

# Spidell's Quarterly Tax Update™



**SPIDELL**  
TAX • ANALYSIS • EDUCATION

[www.caltax.com](http://www.caltax.com) | E-mail: [CPE@spidell.com](mailto:CPE@spidell.com) | Phone: 714-776-7850 | Fax: 714-776-9906

YOUR CALIFORNIA SOLUTION SINCE 1975

This publication is distributed with the understanding that the authors and publisher are not engaged in rendering legal, accounting or other professional advice and assume no liability in connection with its use. Tax laws are constantly changing and are subject to differing interpretation. In addition, the facts and circumstances in your particular situation may not be the same as those presented here. Therefore, we urge you to do additional research and ensure that you are fully informed before using the information contained in this publication. Federal law prohibits unauthorized reproduction of the material in Spidell's **Quarterly Tax Update™** manual. All reproduction must be approved in writing by **Spidell Publishing, Inc.®**

**This is not a free publication.** Purchase of this electronic publication entitles the buyer to keep one copy on his/her computer and to print out one copy only. Printing out more than one copy — and any electronic distribution of this publication — is prohibited by international and United States copyright laws and treaties. Illegal distribution of this publication will subject the purchaser to penalties of up to \$100,000 per copy distributed.

## SPIDELL'S QUARTERLY TAX UPDATE™

**Course objectives:** This course will provide a review and analysis of important issues pertaining to tax law and practice, which have come up within the quarter leading up to January 31, 2017. Topics addressed include: filing due date changes, new due diligence requirements, Form 8938 for foreign financial assets, rebates, bad debts, casualty losses, QTIP trusts, health reimbursement accounts (HRAs), payroll taxes, identity theft, the President's and the GOP's tax plans, and much more.

After completing this course, you will be able to:

- Recall the consequences for de minimis errors on information returns
- Identify when a domestic partnership or corporation is considered to hold specified foreign financial assets
- Determine if a rebate should be included in gross income
- Recall how an IRC §165(i) election is made
- Identify restrictions on HRAs under the 21st Century Cures Act (HR 34)
- Recall how child care expenses would be treated under the President's tax plan

Category: Taxes

Recommended CPE Hours: CPAs – 2 Tax  
EAs/CRTPs – 2 Federal Tax Update

Level: Update

Prerequisite: General tax preparation knowledge

Advanced Preparation: None

Expiration Date: January 2018

## Table of Contents

<b>Filing issues .....</b>	<b>1</b>
Final reminder: new business return due dates.....	1
California partial conformity .....	3
W-2s and 1099s .....	3
California conformity .....	4
Election to have the safe harbor not apply .....	4A
EDD's new e-file and EFT payment mandate.....	5
Payroll services may help with compliance .....	5
Waivers .....	5
Use e-Services for Business .....	6
New filing requirements for refundable credits .....	6
Due diligence requirements expanded .....	7
Due dates for report of foreign bank and financial accounts (FBAR) changing in 2017 .....	10
April 18, 2017 .....	10
Extensions.....	10
Penalty relief .....	10
<b>Foreign asset disclosure – FATCA – Form 8938.....</b>	<b>11</b>
Entities will be required to file Form 8938 with 2016 returns .....	11
Specified domestic entity .....	11
Passive income.....	12
California conformity – new!.....	13
How and what do you file? .....	13
<b>Individuals .....</b>	<b>13</b>
Workers' compensation settlement denied income exclusion.....	13
Settlements must follow procedures necessary under state law .....	13
State-issued rebates are taxable for both federal and California purposes.....	14
Rebates only excludable when a reduction in purchase price.....	14
Worthlessness of stock must be tied to an identifiable event .....	15
Timing is not the taxpayer's choice .....	15
Business vs. nonbusiness bad debt .....	16
When loans and worthless boyfriends collide .....	16
Flawed appraisal is nonetheless an appraisal.....	17
Election to deduct disaster losses in preceding tax year .....	18
Regulations catch up with notices issued in recent years.....	18
California partial conformity .....	19
Declared disasters in California – January 2017.....	20
<b>Estates and trusts.....</b>	<b>20</b>
New guidance on QTIP elections.....	20
Rev. Proc. 2016-49.....	20
Theft loss deduction allowed for estate tax return.....	21
Bernie Madoff Ponzi scheme is still making waves .....	21

<b>Business .....</b>	<b>22</b>
Relief for HRAs.....	22
Relief from \$100-per-day penalty would be permanent.....	22
HRA ineligibility for 2% S corporation shareholder .....	23
Reporting health insurance of 2% S corporation shareholder .....	23
Proceeds from sale termination ordinary income .....	23
IRC §1231 property is not a capital asset for purposes of IRC §1234A.....	23
Avoiding related-party like-kind exchange rules.....	25
Proving tax avoidance through calculation can add value for your clients.....	25
California Form 3840 Reminder.....	26
Relying on third party to remit payroll taxes.....	26
The taxpayer must pay both penalties and tax .....	26
LLC Manager personally liable for failure to comply with IRS levy on member.....	27
Member distributions and licensing fees constitute income for levy purposes .....	27
No good deed goes unpunished.....	28
Noble business owner feels the tax man's bite.....	28
California LLCs .....	29
<b>Practice and procedures .....</b>	<b>30</b>
E-mail schemes targeting tax professionals.....	30
W-2 fraud notices beginning in 2017 .....	30
Identity theft: stay vigilant.....	31
Knowing what's out there helps protect you and your clients' information.....	31
Responding to Form FTB 4734D .....	33
FTB suspects identity theft.....	33
Appeals conferences will now take place via phone.....	34
IRS wants to increase fees .....	35
Installment agreements .....	35
Offers in compromise .....	35
<b>Miscellaneous.....</b>	<b>35</b>
Deadline for furnishing health coverage forms extended.....	35
Employer state ID numbers no longer transfer in many software programs.....	35
<b>Tax Reform – what to tell clients.....</b>	<b>36</b>
Comparing tax plans of President Trump and House Republicans .....	36
The President's tax plan .....	36
The GOP's "A Better Way" tax plan.....	40
California conformity .....	45
Tax plan comparison chart .....	46
<b>Case study – What's an 8867?.....</b>	<b>49</b>
The facts.....	49
The form .....	49
The dilemma .....	51

