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IRS Explains How To Elect Five-Year NOL Carryback Under New Law

◆ *IR-2009-105, Rev. Proc. 2009-52*

Responding to the urgent taxpayer need for guidance, the IRS has quickly issued procedures for taxpayers that want to elect an extended carryback period for net operating losses (NOLs) provided by the *Worker, Homeownership, and Business Assistance Act of 2009 (2009 Worker Act)*. Rev. Proc. 2009-52 explains when and how to elect to carry back an NOL from 2008 or 2009 for three, four or five years.

■ **CCH Take Away.** The revenue procedure provides “a fairly simple method to make the election,” David Culp, a senior manager with KPMG LLP’s Washington National Tax Practice, told CCH. However, “the expansion [of the extended carryback] from small business to larger businesses raises a lot more questions in terms of technical and procedural issues,” Paul Manning, KPMG’s head of Practice, Procedure, and Administration, Washington National Tax Practice, told CCH. “The carryback could impact Section 199 or the use of foreign tax credits or other credits. There’s potentially a lot of paperwork,” including the use of Forms 1138 and 4466 to determine refunds of estimated taxes, he said. “You wonder if the IRS could streamline any of that.” Culp said it would also be helpful if the IRS addressed a number of issues involving consolidated groups.

■ **Comment.** A previous law, the *American Recovery and Reinvestment Act of 2009 (2009 Recovery*

Act), provided an extended carryback period, but only for electing small businesses (ESBs) and only for 2008 losses.

New law

The *2009 Worker Act* allows a business to elect the extended carryback period for an applicable NOL incurred in a tax year ending after December 31, 2007 and beginning before January 1, 2010, to three, four or five years from two years (with a limit on the amount of the NOL carried back to the fifth tax year preceding the tax year of the loss to 50 percent of the taxpayer’s taxable income for that carryback year). Businesses do not have to make their election until the due date (including extensions) for filing the return for taxpayer’s last tax year beginning in 2009. Generally, the election is irrevocable once made, however, and can only be made for one year. An ESB that made or makes an election under the *2009 Recovery Act* may also make an election under the new law for another tax year.

■ **Comment.** Now that the procedures are out, a business can go ahead and claim a refund for 2008 losses, or it can wait for 2009 results and compare the two years.

Electing on return for NOL year

A taxpayer that has not claimed an NOL carryback can make an election by attaching a statement to the taxpayer’s original or amended federal income tax return (Form 1040, individuals, or Form 1120, corporations) for the tax year in which the NOL arises. The election must:

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Route to: _____

CCH Projects Rise In 2010 Limits On Vehicle Depreciation/Fringe Benefits

CCH has calculated the depreciation caps on automobiles and trucks/vans first put into use for business and investment purposes in 2010 and the maximum allowance used in valuing fringe benefits for vehicles first put to personal use by an employee in 2010. Based on the inflation-adjustments called for under Code Sec. 280F(d)(7)(B), all limits are going up from their 2009 counterparts despite the general economic downturn.

Luxury auto depreciation

The unofficial annual maximum depreciation amounts for passenger automobiles first placed in service in calendar year 2010 are:

- \$3,060 for the first tax year (up from \$2,960 in 2008 and 2009);
- \$4,900 for the second tax year (up from \$4,800 in 2008 and 2009);
- \$2,950 for the third tax year (up from \$2,850 in 2008 and 2009); and

■ \$1,775 for each tax year thereafter (the same as 2008 and 2009 due to rounding rules).

■ **Comment.** The first-year luxury automobile depreciation cap was increased by \$8,000 if bonus depreciation under Code Sec. 168(k) was claimed on a vehicle acquired after December 31, 2007 and placed in service before January 1, 2010. This benefit, however, has not yet been extended by Congress for 2010, although year-end legislation may alter that result. Bonus depreciation is limited to new vehicles.

Luxury trucks

The IRS typically allows a higher depreciation deduction for trucks and vans. That remains the case for 2010 when compared to the projected 2010 automobile amounts.

The limits for trucks and vans also increased across the board for 2010 from the limits applicable to 2009, up to their former levels during 2008. The amounts are projected to be:

- \$3,160 for the first tax year (up from \$3,060 in 2009);
- \$5,100 for the second tax year (up from \$4,900 in 2009);
- \$3,050 for the third tax year (up from \$2,950 in 2009); and
- \$1,875 for each tax year thereafter (up from \$1,775 in 2009).

To qualify for the truck and van depreciation deduction, a vehicle must be a passenger vehicle built on a truck chassis with an unloaded gross weight of over 6,000 pounds. A vehicle built on an automobile chassis is classified as an automobile regardless of weight; even if its manufacturer calls it an SUV.

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NOL Carryback

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- State that the taxpayer is electing the extended carryback period under Rev. Proc. 2009-52;
- State that the taxpayer is not a TARP (Troubled Asset Relief Program) recipient or an affiliate of a TARP recipient; and
- Specify the length of the carryback period being elected (three, four, or five years).

The election statement must be filed with the taxpayer's original or amended return for the tax year of the applicable NOL by the due date (including extensions) for filing the return for the taxpayer's last tax year beginning in 2009. A taxpayer that subsequently files a ten-

tative carryback adjustment (Form 1045, individuals, or Form 1139, corporations) for the refund must include a copy of the election statement.

Electing on appropriate form

A taxpayer that has not yet claimed an NOL carryback can make the election and attach the election statement to the "appropriate form," such as Forms 1045, 1040-X, 1139, or 1120-X.

Previous NOL claim

If the taxpayer previously filed a refund claim or amended return to carry back an NOL for two years, the taxpayer can follow the same election procedures available for taxpayers who have not yet failed a claim. The taxpayer's election statement must state that the election

amends a previous carryback application or claim.

If the taxpayer previously elected to forgo the two-year carryback period for an NOL from a tax year ending before November 6, 2009, the taxpayer may revoke that election and elect the extended carryback. These taxpayers also can use the same election procedures. The taxpayer's election must state that the taxpayer is revoking an NOL carryback waiver.

