2010 Regional Forums - Individual Developments

New Laws

Tax Changes for Individuals in the "Worker, Homeownership, and Business Assistance Act of 2009"

On Nov. 6, President Obama signed H.R. 3548, the "Worker, Homeownership, and Business Assistance Act of 2009" (the Act) into law (P.L. 111-92). The signing came just one day after the House passed it and two days after the Senate did.

Homebuyer Credit Extended and Liberalized

New law. The Act extends the FTHTC and liberalizes it by making it available to (1) higher-income taxpayers and (2) to existing homeowners who are qualifying “long-time residents” and who buy another principal residence. However, for the first time there will be a dollar cap on residences qualifying for the FTHTC.

FTHTC extended. Under the Act, the FTHTC is extended to apply to a principal residence purchased by the taxpayer before May 1, 2010. (Code Sec. 36(h), as amended by Act Sec. 11(a)) The FTHTC also applies to the purchase of a principal residence before July 1, 2010 by any taxpayer who enters into a written binding contract before May 1, 2010, to close on the purchase of a principal residence before July 1, 2010. (Code Sec. 36(h), as amended by Act Sec. 11(a)(1)(C))

FTHTC available to higher income taxpayers. For purchases after Nov. 6, 2009 (the enactment date), the FTHTC phases out for individual taxpayers with modified adjusted gross income (AGI) between $125,000 and $145,000 ($225,000 and $245,000 for joint filers) for the year of purchase. (Code Sec. 36(b)(2)(A)(i)(II), as amended by Act Sec. 11(c)(2))

FTHTC available for existing homeowners who are “long-time residents.” For purchases after Nov. 6, 2009, any individual (and, if married, the individual's spouse) who has maintained the same principal residence for any 5-consecutive year period during the 8-year period ending on the date of the purchase of a subsequent principal residence is treated for FTHTC purposes as a first-time homebuyer of that subsequent principal residence. The maximum allowable credit for such taxpayers is the lesser of: (1) $6,500 ($3,250 for a married individual filing separately); or (2) 10% of the purchase price of the subsequent principal residence. (Code Sec. 36(c)(6) and Code Sec. 36(b)(1)(D), as amended by Act Secs. 11(b) and 11(c))

> RIA observation: There's no requirement for the existing principal residence to be sold in order to qualify for a FTHTC on the replacement principal residence. Thus, the replacement residence can be purchased to beat the new deadlines under the Act (see above) before the old home is sold. For that matter, the prior principal residence can be retained in the hope of achieving a better selling price later on.

New limitation on home price for FTHTC. For purchases after Nov. 6, 2009, the FTHTC cannot be claimed for buying a residence if its purchase price exceeds $800,000. (Code Sec. 36(b)(3), as amended by Act Sec. 11(d))

The Act includes the following “housekeeping” changes to conform the general FTHTC rules to the above changes:

> ... A taxpayer may elect to treat a qualifying home purchase after 2008 as made on December 31 of the calendar year preceding the purchase for purposes of claiming the credit on the prior year's tax return. (Code Sec. 36(g), as amended by Act Sec. 11(a)(3))

New Anti-Abuse Provisions for Homebuyer Credit

The Act makes the following changes to help prevent abuse of the FTHTC.

... For purchases after Nov. 6, 2009, the FTHTC can't be claimed unless the taxpayer has attained 18 years of age as of the date of purchase. A taxpayer who is married is treated as meeting the age requirement if the taxpayer or his spouse meets the age requirement. (Code Sec. 36(b)(4), as amended by Act Sec. 12(a))

... For purchases after Nov. 6, 2009, the FTHTC can't be claimed by a taxpayer if he can be claimed as a dependent by another taxpayer for the tax year of purchase. (Code Sec. 36(d)(3), as amended by Act Sec. 11(g))

... For returns for tax years ending after Nov. 6, 2009, the FTHTC is not allowed unless the taxpayer attaches to the relevant tax return a properly executed copy of the settlement statement used to complete the purchase. (Code Sec. 36(d)(4), as amended by Act Sec. 12(b))

... For purchases after Nov. 6, 2009, the definition of a qualifying purchase for FTHTC purposes is amended to exclude property acquired from a person related to the person acquiring the property or the spouse of the person acquiring the property, if married. (Code Sec. 36(c)(3)(A)(i), as amended by Act Sec. 12(c))

New law extending homebuyer credit closing date and IRS guidance on it **IR 2010-80**

On July 2, 2010, President Obama signed into law H.R. 5623, the "Homebuyer Assistance Improvement Act of 2010" (the Act), which provides first-time homebuyer credit relief to taxpayers who couldn't meet a key June 30, 2010 closing date. The Senate passed the Act on June 30, 2010, by unanimous consent, and the House of Representatives passed it on June 29 by a vote of 409-5. On the same day that it was signed into law, IRS issued a reminder that special filing and documentation requirements apply in claiming the homebuyer credit, including the information that must be provided by those taxpayers eligible to take advantage of the new law relief.

New law. The Act provides that if a written binding contract to purchase a principal residence was entered into before May 1, 2010, to close on the purchase of a principal residence before July 1, 2010, the credit may be claimed if the purchase is closed before Oct. 1, 2010. (Code Sec. 36(h)(2), as amended by Act Sec. 2(a)) Thus, this extension allows homebuyers who signed a contract no later than the April 30th deadline, intending to close before July 1, 2010, to complete their closing by the end of September and still qualify for the credit. Conforming amendments are made for purposes of the longer periods for those service members on qualified official extended duty service outside of the U.S. (Code Sec. 36(h)(3)(B))

A taxpayer who entered into a binding contract before May 1, 2010 to buy a home before July 1, 2010, and purchases the home after Apr. 30, 2010, and before Oct. 1, 2010, must also attach pages from a signed contract showing all parties' names and signatures, the property address, the purchase price, and the date of the contract.

A taxpayer claiming the credit as a long-term resident of the same main home must attach copies of one of the following: Form 1098, Mortgage Interest Statement (or substitute statement), property tax records, or homeowner's insurance records. These records should be for 5 consecutive years of the 8-year period ending on the purchase date of the new principal residence.

Options for claiming the credit. IR 2010-80 also reminds taxpayers that there are three options for claiming the credit on a qualifying 2010 purchase:

... If a 2009 return hasn't yet been filed, a taxpayer can claim the credit on Form 1040 for the 2009 tax year. Though such a return cannot be filed electronically, taxpayers can still use IRS Free File to prepare their return. The returns must be printed out and sent to IRS, along with all required documentation. (Taxpayers can use direct deposit for their refunds.)

... If a 2009 return has already been filed, a taxpayer can claim the credit on an amended return using Form 1040X.

... Whether or not a 2009 return has been filed, a taxpayer can wait until next year and claim the credit on a 2010 Form 1040.

Haiti earthquake relief donations before March 2010 may be deducted on 2009 returns

IR 2010-12 ; P.L. 111-126, An Act to Accelerate the Income Tax Benefits for Charitable Cash Contributions for the Relief of Victims of the Earthquake in Haiti

On Jan. 22, 2010, President Obama signed into law H.R. 4462 (the Act, P.L. 111-126), which allows taxpayers to claim a charitable contribution deduction in tax year 2009 for donations made after Jan. 11, 2010 and before Mar. 1, 2010, for the relief of victims in areas affected by the Jan. 12, 2010 earthquake in Haiti. This option is available only if the contribution is in cash and otherwise meets the requirements for charitable contribution deductions under Code Sec. 170.

HIRE Act with hiring incentives and foreign compliance rules awaits President's signature

The Hiring Incentives to Restore Employment Act (HIRE Act, P.L. 111-147) was signed into law by the President on Mar. 18, 2010, one day after it passed Congress. A summary of the various HIRE Act provisions follows.

The HIRE Act:

- Exempts employers from paying the employer share of Social Security employment taxes on wages paid in 2010 to newly hired qualified unemployed workers. These are workers who: (1) begin employment with the employer after February 3, 2010 and before January 1, 2011, (2) were previously unemployed and (3) do not replace other employees of the employer. The payroll tax relief applies only for wages paid with respect to employment beginning on the day after the enactment date (the date the HIRE Act is signed into law by the President) and before 2011.
- Provides employers with an up-to-$1,000 tax credit for retaining qualified unemployed workers. The workers must be employed by the employer for a period of not less than 52 consecutive weeks, and their wages for such employment during the last 26 weeks of the period must equal at least 80% of the wages for the first 26 weeks of the period.
- For tax years beginning in 2010, boosts to $250,000 the maximum amount that can be expensed under Code Sec. 179, and boosts to $800,000 the beginning of the investment based phaseout amount.
- Allows issuers of certain tax credit bonds to elect to receive a direct payment instead of a tax credit to the bondholder.
- Enacts a comprehensive set of measures to reduce offshore noncompliance, including reporting by individuals on their tax returns of offshore accounts and other foreign financial assets with values of $50,000 or more.
- Delays the application of worldwide allocation of interest for an additional three years.
- Tinkers with estimated tax payments of large corporations in future tax years.

