Remarks from Beanna

Overview of the Presidential Election Process

An election for President of the United States occurs every four years on Election Day, held the first Tuesday after the first Monday in November.

The election process begins with the primary elections and caucuses and moves to nominating conventions, during which political parties each select a nominee to unite behind. The nominee also announces a Vice Presidential running mate at this time. The candidates then campaign across the country to explain their views and plans to voters and participate in debates with candidates from other parties.

During the general election, Americans head to the polls to cast their vote for President. But the tally of those votes—the popular vote—does not determine the winner. Instead, Presidential elections use the Electoral College. To win the election, a candidate must receive a majority of electoral votes. In the event no candidate receives the majority, the House of Representatives chooses the President and the Senate chooses the Vice President.

The Presidential election process follows a typical cycle:

- Spring of the year before an election – Candidates announce their intentions to run.
- Summer of the year before an election through spring of the election year – Primary and caucus debates take place.
- January to June of election year – States and parties hold primaries and caucuses.
- July to early September – Parties hold nominating conventions to choose their candidates.
- September and October – Candidates participate in Presidential debates.
- Early November – Election Day
• December – Electors cast their votes in the Electoral College.
• Early January of the next calendar year – Congress counts the electoral votes.
• January 20 – Inauguration Day

Tuesday, November 8, 2016 Americans will vote for the individual to lead America into what we anticipate to be a challenging and hope to be a rewarding time for the United States. In one word

VOTE!

While it is not the only reason, tax professionals should familiarize themselves with the position on tax of all candidates. Your client’s will be asking, wondering and anticipating what impact there will be on their taxes. The ncpe way is through education! Be ready to address your client’s concerns. As always, stay well and finish well.

Beanna

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It’s Time for Congress to Pass Reaganesque Tax Reforms

It’s been 30 years since Reagan’s tax reform. Today’s House of Representatives have a blueprint to ensure a new era of prosperity. Thirty years ago President Ronald Reagan signed into law the Tax Reform Act of 1986, landmark legislation recognized as the most sweeping overhaul of the U.S. tax code in our nation’s history. Upon signing the bill into law, President Reagan described the new tax code as one “designed to take us into a future of technological invention and economic achievement, one that will keep America competitive and growing into the 21st century.” True to these words, the American economy saw remarkable improvements as our nation led the way in developing breakthrough products and technologies. But our tax code also has changed significantly since 1986 — and not for the better. Unlike the American inventions and achievements that have expanded horizons of possibility, our nation’s tax code has become an excessive burden that strangles individual opportunity and economic freedom.

Over the past decade alone, more than 4,400 changes have been made to the U.S. tax code. That equals more than one change per day. Meanwhile, our nation’s tax laws have come to fill more than 70,000 pages, forcing taxpayers to spend an incredible amount of time and money preparing their tax returns each year. A recent study by the Tax Foundation projects that Americans will devote over 8.9 billion hours to complying with IRS tax-filing requirements in 2016.

House Republicans believe that now is the time to move forward with bold, pro-growth tax reform. That’s why, earlier this year, we put forward a detailed blueprint for comprehensive tax reform that will lift the burdens on families and job creators and propel our nation into a new era of economic prosperity and leadership. This blueprint is the first consensus proposal put forward by House Republicans to overhaul the tax code since the Reagan reform of 1986. And, similar to that legislation, our plan takes action to make the tax code simpler, flatter, and fairer for all Americans. Our plan eliminates dozens of special-interest loopholes, lowers tax rates for individuals and families, and consolidates the seven income-tax brackets of our current code into just three. Additionally, we improve and streamline provisions that support families, higher education, and charitable giving while also reducing taxes on savings and investment. These reforms provide unprecedented simplicity. In fact, our blueprint delivers a tax code so straightforward and fair that, for the first time in modern history, nearly all Americans would be able to file their taxes on a form as simple as a postcard. Above all, our blueprint delivers a tax code that is built for growth — the growth of families’ paychecks, the growth of small businesses, and the growth of our economy as a whole. Our plan lowers tax rates on American job creators of all sizes so they have more freedom to expand, hire new workers, and energize our local economies. We take bold action to level the playing field for U.S. businesses and workers by transforming our nation’s outdated international tax system into one of the most modern, pro-growth systems in the world. Not only will our blueprint remove incentives for companies to relocate overseas, it will make American communities the most attractive places in the world to invest, hire, and headquarter a business. That means better job opportunities for our workers, better wages for American families, and a better chance for all Americans to achieve their personal and professional goals. Put simply, our blueprint is designed to help Americans of all walks of life. For recent college graduates, it increases your ability to find a fulfilling job where you can put your hard-earned knowledge and skills into action. For America’s working families, it delivers the support and economic security needed to save for retirement and put your kids through school. And, for our nation’s small business owners, our blueprint offers more freedom to dream big and go bold in developing that next groundbreaking invention.

Looking back on the tax reform effort 30 years ago, it’s important to recognize the key factors that led to its success. First, the American people were fed up with the tax code and the burdens it imposed on their lives. Second, members of Congress had bold solutions to overhaul the code from top to bottom. Third, President Reagan was committed to leading the charge on pro-growth tax reform. House Republicans recognize that many of these same factors are present today. We will continue to lead with bold, pro-growth tax reform. For America to see success in this crucial effort, our next president must be equally committed.

Editor’s Note: The above article was released by House Republicans. If you were in the business of tax in 1986 you remember all too well the impact of the 1986 Tax Act. Anyone in the business of tax age 37 and younger have long-lived with this legislation and those age 30 and younger were not even alive when the legislation was passed.

What’s New on the 2016 draft Form 1040

Form 1040—Items That Are Not Specific To Specific Lines On The Form

No new or changed lines. The 2016 draft form 1040 contains no new lines and no lines with changed captions.

Due date. Form 1040’s due date is Apr. 18, 2017.

Extensions. Taxpayers can obtain an automatic 6-month extension by, no later than the return due date, either filing Form 4868, Application for Automatic Extension of Time to File U.S. Individual Income Tax Return, or by making an electronic payment.

Delivery services. Eight delivery services have been added to the list of designated private delivery services. For a complete list of private delivery services, see page 8 of the draft Form 1040 instructions.

Electronic Filing PIN. Electronic Filing PIN, an IRS-generated
PIN used to verify the signature on self-prepared, electronic tax returns, is no longer available. To validate the signature on such a return, the taxpayer must use his prior-year adjusted gross income or prior-year self-select PIN.

Form 1040—Adjusted Gross Income

Line 23. Educator expenses. Beginning in 2016, this up-to-$250 per educator deduction can include certain expenses for professional development courses related to the curriculum, or to the students, that the educator teaches.

Line 26. Moving expenses. The 2016 standard mileage rate for moving expenses is 19¢ per mile.

Line 32. IRA deduction. In general, an individual who isn’t an active participant in certain employer-sponsored retirement plans, and whose spouse isn’t an active participant, may make an annual deductible cash contribution to an IRA up to the lesser of: (1) a statutory dollar limit, or (2) 100% of the compensation that’s includible in his gross income for that year. For 2016, the statutory dollar limit is $5,500, plus an additional $1,000 for those age 50 or older. If the individual (or his spouse) is an active plan participant, the deduction phases out over a specified dollar range of modified AGI (MAGI). For 2016, a taxpayer may be able to take an IRA deduction if he was covered by a retirement plan and his 2016 MAGI is less than $71,000 ($118,000 if married filing jointly or a qualifying widow(er)). If the taxpayer’s spouse was covered by a retirement plan, but the taxpayer was not, he may be able to take an IRA deduction if 2016 MAGI is less than $194,000.

Form 1040—Tax And Credits

Line 40. Itemized deductions or standard deduction. For 2016, the standard deduction is $6,300 for single filers and for married persons filing separately, $12,600 for joint filers and qualifying widow(er)s, and $9,300 for heads of household.

Line 42. Exemptions. The amount for each exemption for 2016 is $4,050. Exemptions are reduced for taxpayers with AGIs in excess of the “applicable amount” ($311,300 for joint filers or a surviving spouse, $285,350 for a head of household, $259,400 for a single individual who isn’t a surviving spouse, and $155,650 for marrieds filing separately).

Line 45. Alternative minimum tax. Under Code Sec. 55(d), the alternative minimum tax (AMT) exemption amount for 2016 is $53,900 ($83,800 if married filing jointly or a qualifying widow(er); $41,900 if married filing separately). The AMT exemption amount is reduced if alternative minimum taxable income is above statutorily-defined amounts that depend upon filing status.

Line 54. Other credits. For 2016, the maximum adoption credit is $13,460 per eligible child for both non-special needs adoptions and special needs adoptions. The amount begins to phase out if modified adjusted gross income (MAGI) is in excess of $201,920 and is completely phased out if MAGI is $241,920 or more.

Form 1040—Other Taxes

Line 57. Self-employment tax. Maximum amount of self-employment income subject to FICA tax is $118,500; there is no ceiling on Medicare wage base.

An individual may use the farm optional method only if (a) his gross farm income was not more than $7,560 or (b) his net farm profits were less than $5,457. Using this method, farm self-employment earnings equals the smaller of (1) two-thirds of gross farm income, or (2) $5,040.

An individual may use the nonfarm optional method only if (a) his net nonfarm profits were less than $5,457 and also less than 72.189% of his gross nonfarm income and (b) he had net earnings from self-employment of at least $400 in 2 of the prior 3 years. Individuals may compute their self-employment earnings as the smaller of two-thirds of gross nonfarm income or $5,040.

A self-employed individual with both farm and nonfarm incomes is allowed to use both optional computation methods if the farm income qualifies for the farm optional method and the nonfarm income qualifies for the nonfarm optional method. If both optional methods are used to compute net earnings from self-employment, the maximum combined total net earnings from self-employment for any tax year can’t be more than $5,040.

Line 61. Health care: individual responsibility. As was the case in 2015, a taxpayer must either:

- indicate on line 61 that he, his spouse (if filing jointly) and his dependents had health care coverage throughout 2016;
- claim an exemption from the health care coverage requirement for some or all of 2016 and attach Form 8965; or
- make a “shared responsibility payment” if, for any month in 2016, he, his spouse (if filing jointly) or his dependents did not have coverage and do not qualify for a coverage exemption.

However, the monthly shared responsibility payment amount has increased for 2016. For 2016, it is lesser of (i) the sum of the monthly penalty amounts for months in the tax year during which one or more failures occurs, or (ii) the sum of the monthly national average bronze plan premiums for the plan. The monthly penalty amount is equal to 1/12 of the greater of $695 per family member (up to a ceiling of $2,085) or 2.5% of the amount by which the taxpayer’s household income exceeds the filing threshold.

Form 1040—Payments And Refunds

Line 66. Earned income credit (EIC). The maximum credit is higher, and the AGI-based phaseout figures are revised.

Line 71. Excess social security and RRTA tax withheld.

Maximum Social Security (OASDI) tax for 2016 is $7,347
Line 73. Credits. Line 73, box b is labeled as “Reserved.” The draft instructions contain no information on this box. The final version of 2015 Form 1040 also had this box labeled as “Reserved.”

Lines 74-77. Refund. Effective for credits or refunds made after Dec. 31, 2016, IRS can’t issue refunds before Feb. 15, (thus, before Feb. 15, 2017 for 2016 returns), for returns that claim the earned income credit and/or the additional child tax credit. This rule applies to the entire refund, not just the portion associated with those credits.

Line 78. Amount you owe. The Form 1040 instructions reflect the fact that IRS2GO is the IRS mobile application; taxpayers can access “Direct Pay” or “Pay By Card” by downloading the application.

And, cash is a new in-person payment option for individuals. This option is provided through retail partners of IRS and has a maximum of $1,000 per day per transaction. To make a cash payment, a taxpayer must first be registered online at www.officialpayments.com/fed. There is a fee associated with this payment method.

Editor’s Note: Draft Forms will be found under Resources on the Website.

Getting Ready for Tax Season

By Roger Russell

For tax preparers getting ready for tax season, the environment has changed, according to Annie Schwab, tax manager at Padgett Business Services.

“In the past, the focus was on tax law, new legislation and tax strategies,” she observed. “But now, it’s more than just the Internal Revenue Code that impacts the preparation business. Preparers must now be familiar with requirements from Health and Human Services and the Department of Labor, and must know the ins and outs of shielding their business from scammers and protecting taxpayers from identity theft.”

“It is your legal responsibility to protect client’s business and personal records from unauthorized access,” she reminded preparers. “Internal controls should be put in place to protect sensitive data from dishonest employees and outside thieves. This includes information that is on paper as well as in computerized format.”

Schwab recommends that tax business owners check their E&O [errors and omissions, or malpractice, insurance] policy to see if it covers data breach. If it doesn’t, consider adding to it, she advised.

Schwab cited the new overtime rules, slated to go into effect on Dec. 1, 2016, as a potential cause of headaches for many business owners. Practitioners should be prepared to discuss them with their clients, she advised.

They require employers to pay their workers earning less than $47,476 per year overtime pay when they work more than 40 hours per week, with certain exemptions. “Among the exceptions are individuals who own at least 20 percent of the equity interest and actively participate in the business,” she observed.

“Not only do startups have to consider the tax implications when forming a business, but also the implications of the FLSA [Fair Labor Standards Act] rules when paying owner-employees,” she pointed out.

For example, she said, six individuals may want to form a corporation in which each will actively participate and own an equal share of the business. As a startup, the corporation will not have money in the first year to pay wages to any of the shareholders so no distributions will be made. Under the IRS rules for reasonable compensation, the corporation has no risk of audit since no distributions were made to the shareholders. However, according to the DOL, the corporation is in violation of the FLSA. Since each shareholder’s ownership was less than 20 percent, the owners are not exempt from the new rules and the corporation should have paid them at least the minimum wage, including overtime pay, for the services they provided, she said.

Taxpayers who claim the Earned Income Tax Credit or Additional Child Tax Credit early during tax season may not be receiving their refunds as early as they expect, Schwab said. Beginning in 2017, the IRS will hold refunds on EITC and ACTC returns until February 15, she noted. “The delay results from the Protecting Americans from Tax Hikes Act of 2015 [PATH Act], which is intended to help prevent revenue lost due to identity theft and refund fraud,” she said. “Under the law, the IRS cannot release the part of the refund that is not associated with EITC or ACTC.”

In addition to learning how the new rules might affect their clients, Schwab offered this checklist for preparers who want to be ahead of the game before year’s end:

- Order Forms W-2, 1099, transmittals and envelopes.
- Identify any missing employee or vendor information for W-2/1099 preparation.
• Consider hiring a marketing representative and/or tax assistant for tax season.

• Order holiday gifts.

• Purchase tax software and tax research materials.

• Purchase office and computer supplies.

• Schedule routine maintenance for your copier and printer.

• Set up client tax files and backup and archive your 2015 tax software files.

• Renew your PTIN.

• Notify clients about the open enrollment period for buying health insurance on the Marketplace for 2017.

• Remind clients who purchased their health insurance on the Marketplace in 2016 to retain a copy of Form 1095-A, Health Insurance Marketplace Statement.

• Prepare and distribute tax organizers to help clients gather information to prepare their personal returns.

• Consider distributing a year-end package to small business clients to help them gather account balances, business mileage, employee and vendor information, confirm asset purchases or dispositions, insurance information, etc.

• Issue email reminders to clients prompting them to get caught up and organized before tax season.

• Schedule year-end planning meetings with clients to discuss strategies to reduce their tax liability and to assess any major changes, both business and personal.

PTIN Class Action Lawsuit Affects All Tax Return Preparers

Tax practitioners across the country have started receiving emails notifying them that if they do not opt out, they will be included in the class of plaintiffs in a lawsuit that is currently pending before the U.S. District Court for the District of Columbia. The class action lawsuit includes as plaintiffs everyone who paid the IRS money to obtain or renew a preparer tax identification number (PTIN) on or after Sept. 30, 2010, unless they choose to opt out of the class. Practitioners have until Dec. 7, 2016, to opt out. The plaintiffs in the case estimate that some 700,000 to 1,200,000 preparers are affected (Plaintiffs’ Amended Class Action Complaint ¶32 (8/7/15)).

The case, Steele, No. 1:14-cv-01523-RCL (D.D.C.), was filed by three tax return preparers who are challenging the legality of the IRS’s PTIN fees. The questions raised by the plaintiffs include:

• Does the IRS have the legal authority to charge a fee to obtain a PTIN?

• Does the IRS have the legal authority to charge a fee to renew a PTIN?

• Are the fees imposed excessive?

The plaintiffs argue that PTIN fees are illegal for two reasons: First, that the IRS has no authority to charge the fees because tax return preparers receive no special benefit in return for the fees, only an identifying number. And, second, that even if the IRS is authorized to charge PTIN fees, the amount it charges is far in excess of the costs the IRS incurs to issue the PTIN. (The IRS currently charges $50 (including a third-party vendor fee) to obtain or renew a PTIN.)

PTIN fees were originally introduced by the IRS to fund its tax return preparer regulation program, which was struck down by a federal appeals court in Loving, 742 F.3d 1014 (D.C. Cir. 2014). Although the program was struck down, the IRS continued to require the use of PTINs and to charge a fee. (Until 2010, the use of PTINs was not mandatory, and the IRS charged no fee to issue them.)

The plaintiffs allege that the IRS has collected over $175 million in PTIN fees (Plaintiffs’ Amended Class Action Complaint ¶26 (8/7/15)). They are seeking the recovery of either all PTIN fees paid or the excessive portion of the PTIN fees.

The district court granted the plaintiffs’ motion to certify the lawsuit as a class action on Feb. 9, 2016. Lawyers representing the plaintiffs are now contacting members of the class (return preparers who have paid to obtain and/or renew a PTIN) notifying them of the suit and that if they want to opt out of the class, they must do so by Dec. 7.

The notice tells recipients that only preparers who remain in the class will have the possibility of receiving money or benefits from the class action lawsuit. If the plaintiffs prevail in the lawsuit (or settle) and obtain money or benefits as a result, class members will be notified of how to apply for their share.

The notice contains instructions on how potential class members can opt out of the lawsuit, which involves sending a letter with specified information in it to the lawsuit’s administrator by Dec. 7.

The AICPA is not involved in this lawsuit and has no position regarding the suit.
Anyone who has ever paid the IRS money to register their Preparer Tax Identification Number (PTIN) will have until December to opt out of being represented as a plaintiff in a class action lawsuit over whether the government has the authority to charge a fee to obtain or renew a PTIN, and whether the fees are too expensive according to The Journal of Accountancy. The three tax preparers who filed the initial suit argued that the IRS has no authority to charge fees because the preparers receive no special benefits in return for them, and that even if the IRS did have the authority, the fees themselves are far in excess of the costs it takes for the IRS to issuer the PTIN in the first place.

The class action notice says that tax preparers who paid the IRS to get or renew a PTIN will be included as a plaintiff in the class action suit unless they deliberately opt out by Dec. 7. If the preparer opts out, then they will get no benefits from the suit itself but will also retain the right to launch an individual claim against the service over PTINs; if the preparer does nothing, then they will be counted as a plaintiff and retain the possibility of money or other benefits as a result of court action, though will lose the right to sue the U.S. separately about the same claims in the lawsuit.

FTC Charges Tech Support Companies with Using Deceptive Pop-Up Ads to Scare Consumers Into Purchasing Unneeded Services

The Federal Trade Commission has charged the operators of a multi-national tech support company with using deceptive pop-up internet ads to scare thousands of consumers into paying hundreds of dollars each for unnecessary technical support services.

A federal court has issued an order temporarily stopping the defendants’ practices and freezing their assets. The defendants in the case have commonly operated under the name Global Access Technical Support.

The FTC’s complaint alleges that the defendants used affiliate marketers to place internet pop-up ads designed to deceive consumers into thinking the ads originated from legitimate technology companies like Apple or Microsoft to warn the consumer that their computer was infected with viruses or malware. The ads often included loud alarms or recorded messages warning of the apparent dire threat to consumers’ computers and “hijacked” consumers’ browsers, leaving consumers unable to navigate around the ads or close them. The ads prompted consumers to contact a toll-free number.

According to the complaint, once consumers called the toll-free number, they were connected to a call center in India and pitched by telemarketers who claimed to be affiliated with or certified by a major technology company. Consumers were told that in order to diagnose the problem, they must provide the telemarketer remote access to their computer. The telemarketers then showed consumers otherwise innocuous screens and directories on their computers, deceiving them into believing they were evidence of problems that require technical support services to repair.

The complaint alleges that the telemarketers pressured consumers to spend anywhere from $200 to $400 for repair services that could take hours to complete and which were at best useless, and in some cases could actually harm consumers’ computers.

The FTC’s complaint alleges that the defendants violated the FTC Act. The defendants are Global Access Technical Support, LLC (also doing business as Global S Connect, Yubdata Tech and Technolve); Global sMind LLC (also doing business as Global S Connect); Source Pundit LLC (also doing business as OneSource Tech Support); Helios Digital Media LLC; VGlobal ITES Pvt. Ltd.; Rajiv Chhatwal; Rupinder Kaur; and Neeraj Dubey.

The Commission thanks the Better Business Bureau Serving Eastern Missouri and Southern Illinois for their collaboration and contributions to this case.

The Commission vote authorizing the staff to file the complaint was 3-0. The complaint was filed in the U.S. District Court for the Eastern District of Missouri.

Note: The Commission files a complaint when it has “reason to believe” that the law has been or is being violated and it appears to the Commission that a proceeding is in the public interest. The case will be decided by the court.

7 Tax Planning Tips for Millionaires

Taxes. It’s perhaps the most dreaded five-letter word in the English language next to “audit,” and the scourge of all working Americans.

Between 1955 and 2015, the U.S. tax code grew from just two documents totaling 1.4 million words into an impressive manifesto spanning over 10 million words. As the Tax Foundation pointed out last year, this 10 million-word figure doesn’t even include the legal tax cases that allow Americans to make sense of the U.S. tax code.
Despite its complexity, tax time can also bring joy to many Americans. About 80% of all federal taxpayers receives refunds in a given year. This refund can help fund emergency accounts, kick-start a retirement fund, or be used to pay down debt.

But high-income earners, specifically millionaires, aren’t typically so lucky. Millionaires almost always owe tax to the federal government, assuming their earned income stays consistent or grows from one year to the next. Millionaires can’t do a whole lot to impact their earned income with regard to their federal taxes, but there are still a number of tax planning strategies that can be employed to improve their financial outlook each year.

Here are seven tax planning tips millionaires should take into consideration.

1. Think long-term

One of the smartest tax moves millionaires can make is to think long-term to minimize what they’ll owe come tax time. For example, most interest and short-term stock gains are taxed at the ordinary income tax rate. Individuals earning in excess of $415,050, and couples with more than $466,950 in adjusted gross income are lumped into the highest ordinary income tax bracket, 39.6%. Thus, interest earned on a bank CD or the capital gain on a stock held for 365 days or less could be taxed quite heavily. Furthermore, individuals and couples earning more than $200,000 and $250,000, respectively, could be subject to the 3.8% net investment income tax (NIIT) and 0.9% Medicare surtax.

On the other hand, long-term capital gains taxes for the highest-income earners are just 20%, plus the aforementioned NIIT. Paying 20% on capital gains for investments held for 366 days or longer is a lot more favorable than 39.6%. Reasonably low long-term capital gains have allowed millionaires the ability to retain a sizable chunk of their wealth.

2. Contribute to tax-advantaged retirement vehicles

Secondly, millionaires should strongly consider maximizing their contributions to tax-advantaged retirement tools like employer-sponsored 401(k)s or Traditional IRAs. Chances are that millionaires are going to be saving and investing regardless of whether they’re using tax-advantaged retirement tools or not. However, utilizing a 401(k) and/or Traditional IRA can provide upfront tax benefits. According to the Tax Policy Center, the top 20% of income earners receive about 80% of the tax write-offs for retirement saving compared to just 7% for the bottom 60% of income earners.

Contributions to a 401(k) and Traditional IRA are made with before-tax dollars, meaning that you’ll owe ordinary income tax when you begin making withdrawals during retirement (i.e., between age 59-1/2 and 70-1/2). However, contributions also reduce your tax liability since it’s money that’s taken out before taxes. Maxing out a 401(k) with an $18,000 contribution limit for those aged 49 and under, or $24,000 for those aged 50 and up, and/or a Traditional IRA with limits of $5,500 or $6,500 based on those same age ranges, could certainly lower your current-year liability. As an added bonus, as noted above, investment gains can grow on a tax-deferred basis for years, if not decades.

3. Use investment losses to your advantage

Another smart option for millionaires to consider is harvesting investment losses.

At some point, all investors will make bad trades and lose money. But for millionaires this bad choice can be quite helpful. Selling investments at a loss may not be what you had in mind when you originally purchased an asset, but tax-loss selling can help reduce your current-year capital gains tax liability, or
possibly provide a carryover to future years if the loss is large enough. Selling a loser could be what pushes a high-income earner into a lower tax bracket, or for a millionaire it could help lower what you’ll owe in federal taxes for the current or upcoming year.

4. Consider municipal bonds

The vast majority of interest income is taxed at the ordinary income tax rate, which isn’t good news for millionaires looking for steady interest-based income. However, a solution exists: municipal bonds.

Municipal bonds are debt securities issued by a state, county, or city that are often used to fund large projects, such as building a new bridge or highway restoration. The beauty of municipal bonds is that they’re exempt from federal taxation -- and, if you purchase a municipal bond from the same state you live in, there’s a really good chance it’ll be exempt from state taxation, too.

Municipal bonds are obviously subject to the risk of a city or state declaring bankruptcy, but history has shown this to be a rarity, making muni bonds a keen investment opportunity for risk-averse millionaires.

5. Give to charity

Millionaires also have access to considerably larger deductions than the lower- and middle-income classes when it comes to charitable contributions. The charitable tax deduction is based on an individual’s or couple’s peak ordinary income tax bracket. Thus, millionaires effectively receive a deduction of $0.396 for every $1 they donate to charity since the peak marginal tax rate is 39.6%. Comparatively, low- and middle-income Americans are liable to receive just $0.10, $0.15, or $0.25 on every $1 they donate.

