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White House, GOP Launch Negotiations On Looming Fiscal Cliff

President Obama and the GOP have started negotiations to avoid the so-called "fiscal cliff," the combination of the scheduled expiration of the Bush-era tax cuts and across-the-board spending cuts scheduled to take affect after 2012. President Obama, strengthened by an impressive win in the Electoral College, is expected to push for a package of tax increases and spending cuts. Republicans, following their setbacks, may be open to revisiting their pre-election position of no tax increases.

■ ***CCH Take Away.*** "It appears that Americans voted for the status quo. President Obama is re-elected, Republicans still control the House and Democrats still control the Senate," Rick Bailine, principal-in-charge, Washington National Tax Office, McGladrey LLP, told CCH. "The White House and Congress must come together to address the fiscal cliff and they will. Before year-end, one compromise could be a temporary extension of the current tax regime through 2013."

■ ***Comment.*** "For many taxpayers, especially business taxpayers, the biggest issue looming before year-end is the uncertainty over what their tax obligations will be next year," Robert Jazwinski, CPA, president of the Pennsylvania Institute of Certified Public Accountants (PICPA), told CCH. "After the election, there is the expectation that leaders in Washington will begin to work on legislation to alleviate the negative implications of the fiscal cliff," Jazwinski predicted.

Tax cuts

Reduced individual income tax rates, lower capital gains and dividends tax rates, the $1,000 child tax credit, and other tax provisions enacted during the Bush administration and extended by the Tax Relief Act of 2010 are scheduled to sunset after December 31, 2012. Many individual tax extenders have already expired or will expire after 2012. Additionally, the alternative minimum tax (AMT) is on course to expand its reach into middle income households, without a 2012 "patch," and the employee-side payroll tax holiday will expire after December 31, 2012.

■ ***Comment.*** Since winning re-election, President Obama has reiterated his opposition to extending the Bush-era tax cuts for higher income taxpayers. President Obama has used the income thresholds of $200,000 for single individuals and $250,000 for families to describe the end point of extending the Bush-era tax cuts. Some lawmakers have floated higher income thresholds (such as $500,000 or $1 million).

■ ***Comment.*** House Speaker John Boehner, R-Ohio, has indicated that the GOP may be open to raising revenues but apparently only through tax reform, which could cap some unspecified deductions for higher income individuals. Sen. Bob Corker, R-Tenn., predicted that entitlement reform would be a greater stumbling block to reaching an agreement than taxes.

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IRS Expands Disaster Relief For Hurricane Sandy Victims

◆ *IR-2012-87, -88, -91, Notice 2012-69, CT-2012-48, NJ-2012-47, NY-2012-47*

The IRS has added to the list of localities eligible for Hurricane Sandy disaster relief and announced it will expedite the processing of returns claiming a casualty loss. The agency also issued guidance on leave donation programs, cautioned taxpayers about disaster relief scams and indicated it will speed up the approval of exempt organizations providing relief.

■ ***CCH Take Away.*** The IRS also announced that it will expedite processing of returns claiming a Hurricane Sandy disaster loss. Taxpayers should write the disaster designation "Connecticut/Hurricane Sandy," "New Jersey/Hurricane Sandy," or "New York/Hurricane Sandy" at the top of their return.

Extended deadlines

Shortly after Hurricane Sandy hit, the IRS announced extended filing and payment deadlines for taxpayers in affected localities in Connecticut, New Jersey and New York. Now, the IRS has expanded disaster relief to more counties in New Jersey and New York. Generally, deadlines falling on or after December 26, 2012 and on or before February 1, 2013 are postponed to February 1, 2013.

■ ***Comment.*** The additional counties in New Jersey are Burlington, Camden, Cumberland, Gloucester, Hunterdon, Mercer, Morris, Passaic, Salem, Somerset, Suffolk, and Warren. The additional county in New York is New York (Manhattan).

Leave donations

Leave donation programs allow employees to elect to forgo vacation, sick or personnel leave in exchange for cash payments an employer makes to a qualified charitable organization. The IRS explained that it will not assert that these cash payments, made to charitable organizations assisting Hurricane Sandy victims, are gross income or wages to the employee. The cash payments must be made before January 1, 2014.

■ ***Comment.*** Employees who make a donation of leave cannot claim a charitable deduction.

