THE ELITE QUARTERLY – Taxation

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We hope you have a Happy Holiday season and a happy, healthy, and productive 2018. Thank you for your business. This is our final newsletter for 2017. There were four quarterly newsletters and two hours of ethics for 2017. If you did not receive all of our 2017 newsletters, you may download them from our website. **Please try to complete the quizzes for the 2017 items you purchased by December 31, 2017, and no later than January 31, 2018.** Currently, we are not taking newsletter subscriptions for 2018. In the next month or two, we will contact you regarding 2018 subscriptions. We appreciate your business very much and we hope you enjoy 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 Congress, IRS rulings, court decisions, Treasury items, Special Topics, and *An Elite Possibility* dealing with observations of the proposed tax changes from Item 1, and some tax planning tips for December 2017. The content level of the newsletter is an update of these items. The learning objective for the Congressional item is to identify the key tax provisions in the House tax reform bill. For the IRS and Treasury Items, the learning objectives are: (1) Determine the inflation-adjusted amounts for selected 2018 provisions; (2) Know the 2018 retirement plan limitations; (3) Know the 2017-2018 per diem rates to substantiate business travel expenses; (4) Know the IRS rules for leave-based donation programs; (5) Know the updated Social Security amounts for 2018; (6) Determine which individual income categories and tax entities experienced the largest decline in IRS audit rates; and, (7) Know the rules related to two relief provisions recently provided to partnerships. 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) Determine the amount of gain (loss) on the sale of a principal residence; (2) Know how to apply the terms portion, exclusively, and regular to the home office deduction; and, (3) Determine whether the principal place of business requirement pertaining to the home office deduction is satisfied The learning objective for the Elite Possibility is: Identify effective year-end tax planning opportunities for 2017. 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 4] High-low method: IRS method providing per diem rates for use by taxpayers to substantiate the amount of ordinary and necessary business expenses incurred while traveling away from home.

[Item 5] Leave-based donation program: An employer program under which employees can elect to forgo vacation, sick, or personal leave in exchange for cash payments that the employer makes to qualified charitable organizations.

Key Terms - Continued

[Item 7] Establishment Clause: Part of the First Amendment which prohibits the government from making any law "respecting an establishment of religion."

[Items 7 and 19] Convenience of employer doctrine: A principle for certain employee tax benefits that requires that the action is motivated by benefitting the employer rather than the employee. For example, lodging provided on the employer premises is tax free provided it is for the convenience of the employer. A home office used by employees also must satisfy this doctrine.

[Item 8] Advance premium tax credit: Under the Affordable Care Act provisions, this credit is a monthly reduction in health insurance premium costs under a health exchange which is based on the taxpayer's household income at the time of enrollment.

[Item 10] Section 6013(a) election: Code election permitting married taxpayers to file separate returns rather than a joint return.

[Item 10] Section 6013(b) election: Code election permitting married taxpayers who have filed separate returns to switch to a joint return.

[Item 11] Hypothetical claim for refund date: Under the provisions governing the limitation period for refund claims, this date is the date the IRS issues a notice of deficiency when a taxpayer has not filed an annual income tax return. This date "locks in" the time the taxpayer has to file a refund claim for an overpayment of taxes.

[Item 13] Contemporaneous written acknowledgment: Under Section 170(f)(8)(B), donee substantiation requirements when there is a contribution of $250 or more made by the taxpayer to a charity. The requirements include the donee's providing the amount of cash and description of other property contributed, whether the donee provided any goods or services in exchange, and a description and good faith estimate of the value of any goods or services provided.

[Item 15] Section 754 election: An election which allows partnerships to adjust the basis of partnership assets as a result of adjustments triggered by a sale under Section 743(b) or a distribution under Section 734(b).

[Item 16] Adjusted basis for property: Includes the taxpayer's initial basis for property, which depends on how the property was acquired, plus or minus subsequent adjustments that affect the initial basis of the property.

[Items 18 and 19] Home office deduction: A deduction for self-employed taxpayers and employees who use a portion of their home exclusively as an office for business purposes on a regular basis.

[Item 19] Principal place of business: One of the business purposes that qualifies for the home office deduction.

CONGRESS

[ITEM 1] HOUSE AND SENATE PROPOSE SUBSTANTIAL TAX REFORM

On November 16, 2017, the House passed by a vote of 227-205 HR 1 titled the "Tax Cuts and Job Acts." Later that day, the Senate Finance Committee approved a similar proposal by a vote of 14-12. The full Senate is expected to take action on the bill the week after Thanksgiving. While it may take many weeks before a final bill is passed, a number of commentators believe that a tax reform bill will be passed. This item focuses on the key House provisions affecting individual income taxpayers. In addition, key corporate and business provisions are summarized. Unless otherwise indicated, the effective date is taxable years beginning after 12/31/17. The current seven tax brackets will be reduced to the following 4 tax brackets – 12%, 25%, 35%, and 39.6%. The three larger tax rates kick in for single taxpayers, head of household taxpayers (HOH) and married joint return taxpayers (MJ) above the following taxable income amounts:

Rate	Single	HOH	MJ
25%	$ 45,000	$ 67,500	$ 90,000
35%	$200,000	$200,000	$ 260,000
39.6%	$500,000	$500,000	$1,000,000

For taxpayers with taxable income exceeding $1.2 million ($1 million for single taxpayers), the "tax benefit" (savings) from the 12% tax bracket (27.6%, which is 39.6% - 12%) is phased out by increasing the tax rate by 6% until the tax benefit is eliminated. Other tax-rate provisions include: a special maximum 25% tax rate on business income of individuals; repeal of the alternative minimum tax; and, modifying when the various capital gain rates (0%, 15%, and 20%) apply. The standard deductions for 2018 will be nearly double the amounts in 2017 as follows: married joint – $24,400; head of household – $18,300 (75% of MJ); and single/married separate – $12,200 (50% of MJ). However, the personal and dependent exemption deduction ($4,050 in 2017, $4,150 scheduled in 2018) is repealed. Other deductions which are repealed include: (1) alimony; (2) moving expenses; (3) nonbusiness state and local income or sales taxes except for property taxes up to $10,000; (4) personal casualty losses; (5) medical expenses; (6) employee business expenses; and, (7) tax preparation costs which currently are deductible as a production of income expense (business-related tax preparation costs still would be deductible). The deduction for mortgage interest would be limited to $500,000 of acquisition debt ($250,000 for married separate). For charitable deductions, the 50% AGI limit is increased to 60%. The child tax credit is increased from $1,000 per qualifying child to $1,600. The following nonrefundable credits are repealed – (1) elderly and disabled; (2) adoption expenses; and, (3) qualified plug-in electric drive motor vehicle. While the American Opportunity Tax Credit is retained and extended to five taxable years under certain circumstances, other education tax provisions either are eliminated or limited. For example, no contributions to Coverdell Education Savings accounts can be made after 2017, and the above-the-line deductions for qualified education expenses and interest expense on education loans would be repealed. Income exclusions related to educational assistance programs and U.S. savings bonds used for higher education expenses also would be repealed. Other income exclusions which would be repealed include: (1) employee achievement awards; (2) dependent care assistance programs; (3) qualified moving expense reimbursement; and, (4) adoption assistance programs. The residential gain exclusion would be modified by (1) requiring the residence be used as the taxpayer's personal residence for five of the previous eight years, and (2) phasing out the exclusion for modified AGIs (averaged over the last three years) beginning at $250,000 ($500,000 for joint return).

The major corporate and business reforms include (1) lowering the corporate tax rate from 35% to 20%; (2) increasing bonus depreciation to 100% of the adjusted basis of qualified property; (3) increasing the immediate expense deduction from $500,000 to $5 million; (4) limiting the deduction of net business interest expense to 30% of adjusted taxable income; (5) limiting like-kind exchange treatment to real property; (6) repealing the deduction for local lobbying expenses; (7) repealing the deduction for income attributable to domestic production activities; and, (8) repealing several tax credits, including rehabilitation, work opportunity, and the credit for expenditures to provide access to disabled individuals. As in the case of individuals, the alternative minimum tax applicable to corporations would be repealed.

The estate tax is scheduled to be repealed for decedents dying after 2023. In the meantime, the unified credit would be doubled (currently the $5 million credit after inflation adjustments is $5.49 million).

Some of the major differences in the Senate bill include the following: (1) it has seven tax brackets ranging from 10% to 38.5%; (2) no deduction for state and local taxes; (3) the child credit would be available to children less than age 18 rather than 17 and available to families with incomes up to $500,000, and would increase to $2,000 rather than $1,600; (4) make no changes to the mortgage interest on acquisition debt but repeal the interest deduction on home-equity loans; (5) delay the corporate tax rate deduction until 2019; (6) for married taxpayers with taxable income below $500,000 ($250,00 for others), allow a 17.4% deduction for pass-through business income (the House bill lowers the maximum tax rate to 25% on business income); and, (7) perhaps the most controversial, eliminate the individual shared responsibility payment pertaining to the Affordable Care Act.

****REVIEW QUESTION AND SOLUTION****

1. Based on recent tax reform proposals in Congress, **which one** of the following statements **is true**?

    a. The 35% tax rate for single taxpayers would begin at taxable incomes above $260,000.

    b. For taxpayers excluding residential gain, the home would have to be used as the taxpayer's residence for each of the last five years.

    c. The deduction for personal and dependent exemptions would be repealed.

Solution

1. **"C" is the correct response**. While the standard deduction would nearly be doubled, the personal exemption deduction would be repealed under the current tax reform proposals.

    "A" is an incorrect response. The 35% tax rate for single taxpayers would begin at taxable incomes above $200,000, not $260,000.

    "B" is an incorrect response. The home would have to be used as the taxpayer's residence for five of the previous eight years, not the last five years. *Tax Cuts and Job Acts*.

