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STANDARD FEDERAL TAX REPORTS Taxes on Parade

INSIDE THIS ISSUE

Lawmakers Begin Revising House GOP Tax Reform Bill

Tax Cuts and Jobs Act, HR 1

At press time, the House GOP's Tax Cuts and Jobs Act (HR 1) is being marked up and revised by the Ways and Means Committee. As the mark-up continues, more revisions to the bill are likely to be made. At the same time, Senate Republicans continue to work on their tax reform bill.

- ***Take Away.*** With release of the Tax Cuts and Jobs Act, taxpayers and tax professionals have more clarity about the effective dates of many proposed changes, Melissa Labant, CPA, Director, Tax Policy and Advocacy, AICPA, told Wolters Kluwer. The bill, as introduced, provides for prospective effective dates, after 2017, with some exceptions, Labant noted. "We are early in the legislative process and there could be changes," Labant added.
- ***Comment.*** "As expected, the bill moves away from our current worldwide tax system to a territorial approach where most foreign earnings would be exempt from U.S. tax. This is accomplished by a 100-percent dividends received deduction," Cory Perry, Senior Manager, International Tax, Washington National Tax Office, Grant Thornton LLP, told Wolters Kluwer.

Individuals

Tax rates. In place of the current seven individual rates, there would be four rates: 12, 25, 35, and 39.6 percent. The top rate would apply to married couples filing jointly earning more than $1 million and to single individuals/heads of households earning more than $500,000.

State and local taxes. The deduction for state and local income taxes would be repealed after 2017. Similarly, taxpayers would no longer be able to elect to deduct state and local sales taxes in lieu of state and local income taxes. Property taxes up to $10,000 could be deducted.

- ***Comment.*** "The state tax deduction is a method that tries to adjust for the different cost of livings in the different states." Fred Slater, CPA, MS 1040 LLC, New York, told Wolters Kluwer. It is not great but it helps. The bill takes that away and allows a maximum of $10,000 of real estate taxes," Slater said.

AMT/Estate tax. The House GOP bill would repeal the alternative minimum tax (AMT). The federal estate tax would be repealed after 2023. In the meantime, the exemption amount would double.

Mortgage interest. Under current law, individuals who itemize can deduct interest payments on up to $1 million in acquisition indebtedness. The $1 million limitation would be reduced to $500,000 for debt incurred after November 2, 2017. Interest would be deductible only on a taxpayer's principal residence.

Education. The House GOP bill would consolidate the American Opportunity Tax Credit, the Hope Credit and the Lifetime Learning credit into one incentive. The student loan interest deduction, tuition and fees deduction, and other education incentives would be repealed.

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GOP Bill

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Credits and deductions. The standard deduction would nearly double. The deduction for personal exemptions and the personal exemption phase-out would be repealed. The child tax credit would increase to $1,600. The earned income tax credit (EITC) would be preserved. The adoption credit would be repealed. The deduction for casualty losses generally would be repealed except for personal casualty losses associated with disaster relief legislation. The deduction for contributions to charity would be preserved with some adjustments. The deduction for unreimbursed employee expenses would be repealed.

Medical expenses. Under current law, taxpayers who itemize may deduct qualified medical expenses subject to a floor. The House GOP bill would repeal the medical expense deduction.

Housing exclusion. Under the House GOP bill, taxpayers would be able to use the exclusion of gain from sale of a principal residence only once every five years, among other changes.

Businesses

Corporate tax rate. The current maximum corporate tax rate is 35 percent. The House GOP bill would reduce the corporate tax rate to 20 percent beginning in 2018. The 20 percent rate would be permanent.

Passthroughs. The House GOP bill proposes a 25 percent tax rate for pass-through income after 2017. Generally, 30 percent of income could be categorized as business income, taxable at 25 percent, except for certain service providers. The House GOP bill includes an alternative formula based on facts and circumstances.

Credits and deductions. The research and development credit would be retained under the House GOP bill. However, a host of business tax preferences would be repealed after 2017. They include the Work Opportunity Tax Credit (WOTC), Indian employment credit, Code Sec. 199 deduction, and more. The New Markets Tax Credit would be eliminated.

