



THE ELITE QUARTERLY – Taxation

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Thank you for your ongoing support of *The Elite Quarterly*. We hope that you had a successful tax filing season. Many of you have renewed your newsletter subscriptions for 2019 – we thank you very much! Please refer to pages 22 and 23 for details of all of our subscription packages for 2019. Thank you for being a customer – we appreciate your business!

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Instructions, Content Level, & Learning Objectives

Read the content on pages 1-17, the exam questions on pages 18-20, and the exam instructions on page 21. Select the best answer for each exam question and record the answers either on the answer sheet on page 21 or online at www.cpelite.com. This edition of the Elite Quarterly addresses several recent IRS pronouncements issued in the beginning of 2019. We are also focusing on the Office of the Taxpayer Advocates Annual Report presented to Congress which highlights many of the challenges facing the IRS. Sweeping tax reform along with ongoing political gridlock are adding to an ever-expanding list of problems in need of solutions at the agency. A review of these current issues will aid practitioners in future proceedings with the Service. The content level for this course material is "Update" and field of study classification is "Taxation". A general understanding of federal income taxation is the prerequisite for this course. No advance preparation is required. The **Learning Objectives** for this course are:

1. Identify recent IRS pronouncements concerning penalty relief and issuance of tax guidance.
2. Recall the issues concerning the legality of PTIN fees imposed by the IRS.
3. Identify key planning considerations in divorce negotiations after passage of the TCJA.
4. Recall the most serious problems encountered by taxpayers as identified by the National Taxpayer Advocates report to Congress.
5. Recall penalties imposed for failure to file an FBAR.
6. Identify factors contributing to the early reduction of refunds and tax filings for 2019.

Key Terms in This Issue of THE ELITE QUARTERLY

[Item 2] **"FAVR" plan**: A "FAVR" plan reimburses employees through a combination of a mileage reimbursement and a monthly allowance. It covers fixed and variable expenses by employees that are using vehicles for business purposes.

[Item 4] **APA**: The Administrative Procedures Act prescribes procedural requirements that govern the rulemaking activities of administrative agencies, including the Internal Revenue Service.

[Item 6] **FAST Act**: The 2015 legislation entitled the *Fixing America's Surface Transportation Act*. A component of this legislation requires the US State Department to deny renewal of or even revoke the passports of individuals who the IRS identifies as having delinquent tax debts.

[Item 8] **Alimony Trust**: A legal arrangement where property, investments or equity from a business are transferred into a trust and income generated from the sources is used to pay alimony following the final settlement of a divorce or separation.

[Item 8] **QTIP Trust**: A Trust instrument often used in order to take advantage of the marital deduction and still control the

ultimate distribution of the assets at the death of the surviving spouse.

[Item 9] TAS: The Taxpayer Advocate Service is an independent organization within the IRS responsible for protecting taxpayers' rights under the *Taxpayer Bill of Rights*, assisting taxpayers resolve problems, and also recommend changes to prevent problems with the IRS.

[Item 9] OCC: The Office of Chief Counsel. The Chief Counsel is appointed by the President of the United States with the advice and consent of the U.S. Senate. As the chief legal advisor to the IRS Commissioner on all matters pertaining to the interpretation, administration and enforcement of the Internal Revenue Laws (as well as all other legal matters) the Chief Counsel provides legal guidance and interpretive advice to the IRS, Treasury and to taxpayers.

[Item 10] Retroactivity: Made effective as of a date prior to enactment, promulgation, or imposition.

[ITEM 1] Individual taxpayers receive relief from underpayment penalty

The IRS expressed recent concern that the updated withholding calculator it released back in February 2018 and the new Form W-4, Employee's Withholding Allowance Certificate, have not alleviated the problem of calculating tax withholding after enactment of the Tax Cuts and Jobs Act, P.L. 115-97. In response, the IRS issued relief from the penalty for underpayment of estimated income tax to individual taxpayers who have paid 85% of their 2018 tax liability with withholding and estimated tax payments. Details of this relief pronouncement are contained in IRS Notice 2019-11.

Under Sec. 6654(d)(1)(B), the required annual income tax payment an individual taxpayer is required to make is the lesser of (1) 90% of the tax shown on the return for the tax year or (2) 100% of the tax shown on the taxpayer's return for the preceding tax year (110% if the individual's adjusted gross income on the previous year's return exceeded \$150,000). Sec. 6654(a) imposes an addition to tax for failure to make a sufficient and timely payment of estimated income tax. The IRS, however, is entitled to waive this addition to tax in certain unusual circumstances if its imposition would be against equity and good conscience.

Accordingly, under Sec. 6654(e)(3)(A), the IRS is waiving the Sec. 6654 addition to tax for failure to make estimated income tax payments for the 2018 tax year otherwise

required to be made on or before Jan. 15, 2019, for any individual taxpayer whose total withholding and estimated tax payments made on or before Jan. 15, 2019, equal or exceed 85% of the tax shown on that individual's 2018 return. To request this waiver, an individual taxpayer must file Form 2210, Underpayment of Estimated Tax by Individuals, Estates, and Trusts, with his or her 2018 income tax return. The taxpayer will need check the waiver box in Part II, box A, of the form and include the statement "85% waiver" on the return. The IRS has indicated that this waiver computation will be integrated into commercially-available tax software and reflected in Form 2210 and instructions.

We will discuss the impact of these underpayments in greater detail during the latter half of this newsletter. Worth noting is the importance of communications with clients on relief provisions contained in this IRS notice. Additionally, practitioners need to work with their clients to be sure that 2019 withholdings are reviewed and adjustments made as needed. This holds particularly true for clients on extension to file their individual tax return. The prudent course of action is to review these calculations now and avoid catch up withholding's adjustments compressed during the late stages of the calendar year.

[ITEM 2] 2019 standard mileage rates announced

The IRS also issued the 2019 optional standard mileage rates used to calculate the deductible costs of operating an automobile for business, charitable, medical or moving purposes.

Beginning on Jan. 1, 2019, the standard mileage rates for the use of a car (including vans, pickups or panel trucks) will be:

58 cents per mile driven for business use, up 3.5 cents from the rate for 2018

20 cents per mile driven for medical or moving purposes, up 2 cents from the rate for 2018, and

14 cents per mile driven in service of charitable organizations. The charitable rate is set by statute and remains unchanged

The portion of the business standard mileage rate that is treated as depreciation will be 26 cents per mile for 2019, 1 cent more than 2018. Details in connection with this release are contained in IRS Notice 2019-02.

As we know, the TCJA suspended the miscellaneous itemized deduction under Sec. 67 for unreimbursed employee business expenses from 2018 to 2025, the notice

explains that the standard mileage rate cannot be used to claim a deduction for those expenses during that period.

However, an exception to that disallowance applies to members of a reserve component of the U.S. armed forces, state or local government officials paid on a fee basis, and certain performing artists. They are permitted to deduct mileage expenses on Form 1040, and may continue to use the 58 cents per mile business standard mileage rate.

The standard mileage rate also can be used under Rev. Proc. 2010-51 as the maximum amount an employer can reimburse an employee for operating an automobile for business purposes without substantiating the actual expense incurred.

Notice 2019-02 also provides the amount taxpayers must use in calculating reductions to basis for depreciation taken under the business standard mileage rate, and the maximum standard automobile cost that may be used in computing the allowance under a fixed and variable rate (FAVR) plan. A “FAVR” plan reimburses employees through a combination of a mileage reimbursement and a

monthly allowance. It covers fixed and variable expenses by employees that are using vehicles for business purposes.

Fixed costs include things like insurance, taxes and registration fees. Variable costs include expenses like oil, maintenance, and fuel to name a few. All mobile employees need gas for their cars. But, your employees in New York are paying more for it than employees in Nebraska. As such, A FAVR Plan may allow businesses to provide a more accurate reimbursement with a team that’s distributed across many states.

To compute the allowance under this type of plan, the maximum standard automobile cost is \$50,400 for 2019 for all automobiles (including trucks and vans), an increase of \$400 from 2018. The FAVR amounts were recalculated last year after the TCJA retroactively amended the bonus depreciation rules.

[ITEM 3] Court upholds IRS PTIN fees

The IRS PTIN user fee saga has taken yet another turn. This never-ending tale started back in 2010 when the IRS required all paid tax preparers to obtain and use a PTIN. Since then, numerous legal actions, decisions and reversals have been passed down. Fast forward to March 2019 whereby a federal appeals court decided in the IRS’s favor, paving the way for the agency to reinstate charges for obtaining and renewing a PTIN (Montrois, No. 17-5204 (D.C. Cir. 3/1/19)). The IRS stopped charging a user fee for PTINs in 2017, after it lost a case in federal district court (Steele, 260 F. Supp. 3d 52 (D.D.C. 2017)) that held the IRS had no authority to charge a fee to tax preparers to obtain PTINs.