IRS

[ITEM 2] CERTAIN 2018 INFLATION-ADJUSTED AMOUNTS AFFECTING INDIVIDUALS ARE PROVIDED

Revenue Procedure 2017-45 [10/19/17] contains inflation-adjusted amounts for some key items for 2018. **Note:** If the tax reform proposals described above become law, many of the amounts provided below will change. For married couples filing jointly, the amounts of taxable income at which the various income tax rates begin to apply are: over $19,050 – 15%; over $77,400 – 25%; over $156,150 – 28%; over $237,950 – 33%; over $424,950 – 35%; and, over $480,050 – 39.6%. For single taxpayers, the amounts of taxable income at which the various income tax rates begin to apply are: over $9,525 – 15%; over $38,700 – 25%; over $93,700 – 28%; over $195,450 – 33%; over $424,950 – 35%; and, over $426,700 – 39.6%. The personal and dependent exemption deduction for 2018 is $4,150, up $100 from 2017. The AGI amount for the phaseout of personal and dependent exemption amounts for 2018 begins above $320,000 for married couples filing jointly and above $266,700 for single taxpayers. The 2018 standard deduction amounts are: married couple filing jointly – $13,000 (up $300); married taxpayer filing separately – $6,500 (up $150); head of household – $9,550 (up $200); single – $6,500 (up $150); and, dependent – the greater of $1,050, or the sum of $350 and the individual's earned income, not to exceed $6,500 For purposes of calculating the "kiddie tax," the net unearned income of the child is reduced by $1,050. The additional standard deduction for age and blindness is $1,300 for married taxpayers, and $1,600 for an unmarried taxpayer who is not a surviving spouse. As in the case of the personal and dependent exemption phaseout, the AGI amount for the phaseout of itemized deductions begins above $320,000 for married couples filing jointly and above $266,700 for single taxpayers. The income limit for the maximum earned income tax credit for 2018 is $6,800 for a qualifying individual with no children, $10,200 for a qualifying individual with one child, and $14,320 for a qualifying individual with either two or three or more children. The maximum 2018 earned income tax credit amounts are as follows: no child – $520; one child – $3,468; two children – $5,728; and, three or more children – $6,444. The taxpayer is not eligible for the earned income tax credit if certain investment income exceeds $3,500 in 2018. The modified AGI phaseout range for the $2,500 maximum deduction for interest paid on qualified education loans remains the same as for 2017 – $65,000 - $80,000 for single taxpayers and $135,000 - $165,000 for married taxpayers filing a joint return. The annual gift exclusion for 2018 is up $1,000 from 2017 at $15,000.

[ITEM 3] IRS ISSUES KEY LIMITATIONS COVERING 2018 RETIREMENT PLANS

In Notice 2017-64 [10/19/17], the IRS announces revised 2018 dollar limitations on benefits under qualified retirement plans that take effect on January 1, 2018. Here are selected amounts that have increased from 2017: (1) the AGI limitation for determining the maximum Roth IRA contribution increased $3,000 to $189,000 for joint return taxpayers, and increased $2,000 to $120,000 for single taxpayers; (2) the applicable dollar amount for determining the deductible IRA amount for taxpayers who are active retirement plan participants increased as follows: $1,000 to $63,000 for single taxpayers; $2,000 to $101,000 for joint taxpayers who both are active participants; and, $3,000 to $189,000 for a married taxpayer who is not an active retirement plan participant but whose spouse is an active participant; (3) the annual benefit under defined benefit plans increased $5,000 to $220,000; (4) the limitation for defined contribution plans increased $1,000 to $55,000; (5) the annual compensation limit increased $5,000 to $275,000; and, (6) the maximum exclusion for elective deferrals for IRC Section 401(k) plans, the federal government's Thrift Savings Plans, and IRC Section 457(b) government plans increased $500 to $18,500 ($24,500 for individuals age 50 or older). Certain retirement amounts which have not changed from 2017 include the following: (1) the limitation used in defining a highly-compensated employee – $120,000; (2) the compensation amount regarding simplified employed pensions – $600; (3) the general limitation regarding SIMPLE contributions – $12,500; and, (4) the maximum IRA contribution for taxpayers less than age 50 – $5,500.

[ITEM 4] IRS ISSUES CURRENT RATES FOR HIGH-LOW METHOD

In Notice 2017-54 [9/25/17], the IRS provides the 2017 - 2018 per diem rates for taxpayers to use in substantiating the amount of ordinary and necessary business expenses incurred while traveling away from home. The new rates are effective October 1, 2017. Under the high-low method, the per diem rates are $284 (up $2 from 2016 - 2017) for travel to any "high-cost" locality, and $191 (up $2) for travel to any other locality within the continental United States (CONUS). The amount of the $284 ($191) per diem that is treated as paid for meals for purposes of Section 274(n) is $68 (unchanged) for travel to any high-cost locality, and $57 (unchanged) for travel to any other locality within the CONUS. A "high-cost" locality is one with a federal per diem rate of $238 (up $2) or more. The special transportation industry M&IE rate for any locality of travel inside the CONUS is $63 (unchanged). The M&IE rate for any locality of travel outside the continental United States (OCONUS) is $68 (unchanged). The rate for any CONUS or OCONUS locality of travel for the incidental expenses only deduction is $5 (unchanged) per day. Incidental expenses include only fees and tips given to porters, baggage carriers, hotel staff, and staff on ships. Transportation between places of lodging or business and places where meals are taken, and the mailing costs of filing travel vouchers and paying employer-sponsored charge card billings, are not included in incidental expenses.

[ITEM 5] IRS PROVIDES SPECIAL RELIEF THROUGH 2018 WITH RESPECT TO LEAVE-BASED DONATION PROGRAMS

In Notice 2017-62 [10/6/17], the IRS provides guidance on the treatment of leave-based donation programs to aid victims of Hurricane and Tropical Storm Maria. Under the programs, employees can elect to forgo vacation, sick, or personal leave in exchange for cash payments that the employer makes to qualified charitable organizations. The IRS will not assert that such cash payments constitute gross income or wages of the employees. Two conditions must be met to receive the IRS-prescribed treatment: (1) the payments must be made to the organizations for the relief of victims of Hurricane or Tropical Storm Maria; and, (2) they must be made before January 1, 2019. The IRS also states that it will not assert that the opportunity to make the election results in constructive receipt of gross income or wages for employees. Electing employees may not claim a charitable contribution deduction for the value of forgone leave that is excluded from compensation and wages. An employer deducts the cash payments as Section 162 ordinary and necessary business expenses, not as Section 170 charitable contribution deductions. **Note:** Similar relief was provided to victims of Hurricanes Harvey (IR-2017-143) and Irma (IR-2017-154).

[ITEM 6] SOCIAL SECURITY ADMINISTRATION ANNOUNCES 2018 THRESHOLDS

On October 13, 2017, the Social Security Administration announced at its website (ssa.gov) two threshold amounts for 2018. It announces that the maximum taxable earnings for Social Security purposes for 2018 will increase by $1,500 from $127,200 in 2017 to $128,700 in 2018. In addition, the domestic employee coverage threshold for 2018 increases $100 from 2017 to $2,100.

REVIEW QUESTIONS AND SOLUTIONS

2. Regarding 2018 retirement plan limitations, **which one** of the following statements **is false**?

a. The limitation for defined contribution plans increases $2,000.

b. The maximum Section 401(k) exclusion for elective deferrals for taxpayers age 50 and older is $24,500.

c. The limitation used in defining a highly-compensated employee is $120,000.

3. Regarding per diem rates for taxpayers to use in substantiating business expenses incurred while traveling away from home during 2017 - 2018, **which one** of the following **is** an incidental expense?

a. Transportation between the place of lodging and the place where meals are taken.

b. Fees and tips given to porters.

c. Mailing costs of filing travel vouchers.

Solutions

2. **"A" is the correct response**. The limitation for defined contribution plans increases by $1,000 to $55,000 for 2018.

"B" is an incorrect response. The maximum Section 401(k) exclusion for elective deferrals for taxpayers age 50 and older increases by $500 in 2018 to $24,500.

"C" is an incorrect response. The limitation used in defining a highly-compensated employee remains at $120,000 for 2018. *Notice 2017-64*.

3. **"B" is the correct response**. Incidental expenses include only fees and tips given to porters, baggage carriers, hotel staff, and staff on ships.

"A" is an incorrect response. Transportation between places of lodging or business and places where meals are taken are not included in incidental expenses.

"C" is an incorrect response. The mailing costs of filing travel vouchers are not included in incidental expenses. *Notice 2017-54*.

COURT DECISIONS

[ITEM 7] A DISTRICT COURT STRIKES DOWN EXCLUSION FOR RENTAL ALLOWANCE PROVIDED TO MINISTERS

Under Section 107(1), gross income does not include the rental value of a home furnished to a minister of the gospel. If the minister owns or rents his or her home, Section 107(2) excludes from gross income any rental allowance paid to the minister as part of the minister's compensation to the extent used to rent or provide a home. The exclusion is limited to the fair rental value of the home, including furnishings and appurtenances such as a garage, plus the cost of utilities. In Gaylor v. Mnuchin [10/6/17], the Plaintiff Freedom from Religion Foundation, Inc., a nonprofit organization (Freedom from Religion), challenged Section 107(2) on the ground that it discriminates against secular employees and violates both the establishment clause of the First Amendment and the equal protection component of the Fifth Amendment. A few years ago, it challenged the constitutionality of Section 107(1) in the same Western District Court in Wisconsin. The District Court sided with the plaintiff but the Seventh Circuit vacated the judgment on the ground that plaintiffs did not have standing to sue. In order to have standing, a plaintiff must suffer an "injury in fact" that is fairly traceable to defendants' conduct and capable of being redressed by a favorable decision from the court. Not to be denied, for two of its employees (co-presidents) Freedom of Religion designated part of their compensation as a housing allowance, The two employees then filed amended returns and claimed the designated housing allowance as an exclusion from income. They stated that they were "not clergy" and that their "employer was not a church," but they believed it is unfair that ministers can exclude housing costs while they could not. The IRS denied their claim in 2015. After reviewing the IRS's denial and arguments by the defendants, the District Court concluded the plaintiffs have standing to seek declaratory and injunctive relief. In a long-winded analysis, the court concluded that this provision violated the establishment clause. The court relied on a 1989 Supreme Court case (Texas Monthly, Inc. v. Bullock) which involved a state sales tax exemption for "periodicals that are published or distributed by a religious faith and that consist wholly of writings promulgating the teaching of the faith and books that consist wholly of writings sacred to a religious faith." A plurality of the court concluded that the exemption violated the establishment clause, but no single opinion in the case garnered at least five votes. The plurality concluded that the exemption did not have a secular purpose or effect and conveyed a message of religious endorsement because it provided a benefit to religious publications only, without a corresponding showing that the exemption was necessary to alleviate a significant burden on free exercise. In the current case, the defendants proposed several arguments, including that Section 107 was similar to Section 119, which excludes from gross income free or reduced lodging costs on the business premises of the employer. This argument was dismissed on the basis that Section 107 does not require the convenience of the employer doctrine, which is required in Section 119. The defendants also offered the following four reasons as potential secular purposes for special tax treatment under Section 107: (1) providing for the "unique housing needs" of ministers; (2) eliminating discrimination among religions; (3) reducing entanglement between church and state; and, (4) alleviating financial hardship on ministers. With respect to the first point, the District Court observed that there are many groups of professionals who "often" need to live near their work and be on call even when they are not working, such as certain types of healthcare providers, hotel managers, maintenance staff, funeral service directors and many others. However, none of those groups receive a categorical tax exemption for housing expenses as ministers do. Although Section 107(2) applies to all religions (point #2), the District Court noted that it does not justify the disparate treatment between religious persons and secular persons. Point numbers 3 and 4 also were summarily dismissed by the court as the defendants provided no evidence to support that entanglement had anything to do with Section 107(2) and many financially well-off ministers benefit from this provision. In conclusion, the District Court ruled that Section 107(2) violates the establishment clause of the First Amendment of the constitution. **Note**: The establishment clause prohibits the government from making any law "respecting an establishment of religion." This clause not only forbids the government from establishing an official religion, but also prohibits government actions that unduly favor one religion over another. It also prohibits the government from unduly preferring religion over non-religion, or non-religion over religion. We suspect that litigation on this issue will continue until either it is heard by the Supreme Court or addressed by Congress.