Scams

The IRS has received reports of scam artists impersonating legitimate charities following Hurricane Sandy. The agency reminded taxpayers to donate to recognized charities and to make donations by check or credit card or another way that provides documentation for the gift.

The IRS also cautioned that bogus websites may solicit funds for Hurricane Sandy relief. These bogus sites frequently mimic the sites of, or use names similar to, legitimate charitable organizations. Scam artists also frequently attempt to contact taxpayers by email, the IRS cautioned.

Charities

The IRS will expedite its review and approval process for organizations seeking tax-exempt status to provide relief to Hurricane Sandy victims. Organizations should write "Disaster Relief, Hurricane Sandy" at the top of Form 1023, Application for Recognition of Exemption.

References: FED ¶¶46,517, 46,521, 46,522, 46,523, 46,531; TRC FILEIND: 15,204.25.

White House/GOP

Continued from page 1

Estate and gift taxes

The maximum federal estate tax rate is scheduled to increase to 55 percent for estates of decedents dying after December 31, 2012, without Congressional intervention. The estate tax exclusion will fall from \$5.12 million to \$1 million after 2012 and portability will no longer be available.

■ ***Comment.*** "Many taxpayers are looking at their gifting options before the end of the year in light of the scheduled decline in the lifetime gift tax exclusion," Gary Phillips, partner, Cole Schotz, told CCH. The lifetime gift tax exclusion under current law is \$5.12 million through the end of 2012. Unless extended, the amount is scheduled to decline to \$1 million after 2012 (to be adjusted for inflation), Phillips explained.

Businesses

Corporate tax reform may take a back seat to negotiations over taxes on individuals and spending cuts. Some expired business extenders could be extended as part of a year-end agreement. These include the research tax credit, the Work Opportunity Tax Credit (WOTC) for veterans and non-veterans, and others. Bonus depreciation and enhanced small business expensing could also be revived in a year-end agreement.

Affordable Care Act

The President's re-election means that the tax provisions in the *Patient Protection and Affordable Care Act* (PPACA) will move forward. On January 1, 2013, the new 3.8 percent Medicare contribution tax and 0.9 percent additional Medicare tax will take effect, largely impacting higher income taxpayers. New rules limiting the itemized deduction for qualified medical expenses to a 10 percent floor and a \$2,500 cap on contributions to health flexible spending arrangements (health FSAs) also kick-in.

■ ***Comment.*** "The Affordable Care Act is unlikely to go through more than minimal disruption," Kimberly McCarthy, partner, Partridge, Snow and Hahn, LLP, Providence, R.I., told CCH. "However, some provisions of the Affordable Care Act rely on discretionary funding. Most discretionary funding would be subject to direct spending reductions under sequestration."

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Reference Key

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

Plan Sponsors In Bankruptcy May Nix Single-Sum Distribution Option Under Final Regs

◆ *TD 9601*

The IRS has adopted final regs that provide a limited exception to the anti-cutback rules of Code Sec. 411(d)(6). The exception permits an employer in bankruptcy to amend its single-employer defined benefit plan to eliminate a single-sum distribution option (or other optional form of accelerated benefit) if certain conditions are met.

■ ***CCH Take Away.*** The anti-cutback rules prohibit an employer from eliminating certain benefits if they have accrued. Code Sec. 436 limits certain benefit payments by an underfunded plan. The final regs address a potential conflict between these two provisions and help to preserve the plan's solvency when a plan sponsor is in bankruptcy.

Background

The anti-cutback rules prohibit amendments to a qualified pension plan that eliminate or reduce an early retirement benefit or retirement-type subsidy, or eliminating an optional form of benefit. However, the IRS can allow the elimination of an optional form of benefit, provided that plan participants do not lose either a valuable right or an employer-subsidized optional form of benefit.

Under Code Sec. 436(d)(2), a single-employer plan sponsored by an employer in bankruptcy may not pay a "prohibited payment" whose annuity starting date occurs during a period of bankruptcy, unless the plan's adjusted funding target attainment percentage (AFTAP) is at least 100 percent. Prohibited payments include any payment that exceeds the monthly amount paid under a single life annuity.

■ ***Comment.*** The AFTAP essentially is the ratio of the value of the plan's assets to the plan's funding target for the year.

