

Federal Tax Update

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Quote of the Day: “Government’s view of the economy could be summed up in a few short phases: If it moves, tax it. If it keeps moving, regulate it. And if it stops moving, subsidize it.” *Ronald Reagan*

Show Me the Money: The FTC, in its first action against a tax relief company, nets more than \$15 million in cash and assets.(Federal Trade Commission v. American Tax Relief LLC C,D, Cal No 1:10-cv-06123, 1/29/13). In addition, a \$103.3 million judgment was entered against the defendants.

Quid Pro Quo is No Dice: In Pollard v, Comm. T.C, No. 22950-09 T.C. Memo, 20`3-38, 2/6/13, no charitable contribution deduction was allowed for deemed quid pro quo exchange. The court held the granting of a conservation easement by the taxpayer was in exchange for the County granting a sub-division exemption to the taxpayer developer.

Perfect Storm Coming: According to a report issued by TIGTA, the IRS is facing a perfect storm in its efforts to recruit and retain skilled workers. The Service has to try to address the impact of 40% of its workforce will be eligible for retirement in the next five years, the added responsibility of ACA amid budget cutbacks and sequestration. The report can be found at <http://www.treasury.gov/tigta/auditreports/2013reports/201310017fr.pdf>.

Who Has Your Number? During January the IRS conducted a multi-state sweep dealing with identity theft which resulted in 734 enforcement actions. Spread out over 32 states and Puerto Rico with 389 suspects leading to 109 arrests and 189 indictments. They have also installed new filters in an attempt to stop ID theft upfront. They also announced a plan to make permanent, the pilot program to truncate taxpayer ID numbers on some forms provided to taxpayers. However, employer Id numbers are not included. According to a Big Four Accounting Firm observation report, there may be a higher risk for fraud at the employer level than at the individual level because the system takes a very long time to identify discrepancies between forms W-2, 941 and 940. Be sure to safeguard all information.

What are You? The IRS has now give non-501(c) (3) organizations the same 27 months after they are formed to apply for exempt status. (See Rev. Rul. 2013-9). The purpose is to cut down on self-declarers and to establish if the organizations have classified themselves correctly.

Who's on First? In *Spoehy v. Commissioner*, 9th Cir., No. 12-73261, petitioners' brief filed 1/30/13, the key issue on appeal is whether the home interest deduction is on a per-residence or per-taxpayer basis. The Tax Court ruled it was a per residence basis. The potential impact if the ruling is overturned is that un-married co-owners of homes could be eligible for increased deductions for home mortgages. Maybe you will want to buy that \$2 million vacation home with cousin Sal.

Details, Details! The Tax Court found that a father was not entitled to a dependency exemption or child care credit for either of his two children for 2008. (*Vokovan v. Commissioner*. T.C. No. 7806-11. T.C. Memo. 2013-37, 2/15/13). The taxpayers divorced in 1990 and had two minor children. In 2008, the former wife claimed both children and the taxpayer claimed one of the children. The taxpayer failed to attached Form 8332 to his 2008 return. Based on that, the Court rule against him. Always be sure to have the 8332 where appropriate, before claiming exemptions.

Don't Tell- They Will Ask First:- At a regional practioner conference, An EO Group Manager said that when a exempt organization governance check sheet looked incomplete or suspect, questions would be asked first before commencing an audit.

And The Circuits Dwindles Down? The Eleventh Circuit Court of Appeals has joined the Ninth, Seventh and Fifth Circuit in finding subpoenaed records are an exception to fifth amendment privilege against self-incrimination and meet the Required Records Exception under the Bank Secrecy Act.

No STAR light Tonight: In the *Bank of New York Mellon Corp. v. Commissioner*. T.C. No 26683-09, 140 T.C. No 2, 2/11/13. The Tax Court held that STARS (structured trust advantaged repackaged securities) lacked economic substance and taxpayers are not entitled to resulting foreign tax credits. While meeting the relevant code and regulations, the transactions were nothing more than “an elaborate series of pre-arranged steps designed as a subterfuge for generating, monetizing and transforming the value of foreign tax credits among the STARS participants.” Upon analysis the Court determined the transactions failed the tests under the economic substance doctrine.