- ***Comment.*** "As expected, the proposed legislation retains the research credit. Keeping a strong research and development tax incentive is an important part of tax reform as other countries aggressively seek R&D investment from U.S. companies by offering both lower corporate tax rates and more generous research and development incentives," Joe Stoddard, CPA, Partner, Eide Bailly LLP, National Tax Office, told Wolters Kluwer.
- ***Comment.*** "The legislation would impact certain pharmaceutical companies involved in developing drugs for rare diseases and conditions by the elimination of the 'orphan drug' credit. Under the proposal, most of the costs that were previously eligible for the more lucrative orphan drug credit would now be eligible for the research and development credit," Stoddard said.

Expensing. Businesses would be able to immediately expense qualified property placed in service after September 27, 2017 and before January 1, 2023 (certain longer production period property would have an additional year). Property would be eligible for the additional depreciation if it is the taxpayer's first use.

Small business expensing. Additionally, Code Sec. 179 expensing would be temporarily enhanced. The expensing limitation would increase to $5 million and the phase-out amount to $20 million. The enhancements would be temporary.

Business interest. New rules would limit the deduction for business interest. Generally, the interest deduction would be limited to 30 percent of a business' earnings (before interest, tax, depreciation, and amortization). However, businesses with average gross receipts of $25 million or less would be exempt from the interest limitation.

Net operating losses. Net operating losses (NOL) would be limited. A taxpayer would be able to deduct an NOL carryover or carryback only to the extent of 90 percent of the taxpayer's taxable income (determined without regard to the NOL deduction). The bill would create a special one-year carryback for casualty losses suffered by small businesses and farms.

Compensation/Carried interest

Compensation. The House GOP bill would tax nonqualified deferred compensation once there is no longer a substantial risk of forfeiture. A new excise tax would apply to compensation above $1 million for executives at tax-exempt organizations.

Carried interest. An amendment offered by the GOP would impose a three-year holding requirement for qualification as long-term capital gain with respect to certain partnership interests received in connection with the performance of services.

International

Under the House GOP bill, a portion of deferred overseas-held earnings and profits (E&P) of subsidiaries would be taxed at a reduced rate of 12 percent (five percent for illiquid holdings). Foreign tax credit carryforwards would be fully available, and foreign tax credits triggered by the deemed repatriation would be partially available, to offset the U.S. tax. The House GOP bill includes a number of other international tax changes, such as modification to the subpart F rules.

- ***Comment.*** "The bill contains a provision that would amount to a global minimum tax by subjecting a portion of certain foreign income that is deemed to earn a high return to U.S. tax. The provision is intended to prevent certain common base erosion tactics by taxing foreign high returns, often associated with intangibles, in the U.S.," Perry added.

REFERENCE KEY

FED references are to ***Standard Federal Tax Reporter***
USTC references are to ***U.S. Tax Cases***
Dec references are to ***Tax Court Reports***
TRC references are to ***Tax Research Consultant***

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IRS Describes Requirements For Qualified Small Employer HRAs

Notice 2017-67

The IRS has issued guidance, in Q&A format, on qualified small employer health reimbursement arrangements (QSEHRAs). The guidance describes who may participate, dollar limits, and more. In response to a recent Executive Order, the IRS predicted more guidance will be issued on QSEHRAs.

- ***Take Away.*** "To meet the definition of eligible employer, the employer cannot offer a group health plan to any of its employees," Stephanie Moscetti, Fox Rothschild LLP, Minneapolis, told Wolters Kluwer. "A group health plan includes a health reimbursement arrangement (HRA), health flexible spending arrangement (FSA), vision plan, dental plan or presumably an employee assistance program that provides medical care such as mental health counseling."
- ***Comment.*** In October, President Trump issued Executive Order (EO) 13813, directing the Treasury Department, and the Departments of Health and Human Services (HHS) and Labor (DOL), to consider proposing regulations or revising guidance to increase the usability of HRAs and to expand employers' ability to offer HRAs to their employees The EO also instructs the departments to consider allowing HRAs to be used in conjunction with non-group coverage. The IRS explained that Notice 2017-67 addresses the objectives of the EO. More guidance is also expected, the IRS added.