Any amendment of a carryback or revocation of an election also applies to the alternative minimum tax NOL.

Affiliated groups

A taxpayer includes an affiliated group filing a consolidated return, and an NOL includes a consolidated NOL. The common parent of the group must make the election. However, Rev. Proc. 2009-52 does not address a consolidated return group that wants to make or revoke a carryback election for the CNOL attributable to a member acquired from another group. The IRS indicated it will issue separate guidance on this election.

*References: FED ¶¶46,533, 46,534;
TRC NOL: 12,103.*

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*

Senate Democrats Propose \$370 Billion In Revenue Raisers To Fund Health Care Reform

◆ *Patient Protection and Affordable Care Act, H.R. 3590*

A blended Senate Democratic health care reform bill with \$370 billion in revenue raisers survived a critical cloture vote, 60-39, on November 21 and remains on track to passage. The bill includes a new excise tax on high-dollar health insurance plans, a higher threshold for the itemized medical expense deduction, an additional Medicare tax, and more to fund health care reform. In a break from the House, the Senate bill would not require employers to provide health insurance to their employees but those who elect not to offer coverage would pay an additional tax. The bill now moves to the Senate floor for debate (and probable floor amendments) starting on November 30.

■ **CCH Take Away.** As expected, the blended Senate bill does not include the House-passed income surtax on higher-income individuals. The fate of the surtax will be determined when House and Senate conferees negotiate a final bill. The White House has not rejected the surtax outright, which will embolden supporters to fight to include it in the final bill.

Excise tax

High-dollar health insurance plans would be subject to a 40 percent excise tax effective for tax years beginning after December

31, 2012. The blended Senate bill generally defines high-dollar plans as plans costing in excess of \$8,500 for individual coverage and \$23,000 for family coverage. The annual thresholds are higher for retired individuals along with workers in high risk occupations (\$9,850 for individual coverage and \$26,000 for family coverage). The thresholds would be indexed for inflation.

■ **Comment.** The Senate bill provides transition relief in the form of higher thresholds for individuals in 17 “high costs” states. “To some extent these are states with higher costs of living, higher wages, and so on,” Paul Van de Water, senior fellow, Center on Budget and Policy Priorities (CBPP), Washington, D.C., told CCH. “Regional differences in the style of medical practice are a factor just as much as costs.” The transition relief would be 120 percent of the annual thresholds for 2013 and 2014; 105 percent for 2015.

Medical expense deduction

The current 7.5 percent floor for the itemized medical expense deduction would rise to 10 percent of adjusted gross income for regular income tax purposes. The 10 percent floor would be effective for tax years beginning after December 31, 2012. The increase is projected to raise \$15.2 billion over 10 years.

set in Reg. §1.61-21(e)(iii)(A), the base amount of these deductions before adjustment each year for inflation (or deflation) is \$12,800.

CCH calculates that, given the applicable inflation rates now available, an automobile first put into use as a fringe benefit during the 2010 calendar year must have a value of not more than \$15,300 for a business to use the cents-per-mile method (up from \$15,000 for 2009). For employers wanting to use the cents-per-mile rule for trucks and vans placed into use for employees during 2010, the cap is \$16,000 (up from \$15,200 for 2009 after dropping from \$15,900 for 2008).

■ **Comment.** The 10 percent floor would be delayed for seniors. The 7.5 percent floor would apply to tax years beginning after December 31, 2012 and ending before January 1, 2017 if an individual or his or her spouse has attained age 65 before the close of the tax year.

Medicare tax

Individuals with earned income over \$200,000 and married couples filing joint returns with earned income over \$250,000 would pay an additional Medicare tax of 0.50 percent (for a total tax of 1.95 percent). The additional Medicare tax would also apply to self-employed individuals. The additional tax would be permanent and is projected to raise \$53 billion over 10 years.

More provisions

Other provisions in the blended Senate bill would:

- Impose an additional tax on employers that fail to provide minimum essential coverage;
- Provide temporary tax credits to small employers;
- Impose a penalty on individuals who do not obtain minimum essential coverage;
- Provide premium assistance tax credits to lower-income individuals;
- Set a \$2,500 cap (not indexed for inflation) on annual FSA contributions;
- Limit health FSA dollars to prescription medications (with some exceptions);
- Modify information reporting requirements for payments to corporations;
- Impose a five percent excise tax on elective cosmetic surgery;
- Limit the Code Sec. 162(m) deduction for certain highly-compensated employees of health insurance providers;
- Heighten IRS oversight of tax-exempt hospitals;
- Require employers to report the value of health benefits on employees' Forms W-2; and
- Impose annual fees on manufacturers and importers of drugs and medical devices and on health insurance providers.

Vehicle Depreciation

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Personal use, company vehicle

The value of the fringe benefit from personal use of a company vehicle may be computed by multiplying the number of miles driven for personal purposes by the standard mileage rate. However, among other requirements, the cents-per-mile rule cannot be used to value an automobile whose fair market value, as of the first day on which it is made available to any employee for personal use, exceeds the sum of the maximum recovery deductions allowed for the first five years. As originally

IRS Updates Homebuyer Credit FAQs; Clarifies Who Is a “Repeat” Buyer For Reduced Credit

◆ www.irs.gov

The IRS has updated its online frequently asked questions (FAQs) on the first-time homebuyer tax credit. The revised FAQs reflect expansion and extension of the credit in the *Worker, Homebuyer and Business Assistance Act of 2009 (2009 Worker Act)*.

■ **CCH Take Away.** One important concept waiting for further clarification in expected published guidance is “repeat” homebuyer for purposes of the new \$6,500 credit for non-first-time homebuyers. The updated FAQs explain that a repeat buyer need not sell or otherwise dispose of his or her current residence to qualify for the \$6,500 credit. However, the purchased residence for which the taxpayer claims the credit must be the taxpayer’s new principal residence. There is also no requirement that the new principal residence be a “move up” property; the new residence can be less expensive than the taxpayer’s former home.