One thing to keep in mind is that you’ll want to ensure that your donation is both documented and headed to an eligible charity. If the charity isn’t a federally recognized nonprofit organization, or you have no documentation to back up your donation, it won’t help reduce your tax liability.

6. Buy health insurance

Health insurance may not be something that immediately springs to mind when you’re thinking about tax planning, but being covered has two big benefits for millionaires.

To begin with, having health insurance is mandated in the United States via the Affordable Care Act’s individual mandate. If you don’t buy health insurance, you could face a penalty known as the Shared Responsibility Payment, or SRP. In 2016, the SRP is the greater of $695 or 2.5% of modified adjusted gross income (capped at the annual cost of a bronze plan in your state). In other words, having no health insurance will probably result in an SRP of $2,500 or higher for top-income earners.

Secondly, medical bills are the leading cause of bankruptcy in the United States. Having health insurance could provide the financial protection you need in case an unexpected and costly illness or accident arises.

7. Where you live matters

Finally, millionaires should take into consideration that where they decide to live could greatly impact their finances.

For instance, seven states have no state income tax. These
The annual cost-of-living adjustment (COLA) usually means an increase in the benefit amount people receive each month. By law, the monthly Social Security and Supplemental Security Income (SSI) federal benefit rate increases when there is a rise in the cost of living. The government measures changes in the cost of living through the Department of Labor’s Consumer Price Index (CPI-W).

The CPI-W rose this year. When inflation increases, your cost of living also goes up. Prices for goods and services, on average, are a little more expensive. Since the CPI-W did rise, the law increases benefits to help offset inflation. As a result, monthly Social Security and SSI benefits for over 65 million Americans will increase 0.3 percent in 2017.

Other changes that would normally take effect based on changes in the national average wage index will begin in January 2017. For example, the maximum amount of earnings subject to the Social Security payroll tax will increase to $127,200.

Self-Filing, or Self-Defeating?

Taxpayers can’t fill their own teeth or cut their own hair, yet in recent years at least some 30 million Americans filed their tax returns from home computers, an increasing trend.

Earlier this year a GoBankingRates survey revealed that 43 percent of Americans now file taxes “from the comfort of their home.”

“A ‘digital tax-prep tool’ is the most popular option among tax filers, with more than a third … of survey respondents saying this is the method they use,” surveyors reported. “Tax-filing software is a popular option most likely due to the lower costs associated with filing digitally, as well as the ease of using a program to automate calculations and file online.” Only 28.5 percent of respondents said an accountant files their taxes.

“There’s been a DIY trend in many industries because people are trying to conserve money,” admitted Enrolled Agent Jennifer Brown at Implex Tax & Accounting in Clearfield, Utah. That supposed “ease of use” seems to motivate many self-filers. “Many people who self-file believe they can buy software and it will automatically prepare a correct return,” says G. Faith Owens, an EA at Grade A Business Services in Glendale, Ariz. “And it will if that person has a clear understanding of their own source documents, accounting and the question presented on the screen.”

“Have you ever sat down and seen how long it takes people to use software such as TurboTax?” said Michael Deininger of Deininger & Co. in Kenosha, Wis. “A return that I could have input, printed and e-filed in five minutes [can take] 90 minutes to complete on TurboTax, and then you can’t see the completed return until you e-file. I don’t see self-filing cutting into my business, but I charge a minimum of $250 a return so I can devote myself to my existing clients.”

‘Not even close’

“The main reason I am concerned about the increase in self-filing is that they are wrong wrong wrong!” said Terri Ryman, an EA at Southwest Tax & Accounting in Elkhart, Kansas. “I can’t imagine how much money the IRS is unable to collect because of the antics of self-filers. They post on the wrong forms and lines, don’t pay SE tax when required [and] take ridiculous deductions that are not even close to tax law.”

“I’m concerned for those who self-file in that the code is getting so complex that they’ll find themselves in situations of hearing
from the IRS,” said Twila Midwood, an EA at Advanced Tax Centre, in Rockledge, Fla. “I am not concerned that it will cut into my practice. We may prepare fewer returns but may [also] find ourselves helping more taxpayers who’ve received correspondence from the IRS.”

Representation work is proving just one of the unintentional benefits for preparers from self-filing. “Although I’ve had folks do their own returns in the last five to 10 years,” Ryman said, “inevitably they end up coming to me with the mandatory IRS letter, not understanding what they did wrong. And once burned, they usually end up using our services from then on.”

EA John Dundon, of Taxpayer Advocacy Services in Englewood, Colorado, applauds and encourages DIY filers. “More people doing their own income tax preparation,” he said, “means more audit and appeal representation work in the future for me.”

Ryman noted that such added services as representation have reduced prep to only about 40 percent of her practice.

Brown sees a few varieties of DIY filers — and noted some ways to turn them into paying clients.

“The ‘changers’ come in whenever they have a change, see how we handle it and then go back to self-preparing,” Brown said. “If we build a good relationship with these clients, at some point they’ll stop doing it themselves or they’ll refer others that don’t want to do [taxes] themselves.

“Fixers’ are the ones that have us fix what they’ve messed up,” Brown added. “They usually become great clients after their first IRS scare. The ‘not a chancers’ would never consider doing it themselves.”

Brown’s point? “There are a lot of different types of clients out there. If we show them value in what we do and educate them on why they need us, we will always have enough clients.”

Added Owens, “I spend more time now educating my clients about their own errors after the fact then preventing the errors up front. Often, untangling those errors will require more work than to have prepared the return correctly in the beginning, so those self-filers are actually adding to my billable hours and bottom line.”

The need for tax research tools hasn’t diminished over time, even as tax preparation software has gained increased intelligence. Rather, it has increased due to the continually growing complexity of the various tax codes, laws, private letter rulings and other morass of information that has to be perused and interpreted. And with the increasing number of clients moving into the global economy, don’t count on things getting any simpler in the future.

While many practitioners do subscribe to one or more tax research providers, there is a considerable amount of information available for free over the Internet. However, there are several problems with using the Internet as your primary source for researching tax issues. One is that, in many cases, it’s not possible to determine the veracity of the information you find, especially if it’s not from a trusted source such as the agency responsible for creating the code, rulings or findings in the first place.

Another problem is that, in many cases, the information provided is unfiltered. It’s just raw code, citations or case law, all provided without any interpretation. And for many, it’s the expert opinions and interpretations that provide the value-add. And while natural-language search engines like Google are easy to use, they can return hundreds or even thousands of responses.

That’s not to say that there’s no value in using the Internet as a resource in addressing your research questions. Almost all code is available online, whether it is federal, state, local jurisdictional or even international. One area that often gets short shift is case law. While most tax research vendors do offer case law databases and often options on code and rulings as well, there are some free or inexpensive places to look. Many of the major law schools have law libraries online that are available for free or paid access. Also useful: Mayfield Publishing’s legalbitstream.com Web site and the American Institute of CPAs’ Tax Research Information and Tools Web page. The U.S. Federal Tax Law Hierarchy Quick Reference Chart is something that most practitioners should probably print out and post in a prominent place.

But for many practitioners, access to free or inexpensive resources isn’t going to be sufficient. There aren’t a lot of tax research vendors in the market. Fortunately, those that do exist offer a variety of products and services to meet the requirements of many tax preparers. And some of these vendors have paired with tax preparation software vendors to allow access to their research databases directly from the tax prep product, sometimes directly from a particular line item. One of the more obvious trends in the industry is that it can’t afford to be static. With more data to search through, coming up with more efficient and effective ways to conduct searches is, and will continue to be, a priority. Paper-based loose-leaf services, which still exist, had some severe limitations in how you searched them.

Things have gotten a bit better since those days, but we haven’t come as far as any of us, including the vendors, would like. Effective searching still requires skills honed in the early
days of electronic research. And while many practitioners have developed skills in using Boolean operators like “and,” “or” and “not,” natural-language processing still remains the Holy Grail. Google is a good example of natural-language search technology.

George Farrah, editorial director at Bloomberg BNA, points out one of the challenges that vendors and users face: “Tax research solutions have had to evolve to meet the expectations born out of the Google effect. Researchers want systems that effectively interpret their search terms and display on-point results that they can quickly and easily review to find answers to their questions. Of course, the quality of those answers is still paramount, especially in an increasingly complex area of law and a growing pressure on businesses to be more efficient.”

But while natural-language searching may seem like a panacea, it’s not, at least not yet. To see why not, go to Google and type in the word “soda.” You’ll wind up with 195 million hits! Obviously, even natural-language searching needs to be approached with a search plan and knowledge of relevant terms and search techniques in hand.

Both Thomson Reuters and Bloomberg BNA report that they are making strides in natural-language search, while Tax Materials’ business development manager Jacob Meyer told us that, “Natural-language search is on the radar screen but not a near-term goal.”

According to Colleen Dillon, director of the Tax Practitioner Segment at Thomson Reuters Tax & Accounting, “Thomson Reuters Checkpoint’s unique Intuitive Search employs ‘triple-powered relevancy’ factors to amplify what is traditionally thought of as natural-language searching and enables users to search the way they think. Our Intuitive Search capability uses a multi-layered approach that goes beyond keyword matching to intuitively interpret the meaning behind search terms.”

Bloomberg BNA’s Farrah added, “We have focused much development [effort] to make searching simple and easy and to deliver the most relevant and reliable results through tax-specific search suggestions as well as an automatic function to true up the search string with alternate terms to include all variations of a topic. This greatly streamlines the search experience and delivers comprehensive results on the first attempt. Natural language is still evolving in tax-specific research. We continue to leverage new approaches as they prove to be effective in moving the performance needle forward.”

Wolters Kluwer’s product manager for CCH IntelliConnect, Jill Weinstein, agreed about the importance of making searching more productive: “We have been developing natural-language search for a long time now, and are always working to strengthen and refine this. Professionals want to search quickly and easily using the everyday language they use in their offices with clients and colleagues.”

Parker Tax Publishing is also gung ho on natural-language searching. “We see natural-language processing as being second only to predictive autocomplete in the future of search engine capabilities, and we’ve allocated our development time accordingly,” said publisher James Levey. “Natural-language search has been around in some form for decades, but until recently it has been more of a gimmick than a truly beneficial feature. But in the past five years, it’s become a highly effective technology, and we’ve been incorporating it into our search engine at a rapid clip. We still see ourselves as being a year or two behind popular public search engines like Google on natural language, but we’re closing the gap.”

Searching is getting easier and more direct, but obviously, there’s still a lot of room for improvement. And while natural language is one goal, in the end it may not turn out to be the most effective way to conduct a search. Vendors certainly see ease of use as a major consideration in their product development, and an ongoing challenge. And whether the answer is natural-language search or some other approach, you can be sure vendors are trying to make searching as productive and easy as possible.

Another industry trend that ties into the overall ease of use mentioned above is delivery of data and the results of searches. Back in the “good old days” of tax research, paper was pretty much the only media that tax research subscriptions were delivered on. In the late 1980s, CD-ROM drives became available and affordable, and many of the vendors started to provide their research services on CDs, and later on higher-capacity DVDs.

Today, DVDs are pretty much forgotten, having been replaced by online services. Still, paper-based research not only still exists — it’s actually flourishing. All of the major players in the tax research market still offer paper products and services. And it looks as if this mode of information delivery is not going to vanish any time in the near future.

Tax Materials’ Meyer told us, “Our paper-based tax research products continue to grow and the renewal rates have remained strong. In addition, we have seen a trend in which our ‘book-only’ customers have started to order both hard-copy books and online tax research. Because our online tax research products are intuitive and easy to use, the transition from book to online is seamless. As the demographics change and the industry ages I foresee more of a shift to online tax research. But I don’t foresee a major dropoff over the next five years. The transition will be very gradual. Tax professionals love having a hard-copy book and are very hesitant to change.” And he is far from alone in this assessment. Thomson Reuters’ Dillon and Bloomberg BNA’s Farrah both agree.

“Paper-based formats are expected to continue for the foreseeable future as part of an extended ecosystem for knowledge-based resources; the most popular print formats tend to be those used for quick reference purposes, desktop guides and journals,” Dillon told us.

Bloomberg’s Farrah added, “Because of the unique nature of
The retirement of DVD and Blu-Ray search materials has been hastened by several factors. The most obvious one is the all-encompassing use of the Internet, but it’s also a side-effect of the fact that many computing devices simply don’t have an optical media drive. That’s a result of the small form factor of these devices, which simply provide no room for an optical drive, as well as the ubiquitous access to and use of the Internet, which pretty much obviates the need for an optical drive.

With almost universal access to the Internet, it’s not surprising that there has been a tremendous shift in recent years for vendors to offer mobile access. Cloud-based research services just make sense, largely for the same reasons that almost every cloud-based application does: There are no capital equipment costs, no maintenance, and instant updates. When it comes to tax research, that instant update capability is a real crowd-pleaser.

And all the vendors we surveyed are enthusiastic about providing mobile access to their products. For instance, Parker Publishing’s Levey is very optimistic about mobile access, but not sure doing even initial research while sitting in front of the client is a particularly good idea: “During each of the past three years, we’ve seen double-digit increases in mobile access to our tax news bulletins, but far more modest increases in mobile access for core research. To the extent the research is being done in a client’s presence, it’s mainly about providing quick answers to straightforward questions about rates, limits, credit amounts, or perhaps a list of requirements to qualify for a tax break. Most practitioners we talk to remain averse to doing preliminary research on more complex questions in the presence of clients, and not just because it’s easy to get this stuff wrong. They feel that doing quickie research on a phone or an iPad in front of a client tends to trivialize the skill and professionalism required to answer tougher tax questions (even with the best research materials), and that getting back to a client later the same day or the next with an actual answer allows them to provide great service without underselling themselves.”

But a quick response to a client is important. “Clients of accounting firms expect rapid responses from their tax and accounting professionals,” noted Wolters Kluwer’s Weinstein. “This means if a client sends a text, e-mail or phone call to their professional, they are expecting a near-immediate reply. This is where mobility really drives value for professionals because they now have answers at their fingertips wherever they are, at any time, so they can respond quickly and appropriately to their clients. Interaction with clients is not just during face-to-face meetings and phone calls. Rather, it takes place on a 24/7 basis, and products that deliver strong mobility and are optimized for rapid use on-the-go are invaluable to professionals.”

Finally, we asked each vendor what they see happening in the foreseeable future. Bloomberg BNA’s Farrah believes much of the change will happen as clients become multinational, and practitioners younger. “As companies become more multi-jurisdictional, both in the U.S. and globally, and as tax laws become more complex, we see a growing need for information and analysis that help resource-constrained tax departments and service providers stay current and comply. Some examples of this include BEPS and state sourcing rules,” he said. “Like corporations, CPA firms will need to continue to increase efficiencies in order to do more with less — while maintaining a competitive edge in a market that continues to contract due to mergers and acquisitions. And as the demographics of CPA firms become younger, firms need to provide their staff with tools to help them become more knowledgeable and that work the way they do.”

“The optimal tax research service will need to provide a Google-like experience built on the foundation of trusted content, including efficiency-focused practice aids — like step-by-step instructions for transactions,” he concluded.

Thomson Reuters’ Dillon added that she expects to see improvement in the workflow: “We continue to transform our solutions to deliver information at the point in the workflow where it is of most relevance and value.”

Wolters Kluwer’s Weinstein also agreed that workflow is important: “Professionals should also work with a provider who connects to their workflows in order to save them time, which can easily be a challenge with so many options for information out there today.”

We also asked our vendor panel about offering “pay as you go” for research services, similar to the pay-per-return that some tax preparation software vendors offer. The resounding answer we got was that there doesn’t seem to be a desire on the part of practitioners for this kind of approach, and customers were quite satisfied with the available subscription plans.

One thing is certain: Tax research down the road a few years will look very different than it does today.

**Question of the Month**

Where and how do you file Form 56?

**Answer**

When a fiduciary relationship is created or terminated, file Form 56 with the specific Internal Revenue Service center where the person is required to file his tax returns, according to the IRS. Receivers in a receivership proceeding or similar fiduciaries or assignees for the benefit of creditors must file the form on or within 10 days of the date of appointment with the advisory group manager of that area office of the IRS.
Form 56 must be filed to notify the IRS of the creation or termination of a fiduciary relationship under section 6903, and the taxpayer must provide the qualification for the fiduciary relationship under section 6036, states the IRS. For example, if someone is acting as fiduciary for an individual or a decedent’s estate or a trust, he may file this form. Bankruptcy trustees, debtors-in-possession or similar fiduciaries in bankruptcy proceedings are not required to give notice of qualification under section 6036. For these relationships, these individuals are subject to the notice requirements under title 11 of the U.S. Code.

Do not use this form to update the last known address of the person for whom the receiver is acting, reports the IRS. Instead, use the change of address form, Form 8822, for updating the last known address.

News from Capitol Hill

Congress Blocks ‘Victory Tax’ On Olympic Athletes

U.S. Olympic athletes would be exempt from a so-called victory tax under legislation approved by Congress and sent to the president.

The Senate gave final legislative approval to a bill that would block the IRS from taxing most medals or other prizes awarded to U.S. Olympians.

The U.S. Olympic Committee awards cash prizes to medal winners: $25,000 for gold, $15,000 for silver and $10,000 for bronze. That’s in addition to the cash value of the medals themselves — about $600 for gold, $300 for silver. Bronze medals have little monetary value.

Because the money is considered earned income, it is taxed — a practice some lawmakers refer to the “victory tax.”

The bill would allow Olympic taxes on high-profile athletes such as swimmer Michael Phelps or NBA star Carmelo Anthony who earn more than $1 million a year.

For Phelps, the tax bill for his five golds and one silver won in Rio could be steep — as much as $55,000. Gymnast Simone Biles faces a possible $43,000 tax bill for her haul of four golds and one bronze.

The Senate vote came as President Barack Obama and first lady Michelle Obama hosted several hundred members of the 2016 U.S. Olympic and Paralympic teams to the White House. The U.S. won 121 medals at the Rio Olympics, including 46 gold medals.

The president applauded American women for their performance in the summer games, where they won 61 medals, the most ever.

“2016 belonged to America’s women Olympians,” he said, singling out Biles, swimmer Katie Ledecky and track star Allyson Felix. Obama also hailed Phelps, the most-decorated Olympian of all time with a total of 28 medals.

Sen. Chuck Schumer, D-N.Y., said many countries subsidize their Olympic athletes. “The least we can do is make sure our athletes don’t get hit with a tax bill for winning a medal,” he said.

President Obama Ends “Victory Tax” On Olympic Athlete’s Medals

U.S. Olympic Athletes will no longer have their winnings taxed, thanks to a new bill signed by President Obama. Athletes can usually earn anywhere from $25,000 for a Gold Medal to $10,000 for a Bronze, and were taxed by the IRS because their earnings count as “earned income.” The value of the actual gold and silver medals were taxed as well. Since bronze medals are composed of mostly copper, and were worth a negligible amount, they were spared.

The bill was passed by Congress this summer, and effects all winnings earned from January 1, 2016 to January 1, 2021. Some Olympic athletes are already burdened by the heavy cost that comes with training, and for whatever reason, the United States is one of the few countries that doesn’t provide government funding to its Olympic athletes. If Olympians are lucky, they will land an endorsement deal, but the majority rely on stipends from the Olympic Committee, support from local businesses, or an income earned from a day job.

Tax professor Dr. Steven Gill feels that this new action will hardly change a thing however. He believes that the USOC could reduce the amount of prize money given, and is perplexed why the U.S. doesn’t provide the kind of support athletes from other countries receive. “When I think about why these prizes exist, it’s to compete with state-supported athletes from other countries. Cutting taxes isn’t going to fix the fact that these athletes don’t get paid enough — it’s a short-term fix.”

The new bill, however, will still allow for taxes on high-profile athletes, such as multiple gold medal winner swimmer Michael Phelps.
Among the ignored recommendations are 2,000 for the Department of Housing and Urban Development (HUD), according to its inspector general – including some that had not been implemented for up to 15 years.

The Pentagon inspector general reported that the Department of Defense could save $33 billion if it heeded all recommendations, the report said.

“The numbers show that the Executive Branch would likely improve the effectiveness of its operations – and save taxpayer money – by implementing recommendations made by the IG community,” the report said.

The report, which was based on the responses of 72 inspectors general, said eight inspectors general are stymied by their agencies who refuse to give them the documents they request for audits or investigations.

This should surprise nobody. In 2012, then-Senator Tom Coburn (R-OK) released a report examining $70 billion out of about $700 billion in federal grants and other spending he said was appropriated but left unspent. From my interview with Coburn at the time:

Senator Coburn: I can’t tell you the full amount, but I can tell you that money from the 1996 Olympics is still locked in, for example. And that was 16 years ago.

The importance of this report is that it highlights just how bad oversight and accountability are in Washington. For example, $7.5 billion in earmark transportation funding that is never going to be spent has been appropriated. It shows the incompetence of Congress, the incompetence of the process, and the incompetence of the bureaucracy. The federal government is so big it doesn’t know what it’s doing. People may have right intentions, but we’re incompetent because it’s so big.

Coburn also brought duplication in the budget, which he said could save at least $200 billion annually if eliminated, into the limelight during his time as Senator.

Earlier this year, I examined how the federal government’s official estimate of $136 billion lost to “improper payments” almost certainly undercounts the total. And the federal government’s health care and Pentagon spending is vastly oversized, thanks to incompetence and a blind eye to reforms. Clearly, the federal government needs to keep a better eye on taxpayer resources. This level of incompetence ought to be criminal.

This leads to an important question, however: Is it even possible to properly oversee trillions of dollars in scores of separate programs, many of which have sub-programs? I agree with Coburn; the answer is no.

It’s long past time for Democrats and Republicans to stand up for taxpayers by slashing the federal budget itself — by reforming health care spending, eliminating corporate welfare, reforming food stamps and other programs for the poor, and making sure the Department of Defense’s budget serves the public instead of contractors.

Only a smaller government can be truly transparent, and effectively held accountable. Until then, reports like Johnson’s and Grassley’s, and the “Federal Fumbles” report by Senator James Lankford (R-OK), will gain headlines…but do little else.

**Treasury Targets Tax Deferral in Leveraged Partnership Structures with New Regulations**

In general, a contribution of property to a partnership is a tax deferred transaction unless the contributing partner receives property other than a partnership interest and that transfer of other property is sufficiently related to the contribution under the “disguised sale” rules. The assumption of a “nonqualified liability” by the partnership results in a disguised sale to the extent the debt exceeds the contributing partner’s allocable share of the debt after it is assumed by the partnership. Similarly, if the partnership incurs debt to finance a distribution to the contributing partner, a disguised sale generally results if the full amount of the debt is not allocated to the contributing partner under applicable Treasury regulations. As a result, the amount of the partnership liability “allocated” to the contributing partner for tax purposes is critical in determining whether the contributing partner recognizes gain or achieves tax deferral.

Under the old disguised sale rules, payments to the contributing partner financed with partnership debt for which the contributing partner had economic risk of loss (for example, through the partner’s guarantee of the debt) would be allocated entirely to the contributing partner, and thus could be structured to avoid gain recognition under the disguised sale rules. Under the new regulations, however, all partnership debt is treated as nonrecourse debt for purposes...
of the disguised sale rules, regardless of any legal obligations that a partner has to guarantee or otherwise repay the debt, with the result that the debt must be allocated in accordance with the partners' interest in partnership profits. Consequently, contributing partners will not be able to avoid disguised sales by guaranteeing or similarly backstopping the debt assumed by the partnership or incurred by the partnership to source a distribution. Moreover, in determining a partner's share of profits for these purposes, the parties are not permitted to use certain long-standing mechanical allocation rules and must make a determination on the facts without any further guidance from the regulations. The absence of clear rules for identifying a partner’s share of profits for disguised sale purposes will make planning and compliance difficult if not impossible outside of simple pro rata partnerships, as it is completely unclear how to apply the partners’ interest in profits standard where the partners’ interest in profits change as economic hurdles are satisfied. Finally, in no event may debt be allocated to a partner if another partner bears the economic risk of that debt; therefore, a guarantee by a partner may not attract that debt to that partner, but it will prevent any other partner from being allocated that debt for disguised sale purposes. In light of the foregoing, we expect the new rules to either drastically limit, and in some cases foreclose, the ability to achieve tax deferral in leveraged LLC/partnership transactions.[1]

The new rules apply to any transaction with respect to which all transfers occur on or after January 3, 2017.

**Bottom Dollar Guarantees and DROs are no Longer Effective for General Partnership Debt Allocation Rules**

Outside of the disguised sale rules, guarantees and other arrangements that cause a partner to bear the economic risk of loss with respect to partnership debt still result in the debt being allocated to the partner for purposes of determining the partner’s tax basis in its partnership interest. However, the new rules provide that “bottom dollar payment obligations” will be ignored with the result being that these bottom dollar obligations will not attract debt basis (and thus, for example, will not be effective to defer recapture of a partner’s “negative capital account”).

A bottom dollar payment obligation is defined very broadly to include any obligation of the partner to pay any portion of partnership debt (or reimburse another party for payments of that debt) unless the partner or a related person is liable for the full amount of their obligation to the extent the partnership debt is not paid. It also includes tranched debt arrangements that are structured with a view to avoiding the new rules. Any obligation, however structured (including guarantees, DROs, capital contribution obligations, etc.), is subject to the new rules.

There are four exceptions that by themselves will not cause a payment obligation to be disregarded:

- a “vertical slice” payment obligation (i.e., where a partner is obligated to pay a fixed percentage of every dollar of partnership debt that is not paid);
- a reimbursement right of up to 10% of the partner’s obligation;
- a right of proportionate contribution amongst partners to share the liability for a payment obligation where the partners have joint and several liability; and
- a cap on a partner’s payment obligation so long as the partner is economically exposed for the capped amount if the partnership debt is not paid.

A partnership is required to disclose the use of a bottom dollar payment obligation in the year in which the obligation is entered into.

