Remarks from Beanna

A Life Remembered: Nick Fiorillo ‘Was Always Talking Taxes’

Nicholas J. Fiorillo, 82, of Paxton, died at 8:25 am. Tuesday, July 12, 2016, at the Illinois Knights Templar Home in Paxton.

Nick Fiorillo loved to talk. Taxes, the focus of his profession, were often the subject.

Even as Mr. Fiorillo was recovering from hip-replacement surgery this month at the Illinois Knights Templar Home in Paxton, his conversations with his fellow residents and the facility’s nurses always seemed to lead to the inevitable topic.

“He was always talking taxes,” said Jeff Shaffer, who worked alongside Mr. Fiorillo for 18 1/2 years at Fiorillo, Shaffer & Associates Ltd. in Paxton.

Shaffer’s last conversation with Mr. Fiorillo was on Monday night, the eve of Mr. Fiorillo’s unexpected death. But as one might expect with Mr. Fiorillo, the 82-year-old Paxton tax preparer/accountant wasn’t particularly concerned about his health — only his clients.

“He was still doing tax returns, and he was still worried about the extensions and giving me instructions on people to call,” Shaffer said. “And he was talking to one of the workers at the nursing home about their tax situation, and they were seeking his advice and help.”

Mr. Fiorillo’s dedication to his job, and the community as a whole, was evident, Shaffer said. It showed in the hours he would spend helping each of his clients prepare their tax returns. It showed in the conversations he had with his colleagues, imparting on them his knowledge about changes in tax law and other matters. It showed in the seminars he led for his fellow tax professionals in Illinois, as well as in the weekly radio program, “Tax Tips,” that he did on Paxton’s WPXN Radio for some 30 years.

And it showed in his clients’ loyalty to his accounting firm, which Mr. Fiorillo started in the early 1970s and continued to own and operate until 2008, when he sold the business to Shaffer.

The relationships Mr. Fiorillo developed with his customers went beyond his job. He treated all of them as friends, with his meetings with them sometimes lasting into the night, they said.

“I’d have a 4 o’clock appointment, but it would last four hours because the first two hours we’d spend talking about everything other than taxes and accounting,” recalled Marvin Perzee, a rural Ashkum farmer who was a client of Mr. Fiorillo for 50 years. “We got to be great friends, and I’ve been doing business with him every year since.”

“He always had time for everybody — maybe sometimes a little bit too much time — but as a tax person he was a very, very friendly person,” said Chuck Crane, a 66-year-old rural Clifton farmer who was a customer of Mr. Fiorillo for 41 years. “We just always had a longtime relationship — it was kind of more than him just being my accountant; we were friends, too.”
The 64-year-old Shaffer, who began working as an accountant in Mr. Fiorillo’s firm in 1998, said Mr. Fiorillo had a way of making his clients feel important.

“People were drawn to Nick by his easy-going manner, his charm, his warmth,” Shaffer said. “But most important, he had a very encouraging nature — he made people feel good about themselves, and he was a good listener and he was just a good friend.”

“He always encouraged people to expand (their business) and take off if they had good ideas,” Crane added. “He could see when a person was doing good, and if they had growth in mind he would always expound on that — he would tell you, ‘Go for it!’ He was always a go-getter.”

After graduating from Mattoon High School and then studying accounting and business at Eastern Illinois University and the University of Illinois, Mr. Fiorillo served in the U.S. Army for two years as a medic stationed in Germany. He then became a registered agent with the Internal Revenue Service, a job he held from 1964 to 1969. After moving to Paxton in 1965, he began working for the Clifton-based father-and-son accounting firm, Granzow & Granzow, before he opened his own accounting firm, then known as Fiorillo & Associates, in the early 1970s in Paxton.

Shaffer said he doesn’t think Mr. Fiorillo ever would have retired, because he was so devoted to his clients, who would “just never let him.”

“Each year we would try to pare down his work schedule, but they just had to see Nick,” Shaffer said.

Shaffer said that Mr. Fiorillo’s clients had “so much confidence in Nick” that even after they moved away from Paxton to other states across the U.S., they would still continue to use his accounting and tax-preparation services. Mr. Fiorillo at one point had clients living in 31 states, Shaffer noted.

“Nick’s always going to remain very much alive in the memories of those clients and friends who loved and respected him over his 50-plus years as a tax accountant,” Shaffer said. “His stories will go on, because he helped so many different people. We were working with three generations (of clients). He was doing the grandpa and then the son, and now I’m doing the grandkids. … It just went on and on.”

‘Shocked and saddened’

Shaffer said he and the other employees of Fiorillo, Shaffer & Associates — including accounting manager Denise Peers, receptionist Darlos Shaffer, office assistants Rachel Palmer, Lori Heinz, Rebecca Caspers and Alyssa Frye, and ICE student Natalie Balnius — were “all shocked and saddened” by Mr. Fiorillo’s unexpected death.

Mr. Fiorillo had just undergone hip-replacement surgery one week earlier, and he was undergoing rehabilitation at the local nursing home with the expectation he would be released soon, Shaffer said.

“I had spoke with him that Monday evening (the day before he died), and we talked about business and joked and made plans for the future, and then he just never woke up on Tuesday morning,” Shaffer said. “You’re saddened, but you realize that life will go on.”

A true civic leader

Mr. Fiorillo was a civic leader in the Paxton community in addition to being a locally prominent accountant.

“Nick was a champion of the common man and, more importantly, the underdog,” Shaffer said. “If somebody was down on their luck and needed a helping hand, Nick was drawn to them to assist.”

“He was very benevolent, always very friendly and willing to help people out,” added friend Bob Thorthesen. “He was a super, super person.”

Mr. Fiorillo’s community involvement included being a longtime member and past president and treasurer of the Paxton Rotary Club.

“Nick was a stalwart member of the Paxton Rotary Club for decades and fought to keep the club alive and viable until the organization dissolved,” said former Paxton Rotary Club member Tom McCabe, chief executive officer of Farmers-Merchants National Bank in Paxton. “He was always ready and generous in committing resources to assist various groups and individuals. He seemed to enjoy immensely the camaraderie (of the club’s weekly noon meetings) and was quick with a witticism to stimulate lunch-time conversation.”

Former Paxton Rotary Club member Bob Martensen, a local attorney, recalled that Mr. Fiorillo was “always willing to share with me his knowledge and expertise.”

Mr. Fiorillo also for many years was involved in the PBL Area Community Food Pantry, currently serving as the pantry’s comptroller.

“He did all the reporting to the government agencies and all that,” said Gary Popel, the pantry’s treasurer. “He was also instrumental for a while in getting us bread for the pantry, but something happened and that fell through.”

Mr. Fiorillo was also a long-time sponsor of Paxton-Buckley-Loda High School’s ICE Program, which places students in the workforce so they can gain first-hand experience in jobs they may want to pursue following graduation.

Doug Anderson, who oversaw the ICE program for 22 years prior to his retirement this summer, said Mr. Fiorillo throughout the decades had always welcomed students into his office to talk to them about taxes, including changes in tax law and “some of the statistics that are relative to what kids would want to know.”

“And as a gesture of kindness for the last 22 years, any of our ICE kids who wanted Fiorillo’s to do their taxes for them, they
would do it for free of charge," Anderson said. "Of course, all the kids make money and have to file (income) taxes, so that was just a really nice gesture on his part. He was always very caring. Whenever I took groups up there, he would always spend time going around the room, wanting to know where each kid works, what their future plans were. He was just a really kind and generous man."

Paul Gill, a tax accountant in Bloomington who served with Mr. Fiorillo on the board of directors of the NATP’s Illinois chapter, recalled how Mr. Fiorillo seemed to have “never met a stranger in his life.”

“When we would go to national meetings, he was always outgoing and willing to talk to other tax professionals with great ease, and he wanted to talk to as many of them as he could,” Gill said. “Going from one session to the next session, he would be late because he was talking to somebody. “And he was always outgoing and eager to learn. Even in his later years here, he tried to learn as much as he could because the dynamics of the tax business changes every year.”

“He was always insightful; he always had something to contribute. He wanted to just improve things and was always diligent,” Marti said. “In fact, he stayed on the state board beyond his allotted time just because he wanted to continue to contribute. I’m 30 years younger than Nick ... and I just hope I can be like Nick when I’m 80 years old, because he just continued to work and to give.”

Mr. Fiorillo also had a weekly radio show on Paxton’s radio station, during which he would talk about changes in tax law and other tax-related issues.

“There was a tax law change back in the ’80s, and I think he started it out to just talk about the changes that were going to be significant that year,” Shaffer said, “and it just continued each year.”

‘Nick was very social’

Mr. Fiorillo was also a member and past secretary/treasurer of Lakeview Country Club at Bayles Lake. Shaffer said Mr. Fiorillo was not much of a golfer, but he enjoyed the camaraderie.

“Nick was very social,” Shaffer said. “He always had time for a friend and conversation. He was very generous with his time. He was never in a hurry.”

Paxton Mayor Bill Ingold — who used Mr. Fiorillo for tax preparation for 45 years — said he was still in shock by Mr. Fiorillo’s death. Ingold recalled how whenever he would visit Mr. Fiorillo’s office as a customer, Mr. Fiorillo always had some “great stories to tell about a lot of different things while he was getting (my taxes) done.” And sometimes, Mr. Fiorillo would turn the conversation’s focus to what the mayor could do to improve the town, Ingold recalled.

“He had some great ideas,” Ingold said. “A lot of times what ended up being a pretty short meeting ended up being a long one.”

Editor’s Note: I didn’t know Mr. Fiorillo, but coming across his obituary, I was overwhelmed by his dedication to this profession. He did as I often suggest, he stayed well and finished well.

We hear so much about bad tax preparers – now this is one we should celebrate.

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**Tax News**

**Percentage of Americans Who Pay NO Federal Income Tax**

The percentage of Americans who pay no federal individual income taxes now stands at 44%, according to an updated estimate announced by the nonpartisan Tax Policy Center (TPC) on July 11. (A Closer Look At Those Who Pay No Income Or Payroll Taxes)

This was roughly the same as it was in 2015. At the peak of the Great Recession, the figure was 50%.

TPC estimates that about one-third of workers who pay no federal income tax get net refundable credits that fully cover their payroll taxes, including their employer’s share.

**Tax Army Larger than U.S. Army**

The Office of Management and Budget has released new data on the amount of time Americans spend complying with the federal tax code. Tax Foundation summarizes the data here. Individuals and businesses spend 8.9 billion hours a year on federal tax paperwork, which is equivalent to 4.3 million people working full-time and year-round on this unproductive activity. That “tax army” is three times larger than our uniformed military of 1.4 million active duty service members.

The burden of tax paperwork can be expressed in dollars. Based on the average earnings of U.S. workers, Tax Foundation finds that federal tax paperwork imposes a $409 billion annual cost on the economy.

The main reason to overhaul the tax code is to increase incentives for working, investing, and other productive activities. But you can appreciate how wasteful the tax code is by considering the paperwork burden of particular provisions. For example, the federal estate tax imposes $20 billion a year in paperwork costs, but the tax only raises $21 billion a year for the government. It clearly makes no sense to impose a tax if it costs as much to collect as the money raised.

The largest paperwork costs stem from the income tax. Tax Foundation has found that replacing the federal income tax with a simple flat tax would reduce the paperwork burden by about 90 percent. With that reform, Americans would be at peace with the tax code, and we could demobilize the tax army.

**High Times with 280E**

Introduced by the Reagan Administration, Section 280E of the Internal Revenue Code prohibits businesses selling cannabis from deducting otherwise ordinary business expenses from their gross income. However, with the industry rapidly expanding at the state and local level, many predict that it is only a matter of time before Congress acts to explain this archaic code section.

Today, the cultivation and sale of cannabis remains illegal under federal law (Controlled Substances Act 3), but a number of newly enacted laws demonstrate that states are willing to support this emerging industry.

Prior to 1982, when Section 280E was enacted, the tax code permitted businesses to deduct otherwise ordinary business expenses from gross income associated with the “trafficking” of controlled substances. In 1981, the Tax Court allowed an illegal business to recover the cost of the controlled substances obtained on consignment and also claim certain business deductions, such as packing, telephone and automobile expenses (Jeffrey Edmondson v. Commissioner, T.C. Memo. 1981-623).

Congress believed that it was against public policy to allow those who illegally trafficked in controlled substances to receive the same tax benefits as legitimate businesses. In 1982, Congress enacted Section 280E, which reversed the holdings in Jeffrey Edmondson v. Commissioner. As defined in Internal Revenue Code, Section 280E reads as follows:

No deduction or credit shall be allowed for any amount paid or incurred during the taxable year in carrying on any trade or business if such trade or business (or the activities which comprise such trade or business) consists of trafficking in controlled substances (within the meaning of schedule I and II of the Controlled Substance Act) which is prohibited by Federal Law or the law of any State in which such trade or business is conducted.

Section 280E penalizes “traffickers of controlled substances” by denying deductions from gross income for business expenses. However, drug dealers do get a deduction for the cost of goods sold because it would be unconstitutional for Congress to deny them this deduction, since the 16th Amendment does not permit Congress to impose a tax on gross receipts. As one might imagine, the denial of ordinary business deductions greatly impacts those doing business
within the cannabis industry. Many argue that Section 280E is applied to state-regulated cannabis businesses more often than it is to the types of illegal drug dealers that the provision was originally intended to penalize. The table below demonstrates the obvious disparity in effective rate of tax resulting from the application of Section 280E for a cannabis business compared with that of a normal business. In fact, despite large sales figures, many cannabis businesses are actually in the red because of the high amount of income taxes being paid.

In 2010, lawmakers in Arizona, California, Colorado and Massachusetts drafted a letter to the IRS requesting that it stop enforcing Section 280E in states that have legalized medical cannabis sales. In response, the IRS explained that under the 16th Amendment of the United States Constitution, Congress is ultimately authorized the power to lay or collect taxes on incomes.

As a result, legal cannabis businesses have had to change the way they traditionally do business. For example, a common method dispensaries use to limit the burden of Section 280E is by diversifying the services offered by the business.

In a 2007 case, Californians Helping to Alleviate Medical Problems Inc. v. Commissioner of Internal Revenue, a California not-for-profit corporation (known as “CHAMP”) that was taxed as a regular corporation for federal purposes opened the door to this diversification method. The company’s mission was to provide a variety of “caregiving” services to its patients. CHAMP charged a membership fee that included limited amounts of medical cannabis, support groups, counseling, massages, yoga and a number of other ancillary services.

The IRS argued that all of CHAMP’s activities consisted of trafficking in cannabis. However, the court ruled that because CHAMP was able to demonstrate that it had incurred expenses related to the separate “caregiving” services (justified under Section 162 and appropriately substantiated), the organization was allowed to deduct such expenses as incurred.

Legislative Reform Gaining Momentum

The CHAMP case was a significant win for the medical cannabis industry, and as the industry has evolved, and as states have loosened their laws to allow legal cannabis businesses to operate, pressure has begun mounting for federal action.

In 2013, the U.S. Department of Justice released a memorandum that provided guidance to federal prosecutors relating to cannabis enforcement under the Controlled Substance Act (CSA). The memo instructed Department attorneys and law enforcement to focus on the following priorities in enforcing the CSA against cannabis-related conduct (Guidance Regarding Marijuana Related Financial Crimes, February 2014):

1. Preventing the distribution of marijuana to minors;
2. Preventing revenue from the sale of marijuana from going to criminal enterprises, gangs, and cartels;
3. Preventing the diversion of marijuana from states where it is legal under state law in some form to other states;
4. Preventing state-authorized marijuana activity from being used as a cover of pretext for the trafficking of other illegal drugs or other illegal activity;
5. Preventing violence and the use of firearms in the cultivation and distribution of marijuana;
6. Preventing drugged driving and the exacerbation of other adverse public health consequences associated with marijuana use;
7. Preventing the growing of marijuana on public lands and the attendant public safety and environment dangers posed by marijuana production on public lands; and
8. Preventing marijuana possession or use on federal property.

Under this guidance, law enforcement must consider whether the cannabis-related issue implicates one or more of these priorities when considering prosecution under the CSA. Additionally, this memo has no impact on federal law, as the possession, cultivation and sale of cannabis remains illegal (under federal law), and states have no power to prevent the federal government from enforcing its own laws.

Although this memo has no impact on federal law, it is obvious that the federal government has taken a step back on its enforcement related to the possession, cultivation and sale of cannabis. As a result, federal cannabis policy has provided states with the freedom to implement statutes and enact legislation from a civic and business perspective.

State Developments

As cannabis continues to become more popular in our society, certain states are jumping at this revenue opportunity and legalizing medical or recreational use, although it remains illegal under federal law. At the time this article was written, four states and the District of Columbia had legalized the sale of recreational cannabis, with an additional 24 states permitting the sale of medical cannabis. With the state and federal governments not on the same page, businesses that
produce and sell cannabis are left in an unclear tax scenario. We are going to look at several states where recreational cannabis has been legalized to examine the tax impact on the respective state from a revenue and regulatory perspective.

Colorado

Colorado, where a billion-dollar-a-year legal cannabis industry has emerged since 2014, continues to exceed initial tax revenue projections. According to the Colorado Department of Revenue, the state sold $996 million worth of recreational and medical cannabis in 2015, a 70 percent increase over 2014. Collections from recreational cannabis were $56 million in 2014 and $133 million in 2015, and are likely to exceed $140 million in 2016. Of the revenue collected, 15 percent is allocated to Colorado’s school districts ($13.3 million in 2014 and $35 million in 2015), leaving the remainder to be dispersed between law enforcement and general state funds. The state’s cannabis tax is structured as:

- A 15 percent excise tax on the “average market rate” of wholesale cannabis, plus
- A 10 percent state tax on retail cannabis sales, plus
- The state sales tax of 2.9 percent, plus
- Local sales taxes, plus
- Local cannabis taxes such as a 3.5 percent in Denver.

When added, Colorado’s effective tax rate on recreational cannabis totals to 29 percent. In 2015, Colorado’s cannabis tax revenues were twice those of alcohol taxes, and some predict that they may even quadruple by the end of 2016. However, as the industry continues to evolve, many of the current tax rates and structures in place will likely need to be revisited by lawmakers. One example of this includes Colorado’s reduction in its state cannabis tax, which is expected to drop to 8 percent beginning July 1, 2017, due to concerns related to the competitiveness of the black market.

Washington

The Washington State Liquor Control Board, which oversees the state’s cannabis industry, reported that dispensaries sold over $257 million worth of cannabis in its first year, of which the state collected $70 million in tax revenue. Looking forward, Washington estimates that sales will average over $2 million a day, which could mean excise tax revenue may hit $270 million for 2016.

Oregon

In January 2016, Oregon collected $3.48 million in taxes on $14 million in sales, exceeding initial revenue projections by a factor of three. The state plans to distribute the tax revenue, with 40 percent going to schools, 20 percent to mental health and drug services, 15 percent to state law enforcement, 10 percent to cities, and 5 percent to the Oregon Health Authority.

Looking Ahead

Seeing the success that states are having from a revenue generation standpoint could spur the federal government to act. A recent study published by the Tax Foundation estimates that if every state imposed retail cannabis tax, total annual collections could range from $5.3 billion at a 15 percent rate to $8.8 billion at a 25 percent rate. With all this revenue potential, many argue that it’s only a matter of time until the feds budge, whether it is from a legal perspective through the decriminalization of cannabis and removing it from the Schedule I list of controlled substances or from a tax perspective by reforming Section 280E.

Coincidentally, on June 6, 2016 in San Francisco, Harborside Health Center, the country’s largest medical cannabis dispensary, was in Tax Court arguing against the application of Section 280E of the Internal Revenue Code to state-recognized cannabis dispensaries. A decision on the case is not expected until early 2017, but the case has potential landmark implications for the industry.

Why a $2 Trillion Tax Bill Is Coming Due for Baby Boomers

Uncle Sam has been waiting a long time for this big tax payoff. It starts this year, as the oldest baby boomers hit age 70½ on July 1 and begin taking money out of their tax-advantaged savings accounts as required by law—and paying the income tax that has been deferred, in some cases for decades.

Boomers were the first generation to build their retirement plans around traditional IRAs, 401(k) plans and other tax-deferred savings vehicles. These were introduced in the mid-1970s and came into broad circulation in the 1980s, as part of the seismic shift to employer-sponsored defined contribution plans from defined benefit plans.

Traditional IRAs and 401(k) plans now hold more than $14 trillion. Even if that money comes out at the relatively low marginal income tax rate of 15%, this figure represents more than $2 trillion for the federal government. Of course, it will come out over many years. And the windfall actually began to take shape 11 years ago, when these same leading edge boomers turned 59½ and became eligible to begin tapping their tax-deferred accounts.

But most investors tend to leave their retirement savings untouched to grow tax deferred in order to get the maximum benefit. For millions of retirees, that deferral is coming to an end. The oldest boomers—those born the first six months of 1946—are now subject to annual required minimum distributions (RMDs) from their pre-tax savings. The penalty for not taking an RMD is a stiff 50% of the amount you were obligated to withdraw.

You must take your distributions by Dec. 31, although there is a grace period the first year—those turning 70½ in 2016 have until April 1, 2017 to take an RMD. But you must make your withdrawals every year after that by Dec. 31. That includes a second distribution next year if you wait until April 1 to take your initial distribution for 2016. Generally, all tax-deferred savings accounts, such as traditional IRAs and 401(k)s fall
under this rule. The exception is a Roth IRA, which is funded with after-tax money, gains are untaxed if you meet certain conditions, and no withdrawals are required during the original owner’s lifetime.

How much will you be required to withdrawal? The RMD calculation is based on your total tax-deferred savings balance at year end and the number of years you are expected to live. For most people, your projected life expectancy can be found on table III of IRS Publication 590-B, which includes a RMD worksheet. If you are 71, for example, you are expected to live 26.5 more years, so your RMD will be a little less than 4% of your tax-deferred portfolio.

One way to minimize your required distributions is to purchase what’s called a qualified longevity annuity contract (QLAC) inside your IRA or 401(k). These are deferred annuities that begin paying an income stream at a later date—typically no later than age 85. The full purchase price of a QLAC is removed from your portfolio for purposes of figuring your RMD in the years before the income stream begins. But your QLAC purchase is limited to 25% of your portfolio or a maximum of $125,000.

Other ways to reduce your RMDs include staying on the job—you do not have to withdraw money from a current employer-sponsored 401(k). You can also donate up to $100,000 of your RMD to charity and avoid paying federal income tax on that amount. For younger boomers not already on Medicare, with high-deductible plans, you can use part of your RMD to fund a health savings account, which is sheltered from federal income taxes.

But don’t let tax and RMD considerations dictate your strategy. Hopefully, you have benefited a great deal over the years by having your savings compound tax-free, possibly while in a higher tax bracket. This money was always meant to be withdrawn, hopefully at a lower tax rate, and used to live well in retirement.