Background

Small employers have traditionally use health reimbursement arrangements (HRAs) to help employees with the costs of health insurance premiums and other qualified medical expenses. After passage of the *Affordable Care Act* (ACA), questions arose about the impact of the ACA's market reforms on HRAs. The *21st Century Cures Act,* passed in 2016, created QSEHRAs. Only qualified small employers, generally employers with less than 50 employees, may offer QSEHRAs. Additionally, a QSEHRA must be funded solely by the employer; no salary reduction contributions may be made.

Employees

Notice 2017-67 describes which employees may not participate in a QSEHRA. These include employees who have not completed 90 days of service with the employer, employees who have not attained age 25 before the beginning of the plan year, part-time or seasonal employees, and employees covered by a collective bargaining agreement.

An eligible employee may not waive participation in a QSEHRA. The statute "requires that the eligible employer provide, rather than offer, a QSEHRA on the same terms to all eligible employees," the IRS explained.

Minimum essential coverage

An employee may receive reimbursements from a QSEHRA only if he or she has minimum essential health coverage. Otherwise, the reimbursements would be included in the employee's gross income. The employee must show that he or she has minimum essential coverage, for example, an insurance card or an explanation of benefits, the IRS explained. A QSEHRA may not reimburse medical expenses incurred before the employee is provided the arrangement.

- ***Comment.*** "An employee can use the funds made available under a QSEHRA to obtain health insurance through the ACA Marketplace. However, the employee will not be eligible for the premium tax credit if the QSEHRA constitutes 'affordable' coverage as defined in the Code," Moscetti explained.

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2016 E-Filing Closes November 18; IRS Turns To Next Filing Season

Individuals who have not yet filed their 2016 federal tax return will be able to e-file only through November 18, 2017. The IRS will only accept paper-filed returns after that date, the IRS has announced. At the same time, the IRS reminds certain taxpayers living in a federal-declared disaster area who were on a six-month extension that would have ended on October 15, have until January 31, 2018 to file their 2016 federal tax return. These taxpayers include hurricane and tropical storm victims in Georgia, Florida, Puerto Rico, the U.S. Virgin Islands and parts of Texas, Louisiana and South Carolina, as well as wildfire victims in parts of California.

2018 filing season. The IRS has also announced that it has not yet decided on the date it will begin accepting individual tax returns for the 2018 tax filing season. It has denied any credence to rumors that filing season would begin on January 22, 2018, or after the Martin Luther King, Jr Day holiday.

- ***Comment.*** The IRS also must wait for any legislation that may impact 2017 tax year returns. These include a number of "extender" tax provisions that expired at the end of 2016 that could be renewed by Congress for tax year 2017; as well as proposed provisions in current tax reform legislation impacting 2017, including, for example, a limitation on the interest deductions for mortgage indebtedness incurred after November 2, 2017, and full expensing on assets acquired and placed in service after September 27, 2017.

ITIN reminder. The IRS also is reminding taxpayers with Individual Taxpayer Identification Numbers (ITINs) to file a renewal application in time to have a renewed ITIN for the upcoming tax season and to avoid refund and processing delays.

IR-2017-183, IRS Statement on 2018 Filing Season Start Date (November 3, 2017), IR-2017-184; TRC FILEIND: 15,204.25.

LB&I Nearly Doubles Number Of Compliance Campaigns

www.irs.gov

Eleven more compliance campaigns have been launched by the IRS Large Business and International Business (LB&I) Division. LB&I now has identified a total of 24 compliance campaigns. LB&I added that more compliance campaigns are expected to be announced in the future.

- ***Take Away.*** "The concept (of compliance campaigns) is not that radical of a development. It is trying to marshal our resources around a specific issue," John Hinding, Director, Cross Border Activities, LB&I, told tax professionals in Washington, D.C. on October 27.

Background

Previously, LB&I announced that it is moving toward issue-based examinations and a compliance campaign process. LB&I explained that some compliance issues require a response in the form of one or multiple treatment streams. In January, LB&I identified 13 initial compliance campaigns.