Summary of key provisions in ground-breaking health reform law

The President's signature on H.R. 4872, the Health Care and Education Reconciliation Act of 2010 (Reconciliation Act, P.L. 111-152, 3/30/2010) completes a massive overhaul of the U.S. health care system affecting nearly all taxpayers, many employers, and many elements of the health care industry.

The Reconciliation Act modifies legislation signed into law on March 23 that contains the bulk of the health reform law, H.R. 3590, the Patient Protection and Affordable Care Act (Health Care Act, P.L. 111-148). However, the Reconciliation Act also includes new provisions that weren't part of the earlier legislation, such as

codification of economic substance, elimination of a tax credit for "black liquor" and expanded dependent coverage in employer health plans.

Tax Changes Relating to Universal Health Coverage Mandate

Penalty for remaining uninsured. For tax years ending after Dec. 31, 2013, non-exempt U.S. citizens and legal residents will have to maintain minimum essential coverage or pay a penalty.

Those failing to maintain minimum essential coverage in 2016 will be subject to a penalty equal to the greater of: (1) 2.5% of household income over the threshold amount of income required for income tax return filing, or (2) $695 per uninsured adult in the household. The fee for an uninsured individual under age 18 will be one-half of the fee for an adult. The total household penalty won't exceed 300% of the per adult penalty ($2,085), nor exceed the national average annual premium for the "bronze level" health plan offered through the Insurance Exchange that year for the household size.

Low-income tax credits for participating in health exchanges. For tax years ending after 2013, tax credits will be available for individuals and families with incomes up to 400% of the federal poverty level ($43,320 for an individual or $88,200 for a family of four) that are not eligible for Medicaid, employer sponsored insurance, or other acceptable coverage. These individuals and families will have to obtain health care coverage in newly established Insurance Exchanges in order to obtain credits. (New Code Sec. 36B, Health Care Act Sec. 1401, 1411 and 1412, as amended by Health Care Act Secs. 10104, 10105, and 1017, and as further amended by Reconciliation Act Sec. 1001) A "cost-sharing subsidy" will be provided to low income individuals to help with health insurance costs. (Health Care Act Secs. 1402, 1411, and 1412, as amended by Health Care Act Sec. 10104, and further amended by Reconciliation Act Sec. 1001)

Employer responsibilities. For months beginning after Dec. 31, 2013, an "applicable large employer" (generally, one that employed an average of at least 50 full-time employees during the preceding calendar year) not offering coverage for all its full-time employees, offering minimum essential coverage that is unaffordable, or offering minimum essential coverage that consists of a plan under which the plan's share of the total allowed cost of benefits is less than 60%, will have to pay a penalty if any full-time employee is certified to the employer as having purchased health insurance through a state exchange with respect to which a tax credit or cost-sharing reduction is allowed or paid to the employee. The penalty for any month will be an excise tax equal to the number of full-time employees over a 30-employee threshold during the applicable month (regardless of how many employees are receiving a premium tax credit or cost-sharing reduction) multiplied by one-twelfth of $2,000 (indexed for inflation after 2014).

Tax credits for small employers offering health coverage. For tax years beginning after Dec. 31, 2009, an eligible small employer will be given a tax credit for nonelective contributions to purchase health insurance for its employees. An eligible small employer generally is an employer with no more than 25 full-time equivalent employees (FTEs) employed during the employer's tax year, and whose employees have annual full-time equivalent wages that average no more than $50,000. However, the full amount of the credit is available only to an employer with 10 or fewer FTEs and whose employees have average annual full-time equivalent wages from the employer of not more than $25,000. These wage limits will be indexed to the Consumer Price Index for Urban Consumers ("CPI-U") for years beginning in 2014.

For tax years beginning in 2010 through 2013, the credit will be 35% (25% in the case of certain tax-exempts) for small employers with fewer than 25 employees and average annual wages of less than $50,000 who offer health insurance coverage to their employees. In 2014 and later, eligible small employers who purchase coverage through the Insurance Exchange will be eligible for a tax credit for two years of up to 50% (35% in the case of certain tax-exempts) of their contribution. (Code Sec. 45R, as added by Health Care Act Sec. 1421, as amended by Health Care Act Sec. 10105)

Dependent coverage in employer health plans. Effective on Mar. 30, 2010, the general exclusion for reimbursements for medical care expenses under an employer-provided accident or health plan is extended to any child of an employee who has not attained age 27 as of the end of the tax year. The Committee Report says this change is also intended to apply to the exclusion for employer-provided coverage under an accident or health plan for injuries or sickness for such a child. Also, self-employed individuals may take a deduction for any child of the taxpayer who has not attained age 27 as of the end of the tax year. (Code Sec. 105, Code Sec. 162, Code Sec. 401, and Code Sec. 501, as amended by Reconciliation Act Sec. 1004(b))

Health-Related Revenue Raisers

Excise tax on high-cost employer-sponsored health coverage. For tax years beginning after Dec. 31, 2017, a 40% nondeductible excise tax will be levied on insurance companies and plan administrators for any health coverage plan to the extent that the annual premium exceeds $10,200 for single coverage and $27,500 for family coverage. An additional threshold amount of $1,650 for single coverage and $3,450 for family coverage will apply for retired individuals age 55 and older and for plans that cover employees engaged in high risk professions.

Cost of employer sponsored health coverage included on Form W-2. For tax years beginning after Dec. 31, 2010, employers must disclose the value of the benefit provided by them for each employee's health insurance coverage on the employee's annual Form W-2. (Code Sec. 6051(a)(14), as amended by Health Care Act Sec. 9002)

Other new employer reporting responsibilities for health coverage. For periods beginning after 2013, insurers (including employers who self-insure) that provide minimum essential coverage to any individual during a calendar year must report the following to both the covered individual and to IRS: (1) name, address, and taxpayer identification number (TIN) of the primary insured, and name and TIN of each other individual obtaining coverage under the policy; (2) the dates during which the individual was covered under the policy during the calendar year; (3) whether the coverage is a qualified health plan offered through an exchange; (4) the amount of any premium tax credit or cost-sharing reduction received by the individual with respect to such coverage; and (5) such other information as IRS may require. To the extent coverage is through an employer-provided group health plan, the insurer also must report the name, address and employer identification number of the employer, the portion of the premium, if any, required to be paid by the employer, and any other information IRS may require to administer the new tax credit for eligible small employers (see discussion above). (Code Sec. 6056, as added by, and Code Sec. 6724, as amended by, Health Care Act Sec. 1514)

Additional Hospital Insurance Tax (HI) for high wage workers. For tax years beginning after Dec. 31, 2012, the HI tax rate is increased by 0.9 percentage points on an individual taxpayer earning over $200,000 ($250,000 for married couples filing jointly); these figures are not indexed. (Code Sec. 1401 and Code Sec. 3101, as amended by Health Care Act Sec. 9015, as amended by Health Care Act Sec. 10906)

Surtax on unearned income. For tax years beginning after Dec. 31, 2012, a 3.8% surtax (called the Unearned Income Medicare Contribution) will apply to net investment income of higher income taxpayers. The surtax for individuals is 3.8% of the lesser of (1) net investment income or (2) the excess of modified adjusted gross income (AGI) over the threshold amount. The threshold amount is $250,000 for a joint return or surviving spouse, $125,000 for a married individual filing a separate return, and $200,000 in any other case. Modified AGI is AGI increased by the amount excluded from income as foreign earned income under Code Sec. 911(a)(1) (net of the deductions and exclusions disallowed with respect to the foreign earned income).

