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# Private Tax Collection Expected To Be Running Full Speed By Summer

*IR-2017-74, www.irs.gov*

Private collection agencies will soon start to work some taxpayer accounts, the IRS has announced. However, the IRS predicts that this iteration of private tax collection will move at a pace different from previous ones, with a slower initial start. By summer, thousands of taxpayer accounts will be received by private collection agencies, the IRS predicted.

- ***Take Away.*** "According to the IRS, taxpayers whose tax debts are being assigned to private collectors would have had multiple contacts from the IRS in previous years and still have an unpaid tax bill," Matthew Lee, Partner, Fox Rothschild LLP, Philadelphia, told Wolters Kluwer.
- ***Comment.*** Private tax collection begins this month with several hundred taxpayer accounts being transferred to the collection agencies, IRS Small Business and Self-Employed Division Commissioner Mary Beth Murphy told reporters at a press conference in Washington, D.C. The number of taxpayer accounts worked by each private collection agency will increase during the coming weeks and months, Murphy indicated.

## Background

The *Fixing America's Surface Transportation Act of 2015* (FAST Act) directed the IRS to contract with private collection agencies to collect inactive tax receivables. Tax receivables are defined as any outstanding assessment that the IRS includes in potentially collectible inventory.

The FAST Act applies to any tax receivable:

- Removed from the active inventory for lack of resources or inability to locate the taxpayer;
- For which more than one-third of the applicable limitations period has lapsed and no IRS employee has been assigned to collect the receivable; or
- For which, a receivable has been assigned for collection but more than 365 days have passed without interaction with the taxpayer or a third party for purposes of furthering the collection.
- ***Comment.*** The IRS engaged with private collection agencies in the 1990s and again around 10 years ago. Both programs were terminated. Congress revived private tax collection to offset the cost of transportation and highway spending in the FAST Act. Now, the IRS has contracted with CBE Group, Cedar Falls, Iowa; Conserve, Fairport, N.Y.; Performant, Livermore, Calif.; and Pioneer, Horseheads, N.Y. to work some taxpayer cases.

## Exceptions

Certain taxpayer accounts will not be outsourced to private collection agencies. They include taxpayer accounts subject to a pending or active offer-in-compromise or installment agreement; classified as an innocent spouse case; or involving a taxpayer identified by the IRS as being deceased, under the age of 18, in a designated combat zone, or a victim of identity theft. Private collection agencies also will not work accounts that are currently under examination, litigation, criminal investigation, or levy; or accounts currently subject to a proper exercise of a right of appeal.

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# Chief Counsel Describes Procedures For Whistleblower Disclosures

*CC-2017-005*

IRS Chief Counsel has described the procedures for its staff to disclose the existence or identity of a whistleblower. Before any disclosure may be made, Chief Counsel personnel must submit a detailed memorandum.

- ***Take Away.*** Chief Counsel used the example of where a whistleblower is an essential witness in a judicial proceeding. Chief Counsel reiterated that it is committed to protecting the confidentiality of whistleblowers but recognized that disclosure could be necessary in certain circumstances.

## Background

Generally, mandatory awards to whistleblowers are available under Code Sec. 7623(b) and discretionary awards may be paid under Code Sec. 7623(a). Code Sec. 7623(b) provides that if the taxes, penalties, interest and other amounts in dispute exceed $2 million, the IRS will pay 15 percent to 30 percent of the amount collected. If the case deals with an individual, his or her annual gross income must be more than $200,000. If a whistleblower submission does not meet the criteria for an award under Code Sec. 7623(b), the IRS may consider it under discretionary authority in Code Sec. 7623(a).

## Disclosure

Chief Counsel explained that in some cases it may be necessary to reveal the existence or identity of a whistleblower. Chief Counsel will consider and weigh the potential risks to the whistleblower, the government's need to disclose the existence or identity of the whistleblower, and alternative solutions.

Approval from Deputy Chief Counsel (Operations) and the Director of the IRS Whistleblower Office must be obtained before any disclosure of the existence or identity of a whistleblower. To request approval, Chief Counsel personnel must submit a memorandum, approved by Division Counsel. This memorandum will be reviewed by Deputy Chief Counsel (Operations) and the Director of the Whistleblower Office.

## Format

Chief Counsel outlined the format of the memorandum. The memorandum must describe the purpose for the request, summarize the facts of the case, and explain why disclosure of the whistleblower's existence or identity is needed. The memorandum must also describe alternatives to disclosure, if any, as well as the extent of any potential risks to the whistleblower. Further, the memorandum must report any time limitations, such as an expiring assessment statute or trial deadline.

Some cases may call for the disclosure of whistleblower documents, Chief Counsel noted. The memorandum must describe the documents, the information in the documents, and any known information about how the whistleblower obtained the documents.

Further, the memorandum must relay if the whistleblower has consented to disclosure of his or her identity. If the whistleblower is represented by counsel, the memorandum must state so.

- ***Comment.*** If there is potential overlap with a criminal investigation or matter, the views of the agency's Criminal Investigation division will be incorporated into the memorandum, Chief Counsel explained.

*References: TRC IRS: 63,060.05.*

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## Tax Collection

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## Communications

Before a private collection agency works a taxpayer's account, the taxpayer will be contacted by the IRS. The IRS explained that first it will send a letter to the taxpayer advising that the taxpayer's account has been assigned to a private collection agency. After the IRS mails its letter, the private collection agency will contact the taxpayer by letter.

## Collection and enforcement

Private collection agencies will accept payments from taxpayers. All payments must be made to the IRS. Private collection agencies may discuss payment options, including installment agreements.

Similarly, private collection agencies will have no enforcement powers. Private collection agencies cannot file a notice of federal tax lien or issue a levy. Private collection agencies must adhere to federal collections laws.

- ***Comment.*** Taxpayers who do not want their account to be worked by the private collection agency must request in writing that their account be returned to the IRS.

## Scams

The IRS reminded taxpayers to beware of criminals pretending to be from the government or a private collection agency. Phone scammers typically demand immediate payment by gift card or prepaid debit card. The private collection agencies working taxpayers accounts will never demand immediate payment using a specific method, the IRS explained. Likewise, private collection agencies will not threaten taxpayers with arrest or deportation, as criminals often do.