The first 13 compliance campaigns were:

- Code Sec. 48C Energy Credit Campaign;
- OVDP Declines-Withdrawals Campaign;
- Domestic Production Activities Deduction, Multi-Channel Video Program Distributors (MVPD's) and TV Broadcasters;
- Micro-Captive Insurance Campaign;
- Related Party Transactions Campaign;
- Deferred Variable Annuity Reserves and Life Insurance Reserves IIR Campaign;
- Basket Transactions Campaign;
- Land Developers - Completed Contract Method (CCM) Campaign;
- TEFRA Linkage Plan Strategy Campaign;
- S Corporation Losses Claimed in Excess of Basis Campaign;
- Repatriation Campaign;
- Form 1120-F Non-Filer Campaign; and
- Inbound Distributor Campaign.

New compliance campaign

Now, LB&I has rolled out 11 new compliance campaigns. The 11 new compliance campaigns are:

- Form 1120-F Chapter 3 and Chapter 4 Withholding Campaign;
- Swiss Bank Program Campaign;
- Foreign Earned Income Exclusion Campaign;
- Verification of Form 1042-S Credit Claimed on Form 1040NR;
- Agricultural Chemicals Security Credit Campaign;
- Deferral of Cancellation of Indebtedness Income Campaign;
- Energy Efficient Commercial Building Property Campaign;
- Corporate Direct (Section 901) Foreign Tax Credit;
- Section 956 Avoidance;
- Economic Development Incentives Campaign; and
- Individual Foreign Tax Credit (Form 1116).

COD income. During 2009 and 2010, taxpayers who incurred cancellation of indebtedness (COD) income from the reacquisition of debt instruments at an issue price less than the adjusted issue price of the original instrument may have elected to defer the COD income. Taxpayers must report the COD income ratably over five years beginning in 2014 and running through 2018. This campaign will check if taxpayers that deferred COD income in 2009/2010 properly reported it in subsequent years, LB&I explained.

Agricultural credit. The agricultural chemicals security credit provides a nonrefundable 30 percent credit for costs to safeguard agricultural chemicals. This compliance campaign will check that only qualified expenses by eligible taxpayers are considered and that taxpayers are properly defining facilities when computing the credit, LB&I explained. The treatment stream for this campaign is issue-based examinations, LB&I added.

Swiss Bank Program. The Swiss Bank Program campaign relates to an initiative launched by the U.S. Department of Justice (DOJ) in 2013. More than 70 Swiss banks have entered into nonprosecution agreements with DOJ. These banks provide information on certain U.S. accountholders. The compliance campaign will address noncompliance, involving taxpayers who are or may be beneficial owners of these accounts, through a variety of treatment streams including, but not limited to, examinations, LB&I explained.

Foreign tax credit. Another new compliance campaign will look at the computation of the foreign tax credit limitation on Form 1116, Foreign Tax Credit (Individual, Estate, or Trust). Noncompliance will be addressed through a variety of treatment streams including examinations, LB&I explained. More compliance campaigns related to the foreign tax credit are likely, LB&I added. Future foreign tax credit compliance campaigns may address indirect credits and Code Sec. 904(a) limitation issues.

- ***Comment.*** The IRS noted that some campaigns may make use of so-called "soft letters." A soft letter may ask a taxpayer to clarify an issue, Holly Paz, Director, Pass-Through Entities, LB&I, said on October 27.

Reference: TRC IRS 15,100.

QSEHRA

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Dollar amounts

QSEHRAs are subject to dollar limits, adjusted for inflation. For 2017 the dollar limits are $4,950 for self-only coverage and $10,050 for family coverage. These amounts increase to $5,050 for self-only coverage and $10,250 for family coverage for 2018. If an arrangement assumes statutory dollar limits in excess of the actual indexed dollar limits for the applicable year, the arrangement will fail to be a QSEHRA, the IRS explained. If a QSEHRA permits carryover amounts, an employee's total permitted benefit, taking into account both carryover amounts and newly available amounts, may not exceed the applicable statutory dollar limit, the IRS added.

Notice

The *Cures Act* imposes a written notice requirement. The law included a transition rule. Notice 2017-67 describes when employers must provide initial written notice in 2018. Notice generally may be made electronically.

References: FED ¶46,415; TRC HEALTH: 18,110.