Net investment income for surtax purposes is interest, dividends, royalties, rents, gross income from a trade or business involving passive activities, and net gain from disposition of property (other than property held in a

trade or business). Investment income is reduced by properly allocable deductions to such income to arrive at net investment income. (Code Sec. 1411, as added by Reconciliation Act Sec. 1402)

New limit on health FSA contributions. For tax years beginning after Dec. 31, 2012, the amount of contributions to health flexible spending accounts (FSAs) under cafeteria plans will be limited to $2,500 per year. The dollar amount will be inflation indexed after 2013. (Code Sec. 125, as amended by Health Care Act Sec. 9005, as amended by Health Care Act Sec. 10902, and as further amended by Reconciliation Act Sec. 1403)

Restricted definition of medical expenses for employer-provided coverage. For purposes of employer-provided health coverage (including health reimbursement accounts (HRAs) and health flexible savings accounts (FSAs), health savings accounts (HSAs), and Archer medical savings accounts (MSAs)), the definition of medicine expenses deductible as a medical expense is generally conformed to the definition for purposes of the itemized deduction for medical expenses. But this change does not apply to doctor prescribed over-the-counter medicine. Thus, the cost of over-the-counter medicine (other than insulin or doctor prescribed medicine) cannot be reimbursed through a health FSA or HRA. In addition, the cost of over-the-counter medicines (other than insulin or doctor prescribed medicine) cannot be reimbursed on a tax-free basis through an HSA or Archer MSA. These changes for HSAs and Archer MSAs apply for amounts paid out with respect to tax years beginning after Dec. 31, 2010. The changes for health FSAs and HRAs apply for reimbursement of expenses incurred with respect to tax years beginning after Dec. 31, 2010. (Code Sec. 106(f), Code Sec. 220(d)(2), and Code Sec. 223(d)(3), as amended by Health Care Act Sec. 9003)

Increased tax on nonqualifying HSA or Archer MSA distributions. For tax years beginning after Dec. 31, 2010, the additional tax for HSA withdrawals before age 65 that are used for purposes other than qualified medical expenses is increased from 10% to 20%, and the additional tax for Archer MSA withdrawals that are used for purposes other than qualified medical expenses is increased from 15% to 20%. (Code Sec. 220(f)(4)(A) and Code Sec. 223(f)(4)(A), as amended by Health Care Act Sec. 9004)

Modified threshold for claiming medical expense deductions. For tax years beginning after Dec. 31, 2012, the adjusted gross income (AGI) threshold for claiming the itemized deduction for medical expenses will be increased from 7.5% to 10%. However, the 7.5%-of-AGI threshold will continue to apply through 2016 to individuals age 65 and older (and their spouses). (Code Sec. 56(b)(1)(B), Code Sec. 213(a), and Code Sec. 213(f), as amended by Health Care Act Sec. 9004)

Non-Health Related Revenue Raisers

Corporate information reporting. For payments made after Dec. 31, 2011, businesses that pay any amount greater than $600 during the year to corporate providers of property and services will have to file an information report with each provider and with IRS. (Code Sec. 6041(h), as amended by Health Care Act Sec. 9006)

Codification of economic substance doctrine and imposition of penalties. The economic substance doctrine is a judicial doctrine that has been used by the courts to deny tax benefits when the transaction generating these tax benefits lacks economic substance. The courts have not applied the economic substance doctrine uniformly. For transactions entered into after Mar. 30, 2010 and for underpayments, understatements, and refunds and credits attributable to transactions entered into after Mar. 30, 2010, the manner in which the economic substance doctrine should be applied by the courts is clarified and a penalty is imposed on understatements attributable to a transaction lacking economic substance. (Code Sec. 6662, Code Sec. 6662A, Code Sec. 6664, Code Sec. 6676, and Code Sec. 7701, as amended by Reconciliation Act Sec. 1409)

Other Tax Changes

Simple cafeteria plans for small businesses. For years beginning after 2010, a new employee benefit cafeteria plan known as a Simple Cafeteria Plan will be available. This plan will be subject to eased participation restrictions so that small businesses could provide tax-free benefits to their employees; it will include

self-employed individuals as qualified employees. (Code Sec. 125(j), as amended by Health Care Act Sec. 9022)

Liberalized adoption credit and adoption assistance rules. For tax years beginning after Dec. 31, 2009, the adoption tax credit will be increased by $1,000, and made refundable. The adoption assistance exclusion also will be increased by $1,000. Both credit and exclusion are extended through 2011. (Code Sec. 36C and Code Sec. 137, as amended by Health Care Act Sec. 10909)

New exclusion for certain health professionals. Payments made under any State loan repayment or loan forgiveness program that is intended to provide for the increased availability of health care services in underserved or health professional shortage areas are excluded from gross income, effective for amounts received by an individual in tax years beginning after Dec. 31, 2008. (Code Sec. 108(f), as amended by Health Care Act Sec. 10908)

President signs financial reform package with new exclusions from Code Sec. 1256 treatment

On July 21, the President signed into law H.R. 4173, the "Restoring American Financial Stability Act of 2010" (the Act). This landmark financial reform package contains one Code amendment broadening the list of contracts that are excepted from the definition of Code Sec. 1256 contracts and thus are excepted from mark-to-market treatment.

New law. For tax years beginning after July 21, 2010, the Act provides that all of the following also are excepted from the definition of a Section 1256 contract: any interest rate swap; currency swap, basis swap, interest rate cap, interest rate floor, commodity swap, equity swap, equity index swap, credit default swap, or similar agreement. (Code Sec. 1256(b), as amended by Act Sec. 1601)

House passes Education Jobs Act carrying foreign-related tax offsets

On August 10, the House of Representatives by a vote of 247-161 approved the motion to concur with the Senate amendment to H.R. 1586, the Education Jobs and Medicaid Assistance Act. Later in the day August 10, the President signed the measure into law. Among other provisions, H.R. 1586 provides $10 billion to support local school districts and thereby help prevent massive layoffs of teachers. Its revenue offsets include a package of crackdowns related to foreign tax credits, plus a repeal of the advanced earned income tax credit (EITC).

Updated Regulations

Final regs update rules on installment payment of tax liabilities

Preamble to TD 9473, 11/24/2009 ; Reg. 301.6159-1

IRS has issued final regs carrying procedures for entering into installment agreements with IRS to pay tax liabilities. The regs, which are effective Nov. 25, 2009, update preexisting guidance to reflect legislative changes.

Background. Under Code Sec. 6159, IRS may enter into written agreements with any taxpayer under which the taxpayer pays any tax in installment payments if IRS determines that the installment agreement will facilitate full or partial collection of the tax liability. In '97, IRS issued proposed regs on such agreements but didn't act on them before the passage of several laws amending Code Sec. 6159. In 2007, IRS withdrew the '97 regs and replaced them with new proposed regs that reflected changes made by the Taxpayer Bill of Rights II, '98 IRS Restructuring and Reform Act (RRA '98) and the American Jobs Creation Act of 2004 (AJCA).

IRS has now finalized the proposed regs issued in 2007 with the changes noted below.

Overview of final regs. The final regs provide rules for: submitting proposed installment agreements; IRS's processing, acceptance, and rejection of agreements; terminating or modifying existing agreements; and appealing rejections, modifications, and terminations to IRS's Office of Appeals. The majority of the rules are unchanged from those contained in the prior proposed regs or reflect long-standing IRS administrative practice.

Here's a summary of the guidance on installment agreements in the final regs:

... An installment agreement request must be submitted according to procedures prescribed by IRS. There's no specific time frame for IRS to accept or reject the request. (Reg. 301.6159-1(b)(1))
... An installment agreement request becomes pending when it is accepted for processing. If an installment agreement request does not contain sufficient information to permit IRS to evaluate whether the request should be accepted, then IRS will request the needed information. (Reg. 301.6159-1(b)(2))
... A taxpayer may submit a good faith revision of a rejected installment agreement request within 30 days of rejection. (Reg. 301.6159-1(b)(3))
... An installment agreement request isn't accepted until IRS notifies the taxpayer or his representative of the acceptance. (Reg. 301.6159-1(c)(1))
... An installment agreement, which must be in writing, may take the form of a document signed by the taxpayer and IRS or the written confirmation of an agreement entered into by the taxpayer and IRS that is mailed or personally delivered to the taxpayer. (Reg. 301.6159-1(c)(2))
... IRS may not notify a taxpayer or the taxpayer's representative of the rejection of an installment agreement until an independent review of the proposed rejection is completed. (Reg. 301.6159-1(d)(2))
... The proposed regs had provided that IRS and the taxpayer may agree to modify or terminate an installment agreement or may agree to a new installment agreement that supersedes the existing agreement. Adopting a commentator's recommendations, the final regs: (a) explicitly allow taxpayers to request a modification or termination of an existing installment agreement; (b) require the taxpayer to comply with the terms of an installment agreement while a request for modification is being considered; and (c) provide that a proposed modification will not result in a suspension of the statute of limitations on collection. (Reg. 301.6159-1(e)(3))
... The proposed regs had provided that IRS may modify or terminate an installment agreement if the taxpayer fails to provide a financial condition update requested by IRS. Adopting a commentator's suggestion, the final regs provide explicitly that IRS may terminate an installment agreement if the taxpayer provided materially inaccurate or incomplete information. (Reg. 301.6159-1(e)(1)(i))
... Unless it determines that collection of the tax is in jeopardy, IRS will notify the taxpayer in writing at least 30 days prior to terminating an installment agreement and describe the reason for the termination, after which the taxpayer may provide information showing that IRS's reason is incorrect. (Reg. 301.6159-1(e)(4)) The taxpayer may administratively appeal the modification or termination of an installment agreement to the Office of Appeals if the request is properly made within 30 days after the termination or modification is to take effect. (Reg. 301.6159-1(e)(5))
... IRS may not levy during the time an installment agreement is pending, but levy is not prohibited if an installment agreement request was made solely to delay collection. (Reg. 301.6159-1(f)(1), Reg. 301.6159-1(f)(2))
... The statute of limitations on collection under Code Sec. 6502 is suspended for the period that a proposed installment agreement is pending, plus 30 days following a rejection, and during any appeal. (Reg. 301.6159-1(g))
... IRS must provide taxpayers with an annual statement setting forth the balance owed at the beginning of the year, the payments made during the year, and the remaining balance at the end of the year. (Reg. § 301.6159-1(h)) It also must perform a review of the taxpayer's financial condition at least once every two years in cases of partial payment installment agreements. The purpose of the review is to see if the taxpayer's financial condition has changed so as to warrant an increase in the payments being made or termination of the agreement. (Reg. 301.6159-1(i))