*Reference: TRC FILEBUS: 6,100.*

**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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# Tax Court Finds Return Information Disclosable To Show How Workers View Status

*Mescalero Apache Tribe, 148 TC No. 11*

In a case of first impression, the Tax Court has held that return information was subject to disclosure to the employer in a worker classification dispute. The return information would show evidence of how the workers viewed their status, whether as employees or independent contractors.

- ***Take Away.*** Although this case arose out of a worker classification dispute, the court's holding would appear to be applicable to other cases. The court could have limited disclosure, as some other courts have done; instead, it took an apparently broad approach.
- ***Comment.*** Code Sec. 3402(a) requires employers to withhold taxes on wages. Code Sec. 3402(d) provides that if employer fails to withhold, but the worker pays the tax, the tax is not collected from the employer. In this case, the taxpayer wanted the IRS to search its records to determine how many of its workers had made tax payments, thereby providing it relief under Code Sec. 3402(d).

## Background

The taxpayer employed several hundred individuals. Some workers were employees of the taxpayer; other workers were treated as independent contractors. The IRS determined that some of the independent contractors were properly treated as employees and reclassified them. The taxpayer disagreed with the IRS's determination.

The taxpayer asked each worker to complete Form 4669, Statement of Payments Received. The taxpayer obtained Forms 4669 from all but 70 of the workers. The taxpayer requested that the IRS search its records to determine if any of the 70 individuals had paid their tax liabilities as independent contractors.

- ***Comment.*** Generally, the IRS accepts Form 4669 as prima facie evidence that a worker filed an individual return and paid the income tax due. This relieves the employer of its withholding tax liabilities.

## Court's analysis

The court first found that Code Sec. 6103 protects the confidentiality of return information. However, there are exceptions. One exception provides for disclosure in judicial and administrative tax proceedings.

Some courts have taken a limited view of the exception, limiting disclosure to officials of government agencies, the court noted. The Tenth Circuit has taken a broad view of this exception. In *First Western, 796 F.2d 356 (1986),* the Tenth Circuit found disclosure proper in judicial and administrative tax proceedings in general. In this case, an appeal would go to the Tenth Circuit. The Tax Court followed the Tenth Circuit's decision in *First Western* and held that third-party tax-return information may be disclosed in judicial and administrative tax proceedings to persons other than government officials under Code Sec. 6103(h)(4), so long as the other requirements of subsection (h) are satisfied.

The court further found that Code Sec. 6103(h)(4)(C) authorizes disclosure of returns or return information only if the return or return information directly relates to a transactional relationship between a person who is a party to the proceeding and the taxpayer which directly affects the resolution of an issue in the proceeding. The court found that the relationship between the taxpayer and its workers was the type of relationship contemplated by Code Sec. 6103(h)(4).

Further, the information sought by the taxpayer directly related to the relationship. The tax records would show evidence of how the workers viewed their status and relationship with their employer. How they viewed themselves would be a factor in any worker classification dispute.

Additionally, the court rejected the IRS's argument that the return information was not discoverable. The court noted that its rules provide that information is discoverable or not regardless of the burden of proof involved. Who bears the burden of proof on an issue has no effect on the obligation to comply with appropriate discovery requests.

*References: Dec. 60,867; TRC LITIG: 6,512.*

## IRS Reports Progress Issuing Refunds; Answering Calls

As the 2017 filing season draws to a close, the IRS has reported progress issuing refunds and answering taxpayers' questions. Some taxpayers experienced delayed refunds this filing season because of new requirements in the *Protecting Americans from Tax Hikes Act of 2015* (PATH Act).

***Returns.*** The IRS reported it had received 93.6 million returns as of March 31, 2017 (the most recent date for which statistics are available). Tax professionals have e-filed 48.6 million returns so far this year, reflecting a 4.6 percent decline from the same time last year.

***Refunds.*** The IRS reported that it had issued 74.1 million refunds as of March 31, 2017. At the same time last year, the IRS had issued 76.0 million refunds, reflecting a decline of 2.4 percent.

***Telephone assistance.*** IRS Commissioner John Koskinen told lawmakers on April 6 that its telephone assistance level of service is approximately 76 percent."The average for the 2017 filing season as a whole will be about 75 percent," Koskinen said. Koskinen added that the agency's toll-free telephone lines will be available on Saturday April 15, 9 a.m. to 5 p.m. (callers' local time).

*www.irs.gov, IR-2017-75;TRC FILEIND: 18,052.*

# IRS Nonacquiesces In Contract Method And Depreciation Cases; Agrees "In Result Only" On Employment Tax

*AOD 2017-02, -03, -04*

The IRS has announced its nonacquiescence in decisions by the Ninth Circuit Court of Appeals and a federal district court relating to the completed contract method (CCM) of accounting and depreciation, respectively. At the same time, the IRS announced its acquiesence in result only in a Tax Court decision relating to S corps and employment taxes.

- ***Take Away.*** The IRS, like many federal agencies, is currently operating under Executive Order 13771, which generally calls for an agency to remove two current regs for every new reg. The IRS has indicated that some sub-regulatory guidance is outside the scope of EO 13771. Now, it appears that AODs also are outside EO 13771.

## Completed Contract Method

In *Shea Homes, Inc., 2016-2* USTC *50,391,* the Ninth Circuit found that a residential home developer properly used the CCM of accounting for the entire development, not just individual houses. The taxpayer's method of accounting was deemed to clearly reflect income.

The Ninth Circuit found that the taxpayer was selling more than just homes. The communities offered a planned life-style. Until all the work was completed, the taxpayer had an obligation to fulfill the promises regarding the development of which it had induced the buyers to become a part. The Ninth Circuit concluded that the taxpayer had used a permissible method of accounting.

***Nonacquiescence.*** The IRS announced that it will not acquiesce in the Ninth Circuit's holding that under the contract method of accounting, a taxpayer completed home construction when it incurred 95 percent of the estimated cost of constructing an entire development.

## Depreciation

In *Stine, 2015-1* USTC *¶50,172 (DC-La, 2015),* the district court held that buildings designed to be retail stores were placed in service when substantially completed. The district court rejected the government's argument that the buildings were not placed in service until open to the public for business.