# QUARTERLY TAX UPDATE — JANUARY 31, 2017

## FILING ISSUES

### FINAL REMINDER: NEW BUSINESS RETURN DUE DATES

We previously wrote about return due date changes for taxable years beginning after December 31, 2015. Please remember the new due dates as we head into another filing season:

<b>Business Entity Due Date and Filing Extensions</b> (Due dates for 2016 returns in italics)			
<b>Entity type</b>	<b>Due Date</b>	<b>Extension period</b>	<b>Extension forms</b>
<b>Partnerships (including SMLLCs owned by a partnership)</b>	2½ months <i>March 15, 2017</i>	6 months <i>September 15, 2017</i>	<b>Federal:</b> Must file Form 7004 by original due date  <b>CA:</b> Automatic. No form required, but must submit any tax due with Form FTB 3538
<b>S corporations (including SMLLCs owned by an S corporation)</b>	2½ months <i>March 15, 2017</i>	6 months <i>September 15, 2017</i>	<b>Federal:</b> Must file Form 7004 by original due date  <b>CA:</b> Automatic. No form required, but must submit any tax due with Form FTB 3539
<b>C corporations (calendar year)</b>	3½ months <i>April 18, 2017</i>	<b>Federal:</b> 5 months until 2026, then 6 months <i>September 15, 2017</i>  <b>CA:</b> 6 months <i>October 16, 2017</i>	<b>Federal:</b> Must file Form 7004 by original due date  <b>CA:</b> Automatic. No form required, but must submit any tax due with Form FTB 3539
<b>C corporations (June 30 year)</b>	<b>Federal:</b> 2½ months until 2026, then 3½ months <i>September 15, 2017</i> <b>CA:</b> 3½ months <i>October 16, 2017</i>	<b>Federal:</b> 7 months until 2026, then 6 months <i>April 17, 2018</i>  <b>CA:</b> 6 months <i>April 17, 2018</i>	See above
<b>C corporations (other than calendar-year and June 30)</b>	3½ months	6 months	See above

*(continued)*

<b>Business Entity Due Date and Filing Extensions (continued)</b> (Due dates for 2016 returns in italics)			
<b>Entity type</b>	<b>Due Date</b>	<b>Extension period</b>	<b>Extension forms</b>
<b>Exempt corporations</b>	4½ months <i>May 15, 2017</i>	6 months <i>November 15, 2017</i>	<b>Federal:</b> Must file Form 8868 by original due date  <b>CA:</b> Automatic. No form required, but must submit any tax due with Form FTB 3539
<b>Trusts</b>	3½ months <i>April 18, 2017</i>	<b>Federal:</b> 5½ months <i>September 30, 2017</i>  <b>CA:</b> 6 months <i>October 16, 2017</i>	<b>Federal:</b> Must file Form 7004 by original due date  <b>CA:</b> Automatic. No form required, but must submit any tax due with Form FTB 3563

***Reminder***

The April due date is pushed back to April 18, 2017, because April 15, 2017, falls on a Saturday, and Monday April 17, 2017, is the day Emancipation Day is observed in Washington, D.C.

**⚠ Caution**

Notice the two exceptions:

- The original due date for C corporations is three and one-half months after the end of the taxable year, except for June 30 year-ends (two and one-half months after); and
- The extended due dates for C corporations are six months after the end of the taxable year, except for calendar-year corporations (five months after) and June 30 C corporations (seven months after).

The exceptions end in 2026 when those dates fall in line with the original and extended due dates for all other C corporations (that is, three and one-half months for the original due date and six additional months for the extended due date).



## California partial conformity

Beginning with the 2017 filing season, for both federal and California tax purposes, the due dates for business entity returns are as follows:

- **Partnerships:** The 15th day of the third month following the close of the taxable year;
- **C corporations:** Generally, the 15th day of the fourth month following the close of the taxable year; and
- **S corporations:** Returns remain due by the 15th day of the third month of the taxable year.
- **SMLLCs (CA Form 568):** Due date is the same as the owner.
  - **SMLLCs owned by individuals and C corporations:** April 15 (April 18, 2017)
  - **SMLLCs owned by partnerships, LLCs, and S corporations:** March 15

### Nonconformity

California does not conform to the federal due dates in two ways:

- There is no two and one-half month deadline for June 30 C corporations; and
- There are different extended deadlines for calendar-year C corporations and trusts.

### June 30 C corporations

California has not conformed to the federal delay in the due-date change for C corporations with a fiscal year ending on June 30. For *federal* purposes, these C corporations will continue to file their returns by the 15th day of the *third* month following the close of the fiscal year until taxable years beginning after December 31, 2025.

For *California* purposes, these corporations are not required to file their returns until the 15th day of the *fourth* month following the close of their fiscal year.

### Extended due dates

California has its own extended due date provisions that are independent of the federal extended due date provisions. For the 2016 tax year, California provides an automatic six-month extension for partnerships, S corporations, and C corporations.

## W-2s and 1099s

For calendar years after 2015, Forms W-2 and W-3 must be filed with the Social Security Administration by January 31, not February 28. In addition, under the PATH Act, Forms 1099-MISC (and related Forms 1096) containing nonemployee compensation in box 7 must be filed with the IRS by no later than January 31, no longer February 28. The filing date with the IRS for Form 1096 and Forms 1099 that do not contain nonemployee compensation remains February 28.

### Penalties

There is a \$260 per-return federal penalty for failure to file these information returns or if the returns are incorrect. (IRC §6721) The penalties are reduced if corrected as follows:

- Within 30 days of the due date, the federal penalty is reduced to \$50 per return; and
- Before August 1, the federal penalty is reduced to \$100 per return.





## California conformity

California conforms to these due dates.