Expansion

The *2009 Worker Act* extends the 10 percent (up to \$8,000) refundable first-time homebuyer credit for qualified taxpayers purchasing principal residences to sales occurring on or before April 30, 2010. If a binding sales contract is signed on or before April 30, 2010, a home purchase completed by June 30, 2010 will qualify for the credit. Long-time homebuyers may qualify for a reduced credit of \$6,500. Income limits apply to both groups of homebuyers.

Homebuyers

Taxpayers who have not owned another principal residence at any time during the three years prior to the date of purchase are considered first-time homebuyers. The time-frame is different for claiming the \$6,500 credit. Long-time homeowners must have owned and used the same home as their principal residence for at least five consecutive years of the eight-year period ending on the date they purchase their new principal residence, the IRS explained.

■ **Planning Note.** The IRS clarified that an individual who has owned and lived in a recreational vehicle (RV), or has owned a home abroad, during the past three years is not disqualified from now claiming the first-time homebuyer credit on a new residence. An RV with a built-in motor is personal property; and a residence outside of the U.S. does not count as a prior residence for purposes of the credit.

Dependents/minors

To curb abuses, the *2009 Worker Act* tightened the rules for dependents and minors claiming the credit. Dependents are ineligible to claim the credit on any purchase after November 6, 2009. Minors generally cannot take the credit on home purchases after November 6, 2009. Only one spouse, however, must meet the requirement that a purchaser be at least age 18 on the date of purchase.

Reference: TRC INDIV: 57,950.

Use Of Higher Interest Rate For Cash Balance Opening Balances Proper, Eighth Circuit Holds

◆ *Sunder, CA-8, November 9, 2009*

Long-time employees recently failed to persuade the Eighth Circuit Court of Appeals that their employer’s conversion to a cash balance plan decreased their accrued benefits. The cash balance plan properly used a higher discount rate to calculate the opening cash balances.

■ **CCH Take Away.** The lump sum payment must be the actuarial equivalent of the normal accrued pension benefit. When the taxpayers retired, determining actuarial equivalent was a two-step process requiring the plan to project the hypothetical account balance forward to age 65 using the rate of future interest credits that would have accrued under the plan if the participant had remained in the plan and discount the amount back to its present value on the date of the

actual distribution using the Code Sec. 417(e)(3) discount rate.

Background

The plan did not use the Code Sec. 417(e)(3) discount rate in calculating the opening cash balances. Rather, the plan required that the opening cash balance be set using a higher discount rate (eight percent versus six percent). The result, according to the taxpayers, was a decreased lump sum at payout. A federal district court agreed and the plan appealed to the Eighth Circuit.

■ **Comment.** It was not disputed that the plan properly calculated the final lump sum distributions using the Code Sec. 417(e)(3) discount rate.

Appellate analysis

The Eighth Circuit reversed the lower court. Neither *ERISA* nor the terms of the plan prevented the plan from calculating the opening

cash balances using the higher discount rate.

When the employer converted its defined benefit plan to a cash balance plan, there was no provision in *ERISA* governing the creation of an opening cash balance, the court found. The *Pension Protection Act of 2006 (PPA)* amended *ERISA* to require the benefit under the new plan to be no less than the sum of the accrued benefit determined under the terms of the old plan plus the accrued benefit after the amendment was determined under the new plan. This provision, the court noted, could be interpreted as influencing the opening balance calculation.

However, the *PPA* was enacted in 2006. In 2000, the only restriction on the plan was a prohibition that the opening cash balance could not be set in a manner that would decrease already accrued benefits in the original plan.

References: FED ¶(to be reported); TRC RETIRE: 39,058.

IRS Launches Pilot Program Allowing Paper Information Returns To Truncate Identification Numbers

◆ Notice 2009-73

To mitigate identity theft, the IRS has created a pilot program allowing certain paper information returns to truncate an individual payee's Social Security number (SSN), individual taxpayer identification number (ITIN), or IRS adoption taxpayer identification number (ATIN) on paper payee statements. The program only applies for the 2009 and 2010 calendar years.

- **CCH Take Away.** The IRS is seeking comments on whether it should require truncation, rather than simply permit it; whether additional types of paper payee statements should be included, and, among other issues, whether truncation should be permitted or required for electronically furnished payee statements. Once truncation is permitted, however, some information filers could become concerned whether confidentiality laws, irrespective of tax rules, may impose liability should their customers' SSNs be compromised.

Truncation

The pilot program allows filers of certain paper information returns to use a truncated

version of an individual's SSN, ITIN, or ATIN on qualifying paper payee statements. Since these numbers are sensitive personal information that can be used to facilitate identity theft if misappropriated, the IRS pilot program attempts to shorten the payee's nine-digit number on paper payee statements if certain requirements are met.

Eligible participants

While the pilot program does not apply to all types of payee statements, it covers three that are sent to tens of millions of taxpayers at the beginning of each tax season. The pilot program only applies for paper payee statements in the:

- Form 1098 series (mortgage interest);
- Form 1099 series (interest and dividends, etc.); and
- Form 5498 series (IRAs and other items).

The pilot program also explicitly permits substitute and composite substitute statements as defined by Reg. §301.6722-1(a)(1) that meet the requirements set forth in the notice (discussed, below). However, the pilot program does not apply to any information return filed with the IRS, any payee statement provided

electronically, or any payee statement not in Form 1098, Form 1099, and Form 5498 series.

Requirements

Notice 2009-73 sets forth the three requirements that taxpayers must meet to participate in the pilot program allowing truncation of an individual payee's nine-digit identifying number. To be able to truncate identifying numbers for individuals on paper payee statements, the following requirements must be met:

- The identifying number is an SSN, ITIN, or ATIN;
 - The identifying number is truncated by replacing the first five digits of the nine-digit number with asterisks or Xs; and
 - The truncated number appears on a paper payee statement (including substitute and composite substitute statements) in the Form 1098, 1099, or 5498 series for the 2009 and 2010 calendar years.
- **Example.** A truncated SSN would appear as follows on a paper payee statement: XXX-XX-1234.