- ***Comment.*** The buildings were located in the Gulf Opportunity (GO) Zone. Congress provided 50 percent bonus depreciation for nonresidential real property, provided the property was placed in service before January 1, 2009. In this case, as of December 31, 2008, the buildings were not open for business, and the certificates of occupancy did not allow customers to enter the buildings.

The district court found that the buildings were placed in service under Code Sec. 167 when they were substantially completed and in a condition of readiness to perform the function for which they were built; this is, to house and secure racks, shelving and merchandise. Accordingly, the buildings qualified for 50 percent bonus depreciation in 2008.

***Nonacquiescence.*** The IRS announced that it will not acquiesce to the holding that buildings built to operate as retail stores are placed in service for depreciation purposes when substantially completed to house and secure racks, shelving and merchandise.

## Employment tax

In *Scott Singer Installations, Dec. 60,682(M), (2016),* the Tax Court found that the sole shareholder and officer of an S corp was its employee. Advances made by the shareholder to the S corp were bona fide loans in part and capital contributions in part. In addition, payments made by the S corp on behalf of the shareholder were repayments of those loans and not wages. The advances were reported as loans, and payments to the shareholder were reported as repayments, rather than expenses, so the shareholder apparently intended to form a debtor-creditor relationship, the Tax Court found.

However, the shareholder could not have reasonably expected repayment after a downturn in business, so advances made in later years were capital contributions. Because of the loan balance at the time of the repayments, those payments were not wages subject to employment taxes, the Tax Court concluded.

***Acquiescence in result only.*** The IRS announced its acquiescence in the result only was to whether the taxpayer's payment of personal expenses on behalf of its sole shareholder constituted wages subject to federal employment taxes.

*References: FED ¶46,265; TRC DEPR: 15,250, TRC ACCTNG: 33,252, TRC COMPEN: 3,050.*

## IRS Data Retrieval Tool Remains Offline; 100,000 Accounts Possibly Compromised

The IRS Data Retrieval Tool (DRT), used by students to complete the Free Application for Federal Student Aid, will continue to be unavailable while security is upgraded, the agency has announced. The IRS is investigating breaches of the data tool by cybercriminals.

- ***Comment.*** IRS Commissioner John Koskinen told lawmakers on April 6 that the information of some 100,000 taxpayers may have been compromised by cybercriminals. Approximately 8,000 fraudulent refunds were issued, reaching some $30 million. The IRS is identifying affected taxpayer accounts and contacting taxpayers by letter, Koskinen said.

In March, the IRS announced that the DRT was taken offline. As a result, individuals completing the FAFSA, and applying for an income-driven repayment plan, must manually enter the required information. The IRS reminded individuals that the necessary information can be found on a previously filed return. The agency has posted questions and answers on its website.

*www.irs.gov; TRC INDIV: 60,152.*

# Employer Liable After PEO Fails To Pay Over Employment Taxes

*FAA 20171201F*

In a just-released field attorney advice (FAA), IRS Chief Counsel has determined that an employer is liable for employment taxes unpaid by a professional employer organization (PEO). The taxpayer had contracted with the PEO, which failed to pay over federal employment taxes.

- ***Take Away.*** "The FAA serves as a reminder that the common law employer cannot easily offload its liability for employment taxes by using a contract. Employers who choose to make use of a PEO should carefully monitor the PEO's compliance with the payroll tax rules to ensure that they do not end up in this taxpayer's position," Mike Chittenden, Counsel, Miller & Chevalier Chartered, Washington, D.C., told Wolters Kluwer.
- ***Comment.*** The IRS has established a voluntary certification program for PEOs (sometimes referred to as employee leasing companies). To become and remain certified under the new program, CPEOs must meet tax status, background, experience, business location, financial reporting, bonding and other requirements.

## Background

The taxpayer, an S corp, owned and operated a limousine business. The business employed drivers, dispatchers, technicians, and others. The taxpayer contracted with a PEO. The agreement provided that the taxpayer and the PEO would share the responsibilities of being the employer. The agreement further provided that the taxpayer would pay to the PEO an amount equal to the wages of the leased employees. This amount would be paid before the payroll date. The PEO would subsequently, pay federal employment taxes, and file federal employment returns, along with Forms W-2.

The PEO failed to file any returns. The PEO also failed to pay over federal employment taxes. The taxpayer argued that a state statute mandated that PEOs assume responsibility for paying over all taxes. The taxpayer also argued that the PEO was the statutory employer. Additionally, the PEO argued that it was entitled to relief under Section 530 of the *Revenue Act of 1978.*

## Chief Counsel's analysis

Chief Counsel first considered the taxpayer's state law argument. The state law, Chief Counsel determined, did not supersede the Tax Code. Employment tax liability is not based on state law.

Chief Counsel further rejected the taxpayer's statutory employer argument. To determine if an employer is a statutory employer, courts look to which entity controls the payment of wages. Here, the taxpayer and not the PEO controlled the payment of wages. The PEO did not assume responsibility for the payment of wages.

Additionally, Chief Counsel rejected the taxpayer's Section 530 argument. Section 530, Chief Counsel determined, is limited to worker classification disputes. Chief Counsel found no evidence that Congress intended Section 530 to apply in cases where a PEO failed to pay over federal employment taxes.

Code Sec. 6205(a) and Code Sec. 6413(a) allow employers to make interest-free adjustments for underpayments and overpayments. Here, Chief Counsel noted that the taxpayer's reliance on the PEO was in error. An interest-free adjustment could be appropriate, Chief Counsel concluded.

*Reference: TRC PAYROLL 66,100.*

# Chief Counsel Reviews Tax Court's Jurisdiction Over Recharacterization Of Payments To Corporate Officers

*PMTA 2017-05*

The Tax Court lacks jurisdiction to review the IRS's recharacterization of payments to corporate officers as wages, resulting in additional employment taxes. IRS Chief Counsel provided the explanation in recently released Program Manager Technical Assistance (PMTA).

- ***Take Away.*** The employer did not dispute that the corporate officers were employees. The taxpayer also agreed that it was not entitled to Section 530 relief. Section 530 of the *Revenue Act of 1978* operates as a safe harbor that relieves qualified employers from federal employment tax liability.