At the time, the district court had agreed with the tax preparers who filed the suit (a class action on behalf of more than 700,000 tax return preparers) that the fee violates the Independent Offices Appropriations Act (IOAA) (31 U.S.C. §9701) and had found that “for an assessment to qualify as a fee under that Act as opposed to an unauthorized general tax, the assessment must relate to a specific benefit conferred to an identifiable set of users”. The district court agreed that the PTIN program did not confer a specific benefit on tax preparers and also rejected the IRS’s argument that the PTIN program provides a benefit to tax preparers by protecting their Social Security numbers (SSNs) from identity theft. The IRS appealed the lower court’s decision.

The appeals court looked at each factor in turn and concluded that the IRS provided a specific service to tax return preparers in exchange for the PTIN fee because it required personnel and resources to generate a PTIN, thus providing PTINs was a service. The court found that the PTIN program conferred a specific benefit to preparers of being able to use a number other than a SSN on tax returns, which protected the confidentiality of the preparers’ SSNs. According to the court, although anyone can be a tax return preparer, so anyone in the public at large can request a PTIN, the service was bestowed on identifiable individuals — tax return preparers — and not the public at large.

The next issue was whether the IRS’s decision to continue charging the fee for the PTIN program after the court invalidated the registered tax return preparer program in Loving, 742 F.3d 1013 (D.C. Cir. 2014), was arbitrary and capricious. The appeals court found that the IRS decision to recover the substantial cost of providing PTINs and maintaining a database by charging tax return preparers a fee rather than obtaining funding for the program from the public was not arbitrary and capricious. The service of providing PTINs is distinct from the service involved in Loving, which was the registered tax return preparer program that was struck down.

Having upheld the IRS’s authority to require return preparers to obtain a PTIN and charge a fee, the court then discussed whether the fee the IRS charged was excessive. It noted at first that the IRS had lowered the fee from \$50 to \$33 (plus

a separate processing fee). The appeals court remanded the case to the district court to determine whether the fee is reasonable and complies with the Independent Offices Appropriations Act.

In summary the lower court's judgment is no longer valid. The Montrois decision provides the IRS a way forward to reinstate PTIN fees and deny any refund of previously paid PTIN fees.

[ITEM 4] Changes by Treasury Department - Tax Guidance

The Treasury Department and the IRS recently announced that they are making changes for issuing tax guidance, including adding a statement of good cause to temporary regulations and restricting notices of proposed regulations. According to the Treasury Department, the "Policy Statement on the Tax Regulatory Process," is intended to clarify and affirm the government's commitment to sound regulatory practices. It first reaffirms Treasury and the IRS's commitment to follow the notice-and-comment process in the Administrative Procedure Act (APA), even though interpretive rules are exempt from the APA's process.

As a result, the IRS will start including a statement of good cause when it issues temporary regulations. The APA allows government agencies to issue interim final rules that are effective immediately without notice and comment, if the agency finds that it has good cause to do so. In the past, Treasury and the IRS have interpreted the Code to allow them to issue temporary regulations that are effective immediately without a statement of good cause. From now on, temporary regulations will include a statement of good cause in the preamble.

This policy statement also addresses sub-regulatory guidance published in the Internal Revenue Bulletin, such as revenue

rulings, revenue procedures, notices, and announcements. The statement says that such sub-regulatory guidance "is not intended to affect taxpayer rights or obligations independent from underlying statutes or regulations . . . [and] does not have the force and effect of law." They will also not issue sub-regulatory guidance that would have the effect of modifying existing legislative rules or creating new legislative rules not addressed in existing regulations, "absent exceptional circumstances."

The IRS stated that it will limit its use of notices to announce its intent to issue proposed regulations. Such notices generally describe the scope and content of proposed regulations that the IRS intends to issue and sometimes allow taxpayers to rely on the notice when taking tax positions on a return. However, if those proposed regulations are not issued promptly, the statement says that this "can cause confusion or uncertainty for taxpayers." To reduce this uncertainty, in future notices announcing the IRS's intent to issue proposed regulations, the IRS will include a statement saying that if the intended proposed regulations are not issued within 18 months of the date the notice is published, taxpayers may continue to rely on the notice, but, until additional guidance is issued, Treasury and the IRS "will not assert a position adverse to the taxpayer based in whole or in part on the notice."

[ITEM 5] Safe harbor method of accounting for passenger automobiles

Moving along with some additional pronouncements, the IRS has issued guidance providing practitioners with a safe harbor method for determining depreciation deductions for passenger automobiles that qualify for the 100-percent additional first year depreciation deduction and that are subject to the depreciation limitations for passenger automobiles (Rev. Proc. 2019-13) which became effective on February 13, 2019.

Under the Tax Cuts and Jobs Act (TCJA), the additional first year depreciation deduction applies to qualified property, including passenger automobiles, acquired and placed in service after September 27, 2017, and before January 1, 2027.

In general, the section 179 and depreciation deductions for passenger automobiles are subject to dollar limitations for the year the taxpayer places the passenger automobile in service and for each succeeding year. For a passenger automobile that qualifies for the 100-percent additional first year depreciation deduction, TCJA increased the first-year

limitation amount by \$8,000. If the depreciable basis of a passenger automobile for which the 100-percent additional first year depreciation deduction is allowable exceeds the first-year limitation, the excess amount is deductible in the first taxable year after the end of the recovery period.

To apply the safe-harbor method, the taxpayer must use the applicable depreciation table in Appendix A of IRS Publication 946 (updated on Feb 15, 2019). The safe harbor method does not apply to a passenger automobile placed in service by the taxpayer after 2022, or to a passenger automobile for which the taxpayer elected out of the 100-percent additional first year depreciation deduction or elected under section 179 to expense all or a portion of the cost of the passenger automobile.

This safe harbor method is employed by applying it to deduct depreciation of a passenger automobile on their return for the first taxable year following the placed-in-service year. The above referenced Rev. Proc. (2019-13) provides detailed examples and calculation of the application of the 280F(a)

safe harbor method including the impact of claiming a Section 179 expense along with the impact of not claiming the 100-

percent additional first year depreciation under Section 168(k)(7).

[ITEM 6] Passports guidelines for those who owe

Summer is just around the corner (thankfully!) and with it, increases in air travel. As such, we find it timely to share recent reminders issued by the IRS concerning taxpayers who may not be able to renew a current passport or obtain a new passport if they owe federal taxes.

In January 2018, the IRS began implementing new procedures affecting individuals with “seriously delinquent tax debts.” These new procedures implement provisions of the Fixing America’s Surface Transportation (FAST) Act. The law requires the IRS to notify the State Department of taxpayers the IRS has certified as owing a seriously delinquent tax debt (IRS Notice 2018-1). The FAST Act also requires the State Department to deny their passport application or deny renewal of their passport. In some cases, the State Department may revoke their passport.

Taxpayers affected by this law are those with a seriously delinquent tax debt. A taxpayer with a seriously delinquent tax debt is generally someone who owes the IRS more than \$52,000 in back taxes, penalties and interest for which the IRS has filed a Notice of Federal Tax Lien and the period to challenge it has expired or the IRS has issued a levy. Note that this figure is adjusted annually for inflation (\$52,000 is the figure for tax year 2019).

There are several ways taxpayers can avoid having the IRS notify the State Department of their seriously delinquent tax debt. They include the following:

- Paying the tax debt in full
- Paying the tax debt timely under an approved installment agreement,
- Paying the tax debt timely under an accepted offer in compromise,
- Paying the tax debt timely under the terms of a settlement agreement with the Department of Justice,
- Having requested or have a pending collection due process appeal with a levy, or

- Having collection suspended because a taxpayer has made an innocent spouse election or requested innocent spouse relief.

A passport won’t be at risk under this program for any taxpayer:

- Who is in bankruptcy
- Who is identified by the IRS as a victim of tax-related identity theft
- Whose account the IRS has determined is currently not collectible due to hardship
- Who is located within a federally declared disaster area
- Who has a request pending with the IRS for an installment agreement
- Who has a pending offer in compromise with the IRS
- Who has an IRS accepted adjustment that will satisfy the debt in full

For taxpayers serving in a combat zone who owe a seriously delinquent tax debt, the IRS postpones notifying the State Department and the individual’s passport is not subject to denial during this time.

- In general, taxpayers behind on their tax obligations should come forward and pay what they owe or enter into a payment plan with the IRS. Frequently, taxpayers qualify for one of several relief programs, including the following:
 - Taxpayers can request a payment agreement with the IRS by filing Form 9465. Taxpayers can download this form from IRS.gov and mail it along with a tax return, bill or notice. Some taxpayers can use the online payment agreement to set up a monthly payment agreement for up to 72 months.

We are hopeful that many of you do not have clients in this situation, but we are all familiar with the old adage, “An ounce of prevention.....”.

[ITEM 7] - Form 8995

The IRS on Friday posted a draft of a form that affected taxpayers will submit with their 2019 tax returns showing how they computed their qualified business income (QBI) deduction under Sec. 199A. Taxpayers who have QBI, qualified real estate investment trust (REIT) dividends, or qualified income from a publicly traded partnership (PTP) will use Form 8995,

Qualified Business Income Deduction Simplified Computation, to report the computation.

The one-page draft form contains the same computation that is found in the “2018 Qualified Business Income Deduction — Simplified Worksheet,” on p. 37 of this year’s instructions to

Form 1040, U.S. Individual Income Tax Return. However, the worksheet is retained by the taxpayer, while Form 8995 will be attached to the taxpayer's return and submitted to the IRS.

