ONPOINT PUBLICATIONS – TALKING POINTS GUIDE

TOPIC:

TAX WEEK IN REVIEW – NOVEMBER 11, 2016

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Opinions, Decisions and Rulings Released This Week

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WHISTLEBLOWER 26876-15W v. COMMISSIONER, 147 T.C. No. 12

Issue: Does a determination letter from the Whistleblower Office need a Director's signature to be valid?

- Individual W reported information to the IRS regarding Taxpayer A's tax returns.
- Upon examination of A's returns, the case was closed with no changes to A's tax liability.
- Director of the Whistleblower Office denied W's claim, as no additional tax was collected. A member of the Director's staff signed the letter and mailed the letter to an address that was not W's current location.

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- W contacted the Director's office and was told the case was closed. A copy of the original determination letter was provided to W.
- W filed a petition with the Tax Court and a subsequent motion for dismissal of the case for lack of jurisdiction, arguing the final determination letter was invalid for lack of the Director's signature.
- Decision: The court found that the Director had fulfilled his duties properly and there is no requirement that the Director personally sign letters of determination.

The full text can be read here: [147 T.C. No. 12]

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Comments: What is the general purpose of the Whistleblower's Office & the signing rules for determination letters?

1. *The IRS Whistleblower's Office pays monetary awards to individuals who provide information regarding taxpayers who have failed to pay taxes owed. Awards can be up to 30% of the additional tax, penalties and other amounts collected.*
2. *Information provided for investigation:*
   - *Must be specific and credible*
   - *Not an "educated guess" or speculation.*
   - *Involve a significant federal tax issue.*
3. *Generally, awards fall under 2 programs:*
   - *Examinations yielding more than $2 million –*
     - *Awards range from 15% to 30% of collections*
     - *Individuals under examination must have AGI in excess of $200,000*
     - *Other qualifications apply.*
     - *Whistleblower can appeal to the Tax Court if he disputes the claim.*
   - *Examinations involving collections under $2 million or individuals with less than $200,000 of income*
     - *Awards are 15% or less, with a maximum of $10 million.*
     - *Awards are discretionary and whistleblowers cannot petition the Tax Court in the event of a dispute.*
4. *In the Internal Revenue Manual, Part 1, Chapter 2, Section 52, Delegation Order 25-7 – Authorization to Make a Determination under IRC 7623, authority to approve or deny awards is delegated to the Director of the Whistleblower Office. While there are situations where the authority to approve or deny claims can be re-delegated to a Senior Manager or other office manager, under the delegation order, there is no stated requirement that the determination letters be signed personally by the Director.*

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GREENBERG v. COMMISSIONER, 147 T.C. No. 13

Issue: Should the representing attorney of an administrative proceeding be allowed compensation for administrative costs?

- Attorney (P) represented his client before the IRS pursuant to a power of attorney. The matter before the IRS was eventually settled.
- P was owed fees for his services and his client promised to forward any administrative fees collected under Section 7430.
- P submitted a letter to the IRS requesting the reimbursement of administrative costs under IRC 7430, on behalf of his client. Requests were subsequently denied.

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- P restated that his interest in the administrative costs was related to his own rights for administrative costs, rather than his client's.
- Decision: The Tax Court upheld the denial of compensation. The attorney was not the "prevailing party" as defined by Section 7430(c)(4), as he was not a party to the underlying proceeding.

The full text can be read here: [147 T.C. No. 13]

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BOBO v. COMMISSIONER, T.C. Summary Opinion 2016-74

Issue: Does a separate payment received as part of a "cash for keys" program represent ordinary income or gross receipts related to the sale of property?

- Husband (H) and wife (W) lived in California, but worked for extended periods in North Carolina. H & W purchased a second home in North Carolina for $850,000.
- Financial problems prompted H & W to seek a mortgage modification. They proceeded to enter into a deed in lieu of foreclosure transaction with the mortgage company.
- The sale included a "cash for keys" program. In exchange for vacating the house by an agreed date and leaving the house in "broom-swept" condition, they would receive an incentive cash payment of $20,500. The mortgage company issued a Form 1099-MISC for $20,500 and a Form 1099-A for $716,426, representing the outstanding loan balance that was relieved.