Final regs explain deduction of travel expenses by state legislators

T.D. 9481, 04/07/2010 ; Reg. 1.162-24

IRS has issued final regs on the deduction of travel expenses of state legislators while away from home. The regs, which affect eligible state legislators who make the election under Code Sec. 162(h), apply to expenses paid or incurred, or deemed expended under Code Sec. 162(h), in tax years beginning after Apr. 8, 2010.

Background. Code Sec. 162(a)(2) provides that a taxpayer generally is allowed a deduction for ordinary and necessary expenses paid or incurred during the tax year in carrying on a trade or business, including traveling expenses while away from home. An eligible individual who is a state legislator at any time during the tax year may make an election under Code Sec. 162(h) (an electing legislator). Under Code Sec. 162(h)(4), the election is not available to any legislator whose place of residence within the legislative district represented by the legislator is 50 or fewer miles from the state capitol building.

As a result of making the election for a tax year, the legislator's place of residence within the district represented by the legislator is treated as the legislator's home. (Code Sec. 162(h)(1)(A)) In addition, the electing legislator is deemed to have expended for living expenses (in connection with the trade or business of being a legislator), on each legislative day of the electing legislator, the greater of the amount generally allowable for the day (i) to employees of the legislator's state for per diem while away from home, to the extent the amount does not exceed 110% of the amount described in (ii); or (ii) to employees of the executive branch of the Federal government for per diem while traveling away from home in the U.S. (Code Sec. 162(h)(1)(B)) Under Code Sec. 162(h)(1)(C), an electing legislator is deemed to be away from home in the pursuit of a trade or business on each legislative day.

A legislative day for an electing legislator is any day on which (A) the legislature is in session (including any day in which the legislature is not in session for a period of 4 consecutive days or less), or (B) the legislature is not in session but the physical presence of the electing legislator is formally recorded at a meeting of a committee of the legislature. (Code Sec. 162(h)(2))

Rev Rul 82-33, 1982-1 CB 28, held that (1) an electing legislator's tax home for all legislative travel, including travel between sessions, was the legislator's place of residence within the legislative district represented by the legislator; (2) the term “living expenses” for purposes of Code Sec. 162(h) included expenses for lodging, meals, laundry, and other incidental expenses but did not include expenses for travel fares, local transportation, or telephone calls; (3) a legislative day included the days of any period for which the legislature was not in session for 4 consecutive days or less, without extension for Saturdays, Sundays, or holidays; (4) for purposes of Code Sec. 162(h)(1)(B)(ii), the amount generally allowable to employees of the executive branch of the Federal government while traveling away from home in the U.S. was the per diem amount for the particular city in which the state capitol was located; and (5) any amount deductible by an electing legislator for deemed living expenses under Code Sec. 162(h) was in addition to any other amount deductible under Code Sec. 162(a) for other expenses incurred while traveling away from home.

In March of 2008, IRS issued proposed regs on the deduction of travel expenses of state legislators while away from home. The proposed regs incorporated the holdings of Rev Rul 82-33.

Final regs. The final regs, which adopt the proposed regs with minimal changes, provide that:

... a taxpayer becomes a state legislator on the day the taxpayer is sworn into office and ceases to be a state legislator on the day following the day on which the taxpayer's term in office ends; (Reg. 1.162-24(d)(1))
... the legislature of which an electing legislator is a member is in session when the members of the legislature are expected to attend and participate as an assembled body of the legislature, whether or not the electing legislator actually attends. (Reg. 1.162-24(d)(3))
... a legislator's legislative days include a day on which the legislator's attendance at a meeting of a committee of the legislature is formally recorded. (Reg. 1.162-24(b)(3)) A committee of the legislature is

any group that includes one or more legislators and that is charged with conducting business of the legislature. They include, but are not limited to, committees to which the legislature refers bills for consideration, committees that the legislature has authorized to conduct inquiries into matters of public concern, and committees charged with the internal administration of the legislature. Groups that are not considered committees of the legislature include, but are not limited to, groups that promote particular issues, raise campaign funds, or are caucuses of members of a political party. (Reg. 1.162-24(d)(4))
... a legislator's legislative days include the legislator's attendance at any session of the legislature that only a limited number of members are expected to attend (such as a pro forma session), on any day that is not otherwise a legislative day if the legislator's attendance at a session of the legislature on that day is formally recorded. (Reg. 1.162-24(b)(4))

Reg. 1.162-24(e), provides that a legislator's Code Sec. 162(h) election must be made for each tax year for which it is to be in effect and must be made no later than the due date (including extensions) of the legislator's federal income tax return for the tax year. The election is made by attaching a statement to the taxpayer's return that includes the information required in the regs. The election may be revoked only with IRS consent. An application for consent to revoke an election must be signed by the taxpayer and filed with the submission processing center with which the election was filed, and must include the information required in the regs.

Rev Rul 82-33 is obsoleted, effective Apr. 8, 2010.

Cases and Rulings

Interests in LLPs and LLCs weren't presumptively passive under PAL rules

Garnett (2009), 132 TC No. 19

The Tax Court has held that taxpayers didn't hold their interests in limited liability partnerships (LLPs) and limited liability companies (LLCs) as “limited partners” for purposes of the special Code Sec. 469(h)(2) material participation provision under the passive activity loss rules. That special provision treats losses from an “interest in a limited partnership as a limited partner” as presumptively passive.

LLC interest wasn't equivalent to a limited partnership interest for PAL purposes

Thompson v. U.S., (Ct Fed Cl 7/20/2009) 104 AFTR 2d ¶2009-5124

In a case of first impression for it, the Court of Federal Claims decisively rejected IRS's view that a taxpayer's interest in a limited liability company (LLC) should be treated as a limited partnership interest for purposes of the Code Sec. 469 passive activity loss (PAL) rules. The Court concluded that the LLC wasn't a partnership under state law and couldn't be treated as the equivalent of a limited partnership for PAL purposes. It also suggested that limited liability wasn't the determining factor in deciding whether a taxpayer's interest in an activity is passive; rather, Congress' primary concern was the level of involvement in the activity.

Charter boat losses OK'd; LLC interest not limited partnership interest for PAL rules

Hegarty, TC Summary Opinion 2009-153

In a Summary Opinion, the Tax Court has once again rejected IRS's position that under the passive activity rules, a taxpayer who holds an interest in a limited liability company (LLC) is a “limited partner” for purposes of the Code Sec. 469(h)(2) material participation standard. That standard, as interpreted by IRS regs, treats losses from an interest in a limited partnership as a limited partner as presumptively passive, unless one of three difficult participation tests are met. The taxpayers in the case were able to establish material participation under a more lenient test, and as a result, were entitled to claim a large loss from their fishing boat charter activity.