## Background

The employer paid wages to its corporate officers. These amounts were reported as wages to the IRS and were reflected as wages on Forms W-2. The corporation also made other payments to the officers, which the corporation did not report as wages. Additionally, the corporation paid some personal expenses of its officers. These payments also were not reported as wages. The IRS determined that the various payments were wages. The agency assessed additional employment taxes.

- ***Comment.*** Chief Counsel noted without elaboration that the corporation characterized these various payments as dividends or distributions, return of capital, loan repayments, among other characterizations.

## Chief Counsel's analysis

Chief Counsel first explained that the Tax Court is a court of limited jurisdiction. The Tax Court may review IRS determinations that individuals are employees for purposes of employment taxes. The Tax Court may review IRS determinations that the person for whom services are performed is not entitled to relief under Section 530.

Here, Chief Counsel observed that the IRS and the employer did not dispute the status of the officers as employees. The agency and the employer also did not dis-

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# Product-Liability Legal Fees Did Not Reduce Code Sec. 199 Deduction

*CCA 201714029*

IRS Chief Counsel has determined that a taxpayer's current qualified production activities income (QPAI) was not reduced by current legal fees related to similar products manufactured and sold before Code Sec.199's effective date. Under the required "section 861 method" of allocation, those legal defense costs did not lower QPAI on which the Sec. 199 domestic activities production deduction is computed. Therefore, the taxpayer was entitled to a higher Code Sec. 199 deduction.

- ***Take Away.*** For this ruling to be applied, however, it appears that both the manufacture and the revenue from the manufactured product should occur prior to Code Sec. 199's effective date (that is, prior to tax years beginning before January 1, 2005). Chief Counsel did not address a situation in which costs were initially capitalized. Nor did Chief Counsel consider differences in cost allocations between years during which the Code Sec. 199 amount, starting at three percent, had not yet reached its current maximum level of nine percent.

## Background

A disregarded entity and a holding company within a consolidated group manufactured and sold Products W and X in years preceding and after the enactment of Code Sec. 199. During post-2004 Years 1 and 4, legal fees were incurred within the group to defend lawsuits filed against them alleging harm from the use of Products W and X manufactured and sold in years before the effective date of Code Sec. 199. None of the legal fees was capitalized under section 263A.

## Section 861 method

QPAI is the excess of a taxpayer's DPGR for the tax year over the sum of the taxpayer's cost of goods sold (CGS) that is allocable to DPGR and the taxpayer's other expenses, losses, and deductions (other than the Code Sec. 199 deduction) that are properly allocable to DPGR. Regulations generally require a taxpayer use the section 861 method to allocate and apportion deductions to gross income attributable to DPGR in determining QPAI unless the taxpayer qualifies for, and elects to use, one of the two simplified methods available only to small taxpayers.

Under the section 861 method, a deduction is allocated to a class of gross income, and then, if necessary, apportioned between the statutory and residual groupings of gross income within that class. The allocation and apportionment of the deduction is based on the factual relationship of the deduction to a class of gross income and to the statutory and residual groupings of income in that class.

## Chief Counsel's findings

Chief Counsel found a strong factual relationship between the deductible legal fees at issue and the class of gross income attributable to the specific sales to the plaintiffs in the lawsuits of Products W and X. Because gross receipts from those sales did not generate gross income attributable to DPGR in the years the gross income was realized, no portion of the deductions for the legal fees at issue should be apportioned under the section 861 method to the statutory grouping of Code Sec. 199 gross income in Years 1 through 4.

*Reference: TRC BUSEXP: 6,108.10.*

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### Chief Counsel

*Continued from page 173*

pute that certain payments should be treated as wages or any worker classification or entitlement to Section 530 relief. Therefore, Chief Counsel determined that the IRS did not make a determination regarding the employment status of the officers when it recharacterized the payments as wages. The IRS also did not make a determination about Section 530 relief. As a result, the Tax Court would lack jurisdiction.

Chief Counsel also determined that the IRS should not issue a Notice of Determination of Worker Classification (Letter 3523) before the assessment of additional employment taxes. The IRS, Chief Counsel reiterated, did not make a determination about worker classification or entitlement to Section 530 relief. Letter 3523 would not be necessary. Instead, Chief Counsel explained that the additional taxes should be directly assessed.

*Reference: TRC PAYROLL: 66,100.*

## Supreme Court Asked To Hear Employee Stock Transfer Case

The Supreme Court has been asked to hear *Qinetiq US Holdings, Inc. & Subsidiaries,* a 2017 case in which the Fourth Circuit Court of Appeals had found that a corporation was not entitled to deduct stock purportedly given out for services rendered as compensation because (1) the stock was given years earlier and was not then subject to a substantial risk of forfeiture and (2) a notice of deficiency was procedurally adequate:

The likelihood of forfeiture due to the employee's voluntary resignation did not amount to a substantial risk under Code Sec. 83 --the role of the individual in question was not as an employee, but as an initial investor in the original entity; and

The *Administrative Procedures Act's* requirement that a final agency decision provide a reasonable explanation did not apply to the notice of deficiency, which is governed solely by the Internal Revenue Code.

*Sup. Ct. Petition for Review, April 5, 2017: Qinetiq US Holdings, Inc. & Subsidiaries; 2007-1 USTC ¶50,119; TRC COMPEN: 18,202.*

# TAX BRIEFS

### *Internal Revenue Service*

The IRS has released a fact sheet providing information on Taxpayer Bill of Rights (TBOR) that clearly outlines the fundamental rights of every taxpayer in the event they need to work with the IRS on a personal tax matter. A list of the taxpayer's rights and IRS obligations to protect them are discussed in IRS Publication 1, Your Rights as a Taxpayer.

*FS-2017-5, FED ¶46,264; TRC IRS: 12,350*

The authority to permit the disclosure of returns, return information, testimony or the production of documents was delegated to officers and employees identified in the reference chart provided in the delegation order issued by the IRS commissioner. The order, which supersedes Delegation Order No. 11-2 (Rev. 1), is effective March 7, 2017.

*CDO No. 11–2 (Rev. 3), FED ¶46,263; TRC IRS: 66,360.15*

The IRS has updated the list of countries with which it is appropriate to have an automatic exchange of information collected various regulations. The new guidance adds Belgium, Colombia and Portugal to the list.