[ITEM 8] TAXPAYER FINDS OUT THE HARD WAY THAT ADVANCE PREMIUM TAX CREDITS MAY HAVE TO BE PAID BACK

Under the Affordable Care Act (ACA), taxpayers who are not insured under their employer health plan must enroll in a health care plan offered in their state's insurance exchange. Taxpayers whose household incomes are between 100% to 400% of the Federal poverty line qualify for an advance premium tax credit, which is applied to the cost of the monthly health insurance premium for the health plan chosen in the exchange. In McGuire [8/28/17], the taxpayers enrolled in a Blue Shield Silver plan with a 2014 monthly premium of about $1,200 per month. Their advance premium tax credit was 50% of the premium so their share was about $600 per month. At the time of the enrollment, only the husband was employed and he was earning about $800 per week. Shortly after enrollment, the wife began working at a job which paid about $600 per month. She promptly notified the exchange but it took six months before the exchange responded. The exchange indicated that the taxpayers no longer qualified for the plan because their income was too high. It also mentioned that they may have to pay back some of the advanced credit. The record is unclear whether the taxpayers would have been unable to qualify for a lower-cost plan. In the taxpayers' letter to the exchange, they indicated a change in address but they never received Form 1095-A (Health Insurance Marketplace Statement), which is used to calculate the premium credit. On their 2014 tax return, they left line 69 (net premium tax credit) blank on Form 1040. In August 2016, the IRS issued a notice of deficiency of $7,092, which equaled the disallowed advanced premium credit. The credit was disallowed because the taxpayers' household income exceeded 400% of the Federal Poverty line. The taxpayers' only argument was how unfair this whole matter was. Specifically, they felt it was the exchange's responsibility to ensure clients receive credit advances for which they qualified. They never would have committed to paying for medical coverage in excess of $14,000 per year (over 22% of their gross income), and had they known they would have to pay another $7,000, they would have shopped in the private sector for a more affordable plan or gone without coverage. They told the Tax Court that this matter has become an absolute nightmare and hoped that the court would rule fairly and justly. The Tax Court indicated that it was sympathetic to the taxpayers' situation. However, the statute is clear – (1) the premium tax credit is available only to taxpayers whose household incomes are between 100% to 400% of the Federal poverty line, and (2) excess advance premiums are treated as an increase in the tax imposed. **Note:** The taxpayers resided in the State of California, where the cost of living is higher than most states. Presumably, wages are higher and the cost of health insurance may also be higher. Yet the poverty line is a Federal calculation. Therefore, it is likely that fewer taxpayers in higher cost of living states qualify for the premium tax credit.

[ITEM 9] CANADIAN CITIZEN'S OHIO UNEMPLOYMENT COMPENSATION IS SUBJECT TO US TAX

The taxpayer was a Canadian citizen. She moved to Ohio to take a position as a post-doctoral fellow at the University of Cincinnati (UC), where she was employed from October 2010 through November 2011 on a nonimmigrant professional visa. She never applied to be a US lawful permanent resident. Her employment contract expired on 11/30/2011, she unsuccessfully attempted to find other US employment, then returned to Canada and reestablished her Canadian residence on 12/1/2011. From then to the end of 2012 she remained a Canadian resident, being physically present in the US for only 2 days in 2012. After termination of her UC employment, she applied to the state of Ohio Department of Job and Family Services for unemployment compensation. Her application was approved, and during 2012 she received biweekly unemployment compensation that totaled $15,972 for 2012. The department issued her a Form 1099-G reporting the compensation, and stating that no federal income tax had been withheld. The taxpayer filed Form 1040NR-EZ, "US Income Tax Return for Certain Nonresident Aliens with no Dependents," for 2012, and took the position that her unemployment compensation was exempt from tax under the income tax treaty between the US and Canada. She reported the compensation on her Canadian income tax return for 2012, but paid no tax because of offsetting deductions and credits. The issue in Guo [10/2/17] was whether her 2012 US-source unemployment compensation income was exempt from tax under the US-Canadian income tax treaty. The Tax Court noted that the treaty did not specify how unemployment compensation is to be treated. The taxpayer relied on Article XV of the treaty, entitled "Dependent Personal Services." The article governs the "treatment of salaries, wages, and other similar remuneration derived by a resident of a Contracting State in respect of employment." The court noted that unemployment compensation is not salaries or wages, and that "remuneration" is not defined by the treaty. The court noted that, while "remuneration" appears in Code Sections 3401 and 3121, which supply definitions for purposes of withholding income tax from wages and for purposes of withholding FICA tax from wages, it is not defined in the Code. The court decided that unemployment compensation is not wages or salaries, nor does it constitute similar remuneration in respect of employment. The court decided that treaty Article XV does not govern unemployment compensation. It then considered the IRS's argument that treaty Article XXII, "Other Income," governs unemployment compensation. The court observed that this article is a catchall provision covering items of income not dealt with elsewhere in the treaty. Its language expressly permits the US to tax the taxpayer's unemployment compensation because it arose in the US. It ruled the unemployment compensation taxable, stating that the taxpayer avoids double taxation (generally the overarching goal of income tax treaties) because Canada permits her a Canadian income tax deduction for income tax paid to the US.

[ITEM 10] TAX COURT DETERMINES IF TAXPAYER WHO FILED SINGLE RETURN MAY LATER ELECT JOINT FILING STATUS

In Camara [9/28/17], the married taxpayer erroneously checked the box for single filing status when he filed his 2012 US Form 1040 on 4/15/2013. He should have filed either married filing separately or jointly. The IRS issued a notice of deficiency to the taxpayer on 2/10/2015, on which it changed the taxpayer's filing status to married separately. On 5/8/2015, the taxpayer timely petitioned the Tax Court with respect to the notice of deficiency. On 5/27/2016, the taxpayer filed a 2012 joint return with his wife. His wife had not previously filed a 2012 tax return. The taxpayers and IRS agreed that the joint return with certain changes correctly reflected their 2012 tax liability. But, the IRS asserted that Section 6013(b)(2) bars them from filing a joint return. The court noted that Section 6013(b) permits married taxpayers to elect in certain circumstances to switch from a "separate return" to a joint return. The court clarified the two "switches" with respect to married taxpayers in Section 6013: (1) Section 6013(b) election – permits married taxpayers to elect in certain circumstances to switch from a "separate return" to a joint return; and, (2) Section 6013(a) election – rather than filing a joint return, married taxpayers may elect to file separate returns. The court stated the general rule in Section 6013(b)(1) as: "If an individual has filed a 'separate return' for a taxable year for which that individual and his or her spouse could have filed a joint return, that individual and his or her spouse may nevertheless 'make a joint return' for that year." Section 6013(b)(2) lists four limitations on the election to switch to a joint return. The IRS contended that the taxpayer's original 2012 return, on which he erroneously claimed single filing status, constituted a "separate return," and the Section 6013(b)(2) limitations prevented him from making the Section 6013(b) election to switch to a joint return. The IRS invoked two of the four limitations: (1) the election is barred after three years from the filing deadline (without extensions) for filing the return for that year; and, (2) the election is barred after there has been mailed a notice of deficiency to either spouse, with respect to the taxable year and the spouse in the notice files a petition with the Tax Court within 90 days. The IRS argued the first limitation was met because the taxpayer and his wife filed their joint return on 5/27/2016, more than three years after the taxpayer had "filed his separate return." It argued the second limitation was met because the taxpayer received a notice of deficiency and filed a petition with the Tax Court before filing a joint return. Both limitations turn on whether the taxpayer's erroneously filed single return is a "separate" return. The Tax Court stated that some of its prior decisions had interpreted a "separate return" to include a single return or a head of household return. But it noted that in those earlier cases, the effect of an erroneous claim of filing status was not addressed or presented. The term "separate return" in Section 6013(b)(1) is not defined in the Code or the regulations. The court stated that no appellate court has held that a single or head of household return is a separate return for purposes of Section 6013(b). It stated that Section 6013(b)(1) describes filing a separate return as an "election." It felt "election" embodies the notion of "choice." It thought that there is no valid "choice" embodied in a return on which the taxpayer has erroneously indicated a filing status that is not legally available to him or her. So, it stated that the use of the word "election" in the Code strongly supports the conclusion that an erroneous single return is not a "separate" return. The court stated that the legislative history for Section 6013(b) was originally intended to alleviate a problem arising from a perceived lack of authority for a married taxpayer to change a permissible and otherwise irrevocable election as to his or her filing status. It found nothing to suggest that Section 6013(b) was intended to prevent a married taxpayer who had filed an incorrect return from altering the return so as to make it correct and in compliance with the Code. The court decided that the taxpayer's 2012 return erroneously filed claiming "single" status did not constitute a "separate return" for purposes of Section 6013(b). Consequently, Section 6013(b), including its Section 6013(b)(2) limitations, is not applicable. His wife and he were permitted to file a 2012 joint return.

[ITEM 11] TAXPAYER DENIED TAX REFUND BASED ON A TECHNICAL INTERPRETATION OF THE STATUTE OF LIMITATIONS

Section 6511(a) provides the maximum amount of time a taxpayer has to claim a refund for an overpayment of income tax. In cases where the taxpayer is required to file a tax return, the refund claim must be filed within three years from the time the return was filed or two years from the time the tax was paid, whichever period is later. However, if no tax return was filed, the refund claim must be made within two years from the time the tax was paid. Section 6511(b)(2)(B) goes on further to say, if a refund claim is not filed within the three-year period, the amount of refund may not exceed the amount of tax paid during the two years immediately preceding the filing of the claim. So for example, assume a taxpayer files her 2012 tax return on April 15, 2013. All tax payments were made prior to 2013 through tax withholdings, and the taxpayer received a $1,000 refund. Sometime later, the taxpayer discovers she was entitled to a deduction she did not claim which would have increased her refund by $2,000. Under Section 6511, the taxpayer had until April 15, 2016, to amend her 2012 tax return and file the refund claim. Assume instead that on April 15, 2013, she only filed an extension and made a $1,500 extension payment. However, she failed to file a timely 2012 tax return by October 15, 2013. Had she filed timely, her refund would have been $2,500 ($1,000 as in the first example plus the $1,500 extension payment). The bad news is that the three-year rule for filing a refund claim does not apply because she never filed her 2012 tax return. The good news is that the two year-rule indicates that she has two years to file a refund claim from the date of the last tax payment (which was on April 15, 2013). However, the refund is limited to $1,500, the amount of payments made during the two years preceding the claim. She would have to have filed the refund claim by April 15, 2015, in order to receive $1,500 of the refund claim. The other $1,000 is lost.