*References: FED ¶46,531;
TRC FILEBUS: 12,106.*

Defective Merchandise Allowances Reduce Costs Of All Inventory; Capitalization Not Required

◆ CCA 200945034

IRS Chief Counsel recently determined that defective merchandise vendor allowances are not sales. Instead, they are a discount that reduces the cost of inventory. Chief Counsel also determined that the allowances reduce the cost of all inventory, not just the cost of defective merchandise. Finally, the cost of the defective goods can be deducted and does not have to be capitalized as an indirect cost of nondefective merchandise.

- **CCH Take Away.** This Advice Memo addressed how a taxpayer should account for defective inventory so that it could properly determine gross income. Chief Counsel

decided that, under the facts, the taxpayer had a choice to either deduct or capitalize costs that entered into sales income and the cost of goods sold (COGS).

Background

The taxpayer sold merchandise, acquired from numerous vendors. Some of the merchandise was defective. Defective items were discarded, marked down, or returned to the vendor.

The taxpayer received refunds for defective merchandise returned to some vendors. Other vendors agreed to provide "returned/defective merchandise vendor allowances,"

as a fixed percentage of purchases. The allowances cover the estimated costs of defective merchandise. The taxpayer could file an additional claim if the allowance was not adequate to cover all defective merchandise.

For some accounts, the taxpayer did not have to return the goods, notify the vendor of the defective amounts, or account for the proceeds of disposal of the goods. Instead, the taxpayer could liquidate, recycle, or otherwise dispose of the goods. The taxpayer and the vendors periodically reevaluated the allowance to determine if it represented the actual defective rate. Future allowances may be changed, but

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Appeals Court Affirms Tax Court Valuation Of Disclaimed Interest To Charity, Rebuffs IRS

◆ *Estate of Christiansen, CA-8, November 13, 2009*

The U.S. Court of Appeals for the Eighth Circuit has affirmed a Tax Court decision allowing a decedent's estate an increased charitable deduction as a result of a partial disclaimer. The entire value of the property passing to a charitable foundation as a result of the partial disclaimer was deductible because the disclaimer was qualified and no public policy barred the increased deduction amount.

■ **CCH Take Away.** "Although the Eighth Circuit of Appeals' decision to affirm the Tax Court's decision... focuses on the validity of a partial

disclaimer to charity, the appellate opinion contains much broader principles that touch the entire area of charitable gift law," Jason Havens, attorney, Havens & Miller, PLLC, Destin, Fla., told CCH. "The Eighth Circuit essentially forced the IRS to abide by its own regulations, which determine the existence and value of a transferred asset and any related disclaimers as of the date of death."

Background

Expecting her daughter to disclaim a portion of her inheritance, the decedent

named her charitable foundation as a contingent beneficiary, with 25 percent of any disclaimed amount passing to the foundation. The IRS and the decedent's estate later settled on a substantially increased valuation for the estate, resulting in a corresponding increase in the value of the estate's charitable deduction, which the IRS subsequently contested.

Appellate analysis

The Eighth Circuit rebuffed the IRS's claim that because the overall value of the estate was not finally determined at the time of the decedent's death, the transfer to the charitable foundation was ultimately dependent on the performance of some act or occurrence of a precedent event, in violation of Reg. §20.2055-2(b)(1). The court found the regulation was clear and unambiguous and did not speak in terms of the existence or finality of an accounting violation at the date of death or disclaimer. The only uncertainty that remained following the disclaimer was the estate's valuation and, therefore, the value of the charitable donation. Despite noting that the Tax Court's ruling could "marginally detract" from the incentive to audit estate tax returns, the appeals court rejected the IRS's argument that it must interpret the statute and regs to maximize the incentives to audit estate tax returns.

■ **Comment.** "Importantly, the Eighth Circuit rejected the IRS's argument that formula clauses which result in increased charitable deductions rather than increased audit collections should be viewed as somehow violating public policy. The Eighth Circuit pointed out that the IRS's role is not to maximize audit collections, but 'rather ... to enforce the tax laws.' In other words, the fact that an adjustment to an asset's estate tax value -- whether via a disclaimer or otherwise -- merely increases an estate's charitable transfer is not a bad thing," Havens told CCH.

References: FED ¶(to be reported);
TRC ACCTNG: 15,206.05.

References: ETR ¶60,585;
TRC ESTGIFT: 45,066.20.

Cost Of Inventory

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the taxpayer did not have to repay or retroactively reduce an allowance.

Trade discounts

In merchandising, gross income equals sales minus COGS. COGS equals the total merchandise (invoice) price minus any discounts. The IRS noted that trade discounts are treated as adjustments to the purchase price.

Chief Counsel analysis

Chief Counsel determined that the allowances are reductions in the costs of merchandise. The allowances are fixed, regardless of the amount of defective items, and are not dependent on proof of defects or the actual return of goods.

Because the taxpayer and the particular vendor agreed on the net selling price for all merchandise, the allowances are not part of total sales. Instead, they resembled trade discounts and reduce inventory costs.

Chief Counsel further determined that the allowances would reduce the cost of all merchandise; not just the defective items. The existence and amount of defective items was irrelevant to the net sales price. Moreover, the taxpayer would not be required to return or repay any allowances if the amount of defective inventory is less than expected.

Therefore, the allowances are not tied to specific defective inventory items.

Costs

The costs of "subnormal goods" may be deducted in the first year the goods are determined to be subnormal. The goods are valued at the sales price minus the direct cost of disposition. Subnormal goods include merchandise that is unsalable at normal prices or unusable in the normal way because of damage, imperfections, or other problems.

In contrast, the costs of "spoiled" items have to be capitalized under Code Sec. 263A as indirect costs and included in the costs of nondefective merchandise acquired for resale.

■ **Comment.** Spoilage is production that does not meet prescribed standards and that must be discarded or sold at reduced prices. It includes defective items.

Chief Counsel determined that goods that were defective at the time of purchase qualified as subnormal goods. While the term "spoilage" could fit within the resale context, it was not intended to limit a reseller's ability to apply the subnormal goods inventory rules in Reg. §1.471-2(c). Therefore, the taxpayer would not have to capitalize the acquisition costs of defective merchandise as an indirect cost of nondefective merchandise.