Basis For Passthough Losses Not Created By Indirect Ownership Of S Corp's Debt

Messina, TC Memo. 2017-213

The Tax Court has rejected pass-through losses claimed by two individual S corporation shareholders based on their argument that a loan taken by a QSub should be deemed their indebtedness for purposes of increasing their stock basis. The court sided with the IRS, finding that the corporate existence of the wholly owned S corporation that the individuals formed to own the Qsub's loan, should be respected and the step-transaction doctrine did not apply.

- ***Take Away.*** The step transaction doctrine, which is typically used by the IRS, was unsuccessfully used here by two S corporation shareholders in an attempt to take down the self-imposed walls created by them in arranging a series of transactions in a certain way. In this case, the individuals were "bound by the form of their transaction," according to the court.

Background

The taxpayers owned 80 percent of an S corporation (S Corp #1), which in turn owned a QSub (a qualified Subchapter S subsidiary). QSub was the borrower of record of a loan. The taxpayers then organized another S corporation (S Corp #2) to acquire the loan and eventually make repayment.

The taxpayers argued that their S Corp #2 should be disregarded and that the loan should therefore be deemed to be indebtedness of S Corp #1 to the taxpayers. That treatment would allow the taxpayers to count their adjusted basis in the loan in calculating the amounts of S Corp #1's flow-through losses they could deduct for the tax year. The IRS argued that S Corp #2's separate corporate existence should be respected and that the loan should not be treated as indebtedness of S Corp #1 to the taxpayers.

Court's analysis

The Tax Court agreed with the IRS; the taxpayers were not entitled to deduct passthrough losses from their S corporation (S Corp #1) because they lacked sufficient basis in their S Corp. #1 stock. The taxpayers' stock basis was not increased by the loan made to their S corporation's QSub.

The lending entity did not rise to the level of being their incorporated pocketbook. Nor did it function as their agent or conduit. Although owned by the taxpayers, the entity operated in its own name and for its own account. In addition, there was no evidence that the shareholders were bound by the lending entity's actions; nor was the entity under any legal or contractual obligation to turn over to them the income generated by the loan.

The step transaction doctrine did not cause the lender to be disregarded in the shareholder's transactional arrangement. The shareholders made economic outlays to the lender, which in turn made an actual economic outlay to the S corporation; there were no separate "steps" to consolidate, according to the court. The loan's acquisition corresponded to its substance and was respected for federal tax purposes as it was arranged. As a result, the shareholders did not carry their burden of establishing that their basis was increased by the loan.

References: Dec. 61,057(M); TRC SCORP: 404.

Assistance Payments, Pension Overpayment Excluded From Income

LTR 201743010, 201743011

Payments made to assist individuals living with developmental and/or intellectual challenges qualify for the general income exclusion, the IRS has determined. In another ruling, the IRS determined that an individual had qualified for a waiver of collection of a pension overpayment. As a result, the individual did not have to include the overpayment amount in income.

- ***Take Away.*** The general welfare exclusion has encompassed many types of payments. These include debt forgiveness for public safety officers killed in the line of duty; amounts paid in connection with job training for the economically disadvantaged; and payments made under government grant for retraining individuals for better job skills.

Assistance payments

A state agency makes payments to individuals with developmental and/or intellectual challenges. Funding comes from the state's legislature. The goal of the program, the IRS explained, is to support individuals so that they can avoid institutional placement and continue living in their own or their families' homes.

Payments are made directly to recipients. Payments may be used for transportation, respite care, medical or dental expenses, and more. The state agency considers applicants on a first-come, first-served basis. Generally, individuals seek assistance after exhausting other types of governmental help. There is no expectation that recipients or family members perform services in exchange for the payments.

Some payments from government programs are excluded from income. Generally, these payments are not included in income under the general welfare exclusion. To qualify under the general welfare exclusion, payments must be made from a governmental fund, be for the promotion of general welfare, and not represent compensation for services.

- ***Comment.*** The general welfare exclusion applies if the grant is received under a program requiring the individual recipient to establish need. Grants received under social welfare

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Business Owner Liable For Trust Fund Taxes Despite Lock-Box Arrangement

Karban, CA-6

An individual, as a responsible person for the payment of employment taxes, remained liable for trust fund recovery penalty while a lender took control of certain aspects of his business's finances. The appellate court affirmed that, despite a "lock-box" arrangement, the taxpayer had sufficient influence and control over the company's financial affairs, including disbursing funds and paying creditors.