Managing member's LLC interest not equivalent to limited partnership interest for PAL purposes **Newell, TC Memo 2010-23**

The Tax Court has once again rejected IRS's position that a taxpayer's interest in a limited liability company (LLC) had to be treated as a limited partnership interest for purposes of Code Sec. 469(h)(2), which treats limited partnership interests as passive interests for passive activity loss (PAL) purposes except as regs provide otherwise. The taxpayer, who acted as the day-to-day manager of the LLC's operations, functioned just as a general partner would function in a limited partnership. As a result, the taxpayer's share of losses from the LLC wasn't subject to the PAL restrictions.

> RIA observation: This is IRS's fourth defeat on this issue. In 2009, the Court of Federal Claims (Thompson v. U.S., (Ct Fed Cl 7/20/2009) 104 AFTR 2d ¶2009-5124 and the Tax Court (Garnett (2009), 132 TC No. 19 both rejected IRS's expansive view of the limited partner restriction in Code Sec. 469(h)(2). The Tax Court also ruled against IRS in a TC Summary Opinion, which can't be cited as precedent (Hegarty, TC Summary Opinion 2009-153, 10/15/2009). These losses may lead IRS to revise temp regs that were issued in '98 to address how the PAL rules apply to LLCs.

IRS acquiesces in decision holding LLC interest not equivalent to a limited partnership interest for PAL purposes **Action on Decision Memorandum**

IRS has acquiesced, in result only, in the Court of Federal Claims' decision in Thompson v. U.S., (Fed. Cl. 2009) 104 AFTR 2d 2009-5381 which concluded that a taxpayer's interest in a limited liability company (LLC) was not a "limited partnership interest" for purposes of Reg. 1.469-5T(e)(3)(i).

IRS's position. In an Action on Decision (AOD), that will be published in IRB 2010-14 on Apr. 5, 2010, IRS has acquiesced, in result only, in the Court of Federal Claims' decision in *Thompson.* An acquiescence in result only means that IRS accepts the holding of the court in the case and that IRS will follow it in disposing of cases with the same controlling facts. However, an acquiescence in result also indicates that IRS either disagrees or has concern with some or all of the court's reasoning.

Travel deductions but not unsubstantiated cell phone expenses OK'd for temporary work assignment **Senulis, TC Summary Opinion 2009-97**

In a summary opinion, the Tax Court has concluded that a taxpayer could claim business travel and meal and incidental expenses (M&IE) for the first 12 months of a temporary work assignment that ended up lasting 13 months. The Tax Court allowed the taxpayer to reconstruct his business and M&IE expenses, which had been lost due to Hurricane Katrina, but disallowed his cell phone expenses because the taxpayer couldn't substantiate his business versus personal use of the phone.

Casualty loss deductions would ease the financial pain of faulty Chinese drywall

Responding to legislators' requests that IRS clarify whether damage caused by defective Chinese drywall can result in a casualty loss deduction, IRS Associate Chief Counsel George Blaine has responded with a conditional "yes." The damage would be deductible as a casualty loss under Code Sec. 163(h) but only if the Environmental Protection Agency (EPA) and Consumer Product Safety Commission (CPSC) determine that the defective drywall is the source of unusual damage.

Same-sex couple wasn't entitled to joint filing status **Merrill, TC Memo 2009-166**

The Tax Court has held that a same sex couple was not entitled to joint filing status.

Court paves the way to joint filing by same sex married couples

Nancy Gill, et al. v. Office of Personnel Management, (DC MA 07/08/2010) 106 AFTR 2d ¶ 2010-5058

A Federal district court in the State of Massachusetts, which allows same-sex couples to marry, has held that Section 3 of the Defense of Marriage Act violates equal protection principles embodied in the Fifth Amendment to the U.S. constitution. The decision paves the way for those individuals who brought the suit to file Federal income tax returns jointly with their spouses to do so.

> RIA observation: The suit was brought by seven same-sex couples and three survivors of same-sex couples married in Massachusetts. The individuals sought various Federal benefits available to spouses in heterosexual marriages, such as, social security retirement and survivor benefits. Some individuals also sought the right to file jointly. Various Federal officials and agencies, not including IRS or IRS's commissioner, were named as defendants. Presumably, pending an appeal by the government, the affected individuals will attempt to amend their open returns to file jointly. How IRS will proceed with them or other same-sex married couples who weren't parties to the case but who attempt to file jointly on the strength of the case remains to be seen.

Meal deduction for seaman aboard fishing vessel subject to 50% limit

Kurtz v. U.S., (CA 11 7/23/2009) 104 AFTR 2d ¶2009-5137

Affirming the Tax Court, the Eleventh Circuit Court of Appeals has ruled that a seaman's deduction for meals while aboard a fishing vessel is subject to the 50% deduction limit of Code Sec. 274(n)(1). The Court held that the exception to the deduction limit for commercial vessel crews doesn't apply to fishing vessel crews.

IRS explains how self-employment tax applies to businesses abroad

Self-Employment Tax for Businesses Abroad, International Tax Gap Series

IRS has posted information on its web site explaining how self-employment taxes apply for businesses abroad. As that information notes, the rules for paying self-employment tax for a U.S. citizen or resident generally are the same whether the individual is living in the U.S. or abroad.

Cost of doctorate in psychology not deductible as education expense

Ortega, TC Summary Opinion 2009-120

In a Summary Opinion, the Tax Court has held that a mental health practitioner and psychological assistant couldn't deduct the cost of getting a doctorate in psychology. Although she worked in the field of psychology both before and after incurring the expenses, the degree qualified her for a new trade or business as a licensed psychologist.

Tax Court holds basis overstatement isn't omission of income for 6-year limitations period

Beard, TC Memo 2009-184

The Tax Court has again held that an overstatement of basis is not an omission of gross income for purposes of the 6-year limitations period of Code Sec. 6501(e)(1)(A).

Basis overstatement did not trigger 6-year limitations period

Intermountain Insurance Service of Vail, LLC, Thomas A. Davies, TMP, TC Memo 2009-195

Following its opinion in Bakersfield Energy Partners, LP, et al., (2007) 128 TC 207, that a basis overstatement is not an omission of income for purposes of the 6-year limitations period, the Tax Court has dismissed a case as requested by the taxpayer. The Court granted summary judgment because IRS made partnership item

adjustments after the general 3-year period of limitations for assessing tax had expired. IRS asked the Court to overrule *Bakersfield* and find that the 6-year limitations period applied in this situation but the Court declined to do so.

RIA observation: Indeed, the Tax Court stressed that the Court of Appeals for the Ninth Circuit recently affirmed *Bakersfield* and the Federal Circuit recently reached the same result.

Chief Counsel Notice explains how to handle overstated basis cases in Tax Court

Chief Counsel Notice 2010-001

A new Chief Counsel Notice (CCN) provides IRS attorneys direction for handling docketed Tax Court cases in which a taxpayer or entity has claimed an overstated basis in a sold asset resulting, under recent regs, in an omission from gross income exceeding 25% of the income stated on the return for purposes of the six-year limitations period.

RIA observation: It looks like IRS is going to vigorously pursue all open cases, even those in jurisdictions where it lost before issuing the clarifying temporary regs. Where this ultimately will lead remains to be seen.

Tax Court holds basis overstatement didn't trigger 6-year limitations period; contrary regs held invalid

Intermountain Insurance Service of Vail, LLC, Thomas A. Davies, TMP, (2010) 134 TC No. 11

Despite temporary regs holding to the contrary, the Tax Court in a reviewed decision has denied IRS's motion to reconsider and vacate its previous decision that a basis overstatement isn't an omission of income for purposes of the 6-year limitations period. The Court stuck to its original decision, concluding that the temporary regs were invalid and not entitled to deferential treatment. In that previous decision, the Court, following its opinion in Bakersfield Energy Partners, LP, et al., (2007) 128 TC 207, had granted summary judgment to a taxpayer where IRS made partnership item adjustments after the general 3-year period of limitations for assessing tax had expired (Intermountain Insurance Service of Vail, TC Memo 2009-195.

RIA observation: While there was no dissenting opinion, it was not a simple decision for the Tax Court. Seven judges agreed with the majority opinion. Another judge, with three other judges agreeing, concurred with the result on narrower grounds than the majority. Two judges concurred in the result only. (Two judges did not participate in consideration of the opinion.)

Salesman wasn't statutory employee; deductions were subject to 2% of AGI floor

Rosemann, TC Memo 2009-185

The Tax Court has held that a salesman didn't qualify as a statutory employee under Code Sec. 3121(d)(3) and as a result, couldn't claim business deductions on Schedule C. Rather, he was a common law employee whose out-of-pocket employment related expenses were only deductible on Schedule A, subject to the 2% of adjusted gross income (AGI) floor. The fact that an audit of an earlier tax year permitted him to file as a statutory employee didn't matter.