The form contains lines at the top for listing the name, taxpayer identification number, and QBI or loss for up to five trades or businesses. Note that the form does not help taxpayers compute their QBI. QBI from the taxpayer's trades or businesses is then totaled and combined with any QBI or loss from the prior year. The form also has separate lines for qualified REIT dividends and PTP income or loss, plus a separate line for the net capital gain limitation calculation.

Sec. 199A allows taxpayers to deduct up to 20% of QBI from a domestic business operated as a sole proprietorship or through a partnership, S corporation, trust, or estate and can be taken by individuals and by some estates and trusts. The deduction is not available for wage income or for business income earned through a C corporation.

The deduction is generally equal to the lesser of 20% of the taxpayer's QBI plus 20% of the taxpayer's qualified REIT dividends and qualified PTP income, or 20% of taxable income minus net capital gains. Deductions for taxpayers with taxable incomes above certain threshold amounts (which are adjusted annually for inflation) may be limited.

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

1. IRS Notice 2019-11 details relief from the penalty for underpayment of estimated income tax to individual taxpayers who have paid _____ of their tax liability with withholding and estimated tax payments
 - a. 85%
 - b. 90%
 - c. 110%

2. Beginning on Jan. 1, 2019, the standard mileage rates for the use of a car in service of a charitable organization (including vans, pickups or panel trucks) will be _____ cents per mile driven.
 - a. 58
 - b. 20
 - c. 14

3. Which of the following court cases involved the invalidation of the IRS Registered Tax Preparer Program?
 - a. Loving, 742 F.3d 1013 (D.C. Cir. 2014)
 - b. Steele, 260 F. Supp. 3d 52 (D.D.C. 2017)
 - c. Montrois, No. 17-5204 (D.C. Cir. 3/1/19)

4. According to the Tax Cuts and Jobs Act (TCJA), the additional first year depreciation deduction will apply to qualified property acquired and placed in service after _____.
 - a. January 1, 2018
 - b. February 13, 2019
 - c. September 27, 2017

5. In January 2018, the IRS began implementing new procedures affecting individuals with "seriously delinquent tax debts." These new procedures implement provisions of the Fixing America's Surface Transportation (FAST) Act. The law requires the IRS to notify the State Department of taxpayers the IRS has certified as owing a seriously delinquent tax debt (IRS Notice 2018-1). Which of the following actions DOES NOT represent a way in which taxpayers can avoid having the IRS send this notification to the State Department?
 - a. Submitting an Offer in Compromise to the IRS
 - b. Paying the tax debt in full
 - c. Having collection suspended because a taxpayer has made an innocent spouse election.

6. Which of the following is true regarding proposed tax form 8995, Qualified Business Income Deduction Simplified Computation?
 - a. This form should be used beginning with the 2018 tax returns.
 - b. This form does not help taxpayers to compute their Qualified Business Income.
 - c. This form should accompany "C Corporation" tax filings

Solutions

1. **"A" is the correct response.** To request this waiver, an individual taxpayer must file Form 2210, Underpayment of Estimated Tax by Individuals, Estates, and Trusts, with his or her 2018 income tax return.
"B" is an incorrect response. Under Sec. 6654(e)(3)(A), the IRS is waiving the Sec. 6654 addition to tax for failure

to make estimated income tax payments for the 2018 tax year otherwise required to be made on or before Jan. 15, 2019, for any individual taxpayer whose total withholding and estimated tax payments made on or before Jan. 15, 2019, equal or exceed 85% of the tax shown on that individual's 2018 return.

"C" is an incorrect response. Under Sec. 6654(d)(1)(B), the required annual income tax payment an individual taxpayer is required to make is the lesser of (1) 90% of the tax shown on the return for the tax year or (2) 100% of the tax shown on the taxpayer's return for the preceding tax year (110% if the individual's adjusted gross income on the previous year's return exceeded \$150,000). Under Sec. 6654(e)(3)(A), the IRS is waiving the Sec. 6654 addition to tax for failure to make estimated income tax payments for the 2018 tax year otherwise required to be made on or before Jan. 15, 2019, for any individual taxpayer whose total withholding and estimated tax payments made on or before Jan. 15, 2019, equal or exceed 85% of the tax shown on that individual's 2018 return.

2. **"A" is an incorrect response.** 58 cents per mile is the standard mileage rate for business use
"B" is an incorrect response. 20 cents per mile is the standard rate for medical or moving purposes
"C" is the correct response. The charitable rate is set by statute and remains unchanged
3. **"A" is the correct response.** The court in this case decided that the program was "arbitrary and capricious".
"B" is an incorrect response. The outcome of this case required that the IRS stop charging a user fee for PTINs in 2017 and held the IRS had no authority to charge a fee to tax preparers to obtain PTINs
"C" is an incorrect response. This 2019 federal appeals court case decided in the IRS's favor paving the way for the agency to reinstate charges for obtaining and renewing a PTIN.
4. **"A" is an incorrect response.** The additional first year depreciation deduction applies to qualified property, including passenger automobiles, acquired and placed in service after September 27, 2017, and before January 1, 2027.
"B" is an incorrect response. February 13, 2019 represents the effective date for Rev. Proc 2019-13, providing a safe harbor method for determining depreciation deductions for passenger automobiles that qualify for the 100-percent additional first year depreciation deduction and that are subject to the depreciation limitations for passenger automobiles.
"C" is the correct response. In general, the section 179 and depreciation deductions for passenger automobiles are subject to dollar limitations for the year the taxpayer places the passenger automobile in service and for each succeeding year.
5. **"A" is the correct response.** Taxpayers can avoid having the IRS notify the State Department if the taxpayer is paying the tax debt timely under an accepted Offer in Compromise.
"B" is an incorrect response. Additionally, taxpayers who are paying their tax debt timely under an approved installment agreement would also apply under IRS Notice 2018-01
"C" is an incorrect response. Taxpayers affected by this law are those with a seriously delinquent tax debt. A taxpayer with a seriously delinquent tax debt is generally someone who owes the IRS more than \$52,000 in back taxes, penalties and interest for which the IRS has filed a Notice of Federal Tax Lien and the period to challenge it has expired or the IRS has issued a levy.
6. **"A" is an incorrect response.** The IRS anticipates having Form 8995 available beginning with the 2019 tax year.
"B" is the correct response. This form will assist in aggregating Qualified Business Income from the taxpayer's trades or businesses, however it will not assist in the actual calculation of Qualified Business Income.
"C" is an incorrect response. Sec. 199A allows taxpayers to deduct up to 20% of QBI from a domestic business operated as a sole proprietorship or through a partnership, S corporation, trust, or estate and can be taken by individuals and by some estates and trusts. The deduction is not available for wage income or for business income earned through a C corporation.

[ITEM 8] - Divorce post-TCJA

Many areas of taxation were profoundly impacted with the passage of the Tax Cuts and Jobs Act. We'll take this opportunity to review one area in particular that deserves special attention. Divorce is a life altering decision fraught with personal and financial difficulties and much uncertainty. Taxpayers that are about to divorce their spouse will now face a series of important decisions to consider as a result of the elimination of deductible alimony post TCJA. We'll take this opportunity to review many of the key considerations, both direct and indirect, in connection with divorce. In many instances, the TCJA amendments will change long-time planning. Practitioners should be aware of what current plans

clients may have in place and whether the fundamentals of planning still apply.

The most obvious change of the TCJA is that alimony payments will not be deductible by the payer spouse but will also not be included in income of the payee ex-spouse. This rule applies to any divorce or separation instrument executed after Dec. 31, 2018, or for any divorce or separation instrument executed on or before Dec. 31, 2018, and modified after that date, and if the modification expressly provides that the TCJA amendments apply. Note that this change is permanent and will not sunset.

Practitioners determining the tax status of alimony payments should confirm the date of the divorce agreement, whether it was modified, and, if modified, whether the TCJA provisions apply. The clients divorce attorney should be consulted if there is any ambiguity as to whether a modification applied to the Tax Cuts and Jobs Act rules.

Under pre-TCJA law, until the end of 2018, an alimony trust could have been used in a divorce to minimize the interactions of the former spouses. If a family business was involved, the alimony trust could have been used to hold interests in the business to protect the business interest while securing the interests of the payee spouse. The TCJA prevents the prospective use of alimony trusts in divorces after 2018 — with the TCJA's repeal of Sec. 682, the spouse who creates the trust will be taxed on the income under the Sec. 672(e) grantor trust rules.

Many divorce settlement agreements included good-faith negotiated provisions specifying which ex-spouse would get to claim which children as exemptions and in which years. The TCJA has suspended personal exemptions for the foreseeable future (the elimination of these exemptions sunsets after Dec 31, 2025). Clients who had given up other items of value to claim exemptions under the divorce settlement will be dismayed to learn that the bargained-for benefit has evaporated. The tax benefit of pursuing a remedy to recover this lost benefit, in all likelihood, seems negligible.