*Rev. Proc. 2017-31, FED ¶46,262; TRC FILEBUS: 9,158.12*

### *International*

An attorney, who was a partner in a multinational law firm working in the U.K., was entitled to exclude foreign earned income and to deductions as determined. The taxpayer was allowed Schedule C deductions and itemized deductions as determined and owed self-employment taxes. Accuracy-related penalties and late-filing penalties were imposed.

*Larkin, TC, CCH Dec. 60,864(M), FED ¶47,978(M); TRC BUSEXP: 24,806*

### *Summons*

An IRS summons was ordered enforced. The IRS issued a summons to secure an individual's books and records as part of an investigation into the individual's tax liability. The IRS's evidence supported a *prima facie* case under *Powell*, which the individual failed to rebut.

*Hernandez, DC Calif., 2017-1 USTC ¶50,196; TRC IRS: 21,052*

The government was not entitled to enforce summonses issued to various taxpayers because they properly raised the attorney-client privilege. The taxpayers did not waive their attorney-client privilege by sharing documents because the taxpayers jointly retained the law firm for the purposes of forming and managing a captive insurance company and had a clear commonality of interest.

*Micro Cap KY Insurance Company, Inc., DC Ky., 2017-1 USTC ¶50,192; TRC IRS: 21,402*

### *Income*

Married individuals, who were employees and officers of a U.S. subsidiary of a foreign (Chinese) corporation, underreported their wages, rental income, gambling winnings and other income. The couple failed to keep proper records for themselves or the corporation; therefore, the IRS reconstructed the couple's unreported income using the specific-items method.

*Zang, TC, CCH Dec. 60,865(M), FED ¶47,979(M); INDIV: 6,052*

### *Tax Accounting*

The government failed to show that the individual did not have an installment agreement request (IAR) "pending" when it levied his wages and his Thrift Savings Account; therefore, an individual's unauthorized collection action was only partially dismissed. Contrary to the government's argument, proposals to enter into installment agreements can be made via letter, phone, voice-mail, email or other communications between taxpayers and the IRS. Therefore, the individual's IAR was not automatically nonprocessable because it was not submitted on the proper form.

*Cummings, DC Ind., 2017-1 USTC ¶50,190; TRC IRS: 45,114*

### *Employee Plans*

An employee defined-benefits plan established by a church-affiliated hospital was

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## IRS Provides Relief For Beneficial Owner Withholding Certificates Lacking Foreign TINs, Dates Of Birth

A beneficial owner withholding certificate will not be treated as invalid if it fails to include a foreign taxpayer identification number (TIN) or date of birth for the beneficial owner identified on the certificate, the IRS has announced. The IRS updated its online frequently asked questions (FAQs) about the *Foreign Account Tax Compliance Act* (FATCA).

***Foreign TIN.*** The IRS explained that withholding agents are not required to treat an otherwise valid beneficial owner withholding certificate as invalid when the certificate does not include a foreign taxpayer TIN. In the absence of actual knowledge otherwise, the withholding agent may assume that the foreign person does not have a foreign TIN. This relief is available for calendar year 2017, the IRS explained on its website.

***Date of birth.*** The IRS also explained that for beneficial owner withholding certificates obtained by a withholding agent on or after January 1, 2017, the withholding agent must collect a date of birth on a beneficial owner withholding certificate for an individual beneficial owner. However, if the withholding agent has the beneficial owner's date of birth in its files, it may use that information for reporting purposes and will not be required to treat a Form W-8BEN as invalid because it did not include a date of birth.

*www.irs.gov; TRC INTL: 33,054.05.*

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not exempt from the requirements of the Employee Retirement Income Security Act (ERISA) because the hospital's plan was not a "church plan." In order to qualify as a church plan under ERISA, the plan must be established and maintained by a church or a convention or association of churches and the hospital was not a church.

*Stapleton v. Advocate Health Care Network, CA-7, 2016-2 USTC ¶50,513; RETIRE: 69,302*

### *Liens and Levies*

Federal tax liens attached to interpleaded funds were entitled to priority over the claims of a surety, judgment creditor and subcontractors and materialmen. There was no dispute that the government had a valid tax lien and the other claimants' argument that the interpleaded funds were not legally the property of the taxpayer was rejected.

*City of Galveston v. Consolidated Concepts, Inc., DC Tex., 2017-1 USTC ¶50,193; TRC IRS: 48,152*

A married couple's wrongful levy claim was dismissed for failure to state a claim. While their failure to exhaust their administrative remedies did not create a jurisdictional bar, the failure meant they failed to state a claim for relief.

*Hassen, DC V.I., 2017-1 USTC ¶50,191; TRC IRS: 45,114*

An IRS Appeals officer (AO) properly sustained the filing of a Notice of Federal Tax Lien (NFTL) and proposed levy to collect an individual's unpaid income tax liability. The individual failed to rebut the presumption of delivery of the deficiency notice. Therefore, the individual could not challenge the underlying tax liability because he was deemed to have received the notice.

*Rivas, TC, CCH Dec. 60,866(M), FED ¶47,980(M); TRC IRS: 51,056.25*

### *Refund Claims*

The IRS's offset of a debtor's income tax refund against a federal income tax debt was proper and the debtor was not entitled to a turnover of the alleged improper offset. The IRS conceded that the debtor was entitled to a refund in the amount of the offset; however, it applied the entire refund against past due taxes, which left nothing in which a debtor had an interest. The setoff of an income tax liability against an income tax overpayment was excepted from the automatic stay.

*In re Benson, BC-DC Va., 2017-1 USTC ¶50,197; TRC IRS: 57,054.10*

## District Court Upholds Summons For Medical Marijuana Business

A federal district court has upheld an IRS summons against a medical marijuana business. The court rejected the taxpayer's argument that the IRS was engaged in a criminal investigation.

■ ***Comment.*** Under Code Sec. 280E, all deductions and credits for amounts paid or incurred in the illegal trafficking in drugs in the federal *Controlled Substances Act* are disallowed.

***Background.*** The IRS undertook an audit of the taxpayer and issued summonses to various entities, including financial institutions and the state department of health. The taxpayer argued that the IRS abused its authority to conduct a criminal investigation into whether the taxpayer was violating federal controlled substances law and trafficking controlled substances.