Refund denied on tax from exercise of option for stock with fraudulently inflated value

Gourley v. U.S., (Ct Fed Cl 8/26/2009) 104 AFTR 2d ¶ 2009-5302

The U.S. Court of Federal Claims has denied a taxpayer's refund based on the theory that he was issued a fraudulent Form W-2 by his employer WorldCom, upon which his tax was erroneously assessed. The Form W-2 reflected the taxpayer's exercise of nonqualified stock options for WorldCom stock, which—as subsequently

irregularities in their finances revealed—was actually worth $13, rather than the $42 reflected on the Form W-2.

Court rejects efforts to reduce income from compensatory stock besieged by fraud

Gudmundsson v. U.S., (NY DC 10/26/2009) 104 AFTR 2d ¶ 2009-5533

A district court has held that a taxpayer wasn't entitled to a refund based on an alternate valuation date for a stock distribution received under an employee incentive compensation plan in conjunction with an initial public offering (IPO). Despite a slew of arguments—including underlying fraud that caused the stock's value to plummet and securities rules—the taxpayer failed to show that on the original valuation date the stock was subject to a substantial risk of forfeiture under Code Sec. 83.

Payment to settle trade secret misappropriation taxable as ordinary income

Freda et al, TC Memo 2009-191

The Tax Court has held that a payment by Pizza Hut to settle a suit arising from trade secret misappropriation was taxable to the recipients as ordinary income, not capital gain. The settlement payment represented damages for lost profits or other items taxed as ordinary income. The Tax Court also rejected alternate arguments that the settlement payment represented gain from the sale of a trade secret under Code Sec. 1235(a), and qualified as gain from a termination under Code Sec. 1234A.

Neither hardship nor disability shielded taxpayer from early distribution penalty

Dollander, TC Memo 2009-187

The Tax Court has concluded that an individual who received a hardship distribution from his retirement plan because he claimed he was disabled couldn't escape the Code Sec. 72(t) early distribution penalty. Neither the taxpayer's hardship nor disability due to post-traumatic stress and depression proved to be sufficient grounds to avoid the additional 10% tax.

Debt on home purchase can be home equity debt as well as acquisition debt

Chief Counsel Advice 200940030

In Chief Counsel Advice (CCA), IRS has concluded that acquisition indebtedness that is incurred by a taxpayer to acquire, construct, or substantially improve a qualified residence can also qualify as home equity indebtedness under Code Sec. 163(h)(3)(C) to the extent it exceeds $1 million. As a result, a taxpayer can deduct up to $1.1 million of the debt securing the purchase of his principal residence.

Brief stint as a contract attorney was insufficient to support business deductions

Ernestine Forrest, TC Memo 2009-228

The Tax Court has held that an individual who held herself out as a contract attorney for a brief period during the year at issue couldn't deduct business expenses because her activity was not regular and continuous.

Guidance issued on mark-to-market rules for expatriates **Notice 2009-85, 2009-45 IRB**

A new Notice carries detailed interim guidance on the Code Sec. 877A market-to-market rules that apply to certain expatriates. These rules were enacted by the Heroes Earnings Assistance and Relief Tax Act of 2008 (Heroes Act, P.L. 110-245), effective for individuals who on or after June 17, 2008, relinquish U.S. citizenship or cease to be lawful permanent residents of the United States.

Taxpayers prevail in challenging reported debt cancellation income

McCormick, TC Memo 2009-239

The Tax Court has held that a married couple had to report only a small amount of cancellation of debt (COD) income. IRS could not rely on the amounts reported as COD income by the lenders because the taxpayers produced records establishing that there was no COD income from one lender and only a small amount of COD income from another lender.

> RIA observation: Practitioners should advise clients to keep detailed records of any disputes with lenders. As in this case, the records may help to reduce the amount of COD income that will be includible in gross income if the debt is forgiven and the lender reports a higher amount than is shown in the records.

Payouts to departing partner were guaranteed payments **Wallis, TC Memo 2009-243**

The Tax Court has held that partnership payments to a departing partner were guaranteed payments taxable as ordinary income rather than payments for his interest in the partnership taxable as capital gain. The payments were in the nature of retirement payments. The departing partner, a tax lawyer, also was hit with an accuracy related penalty for not having included the payments on his return. However, he didn't have to pay tax on capital account payments from the partnership because IRS couldn't prove the payments he received exceeded his basis in the partnership interest.

Life insurance surrender triggered ordinary income from loan satisfaction

Barr, TC Memo 2009-250

The Tax Court has held that a married couple had a sizeable amount of ordinary income on a surrender of a life insurance policy, rejecting arguments that the gain should be treated as capital gain. While they only received $11,648.33 in cash on the surrender, the Court found that they had ordinary income of $135,693.44, taking into account a loan repayment that occurred as part of the transaction.

PAL activity groupings and regroupings must be reported to IRS

Rev Proc 2010-13, 2010-4 IRB

A new revenue procedure requires taxpayers to report to IRS their groupings and regroupings of activities and the addition of specific activities within their existing groupings of activities for purposes of the Code Sec. 469 passive activity loss (PAL) rules and Reg. 1.469-4. The new rules are effective for tax years beginning on or after Jan. 25, 2010.

Tax Court finds restitution payments were deductible as business expense

Cavaretta, TC Memo 2010-4

The Tax Court has held that a husband's repayment of amounts his wife fraudulently billed insurance companies while working in his dentistry practice was deducible as a Code Sec. 162 business expense. The Court rejected IRS's contention that the amounts were restitution only deductible under Code Sec. 165(c)(2) as losses incurred in a transaction (i.e. fraud) entered into for profit.

> RIA observation: As a nonbusiness Code Sec. 165(c)(2) deduction, the amount paid as restitution would be a miscellaneous itemized deduction subject to the 2%-of-AGI floor. The deduction also would be disallowed for purposes of the alternative minimum tax.

Settlement payment for depression wasn't excludable from gross income

Wells, TC Memo 2010-5

The Tax Court has held that a settlement payment to a taxpayer for depression as a result of alleged employment related retaliation wasn't excludable from gross income under Code Sec. 104(a)(2), except to the extent of any amount that she paid for medical care to treat her emotional distress.

Medical deduction denied for in vitro fertilization costs of taxpayer who wasn't infertile

Magdalin v. Comm., (CA 1 12/17/2009) 105 AFTR 2d ¶ 2010-335

The Court of Appeals for the First Circuit, affirming the Tax Court, has held that a taxpayer, who wasn't infertile and had previously had two children via natural processes, couldn't deduct in vitro fertilization expenses incurred in fathering two other children.

Portion of settlement with former employer was excludable

Julie Leigh Domeny, TC Memo 2010-9

The Tax Court has held that a portion of an individual's settlement with her former employer compensated her for a physical illness caused by a hostile and stressful work environment. Accordingly, the Court found that it was excludable under Code Sec. 104(a)(2).

Whistleblower's award under Federal False Claims Act wasn't excluded from income

Albert Campbell (2010), 134 TC No. 3

The Tax Court has held that a taxpayer had to include in income the entire $8.75 million that he received from a settlement under a Federal False Claims Act (FCA) action against his former employer. The Court rejected his contention that the amount was a nontaxable share of the U.S. Government's recovery. Because he substantiated the payment of the contingent attorney's fees, he could deduct $3.5 million of that payment as a miscellaneous itemized deduction.

Qualified small business stock doesn't include options to acquire stock

Natkunanathan, TC Memo 2010-15

The Tax Court has concluded that the term “stock” for purposes of the exclusion from gain on the sale of “qualified small business stock” (QSBS) in Code Sec. 1202 doesn't include options to acquire stock.

Sex change costs except those for breast augmentation held deductible as medical expenses

O'Donnabhain (2010), 134 TC No. 4

The Tax Court has held that an individual could deduct as a medical care expense under Code Sec. 213 amounts paid for hormone therapy and sex reassignment surgery that were incurred in connection with a condition known as gender identity disorder, which the Tax Court found to be a disease. However, it found that breast augmentation surgery that the individual also had in connection with the disorder was cosmetic surgery and amounts paid for it were not deductible under Code Sec. 213(d)(9).

60-day deadline doesn't apply to direct rollover via check to eligible retirement plan

PLR 201005057

IRS has ruled that the 60-day deadline on retirement plan rollovers doesn't apply to direct rollovers made by way of a properly drawn check. The fact that the taxpayer held onto the check drawn by the transferor plan for more than 60 days didn't convert the rollover into a taxable transfer.