Final regs

The final regs apply to a plan amendment that is adopted and effective after November 8, 2012. The final regs allow an employer in bankruptcy to eliminate a single-sum distribution option (or other optional form of benefit providing for accelerated payments) if four conditions are satisfied:

- The plan's enrolled actuary must certify that the plan's AFTAP for the plan year of the amendment is less than 100 percent.
- The plan is not permitted to pay any prohibited payment under Code Sec. 436(d)(2) because the plan sponsor is a debtor in bankruptcy.
- The bankruptcy court has issued an order, after notice to the affected parties, finding that the amendment eliminating the optional form of benefit is necessary to avoid a distress termination or an involuntary termination of the plan before the plan sponsor emerges from bankruptcy.
- The Pension Benefit Guaranty Corporation (PBGC) has also determined that the plan amendment is necessary to avoid a distress or involuntary termination of the plan during bankruptcy.

■ ***Comment.*** The final regs clarify that the failure to notify a particular participant or beneficiary does not automatically invalidate the amendment.

Survivor benefits

The IRS declined to impose additional conditions on the elimination of particular payment options, such as a condition that the plan must offer annuity distribution options that provide substantial survivor benefits. However, to allow participants with substandard mortality to protect their survivors, the plan sponsor can choose to add other optional forms of benefit.

References: FED ¶47,041; TRC RETIRE: 15,402.

IRS Nonacquiesces In Gift Tax Case Approving Dollar Value Formula Clause

The IRS has announced its nonacquiesence in *Wandry, CCH Dec. 59,000(M) (2012)* a controversial Tax Court gift tax decision that approved a formula clause to determine the amount of particular gifts. The formula used a specific dollar value to determine the total number of partnership units transferred.

■ ***Comment.*** "The nonacquiescense in the *Wandry* case is disappointing and leaves taxpayers and their advisors in a perplexing situation," Robert Keebler, CPA, MST, AEP, Keebler & Associates, LLP, Green Bay, Wisconsin, told CCH. "The debate will obviously continue until there is a split between the circuits and the issue moves to the U.S. Supreme Court. It is critical to remember that the recent Appeals Court decisions in *Christiansen*, *Hendrix*, *Petter* and *McCord* have all been in favor of the taxpayer."

Background. In *Wandry*, the taxpayers gave units of LLC interests to family members. The number of units equaled the value of the applicable federal gift tax exclusions for 2004—the $11,000 annual exclusion, plus the $1 million lifetime exclusion. The parties subsequently agreed that the units were worth more than the amounts claimed by the taxpayers.

The gift documents automatically reduced the number of units given, so that the total gifts continued to equal the gift tax exclusions. The IRS argued that the taxpayers could not reduce the number of units, and that the revalued units exceeded the gift tax exclusions. The Tax Court disagreed, allowing the reduction in units.

IRS withdraws appeal. The IRS appealed the decision to the Tenth Circuit Court of Appeals, but recently withdrew its appeal without explanation, generating much speculation among estate planning practitioners. By nonacquiescing, the IRS has signaled that it generally will not follow the decision in other cases.

IRS AOD, Wandry, TC Memo. 2012-88, CCH Dec. 59,000(M); TRC ESTGIFT: 3,064

Growing Number Of Countries Express Interest In Pursuing FATCA Agreements, Treasury Reports

◆ *TDNR TG-1759*

Treasury has announced that it is actively engaged in discussions with over 50 countries and jurisdictions about implementing the Foreign Account Tax Compliance Act (FATCA). Earlier this year, Treasury reported that France, Germany, Italy, and Spain intend to pursue a government-to-government framework for implementing FATCA. The U.S. and the U.K. concluded a FATCA reporting agreement in September 2012.

■ ***CCH Take Away.*** "Global cooperation is critical to implementing FATCA in a way that is targeted and efficient," Treasury Assistant Secretary for Tax Policy Mark Mazur said in a statement. "By working cooperatively with foreign governments and financial institutions, we are intensifying our ability to combat tax evasion while minimizing burdens on financial institutions."