The corresponding per-return California penalties are as follows:

- **1099s:** \$100 for failure to file, \$30 if filed within 30 days of the due date; and
- **W-2s:** \$50 for failure to file.  
(R&TC §19175, UIC §13052)

### Exceptions for *de minimis* failures

The IRS provides a limited exception to the information return penalties for *de minimis* errors in the following situations. Where a W-2 or 1099 is timely filed with incorrect information but is corrected by August 1, the number of information returns for which relief is provided is limited to the greater of:

- 10 returns; or
- 0.5% of the total number of information returns required to be filed by the taxpayer.

#### *Example of de minimis relief*

Jones Co. timely files and issues W-2s to its 3,000 employees and issues 200 1099s to vendors. Due to an error, 20 W-2s were incorrect and were amended on June 1.

Jones Co. is subject to a federal penalty of \$100 per return because the errors were corrected after 30 days from the January 31 due date, but before August 1.

The \$100 per-return penalty relief applies to the greater of 10 returns or 0.5% of the total returns Jones Co. files (3,200 total returns x 0.5% = 16).

The penalty is calculated as follows:

Total incorrect returns	20
Returns eligible for penalty relief	- 16
Returns subject to penalty	4
Penalty per return	× \$100
Total penalty	<u>\$400</u>

Additionally, if the errors relate to an incorrect dollar amount and the errors do not exceed \$100 for any single amount or \$25 in the case of withholding, then no corrections are required. In other words, the return is treated as if it was correct as filed.

Penalty relief is not available in the case of intentional disregard of the filing requirements by a taxpayer.

### Extension of time to file information returns

Form 8809, Application for Extension of Time to File Information Returns, must be used to request either an initial or additional extension of time to file information returns. Extensions may be requested for W-2s and 1099s among others.

Form 8809 must be filed by the due date of the return. Requests must include a detailed explanation of why an extension is necessary. Requests are individually evaluated and are not automatic.

Only two extension requests may be made – an initial request and an additional request. Each extension is 30 days.

An extension only extends the due date for filing the information returns with the IRS. They do not extend the due date for furnishing statements to recipients.

### **Election to have the safe harbor not apply**

Recipients of information returns (payees) may make an election that the de minimis safe harbor not apply so that penalties are applicable to a payor who fails to correct an error on an information return, even if the error is *de minimis*. (IRC §§6721(c)(3)(B), 6722(c)(3)(B))

If a payee makes the election and the payor furnishes a corrected payee statement to the payee and files a corrected information return with the IRS within 30 days of the date of the election, then the error will be treated as due to reasonable cause and not willful neglect, and the information return penalties will not apply.

Payors may set any reasonable manner for making the election, including in writing, on-line, or by telephone, provided by the payor gives the payee written notification of the reasonable manner before the date the payee makes the election. If the payor does not set the manner for making the election, then the payee may make the election in writing to the payor's address.

Payors may not impose prerequisites, conditions, or time limits on a payee's ability to request a corrected information return.

#### ***Example of payee election***

Jeff works for Jones Co. from the previous example. On February 1, 2017, Jones Co. instituted a new policy that it will not automatically issue corrected W-2s or 1099s if the amount shown on a W-2 or 1099 is incorrect by less than \$100 for any single amount or less than \$25 in the case of withholding (the de minimis safe harbor limits)

However, Jones Co. allows information return recipients to request corrections to their W-2s and 1099s that fall within the de minimis safe harbor limits either by e-mail or in person to a designated human resources manager.

On March 2, 2017, Jeff discovers that his W-2 is overstated by \$80 and his withholding is understated by \$20 and he notifies Jones Co.'s designated human resources manager and requests a corrected W-2.

Jeff's notification and request to the human resources manager amounts to an election to have the safe harbor rules not apply and Jones Co. has 30 days to issue a corrected W-2 to Jeff and still avoid information return penalties.

## EDD'S NEW E-FILE AND EFT PAYMENT MANDATE

### Payroll services may help with compliance

Beginning January 1, 2017, California law requires employers with 10 or more employees to electronically submit employment tax returns, wage reports, and payroll tax deposits to the EDD. (AB 1245 (Ch. 15-222); UIC §§1088, 1110, 1112, 1112.1, 1114, 13002, 13021) All remaining employers will be subject to this requirement beginning January 1, 2018.

Although the electronic filing mandate is being phased in over a two-year period, employers who fail to comply without good cause will not be subject to a penalty until January 1, 2019. (UIC §§1112, 1112.1, 1114) Effective January 1, 2019, failure to comply with this mandate will result in the following penalties, which are in addition to any other penalties that might apply:

Penalties for Not Electronically Filing or Paying		
Type	Forms	Penalty
Tax returns	<ul style="list-style-type: none"> <li>• <b>DE 9:</b> Quarterly Contribution Return and Report of Wages</li> <li>• <b>DE 3HW:</b> Employer of Household Worker(s) Annual Payroll Tax Return</li> <li>• <b>DE 3D:</b> Quarterly Contribution Return</li> </ul>	\$50 per return (UIC §1112.1)
Wage reports	<ul style="list-style-type: none"> <li>• <b>DE 9C:</b> Quarterly Contribution Return and Report of Wages (Continuation)</li> <li>• <b>DE 3BHW:</b> Employer of Household Worker(s) Quarterly Report of Wages and Withholdings</li> </ul>	\$20 per wage item (UIC §1114)
Payments	<ul style="list-style-type: none"> <li>• <b>DE 88:</b> Payroll Tax Deposit</li> </ul>	15% of amount due (UIC §1112)

### Waivers

Waivers from the mandate are available for good cause, including but not limited to lack of automation, severe economic hardship, or a current exemption from federal electronic filing requirements. Approved waivers are valid for one year, beginning with the quarter of the request date. Denied waivers may not be appealed. (EDD FAQs – E-file and E-pay Mandate (Assembly Bill 1245) available at: [www.edd.ca.gov/payroll\\_taxes/FAQ\\_-\\_E-file\\_and\\_E-pay\\_Mandate\\_for\\_Employers.htm](http://www.edd.ca.gov/payroll_taxes/FAQ_-_E-file_and_E-pay_Mandate_for_Employers.htm))

To request a waiver, employers must complete and submit the DE 1245W, E-file and E-pay Mandate Waiver Request.