The new bottom dollar payment obligation rules apply to payment obligations entered into on or after October 5, 2016, unless the payment obligation was undertaken pursuant to a prior written agreement. Payment obligations existing on or before October 5, 2016, are not subject to the new rules. However, subject to the transition rules discussed immediately below, the foregoing rules generally will apply to payment obligations entered into prior to October 5, 2016, if the payment obligation is modified or the associated debt is modified or refinanced. Under special transition rules, a partnership may apply the prior law with respect to payment obligations entered into after October 5, 2016, to the extent that its partners’ negative capital accounts being protected by an allocation of recourse debt (as reduced by certain gain allocations) as of that date for a period of seven years. Partnerships are permitted to elect into the new rules for all pre-existing payment obligations starting with their tax year that includes October 5, 2016.

**Key Takeaways for Clients**

- Clients with existing bottom dollar guarantees or DROs should work with counsel to revisit those arrangements to understand any legal obligations they may have with respect to the counterparty in light of these new regulations.
- For example, a partnership that provided tax protection to a counterparty may be required to elect into the seven year transition rule, or a partnership may not be able to refinance nonrecourse debt that is being allocated to a tax protected partner for recourse debt with a bottom dollar guarantee from the tax protected partner.
- Alternatively, a beneficiary of tax protection may have exposure on its negative capital account if the tax protection did not contemplate a change in law and the counterparty wants to refinance or modify its debt.
- Clients desiring to acquire property in tax deferred partnership transactions should expect the contributing property owner to push for the partnership to maintain nonrecourse debt during the life of any tax protection to the extent that debt can be allocated to the contributing partner.

For example, a beneficiary of tax protection may have exposure on its negative capital account if the tax protection did not contemplate a change in law and the counterparty wants to refinance or modify its debt.

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under the nonrecourse debt rules.

Additional Changes to the Disguised Sale Rules

Amongst other less extensive technical changes, the new rules also provide for modifications to the exception to the disguised sale rules for the reimbursement of a contributing partner’s preformation expenditures. This important exception now applies on a property-by-property basis, and can no longer be applied to capital expenditures funded by a qualified liability. In addition, the preamble to the new rules included ominous language suggesting the Treasury plans to consider whether this exception should be repealed completely. These new rules, and all other technical changes, apply to all transactions occurring on or after October 5, 2016.

The new rules also provide a small amount of relief to contributing partners by preventing gain recognition in respect of “qualified liabilities” where a de minimis amount of nonqualified liabilities are also assumed by the partnership. However, this beneficial rule is so narrow that we do not think it will have much practical application.

Business Promotion

Should I Build, Buy or Sell a Practice

Buying or selling a CPA practice is dramatically different today from 20 years ago, and it’s a seller's market. In the ‘80s an exiting owner was likely to sell to an interested younger CPA for a small percentage of fees over a five- or 10-year period. The current market is a lot more varied: Public companies and large firms swallow up small ones, independent firms merge to get big, and young professionals buy their first practices more often than build them. At the moment, that adds up to more potential buyers than owners interesting in selling.

For Tax Professionals considering growth or succession options, this article examines:

- The market now for potential buyers and sellers of tax firms.
- Points to consider about whether to build a practice or buy one.
- Solid reasons to sell.

Readers will gain working knowledge of some of the considerations involved in establishing, developing and eventually realizing the full cash value of a public practice. Key factors for buyers and sellers include personal ambitions and preferences as well as business concerns.

Where Are The Sellers?

While it seems counterintuitive in this age of impending baby-boomer retirement, Tax firm buyers, brokers and several studies, including AICPA-published reports, confirm it's a seller’s market. Possibly sellers are playing their cards close to the vest, but another reason for the tight market may be that a Tax Professional can practice successfully into his or her 70s or 80s. Many Tax Professionals in practice feel they can find ways to handle more business and grow annual revenues indefinitely. Others just don’t want to give up the autonomy their practice provides.

Who Buys?

Buyers come in different forms. Financial buyers typically are national consolidators that acquire firms as investments or to expand their offerings or to gain market share. Synergistic or corporate strategic buyers are established partnerships or sole proprietors in a geographic market who acquire one or more local firms for economies of scale and business growth.

Advantages of buying a practice included:

- Acquiring an instant track record.
- Seasoned guidance from the seller.
- Immediate cash flow.
- Trained employees in place.
- Established clients and potential referrals.
- Existing facilities and operations.

If you’re a tax professional thinking about buying a practice for a change in lifestyle, more personal freedom or greater profitability, the most important due diligence you perform will be to obtain information about the client base of the acquisition you choose. It should match your individual interests, goals and capabilities as much as possible.

Thinking of Selling?

If you are considering selling, evaluate your practice’s strengths and weaknesses: Is your market growing or declining? Are competitors looking to expand into your area? Are qualified local buyers interested in your practice? Your services, staff, clients, revenue, expenses, cash flow, profitability, fee mix, sale timing and the demand for that type of practice and its geographic location will determine the firm’s value to a buyer.

The practice’s cash flow, growth and stability—that is, its moneymaking capacity—will matter most. Profitable practices usually generate higher selling prices and sell quickly. Don’t overlook value-building strategies such as minimizing discretionary expenses to strengthen cash flow, adjusting fees in accord with market trends and developing skills of key staff members who will stay with the new owner.

A good broker can help buyers and sellers over the speed bumps that transitioning a professional practice entails. Their services include valuing a practice accurately, developing a successful marketing campaign, screening candidates,
Tips for Sellers

If you are ready to sell:

- Prepare a comprehensive profile of your practice before offering it for sale.
- Resist overvaluing your practice.
- Follow a proven sales process and be prepared during all of its phases.
- Maintain business as usual; don’t become complacent with clients and staff.

Create competition by talking to multiple buyers.

- Be open-minded and professional when dealing with buyers. A buyer who does not work out may refer one who will.
- Check buyers’ peer review reports. You want the buyer to be right for your clientele.
- Consider a background investigation.
- Negotiate to create success for both parties.
- Work with the buyer to jointly plan and execute a transition.
- Keep things moving—time kills deals.

Tips for Buyers

If you decide buying an existing firm meets your goals:

- Give yourself time to find the right practice. Look beyond the strategic business issues to the entity’s mission, makeup and personnel issues. The acquisition should have a base compatible with your skills and expansion plans.
- Consider firms you already know.
- Look for classified ads in publications such as the Journal of Accountancy and state society magazines.
- Learn how the practice has been valued (see FAQs).
- Recognize red flags: The seller cancels or postpones meetings or drags out negotiations. Be on the lookout for hidden costs—software incompatibility, for example.
- Allow adequate time for due diligence and a smooth transition. Pay close attention to details.
- Consider engaging a trusted intermediary such as a broker or an attorney to expedite your search and help you negotiate.
- Get prequalified for financing. Brokers who have relationships with financial institutions experienced in working with CPA firm mergers and acquisitions may be helpful.

Military Taxes

Extension of Deadlines — Combat Zone Service

Q-11: I have been serving in a combat zone since last November. I understand that the deadline for performing certain actions required by the tax laws is extended as a result of my service. When did these deadline extensions begin for me?

A-11: The deadline extension provisions apply to most tax actions required to be performed on or after the beginning date for your combat zone, or the date you began serving in that combat zone, whichever is later. In your case, the deadline extensions began the day you started serving in the combat zone last November.

Q-12: My son is a member of the U.S. Armed Forces who has been serving in a combat zone since March 1. Is he entitled to an extension of time for filing and paying his federal income taxes? Are any assessment or collection deadlines extended?

A-12: For both questions, the answer is yes. In general, the deadlines for performing certain actions applicable to his taxes are extended for the period of his service in the combat zone, plus 180 days after his last day in the combat zone. This extension applies to the filing and paying of your son’s income taxes that would have been due April 15. In addition to the 180 days, his extension period will include the 46 days that were left before the April 15th deadline when he entered the combat zone. During his 226-day extension period, assessment and collection deadlines will be extended, and he will not be charged interest or penalties attributable to the extension period.

Q-13: Assuming the same facts as in question 12, does the extension for filing and paying his individual income taxes apply to unearned income from my son’s investments?

A-13: Yes. The extensions apply without regard to the source of your son’s income.
Q-14: Assuming the same facts as in question 12, will the deadline extension provisions continue to apply if my son is hospitalized as a result of an injury sustained in the combat zone?

A-14: Yes. The deadline extension provisions will apply for the period that your son is continuously hospitalized outside of the United States as a result of injuries sustained while serving in a combat zone, including 180 days thereafter. For hospitalization inside the United States, the extension period cannot be more than 5 years.

Q-15: My son is a member of a unit of the U.S. Armed Forces and most members of the unit have been serving in a combat zone since April 1. My son has been overseas since February 1, but he did not enter the combat zone until May 1. Is he entitled to an extension of time for filing and paying his federal income taxes that were due April 15?

A-15: No. The extension applies only to a deadline arising on or after the date your son entered the combat zone on May 1.

Q-16: Do the deadline extension provisions apply only to members of the U.S. Armed Forces serving in the combat zone?

A-16: No. Unlike the combat zone military pay exclusion, the deadline extensions also apply to individuals serving in the combat zone in support of the U.S. Armed Forces, such as merchant marines serving aboard vessels under the operational control of the Department of Defense, Red Cross personnel, accredited correspondents, and civilian personnel acting under the direction of the U.S. Armed Forces in support of those forces.

Q-17: Do the deadline extensions apply only to those within a combat zone?

A-17: No. Members of the U.S. Armed Forces who perform military service in an area outside a combat zone qualify for the suspension of time provisions if their service is in direct support of military operations in the combat zone, and they receive special pay for duty subject to hostile fire or imminent danger as certified by the Department of Defense.

Q-18: My son is a civilian explosive specialist who is in a combat zone training U.S. Armed Forces personnel serving in a combat zone. Do the deadline extension provisions apply to my son?

A-18: Yes. The deadline extension provisions apply to your son because he is serving in a combat zone in support of the U.S. Armed Forces.

Q-19: My husband is a private businessman working in a combat zone on nonmilitary projects. Do the deadline extension provisions apply to my husband?

A-19: No. Other than military personnel, the only individuals working in a combat zone that are entitled to the deadline extension provisions are those serving in support of the U.S. Armed Forces.

Q-20: I am a member of the U.S. Armed Forces serving in a combat zone. Do the deadline extension provisions apply to my husband who is in the United States?

A-20: Yes. The deadline extension provisions apply not only to members serving in the U.S. Armed Forces (or individuals serving in support thereof) in the combat zone, but to their spouses as well, with two exceptions. First, if you are hospitalized in the United States as a result of injuries received while serving in a combat zone, the deadline extension provisions would not apply to your husband. Second, the deadline extension provisions for your husband do not apply for any tax year beginning more than 2 years after the date of the termination of the combat zone designation.

Q-21: Assuming the same facts as in question 20, will my husband have to file a joint tax return in order to benefit from the deadline extension provisions?

A-21: No. The deadline extension provisions apply to both spouses whether joint or separate returns are filed. If your husband chooses to file a separate return, he will have the same extension of time to file and pay his taxes that you have.

Q-22: My husband is serving in the U.S. Armed Forces in a combat zone. Last year, our son, who is 12 years old, received interest income on which he owes tax because the amount exceeded his standard deduction. Our daughter, who is 17 years old, received both investment income and earned income from a part-time job. She is entitled to a refund of part of the tax withheld from her pay. We claim both children as dependents on our federal individual income tax return. Must I file individual income tax returns for our children while my husband is in the combat zone?

A-22: No. Filing individual income tax returns for your dependent children is not required while your husband is in the combat zone. Instead, these returns will be timely if filed on or before the deadline for filing your joint income tax return under the applicable deadline extensions. When filing your children’s individual income tax returns, put “COMBAT ZONE” in red at the top of those returns. Because your older child is entitled to a refund, she may want to file her income tax return and obtain her refund without regard to the extension.

Q-23: I am a member of the U.S. Armed Forces serving in a combat zone. My spouse and our three children live in our home in the United States. During the year, a child care provider took care of our children in our home. We are required to file a Schedule H, Household Employment Taxes, as an attachment to our joint income tax return to report the employment taxes on wages we paid to our child care provider. Does the deadline extension apply to the filing of Schedule H as an attachment to our income tax return?

A-23: Yes. The deadline extension applies to all schedules and forms that are filed as attachments to an income tax return.
Q-24: Almost two years ago, the IRS contacted me to collect tax on a joint income tax return I had filed with my now former spouse. I believe only my former spouse should be held liable for the tax. I understand that I may file Form 8857, Request for Innocent Spouse Relief, within 2 years of the first collection activity against me by the IRS. I have just entered a combat zone. Do the deadline extensions apply to the filing of Form 8857?

A-24: Yes. In addition to deadlines for filing and paying taxes, there are various time-sensitive acts for which performance may be postponed because of combat zone service. The 2-year period after the first collection activity for requesting innocent spouse relief is one of these. Other examples are the 90-day limit for filing a Tax Court petition, the 30-day limit for requesting a Collection Due Process hearing, the 60-day period for rolling over a distribution from a qualified tuition plan or Coverdell Education Savings Account into another such plan or ESA, respectively, and the annual distribution from a retirement plan of substantially equal amounts to avoid an excise tax for premature distributions.

Q-25: I served in the U.S. Armed Forces in Afghanistan from April 1, 2002, until August 31, 2002. I was reassigned to the Arabian Peninsula Areas on March 5, 2003. I understand that I was entitled to an extension of time for filing and paying my 2001 income taxes of 195 days (180 days plus the 15-day period that was left before the April 15, 2002 deadline). This extension period would have expired on March 14, 2003 -- 195 days from September 1, 2002 (my first day out of the combat zone in Afghanistan). What effect does my reentry into a combat zone have on my extension for filing and paying my 2001 income taxes?

A-25: Because the extension period had not expired for your 2001 individual income tax return before you reentered a combat zone, a new 180-day period will begin after you leave the combat zone for the second time. In addition, any time that remained in the 15-day period when you entered the Arabian Peninsula Areas adds to the new 180-day period when you leave the Arabian Peninsula Areas. In determining how much of the 15-day period is unused, treat the 180-day period as being used first. In your case, on March 5, 2003, 10 of the 15 days remained. After you leave the Arabian Peninsula Areas, you will have a 190-day extension period for filing and paying your 2001 income taxes. You will have a 222-day period (180 days plus the 42 days that remained before April 15, 2003) to file and pay your 2002 taxes.

Q-26: My wife is a member of the U.S. Armed Forces serving in a combat zone. Can she make a timely qualified retirement contribution for last year to her individual retirement account (IRA) after April 15 this year but on or before the due date of her individual income tax return after applying the deadline extension provisions?

A-26: Yes. Your wife can make a timely qualified retirement contribution for the year to her IRA on or before the extended deadline for filing her income tax return for that year under the extension provisions.

Q-27: My brother, who began serving in the U.S. Armed Forces in a combat zone in early January, did not make his fourth estimated tax payment for the year, due January 15. Will he be liable for estimated tax penalties?

A-27: No. Your brother is covered by the deadline extension rules and will not be liable for any penalties if he files and pays any tax due by his extended filing due date.

Q-28: My son, who is a member of the U.S. Armed Forces, was on an installment payment plan with the IRS for back income taxes before he was assigned to a combat zone. What should be done now that he is in the combat zone?

A-28: The IRS office where your son was making payments should be contacted. Because your son is serving in a combat zone, he will not have to make payments on his past due taxes for his period of service in the combat zone plus 180 days. No additional penalties or interest will be charged during this deadline extension period.

Q-29: My son, who is a member of the U.S. Armed Forces serving in a combat zone, will file his individual income tax return for last year after the regular April 15 due date, but on or before the end of the deadline extension for filing that return. He expects to receive a refund. Will the IRS pay interest on the refund?

A-29: Yes. The IRS will pay interest from the April 15 due date on a refund issued to your son if he files his individual income tax return on or before the due date of that return after applying the deadline extension provisions. If his return is not timely filed on or before the extended due date, no interest will be paid on the refund except as provided under the normal refund rules. Even though the deadline is extended, your son may file a return earlier to receive any refund due.

Q-30: Do the deadline extension provisions apply to tax returns other than the individual income tax return?

A-30: Yes. The deadline postponement provision also applies to estate, gift, employment, and excise tax returns. However, the provision only applies to employment and excise tax returns of individual, sole-proprietors (generally Schedule C filers) in a combat zone. The provision does not apply to other tax and information returns, such as those for corporate income taxes, or to employment or excise taxes of an entity, such as an S Corporation or Limited Liability Company (LLC) where the owner or main person is in the combat zone.

Q-31: My husband and I are civilian employees of defense contractors. I work in the United States and my husband temporarily works in Germany. Our jobs involve the production of equipment used by the U.S. Armed Forces for a combat zone operation. Do the deadline extension provisions apply to either of us?

A-31: No. The deadline extension provisions do not apply to civilian employees of defense contractors unless they are serving in a combat zone in support of the U.S. Armed Forces.
A/B Trusts - Survivor's Trusts & Exemption Trusts

In estate planning documents, it has been common for a married couple to create a single joint-trust that divides into two trusts upon the death of the first spouse.

Commonly, the goal was for the surviving spouse to inherit the use of, but not the assets of, the decedent’s half of the couple’s estate. Then, when the second spouse died, the entire estate was passed to the children. The A/B strategy: The couple created a joint revocable living trust (RLT) which held the couple’s assets in trust for their own benefit and, of course, it could be changed or revoked at any time while they were both living. The assets were listed in the name of the joint trust when they funded the trust.

First spouse death creates two trusts: “A” and “B”

With this estate planning strategy, when the first spouse dies, the trust is split into two trusts, the “A” and “B” trusts.

The first trust, the “A” trust, created from the original RLT is a Survivor’s Trust. It is a continuation of the original trust for the benefit of the living spouse. The assets in the trust are the surviving spouse’s share of the couple’s estate. As with the original RLT, it is revocable, changeable, and assets can be acquired and/or sold at the desire of the surviving spouse who is the grantor of this Survivor’s Trust.

A/B Trust Strategy - To maximize each person’s Exemption Amount

The second trust, the “B” trust, is often known by alternative names including “exemption trust,” “bypass trust,” “credit shelter trust,” “dependent’s trust,” and “family trust.” The reason for these various names is that the “B” trust bypasses the spouse’s estate and the assets pass to the children upon the death of the second spouse. Commonly, the “B” trust was funded up to the estate tax exemption amount, often the amount for federal transfer tax purposes (see also Form 706 and instructions). While the surviving spouse does not own these assets, the trust document gives the spouse access to them for defined purposes, usually the ascertainable standards of health, education, maintenance, and support (HEMS). It is the inclusion of ascertainable standards that permits the surviving-spouse-beneficiary to be the trustee of the “B” trust without triggering the trust’s assets to be included in the surviving spouse’s estate. The “B” trust is not revocable. The trust assets receive a date-of-death basis from the first spouse to die. They are not “stepped-up” again when the second spouse passes away.

In the years before portability, the “A” Survivor’s Trust and the “B” Exemption Trusts worked together to allow a couple to pass to their heirs, estate transfer tax free, the full exemption amount applicable for each year of death.

Are A/B Trusts still used today?

With portability, for federal tax purposes, the A/B trust arrangement may not be found as often in recently drafted estate planning documents. Yes, the strategy is still being used. More importantly, many documents written with the A/B strategy continue to exist. It is important for us, as tax professionals, to understand the basic construction of this type of estate planning. Trust document provisions are vast and varied. It is important for us to understand the basics of estate planning strategies so that when we read a client’s trust document, we are better able to understand whether this “common” pattern, or another, applies to our clients.

Practical Application

Sometimes our clients like to tell us what the trust documents said. Sometimes they want us to rely upon previous returns prepared by other tax professionals and ask us to prepare the return “same as last year.” While the probability is high that the prior returns are correct, we need to use due diligence and read the documents as well as review the previous year returns ourselves. In short: You cannot prepare a trust return until you have read the applicable trust document.

Editor’s Note: Those of you who heard me teach the Estates, Gifts and Trust Seminar for ncpe this summer understand the term “Above the ground and Below the Ground Trust. Ncpe is keeping a very close eye on the election results relating to the Estate Tax.

IRS Announces 2017 Estate and Gift Tax Limits: The $11 Million Tax Break

For 017, the estate and gift tax exemption is $5.49 million per individual, up from $5.45 million in 2016. That means an individual can leave $5.49 million to heirs and pay no federal estate or gift tax. A married couple will be able to shield just shy of $11 million ($10.98 million) from federal estate and gift taxes. The annual gift exclusion remains at $14,000 for 2017. The estate tax changes matter to wealthy folks who try to whittle down their estates to keep below the threshold and avoid the 40% federal estate tax. “There are clients who use every dollar of exemption as soon as it’s available,” says Beth Kaufman, an estate lawyer with Caplin & Drysdale in Washington, D.C. Now a couple who has used up every dollar of their exemption before the increase has another $80,000 to play with. They could use it as seed money for a trust or to fund a GRAT, two popular wealth transfer strategies that can leverage these little slivers of exemptions, Kaufman says.

The fate of the federal estate tax is uncertain. Republican presidential candidate Donald Trump wants to repeal it, and impose a new carryover basis regime for estates over $10 million. And Democratic presidential candidate Hillary Clinton has proposed returning to a $3.5 million exemption, and a graduated tax rate starting at 45%, going up to 65% for $500 million-plus estates.
In the meantime, if you live in one of the 18 states or the District of Columbia that levy separate estate and/or inheritance taxes, there’s even more at stake, with death taxes sometimes starting at the first dollar of an estate. (See Where Not To Die In 2017). New Jersey just repealed its estate tax (for 2018) but left its inheritance tax on the books.

The federal gift tax is tied to the estate tax, so the inflation indexing helps the wealthy make the most of tax-free lifetime giving too. You can make the gifts during your lifetime; just you have to keep track of them as they count against the eventual estate tax exemption amount. So a woman who set up a trust for her kids with $5 million a few years ago could make new gifts to add to the trust and bring it up to the $5.49 million amount.

Don’t let the $11 million number fool you. The rules for couples are tricky. Sure a husband and wife can each get their own exemption, meaning a couple will be able to give away nearly $11 million tax-free in 2017 (assuming they haven’t made prior lifetime gifts), but it’s not automatic. An unlimited marital deduction allows you to leave all or part of your assets to your surviving spouse free of federal estate tax. But to use your late spouse’s unused exemption — a move called “portability”— you have to elect it on the estate tax return of the first spouse to die, even when no tax is due. The problem is if you don’t know what portability is and how to elect it, you could be hit with a surprise federal estate tax bill.

Totally separate from the lifetime gift exemption amount is the annual gift tax exclusion amount. It’s $14,000 for 2017, stuck at that level since 2014. You can give away $14,000 to as many individuals as you’d like. A husband and wife can each make $14,000 gifts. So a couple could make $14,000 gifts to each of their four grandchildren, for a total of $112,000. The annual exclusion gifts don’t count towards the lifetime gift exemption. Stuffing 529 college savings accounts or funding a gift trust are two ways to prepare your heirs for college. Which is better?

When you’re making gifts to children and grandchildren, keep in mind that there’s a federal kiddie tax that covers students through the age of 23 and puts investment income, above small amounts, into the parents’ tax bracket. For 2017, the kid pays no tax on the first $1,050 of unearned income and then 10% rate on the next $1,050, the same as in 2016. It pays to make gifts early in the year.

If you want to make gifts and not have to bother to keep track for gift tax purposes, you can make gifts for medical, dental, and tuition expenses for as many relatives (or friends) as you’d like so long as you pay the provider directly. These gifts don’t count towards any of the limits.

### People in the Tax News

#### Couple Stole Social Security Benefits, Didn’t Pay Taxes

The Hunterdon County Prosecutor’s Office announced the arrest of a Pittstown couple for theft and tax evasion.

Christopher Pennetta, 52, and Catherine Pennetta, 57, both of Pittstown.

Christopher Pennetta, 52, and Catherine Pennetta, 57, both of Pittstown, are facing a number of charges following an eight-month investigation, Hunterdon County Prosecutor Anthony P. Kearns, III, said.

“Christopher and Catherine Pennetta were responsible for the submission of misleading applications for social services and social security benefits since March of 2014, and failing to file and pay income taxes in 2014 and 2015,” Kearns said. “The Pennetta’s were also found to be operating a home improvement business without the proper registration in 2015 and 2016.”

Christopher Pennetta, arrested on Oct. 12, was charged with second-degree theft by deception, and conspiracy to commit theft by deception, hindering apprehension or prosecution, failure to pay taxes and failure to file tax returns, all third-degree crimes.

He was also charged with falsifying or tampering with records and violation of contractor’s registration, both fourth-degree crimes.

He was sent to the Somerset County Jail on $75,000 bail by state Superior Court Judge Angela F. Borkowski pending a court appearance.
Catherine Pannetta was arrested and charged with theft by deception, conspiracy to commit theft by deception, hindering apprehension or prosecution, failure to pay taxes and failure to file tax returns, all third-degree crimes, as well as falsifying or tampering with records and violation of contractor’s registration, both fourth-degree crimes.

She was released on her own recognizance pending her first court appearance.

The arrests were announced by Kearns, as well as New Jersey State Police Kingwood Station Commander Lt. Roger Malone.

The joint investigation was done by detectives from the Hunterdon County Prosecutor’s Office, Office of the Inspector General – Social Security Administration, New Jersey Division of Taxation Office of Criminal Investigation, New Jersey State Police Kingwood Barracks, Hunterdon County Division of Adult Protective Services and the Hunterdon County Department of Human Services.

**Maryland Comptroller’s Office Honored**

The Maryland Comptroller’s Office has been selected by a national panel recognizing the agency for its work in identifying tax fraud and identity theft. Created by Drexel University and CIO.com, the Analytics 50 Awards selected 50 executives who use analytics to solve business challenges. The Comptroller’s Office was chosen for its “innovative use of analytics to create and deliver business value” by judges for Drexel University’s LeBow College of Business and CIO.com, an information technology media company.