Background

FATCA generally requires foreign financial institutions (FFIs) to report to the U.S. certain information about financial accounts held by U.S. taxpayers, or by foreign entities in which U.S. taxpayers hold a substantial ownership interest. An FFI will have to enter into a special agreement with the IRS by June 30, 2013. A "participating FFI" will:

- Undertake certain identification and due diligence procedures with respect to its accountholders;
- Report annually to the IRS on its accountholders who are U.S. persons or foreign entities with substantial U.S. ownership; and
- Withhold and pay over 30-percent of any payments of U.S. source income, as well as gross proceeds from the sale of securities that generate U.S. source income, made to non-participating FFIs, individual accountholders failing to provide sufficient information to determine whether or not they are a U.S. person ("recalcitrant" accountholders), or foreign entity accountholders failing to provide sufficient information about the identity of their substantial U.S. owners.

Model agreements

Treasury has developed two model agreements (Model I and Model II) after negotiations with foreign jurisdictions. Model I contemplates reporting by FFIs to their respective governments, followed by the automatic exchange of this information with the U.S. Model II establishes a framework of direct reporting by foreign financial institutions to the IRS, supplemented by information exchanged between the foreign government and the U.S. government upon request.

Model I has two versions. The reciprocal version provides for the U.S. to exchange information on accounts held in U.S. financial institutions by residents of partner countries. The nonreciprocal version does not provide for the U.S. to exchange information on accounts in the U.S. held by residents of partner countries.

■ ***Comment.*** The reciprocal version of Model I is only available to jurisdictions with which the U.S. has an income tax treaty or tax information exchange agreement. The IRS also must determine that the foreign jurisdiction has robust protections and practices to ensure that the information remains confidential and that it is used solely for tax purposes. The IRS will make this determination on a case by case basis.

Worldwide discussions

Treasury reported that it aims to finalize FATCA agreements by year-end with France, Germany, Italy, Spain, Japan, Switzerland, Canada, Denmark, Finland, Guernsey, Ireland, the Isle of Man, Jersey, Mexico, the Netherlands, and Norway.

■ ***Comment.*** Guernsey, the Isle of Man and Jersey are Crown dependencies of the U.K. Their taxing authorities have indicated that their agreements with the U.S. will likely track the agreement entered into between the U.S. and the U.K.

References: FED ¶46,525; TRC FILEBUS: 9,108.

U.S. Withholding Agents May Accept Electronic Forms W-8 Under Certain Circumstances

IRS Chief Counsel has determined that U.S. withholding agents can accept an electronic Form W-8 under certain facts and circumstances. A Form W-8 that is signed with a handwritten signature, scanned into an electronic system, and then transmitted directly to a withholding agent through that electronic system would meet the electronic submission requirements.

Electronic submission. An electronically transmitted Form W-8 meets the requirements of Reg. §1.1441-1(e)(4)(iv) if:

■ The withholding agent's electronic system ensures that the information received is the information sent and documents all occasions of user access that result in the submission, renewal, or modification of the form;

■ The electronic W-8 provides the same information as the paper form;

■ The electronic W-8 contains an electronic signature by the person—or his authorized designee—whose name is on the Form W-8 and who is subject to the penalties of perjury statement on the paper form; and

■ Upon the IRS's request during an exam, the withholding agent can supply the electronically submitted Form W-8 in hard copy along with a statement that the electronic Form W-8 was filed by the person whose name is on the form.

AM 2012-008; TRC INTL: 33,056.20.

District Court Finds Failure To File FBARs Sufficiently Willful; Upholds Penalties

◆ *McBride, DC Utah, November 9, 2012*

A federal district court has upheld the IRS's imposition of two $100,000 penalties for failing to disclose foreign financial accounts on Form TD F 90-22.1, Report of Foreign Bank and Foreign Accounts (FBAR) in two years. The taxpayer had attempted to hide his ownership of the accounts and his failure to file FBARs was willful for purposes of applying FBAR penalties.

■ ***CCH Take Away.*** The Court of Appeals for the Fourth Circuit reached a similar conclusion in *Williams, 2012-2* USTC *¶50,475*. Reversing the trial court, the Fourth Circuit found that the taxpayer's conduct evidenced his willful blindness to the FBAR filing requirement.

Background

The taxpayer was a co-owner of a limited liability company (LLC) and oversaw the LLC's finances. The LLC engaged in a number of transactions which were later determined to be motivated by tax evasion. Large sums generated from these transactions were deposited into accounts at foreign banks. The taxpayer did not share knowledge of these foreign accounts with his return preparer and their existence was not disclosed on the taxpayer's Form 1040 nor did the taxpayer file FBARs.