Also, elevated estate and gift tax exemptions (\$11.4 million per individual in 2019) may lead some taxpayers to pass over true estate planning and simply rely upon overly simplistic wills. As such, divorce protection for heirs such as outright bequests to children may result in clients and heirs needlessly

exposing assets to divorce claims. Clients should meet with their advisors to consider which trust vehicles are suitable under these new rules. Trust instruments such as credit shelter trusts and QTIP's deserve a second review.

Negotiated divorce settlements may have included calculations based on tax rules formerly in place, however those assumptions are no longer valid. The deduction limitation on state and local taxes may adversely impact one of the parties. Additionally, property values may be impacted as a result of this lost deduction. The TCJA also introduces new deduction (20% 199A), however limitations may be in place depending if the taxpayer is in a specified service trade or business. The variations on this theme may seem endless, however a few key changes in the law may alter dollars between parties. This holds particularly true with negotiations currently in play.

In certain cases, taxpayers may wish to consult an attorney to reopen an existing divorce arrangement for changed circumstances. Would that succeed? If a prenuptial agreement already in place provides for a certain level of alimony (when it was anticipated it would be deductible under Sec. 215), would a court permit it to be modified now that, if the divorce occurs after 2018, it will no longer be deductible? It's too early to tell whether an impacted party can set aside a prenuptial or other marital agreement. The client might have to prove fraud, duress, overreaching, or unconscionability. Court cases are bound to appear in the near term to provide some guidance through precedent. Until then, it remains to be seen whether the new issues that arise by virtue of the TCJA will constitute enough of a change in circumstances or other basis to warrant a modification in court.

[ITEM 9] - National Taxpayer Advocate delivers annual report to Congress

Each year, as with the passing of the seasons, comes the Annual Report presented to Congress, which is issued by the Office of the Taxpayer Advocate. The Office of the Taxpayer Advocate, also called the Taxpayer Advocate Service (TAS), is an independent office within the IRS. It is under the supervision and direction of the Taxpayer Advocate who is appointed by and reports directly to the Commissioner of Internal Revenue. The office was created under the Taxpayer Bill of Rights 2, an act of the United States Congress which became law on July 30, 1996. The office replaced the previous Office of the Ombudsman within the IRS.

The current Taxpayer Advocate, Nina E. Olson, presented her report to Congress which described many of the ongoing challenges the IRS is facing as a result of the recent

government shutdown and recommending that Congress provide the IRS with additional multi-year funding to replace its core 1960s-era information technology systems. The release of the National Taxpayer Advocate's report was delayed by a month because of the government shutdown.

Olson also released the second edition of the National Taxpayer Advocate's "Purple Book," which presents 58 legislative recommendations designed to strengthen taxpayer rights and improve tax administration.

The largest section of the report, which identifies at least 20 of the most serious problems taxpayers face in their dealings with the IRS, is titled, "The Taxpayer's Journey," and is organized sequentially to track a taxpayer's interactions with

the tax system from start to finish. Among other issues, it addresses the ability of taxpayers to obtain answers to tax-law questions, return filing, notices, audits, collection actions and Tax Court litigation. The report also contains “road maps” – pictorial representations of the process.

In the preface to the report, Olson discusses the impact of the recent government shutdown. A major point of discussion before and during the shutdown was the permissible scope of IRS activities. Under the Anti-Deficiency Act, federal funds may not be spent in the absence of an appropriation except where otherwise provided by law. One exception provided by law is for “emergencies involving the safety of human life or the protection of property.” Although not stated in the law or Justice Department guidance, the IRS Office of Chief Counsel has interpreted the “protection of property” exception to apply only to the protection of government property – not a taxpayer’s property.

The report says this narrow interpretation can cause severe harm to taxpayers. When the IRS issues a levy to a bank, the bank must freeze the taxpayer’s account for 21 days, and then if the levy has not been released, the bank must turn the funds over to the IRS. The Internal Revenue Code requires the IRS to release a levy if it has determined the levy “is creating an economic hardship due to the financial condition of the taxpayer.” However, the IRS’s legal interpretation of the Anti-Deficiency Act would not permit personnel to be excepted to release levies even in extreme cases, such as where a taxpayer needs the levied funds “to pay for basic living expenses [or even] a life-saving operation,” Olson wrote.

The IRS’s Lapsed Appropriations Contingency Plans excepted employees of the Taxpayer Advocate Service (TAS) to open mail solely to search for checks payable to the government. The plans do not permit TAS employees to assist taxpayers experiencing an economic hardship.

“The IRS’s authority to collect revenue is not unconditional,” Olson wrote. “It is conditioned on statutory protections, and a lapse in appropriations does not eliminate those protections.” If the IRS does not change its interpretation of the Anti-Deficiency Act, the report recommends Congress amend the Act to ensure that taxpayer protections and rights enacted by Congress remain available when the IRS takes enforcement action against a taxpayer during, or has taken enforcement action just prior to, a shutdown.

The report says the shutdown has had a significant impact on IRS operations. The IRS opened the 2019 filing season immediately after the shutdown ended, and a comparison of IRS telephone service during the first week of the 2019 filing

season and the first week of the 2018 filing season shows taxpayers are having greater difficulty getting help this year. During the first week of the 2018 filing season, the IRS answered 86 percent of calls routed to an Accounts Management telephone assistant, and the average wait time was about four minutes. During the first week of this year’s filing season, the IRS answered only 48 percent of its calls, and the average wait time was 17 minutes.

Among taxpayers calling the Automated Collection System line, 65 percent got through and waited an average of 19 minutes last year. This year, only 38 percent of calls were answered, and the average wait time was 48 minutes.

Among callers seeking help on the IRS’s Installment Agreement/Balance Due telephone line, the IRS answered 58 percent of its calls with an average wait time of 30 minutes during the first week of the filing season last year. This year, the IRS answered only 7 percent of its calls, and taxpayers who got through had to wait an average of 81 minutes to speak with an assistant.

On a “dedication” page at the beginning of the report, Olson expressed her appreciation to the IRS workforce, including TAS employees. “Most IRS employees experienced financial challenges as a result of missing two pay checks,” she wrote. “Yet when the shutdown ended, IRS employees returned to work with energy and generally hit the ground running. The IRS faces many challenges as an agency – and this report documents many of them – but the dedication of the IRS workforce is a notable bright spot.”

Funding for IT modernization

The report’s #1 legislative recommendation is that Congress provide significantly more funding for the IRS to replace its antiquated core IT systems. The IRS systems that hold the official records of taxpayer accounts — the Individual Master File and the Business Master File — date to the 1960s and are the oldest major IT systems still in use in the federal government. In addition, taxpayer information is stored in over 60 separate case management systems that generally do not communicate with each other. There is no database that holds or provides a 360-degree view of the taxpayer’s account and interactions with the IRS. As a result, although the IRS is trying to create taxpayer-friendly online accounts, the report says the inability to pull data from a consolidated case management system poses a significant obstacle.

The report says the IRS does not have an enterprise case selection system, so it cannot be sure it is focusing on the right taxpayers or the right issues in its outreach, audit, and collection activities. A key measure of audit effectiveness is the “no change” rate, which reflects the percentage of audits

that do not change a taxpayer's liability for the year under audit. From FY 2010 through FY 2018, the report says, the average no change rate was 23 percent for field audits conducted by the Small Business/Self-Employed Division and 32 percent for field audits conducted by the Large Business and International Division. With better technology, the report says, the IRS audit functions could do a better job of selecting productive cases.

In 2018, the IRS experienced a system crash on the final day of the filing season, forcing it to extend the filing season by a day. The crash prompted talk of the risk of a catastrophic system collapse. "That risk does, indeed, exist," the report says. "But there is a greater risk: IRS performance already is significantly limited by its aging systems, and if those systems aren't replaced, the gap between what the IRS should be able to do and what the IRS is actually able to do will continue to increase in ways that don't garner headlines but increasingly harm taxpayers and impair revenue collection."

According to the report, the IRS is effectively the "accounts receivable department" of the federal government. In FY 2018, it collected nearly \$3.5 trillion on a budget of \$11.43 billion — a return on investment of about 300:1. Yet the report says funding for IRS technology upgrades — provided through the Business Systems Modernization (BSM) account — has been very limited in both absolute and relative terms. BSM funding was reduced by 62 percent from FY 2017 (\$290 million) to FY 2018 (\$110 million) and constituted just one percent of the agency's overall appropriation in FY 2018.

The report says congressional funding for the BSM account has been limited in part because the IRS historically has not done an effective job of planning and executing technology upgrades. To address that concern, the report recommends that additional funding be provided, subject to accountability measures. Specifically, Olson recommends that Congress provide the IRS with additional dedicated, multi-year funding to replace its core IT systems pursuant to a plan that sets forth specific goals and metrics and is evaluated annually by an independent third party.

Other major issues addressed

Federal law requires the Annual Report to Congress to identify at least 20 of the "most serious problems" encountered by taxpayers and to make administrative and legislative recommendations to mitigate those problems. Overall, this year's report identifies 20 problems, makes dozens of recommendations for administrative change, makes 10 recommendations for legislative change, analyzes the 10 tax issues most frequently litigated in the federal courts, and presents six research studies and one literature review.