***Court's analysis.*** The court found that the IRS may apply Code Sec. 280E without conducting a criminal investigation. Code Sec. 280E does not require that the IRS determine that a crime has been committed or the taxpayer has engaged in illegal activity. Further, trafficking as used in Code Sec. 280E means to buy or sell regularly, the court explained. In this case, the question was whether the taxpayer regularly bought or sold marijuana, the court held.

*High Desert Relief, Inc., DC-N.M.; TRC IRS: 21,050.*

### *Deficiencies and Penalties*

An individual was properly liable for penalties for fraudulent failure to file and he and his wife were liable for penalties for failure to pay taxes. Moreover, the IRS was not required to take into account various payments made years later. Those payments were made too late to affect the penalty because they were not made "on or before" the date prescribed for payment but years after the maximum penalty had accrued.

*Crummey, CA-5, 2017-1 USTC ¶50,195; TRC PENALTY: 3,050*

An individual, who was a 50-percent owner and one of two officers of a member-managed company, was liable for a trust fund recovery penalty. As one of two managing members, the individual clearly ought to have known that the withholding taxes were not being paid and he was in a position to find out. Moreover, he knew that the company had to pay the taxes but he paid employees and other creditors and did not remedy the tax deficiency.

*Commander, DC N.J., 2017-1 USTC ¶50,194; TRC PAYROLL: 6,304*

A tax protestor, who made frivolous and groundless arguments and otherwise delayed collection, was liable for delay penalties.

*Willams, TC, CCH Dec. 60,869(M), FED ¶47,983(M); TRC IRS: 51,056.20*

Married individuals, who were deemed to have stipulated to the IRS's proposed facts as a sanction for their failure to respond to a show cause order, were liable for the deficiencies determined by the IRS. Moreover, the deemed admissions established strong evidence of the husband's fraudulent conduct; therefore, he was liable for the fraud penalty.

*Ballard, TC, CCH Dec. 60,868(M), FED ¶47,982(M); TRC INDIV: 6,052*

### *Innocent Spouse Relief*

A resource manager was not entitled to innocent spouse relief for the two tax years at issue. The individual prepared the returns; therefore, she knew about the gambling losses that caused the tax understatements when she signed the joint returns. Thus, it was not inequitable to deny the individual relief.

*Yancey, TC, CCH Dec. 60,870(M), FED ¶47,984(M); TRC INDIV: 18,054.10*

# IRS Officials Continue To Detail LB&I's New Issue-Based Audits And Compliance Campaigns

The IRS Large Business and International (LB&I) division has seen a number of structural and procedural changes over the last two years. Most notably, it is expected to soon unveil additional changes to its evolving issue-based audit examination process of large and mid-size businesses with assets that exceed $10 million. Among these additions, the LB&I Division on January 31 announced the launch of its first 13 compliance campaigns designed to enhance tax compliance through the identification of specific tax areas that present compliance risks.

LB&I executives on March 28 provided an updated explanation of LB&I's new campaign initiatives in the second webcast, as sponsored by Ernst & Young, LLP (EY), in a series of eight that are designed to provide taxpayers and practitioners with more information concerning LB&I's evolving, interconnected campaign and examination process. Kathy Robbins, director of enterprise activities for the LB&I Division and Tina Meaux, LB&I assistant deputy commissioner for compliance integration, addressed a number of questions, which have developed since the launch of the campaigns.

## Reorganization

Effective in February 2016, LB&I reorganized its core structure into nine practice areas, five of which are based on subject matter and four on geographical compliance areas. The subject matter practice areas include:

- Pass-though entities;
- Enterprise activities;
- Cross-border activities;
- Withholding and international individual compliance; and
- Treaty and transfer pricing.

The geographic practice areas (and corresponding headquarters) include the:

- Northeast (New York);
- East (Downers Grove, Illinois);
- Central (Houston); and
- West (Oakland, California).

With the recent launch of the LB&I compliance campaigns this year, the audit process is transitioning from industry, taxpayer focused examinations to targeted return selection within specifically identified tax areas in which the risk of noncompliance has been deemed significant.

*"Some taxpayers will initially be preselected....campaign preselection, however, does not automatically equate to an assumption of noncompliance or a resulting audit."*

The initial 13 campaigns, addressing both domestic as well as international issues, are as follows:

- Section 48C energy credit campaign;
- Offshore Voluntary Compliance Program;
- Domestic production activities deduction (TV);
- Micro-captive insurance campaign;
- Related party transactions campaign (mid-market);
- Deferred variable annuity reserves and life insurance reserves IIR campaign;
- Basket transactions campaign (structured financial transactions);
- Land developers, completed contract method campaign;
- TEFRA linkage plan strategy campaign;
- S corporation losses claimed in excess of basis campaign;
- Repatriation campaign (mid-market);
- Fornm 1120-F nonfiler campaign; and
- Inbound distributor campaign.

Additional campaigns will be identified and developed in the coming months, according to Robbins and Meaux. These 13 campaigns represent only the first wave of LB&I's issue-based compliance work, the IRS has indicated.

All new campaigns would be announced publicly so long as doing so would not impair tax administration, Meaux said. "We are looking at how we are going to do that…this is a new way of work for us."

## Budget

LB&I executives discussed how diminishing resources and significant budget cuts have affected the agency's audit process. The IRS's budget has been cut by 17 percent from 2010 to 2016, as noted during the webcast. The campaign initiative is said to be one of the first efforts of the IRS to approach reforming management procedures under limited resources. Additionally, the IRS has seen a 20-percent reduction in personnel, which has resulted in a loss of nearly 17,000 employees, as noted by Commissioner John Koskinen recently. Moreover, that personnel loss has resulted in 12,000 fewer enforcement employees, according to the webcast.

Accordingly, the IRS has experienced the lowest individual and business audit coverage in a decade. As for large corporations, the chance of being audited went from 16.6 percent in FY 2010 down to 9.5 percent in FY 2016. Similarly, on the individual side, audits went from 1.1 percent in FY 2010 down to 0.7 percent in FY 2016.