The IRS subsequently investigated the LLC and requested that the taxpayer file FBARs for 2000 and 2001. The taxpayer did not. The IRS imposed two $100,000 penalties (one for failing to file an FBAR for 2000 and another for failing to file an FBAR for 2001).

Court's analysis

The court first noted that the Tax Code does not define how to assess whether an individual acted willfully in his or her failure to comply with the FBAR reporting requirements. Where willfulness is a condition of civil liability, it covers not only knowing violations of a standard, but reckless ones as well.

Here, the court found that the taxpayer knew of his obligation to file an FBAR. His income tax returns, which he signed, plainly informed him that he had the duty to report an interest in any foreign financial or bank accounts.

The court further found that the taxpayer repeatedly lied to the IRS about the existence of the foreign accounts and withheld certain documents from the agency. They amounted to circumstantial evidence of willfulness.

Additionally, the taxpayer's behavior was reckless. The simple yes-or-no format of the question on Form 1040 made it inconceivable that he could have misinterpreted the question.

Reference: TRC FILEBUS: 9,104.35.

Shulman Highlights Achievements In Farewell Address, Urges Action On AMT Patch, Funding And More

◆ *IR-2012-89*

In his final public address as IRS Commissioner, Douglas Shulman reflected on some of his accomplishments and urged Congress to pass an alternative minimum tax (AMT) patch for 2012 to avoid delaying the 2013 filing season. Speaking on November 7 at the National Tax Conference of the American Institute of Certified Public Accountants (AICPA) in Washington, D.C., Shulman also said that the nation needs a well-funded IRS to enforce the tax laws.

■ ***CCH Take Away.*** Shulman stepped down on November 9, 2012. IRS Deputy Commissioner Steven Miller will serve as Acting IRS Commissioner until President Obama nominates and the Senate approves a permanent replacement. President Obama is not expected to nominate an individual to serve as IRS commissioner until early in 2013.

2013 filing season

Shulman warned that the start of the 2013 filing season could be delayed if Congress passes tax legislation late in the year. One major issue to resolve before 2013 is the AMT patch, Shulman. "Our systems are coded assuming that there is an AMT patch. And so, if for some reason the AMT patch does not happen, there would be significant delays in the filing season."

Achievements

Shulman lauded the IRS's achievements in international taxation, which included offshore voluntary disclosure initiatives, agreements with foreign jurisdictions to promote transparency, and greater international cooperation. Shulman said that the offshore voluntary disclosure initiatives have been highly successful, having collected approximately $5.5 billion in additional revenue to date.

The IRS has also transformed its relationship with corporate taxpayers, Shulman said. The agency has used the Compliance Assurance Process (CAP), Fast Track Appeals program, and industry issue resolution program to resolve issues with corporate taxpayers more efficiently.

The IRS has also succeeded in modernizing its tax return processing database, which enables the agency to process taxpayer data on a daily basis. As a result, the agency is able to process returns more quickly.

Return preparers

Shulman oversaw implementation of the IRS return preparer initiative. Shulman said that more than 850,000 tax return preparers have obtained preparer tax identification numbers (PTINs). Shulman predicted that the registered return preparer program would ensure a basic level of competency, which would ultimately prove beneficial to taxpayers, tax professionals, and tax compliance.

Reference: TRC FILEIND: 30,402.

Tax Court Allows Married Couple To Claim First-Time Homebuyer Credit, Each Qualifying For Different Reason

◆*Packard, 139 TC No. 15*

The Tax Court has found in a case of first impression that a married couple may claim the $6,500 first-time homebuyer credit, even though the husband and wife qualified under different subsections of Code Sec. 36(c). The husband was a first-time homeowner under Code Sec. 36(c)(1); the wife had previously owned a principal residence but qualified under the Code Sec. 36(c)(6) long-time resident exception.

■ ***CCH Take Away.*** The *Worker, Homeownership, and Business Assistance Act of 2009* added the Code Sec. 36(c)(6) exception, which generally allowed homebuyers who had previously owned a principal residence to claim the credit. The exception provides that an individual, who owned and used the same residence as a principal residence for a period of five consecutive years during the eight-year period ending on the date of the purchase, could claim a credit of up to $6,500.

Background

The taxpayers were married on November 22, 2008. They lived separately until they purchased a house together on December 1, 2009. The husband had previously rented and had never owned a home. The wife had previously purchased a home on April 1, 2004 and used it as her principal residence from that time until November 17, 2009. On their 2009 joint income tax return, they claimed a $6,500 first-time homebuyer tax credit.