Overstatement Of Basis Not Understatement Of Income By Partnership-Shelter Participant

◆ *UTAM Ltd., T.C. Memo. 2009-253*

The Tax Court has ruled that an S corp's artificial increase of basis in its partnership interest failed to extend the limitations period for assessing an income tax deficiency against its sole owner. Against the objection of the IRS, the court found that the Son of BOSS tax shelter participant's overstatement of basis was not an overstatement of income within the meaning of Code Sections 6229(c) or 6501(e)(1). As a result, the general three-year statute of limitations under Code Sec. 6501, which the IRS failed to meet, applied.

■ **CCH Take Away.** This ruling is in line with other recent Tax Court cases, including *Bakersfield Energy Partners*, 128 T.C. No. 17, June 14, 2007; a decision that was affirmed by the U.S. Court of Appeals for the Ninth Circuit. However, in *Brandon Ridge Partners*, DC Fla., July 30, 2007, a federal district court, applying Fifth Cir-

cuit law, found that the extended six-year limitations period did apply to a partnership that sold stock and claimed an artificially high basis. In *Salman Ranch Ltd.*, 79 FedCl 189, the Court of Federal Claims applied a similar rule.

Background

The S corp had standing plans to sell its partnership to an unrelated insurance company. However, before this transaction was performed, it participated in a Son of BOSS tax shelter transaction, using the short sale of \$38 million in U.S. Treasury notes to artificially inflate its outside partnership basis. It subsequently claimed a \$13.2 million tax loss on the sale of its partnership interests as a result; treating the sale as a deemed sale of partnership assets under Code Sec. 338(h)(10). The IRS issued a notice of final notice of partnership administrative adjustment (FPAA) to the partnership. However, this FPAA came after the

general three-year limitations period for assessment against a taxpayer under Code Sec. 6501(a) or a partner under Code Sec. 6229(a) had expired.

Court's analysis

Under Code Sections 6501(e)(1) or 6229(c)(2), the normal three-year statute of limitations period for assessment of a tax liability may be extended to six years if a taxpayer or partnership omits an amount includible in gross income that exceeds 25 percent or more of the gross income stated in the return. However, the court disagreed with the IRS's argument that overstatement of tax basis in an asset reducing taxable income constituted such an omission of gross income. The six-year statute of limitations did not apply. Since the IRS failed to issue the FPAA within the normal three-year time frame, the court granted the partnership summary judgment.

References: CCH Dec. 57,984(M);
TRC IRS: 30,152.15.

Tax Briefs

Jurisdiction

The Court of Federal Claims lacked subject matter jurisdiction over a tort claim in which a married couple alleged improper and fraudulent collection actions by the IRS in violation of their due process rights. Federal district courts have exclusive jurisdiction over damages claims for unauthorized collections by the IRS and for wrongful levy claims, and the couple had not paid the full amount of taxes owed; therefore, a refund claim was not also available.

Montagne, FedCl, 2009-2 USTC ¶50,747;
TRC LITIG: 3,052.

A federal district court lacked subject matter jurisdiction to consider an indi-

vidual's petition to quash IRS third-party summonses issued to third parties that neither resided in nor were found within the judicial district in which the petition was filed. These third parties did not have a physical presence in that district and transacted all business through offices in other states.

Berkowitz, DC S.C., 2009-2 USTC ¶50,738;
TRC IRS: 21,108.

Two taxpayers' appeals of Tax Court orders were dismissed for lack of jurisdiction because they were mailed more than 90 days after the entry of the Tax Court's order.

H.M. Dietsche, CA-D.C., 2009-2 USTC ¶50,740;
P.B. Dietsche, CA-D.C., 2009-2 USTC ¶50,741.

Tax Crimes

Expert witness testimony was allowed in the case of an individual charged with preparing false tax returns in violation of Code Sec. 7206(2), and rulings were issued regarding the admissibility of other evidence. An IRS agent qualified as an expert witness and his testimony was helpful to the jury. Evidence that the individual did not timely file his personal tax returns for a few tax years because of a disagreement with the IRS was not admissible, but evidence that the individual falsely represented that he was a former IRS employee, professed personal animosity towards the IRS and

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that certain customers invested money in the individual's cabinet-making business was admissible.

Turner, DC Ky., 2009-2 USTC ¶50,743; TRC IRS: 66,204.

Summons

IRS third-party summonses issued to a wholesale corporation and seeking documents regarding business transactions between the corporation and various business entities that may be related to a married couple were not quashed. The government established its *prima facie* case for enforcement under *Powell*, which the couple failed to rebut. Furthermore, the summonses were not overbroad.

Wang, DC Wash., 2009-2 USTC ¶50,744; TRC IRS: 21,112.

An individual's emergency motion for temporary restraining order and preliminary injunction was denied. Third-party summonses issued to banks were not quashed and the IRS was not prevented from further issuing summonses because the individual failed to prove an alleged violation of his right to privacy or show irreparable harm if the documents were turned over.

Metz, DC Fla., 2009-2 USTC ¶50,739; TRC IRS: 21,052.

Income

A tax-exempt credit unions income from the provision of products and services to its members by an outside broker-dealer was substantially related to the credit unions tax-exempt purposes; therefore, the income was exempt from unrelated business income tax (UBIT). The products catered to the credit unions members financial goals and promoted member thrift. However, income from the provision of the same products and services to nonmembers was not exempt.

Bellco Credit Union, DC Colo., 2009-2 USTC 50,749; TRC EXEMPT: 15,056.

Deductions

Genuine issues of material fact existed as to the method by which the owner of

a medical transcription business could claim automobile expenses and the deductibility of his business expenses. The individual potentially met the substantiation requirements of Code Sec. 274, and the *Cohan* rule could be used to estimate business expenses for months for which he could not produce credit card statements.

Norlem, DC Minn., 2009-2 USTC ¶50,748; TRC BUSEX: 3,200.