The Unstoppable Train Passes Another Station: Observations from the Hearing on Proposed Earnings Stripping Regulations

The U.S. Treasury Department held its much anticipated hearing on the controversial proposed earnings stripping regulations under Section 385 of the Internal Revenue Code. We attended the hearing on behalf of our clients and readers. In spite of all the legitimate concerns expressed by the more than a dozen speakers at the hearing and in the written comments, there was no indication of any appetite at Treasury or IRS for any major changes or delays in implementation. The IRS and Treasury attendees expressed no interest in responding to comments or questions raised by the speakers. Even many speakers themselves commented as if these proposed regulations would certainly be finalized and therefore spent their allotted time suggesting modifications.

Given the volume and content of written comments received by Treasury and published prior to the hearing, the hearing itself provided no major surprises. Nonetheless, many of the statements made by speakers revealed some common themes worthy of note.

Actionable Items:

From a practical perspective, perhaps the most important observation from the hearing relates to something that was largely left unsaid by the speakers. Specifically, apart from concerns regarding the application of the documentation rules to cash pooling arrangements and trade payables entered into as part of the ordinary course of business and a desire for the documentation not to be required until the extended due date of the tax return for the year in which the instrument was entered into, none of the speakers raised serious concerns about any of the first three out of the four documentation requirements imposed by Section 1.385-2. Those first three requirements are:

(i) There must be written documentation establishing an unconditional and legally binding obligation to pay a sum certain on demand or at one or more fixed dates;

(ii) The written documentation must establish that the holder has “creditor’s rights”; and

(iii) There must be written documentation establishing that the issuer’s financial position supported a reasonable expectation that the issuer intended to, and would be able to, meet its obligations pursuant to the debt agreement.

The lack of any objection to those documentation requirements might be explained by the fact that, even prior to the issuance of the proposed regulations, many (if not most) competent tax professionals advised their clients to prepare and maintain those types of documentation to minimize risk that debts might be recast under pre-existing case law. But a surprising number of taxpayers have failed to implement such documentation procedures. Every indication from the hearing and previous statements by Treasury officials suggests that a failure to heed that advice in the future will no longer be a viable option.

To us, this means that taxpayers should at least be complying with these minimum requirements. For some clients, this will involve adopting new processes and procedures, including preparing financial analytics to satisfy the reasonable expectation of repayment documentation requirement.

Other Comments:

Several speakers suggested that Treasury may have exceeded its authority in creating several of the rules in the proposed regulations. Several speakers also suggested that Treasury’s aggressive timetable for finalization of the proposed regulations may render them vulnerable to challenge under the Administrative Procedure Act (the same basis on which a recent cost-sharing regulation was stricken down by the Tax Court in Altera). Through their lack of response, representatives from Treasury and IRS refused to acknowledge any vulnerability to
challenge on either of those bases.

At the other end of the spectrum, one speaker from academia praised the proposed regulations and expressed the view that Treasury acted well within the authority delegated to it by Code Section 385. Just two days earlier, Bernie Sanders announced similar support for Treasury and the proposed regulations.

As expected, many of the speakers described numerous and potentially severe problems that would result if the regulations were to be finalized without substantial changes, including but not limited to the following:

• There is a lack of clear guidance as to the application of the documentation rules to cash pooling arrangements and the inability of taxpayers to satisfy such requirements without excessive burden.
• Several of the rules are extremely complicated and will pose a significant compliance burden for many companies, particularly with respect to documenting routine trade payables.
• The broad application of the proposed regulations has unintended consequences impacting many taxpayers that do not engage in highly tax-motivated intercompany lending transactions.
• The 72-month non-rebuttable presumption of tax avoidance, contained in the so-called funding rule in Section 1.385-3, would cause the regulations to apply to numerous non-abusive routine lending transactions.
• The speed at which these rules could be implemented with little to no transition time could result in inadvertent recasts with dire consequences if there isn’t a postponement of the effective date.

Several speakers voiced concerns that it would be virtually impossible to comply with some of the rules in the proposed regulations as they apply to trade payables and cash pooling arrangements. Representatives from the financial services industry voiced concerns about the unduly harsh impact of the proposed regulations on their industry sectors (banking in particular).

Can This Train Be Stopped?

Based on the lack of any attempt to comment or respond by the Treasury Department and IRS officials at the hearing, it seems that Treasury is not open to considering any change of course. Query whether that may indicate that a deal has already been made behind the scenes (perhaps with members of Congress or special interest groups). Or maybe the orders to proceed on course are coming from a higher authority. Other than the possibility of a behind-the-scenes deal, there appears to be nothing stopping this train. Chairman Kevin Brady of the House Ways and Means Committee has threatened to invoke the Congressional Review Act, but we wonder how likely this is in our current political environment. If the regulations are finalized, taxpayers hoping for a change might have to wait until either: (1) a subsequent administration revokes them, or (2) eventually someone challenges these regs on constitutional grounds or via the Administrative Procedure Act.

Unclaimed federal income tax deductions can impact your tax return.

Here are some commonly missed tax deductions that may save you money when it comes time to file your taxes.

Every year at tax season, Americans leave money on the table in unclaimed federal income tax deductions.

Knowing which types of federal income tax deductions you can claim can help you lower your tax bill.

Of course, it’s not just tax deductions that help slash your tax tab. Here are 8 smart moves, including credits and other strategies, that could reduce your bill to Uncle Sam—or even help you collect a refund this year.

1. Claim the dependent care credit. You can take a 20-35% credit for up to $3,000 in child care expenses for one child (or $6,000 for 2 or more children) under age 13 when the care was provided. Depending on your income, that could amount to a $1,050 credit for one child or $2,100 for 2.

   Your exact tax benefit depends on how much you and your spouse pay for qualifying child care expenses while you both work or seek employment, as well as the size of your adjusted gross income.

   You can still claim the dependent care credit if you use a dependent care flexible spending account (FSA) at work, meaning you put pretax dollars into a special account you can use to pay for child care. Bear in mind, though, that you can’t claim the same expenses for both the credit and the FSA.

2. Track your reinvested dividends. If you’re selling stocks or stock mutual funds this year from a taxable account, be sure not to mistakenly pay capital gains taxes on shares purchased with reinvested dividends.

   The best way to ensure you’re calculating your capital gains tax correctly: Keep all your investment account statements, which will show how many shares you purchased with reinvested dividends over the life of your account. Read more about mutual funds and taxes at Merrill Edge

3. Claim the American opportunity tax credit. If you, your
spouse or your dependent child is in college at least half the year, you can take a tax credit of up to $2,500 annually for up to 4 years of qualified college costs.

You’re eligible for the full credit if your modified adjusted gross income is $80,000 or less in 2015 ($160,000 for married couples filing jointly). The credit is phased out for incomes above $90,000 ($180,000 for those filing jointly).

Keep your tuition bills, as well as receipts for school-related books and supplies, to document your spending. Also, check out the Internal Revenue Service’s Q&A on the American opportunity tax credit

4. Track out-of-pocket charitable contributions. Donations to qualified charities are deductible, so save your receipts whenever possible. If you don’t have all of your receipts, review your checkbook and credit card bills to jog your memory about donations you’ve made. Review the IRS details on determining the value of donated property

5. Record travel expenses if you’re a National Guard member or military reservist. The federal tax code provides deductions for some military service-related travel expenses including mileage, hotel, parking, tolls and some meal costs. Before you can start claiming these costs as a deduction, they must exceed 2% of your adjusted gross income.

Note that you’re eligible for these deductions even if you don’t itemize and, unlike employment-related expenses, they aren’t subject to any adjusted gross income limits.

6. Claim energy-efficient home improvements. You can claim a tax credit of 30% of the cost of installing renewable energy systems including solar electric panels, solar hot water heaters, geothermal heat pumps, residential wind turbines and fuel cells. This energy efficiency tax credit is currently set to expire at the end of 2016.

7. Track work-related moving expenses. If you’re moving for a new job, you may be able to deduct moving and travel costs to your new location. To qualify for the deduction, your new job must be at least 50 miles farther from your home than the old job. You must also work full time for a minimum of 39 weeks during your first year in the new home. Consult the IRS web page about moving expenses for more details.

8. Deduct mortgage interest payments and points. Whether a mortgage is original or refinanced, the interest you pay is tax deductible in 2 circumstances: if the loan is for your primary residence or if it is for a second home you don’t rent out and the loan is secured by your primary home.

If you paid points (prepaid interest that helps you get a lower rate) on your refinanced mortgage, you may be able to deduct these as well. The IRS offers a list of the criteria you must meet in order to deduct points Filing your taxes may not be at the top of your list of favorite activities. But paying careful attention to commonly missed tax deductions, credits and other available strategies can help you minimize your tax bill and keep more cash in your pocket.

Twice Around the World May Be Too Much Mileage for IRS. And: Another Iowa Payroll Tax Plea.

Driving yourself to an audit. A Tax Court case issued reminds us that claiming unrealistic vehicle expenses may attract IRS attention. It also helps show the difference between non-deductible “commuting” and deductible business travel.

The taxpayer, Mr. H., was a union electrician living in Lake County, Illinois. He had regular jobs doing work for the Chicago Transit Authority and for the University of Illinois in Champaign. His wife worked as a project engineer, often working on CTA projects. For readers unfamiliar with Chicagoland geography, Lake County, the next county north of Chicago, is all considered suburban nowadays, while Champaign is considered “downstate” and not part of the greater Chicago sprawl.

Tax Court Special Trial Judge Guy sets the stage (my emphasis):

Ms. H began to prepare the couple’s joint Federal income tax return for 2012 in early January 2013 using TurboTax software. Petitioners’ vehicle mileage logs were destroyed when their basement office flooded on January 30, 2013. Ms. H testified that she had substantially completed the couple’s tax return before the flooding occurred.

It’s remarkable how many floods precede Tax Court cases.

Petitioners reported total income of $141,657 comprising wages of $86,110, taxable refunds of $349, taxable pensions of $29,095, and unemployment compensation of $26,103. Petitioners attached a Schedule A, Itemized Deductions, to their tax return and claimed, in pertinent part, deductions for charitable gifts of $5,427 ($2,000 of cash gifts and $3,427 of gifts other than by cash or check) and unreimbursed employee business expenses of $40,783 (before application of the 2% limitation prescribed in section 67(a)).

That $40,783 number might have caused IRS computers to identify the return as a likely audit target. Sure enough, the taxpayers ran into trouble with respect to those expenses, especially the travel expenses. From the Tax Court:

Petitioners claimed a deduction of $30,525 for vehicle expenses on their 2012 tax return. At trial, however, Mr. H and Ms. H significantly reduced the number of estimated miles they had driven for business purposes in 2012 to 13,705 and 24,631 miles, respectively. They offered scant objective evidence to support their testimony regarding parking expenses.

The original returns claimed 55,000 business miles, or 110 miles a day each for Mr. and Mrs. H, assuming 250 work days a year. For reference, the earth’s circumference is 24,901
miles. While driving in Chicago may feel longer, a 40 mile one-way commute is unusually long.

Respondent concedes that petitioners are entitled to a deduction of $183 for Mr. H's vehicle expenses. Specifically, respondent agrees that Mr. H drove 330 miles for business purposes in 2012 — round trip mileage from petitioners' residence to Champaign, Illinois, where he performed work for Aldridge. The deduction of $183 is the product of 330 miles multiplied by the standard mileage rate of 55.5 cents per mile.

The difference between commuting and out-of-travel is critical. Commuting costs are non-deductible, but out-of-town business travel can be deducted. The Tax Court opinion explains:

As a general rule, a taxpayer's costs of commuting between his or her residence and place of business or employment are nondeductible personal expenses. See Fausner v. Commissioner, 413 U.S. 838, 839 (1973); Commissioner v. Flowers, 326 U.S. 465, 473-474 (1946); sec. 1.262-1(b) (5), Income Tax Regs. There are various exceptions to this general rule. In accordance with Rev. Rul. 99-7, 1999-1 C.B. 361, 362, a taxpayer may deduct travel expenses "incurred in going between the taxpayer's residence and a temporary work location outside the metropolitan area where the taxpayer lives and normally works." As another exception to the general rule, a taxpayer may deduct travel expenses for commuting between the taxpayer's residence and his or her work locations if the residence is the taxpayer's principal place of business.

The judge said the taxpayers' case fell short:

The record reflects that petitioners normally worked in or near Chicago. Without suggesting the adoption of any rigid definition of the term "metropolitan area" for this purpose, we conclude that Lake County and petitioners' work sites in Chicago and Joliet fall within the Chicago metropolitan area. The distances that petitioners routinely traveled to work were not so unusually long as to justify an exception to the general rule that commuting expenses are nondeductible personal expenses.

Keep in mind that a commute to your regular job doesn't become deductible just because it is long. If you live in Chicago and drive six hours to work to your regular job in Des Moines, it's still a non-deductible commute.

The taxpayers did win some deductions for work clothes and other minor expenses, but they lost almost all of their claimed mileage deduction.

The Moral? Claiming more than one trip around the globe as business miles may attract IRS attention. You can't deduct your commute. And keep your mileage logs somewhere waterproof.

The Government Accountability Office has issued a report on the design and administration of three large refundable tax credits. The report (GAO-16-475) is titled "Refundable Tax Credits: Comprehensive Compliance Strategy and Expanded Use of Data Could Strengthen IRS's Efforts to Address Noncompliance."

The report was sent to congressional requesters, on May 27. Here are excerpts of summaries associated with the report.

Why GAO Did This Study: “Refundable tax credits are policy tools available to encourage certain behavior, such as entering the workforce or attending college. GAO was asked to review the design and administration of three large RTCs (the EITC, AOTC, and ACTC). The ACTC is sometimes combined with its nonrefundable counterpart, the Child Tax Credit. For this report GAO described RTC claimants and how IRS administers the RTCs. GAO also assessed the extent to which IRS addresses RTC noncompliance and reviewed proposed changes to the RTCs.

GAO reviewed and analyzed IRS data, forms and instructions for claiming the credits, and planning and performance documents. GAO also interviewed IRS officials, tax preparers, and other subject-matter experts.”

What GAO Found: “The Earned Income Tax Credit (EITC), the Additional Child Tax Credit (ACTC), and the American Opportunity Tax Credit (AOTC) provide tax benefits to millions of taxpayers--many of whom are low-income--who are working, raising children, or pursuing higher education. These credits are refundable in that, in addition to offsetting tax liability, any excess credit over the tax liability is refunded to the taxpayer. In 2013, the most recent year available, taxpayers claimed $68.1 billion of the EITC, $55.1 billion of the CTC/ACTC, and $17.8 billion of the AOTC.

Eligibility rules for refundable tax credits (RTCs) contribute to compliance burden for taxpayers and administrative costs for the Internal Revenue Service (IRS). These rules are often complex because they must address complicated family relationships and residency arrangements to determine who is a qualifying child. Compliance with the rules is also difficult for IRS to verify due to the lack of available third party data. The relatively high overclaim error rates for these credits (as shown below) are a result, in part, of this complexity. The average dollar amounts overclaimed per year for 2009 to 2011, the most recent years available, are $18.1 billion for the EITC, $6.4 billion for the CTC/ACTC, and $5.0 billion for the AOTC.

IRS uses audits and automated filters to detect errors before a refund is sent, and it uses education campaigns and other methods to address RTC noncompliance. IRS is working on a strategy to address EITC noncompliance but this strategy does not include the other RTCs. Without a comprehensive compliance strategy that includes all RTCs, IRS may be limited in its ability to assess and improve resource allocations. A
IRS Investigating Facebook Over ‘Billion-Dollar Tax Understatement’

The Internal Revenue Service said Facebook may have understated the value of intellectual property it transferred to Ireland by “billions of dollars,” unfairly cutting its tax bill in the process, according to court papers.

The U.S. Justice Department filed a lawsuit on Wednesday in federal court in San Francisco seeking to enforce IRS summonses served on Facebook and to force the world's largest social network to produce various documents as part of the probe.

The tax authority is examining whether Facebook understated its U.S. income by selling rights to an Irish subsidiary too cheaply.

Doing so could boost taxable profits in Ireland, which has a corporate tax rate of 12.5 percent, and reduce taxable income in the United States which has a rate of at least 35 percent. Facebook denied any wrongdoing.

"Facebook complies with all applicable rules and regulations in the countries where we operate," Anteneh Daniel, a spokesperson for the company, said in a statement.

The complex tax structuring used by big technology companies such as Google and Amazon has prompted governments in recent years to launch a program to rewrite tax rules so that inter-group deals that shift profits into tax havens are no longer possible.

The lawsuit said that in 2010 Facebook sold the rights to exploit the Facebook platform outside the United States and Canada to Facebook Ireland Holdings.

The price used for the intangible property was determined by Facebook's tax adviser Ernst & Young (E&Y).

"The IRS examination team's preliminary positions suggested that the E&Y valuations of the transferred intangibles were understated by billions of dollars," the lawsuit said.

E&Y was not immediately available for comment.

Facebook Ireland Holdings in turn leased the rights to exploit the Facebook platform to its own subsidiary, Facebook Ireland Ltd, in return for a fee, accounts for Facebook Ireland Ltd, filed with the Irish company registry, show.

Facebook Ireland Ltd. is Facebook’s main international business unit, reaping sales of 4.8 billion euros ($5.3 billion) in 2014, the last year for which accounts are available.

Facebook Inc in the United States could have licensed its intellectual property directly to Facebook Ireland Ltd but then it would have to report that income in the United States and pay tax there.

It does have to pay tax on the money it received from intermediary Facebook Ireland Holdings.

Moreover, if Facebook Ireland Holdings paid less for the rights than it charges Facebook Ireland Ltd., this margin allows profit to be built up in the lower tax jurisdiction.

U.S. technology companies sometimes don’t even have to pay the 12.5 percent Irish corporate tax rate.

They frequently take advantage of a quirk of Irish tax law which allows companies to designate an Irish registered company as being tax resident elsewhere -- an arrangement tax professionals have termed a “double Irish.”

This involves the rights-holding company being designated as tax resident in a tax haven. However, since the companies concerned are Irish-registered, the transactions don’t trigger a U.S. tax bill.

Facebook declined to say where Facebook Ireland Holdings was tax resident. It is an unlimited company, which means it doesn’t have to file accounts so there are no public documents on its status.

Airbnb, Just Pay Your Taxes and Follow the Law and Shut Up

Airbnb is set for a new round of fundraising that would value the company at $30 billion. How do we regulate this ephemeral behemoth before it swallows our urban real estate markets whole?
San Francisco, the very epicenter of loud ideological battles over the future of housing, had its own idea about how to regulate Airbnb: the city passed an ordinance saying that the company itself could be fined for every user who rented out their apartment without being registered with the city. This tactic of making Airbnb itself liable for the massive black market of short term housing it creates was apparently very effective! So effective, in fact, that the company wasted no time in suing the city over the ordinance. The company’s argument is that “It is a content-based restriction on advertising rental listings, which is speech.”

Other cities have had success in taxing Airbnb rentals in more or less the same way they tax hotels—something that the company has said it is willing to do, based, no doubt, on the political calculation that collecting taxes from users in exchange for the freedom to operate is vastly preferable to being fined for all of its non-compliant users.

Airbnb knows that its long-term future depends on reaching a stable arrangement with local governments. Collecting taxes is really no sweat for Airbnb, considering the company’s fantastically profitable business model. It is valued, for example, at significantly more than the Hilton Hotel company, without needing to own, staff, or operate any hotels. But the hotel industry is actually the least of Airbnb’s worries; more significant are cities themselves (and their angry residents), particularly those in which affordable housing is a constant near-crisis. In New York City, a new report says, Airbnb listings “took about 10% of the city’s available rentals off of the market.” That is quite clearly an unsustainable situation in a city that lacks enough affordable housing for its full-time residents. And collecting 8% taxes will not solve that problem.

Airbnb needs to be taxed and regulated. Airbnb needs to be collecting taxes and ensuring that its users are only renting out apartments that are allowed to be rented out. It’s absurd and insulting for a $30 billion company in such an enviable business position to act as if it can do nothing to see to it that its users are not undermining the very stability of municipal housing in cities around the world. Airbnb gets paid for all those listings; if the listings are illegal, so is its business model. Enabling regular people to make some extra income from their apartments is a good and useful thing. Enabling landlords to turn vast swaths of neighborhoods into off-the-books hotels is not. Airbnb doesn’t necessarily have to be the enemy to housing advocates. Their tax revenue can pay for a lot of housing. And, whether you like it or not, their business model is here to stay. They just have to stop acting like they don’t operate according to the rules of planet Earth.

So You’ve Lost Your Social Security Card

Losing important documents is frustrating, especially something as important as your Social Security card. But there’s no need to panic; we’re here to help.

You’ll want to consider whether you really need to get a replacement card. Knowing your number is what’s important, after all. You’ll rarely need the card itself — perhaps only when you get a new job and have to show it to your employer. However, if you decide you really must replace your card, go to www.socialsecurity.gov/ssnumber before visiting your local Social Security office. There you’ll find a “decision tree” that will walk you through the steps to getting a replacement card.

The first step is to learn what documents you need. You’ll need to show us a U.S. birth certificate or U.S. passport to prove your citizenship. And, you’ll need to produce a U.S. driver’s license, a state issued non-driver identification card, or a U.S. passport to prove your identity.

Keep in mind that all documents must be either originals or copies certified by the issuing agency. We can’t accept photocopies or notarized copies of documents. We also can’t accept a receipt showing you applied for the document.

Once you’re clear on what documents you’ll need, the second step of the decision tree will take you to the Application for a Social Security Card, so you can print it and fill it out. Finally, the third step will take you to a screen where you can find the address of your local office so you can take or mail your application and original documents to us.

You can replace your Social Security card for free from Social Security if it’s lost or stolen. Stay away from services that want to charge you a fee to get your replacement card. Keep
in mind that you’re limited to three replacement cards in a year, and 10 during your lifetime. Legal name changes and other exceptions don’t count toward these limits. Changes in immigration status that require card updates may not count toward these limits. Also, you aren’t affected by these limits if you can prove you need the card to prevent a significant hardship.

Your card will be mailed as soon as all of your information and have verified your documents. Your replacement card will have the same name and number as your previous card.

The Role of the IRS as a Social Benefit Administrator

The Internal Revenue Service (IRS) primarily serves as our nation’s tax collector, but it is also one of our nation’s largest conduits for delivering social benefits. The most prominent of these is the earned income tax credit (EITC), one of the largest and most successful antipoverty programs. Several advantages derive from having the EITC in the tax system, but having the IRS serve as an administrator of cash benefits also presents challenges.

This paper examines the opportunities and obstacles associated with tax-administered assistance to low-income families in the United States, with a particular focus on the EITC. It aims to provide greater clarity about the issues involved, to identify key challenges, and to suggest strategies for moving forward productively.

The EITC is a hybrid of tax and social policy, leading to linguistic battles over how it should be described. Before assessing the appropriate role for the IRS, we should acknowledge that the EITC is neither just a refund of all taxes paid nor welfare as we used to know it. It is a government transfer payment administered through the tax system that provides cash assistance to low-income workers.