Court's analysis

The court first found that Code Sec. 36 temporarily provided a tax credit to a qualified first-time homebuyer for year in which the residence is purchased. For purposes of the credit, Code Sec. 36(c)(1) defined a first-time homebuyer as a taxpayer (and if married, the taxpayer's spouse) who has not owned a principal residence during the three years prior to purchasing the principal residence for which the credit is claimed. The court further found that Congress expanded the definition of first-time homebuyer when it added the Code Sec. 36(c)(6) exception for long-time residents.

In this case, both the husband and the wife qualified as first-time homebuyers, albeit under different subsections of Code Sec. 36 (the husband under Code Sec. 36(C)(1) and the wife under Code Sec. 36(C)(6)). Therefore, the court concluded that the taxpayers could claim the credit but their credit would be limited to $6,500 because the wife would not have qualified for the credit except for the Code Sec. 36(C)(6) exception.

References: CCH Dec. 59,244; TRC INDIV: 57,952.

IRS Takes Steps To Recover Erroneous Credits, Stop Identity Theft, TIGTA Reports

◆*TIGTA-2012-65, November 9, 2012*

The IRS will attempt to recover millions of dollars paid for fraudulent claims of tax credits, the Treasury Inspector General for Tax Administration (TIGTA) recently reported. TIGTA also cautioned that identity theft continues to grow but reported that the IRS is combatting the problem with new tools and is stopping the issuance of fraudulent refunds.

■ ***Comment.*** If a taxpayer receives a letter from the IRS that his or her return has been flagged for potential identity theft, the taxpayer must contact the agency personally (not the taxpayer's representative), Cindy Hockenberry, EA, National Association of Tax Professionals (NATP), told CCH. Taxpayers have 75 days to respond to the IRS. The agency will ask them certain personal questions to verify their identities, Hockenberry explained.

Erroneous credits

TIGTA uncovered problems with the American Opportunity Tax Credit (AOTC) and nonbusiness energy property credits. The AOTC (an enhanced version of the HOPE education credit that is scheduled to sunset after 2012) reaches a maximum of $2,500. Qualified taxpayers may be eligible for partial refundability of the AOTC.

TIGTA identified approximately 35,000 individuals who were younger than the typical age of individuals enrolled in a four-year college degree program or post-secondary vocational program eligible for the AOTC. Of the 35,000 individuals, 13,870 were age 10 and younger. According to TIGTA, approximately 110,000 taxpayers received a refundable AOTC for 2011 totaling more than $159 million for students who were unlikely to be enrolled in a four-year college degree program or vocational program. The IRS agreed to initiate a program to recover the $159 million paid in erroneous AOTC refunds.

The Code Sec. 25C nonbusiness energy property credit has also generated erroneous refunds, TIGTA discovered. According to TIGTA, the IRS has not developed processes to ensure that taxpayers do not claim more than the allowable maximum credit. Approximately 126,000 taxpayers have claimed more than the maximum amount, generating nearly $30 million in erroneous refunds. The IRS agreed to take steps to recover the erroneous payments of the credit

Identity theft

Beginning in the 2012 filing season, the IRS implemented new filters to detect identity theft, TIGTA reported. Returns flagged by the new filters are held during processing until the IRS can verify the taxpayer's identity. Once a taxpayer's identity has been confirmed, the return is released for processing and any refund is issued.

TIGTA reported that as of April 28, 2012, the IRS had identified returns with $6.4 billion claimed in fraudulent refunds. The IRS prevented the issuance of $6.1 billion of the fraudulent refunds.

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IRS Questions Whether Non-Payment Testing Period Should Trigger Cancellation of Indebtedness Income

◆ *Notice 2012-65*

The IRS has requested comments on whether it should continue to require reporting cancellation of indebtedness (COI) income on the expiration of a "non-payment testing period." The IRS reported that it is aware of taxpayers who may be confused after receiving a Form 1099-C whether to include as income the amount reported because of the expiration of the non-payment testing period.

■ ***CCH Take Away.*** The regs under Code Sec. 6050P impose reporting of COI income on the occurrence of an identifiable event. The regs describe seven identifiable events that are specific occurrences resulting from an actual discharge of indebtedness. The eighth identifiable event—expiration of a non-payment testing period—does not necessarily result from an actual discharge of indebtedness.