The most serious problems encountered by taxpayers per the report include:

- 1) **Tax Law Questions**: The IRS's failure to answer the right tax law questions at the right time harms taxpayers, erodes taxpayer rights, and undermines confidence in the IRS.
- 2) **Transparency of the office of Chief Counsel**: Counsel is keeping more of its analysis secret, just when taxpayers need guidance more than ever
- 3) **Navigating the IRS**: Taxpayers have difficulty navigating the IRS, reaching the right personnel to resolve their tax issues, and holding IRS employees accountable
- 4) **Free File**: The IRS's free file offerings are underutilized, and the IRS has failed to set standards for Improvement
- 5) **False Positive Rates**: The IRS's fraud detection systems are marred by high false positive rates, long processing times, and unwieldy processes which continue to plague the IRS and harm legitimate taxpayers
- 6) **Improper earned income tax credit payments**: Measures the IRS takes to reduce improper earned income tax credit payments are not sufficiently proactive and may unnecessarily burden taxpayers
- 7) **Return Preparer Oversight**: The IRS lacks a coordinated approach to its oversight of return preparers and does not analyze the impact of penalties imposed on preparers
- 8) **Correspondence examination**: The IRS's correspondence examination procedures burden taxpayers and are not effective in educating the taxpayer and promoting future voluntary compliance
- 9) **Field Examination**: The IRS's field examination program burdens taxpayers and yields high no change rates, which waste IRS resources and may discourage voluntary compliance
- 10) **Office examination**: The IRS does not know whether its office examination program increases voluntary compliance or educates the audited taxpayers about how to comply in the future
- 11) **Post Processing math error authority**: The IRS has failed to exercise self-restraint in its use of math error authority, thereby harming taxpayers
- 12) **Math errors notice**: Although the IRS has made some improvements, math error notices continue to be unclear and confusing, thereby undermining taxpayer rights and increasing taxpayer burden
- 13) **Statutory notices of deficiency**: The IRS fails to clearly convey critical information in statutory notices of deficiency, making it difficult for taxpayers to understand and exercise their rights, thereby diminishing customer service quality, eroding voluntary compliance, and impeding case resolution
- 14) **Collection due process notices**: Despite recent changes to collection due process notices, taxpayers are still at

risk for not understanding important procedures and deadlines, thereby missing their right to an independent hearing and tax court review

- 15) Economic Hardship: The IRS does not proactively use internal data to identify taxpayers at risk of economic hardship throughout the collection process
- 16) Field Collection: The IRS has not appropriately staffed and trained its field collection function to minimize taxpayer burden and ensure taxpayer rights are protected
- 17) IRS's automated collection system (ACS): ACS lacks a taxpayer centered approach, resulting in a challenging taxpayer experience and generating less than optimal collection outcomes for the IRS
- 18) Offer in Compromise: Policy changes made by the IRS to the offer in compromise program make it more difficult for taxpayers to submit acceptable offers
- 19) Private debt collection: The IRS's expanding private debt collection program continues to burden taxpayers who are likely experiencing economic hardship while inactive PCA inventory accumulates
- 20) Pre-Trial Settlements in the U.S. Tax court: Insufficient access to available pro bono assistance resources impedes unrepresented taxpayers from reaching a pre-trial settlement and achieving a favorable outcome

The report contains details for each of the 20 issues listed above. Details on some noteworthy line items include:

Tax Law Questions.

In 2014, the IRS implemented a policy to only answer tax law questions during the filing season, roughly from January through mid-April of any year. It justified this abrupt change in policy as a cost savings effort in a time of budget constraints. This change does not comport with an agency charged with administering the tax law and focused on the customer experience. Taxpayers have ever-changing tax situations year-round. People move, open a business, close a business, get married, get divorced, have children, and experience many other life changes that affect their tax obligations. Forcing taxpayers into a 3.5-month window to ask questions or making it necessary for them to seek advice from a third-party source can be frustrating and costly to the taxpayer and result in eroded trust and confidence in the IRS.

The IRS designates certain tax law topics as out-of-scope, meaning it does not provide answers to taxpayers who call or visit the IRS inquiring about those issues. The IRS does not track what taxpayers ask about if the topic is out-of-scope. Failing to do so limits the ability of the IRS to determine if there is sufficient demand for information about a topic to consider declaring the topic in-scope. Providing taxpayers timely and accurate answers to their tax law questions is

crucial to helping taxpayers understand and meet their tax obligations and is fundamental to the right to be informed. If a taxpayer cannot find answers from the IRS, it undermines all taxpayer rights. Testing by TAS in spring and fall of 2018 revealed inconsistent service by the IRS in answering tax law questions on the phone. Despite assurances from the IRS that it would answer Tax Cuts and Jobs Act questions year-round, TAS test calls revealed that employees were not able to answer even basic questions about the new tax law. The IRS has many tools available to meet the needs of taxpayers and ensure that taxpayers can find the assistance they need promptly. By meeting taxpayers where they are, whether on the phone or online, more taxpayers will be able to get answers to their tax law questions.

The National Taxpayer Advocate recommended that the IRS answer in-scope tax law questions year-round; deem all questions related to the new tax law as in-scope for a reasonable period of at least two years and evaluate taxpayer demand prior to declaring topics out of scope; track calls and contacts about out-of-scope topics and develop Individual Tax Law Assistant scripts for frequently asked questions or consider declaring topics in-scope; and develop a method to respond to uncommon or complex questions (i.e., those that are out-of-scope for the phones and TACs) via email or call back to the taxpayer, such as using Artificial Intelligence and pattern recognition technology and regularly publish these answers online for the general public.

Transparency of the Office of Chief Counsel.

The IRS Office of Chief Counsel (OCC) provides advice to headquarters employees called Program Manager Technical Advice (PMTA(s)). PMTAs must be disclosed to the public pursuant to a settlement with Tax Analysts. Due to the Tax Cuts and Jobs Act (TCJA), taxpayers need prompt guidance now more than ever. Notwithstanding their increased need to for guidance, the OCC (1) has been disclosing fewer PMTAs, (2) allows its attorneys to avoid disclosure by issuing advice as an email, rather than a memo; (3) has not issued written guidance to its attorneys describing what must be disclosed as PMTA; and (4) has no systems to ensure all PMTAs are timely identified, processed as PMTAs, and disclosed.

The right to be informed is the first right listed in the Taxpayer Bill of Rights for good reason. If taxpayers do not know the rules and why the IRS has adopted them, they cannot determine if they should exercise their other rights (e.g., the right to challenge the IRS's position and be heard or the right to appeal an IRS decision in an independent forum). Information about how the OCC interprets the law also helps them avoid taking positions that would incur penalties or ensnare them in audits or litigation. In its formal response to TAS, however, the OCC does not acknowledge that a

function of its advice is “to inform taxpayers or practitioners about how it interprets the law,” and says its failure to do so “is not a problem that taxpayers have” and “is not a serious problem encountered by taxpayers.” Accordingly, it has declined to specify in writing what advice must be disclosed as PMTA, except to say that documents other than memoranda (e.g., email) need not be disclosed. It also has no procedures to ensure PMTAs are timely identified. The results are predictable. Although it released 68 PMTA following tax law changes in 1998, it has released only 11 in 2018, only one of these related to the TCJA, and it was released only because of a request by the IRS, not because of the settlement with Tax Analysts.

The National Taxpayer Advocate recommended that the OCC should develop clear written guidance that defines when advice constitutes PMTA that must be disclosed; it should not withhold advice based on its form (e.g., email); and it should establish a process to ensure advice that should be disclosed as PMTA is being identified and disclosed in a timely manner.

Correspondence Examination.

IRS correspondence audits may involve complicated rules and procedures, or complicated fact situations, or both as in the case of the Earned Income Tax Credit (EITC). Taxpayers in correspondence exams may suffer greater burden because of the difficulty of sending and receiving correspondence (including having it considered at the right time); the lack of clarity in IRS correspondence; and the lack of a single employee assigned to the taxpayer’s case. Correspondence examiners do not receive sufficient training on complex issues, and IRS correspondence exam measures do not adequately consider taxpayer needs and preferences. These problems are exacerbated when the audited taxpayer is low income or has limited English proficiency, or when there are other impediments that hinder communication during the audit.

In fiscal year (FY) 2017, the IRS audited almost 1.1 million tax returns (including business and individual returns), approximately 0.5 percent of all returns received that year. During FY 2017, the IRS conducted approximately 71 percent of all audits (business and individual) by correspondence. For FY 2018 correspondence audits, the IRS took more than 65 days to respond to the majority of taxpayer replies in refundable credit cases. During FY 2018, Small Business/Self-Employed (SB/SE) division exam employees answered the exam phone only about 35 percent of the time. An examination is primarily an education vehicle, so the taxpayer learns the rules, corrects mistakes, and can comply in the future. In fact, the IRS gains about twice as much from the long-term effects of an audit than it does from the actual audit itself. Yet, a significant number of correspondence

audits—about 42 percent— were closed with no personal contact in FY 2018. IRS correspondence and forms are inadequate to inform and educate taxpayers, and they fail to include contact information for the employee who reviewed the taxpayer’s reply. The measures for correspondence exams are inadequate to determine whether the IRS is choosing the best cases to audit, educating the taxpayer, and increasing future compliance.