“The state-of the art technology used by my agency, together with the diligent work of my team of investigators, has helped to halt the brazen filing of radioactive state tax returns,” said Comptroller Peter Franchot. “I’m very proud of our efforts to root out fraudsters who try to cheat Marylanders and steal the money our state needs for schools, roads and many worthy programs.”

The Comptroller’s Office was selected for its ability to uncover fraudulent tax returns. For the 2015 tax year, the agency prevented $38.6 million in about 35,000 fraudulent refunds from being issued. For current tax season, the agency was able to detect fraudulent returns filed by 61 private tax preparers at 68 locations throughout the region and out of state.

“As the perpetrators of this type of fraud have proliferated in recent years and their methods have become highly sophisticated, the Comptroller of Maryland sought a new strategy with analytic modeling,” said Andrew Schaufele, director of the Bureau of Revenue Estimates.

“We are extremely impressed with the company honorees and to learn how the use of innovative analytics has played a pivotal role in providing organization solutions across industries,” said Dr. Murugan Anandarajan, department head of Decision Sciences and MIS at Drexel University.

The Analytics 50 selectees represent a broad spectrum of industries, ranging from pharmaceuticals and healthcare to sports and media. The winners will be recognized November 9 at Drexel University in Philadelphia.

**Retired U.S. Tax Court Judge Pleads Guilty To Tax Fraud While She Sat On The Court**

A former U.S. Tax Court judge pleaded guilty Friday to conspiring with her husband to fraudulently omit nearly $1 million of income from their tax returns while she served as judge, using the gains on personal expenses like international trips and Pilates classes.

Diane Kroupa, 61, faces up to five years in prison after pleading guilty to conspiracy to defraud the United States in federal court in St. Paul. A federal grand jury indicted Kroupa and her then-husband, Robert Fackler, 63, in April.

Fackler, a self-employed lobbyist and political consultant, pleaded guilty last month; sentencing dates have yet to be scheduled for either defendant. The couple began divorce proceedings shortly after their indictment.

Kroupa, who was appointed to the court in 2003 and retired in 2014, and Fackler have admitted to purposely understating their taxable income by about $1 million and their amount of taxes owed by about $450,000 from 2004 through 2010.

Both defendants admitted to fraudulently deducting at least $500,000 of personal expenses, which they listed as expenses at Fackler’s consulting firm, and another $450,000 in purported business costs, for which clients had actually reimbursed Fackler. Kroupa also failed report a $44,520 real estate transaction, instead claiming it was part of an unrelated inheritance.

**IRS News**

**2017: Some Tax Benefits Increase Slightly Due to Inflation Adjustments, Others Are Unchanged**

The Internal Revenue Service announced the tax year 2017 annual inflation adjustments for more than 50 tax provisions,
including the tax rate schedules, and other tax changes. Revenue Procedure 2016-55 provides details about these annual adjustments. The tax year 2017 adjustments generally are used on tax returns filed in 2018. The tax items for tax year 2017 of greatest interest to most taxpayers include the following dollar amounts:

- The standard deduction for married filing jointly rises to $12,700 for tax year 2017, up $100 from the prior year. For single taxpayers and married individuals filing separately, the standard deduction rises to $6,350 in 2017, up from $6,300 in 2016, and for heads of households, the standard deduction will be $9,350 for tax year 2017, up from $9,300 for tax year 2016.

- The personal exemption for tax year 2017 remains as it was for 2016: $4,050. However, the exemption is subject to a phase-out that begins with adjusted gross incomes of $261,500 ($313,800 for married couples filing jointly). It phases out completely at $384,000 ($436,300 for married couples filing jointly.)

- For tax year 2017, the 39.6 percent tax rate affects single taxpayers whose income exceeds $418,400 ($470,700 for married taxpayers filing jointly), up from $415,050 and $466,950, respectively. The other marginal rates – 10, 15, 25, 28, 33 and 35 percent – and the related income tax thresholds for tax year 2017 are described in the revenue procedure.

- The limitation for itemized deductions to be claimed on tax year 2017 returns of individuals begins with incomes of $287,650 or more ($313,800 for married couples filing jointly).

- The Alternative Minimum Tax exemption amount for tax year 2017 is $54,300 and begins to phase out at $120,700 ($84,500, for married couples filing jointly for whom the exemption begins to phase out at $160,900). The 2016 exemption amount was $53,900 ($83,800 for married couples filing jointly). For tax year 2017, the 28 percent tax rate applies to taxpayers with taxable incomes above $187,800 ($93,900 for married individuals filing separately).

- The tax year 2017 maximum Earned Income Credit amount is $6,318 for taxpayers filing jointly who have 3 or more qualifying children, up from a total of $6,269 for tax year 2016. The revenue procedure has a table providing maximum credit amounts for other categories, income thresholds and phase-outs.

- For tax year 2017, the monthly limitation for the qualified transportation fringe benefit is $255, as is the monthly limitation for qualified parking.

- For calendar year 2017, the dollar amount used to determine the penalty for not maintaining minimum essential health coverage is $695.

- For tax year 2017 participants who have self-only coverage in a Medical Savings Account, the plan must have an annual deductible that is not less than $2,250 but not more than $3,350; these amounts remain unchanged from 2016. For self-only coverage the maximum out of pocket expense amount is $4,500, up $50 from 2016. For tax year 2017 participants with family coverage, the floor for the annual deductible is $4,500, up from $4,450 in 2016, however the deductible cannot be more than $6,750, up $50 from the limit for tax year 2016. For family coverage, the out of pocket expense limit is $8,250 for tax year 2017, an increase of $100 from tax year 2016.

- For tax year 2017, the adjusted gross income amount used by joint filers to determine the reduction in the Lifetime Learning Credit is $112,000, up from $111,000 for tax year 2016.

- For tax year 2017, the foreign earned income exclusion is $102,100, up from $101,300 for tax year 2016.

Estates of decedents who die during 2017 have a basic exclusion amount of $5,490,000, up from a total of $5,450,000 for estates of decedents who died in 2016.

**IRS Explains Penalties Applicable to Taxpayers Participating in OID Scheme**

Chief Counsel Advice 201640016

In a highly redacted Chief Counsel Advice (CCA), where taxpayers filed returns claiming false Original Issue Discount (OID) income and identical false withholding, and obtained a refund, IRS concluded that it was likely that a court would consider the returns to be valid, even if they contained a frivolous position. Such a valid return would give rise to an underpayment potentially subject to a Code Sec. 6663 fraud penalty. Alternatively, if the returns were treated as invalid, the taxpayers could be subject to a Code Sec. 6651(f) fraudulent failure to file penalty. IRS also explained where the assertion of the Code Sec. 6676 penalty on erroneous claims for refund or credit would be applicable.

The Code Sec. 6663 fraud penalty cannot apply when a taxpayer has not filed a valid tax return. (Code Sec. 6664(b), Mohamed, TC Memo 2013-255)

Beard, (1984) 82 TC 766, sets out a 4-part test for determining whether a defective or incomplete return is nonetheless treated as valid: (1) the return must have sufficient data to calculate tax liability; (2) the document must purport to be a return; (3) there must be an honest and reasonable attempt to satisfy the requirements of the tax law; and (4) the taxpayer must execute the return under penalties of perjury.

Where taxpayers have included false overstated withholding information on their returns, courts have held that the returns were inaccurate, but not invalid. For example, in Feller, (2010) 135 TC 497, the court treated a return as valid where it reported overstated withholding attributable to false OID income. In Sadler, (1999) 113 TC 99, and Rice, TC Memo 1999-65, the
courts treated a return as valid where it falsely overstated the taxpayer’s income tax withholding.

For the frivolous filing penalty to apply, Code Sec. 6702 requires that the purported return contain information that “on its face indicates that the self-assessment is substantially incorrect.” (Code Sec. 6702(a)(1)(B))

Code Sec. 6676 provides that, where a taxpayer makes a claim for refund that is erroneous and without a reasonable basis, a penalty equal to 20% of the amount erroneously claimed will apply. (Code Sec. 6676(a))

Taxpayers, husband and wife, each filed purported income tax returns (Forms 1040) claiming Form 1099-OID (Original Issue Discount) income and an identical amount of tax withheld. No Form 1099-OID was attached. The purported returns were processed by IRS, and refunds were issued to the taxpayers for some of the years at issue.

All of the entities purportedly issuing the Forms 1099-OID verified that, contrary to the taxpayers’ claim, there were no Forms 1099-OID associated with their accounts.

For later years at issue, the purported return claiming Form 1099-OID income and an amount of tax withheld was either not processed or processed but the requested refund was frozen.

IRS subsequently assessed a $5,000 Code Sec. 6702 frivolous filing penalty with respect to each purported return.

In addition to the original returns, the wife filed amended income tax returns claiming additional Form 1099-OID income and an identical amount of additional withholding on the return. These amended return were not processed, and the refunds claimed on the amended return were not issued.

To determine whether the taxpayers were subject to the fraud penalty under Code Sec. 6663, IRS found that it must first determine whether the purported returns the taxpayers filed constitute valid tax returns. In the CCA, IRS found that the returns were likely to be held to be valid returns.

The Supreme Court has held that a return that is incorrect, or even fraudulent, may still be a valid return if “on its face it plausibly purports to be in compliance.” (Badaracco v. Comm., (S Ct 1984) 53 AFTR 2d 84-446) And in Feller, the Tax Court treated as valid returns that claimed refunds on the basis of overstated withholding.

To be valid, a return must meet the four Beard requirements. IRS reasoned that the Forms 1040 filed by the taxpayers met three requirements of the Beard test. As to the first requirement, the returns filed by taxpayers contained sufficient data to calculate their tax liability because, aside from the overstated withholding, the returns were largely correct. As to the second and fourth factors, all the returns purported to be returns and were executed under penalties of perjury.

IRS found that whether the purported returns were an honest and reasonable attempt to satisfy the requirements of the tax law, in satisfaction of the third requirement, was a closer call. Because IRS assessed the Code Sec. 6702 frivolous return penalty, it determined that the Forms 1040 that the taxpayers submitted contained some information that, on the face of the returns, indicated that the self-assessments were incorrect. It was arguable that, if a return was so facially implausible that a Code Sec. 6702 penalty applied, the return may also fail the “honest and reasonable attempt” third prong of the Beard test. However, IRS noted, citing Sakkis, TC Memo 2010-256, that rarely, if ever, has a court found a purported return to be invalid solely for failure to satisfy the third prong of the Beard test. Here, the taxpayers accurately reported most of their tax information for the years at issue. The inclusion of falsely overstated withholding information rendered their returns inaccurate, but likely not invalid. Most likely, a court would find that the returns were valid returns and thus could give rise to liability for the fraud penalty under Code Sec. 6663, if there was an underpayment.

To guard against the possibility that the returns were found to be not valid, IRS advised in the CCA that a Code Sec. 6651(f) fraudulent failure to file penalty should be included as an alternative position in any statutory notice of deficiency issued to the taxpayers for the years at issue.

IRS concluded that the returns, which claimed refunds that IRS did not pay, would not give rise to underpayments, and so the Code Sec. 6663 fraud payment was inapplicable. The CCA noted that IRS has adopted the practice of treating the amount of a frozen refund as a sum collected without assessment. As a result, in many cases, no underpayment will exist. However, the CCA recommended assertion of the Code Sec. 6676 penalty on erroneous claims for refund or credit.

As to amended returns, IRS explained that they differ from original returns in that a taxpayer is required to file an original return, whereas amended returns are a matter of administrative grace. The Tax Court has said that a “rejection of a claim for refund or abatement in an amended return does not convert the disallowed claim into a deficiency.” (Fayeghi, TC Memo 1998-297) Further, IRS, as noted above, treats the amount of a frozen refund as a sum collected without assessment. Thus, underpayments cannot arise from false refund claims that are not paid.

In the CCA, IRS concluded that the appropriate penalty for this type of situation—where a taxpayer makes a false claim for refund that is not paid—is the Code Sec. 6676 penalty on erroneous claims for refund. Here, the taxpayer’s amended returns made claims for refund that were both erroneous and without reasonable legal or factual basis. Consequently, those claims were subject to the 20% penalty imposed by Code Sec. 6676.
IRS Issues Update of Extreme Drought Areas for Extended Livestock Replacement Period

IR 2016-127; Notice 2016-60, 2016-42 IRB

IRS has released the latest version of an annual list (published each September) of counties or parishes in which exceptional, extreme, or severe drought has been reported during the preceding 12 months. Farmers and ranchers in these areas whose drought sale replacement period for a tax-free sale or exchange under Code Sec. 1033 was scheduled to expire at the end of this tax year—Dec. 31, 2016, in most cases—will now have until the end of their next tax year. The list can be used instead of U.S. Drought Monitor maps to determine whether an extended replacement period applies for livestock sold because of drought.

An involuntary conversion is the compulsory or involuntary conversion of a taxpayer's property into similar property, dissimilar property or money as a result of the property's destruction, theft, seizure, requisition or condemnation (actual or threatened). (Code Sec. 1033(a)) Involuntary conversion includes the sale or exchange of livestock (in excess of the number that the taxpayer would sell if he followed his usual business practices) solely on account of drought, flood, or other weather-related conditions. (Code Sec. 1033(e)(1)) Where property is involuntarily converted into other property similar or related in service or use to the converted property, no gain is recognized. (Code Sec. 1033(a)(1))

If a taxpayer sells livestock on account of drought, flood, or other weather-related conditions which result in the area being designated as eligible for assistance by the federal government, the involuntary conversion replacement period is four years. This 4-year period may be extended further by IRS on a regional basis if the weather-related conditions continue for more than three years. (Code Sec. 1033(e)(2))

In Notice 2006-82, 2006-2 CB 529 IRS said that if a sale or exchange of livestock is treated as an involuntary conversion because of drought, the 4-year replacement period is extended until the end of the taxpayer's first tax year ending after the first drought-free year for the applicable region. The first drought-free year for the applicable region (which is the county that experienced the drought and all contiguous counties) is the first 12-month period that: (1) ends on Aug. 31; (2) ends in or after the last year of the taxpayer's 4-year replacement period; and (3) does not include any weekly period for which exceptional, extreme, or severe drought is reported for any location in the applicable region. Taxpayers can determine whether drought conditions exist for an applicable region by referring to either the U.S. Drought Monitor maps produced by the National Drought Mitigation Center (NDMC) or a list that IRS publishes in September.

List of areas with exceptional, extreme, or severe drought. In the Appendix to Notice 2016-60, IRS lists counties in 37 states and Puerto Rico for which exceptional, extreme, or severe drought was reported during the 12-month period ending Aug. 31, 2016. Any county contiguous to a county listed by the NDMC also qualifies for relief. (IR 2016-127)

Under Notice 2006-82, the 12-month period ending on Aug. 31, 2016, is not a drought-free year for an applicable region that includes any county on this list. For a taxpayer who qualified for a 4-year replacement period for livestock sold or exchanged on account of drought and whose replacement period is scheduled to expire at the end of 2016 (or, in the case of a fiscal year taxpayer, at the end of the tax year that includes Aug. 31, 2016), the replacement period under Code Sec. 1033(e)(2) and Notice 2006-82 will be extended if the applicable region includes any county on this list. This extension will continue until the end of the taxpayer's first tax year ending after a drought-free year for the applicable region.

IRS notes that the 1-year extension of the replacement period generally applies to capital gains realized by eligible farmers and ranchers on sales of livestock held for draft, dairy or breeding purposes due to drought. Sales of other livestock, such as those raised for slaughter or held for sporting purposes, and poultry aren't eligible. (IR 2016-127)

IRS Disagrees with Decision Allowing Accrual Basis Taxpayer to Deduct Customer Loyalty Discounts

Action on Decision, 2016-003

In an Action on Decision, IRS has announced its nonacquiescence with a Third Circuit decision that held that a retailer that issued loyalty discounts to its customers was entitled to deduct its liabilities attributable to discounts that were accrued but that had not yet been redeemed.

Under Code Sec. 461(a), a deduction or credit must be taken for the tax year that is the proper tax year under the accounting method used by the taxpayer to compute its taxable income. Under Reg. § 1.461-1(a)(2)(i) , a liability is generally incurred and taken into account under an accrual accounting method in the tax year in which: (1) all the events have occurred that establish the fact of the liability; (2) the amount of the liability can be determined with reasonable accuracy; and (3) economic performance has occurred with respect to the liability under Code Sec. 461(h).

If the taxpayer's liability is to pay a rebate, refund, or similar payment to another person (whether paid in property, money, or as a reduction in the price of goods or services to be provided in the future by the taxpayer), economic performance generally occurs as payment is made to the person to which the liability is owed. (Reg. § 1.461-4(g)(3))

However, under the Code Sec. 461(h)(3) recurring item exception, certain recurring items can be deducted for a tax year, even if economic performance has not been met, if:

- at the end of the tax year, all events have occurred
that establish the fact of the liability and the amount can be determined with reasonable accuracy; (Reg. § 1.461-5(b)(1)(i))

- economic performance occurs on or before the earlier of (i) the date that the taxpayer files a return (including extensions) for the tax year, or (ii) the 15th day of the ninth calendar month after the close of the tax year; (Reg. § 1.461-5(b)(1)(ii))

- the liability is recurring in nature; (Reg. § 1.461-5(b)(1)(iii)) and

- either the amount of the liability is not material or accrual of the liability in the tax year results in better matching of the liability against the income to which it relates than would result from accrual of the liability in the tax year in which economic performance occurs. (Reg. § 1.461-5(b)(1)(iv))

The taxpayer, Giant Eagle, operated supermarkets, pharmacies and gas stations.

During the years at issue, Giant Eagle had a customer loyalty program (the program). Under the program, customers would present a customer loyalty card when purchasing qualifying groceries and, for every $50 spent, earn a 10¢ per-gallon price reduction for gasoline purchased in one transaction. The discounts were aggregated so they could potentially reduce the per-gallon gas price to zero. Although the discounts were described in a program brochure as expiring three months after the last day of the month in which they were earned, Giant Eagle did not in fact revoke any accumulated discounts during 2006 or 2007 (the years at issue).

On its corporate income tax returns for the years at issue, Giant Eagle claimed a deduction for the discounts its customers had accumulated but, at year’s end, had not yet applied to fuel purchases, amounting to $3.4 million for 2006 and $313,490 for 2007. Giant Eagle computed the deductions by: (1) ascertaining the total dollar amount spent at its supermarkets on discount-qualifying items, (2) dividing that figure by 50 to determine the number of outstanding accumulated discounts, and (3) multiplying the quotient by 10¢ to determine the face value of the discounts. Next, Giant Eagle (4) multiplied the discounts’ face value by the historical redemption rate of discounts in their expiring month, and (5) multiplied that product by the average number of gallons purchased in a discounted fuel sale.

IRS disallowed the deductions, and Giant Eagle challenged the disallowance in Tax Court.

Tax Court sided with IRS. Giant Eagle argued that the discounts accumulated but not applied by year’s end satisfied the “all events” test under the recurring items exception because Giant Eagle’s liability became fixed upon issuance of the discounts and the amount of that liability was reasonably ascertainable. The Tax Court, however, found that the claimed deductions did not satisfy the “all events” test because, since the program was structured as a discount against the purchase price of gas, the purchase of gas was necessarily a condition precedent before Giant Eagle could claim a deduction. (For more details on the Tax Court’s decision.

Giant Eagle appealed, and based on IRS concessions, the only unresolved issue on appeal was whether the “fact of the liability” was fixed at year’s end—i.e., whether, before the end of the tax year, Giant Eagle had become liable to pay the discount to its customers who had purchased qualifying groceries under the program.

Third Circuit reversed. In a 2-1 decision, the Third Circuit, looking to contract law principles, noted that unilateral contracts involve one party’s promise in exchange for another party’s act or performance, and that Giant Eagle’s liability in this case attached when a customer made qualifying purchases under the program. (Giant Eagle, Inc. (CA 3 5/6/2016) 117 AFTR 2d ¶2016-674; The Third Circuit found it irrelevant that neither the total amount of Giant Eagle’s anticipated liability nor the identity of all the customers who eventually applied discounts toward gasoline purchases could be conclusively identified at year’s end. The Court acknowledged that there was some possibility that the claimed deductions would overstate the value of the rewards its customers ultimately redeemed, but that Giant Eagle significantly mitigated that risk by tracking its customers’ monthly redemption rates and offsetting the deductions accordingly to account for prospective non-redeemers.

Overall, the Third Circuit was convinced that Giant Eagle demonstrated the existence, as of year’s end, of both an absolute liability and a near-certainty that the liability would soon be discharged by payment. The Court found that Giant Eagle’s method for calculating the deduction reasonably took into account the chance of non-redeemption with “reasonable accuracy.” It noted that this is all that is required to satisfy Reg. § 1.461-5(b)(1)(i)’s “all events” test and that Giant Eagle was therefore entitled to deduct its program-related liabilities incurred during the years at issue.

Third Circuit dissenting view. The dissenting judge believed that Giant Eagle’s liabilities were not determined until the discounts were redeemed. He said that the fact that the rewards technically expired after a set period, regardless of whether this rule was enforced in practice, meant that Giant Eagle wasn’t absolutely liable to shoppers unless and until the rewards were redeemed.

IRS disagrees. IRS has now announced its nonacquiescence with the Third Circuit’s holding that all events fixing a liability for federal income tax purposes occur when discount fuel purchase coupons are issued to a customer for retail grocery purchases.

Fake IRS Collection Job Lands India ‘Scam Center’ Workers in Jail

Minaz Husain Ladaf couldn’t believe his luck this summer when he was offered a 40% bump in salary and other perks to work for what he thought was the U.S. government. But when
Mr. Ladaf and dozens of fellow call-center workers have been locked in dusty jail cells in this booming Mumbai suburb since Wednesday. Police say they managed a telephone “scam center” where close to 700 workers called targeted Americans, pretending to be from the U.S. Internal Revenue Service, and raking in an estimated $150,000 a day.

They would follow a precise script, police said, trying to trick people into believing they owed thousands of dollars in taxes and were facing all kinds of ruinous penalties or even jail, in the latest example of what U.S. authorities say is a recent wave of tax-related swindles.

“Your 401(k) [retirement] plan will be frozen and confiscated, all your wages and benefits would be frozen,” one script went, according to a phone recording released by police here. “Your passport will be seized along with your state ID and if you belong to a country other than the United States then you will be deported…your Social Security number will be blocked for the next seven years and you will not be eligible for any benefits such as disability benefits, unemployment benefits, child-protection income or retirement or pension.”

The Inspector General for Tax Administration in the U.S. says it has fielded more than 1.7 million complaints from victims who have lost a total of more than $47 million to such scams in the last three years.

Police arrested Nasreen Bano Iqbal Bale Sahib and her two sons, Nadeem Iqbal Balasaheb and Shain Iqbal Balasaheb, who were listed as owners of the company, MAC Outsourcing Services Private Limited, that managed the floor in the 7-story building that hosted the call center.

There wasn’t any immediate reply to a request for comment sent to an email address included with the company’s registry. A phone number couldn’t be located and police said they didn’t have a contact for the family’s lawyer.

Police said they were investigating the individuals who managed the other floors to determine if they had any involvement.

Of the 772 people in the building at the time of Tuesday’s raid, deputy police commissioner Parag Manere said 70 so far were being charged with “cheating by impersonation” and forgery. Another 72 were questioned and released and the rest were asked to come to the police station to be questioned starting Friday.

Speaking on Thursday through the bars of a jail cell at the Thane police station, the 25-year-old Mr. Ladaf said he would plead innocent to any charges.

“We didn’t want to cheat people,” he said.

Mr. Ladaf said he found the job through a flier with bright-red letters advertising “An Urgently Huge Requirement” for call-center workers. With his strong English and experience at other call centers, he was offered the top salary as well as promises of bonuses and regular days off, he said.

When he started work Aug. 1, he said, the owner informed him and the other new recruits that the company had won a contract with the U.S. government.

“He said that we just had to collect money,” said Mr. Ladaf. “He said we were getting data from a U.S. government department and that we were partners with them.”

He was given a long list of people to call, he said, but as almost every customer swore at him before slamming down the phone, he realized he was probably not actually working for the U.S. government. He was planning to quit after getting his paycheck on Tuesday, but when he got to work police were raiding the office.

According to Indian police, the scam operators received phone numbers and other details about U.S. taxpayers from a contact in the U.S. The call-center workers directed the victims to nearby stores to buy $500 gift cards.

The victims were then instructed to disclose the registration numbers of the cards, giving the call-center worker access to the cash.

According to the recordings released by police, some victims were told they only had hours to make some kind of payment or they would be arrested and face years in jail and a $100,000 fine.

Closers, as the most skilled workers were known, would keep their victims on the phone for as long as three hours, police said, threatening them with immediate imprisonment if they hung up.

Police Inspector Nitin Thakare said he snatched a headset from one dialer during the raid and heard what sounded like an elderly woman on the other end. “She was weeping,” the inspector said. “We felt so bad about it.”

Every dollar squeezed from a victim would bring the employee a bonus of one rupee, or 1.5 cent. Police say one victim lost $88,000, earning the dialer more than $1,300.

When one employee made a big score, the others would applaud and bonuses were immediately handed out in cash, police said.

But the job could be tough, Mr. Ladaf said, as 99% of the people they called weren’t fooled by the scam. “It was extremely frustrating,” he said. “We took abuse for hours on end.”

**IRS Announces Position on Unilateral APA Applications Involving Maquiladoras**

The Internal Revenue Service announced that U.S. taxpayers...
with maquiladora operations in Mexico will not be exposed to double taxation if they enter into a unilateral advance pricing agreement (APA) with the Large Taxpayer Division of Mexico’s Servicio de Administración Tributaria (SAT) under terms discussed in advance between the U.S. and Mexican competent authorities.

Maquiladoras typically operate in Mexico as contract manufacturers of foreign multinationals.