The EITC has proven to be a political, economic, and social success with a very high rate of participation and low administrative costs. Yet housing the EITC at the IRS is also problematic. Administering the EITC is not a role for which the IRS was created. It creates a timing mismatch that requires recipients to wait until the next year before receiving the benefit, and it shifts costs of program administration onto the beneficiaries. Most significant, at least politically, is the compliance problem. A quarter of EITC payments are categorized as improper, with both unknowing mistakes and willful fraud contributing to the problem. Despite an array of IRS efforts to ensure EITC claims are administered properly (and the relatively small size of the EITC overclaims compared to the overall tax gap), concerns about error and fraud continue to undermine the credit’s credibility and prevent the program from fully achieving its goals.

Given the challenges faced by the IRS in administering the EITC, perhaps some other entity—employers, public benefits agencies, health insurance marketplaces, or the Social Security Administration—is better situated and equipped to play the role. On examination, each of these alternatives falls short, especially when seen through the lens of the pride and legitimacy working households gain from tax-based administration (and the resulting benefits to society as a whole).

With no obvious alternatives and a value in having the IRS play the role, the focus needs to be on how to make the IRS a better administrator of social benefits, including the EITC. This starts by helping the IRS affirmatively embrace its dual mission, by providing it with adequate resources, and by using more data sooner to enhance program management and decrease improper claims and errors. The IRS should formalize the role of the intermediaries (for example, tax preparers) who serve as its de facto deputies in running the program. It should develop tools to supervise these intermediaries effectively. Most importantly, the IRS needs fresh compliance strategies that include:

- Revising eligibility rules so that they are realistic and enforceable;
- Distinguishing the earnings supplement and child allowance components of the EITC;
- Making compliance salient for both taxpayers and preparers to increase voluntary and appropriate compliance; and
- Avoiding seemingly attractive yet counterproductive approaches.

The choice facing lawmakers and government officials is either to continue muddling through, aware of but not meaningfully addressing the challenges the IRS faces in administering assistance programs such as the EITC to low-income families, or to affirm the advantages afforded by tax-based administration while being honest about the shortcomings and vulnerabilities and making serious efforts to address them. Sensible changes can make the IRS a viable, trusted, and effective administrator of programs delivering important benefits to low-income Americans.

Question of the Month

What is the Annual Filing Season Program Offered by IRS?

The IRS offers the following:

General Guidance

1. What is the Annual Filing Season Program for return preparers?

The Annual Filing Season Program is a voluntary program designed to encourage non-credentialed tax return preparers to participate in continuing education (CE) courses.

Non-credentialed return preparers can elect to voluntarily
demonstrate completion of basic 1040 filing season tax preparation and other tax law training through continuing education.

Return preparers who complete the requirements for the Annual Filing Season Program will be issued a Record of Completion that they can display and use to differentiate themselves in the marketplace if desired.

Preparers who participate are also included in a public database on IRS.gov that taxpayers use when searching for qualified tax return preparers. The Directory of Federal Tax Return Preparers with Credentials and Select Qualifications only includes attorneys, certified public accountants (CPAs), enrolled agents, enrolled retirement plan agents (ERPAs), enrolled actuaries, and individuals who have received an Annual Filing Season Program – Record of Completion.

2. Who can participate in the Annual Filing Season Program? The Annual Filing Season Program is intended to recognize and encourage the voluntary efforts of non-credentialed tax return preparers to increase their knowledge and improve their filing season competency through continuing education. The program is not directed at or necessary for credentialed preparers such as attorneys, CPAs, enrolled agents, enrolled retirement plan agents or enrolled actuaries. They are already in possession of higher level qualifications.

3. What are the requirements for obtaining an Annual Filing Season Program – Record of Completion?

In general, to obtain an Annual Filing Season Program – Record of Completion a return preparer must obtain 18 hours of continuing education from an IRS-approved CE Provider. The hours must include a 6 credit hour Annual Federal Tax Refresher course (AFTR) that covers filing season issues and tax law updates. The AFTR course must include a knowledge-based comprehension test administered at the conclusion of the course by the CE Provider. Unenrolled preparers who have passed recognized state or national tests qualify for an exemption from the AFTR course but still must obtain 15 hours of continuing education.

In addition to completing the appropriate CE courses, the return preparer must also renew his or her preparer tax identification number (PTIN) for the upcoming year and consent to adhere to the obligations in Circular 230, Subpart B and section 10.51. View a tutorial on how to sign the Circular 230 consent and print the Record of Completion.

Note: See question 6 below for more information about exemptions and see question 23 below for information about eligibility restrictions.

4. Is there a fee to obtain an Annual Filing Season Program – Record of Completion?

Just as for all CE courses, each IRS-approved CE provider will determine the course participant fee. However, the IRS does not charge any fee for participating in the program.

5. Do I need to notify the IRS once I have completed the Annual Filing Season Program’s Continuing Education requirements? No, following the completion of all Continuing Education requirements and renewal of PTIN for the upcoming year, eligible return preparers will receive an email from the IRS. The email will provide instructions for logging into your PTIN account and completing the process. Among the final steps will be a required consent to adhere to specific practice obligations outlined in Subpart B and section 10.51 of Treasury Department Circular No. 230. Following successful completion of these steps, you will be issued an Annual Filing Season Program - Record of Completion.

Please note that it may take up to four weeks following the completion of all requirements for return preparers to receive a Record of Completion and be placed on the Directory of Federal Tax Return Preparers with Credentials and Select Qualifications. Additionally, you will not be issued a Record of Completion until your PTIN is renewed for the upcoming tax year.

6. Who is exempt from taking the AFTR course?

Some unenrolled preparers are exempt from the AFTR course requirement because of their completion of other recognized state or national competency tests. These exempt groups are still required to meet other program requirements, including 15 CE credits (10 Federal Tax Law, 3 Federal Tax Law Updates, and 2 Ethics).

Return preparers who can obtain the AFTR – Record of Completion without taking the AFTR course are:

- Anyone who passed the Registered Tax Return Preparer test administered by the IRS between November 2011 and January 2013
- Established state-based return preparer program participants currently with testing requirements: Return preparers who are active registrants of the Oregon Board of Tax Practitioners, California Tax Education Council, and/or Maryland State Board of Individual Tax Preparers.
- SEE Part I Test-Passers: Tax practitioners who have passed the Special Enrollment Exam Part I within the past two years
- VITA volunteers: Quality reviewers and instructors with active PTINs
- Other accredited tax-focused credential-holders: The Accreditation Council for Accountancy and Taxation’s Accredited Business Accountant/Advisor (ABA) and Accredited Tax Preparer (ATP) programs

7. How do I obtain an Annual Filing Season Program – Record of Completion if I am exempt from the AFTR course?

Those who are exempted from the AFTR course must meet the alternative requirements (15 hours of IRS-approved CE, consent to Circular 230 practice requirements, and a valid PTIN for the upcoming filing season) in order to receive an AFSP Record of Completion. Once all requirements are met, the exempted return preparer will be issued a Record of
Completion.

A return preparer will not be required to notify the IRS of an exemption. The IRS obtains information about exemptions directly from the testing source (e.g. Oregon Board of Tax Practitioners).

8. How and when will I get my Record of Completion?

Once a return preparer has completed their CE requirements and renewed their PTIN for the upcoming year, they will receive an email from TaxPro_PTIN@irs.gov with instructions on how to consent to the Circular 230 practice requirements and receive their certificate in their online secure mailbox. (Watch tutorial on Consenting to the Circular 230 Requirements and Printing Your Record of Completion.)

Tax return preparers without an online PTIN account will receive a letter with instructions for completing the application process and obtaining their certificates.

9. Are credentialed preparers precluded from participating in the AFSP?

No, as indicated above, this program is not designed, directed or intended for credentialed preparers who already possess a much higher level of qualification. However, if a credentialed preparer seeks to participate in the program, a credentialed preparer would be required to meet the same requirements as those preparers in the exempt category.

10. Can an EA take an AFTR course and earn CE credit towards AFSP requirements and/or their EA credentials? (posted 11/13/14)

No. Due to the high level of knowledge required of Enrolled Agents (EAs), this basic level “refresher” course is not allowed for IRS credit.

Note: If an EA voluntarily takes an AFTR course (for no IRS credit), it may show in the CE history in their PTIN account, but it will not count towards either AFSP or EA CE requirement calculations.

11. What if a preparer has more federal tax update credits than is required for the federal tax law update category in any one calendar year?

The excess federal tax update credit will count toward their federal tax law requirement for that particular calendar year. The PTIN system will automatically apply the excess credit hours to the federal tax law category, although the excess will still show in the PTIN holder’s Federal Tax Update category in the preparer’s online account.

12. Will I still be able to represent clients before the IRS if I don’t participate in the Annual Filing Season Program?

Yes, as a PTIN holder you will continue to have limited representation rights before limited offices of the IRS with respect to clients whose returns you prepare and sign until December 31, 2015. However, beginning in 2016 only AFSP participants who obtain a Record of Completion will have those limited representation rights before the IRS for clients whose returns they prepared and signed after December 31, 2015. PTIN holders without an AFSP - Record of Completion or without other professional credentials will not be able to represent clients before the IRS in any matters for returns prepared and signed after December 31, 2015.

Attorneys, CPAs, and enrolled agents will continue to have unlimited representation rights and can represent clients before any office of the IRS.

13. I am a non-1040 preparer. Do the limited representation restrictions discussed in the previous FAQ apply to me as well?

Yes. Both 1040 and non-1040 preparers will need a Record of Completion for returns completed after December 31, 2015 to engage in limited practice.

14. Are preparers who participate in the Annual Filing Season Program subject to Circular 230 regulations?

To participate in the AFSP, non-credentialed preparers must agree to adhere to the practice requirements for tax practitioners outlined in Subpart B and section 10.51 of Treasury Department Circular No. 230.

Any return preparer who represents a taxpayer before the IRS is subject to Circular 230.

15. Why did the IRS launch this voluntary program? Why not wait to see if Congress passes legislation regarding return preparer oversight?

The IRS believes in a mandatory competency standard for federal tax return preparers. To this end, legislation continues to be our priority. In the interim, however, this program recognizes the efforts of unenrolled return preparers to improve their professional competency through continuing education. Anyone with a PTIN can prepare a federal tax return, but for those preparers with a PTIN who also work to ready themselves for the filing season through educational efforts, the program affords them a level of differentiation from the rest of the marketplace.

16. Do return preparers have to participate in the Annual Filing Season Program?

No, it is a voluntary program. Anyone with a preparer tax identification number (PTIN) can prepare tax returns for compensation, but continuing education is encouraged for all tax return preparers.

17. Will the AFSP – Record of Completion indicate the filing season for which it was issued?

Yes, each Record of Completion will clearly indicate the filing season for which it was issued.
proposes to revoke your participation, you will be provided an explanation in writing, along with instructions on how to appeal the decision.

**Annual Federal Tax Refresher Course and Test**

1. Does the IRS administer the comprehension test given at the end of the Annual Federal Tax Refresher Course?  
No, the IRS does not administer the comprehension test. IRS-approved Continuing Education Providers offer the Annual Federal Tax Refresher course and are responsible for the development and administration of the comprehension test associated with the AFTR course. The IRS does provide a course outline and test parameters which must be followed by providers.

2. How do I find a provider offering the AFTR course?  
The IRS provides a complete listing of all IRS-approved Continuing Education Providers. Refer to the Annual Federal Tax Refresher column under Program Categories Offered for providers who offer the AFTR course.

3. What does the AFTR course cover?  
The Annual Federal Tax Refresher course will cover tax law topics across three domains: New Tax Law/Recent Updates, General Review, and Practices, Procedures and Professional Responsibility. The IRS will publish course content guidelines annually for IRS-approved CE Providers. It is the responsibility of CE Providers to ensure all course content is covered in the Annual Federal Tax Refresher course.

4. What does the AFTR test cover? What is the format and how long is it?  
The AFTR Course comprehension test will include all tax law topics covered in the AFTR course. Each AFTR test includes 100 questions that assess a return preparer's comprehension of each of the three domains on the AFTR course outline. Each AFTR test consists of only multiple choice questions with four potential answers and only one correct answer. Participants have a maximum of 3 hours to complete the exam. Refer to the test parameters published by the IRS for more information.

5. What if I take the course but do not pass the test?  
The course has not been satisfactorily completed until the comprehension test is passed. CE Providers will not provide course completion information to the IRS until you pass the ATFR exam. Your provider's policy will determine whether you must re-take the course or just the course exam.

6. Is there a deadline for taking the AFTR course? For obtaining a Record of Completion?  
To be eligible for an AFSP – Record of Completion, a return preparer must complete and pass the AFTR course and obtain their other CE by December 31 prior to the start of the tax season. As AFTR courses are offered by CE providers, return preparers are subject to the schedule of courses offered by the providers.
these providers.

In no circumstance will the AFSP – Record of Completion be issued before a return preparer has registered or renewed their PTIN for the upcoming year.

7. Do I need a PTIN to take the AFTR course and related comprehension test?

Yes, to obtain credit for the course and enable the CE provider to report your course completion to the IRS, you must have a PTIN.

8. How long will it take to complete the AFTR course and test?

An AFTR course is 6 hours in length, regardless of the delivery method (online, in-person, self-study).

The related comprehension test will take a maximum of three continuous hours.

9. What is the cost of the AFTR course and test?

Each IRS-Approved CE Provider will determine their fee.

10. Can I take the test without completing the AFTR course?

No. You must complete the course before taking the test.

Public Directory of Tax Return Preparers

1. What is the Directory of Federal Tax Return Preparers with Credentials and Select Qualifications? When will it be available?

The Directory is a public listing on the IRS website of tax return preparers with credentials and select qualifications. It is a searchable, sortable listing that taxpayers can use to find a return preparer that carries their preferred credentials or qualification(s).

2. Who is included in the Directory and what information is shown?

The Directory includes the name, city, state and zip code, of all attorneys, CPAs, enrolled agents, enrolled retirement plan agents, enrolled actuaries, and AFSP participants who have obtained a Record of Completion and who have a valid PTIN.

3. I understand that if I receive an AFSP Record of Completion, I will be included in the public directory. Are there any advertising or endorsement restrictions that I must follow?

Revenue Procedure 2014-42, which established the Annual Filing Season Program, specifies that you may state you hold a valid Annual Filing Season Program Record of Completion for the calendar year and that you have complied with the IRS requirements for receiving the Record of Completion.

You may not use the terms “certified,” enrolled,” or “licensed” to describe this designation or in any way imply an employer/employee relationship with the IRS or make representations that the IRS has endorsed you.

News from Capitol Hill

Details of the House GOP Tax Plan

The office of House Speaker Paul Ryan released a blueprint for tax reform that would overhaul major components of the U.S. tax code and lower taxes for households and businesses. The key details of the plan are listed below:

Individual Income Tax Changes

- Consolidates the current seven tax brackets into three, with rates of 12 percent, 25 percent, and 33 percent (see table below).

- Provides a 50 percent exclusion of capital gains, dividends, and interest income. This is equivalent to taxing capital gains, dividends, and interest income at half the rate of ordinary income: with three brackets of 6 percent, 12.5 percent, and 16.5 percent.

- Increases the standard deduction from $6,300 to $12,000 for singles, from $12,600 to $24,000 for married couples filing jointly, and from $9,300 to $18,000 for heads of household.

- Eliminates the personal exemption.

- Creates a $500 non-refundable credit for dependents who are not children.

- Increases the child tax credit to $1,500 per child, the first $1,000 of which is refundable, as under current law.

- Raises the phaseout threshold for the child tax credit for married households from $110,000 to $150,000.

- Eliminates all itemized deductions besides the mortgage interest deduction and the charitable contribution deduction.

- Eliminates the individual alternative minimum tax.
Business Income Tax Changes

- Reduces the corporate income tax rate from 35 percent to 20 percent.
- Eliminates the corporate alternative minimum tax.
- Taxes income derived from pass-through businesses at a maximum rate of 25 percent.
- Allows the cost of capital investment to be fully and immediately deductible.
- Eliminates the deductibility of net interest expenses.
- Allows net operating losses to be carried forward indefinitely, and increased by a factor reflecting inflation and the real return to capital.
- Does not allow net operating losses to be carried back.
- Restricts the deduction for net operating losses to 90 percent of net taxable income.
- Preserves the last-in, first-out method of accounting.
- Eliminates the domestic production activities deduction (section 199).
- Creates a fully territorial tax system, exempting 100 percent of dividends from foreign subsidiaries from U.S. tax.
- Enacts a deemed repatriation of currently deferred foreign profits, at a tax rate of 8.75 percent for cash and cash-equivalent profits and 3.5 percent on other profits.
- Modifies all business income taxes to be border-adjustable. This means that businesses are taxed on their imports but are not subject to tax on their exports.

Other

- Eliminates the estate tax.
- Reorganizes the Internal Revenue Service and alters certain tax administration rules.

Pending Bill Responds to Agency Action

Since its introduction, TASC has been actively monitoring a piece of legislation known as the Small Business Healthcare Relief Act with great interest. Last week the House of Representatives passed H.R. 5447 on a voice vote.

Sponsored by Rep. Boustany (R-LA) and Rep. Thompson (D-CA), this measure would greatly improve small business access to competitive health benefits by restoring the use of stand-alone HRAs that could be used to reimburse employees for qualified medical expenses and/or individual health insurance premiums. It is specifically aimed at those entities not subject to the ACA’s Employer Mandate (i.e. those with fewer than 50 full-time employees) and who do not offer a group health plan to their employees. To qualify, the maximum benefit provided under the plan would be capped at $5,130… or $10,260 if the HRA includes reimbursements for family members.* Employees covered under these arrangements would be prohibited from receiving a subsidies for health insurance purchased under the public marketplaces.**

For eligible employers, this bill would overturn guidance issued by the Internal Revenue Service and the Department of Labor that stated that these arrangements violated the ACA’s insurance market reforms.*** As a result of that previous interpretation, employers who continue to offer stand-alone HRAs today face the potential of a $100 per day, per employee penalty ($36,500 per year).

While it’s a good sign that this bi-partisan legislation passed the House with very little opposition, our work is not done. The measure now goes to the Senate where a companion bill – S. 3060 – has been introduced by Sen. Grassley (R-IA) and Sen. Heitkamp (D-ND). Although similar legislation has received opposition in the past from members of the Democratic leadership in that body, we’re hopeful that it will be taken up this fall/winter as part of the year-end agenda.

This a common-sense solution ensuring that small businesses aren’t penalized for trying to do the right thing. HRAs are an affordable solution for both employees and employers to combat the escalating cost of health insurance. Since many small employers do not have human resource departments or benefits specialists, this change would provide them with the necessary flexibility to help their employees pay for health care.

TASC remains a strong supporter of both H.R. 5447 & S. 3060, and we will continue to advocate for their passage throughout the remainder of this Congressional session by engaging with Senators and their staff.

* Indexed for inflation
** H.R. 5447 also establishes a number of notice/reporting requirements and requires that employers report contributions on their employees’ W-2 forms.

Bill to Remove Tax on Olympic Medals a D.C. Tradition

Rep. Blake Farenthold, R-Texas, introduced legislation in 2014 that would have removed taxes from Olympic medals.

As United States athletes prepare for the Olympics, Congress is once again complaining about taxes on Olympic medals. Rep. Blake Farenthold, R-Texas, and Rep. G.K. Butterfield, D-N.C., are the sponsors of the Tax Exemptions for American Medalists Act of 2015, which would remove the taxes that are levied on Olympic medalists. American contest winners currently receive around $10,000 for bronze medals, $15,000 for silver medals and $25,000 for gold medals.
However, the language of the legislation states: “Gross income shall not include the value of any medal awarded in, or any prize money received from the United States Olympic Committee on account of, competition in the Olympic Games.” Posturing about the taxes levied on Olympic medals has become routine for both Republicans and Democrats in recent Olympic cycles.


### Lawmakers Question IRS Proposal to Raise Enrolled Agent Exam Fee

Eight legislators have asked IRS Commissioner John Koskinen to explain why the agency is proposing an 80 percent hike in user fees for the Special Enrollment Examination (SEE) that tax professionals must take to earn the enrolled agent (EA) credential.

In a July 13 letter, the eight House members noted that the fee would increase from $11 per exam part to $99 for each part of the three-part exam. Coupled with the $98 per-part fee that testing company Prometric charges for developing and administering the exam, the proposed exam fee would be about $600.

“The in an environment where complex tax laws necessitate most Americans to seek professional assistance in filing their returns, not to mention interacting with the IRS on individual tax matters at issue, we believe having more professional tax practitioners – enrolled agents, CPAs, and attorneys – is both intuitive and common-sense,” the letter states. “The IRS’s proposed fee increases will result in fewer tax professionals, ultimately hurting consumers. Many tax preparers that have not yet enrolled ultimately take the SEE to increase their professionalism in obtaining a highly regarded and respected credential.”

The letter also asks Koskinen to consider what effect the fee increase will have on taxpayers who need help preparing their taxes.


“IRS believes more EAs are better than fewer EAs, yet it has not explained why it needs the equivalent of a dozen full-time staff to oversee the SEE program or in fact why it needed to charge an administrative fee whatsoever,” Robert Kerr, senior director of government relations for the National Association of Enrolled Agents, said in a prepared statement.

The IRS did not respond to a request for comment by AccountingWEB.

The agency’s proposal, issued in February, states that increased exam implementation costs are driving the fee increase, including:

- A $270,000 annual increase in the cost of background checks required for workers at the contractor’s testing centers.
- Total exam costs are being recovered from fewer people because the contractor will administer 14,000 fewer parts of the exam annually than the estimated number used to calculate the $11 fee.
- The costs of verifying the contractor’s compliance with cybersecurity requirements to protect exam-takers’ personal information have increased.

Original cost estimates of overseeing the exam contract didn’t cover all of the work that the IRS now does, the proposal states. The proposed fee is more accurate in covering the time and personnel involved with the exam.

The agency states that its costs include:

- Reviewing and approving materials used by the contractor in developing the exam.
- Reviewing existing EA surveys that help determine topics to be covered in the exam.
- The composition of potential exam questions in coordination with the contractor’s external law experts.
- IRS chief counsel reviewing and revising potential questions for legal accuracy.
- Analyzing answers and raw scores of a testing population to determine what a passing score should be.
Hidden Dangers

Your tax practice may be opening you up to liability

Most accountants perform at least some tax work, so it’s not surprising that the majority of professional liability claims against accountants are in the tax arena.

“The higher-dollar claims against accountants are in the financial statement area, but the opportunity for tax claims is greater,” said Ron Parisi, of Orchard Accounting and a former insurance company executive. “But there are a lot of ‘black and white’ errors. The consequences and penalties can be calculated almost immediately, as opposed to the true value of damages on fraud and audit. The legal concept of ‘proximate cause’ can link damages with the breach easier on tax than in audit cases.”