The National Taxpayer Advocate recommended the IRS require at least one personal contact between an IRS employee and the taxpayer before closing a correspondence exam; measure taxpayers’ filing compliance following correspondence exams and apply this data to guide audit selection; continue to assign a single employee for a correspondence exam when the IRS receives a response from the taxpayer by phone or mail, and expand by retaining this employee as the single point of contact throughout the exam; place on outgoing taxpayer correspondence the name and telephone number of the tax examiner who reviewed the taxpayer’s correspondence where a tax examiner has reviewed and made a determination regarding that specific documentation; conduct surveys of taxpayers following correspondence examinations to gauge their understanding of the exam process and their attitudes towards the IRS and towards filing and paying taxes; collect data about which forms of taxpayers’ documentation were deemed insufficient in a correspondence exam and revise existing correspondence exam letters to better explain documentation requirements; and end the practice of using the combination letter and provide taxpayers with an initial contact prior to issuing the preliminary audit report.

Analysis

The report provided to Congress totals 96 pages, but one can glean from the narrative provided above that the problems are wide, deep and systemic. As expressed at the outset of this section, government shutdowns and antiquated information technology systems lead the discussion. Unfortunately, solutions come in the form of appropriations and legislative consensus. Given the hyper partisan climate in Washington, it’s hard to imagine that solutions to these concerns are forthcoming. In fact, we dare say that the problems will only grow worse.

A “modernization” of the IT system comes with a history of unsuccessful implementations, but also a bigger threat – cyber security. Identity theft is rampant and a huge concern at the IRS. Change from the current system must come but one can only imagine that this change will be slow. And will it be too slow to stay at pace with the rapid evolution of electronic fraud and those who continue to commit such acts?

Additionally, government shutdowns are becoming an all too frequent occurrence, with endless rounds of kicking the can down the road. Elected officials breeze over the real-life impact of these negotiations as “necessary tactics”. In the end, the true losers of all this jousting are taxpayers and we

the tax practitioners who must work tirelessly on their behalf given the current system in place.

[ITEM 10] - NC Department of Revenue v. The Kimberley Rice Kaestner 1992 Family Trust

Last year’s landmark decision in favor of the state in *South Dakota v. Wayfair, Inc.* is rippling through the courts and providing us with many opportunities to revisit current law. Case in point, the U.S. Supreme Court granted certiorari in *North Carolina Department of Revenue v. The Kimberley Rice Kaestner 1992 Family Trust*. This may prove to be the most important state tax taxation and trust case in decades. The problem in *Kaestner Trust* case is fairly straightforward: In which state is a trust subject to taxation? However, the question presented is more difficult, e.g., does the Due Process clause of the U.S. Constitution prohibit North Carolina from taxing the undistributed income of a New York trust based on a beneficiary’s residency in North Carolina? But the basic question is important and certain to force trustees to focus on state tax consequences.

the case by which many practitioners relied upon concerning state tax nexus issues.

Following the release of the *Kaestner Trust* decision, the U.S. Supreme Court issued its historic ruling in *South Dakota vs. Wayfair* allowing states to impose sales tax collection responsibilities upon certain remote internet sellers. In *Wayfair*, the Court overruled its earlier holding in *Quill* that the Commerce Clause prohibited states from taxing the activities of non-resident taxpayers unless those taxpayers had a physical presence in the state. The decision did not address *Quill*’s Due Process considerations, specifically whether remote internet sellers had sufficient “minimum contacts” with South Dakota to satisfy the Due Process “minimum contacts” nexus standard.

Case Facts

In 1992, settlor Joseph Lee Rice III established a trust with William B. Matteson as trustee. The situs of the trust was New York and none of the beneficiaries of the trust were North Carolina residents at that time. In 2002, the trust was divided into separate trusts for the benefit of each of the settlor’s three children, one of whom, Ms. Kimberly Rice Kaestner, was then a resident and domiciliary of North Carolina. All of the activities of administering the trust and the location where the trust’s assets were held occurred outside of North Carolina.

By granting certiorari in *Kaestner Trust*, the Court will effectively revisit *Quill*, this time addressing the state nexus standard under the Due Process clause. It is interesting that the Court decided to hear a state tax nexus case so soon after *Wayfair*, especially given that the Court has not heard a state “due process” tax nexus case since deciding *Quill* nearly 30 years ago.

In 2005, the trustee changed. The new trustee filed state tax returns in North Carolina for each of the tax years from 2005 through 2008. In 2009, the trust filed a refund claim for those same tax years claiming that, under the Due Process Clause of the U.S. Constitution, the trust did not have the requisite minimum contacts with the state to be subject to taxation. The North Carolina Department of Revenue denied the trust’s refund claim.

Practical considerations

Along with constitutional considerations, the Court’s acceptance of *Kaestner Trust* raises practical considerations for trustees of multistate trusts.

The case ultimately reached the North Carolina Supreme Court, which upheld a lower court and concluded that North Carolina’s taxation of the trust’s income was unconstitutional, primarily because the trust lacked sufficient contacts with North Carolina under both the Due Process Clause of the U.S. Constitution and the corresponding, similar Due Process Clause of the North Carolina Constitution. In reaching this conclusion, the North Carolina court relied on the U.S. Supreme Court’s 1992 opinion in *Quill Corp. v. North Dakota*;

Assume that the Court agrees with the North Carolina Supreme Court and finds that the taxation was unconstitutional. That decision is likely to come out after April 15. If a trust filed a tax return on time, the statute of limitations for various tax years might be running out. A trustee could lose an entire year of a state refund by waiting until after the case is decided. Should the trustee be filing protective refund claims in North Carolina (or other similar states) just in case the Court affirms the decision of the North Carolina Supreme Court?

On the other hand, what if the Court finds that the taxation was constitutional? Supreme Court decisions generally interpret the Constitution as it always has been, which raises the question of retroactivity. It is likely that many trusts with North Carolina beneficiaries have never filed North Carolina

state tax returns, relying upon existing interpretations of law. If a trust did not file a tax return and should have because of a new ruling by the Court, the statute of limitations never began running. That means that North Carolina could arguably assess taxes from these trusts for as long as a beneficiary was resident of the state.

If the tax preparers for those trusts concluded that North Carolina taxes did not apply and filed returns and paid taxes to other states, should the trustee be filing protective refund claims in those other states too as they try to assess the potential filing deficiency in North Carolina.

The stakeholders in this decision are many. In addition to trustees and beneficiaries holding their collective breath at

[ITEM 11] - Failure to file FBAR

Tales of FBAR non filing catastrophes have been around for ages, but one schoolteacher's failure to file her FBAR was truly a nightmare. The result? An \$800,000 penalty!

The Court of Federal Claims ruled that a taxpayer's failure to file FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR), was willful, as she concealed her income and avoided learning of her reporting requirements, and her actions reached the standard for reckless disregard for the law. Also, it held that the penalty of one-half of the balance of her unreported financial account was properly assessed.

Facts

In 1999, Mindy Norman, a schoolteacher, signed documents to open a numbered bank account, which concealed her income and financial information, with Union Bank Switzerland (UBS). In 2000, she further concealed her financial information from U.S. authorities by signing to waive her right to invest in U.S. securities.

In 2008, Norman transferred her funds from UBS after being informed it would no longer provide offshore banking and would assist the U.S. government in identifying U.S. clients who may have engaged in tax fraud. Remember that this was during the push by the US government to single out UBS and other Swiss entities to release records in connection with American taxpayers avoiding their US tax obligations.

In addition to concealing her financial information, Norman did not attempt to find out her reporting requirements. Norman claimed on her 2007 tax return not to have a foreign account. In 2009, rather than apply to the Offshore Voluntary Disclosure Program, which provided for a reduction in FBAR penalties, Norman filed a "quiet disclosure" through her Swiss accountant by filing amended tax returns and FBARs for the

the outcome, many states will also be paying careful attention. According to the North Carolina petition, states are split on the issue. California, Connecticut, Illinois, and Missouri courts have concluded (or suggested) that a beneficiary's residency can support the imposition of tax on the trust's income while courts in Minnesota, New Jersey, New York and other states have indicated that such taxation violates Due Process. A fair guess would be that a decision in this case will be coming this summer, only fitting considering how nexus issues have heated up since Wayfair! Stay tuned!

years 2003—2008 without notifying the IRS or admitting violating 31 U.S.C. Section 5314.

In 2013, the IRS assessed an \$803,530 penalty for a willful failure to file an FBAR in connection to the Swiss bank account she had in 2007, which was 50% of the unreported balance in her account. Norman paid the penalty and sued for a refund.

Issues

U.S. citizens with an interest in or control over one or more foreign financial accounts with an aggregate value above \$10,000 at any time during a calendar year generally is required to file an FBAR on or before April 15 (June 30 in 2007) of the following year. The IRS may assess an inflation-adjusted "civil money penalty on any person who violates ... any provision of section 5314," which currently generally may not exceed \$12,459 (\$10,000 in 2007) per non-willful violation. The maximum inflation-adjusted penalty for each willful violation involving a failure to report the existence of an account is the greater of \$124,588 (\$100,000 in 2007), or 50% of the balance in the account at the time of the violation.