Liens and Levies

A limited liability company (LLC) could not bring a wrongful levy action under Code Sec. 7426(a) because it did not have a legally cognizable interest in the property on which the government had levied. An individual had quitclaimed his interest in the property to the LLC; however, at the time of the quitclaim, he did not have any interest to convey. Although the individual subsequently obtained title to the property, such title did not pass to the LLC because a quitclaim deed cannot operate to convey an after-acquired title.

Turcar, LLC, DC Mich., 2009-2 USTC ¶50,742; TRC IRS: 51,156.

Collection Due Process

The IRS did not abuse its discretion when it refused to abate interest due on the tax liability of a deceased taxpayer. The taxpayer's estate failed to demonstrate that the delay in payment of the tax was due to anything other than its own conduct. The IRS had sent letters to the estate on seven different occasions concerning the liability. Accordingly, it was not grossly unfair to assess interest on the delinquent amount. The estate's argument that the IRS should have more aggressively pursued the collection of the liability was rejected.

Ball Est., TC, CCH Dec. 57,994(M), FED ¶48,221(M); TRC IRS: 33,410.

Deficiencies and Penalties

An individual's petition seeking review of the IRS's determination of a deficiency in and additions to her income tax was properly dismissed for failure to state a claim. Her case was properly before a special trial judge, and her other

arguments were frivolous. Sanctions were imposed.

Collard, CA-5, 2009-2 USTC ¶50,746; TRC LITIG: 6,058.

A taxpayer who withdrew funds from his individual retirement account when he was under age 59 1/2 in order to pay tax and other liabilities was liable for the 10-percent additional tax on early distributions. The taxpayer could not establish that the IRA distribution qualified as an exception to the additional tax because the taxpayer initiated, received and controlled the IRA distribution prior to receiving a notice of intent to levy from the IRS, and the IRA itself was not levied.

Willhite, TCM, CCH Dec. 57,995(M), FED ¶48,222(M);

Offer-in-Compromise

An IRS Appeals officer's decision to sustain the filing of a federal tax lien against an individual was not an abuse of discretion. The Appeals officer's decision to reject the taxpayer's offer in compromise was proper, based on the determination that the taxpayer's reasonable collection potential exceeded the amount of his tax liability. The Appeals officer considered the unique circumstances of the taxpayer's individual situation and, based on additional communication with the taxpayer, made adjustments to his calculations of the taxpayer's income.

Romero, Jr., TC, CCH Dec. 57,996(M), FED ¶48,223(M); TRC IRS: 42,120.

Bankruptcy

IRS assessments of an individual's tax liabilities were timely made, taking into consideration a number of extensions of time. The 60-day suspension provided in Code Sec. 6503 and Form 872, Consent to Extend the Time to Assess Tax, is not a grace period during which the IRS may make an assessment that it could not make after the entry of the Tax Courts decision. Furthermore, the tax liabilities were nondischargeable because they were assessed less than 240 days before the date of the debtor's bankruptcy petition.

In re Depasture, BC-DC Ga., 2009-2 USTC 50,750; TRC IRS: 30,202.05.

Practitioners' Corner

Expiring Incentives And Tax Legislation Complicate Year-End Planning

The new mantra on Capitol Hill is “jobs” and tax incentives are expected to play a key role in avoiding or minimizing the harm from a “jobless recovery.” Democratic leaders in Congress are reportedly drafting a jobs bill, which would include new tax incentives to encourage job creation and extend some temporary incentives. At the same time, House and Senate leaders are trying to move health care reform, estate tax relief, international tax reform, a package of extenders, an alternative minimum tax (AMT) patch, and more before year-end. This Practitioners' Corner describes some of the expiring provisions and provides some planning tips.

■ **Comment.** The House is scheduled to recess December 18 but Democratic leaders have indicated that the House could remain in session until December 22. The Senate is scheduled to recess December 18.

Jobs bill

At this time, details of tax incentives in the proposed jobs bill are sketchy. Some lawmakers propose expanding business tax breaks, such as bonus depreciation and Code Sec. 179 expensing, as the best way to create jobs. The White House has endorsed the idea of creating a new tax incentive that would reward employers who create or preserve jobs.

Congress could also expand and extend the Work Opportunity Tax Credit and the Welfare to Work Credit, which provide tax breaks to employers who hire economically disadvantaged individuals. Other employment-related incentives include the Indian Employment Credit and employer tax breaks to create “green” jobs, such as for wind and solar energy. A jobs bill is also expected to extend eligibility for COBRA premium assistance, which is scheduled to expire after December 31, 2009.

■ **Planning Note.** A jobs bill could extend the temporary ex-

clusion for the first \$2,400 in unemployment benefits, which will sunset after December 31, 2009. Revenue to fund tax incentives in a jobs

Code Sec. 6707A to make the penalties for failure to include reportable transaction information with the taxpayer's return proportional to the tax benefits received by the

“As year-end approaches, a package of extenders typically starts to make its way forward in Congress. This year is no different.”

bill could come from a new tax on stock and similar trades. *H.R. 3153*, introduced earlier this year in the House, would impose a 0.25 percent excise tax on over-the-counter derivative transactions. Taxable transactions would include, among other things, any option, forward contract, short position, and notional principal contract.

Lawmakers could also take money from the Troubled Asset Relief Program (TARP) and divert it to a jobs bill. Some lawmakers support a hike in the federal gasoline tax to pay for a jobs bill.

■ **Planning Note.** Bonus depreciation and Code Sec. 179 expensing are likely the only two business-related tax incentives to be extended, if at all, in a jobs bill. The *Worker, Homeownership and Business Assistance Act of 2009 (2009 Worker Act)* provides expanded net operating loss carrybacks to all businesses.

A lower corporate tax rate is unlikely to be part of a jobs bill or any bill in the near future. The White House had previously indicated its interest in lowering the corporate tax rate in exchange for closing some unspecified “loopholes.” However, nothing concrete has been proposed.

Small businesses may get some relief from Code Sec. 6707A penalties before year-end. Pending legislation would amend

taxpayer. The IRS has suspended collection efforts through the end of 2009.