Parisi cautions that due to Internal Revenue Service resource constraints, tax matters are taking longer to resolve. “This is driving up costs and expenses, and consequently CPAs should be cognizant of their deductible and the limits on their professional liability policy,” he said.

“Once a mistake comes to light, try to amend the return,” he said. “Work with the IRS to abate penalties or restructure a transaction. [Private letter rulings] are very expensive and take a long time. The resolution of tax issues takes longer and drives up the cost.”

The IRS is taking a closer look at nonprofits, Parisi noted. “Their Form 990s usually have a different deadline [the 15th day of the fifth month after the organization’s accounting period ends]. Practitioners often miss these.”

Late, And Liable

The most common mistake accountants make giving rise to liability is simply late filing, observed Bill Thompson, president of CPA Mutual. “Late filing is especially prevalent in the estate area,” he said. “For whatever reason, CPAs don’t file the estate return on time, and the penalties are pretty large. Then there are CPAs that tend to dabble in some areas they’re not familiar with, such as Code Section 1031 [‘like-kind’] exchanges. They just don’t handle it correctly because they haven’t done it before.”

Allowing time to run out on a year in which there was a return error is also a common mistake, according to Thompson. “We have a situation where the CPA could have prepared the return incorrectly and they let the deadline pass for refiling the return. When the statute of limitations expires, the IRS considers it a closed year, which would prohibit the CPA from refiling the tax return correctly and getting a refund for overpaid taxes.”

“These mistakes — late filing and allowing the statute of limitations to expire on a prior year in which there were errors — can be avoided pretty easily,” advised Thompson.

“Far too often, our loss prevention specialists receive calls close to a filing deadline asking for help to disengage from a client who has put them at risk by failing to provide the necessary information for a return to be prepared on time,” said Randy Werner, loss prevention executive at Camico. “The client’s failure may even include failing to provide the information to complete a year’s worth of bookkeeping which will then be used to prepare returns. If a client has previously exhibited behavior that indicates they will not have their information to the CPA in a timely manner or have not paid on an outstanding account balance, we recommend that the CPA either enforce their stop-work clause in their engagement or write what I call a ‘drop-dead’ letter, which is a pre-disengagement letter indicating the problem the client needs to resolve, such as payment, providing information, or merely contacting the firm for a further consultation. The letter should include a drop-dead date by which the client must comply or the CPA will disengage. However, this must be done well before the due date to allow the client sufficient time to obtain the services of another tax preparer and thereby reduce the risk of a claim against the CPA. This is good defensive documentation in the event of an actual claim.”

“CPAs are often buried in their work during the tax season and often don’t recognize or acknowledge a potential claim as it is developing,” she said. “This has been an ongoing issue for CPAs and is particularly devastating when the damages claimed are significant and the CPA is denied professional liability coverage because of late reporting.”

“CPAs need to pay more attention to potential issues and report to their carriers as soon as they think there may be a problem with their services,” she said. “We are now offering ‘continuity of coverage’ which permits much later reporting by a CPA who has consistently renewed with us even if that CPA knew of a potential claim but did not report it until the client makes an actual claim months or even years later.”

Hot Spots

“The primary reason tax is the most frequent claim is that there is more tax work being performed by CPAs across the country than any other type of service,” said John Raspante, senior vice president and director of risk management for NAPLIA. “We represent many carriers, and they all report between 55 to 60 percent of claim activity against accountants arise out of tax engagements,” he said.

“There are more audits now, and there is a direct relation between audits and claims,” he said. “When audits are quiet, claims are quiet. When audits go up, there’s an upward trend in claims, because the client thinks it’s the accountant’s responsibility.”

For example, Raspante observed, a preparer might list the taxpayer as a real estate professional on the return, but the IRS successfully contends that the taxpayer is not a real estate professional. “When allowable real estate losses are
now unallowable, the client’s reaction is to hold the accountant responsible for advising him on the matter.”

“And of course, the Tax Code is very complex and it’s not getting any easier,” he noted. “With that comes the challenge of being a tax preparer.”

Issues with the FBAR, or Foreign Bank and Financial Accounts report, are still prevalent, according to Raspante. “The IRS hasn’t let go of the issue,” he said. “CPAs have a great deal of exposure to risk in this area, and they’re getting more of the blame for clients not complying with FBAR reporting. This area is growing both in frequency and severity of claims.”

Naturally, insurers would much rather avoid lawsuits than successfully defend them, observed Frederick Fisher, president of Fisher Consulting Group Inc., which specializes in professional risk management. “There are basically two models. The first is to strictly do taxes based on what the preparer has been provided by way of documentation. The second is to give advice and offer tax planning. That’s the better model, but it also gives rise to more claims arising out of the services provided.”

“Plaintiffs rarely if ever get tax owed as part of damages, because tax is a debt,” he said. “The damages arising out of lawsuits against tax preparers are normally confined to fines, penalties and interest.”

“There are dangers that lurk in policies on the street. They’re not standardized, and they’re loaded with ‘gotchas,’” he said. “What you think is covered may not be. The key to protect yourself is to be well-documented.”

“Document everything,” agreed Gary Shendell, CPA, Esq., a partner at Shendell & Pollock. “The six most common words plaintiffs suing their CPA/tax preparer say during their deposition are, ‘My accountant never told me that!’ Usually followed by, ‘Had I known that, I would have acted completely differently!’”

When CPAs become mired in the preparation of taxes and meeting deadlines, other important parts of their practice may suffer, Camico’s Werner observed. “In particular, it is good risk management for CPAs to document significant interactions with their clients contemporaneously no matter now busy the CPA is with their practice,” she said. “Those important telephone calls should be documented as contemporaneously as possible and then placed in the client’s file.”

Too Trusted?

“The most challenging claims to defend against CPAs acting in a tax preparation role involve assertions that the tax preparer was aware of information from the client but took an inconsistent or aggressive position on their return, often contrary to the client’s explicit verbal instructions,” Shendell said. “If a preparer’s file does not contain copies of the information originally provided, plus letters documenting key communications regarding significant decisions or instructions, it is difficult to defend these claims. If a preparer cannot substantiate what information was received by the client, then it will be an issue for the jury to decide.”

“Keep the ball in the client’s court,” he advised. “Claims regarding failing to file a return or to file a return on time typically devolve into finger pointing over who is at fault. Sadly, once a return is filed late, any reason that the CPA provides comes across as self-serving. Plaintiffs’ counsel frequently point to the CPA’s Web site advertising that the CPA is a ‘trusted advisor’ and then turn to the jury to ask why a trusted adviser would not follow up with their loyal client in writing to tell them they had to act in order to avoid filing late and incurring penalties. If your client has not provided you with sufficient information to prepare their return or is non-responsive to requests for additional information, make sure you advise them in writing that their return cannot be timely prepared without further action on their part.”

“We always advise our CPA tax preparer clients to have a detailed engagement letter and place a deadline on their clients to return the necessary information to prepare their returns. If you send an engagement letter and tax planner to your client and they fail to return it, have you impliedly agreed to file their extension? One CPA’s client thought so. When the IRS penalized him for failure to timely file his return, he threatened a civil and professional responsibility complaint against his CPA. He argued that because he had been a multi-year client who always filed an extension and never previously signed an engagement letter, he and his CPA had an implied contract to file the extension. The litigation that ensued could have been avoided if the engagement letter had clearly stated that no activity on the client’s file would be undertaken by the accounting firm unless, and until, the signed retainer was returned.”

Ricard Jorgensen, president and chief underwriting officer at Jorgensen & Co., a professional liability and risk management consulting firm, agreed: “The key issue is to secure an engagement letter or some form of signed acknowledgement regarding the scope of services. Otherwise, CPAs leave themselves open to allegation for risks beyond the scope of a relatively conventional tax assignment. We have seen tax preparers pulled into defalcation claims because the CPA failed to clarify the scope of the assignment. Even where the scope of services is obvious, stating in writing what you are not going to do can avoid a lot of grief in the long run.”

“Of course, the evolving cyber-exposure and theft of your clients’ data, resulting in the filing of a bogus tax return, is an increasing problem,” Jorgensen cautioned. “Take nothing on face value — treat all client instruction e-mails with suspicion until physically verified. Don’t open that e-mail offering you a free cruise to the Bahamas, and conduct background checks on all new hires. Many thefts of client data are ‘inside jobs,’ according to the FBI. It’s a cyber jungle out there!”

Editor’s Note: Looking for E & O insurance? Check out Target, a Sponsor of the Fellowship.
Guide to IRS Form 3903: Moving Expenses

If you moved to a new location because of work this year, you may qualify to use IRS Form 3903 to claim the cost of your moving expenses as a deduction on your federal income tax return. The IRS allows taxpayers to deduct eligible moving costs from the taxable income they report on Form 1040.

This deduction is not subject to any limits, so you can claim all of your qualified moving costs if you meet the eligibility requirements. While moving expenses you pay yourself are deductible, expenses that your employer reimburses you for are not eligible for the deduction.

Meeting the time test

The timing of your move must be closely related to the start of your new employment in order to qualify for the tax deduction. To meet this standard, you'll have to start your new job and work full-time for at least 39 weeks within the first 12 months after your move.

There is an exception: If you start your new job months before your family moves to the new location because of special circumstances, such as a spouse who is receiving medical care or a child who is finishing school near your old home, you can still deduct your moving expenses despite the fact that your move occurs long after your first day of work.

Meeting the distance test

Another requirement involves the distance between your new workplace and your old home. To claim your moving costs, your new place of employment must be at least 50 miles farther away from your old home than your old place of employment. As an example, if you lived in a home that was 20 miles away from your old job, you'll have to take a job at a new company that is at least 70 miles away from your old home to qualify for the deduction.

Members of the United States military can claim their moving expenses regardless of the distance or employment requirements if they are making a permanent change in their military status such as retirement or termination of service.

Qualifying expenses

All of the expenses you claim must be both reasonable and necessary to your move. Reasonable moving expenses may include the cost of gas or the mileage on your vehicle, rental trucks, short-term storage, and boxes. For a long move, you might include the cost of lodging at a hotel on the way to your new home. The IRS allot a standard mileage rate that you can use to calculate your travel expenses, but if you prefer, you can keep up with your actual transportation costs and deduct those instead. Eligible travel costs include gas, oil, parking fees, and tolls.

Completing Form 3903

Shipping and storage costs go on line 1 of Form 3903. Travel, lodging, and gas costs go on line 2. Reimbursements from your employer for any moving expenses, are reported on line 4. If your reimbursement exceeds the total of your out-of-pocket expenses, you won't be able to deduct your moving expenses and you'll have to claim the excess reimbursement as taxable income. However, if your personal expenses were more than the amount your employer reimbursed you, you can deduct your out-of-pocket moving expenses to reduce your taxable income.

Estate and Trust News

Decedent's IRA - Caveats and Cautions

A trustee-to-trustee transfer may not include any unpaid required minimum distribution amounts since, amounts that are required to be distributed (the RMDs) are not eligible for rollover treatment.

You can never make a rollover contribution of a required minimum distribution. Any rollover contribution is subject to the 6% tax on excess contributions. See chapter 1 of Pub. 590-A for more information on the tax on excess contributions.

While the IRS publications are clear about this (cf. Pub 590-A, Ch. 1 and Pub 590-B, Ch. 1), the regulations provide the substantial authority behind the “caution statements” found in the publications. As can be seen in the Regulations found in 1.402(c)-2, the portion of a distribution that is a required minimum distribution from an IRA and thus not eligible for rollover is determined in the same manner as provided in A-7 of § 1.402(c)-2 for distributions from qualified plans.

IRC Regulations

The following questions and answers relate to the rollover rules under section 402(c) of the Internal Revenue Code of 1986, as added by sections 521 and 522 of the Unemployment Compensation Amendments of 1992, Public Law 102-318, 106 Stat. 290 (UCA). For additional UCA guidance under sections 401(a)(31), 402(f), 403(b)(8) and (10), and 3405(c), see §§ 1.401(a)(31)-1, 1.402(f)-1, and 1.403(b)-7(b), and § 31.3405(c)-1 of this chapter, respectively.

Q-7: When is a distribution from a plan a required minimum
distribution under section 401(a)(9)?

A-7: (a) General rule. Except as provided in paragraphs (b) and (c) of this Q&A, if a minimum distribution is required for a calendar year, the amounts distributed during that calendar year are treated as required minimum distributions under section 401(a)(9), to the extent that the total required minimum distribution under section 401(a)(9) for the calendar year has not been satisfied. Accordingly, these amounts are not eligible rollover distributions. For example, if an employee is required under section 401(a)(9) to receive a required minimum distribution for a calendar year of $5,000 and the employee receives a total of $7,200 in that year, the first $5,000 distributed will be treated as the required minimum distribution and will not be an eligible rollover distribution and the remaining $2,200 will be an eligible rollover distribution if it otherwise qualifies. If the total section 401(a)(9) required minimum distribution for a calendar year is not distributed in that calendar year (e.g., when the distribution for the calendar year in which the employee reaches age 70 1/2 is made on the following April 1), the amount that was required but not distributed is added to the amount required to be distributed for the next calendar year in determining the portion of any distribution in the next calendar year that is a required minimum distribution.

In brief: According to IRS rules, an RMD is not eligible for a rollover. The “first out” concept says that the first monies removed from a traditional IRA are considered to be applied toward the required minimum distribution amount for that year. A plan-to-plan transfer is considered a removal of money from the original plan.

People in the Tax News

Mortimer Caplin: 100 Years Young, and Still Serving

His name is well-known to every graduate of the University of Virginia’s School of Law, and his penchant for bow ties is almost as famous. Over the course of a career in law, education and government service, Mortimer Caplin has seemingly lived several lifetimes, each distinguished by remarkable and influential achievements, from his time as an actor and boxer when he was a UVA undergraduate, to his service in the U.S. Navy on D-Day, to his work as IRS commissioner during the administration of President John F. Kennedy, and beyond.

On July 11, Caplin celebrated his 100th birthday, providing an excellent occasion to look back over the accomplishments of, in the words of former Law School Dean Robert Scott, “an exemplar of a professional life well-lived.” In honor of this milestone, we spoke with Caplin and some of his peers and colleagues about highlights of his life and career. ...

He returned to UVA Law in 1950, teaching classes on corporations and taxation. It was during this time that he taught Robert and Ted Kennedy of the classes of 1951 and 1959, respectively.

“Bob didn’t volunteer very much, but he was a better student than Ted,” Caplin remembered. “I got to like Bob very much when I came to Washington, when he was attorney general, and we worked very closely together. He was a real star.”

It was through the younger Kennedys, and Bill Battle, a 1947 Law School alumnus and partner in a Charlottesville law firm, that Caplin met John F. Kennedy, who was visiting the University during his campaign for president. After Kennedy was elected, Caplin received a phone call from Ted Sorensen, Kennedy’s chief adviser and speechwriter, asking if he wanted to join his “tax task force.”

“I didn’t wait very long to give the answer,” Caplin said.

In 1961, Caplin became the IRS commissioner under President Kennedy, and in 1963 he appeared on the cover of Time magazine in that role. “We were trying to change the underlying philosophy” of the IRS, Caplin explained. “We put the emphasis on better self-assessment, and not so much on putting people in jail.”

George K. Yin, Edwin S. Cohen Distinguished Professor of Law and Taxation at UVA, said that Caplin’s commitment to the rule of law and to public service were vividly illustrated in his time as IRS commissioner.

“He really emphasized the importance of full compliance with the law and promoted policies and practices to help taxpayers achieve that objective and help the agency enforce it,” Yin said. “He is extremely proud – rightfully so – to have gotten President Kennedy to visit the IRS to speak to the employees during his tenure as commissioner – the only president to do so. Mort understood full well that the work of the staff who
perform the thankless task of collecting taxes really epitomizes public service."

When Caplin left the IRS in 1964, he received the Alexander Hamilton Award, the highest honor conferred by the secretary of the Treasury.

Soon after leaving the government, Caplin founded the tax firm Caplin & Drysdale with a former law student of his, Doug Drysdale, class of 1953.

"Mort had identified a number of very talented young lawyers working for the Treasury and in the IRS chief counsel’s office," Drysdale said. "That first year or so a number of those lawyers joined us. Our objective was to have a firm of highly talented people and do good work." The firm emphasized hiring people with a sense of public service and did very little lobbying.

"Mort was very generous, both in a financial sense and in relation to the management of the firm," Drysdale added. "It was possible for a young person to advance more quickly than in most typical firms."

The boutique firm has now been in business for more than 50 years – "a good sign," Drysdale joked.

Michael Graetz, a 1969 Law School alumnus, tax law expert and former member of the Law School faculty currently serving as the Columbia Alumni Professor of Tax Law at Columbia Law School, noted that Caplin played an important role in institution-building in his time as IRS commissioner and in founding Caplin & Drysdale. "He’s a far-sighted individual," said Graetz, who has also served on the annual Virginia Tax Study Group, a conference hosted by the Law School, with Caplin. "He saw an opportunity to create a law firm and build it by hiring Supreme Court clerks, which was not an obvious thing for a tax practice. He hired the best people he could possibly find."

Subway Shop Owner’s Off Books $6M Tax Evasion Gets Prison, Millions in Restitution

Obayedul Hoque, a Subway franchisee and resident of Alexandria, Virginia, has been sentenced to two and one half years in prison for conspiracy to defraud the United States. After his 30 month prison term, he will have two years of supervised release. Hoque was also ordered to pay a $20,000 fine, plus a whopping $2,022,106 in restitution to the IRS to cover his tax liabilities for 2008 through 2013.

Some parts of his tax scam were ingenious, but much of it came down to collecting a lot more in income than he actually reported to the IRS. There was about a $6 million shortfall, and his own records apparently did him in. Keeping two sets of books is one of the most classic badges of tax evasion there is. And Hoque ran a large enough operation that he had to have help in doing it.

Hoque owned and operated Skyhill Shell, a service station in Alexandria, Virginia. Plus, he operated multiple Subway restaurant franchises in Washington, D.C., Arlington, Virginia, and Alexandria. Hoque admitted that between 2008 and 2014, he and the managers of some of his Subway franchises and the gas station shorted the IRS. They simply did not deposit all of the gross receipts of the gas station or the Subway franchises into the corporate or partnership bank accounts.

Instead, Hoque and the managers retained a portion of the gross receipts for their personal benefit and failed to report those funds to the IRS. Skimming is frowned on by the IRS and by prosecutors. For the Subway franchises that had no co-conspirator managers, Hoque retained all of the unreported gross receipts for himself. From 2008 through 2013, point of sales records for the Subway franchises reflected total sales of $20,805,667.

However, Hoque and his co-conspirators provided false monthly sales figures to the accounting firm to prepare the Subway entities’ tax returns. As a result, Hoque and his co-conspirators caused false corporate and partnership tax returns to be filed for the Subway franchises which reported sales of only $14,377,696.

Hoque and his co-conspirators also filed false corporate tax returns for Skyhill Shell. For some years, some of the entities did not even file tax returns with the IRS. Additionally, Hoque filed false individual income tax returns with the IRS. Hoque admitted that his conduct caused a tax loss to the IRS of between $1.5 million and $3.5 million.

Is keeping two sets of books ever justified? Yes, and it is more common than you might think. Keeping two sets of books—or two sets of accounting records—can distinguish between income tax rules and accounting rules. Some people refer to his distinction as the difference between book purposes (which means accounting) and tax purposes.

It’s also true that there can be significant differences between a company’s accounting and tax records. But the kind of under-reporting and cash skim being conducted by Mr. Hoque is quite different. And remember, Al Capone famously kept two sets of books, and we all know how that turned out.
Intuit, H&R Block to Cover Cost of Tax Preparation Glitch

Taxpayers affected by a glitch with TurboTax and other income tax preparation software do not have to file amended returns with the state.

Two companies have agreed to pay the state after errors in their tax software led thousands of Vermonters to submit incorrect tax returns this year.

Intuit, which runs the software TurboTax, will pay the state $2.38 million. H&R Block will pay $44,000. The state has reached a “handshake agreement” with one other company, and negotiations continue with two others, according to the Tax Department.

Tax Commissioner Mary Peterson said the state estimates it could have lost as much as $2.75 million because of a problem with some tax preparation software.

“We would never expect to recover 100 percent of that,” Peterson said. In general, collections are challenging because it is difficult to track down filers and get amended returns, she said.

Software from Intuit and other companies did not take into account some of the changes to Vermont’s tax code that took effect with this filing season. As a result, between 15,000 and 20,000 people who itemize their deductions underpaid their taxes, according to the Tax Department.

State officials blamed the coding error for some part of a disappointing revenue report in April, a key month for state finances because of the personal income tax filing deadline.

However, Secretary of Administration Justin Johnson said Wednesday that the agreements with Intuit and H&R Block will not affect a shortfall against projections for fiscal year 2016 that he expects will be about $17 million. The money from the agreements will come through in fiscal 2017, he said.

Johnson said “most of” the shortfall against projections came from the poor performance of income taxes in April. But only a portion of that came from the miscalculation. He said the state has been operating on the assumption that the money would not be recouped before the close of the fiscal year.

The administration is still in the process of calculating state expenses for the fiscal year. Those totals will be published later this month, but Johnson said he expects that expenses are also below projections, “so we’ll come out balanced.”

The Tax Department had set a deadline at the end of June for Vermonters affected by the glitch to file amended tax returns. Peterson said the average underpayment was about $130.

However, according to Peterson, recouping the unpaid amounts from taxpayers proved to be logistically difficult. TurboTax does not have an option to electronically file amendments, which meant people who were amending their returns needed to do so by paper. As of the end of last month only about $400,000 had been collected from roughly 4,000 people, Peterson said.

“It was ineffective,” she said. “Taxpayers were really frustrated because the process was onerous.”

Generally, Peterson said, the department holds taxpayers responsible for any failures by their tax preparers. Taxpayers can often seek recourse independently from the preparers, she said. But this case “just was not a normal situation,” she said.

She also said the workload on the department as a result of the error was significant and risked hurting the rollout of the department’s new tax software project, due to go online at the end of the year.

As a result of the payouts from Intuit and H&R Block, taxpayers affected by the glitch do not have to file amended returns. The department will contact those people who have already filed, and their checks will be voided, she said.

A few weeks ago, a representative of Intuit flew to Vermont to discuss the situation, which led to the financial agreement, according to Peterson.

Taxpayers Failed to Substantiate Noncash Charitable Contributions

In 2010 and 2011, the taxpayers claimed noncash charitable contribution deductions of $79,000 and $90,000, respectively. These amounts represented approximately 46% of the taxpayers’ adjusted gross income for each year.

According to summary spreadsheets prepared by the taxpayers after their returns were filed, the contributed property included over $110,000 of used clothing. Upon audit, the IRS disallowed most of the deductions, concluding that year that ended June 30 will be out later this week.

Johnson said “most of” the shortfall against projections came from the poor performance of income taxes in April. But only a portion of that came from the miscalculation. He said the state has been operating on the assumption that the money would not be recouped before the close of the fiscal year.
the taxpayers failed to properly substantiate their donations. The Tax Court agreed, finding the claims to be wholly unrealistic and incredible. Perry W. Payne, TC Summ. Op. 2016-30 (Tax Ct.).