Waiver requests can be submitted by mail or fax to:

 **Address**

Employment Development Department  
Document and Information Management Center  
P.O. Box 989779  
West Sacramento, CA 95798-9779

 **Fax**

(916) 255-1181

Employers will be notified by mail if their waiver is approved or denied. Upon the expiration of the approval period, an employer must start to electronically file and pay or submit a new waiver request to avoid a noncompliance penalty.

### Use e-Services for Business

Employers can use the EDD's e-Services for Business to comply with the e-file and e-pay mandate and perform other activities as well, including:

- Registering for an employer payroll tax account number;
- Filing returns and reports;
- Making payroll tax deposits and paying other liabilities; and
- Viewing and updating account information.

To access e-Services for Business, go to:

 **Website**

[www.edd.ca.gov/Payroll\\_Taxes/e-Services\\_for\\_Business.htm](http://www.edd.ca.gov/Payroll_Taxes/e-Services_for_Business.htm)

## NEW FILING REQUIREMENTS FOR REFUNDABLE CREDITS

Taxpayers and tax professionals claiming certain individual credits will face new filing requirements in the 2016 filing season. The credits affected include the Child Tax Credit (CTC), the American Opportunity Tax Credit (AOTC) and the Earned Income Tax Credit (EITC). The new requirements include:

- Paid tax preparers are subject to due diligence requirements for all three credits, similar to the longstanding requirements for the EITC;
- Timely taxpayer identification numbers are now required for all three credits (credits cannot be claimed on an amended return, or on an original return if the taxpayer previously failed to file, for a year in which he or she didn't have a valid TIN);
- Refunds will be delayed for taxpayers claiming the EITC or the refundable Additional Child Tax Credit (ACTC); and
- Taxpayers improperly claiming a refundable ACTC will be denied the credit for a certain number of subsequent years, similar to the rules pertaining to the EITC already in place (see below).

In addition, the PATH Act made the enhanced CTC permanent. The refundable portion of the CTC (the ACTC) is permanently 15% of the amount by which the taxpayer's earned income exceeds \$3,000.

Also, the enhanced EITC for taxpayers with three or more qualifying children is made permanent under the PATH Act.

## Due diligence requirements expanded

As a result of the PATH Act, Form 8867, Paid Preparer's Due Dilligence Checklist, is expanded for the 2016 tax year to include due diligence with respect to claiming not only the EITC, but also the AOTC and the CTC. Generally, tax professionals who prepare EITC claims must not only ask all the questions to get the information required on Form 8867, but they must also ask additional questions when the information their client provides seems incorrect, inconsistent, or incomplete.

Tax preparers must keep copies for three years, either on paper or electronically, of any documents provided by the taxpayer that were relied on to determine whether any child is a qualifying child. Tax preparers must also keep all worksheets showing how the credit was computed.

Note, also, that the \$510 penalty is *per credit*; that is, if all three credits are reported on the return and the tax preparer fails due diligence with respect to all three, the penalty is \$1,530.

### Practice Pointer

For tax preparers who are not accustomed to dealing with low-income clients, the Form 8867 is rarely seen in their practice. However, the expansion of Form 8867 for use with the Child Tax Credit and the American Opportunity Tax Credit means that all preparers will need to deal with its requirements on a regular basis.

Practitioners should review the form and its instructions in detail early this tax season and become familiar with it. Doing so will save time during the peak of the season.

See the new temporary regulations on due diligence and IRS Publication 4687.

**Paid Preparer's Due Diligence Checklist**  
*Earned Income Credit (EIC), Child Tax Credit (CTC), and American Opportunity Tax Credit (AOTC)*  
 ▶ To be completed by preparer and filed with Form 1040, 1040A, 1040EZ, 1040NR, 1040SS, or 1040PR.  
 ▶ Information about Form 8867 and its separate instructions is at [www.irs.gov/form8867](http://www.irs.gov/form8867).

Taxpayer name(s) shown on return

Taxpayer identification number

Enter preparer's name and PTIN

**Due Diligence Requirements**

Please complete the appropriate column for all credits claimed on this return (check all that apply).	EIC	CTC/ACTC	AOTC
<b>1</b> Did you complete the return based on information for tax year 2016 provided by the taxpayer or reasonably obtained by you? . . . . .	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
<b>2</b> Did you complete the applicable EIC and/or CTC/ACTC worksheets found in the Form 1040, 1040A, 1040EZ, or 1040NR instructions, and/or the AOTC worksheet found in the Form 8863 instructions, or your own worksheet(s) that provides the same information, and all related forms and schedules for each credit claimed? . . . . .	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
<b>3</b> Did you satisfy the knowledge requirement? Answer "Yes" only if you can answer "Yes" to both 3a and 3b. To meet the knowledge requirement, did you:	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
<b>a</b> Interview the taxpayer, ask adequate questions, and document the taxpayer's responses to determine that the taxpayer is eligible to claim the credit(s)? . . . . .	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
<b>b</b> Review adequate information to determine that the taxpayer is eligible to claim the credit(s) and in what amount? . . . . .	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
<b>4</b> Did any information provided by the taxpayer, a third party, or reasonably known to you in connection with preparing the return appear to be incorrect, incomplete, or inconsistent? (If "Yes," answer questions 4a and 4b. If "No," go to question 5.) . . . . .	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
<b>a</b> Did you make reasonable inquiries to determine the correct or complete information? . . . . .	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
<b>b</b> Did you document your inquiries? (Documentation should include the questions you asked, whom you asked, when you asked, the information that was provided, and the impact the information had on your preparation of the return.) . . . . .	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
<b>5</b> Did you satisfy the record retention requirement? To meet the record retention requirement, did you keep a copy of any document(s) provided by the taxpayer that you relied on to determine eligibility or to compute the amount for the credit(s)? . . . . .	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
In addition to your notes from the interview with the taxpayer, list those documents, if any, that you relied on. _____ _____ _____			
<b>6</b> Did you ask the taxpayer whether he/she could provide documentation to substantiate eligibility for and the amount of the credit(s) claimed on the return? . . . . .	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
<b>7</b> Did you ask the taxpayer if any of these credits were disallowed or reduced in a previous year? . . . . . (If credits were disallowed or reduced, go to question 7a; if not, go to question 8.)	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
<b>a</b> Did you complete the required recertification form(s)? . . . . .	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
<b>8</b> If the taxpayer is reporting self-employment income, did you ask adequate questions to prepare a complete and correct Form 1040, Schedule C? . . . . .	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No