Only in America! In *Thomas v. UBS, AG*, 7th Cir. No. 12-2724, 2/7/13. A proposed class of “tax cheats” tried to sue UBS for UBSs' failure to prevent them from evading taxes. In denying the motion for class certification, Judge Richard A. Posner said, “this is like suing one's parents to recover tax penalties...on the grounds that the parents failed to bring one up to be an honest person.”

Ding-Dong the Tax Bells are Ringing! The IRS 1099-K matching program is in play. .Expect to see soft letters to occasional sellers such as website auction players, food car operators, mom and pop shops or swap meet participants when the cash versus credit card sales don't make sense. For most other businesses the matching program will be a non-issue as reporting will usually be a matter of timing. Someone recently asked me if they had to report income from a small part-time hobby which is selling handmade jewelry on e-bay. I asked what were their sales? Oh, not much, about \$375,000! Granted they have expenses, but this is the type of low hanging fruit the IRS will clean up with.

New Year- New Rules! Be aware the IRS has issued new rules for supporting organizations to meet regarding control by donors to the supporting charitable organizations, See the proposed regulations,REG-155929-06 and the temporary and final rules, T.D 9605, which were issued in December, 2012.

Maybe a Flood! In *Mears v. Commissioner*, T.C., No 8175-10,T.C. Memo 2013-52 2/19/13, The taxpayer failed to produce evidence of business deductions. Although he claimed he lost his records in a fire there was no proof of any insurance claim or any third party substantiation. A negligence penalty was also sustained as Chief Judge Michael Thornton rejected the argument that he did not understand the law and was confused.

Illegal Offence! Bill Romanowski played for 16 seasons in the NFL and his spouse took care of their children during his football career. In 2002 they had issues with a real estate investment and sought the advice of Rodney Atherton, an attorney. Rodney advised them to invest in ClassicStar, a horse breeding operation, which they did. The IRS audited their returns and assessed deficiencies of approximately \$700,000 plus penalties. The court found the breeding operation was a sham and disallowed the losses claimed but did not sustain the penalty as they had relied on the advice of a tax attorney. What came out at trial was that the attorney was receiving fees from the shelter, which were not disclosed to the taxpayers and the attorney or his firm has issued the tax opinion letter. Methinks the attorney has some explaining to due to OPR. See *Romanowski v. Commissioner*, T.C. No. 15562-10 T.C. Memo 2013-55, 2/20/13

Head in the Sand Not an Option! You can't avoid the IRS without suffering the consequences. In *Campbell v. Commissioner* T.C. No.13687-11L, T,C, Memo 2013-57, 2/21/13, Alfred Campbell had received IRS notices regarding the preparation of substitute for returns for tax years 2001 through 2007. However he failed to claim any of the notices which were sent by certified mail. When Campbell was served with a Notice of Intent to Levy, he claimed he had not received the notices of deficiency. The IRS then denied him a face to face meeting because he was not current and issued a notice of determination. He brought suit in Tax Court. The Judge ruled he could not avoid the receipt of notices and therefore there was no right of appeal at this time. Also ruling the IRS did not abuse their discretion in denying the face to face meeting as he was **not current** and had failed to provide any of the information previously requested.

Tables Turned! In *United States v. Bello*, D. Conn., No.3:12-cr-84 (AWT) jury verdict 2/20/13, two Conn. women were found guilty of operating a pyramid scheme called “The Gifting Table”. Despite their claims that accountants and lawyers had signed off on the legality of the scheme being a tax-free transaction, the jury returned its verdict in two hours.

Fix It Now! The IRS has released a 403(b) Plan Fix-It Guide on their website which addresses ten common errors and how to fix them. Go to [www.irs.gov/Retirement-Plans/403\(b\)-Plan-Fix-It-Guide](http://www.irs.gov/Retirement-Plans/403(b)-Plan-Fix-It-Guide)

No Free Lunch! In CCA 21308030, The IRS Chief Counsel concluded that a 2% shareholder-employee’s failure to include disability insurance premiums in income precluded any later claim that the benefits are not taxable and that no amended return of the open years would be available at to allow an amended return would violate the rules of consistency.