Editor’s Note: This information was furnished by Fellowship Member Larry Pon, who contributes regularly to the Taxing Times sharing his knowledge of tax. Thank you Larry.

Oil Investor Zukerman Pleads Guilty in Tax Evasion Case

Oil-industry investor Morris Zukerman faces more than seven years in prison after pleading guilty to federal charges of evading more than $40 million in taxes.

Zukerman’s plea comes just a month after prosecutors accused the 72-year-old of aggressively seeking to evade taxes beginning in 2007, falsely claiming millions of dollars in deductions and providing false information for IRS audits. He admitted to failing to report $28 million in profits from the sale of an oil company and repeatedly lying to his accountants -- in one instance creating backdated documents to support his claim.

“These statements to the court mark the start of the difficult and painful process of accepting responsibility for and redressing what I recognize as serious criminal wrongdoing,” Zukerman told a judge in Manhattan federal court, pausing several times to compose himself. He said his guilty plea “gives me an opportunity to repair some of the damage my actions have caused my family, my government, and the many friends, colleagues, and business associates.”

Amended Returns

Zukerman plans to file “at least 80 amended tax returns” before his Dec. 5 sentencing date, his lawyer, James Bruton, told the judge in a conference at the bench, adding, “So when you see him next you will see a clean slate.”

“The tax lawyers are working feverishly,” Bruton said. In addition to his guilty plea, Zukerman agreed to pay $37 million to the IRS in unpaid taxes.

Zukerman declined to comment after the hearing, but Bruton said his client is “doing everything he can to do the right thing.”

Zukerman spent 16 years at Morgan Stanley, at one point overseeing its energy practice. He started his own investment firm in the late 1980s, M. E. Zukerman & Co., and his firm’s partners have included ConocoPhillips, Exxon Mobil Corp. and Kinder Morgan Inc. He endowed a Harvard sociology professorship and collected dozens of expensive paintings, including works loaned to the Metropolitan Museum of Art.

The indictment alleged that Zukerman shipped paintings to addresses in Delaware and New Jersey to evade New York state sales tax on artwork that immediately went to his Park Avenue duplex in Manhattan. He didn’t plead guilty to that charge but will pay restitution to New York state of $4.6 million. Zukerman also took a charitable deduction for money he claimed was donated to a local conservation group in Maine to acquire land on Black Island, when in reality he had simply bought the land himself, according to his guilty plea.

He pleaded guilty to one count of tax evasion and another count of impeding the Internal Revenue Service.

The case is U.S. v. Zukerman, 16-cr-00194, U.S. District Court, Southern District of New York (Manhattan).

Millionaire Executive Gets Probation for Failing to Pay Taxes

A millionaire UPS executive was given probation Friday for failing to pay thousands of dollars in taxes eight years ago.

Steven Turner, 63, of New Hope, Pa., was given three years of probation and ordered to pay $345,000 in restitution, Mercer County prosecutors said.

The decision came nearly three months after Turner was found guilty of third-degree failure to pay income taxes for neglecting to pay nearly $248,000 in 2008, prosecutors have said.

That year, Turner had worked as a controller for UPS and made $2.2 million. Prosecutors have said he lived in a $1 million house at the time.

His case caught the attention of the New Jersey Division of Taxation, which launched an investigation and indicted Turner on Oct. 30, 2013.

The sentence Friday comes with a caveat – if Turner does not pay the $345,000 he owes in restitution by the time his probation is through, he will have to spend a year in jail, prosecutors said.

Judge Hands Entrepreneur Sam Wyly a $1.1 Billion Tax Bill

A federal judge slammed entrepreneur Sam Wyly’s use of offshore firms to ‘escape his obligation.

A federal judge has ordered Texas entrepreneur Sam Wyly to pay $1.1 billion in taxes and penalties for committing tax fraud using offshore accounts, even though the former billionaire’s net worth has fallen to a fraction of that amount.

The payment demand from Judge Barbara Houser on Monday was made for federal taxes due as far back as 1992. In a court opinion filed last month, she admitted that the money “may now be more difficult for the government to collect given the passage of time and the dissipation of Sam’s wealth.”

Financial statements filed with the U.S. Bankruptcy Court in
Dallas in November 2014 declared that Mr. Wyly’s assets were worth $382.83 million. His spokesman didn’t return requests for comment on the order.

In a May 10 opinion, Judge Houser ruled that Mr. Wyly, 81 years old, and his lawyers created a complex network of offshore accounts to conceal trading profits and “amass tremendous untaxed wealth.”

Specifically, Judge Houser said Mr. Wyly transferred stock options he earned, as compensation for serving as a director of business for software maker Sterling Software Inc. and arts-and-crafts chain Michaels Stores Inc., into the offshore trusts in exchange for a private annuity.

The network enabled Mr. Wyly to “escape his obligation to pay tax on the annuity income he was contractually entitled to receive,” wrote Judge Houser, who called the offshore system “nothing short of mind-numbing…with identically named domestic and foreign corporations, and layers upon layers of foreign entities.”

Mr. Wyly’s lawyers, during a three-week trial, blamed his hired financial professionals. Mr. Wyly testified that he hasn’t prepared his own tax returns since the 1960s.

Judge Houser was not convinced.

“[T]o accept [his] explanation requires the court to be satisfied that it is appropriate for extraordinarily wealthy individuals to hire middlemen to do their bidding in order to insulate themselves from wrongdoing so that, when the fraud is ultimately exposed, they have plausible deniability,” she wrote. Judge Houser also found that Mr. Wyly’s brother Charles, who died in a 2011 car accident, was also part of the “deceptive and fraudulent” scheme.

In her 459-page opinion, Judge Houser traced Mr. Wyly’s transfer strategy to a 1991 asset protection and tax deferral seminar held in New Orleans by trust promoter David Tedder, who later visited the Wylys at Sam Wyly’s Malibu, Calif., home. The Wyly family used offshore money to buy art and jewelry and to build homes in Texas and Colorado in a way that Mr. Wyly “believed prevented them from being taxed as gifts or other distributions from offshore,” the opinion said.

U.S. Securities and Exchange regulators later sued Mr. Wyly for securities fraud, a dispute that led to a $198.1 million judgment. He filed for chapter 11 protection in October 2014, saying he couldn’t afford such a steep penalty.

The payment breakdown in the court order shows that roughly $745 million is owed for penalties. Judge Houser ordered him to pay about $135 million for federal taxes due from 1992 to 2013 and about $227.1 million in interest.

In her opinion, Judge Houser pointed out that the tax bill sharply escalated after Mr. Wyly, who learned of the Internal Revenue Service’s audit in early 2004, opted not to cooperate with tax investigators. She added that Mr. Wyly was “uncooperative” during the trial and “had to be impeached frequently to get him to admit to fairly obvious facts.”

He “simply waited for the IRS to come after him, all the while continuing his offshore activities,” she wrote. “Such a cavalier attitude toward his reporting obligations for 20-plus years reflects, at a minimum, reckless indifference.”

Accountant Who Hid on Appalachian Trail Jailed for Embezzling Millions from Pepsi Bottler

A former controller who embezzled $8.7 million from the Pepsi bottling company where he worked and then spent six years as a fugitive on the Appalachian Trail has been sentenced to eight years in prison.

James T. Hammes, 54, a former resident of Lexington, Ken., agreed Wednesday to pay nearly $7.7 million in restitution, including $6.7 million to his former employer, G&J Pepsi-Cola Bottlers, and $1 million to Cincinnati Insurance Company, according to a news release.

While working as controller at the soda bottler, he made off with about $8.7 million between 1998 and February 2009 by setting up fictitious vendor accounts and manipulating the monthly accounting reports. Hammes allegedly used a miscellaneous account where he could charge off fraudulent checks and manipulated the legitimate accounts to offset the amounts in the miscellaneous account.

Hammes then used the stolen money for investing and trading, which in turn generated 1099 forms for the Internal Revenue Service. He sent estimated tax payments to the IRS amounting to at least $2.7 million with the help of the funds he stole from the Pepsi bottler. Nevertheless, he still managed to miss filing his tax returns for several years.

When his company and FBI agents questioned Hammes in February 2009 about the suspicious checks he had generated, he ran away to the Appalachian Trail, where he spent most of six years hiking and living under someone else’s name. He also used the nickname “Bismarck,” according to Reuters.
During that time, the authorities filed federal criminal charges against him. A fellow hiker saw his story on TV and tipped off law enforcement. Hammes was arrested in May 2015 at an inn where he was staying in Virginia.

U.S. District Judge Susan J. Dlott sentenced him to 96 months in prison.

“Hammes embezzled a lot of money over a long period of time,” Acting U.S. Attorney for the Southern District of Ohio Benjamin C. Glassman said in a statement. “As the district court recognized, his scheme was sophisticated; he abused the trust that his employer had placed in him; and sheer greed motivated him. Hammes followed up his crime by coldly abandoning his family without explanation or warning and running from the law for six years under someone else’s name. But no one can run from justice forever, and today his lies were punished. Hammes more than earned every minute of the term of imprisonment that the district court imposed today.”

Bridgewater CVS Worker Stops IRS Scam

Township police are commending a CVS worker who saved an elderly woman on from becoming the victim of an IRS phone scam.

Police say that an elderly woman came into the pharmacy at the corner of Union and Finderne avenues to buy a gift card to an IRS scammer who was on her phone.

The scammer was telling the woman that she needed to buy an Apple gift card to satisfy an $8,000 debt to the government, police said.

A store worker noticed what was going on and called township police. When officers arrived at the store, they spoke on the phone to the scammer, who promptly hung up.

Throughout Central Jersey and the rest of the country, police have been receiving complaints from residents who say they have been receiving telephone calls from people who claim to be IRS agents. Police say the residents are being told that if they do not make a tax or warrant payment, they will be arrested. The scammers use this threat to bully you into paying money to them through Western Union or gift cards, police say.

“The phone fraud scam has become an epidemic, robbing taxpayers of millions of dollars of their money,” said J. Russell George, the federal Department Treasury Inspector General for Tax Administration. “We are making progress in our investigation of this scam.”

While the number of phone scams from phony IRS agents usually peak around filing time in April, authorities have seen an uptick in the number of complaints in recent weeks. Some residents are reporting several calls a day. Some are also report messages left on answering machines. Sometimes, even the caller ID says it’s a call from the IRS or a local law-enforcement agency.

In some instances, the scammer will send a follow-up email with a bogus address from the government.

“This scam has proven to be the largest of its kind that we have ever seen. The callers are aggressive and relentless,” George said. “Once they have your attention, they will say anything to con you out of your hard-earned cash.”

Since 2013, more than 5,000 victims have lost more than $26.5 million as a result of the scam, according to the IRS.

The IRS first contacts people by mail — not by phone — about unpaid taxes. The IRS will not ask for payment using a prepaid debit card, a money order or wire a transfer. The IRS also will not ask for a credit card number over the phone. The IRS also reminds residents that it never requests personal or financial information by email, text or social media.

The IRS says it’s best just to hang up if you get a call from a scammer.

“If someone unexpectedly calls claiming to be from the IRS and uses threatening language if you do not pay immediately, that is a sign that it is not the IRS calling, and your cue to hang up,” George said. “Again, do not engage with these callers. If they call you, hang up the telephone.”

If you get a call from someone claiming to be with the IRS asking for a payment and if you think you owe money, hang up and call the IRS at 800-829-1040. IRS workers can help you with your payment questions.

Nevada Dentist Sentenced for Tax Fraud

A Las Vegas-area dentist was sentenced to 13 months in prison for tax evasion, announced Acting Assistant Attorney General Caroline D. Ciraolo of the Justice Department’s Tax Division and U.S. Attorney Daniel G. Bogden of the District of Nevada.

Leslie Kotler, 56, pleaded guilty in June 2014 to evading his taxes over a nine year period, causing a $600,000 tax loss and admitted to using a number of nominee bank accounts and bogus trusts to hide his income and assets from the Internal Revenue Service (IRS). Kotler also filed false income tax returns for the years 2008 through 2011 that materially understated his income and filed a false bankruptcy petition in an attempt to delay the IRS’s ongoing efforts to collect the large amount of taxes he owned.

“With this sentence, Mr. Kotler is held accountable and pays a heavy price for his egregious conduct in evading both the assessment and payment of taxes,” said Acting Assistant Attorney General Ciraolo. “The court’s sentence reflects the serious harm caused by those who fail to comply with our nation’s tax laws and will serve to deter other individuals contemplating similar criminal conduct.”
An indictment merely alleges that crimes have been committed. Defendants are presumed innocent until proven guilty beyond a reasonable doubt.

Acting Assistant Attorney General Ciraolo and U.S. Attorney Hochul commended special agents of the IRS-Criminal Investigation Division, along with the Department of Justice, will investigate and prosecute those who violate our tax system.

In addition to the term of imprisonment, U.S. District Judge Andrew Gordon of the District of Nevada ordered Kotler to serve three years of supervised release and pay restitution in the amount of $712,280. Before his sentencing, Kotler paid a total of $450,429 in back taxes, interest and fraud penalties.

Upstate NY Couple Indicted in Tax Scheme

A federal grand jury returned a four count indictment in the Western District of New York charging two business owners with conspiracy to defraud the United States and filing a false tax return, announced Acting Assistant Attorney General Caroline D. Ciraolo of the Justice Department’s Tax Division and U.S. Attorney William J. Hochul Jr for the Western District of New York.

According to the indictment, Lizhong “Tony” Shen and Xiaojie “Lucy” Shun, jointly operated BTL International Company Ltd., a tour and travel service company located in Niagara Falls, New York, between April 2004 and November 2009. The defendants were married at the time but, in 2009, they separated and Shen stopped working for BTL International. In January 2011, Shun ceased operation of BTL International and began operating another tour and travel service company, Niagara Falls Universal Inc.

For the tax years 2008 and 2009, Shen and Shun failed to properly report income generated by BTL International to the IRS on both corporate and personal tax returns. Both defendants also signed their 2009 personal tax return knowing the return included incorrect information. Shen and Shun reported income in the amount of $22,880 but it is alleged they knowingly received a significantly higher income.

In addition, Shun is charged with corruptly endeavoring to obstruct the due administration of the internal revenue laws. The indictment charges that, from April 2010 through April 2013, Shun provided inaccurate information to the accounting firm preparing the 2011 tax return for Niagara Falls Universal, the 2010 and 2011 personal tax returns for the couple and the 2012 tax return for herself.

The defendants face a maximum prison term of five years on the charge of conspiracy to defraud the United States and three years for each charge of filing a false return. Shun faces an additional three year term in prison for the charge of corruptly endeavoring to obstruct the due administration of the internal revenue laws. Both defendants also face a term of supervised release and monetary penalties.

An Assault Weapons Ban for the IRS (And Other Federal Regulatory Agencies)

In the aftermath of the Orlando terrorist attack, many Washington politicians tried to shift the conversation to the Second Amendment and called for an assault weapons bans. But former U.S. Senator Tom Coburn, our Honorary Chairman, had another idea. In this interview on CNBC, Coburn said we should improve our system of background checks, but said it was IRS officials and non-military federal personnel who should be subject to an assault weapons ban, not the general public.

This week, our organization at OpenTheBooks.com released our findings in an editorial at The Wall Street Journal that quantified the growing federal arsenal. The number of non-military federal officers with arrest and firearm authority (200,000+) now exceeds the number of U.S. Marines (182,000). Spending on guns, ammo and military-style equipment at 67 federal agencies – including 53 regulatory, administrative agencies amounted to $1.48 billion between 2006-2014.

The IRS gun-locker is an example of this growing federal firepower. Nearly $11 million was spent on guns, ammo, and military-style equipment for 2,316 ‘special agents’ during this period. The IRS stockpile includes pump-action and semi-automatic shotguns with buckshot and slugs; and semi-automatic AR-15 rifles (S&W M&P 15) and military-style H&K 416 rifles. Source: OpenTheBooks Oversight Report – The Militarization of America
Who has more firepower? The U.S. Marines or the rank-and-file, administrative federal agencies?

The recent growth of the federal arsenal begs the questions: Just who are the feds planning to battle?

In 1996, the Bureau of Justice Statistics officially counted 74,500 federal officers who had arrest and firearm authority. By 2008, the Bureau quantified over 120,000 such officers. Newly updated counts were supposed to publish by this July but the Bureau now admits that over 80-percent of federal agencies ignored or stonewalled responses to their latest survey. What are they trying to hide?

Even though our organization at OpenTheBooks.com estimated the number of non-Department of Defense federal officers at 200,000+, the current number of non-military federal officers and security personnel could be much larger. Here’s why:

- The feds refuse to disclose the number of Transportation Security Administration (TSA) officers, claiming a national security exception.

- The growth of officers within the 53 administrative, regulatory agencies since 2008 is uncertain. Our officer count estimate used a no-growth figure of 30,000 – the same count as in 2008.

- Likewise, the count within the Department of Homeland Security is unclear. We found conflicting sources citing figures at 70,000 and 63,000. We used the more conservative figure for our analysis.

At Health and Human Services (HHS), it’s also unclear just how many ‘special agents’ are currently employed. Yet, research uncovered a multi-million-dollar program for HHS ‘Office of Inspector General Special Agents’ that used a sophisticated military-style weapons platform with Special Forces contractors training the agents on domestic special operations.

Today, HHS is operating from a brand new “National Training Operations Center” within the Washington, D.C. area they describe as “an operational readiness, emergency response, crisis room and command post for HHS headquarters and staff.” That’s serious business for an agency supposedly preoccupied with “health” matters.

Across the federal government, we low-balled our estimates. Another reason our numbers may be low is many federal employees are not officially counted within the scope of federal audits. Other agencies operate under different laws and rules that obscure or conceal their weapons caches.

There could be the one bright spot from this disaster, just possibly. Which is that idiot economic policies have now been tested, in the middle income world, in modern times. And we’ve also no other confuting or confounding factors to take into account. We can’t talk about the remains of colonialism or racism, as in Zimbabwe, the detritus of Tsarism, the cruelty of Stalin, war, nor in fact anything at all other than just pig headed, ghastly, purblind stupidity over economic policy. The lesson from this we should take, and it would be a bright spot if we did, is that we do indeed have a range of possible economic policies. We’ve a whole spectrum of them. From that laissez faire free market capitalism of Hong Kong through to that tax and benefits heavy free market social democracy of the Nordics. We can seat ourselves anywhere we like on that spectrum but choices which do not include that free market and prices bit do not work.

As Ben Bernanke pointed out 90% of the use of economics is in pointing out to people those damn stupid ideas which will not work. Not market economies do not work.

IRS Updates Its Employee Email Rules to Reflect PATH Act

IRS Memo “Using IRS and Personal Email Accounts” (June 21, 2016).

IRS has issued an internal memo that instructs its employees on their use of IRS and personal email accounts for corresponding with taxpayers, other external stakeholders, other IRS employees, etc. The memo reflects a provision of the Protecting Americans from Tax Hikes (PATH) Act of 2015. As updated on May 3, 2012, Internal Revenue Manual paragraph 10.8.1.4.6.3.1, “Privately Owned E-Mail Accounts,” bans IRS employee use of non-IRS/Treasury email for any governmental or official purpose.

PATH Act Sec. 402 in effect codified this policy by prohibiting IRS employees from using personal email accounts for official business, effective on Dec. 18, 2015.

IRS has issued a memo that provides the following specific instructions to its employees on their use of IRS and personal email accounts:

...Emailing taxpayers. In general, IRS employees may not use email to conduct business with taxpayers, even if requested, because of the risk of improperly disclosing or exposing their sensitive but unclassified (SBU) data (including personally unidentifiable information (PII)). When taxpayers request email contact and accept the risk of such, limited allowable instances include:

(a) A message sent under a previously authorized IT-approved secure email program.

(b) A brief, unencrypted message confirming the date, time, or location of an upcoming appointment, but not the nature of the appointment. Include no SBU data (including PII) in the email, subject line, or attachment. Permit no follow-up email discussion of any taxpayer account or case.

(c) A link to the publicly available forms and publications sections of IRS.gov. Avoid sending information about specific tax matters (revenue rulings, court cases, and
specific IRS forms), which may unintentionally disclose the nature of a tax matter to an unauthorized third party.

When responding to unsolicited emails from taxpayers or tax professionals, IRS employees should respond by letter or phone; if address or phone number are not available, they should respond by email. In that case, the IRS employee must: a) delete any SBU data (including PII) appearing in the original email; and b) discourage the taxpayer from continuing the discussion by email. For example: “To ensure your privacy, we discourage you from sending your personal information to us by email. Further, IRS doesn’t allow its employees to exchange unencrypted personally identifiable or other sensitive information with email accounts outside of the IRS network, even with your permission. For further discussion about the matters included in your original email, please contact us by telephone, fax, or mail.”

Emailing other external stakeholders. Similar rules apply to authorized IRS email exchanges with external stakeholders, such as contractors that don’t have IRS email accounts, other government agencies, and journalists. Specifically, IRS employees should:

(a) Send SBU data (including PII) through password-protected encrypted attachments or through a previously authorized IT-approved secure email program.

(b) Email taxpayer data outside IRS only when specifically authorized by established written procedures.

(c) Email taxpayer data to officials and employees of another government agency only when the recipient has a need to know and authorization to receive it by email.

(d) Follow the procedures detailed above for responding to unsolicited emails, when receiving unsolicited emails from external parties that contain SBU data (including PII).

(e) Tell those who must provide IRS with their PII to facilitate a business arrangement to fax or mail that information or upload it to a secure system.

Emailing other IRS employees. IRS employees must use IRS email for email communications with other IRS employees about official business matters. They must encrypt all internal email messages that contain SBU data (including PII) with secure messaging or in password-protected encrypted attachments.

Use of personal email accounts. The memo provides that IRS employees may use their personal email accounts under exigent circumstances, such as in emergencies. This includes when the IRS network is down and there is an urgent need to communicate, or in disaster recovery situations. In those cases, employees must limit SBU data to that necessary for the situation. All such personal email account communication must then be copied to the employee’s IRS email account.

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No Rollover Relief for Taxpayer Who Used IRA Distribution as Short-term Loan
PLR 201625022

In a private letter ruling, IRS has refused to waive the 60-day rollover requirement for a taxpayer who used her IRA distribution as a short-term source of funds pending the sale of her vacation home. Although the taxpayer claimed that her failure to accomplish a timely rollover was due to her medical condition during the 60-day period, IRS doubted the veracity of this claim in light of the taxpayer's continued work and travels throughout that period.