Health care reform

Two revenue raisers enjoy significant support in Congress and are likely to be part of a final health care reform bill: new limits on health flexible spending accounts (FSAs) and an increase in the additional tax for unqualified distributions from health savings accounts (HSAs). The House and Senate health care reform bills would limit annual contributions to a health FSA to \$2,500. Additionally, taxpayers could not use health FSA dollars to pay for over-the-counter medications. Only prescription medications would be eligible for purchase with FSA dollars.

■ **Planning Note.** With year-end fast approaching and the likelihood of these provisions passing, taxpayers with health FSAs need to use the remaining balances in their accounts or risk losing it. Many FSA plans require account holders to use all of their health care dollars by the end of the calendar year. Other plans give members until March 15, 2010.

■ **Planning Note.** The Senate health care reform bill would raise the threshold for the itemized medical expense deduction from 7.5 percent of adjusted gross income

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Washington Report

by the CCH Washington News Bureau



Senate approves motion to take up health reform bill

On November 21, the Senate approved by a 60-39 vote a procedural motion to take up the sweeping \$849 billion *Patient Protection and Affordable Care Act*. The bill was introduced by Democratic leaders on November 19. Senate Democratic leadership has warned that if the bill is not finished by the holidays, the Senate could take an abbreviated break and quickly return to work. Issues that are central to the looming debate include whether or not to provide a public option, statutory language prohibiting federal funding for abortion, and a 40 percent tax on high-end insurance plans that could hit middle income taxpayers. *See the article on Page 555 of this newsletter for more information.*

“President Obama is gratified that the Senate has acted to begin consideration of health insurance reform legislation,” a White House spokesperson said. “President Obama looks forward to a thorough and productive debate.”

“This bill is the culmination of years of study and debate,” Senate Finance Committee Chair Max Baucus, D-Mont., said in a statement. “It is fully paid for and will reduce the national debt.”

House may take up jobs bill before December break

House Majority Leader Steny Hoyer, D-Md., recently told reporters that House Democratic leaders may consider a jobs bill before lawmakers leave for their December break and the first session of the 111th Congress ends. According to Hoyer, a “second stimulus” bill is unlikely. House Republican Whip Eric Cantor, R-Va., said that the GOP would submit proposals for business tax incentives. “We urge the Democratic leaders to take into consideration some of the Republican proposals for job creation.”

Hoyer said that House committees may be asked to produce ideas for consideration,

including additional spending on infrastructure or targeted tax incentives. Hoyer indicated that long-term deficit concerns must be balanced against the need to spur job growth.

Permanent estate tax bills contemplated

The House is expected to consider legislation the week of November 30 that would extend the current estate tax rates and exemption levels one more year, into 2010, lawmakers and staffers reported November 19. Some lawmakers have proposed a permanent extension of the 2009 estate tax rates and exemption levels, but the large federal budget deficit has dampened enthusiasm for a permanent fix. One pending proposal would extend the current estate tax through 2010 and then over the next 10 years reduce the rate from 45 percent to 35 percent while raising the exemption from \$3.5 million to \$5 million.

Treasury/SBA highlight role of tax cuts

Tax cuts were highlighted as a possible method to help small businesses increase cash flow during the economic downturn during the Small Business Financing Forum presented by the Treasury Department and Small Business Administration (SBA) on November 18 in Washington, D.C. “Without increased access to credit for American families and small businesses, growth will be weaker, companies will defer long term investments and we will not be able to create a recovery that is self-sustaining and left by private demand,” Treasury Secretary Timothy Geithner, who presided over the forum, said. Geithner highlighted the enhanced net operating loss (NOL) carryback rules for small businesses, which were recently extended by the *Worker, Homeownership and Business Assistance Act of 2009*. Geithner indicated that Treasury will continue to support tax cuts that make small businesses more liq-

uid, despite some economists’ reports that the recession has already ended or will be ending soon.

IRS working on pension funding guidance

On November 18, IRS Senior Counsel Linda Marshall indicated to practitioners that the IRS is working on additional pension funding regs under Code Sections 430 and 436. Marshall spoke during a luncheon event sponsored by the District of Columbia Bar Association, Taxation Section. Marshall reported that the IRS is trying to determine what to do for nongovernmental plans required to amend their plans by December 31, 2009. According to Marshall, it may be too late for the IRS to issue model amendments, but the IRS is looking at extending relief.

TIGTA identifies improper Hope scholarship credit claims

The Treasury Inspector General for Tax Administration (TIGTA) has identified millions of dollars in improper Hope scholarship credits claimed on tax returns filed for 2006 and 2007. During those years, the Hope scholarship credit applied only to the first two years of post-secondary education for any one student. However, TIGTA found that approximately 200,000 returns for 2006 claimed the credit for the same student for more than two years. More than 58,000 of these returns claimed the credit for all four years, for a total of \$80 million in improper credits. For 2007 returns, TIGTA found that more than 169,000 returns claimed the credit for the same student for more than two years, for total improper credit claims of more than \$242 million.

The *American Reinvestment and Recovery Act of 2009* temporarily enhanced and renamed the Hope credit as the American Opportunity Tax Credit (AOTC). The White House has proposed a permanent extension of the AOTC.

Practitioners' Corner

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(AGI) to 10 percent of AGI for regular income tax purposes. However, individuals age 65 and older (and their spouses) would be temporarily exempt from the increase.

Estate tax

Estate tax relief has languished as lawmakers have worked on health care reform and other issues. House Democrats have expressed support for extending the 2009 estate tax rates and exemption amounts into 2010. Long-term reform will wait until 2010 or beyond.

■ **Comment.** "Many individuals are putting off planning their estates or updating their wills or trust agreements during this period of uncertainty," Mary Kay Foss, CPA, director, Greenstein, Rogoff, Olsen & Co., LLP, Danville, Calif., told CCH. "If the exemption stays at \$3.5 million, many people will re-think the necessity of a Bypass Trust. If their documents currently call for one, they should make a change. The uncertainty is making people put off even simple changes – like changing a trustee or executor – because they want to change everything at once."

