled that the Claims Court improperly required abandonment of the arbitration claim.

    b. The Federal Circuit ruled losses from investment fraud are treated as capital losses and not eligible for the theft loss deduction.

    c. The Federal Circuit ruled that the date of the loss clearly was realized in 2004.

14. Concerning the TIGTA's recent study of the IRS's and the Social Security Administration's Combined Annual Wage Reporting Program, **which one** of the following statements **is true**?

    a. Included in the IRS's selection criterion are employers that have a prior year discrepancy case.

    b. The discrepancy case selection processes do not ensure that priority is given to working discrepancy cases with the highest potential tax assessment.

    c. Currently, there are enough IRS personnel to work each discrepancy case.

15. For the hobby loss rules, **which one** of the following responses **is true**?

    a. To avoid the hobby loss rules, the taxpayer must have a reasonable expectation of profit.

    b. Regarding the factor of the taxpayer's financial status (8th factor in the regulations), the taxpayer's having **substantial** income from other sources may indicate that the activity is engaged in for profit.

    c. If an activity is a not-for-profit activity, the second set of deductions permitted are deductions not affecting a property's basis that would be allowable were the activity engaged in for profit.

16. For a recent case in which the Tax Court determined if a taxpayer had a profit motive in operating his car racing company, **which one** of the following responses **is false**?

    a. The court found the fact that the taxpayer had withdrawn a portion of his Section 401(k) plan to fund his initial investment in his racing company favored his having a profit objective.

    b. The court concluded that 6 of the 9 factors in the regulations favored the IRS's position that the taxpayer did not have a profit objective for his racing company.

    c. The court used factors other than the 9 factors in the regulations in determining if the owner had a profit motive for his racing company.

17. While there are three ways to obtain tax relief under the innocent spouse provisions, **which item** below **is a factor** in granting relief in all three subsections?

    a. The taxpayer's spouse committed fraud.

    b. Except for domestic violence situations, the taxpayer had no reason to know that the understated tax existed.

    c. The taxpayer is divorced.

18 In a recent case dealing with the timeliness of filing Form 8757, **which one** of the following statements **is false**?

    a. The taxpayer filed the incorrect form for innocent spouse relief.

    b. The Ninth Circuit applied the informal claim doctrine.

    c. The Ninth Circuit affirmed the Tax Court decision.

19. On the basis of a recent court case addressing the 90-day requirement to petition for a Tax Court review, **which one** of the following statements **is true**?

    a. The Third Circuit affirmed the Tax Court's dismissal of the taxpayer's petition for lack of jurisdiction.

    b. The Third Circuit ruled that the 90-day deadline is a claims-processing statute.

    c. Twice the IRS reminded the taxpayer about the correct date to file her petition for a Tax Court review.

20. Concerning the vacation home provisions and a recent court case dealing with repair and maintenance (R&M) days, **which one** of the following statements **is false**?

    a. The taxpayer's testimony did not provide specific details about the R&M activities that he performed.

    b. If a taxpayer's spouse staying at the rental home is not engaged in R&M on a day the taxpayer is, the day will not count as a R&M day.

    c. Whether a travel day to the property counts as a R&M day depends on whether the stay was primary for pleasure or R&M.

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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)** _____

Select Courses for Options 2, 5, and 6

**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 **CPElite**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 - **CPElite**, 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's[T.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

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ON-LINE TESTING AT NO ADDITIONAL CHARGE
FREE ELECTRONIC REPORTING OF CPE TO THE IRS
The leader in "continuing professional education newsletters" for tax professionals
(Visit us at www.cpelite.com or Call us at 1-800-950-0273)

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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 incom e 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.