Wife had no survivorship interest in deceased husband's rollover IRA

Charles Schwab & Co v. Debickero, Cheryl M. (CA 9 1/22/2010) 105 AFTR 2d ¶ 2010-407

The Ninth Circuit has held that an IRA's named beneficiaries, rather than his wife, were entitled to the IRA funds after his death, even though some of the funds in the IRA had been rolled over from a 401(k) plan subject to ERISA's surviving spouse provisions.

Value of clothing exempt from taxation under de minimis fringe benefit rule **PLR 201005014**

IRS has issued a private letter ruling (PLR) that allows employees to exclude the value of employer-provided clothing and related accessories from their taxable income as a de minimis fringe benefit.

Pension Asset Transfer scheme shot down by Tax Court

Karl L. Matthies And Deborah Matthies, 134 TC No. 6

The Tax Court has thwarted a couple's attempt to use a Pension Asset Transfer (PAT) plan to transfer tax-favored retirement plan assets to them at reduced tax cost. Specifically, one of the taxpayers purchased a life insurance policy from his S corporation profit-sharing plan for an amount that slightly exceeded the policy's cash surrender value, net of a substantial surrender charge without reporting any gain on the transaction. The Court held that the entire cash value of the policy without reduction for the surrender charge had to be taken into account in determining the amount taxable.

Sixth Circuit looks to reasonably prudent spouse's knowledge of understatement

Greer v. Comm., (CA 6 2/17/2010) 105 AFTR 2d ¶ 2010-490

The Court of Appeals for the Sixth Circuit has concluded that a spouse in an erroneous-deduction case has reason to know of a substantial understatement—so that relief from joint and severable liability under Code Sec. 6015(b) is denied—if a reasonably prudent taxpayer in her position at the time she signed the return could be expected to know that the return contained a substantial understatement. Applying this standard, the Court found that the Tax Court didn't err in concluding that the taxpayer should have inquired into the too-good-to-be-true tax benefits thrown off by the couple's investment.

Tax Court found salesman was a common law employee

Thomas & Carol Rosato, TC Memo 2010-39

The Tax Court has found that a salesman was a common law employee and not an independent contractor or statutory employee for the year at issue. As a result, it sustained IRS's disallowance of expenses claimed by the individual on a Schedule C. In addition, the Court socked him with an accuracy-related penalty under Code Sec. 6662(a).

Sixth Circuit finds settlement payments for false imprisonment not excludable

Stadnyk v. Comm., (CA 6 2/26/2010) 105 AFTR 2d ¶ 2010-537

The Court of Appeals for the Sixth Circuit, affirming the Tax Court, has concluded that a taxpayer couldn't exclude a settlement award for false imprisonment under Code Sec. 104(a)(2). The mere fact that false imprisonment involves a physical act—restraining the victim's freedom—didn't mean that the victim was necessarily physically injured.

Settlement from car accident was excluded income not reportable on Form 1099

Chappell v. International Steel Group, (DC IN 2/26/2010) 105 AFTR 2d ¶ 2010-563

A district court has concluded that an individual's settlement from a motor vehicle accident was excluded from his gross income under Code Sec. 104(a)(2), and as a result there was no reason for the payor to require the individual to provide information to report the settlement to IRS.

Farmer couldn't deduct medical reimbursements paid to working spouse

Milo L. Shellito, TC Memo 2010-41

The Tax Court has held that a farmer could not deduct on Schedule F, Profit or Loss from Farming, as business expenses medical reimbursements paid to his wife whom he claimed was an employee of the farming business. It denied the deductions because it found that the wife was not an employee. However, because they acted in good faith on the advice of their CPA, the Tax Court refused to apply accuracy-related penalties.

Court found no substantial compliance with charitable contribution substantiation rules

Friedman, TC Memo 2010-45

The Tax Court has held that taxpayers who sought to deduct charitable contributions failed to establish substantial compliance because they did not provide adequate descriptions of the diagnostic and laboratory equipment donated and did not identify the valuation methods used, the manner of acquisition, and the cost bases of the equipment. Further, they failed to obtain contemporaneous written acknowledgments of the donations.

Court disallows claimed losses from cabin rental under PAL and vacation home rules

Charles M. Akers, TC Memo 2010-85

The Tax Court has held that the passive activity loss (PAL) rules of Code Sec. 469 barred an individual from deducting Schedule E expenses relating to the rental of a cabin. It also found that the cabin was the individual's residence under Code Sec. 280A. Since it was rented for fewer than 15 days, no income from the rental had to be included in his return and he couldn't deduct any expenses related to the rental.

Court advances IRS case against S corporation for underpaying employment taxes

Watson v. U.S., (DC IA 05/27/2010) 105 AFTR 2d ¶ 2010–908

In a recent district court case in which IRS claimed that a portion of the dividend distributions by an S corporation to its sole owner should be recharacterized as wages subject to employment taxes, the court rejected the corporation's assertion that IRS could not compel the corporation to pay a higher salary to the owner. Accordingly, the court would not order IRS to refund employment taxes paid by the corporation after IRS made the assessment. Rather, it allowed the case to proceed.

California domestic partners are subject to community property laws for federal tax purposes **Chief Counsel Advice 201021050**

In Chief Counsel Advice (CCA), IRS has concluded that for tax years beginning after Dec. 31, 2006, a California registered domestic partner should report one-half of the community income, whether received in the form of compensation for personal services or income from property, on his or her federal income tax return. However, for tax years beginning before June 1, 2010, registered domestic partners may—but are not required to—amend their returns to report community income.

IRS explains impact of California community property law on domestic partners

PLR 201021048 ; Chief Counsel Advice 201021049

In a private letter ruling (PLR), IRS has ruled on a variety of issues flowing from California having extended full community property treatment to registered domestic partners. Registered domestic partners must each report on their individual federal income tax return one-half of their combined income from the performance of personal services and from their community property assets. Each partner is entitled to half of the credits for income tax withholding from his (or her) own wages and from his (or her) partner's wages. The vesting of income under the community property laws does not trigger gift tax consequences. In Chief Counsel Advice (CCA), IRS also concluded that the assets of a taxpayer's registered domestic partner in California can be considered by IRS in determining the reasonable collection potential of a taxpayer's offer in compromise (OIC) under Code Sec. 7122.

IRA's failure to have a designated beneficiary couldn't be corrected after death

PLR 201021038

IRS has privately ruled that a deceased taxpayer's IRA did not have a designated beneficiary under Code Sec. 401(a)(9) and a post-death judicial modification naming a designated beneficiary of the IRA could not be recognized for tax purposes.

Failure to elect aggregation of real estate activities results in disallowed deduction

Anjum Shiekh, TC Memo 2010-126

The Tax Court has concluded that a taxpayer who owned and managed a number of rental properties, had to meet the material participation requirements under the passive activity loss (PAL) rules for each rental property because he failed to file an election to treat his rental properties as single activity. As a result, his deductions for certain losses were disallowed as passive losses.

High compensation held mostly reasonable for multi-role owner-employee

Multi-Pak Corp., TC Memo 2010-139

Successful closely held corporations that pay owner-employees big salaries and bonuses are vulnerable to IRS challenge on the ground that part of their pay represents a nondeductible dividend rather than deductible compensation. However, as a new Tax Court case illustrates, the taxpayer can prevail (or at least do better than IRS's assessment of what is reasonable) where the owner-employee fills multiple roles and is instrumental in the company's success. In this case, all of the owner-employee's pay for one of the contested years was reasonable, while 62.4% of his pay for the other year was held reasonable by the Court.

Construction company's workers were employees, not independent contractors

Bruecher Foundation Services Inc v. U.S. (CA 5 06/18/2010) 105 AFTR 2d ¶ 2010-997

The Fifth Circuit has upheld a district court's finding that a construction company's workers were employees rather than independent contractors. The company's late filing of Forms 1099 for the affected workers didn't meet the reporting consistency requirement for Section 530 relief and its workers were employees under the common law tests. Although IRS failed to provide statutory notice of Section 530 relief before or at the start of its audit, the company didn't try to obtain administrative relief on this ground.

Gain on sale of rebuilt house didn't qualify for homesale exclusion

Gates (2010), 135 TC No. 1

In a reviewed decision, the Tax Court has held that taxpayers, who voluntarily demolished and constructed a new house on their property in order to enlarge and remodel their home, couldn't exclude the gain on the sale of the new house under the Code Sec. 121 exclusion for the sale of a principal residence. Although the taxpayers owned and used their old house as a principal residence for at least two of the five years before the sale, the Code Sec. 121 exclusion didn't apply because they never lived in the new house and it was never used as their principal residence.