This announcement represents the culmination of two years of collaboration between the competent authorities to address SAT’s current inventory of approximately 700 pending unilateral APA requests in the maquiladoras industry. It is an important step forward in strengthening ties between the two governments and providing certainty in the taxation of multinationals.

In 1999, the U.S. and Mexican competent authorities reached an agreement on transfer pricing and other aspects of the tax treatment of maquiladoras of U.S. multinational enterprises. The new agreement updates and expands upon the 1999 agreement in order to reflect recent revisions to Mexican domestic tax rules governing transfer pricing rules, documentation requirements and other tax attributes of maquiladoras.

The centerpiece of the discussions between the competent authorities is an election SAT would extend to qualifying taxpayers with pending unilateral APA requests. These taxpayers may elect to apply a transfer pricing framework that the U.S. and Mexican competent authorities have agreed in advance will produce arm’s length results. Qualifying taxpayers that decline the election may apply the safe harbors provided by the 1999 Agreement or file a request for a bilateral APA with the U.S. and Mexican competent authorities.

SAT will release details shortly about the election and will directly notify qualifying Mexican taxpayers. The notification will include details on the steps the taxpayers must take with regard to their pending unilateral APA requests.

Because the transfer pricing framework adopted under SAT’s program was discussed and agreed upon with the U.S. competent authority in advance, the transfer pricing results set forth in unilateral APAs executed between SAT and Mexican affiliates of U.S. taxpayers pursuant to this program will be regarded as “arm’s length” under section 482 of the Internal Revenue Code.

In conjunction with the 1999 agreement, this announcement will provide certainty for U.S. taxpayers regarding double taxation, foreign tax credits and permanent establishments in relation to transactions with their maquiladoras. Further guidance on the U.S. taxable years and tax consequences of these unilateral APAs will be included in a forthcoming IRS practice unit.

More Disaster Victims in Florida and Georgia Qualify for Tax Relief

Victims of recent severe storms and flooding in numerous states have more time to make tax payments and file returns if they are affected taxpayers in counties that have been designated as federal disaster areas qualifying for individual assistance. Certain other time-sensitive acts also are postponed. IRS has recently announced on its website that additional counties in Florida and Georgia have been designated as federal disaster areas qualifying for individual assistance. This article summarizes the relief that’s available and includes up-to-date disaster area designations and extended filing and deposit dates for all areas affected by storms, floods and other disasters in 2016.

Who gets relief. Only taxpayers considered to be affected taxpayers are eligible for the postponement of time to file returns, pay taxes and perform other time-sensitive acts. Affected taxpayers are those listed in Reg. § 301.7508A-1(d)(1) and thus include:

- . . . any individual whose principal residence, and any business entity whose principal place of business, is located in the counties designated as disaster areas;

- . . . any individual who is a relief worker assisting in a covered disaster area, regardless of whether he is affiliated with recognized government or philanthropic organizations;

- . . . any individual whose principal residence, and any business entity whose principal place of business, is not located in a covered disaster area, but whose records necessary to meet a filing or payment deadline are maintained in a covered disaster area;

- . . . any estate or trust that has tax records necessary to meet a filing or payment deadline in a covered disaster area; and

- . . . any spouse of an affected taxpayer, solely with regard to a joint return of the husband and wife.

What may be postponed. Under Code Sec. 7508A, IRS gives affected taxpayers until the extended date (specified by county, below) to file most tax returns (including individual, estate, trust, partnership, C corporation, and S corporation income tax returns; estate, gift, and generation-skipping transfer tax returns; and employment and certain excise tax returns), or to make tax payments, including estimated tax payments, that have either an original or extended due date falling on or after the onset date of the disaster (specified by county, below), and on or before the extended date.

IRS also gives affected taxpayers until the extended date to perform other time-sensitive actions described in Reg. § 301.7508A-1(c)(1) and Rev Proc 2007-56, 2007-34 IRB 388, that are due to be performed on or after the onset date of the disaster, and on or before the extended date. This relief also includes the filing of Form 5500 series returns, in the way
described in Rev Proc 2007-56, Sec. 8. Additionally, the relief described in Rev Proc 2007-56, Sec. 17, relating to like-kind exchanges of property, also applies to certain taxpayers who are not otherwise affected taxpayers and may include acts required to be performed before or after the period above.

The postponement of time to file and pay does not apply to information returns in the W-2, 1098, 1099 or 5498 series, or to Forms 1042-S or 8027. Penalties for failure to timely file information returns can be waived under existing procedures for reasonable cause. Likewise, the postponement does not apply to employment and excise tax deposits. IRS, however, will abate penalties for failure to make timely employment and excise deposits, due on or after the onset date of the disaster, and on or before the deposit delayed date (specified by county, below), provided the taxpayer made these deposits by the deposit delayed date.

Affected areas and dates for storms, floods and other disasters occurring in 2016 that are federal disaster areas qualifying for individual assistance, as published on IRS’s website, are carried below.

Effective for disasters declared in tax years beginning after Dec. 31, 2007, the term “federally declared disaster” replaced the previously used “presidential disaster area” term (see Code Sec. 1033(h)(3), as amended by Sec. 706(d) (1), Div. C, P.L. 110-343). The new term is substantially the same as the definition of “presidentially declared disaster” under former law.

Florida: The following are federal disaster areas qualifying for individual assistance on account of Hurricane Hermine that took place beginning on Aug. 31, 2016: Citrus, Dixie, Hernando, Hillsborough, Leon, Levy, Pasco, and Pinellas counties.

For these Florida counties, the onset date of the disaster was Aug. 31, 2016, the extended date is Jan. 17, 2017 (which includes the Sept. 15 estimated tax deadline, the 2014 corporate and partnership returns on extension thru Sept. 15, and the Oct. 15 deadline for those who received an extension to file their 2014 return). The deposit delayed date was Sept. 15, 2016.

Florida: The following are federal disaster areas qualifying for individual assistance on account of Hurricane Matthew, which took place beginning on Oct. 3, 2016: Brevard, Duval, Flagler, Indian River, Nassau, Putnam, St. Johns, St. Lucie, and Volusia counties.

For these Florida counties, the onset date of the disaster was Oct. 4, 2016, and the extended date is Mar. 15, 2017 (which includes the Jan. 17 deadline for making quarterly estimated tax payments, 2015 income tax returns that received a tax-filing extension until Oct. 17, 2016, (IRS noted, however, the tax payments related to these 2015 returns, that were originally due on Apr. 18, 2016, are not eligible for this relief), a variety of affected business tax deadlines including the Oct. 31 and Jan. 31 deadlines for quarterly payroll and excise tax returns, and the Mar. 1 deadline that applies to farmers and fishermen who choose to forgo making quarterly estimated tax payments). The deposit delayed date was Oct. 19, 2016. (IR 2016-135)

Georgia: The following are federal disaster areas qualifying for individual assistance on account of Hurricane Matthew, which took place beginning on Oct. 4, 2016: Bryan, Bulloch, Camden, Chatham, Effingham, Glynn, Liberty, McIntosh, Screven, and Wayne counties.

For these Georgia counties, the onset date of the disaster was Oct. 4, 2016, and the extended date is Mar. 15, 2017 (which includes the Jan. 17 deadline for making quarterly estimated tax payments, 2015 income tax returns that received a tax-filing extension until Oct. 17, 2016, (IRS noted, however, the tax payments related to these 2015 returns, that were originally due on Apr. 18, 2016, are not eligible for this relief), a variety of affected business tax deadlines including the Oct. 31 and Jan. 31 deadlines for quarterly payroll and excise tax returns, and the Mar. 1 deadline that applies to farmers and fishermen who choose to forgo making quarterly estimated tax payments). The deposit delayed date was Oct. 19, 2016. (IR 2016-135)

Louisiana: The following are federal disaster areas qualifying for individual assistance on account of severe storms and flooding that took place beginning on Mar. 8, 2016: Allen, Ascension, Avoyelles, Beauregard, Bienville, Bossier, Caddo, Calcasieu, Caldwell, Catahoula, Claiborne, De Soto, East Carroll, Franklin, Grant, Jackson, La Salle, Lincoln, Livingston, Madison, Morehouse, Natchitoches, Ouachita, Rapides, Red River, Richland, Sabine, St. Helena, St. Tammany, Tangipahoa, Union, Vernon, Washington, Webster, West Carroll, and Winn parishes.

For these Louisiana parishes, the onset date of the disaster was Mar. 8, 2016, and the extended date was July 15, 2016 (which includes 2015 income tax returns normally due on April 18, the April 18 and June 15 deadlines for making quarterly estimated tax payments, and a variety of business tax deadlines including the May 2 deadlines for quarterly payroll and excise tax returns). The deposit delayed date was Mar. 23, 2016.

Louisiana: The following are federal disaster areas qualifying for individual assistance on account of severe storms and flooding that took place beginning on Aug. 11, 2016: Acadia, Ascension, Avoyelles, East Baton Rouge, East Feliciana, Evangeline, Iberia, Iberville, Jefferson Davis, Lafayette, Livingston, Pointe Coupee, St. Helena, St. James, St. Landry, St. Martin, St. Tammany, Tangipahoa, Vermilion, Washington, West Baton Rouge, and West Feliciana parishes.

For these Louisiana parishes, the onset date of the disaster was Aug. 11, 2016, and the extended date is Jan. 17, 2017 (which includes individual returns on extension to Oct. 17, the Sept. 15 deadline for making quarterly estimated tax payments, the 2015 corporate and partnership returns on extension through Sept. 15, and the Oct. 31 deadlines for
Mississippi: The following are federal disaster areas qualifying for individual assistance on account of recent storms that took place beginning on Mar. 9, 2016: Bolivar, Clarke, Coahoma, Forrest, George, Greene, Jones, Marion, Panola, Pearl River, Perry, Quitman, Sunflower, Tallahatchie, Tunica, Wayne, and Washington counties.

For these Mississippi counties, the onset date of the disaster was Mar. 9, 2016, and the extended date was July 15, 2016 (which includes the 2015 income tax returns normally due on Apr. 18, the Apr. 18 and June 15 deadlines for making quarterly estimated tax payments, and a variety of business tax deadlines including the May 2 deadlines for quarterly payroll and excise tax returns). The deposit delayed date was Mar. 24, 2016.

North Carolina: The following are federal disaster areas qualifying for individual assistance on account of Hurricane Matthew, which took place beginning on Oct. 4, 2016: Beaufort, Bertie, Bladen, Brunswick, Camden, Carteret, Chowan, Columbus, Craven, Cumberland, Currituck, Dare, Duplin, Edgecombe, Gates, Greene, Harnett, Hoke, Hyde, Johnston, Jones, Lenoir, Martin, Nash, New Hanover, Onslow, Pamlico, Pasquotank, Pender, Perquimans, Pitt, Robeson, Sampson, Tyrrell, Washington, Wayne, and Wilson counties.

For these North Carolina counties, the onset date of the disaster was Oct. 4, 2016, and the extended date is Mar. 15, 2017 (which includes the Jan. 17 deadline for making quarterly estimated tax payments, 2015 income tax returns that received a tax-filing extension until Oct. 17, 2016, (IRS noted, however, the tax payments related to these 2015 returns, that were originally due on Apr. 18, 2016, are not eligible for this relief), a variety of affected business tax deadlines including the Oct. 31 and Jan. 31 deadlines for quarterly payroll and excise tax returns, and the Mar. 1 deadline that applies to farmers and fishermen who choose to forgo making quarterly estimated tax payments). The deposit delayed date was Oct. 19, 2016. (IR 2016-135)

South Carolina: The following are federal disaster areas qualifying for individual assistance on account of Hurricane Matthew, which took place beginning on Oct. 4, 2016: Beaufort, Berkeley, Charleston, Colleton, Darlington, Dillon, Dorchester, Florence, Georgetown, Horry, Jasper, Marion, Orangeburg, and Williamsburg counties.

For these South Carolina counties, the onset date of the disaster was Oct. 4, 2016, and the extended date is Mar. 15, 2017 (which includes the Jan. 17 deadline for making quarterly estimated tax payments, 2015 income tax returns that received a tax-filing extension until Oct. 17, 2016, (IRS noted, however, the tax payments related to these 2015 returns, that were originally due on Apr. 18, 2016, are not eligible for this relief), a variety of affected business tax deadlines including the Oct. 31 and Jan. 31 deadlines for quarterly payroll and excise tax returns, and the Mar. 1 deadline that applies to farmers and fishermen who choose to forgo making quarterly estimated tax payments). The deposit delayed date was Oct. 19, 2016. (IR 2016-135)

Texas: The following are federal disaster areas qualifying for individual assistance on account of severe storms, tornadoes, and flooding that took place beginning on Mar. 7, 2016: Erath, Gregg, Harrison, Hood, Jasper, Limestone, Marion, Newton, Orange, Parker, Shelby, and Tyler counties. For these Texas counties, the onset date of the disaster was Mar. 7, 2016, and the extended date was July 15, 2016 (which includes the 2015 income tax returns normally due on Apr. 18, the April 18 and June 15 deadlines for making quarterly estimated tax payments, and a variety of business tax deadlines including the May 2 deadlines for quarterly payroll and excise tax returns). The deposit delayed date was Mar. 22, 2016.

Texas: The following are federal disaster areas qualifying for individual assistance on account of storms that took place beginning on Apr. 17, 2016: Anderson, Austin, Cherokee, Colorado, Fayette, Fort Bend, Grimes, Harris, Liberty, Montgomery, Parker, San Jacinto, Smith, Walker, Wharton, Wood counties.

For these Texas counties, the onset date of the disaster was Apr. 17, 2016, and the extended date was Sept. 1, 2016 (which includes 2015 income tax returns normally due on Apr. 18, the April 18 and June 15 deadlines for making quarterly estimated tax payments, and a variety of business tax deadlines including the May 2 and Aug. 1 deadlines for quarterly payroll and excise tax returns). The deposit delayed date was May 2, 2016. (IR 2016-67)

Texas: The following are federal disaster areas qualifying for individual assistance on account of the severe storms and flooding that took place beginning on May 26, 2016: Austin, Bastrop, Brazoria, Brazos, Burleson, Eastland, Fayette, Fort Bend, Grimes, Harris, Hidalgo, Hood, Kleberg, Lee, Liberty, Montgomery, Palo Pinto, Parker, San Jacinto, Stephens, Travis, Tyler, Waller, and Washington counties.

For these Texas counties, the onset date of the disaster was May 26, 2016, and the extended date was Oct. 17, 2016 (which includes the June 15 and Sept. 15 deadlines for making quarterly estimated tax payments, the 2015 corporate and partnership returns on extension through Sept. 15, and the Aug. 1 deadlines for quarterly payroll and excise tax returns). The deposit delayed date was June 10, 2016.

West Virginia: The following are federal disaster areas qualifying for individual assistance on account of the severe storms, flooding, landslides, and mudslides that took place beginning on June 22, 2016: Clay, Fayette, Greenbrier, Jackson, Kanawha, Lincoln, Monroe, Roane, Summers, Nicholas, Pocahontas, and Webster counties.

For these West Virginia counties, the onset date of the disaster was June 22, 2016, and the extended date is Nov.
Retirement Plans Can Make Loans, Hardship Distributions to Victims of Hurricane Matthew

The Internal Revenue Service announced that 401(k)s and similar employer-sponsored retirement plans can make loans and hardship distributions to victims of Hurricane Matthew and members of their families. This is similar to relief provided this summer to Louisiana flood victims.

Participants in 401(k) plans, employees of public schools and tax-exempt organizations with 403(b) tax-sheltered annuities, as well as state and local government employees with 457(b) deferred-compensation plans may be eligible to take advantage of these streamlined loan procedures and liberalized hardship distribution rules. Though IRA participants are barred from taking out loans, they may be eligible to receive distributions under liberalized procedures.

Retirement plans can provide this relief to employees and certain members of their families who live or work in disaster area localities affected by Hurricane Matthew and designated for individual assistance by the Federal Emergency Management Agency (FEMA). Currently, parts of North Carolina, South Carolina, Georgia and Florida qualify for individual assistance. To qualify for this relief, hardship withdrawals must be made by March 15, 2017.

The IRS is also relaxing procedural and administrative rules that normally apply to retirement plan loans and hardship distributions. As a result, eligible retirement plan participants will be able to access their money more quickly with a minimum of red tape. In addition, the six-month ban on 401(k) and 403(b) contributions that normally affects employees who take hardship distributions will not apply.

This broad-based relief means that a retirement plan can allow a victim of Hurricane Matthew to take a hardship distribution or borrow up to the specified statutory limits from the victim’s retirement plan. It also means that a person who lives outside the disaster area can take out a retirement plan loan or hardship distribution and use it to assist a son, daughter, parent, grandparent or other dependent who lived or worked in the disaster area.

Plans will be allowed to make loans or hardship distributions before the plan is formally amended to provide for such features. In addition, the plan can ignore the reasons that normally apply to hardship distributions, thus allowing them, for example, to be used for food and shelter. If a plan requires certain documentation before a distribution is made, the plan can relax this requirement as described in the announcement. Ordinarily, retirement plan loan proceeds are tax-free if they are repaid over a period of five years or less. Under current law, hardship distributions are generally taxable. Also, a 10 percent early-withdrawal tax usually applies.

IRS Continuing to Expand W-2 Verification Code Program

During an IRS payroll conference telephone call, IRS provided further information on its plans to expand the W-2 Verification Code (VC) pilot program.

The program was implemented during the 2016 filing season (2015 W-2s) as a way to combat tax-related identity theft and refund fraud. IRS partnered with four major payroll service providers who added a 16-digit verification code to a box on Form W-2, copies B (To be filed with employee’s federal tax return) and C (For employee’s records) on approximately 1.5 million W-2 forms.

Each verification code number was calculated based on a formula and key provided by IRS, using data from the Form W-2 itself, so that each number generated was known only to IRS, the payroll service provider (PSP), and the individual who received the Form W-2. Since this identifier was unique, any changes to the Form W-2 information provided were detected by IRS when filed. Individuals whose W-2 forms were affected by the pilot program, and who used tax software to prepare their personal income tax returns (Form 1040), entered the code when prompted to do so by their Form 1040 software program.

The code is not included on W-2 forms or W-2 data submitted by the PSPs to the Social Security Administration, or any state or local departments of revenue. Individuals who file their personal income tax returns on paper are not included in this project.

IRS considered the pilot program to be highly successful and is looking to expand it.

W-2 pilot program for 2017 filing season (2016 W-2 forms). IRS plans to increase the scope of the W-2 pilot program in the 2017 filing season by expanding on the number of W-2s in the pilot program from roughly 24 million to 50 million (roughly 20% of the W-2s expected to be filed). It also plans to increase the number and types of W-2 issuers in the program to include smaller sized issuers and large federal organizations. IRS will test using the validated verification code (VC) results in such a way that, if the VC is a match, it will accept the W-2 data submitted with Form 1040 to be valid, and reduce the likelihood that IRS will falsely select a personal income tax return as having a potential problem (false positives). IRS is encouraging payroll professionals who are associated with PSPs/employers participating in this initiative to encourage employees to enter the VC at the prompt in their 1040 software program.

W-2 pilot program for 2018 filing season (2017 W-2 forms). Scott Mezistano, IRS Industry Stakeholder Engagement and Strategy, noted that the draft version of the 2017 W-2 form has a specific box number for the verification code (Box 9).
Currently, the box labeled “Verification Code” on Form W-2 is not assigned a box number. The instructions for Box 9 state that the verification code assists IRS in validating the W-2 data submitted with the personal income tax return. It advises e-filers who have a verification code on Box 9 to enter the code when prompted by their personal income tax return software. They should disregard the prompt if their Form W-2 doesn’t have a code in Box 9 (i.e., because their employer is not using a PSP that is participating in the IRS pilot program).

Restaurant Franchisee Wasn’t “Limited Partner” Exempt from Self-Employment Tax

Chief Counsel Advice 201640014

In Chief Counsel Advice (CCA), IRS has concluded that a franchisee who owned and operated a number of restaurants through a partnership was not a “limited partner” exempt from self-employment tax under Code Sec. 1402(a)(13) on his distributive share of partnership income.

In general, a partner must include his distributive share of partnership income in calculating his net earnings from self-employment, for purposes of the self-employment tax. Fees for services, like those generated by an investment management company, are part of the partners’ distributive shares under Code Sec. 702(a)(8). Accordingly, such fees are included in calculating net earnings from self-employment, unless an exclusion applies.

Under Code Sec. 1402(a), a partner’s net earnings from self-employment are generally his distributive share of the partnership’s taxable income arising out of the trade or business of the partnership plus his guaranteed payments. There are several exclusions from the general self-employment tax rule. In particular, Code Sec. 1402(a)(13) provides that the distributive share of any item of income or loss of a limited partner is excluded. This exclusion doesn’t apply to guaranteed payments to that partner for services actually rendered to or on behalf of the partnership, to the extent the payments are established to be remuneration for those services.

The legislative history for the exception in Code Sec. 1402(a)(13) clarified that Congress didn’t intend to allow service partners in a service partnership acting in the manner of self-employed persons to avoid paying self-employment tax. In creating the exclusion for limited partners, Congress stated that the provision excluded from Social Security coverage certain earnings which were basically of an investment nature; however, the exclusion wouldn’t extend to guaranteed payments (as described in Code Sec. 707(c)), such as salary and professional fees, received for services actually performed by the limited partner for the partnership.

Individual partners who are not limited partners are subject to self-employment tax regardless of their participation in the partnership’s business or the capital-intensive nature of the partnership’s business.

In Renkemeyer, Campbell & Weaver, LLP, (2011) 136 TC 137 the Tax Court determined that limited partners in a partnership that provided legal services had self-employment income where the attorney-partners’ distributive shares of the law firm’s income were generated by legal services that the partners performed on the law firm’s behalf. This was the case, even though the interests were designated as limited partnership interests and the partnership was properly established under State law. The Court concluded that the partners weren’t limited partners within the meaning of Code Sec. 1402(a)(13), and so their distributive share of the partnership’s fee income was subject to self-employment tax.

Franchisee bought a number of franchise restaurants and contributed them to Partnership that had two members other than himself: his wife and an irrevocable trust. Franchisee owned a majority interest in Partnership and was the only one involved in the business. As Partnership’s operating manager, president, and chief executive officer, Franchisee devoted all of his time to the restaurants’ operation and made all significant decisions relating to their affairs. He had the authority to buy, lease, and sell property; enter into contracts; lend money and invest Partnership funds; hire and fire Partnership’s employees; establish pension plans; and hire accountants, investment advisors, and legal counsel on behalf of Partnership.

In his capacity as a partner, Franchisee directed the operations of Partnership, held regular meetings and discussions with management team and staff, made strategic and succession planning and investment management decisions, was involved in the franchise company’s regional board and conferences, and was involved in its national conferences and strategic planning. Franchisee’s day-to-day activities for Partnership generally consisted of handling e-mails and phone calls, store visits (when in town), management meetings, and staff meetings.

Partnership employed a number of individuals, many of whom had some level of management or supervisory responsibility. Franchisee appointed an executive management team consisting of financial and operations executive employees who did not have an ownership interest in Partnership, but had the responsibility of managing certain of Partnership’s day-to-day business affairs, including making certain key management decisions. However, Franchisee had ultimate responsibility for hiring, firing, and overseeing all Partnership’s employees, including members of the executive management team.

In three tax years, Partnership made guaranteed payments to Franchisee, treated him as a limited partner for Code Sec. 1402(a)(13) purposes, and included only the guaranteed payments, as opposed to his full distributive share, in Franchisee’s net earnings from self employment.

Partnership argued that Franchisee’s income from Partnership should be split for self-employment tax purposes between Franchisee’s (1) income attributable to capital invested or the efforts of others, which is not subject to self-employment tax, and (2) compensation for services rendered, which is subject
to self-employment tax. As a retail operation, Partnership said it required significant capital investment for buildings, equipment, working capital and employees, and that it derived its income from the preparation and sale of food products by its employees, not the personal services of Franchisee. Partnership asserted that Franchisee’s guaranteed payments represented “reasonable compensation” for his services, and that Franchisee’s earnings beyond his guaranteed payments were earnings which were basically of an investment nature. Partnership concluded that Franchisee was a limited partner for Code Sec. 1402(a)(13) purposes with respect to his distributive share.

Franchisee not a limited partner. The CCA takes the position that Franchisee is not a limited partner in Partnership within the meaning of Code Sec. 1402(a)(13) and is subject to self-employment tax on his full distributive shares of Partnership’s income described in Code Sec. 702(a)(8).

The CCA points out that the hallmark of a limited partner is someone whose interest is generally akin to a passive investor—someone who lacks management powers but enjoys immunity from liability for debts of the partnership. Franchisee didn’t exhibit these characteristics. He had sole authority over Partnership and was its majority owner, operating manager, president, and chief executive officer with ultimate authority over every employee and each aspect of the business. Even though Partnership had many employees, including several at the executive level, Franchisee was the only partner of Partnership involved with the business. As such, he was not a mere investor, but rather an active participant in the partnership’s operations who performed extensive executive and operational management services for Partnership in his capacity as a partner (i.e., acting in the manner of a self-employed person). As a result, the income Franchisee earned through Partnership wasn’t income of a mere passive investor that Congress sought to exclude from self-employment tax under Code Sec. 1402(a)(13).

Partnership conceded that under the legislative history and the Renkemeyer opinion, “service partners in a service partnership acting in the manner of self-employed persons” are not limited partners. However, Partnership argued that a different analysis should apply to limited liability members who: (1) derive their income from the sale of products, (2) have made substantial capital investments, and (3) have delegated significant management responsibilities to executive-level employees. Partnership asserted that in such cases, IRS should apply “substance over form” principles to exclude from self-employment tax a reasonable return on capital invested. As a capital intensive business, Partnership argued that Franchisee should be treated the same way as a corporate shareholder-employee: only reasonable compensation should be subject to employment tax.

The CCA dismissed Partnership’s argument, saying it inappropriately conflated the separate statutory self-employment tax rules for partners and the statutory employment tax rules for corporate shareholder employees. Code Sec. 1402(a)(13) provides an exclusion for limited partners, not for a reasonable return on capital, and does not indicate that a partner’s status as a limited partner depends on the presence of a guaranteed payment or the capital-intensive nature of the partnership’s business.