There is no immediate tax if distributions from an IRA are rolled over to an IRA or other eligible retirement plan (i.e., qualified trust, governmental Code Sec. 457 plan, Code Sec. 403(a) annuity and Code Sec. 403(b) tax-shelter annuity). For the rollover to be tax-free, the amount distributed from the IRA generally must be reconstituted to the IRA or other eligible retirement plan no later than 60 days after the date that the taxpayer received the withdrawal from the IRA. ( Code Sec. 408(d)(3) ) A distribution rolled over after the 60-day period generally will be taxed (and also may be subject to a 10% premature withdrawal penalty tax). ( Code Sec. 72(t) ) Only one tax-free IRA-to-IRA rollover per IRA account can be made within a one-year period. ( Code Sec. 408(d)(3)(B) )

IRS may waive the 60-day rule if an individual suffers a casualty, disaster, or other event beyond his reasonable control, and not waiving the 60-day rule would be against equity or good conscience (i.e., hardship waiver). ( Code Sec. 408(d)(3)(I) ) IRS will consider several factors in determining whether to waive the 60-day rollover requirement, including time elapsed since the distribution and inability to complete the rollover due to death, disability, hospitalization, incarceration, restrictions imposed by a foreign country, postal error, errors committed by a financial institution, etc. ( Rev Proc 2003-16, 2003-1 CB 359 )

Early in 2015, Taxpayer’s daughter’s home was in foreclosure. On Apr. 8, 2015, Taxpayer and her spouse put their vacation home up for sale in order to raise funds to purchase their daughter’s home. Prior to the sale of their vacation home, in order to avert foreclosure, Taxpayer took a distribution from her IRA on Apr. 24, 2015. The distribution was used to purchase her daughter’s home on Apr. 27, 2015.

Taxpayer intended to redeposit the distributed amount into her IRA within the 60-day rollover period which ended on June 23, 2015. However, the sale of the vacation home was not completed until July 1, 2015, and Taxpayer didn’t have sufficient funds available during the 60-day period to complete the rollover. Taxpayer indicated that her spouse was willing to take a distribution from his IRA within the 60-day period to complete the rollover but that her medical condition prevented this from occurring. She attempted to complete the rollover once she received the funds from selling the vacation home, but the 60-day period had expired.

Taxpayer requested that IRS waive the 60-day requirement in
IRS found that the documentation and materials submitted by Taxpayer did not demonstrate that her failure to complete a timely rollover was due to any of the factors enumerated in Rev Proc 2003-16. Although Taxpayer represented that her inability to complete a timely rollover was caused by her medical condition during the 60-day period, IRS was “not convinced” given her “continued work and travels.” IRS found that her failure to complete a timely rollover was instead due to her use of the funds as a short-term loan to purchase her daughter’s home, which left her unable to recontribute the amount to her IRA until after the sale of her vacation home was completed.

**IRS Waging New Audit Campaigns Against Business Taxpayers**

The Internal Revenue Service is drawing up plans to wage issue focused “campaigns” against taxpayers. The move represents a big shift in the agency’s approach to business audits and one that corporations need to prepare for.

Historically, many of the nation’s largest corporate taxpayers have been subject to so-called continuous audits of their returns. In practice, this has meant that IRS agents were perpetually stationed in taxpayers’ corporate offices. Indeed, the audit of these sometimes 10,000 page tax returns took an army of IRS agents’ full-time attention for months or even years! Over the last several years, however, Congress has stripped away funding from the IRS. The net result has been a substantial reduction in the number of tax audits over the last several years.

In reaction to having fewer resources to accomplish the same job, the IRS has revamped its methodology and approach. That’s where the campaigns come in.

Late last year, the IRS group that audits the country’s largest taxpayers, the Large Business and International (LB&I) division, announced that it would restructure itself to deal with shrinking resources and a shifting tax environment. One feature of the restructuring is the end of the continuous audit program. Instead, LB&I has chosen to direct all of its resources to focused, coordinated examinations on specific issues that it believes are abusive and could bring in big dollars – the IRS’s new “campaign” methodology. Although this program is in its infancy, taxpayers are beginning to see the contours of the IRS’s latest strategy.

The IRS has leveraged its knowledge throughout its system, identified the most serious tax issues, and allocated its resources to those issues. The emphasis is away from specific taxpayers and on to specific tax issues. So far, the IRS has announced three “campaigns” focused on inbound distributions (for example, moving untaxed, foreign earnings into the U.S.), basket options (a technique used to convert short-term taxable gains into favorable lower tax rate long term gains), and captive insurance (one of the issues on the IRS’s “Dirty Dozen” list). This, however, is just the beginning. We expect the IRS to implement numerous additional campaigns as the program kicks into high gear, and it is possible that a single taxpayer could come under scrutiny in more than one campaign. The IRS has not yet decided whether all of its campaigns will be disclosed to the public, but we expect a heavy focus on anything dealing with taxation of international transactions.

**IRS Announces Additional Low Income Taxpayer Clinic Grant Recipients**

The Internal Revenue Service announced $385,678 in matching grants to nine additional recipients for development of qualified Low Income Taxpayer Clinics (LITCs) in underserved areas around the country for the last six months of the 2016 grant year.

The LITC program is a federal grant program administered by the Office of the Taxpayer Advocate at the IRS, led by National Taxpayer Advocate Nina E. Olson. Although LITCs receive partial funding from the IRS, LITCs, their employees and their volunteers operate independently from the IRS.

The LITC program awards matching grants of up to $100,000 per year to qualifying organizations to develop, expand, or continue low income taxpayer clinics. The LITC program funds organizations to represent low income taxpayers in

**Code Sec. 408(d)(3) with respect to the distribution.**
In addition, the IRS cautioned that use of the IP PIN tool is limited to pre-selected taxpayers. Approximately 2.7 million IP PIN holders will receive a six-digit IP PIN through the mail late in the calendar year ahead of the start of the 2017 filing season.

“Those taxpayers who lose their IP PIN may use the tool to retrieve their number,” said the IRS. “Taxpayers who may be victims of non-tax related identity theft and who submitted an affidavit to the IRS may opt into the IP PIN program and obtain an IP PIN through the tool. Taxpayers from Florida, Georgia and the District of Columbia also may obtain an IP PIN through the tool as part of a pilot project.”

Wellness Program Rewards Are Taxable

IRS’ Chief Counsel has provided the following information in Chief Counsel Advice Memorandum 201622031 (CCA) involving rewards an employer gives to employees.

Many employers are encouraging their employees to be healthy. Some employers are providing employees certain benefits such as cash rewards and gym membership fees. The question posed is whether any or all of these benefits are taxable. Briefly the CCA states any benefits provided by the employer are taxable compensation unless they are specifically excluded by a provision of the Internal Revenue Code:

1) A wellness program that provides employees with a de minimis fringe benefit, such as a T-shirt, would satisfy the requirements to be excluded under Section 132.

2) The employer payment or reimbursement of gym membership fees that do not qualify as a medical expense is not excludible and must be included as compensation.

3) An employer cash reward for participating in a wellness program is not excludible and must be included as compensation. (There is not a de minimis exclusion provision for cash given to an employee by an employer.)

4) A reimbursement of any pretax medical expenses, including pre-tax health insurance premiums, is taxable as compensation.

5) A reimbursement of any deductible medical expense, including post-tax health insurance premiums, is not taxable UNLESS the taxpayer has previously deducted the expense.

Editor’s Note: This timely information was provided by Mary Mellem, Fellowship Member and ncpe Instructor. Catch Mary at one of the ncpe Corporate, Partnership and LLC seminars.
Implementing Health Reform. The National Taxpayer Advocate Service (TAS) has recently released volume 1 of its Objectives Report to Congress for fiscal year 2017. The TAS reports that, overall, “The IRS has done a commendable job of implementing the various stages of the Patient Protection and Affordable Care Act.” In addition to providing data on Affordable Care Act (ACA) tax filings for the 2015 filing year, however, the report also contains information regarding ongoing issues with Internal Revenue Service (IRS) efforts to implement the ACA and recommendations to Congress regarding ACA tax issues that the TAS has identified.

As of April 28, 2016, 4.8 million tax year 2015 returns had been filed with form 8962, which is necessary to claim a premium tax credit (PTC). Three million were prepared by a paid or volunteer tax preparer; the remainder were self-filed. About 4.5 million of these (94 percent) reported the receipt of $15.8 billion in advance PTC; the rest claimed PTCs when they filed their return. The average PTC amount per return was $2,987.

Taxpayers actually claimed entitlement to $14.3 billion in premium tax credits, suggesting that overpayments of APTC equaled at least $1.5 billion. Because of the approximately 300,000 taxpayers who claimed their tax credits at the time of filing rather than in advance, the total amount of overpayments was likely somewhat larger than this amount.

Taxpayers filed 103.6 million returns claiming minimum essential coverage. About 5.6 million taxpayers filed returns recognizing responsibility for an individual shared responsibility payment, with an average payment of $442. Of these returns, 3.6 million were prepared by a paid or volunteer tax preparer. Eleven million forms claimed an exemption from having health coverage; of these, 3.2 million claimed an exemption because their household or gross income was below the filing threshold, while 7.8 million claimed another exemption.

The TAS reports a dramatic increase in premium tax credit cases, where some sort of problem or issue occurred, for FY 2016 over FY 2015, with 8,887 cases as of the end of May 2016. The primary individual tax issues that it reports dealing with included situations where:

- Taxpayers incorrectly received 1095-A forms, which are supposed to report receipt of advance PTC, simply because they contacted the marketplace to enquire about enrollment, even though they actually did not enroll;

- The IRS received incorrect advance PTC data from marketplaces for taxpayers that in fact never received marketplace coverage;

- The IRS received incorrect advance PTC data from marketplaces for taxpayers who in fact enrolled in marketplace coverage but did not receive advance PTC; or

- Taxpayers received advance PTC but filed a 1040EZ return, which does not allow the filing of the 8962 form, and thus were not able to reconcile PTC.

About 96 percent of the 9250 ACA cases reviewed by the TAS dealt with PTC.

The IRS reviews all individual tax returns to check if the taxpayer received advance PTC. When it identifies a taxpayer who received advance PTC but did not file a form 8962 to reconcile PTC, it holds the return in an Error Resolution/Rejected Return unit and sends the taxpayer a Letter 12C informing him or her that the filing is incomplete. If the taxpayer has incorrectly filed a 1040EZ, the IRS can convert the 1040EZ to a 1040 if the taxpayer subsequently files a 1095-A and 8962 reconciliation form, but the process can be lengthy, holding up the finalization for the return.

The TAS has identified several problems through this process:

- Continuing issues with taxpayers not updating their marketplace eligibility information for changed circumstances, resulting in overpayments.

- Delays in processing refunds because of taxpayers not filing 8962 forms.

- State marketplaces being permitted 90 days after the enrollment period closes to finalize tax information reports. This results in confusion if a state marketplace updates the information that it has reported to the IRS after a letter 12C has been sent to a taxpayer because the IRS has incomplete or incorrect data.

- Unscrupulous tax preparers continuing to tell taxpayers that they have to pay the individual responsibility payment directly to the preparer and then pocketing the payment rather than sending it on to the IRS. They seem in particular to be preying on undocumented immigrants (including Deferred Action for Children Arrival immigrants) who do not in fact owe the fee.

- Overpayments of the individual responsibility fee. This was apparently a widespread problem for filing year 2014, but was identified too late in the year to permit a systemic fix. The IRS has sent a letter 5600-C to individuals who overpaid for 2014 instructing them how to file an amended return. It is also putting systemic corrections in place to catch situations where an individual who is eligible for an exemption because income is below the filing limit nonetheless pays the fee.

- The need for relief for people who receive lump sum Social Security Disability Insurance payments that drive their income above 400 percent of the federal poverty limit, requiring them to pay back all advance PTC received. The law allows individuals to prorate lump sum SSDI payments over the period covered by the payment for income tax purposes, but this option is not available for computing modified adjusted gross income, which is used to calculate
PTC eligibility. The report urges the IRS to correct this inequity administratively if possible or Congress to fix it if administrative action is not possible.

Employer Issues

The TAS report also covers ACA issues affecting employers. It notes that there is no “reasonable cause” exception for violations of the employer shared responsibility payment (ESRP) provisions of the ACA. The TAS urges the IRS to respond directly with employers as they attempt to determine whether or not they offer minimum essential coverage (MEC) and whether particular employers are full-time employees who must be offered MEC to avoid the ESRP. The IRS has designated their Small Business/Self Employment division to work with employers on ESRP issues.

The IRS extended the due dates for employers to furnish coverage information for 2015 to employees from January 31 to March 31, 2016, and to the IRS from February 29 to May 31, 2016. Thus the IRS has not yet reported how many informational returns have been filed by employees.

The TAS report expresses concern about the IRS taking action based on incorrect or incomplete data reporting. TAS recommends again, as it did last year, that Congress amend the tax law to allow the IRS to use the taxpayer information number matching program to verify information reported by employers and insurers on health coverage. Currently the program can only be used to verify information returns that report income subject to back-up withholding and thus can’t be used to verify employer or insurer information reports (1095-Bs and 1095-Cs).

The report also expresses concern about the complexity of IRS guidance regarding the application of the $100 per-day per-employee excise tax imposed on employers whose group health plans violate ACA requirements pertaining to employer payment plans and health reimbursement accounts. In particular, it notes IRS guidance delaying until plan years beginning in 2017 the imposition of the tax on colleges and universities that have used these accounts in the past for providing coverage to student employees. The report urges the IRS to continue to work with schools affected by this requirement.

In Other ACA Regulatory News …

In other developments, the Department of Health and Human Services (HHS) released a question and answer document on July 8, clarifying applicability dates for the 2017 summary of benefits and coverage (SBC). Health plans or insurers that have annual open enrollment periods must use the 2017 SBC for open enrollment periods beginning on or after April 1, 2017. This means that qualified health plans will begin using it for the November 1, 2017 to January 31, 2018 ACA marketplace open enrollment period. Plans and insurers without an open enrollment period should start using the 2017 SBC for the first year for the first plan or policy year beginning on or after April 1, 2017.

SBCs for 2017 should be submitted to HHS in direct enforcement states at least 60 days prior to use for form review. In other states, 2017 forms should be submitted in accordance with state form review guidelines. Until further notice, insurers should continue to use the coverage calculator approved for plan year 2016 for calculating data used for the coverage examples “having a baby” and “managing diabetes” and enter a default “$0” for each field under the new “treatment of a simple fracture” example.

HHS also announced that the 2017 Assister Certification Training is available beginning on July 11, 2016. The training is hosted by the Marketplace Learning Management System (MLMS), the online web-based training platform for assisters assisting consumers in Federally Facilitated Marketplaces (FFMs), including State Partnership Marketplaces (SPMs), and State-based Marketplaces using the Federal platform (SBM-FPs). The training is available for new users and for existing users.

IRS Lowers Fee for Applying as Tax-Exempt Charity

On July 1, the IRS decreased the user fee for processing Form 1023-EZ, Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code, from $400 to $275.

In May, the IRS released Revenue Procedure 2016-32 about its plan to reduce the user fee for filing Form 1023-EZ. The IRS introduced the form in 2014 to streamline the process for small organizations to apply for tax-exempt status under Section 501(c)3 of the Tax Code. The IRS wanted to reduce a months-long backlog of applications from approximately 60,000 organizations that ask for tax-exempt status each year (see Easy or Too EZ: New Rules for Tax Exemptions). Organizations with annual gross receipts of $50,000 or less and assets of $250,000 or less can use the three-page form. Charities need to submit the fee through www.pay.gov when filing a 1023-EZ application. They can pay the fee directly from a bank account or via credit or debit card.

The IRS also released regulations last week on how groups should register as tax-exempt organizations under Section 501(c)4 of the Tax Code. Still dealing with fallout from revelations in 2013 that it had given extra scrutiny to political groups applying for tax-exempt status under that section of the Tax Code, which is supposed to apply to social welfare organizations. The then-director of the IRS’s Exempt Organizations unit, Lois Lerner, admitted the agency used terms such as “Tea Party” to sort through the applications. She and other top IRS officials were forced to step down.

IRS Plans to Set Security Standards for Tax Preparers

The Internal Revenue Service held a meeting of its Security Summit members to discuss progress on combating identity theft-related tax refund fraud this past tax season along with
plans for next year, including a greater focus on education and new security standards for tax preparers.

John Koskinen

IRS Commissioner John Koskinen pointed to progress since the Security Summit group was set up in March of last year, bringing together the IRS, state tax authorities and private industry, including major tax prep chains and tax software developers.

He noted that the number of people who have filed affidavits telling the IRS they were victims of identity theft has dropped 48 percent in the first half of 2016, compared to the first half of 2015. In addition, the number of suspicious refunds that financial institutions returned to the IRS for review was 66 percent lower through mid-June of this year compared with the same period last year.

“That's more evidence our fraud filters are getting better and stopping more false returns before refunds can be issued,” Koskinen said during a conference call with reporters following the Security Summit meeting. However, he admitted the IRS could not yet provide hard numbers on the number of identity theft victims this year.

This year through April, though, the IRS stopped over $1 billion in fraudulent refunds claimed by identity thieves on more than 170,000 tax returns. “During the same period last year, we had stopped about $754 million in fraudulent refunds claimed on 141,000 returns,” said Koskinen. “So you can see we’re making progress—stopping tens of thousands more returns worth a quarter billion dollars.”

This year through May 8th, leads from industry partners directly resulted in the suspension of 36,000 tax returns, he noted, on which a total of $148 million in refunds was claimed. “That's more than twice what was identified by industry leads through May 8th of last year—15,000 returns claiming $98 million,” said Koskinen. “That's protecting $50 million more of taxpayer money.”

Koskinen said the Security Summit Group will be made permanent this year, operating under the auspices of the Electronic Tax Administration Advisory Council, or ETAAC. The IRS has also created additional teams for tax professionals, financial services and public communications. In addition, it is establishing a new Identity Theft Tax Refund Fraud Information Sharing and Analysis Center, or ISAC, which will provide a clearinghouse for sharing information about identity theft-related tax fraud.

“We will use the ISAC to centralize, standardize and enhance the way data from Security Summit Group partners is collected and analyzed,” said Koskinen. “This will allow us and our partners to make the best possible use of the data being shared—to analyze and spot trends as they emerge. I'm confident we'll have key components of the ISAC working by the next filing season. With the ISAC in place, the ability of all partners in the Security Summit Group to safely share and access information will be greatly improved, to the benefit of all.”

In addition, Koskinen noted that the IRS is going to be expanding a W-2 Verification Code pilot program for the 2017 filing season. “This involves a special code included on W-2s, which is entered on the tax return to confirm the accuracy and integrity of electronically filed returns,” he said. “We ran a pilot this past filing season with several payroll service providers involving 2 million W-2’s that helped verify information and protect the taxpayer. For 2017, we’re expanding the pilot to add this special protective code on up to 50 million W-2s during the season. We appreciate the support we’ve had from the payroll service community and the software industry on this project. This will be an extra layer of protection that will help taxpayers and the tax system.”

Tax Preparer Security Standards

Another major initiative will be to ensure better awareness among tax preparers on ways to safeguard against identity theft, with education efforts and sessions at the IRS’s Nationwide Tax Forums, along with an upcoming set of security standards.

“We are also expanding our efforts to collaborate with a group that’s absolutely critical to the tax system—the tax return preparer community,” said Koskinen. “We’re very concerned that identity thieves, in their never-ending hunt for taxpayer data, are focusing more and more on tax return preparers. We already saw some evidence of this during the last filing season. So our subgroup devoted to tax professionals is already hard at work identifying steps that we can take to help return preparers safeguard their own information and their clients’ data.”

Efforts will include getting the word out to tax preparers to help them better understand what safeguards they can put in place themselves. “We will be launching a new campaign in this area,” said Koskinen. “We’ll have more details on that available soon, and we will be reaching out directly to return preparers on this issue at this summer’s IRS Nationwide Tax Forums to be held in cities around the country. The first Tax Forum will be in Chicago in two weeks.”

Accounting Today asked if those efforts will include enforcement or just additional education. Koskinen said that subject came
up for discussion during the Security Summit meeting before the press conference.

"I would stress it's not an enforcement operation," Koskinen responded. "We're really trying to be supportive and helpful. We have representatives of preparers and professional groups as part of the Summit, and we stressed this morning that the goal of all of us—certainly the states and everybody in the private sector—is to try to figure out how we can be supportive and helpful. So it's primarily an educational campaign to try to get people aware of the facts and then providing them also with resources of what they can do and what steps they can take to provide security. We also are developing with one of our security working groups a set of security standards that can be agreed upon by all preparers and those in the private sector, large and small. We're sensitive to the fact that there are a lot of preparers out there that are relatively small organizations

agreed upon by all preparers and those in the private sector, large and small. We're sensitive to the fact that there are a lot of preparers out there that are relatively small organizations and to try over time to give them guidance of what the security standards are that people should be meeting."

No Sec. 199 Deduction for Taxpayer’s U.S.-produced Catalogs Advertising Foreign-made Products

Chief Counsel Advice 201626024

In e-mailed Chief Counsel Advice (CCA), IRS denied the Code Sec. 199 domestic production activities deduction for a retail company’s U.S.-produced catalogs, mailers, and similar print publications that advertised its foreign-made products and drove the lion’s share of sales. The printed publications didn’t qualify for an exception in the regs that grants the Code Sec. 199 deduction for income from advertising placed in print media manufactured or produced by the taxpayer in whole or in significant part within the U.S.

Under the Code Sec. 199 domestic production activities deduction (DPAD), a taxpayer is allowed a deduction from taxable income (or adjusted gross income, in the case of an individual) that is equal to 9% of the lesser of the taxpayer’s qualified production activities income (QPAI) or taxable income for the tax year. QPAI is generally domestic production gross receipts (DPGR) reduced by the sum of: (1) the costs of goods sold that are allocable to those receipts; and (2) other expenses, losses, or deductions which are properly allocable to those receipts. The amount of the deduction for a tax year is limited to 50% of the wages paid by the taxpayer, and properly allocable to DPGR, during the calendar year that ends in the tax year.

A taxpayer may have DPGR from one of five sources, including any sale, exchange or other disposition, or any lease, rental or license, of qualifying production property manufactured, produced, grown or extracted (MPGE) by the taxpayer in whole or in significant part within the U.S.

In general, gross receipts derived from a qualified disposition of Code Sec. 199 property do not include advertising income and product-placement income. (Reg. § 1.199-3(i)(5)(i) ) Nevertheless, a taxpayer’s gross receipts that are derived from the lease, rental, license, sale, exchange, or other disposition of newspapers, magazines, telephone directories, periodicals, or other similar printed publications that are MPGE by the taxpayer in whole or in significant part within the U.S. include income from advertisements placed in those media. However, this exception applies only if the gross receipts, if any, derived from the qualified disposition of the printed materials are, or would be, treated as DPGR. (Reg. § 1.199-3(i)(5)(ii)(A) )

For example, assume a taxpayer produces and manufactures a newspaper in the U.S., and its gross receipts from this newspaper include receipts from newsstand sales, subscription, and various forms of advertising placed in the newspaper. The taxpayer’s gross receipts from the placement of advertising in its newspaper are treated as “derived from” the sale of the newspaper, therefore qualifying as domestic production gross receipts. (See Reg. § 1.199-3(i)(5)(ii), Ex. 1)

Taxpayer is a specialty retailer of private branded, casual-to-dressy clothing, intimates, accessories, and non-clothing gift items under certain Brand Names. The products are made available to customers, through its website and via telephone through call centers for its catalogs. The MPGE of the physical products is outside of the U.S.