A person who knowingly or recklessly fails to file an FBAR willfully violates 31 U.S.C. Section 5314. A willful violation may be proved by inference from action intended to conceal sources of income and financial information and from a conscious effort to avoid learning about reporting requirements.

The issues decided were whether Norman willfully violated 31 U.S.C. Section 5314 by knowingly or recklessly failing to file an FBAR in 2007 and if the penalty assessed was appropriate.

Conclusion

The court held that Norman willfully violated 31 U.S.C. Section 5314, as she "acted to conceal her income and financial information, and also that she either recklessly or consciously avoided learning of her reporting requirements." It did not find Norman's testimony credible and rejected her claim that she did not know of her duty to report her foreign income until 2009 and did not willfully fail to file an FBAR. It held that when she signed her 2007 tax return, she was "put on inquiry notice of the FBAR requirement" but did not seek more information. The court stated that "simply not reading the return does not shield Ms. Norman from the implications of its contents."

It ruled that her repeated and admitted lack of care in (1) filing inaccurate official tax documents without any review, (2) signing foreign banking documents without any review, and (3) later providing false sworn statements both to the IRS and to this Court, both with and without review, reaches the

standard of reckless disregard for the law required to constitute a willful violation of § 5314.

The court rejected Norman's post-trial argument relying on a recent district court case, Colliot, that a regulation adopted before an amendment to 31 U.S.C. Section 5321 in 2004 capped the maximum penalty at \$100,000. The Court of Federal Claims held that Congress clearly raised the maximum penalty when it amended 31 U.S.C. Section 5321, which rendered the regulation invalid. Thus, the penalty assessed under 31 U.S.C. Section 5321 in the amount of 50% of her account's balance was appropriate, the court held.

Practitioners beware!.....be sure to have adequate confirmation from your clients concerning this question. The Foreign Bank Account rules are fraught with peril. Assume nothing and document responses.

[ITEM 12] – Refunds are down....

Early returns are in (pardon the pun), on tax filings for 2018 and as we anticipated and discussed during the Fall edition of the *Elite Quarterly*, refunds are down from the previous year. Some recent statistics from the IRS:

- Tax season opened on January 28, 2019. Three weeks into the season (week ending February 15, 2019), the IRS has received 39,747,000 individual income tax returns. That compares with 41,738,000 individual income tax returns received by the same time last year, a drop of nearly 5%.
- The IRS also reported a drop in the rate that individual income tax returns were processed. The IRS has processed 37,810,000 returns to date, or nearly 7% fewer returns compared with the same time last year.
- The IRS has issued just 23,485,000 tax refunds as compared to 31,937,000 for the same period last year. A reduction of 26.5%. The total amount of tax refunds issued is just \$61.993 billion, nearly \$40 billion off of the pace from last year. Down almost 40%.

It's evident that the combination of tax law changes along with increased net pay for wage earners resulting from

changes to withholding tables last spring has translated into smaller refunds. The reduction in filings can be attributed to the government shutdown along with delays in receiving tax forms needed to prepare one's tax return. One can also surmise that filings are down simply because individuals who may have experienced refunds in the past, and now find themselves in a position where they have a balance due, are in no hurry to file their tax return before April 15th.

We still have an opportunity to work with clients to reduce taxes for 2018 by the way of retirement plan contributions if available to taxpayers (i.e. Sep/IRA's). Additionally, we have to look forward to 2019. Withholding amounts should be reviewed, and changes initiated sooner rather than later for those taxpayers who are seeking to switch back to "refund mode". As we stated last fall....it's better to begin making those withholding adjustments starting now and avoid making that dreaded phone call next filing season! With that said, we truly hope you enjoy a well-deserved break from this past tax season. Enjoy the Spring!

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

7. Under the TCJA, alimony payments will not be deductible by the payer spouse but will also not be included in income of the payee ex-spouse. This rule applies to any divorce or separation instrument executed _____ .
 - a. After Dec 31, 2018
 - b. After September 27, 2017
 - c. After January 1, 2018
8. Which of the following statements is true after passage of P.L. 115-97?
 - a. Elevated estate tax exemptions have increased the need for credit shelter trusts
 - b. The TCJA will increase the likelihood of taxpayers utilizing an alimony trust
 - c. Taxpayers should consider revisiting Trust instruments under these new rules
9. Federal law requires the Office of the Taxpayer Advocate to make an Annual Report to Congress to identify at least 20 of the “most serious problems” encountered by taxpayers and to make administrative and legislative recommendations to mitigate those problems. Based on the most recent report, which of the following was not shown as a problem on this list?
 - a. The IRS has overstaffed Field Collection units creating confusion with taxpayers.
 - b. The IRS lacks a coordinated approach to its oversight of return preparers and does not analyze the impact of penalties imposed on preparers
 - c. The IRS has failed to exercise self-restraint in its use of math error authority, thereby harming taxpayers
10. The IRS is in desperate need to replace its antiquated information technology systems. Which of the following is true in connection with current IRS information technology systems?
 - a. Individual taxpayer account information is contained in the IGGUS Master File
 - b. Case Management files are centrally organized.
 - c. Historically the IRS has not done an effective job executing technology upgrades.
11. The case of NC Department of Revenue v. The Kimberley Rice Kaestner 1992 Family Trust addresses will address which central issue?
 - a. Identifying which State is a trust subject to taxation
 - b. The relevance of a Due Process Clause
 - c. Whether protective refund claims fall within the statute of limitations
12. Which of the following statements is true concerning Foreign Bank and Financial Account reporting requirements?
 - a. Penalties are not indexed for inflation
 - b. “Willful violations” of these rules may trigger maximum penalties.
 - c. Offshore banking in Switzerland continues to provide a safe haven for concealing foreign bank accounts.

Solutions

7. **"A" is the correct response.** Practitioners determining the tax status of alimony payments should confirm the date of the divorce agreement, whether it was modified, and, if modified, whether the TCJA provisions apply.
"B" is an incorrect response. This is the cutoff date for assets placed in service relating to additional first year depreciation rules under the TCJA.
"C" is an incorrect response. A client’s divorce attorney should be consulted if there is any ambiguity as to whether a divorce modification applies to the Tax Cuts and Jobs Act rules.
8. **"A" is an incorrect response.** Elevated estate and gift tax exemptions have reduced the overall need for such a trust.
"B" is an incorrect response. The TCJA prevents the prospective use of alimony trusts in divorces after 2018 — with the TCJA's repeal of Sec. 682, the spouse who creates the trust will be taxed on the income under the Sec. 672(e) grantor trust rules.
"C" is the correct response. The TCJA represents the single largest piece of legislation to impact the IRC in nearly thirty years. Taxpayers would be wise to revisit their existing estate plans as a result.
9. **"A" is the correct response.** Conversely this report states that the IRS has not appropriately staffed and trained its field collection function.
"B" is an incorrect response. Overall, this year’s report identifies 20 problems, makes dozens of recommendations for administrative change, makes 10 recommendations for legislative change, analyzes the 10 tax issues most frequently litigated in the federal courts, and presents six research studies and one literature review.
"C" is an incorrect response. Despite some IRS improvements in this area, math error notices continue to be unclear and confusing, thereby undermining taxpayer rights and increasing taxpayer burden

10. **"A" is an incorrect response.** Individual records of taxpayer accounts are contained in a file not ironically titled the Individual Master File
"B" is an incorrect response. Currently, taxpayer information is stored in over 60 separate case management systems that generally do not communicate with each other.
"C" is the correct response. The IRS systems that hold the official records of taxpayer accounts — the Individual Master File and the Business Master File — date to the 1960s and are the oldest major IT systems still in use in the federal government.
11. **"A" is the correct response.** Consensus indicates that this may prove to be the most important state tax taxation and trust case in decades.
"B" is an incorrect response. The due process clause acts as a safeguard from arbitrary denial of life, liberty, or property by the government outside the sanction of law.
"C" is an incorrect response. Protective claims are often based on current litigation or expected changes in the tax law, other legislation, or regulations. A protective claim preserves the taxpayer's right to claim a refund once the contingency is resolved.
12. **"A" is an incorrect response.** Currently, the maximum inflation-adjusted penalty for each willful violation involving a failure to report the existence of an account is the greater of \$124,588, or 50% of the balance in the account at the time of the violation.
"B" is the correct response. A willful violation may be proved by inference from action intended to conceal sources of income and financial information and from a conscious effort to avoid learning about reporting requirements.
"C" is an incorrect response. Since 2008, the US government has actively sought out UBS and other Swiss entities to release records in connection with American taxpayers avoiding their US tax obligations.