**Offshore Voluntary Compliance Efforts Top $10 Billion**

More Than 100,000 Taxpayers Come Back into Compliance

As international compliance efforts pass several new milestones, the Internal Revenue Service reminds U.S. taxpayers with undisclosed offshore accounts that they should use existing paths to come into full compliance with their federal tax obligations.

Updated data shows 55,800 taxpayers have come into the Offshore Voluntary Disclosure Program (OVDP) to resolve their tax obligations, paying more than $9.9 billion in taxes, interest and penalties since 2009. In addition, another 48,000 taxpayers have made use of separate streamlined procedures to correct prior non-willful omissions and meet their federal tax obligations, paying approximately $450 million in taxes, interest and penalties.

“The IRS has passed several major milestones in our offshore efforts, collecting a combined $10 billion with 100,000 taxpayers coming back into compliance,” said IRS Commissioner John Koskinen. “As we continue to receive more information on foreign accounts, people’s ability to avoid detection becomes harder and harder. The IRS continues to urge those people with international tax issues to come forward to meet their tax obligations.”

Under the Foreign Account Tax Compliance Act (FATCA) and the network of inter-governmental agreements (IGAs) between the U.S. and partner jurisdictions, automatic third-party account reporting has entered its second year. More information also continues to come to the IRS as a result of the Department of Justice’s Swiss Bank Program. As part of a series on non-prosecution agreements, the participating banks continue to provide information on potential non-compliance by U.S. taxpayers.

OVDP offers taxpayers with undisclosed income from foreign financial accounts and assets an opportunity to get current with their tax returns and information reporting obligations. The program encourages taxpayers to voluntarily disclose foreign financial accounts and assets now rather than risk detection by the IRS at a later date and face more severe penalties and possible criminal prosecution.

The IRS developed the Streamlined Filing Compliance Procedures to accommodate taxpayers with non-willful compliance issues. Submissions have been made by taxpayers residing in the U.S. and from those residing in countries around the globe. The streamlined procedures have resulted in the submission of more than 96,000 delinquent and amended income tax returns from the 48,000 taxpayers using these procedures. A separate process exists for those taxpayers who have paid their income taxes but omitted certain
other information returns, such as the Report of Foreign Bank
and Financial Accounts (FBAR).

New Proposed Regs Call for Slightly Less
Dramatic Increase in Enrolled Agent Examination Fee

Preamble to Prop Reg 10/24/2016, Prop Reg § 300.4

IRS has issued proposed regs that would raise the fee for taking the 3-part enrolled agent special enrollment examination from $11 (i.e., $33 for all three parts) to $81 per part (i.e., $243 for all three parts). The regs withdraw the recently issued prior proposed regs, which would have raised the fee to $99 per part (i.e., $297 for all three parts). The $81 amount is the cost to the government for overseeing the development and administration of the examination, but doesn't include any fees charged by the administrator of the examination. The proposed regs are to be effective when finalized.

Section 10.4(a) of Circular 230 authorizes IRS to grant status as enrolled agents to individuals who demonstrate special competence in tax matters by passing a written examination (the Enrolled Agent Special Enrollment Examination, or EA-SEE) administered by, or under the oversight of, IRS. These individuals must not have engaged in any conduct that would justify suspension or disbarment under Circular 230. As of Sept. 1, 2016, there were 51,755 active enrolled agents. After becoming enrolled, an enrolled agent must, as provided in Circular 230 §10.6(d), renew enrollment every three years to maintain active enrollment and to be able to practice before IRS. To qualify for renewal, an enrolled agent must certify the completion of the continuing education requirements set out in Circular 230 §10.6(e).

The EA-SEE is comprised of three parts, which are offered in a testing period that begins each May 1 and ends the last day of the following February. An applicant must pass all parts of the EA-SEE to be granted enrolled agent status through written examination. Starting in 2006, IRS engaged the services of a third-party contractor to develop and administer the EA-SEE.

The Independent Offices Appropriations Act (IOAA) of 1952 (31 U.S.C. 9701) authorizes agencies to prescribe regs that establish charges for services they provide, including user fees. In general, a user fee should be set at an amount that allows the agency to recover the full cost of providing a special service, unless the Office of Management and Budget grants an exception.

Because the opportunity to take the EA-SEE is a special benefit beyond those that accrue to the general public, IRS charges a user fee to take the examination. Individuals who take the EA-SEE are provided with an opportunity to demonstrate special competence in tax matters by passing a written examination and so satisfy one of the requirements for becoming an enrolled agent under Circular 230 §10.4(a). The current user fee is $11 to take each part of the EA-SEE. IRS hasn't increased the EA-SEE user fee since 2006, when it published the existing user fee regs.

The contractor who administers the EA-SEE also charges individuals taking the EA-SEE an additional fee for its services. For the May 2016 to February 2017 testing period, the contractor’s fee is $98 for each part of the EA-SEE. For the March 2017 to February 2019 testing periods, the contractor’s fee will be $100.94. For the March 2019 to February 2020 testing period, the contractor’s fee will be $103.97. The fee charged by the contractor is fixed by the current contract terms and therefore may not be reduced or renegotiated at this time. The contract will expire on Feb. 29, 2020.

In January 2016, IRS issued proposed regs (the January 2016 proposed regs) that would have raised the fee from $11 per part to $99 per part. IRS has now redetermined that amount.

New proposed regs issued by IRS would raise the fee for taking the EA-SEE to $81 per part (i.e., $243 for all three parts)—i.e., the cost to the government for overseeing the development and administration of the examination (excluding any fees charged by the administrator of the examination). The proposed fee would more accurately account for the time and personnel necessary to oversee the development and administration of the EA-SEE and to ensure the contractor complies with the terms of its contract. The January 2016 proposed regs are withdrawn.

CCA Explains Gift Tax Extended Period of Limitation

Chief Counsel Advice 201643020

In Chief Counsel Advice (CCA), IRS has concluded that where a taxpayer filed a gift tax return that reported a gift for the calendar year in which the gift was made but did not report prior years’ gifts on the return as required, causing an underassessment of tax on the reported gift, Code Sec. 6019 doesn’t provide an extended period of limitation for assessing the additional tax due on the reported gift.

The Code imposes a tax on a transfer of property by gift. (Code Sec. 2501(a)) In general, any individual who makes a transfer by gift in any calendar year must file a gift tax return for that year using Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return. (Code Sec. 6019, Reg. § 25.6019-1(a))

Absent an exception, IRS must assess the amount of any gift tax within three years after Form 709 is filed. (Code Sec. 6501(a)) In the case of a gift that is required to be “shown” on a return, but which is not shown, the gift tax may be assessed at any time. (Code Sec. 6501(c)(9)) That is, Code Sec. 6501(c)(9) extends the period of limitations indefinitely if a gift of property, the value of which is required to be shown on a gift tax return, is not in fact shown on the return. This exception to the 3-year assessment rule doesn’t apply to a gift that is disclosed on the return or in a statement attached to the return in a matter that is adequate to apprise IRS of the nature of the gift and of the basis for the value so reported.
Reg. § 25.6019-3(a) provides that a gift tax return must set out each gift made during the calendar year (or calendar quarter with respect to gifts made after Dec. 31, 1970, and before Jan. 1, 1982) that, under Code Sec. 2511 through Code Sec. 2515, is to be included in computing taxable gifts; the deductions claimed and allowable under Code Sec. 2521 through Code Sec. 2524; and the taxable gifts made for each of the preceding reporting periods.

A taxpayer filed a gift tax return for tax year Year 31, reporting a taxable gift, with tax due. The taxpayer had previously made gifts in Year 1, Years 6 through 9 and Year 15 that were reported on prior gift tax returns. On the Year 31 return, the taxpayer failed to report the prior years’ gifts as required by Reg. § 25.6019-3(a). Because the amount of prior years’ gifts is necessary to calculate the tax on a current year’s gifts, the taxpayer’s failure to report the prior years’ gifts on the Year 31 return caused the tax on the reported gift to incorrectly be calculated at a lower rate than if the prior years’ gifts were reported on the Year 31 return.

The issue. In the CCA, IRS was asked, where a taxpayer filed a gift tax return that reported a gift for the calendar year in which the gift was made but did not report prior years’ gifts on the return as required, causing an underassessment of tax on the reported gift, whether Code Sec. 6501(c)(9) provides an extended period of limitation for assessing the additional tax due on the reported gift.

In the CCA, IRS determined that Code Sec. 6501(c)(9) only applies to gifts that weren’t reported on a gift tax return. Because the gift was reported on the gift tax return, the extended period of limitation for assessing additional tax due on the reported gift in Code Sec. 6501(c)(9) doesn’t apply to the reported gift, even though prior years’ gifts weren’t reported on the return. IRS reasoned that there are two rules in Code Sec. 6501(c)(9) that limit when the special limitation period applies. The first rule is that it only applies to a gift that is not reported on the gift tax return. The second rule is that it doesn’t apply to an item that was adequately disclosed on the return, or on an attachment to the return. As such, there is a two-step analysis for applying the special limitation period in Code Sec. 6501(c)(9).

Step one is to determine if the gift was reported on the gift tax return. If the gift was reported, then the special limitation period does not apply to the gift, and the analysis is concluded. If the gift wasn’t reported, then the analysis moves to step two. Step two is to determine if the item was adequately disclosed. If the item was disclosed, then the special limitation period in Code Sec. 6501(c)(9) doesn’t apply to the item. If the item was not disclosed, then the special limitation period applies and tax may be assessed on the gift at any time.

Although it is arguable that Reg. § 301.6501(c)-1(f)(1) is silent concerning the omission of prior taxable gifts, the clear language of Code Sec. 6501(c)(9) precludes it from applying to a gift that was reported on the gift tax return, even if prior years’ gifts were omitted. In this case, the gift was reported on the Year 31 gift tax return. Thus, step one is met, and so the matter was concluded. Accordingly, despite the taxpayer’s failure to report prior years’ gifts on the Year 31 return, the special limitation period in Code Sec. 6501(c)(9) didn’t apply to the Year 31 gift.

IRS Advises Non-spouse Roth IRA Beneficiary on RMD Rules

Information Letter 2016-0071

In an Information Letter, IRS has advised an individual on the consequences of a Roth IRA non-spouse beneficiary’s failure to timely begin taking the required minimum distributions (RMDs) under Code Sec. 401(a)(9)’s “life expectancy rule.” The individual asked whether a non-spouse beneficiary’s failure to begin such distributions within one year of the Roth IRA owner’s death made the life expectancy rule inapplicable and required that distributions be made under Code Sec. 401(a)(9)’s “five-year-rule.”

Employer-provided defined contribution qualified retirement plans, traditional IRAs and individual retirement annuities are subject to the RMD rules. Generally, RMDs must begin by the required beginning date, which usually is April 1 of the calendar year following the calendar year in which the individual (employee or IRA owner) reaches age 70½.

Code Sec. 4974 imposes a 50% excise tax on any amounts that were required to be distributed under Code Sec. 401(a)(9) but were not timely distributed, unless the imposition of such tax is waived.

Roth IRAs aren’t subject to the RMD rules of Code Sec. 401(a)(9)(A). However, the post-death RMD rules (which apply to traditional IRAs), also apply to Roth IRAs, with the exception of the “at-least-as-rapidly” rule (i.e., the rule requiring that the remaining portion of the participant’s (or the Roth IRA owner’s) interest be distributed at least as rapidly as under the method of distribution that was in effect at the date of the owner’s death, under Code Sec. 401(a)(9)(B)(i)). (Code Sec. 408A(c)(5))

Thus, the entire interest in the Roth IRA must be distributed:

• (1) by the end of the fifth calendar year after the year of the owner’s death (the “5-year rule”); or

• (2) to a designated beneficiary over a period of not greater than that beneficiary’s life expectancy, and distribution must begin before the end of the calendar year following the year of death. (Reg. § 1.408A-6, Q&A 14(a))

Under Code Sec. 401(a)(9), the treatment of minimum distributions after the death of a traditional IRA owner depend on whether he died before or after his required beginning date and whether or not he designated a beneficiary. Where the death is before the required beginning date:
If the IRA owner designated a nonspouse beneficiary for the account, there are two methods for satisfying the after-death RMD rules: (1) Under the 5-year rule, the individual’s entire account must be distributed no later than December 31 of the calendar year containing the fifth anniversary of his death; (Code Sec. 401(a)(9)(B)(ii)) (2) Under the life expectancy method, annual RMDs over the beneficiary’s life, or over a period not extending beyond his life expectancy, must begin no later than December 31 of the calendar year immediately following the calendar year in which the individual died. (Code Sec. 401(a)(9)(B)(iii); Code Sec. 408(a)(6))

If he did not designate a beneficiary for the IRA, the remaining balance in the IRA must be distributed no later than December 31 of the calendar year which contains the fifth anniversary of the date the owner died. (Code Sec. 401(a)(9)(B)(ii); Reg. § 1.401(a)(9)-3, Q&A 1(a); Reg. § 1.401(a)(9)-3, Q&A 2)

A plan may contain a provision that allows employees (or beneficiaries) to elect, on an individual basis, whether the 5-year rule or the life expectancy rule applies to distributions after the death of an employee who has a designated beneficiary. An employee’s election between the 5-year rule and the life expectancy rule must be made no later than the earlier of: (1) Dec. 31 of the calendar year in which distribution would have to start in order to satisfy the requirements for the life expectancy rule, or (2) Dec. 31 of the calendar year which contains the fifth anniversary of the employee’s death. As of the last date the election may be made, the election must be irrevocable with respect to the beneficiary (and all subsequent beneficiaries) and must apply to all later years. (Reg. § 1.401(a)(9)-3, Q&A 4(c))

IRS advises. In the Information Letter, IRS noted that post-death distributions from a Roth IRA to a designated beneficiary generally must be made in accordance with the RMD rules under Code Sec. 401(a)(9)(B) as if the Roth IRA owner died before his or her required beginning date. Under these rules, if an employee dies before the employee’s required beginning date, distribution of the employee’s entire interest must be made either (1) in full within five years of the employee’s death (i.e., under the 5-year rule), or (2) over a period not extending beyond the beneficiary’s life expectancy, beginning within one year of the employee’s death (the life expectancy rule). Special rules apply if the beneficiary is the employee’s spouse.

IRS noted that whether the life expectancy rule or the 5-year rule applies in a particular situation is governed by Reg. § 1.401(a)(9)-3, Q&A 4. The regs provide that if there is a designated beneficiary, distributions are to be made in accordance with the life expectancy rule, unless the terms of the plan either (a) require that distributions be made under the 5-year rule, or (b) allow the beneficiary to elect to use the 5-year rule. If the plan permits such elections by the beneficiary, the life expectancy rule will apply unless the beneficiary makes such election within a specific time period, or the plan provides that distributions will be made under the 5-year rule if no such election is made. The determination of which distribution period applies is made in accordance with these rules, and isn’t based on whether distributions in fact begin timely under the applicable rule.

In addition, IRS explained that a taxpayer may request a waiver of the Code Sec. 4974 excise tax by attaching a statement of explanation and completing Form 5329 (Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts) as instructed under Waiver of tax in the Instructions for Form 5329.

**Tax Pros in Trouble**

**Announcement of Disciplinary Sanctions from the Office of Professional Responsibility**

The Office of Professional Responsibility (OPR) publishes all disciplinary actions in the Internal Revenue Bulletin (IRB). Published sanctions include censure, suspension or disbarment from practice before the Internal Revenue Service. The below listed individuals have recently been disciplined by OPR and are published in IRB Number 2016-38, dated September 19, 2016, on pages 376-379:

To view a complete list of all OPR IRB’s visit the Disciplinary Sanctions - IRB page.

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Houston Man Convicted of Sexual Exploitation of Children and Tax Fraud

Benjamin Douglas Guidry has entered a guilty plea to two counts of sexual exploitation of children and for knowingly making a false claim in the nature of preparing and filing a false tax return, announced U.S. Attorney Kenneth Magidson along with Special Agent in Charge D. Richard Goss of IRS-Criminal Investigation (CI) and Special Agent in Charge Perrye K. Turner of the FBI.

“The diligent investigative efforts of IRS-CI special agents not only uncovered evidence of tax crimes but also discovered something much, much, worse, beginning with the discovery of disturbing images on this defendant’s computer,” said Goss. “The collaborative effort between IRS-CI and the FBI ultimately led to Guidry pleading guilty not only to the tax crimes in question but also to the sexual exploitation of children.”

According to the plea agreement filed in the record of the case and to statements made in court, the IRS had been investigating Guidry for possible tax offenses. In May 2015, authorities executed a search warrant at Guidry’s place of business, Financial Precision Group, at which time they seized several computers and boxes of documents. Agents noticed, among other things, that several files on Guidry’s external hard drive had titles that led the IRS to believe they may contain child pornography. Authorities also noticed text messages on his cell phone that appeared to be inappropriate communications with a minor and a video of a minor.

The FBI joined the investigation and later executed a search warrant at Guidry’s residence. During that search, authorities found items present in the video on Guidry’s cell phone, including clothes worn by one of identified minor victims in the video. They also seized a cell phone and multiple computers.

Guidry was arrested at that time.

On two of Guidry’s external hard drives, authorities ultimately discovered a total of at least 164 images and 28 videos of child pornography. Additionally, a cell phone contained at least three videos of child pornography.

As to the tax offense, Guidry also agreed in the plea agreement that the intended income tax loss was between $250,000 and $550,000.
Baird, 60, pleaded guilty to one count of tax evasion and one count of corruptly endeavoring to impede the due administration of the internal revenue laws.

According to court documents, Baird filed returns each year but has not paid his self-assessed taxes since at least 1998. Baird was an IRS revenue officer for 12 years before he established HL Baird’s Tax Consultants, which he operated from 1989 to 2014.

Baird advertised himself to clients as specializing in “IRS problems, delinquent returns, offer-in-compromise, tax problems, delinquent employee taxes and release of liens and levies.” He used his knowledge and experience to evade payment of his own taxes, creating over 10 nominee bank accounts in the names of his children to hide hundreds of thousands of dollars, submitting a false 433-A to the investigating revenue officer that did not reveal all of his nominee bank accounts, filing, in bad faith, a Chapter 13 petition, a cash offer in compromise, a request for discharge and an application for subordination of his federal tax lien and transferring funds out of nominee accounts to avoid impending IRS levies.

During this time, Baird continued to pay the mortgage on his 4,300-square-foot home, annual fees for his timeshare in Florida and car payments on his BMW. He admitted to the revenue officer and the mortgage holder that he did not keep money in bank accounts because he feared a levy or garnishment.

Baird also used his stepson’s identity, without his knowledge, to apply for a PTIN that he then used to file more than 900 income tax returns for clients, as well as his own income tax returns. Additionally, Baird submitted at least 120 Forms 2848 on behalf of clients that falsely stated he was an Enrolled Agent even though the IRS revoked his authorization to represent taxpayers.

Penalties and interest on Baird’s taxes will continue to accrue until he pays the IRS in full. As of Sept. 20, Baird’s evasion of payment totals $477,028.80 in tax, penalties and interest for tax years 1998 through 2013.

Sentencing is Jan. 17, when Baird faces a maximum of five years in prison for his conviction on the tax evasion count.
DeKalb Man Barred from Tax Preparation After IRS Finds Fraudulent Returns

A district court served a permanent injunction to a tax preparer from DeKalb, barring him from tax preparation for others for life.

Christopher Chamberlin, under the business C&T Services, LLC, lied on the tax returns of his customers, exaggerating their business and farming losses to get better refunds, authorities said.

The United States, the case plaintiff, estimates that Chamberlin cost the U.S. Treasury $1 million alone in 2012 and 2013. The plaintiff filed the case on April 8.

Chamberlin must now turn over all tax returns he prepared after Jan. 1, 2014 to the United States as ordered by the United States District Court, Southern District of Mississippi, Northern Division on Oct. 4 of this year.

The IRS lists return preparer fraud as one of its Dirty Dozen Tax Scams for 2016. On their website, the IRS has tips for avoiding these scammers and a directory of accredited and qualified federal tax preparers.

The Justice Department has their own list of persons prohibited from preparing tax returns and encourages the public to email tax.mail@usdoj.gov if they believe a banned tax preparer may be breaking their injunction.

Logan County Tax Return Preparers Plead Guilty to Preparing False Returns

Bowling Green, Ky: Two former tax preparers in Logan County pleaded guilty in U.S. District Court to conspiring to defraud the United States through false tax returns and aiding in the preparation of false tax returns.

Tara L. Mitchell and Mechelle Blankenship were initially charged in a 21-count grand jury indictment involving tax returns filed on behalf of themselves and Triple J Tax.

Mitchell and Blankenship admitted Tuesday, in separate plea agreements, between March 2012 and November 2012 they prepared and electronically filed U.S. Individual Income Tax Returns they knew were false, causing a loss of more than $250,000 through tax refunds issued by the IRS.
If convicted, Blankenship could be sentenced to up to 41 years in prison, fined $1,450,000, and required to serve a 3 year period of supervised release. Mitchell could be sentenced to 29 years in prison, fined $1,050,000 and required to serve a 3 year period of supervised release.

**Tax-return Business Accused of Fraud by Feds**

Federal attorneys are attempting to shut down a southeast Michigan tax-return business that has two Warren locations, based upon fraud allegations.

The U.S. Justice Department on Wednesday filed a civil lawsuit against Tax R Us, accusing its operators of unlawfully understating its customers’ income tax liabilities and overstating refunds by making deliberate misstatements on the returns. The alleged fraudulent claims cost the U.S. government more than $3 million, officials said.

The feds say Tax R Us has seven locations: four in Detroit, two in Warren and one in Pontiac. The Warren offices are located at 7635 Eight Mile Road and 21234 Van Dyke Ave.

In the complaint filed in U.S. District Court in Detroit, the feds seek to permanently bar Tax R Us, Vannak Long, Rosalind Warnock, Jasmine Jackson and Mary Jackson from preparing tax returns for others, and turn over lists of returns they have prepared.

Long, the owner of Tax R Us, frequently understated his customers’ gross receipts and overstated their business deductions to minimize their income subject to tax, according to the feds. The complaint also alleges that Warnock, a past Tax R Us preparer, and current Tax R Us preparers, Jasmine and Mary Jackson, drafted returns that fabricate self-employment businesses and business losses to offset their customers’ taxable income from other sources and to increase their customers’ Earned Income Tax Credit. Warnock, Jasmine Jackson and Mary Jackson also wrongfully claimed education credits the customers are not entitled to receive, according to the complaint.

**Thomas Frey, an Edison Resident, Extorted Legal Fees from Clients, Saying He Could End IRS Investigations**

A borough lawyer, serving time in federal prison on charges of conspiracy to commit extortion and wire fraud, has been disbarred.

Thomas G. Frey, 57, who was disbarred by the state Supreme Court on Sept. 26, is scheduled to be released from the medium-security Schuykill Federal Correctional Institution in Minersville, Pennsylvania, on July 25, 2017.

Frey, an Edison resident and certified public accountant, pleaded guilty to a scheme in which he extorted legal fees from his clients when he told them that they were under criminal investigation by the IRS and that he could arrange for the end of the investigation if they retained him as a lawyer and paid him $20,000 in legal fees.

The scheme fell through when one of the clients called the IRS and discovered there was no pending investigation.

Frey was sentenced to 27 months in federal prison, ordered to perform 300 hours of community service and fined $25,000.

“The nature and severity of the crimes, along with his history of dishonest conduct support (Frey’s) disbarment,” the state’s Disciplinary Review Board wrote in its recommendation to the state Supreme Court. “In our view, he is no longer worthy of the public’s trust.”

The disciplinary review board said Frey’s actions were
“particularly egregious” because he conspired to victimize his own clients “for his own financial benefit.”

According to documents filed in the case and statements made in court, Frey, Robert G. Cusic Jr. — a Millstone Township mortgage broker — and another conspirator schemed to defraud four victims, including two police officers, by falsely representing to them that they were the subjects of criminal investigations by the IRS in connection with rental properties that some of them owned.

Frey and Cusic falsely represented that while Cusic was at a property formerly owned by one of the victims, Cusic encountered two IRS special agents who questioned him extensively about some of the victims.

Frey falsely told the victims he had ongoing communications with one of the IRS special agents about the purported investigation and had a special relationship with him, authorities said.

Frey told the victims that if they paid up to $20,000 each, he would call the agent and have the investigation converted from a criminal tax investigation to an IRS desk audit, a civil matter.

Frey and Cusic falsely stated that if the victims did not retain his services and pay the fee, the investigation would likely result in the arrest of certain of the victims, authorities said.

Frey was charged by complaint on April 8, 2011, along with Cusic, with one count of conspiracy to commit extortion and one count of wire fraud. Cusic pleaded guilty Nov. 28, 2011, to conspiring with Frey and was sentenced to one year in federal prison. Cusic was released on Sept. 2.

Washington State CPA Sent to Prison for Filing False Income Tax Returns

A Spokane, Washington certified public accountant was sentenced yesterday to 15 months in prison for making and subscribing false corporate income tax returns, announced Principal Deputy Assistant Attorney General Caroline D. Ciraolo, head of the Justice Department’s Tax Division, and U.S. Attorney Michael C. Ormsby for the Eastern District of Washington.

According to documents filed with the court, Roger Stadtmueller owned and operated Stadtmueller & Associates P.S., an accounting firm that offered accounting and consulting services, including income tax preparation, bookkeeping and financial auditing. Stadtmueller also owned Zazz, Inc., the corporate entity under which Stadtmueller & Associates P.S. conducted business. Stadtmueller willfully made and subscribed false and fraudulent corporate income tax returns for Zazz, Inc. for 2006, 2007 and 2008, which understated gross receipts by approximately $1.8 million.