Background

A governmental entity and a financial entity must report COI income on Form 1099-C, Cancellation of Debt, if the entity discharges $600 or more of debt. A financial entity has a significant trade or business of lending money. Reporting is triggered by a judicial proceeding, an agreement between the creditor and debtor, a defined policy to discontinue collection activity, or other specific occurrences that represent an actual discharge of indebtedness.

The non-payment testing period is a 36-month period during which the creditor has not received any payments on the debt. A rebuttable presumption arises that an identifiable event has occurred. The creditor may rebut this presumption by engaging in significant bona fide collection activity at any time during the 12-month period ending with the calendar year, or by facts and circumstances indicating that the debt has not been discharged.

Comments requested

In 1996, at the request of creditors, the IRS added the non-payment testing period as an identifiable event. However, because there may never be an actual discharge of the debt, this can cause confusion for debtors. Therefore, the IRS is considering whether to clarify, revise or remove the non-payment testing period as a discrete event.

The IRS requested comments on:

- Removing the testing period;
- Whether removal would affect the burden on creditors and taxpayers;
- Whether, instead, new rules should address continuing collection activity; and
- Retaining the period but modifying it to improve its usefulness.

References: FED ¶46,530; TRC SALES: 12,452.

Jurisdiction

An individual's complaint seeking to carry back net operating losses (NOLs) to an outstanding arrearage for a prior tax year was dismissed for lack of subject matter jurisdiction. The individual failed to meet the jurisdictional prerequisite of filing an administrative claim for refund before filing his lawsuit.

Akers, DC Conn., 2012-2 USTC ¶50,656; TRC LITIG: 9,102.05.

Income

An individual was required to include in income all of the unemployment compensation that he received because the $2,400 exclusion for unemployment compensation only applied for tax years beginning in 2009.

Harris, Jr., TC, CCH Dec. 59,250(M), FED ¶48,264(M); TRC INDIV: 6,208.

Deductions

The CEO of an Internet advertising company, who made cash advances to the company that he was unable to recover, was properly denied a claim for a business loss deduction for the tax year at issue because he knew in a prior year that the loans would not be repaid. He could not claim a theft-loss deduction because he failed to show that the company committed acts of larceny or fraud.

Alioto, CA-6, 2012-2 USTC ¶50,659; TRC BUSEXP: 30,102.10.

A married couple was not entitled to a net operating loss carryover for various insurance and financial service, as well as real estate, activities. There was no evidence (1) substantiating the amount of the loss claimed; (2) indicating whether the intended activity was active or passive; (3) showing that any or all of the loss had not been claimed for prior years; or (4) establishing the husband's basis in a certain S corporation.

Philpott, TC, CCH Dec. 59,245(M), FED ¶48,259(M); TRC FILEIND: 15,208.

Anti-Injunction Act

An individual's suit seeking declaratory and injunctive relief from tax assessment and collection was barred by sovereign immunity the Declaratory Judgment Act and the Anti-Injunction Act.

Bufkin, DC Fla., 2012-2 USTC ¶50,650; TRC LITIG: 9,252.05.

Default Judgment

The Tax Court entered a default decision against a taxpayer who failed to file an opening brief.

Bond, TC, CCH Dec. 59,251(M), FED ¶48,265(M); TRC LITIG: 6,656.15.

A default judgment was entered against an individual, who failed to file his tax returns for several years, on the grounds that he failed to appear at his trial and he failed to follow the provisions of the Tax Court's standing pretrial order.

Tucker, TC, CCH Dec. 59,247(M), FED ¶48,261(M); TRC IRS: 30,052.

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Liens and Levies

The government was entitled to reduce to judgment an individual's unpaid federal tax liabilities and foreclose federal tax liens on her real property. The documents submitted by the government established a *prima facie* case against the individual, which she failed to rebut.

Nitz, DC La., 2012-2 USTC ¶50,651; TRC IRS: 45,158.

Deficiencies and Penalties

An estate was not entitled to a refund of the late-payment penalty because the estate failed to request an extension of time to pay the estate taxes when it requested an extension of time to file the estate tax return. The executor's reliance on an attorney for compliance with an unambiguous deadline did not constitute reasonable cause for late payment under Code Sec. 6661(a)(2).