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- Taxpayers included the incentive payment as part of the gross sale receipts for the sale of the home. The IRS reclassified the payment as ordinary income and issued a notice of deficiency.
- Decision: The Court looks to the substance of the transaction when determining how a deed in lieu of transaction or a similar exchange is taxed. The evidence supported that the sale and the foreclosure were part of a single event, the sale of the property.

Comment: The IRS argued that the payment was made under a separate agreement for returning the house in "broom swept" condition. The Tax Court disagreed with the position that H was paid for cleaning and leaving the house in good condition. H was not employed by the mortgage company and the "cash for keys" program was merely part of an overall incentive to sell the house and would not have been paid without the foreclosure transaction.

The full text can be read here: [T.C. Summary Opinion 2016-74]

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BALLARD v. COMMISSIONER, T.C. Memo. 2016-205

Issue: Taxpayer who does not contest IRS findings, assessments or stipulations, can be held in default by the Court. Accordingly, the Court may enter a decision against the defaulting party.

- Taxpayer had filed 3 years of tax returns late. Upon notification of examination, taxpayer filed amended returns for the same years, reporting additional revenues.
- Taxpayer maintained that his was a cash business, but he did not keep adequate records and expenses were unsubstantiated.
- IRS claimed that the taxpayer's income was derived from illegal activities (pirated DVD's and CD's).

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- Having petitioned the Court for a hearing, Taxpayer failed to appear. Under the circumstances (understatement of income, unsubstantiated expenses), the IRS assessed additional taxes and penalties, including fraud penalties under Section 6663(a).
- Decision: Held – Taxpayer was liable for penalties for fraud under Section 6663(a). Per the Tax Court's memo:
    - *"Petitioner cannot escape fraud penalties simply by failing to respond to the Court's orders or to show up to contest his case. The deemed admissions presented by respondent and not contested by petitioner are clear and convincing evidence of fraud with respect to each year in issue, satisfying respondent's burden of proof."*

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The Badges of Fraud:

The IRS has the burden of proving fraud by clear and convincing evidence. By showing that the taxpayer ***intended*** *to conceal, mislead, or otherwise prevent the collection of taxes known or believed to be owing, the IRS can satisfy this burden of proof. (Note – fraud is an intentional act to deceive)*

Intent can be inferred from the actions of the taxpayer and circumstantial evidence. The Court outlined the following actions as "badges of fraud:"

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(1) understating income,
(2) maintaining inadequate records,
(3) failing to file tax returns,
(4) giving implausible or inconsistent explanations of behavior,
(5) concealing assets,
(6) failing to cooperate with tax authorities,
(7) engaging in illegal activities,
(8) attempting to conceal illegal activities,
(9) dealing in cash, and
(10) failing to make estimated tax payments.

How many badges did our taxpayer earn? The Court mentioned specifically Nos. 1, 2, 7, and 9. Having petitioned for a court hearing and failing to appear on the court date would suggest that Nos. 4 and 6 apply as well.

The full text can be read here: T.C. Memo. 2016-205

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CCA 201645012 - Matching Contributions 409A Substantial Risk of Forfeiture

Issue: Employer's matching contributions under an employee's salary deferral agreement raises the PV of the amount deferred above the 25% threshold, resulting in a substantial risk of forfeiture under Section 409A.

- In the facts presented, an employee agreed to defer $15,600 of salary, that otherwise would have been paid in 2015.

- Under the agreement:

    - The deferred payment would be made on January 1, 2018, if the employee continued to provide substantial future services until December 31, 2017.

    - Employee's salary would be reduced by $600 each biweekly pay period.

    - Employer would match employee deferral by an additional 25% of each salary reduction. Total deferral, with matching was $19,500.