This brings us to Borenstein [8/31/17] case, which recently was decided by the Tax Court in a "regular" decision. The facts of the case are similar to the second example. On April 15, 2013, the taxpayer filed an extension for her 2012 tax return and included an extension payment of $40,000. However, she failed to timely file her 2012 tax return by the October 15, 2013 deadline. On June 19, 2015, more than two years from when the taxpayer filed her extension along with the $40,000 tax payment, the IRS issued her a notice of deficiency for almost $80,000. This amount was based on the taxpayer's gross income without any deductions from gross income, such as tax basis on securities sold. In August 2015, she filed her 2013 tax return. After the filing, both the taxpayer and IRS agreed that there was not a tax deficiency but rather a tax overpayment of $32,441. Section 6512 governs the statute of limitations in cases where taxpayers petition the Tax Court for refund claims. Essentially, it applies the statute of limitations set forth in Section 6511 with a couple of twists. The first twist is that the date of filing for the refund claim is considered to be the date of the tax notice of deficiency, which in this case is June 19, 2015. This is known as the "hypothetical claim for refund" date. Because the taxpayer never filed her 2012 tax return, the IRS argued that the refund is limited to the taxes paid within two years from the deficiency notice, which would be from June 19, 2013 - June 19, 2015. Since no tax payments were made during this period, the IRS argued that she is not entitled to any refund. The second twist involves an amendment to Section 6512 following a 1997 Supreme Court decision (Lundy), which sanctioned the hypothetical claim for refund date (date of tax deficiency notice). Section 6512(b)(3) was amended to provide that in the case of the mailing of a notice of deficiency in the third year after the due date for filing the tax return and where no tax return was filed, the applicable period shall be three years. Based on this amendment, the taxpayer argued that the look-back period for payment of taxes should be three years not two. That is, if the tax deficiency were filed in year 3 between October 16, 2015 and April 15, 2016, the lookback period and tax payments between April 15, 2013 and April 2016, would be eligible toward any refund claim. In this case, having made a $40,000 extension payment on April 15, 2013 would entitle her to her $32,441 refund if the claim were filed by April 15, 2016. Unfortunately for the taxpayer, the Tax Court applied a literal interpretation of the statute and said that the amendment does not apply since the tax notice was issued in the second year rather than the third year. Therefore, it ruled that she was not entitled to the refund. **Note:** In our opinion, the decision reached by the Tax Court was not consistent with the intent of the amendment – to allow a greater time period for the taxpayer to seek a refund claim when the tax deficiency notice was sent in the third year of the limitations period. We don't believe that Congress realized that there could be a "black whole" period (April 16, 2015- October 15, 2015) in the second year where the taxpayer would be prevented from seeking a refund.

[ITEM 12] SOCIAL CLUB MAY NOT OFFSET ITS INVESTMENT INCOME WITH NONMEMBER SALE LOSSES

The taxpayer is a Section 501(c)(7) club incorporated in Ohio. Its facilities include an 18-hole golf course, a swimming pool, tennis courts, dining facilities, meeting and reception rooms, and associated grounds. Members pay dues, assessments, food minimums, and miscellaneous fees to use the taxpayer's facilities. Nonmembers pay surcharges to use the taxpayer's facilities. Annually it files Form 990-T, "Exempt Organization Business Income Tax Return," on which it reports gross receipts, direct expenses, and indirect expenses relating to its nonmember sales activities. The taxpayer uses the ratio of nonmember sales to total sales to allocate a portion of the indirect expenses to compute nonmember income or loss (gross-to-gross allocation method). For the 2010 - 2012 tax years at issue, the club reported net losses relating to nonmember sales of $112,365, $93,524, and $99,522, respectively. On its amended 2010 return, and its original 2011 and 2012 returns, the taxpayer's accountant offset the club's investment income with the losses attributable to its nonmember sales, thus showing no unrelated business taxable income (UBTI). A Supreme Court decision issued 20 years earlier had held that losses from nonmember sales may offset investment income only if the sales were entered into for profit. The IRS determined that the club's nonmember sales activities were not entered into for profit, the related losses could not offset its investment income, and thus its investment income was UBTI. In Losantiville Country Club [8/14/17], the Tax Court noted that for most exempt organizations, UBTI is limited to income derived from any unrelated trade or business. It stated that Section 501(c)(7) organizations include investment income in its UBTI. Expenses in excess of unrelated business income are deductible only to the extent that the Section 501(c)(7) organization intended to profit from its unrelated business activities. Consequently, the taxpayer may offset investment income with losses incurred in sales to nonmembers only if its nonmember sales are motivated by an intent to profit. To prove its intent to profit, the taxpayer must establish that its gross receipts from nonmember sales exceed the direct and indirect costs relating to those sales. The court rejected the club's contention that its intent to profit may be established by the factors set forth in Regulation 1.183-2(b) relating to not-for-profit (hobby) activities. The court held that Section 183 and its regulations are not applicable to Section 501(c)(7) organizations. It decided that because the taxpayer did not intend to profit from its nonmember sales, it could not offset its investment income with losses relating to those nonmember sales.

[ITEM 13] DEED WITH MERGER CLAUSE WORKS AS ACKNOWLEDGMENT FOR EASEMENT CONTRIBUTION

An LLC (taxpayer) acquired a Chicago building completed in 1924, and in 2005 began renovating and converting it from commercial office use into a residential complex. On 12/30/05, the LLC executed a deed of easement granting a qualified charitable organization (charity) an easement over the facade of the building. The deed was recorded the same day. The deed contained no reference to any goods or services being furnished by the charity to the LLC. The deed stated that "this instrument, including the exhibits attached hereto, reflects the entire agreement of Grantor and Grantee" and "that any prior or simultaneous correspondence, understanding, agreements, and representations are null and void upon execution hereof unless set out in this instrument." The LLC obtained an appraisal dated 12/30/05 of $26.7 million for the facade easement, and the LLC claimed a charitable contribution deduction for that amount on its 2005 Form 1065. It attached a Form 8283, "Non-Cash Charitable Contributions," to the return. On 7/30/09, the charity supplied the LLC with a letter stating that no goods or services had been provided in consideration of the donation. The letter stated that the charity believed it had acknowledged the donation with a receipt letter at the time of the gift, but could not find a copy of the letter in its files. The IRS audited the LLC's 2005 return, and in November 2009 the IRS sent the LLC a letter saying it intended to disallow the deduction for the easement. In August 2012, the charity filed an amended unsigned Form 990 for its fiscal year ending (FYE) 6/30/06, referring to the easement and stating that no goods or services had been furnished to the donor in exchange for the gift, though not identifying the donor. On 6/30/14, the IRS issued the LLC notice of final partnership administrative adjustment disallowing the deduction in full for failure to satisfy the requirements in Section 170. In September 2014, the LLC petitioned the Tax Court to hear the dispute, and three months later the charity filed Form 990 for its FYE 2014, in which it referred to the 2005 facade easement, identified the LLC as the donor, and stated that no goods or services had been furnished to the LLC in exchange for the gift. The issue in 310 Retail, LLC [8/24/17] was whether the LLC had met the Section 170(f)(8)(B) substantiation requirements for quid pro quo contributions, namely that for contributions of $250 or more the donee acknowledgment (contemporaneous written acknowledgment (CWA)) was provided in a timely manner. The CWA must include the following information: (1) the amount of cash and a description of any property other than cash contributed, (2) whether the donee provided any goods or services in consideration for the property contributed, and (3) a description and good faith estimate of the value of any goods or services provided. The donor must receive the CWA by the earlier of (1) the date the tax return which includes the contribution is filed or (2) the due date of the tax return, including extensions. The letter the charity supplied in July 2009, while including the required information, was not contemporaneous, postdating the facade easement by more than three years. The charity's 2012 amended Form 990 for FYE 2006, disclosing the facade easement and stating that no goods or services were provided in exchange for the easement, was unsigned and did not identify the LLC as the donor. The December 2014 Form 990 filed by the charity for FYE 2014 identifying the LLC as the donor and including the required CWA statement was filed six years or more after the gift was made. The taxpayer's contention was that the deed of easement constituted the CWA. The Tax Court stated that a CWA need not take any particular form, and may be furnished to the donor, for example, by letter, postcard, or computer-generated media. But, whatever form the CWA takes, it must include an affirmative indication that the donee has provided no goods or services to the donor. The court found that, while the deed of easement did not include an explicit statement that the donee had provided no goods or services to the donor in exchange for the easement, it included a merger clause stating: "This instrument sets forth the entire agreement of the parties with respect to the Easement and supercedes all prior discussions, negotiations, understandings, or agreements related to the Easement, all of which are merged herein." It held that the merger clause, read in conjunction with other statements in the deed of easement, supplied the affirmative indication required by Section 170(f)(8)(B). It noted that the deed was properly executed by the charity's president, and recorded by the county's Recorder of Deeds on 12/30/05 – so it was contemporaneous. The deed's merger clause negated the provision or receipt of any consideration that was not stated within the deed. The court observed that neither the taxpayer nor the IRS contended that the charity actually furnished the LLC with any valuable goods or services in exchange for the facade easement. It ruled that, taken as a whole, the deed was a CWA sufficient to substantiate the LLC's gift.

REVIEW QUESTIONS AND SOLUTIONS

4. In a recent court case involving the rental allowance exclusion for ministers, **which one** of the following statements **is true**?

   a. The plaintiff was employed by a church.

   b. In an earlier case by the same plaintiff, the court ruled that the plaintiff did not have standing.

   c. The rental allowance exclusion under Section 107(2) applies only to ministers of the Christian faith.

5. **Which one** of the following **was not** a fact in a recent Tax Court decision dealing with a Canadian citizen who received unemployment compensation from the state of Ohio?

   a. The Ohio department that approved and paid her unemployment compensation withheld US tax from the unemployment compensation it paid her.

   b. For the tax year she received the unemployment compensation, she was physically present in the US for only 2 days.

   c. The taxpayer filed both US and Canadian income tax returns.

6. For a recent case in which a married taxpayer filed in error as a single taxpayer, **which one** of the following responses **is false**?

   a. The Tax Court stated that the Section 6013(b)(1) description to file a separate return as an "election" embodies the notion of a "choice."

   b. The Tax Court stated that while in prior cases it had interpreted a "separate return" to include a single or head of household return, none of those cases addressed the effect of an initial return filed with an erroneous filing status.

   c. For the Section 6013(b) election permitting married taxpayers in certain circumstances to switch from having filed a separate return to file a joint return, the term "separate return" is clearly defined in the Code and regulations.