It is unclear if estate tax reform will address portability. Generally, one spouse could transfer his or her used portion of the estate tax exemption to his or her surviving spouse and the surviving spouse would have a larger exemption. Portability has been proposed in past legislation.

■ **Comment.** Portability is less important in community property states, Foss noted. "With community property each spouse is assumed to own one-half of the total assets so the exemption is not lost. It helps in California when there is separate property. That would be property that one spouse owned before the marriage – that was kept separate, and property received by gift or inheritance."

Tax rates

Only one year remains before the lower individual marginal income tax rates enacted in 2001 expire. Under current law, the top individual marginal rates will revert to 36

percent and 39.6 percent (from their current levels of 33 percent and 35 percent) after December 31, 2010. President Obama and Democratic leaders in Congress have endorsed extending the lower individual rates but allowing the 36 percent and 39.6 percent rates to revive after 2010.

■ **Planning Note.** Individuals in the top bracket saw the largest reduction on a percentage basis (39.6 percent to 35 percent). After 2010, they will see the largest increase. This increase will be in addition to a possible surtax and expected higher dividend and capital gains rates. The traditional planning technique of accelerating the recognition of income takes on new urgency for 2010. The higher rates will also make tax deferred investments such as IRAs more attractive. Higher-income individuals should also not expect any extension of the repeal on the limit on itemized deductions or repeal of the personal exemption phaseout.

International taxation and disclosure

The IRS's recently concluded offshore compliance initiative and its high-profile settlement with Swiss banking giant UBS AG have fueled interest on Capitol Hill in reforming the international tax reporting rules. Pending legislation supported by the White House and senior Democrats in the House and Senate would require individuals to report offshore accounts with values of \$50,000 or more on their tax returns. The bill would heighten the qualified intermediary (QI) regime.

■ **Planning Note.** The IRS's offshore initiative closed October 15. Nonetheless, taxpayers can still make a voluntary disclosure and avoid criminal prosecution, James Mastacchio, partner, Caplin Drysdale, Chartered, Washington, D.C., told CCH. However, the penalty framework under the initiative would not be available to those taxpayers.

Homeowners

The IRS's recent reminder of "winterization" tax credits for homeowners may foreshadow a new incentive: "cash-for-caulkers." The White House is reportedly exploring a program that would reimburse qualified

homeowners up to 50 percent of the cost of "weatherization" expenses, such as insulation and related items. It is expected that the incentive payments would be excluded from the recipient's income.

The recent extension and expansion of the first-time homebuyers credit is expected to be the last extension and the window to take advantage of the credit is short. The 2009 Worker Act provides an \$8,000 refundable credit to qualified first-time homebuyers and a \$6,500 credit to long-time homeowners for purchases on or before April 30, 2010 (with an extended sunset if the taxpayer enters into a binding contract before May 1, 2010 to close on the purchase of a principal residence before July 1, 2010).

Extenders

As year-end approaches, a package of extenders typically starts to make its way forward in Congress. This year is no different. A host of temporary tax incentives are set to expire at the end of 2009. They include:

- State and local sales tax deduction;
- Higher education tuition deduction;
- Research tax credit;
- Brownfields remediation;
- Teacher's classroom expense deduction; and
- National disaster relief.

■ **Planning Note.** The temporary new vehicle state and local sales tax deduction is not expected to be extended. The deduction also has been linked, some say unfairly, to criticism over the cash-for-clunkers program.

■ **Planning Note.** In recent years, Congress has also extended the AMT patch with the extenders. The 2009 AMT exemption amounts are \$70,950 for married couples filing joint returns and surviving spouses and \$46,700 for single individuals and heads of households. If Congress patches the AMT for 2010, the 2010 AMT exemption amounts will be in the neighborhood of the 2009 amounts because of low inflation.

Tax reform

President Obama's special White House panel on tax reform is expected to make its recommendations before year-end. The panel has discussed tax simplification and expansion of individual tax incentives.

Compliance Calendar

December 2

Employers deposit Social Security, Medicare, and withheld income tax for November 25, 26, and 27.

December 4

Employers deposit Social Security, Medicare, and withheld income tax for November 28, 29, 30, and December 1.

December 9

Employers deposit Social Security, Medicare, and withheld income tax for December 2, 3, and 4.

December 10

Employees who received \$20 or more in tips during November report them to their employers.

December 11

Employers deposit Social Security, Medicare, and withheld income tax for December 5, 6, 7, and 8.

December 15

Corporations deposit fourth installment of estimated income tax for 2009.

Monthly depositors deposit Social Security, Medicare, and withheld income tax for December.

December 16

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

December 18

Employers deposit Social Security, Medicare, and withheld income tax for December 12, 13, 14, and 15.

December 23

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

Monthly Quizzer

The following questions (with answers at the bottom of the column) will help you review some of the more important developments in *CCH Federal Tax Weekly* during the past month.

Q 1. The *Worker, Homeownership, and Business Assistance Act* (the 2009 *Worker Act*) does which of the following?

- (a) Provides all businesses with an expanded net operating loss carryback
- (b) Extends the first-time homebuyer tax credit
- (c) Increases penalties for failure to file certain returns
- (d) All of the above

Q 2. Nonresident aliens may not claim the Making Work Pay Credit. *True or False?*

Q 3. Taxpayers may only claim either the nonbusiness energy property credit or the residential energy efficient property credit enacted under the *American Recovery and Reinvestment Act of 2009*, not both. *True or False?*

4. Under the 2009 *Worker Act*, what is the latest date by which a taxpayer must generally purchase a home to claim the first-time homebuyer tax credit, absent a binding contract to close before July 1, 2010?

- (a) April 30, 2010
- (b) August 1, 2010
- (c) December 31, 2010
- (d) None of the above

Answers:

- Q1.** (d). See *Issue #45*, page 529.
Q2. True. See *Issue #46*, page 541.
Q3. False. See *Issue #44*, page 519.
Q4. (a). See *Issue #45*, page 530.

TRC Text Reference Table

The cross references at the end of the articles in *CCH Federal Tax Weekly (FTW)* are text references to *CCH 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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