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***** EXAM QUESTIONS *****

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

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1. Patrick is asking you whether there is any penalty relief for the underpayment of estimated tax payments for tax year 2018. Which of the following is statements is true in connection with Patrick's question?
 - a) The IRS issued relief from the penalty for underpayment of estimated income tax to individual taxpayers who have paid 85% of their 2018 tax liability with withholding and estimated tax payments.
 - b) To request this waiver, an individual taxpayer must file Form 2210, Underpayment of Estimated Tax by Individuals, Estates, and Trusts, with his or her 2018 income tax return.
 - c) The taxpayer must include the statement "85% waiver" on his return.
 - d) All of the above

2. Beginning on Jan 1, 2019, the standard mileage rate for use of a van driven in service of charitable organizations is _____ cents per mile driven.
 - a) 14
 - b) 20
 - c) 55
 - d) 58

3. Which statement best describes the imposition of fees by the IRS to secure a PTIN?
 - a) PTIN fees have remained unchanged since inception in 2010.
 - b) The legality of this fee has been challenged numerous times in court.
 - c) The "Montrois" court decision prohibits the IRS from imposing a PTIN fee.
 - d) None of the above.

4. The Treasury Department and the IRS recently announced that they are making changes for issuing tax guidance, including adding a _____ to temporary regulations and restricting notices of proposed regulations.
 - a) statement of good cause
 - b) summary brief
 - c) scope disclosure
 - d) rulings clause

5. In connection with the Treasury Department and the IRS's recent announcement concerning tax guidance, the IRS stated that it will _____ its use of notices to announce its intent to issue proposed regulations.
 - a. Increase
 - b. Limit
 - c. Eliminate
 - d. Redact

6. In general, the section 179 and depreciation deductions for passenger automobiles are subject to dollar limitations for the year the taxpayer places the passenger automobile in service and for each succeeding year. For a passenger automobile that qualifies for the 100-percent additional first year depreciation deduction, TCJA increased the first-year limitation amount by _____ .
 - a. \$6,000
 - b. \$8,000
 - c. \$10,000
 - d. \$12,500

7. Tony is meeting with you to discuss his seriously delinquent federal tax situation and his business which involves travel overseas. He currently owes \$75,000 in back taxes. You correctly advise him that _____.
 - a) He will not be able to renew his passport even if he pays the debt in full.
 - b) He is at risk concerning his passport, that he may not be able to renew his current passport given his current tax situation.
 - c) His delinquent tax situation has no impact on his upcoming passport renewal.
 - d) That the FAST Act notification rule for delinquent taxes applies to taxpayers owing more than \$100,000 in back taxes.

8. Which of the following is true regarding proposed Form 8995?
- The draft form will not assist taxpayers in calculating qualified business income.
 - This form is not available for tax year 2018
 - This form contains separate lines for qualified REIT dividends and PTP income or loss
 - All of the above
9. Jonathon is seeking your advice concerning his recent divorce from his former wife Maggie. The divorce was finalized on October 10, 2018. On Jan 31st 2019 alimony provisions in the divorce agreement were modified and includes amendments stating that the Tax Cuts and Jobs Act would apply to this modified agreement. Which of the following statements is true in connection with Jonathon's situation?
- Alimony payments will be deductible by the payer spouse
 - Alimony payments will not be deductible by the payer spouse
 - Alimony received will be included as income of the payee ex-spouse
 - None of the above
10. Which statement best describes the impact of the Tax Cuts and Jobs Act as it relates to divorce and related tax planning?
- Elevated estate and gift tax exemptions may lead some taxpayers to pass over true estate tax planning. *
 - Limitations on state and local tax deductions will not typically impact previously negotiated divorce settlements.
 - Clients who had given up other items of value during divorce negotiations in order to claim deductible personal exemptions under the divorce settlement would be well advised to aggressively seek a remedy regardless of cost.
 - The benefits of an alimony trust is expanded after the passage of the TCJA.
11. The issuance of the National Taxpayer Advocate's most recent _____ presents 58 legislative recommendations designed to strengthen taxpayer rights and improve tax administration.
- Yellow Book
 - Green Book
 - Purple Book
 - Waste Report
12. Information Technology modernization is a top priority for the IRS. Which of the following statements is true concerning current technology systems at the IRS?
- Case Management Systems are integrated
 - Current systems holding official taxpayer records date back to the 1980's
 - No one database holds or provides a 360-degree view of the taxpayer's account
 - The IRS's "enterprise case selection system" is the one bright spot concerning its IT platform.
13. The National Taxpayer Advocates annual report to Congress identifies the 20 most serious problems encountered by taxpayers in its interaction with the IRS. Which of the following problems is not identified on this list?
- The IRS's failure to answer the right tax law questions at the right time harms taxpayers, erodes taxpayer rights, and undermines confidence in the IRS.
 - The IRS lacks a coordinated approach to its oversight of return preparers and does not analyze the impact of penalties imposed on preparers
 - The IRS's field examination program yields many high change rates, making taxpayers feel that they are specifically "targeted"
 - The IRS does not proactively use internal data to identify taxpayers at risk of economic hardship throughout the collection process
14. In 2014, the IRS implemented a policy to only answer tax law questions during _____ .
- January through mid-April of any year
 - April 15th through September 15th
 - April 15th through December 31st
 - Periods of predetermined "peaks"
15. The first item to be listed on the IRS Taxpayer Bill of Rights is _____ .
- the right to quality service
 - the right to finality

- c. the right to retain representation
 - d. the right to be informed
16. Which of the following court case rulings allowed states to impose sales tax collection responsibilities upon certain remote internet sellers?
- a. South Dakota v. Wayfair
 - b. NC Department of Revenue v. The Kimberley Rice Kaestner 1992 Family Trust
 - c. Quill Corp. v. North Dakota
 - d. New York v. Amazon Corp.
17. A _____ preserves a taxpayer's right to claim a refund once a legal contingency is resolved.
- a. statutory affidavit
 - b. protective refund claim
 - c. due process filing
 - d. none of the above
18. Which of the following states have indicated (through court cases) that a beneficiary's residency can support the imposition of a tax on the trust's income?
- a. Minnesota
 - b. New Jersey
 - c. New York
 - d. California
19. Your new client, Heather, is concerned about a foreign bank account that she owns and the fact that she has not disclosed this on FinCen Form 114 for tax year 2017. You correctly advise her that _____ .
- a. filing a "quiet disclosure" is a proven strategy to avoid FBAR penalties.
 - b. closing the foreign bank account will prevent the IRS from pursuing any penalties against her.
 - c. penalties for a "willful violation" related to FBAR non-filings may equal 50% of the balance in the foreign bank account at the time of the violation
 - d. she can avoid any imposition of penalties because she relied on her prior tax advisor to prepare this form.
20. Which of the following is not true in connection with early IRS reports regarding tax filing statistics for 2018?
- a. Tax season opened on February 15, 2019
 - b. The IRS reported a drop in the rate that individual income tax returns were processed.
 - c. Tax refunds issued are down when compared to this same period last year.
 - d. The government shutdown impacted the IRS's ability to process tax returns in 2019.

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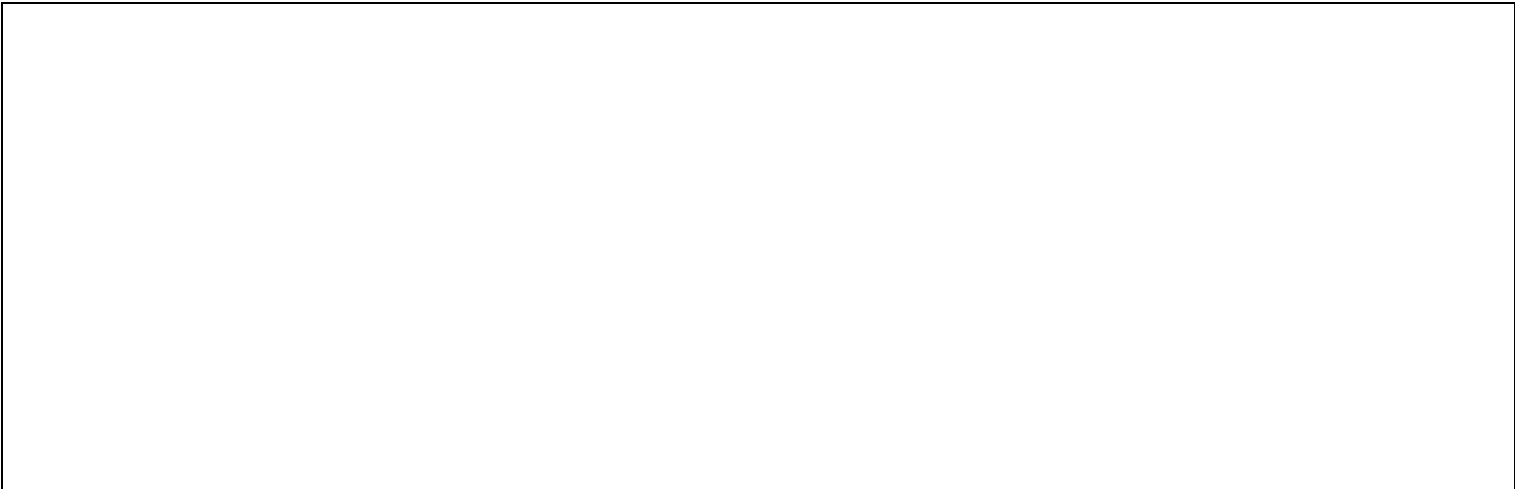
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