“As a tax professional, Roger Stadtmueller was clearly aware of his legal obligation to honestly and accurately report corporate income, and willfully disregarded this obligation when he filed false corporate income tax returns,” said Principal Deputy Assistant Attorney General Ciraolo. “With yesterday’s sentence, Mr. Stadtmueller pays a substantial price for his criminal conduct. The department, together with its colleagues in the Internal Revenue Service (IRS) and other law enforcement partners, will continue to pursue and prosecute those who violate our nation’s tax laws.”

Stadtmueller pleaded guilty on July 26. In addition to the prison term, Stadtmueller was ordered to serve one year of supervised release and to pay restitution to the IRS in the amount of $400,000.

“It really is inconceivable that a CPA would cheat on his own corporate returns, but that is exactly what Roger Stadtmueller did,” said Special Agent in Charge Darrell Waldon of IRS-Criminal Investigation (CI). “Now the accountant is being held accountable. Accountants are known for their trustworthiness and integrity and IRS-CI exists to ensure that those qualities permeate our tax system. When someone violates those principles, and in so doing breaks the law, they will be brought to justice.”

Tax Fraud Blotter: What Happened in Vegas

Russellville, Ky.: Former preparers Tara L. Mitchell and Mechelle Blankenship have pleaded guilty to conspiring to defraud the U.S. through preparing false tax returns and aiding in the preparation of the false returns.

The two were initially charged in a 21-count grand jury indictment in March. According to the plea agreement, they worked together at Triple J Tax, where Mitchell managed the office and, in 2012, hired and trained Blankenship to prepare returns.

The defendants admitted that between March 2012 and November 2014 they knowingly prepared and e-filed U.S. individual income tax returns, on behalf of themselves and clients of Triple J Tax, that contained statements that they knew were false and fraudulent. The loss to the government was more than $250,000.

The returns stated that clients incurred educational expenses when they had not and falsely claimed unjustified education-related credits.

Mitchell and Blankenship also included fraudulent education credits on their own returns. On or about Jan. 10, 2013, they prepared Mitchell’s 2012 return, fraudulently claiming education expenses of $3,500, resulting in a $950 American Opportunity Credit. On or about April 11, 2013, Mitchell and Blankenship prepared Blankenship’s 2012 return and fraudulently claimed education expenses of $4,000, resulting
in a $371 AOC and a $557 education credit.

If convicted, Blankenship could receive up to 41 years in prison, be fined $1.45 million and be required to serve three years of supervised release. Mitchell could be sentenced to up to 29 years in prison, fined $1.05 million and also required to serve three years of supervised release.

Las Vegas: Preparer Roger Linares, 43, has been sentenced to 18 months in prison and three years of supervised release and been ordered to pay some $182,000 restitution for aiding and assisting in the preparation of multiple fraudulent individual income tax returns.

According to the plea agreement, in October 2004 Linares and his wife opened the prep business America Services. By 2010, the business had 11 locations, including seven in Las Vegas and other locations in Nevada and Utah. The couple registered the business in the name of Linares’s wife because Linares did not become a U.S. citizen until approximately 2009.

Linares actively participated in running the day-to-day operations of the business from 2004 to early 2010; the business established a large clientele consisting mostly of Hispanic individuals who spoke little or no English and possessed little tax knowledge.

Linares aided and assisted in the preparation of at least 18 false individual income tax returns without clients’ knowledge that the returns included false information that inflated refunds. Linares benefited from the large volume of customers because he was part-owner of the business and received a substantial portion of the proceeds. Other employees were paid commissions and the more returns they prepared, the more money they earned.

Tax loss to the government for the 2008 and 2009 returns prepared by the defendants was $181,818.

Another defendant charged in the scheme, Sergio Acosta, also pleaded guilty to one count of conspiracy to defraud the U.S., and was sentenced in September to five years of probation and six months of home confinement and was ordered to pay $182,000 restitution.

Mount Pocono, Pa.: Preparer Janice C. Bailey, 49, representing Tax Centers of America, has been arrested for allegedly misappropriating $40,000 from former clients.

Investigation determined that a local resident hired Bailey as her tax preparer in 2007; Bailey continued to prepare the client’s income tax returns through 2012. In July 2013, the client received an insurance cash settlement of $57,318.05 and soon consulted with Bailey about any tax implications. Authorities said Bailey told the client that she did not incur any tax obligations on the $57,318, then told the client that Bailey was investing in a Las Vegas property and asked if the client would give her $40,000 towards that property investment, promising to pay back $50,000 within 18 months.

In August 2013, a contract was signed by Janice Bailey and the client and spouse whereby Bailey received $40,000 for “valuable consideration.” A month later, according to police, the client gave Bailey $40,000 in cash.

From then until January 2015, Bailey allegedly provided the client with no updates or documentation on the investment, though she did promise the client would receive $50,000 by the end of that month. The client told police she didn’t hear from Bailey until June 2015, when the client met Bailey at her office and asked about her money. Authorities said Bailey responded angrily that she did not have the money. At a chance meeting a month later, police said, Bailey responded to the subject “with obscenities, threatening to use the information she had obtained preparing Vidalina’s tax returns for nefarious purposes.” Police said Bailey also claimed at that time that she was filing bankruptcy and would not need to return the money.

Investigation determined that Bailey did not invest the funds on behalf of her client, police said.

Bailey has been charged with theft by deception, theft by failure to make required disposition of funds received and receiving stolen property, all third-degree felonies. She has been released on $2,500 bail, with the next hearing scheduled for Nov. 9.

West Palm Beach, Fla.: A federal court has permanently barred Renel Herard, individually and doing business as Herard Tax Services and Herard Security & Training Inc., from preparing federal returns for others.

In February, the government filed suit against Herard and alleged that returns prepared by Herard and his businesses unlawfully understated clients’ income tax liabilities by creating or inflating deductions or fabricating business losses for non-existent businesses, and overstated refunds by falsely claiming tax credits, including education credits, fuel tax credits and medical and child-care expenses.

The government alleged that, beginning with returns he prepared for the 2014 tax year, Herard prepared returns that falsely claimed the Premium Tax Credit.

In addition, the court ordered Herard to publish notice of the injunction in local media and to prominently post a copy of the final injunction in the front window of the defendants’ offices until April 30, 2017. Herard must also turn over to the U.S. a list of all customers for whom he or his businesses prepared returns after Jan. 1, 2015, and provide a copy of the injunction order to anyone with whom he worked to prepare or file returns for others.
Limited Liability Company

A limited liability company is a hybrid type of legal structure that provides the limited liability features of a corporation and the tax efficiencies and operational flexibility of a partnership.

The “owners” of an LLC are referred to as “members.” Depending on the state, the members can consist of a single individual (one owner), two or more individuals, corporations or other LLCs.

Unlike shareholders in a corporation, LLCs are not taxed as a separate business entity. Instead, all profits and losses are “passed through” the business to each member of the LLC. LLC members report profits and losses on their personal federal tax returns, just like the owners of a partnership would.

Forming an LLC

While each state has slight variations to forming an LLC, they all adhere to some general principles:

Choose a Business Name. There are 3 rules that your LLC name needs to follow: (1) it must be different from an existing LLC in your state, (2) it must indicate that it’s an LLC (such as “LLC” or Limited Company”) and (3) it must not include words restricted by your state (such as “bank” and “insurance”). Your business name is automatically registered with your state when you register your business, so you do not have to go through a separate process.

File the Articles of Organization. The “articles of organization” is a simple document that legitimizes your LLC and includes information like your business name, address, and the names of its members. For most states, you file with the Secretary of State. However, other states may require that you file with a different office such as the State Corporation Commission, Department of Commerce and Consumer Affairs, Department of Consumer and Regulatory Affairs, or the Division of Corporations & Commercial Code. Note: there may be an associated filing fee.

Create an Operating Agreement. Most states do not require operating agreements. However, an operating agreement is highly recommended for multi-member LLCs because it structures your LLC’s finances and organization, and provides rules and regulations for smooth operation. The operating agreement usually includes percentage of interests, allocation of profits and losses, member’s rights and responsibilities and other provisions.

Obtain Licenses and Permits. Once your business is registered, you must obtain business licenses and permits. Regulations vary by industry, state and locality. Use the Licensing & Permits tool to find a listing of federal, state and local permits, licenses and registrations you’ll need to run a business.

Hiring Employees. If you are hiring employees, read more about federal and state regulations for employers.

Announce Your Business. Some states, including Arizona and New York, require the extra step of publishing a statement in your local newspaper about your LLC formation. Check with your state’s business filing office for requirements in your area.

LLC Taxes

In the eyes of the federal government, an LLC is not a separate tax entity, so the business itself is not taxed. Instead, all federal income taxes are passed on to the LLC’s members and are paid through their personal income tax. While the federal government does not tax income on an LLC, some states do, so check with your state's income tax agency.

Since the federal government does not recognize LLC as a business entity for taxation purposes, all LLCs must file as a corporation, partnership, or sole proprietorship tax return. Certain LLCs are automatically classified and taxed as a corporation by federal tax law. LLCs that are not automatically classified as a corporation can choose their business entity classification. To elect a classification, an LLC must file Form 8832. This form is also used if an LLC wishes to change its classification status.

You should file the following tax forms depending on your classification:

- Single Member LLC. A single-member LLC files Form 1040 Schedule C like a sole proprietor.
- Partners in an LLC. Partners in an LLC file a Form 1065, partnership tax return like owners in a traditional partnership.
- LLC filing as a Corporation. An LLC designated as a corporation files Form 1120, the corporation income tax return.

The IRS guide to Limited Liability Companies provides all relevant tax forms and additional information regarding their purpose and use.

Combining the Benefits of an LLC with an S-Corp

There is always the possibility of requesting S-Corp status for
New E-mail Scam Used False IRS Notice to Fraudulently Claim ACA Claim

Did you get a notice you thought was from the IRS? Make sure it is a real one before paying.

The IRS has issued a warning to taxpayers and tax professionals about a new scam related to the Affordable Care Act.

The warning encourages people to be on the alert against fake emails purporting to contain an IRS tax bill related to the Affordable Care Act. Reports from around the country tell of scammers sending fraudulent version of IRS CP2000 notices for tax year 2015. Generally, the scam involves an email that includes the fake CP2000 notice as an attachment.

Don't be fooled into making a payment. The IRS provides details on how to spot a fake notice and report scams in this press release. If you are not sure what is real or what is fake, always investigate first before taking action.

One good resource for the latest scam awareness news is IRS's Tax Scams/Consumer Alerts page.

Please be assured this issue has been reported to the Treasury Inspector General for Tax Administration for investigation.

If you have a valid notice and need further assistance, our Taxpayer Advocate Service (TAS) website has many resources to help you when you:

- get a notice from the IRS,
- respond to a legitimate audit,
- need to secure a payment arrangement, or
- need to know what to do about identity theft, and many more tax related topics.

Advantages of an LLC

- Limited Liability. Members are protected from personal liability for business decisions or actions of the LLC. This means that if the LLC incurs debt or is sued, members’ personal assets are usually exempt. This is similar to the liability protections afforded to shareholders of a corporation. Keep in mind that limited liability means “limited” liability - members are not necessarily shielded from wrongful acts, including those of their employees.

- Less Recordkeeping. An LLC’s operational ease is one of its greatest advantages. Compared to an S-Corporation, there is less registration paperwork and there are smaller start-up costs.

- Sharing of Profits. There are fewer restrictions on profit sharing within an LLC, as members distribute profits as they see fit. Members might contribute different proportions of capital and sweat equity. Consequently, it’s up to the members themselves to decide who has earned what percentage of the profits or losses.

Disadvantages of an LLC

- Limited Life. In many states, when a member leaves an LLC, the business is dissolved and the members must fulfill all remaining legal and business obligations to close the business. The remaining members can decide if they want to start a new LLC or part ways. However, you can include provisions in your operating agreement to prolong the life of the LLC if a member decides to leave the business.

- Self-Employment Taxes. Members of an LLC are considered self-employed and must pay the self-employment tax contributions towards Medicare and Social Security. The entire net income of the LLC is subject to this tax.

Beanna asked me to reply to many questions received by the Fellowship on LLC’s. An LLC has no tax identity until it elects or defaults. IRS has no special tax treatment for LLCs, but the tax classification of the LLC plays by all the rules for that classification. I hope this is helpful.
Foreign Taxes

Retiring Overseas? What You Need to Know About Getting Benefits Abroad

There are a number of people who choose to live their retirement years in places outside of the United States. Perhaps retirement in Thailand or Portugal is in your plans. Maybe you plan to split your year between Central Europe and Central Asia. In many cases, it’s still possible to receive your retirement benefits while living abroad. Our website can help you navigate your benefit eligibility while living overseas.

If you’ve worked in both the United States and another country, it may be possible for your credits to combine for a larger benefit. Currently, there are 25 countries with such international agreements with the United States. To find out if you have qualifying work in a country with such an agreement, visit www.socialsecurity.gov/international.

You can receive benefits in many countries. To find out whether you can receive your benefits in the country where you are retiring, you should use our Payments Abroad Screening Tool at www.socialsecurity.gov/international/payments_outsideUS_page10.html

How Do US Taxes Compare Internationally?

Total tax revenue equaled 24 percent of gross domestic product (GDP), well below the 34 percent average for developed countries (figure 1).

US taxes are low relative to those in other developed countries. In 2012, US taxes at all levels of government represented 24 percent of GDP, compared with an average of 34 percent of GDP for the 34 member countries of the Organization for Economic Co-operation and Development (OECD).

Among OECD countries, only Chile and Mexico collected less than the United States as a percentage of GDP. In many European countries, taxes exceeded 40 percent of GDP. But those countries generally provide more extensive government services than the United States does.

Composition of Tax Revenue

Income and Profits Taxes: Taxes on personal income and business profits made up 48 percent of US tax revenue in 2012, a higher percentage than in most other OECD countries, where such taxes averaged 34 percent of the total. Australia, Denmark, and New Zealand topped the United States in this category, generating just over half of their total revenue from such taxes. In the United States, personal income taxes alone generated 30 percent of total tax revenue compared with 25 percent on average within the OECD.

Social Security Contributions: The United States collects relatively less revenue dedicated to retirement, disability, and other social security programs—22 percent of total tax revenue—than the 26 percent OECD average. Some
countries were well above that average: the Slovak and Czech Republics, Slovenia, the Netherlands, and Japan all collected more than 40 percent of their revenue from that source.

Property Taxes: Property taxes provided more than twice as large a share of US tax revenue—12 percent in 2012—than the OECD average of 5 percent. Almost all revenue from taxes on property in the United States is collected by state and local governments.

Goods and Services Taxes: The United States relies less on taxes on goods and services (including both general consumption taxes and taxes on specific goods and services) than any other OECD country, collecting 18 percent of tax revenue this way compared with 33 percent for the OECD. The value-added tax (VAT)—a type of general consumption tax collected in stages—is the main source of consumption tax revenue, employed worldwide in 160 countries including all 34 OECD member countries except the United States. Most consumption tax revenue in the United States is collected by state and local governments.

State News of Note

Understanding Nexus

As a business, it can be quite confusing whether or not you should be collecting and remitting sales and use taxes, or paying income taxes to states in which you have employees, remote locations, warehouses, etc. Or, even if you are selling products over the Internet through partner websites that are based in other states, you can be held responsible for collecting state sales taxes.

In order for states throughout the country to determine whether or not certain entities are required to pay state sales and income taxes, they implement “nexus” regulations. Nexus is the connection between a company and a state that allows the state to impose those taxes.

“Nexus is a Latin word meaning ‘connected,’” says Tim Brennan, CPA, MST of Bederson. “In the context of state taxation, it refers to a connection between your business and typically another state other than the one you are formed in and carry out your everyday operations in. Depending on the degree of connections you have to another state, it would traditionally determine whether or not you had ‘nexus’ with that state.”

Background of Nexus

The Commerce Clause of the US Constitution requires a taxpayer to have a connection with a state before the state can impose a sales tax jurisdiction. The US Supreme Court ruled that under the Commerce Clause, out-of-state sellers who do not have a physical presence in a state, cannot be required to collect the sales tax.

In 1992, the landmark Quill Corp. v. North Dakota case was aimed to challenge this. However, it was determined that to have nexus, a business must generally have a more than the minimum “physical” presence in a state before the state could impose income taxation or sales tax collection on a business. “The US Supreme Court ruled that requiring Quill – an out-of-state mail order company that sold goods to North Dakota customers – to collect North Dakota use tax, it violated the Commerce Clause since the vendor had no outlets, sales representatives or other significant property in the state,” Brennan says.

“Because of this case, it set the standard as to what general nexus is today,” adds Scott Smith, director of CohnReznick’s state and local tax practice.

A business with a physical presence in a state almost always has sales and use tax nexus. “Basically, the states are saying, ‘If you are located here, then you are required to register and collect sales tax on all taxable transactions,’” Smith says.

However, having a main office or a location in a particular state is not the only way to determine an obligation to collect sales and/or income tax. Each state has different definitions as to what determines nexus. In New Jersey, for instance, working within the US Constitution Commerce Clause, and as explained by the New Jersey Division of Taxation, “nexus-triggering” activities in the state include, but are not limited to: “Selling, leasing or renting tangible personal property or specified digital products or services; maintaining an office, distribution house, showroom, warehouse, service enterprise, or other place of business; having employees, independent contractors, agents or other representatives working in the state; selling, storing, delivering or transporting energy to users or customers; collecting initiation fees, membership fees, or dues for access to or use of health, fitness, athletic, sporting or shopping club property or facilities; and parking storing, or garaging motor vehicles.”

Daniel Kruesi, director, state and local tax, at Smolin Lupin, stresses the fact that even though the precedent of the Quill case was set, states have become creative in the ways they define and impose nexus.

“There are a lot of gray areas between states as to whether
Click-through Nexus

More recently, states have begun to adopt “click-through” nexus, due to companies like Amazon and the influx of businesses selling products over the Internet, which can even make things more complicated.

“‘Click-through’ nexus, frequently referred to as the ‘Amazon’ nexus, is a new form of nexus created when a business makes taxable sales into a state that they otherwise do not have traditional nexus (physical presence as defined by each state) with, via the internet or use of an agent,” Bederson’s Brennan says. “In this case [in 2008], Amazon did not maintain the requisite connections to the State of New York that would normally allow New York to impose the requirement for Amazon to collect sales tax. However, Amazon allowed various organizations to maintain links on its website, for which Amazon would receive a small percentage of any sales generated from those links. It was this connection which ultimately caused Amazon to have nexus with New York, requiring Amazon to collect sales tax on all taxable sales into the state. The Amazon case opened the door for many other states to enact similar ‘click-through’ regulations including ones similar to Amazon and others based on a dollar amount. At this point, most states have either enacted or are working on enacting ‘click-through’ nexus regulations.”

New Jersey was one state that followed in New York’s footsteps in constituting click-through nexus.

“New Jersey legislation (A.B. 3486, P. L. 2014, c. 13), enacted on June 30, 2014, adopts click-through nexus sales tax provisions,” says Jamie Brenner, partner, state and local tax, PwC. “The legislation creates a rebuttable presumption of nexus when a seller makes sales of tangible personal property, specified digital products or services via a commissioned independent contractor who directly or indirectly refers potential customers, by a link on an Internet website or otherwise, to the seller.”

Bederson’s Brennan adds that for this type of click-through nexus to apply, the cumulative gross receipts from such click-through sales must be in excess of $10,000 during the preceding four calendar quarterly periods, ending on the last day of March, June, September and December. “If these requirements are met, the out-of-state seller must collect and remit sales tax,” he says.

The creation of the click-through nexus has expanded the outreach of states to collect taxes that they may not have otherwise collected before.

“States have been looking to find more ways to generate revenue, without having to burden their own residents,” says Michele Vetlov, a tax manager at Wiss & Company, LLP. “It is all part of that evolution, where there were only brick-and-mortar stores driving these tax revenues for states, but that is no longer the case. There are a lot more companies conducting business online, so, many states figured they would go after that market.”

Sandy Weinberg, principal, state and local tax at PKF O’Connor Davies, LLP, says that states have lost billions of dollars in revenue due to internet sales, and click-through taxes are a way to recoup some of that.

“Because these online companies do not have a physical presence in the state, nexus never applied to them, and thus, states were losing revenue,” he says. “It never meant that sales tax was never due. Because, for example, individuals buying an item from an online retailer in New Jersey, were legally the ones with a sales tax obligation. But, that is a lot of people that the state would have to go after and frankly, they don’t have the dollars or manpower to go after all individuals. It is a lot easier to go after a company with a lot of sales. But, they never were able to do that, because those companies may not have had nexus. So, that is why click-through nexus was developed.”

Emerging Nexus Regulations

Click-through nexus has been adopted by approximately half of the states in the country. However, a few states, including Alabama and South Dakota, recently expanded their nexus regulations to all remote entities, challenging the requirements set forth by Quill v. South Dakota.

“Alabama requires remote sellers to collect and remit Alabama’s sales and use tax if annual sales of tangible personal property into the state exceed $250,000,” Vetlov says. “And, in South Dakota, if an out-of-state seller has more than 200 total transactions annually, or $100,000 in sales annually, to individuals or entities in its state, then that entity has to collect and remit sales tax as well, exactly as they would if they had a physical presence within the state.”

Many tax experts say that it is just a matter of time until other states follow suit as well.

“Other states are going to challenge the Quill v. North Dakota ruling,” O’Connor Davies’ Weinberg says. “But then, those sellers will point to that case and say ‘you can’t do that,’ and they will challenge whether or not they have nexus. So, right now, it is all still up in the air.”

How Can a Business Comply?

In this ever-changing tax landscape, what can businesses do to make sure they are following state nexus regulations and what type of penalties can they face if they are not complying? “As nexus provisions expand, businesses will possibly have additional sales tax collections,” says CohnReznick’s Smith. “So, if you are not complying with the rules, you can become susceptible to audits. Audits can lead to fines and exposure as a company.”
“It is important to have an awareness of where your company is conducting its business activities, or what states your company is selling into to determine its nexus footprint,” PwC’s Brenner adds. “Failure to follow each state’s sales tax laws may subject the company and/or responsible individuals to civil or criminal penalties.”

Besides having to face an audit, companies may not only have to pay back sales and income tax, but interest and other fees. “It can be quite costly for businesses if they don’t comply,” O’Connor Davies Weinberg adds. “And, for small- to mid-sized businesses that may not necessarily have in-house departments and/or resources to help them, having an advisor who knows the ins and outs of nexus and state sales and income tax laws, is something that is very important.”

Weinberg says that many companies are not aware that these nexus regulations exist. However, there are companies that are aware, but aren’t able to properly address them.

“Many times, the administrative burden might be simply too much and businesses aren’t going to engage in putting their time, energy and money towards complying,” he says. “Then, at some point, companies start to realize that they are growing, making enough money and say they have to fix the problem before it costs them a lot of money or even their entire business.”

At the end of the day, companies need to figure out whether or not they are conducting any form of businesses outside of the state in which they are located, find the right advisor, and make sure they are complying with state taxes.

“It is important to determine if [businesses] are selling remotely into states and whether they participate in any type of commission-based referral programs in these states,” PwC’s Brenner concludes. “If they have any in-state affiliates, either through websites or in-person, receiving payments for referring potential customers to your client, they may have nexus in these states [and can be] subject to taxes.”

When Data Exchanged with Foreign Tax Administrations Becomes Confidential

Legal Advice Issued by Associate Chief Counsel 2016-004

In Legal Advice Issued by Associate Chief Counsel, IRS has given its opinion on the exact moment when information that it provides to and receives from foreign tax administrations via the Organization for Economic Cooperation and Development (OECD)’s Common Transmission System (CTS) becomes protected under the Code’s confidentiality rules.

Background—the OECD’s CTS. In light of recent global developments in the areas of transparency and exchange of information, and recognizing that automatic exchanges of information between tax administrations will likely increase over the coming years, the OECD is in the process of developing a common system for transmissions of data between governments. The projected increase in the number of automatic exchanges of information is due, in large part, to the OECD’s “Common Reporting Standard,” which provides for automatic exchanges of financial account information, and the output of Action Plan 13 of the OECD’s Base Erosion and Profit Shifting (BEPS) Project. That common system is the CTS; the CTS will facilitate the automatic exchange of financial account information, “country-by-country” reporting, and other exchanges of information between tax administrations.

The OECD will negotiate and conclude an agreement with a selected vendor to develop, maintain, and provide ongoing support for the CTS.

Observation: IRS notes in the Legal Advice that all aspects of the CTS that are discussed in the Legal Advice are based on information and representations provided by the OECD. Since the CTS project is still ongoing, IRS says that it is not able to confirm that the CTS will, in fact, be constructed as described by the OECD.

Background—FATCA and IDES. Chapter 4 of Subtitle A to the Code, commonly known as the Foreign Account Tax Compliance Act (FATCA), generally requires withholding agents to withhold tax on certain payments to a foreign financial institution (FFI), unless the FFI has entered into a FFI agreement with the U.S. to, among other things, report certain information with respect to U.S. accounts. In addition, it also imposes withholding, documentation, and reporting requirements on withholding agents, with respect to certain payments made to certain non-financial foreign entities. (See Code Sec. 1471 to Code Sec. 1474.)

In cases in which foreign law would prevent an FFI from complying with the terms of an FFI agreement, IRS has collaborated with other governments to develop two alternative model intergovernmental agreements (IGAs) that facilitate FATCA implementation.

The International Data Exchange Service (IDES) is a system to report and exchange financial account information to and between tax administrations around the world developed as part of the OECD’s implementation of FATCA. It was primarily designed by IRS and developed and implemented by a third-party vendor with whom IRS has a contract.

For when information that IRS provides to, and information it receives from, foreign tax authorities and other parties pursuant to FATCA, becomes protected under the Code’s confidentiality rules.

Code Sec. 6103(a) provides the general rule that returns and return information must be kept confidential and can only be disclosed as authorized under the Code.