Not in the CARDS! In *Crispin v. Commissioner*, 3rd Cir. No. 12-2275, 2/25/13, the appeals court held that no ordinary deduction was available from participation in a Custom Adjustable Rate Debt Structure (CARDS) as the transaction lacked economic substance and also upheld a 40% accuracy-related penalty for gross valuation misstatements. Cost- \$3mil tax and \$1.2 mil penalty. Crispin was a former accountant who tried to argue that he relied on the accountant who prepared his returns. Seems the accountant relied on Crispin’s statements and representations as to the validity of the deal.

Follow the Path! In *Thompson v. Commissioner*, T.C. No. 6063-11L, T.C. Memo. 2013-61, 2/26/13, Charlie Thompson claimed, “I don’t owe you guys anything” when protesting a tax lien. However, the Court found that he failed to petition the court for a redetermination of the underlying tax adjustment when the 90 day statutory notice of deficiency was issued and failed to raise any substantive issues at the collection due process hearing and therefore was barred from doing so in the current proceeding.

Just Doin’ Time! According to IRS, more than 80% of criminal tax fraud cases resulted in jail time which shows that judges are being more inclined to go beyond the sentencing guidelines which are advisory and not mandatory. The conviction rate for 2012 was 93%.

Income NOT Capital! The IRS has opined in FAA 20124103F, that a portion of a state loan which had job creation conditions attached which is cancelled when the job creation conditions are met is income and not a contribution to capital.

Sending a Message! A California CPA was sentenced to 36 months in jail for failing to report more than \$1 million in earned income which he had diverted to a charitable organization which he created to be a front for depositing income from his practice. The CPA did not think he was doing anything wrong and will appeal.

Home Sweet Home! In *Urtis v. Commissioner*, T.C. No 21203-11 T.C. Memo, 2013-66, 3/15/13, the Tax Court ruled a theft loss deduction was available where home improvement contractor engaged in home repair fraud. The key to the deduction is proving that the activity is a violation of state law and constitutes “home repair fraud” under the respective statute.

End of an Era! Effective March 11, 2013, the Internal Revenue Bulletin will no longer be printed in paper nor will the cumulative bulletin be created. UPGPO subscribers will still receive a printed version of the IRB.

Ferret This Out! The Tax Court affirmed the disallowance of a charitable contribution to a ferret rescue organization of over \$250 because the donations were not substantiated by a contemporaneous written acknowledgement. The taxpayer was the organization’s president. Expect this to be a big audit issue and be sure the documentation has been secured and available upon request. In addition, expect to see taxpayers asked to substantiate miscellaneous and OOP Contributions.

Hole in One! Sergio Garcia made a hole in one when the Tax Court determined that his royalties associated with endorsement with TaylorMade constituted royalty income taxable in Switzerland at a lower rate under the US-Swiss Tax Treaty.

It Is What It Is! In *Knappe v. United States*, 9th Cir, No.10-56904, 4/4/13 the Court of Appeals ruled that a taxpayer cannot rely on erroneous advice from professionals when the tax law provisions are not ambiguous. The executor of an estate relied upon the advice of a CPA who informed him it was possible to get a 12 month extension to file the estate tax return. The court found the due date instructions to be unambiguous and therefore the late filing penalty was upheld.

Use It or Lose It! In *Barnes v. Commissioner*, D.C. Cir. No. 12-1284, 4/15/13, The US Court of Appeals affirmed a Tax Court decisions that the a shareholder’s basis is reduced each year there is a loss to the extent of available basis even if the taxpayer did not claim the loss. Therefore the taxpayers could not apply their basis in a subsequent year to claim losses. In addition, A substantial understatement penalty was also affirmed as the taxpayers failed to present any evidence that what they did had any substantial authority or reasonable cause and good faith.

And the Beat Goes ON! The IRS is will be assessing \$306 million in fines for failure to submit due diligence forms required when claiming an EITC on a tax return prepared by a tax preparer. This will help recoup some of the more than \$11.6-13.6 billion ETIC claims paid in error.