7. In a recent court case dealing with the statute of limitations for claiming a refund, **which one** of the following statements **is false**?

   a. In cases where the taxpayer is required to file a tax return, the refund claim must be filed within three years from the time the return was filed or two years from the time the tax was paid, whichever period is later.

   b. Because the IRS issued a notice of deficiency prior to the end of the three-year limitation period, the taxpayer could file a refund claim prior to three years from the date of the last tax payment.

   c. The taxpayer failed to timely file her tax return.

8. Regarding a "merger clause" which the Tax Court recently held as satisfying the Section 170(f)(8)(B) donee contemporaneous written acknowledgment requirement for a conservation easement made by a donor, **which one** of the following responses **is true**?

   a. The clause was in the Form 8283 that the taxpayer attached to the tax return for the year that the facade easement donation was made.

   b. The clause was in the deed of easement for the facade donated by the taxpayer to a qualifying charity.

   c. The clause actually was not necessary in that the deed of easement contained an explicit statement that the donee had provided no goods or services to the donor in exchange for the easement.

Solutions

4. **"B" is the correct response**. Because the plaintiff had not been denied an income exclusion under the rental allowance provision, the Seventh Circuit indicated that the plaintiff lacked standing. After this decision, two of the plaintiff's employees obtained standing by filing amended returns, claiming the rental allowance exclusion, and then being denied by the IRS.

   "A" is an incorrect response. The plaintiff was a nonprofit organization which sought "freedom from religion."

   "C" is an incorrect response. The rental allowance exclusion under Section 107(2) applies to all religions. *Gaylor v. Mnuchin*.

5. **"A" is the correct response**. The department issued her a Form 1099-G reporting the compensation, and stating that no federal income tax had been withheld.

   "B" is an incorrect response. From 12/1/2011 to the end of 2012 (tax year in question) she remained a Canadian resident, being physically present in the US for only 2 days in 2012.

   "C" is an incorrect response. She filed a tax return in both jurisdictions. Because of offsetting deductions and credits, she paid no Canadian income tax. She also paid no tax with her US return, arguing that the unemployment compensation was not taxable under a provision in the US/Canadian income tax treaty. *Guo*.

6. **"C" is the correct response**. The court stated that the term "separate return" in Section 6013(b)(1) is not defined in the Code or the regulations.

   "A" is an incorrect response. The court stated that Section 6013(b)(1) describes filing a separate return as an "election." It felt "election" embodies the notion of "choice."

   "B" is an incorrect response. The Tax Court stated that, while some of its prior decisions had interpreted a "separate return" to include a single return or a head of household return, in those earlier cases the effect of an erroneous claim of filing status was not addressed or presented. *Camara*.

7. **"B" is the correct response**. The IRS issued the deficiency notice in the second year of the limitations period. On that basis, the three-year lookback amendment did not apply because the deficiency notice was not issued in the third year of the limitation period.

   "A" is an incorrect response. The general rule for refund claims under Section 6511 is the latter of three years from the time the return was filed or two years from the time the tax was paid.

   "C" is an incorrect response. Although the taxpayer filed a timely extension, she failed to file a timely tax return. *Borenstein.*

8. **"B" is the correct response**. The clause was in the deed of easement.

   "A" is an incorrect response. The clause was not in the Form 8283.

   "C" is an incorrect response. The court found that, while the deed of easement did not include an explicit statement that the donee had provided no goods or services to the donor in exchange for the easement, it included a merger clause which when read in conjunction with other statements in the deed satisfied the "no goods or services" statement requirement. *310 Retail, LLC*.

TREASURY

[ITEM 14] THE TIGTA REPORTS ON IRS STAFFING DECLINES AND AUDIT RATES

In Report 2017-30-072 [9/11/17], the Treasury Inspector General for Tax Administration (TIGTA) reports on the continual decline in IRS staff and examinations. Examination staffing in FY 2016 reached a 20-year low with only 8,847 employees, a decrease of 4% from FY 2015 (9,189) and 23% lower than FY 2012 (11,432). In FY 2016, the number of examinations conducted by the IRS decreased approximately 9% from those conducted during FY 2015 and nearly 32% lower than the number conducted during FY 2012. The decline was most significant in field examinations. The IRS examined 1,035,000 (one of every 143 or .7%) tax returns in FY 2016. This is 16% less than the number of examinations performed in FY 2015 and 30% fewer examinations than the five-year high reported in FY 2012 of 1,482,000 (one of every 97). Of the 1,035,000 individual tax returns that were examined, 852,000 (82%) of the examinations were performed by correspondence. Only one of every 811 individual income tax returns filed received a face-to-face examination, which is a 14% decline compared with FY 2015, when one of every 714 individual returns received a face-to-face examination. This is the least number of individual examinations in either category since FY 2004. Tax return examinations for individuals with incomes between $200,000 and $1,000,000 (nonbusiness) experienced the largest decrease (more than 36%) from the previous year, followed by individual tax returns with more than $1,000,000 in income which decreased nearly 29% during the same period. Examinations of individual returns with income less than $25,000 of income that claimed the Earned Income Tax Credit declined more than 11% from the previous year and 23% from five years earlier. Fewer corporate tax returns were examined during FY 2016 than any year since FY 2004. The number of corporate tax returns examined with assets of less than $10 million decreased more than 14% from FY 2015 and 33% from FY 2012. Similar declines occurred for higher income ranges as well with the largest five-year reduction in the assets category of $10 million to $100 million, a 47% decline. FY 2016 examinations of S Corporations and partnerships also declined from the previous year and FY 2012 with five-year declines of 27% and 12%, respectively. The overall audit rates for the various entities for FY 2016 are as follows: Corporations – 1.12%; S Corporations – .34%; and, Partnerships – .38%.

[ITEM 15] TWO RULINGS PROVIDE RELIEF TO PARTNERSHIP TAX RETURN FILINGS

In REG-116256-17 [10/12/17], the Treasury provides relief to partnerships who file their partnership tax return electronically and include an unsigned Section 754 election with the return. A Section 754 election is used to adjust the basis of partnership property for certain events triggered by partnership distributions or a partner's sale of a partnership interest. The Section 754 election must be signed by one of the partners in the partnership. According to the current regulations, a partnership that files an unsigned Section 754 election statement with its partnership return (whether filed electronically or in paper) has not made a valid Section 754 election. The IRS reports that it has received numerous requests for relief of an invalid Section 754 election due to a lack of signature, especially where returns have been filed electronically. Some tax software programs are unable to attach supplemental statements or documents to the tax return that is being electronically filed. The Treasury Department and the IRS are proposing to amend the current regulation to remove the signature requirement in Regulation 1.754-1(b)(1). The amended regulation will provide that a taxpayer making a Section 754 election must file a statement with its return that: (1) sets forth the name and address of the partnership making the section 754 election, and (2) contains a declaration that the partnership elects under Section 754 to apply the provisions of Section 734(b) and Section 743(b).

The second relief provision deals with the late filing of partnership tax returns. This past tax season was the first year in which partnership tax returns were due by the 15th day of the third month following the close of the taxable year. In previous years, the due date was the 15th day of the fourth month following the close of the taxable year. So for 2016 calendar-year partnership returns, the due date was March 15, 2017, rather than April 18, 2017 (April 15 was a Saturday and April 17 was a legal holiday in D.C.). In Notice 2017-47 [9/1/17], the IRS announced that it will grant relief from late-filing penalties for partnerships which began after December 31, 2015, under two options. First, the partnership filed the Form 1065, 1065-B, 8804, 8805, 5471, or other return required to be filed with the IRS and furnished copies (or Schedules K-1) to the partners by the date that would have been timely under Section 6072 before the law change. For example, a 2016 calendar partnership return must be filed by April 18, 2017, to qualify for relief under the first option. Second, the partnership filed Form 7004 to request an extension of time to file by the date that would have been timely before the law change (April 18, 2017, for 2016 calendar-year partnerships) and files the return with the IRS and furnishes copies (or Schedules K-1) to the partners by the fifteenth day of the ninth month after the close of the partnership's taxable year (September 15, 2017, for calendar-year partnerships).

REVIEW QUESTION AND SOLUTION

9. Regarding two partnership tax return relief rulings provided by the Treasury and IRS, **which one** of the following statements **is true**?

   a. Under the current rules, a Section 754 election must be signed by one of the partnership's partners.

   b. A partnership which files its 2016 tax return on May 1, 2017, is relieved from the late-filing penalty under a recent IRS relief ruling.

   c. The amended regulation would provide that partnerships making a Section 754 election would no longer be required to file a statement that includes the name and address of the partnership.

Solution

9. **"A" is the correct response**. Because the current rules governing Section 754 elections require a partner signature, unsigned elections received primarily with electronically-filed returns have been considered invalid by the IRS.

   "B" is an incorrect response. The relief applies only to tax returns or extensions filed before the former due date, which for 2016 returns would have been by April 18, 2017. Since the return was not filed until May 1, 2017, the relief ruling does not apply.

   "C" is an incorrect response. Although a signature is not required, a statement must be filed along with the election which includes the partnership's name and address as well as a declaration that the partnership elects under Section 754 to apply the provisions of Section 734(b) and Section 743(b). *REG-116256-17 and Notice 2017-47*.

SPECIAL TOPICS

COMPUTING GAIN (LOSS) ON THE SALE OF ONE'S HOME

This special topic reviews the basic rules of IRC Section 1001 for determining gain or loss on the sale of the taxpayer's home. We discuss the calculation of amount of realized, the selling expenses, and the items which enter into calculating the basis of the home that is sold. We also cover the application of the home-sale exclusion provision of IRC Section 121. Then we provide a court case where the Tax Court determines the proper amount of gain realized and recognized by the taxpayer from the sale of his home.

ITEM [16] BASIC REVIEW OF DETERMINING GAIN (LOSS) ON THE SALE OF YOUR HOME

Amount Realized

Section 1001 provides that realized gain (loss) from the sale or other disposition of property is the excess of the amount realized over the adjusted basis of the property (gain), or the excess of the adjusted basis of the property over the amount realized (loss). It states that generally, unless there are exceptions in the Code, the entire amount of the realized gain (loss) is recognized.

The amount realized equals the selling price of the home, less selling expenses. The selling price includes cash received, the fair market value of all other properties or services received, the value of any notes, mortgages, or other debts that the buyer agrees to assume as part of the sale, and any amount the seller receives for granting an option to buy the home, if the option was exercised. The following items are not considered part of the selling price: buyer payments for personal property, and employer payments or reimbursements.

Selling expenses include sales commissions, fees for a service that helped the seller sell his or her home, advertising fees, legal fees, and any points or other loan charges that the seller paid that normally would have been the buyer's responsibility. Any employer reimbursements reduce the amount of the selling expenses.