- ***Take Away.*** Arranging for a lock-box system to pay employment taxes does not always relieve the underlying owner from liability to the IRS for nonpayment of those taxes. In this case, circumstances showed that the business owner remained in sufficient control of the day-to-day operations of the business to the extent that he knew about the unpaid employment taxes and that his demands to pay the IRS first probably would have been followed. The court even implied that sometimes a lock-box contract may need to be broken and the business owner has the obligation to do so.

Background

Taxpayer was loaned funds to finance the purchase of a business under terms that allowed the lender to take "lock-box" control of the company's financial activities if certain triggering events occurred. One of those events occurred, and the lender exercised its lock-box authority and its approval authority over all payments that taxpayer wished to make. The business then went bankrupt and trust-fund taxes that were withheld from the business's employees remained unpaid.

The IRS determined that the taxpayer was responsible for those unpaid trust-fund taxes and assessed a penalty against him under Code Sec. 6672. The taxpayer sued for a refund of the penalty and counterclaimed for the balance of the assessment made against him for the unpaid trust-fund taxes. The taxpayer lost in district court and claimed, on appeal to the Sixth Circuit, that the district court erred in its determination that he was both the responsible party and willful in the nonpayment of taxes.

Court's analysis

Code Sec. 6672(a) imposes personal liability on unpaid trust-fund taxes on "[a]ny person required to collect, truthfully account for, or pay over any tax imposed by this title who willfully fails" to do so. The appellate court found that the taxpayer fit that profile.

Although the taxpayer did not deny that he was the "responsible person" before his company fell under the supervision of the lender, he argued that he did not continue in that role following the event, which by the terms of a contract required him to relinquish financial control of his company to the lender, as well as implement lock-box supervision. The court determined that his argument failed for two reasons. First, the taxpayer had voluntarily entered into the loan agreement, ceding to the lender whatever authority the lender claimed. And second, the taxpayer's failure to pay the tax was sufficiently willful.

Willfulness is established when a responsible person "had knowledge of the tax delinquency and knowingly failed to rectify it when there were available funds to pay the government," according to the court. The taxpayer had testified that, while the business was under lock-box supervision, he knew that the tax bill was due. He also routinely set priorities for accounts payable, sent the lender a list of bills to be paid, and the lender routinely would approve the list.

- ***Comment.*** Citing *Bell, 355 F.3d 387, (CA-6, 2004),* which held for the IRS, the court pointed out that the taxpayer here was aware that the taxes were not being paid and he had continued to have the authority to sign and issue checks for the company. "*Bell* could have shut down the company, suspended operations, filed for bankruptcy … or simply violated his contract with [the bank that had the lockbox arrangement] …[the taxpayer] could have done the same," reasoned the court.

References: 2017-2 USTC ¶50,395; TRC PENALTY: 3,150.

Exclusions

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programs that do not require recipients to establish individual need do not qualify under the general welfare exclusion, the IRS explained in Rev. Proc. 2014-35.

Here, the IRS determined that the payments qualified for the general welfare exclusion. As a result, the payments would be excluded from recipients' gross income. Further, the state agency would not need to file information returns reporting the payments.

Pension overpayment

An individual made after-tax contributions to his employer's pension plan. The individual left her job and began receiving pension payments. Sometime later, the individual learned that her pension would be reduced because of systematic errors made in the past. These errors had resulted in overpayments to the individual. The individual qualified for a waiver of collection of the overpayment and would receive Form 1099-C, Cancellation of Debt.

The IRS determined that generally the individual would be obligated to repay the overpayment. However, collection of the overpayment had been waived. Therefore, the discharge of indebtedness would not be gross income because the individual had accounted for all pension payments as she received the payments.

Reference: TRC INDIV: 33,250.

IRS Eases Plan Loan/Hardship Rules For Hurricane Maria And California Wildfire Victims

Ann. 2017-15

Victims of recent disasters may be eligible for streamlined procedures to obtain retirement plan loans and hardship distributions, the IRS has announced. This latest round of relief is targeted to victims of Hurricane Maria and the wildfires in California.