Taxpayer claims to be the manufacturer of its catalogs, mailers and other similar printed publications (“print media”) in the U.S. based on the benefits and burdens of ownership during the manufacturing of the printed media by third party contractors. Taxpayer distributes the print media free of charge to existing customers and does not sell advertising to third parties for inclusion in the print media it distributed. The print media only advertises Taxpayer’s own brands. Thus, there is no advertising revenue associated with the print media.

Taxpayer’s position is that it is entitled to a Code Sec. 199 deduction for its print media based on the argument that advertising is a key component of the clothing and accessories it sells. It argues that its print media is a key driver of sales at its stores and websites, encourages repeat sales, and fosters customer loyalty. Sophisticated software shows that its print media is responsible for generating the lion’s share of its sales. As a result, Taxpayer believes that its advertising revenues generated from the disposition of its manufactured printed media which is included in the sales price of its goods sold in its stores and online is qualified under Reg. § 1.199-3(i)(5).

No sale. The CCA says Taxpayer can’t characterize any gross receipts derived from the sale of its products as DPGR from advertising income under Reg. § 1.199-3(i)(5)(ii)(A) (or any other Code Sec. 199 rule). Its products are MPGE outside of the U.S., and therefore, gross receipts from their sale are non-DPGR.

The CCA points out that the exception in Reg. § 1.199-3(i)(5)(ii)(A) for tangible personal property is limited to certain printed publications and only applies to advertising income.
from advertisements placed in those media. Thus, the exception only applies when a taxpayer that has MPGE in the U.S. a printed publication (and meets all other Code Sec. 199 requirements) derives gross receipts from someone advertising in such printed publication-and not when a taxpayer derives gross receipts from the sale of a product it advertises. In this case, no one is paying Taxpayer to have an advertisement placed into Taxpayer’s printed media.

The fact that advertising Taxpayer’s products increases its sales has no bearing in applying Reg. § 1.199-3(i)(5)(ii)(A). For that reg to apply, Taxpayer’s customers would have to pay to advertise in Taxpayer’s print media.

CBO Examines Budgetary Impact of Increasing IRS’s Enforcement Budget

Congressional Budget Office, “Estimating the Revenue Effects of Proposals to Increase Funding for Tax Enforcement.”

The Congressional Budget Office (CBO) has released a document titled “Estimating the Revenue Effects of Proposals to Increase Funding for Tax Enforcement.” It provides estimates of the return on investment (ROI) from boosting IRS funding targeted at enforcement, specifically looking at proposals laid out by President Obama in his FY 2016 budget. Overall, CBO projected that the proposed enforcement initiatives would result in net budgetary gains of $36.6 billion over a 10-year window.

CBO estimates that the budget deficit will be $534 billion in FY 2016.

The “net tax gap” is the difference between the amount of tax that taxpayers should pay under the tax law and the amount they actually pay, either voluntarily or as a result of enforcement actions. IRS estimates that the annual net tax gap from 2008 to 2010 was, on average, $406 billion ($447 billion in 2016 dollars).

The Senate Appropriations Committee recently approved an $11.2 billion budget for IRS in FY 2017-$300 million above that approved in the House, with the difference to be hashed out in conference and the ultimate budget likely to be well below the $12.3 billion requested by President Obama. Funding for IRS has fallen by 15% from 2010 through 2016 (in real dollars), with the biggest cuts in enforcement. However, enforcement still receives the largest share of IRS’s budget, with approximately 43% of IRS’s 2016 budget going toward enforcement activities.

After explaining a number of the “budget scorekeeping guidelines” to which it is subject, as well as certain factors that it doesn’t take into account in its forecasts, CBO provided ROI estimates from increasing certain IRS enforcement activities. CBO specifically looked at President Obama’s FY 2016 budget, which contained a proposal to boost discretionary spending by $667 million to fund IRS “program integrity initiatives,” approximately $421 million of which was designated for enforcement. Program integrity initiatives are essentially a mechanism to increase IRS’s base funding (beyond the amount budgeted by Congress) and target the use of extra funds towards revenue-generating initiatives.

The ROIs were broken down by enforcement initiative, cost in 2016, and return on $1 of investment, as follows:

- . . . Prevent identity theft and refund fraud: cost of $2.7 million; ROI of 9.0.
- . . . Increase audit coverage: cost of $150.7 million; ROI of 2.6.
- . . . Improve audit coverage of large partnerships: cost of $16.2 million; ROI of 2.7.
- . . . Address international and offshore compliance issues: cost of $40.7 million; ROI of 1.2.
- . . . Enhance collection coverage: cost of $122.8 million; ROI of 2.8.
- . . . Other initiatives: cost of $87.5 million; ROI of 0.

The fact that “other initiatives” was assigned zero ROI is presumably due to the fact that they were unspecified and thus their projected revenues couldn’t be scored with any degree of precision, and not necessarily because they wouldn’t generate any return.

Overall, this was a total cost of $420.6 million, with an average ROI of 2.0 per $1 of investment.

President Obama also proposed continuing the 2016 enforcement initiatives throughout the entire 10-year budget period, with the annual costs rising to $435 million in 2018 then staying at that level. CBO estimated that the average ROI on the increased funding for enforcement would gradually rise over three years, and that IRS would see improvements in both technology and staff over that same period as a result of the additional funding. However, CBO projected a drop in the ROI after 2018 as “taxpayers found new ways to evade taxes.”

Specifically, it projected the annual ROIs from increased funding for enforcement initiatives as follows:

- . . . Year 10 (2025): ROI of 5.2.

In addition to the increased funding for IRS enforcement initiatives described above, President Obama’s 2016 budget proposal also called for “further increases in new enforcement and compliance initiatives each fiscal year from 2017 through 2020 and to sustain all of the new initiatives and inflationary costs via cap adjustments through fiscal year 2025.” The budget didn’t provide any details on the components of these future initiatives, and CBO concluded with respect to these
undescribed initiatives that their overall ROI would likely
decline over time as IRS “tackled more difficult types of tax
evasion.”

Listed Property Limits for 2016

IRC §280F (listed property) provides ceilings on the amount
of depreciation and §179 that can be claimed on passenger
automobiles, light duty trucks and vans. This email gives you
these limits for vehicles placed in service beginning in 2015.

These limits are multiplied by the taxpayer’s business use
percentage of the vehicle.

** Limits for passenger automobiles

The §280F limits for passenger automobiles first placed in
service during the calendar year 2016 that are neither trucks
nor vans:

- Year 1 - 3,160 (plus extra $8,000 if bonus depreciation is
  used)
- Year 2 - 5,100
- Year 3 - 3,050
- Year 4 & after - 1,875

** Limits for trucks and vans

The §280F limits for trucks and vans first placed in service
during the calendar year 2016 are:

- Year 1 - 3,560 (plus extra $8,000 if bonus depreciation is
  used)
- Year 2 - 5,700
- Year 3 - 3,350
- Year 4 & after - 2,075

The lease inclusion for 2016 applies to a passenger automobile
when the FMV of the vehicle exceeds $19,000 and apply to a
light duty truck and van when the FMV of the vehicle exceeds
$19,500.

Change To Lease Inclusion Table For 2015

The first three lines of the table for automobiles and the first
two lines of the table for trucks & vans are removed. Therefore
the lease inclusion for 2015 applies to a passenger automobile
when the FMV of the vehicle exceeds $19,000 and apply to a
light duty truck and van when the FMV of the vehicle exceeds
$19,500 (same as 2016). (We suspect most taxpayers will
not want their 2015 return amended for such a minor change.)

Security Summit Reviews 2016 Accomplishments,
Announces 2017 Initiatives

Leaders from the IRS and state tax agencies along with
executives from the private-sector tax industry marked
the first year of their ground-breaking Security Summit
partnership to combat identity theft tax fraud by recapping
2016 accomplishments and turning toward 2017 efforts.

Following the 2016 initiative and cooperative efforts, Summit
partners protected more taxpayers from tax-related identity
theft, stopped more suspicious tax returns and prevented
more fraudulent refunds from getting into criminals’ hands.
Because of the safeguards enacted by this partnership, fewer
people became victims of tax-related identity theft during the
2016 filing season.

“This unique collaboration between the private sector, the
states and the IRS has provided new defenses and protections
for taxpayers and the tax system,” said IRS Commissioner
John Koskinen. “We have made significant progress in this
effort over the last year, but much more work remains. The
Summit group will expand our efforts in the coming year, and
we will work hard to take new steps to combat the rapidly
evolving identity theft and refund fraud schemes.”

The public-private tax administration leaders met in
Washington on June 28 to review the 2016 successes and
finalize the 2017 efforts. The Security Summit first gathered
in 2015 as the IRS, state tax agencies and tax industry sought
to counter increasingly sophisticated criminal enterprises that
were amassing massive amounts of personal data stolen
elsewhere and using more elaborate schemes in an effort to
defeat efforts to identify fraudulent returns.

The Summit priorities remain focused on enhanced
authentication procedures, improved information sharing,
heightened cybersecurity and greater education and outreach
to the public.

A few of the 2016 Security Summit highlights include:

- New protocols required all individual tax software
customers to update their security credentials to a minimum
eight-digit password and establish security questions.

- Software providers shared approximately 20 data
  elements from tax returns with the IRS and states to help
  identify possible fraud. These elements are confidential but
  include information to identify returns prepared quickly by
  automated programs.

- Industry partners performed regular reviews to
  identify possible identity theft schemes and report them to the IRS
  and state partners to help stay on top of emerging schemes.

- Summit partners launched a “Taxes. Security. Together”
campaign to increase public awareness about the need for
  computer security and provide people with tips on how to
  protect their personal information.

Commissioner Koskinen noted these accomplishments had
real and substantial impact on curbing stolen identity refund
fraud:

- From January through April 2016, the IRS stopped $1.1
  billion in fraudulent refunds claimed by identity thieves on
more than 171,000 tax returns; compared to $754 million in fraudulent refunds claimed on 141,000 returns for the same period in 2015. Better data from returns and information about schemes meant better internal processing filters to identify identity theft tax returns.

• Thanks to leads reported from industry partners, the IRS suspended for further review 36,000 suspicious returns January through May 8, 2016, and $148 million in claimed refunds. This was twice the amount of the same period in 2015 of 15,000 returns claiming $98 million. Had industry not flagged these returns, these returns would have passed through IRS processing filters.

• Because of Summit efforts, the number of anticipated taxpayer victims fell between 2015 and 2016. Since January, the IRS Identity Theft Victim Assistance function experienced a marked drop of 48 percent in receipts, which includes Identity Theft Affidavits (Form 14039) filed by victims and other identity theft related correspondence.

• The number of refunds that banks and financial institutions returned to the IRS because they appear suspicious dropped by 66 percent. This is another indication that improved data led to better filters, which reduced the number of bad refunds being issued.

• The Rapid Response Team tackled emerging issues. This team, working together, was able to shut down one scheme in which a criminal stole client data from a tax preparer.

• Working together, Summit partners were able to warn the public – including the payroll industry, human resources and tax preparers – of emerging scams in which criminals either posed as company executives to steal employee Form W-2 information or instances where criminals used technology to gain remote control of preparers’ office computers.

The 2017 initiatives, like those before it, generally will be invisible to taxpayers. A few 2017 initiatives include:

• Expanding a W-2 Verification Code test to cover approximately 50 million forms in 2017. The selected forms contain a 16-digit code that taxpayers and tax preparers enter when prompted by software. The code helps validate not only the taxpayer’s identity but also the information on the form. This pilot is among the most visible Summit action for 2017.

• Identifying additional data elements from tax returns that will help improve authentication of the taxpayer and identify possible identity theft scams and sharing data elements from corporate tax returns.

• Launching the Identity Theft Tax Refund Fraud Information Sharing & Analysis Center (IDTTRF-ISAC) in 2017. This will serve as the early warning system for partners, collecting and analyzing tax-related identity theft schemes.

• Expanding the Security Summit’s “Taxes. Security. Together.” awareness campaign to tax return preparers to ensure they have the information they need to protect themselves from cyberattacks and to safeguard taxpayer data.

• Creating a process for financial institutions to identify questionable state tax refunds and return them to states for validation. Twenty-three states have signed on.

The partners also ensured that the Security Summit’s work will be ongoing. Effective July 1, the Summit will work under the auspices of the Electronic Tax Administration Advisory Council (ETAAC.) The ETAAC charter was changed to expand to identity theft.

Taxpayers Who Sold Condo After Having Second Child Qualify for Reduced Gain Exclusion

PLR 201628002

In a private letter ruling (PLR), IRS has determined that a married couple who had a daughter at the time they bought their 2-bedroom condo, then later had a son, qualified for the reduced maximum exclusion of gain from the sale of their home. IRS determined that that the that the suitability of the condo as their principal residence materially changed as a result of the occurrence of unforeseen circumstances and was the primary reason for the sale.

A taxpayer can exclude up to $250,000 of gain ($500,000 for married taxpayers filing jointly) from the sale or exchange of a home owned and used by him as a principal residence for at least two of the five years before the sale. (Code Sec. 121(a)) The full $250,000/$500,000 exclusion does not apply if, within the 2-year period ending on the sale date, there was another home sale by the taxpayer to which the exclusion applied (Code Sec. 121(b)(3)), but the taxpayer may still be eligible for a reduced maximum exclusion under Code Sec. 121(c) (essentially, a prorated exclusion) when his failure to satisfy Code Sec. 121(a)’s ownership and use requirements is primarily due to the occurrence of unforeseen circumstances.

Reg. § 1.121-3(b) provides that all the facts and circumstances of a sale will determine whether the primary reason for the sale is the occurrence of unforeseen circumstances. Factors that may be relevant in determining the primary reason for a sale include: (1) the suitability of the property as the taxpayer’s residence materially changes; (2) the circumstances giving rise to the sale are not reasonably foreseeable when the taxpayer begins using the property as the taxpayer’s principal residence; and (3) the circumstances giving rise to the sale occur during the period of the taxpayer’s ownership and use of the property as the taxpayer’s principal residence. (Reg. § 1.121-3(b)) There are also a number of safe harbors set out in the regs under which a taxpayer is deemed to have sold due to an unforeseen circumstance if a specified event, such as death, divorce, or multiple births from the same pregnancy,
occur during the period of his ownership and use of the residence as a principal residence. (Reg. § 1.121-3(e)(2))

Taxpayers were married and had a daughter when they purchased Residence 1 on Date 1. Residence 1 is a condominium with two small bedrooms and two baths. The child’s bedroom also served as the Husband’s home office as well as a guest room. After the purchase of Residence 1, the Wife became pregnant and gave birth to a son. On Date 2, Taxpayers moved out of Residence 1, and on Date 3, Taxpayers sold Residence 1.

They requested a ruling that the gain on the sale of Residence 1 may be excluded under the reduced maximum exclusion. Favorable ruling. The PLR concluded that the occurrence of unforeseen circumstances was the primary reason for the sale and that the suitability of Residence 1 as the Taxpayers’ principal residence materially changed. Accordingly, the gain on the sale of Residence 1 can be excluded under the reduced maximum exclusion of gain in Code Sec. 121(c).

In T.D. 9152, which provided final regs relating to the reduced maximum exclusion, IRS emphasized that a “ruling directed to a specific taxpayer does not establish a safe harbor of general applicability.” Thus, a taxpayer in circumstances similar to those described in this PLR should request a ruling from IRS on the issue of whether the sale of his residence would qualify as a sale due to unforeseen circumstances for purposes of the reduced exclusion.

**IRS Will Redact Social Security Numbers from Applications for Exempt Organization Status**

IRS has issued an internal memo that instructs its employees to redact social security numbers that organizations erroneously include in their applications for tax-exempt status.

Approved applications for tax-exempt status, which consist of the application filed by an organization, papers submitted in support of the application or notice, and any letters or documents issued by IRS regarding the application, are available to the public under Code Sec. 6104(a)(1)(A).

The only statutory exceptions to this rule are if the applicant requests that IRS withhold a trade secret, process, patent, style of work, or apparatus and IRS determines disclosure would adversely affect the organization or if IRS determines disclosure of information would adversely affect the national defense. (Code Sec. 6104(a)(1)(D)) IRS is not statutorily required to withhold any other information from public inspection on approved applications for tax-exempt status (and certain other determination letter requests) that are subject to public disclosure under Code Sec. 6104.

Although IRS cautions applicants not to include social security numbers with their exempt organization status applications, some applicants submit social security numbers as part of those applications.

IRS will redact social security numbers. IRS believes that social security numbers on these applications could result in abuse if made public. Because IRS is required to disclose approved application information, in order to protect the privacy of individuals affiliated with these organizations, IRS has announced, in a memo to its employees, that it will make reasonable efforts to redact social security numbers from determination letter requests that are closed on or after July 19, 2016. The announcement also provides specific procedures for IRS employees to follow to achieve the redactions and provides that the Internal Revenue Manual will be amended to reflect this new redaction policy and the procedures to achieve the goals of the policy.

**Tax Pros in Trouble**

**Oxnard-based Tax Preparer Found Guilty of Filing Fraudulent Tax Returns**

A jury has found an Oxnard-based tax preparer known as “El Profe” guilty of filing more than $53 million in fraudulent tax returns through a company he ran from a meat market and other locations, federal officials said.

According to U.S. Attorney Office officials, Rodrigo Pablo “Paul” Lozano, 61, ran a multimillion dollar scheme by applying for individual tax identification numbers, which are issued to undocumented workers who do not have Social Security numbers for filing taxes.

Lozano submitted more than 12,000 false tax returns during 18 months in 2011 and 2012, federal officials said. Lozano called the business Ayuda, or “help” in Spanish, and rented space in businesses that cater to Hispanic clients, including a meat market on Hueneme Road in Oxnard.

Lozano claimed about $53 million in taxes, but had collected more than $23 million in refunds before the Internal Revenue Service identified and stopped the scheme, according to the U.S. Attorney Office.

**Chicago Based Return Preparer Permanently Enjoined from Preparing Returns**

According to a civil complaint the United States filed in 2014, a Chicago-based tax return preparer prepared returns that falsely claimed that recipients of discrimination awards related to a class-action lawsuit could claim large deductions on their federal tax returns and that falsely inflated the amount of wages that city of Chicago employees claimed were withheld from their paychecks. Now a federal court has completely barred this tax return preparer from preparing tax returns for others.

Victor M. Crown promoted two false and fraudulent schemes through which he claimed that his customers could obtain significant federal income tax refunds, the complaint alleged.
In the first scheme, as set out in the complaint, Crown falsely inflated the amount of income tax that was withheld from his customers’ paychecks because the city of Chicago purportedly calculated an incorrect withholding amount. Taxpayers may not claim a withholding credit larger than the amount that was actually withheld from their wages. The second scheme is founded on the 1969 class-action lawsuit Shakman v. Democratic Organization of Cook County, et al., No. 69-cv-2145 (N.D. Ill.), according to the United States’ complaint.

Shakman was a discrimination case against the city of Chicago that alleged that the city improperly used political patronage when hiring and promoting public officials. As part of an agreed Shakman settlement order, the city set up a $12 million fund to compensate claimants for violations of the federal district court’s orders. Claims were submitted to the court-appointed monitor, who was responsible for evaluating the claims and, if justified, assigning a monetary award amount. According to the United States’ complaint against Crown, Crown asserted that his customers who were Shakman award recipients were entitled to claim net operating loss deductions for the difference between their claim and the amount they actually received in their award. The federal tax law does not permit a deduction in the amount of a denied discrimination claim.

In explaining its reasons for enjoining Crown, the court noted that the scope of Crown’s misconduct involved “at least 2,900 fraudulent tax returns,” as well as his “failure to accept responsibility and cease his operations.” The court’s injunction order forbids Crown from preparing tax returns for others and from making false statements about securing any tax benefit by virtue of receiving or not receiving an award in the Shakman litigation. It also requires Crown to give the United States a list of all his tax-preparation customers since 2010.

Federal Court Permanently Shuts Down South Florida Preparer

A federal court in Fort Lauderdale, Florida, has permanently barred a Broward County man from preparing federal tax returns for others, the Justice Department announced.

The United States filed a civil complaint against Eli St. Phard of Oakland Park, Florida, in April. The complaint alleged that he prepared income tax returns that fraudulently understated his customers’ tax liabilities by falsely claiming deductions for business expenses his customers never incurred; fraudulently overstating his customers’ claims for refunds by falsely claiming education or fuel tax credits to which his customers were not entitled; or both. According to the complaint, the Internal Revenue Service (IRS) audited 340 of the returns St. Phard prepared and found that St. Phard understated the tax owed on all but five of the 340 returns—a total of more than $1.8 million in understatements. As a result of St. Phard’s fraudulent activities, many of his customers are now liable for significant tax deficiencies, penalties and interest, the complaint alleged.

In addition to barring St. Phard from preparing federal tax returns, the court ordered St. Phard to give the United States a list of his customers. St. Phard consented to entry of the order by the U.S. District Court for the Southern District of Florida. St. Phard admitted, for purposes of this case, that he had engaged in conduct subject to penalty under the federal tax laws, but he did not admit to civil or criminal wrongdoing or to the specific allegations in the complaint.
Earlier this year, the DOJ issued a serious warning to the public about the looming threats of fraudulent tax return processors and tax scheme promoters.

While the agency noted that individuals must be held responsible for the contents of their own returns, Acting Assistant Attorney General Caroline D. Ciraolo still had some cautionary advice.

“Every year, thousands of federal income tax returns are prepared by people who care much more about making a quick buck than about preparing accurate returns,” Ciraolo explained, noting that, while most tax return preparers are honest, there are many out there looking to take advantage of taxpayers.

Roswell Tax Preparer Sentenced for Filing Fraudulent Returns

A Roswell tax preparer has been sentenced for fraudulently preparing tax returns for 28 individuals from 2011-14. Sylvia Franco, 46, received a suspended 18-year prison sentence with the stipulation that she pay $38,513.40 in restitution to her victims. She will serve 18 months in prison and must also serve five years of supervised probation. It was also ordered that Franco no longer prepare income tax returns.

Franco was sentenced in the Fifth Judicial District Court by Judge James M. Hudson. She was taken into custody immediately to begin serving her prison term.

Franco, of Roswell, owned and operated Sylvia Tax Service, where she prepared tax returns with fraudulent, inflated tax deductions. By fraudulently inflating tax deductions, Franco purportedly ensured her clients would receive larger refunds and cheated the State of New Mexico out of $120,493 in taxes owed.

Court Shuts Down Alabama Tax Preparer

According to a lawsuit the United States filed in April, a Birmingham, Alabama, tax return preparer continually and repeatedly prepared federal income tax returns that understated her clients’ liabilities or overstated their refunds. Now a federal court in Birmingham has permanently barred her from preparing tax returns for others and it has ordered her to give the United States a list of her customers since 2014.