Initial Basis

The initial basis depends on how the taxpayer acquired the home. If he acquired the home through a fair market purchase, he includes the down payment, any amount that he borrowed to pay for the home (for example, first or second mortgages) and notes that he gave the seller to pay for the home. Also, any settlement fees or closing costs paid when he bought the home are added to the initial basis. However, financing-related costs (for example seller-paid points) are not added. The taxpayer increases the purchase price for any unreimbursed real estate taxes or other costs paid on behalf of the seller from whom he bought the home. If he acquired the home through inheritance, the initial basis generally is one of the following: the property's fair market value at the date of the decedent's death, or the fair market value on the alternate valuation date (six months after date of decedent's death, unless the property is distributed from the estate before that date). To use the alternate valuation date, the value of the gross estate must have decreased and the amount of estate and generation-skipping taxes imposed on the property included in the gross estate also must decrease. If he acquired the home as a gift, the initial basis depends on the donor's basis and the fair market value of the home at the time of the gift. If the fair market value of the home equals or exceeds its fair market value at the time of the gift, the taxpayer's basis is the donor's adjusted basis at the time of the gift. If the fair market value is less than the donor's adjusted basis at the time of the gift, the basis depends on whether there is a gain or loss when the taxpayer disposes of the property. If he sells the home later for an amount that is more than the donor's basis, he uses the donor's basis to compute the gain. If the taxpayer sells the home later for less than the fair market value at the time of the gift, he uses the fair market value of the home on the gift date to compute the amount of the loss. If he sells the home later for an amount between the donor's basis and a lower fair market value on the gift date, there is no gain or loss.

Adjusted Basis

There are several items that increase or decrease the initial basis. Any amounts that the taxpayer spends on construction, renovation, or other improvements that are still part of the home when he sells it are added to the initial basis – the costs of repairs and maintenance do not count. Any amounts the taxpayer spends to repair damage to the home increase the initial basis. Special assessments for local improvements, for example special tax or condominium association assessments that are not merely repairs and maintenance, increase the initial basis. The amount of any tax casualty loss deduction reduces the initial basis of the home. The casualty loss deduction is the lesser of the adjusted basis for the home at the time of the casualty, or the difference between the fair market of the home before and after the casualty, reduced by insurance recoveries received. If the home is converted in part or total to rental or business property, any depreciation taken on the home reduces the part of the basis of the home that is converted to rental or business use (such as the home office deduction). **Note:** For partial conversions, the home is viewed as two types of property: business or rental property, and personal-use principal residence.

Recognized Gain or Loss

Since a home not converted in part or whole to rental or business property is a personal-use asset, realized loss is not recognized. But, realized gain generally is recognized. However, under Section 121 part or all of realized gain may be excluded from the selling taxpayer's gross income. Joint filers may exclude up to $500,000 of gain, other filers $250,000, from gross income. The individual must have owned and used the home as the principal residence for at least two of the five years preceding the date of sale or exchange. Also, the seller must not have used the Section 121 exclusion for a disposition of the property during the two years preceding the date of sale. For taxpayers who do not meet the ownership and use tests, a partial or reduced exclusion may be available. For joint filers to be entitled to the maximum $500,000 exclusion, one of the spouses must meet the ownership test, both spouses must meet the use test, and neither spouse may have excluded gain on the sale or exchange of a residence within the two years preceding the year of sale or exchange. A married couple's exclusion is determined on an individual basis. So, as an example, if one spouse is eligible for the exclusion, but the other spouse had used it within the two years preceding the sale, the eligible spouse may take a maximum exclusion of $250,000. The Section 121 exclusion does not apply to a home acquired in a like-kind exchange if the taxpayer sells or exchanges the residence within five years after the acquisition. **Example:** Taxpayer exchanges a rental property for another rental property to which the Section 1031 like-kind exchange rules apply. He continues renting the replacement property for nine months, then converts it to his own personal use. Taxpayer can not use Section 121 to exclude gain on sale of the replacement property for another four years and three months.

ITEM [17] TAX COURT DETERMINES TAXPAYER'S GAIN ON SALE OF HIS PERSONAL RESIDENCE

In March 1993, the taxpayer and his parents bought a home in California. His parents paid $40,000 for their interest in the home. The taxpayer paid $234,312 though borrowing, with the loan being secured by a mortgage on the property. The taxpayer resided on the property until at least August 2007. During 2002 the taxpayer built a swimming pool on the property, and converted a detached garage into a game room. In April 2003, his parents gifted their interest in the property to the taxpayer. On several occasions before August 2007, the taxpayer refinanced his mortgage loan on the property. During 2007, he was unable to make certain loan payments that came due on the property. To avoid foreclosure, he sold the property to his parents. To finance the purchase, his parents borrowed $682,500, using most of those funds to discharge $505,753 and $158,295 of two loan balances the taxpayer had outstanding with respect to the home. The closing statement showed his parents agreed to $975,000 of total consideration, and that the taxpayer was making a gift to his parents. The taxpayer's closing statement showed that the taxpayer incurred $16,751 of settlement charges. The non-penalty issue in Fiscalini [8/24/17] was whether the taxpayer was required to recognize long-term capital gain from the sale of his personal residence. The taxpayer argued he was required to recognize $70,487 of gain, the IRS $473,537. The Tax Court addressed the two parts of IRC Section 1001 to calculate gain: amount realized and adjusted basis for the property. The court ruled that his adjusted basis of $274,312 was comprised of the following: (1) $40,000 basis the parents paid initially for their share of the property, which they later gifted the taxpayer – a carryover basis from the parents' gift; and, (2) $234,312 that the taxpayer paid for his share of the home when his parents and he acquired it. The court rejected the taxpayer's assertion that his basis should be increased by $50,000 that he claimed he incurred in building the swimming pool and converting the detached garage into a game room. It was unwilling to rely on the taxpayer's self-serving, uncorroborated, and general testimony regarding the $50,000 of costs. As to the amount that the taxpayer realized from the sale to his parents, the court ruled the amount was $647,297, comprised of the following: (1) $664,048 for the taxpayer's liabilities on the home that were discharged by his parents at sale; and, (2) a reduction for the $16,751 of the taxpayer's settlement costs at sale. The court noted that there was a part sale and part gift with respect to the property transferred to his parents, based on the $950,000 total consideration given by the taxpayer, and the $664,048 of amount realized on the sale. The court held that the taxpayer had $372,585 of long-term capital gain on the sale ($647,297 - $274,312), and he was required to recognize $122,585 of gain after taking into account the $250,000 exclusion for home sale gain under Section 121. **Note:** The court arrived at $372,585, a number that does not agree with its specification of $647,297 amount realized and $274,312 adjusted basis (a $400 difference).

HOME OFFICE DEDUCTION AND THE PRINCIPAL PLACE OF BUSINESS REQUIREMENT

Use of a principal residence for business purposes is still one of the best tax opportunities available under today's tax laws. Any time personal costs (such as home utilities and insurance costs) which have to be incurred anyway can be converted to deductible business expenses, the taxpayer receives a windfall tax savings. As more and more people work out of the home the importance of this deduction, particularly to self-employed taxpayers, will continue to rise. For self-employed taxpayers, home office deductions result in the reduction in both self-employment taxes and income taxes. Under Section 280A, a home office deduction requires that a **portion** of the residence be used **exclusively** on a **regular** basis either as (1) the principal place of business for any trade or business, (2) a place of business which is used by patients, clients, or customers in meeting or dealing with the taxpayer, or (3) a separate structure, which is not attached to the dwelling unit, in connection with the taxpayer's trade or business. We focus on the most common use in this Special Topic – the principal place of business requirement. The first section reviews the above three terms in bold while the second section discusses the business purpose requirement.

[ITEM 18] BASIC REVIEW OF THE TERMS PORTION, EXCLUSIVELY, AND REGULAR

Investment use of the home office does not qualify for a deduction, irrespective of the extent of the taxpayer's involvement in the investment activity. The home office use must relate to business. Before discussing the business requirement, the terms portion, exclusively, and regular are examined. The courts have given a literal interpretation to the term portion. Thus, the home office may be part of a larger room. However, that portion must be used exclusively for business purposes. The exclusivity requirement may be difficult to enforce. The Cook (1997 Tax Court) case demonstrates the importance of understanding the exclusivity test. The taxpayer was an attorney who, during all of 1991 and the first 5 months of 1992, conducted his law practice in his home. The taxpayer argued that 75% of the total floor space of the home was used for the law practice; however, the space was used only two-thirds of the time for the law practice. The remaining time was used by the taxpayer and his family as their residence for personal use. On the taxpayer's tax return, he claimed a home office deduction of 50% (75% x 2/3) of the home expenses. The Tax Court ruled that even though the taxpayer's business was conducted **exclusively** in his home, the portion of the home in which the business was conducted was **not exclusively** used for that purpose. Thus, the home office deduction was denied. Another case (Mullin, 2001 Tax Court) demonstrates that under certain circumstances, it is simply not possible to satisfy the exclusivity requirement. The taxpayer's apartment home was relatively small (approximately 400 square feet) and the only entryway opened into an open area that was furnished with at least a desk and a couch. Moving between the kitchen and bathroom required going through the dining area, the open area adjacent to the entryway, and the entryway. Given the size and layout of the taxpayer's apartment, the Tax Court concluded that no portion of it could have been used exclusively for business purposes. In Hamacher (1990 Tax Court), the taxpayer held that two business uses do not violate the exclusive use requirement. However, both business uses must qualify independently under the home office rules. With respect to the regular requirement, occasional or incidental business use will not qualify even if the room were not used for any other purpose.

[ITEM 19] BASIC REVIEW OF THE PRINCIPAL PLACE OF BUSINESS REQUIREMENT

Generally, a home office deduction is allowed if the home office is the principal place of business for at lease one trade or business. A home office qualifies as the taxpayer's principal place of business two ways – (1) under a facts and circumstances analysis it is the taxpayer's principal place of business, or (2) the office is used by the taxpayer to conduct administrative or management activities of a trade or business. For the latter, there must be no other fixed location of the trade or business where the taxpayer conducts **substantial** administrative or management activities of the trade or business. The fact that administrative or management activities connected with the taxpayer's trade or business, for example billing activities, are performed by others at other locations will not preclude the taxpayer's claiming a deduction for the home office as long as the taxpayer conducts his administrative duties at his home office. If the taxpayer conducts some administrative or management activities at a fixed location of the business outside the home, the taxpayer still will be eligible to claim a deduction as long as the administrative or management activities conducted at any fixed location of the business outside the home are not substantial. A taxpayer's eligibility to claim a home office deduction will not be affected by the fact that the taxpayer conducts substantial **non-administrative** or **non-management** business activities at a fixed location of the business outside the home, for example, meeting with, or providing services to, customers, clients, or patients at a fixed location of the business away from home. IRS Publication 587 provides several examples where the taxpayer is able to qualify the home as a principal place of business under the administrative or management activity functions. One example includes a self-employed anesthesiologist who spends a majority of his time at three local hospitals and conducts his administrative or management duties at home. One of the three hospitals provides him with a small shared office where he may conduct administrative or management activities. The IRS in the example indicates that his choice to use his home office instead of one provided by the hospital does not disqualify his home office as his principal place of business.