The term “return” means any tax or information return, declaration of estimated tax, or claim for refund required by, or provided for or permitted under, the Code filed with IRS by, or on behalf of, any person. (Code Sec. 6103(b)(1))

Return information includes the taxpayer’s identity and any
taxpayer-related information that is “received by, recorded by, prepared by, furnished to, or collected by the Secretary.” But return information does not include data in a form that cannot be associated with, or otherwise identify, directly or indirectly a particular taxpayer. (Code Sec. 6103(b)(2))

Under Code Sec. 6103(b)(8), the term “disclosure” means the making known to any person in any manner a return or return information.

There are many exceptions to the general rule of Code Sec. 6103(a). Under one such exception, “a return or return information may be disclosed to a competent authority of a foreign government which has an income tax or gift and estate tax convention or other convention or bilateral agreement relating to the exchange of tax information with the United States but only to the extent provided in, and subject to the terms and conditions of, such convention or bilateral agreement.” (Code Sec. 6103(k)(4))

Information received from a foreign government pursuant to a tax convention (tax treaty) is subject to the confidentiality rules of Code Sec. 6105. Code Sec. 6105(a) contains the general rule that tax convention information must not be disclosed unless it falls under one of the exceptions listed in Code Sec. 6105(b). The terms “tax convention information” and “tax convention” are defined in Code Sec. 6105(c)(1) and Code Sec. 6105(c)(2), respectively. In general, tax convention information, subject to the protection of Code Sec. 6105(a), includes information exchanged pursuant to a tax treaty or other bilateral agreement (including multilateral conventions) providing for the exchange of information, which is treated as confidential or secret under the relevant convention or agreement. (Code Sec. 6105(c)(1)(E))

Each of the tax treaties, as well as the IGAs and tax information exchange agreements (TIEAs), to which the U.S. is a party, include confidentiality provisions that require all information exchanged to be kept confidential in accordance with the provisions of such treaty or agreement, as well as provisions generally limiting the use of the information only for purposes of tax administration. For example, Article 26, section 2 of the U.S. Model Treaty provides that any information received under that article must be treated as secret in the same manner as information obtained under the domestic laws of the treaty signatory.

Where terms are otherwise undefined under a treaty, or by mutual agreement by the competent authorities pursuant to a treaty, they have the meaning that is assigned to that term under the law of the country for the purposes of the taxes to which the treaty applies.

Application of Code Sec. 6103 to outbound transactions. In the case of information that will be transmitted by IRS to foreign tax administrations (outbound transmissions) through the CTS, IRS already possesses the data to be transmitted; therefore, that data already constitutes return or return information within the meaning of Code Sec. 6103(b)(1) and Code Sec. 6103(b)(2). Consequently, IRS is responsible for taking appropriate steps to protect the data when it is uploaded for transmission to the CTS.

IRS concluded that the transmission of the data to the CTS is not itself a “disclosure” for purposes of Code Sec. 6103 and that, therefore, the upload of data, even though protected by Code Sec. 6103, does not need the normal permission under a specific exception under Code Sec. 6103. Its conclusion rested on the presumption and understanding that the CTS will operate with the requirement that all information transmitted must be encrypted using agreed upon state-of-the-art encryption methods, and that IRS will ensure that such encryption methods are in place and required of all users prior to uploading any data to the CTS.

Under Code Sec. 6103(b)(8), the term “disclosure” means the making known to any person in any manner a return or return information. Because of the encryption methods employed by the CTS, and the firm restrictions on the vendor’s access to the data flowing through the system, IRS concluded that there would be no “making known” of the uploaded data to the CTS or the vendor. Rather, the CTS may be viewed as a mere conduit for the transmission of the Code Sec. 6103 data to the recipient foreign tax administration.

IRS then said that, even though there is no disclosure for purposes of Code Sec. 6103 to the CTS or the vendor, it is still making a disclosure of the data to its ultimate recipient and therefore must have the requisite statutory authority to do so. It concluded that under Code Sec. 6103(k)(4), IRS may disclose Code Sec. 6103 data in an outbound transmission to a foreign tax administration, provided the disclosure complies with the requirements of that section. Provided IRS only transmits information to tax convention, TIEA, or IGA partners and the outbound transmission of Code Sec. 6103 data is in accordance with the terms and conditions of the applicable convention, TIEA, or IGA, the disclosure of return information via an outbound transmission is permissible under Code Sec. 6103.

Application of Code Sec. 6103 to inbound transmissions. IRS stated that, unlike outbound transmissions through CTS, in which the data is protected by Code Sec. 6103 from the outset, in an inbound transmission, the precise moment when Code Sec. 6103 applies is less clear.

In determining that moment, IRS first looked to case law. It noted that there is broad consensus that, to be protected by Code Sec. 6103, information must be possessed in some manner by IRS. Citing Baskin, (CA 5 1998) 81 AFTR 2d 98-918, it said that, to be return information, any information must first be received by, recorded by, prepared by, furnished to, or collected by IRS. It also cited Stokwitz, (CA 9 1987) 60 AFTR 2d 87-5952, a case in which U.S. Navy investigators searched a personal office, discovered personal copies of income tax returns filed with IRS, and subsequently disclosed information from those returns, and the Ninth Circuit held that the returns were not protected by Code Sec. 6103. The case law emphasizes that it is not enough for information to be related to a tax matter or even that it be in copies of returns.
The Tax Foundation, a nonprofit tax policy group in Washington, D.C., takes an annual look at each state’s tax code, analyzing more than 100 variables in 5 tax categories to determine which jurisdiction is the most competitive.

States are penalized if the Tax Foundation’s analysts find they have overly complex, burdensome and economically harmful tax codes. States get bonus points for having transparent and neutral tax codes that do not unduly prompt businesses to make decisions in response to potential tax effects.

This year, Wyoming once again takes the top honor of having the most competitive tax code in the country.

Making the 2017 most competitive list, in order of ranking:

1. Wyoming
2. South Dakota
3. Alaska
4. Florida
5. Nevada
6. Montana
7. New Hampshire
8. Indiana
9. Utah
10. Oregon

In addition to geography, a common trait among many of this year’s top business climate states is that they don’t collect a major tax.

Wyoming, Nevada and South Dakota have no corporate or individual income tax, although Nevada does impose gross receipts taxes. There is no sales tax in New Hampshire, Montana or Oregon.

Alaska has no individual income or state-level sales tax. Florida has no individual income tax.

New Jersey, meanwhile, remains stuck at the bottom of the tax pack.

Joining the Garden State in being least competitive according to the Tax Foundation’s analysis and going from 41st to No. 50 New Jersey are Louisiana, Maryland, Connecticut, Rhode Island, Ohio, Minnesota, a tie between Vermont and Washington, D.C., California and New York.

Wyoming Has Best Tax Climate; N.J. the Worst

Taxes are not an obstacle in Wyoming, though bison can be for those at Yellowstone National Park.

Horace Greeley’s advice to “Go West, young man” is still worth taking if you’re looking to start a business. A recent survey of state business tax climates found that 7 of the top 10 locations for companies are west of the Mississippi River.

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Horace Greeley's advice to “Go West, young man” is still worth taking if you're looking to start a business. A recent survey of state business tax climates found that 7 of the top 10 locations for companies are west of the Mississippi River.
The Tax Foundation says that states in the bottom 10 tend to share a number of shortcomings. Their tax codes are complex with comparatively high rates.

They also lack the neutrality factor. This means that their tax structures tend to force businesses to make decisions based on tax reasons instead of primarily economic merits.

New Jersey, notes the Tax Foundation, also has some of the highest property tax burdens in the United States and is one of just 2 states to levy both an inheritance tax and an estate tax. Maryland, which joins N.J. in imposing both types of so-called death taxes, also made the 2017 worst tax climate list. Like all top and bottom 10 lists, there’s room for disagreement. Given state residents’ allegiance to their homes, there’s a good chance that such debates about a state’s tax merits or disadvantages could get heated.

The Tax Foundation acknowledges that.

“Our goal with the State Business Tax Climate Index is to start a conversation between taxpayers and policymakers about how their states fare against the rest of the country,” said Tax Foundation Policy Analyst Jared Walczak. “While there are many ways to show how much a state collects in taxes, the Index is designed to show how well states structure their tax systems, and to provide a road map for improvement.”

Disaster Victims in Florida Qualify for Tax Relief

IRS has announced on its website that victims of Hurricane Hermine in counties of Florida that are designated as federal disaster areas qualifying for individual assistance have more time to make tax payments and file returns. Certain other time-sensitive acts also are postponed. This article summarizes the relief that’s available and includes up-to-date disaster area designations and extended filing and deposit dates for all areas affected by storms, floods and other disasters in 2016. Who gets relief. Only taxpayers considered to be affected taxpayers are eligible for the postponement of time to file returns, pay taxes and perform other time-sensitive acts. Affected taxpayers are those listed in Reg. § 301.7508A-1(d) (1) and thus include:

- . . . any individual whose principal residence, and any business entity whose principal place of business, is located in the counties designated as disaster areas;
- . . . any individual who is a relief worker assisting in a covered disaster area, regardless of whether he is affiliated with recognized government or philanthropic organizations;
- . . . any individual whose principal residence, and any business entity whose principal place of business, is not located in a covered disaster area, but whose records necessary to meet a filing or payment deadline are maintained in a covered disaster area;
- . . . any estate or trust that has tax records necessary to meet a filing or payment deadline in a covered disaster area; and
- . . . any spouse of an affected taxpayer, solely with regard to a joint return of the husband and wife.

What may be postponed. Under Code Sec. 7508A, IRS gives affected taxpayers until the extended date (specified by county, below) to file most tax returns (including individual, estate, trust, partnership, C corporation, and S corporation income tax returns; estate, gift, and generation-skipping transfer tax returns; and employment and certain excise tax returns), or to make tax payments, including estimated tax payments, that have either an original or extended due date falling on or after the onset date of the disaster (specified by county, below), and on or before the extended date.

IRS also gives affected taxpayers until the extended date to perform other time-sensitive actions described in Reg. § 301.7508A-1(c)(1) and Rev Proc 2007-56, 2007-34 IRB 388, that are due to be performed on or after the onset date of the disaster, and on or before the extended date. This relief also includes the filing of Form 5500 series returns, in the way described in Rev Proc 2007-56, Sec. 8. Additionally, the relief described in Rev Proc 2007-56, Sec. 17, relating to like-kind exchanges of property, also applies to certain taxpayers who are not otherwise affected taxpayers and may include acts required to be performed before or after the period above.

The postponement of time to file and pay does not apply to information returns in the W-2, 1098, 1099 or 5498 series, or to Forms 1042-S or 8027. Penalties for failure to timely file information returns can be waived under existing procedures for reasonable cause. Likewise, the postponement does not apply to employment and excise tax deposits. IRS, however, will abate penalties for failure to make timely employment and excise deposits, due on or after the onset date of the disaster, and on or before the deposit delayed date (specified by county, below), provided the taxpayer made these deposits by the deposit delayed date.

Affected areas and dates for storms, floods and other disasters occurring in 2016 (or in 2015, with extended dates going into 2016) that are federal disaster areas qualifying for individual assistance, as published on IRS’s website, are carried below. Arkansas: The following are federal disaster areas qualifying for individual assistance on account of severe storms, tornadoes, straight-line winds and flooding that took place beginning on Dec. 26, 2015: Benton, Carroll, Crawford, Faulkner, Jackson, Jefferson, Lee, Little River, Perry, Sebastian, and Sevier counties.

For these Arkansas counties, the onset date of the disaster was Dec. 26, 2015, the extended date was May 16, 2016 (which includes the 2015 income tax returns normally due on Apr. 18, the Jan. 15 and Apr. 18 deadlines for making quarterly estimated tax payments, the Feb. 1 and May 2 deadlines for quarterly payroll and excise tax returns, and the special Mar. 1 deadline for farmers and fishermen who choose to forgo making estimated tax payments). The deposit delayed date was Jan. 11, 2016.
California: The following are federal disaster areas qualifying for individual assistance on account of the Valley and Butte fires that took place beginning on Sept. 12, 2015: Calaveras and Lake counties.

For these California counties, the onset date of the disaster was Sept. 12, 2015, the extended date was Jan. 15, 2016 (which includes individual returns on extension to October 17, the September 15 deadline for making quarterly estimated tax payments, the 2015 corporate and partnership returns on extension through September 15, and for quarterly payroll and excise tax returns). The deposit delayed date was Sept. 28, 2015.

Florida: The following are federal disaster areas qualifying for individual assistance on account of Hurricane Hermine that took place beginning on Aug. 31, 2016: Citrus, Dixie, Hernando, Hillsborough, Leon, Levy, Pasco, and Pinellas counties.

For these Florida counties, the onset date of the disaster was Aug. 31, 2016, the extended date is Jan. 17, 2017 (which includes the Sept. 15 estimated tax deadline, the 2014 corporate and partnership returns on extension thru Sept. 15, and the Oct. 15 deadline for those who received an extension to file their 2014 return). The deposit delayed date was Sept. 15, 2016.

Louisiana: The following are federal disaster areas qualifying for individual assistance on account of severe storms and flooding that took place beginning on Mar. 8, 2016: Allen, Ascension, Avoyelles, Beauregard, Bienville, Bossier, Caddo, Calcasieu, Caldwell, Catahoula, Claiborne, De Soto, East Carroll, Franklin, Grant, Jackson, La Salle, Lincoln, Livingston, Madison, Morehouse, Natchitoches, Ouachita, Rapides, Red River, Richland, Sabine, St. Helena, St. Tammany, Tangipahoa, Union, Vernon, Washington, Webster, West Carroll, and Winn parishes.

For these Louisiana parishes, the onset date of the disaster was Mar. 8, 2016, and the extended date was July 15, 2016 (which includes 2015 income tax returns normally due on Apr. 18, the April 18 and June 15 deadlines for making quarterly estimated tax payments, and a variety of business tax deadlines including the May 2 deadlines for quarterly payroll and excise tax returns). The deposit delayed date was Mar. 23, 2016.

Mississippi: The following are federal disaster areas qualifying for individual assistance on account of recent storms that took place beginning on Dec. 23, 2015: Benton, Coahoma, Marshall, Monroe, Panola, Prentiss, Quitman, and Tippah counties.

For these Mississippi counties, the onset date of the disaster was Dec. 23, 2015, and the extended date was May 16, 2016 (which includes the 2015 income tax returns normally due on Apr. 18, the Jan. 15 and Apr. 18 deadlines for making quarterly estimated tax payments, and a variety of business tax deadlines including the Feb. 1 and May 2 deadlines for quarterly payroll and excise tax returns and the special Mar. 1 deadline for farmers and fishermen who choose to forgo making estimated tax payments). The deposit delayed date was Jan. 7, 2016. (IR 2016-2)

Mississippi: The following are federal disaster areas qualifying for individual assistance on account of recent storms that took place beginning on Mar. 9, 2016: Bolivar, Clarke, Coahoma, Forrest, George, Greene, Jones, Marion, Panola, Pearl River, Perry, Quitman, Sunflower, Tallahatchie, Tunica, Wayne, and Washington counties.

For these Mississippi counties, the onset date of the disaster was Mar. 9, 2016, and the extended date was July 15, 2016 (which includes the 2015 income tax returns normally due on Apr. 18, the Apr. 18 and June 15 deadlines for making quarterly estimated tax payments, and a variety of business tax deadlines including the May 2 deadlines for quarterly payroll and excise tax returns). The deposit delayed date was Mar. 24, 2016.

Missouri: The following are federal disaster areas qualifying for individual assistance on account of recent storms that took place beginning on Dec. 23, 2015: Barry, Barton, Camden, Cape Girardeau, Coos, Crawford, Franklin, Gasconade, Greene, Hickory, Jasper, Jefferson, Laclede, Lawrence, Lincoln, Maries, McDonald, Morgan, Newton, Osage, Phelps, Polk, Pulaski, Scott, St. Charles, St. Francois, St. Louis, Ste. Genevieve, Stone, Taney, Texas, Webster, and Wright counties.

For these Missouri counties, the onset date of the disaster was Dec. 23, 2015, and the extended date was May 16, 2016 (which includes 2015 income tax returns normally due on Apr. 18, the Jan. 15 and Apr. 18 deadlines for making quarterly estimated tax payments, and a variety of business tax deadlines including the Feb. 1 and May 2 deadlines for quarterly payroll and excise tax returns and the special March 1 deadline for farmers and fishermen who choose to forgo making estimated tax payments). The deposit delayed date was Jan. 7, 2016. (IR 2016-9)
South Carolina: The following are federal disaster areas qualifying for individual assistance on account of severe storms and flooding that took place beginning on Oct. 1, 2015: Bamberg, Berkeley, Calhoun, Charleston, Clarendon, Colleton, Darlington, Dorchester, Fairfield, Florence, Georgetown, Greenville, Greenwood, Horry, Kershaw, Lee, Lexington, Marion, Newberry, Orangeburg, Richland, Spartanburg, Sumter and Williamsburg counties.

For these South Carolina counties, the onset date of the disaster was Oct. 1, 2015, and the extended date was Feb. 16, 2016 (which includes the Oct. 15 deadline for those who received an extension to file their 2014 return). The deposit delayed date was Oct. 16, 2015.

Texas: The following are federal disaster areas qualifying for individual assistance on account of severe storms, tornadoes, straight-line winds and flooding that took place beginning on Oct. 22, 2015: Bastrop, Brazoria, Caldwell, Cameron, Comal, Galveston, Guadalupe, Hardin, Harris, Hays, Hidalgo, Liberty, Navarro, Travis, Willacy, and Wilson counties.

For these Texas counties, the onset date of the disaster was Oct. 22, 2015, and the extended date was Feb. 29, 2016. The deposit delayed date was Nov. 6, 2015.

Texas: The following are federal disaster areas qualifying for individual assistance on account of severe storms, tornadoes, and flooding that took place beginning on Mar. 7, 2016: Erath, Gregg, Harrison, Henderson, Hood, Jasper, Limestone, Marion, Newton, Orange, Parker, Shelby, and Tyler counties.

For these Texas counties, the onset date of the disaster was Mar. 7, 2016, and the extended date was July 15, 2016 (which includes the 2015 income tax returns normally due on April 18, the April 18 and June 15 deadlines for making quarterly estimated tax payments, and a variety of business tax deadlines including the May 2 deadlines for quarterly payroll and excise tax returns). The deposit delayed date was Mar. 22, 2016.

Texas: The following are federal disaster areas qualifying for individual assistance on account of storms that took place beginning on Apr. 17, 2016: Anderson, Austin, Cherokee, Colorado, Fayette, Fort Bend, Grimes, Harris, Liberty, Montgomery, Parker, San Jacinto, Smith, Walker, Wharton, Wood counties.

For these Texas counties, the onset date of the disaster was Apr. 17, 2016, and the extended date was Sept. 1, 2016 (which includes 2015 income tax returns normally due on April 18, the April 18 and June 15 deadlines for making quarterly estimated tax payments, and a variety of business tax deadlines including the May 2 and Aug. 1 deadlines for quarterly payroll and excise tax returns). The deposit delayed date was May 2, 2016. (IR 2016-67)

Texas: The following are federal disaster areas qualifying for individual assistance on account of the severe storms and flooding that took place beginning on May 26, 2016: Austin, Bastrop, Brazoria, Brazos, Burleson, Eastland, Fayette, Fort Bend, Grimes, Harris, Hidalgo, Hood, Kleberg, Lee, Liberty, Montgomery, Palo Pinto, Parker, San Jacinto, Stephens, Travis, Tyler, Waller, and Washington counties.

For these Texas counties, the onset date of the disaster was May 26, 2016, and the extended date is Oct. 17, 2016 (which includes the June 15 and Sept. 15 deadlines for making quarterly estimated tax payments, the 2015 corporate and partnership returns on extension through Sept. 15, and the Aug. 1 deadlines for quarterly payroll and excise tax returns). The deposit delayed date was June 10, 2016.

West Virginia: The following are federal disaster areas qualifying for individual assistance on account of the severe storms, flooding, landslides, and mudslides that took place beginning on June 22, 2016: Clay, Fayette, Greenbrier, Jackson, Kanawha, Lincoln, Monroe, Roane, Summers, Nicholas, Pocahontas, and Webster counties.

For these West Virginia counties, the onset date of the disaster was June 22, 2016, and the extended date is Nov. 15, 2016 (which includes individual returns on extension to Oct. 17, the Sept. 15 deadline for making quarterly estimated tax payments, the 2015 corporate and partnership returns on extension through Sept. 15, and the Aug. 1 deadlines for quarterly payroll and excise tax returns). The deposit delayed date was July 7, 2016.

Wayne’s World

S Corporation

An S corporation (sometimes referred to as an S Corp) is a special type of corporation created through an IRS tax election. An eligible domestic corporation can avoid double taxation (once to the corporation and again to the shareholders) by electing to be treated as an S corporation.

An S corp is a corporation with the Subchapter S designation from the IRS. To be considered an S corp, you must first charter a business as a corporation in the state where it is headquartered. According to the IRS, S corporations are “considered by law to be a unique entity, separate and apart from those who own it.” This limits the financial liability for
which you (the owner, or “shareholder”) are responsible. Nevertheless, liability protection is limited - S corps do not necessarily shield you from all litigation such as an employee’s tort actions as a result of a workplace incident.

What makes the S corp different from a traditional corporation (C corp) is that profits and losses can pass through to your personal tax return. Consequently, the business is not taxed itself. Only the shareholders are taxed. There is an important caveat, however: any shareholder who works for the company must pay him or herself “reasonable compensation.” Basically, the shareholder must be paid fair market value, or the IRS might reclassify any additional corporate earnings as “wages.”

Forming an S Corporation

Before you form an S Corporation, determine if your business will qualify under the IRS stipulations.

To file as an S Corporation, you must first file as a corporation. After you are considered a corporation, all shareholders must sign and file Form 2553 to elect your corporation to become an S Corporation. Once your business is registered, you must obtain business licenses and permits. Regulations vary by industry, state and locality. Use the Licensing & Permits tool to find a listing of federal, state and local permits, licenses, and registrations you’ll need to run a business.

If you are hiring employees, read more about federal and state regulations for employers.

Combining the Benefits of an LLC with an S Corp

There is always the possibility of requesting S Corp status for your LLC. Your attorney can advise you on the pros and cons. You’ll have to make a special election with the IRS to have the LLC taxed as an S corp using Form 2553. And you must file it before the first two months and fifteen days of the beginning of the tax year in which the election is to take effect.

The LLC remains a limited liability company from a legal standpoint, but for tax purposes it’s treated as an S corp. Be sure to contact your state’s income tax agency where you will file the election form to learn about tax requirements.

Taxes

Most businesses need to register with the IRS, register with state and local revenue agencies, and obtain a tax ID number or permit.

All states do not tax S corps equally. Most recognize them similarly to the federal government and tax the shareholders accordingly. However, some states (like Massachusetts) tax S corps on profits above a specified limit. Other states don’t recognize the S corp election and treat the business as a C corp with all of the tax ramifications. Some states (like New York and New Jersey) tax both the S corps profits and the shareholder’s proportional shares of the profits.

Your corporation must file the Form 2553 to elect “S” status within two months and 15 days after the beginning of the tax year or any time before the tax year for the status to be in effect. Late election procedures apply.

Advantages of an S Corporation

- Tax Savings. One of the best features of the S Corp is the tax savings for you and your business. While members of an LLC are subject to employment tax on the entire net income of the business, only the wages of the S Corp shareholder who is an employee are subject to employment tax. The remaining income is paid to the owner as a “distribution,” which is taxed at a lower rate, if at all.

- Business Expense Tax Credits. Some expenses that shareholder/employees incur can be written off as business expenses. Nevertheless, if such an employee owns 2% or more shares, then benefits like health and life insurance are deemed taxable income.

- Independent Life. An S corp designation also allows a business to have an independent life, separate from its shareholders. If a shareholder leaves the company, or sells his or her shares, the S corp can continue doing business relatively undisturbed. Maintaining the business as a distinct corporate entity defines clear lines between the shareholders and the business that improve the protection of the shareholders.

Disadvantages of an S Corporation

- Stricter Operational Processes. As a separate structure, S corps require scheduled director and shareholder meetings, minutes from those meetings, adoption and updates to by-laws, stock transfers and records maintenance.

- Shareholder Compensation Requirements. A shareholder must receive reasonable compensation. The IRS takes notice of shareholder red flags like low salary/high distribution combinations, and may reclassify your distributions as wages. You could pay a higher employment tax because of an audit with these results.

As Fellowship members continue to have questions about S Corporations, I am hopeful this information will be of benefit.

Wayne

Letters to the Editor

IP PIN Process

Hi Beanna:

I thought you might be interested in this little report from the
field regarding the IP PIN process. I went to pull transcripts for one of my clients last week – and saw ID theft indicators. This was the first I was aware and taxpayer had received no letters or correspondence from IRS. I called the ID theft unit to see what was going on and apparently there were some attempted filings using his SSN for prior years, so they had JUST issued a CP01A letter on October 11 with an IPPIN for 2015 returns. Letter had not arrived as of yesterday. Even though he was due refunds he didn’t want to file late, so we went through the online IP PIN retrieval process together and were able to get the IP PIN online and successfully e-filed yesterday.

It’s a pretty extensive process involving both an e-mail confirmation code and a text message code + verification of some personal information (I believe the choices were credit card number/last 8 digits, mortgage information, car loan information, home equity loan information) – but the process did work and went pretty quickly and smoothly. In the past this has not worked as well. I also think that one of the things that can trip up the process is if you don’t enter the address exactly the way the IRS has it formatted – particularly thorny with NYC apartment numbers. I looked at a prior IRS account transcript to be sure I was entering the address exactly as they had it.

All best, Phyllis Jo Kubey

Thank you Phyllis for this first-hand account of the procedure and what steps tax professionals have to take in order to assist their clients.

Tax Jokes and Quotes

Paying your taxes is a great way to virtually experience doing time in a Turkish prison without all the hassles of travel.

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Our Software Development Philosophy

We will not develop a program unless at least one of the following criteria apply:

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- Payroll Corrector
- Maryland Personal Property
- New York Sales Tax Preparer
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