**Due Diligence Questions for Returns Claiming EIC** (If the return does not claim EIC, go to question 10.)

	EIC	CTC/ACTC	AOTC
<b>9a</b> Did you explain to the taxpayer the rules about claiming the EIC when a child is the qualifying child of more than one person (tie-breaker rules), and have you determined that this taxpayer is, in fact, eligible to claim the EIC for the number of children for whom the EIC is claimed? . . . . .	<input type="checkbox"/> Yes <input type="checkbox"/> No		
<b>b</b> Did you explain to the taxpayer that he/she may not claim the EIC if the taxpayer has not lived with the child for over half the year, even if the taxpayer has supported the child? . . . . .	<input type="checkbox"/> Yes <input type="checkbox"/> No		

**Due Diligence Questions for Returns Claiming CTC and/or additional CTC** (If the return does not claim CTC or Additional CTC, go to question 11.)

<b>10a</b> Does the child reside with the taxpayer who is claiming the CTC/ACTC? (If "Yes," go to question 10c. If "No," answer question 10b.) . . . . .		<input type="checkbox"/> Yes <input type="checkbox"/> No	
<b>b</b> Did you ask if there is an active Form 8332, Release/Revocation of Claim to Exemption for Child by Custodial Parent, or a similar statement in place and, if applicable, did you attach it to the return? . . . . .		<input type="checkbox"/> Yes <input type="checkbox"/> No	
<b>c</b> Have you determined that the taxpayer has not released the claim to another person? . . . . .		<input type="checkbox"/> Yes <input type="checkbox"/> No	

**Due Diligence Questions for Returns Claiming AOTC** (If the return does not claim AOTC, go to *Credit Eligibility Certification*.)

<b>11</b> Did the taxpayer provide substantiation such as a Form 1098-T and receipts for the qualified tuition and related expenses for the claimed AOTC? . . . . .			<input type="checkbox"/> Yes <input type="checkbox"/> No
---	--	--	--

- **You have complied with all due diligence requirements with respect to the credits claimed on the return of the taxpayer identified above if you:**
- A. Complete this Form 8867 truthfully and accurately and complete the actions described in this checklist for all credits claimed;
  - B. Submit Form 8867 in the manner required;
  - C. Interview the taxpayer, ask adequate questions, document the taxpayer's responses on the return or in your notes, review adequate information to determine if the taxpayer is eligible to claim the credit(s) and in what amount(s); **and**
  - D. Keep all five of the following records for 3 years from the latest of the dates specified in the Form 8867 instructions under *Document Retention*.
    - 1. A copy of Form 8867,
    - 2. The applicable worksheet(s) or your own worksheet(s) for any credits claimed,
    - 3. Copies of any taxpayer documents you may have relied upon to determine eligibility for and the amount of the credit(s),
    - 4. A record of how, when, and from whom the information used to prepare this form and worksheet(s) was obtained, and
    - 5. A record of any additional questions you may have asked to determine eligibility for and amount of the credits, and the taxpayer's answers.
- **If you have not complied with all due diligence requirements for all credits claimed, you may have to pay a \$510 penalty for each credit for which you have failed to comply.**

**Credit Eligibility Certification**

<b>12</b> Do you certify that all of the answers on this Form 8867 are, to the best of your knowledge, true, correct and complete? . . . . .			<input type="checkbox"/> Yes <input type="checkbox"/> No
--	--	--	--

## DUE DATES FOR REPORT OF FOREIGN BANK AND FINANCIAL ACCOUNTS (FBAR) CHANGING IN 2017

H.R. 3236, the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 (P.L. 114-41) (the Act), changes the due date for FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR), filings. The change is effective for taxable years beginning **after** December 31, 2015.

Under the new law, the due date is April 15, and a taxpayer may file for a six-month extension. Previously, the FBAR was due June 30, and no extensions were available.

### April 18, 2017

Section 2006(b)(11) of the Act changes the FBAR due date to April 15 to “coincide with the Federal income tax filing.” Accordingly, FinCEN has announced that the due date for 2016 FBARs will be due April 18, 2017, to be “consistent with the Federal income tax filing due date.” Apparently, this means that the original due date for FBARs will coincide with the original due date for personal returns in the future.

#### Website

[www.fincen.gov/news/news-releases/new-due-date-fbars-0](http://www.fincen.gov/news/news-releases/new-due-date-fbars-0)

### Extensions

The FinCEN announcement, above, notes that the “Act mandates a maximum six-month extension of the filing deadline.” The announcement further states that FinCEN will grant filers “an **automatic** extension to October 15 each year.” Accordingly, specific requests for this extension are not required.

#### Caution

Note the sloppiness and inconsistencies in the FinCEN announcement. Strictly speaking, a six-month extension would give filers an extension until October 18, 2017. To be consistent with personal tax filing, filers would get an extension until October 16, 2017 (the extended due date for 2016 personal returns). Thus, it is not clear whether the extended deadline is October 15, 16, or 18.

Further, it is not clear what they mean by “automatic”; that is, do you have to file an extension which is automatically granted or is no filing of an extension required at all? As of this writing, no extension form is available, and instructions on the FinCEN website indicate “specific requests for this extension are not required.” Further guidance as we approach the deadline would be anticipated and most welcome considering the penalties involved for not filing the form.

### Penalty relief

The Act also provides penalty waiver relief for taxpayers required to file an FBAR for the first time if they file it late by mistake. To qualify, the taxpayer must file by October 15.