"The campaigns are the culmination of an extensive effort to redefine large business compliance work and build a supportive infrastructure inside LB&I. Campaign development requires strategic planning and deployment of resources, training and tools, metrics and feedback. These campaigns were identified through LB&I

*continued on page 179*

# WASHINGTON REPORT *by the Wolters Kluwer Washington News Bureau*

## Koskinen expresses optimism about IRS funding

IRS Commissioner John Koskinen expressed optimism for the Service's funding in fiscal year (FY) 2018, saying he has had positive discussions with the new leadership at Treasury and lawmakers. Koskinen also highlighted customer service, cybercrime, and tax administration, during an address at the National Press Club in Washington, D.C., on April 5.

The IRS received an additional $290 million in appropriations for 2016, Koskinen reported. "We used this funding to strengthen cybersecurity, increase our efforts against identity theft, and improve taxpayer service," Koskinen said. "For the average person, the improvement in service was especially noticeable on the phones,"he said.

Looking ahead, Koskinen said he has had good conversations with Treasury Secretary Steven Mnuchin about funding. "The Treasury Secretary from the time of his confirmation hearing has expressed surprised at the cuts the IRS has had." In a budget outline unveiled last month, President Trump proposed to reduce the agency's fiscal year (FY) 2018 by some $239 million. At this time the IRS, like many other federal agencies, is operating under a temporary, continuing funding resolution.

## Bipartisan RESPECT bill reintroduced in House

House Ways and Means Tax Policy Subcommittee Chair Peter Roskam, R-Ill., and Democratic Caucus Chair Joseph Crowley, D-N.Y., have reintroduced the bipartisan Clyde-Hirsch-Sowers RESPECT Bill. Last year, the bill was approved in the House but the Senate did not take it up before year-end.

If enacted, the bill would limit the IRS's authority in conducting civil asset seizure and forfeiture relating to structuring transactions under the *Bank Secrecy Act* (BSA). "Civil asset forfeiture may have begun as a tool to combat criminal activity, but it has morphed into a complex process that unfairly entangles innocent individuals," the lawmakers said in a statement. "There is no question that the laws are deeply flawed and the process was riddled with abuse," they said.

## Lawmakers unveil bipartisan bill closing "settlement loophole"

Sens. Jack Reed, D-R.I., and Charles Grassley, R-Iowa have introduced the bipartisan Government Settlement Transparency and Reform Bill. The measure would amend the Tax Code to prohibit a tax deduction for amounts paid to any governmental entity relating to illegal conduct or the investigation of a potential violation.

The bill would also require the government and the settling party to establish how settlement payments will be treated for tax purposes. Additionally, it would specify which settlement payments are punitive and, thus, nondeductible under current law, according to Reed. "Federal agencies too often do not consider the tax implications, but you can be sure the company does. This bill will ensure that government agencies think of the tax consequences in settlements going forward and increase transparency for the public," Grassley added.

## House passes Self-Insurance Protection Act

The House has passed the Self-Insurance Protection Act (HR 1304). The House voted 400-16 to approve the measure. Generally, the bill would amend the Tax Code, the Employee Retirement Income Security Act (ERISA), and the Public Health Service Act to clarify that regulators could not redefine stop-loss insurance as traditional health insurance.

The U.S. Department of Labor (DOL) has explained that stop-loss protection allows an employer to self-insure for a set amount of claims costs, with the stop loss insurance covering most or all of the remainder of the claims costs that exceed the set amount. Stop loss insurance policies may be purchased by an employer or by the employer's group health plan.

## SFC reviews filing season, cybersecurity

The Senate Finance Committee held a hearing on April 6 looking at the filing season and cybersecurity at the IRS. IRS Commissioner John Koskinen told lawmakers that the IRS has made continuous improvements in the realm of cybersecurity and stolen identity refund fraud despite dwindling resources. Koskinen credited much of this improvement to the collaborative work of the Security Summit Group, a partnership between the public and private sectors to identify fraud and implement safeguards.

***AICPA comments.*** The American Institute of Certified Public Accountants (AICPA), too, expressed concern over taxpayer security in its written testimony submitted for the hearing's record. According to the AICPA, the IRS's renewed use of private collection agencies, will only add to these concerns.

"Taxpayers have growing concerns about the actions of private collection agencies and their legal authority. Due to the proliferation of fraudulent tax return scams, we believe the use of private collection agencies will add security, authentication, verification, and complexity concerns to an already overburdened system," the AICPA wrote. "The IRS does not have the ability to ensure consistent and fair treatment of taxpayers across multiple private collection agencies."

## Lawmakers discuss farm tax policy

The House Agriculture Committee recently held a hearing on tax reform and its impact on agriculture, farming and ranching. Lawmakers heard from farming experts inside and outside of government.

"Farm businesses are impacted both by individual income tax rates and preferences, as well as business tax preferences as provided by deductions, credits, deferrals and other provisions," an official with the U.S. Department of Agriculture told lawmakers. "The acquisition of land, equipment and livestock is a daunting challenge to a new generation of farmers. An impediment to transferring farm assets during an exiting farmer's lifetime is the increased income tax liability resulting from lifetime transfers of those assets compared to transfers after the exiting farmer's death," an official with the University of North Carolina added.

*Continued from page 177*

extensive data analysis, suggestions from IRS compliance employees and feedback from the tax community. LB&I's goal is to improve return selection, identify issues representing a risk of non-compliance, and make the greatest use of limited resources."

Examiners will receive assignments based on a number of issues, including IRS resources, geographic location, and the agent's skillset, according to Robbins. Additionally, campaigns will be addressed nationwide, and some work on campaigns may be done by agents remotely rather than in local offices.

## Examination tool

The new campaign approach is designed to be a return selection tool, so to speak, for the broader examination process, enabling more focused return selection, according to Robbins and Meaux. The campaign process represents a "fundamental change" in LB&I's selection of work, she added. That said, however, the campaign process is not intended to change the current examination process or increase the number of audits, they noted. Rather, it is expected to result in a more focused analysis and selection of returns.

"The idea is not to audit more returns, but to respond with a variety of treatment streams to maintain a high compliance across our filing population," Meaux said. "It is possible that while a compliance risk exists, there is no issue of noncompliance and thus no adjustment will occur," she added.