Thouron Est., DC Pa., 2012-2 USTC ¶50,660; TRC PENALTY: 3,062.

A federal district court's determination that two partnerships were not liable for gross misstatement of valuation penalties, but were liable for negligence and substantial understatement penalties, was proper. The IRS disallowed the partnership's deduction of ordinary and short-term capital losses incurred through a tax shelter transaction in the Final Partnership Administrative Adjustment (FPAA). Therefore, the IRS could not impose penalties on the partnerships for valuation overstatements resulting from the denial of those deductions.

Woods, CA-5, 2012-2 USTC ¶50,657; 2012-2 USTC ¶50,658; TRC PENALTY: 3,106.

The Tax Court properly sustained notices of deficiency, fraud and late-filing penalties against a married couple and their sham corporation for the tax years at issue. The couple intentionally concealed income through a variety of domestic and offshore transactions that were shams and used their corporation to repatriate offshore income and to deduct personal expenses.

Foxworthy, Inc., CA-11, 2012-2 USTC ¶50,654; TRC CCORP: 42,256.

Offer-in-Compromise

Assets belonging to a successor corporation to the taxpayer should have been included in a proposed offer in compromise. However, the IRS erred in refusing to allow the taxpayer to amend its offer, so the case was remanded for that purpose.

Alessio Azzari, Inc., TC, CCH Dec. 59,248(M), FED ¶48,262(M); TRC IRS: 42,106.

Bankruptcy

IRS tax liens did not attach to monies recovered by a Chapter 7 Trustee through an adversary proceeding to avoid a fraudulent transfer by the debtor. Although the IRS contended that the transfer created a receivable, it produced no evidence to challenge the Trustee's affidavit, which stated that there was no evidence of a loan transaction. Therefore, the IRS's claim was unsecured because its recorded lien did not attach to avoidance power recoveries.

In re Cabral, BC-DC Mass., 2012-2 USTC ¶50,653; TRC IRS: 57,104.

In a case of first impression, a debtor's adoption tax credit for tax year 2011 was exempt as a public assistance benefit under the state (Illinois) exemption statute from inclusion in her bankruptcy estate. The credit was enacted as a financial incentive to defray the high costs associated with the adoption process.

In re Johnson, BC-DC Ill., 2012-2 USTC ¶50,652; TRC INDIV: 57,350.

Innocent Spouse Relief

The Tax Court properly held that an individual was not entitled to equitable relief under Code Sec. 6015(f) for three tax years.

Karam, CA-6, 2012-2 USTC ¶50,655; TRC INDIV: 18,052.05.

Retirement Plans

An individual was liable for the Code Sec. 72(t) additional tax for an early distribution that he received from his qualified retirement plan for the tax year at issue. The distribution was not made to an alternate payee pursuant to a qualified domestic relations order (QDRO) and was, therefore, not exempt from the early distribution penalty.

Hartley, TC, CCH Dec. 59,249(M), FED ¶48,263(M); TRC PLANIND: 15,052.05.

IRS Takes Steps

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2012 filing season

TIGTA also highlighted some statistics from the 2012 filing season. Approximately 111 million returns were filed electronically, accounting for 83.4 percent of all returns filed. The IRS received approximately 22 million returns on paper. TIGTA reported that paper returns declined by 14.1 percent from 2011. The number of returns prepared by practitioners increased 4.1 percent from 2011 to 2012, TIGTA found.

Reference: TRC IRS: 66,202.10.

No Bad Debt Deduction For Unpaid Advances From Related Entity, Tax Court Finds

The Tax Court has rejected a taxpayer's argument that advances from his partnership to a related corporation were debt for which the taxpayer could claim bad debt deductions.

Background. The partnership claimed bad debt deductions for payments to the husband's corporation, a failing consulting business: $245,000 for 2006 and $300,000 for 2007. The IRS disallowed the deductions.

Court's analysis. The Tax Court found that advances between related entities are subject to particular scrutiny. The court cited several factors needed for a valid debtor-creditor relationship.

The court found that the facts overwhelmingly showed that the advances were not bona fide debts. There were no formal loan documents, no repayment schedule or maturity date, and no collateral or security. Of particular importance was the failure to pay or accrue interest.

Herrera, TC Memo 2012-308, CCH Dec. 59,246(M); TRC BUSEXP: 48,050.