---



---

## FOREIGN ASSET DISCLOSURE — FATCA — FORM 8938

---



---

### ENTITIES WILL BE REQUIRED TO FILE FORM 8938 WITH 2016 RETURNS

The filing requirement for Form 8938, Statement of Specified Foreign Financial Assets, previously only applied to individuals. However, the IRS has issued final regulations under IRC §6038D that require certain domestic entities to report their interests in certain foreign financial assets. The final regulations are effective for tax years beginning after December 31, 2015. Accordingly, specified domestic entities will be required to file Form 8938 beginning with their 2016 tax year (their 2016 returns).

#### *No change until 2016*

Corporations and partnerships were not required to file Form 8938 with the 2015 return.

#### *Background*

Under FATCA — a part of the 2010 HIRE Act — a U.S. taxpayer who, during the tax year, holds an interest in a specified foreign financial asset must attach to his or her income tax return for that tax year the “required information” (aka Form 8938) for each such asset if the aggregate value of all the individual’s specified foreign financial assets exceeds \$50,000 on the last day of the tax year or \$75,000 at any time during the year. (IRC §6038D)

The regulations and law refer to a “specified person.” This term refers to either an individual (specified individual) or a business (specified domestic entity) taxpayer.

FATCA requires disclosure on Form 8938 for:

- Specified persons; *who have an interest in*
- Specified foreign financial assets; *with*
- Values above certain dollar thresholds.

A specified person is a specified individual or a specified domestic entity (see below).

Specified individuals were required to file beginning in 2011. However reporting requirements for specified domestic entities were delayed until after final regulations could be issued. They have now been issued.

### **Specified domestic entity**

Disclosure requirements apply to domestic entities that are formed or availed of to hold specified foreign financial assets. (Treas. Regs. §1.6038D-6)

A domestic partnership or corporation is formed or availed of to hold specified foreign financial assets if and only if:

- It has an interest in specified foreign financial assets with an aggregate value exceeding \$50,000 on the last day of the taxable year or \$75,000 at any time during the taxable year;
- It is closely held by a specified individual; and
- At least 50% of its gross income for the year is passive income, or at least 50% of the assets held by it at any time during the year are assets that produce or are held to produce passive income.

The final regulations eliminated the principal purpose test. Under the proposed regulations, a domestic partnership was formed or availed of if:

- At least 10% of its gross income is passive income; or
- At least 10% of its assets held by it at any time during the year are assets that produce passive income; and
- It is formed by a specified individual with a principal purpose of avoiding Form 8938 reporting.

An entity is closely held if at least 80% of the ownership is with one specified individual on the last day of the tax year. (Treas. Regs. §1.6038D-6(b)(1)(ii)) Thus, a domestic corporation is closely held by a specified individual if at least 80% of the total combined voting power of all classes of stock or 80% of the total value of the stock of the corporation is owned by one specified individual. A domestic partnership is closely held if at least 80% of the capital or profits interest in the partnership is held by one specified individual.

In either case, aggregation rules apply. (Treas. Regs. §1.6038D-6(b)(3)(iii))

## Passive income

Under the proposed regulations, passive income was defined by listing specific items of income that are treated as passive. (Prop. Treas. Regs. §1.6038D-6(b)(2)) Passive income included:

- Dividends;
- Interest;
- Rents and royalties other than rents and royalties derived in the active conduct of a trade or business;
- Annuities;
- Gains on the sale of passive assets;
- Foreign currency gains; and
- Net income from notional principal contracts.

The final IRC §1472 regulations modify slightly the original list by including several modifications to the term passive income.

For example, the proposed regulations did not specify how to determine whether 50% of a corporation's or partnership's assets are passive assets. The final regulations specify that the passive asset percentage is determined based on a weighted average approach similar to the rule in Treas. Regs. §1.1472-1(c)(1)(iv) using either fair market value or book value.

Additionally, the final regulations make clear that rents and royalties derived in the active conduct of a trade or business conducted at least in part by employees of the corporation or partnership will not be considered passive income.



## California conformity — new!

For taxable years beginning on or after January 1, 2016, California conforms to the FATCA information reporting requirements for individuals and certain domestic entities with foreign financial assets, including the minimum \$10,000 penalty for failure to file Form 8938 without reasonable cause. (IRC §6038D; AB 154 (Ch. 15-359); R&TC §19141.5(d)) This requirement applies to all individuals and certain domestic entities required to file California income tax returns (not just California residents).

California previously conformed to some of the other foreign information reporting requirements and associated penalties for failure to report:

- Controlling ownership in foreign business entities (Forms 5471 and 8865), with a reduced penalty of \$1,000 (from \$10,000) (IRC §6038; R&TC §19141.2);
- Foreign-owned U.S. corporations, including the minimum \$10,000 penalty (Form 5472) (IRC §6038A; R&TC §19141.5(a));
- Transfers to foreign persons (Form 8865), including the minimum \$10,000 penalty (IRC §6038B; R&TC §19141.5(b)); and
- Foreign corporations involved in U.S. business (Form 5472), including the minimum \$10,000 penalty. (IRC §6038C; R&TC §19141.5(c))

Again, these penalties apply to all taxpayers required to file California returns, including individual residents, nonresidents, and part-year residents.

In all cases, the information required to be filed with the FTB is a copy of the information filed with the IRS. (R&TC §19141.5(e)) This means taxpayers who are required to file California returns may be subject to penalties of \$20,000 (\$10,000 federal and \$10,000 California) for failures to comply with these information reporting requirements. California conforms to the federal reasonable cause exception, but that is a difficult test to meet.

### How and what do you file?

Taxpayers subject to this new filing requirement are generally those who file federal Form 8938.

For individuals, in most cases, the FTB requires a copy of the federal tax return to be attached to the California return. If the federal return is attached, that will include Form 8938, which will meet the requirement. If not, you must attach the form. We do not believe the FTB will have its own form.

For entity returns, you must attach the appropriate form if a complete federal return is not being filed.