Tax Court holds that 90% stock loan program was a disguised sale

Callloway, (2010) 135 TC No. 3

In a case of first impression for it, the Tax Court has held that a purported loan transaction program netting a taxpayer 90% of the value of his IBM stock, with no obligation to repay the amount, was in fact a disguised sale. The program was promoted by a company that engaged in some 1,700 similar transactions involving approximately $1 billion.

Public servants were employees whose expenses were miscellaneous itemized deductions

Davis, TC Summary Opinion 2010-89

The Tax Court has found that a husband and wife who served as public officials (councilman and school board member, respectively) were employees and not independent contractors for the years at issue. The Court rejected the application of the general common law factors usually used to determine a worker's classification and instead relied on the Code and other statutory provisions. Accordingly, it sustained IRS's disallowance of expenses claimed by the individuals on their Schedule C, Profit or Loss From Business.

Forward contract/share lending agreements were taxable sales, not Sec. 1058 lending arrangements

Anschutz, (2010) 135 TC No. 5

The Tax Court has held that variable prepaid forward contract transactions that incorporated a share lending agreement reduced the taxpayer's risk of loss and opportunity of gain. Thus, the integrated transactions were current taxable sales of the underlying stock, and not a Code Sec. 1058 lending arrangement.

Shelter lacked substance and couldn't offset huge compensation as district court had allowed

Sala v. U.S. (CA 10 7/23/2010) 106 AFTR 2d ¶ 2010-5109

The Court of Appeals for the Tenth Circuit has reversed a district court decision that would have allowed an individual to offset $60 million of compensation income with losses from a Son-of-Boss transaction. Disagreeing with the district court, the Appeals Court found that the transaction lacked economic substance.

RIA observation: A “Son of BOSS” tax shelter employs a series of transactions to create artificial financial losses that are used to offset real financial gains, thereby reducing tax liability. Notice 2000-44, 2000-2 CB 355, identified Son of BOSS tax shelters as abusive transactions.

RIA observation: The recently enacted health reform legislation codifies the economic substance doctrine for transactions entered into after Mar. 30, 2010. While the new statutory rules have generated some controversy, one prominent practitioner posits that the codification may be “much ado about nothing.”

Accountant was employee, not independent contractor **Feaster, TC Memo 2010-157**

The Tax Court has determined that an accountant was an employee, not an independent contractor. As a result, he could not deduct business expenses on Schedule C.

Transfer of home to closely held shareholders was constructive dividend; penalties imposed **RVJ Cezar Corporation et al, TC Memo 2010-173**

A new Tax Court decision illustrates the need for closely held corporations to be wary of constructive dividends when dealing with their owners. A closely held construction company's transfer of a home to its shareholders resulted in dividend/capital gain income to them, and taxable gain to the corporation. What's more, both the shareholders and the corporation were held liable for accuracy related penalties.

Personal goodwill received in sale of professional service corporation was corporate asset

Larry E. Howard v. U.S., (DC WA 7/30/2010) 106 AFTR 2d ¶ 2010-5140

A district court has held that the amount received by a sole shareholder (dentist) on the sale of his professional service corporation (engaged in a dental practice) that was allocated to his personal goodwill was in fact a corporate asset. As a result, the amount was recharacterized as a dividend to him from his corporation.

Father-son farm was a partnership; each had equal interest in its expenses

Holdner, TC Memo. 2010-175

The Tax Court has concluded that the farming activity operated by a father and son was a partnership for Federal income tax purposes and that, in the absence of substantial proof rebutting the presumption of equality, each had equal interests in the partnership income, expenses, and other partnership items.

Disability payments to firefighter under union's contract with city weren't excludable

John T. Bayse, TC Summary Opinion 2010-118

The Tax Court has held that payments made by a city to a firefighter injured in the line of duty had to be included in his gross income. The payments, which were made under a collective bargaining agreement, weren't made under a workmen's compensation act as compensation for personal injuries or sickness, and so weren't excludable under Code Sec. 104(a)(1).

Other Items of Interest

TIGTA report recommends using Form 1098 to uncover nonfilers and underreporters

Mortgage Interest Data Could Be Used to Pursue More Nonfilers and Underreporters. (August 6, 2009)

A new report by the Treasury Inspector General for Tax Administration (TIGTA) recommends that IRS should use mortgage interest data reported to it on Form 1098 (Mortgage Interest Statement) to uncover nonfilers and taxpayers who have underreported their income. Extrapolating from a statistical sample, the report concludes that a large number of taxpayers paying mortgage interest either don't file tax returns or report income that's not enough to cover mortgage obligations and living expenses.

Opportunities & challenges presented by post-2009 Roth IRA rollovers

What's so attractive about a Roth IRA? Here's a summary:

- Earnings within the account are tax-sheltered (as they are with a regular qualified employer plan or IRA).
- Unlike a regular qualified employer plan or IRA, withdrawals from a Roth IRA aren't taxed if some relatively liberal conditions are satisfied.
- A Roth IRA owner does not have to commence lifetime required minimum distributions (RMDs) after he or she reaches age 70 1/2 as is generally the case with regular qualified employer plans or IRAs. (For 2009, there's a moratorium on RMDs.)
- Beneficiaries of Roth IRAs also enjoy tax-sheltered earnings (as with a regular qualified employer plan or IRA) and tax-free withdrawals (unlike with a regular qualified employer plan or IRA). They do, however, have to commence regular withdrawals from a Roth IRA after the account owner dies.

Should you consider making the rollover to a Roth IRA? The answer may be “yes” if:

... You can pay the tax hit on the rollover with non-retirement-plan funds. Keep in mind that if you use retirement plan funds to pay the tax on the rollover, you'll have less money building up tax-free within the account.
... You anticipate paying taxes at a higher tax rate in the future than you are paying now. Many observers believe that tax rates for upper middle income and high income individuals will trend higher in future years.
... You have a number of years to go before you might have to tap into the Roth IRA. This will give you a chance to recoup (via tax-deferred earnings and potentially tax-free payouts) the tax hit you absorb on the rollover. In other words, the future potentially tax-free withdrawals can more than offset the tax paid up front.
... You are willing to pay a tax price now for the opportunity to pass on a source of tax-free income to your beneficiaries.

You also should know that Roth rollovers made in 2010 represent a novel tax deferral opportunity and a novel choice. If you make a rollover to a Roth IRA in 2010, the tax that you'll owe as a result of the rollover will be payable half in 2011 and half in 2012, unless you elect to pay the entire tax bill in 2010.

Why on earth would you choose to pay a tax bill in 2010 instead of deferring it to 2011 and 2012? Keep in mind that absent Congressional action, after 2010 the tax brackets above the 15% bracket will revert to their higher pre-2001 levels. That means the top four brackets will be 39.6%, 36%, 31%, and 28%, instead of the current top four brackets of 35%, 33%, 28%, and 25%. The Administration has proposed to increase taxes only for those making $250,000, but it is difficult to predict who will get hit by higher rates. What's more, there's a health reform proposal before the House of Representatives right now that would help finance healthcare reform with a surtax on higher-income individuals.

So if you believe there's a strong chance your tax rates will go up after 2010, you may want to consider paying the tax on the Roth rollover in 2010.

Many tax law changes for individuals go into effect in 2010

Many important tax changes go into effect in 2010 apart from the numerous indexing changes. These non-indexing changes result from various laws that were enacted and regs and other guidance issued over the past few years.

Alternative minimum tax (AMT) will hit many more taxpayers.
Required minimum distributions (RMDs) return.
Conversions to Roth IRAs OK regardless of income.
AGI-based personal exemption phaseout and itemized deduction reduction are gone.
Recapture of first-time homebuyer credit. Taxpayers who claimed a Code Sec. 36 first-time homebuyer credit (FTHTC) for homes bought after Apr. 8, 2008 and before Jan. 1, 2009, must begin repaying the credit in 2010.
New modified carryover basis regime for estates of 2010 decedents.

IRS unveils 2010 list of notorious tax scams—the "Dirty Dozen" **IR 2010-32**

"Dirty Dozen" for 2010. IRS has identified the following tax scams as this year's "Dirty Dozen:"

... Return preparer fraud.
... Hiding income offshore
... Phishing.
... Filing false or misleading forms.
... Nontaxable Social Security benefits with exaggerated withholding.
... Abuse of charitable organizations and deductions.
... Frivolous arguments.
... Abusive retirement plans.
... Disguised corporate ownership.
... Zero wages.
... Misuse of trusts.
... Fuel tax credit scams.

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