A 1998 Tax Court case (Genck, 1998 Tax Court) provides a good example of how taxpayers can qualify for a home office deduction under the facts and circumstances option if the taxpayer cannot meet the second alternative (administrative or management activities option). The taxpayer was a self-employed musician and band manager. She spent an average of 12 hours per week performing as the band's lead singer and spent an average of 30 hours per week managing the band out of her home office. Her office represented about 50% of the total space of the home and included a large studio and a smaller room adjacent to the studio. The studio contained recording equipment and computers. It also contained filing cabinets in which the band's contracts, sheet music, and supplies were stored. The smaller room contained a desk, a telephone, a couch, and a kitchenette. The following management activities were performed at her home office: (1) promoting the band through the distribution of advertising flyers which were designed on the office computers; (2) booking the band's performances and negotiating contracts with its clients; (3) maintaining files of the band's lyrics, music books, and audio and video demos; and, (4) hiring accompanying musicians, coordinating their stage apparel, and issuing their paychecks. The Tax Court found that the importance of, and the time spent on, the activities performed at the home office were sufficient to support its treatment as the taxpayer's principal place of business as manager of the band. The Tax Court was particularly persuaded by the fact that the taxpayer spent an average of 30 hours per week working in the home office.

For employees, an additional requirement is that the home office must be used for the convenience of the employer. A facts and circumstances analysis is employed in determining whether an employee's use of his/her home is for the employer's convenience. Key here is that it is the employer's convenience, not the employee's convenience, which must be demonstrated to satisfy this requirement. The employer does not have to require a home office. Rather, the employee must show that the employer does not provide a suitable place for conducting certain essential business activities. In Weissman (1984 2nd Circuit) a college professor was granted a home office deduction even though his employer provided him an office. The taxpayer was employed as a professor at a college where he shared an office on campus with several other professors. Although the office contained a sufficient number of desks, chairs, and cabinets, it had no typewriter and was not found to be a safe place for leaving research or teaching materials. The facts also indicated that the taxpayer was actively involved in scholarly research and spent about 80% of his work time at his home office where he pursued his research activities. The key to the court's decision was that the employer-provided office was not suitable for the employee to perform his duties adequately and, from a "practical necessity" standpoint, the taxpayer was required to maintain a home office. The Second Circuit stated: "This practical necessity negates any claim that the office was used as a matter of personal convenience rather than for the convenience of the employer. . . ." The maintenance of a home office was not a personal preference of the employee; it spared the employer the cost of providing a suitable private office and thereby served the convenience of the employer.

REVIEW QUESTIONS AND SOLUTIONS

10. Regarding the components in the determination of gain (loss) on a taxpayer's home, **which one**

of the following to the right of the component **has an effect** on the component?

a. Adjusted basis; casualty loss deduction.

b. Fair market value at date of decedent's death; amount realized.

c. Selling price; legal fees incurred in selling the home.

11. Regarding the rules governing the home office deduction, **which one** of the following scenarios **would qualify** for the home office deduction?

a. A taxpayer who uses his home office solely to (1) run his business, and (2) monitor his stocks that he occasionally buys and sells on a trading website.

b. A professor who uses his home office to prepare lectures and write exams. He also has an office at the university used solely by him to hold office hours to meet with his students and to meet with faculty members to discuss curriculum changes.

c. A doctor, who makes his rounds at three hospitals from 8:00 a.m. to 1:00 pm each work day and conducts his billing and other administrative duties at home.

Solutions

10. **"A" is the correct response**. A casualty loss deduction is one of the items that is taken into account in determining the taxpayer's adjusted basis for the home.

"B" is an incorrect response. The fair market value at the date of the decedent's death is a possible amount that one takes as the initial basis (not amount realized) of an inherited home.

"C" is an incorrect response. The "amount realized" from the sale of a home equals selling price less selling expenses. While legal fees incurred in selling the home increase selling expenses and reduce amount realized, they have no effect on selling price. *Special Topics – Basic Review of Determining Gain (Loss) on the Sale of Your Home*.

11. **"C" is the correct response**. This scenario is similar to one example provided in Publication 587 where an anesthesiologist who spends a majority of his time at three local hospitals and conducts his administrative or management duties at home qualified for the home office deduction.

"A" is an incorrect response. Investing, no matter how extensive, is not considered business use. Therefore, the exclusivity requirement is not met.

"B" is an incorrect response. In this scenario, the home office used by the professor fails the convenience of employer requirement as the employer has provided an office suitable for the duties of a professor. *Special Topics – Basic Review of the Terms Portion, Exclusively, and Regular, and Basic Review of the Principal Place of Business Requirement.*

[ITEM 20] AN ELITE POSSIBILITY

This edition of *An Elite Possibility* provides some observations of the proposed tax changes and some tax planning tips for December 2017. On the positive side, the proposed tax legislation reduces both individual income tax rates for most taxpayers and the corporate tax rates. On the negative side, there is a good chance that many individual income tax deductions and tax credits may be eliminated in 2018. It appears that taxpayers who itemize their deductions will benefit the least and even may have a higher tax bill in 2018 compared to 2017. This is due principally to the proposed repeals of the state tax deduction and the exemption deduction (currently $4,150 per exemption in 2018!). While the doubling of the standard deduction may offset most of the loss of the exemption deduction for many taxpayers claiming the standard deduction, there is no offset for taxpayers who claim itemized deductions. Consider the following three taxpayer scenarios – (1) a single taxpayer with an AGI of $100,000 and 1 exemption, (2) a married joint return taxpayer with $150,000 AGI and 4 exemptions, and, (3) a married joint return taxpayer with $250,000 AGI and 4 exemptions. Assume each taxpayer itemizes deductions. Their itemized deductions have been averaging 20% of AGI. Included in the deductions has been a state tax deduction averaging 6% of AGI. These percentages are well within the averages published by the IRS statistics division. Based on the above information, the tax liability was estimated for each taxpayer based on the proposed house tax bill and based on the current law using the 2018 inflation amounts . In each case, the taxpayer's tax liability increases under the proposed law as follows: (1) $1,034 ($15,650 vs. $14,616), a 7.1% increase; (2) $3,392 ($20,550 vs. $117,158), a 19.8% increase, and (3) $4,075 ($42,050 vs. $37,975), a 10.7% increase. **Note:** These examples may not reflect many taxpayers who itemize, but they do show that for some taxpayers who itemize, taxes will go up under the House proposal. For taxpayers with lower AGIs, the increase may not be as large as they may benefit from the additional $600 child credit per child.

Because of the tax rate deductions, two obvious planning opportunities for December 2017 for most taxpayers are to (1) delay the recognition of income, and (2) accelerate deductions. The January 2018 mortgage payment, which includes December 2017 interest, and year-end property taxes should be paid by the end of 2017. Taxpayers who make annual gifts to their church should consider making some or all of their 2018 annual contribution in 2017. Taxpayers should examine the deductions, income exclusions, and tax credits that are expected to be repealed in 2018 and determine whether they can take advantage of these provisions in 2017. For example, for taxpayers claiming medical expenses this year, they should consider getting a physical and their teeth cleaned before year end, prepay prescription drugs, and pay all of their outstanding medical bills before the end of the year. Taxpayers who may be moving in the next several weeks for job reasons should attempt to complete their move before year end. For taxpayers operating their business as a C Corporation, the corporate tax rate reduction offers the same general tax planning opportunities as in the case of the tax rate reduction for individuals – (1) delay the recognition of income, and (2) accelerate deductions. This assumes that the rate reduction will be effective in 2018 rather than the 2019 taxable year proposed by the Senate. It should be an interesting year for tax professionals! Have a great 2018!

REVIEW QUESTION AND SOLUTION

12. Based on this issue's *Elite Possibility* which provides some observations of proposed tax reform and year-end tax planning, **which one** of the following statements **is true**?

    a. Taxpayers who generally claim itemized deductions are more likely to benefit from the House tax proposal than taxpayers who claim the standard deduction.

    b. Taxpayers who operate their business in a C Corporation should accelerate 2018 income into 2017.

    c. If feasible, taxpayers who will be moving for business purposes in the next few weeks should complete their move prior to the end of 2017.

Solution

12. **"C" is the correct response**. Under the House bill, the deduction for moving expenses would be repealed in 2018 so the costs of the move should be incurred in 2017.

    "A" is an incorrect response. Everything else being equal, the repeal of the exemption deduction will cost more in terms of lost tax benefits for taxpayers who itemize than taxpayers who claim the standard deduction. The doubling of the standard deduction offsets all or part of the lost exemption deduction depending on the number of exemptions claimed by the taxpayer. There is no such offset for taxpayers who itemize.

    "B" is an incorrect response. Because C Corporation income tax rates in 2017 would be higher than 2018, corporate taxpayers should consider shifting income from 2017 to 2018, not the other way around. *Tax Cuts and Job Acts and An Elite Possibility.*

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

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

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1. Based on recent tax reform proposals in Congress, **which one** of the following statements **is false**?

   a. The standard deduction in 2018 for single taxpayers would be $12,200.

   b. The mortgage interest deduction would be repealed for married joint return taxpayers with AGIs exceeding $500,000.

   c. The deduction for moving expense would be repealed.

2. Based on Item # 2 regarding the inflation-adjusted amounts for 2018, **which one** of the following statements **is true**? Disregard potential changes from pending legislation summarized in Item #1.

   a. The additional standard deduction for age and blindness is $1,600 for married taxpayers.

   b. The maximum earned income tax credit for two qualifying children is $6,444.

   c. The annual gift exclusion amount for 2018 increases $1,000 from the 2017 amount.

3. Regarding 2018 retirement plan limitations, **which one** of the following statements **is true**?

   a. The maximum annual benefit amount under defined benefits plans in 2018 is $220,000.

   b. The AGI limitation for determining the maximum deductible IRA contribution for single taxpayers who are active retirement plan participants increases $2,000 in 2018 from 2017.

   c. The AGI limitation for determining the maximum Roth IRA contribution for single taxpayers is $189,000 for 2018.

4. For 2017 - 2018, under the high-low method how much is the per diem rate for travel to any non-"high-cost" locality within the continental United States?

   a. $189.
   b. $191.
   c. $284.

5. For a recent IRS ruling on leave-based donation programs to aid victims of Hurricane and Tropical Storm Maria, **which one** of the following responses **is false**?

   a. The payments must be made before January 1, 2019.

   b. The cash payments are not gross income for affected employees.

   c. The employer deducts cash payments under the program as a charitable contribution deduction.