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- Decision: Per the Chief Counsel's Advisory: Salary deferral is considered to be *"subject to a substantial risk of forfeiture under Section 409A if the employer provides a matching contribution resulting in a 25% increase in the present value of the amount deferred."*

The full text can be read here: [CCA 201645012]

Comment: The Importance of "Substantial Risk of Forfeiture"

Under Section 409A, if certain conditions are not met within a taxable year, any ***deferred compensation*** *received in a* ***nonqualified deferred compensation plan*** *for the year must be* ***included in taxable income****, including prior year deferrals,* ***to the extent not subject to substantial risk of forfeiture*** *(and not previously included in income).*

Under Treasury Reg. §1.409A-1(d), there is a substantial risk of forfeiture if the present value of the amount subject to substantial risk of forfeiture is "materially greater" than the present value of the amount the employee otherwise could have received absent such risk of forfeiture.

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PLR 201645017 – Business Activities of a §501(c)(3) Organization

Issue: Non-Profit organization, formed under §501(c)(3), is disqualified after opening and operating a for profit coffee, regardless of claims that 100% of profits were to be donated to other non-profit and community organizations.

- Non-profit corporation was created to operate a coffee shop for the purpose of creating a place where believers could interact with non-believers in a non-confrontational setting outside of church.
- Along with various coffee drinks, food and free wi-fi, the coffee shop was to be a gathering place for bible study groups, church group meetings and similar functions.
- Religious promotions were subtle and indirect, but included monthly partnering with other ministries and non-profit organizations in fund raising programs.

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- At the time of the PLR issuance, the following conditions existed:
    - Most revenue was from the sale of food.
    - The largest expense was salaries and wages.
    - The shop also incurred cost of goods sold expenses, occupancy expenses and other expenses common to for profit businesses.
    - The shop was operating at a loss and continued to be funded by the religious organization that formed the corporation. No profits were available for donating to outside organizations at this time.
    - The coffee shop did not conduct any regular religious or educational activities under its own guidance or perform routine outreach programs of its own.

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Decision: The operation of the coffee shop was done in a commercial manner and operation of the coffee shop was the main function of the corporation. Religious and charitable activities were secondary to their overall operation.

The full text can be read here: PLR 201645017

Comment: Per Treasury Regulation 1.501(c)(3)-1(a)(1) states that, in order to be exempt as organization described in Section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified by that section. To fail either test, it is not exempt.

In the News This Week

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IR 2016-146 – IRS Provides Special Relief to Encourage Leave-Based Donation Programs for Victims of Hurricane Matthew

Similar to programs for Hurricane Katrina and Hurricane Sandy, employees may forego their vacation, sick pay or personal leave in exchange for cash payments the employer makes, before January 1, 2018, to charitable organizations providing relief for victims of this disaster. Donated leave will not be included in income (nor a charitable contribution deduction be allowed for employees) and employers will be permitted to deduct payments as business expenses.

The full text can be read here: IR 2016-146 and Notice 2016-69

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IR 2016-147 – Special Tax Breaks for U.S. Armed Forces

The IRS is reminding members of the military and their families about special tax benefits available to them.

- Combat pay is partially or fully tax-free.
- Reservists whose duties take them more than 100 miles from home can deduct unreimbursed travel expenses, even if they do not itemize.
- The Earned Income Tax Credit may be worth up to $6,269 for low and moderate income service members.

The full text and additional benefits can be found here: IR 2016-147

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T.D. 9793 – Removal of the 36-Month Non-Payment Testing Period Rule

Final regulations that remove the rule that a deemed discharge of indebtedness for which a Form 1099-C, Cancellation of Debt, must be filed occurs at the expiration of a 36-month non-payment testing period. Rules apply to certain financial institutions and governmental entities. The IRS understands that the discharge of indebtedness event may occur after the 36 month period. To have information returns filed before an actual discharge event would cause the IRS to take compliance actions prior to an actual discharge of indebtedness.

The full text and additional benefits can be found here: T.D. 9793