- ***Take Away.*** Employers that sponsor retirement plans for their employees may provide relief to employees, along with some family members, who live or work in the disaster area designated for individual assistance by the Federal Emergency Management Agency (FEMA).
- ***Comment.*** The IRS provided similar relief for victims of Hurricane Irma (Ann. 2017-13) and Hurricane Harvey (Ann. 2017-11).

Relief

In Ann. 2017-15, the IRS explained that a plan will not treated as failing to satisfy any statutory requirement or reg merely because the plan makes a loan, or a hardship distribution for a need arising from Hurricane Maria or the California Wildfires. The individual's principal residence must be in the disaster area and between certain dates. An individual outside of the disaster area may take a loan or hardship distribution from his or her retirement plan and use it to help a son, daughter, parent, grandparent, or other dependent who lived or worked in the disaster area. To make a loan or hardship distribution under Ann. 2017-15, a plan that does not provide for them must be amended no later than the end of the first plan year beginning after December 31, 2017.

- ***Comment.*** Comment. Although participants in IRAs are barred from taking out loans, qualified individuals may be eligible to receive hardship distributions under Ann. 2017-15.

Reliance

Plan administrators, the IRS explained, may rely upon representations from the employee or former employee as to the need for and amount of a hardship distribution. However, a plan administrator with actual knowledge must rely on that knowledge.

Ann. 2017-15 also provides relief from certain documentation requirements. However, as soon as practicable, the plan administrator must make a reasonable attempt to assemble any forgone documentation.

References: FED ¶46,413; TRC FILEIND: 15,204.25.

TAX BRIEFS

Internal Revenue Service

The IRS has announced that it will not acquiescence to the holding in a federal district court case in which the court held that a married couple was entitled to a refund because the IRS incorrectly recharacterized their nonpassive income as passive. The IRS noted that the taxpayer was not a "5-percent owner" of the company because his right to receive the 10-percent "percentage salary," as it was referred to pursuant to the terms of the employment agreements, lacked the indicia of an "entrepreneurial stake" that was the impetus of the 5-percent owner requirement for purposes of Code Sec. 469. Further, the taxpayer provided nothing more than his "time and labor" that is, his work as an employee at the company in exchange for the percentage salary. Moreover, the employment agreements also did not contain any provisions requiring the taxpayer to receive consideration for relinquishing the 10-percent ownership interest, and the taxpayer received no consideration. *See also Issue No. 42 of this newsletter.*

AOD-2017-7, FED ¶46,416; TRC REAL: 12,500

FinCEN

The Financial Crimes Enforcement Network (FinCEN) has issued a final rule prohibiting U.S. financial institutions from opening or maintaining a correspondent account for, or on behalf of, Bank of Dandong, a Chinese bank that facilitates North Korean financial activity.

FinCEN Final Rule RIN-1506-AB38, FED ¶47,025; TRC FILEBUS: 9,324

International

The penalty imposed on an individual who willfully failed to file a Report of Foreign Bank and Financial Accounts (FBAR) was proper. The $1.2 million penalty did not violate the Eighth Amendment's Excessive Fines Clause because it was not grossly disproportionate to the harm she caused. *See, Issue No. 44 of this newsletter.*

Bussell, CA-9, 2017-2 USTC ¶50,384; TRC IRS: 21,256

Jurisdiction

A federal appeals court refused to consider arguments a married couple did not raise in their administrative or Tax Court proceedings. They failed to show why it would be a miscarriage of justice not to address their claims or why they could not have raised the arguments before the Tax Court.

Chapman, CA-11, 2017-2 USTC ¶50,385; TRC IRS: 51,056.05

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Tax Briefs

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Tax Crimes

An individual was properly convicted and sentenced to 51 months imprisonment for tax evasion. The district court properly calculated the tax loss. In addition, the district court properly imposed a sophisticated means enhancement.

Stegman, CA-10, 2017-2 USTC ¶50,394; TRC IRS: 66,052

Litigation Costs

The Tax Court properly denied an individual's for reasonable litigation costs. The individual failed to establish that she met the net worth requirement.

Angle, CA-9, 2017-2 USTC ¶50,383; TRC LITIG: 3,154.20

False Tax Returns

An individual's conviction for filing false tax returns to obtain more than $600,000 in refunds was reversed and remanded. Statements by the judge, in the jury's presence, conveyed that the individual was guilty or dishonest and impaired his ability to represent himself.