6. Regarding taxable earnings for Social Security purposes, **which one** of the following statements **is false**?

   a. The maximum taxable earnings for Social Security taxes in 2018 increases $1,500 from 2017.

   b. The maximum taxable earnings for Social Security taxes in 2018 is $127,200.

   c. The domestic employee coverage threshold in 2018 increases $100 from 2017.

7. In a recent court case dealing with the income exclusion provision applicable to ministers, **which one** of the following statements **is false**?

    a. The income exclusion applicable to the rental allowance under Section 107(2) is limited to the fair rental value of the home, including and furnishings and appurtenances.

    b. The District Court ruled that Section 107(2) violates the establishment clause of the First Amendment of the constitution.

    c. The District Court acknowledged that the rental allowance provided to the minister was for the convenience of the employer.

8. In a recent court case involving the advance premium tax credit, **which one** of the following statements **was a major factor** in the court's reaching its decision?

    a. The couple's household income for the year exceeded 400% of the Federal poverty line.

    b. At the time the taxpayers enrolled in the health plan, they intentionally understated their household income.

    c. The health exchange responded in a timely manner and recommended that the taxpayers choose a lower-cost health plan.

9. For a recent case for a Canadian citizen's receiving unemployment compensation from the state of Ohio, **which one** of the following responses **is true**?

    a. The taxpayer's unemployment compensation was not taxable either in the US or Canada.

    b. The taxpayer was not a US lawful permanent resident.

    c. The Tax Court stated that the US/Canada treaty was specific about whether unemployment compensation received from the US by a Canadian citizen is to be taxed by the US.

10. For a recent case in which a married taxpayer filed in error as a single taxpayer, **which one** of the following responses **is false**?

    a. The court decided that the taxpayer and his wife were not permitted to file a joint return.

    b. The IRS argued that the election to change to a joint return was not filed timely.

    c. The IRS argued that the taxpayer's election to file a joint return was barred because the taxpayer received a notice of deficiency from the IRS and then filed a petition with the Tax Court before filing a joint return.

11. Assume a single taxpayer files her 2016 tax return extension on April 15, 2017 and includes a $2,000 tax payment. Her other tax payments for her 2016 income taxes were made in 2016. The taxpayer failed to file her 2016 tax return in a timely manner. In early 2019, she begins to work on her 2016 tax return and believes she has overpaid her taxes by $1,500. Assuming she has not received a tax deficiency notice from the IRS for her 2016 taxable year, by what date must she file a refund claim for the $1,500 overpayment?

    a. April 15, 2019.
    b. December 31, 2019.
    c. April 15, 2020.

12. For a recent case on the investment income for a Section 501(c)(7) organization, **which one** of the following responses **is true**?

    a. The Tax Court agreed with the IRS that the social club did not intend to profit from its nonmember sales.

    b. The Tax Court decided that the social club could offset its investment income with losses relating to its nonmember sales

    c. The Tax Court agreed with the social club that the not-for-profit regulations under Section 183 applied to determine if the social club intended to profit from its nonmember sales.

13. With respect to a contemporaneous written acknowledgment (CWA) and a recent Tax Court case dealing with an LLC's facade easement donation to a qualified charitable organization, **which one** of the following statements **is false**?

    a. The court found that a letter three years after the donation from the charity to the LLC stating no goods or services had been provided in consideration of the donation was not contemporaneous.

    b. At the time of the donation, the charity provided a statement to the donor that no goods or services were provided to the donor as a result of the donation.

    c. The court stated that a CWA does not need to take any particular form.

14. Based on a TIGTA report which reported IRS examination rates for FY 2016, **which one** of the following statements **is true**?

    a. The decline in "correspondence" examinations of individual income tax returns was higher in percentage terms than the decline in field examinations

    b. The lowest audit rates for entities during FY 2016 were for S Corporation returns.

    c. Tax return examinations for individuals with incomes exceeding $1,000,000 in FY 2016 experienced the largest decline from the previous year.

15. With respect to two partnership tax return relief rulings provided by the Treasury and IRS, **which one** of the following statements **is false**?

    a. The proposed regulations no longer require a partner to sign a Section 754 election which is included with the partnership's year-end tax return.

    b. A partnership which filed its 2016 calendar-year partnership tax return after March 15, 2017, but before April 18, 2017, will not be subject to a late-filing penalty.

    c. A partnership which filed a Form 7004 extension for its 2016 calendar-year partnership tax return after March 15, 2017, but before April 18, 2017, is not eligible for relief of the late filing penalty even if the return was filed on or before September 15, 2017.

16. A taxpayer sells his home for $200,000 cash and assumption by the buyer of a mortgage on the home that has a $250,000 principal balance. The taxpayer paid $1,500 of advertising fees, $2,500 of legal fees, and $2,000 of points that are the buyer's responsibility but are paid by the taxpayer. The taxpayer's basis in his home at sale is $150,000. Without regard to Section 121, how much is the taxpayer's recognized gain (loss) on the sale of the home?

    a. $94,000.
    b. $294,000.
    c. $296,000.

17. Husband, wife, and their daughter together buy a home that the daughter will use her principal residence. Her parents pay $50,000 in cash toward the purchase, and the daughter pays $250,000 through borrowing. A few years later her parents give their interest in the home to their daughter. Six years later when the daughter's borrowing on the home totals $350,000, she sells the home to her parents for $600,000 which discharges the full debt on the home at the time of purchase. The daughter incurred $20,000 of settlement charges as reflected on the closing statement for the sale. Based on a recent Tax Court decision, how much is the daughter's gain recognized on the sale of her residence to her parents assuming the requirements for Section 121 were satisfied?

    a. $30,000.
    b. $50,000.
    c. $80,000.

18. Regarding the terms "portion" and "exclusively" as they apply to the home office deduction, **which one** of the following statements **is true**?

    a. If the portion of the room designated as the home office area is used 80% of the time for business purposes and 20% for personal purposes, 80% of the home-related expenses qualify for a home office deduction.

    b. If a taxpayer uses his home office for two businesses, the exclusive use test according to the Tax Court requires only one of the businesses to qualify for the home office deduction.

    c. The courts have applied a literal interpretation of the term portion – that is, the home office does not have to be in a separate room.

19. Regarding the principal place of business requirement as it apples to the home office deduction, **which one** of the following statements **is false**?

    a. If the taxpayer's home office is used by the taxpayer to conduct substantial administrative and or management activities of the taxpayer's trade or business, the principal place of business requirement is satisfied.

    b. If the taxpayer conducts substantial non-administrative or non-management activities at a fixed location outside the home, the home cannot satisfy the principal place of business requirement.

    c. If an employee uses an office in his home for employment purposes, the home office must be used for the convenience of the employer.

20. Based on the current tax proposals on Congress, **which one** of the following **would not** be an effective tax planning strategy for individual income taxpayers?

    a. Taxpayers who generally claim medical expenses should delay the payment of medical bills incurred in 2017 to 2018.

    b. Defer the recognition of income until 2018.

    c. Consider shifting some or all planned contributions in 2018 to 2017.

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QUIZ INSTRUCTIONS AND ANSWER SHEET – WINTER 2017, VOLUME XXVI, NUMBER 4, TAXATION
(***PLEASE RETURN NO LATER THAN JANUARY 31, 2018***)

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

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

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ANSWER SHEET
4 HOURS OF CPE: FEDERAL TAX LAW UPDATE
DELIVERY METHOD - SELF STUDY

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

CUSTOMERS
WITH ZIP CODES BELOW 56000

CPElite T.M.
P.O. Box 721
White Rock, SC 29177-0721

CUSTOMERS
WITH ZIP CODES ABOVE 55999

CPElite T.M.
P.O. Box 1059
Clemson, SC 29633-1059

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

COMPLETE FOR NEWSLETTER CREDIT

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

ADDRESS ____

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

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

SIGNATURE ____ **COMPLETION DATE** ___________________

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

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

NEWSLETTER EVALUATION (Answer Yes, No, or N/A)
1. The stated learning objective was met. _______ 2. Handout or advance preparation materials were satisfactory._______ 3. The materials were accurate._______ 4. The materials were relevant and contributed to the achievement of the learning objective._______ 5. If applicable, prerequisite requirements were appropriate.______ 6. The time allotted to the learning activity was appropriate._______7. Additional Comments
____

CPElite, T.M. Inc.
In a Class By Yourself T.M.
ORDER FORM

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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. **Please complete all 2017 material for CPE credit by January 31, 2018.** 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

Change Service Requested

COURSES – Field of Study: Federal Tax

[1] INCOME ITEMS AND PROPERTY TRANSACTIONS. Recommended CPE Credit: 6 HRS [B]

To provide an explanation of (1) selected income items affecting individual income taxpayers, including social security income, alimony, and scholarships, and (2) common property transactions involving individual income taxpayers, such as capital gains, sale of personal residence, and like-kind exchanges.

[2] ABOVE-THE-LINE DEDUCTIONS. Recommended CPE Credit: 6 HRS [B]

To provide an explanation of (1) expenses commonly deducted by Schedule C taxpayers, including travel, transportation, and home office deductions, and (2) and common above-the-line deductions.

[3] ITEMIZED DEDUCTIONS. Recommended CPE Credit: 6 HRS [B]

To provide an explanation of medical expenses, taxes, residence interest, charitable contributions, nonbusiness casualty and theft losses, miscellaneous itemized deductions, and the standard deduction.

[4] RATES, CREDITS AGAINST TAX, AND SPECIAL ISSUES. Recommended CPE Credit: 6 HRS [B]

To provide an explanation of the tax rate structure, selected credits (including the earned income tax credit and the education credits), estimated tax payments, and selected special issues (including filing status and exemptions).

[5] PARTNERSHIP TAXATION – PART I. Recommended CPE Credit: 6 HRS [B]

To provide an explanation of (1) the tax implications of formation, including gain or loss, basis of partnership interest, and basis of partnership assets after formation and (2) general reporting procedures of partnership items.

[6] PARTNERSHIP TAXATION – PART II. Recommended CPE Credit: 6 HRS [B]

To provide an explanation of the special topics involving partnership operations and the tax implications of sales of partnership interests, partnership distributions, and redemptions of a partner's interest.

[7] S CORPORATION TAXATION – PART I. Recommended CPE Credit: 6 HRS [B]

To provide an explanation of (1) considerations in being an S Corporation, (2) requirements and election to be an S Corporation, (3) elections and operations, (4) shareholder basis issues, and (5) reporting and compliance.

[8] S CORPORATION TAXATION – PART II. Recommended CPE Credit: 6 HRS [B]

To provide detailed coverage of S Corporation shareholder basis issues, and an explanation of loss limitation issues, distributions made by an S Corporation to its owners, and S Corporation shareholder changes and income taxes.