## Pre-selection

Robbins explained that some taxpayers will initially be preselected to be included in certain campaigns. Such campaign preselection, however, does not automatically equate to an assumption of noncompliance or a resulting audit.

According to Meaux, there is no protocol in place, at this time, to alert taxpayers to their involvement in a campaign. If a taxpayer inquires as to whether their examination resulted from the involvement in a campaign, however, LB&I will confirm those details.

## Soft letters

Taxpayers and practitioners have had questions about a treatment stream known as "soft letters" being used for several of the new campaigns. While soft letters have been used by the IRS before, it is a fairly new tool for LB&I, Robbins said. The four campaigns currently listing soft letters as a treatment stream are Section 48C Credit, Land Developers, S Corp losses claimed in excess of basis, and Form 1120F Non-Filer.

LB&I executives, addressing such concerns, have emphasized that soft letters are not an indication that an examination process will take place; rather, it is a request for additional information. "A soft letter does not request books or records, and does not rise to the level of examination," according to the LB&I executives.

Taxpayers are not required to respond to a soft letter, according to the executives. Failure to do so, however, could possibly result in an examination process that otherwise would not have been initiated, they cautioned. It is important to provide the LB&I with any additional information requested to assess appropriate compliance so that an accurate determination can be made without needing to rely on the examination process to do so, both Robbins and Meaux noted. The soft letters are meant to provide an open-line of communication between the taxpayer and IRS, as well as to encourage voluntary self-correction, if warranted.

As far as taxpayers' expectations of hearing from the LB&I Division after responding to a soft letter, the executives were not able to offer any clarity. LB&I has not had time to "fully consider how or if" it will respond to a taxpayer's response to the soft letters, Robbins said. Soft letter contents, or even use, in a campaign may need be revised as the process goes on, Robbins noted. Several soft letter examples will be published on the IRS website as a link to the particular practice unit.

## Metrics

Success will be measured differently for each campaign, Robbins predicted, while implying no formal metrics have been put into place. Data analytics, changes in taxpayer behavior, and feedback will all be a part of determining how successful a campaign is. At this time, however, there has been no specific metric system designed for measuring the success of the campaigns.

## Integrated feedback loop

The LB&I Division executives stressed the importance of receiving taxpayer feedback to ensure the smooth operation and successful implementation of the new campaigns. The LB&I Division will incorporate its "integrated feedback loop" as a tool to encourage taxpayer and employee engagement and feedback.

"We are looking at feedback in real-time now – that is a game changer for us," Meaux said. Both IRS executives conveyed how different the feedback process is now, whereas feedback provided in situations prior came after the development of a process or procedure; this time, it is concurrent.

Robbins and Meaux both commented on the LB&I Division's potential missed opportunity to address certain issues if they are not made aware of taxpayer concerns, Robbins said. "We would like to hear from the business communities," Meaux added.

As far as how a taxpayer can submit such feedback, LB&I has not yet established that procedure. "We're open to your recommendations on what methods we should use to secure that input," Robbins said, while noting there is no current procedure to advise taxpayers on how to submit their feedback. Robbins did note, however, that taxpayers can reach out directly to the campaign executives as well as participate in future webcasts.

"We do understand the magnitude of this change…and the level of uncertainty as to the whole process in total is concerning to folks…we all are going to have to adapt to this new environment" Meaux said.

## Future webcasts

The remaining six webcasts will be on specific campaigns, rather than a general overview as seen within the first two. The dates of the next two scheduled webcasts in April are the 20 and 26. The fifth webcast will be on May 10. As for the remaining three, those precise dates have not yet been released.

# COMPLIANCE CALENDAR

### April 14

Employers deposit Social Security, Medicare, and withheld income tax for April 8, 9, 10, and 11.

### April 18

Individuals file a 2016 income tax return (1040 series) and pay any tax due. For a six-month extension, file Form 4868 and deposit estimated tax.

Individuals file Form 1040-ES to pay first installment of 2017 estimated tax.

Household employers file Schedule H with Form 1040, if more $2,000 or more paid to household employee.

C corporations on calendar year file Form 1120 for calendar year and pay tax due. For 6-month automatic extension, file Form 7004 and deposit estimated tax.

C corporations on calendar year deposit first installment of 2017 estimated tax.

Employers deposit Social Security, Medicare, and withheld income tax for March if monthly deposit rule applies

### April 20

Employers deposit Social Security, Medicare and withheld income tax for April 12, 13 and 14.

### April 21

Employers deposit Social Security, Medicare and withheld income tax for April 15, 16, 17, and 18.

# TRC TEXT REFERENCE TABLE

*The cross references at the end of the articles in Wolters Kluwer Federal Tax Weekly (FTW) are text references to Tax Research Consultant (TRC). The following is a table of TRC text references to developments reported in FTW since the last release of New Developments.*

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# FROM THE HELPLINE

*The following questions have been answered recently by our "Wolters Kluwer Tax Research Consultant" Helpline (1-800-344-3734).*

**Q** Is there any information regarding whether breakroom/kitchen backspalshes (affixed with cement and grout) can be considered personal property under Code Sec 1245?

**A** Generally, anything that is permanently attached is considered section 1250 property. The IRS cost segregation guide includes a matrix listing section 1250 and 1245 property in the case of a restaurant building. This and other matrixes are reproduced in *TRC DEPR: 6,062.097.* The section of the matrix entitled "Wall Coverings" states that tile that is affixed with cement, etc. is section 1250 property. There appears to be no cost segregation principle that allows section 1250 property to be treated as section 1245 property simply because the section 1250 is removed or must be removed at the same time as the section 1245 property. The cost segregation rules are discussed at *TRC DEPR: 6058.*

**Q** Assume a foreign parent corporation (Company A) on March 31 acquired foreign corporation (Company B) on, which owns a U.S. corporation (Company C), which is on a calendar year. Does Company C need to file a short-period return because of change-in-ownership rules?

**A** The requirements for short-period returns are in Code Sec. 443 and Reg. 1443-1, *see TRC ACCTNG 24,250.* The rules for short-period returns for subsidiaries coming into or leaving a consolidated group are in Reg. Sec. 1. 1502-76(b), (c), *see TRC CONSOL 15,106;* 25 percent foreign-owned U.S. corporations are required to file an information return on Form 5472.