El-Bey, CA-7, 2017-2 USTC ¶50,386; TRC IRS: 66,052

Liens and Levies

A federal district court properly decided that the government was entitled to foreclose federal tax liens on property held by the couple's nominee. The court correctly analyzed the uncontested facts to determine that the bewildering array of unincorporated business trust organizations used by the couple were simply nominees and alter ego entities designed to frustrate a lawful tax levy.

Bogart, CA-3, 2017-2 USTC ¶50,396; TRC IRS: 45,160.05

The IRS was entitled to foreclose the tax liens on the condominium in which a tax debtor lived. The individual's ownership interest in the condominium was subject to the tax lien.

Nassar, CA-2, 2017-2 USTC ¶50,393; TRC IRS: 45,054

Refund Claims

A tax debtor was not entitled to recover fees and costs he incurred getting his refunds back from the IRS. The individual failed to exhaust his administrative remedies. Therefore, the court lacked the authority to consider his claim.

In re Barcelos, BC-DC Calif., 2017-2 USTC ¶50,387; TRC LITIG: 3,154

Collection Due Process

An IRS settlement officer (SO) did not abuse her discretion in sustaining a proposed collection action. She failed to demonstrate that she was not liable for the penalty and made frivolous arguments at her CDP hearing.

Fujita, CA-9, 2017-2 USTC ¶50,392; TRC IRS: 51,056.15

An IRS settlement officer (SO) did not abuse her discretion by sustaining a lien to collect an individual's unpaid tax liability. Contrary to the individual's argument, the IRS properly mailed a deficiency notice to him. Moreover, he failed to properly raise the issue of his underlying tax liability during his initial and supplemental CDP hearings.

Alamo, TC, CCH Dec. 61,059(M), FED ¶48,173(M); TRC IRS: 51,056.25

Filing Status

A taxpayer who had mistakenly claimed "head of household" status in her Form 1040 was allowed to change it to "married filing jointly." The individual was married during the tax year and did not qualify for head of household or single filing status.

Godsey, TC, CCH Dec. 61,058(M), FED ¶48,172(M); TRC FILEIND: 18,056.05

Deficiencies and Penalties

A petition for review was filed in the following case:

An individual, whose lender took control of his business's finances, was liable for the trust fund recovery penalty. He had influence and control over the company's financial affairs, including disbursing funds and paying creditors. Moreover, since he paid other creditors knowing that the tax bill was unpaid his conduct was willful.

Karban, Jr., CA-6, 2017-2 USTC ¶50,395

Bankruptcy

Married debtors were not entitled to discharge their substantial tax liability in bankruptcy. They failed to pay their taxes for more than a decade while realizing more than $13 million in income and living a luxurious lifestyle. Therefore, they willfully attempted to evade or defeat a tax.

In re Feshbach, BC-DC Fla., 2017-2 USTC ¶50,389; TRC IRS: 57,150

No Passthrough Of UBTI Losses To IRA Owner

Affirming the Tax Court, the Court of Appeals for the Ninth Circuit has found that a taxpayer cannot deduct unrelated business taxable income (UBTI) losses sustained by two partnerships held in an IRA from his personal taxable income.

Background. The taxpayer had a traditional IRA and used it to buy and sale shares of two master limited partnerships (MLPs). The taxpayer reported losses from the two MLPs in excess of $88,000 on his 2009 income tax return. The IRS disallowed the losses.

The Tax Court found that an IRA is not a passthrough entity. Distributions from and payments out of an IRA can trigger income tax consequences for the payee or distributee. In 2009, the taxpayer had received distributions totaling more than $40,000 that he properly reported on his return. The taxpayer could not use losses realized within the IRA during that year to offset his income, the Tax Court held. The taxpayer appealed to the Ninth Circuit.

Court's analysis. The Ninth Circuit first found that while IRAs are generally tax-exempt, they are subject to taxes on UBTI of organizations in which they invest. UBTI losses may be carried forward or backward to deduct against gains within an IRA. However, UBTI losses do not pass through to an IRA beneficiary's personal tax return, the appellate court concluded.

Fish, CA-9; 2017-2 USTC ¶50,391; TRC EXEMPT: 15,050.