Jessica Leverett aka Jessica Harris, owns and operates a number of different tax return preparation businesses in and around Birmingham, including Tax Money Now, Dynamic Tax Services, Dynamic Tax Solutions and Express Money Tax, the civil complaint alleged. Leverett’s businesses prepared returns that fabricate Schedule C businesses and business losses to offset their customers’ taxable income from other sources or to increase the customers’ Earned Income Tax Credit, according to the complaint. The complaint also alleged that Leverett's
businesses prepare returns that claim education credits that Leverett’s customers are not entitled to receive and that misreport self-employment income as household employee wages in order to avoid the self-employment tax.

The Internal Revenue Service (IRS) examined 264 returns prepared by Leverett’s businesses and found that 206 understated the customer’s tax due, the complaint alleges. Altogether, Leverett’s activities may have caused the United States to lose over $2.5 million in understated taxes and/or fraudulent refunds, according to the complaint. Leverett did not file a response challenging the government’s allegations.

Ragin Cagin

Keys to a Successful Tax Practice

There is great opportunity in the tax preparation industry. This is an unprecedented time to start and expand our practices. We need a plan and it is as simple as A-B-C.

A - Proper Training and Continuing Professional Education

The foundation of a successful tax practice rests in your skills as a tax advisor and preparer, and that starts with your training and education.

If you are already a practicing tax professional, ncpe, both the Corporate, Partnership and LLC seminar, conducted in the summer will give you the training and CE you need to expand your practice into these areas of preparation.

The ncpe fall update will get you ready for the bulk of your tax preparation business by updating you on the new tax law changes for individuals.

Ncpe’s “special seminars”, whether it is the What’s Happening in the World of Tax with the Fellowship or the Estate, Trust and Gift seminar meet your individual and specialized needs for education.

B - Staying Current in Tax

Six years ago ncpe commissioned the ncpeFellowship, a tax professional organization for tax professionals who were serious about the business of tax. Realizing that tax professionals need more than a seminar in the summer and in the fall, the ncpeFellowship keeps you up to date on industry changes and IRS announcements.

The Fellowship does not compete with any professional organization but enhances the offerings of your professional organization. All professional organizations that enhance your ability, your professional standing and your professionalism are of value.

C - Know What You Know and Know Where to Go for What You Don’t Know

Ncpe and the ncpeFellowship are your “go to” sources for information. Your ncpe books are your hands on tools and as a Fellowship member you can always reach out to the Fellowship, not to work your cases but to give you referenced guidance in the right direction.

My years in the business of tax tell me my tax practice is why I learned my ABC’s early and have never forgotten them.

I’ll be looking for you at a seminar soon and you can count on me to be ABC - Always Be Cagin.

Jerry

Taxpayer Advocacy

W-2s Corrected by IRS Audit Need Only be Filed by Regular Due Date

Chief Counsel Advice 201629008

In email Chief Counsel Advice, IRS has concluded that, where IRS determines on audit that an employer must file one or more Forms W-2c, Corrected Wage and Tax Statement, those forms are not due by the end of the audit but rather are due on their normal due date.

Code Sec. 6721 covers penalties for failure to timely file correct information returns, and Code Sec. 6722 covers penalties for failure to timely furnish correct payee statements. For returns and statements relating to calendar years after Dec. 18, 2015 (e.g., filed in 2017), the Protecting Americans from Tax Hikes (PATH) Act of 2015 provides that those returns and payee statements, and any corrections to those returns and payee statements, must be filed and furnished by Jan. 31 of the following year.

No penalty if filed and furnished by Jan. 31. In the email CCA, IRS concluded that it cannot assert the Code Sec. 6711/Code Sec. 6722 penalties against an employer for failure to file and furnish Forms W-2c, Corrected Wage and Tax Statement,
at the conclusion of an audit. However, IRS can asset the penalties if the employer fails to file and furnish the Forms W-2c by the due date.

Things we thought we knew:

“OUO” is a designation for Internal Revenue Manual materials used to protect information whose release would hinder the law enforcement process with respect to one or more categories of persons.

IRM 11.3.12.3 The Intent of Designation

(3) The identification of a small proportion of IRS printed materials as “Official Use Only” facilitates the ready release to the public of the majority of printed materials that are not designated.

IRM 11.3.12.4 Guidelines for Designation

(3) The overall objective is that the greatest amount of information be made available to the public whenever possible. Guidelines should not be applied in a manner that would produce a result contrary to this objective.

Okay Examples:

IRM 4.19.15.28.5 Examining the Schedule A on Preparer Referrals

1. ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡

2. ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡

3. The examiners are required to familiarize themselves with Schedule A (See IRM 4.19.15.23, Schedule A. This IRM section will provide information related to the allowable and unallowable deductions on the Schedule A.

4. The examiner will consider asserting penalties such as negligence or substantial underpayment as applicable, as in the normal course of any examination if warranted on a case by case basis. Refer to IRM 20.1, Penalty Handbook, for additional procedures. If any indication of fraud is discovered in either the substantiation submitted or in the return itself, this should be brought to the attention of the W&I RPP Coordinator/manager/W&I HQ analyst.

IRM 4.19.15.28.6 Examining the Schedule C on Preparer Referrals

1. ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡

Not So Okay Examples:

5.19.1.5.4 IAs
5.19.1.5.4.7 Pending IA Criteria
5.19.1.5.4.7.1 ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡ ≡

Whenever an IA request is received that does not meet pending IA criteria:

Note: The entire text reproduced but the subsection title is labeled OUO

5.19.1.5.4.7.2 Requests Meeting Pending IA Criteria
5.19.1.5.4.8 IA Managerial Approval
5.19.1.5.5 PPIA 4

Courts May Rule On Expiration of SOL Related to TEFRA Partnership Petitions

MK Hillside Partners, (CA 9 6/23/2016) 117 AFTR 2d ¶ 2016-802

The Court of Appeals for the Ninth Circuit, affirming the Tax Court, has held that pre-2018 Code Sec. 6226(d)(1)—which provides that, under prescribed circumstances, a court to which a partnership has made a petition for readjustment of partnership items can consider whether the statute of limitations (SOL) has expired with respect to a particular partner—also permits the court to determine whether that SOL has expired.

TEFRA partnership audit rules. Under the unified partnership audit procedures that generally apply to partnership tax years that begin before Jan. 1, 2018, IRS issues a Final Partnership Audit Adjustment (FPAA) notifying the partners of any adjustments to the partnership items, and the partners may seek judicial review of the FPAA. (Code Sec. 6223(a)(2), Code Sec. 6226(a), Code Sec. 6226(b)) Once the adjustments are final, IRS may make the resulting “computational adjustments” to the individual partners’ tax liability, usually without a deficiency proceeding, in which case the partners’ only opportunity for further challenge is by way of post-payment refund action. (Code Sec. 6230(a)(1), Code Sec. 6230(c), Code Sec. 6231(a)(6)) Partners are treated as parties to a petition for readjustment of the FPAA if they have an interest in the outcome. (Code Sec. 6226(c), Code Sec. 6226(d)) Such an interest exists if the items at issue remain partnership items for that partner (Code Sec. 6226(d)(1)(A)) and the period within which any tax attributable to the partnership may be assessed against that partner has not yet expired. (Code Sec. 6226(d)(1)(B)) However, even if a partner no longer has an interest in the outcome, it has a limited right specifically to “participate in such action...solely for the purpose of asserting that the period of limitations for assessing any tax attributable to partnership items has expired with respect to such person, and the court having jurisdiction of such action shall have jurisdiction to consider such assertion.” (Code Sec. 6226(d)(1)(B) (flush language))

Generally, an individual’s tax return remains open for three years after the return is filed. (Code Sec. 6501) For partnership items, the period for assessing tax expires no earlier than the later of three years after (1) the date the partnership return was filed, or (2) the last day for filing the partnership return.
If the taxpayer omits from gross income an amount properly includible in gross income that’s in excess of 25% of the amount of gross income stated in the return, IRS can assess the tax, or begin a court proceeding to collect the tax without assessment, at any time within six years after the return was filed, instead of the usual three years. (Code Sec. 6501(e)(1))

Judicial estoppel is an equitable doctrine that prevents a party in a judicial proceeding from asserting a position contrary to one that the party has successfully persuaded a court to accept in a prior proceeding. (Topsnik, (2014) 143 TC 240) For judicial estoppel to apply, first, a party’s later position must be “clearly inconsistent” with its earlier position. Second, that party must have succeeded in persuading a court to accept that party’s earlier position, so that judicial acceptance of an inconsistent position in a later proceeding would create “the perception that either the first or the second court was misled.” And, the party seeking to assert an inconsistent position would derive an unfair advantage or impose an unfair detriment on the opposing party if not estopped. (New Hampshire v. Maine, (S Ct 2001) 532 U.S. 742)

Marcus Katz earned $198,000 in ‘99 income from terminating stock options. Also in ‘99, MK Hillside, a partnership owned by Katz and his wholly-owned corporation, sold real estate at a gain. Katz’s return did not list the $198,000 gain, and MK Hillside’s return reported no gain on the real estate sale. In July of 2006, Katz agreed to extend the time to assess his ‘99 tax liability, including tax attributable to partnership items, until Jan. 31, 2008. IRS issued an FPAA to MK Hillside on Jan. 2, 2008, finding that MK Hillside was a sham, lacked economic substance, and was formed and used principally to avoid taxes.

Katz filed a petition in the Tax Court contesting that finding and asserting the statute of limitations. IRS responded that the Code Sec. 6501(e)(1) 6-year statute of limitations applied because Katz’s omission of the $198,000 on his ‘99 return constituted more than 25% of the gross income reported on the return. Katz moved for summary judgment, arguing that he no longer had an interest in the partnership proceeding under Code Sec. 6226(d)(1), and, in the alternative, that the Tax Court lacked jurisdiction to consider at the partnership stage whether, due to a gross understatement of nonpartnership income, his ‘99 tax year remained open at the time he agreed to extend his assessment period.

The Tax Court held that the period for assessing tax on the ‘99 MK Hillside partnership items was open as to Katz.

Circuit Court affirms—SOL period remained open. On appeal, Katz contended that the “to consider” language in the flush language in Code Sec. 6226(d) cannot mean “to determine.” IRS contended that “to consider” an assertion that the statute of limitations has run necessarily requires either accepting or rejecting the assertion. The Circuit Court agreed with IRS.

Katz made several arguments, each of which the Court rejected. First, he looked to the American Heritage Dictionary definition of “consider” which he cited as to “think carefully about,” to “think or deem to be; regard as,” to “take into account; bear in mind.” But, the Court said, those definitions, listed first, second, and fourth, respectively, in the Dictionary, do not fit the context of the statute nearly as well as the third definition, which Katz neglected to mention: to “form an opinion about; judge.” It said that it was unlikely that Congress enacted Code Sec. 6226(d)(1) to enable a partner to raise an argument pertaining to timeliness about which the Tax Court may only ruminate.

Katz then drew an analogy to Code Sec. 6214(b) and Code Sec. 6214(c), both of which discuss considering facts for the purpose of redetermining a deficiency for one period without making a determination as to another period. Code Sec. 6214(b) provides: “The Tax Court in redetermining a deficiency of income tax for any tax year or of gift tax for any calendar year or calendar quarter shall consider such facts with relation to the taxes for other years or calendar quarters as may be necessary correctly to redetermine the amount of such deficiency, but in so doing shall have no jurisdiction to determine whether or not the tax for any other year or calendar quarter has been overpaid or underpaid.” Code Sec. 6214(c) includes the same idea.

The Court said that, while these sections limit the use of the “considered” information, they do not support Katz’s argument. First, the considered Code Sec. 6214 information is actually used. Second, Code Sec. 6214 expressly limits the Tax Court’s jurisdiction, while Code Sec. 6226(d) does not.

Finally, Katz argued that, because of a purportedly contrary position IRS took in oral argument in Curr-Spec Partners, L.P., (CA 5 2009) 104 AFTR 2d 2009-5894, IRS was judicially estopped from arguing that omission of a nonpartnership item can extend the time to assess tax on partnership items.

The Court here disagreed. Whether or not IRS counsel’s answer to a question at oral argument in Curr-Spec was inconsistent with IRS’s position here, the statutory construction the Tax Court adopted in this case was consistent with the decision in Curr-Spec, which held that “the Tax Court does not overreach its jurisdiction in partnership-level proceedings when, for limitations purposes, it considers whether a partner’s individual tax return remains open to assessment.” Curr-Spec is thus not in conflict with the IRS’s position or the Tax Court’s holding here that “in a partnership-level proceeding we may consider the partner’s period of limitations for the narrow purpose of determining whether the partnership-level action may proceed.”

Thus, the Circuit Court said, because the Tax Court had jurisdiction to consider Katz’s argument regarding the statute of limitations, it necessarily had jurisdiction to reject it, at least for the purposes of the partnership proceeding.
Foreign Taxes

Audit Instructions Cover Foreign Housing Cost Exclusion, Including for Partial Years

LB&I International Practice Service Process Unit – Audit JTO/9431.06_16 (2016)

In an International Practice Unit (IPU), IRS’s Large Business and International (LB&I) division has provided guidance to its auditors who examine taxpayers who take the foreign housing cost exclusion, including examples involving taxpayers who only qualify for the exclusion for only part of their tax year.

U.S. citizens and resident aliens are taxed on their worldwide income. However, U.S. citizens or residents who work and live abroad may qualify to exclude some or all of the amounts paid for their foreign housing costs. The foreign housing exclusion applies only to amounts that are considered paid for with employer-provided amounts for services performed in a foreign country. (Reg. § 1.911-4(d)(1))

There is also a deduction for foreign housing costs that are not paid for with employer-provided amounts. (Code Sec. 911(c)(4)) However, the deduction is not covered by the IPU.

The housing cost amount (which is the amount of housing expenses that can be excluded from gross income) equals the amount by which the housing expenses, up to the limit described below, exceed the base housing amount. (Code Sec. 911(c)(1)) The limit on housing expenses is 30% (subject to adjustment as described below) of the maximum foreign earned income exclusion (FEIE; $80,000 adjusted for inflation), computed on a daily basis for the calendar year in which the tax year begins (Code Sec. 911(c)(2)(A)(i)), multiplied by the number of qualifying days in the tax year. (Code Sec. 911(c)(2)(A)(ii)) The base housing cost amount is 16% (computed on a daily basis) of the maximum FEIE for the calendar year in which the tax year begins (Code Sec. 911(c)(1)(B)(ii)), multiplied by the number of qualifying days in the tax year. (Code Sec. 911(c)(1)(B)(iii)) (For 2014, the maximum FEIE is $99,200 (indexed annually for inflation) per taxpayer). Furthermore, excludable housing expenses include only reasonable expenses that were actually incurred for housing in a foreign country. (Code Sec. 911(c)(3)(A))

Thus, reasonable foreign housing expenses in excess of the base housing amount may be excluded from gross income, but the amount of the exclusion is limited to 30% of the maximum amount of a taxpayer’s FEIE minus the base housing cost amount of 16% of the maximum FEIE.

IPU sets out framework for auditors and contains clarifications and examples of rules. The IPU sets out the following 3-step framework for auditors:

1. (Step 1) Determine if the individual is a qualified individual.
2. (Step 2) Determine if the individual’s housing expenses are excludable under Code Sec. 911.
3. (Step 3) Determine if the individual’s housing exclusion was properly computed.

It then clarifies, and contains examples of the application of, various housing exclusion rules.

...No double dipping. Citing Rev Rul 79-199, 1979-1 CB 246, the IPU says that a taxpayer may not get a double benefit by taking a credit that may be available under a treaty attributable to amounts excluded from gross income under Code Sec. 911.

Citing Rev Rul 90-77, 1990-2 CB 183, the IPU says that once a qualified individual elects to exclude foreign earned income (either the FEIE or employer-provided housing costs), that individual cannot take a foreign tax credit or deduction for taxes on the excluded income. If an individual does take a credit or deduction for foreign taxes on the excluded income, the individual's prior Code Sec. 911 exclusion is considered revoked.

...Definition of “foreign.” Not all overseas locations are “foreign countries” for purposes of the housing exclusion. For example, Antarctica, U.S. possessions and territories, and certain other locations (such as international airspace or waters) are not foreign countries.

...Form to use. Individuals wishing to claim the foreign housing exclusion must complete the appropriate parts of Form 2555 (Foreign Earned Income); Form 2555-EZ (Foreign Earned Income Exclusion) cannot be used to claim the foreign housing exclusion.

...Where the taxpayer only qualifies for part of the year. As indicated under “Background” above, if an individual is not considered a qualified individual under Code Sec. 911 for an entire tax year, then the housing limit and base amount must be prorated based on the number of days that the individual in question was a qualified individual for that particular tax year.
The IPU contains several examples, including the following:

Illustration: In 2014, Individual Y incurred $40,000 of qualified housing expenses under Code Sec. 911. Y qualified as a bona fide resident who had lived and worked in a foreign country since the early ‘80s. He retired in September of 2014, and left the foreign country permanently on Oct. 2, 2014 and was not there for the entire year. For 2014, the housing limit was 30% of the maximum FEIE allowable ($99,200 in 2014) or $29,760, (or $81.53 per day) unless an individual’s foreign tax home had a different housing limit as detailed on the table in the Instructions for Form 2555. Y’s location was not listed in the table.

Allowable housing expenses are limited to the lesser of qualified housing expenses ($40,000) or the housing limit (in Y’s case, $81.53 per day for 275 days, or $22,421). Next, the base amount of $15,872 (or $43.48 per day for 2014), which is 16% of the maximum FEIE allowable ($99,200 for 2014), is subtracted from the allowable housing expenses amount of $22,421. Y’s foreign housing exclusion amount is $10,464.

State News of Note

Tennessee To Become Income-Tax-Free State No. 8

You retire to an income-tax-free state and you don’t expect to pay any income tax. So imagine the surprise a former California couple in their 60s got when they went to a tax preparer in Tennessee for help with their 2015 federal tax return, and she gave them the news that they owed $1,200 in taxes to Tennessee on their capital gains, interest and dividend income, thanks to the 6% state “Hall Tax.”

“A lot of seniors come to Tennessee, and they get a surprise: We have a tax on people who have done things correctly by saving for retirement,” says Friday Burke, an enrolled agent in Brentwood, Tenn. The retired California couple had $125,000 in overall taxable income, including $28,000 in interest, dividends and capital gains, $20,000 of which was subject to the Hall Tax. “That’s $1,200 they hadn’t budgeted,” says Burke.

The good news she was able to deliver to the couple is that the Hall Tax is on its way out. It was one of a trifecta of taxes that kept Tennessee on the list of states unfriendly to business owners and retirees. The state’s gift tax was repealed effective Jan. 1, 2012. The state’s estate tax was repealed effective Jan. 1, 2016. And now the Hall Tax is repealed—as of Jan. 1, 2022. In the meantime, the tax rate was cut from 6% to 5% retroactive to Jan. 1, 2016, and the legislature is meant to decrease the rate one percentage point a year, assuming the state meets certain revenue targets.

“That puts them squarely in Hall Tax territory. Who’s exempt? If you’re 65 or older and have total income from all sources of $37,000 or less ($68,000 or less for joint filers), you’re completely exempt from the tax. Separately, there’s a $1,250 exemption per person, so a couple over the income threshold owes Hall Tax only if taxable interest and dividend income exceeds $2,500. Tennessee Department of Revenue Guidance lists more exclusions, such as interest or dividends from credit unions, dividends from stock in Tennessee chartered state banks.

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receives the premium tax credit for coverage purchased through the Marketplace. If this type of assessable payment is triggered, the annual amount of the payment is $2,000 (adjusted annually; $2,160 for 2016) multiplied by the total number of all the employer’s full-time employees (excluding the first 30).

- Code Sec. 4980H(b) may apply if the employer does offer minimum essential health coverage that is affordable and provides minimum value to at least 95% of its full-time employees, but one or more full-time employees purchases coverage through the Marketplace and receives the premium tax credit. If this type of assessable payment is triggered, the annual amount of the payment is $3,000 (adjusted annually; $3,240 for 2016) multiplied by the total number of the employer’s full-time employees who receive the premium tax credit. An overall limit applies under which the aggregate amount of tax for all employees of an ALE for any month cannot exceed the product of (a) the applicable payment amount under Code Sec. 4980H(a); and (b) the number of individuals employed by the ALE during any month (reduced by reduced by 30).

An employer is subject to Code Sec. 4980H because it employed an average of 50 or more full-time employees in the preceding calendar year. The employer adopts a new policy restricting part-time and seasonal employees from working more than 29 hours of service in any week. However, some of the employer’s part-time and seasonal employees work more than 29 hours of service in a week. Some of these employees are covered by Medicare or another source of coverage.

IRS answers. In the Information Letter, IRS reasoned that the amount of the employer’s potential liability under Code Sec. 4980H(a) is based on the number of employees who average 30 or more hours of service per week in a given month. Accordingly, an employee who works an average of 30 or more hours of service per week during any given month could potentially trigger (or increase the amount of) employer liability for an assessable payment under Code Sec. 4980H(b). An employee who is covered by Medicare is ineligible to receive the premium tax credit, and so generally would not lead to any employer liability under Code Sec. 4980H(b). However, IRS noted that, as indicated above, a full-time employee who is eligible for Medicare could potentially trigger or increase the amount of an employer’s liability for an assessable payment under Code Sec. 4980H(a).
Letters to the Editor

It has been a quiet month, but the “airing of IRS dirty laundry” coming in will be summarized and the letter to the IRS Commissioner with a copy to the House Ways and Means will be posted shortly.

Thank you to all who contributed with their thoughts and ideas for improvement. We are all in this together and as the end user of IRS products we need to tell them what’s work and what’s not.

Tax Jokes and Quotes

On a cool afternoon I decided to take a walk in my neighborhood. I saw a golden lab staked to a sign that said, “Talking Dog for Sale.”

Curious about this talking dog, I walked over and said, I suppose you are the talking dog, halfway thinking someone is really laughing at this.

Much to my surprise the dog said, Yes, I talk, was born this way.

The dog explained that he had been born with this unusual gift and when the government found out about it they used him to listen in on all types of conversations where no one would suspect he could repeat what was said.

He traveled all over the world for the government - State Department - Foreign Service, FBI, and he last worked for the IRS listening in on taxpayer admission that they had committed tax fraud, being very successful testifying as to what he heard and helping the Department of Justice put the taxpayers in jail, recovering millions of dollars for the U. S. Treasury.

I was so impressed I walked to the door of the house, knocked and asked if the dog was really for sale and how much did they want for him.

The owner said $10.

Are you kidding me! With all his incredible experience and knowledge, and that he talks, you would sell him for $10?

You bet I would said the owner - he’s never been out of this yard and he is such a liar!

Submitted as edited, by Irwin Rozen - a member with great humor!

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