---



---

## INDIVIDUALS

---



---

### WORKERS' COMPENSATION SETTLEMENT DENIED INCOME EXCLUSION

#### Settlements must follow procedures necessary under state law

Settlement payments made to a taxpayer were not made "under" California's Workers' Compensation Act and therefore could not be excluded from her income under IRC §104. (*Simpson v. Commissioner* (August 10, 2016) United States Court of Appeals, Ninth Circuit, Case No. 14-72372) Upon reaching a settlement that included only general terms that did not specifically mention California's Workers' Compensation Act as a reason for the settlement, and because the taxpayer failed

to seek approval of the settlement from the California Workers' Compensation Appeals Board, the settlement did not follow the procedures required for the agreement to be valid under California's workers' compensation scheme.

### **Come see the stressful side of Sears**

The taxpayer was a thirty-year employee of Sears. She suffered injuries to her shoulder, knee, and neck and was diagnosed with clinical depression, irritable bowel syndrome, and fibromyalgia, which she reported to Sears' district human resources manager as work-related injuries.

Five months later, the taxpayer's employment was terminated, and she sued Sears for employment discrimination under California's Fair Employment and Housing Act (FEHA). Failing in her FEHA suit on most counts, the taxpayer abandoned that suit and filed a workers' compensation claim.

The taxpayer ultimately came to a settlement with Sears where she released Sears from "each and every claim" she might have against it, "including, but not limited to, claims asserted in" the FEHA suit. Further, the settlement was silent regarding her workers' compensation claims. The Tax Court agreed with the taxpayer that some portion of the settlement was for her workers' compensation but assigned only 10% of the settlement as compensation for physical injuries and sickness, which was therefore excludible from income under IRC §104. The Ninth Circuit affirmed.

## **STATE-ISSUED REBATES ARE TAXABLE FOR BOTH FEDERAL AND CALIFORNIA PURPOSES**

### **Rebates only excludable when a reduction in purchase price**

With the increase in purchases of electric vehicles, the question arises: Are the rebates taxable for federal and/or California purposes? The answer is generally yes: unless the rebate is a reduction of the purchase price. Here is an analysis that generally covers California-issued rebates.

#### **California conforms to IRC §61**

Gross income means all income from whatever source derived, unless specifically excluded by law. (IRC §61; Treas. Regs. §1.61-1(a)) Gross income is interpreted broadly to mean any accession to wealth, clearly realized, and over which a taxpayer has complete dominion and control. (*Comm. v. Glenshaw Glass* (1955) 348 US 429) California conforms to the federal definition of gross income from IRC §61 for both personal and corporate income tax purposes. (R&TC §§17071, 24271)

#### **Rebates may be included in gross income**

The IRS has ruled in multiple private letter rulings that rebates and discounts that represent purchase price reductions are not included in gross income (see, e.g., PLRs 9623035, 201027015, 199939021, 200142019, 200816027). Rebates and discounts that are considered purchase price reductions are those that are offered directly or indirectly from the sellers of goods and services.

In another private letter ruling, the IRS ruled that rebates, nontax credits, and other incentives provided by state agencies are not purchase price reductions and are therefore includible in gross income. (PLR 201004005)

#### **California electric car rebates**

The California electric vehicle rebates are issued through the California Clean Vehicle Rebate Project (CVRP), which is administered by the California Center for Sustainable Energy (CSE) for the California Air Resources Board. Californians must apply for the rebates directly from the CVRP. In other words, the rebates are not state tax credits, and they are issued in a transaction wholly separate

from the purchase price of the vehicle. As such, the rebates do not represent a reduction in the purchase price of the vehicle because they do not come from the seller of the vehicle directly or indirectly.

California's electric car rebates are not specifically excluded from gross income by law for either federal or California purposes, so they are includible in gross income for both.

#### Caution

Note the following excerpt from CVRP's website:

*"CSE does not issue a 1099 for your rebate. We cannot offer tax advice of any kind, and advise you to contact a certified public accountant or tax professional regarding the taxability of the CVRP rebate."*

Just because the CSE, or any other source, does not issue a 1099 does not mean the rebate is not taxable.

## WORTHLESSNESS OF STOCK MUST BE TIED TO AN IDENTIFIABLE EVENT

### Timing is not the taxpayer's choice

Taxpayers are allowed a deduction when stock held as a capital asset becomes worthless during the taxable year. (IRC §165(g)) When filing a tax return, in hindsight it is fairly easy to determine *whether* stock has become worthless because the company issuing the stock typically goes out of business or the business files for bankruptcy. However, it can be much more difficult to determine *when* stock held by a taxpayer becomes worthless.

For closely held businesses, taxpayers want to determine the timing of their loss deductions from the worthlessness of stock in the year that it is most advantageous. Unfortunately, as one couple learned, to establish worthlessness, taxpayers must show a relevant identifiable event that clearly evidences destruction of both the potential and liquidating values of stock. (*In re: Carpenter* (September 15, 2016) U.S. Bkcty. Ct. Dist. of Montana, Case No. 13-61192-11, citing *Austin Co. v. Comm.* (1979) 71 TC 955)

#### Practice Pointer

Practitioners should question their clients thoroughly about the timing of their business's closing and liquidating, bankruptcy filing, or other significant events to be sure losses from the worthlessness of stock are deducted in the correct year. A business that ceases operations may still have value in its physical assets or receivables that may delay a determination of worthlessness of stock, which is deductible as a capital loss to the extent of the taxpayer's basis.

### Background

Husband and wife taxpayers owned and operated a fire suppression business operating as a corporation, as well as an LLC that owned the real property associated with the business.

In 2012, the taxpayers lost an operating line of credit that was critical to its operations and were forced to sell the real estate to fund the company's losses. In 2013, the company filed for bankruptcy. The taxpayers filed their 2012 income tax returns and reported gain from the sale of the real estate of \$707,992, then later amended their income tax return to deduct losses from the worthlessness of their corporation's stock of \$1,128,842.

## Timing of deduction

The taxpayers argued that even though the corporation was still operating in 2012, the stock was worthless because liabilities far exceeded assets, the company experienced losses for multiple years in a row, and after losing the line of credit, the corporation was doomed.

The court rejected the taxpayers' arguments and held in favor of the IRS that the corporation's stock did not become worthless until 2013. The court cited previous cases that held that securities are not worthless even when they have no liquidating value if there is a reasonable hope and expectation that they will become valuable in the future, (*Lawson v. Comm.* (1940) 42 B.T.A. 1103) but such hope and expectation may be foreclosed by the happening of certain events such as the bankruptcy, cessation from doing business, liquidation of the corporation, or the appointment of a receiver. (*Morton v. Comm.* (1938) 38 B.T.A. 1270, *aff'd* (1940) 112 F.2d 320)

No identifiable event occurred in 2012, and the court found persuasive the fact that the company still continued to operate and generate new revenue until August 2013, which showed that the taxpayers had some hope that the business would turn around.

## Claim early

If there is ever a question of which year the stock or other investment became worthless, claim the loss in the earlier year. That way, if the loss is disallowed in that year, the statute of limitations on the future year will likely also be open.

### *Example of worthless stock*

In 2010, Joan and Jed invested \$25,000 in their son Billy's travel consulting corporation, which was very profitable from 2010–2012. In 2013, Billy took a series of six cruises to find the best package deals for his customers, of which he had only two left. At the end of the cruises, he went back to work as a stockbroker. He generated no revenue in 2013 or 2014. However, he kept his bank account open and his license active until the end of 2014.

Joan and Jed's \$25,000 investment in the stock was worthless. They file their returns timely every year. Assume the IRS audits the return with the loss:

- If they claimed the loss on their 2013 tax return and the IRS audits the return in 2015, completing the audit at the end of 2017 and disallowing the loss, they may claim the loss on the 2014 return, as the statute will still be open; or
- If they claim the loss on the 2014 return in 2016 and the audit is complete in late 2017, it will generally be too late to file an amended return to claim the loss on the 2013 return.

## BUSINESS VS. NONBUSINESS BAD DEBT

### When loans and worthless boyfriends collide

The Tax Court has held that loans made by an entertainment company executive to her former boyfriend to fund his development of a comic strip were nonbusiness bad debts deductible only as capital losses and not business bad debts fully deductible against ordinary income, as the taxpayer claimed. (*Hatcher v. Comm.*, TCM 2016-188)

## Deductions for bad debts

Bad debts are deductible in the year they become worthless. (IRC §166(a)(1)) Nonbusiness bad debts — those that are not made in connection with a trade or business of the taxpayer — are treated as short-term capital losses. (IRC §166(d)(1); Treas. Regs. §1.166-5(a)(2)) To be eligible to deduct a loss as a business bad debt, which would allow a taxpayer to deduct the full amount of the bad debt against ordinary income, a taxpayer must show that she was engaged in a trade or business and that the debt was proximately related to her trade or business. (Treas. Regs. §1.166-5(b); *Putoma Corp. v. Comm.* (1979) 66 TC 652, aff'd 601 F.2d 734)

### Familiar practitioner situation

The proposition that nonbusiness bad debts are treated as capital losses and business bad debts are deductible against ordinary income is nothing new for practitioners. We all have clients who have made personal loans that have become worthless, and our client is then surprised when we tell them the loss is a capital loss, and we explain (likely for the hundredth time) the limitations on utilizing capital losses.

The issue becomes more relevant when dealing with clients who are business owners. How would you treat a bad debt made by a client who owns a car wash and loans his fresh-out-of-college son \$500,000 for the son to open his own car wash? Similarly, in the recent *Hatcher* case, an executive for Blockbuster video loaned her boyfriend over \$400,000 to develop a golf-themed comic strip. The taxpayer argued that she was in the entertainment business and because comic strips are entertainment, the loan was a business loan.

### Business bad debt is a strict standard

Practitioners in the car wash or comic strip situations above may take the approach that the loans were in fact business loans and deduct them against ordinary income. However, courts have held that when one individual lends money to another, “[t]he right to deduct bad debts as business losses is applicable only to the *exceptional situations* [emphasis added] in which the taxpayer’s activities in making loans [are] so extensive and continuous as to elevate that activity to the status of a separate business.” (*Imel v. Comm.* (1973) 61 TC 318; *Cooper v. Comm.*, TCM 2015-191)

In *Hatcher*, the following factors were the most relevant to the court’s holding that the comic strip loan was nonbusiness:

- She had a personal motivation for making the loan;
- The loan would not have been made to anyone else on comparable terms;
- The taxpayer in fact made no loans to anyone else;
- No credit check was performed;
- The debtor’s financial information was not reviewed to determine ability to repay; and
- One explicit purpose of the loans was to fund the debtor’s personal living expenses while the comic strip was being developed.

The court also relied on an earlier decision where a retired farmer guaranteed a bank loan for his son’s farm. (*Viani v. Comm.*, TCM 1994-471) Even though the taxpayer used to be a farmer, the court held that the dominant motivation for extending credit was affection for his son, his desire to see him succeed in farming, and that he would not have agreed to the loan guarantees for anyone else.

## FLAWED APPRAISAL IS NONETHELESS AN APPRAISAL

An appraisal of real property sold at a bargain price to a county flood control district was prepared by two appraisers but the forms submitted were missing one signature and one resume. (*Cave Buttes*,

*LLC v. Comm.* (2016) 147 TC 10) The IRS argued the appraisal therefore did not meet the requirements of Treas. Regs. §1.170A-13(c), but the court noted that while the appraisal was not in strict conformity with the regulations, it still met the requirements of an appraisal, and pointed out that strict compliance will help a taxpayer win a charitable contribution deduction, but is not necessary. (Also see *Bond v. Comm.* (1993) 100 TC 32.)

## ELECTION TO DEDUCT DISASTER LOSSES IN PRECEDING TAX YEAR

### Regulations catch up with notices issued in recent years

The IRS has issued temporary and proposed regulations on the election to report a disaster loss in the prior year. (T.D. 9789; Temp. Treas. Regs. §1.165-11T; Prop. Treas. Regs. §1.165-11) In addition, the IRS has released a Revenue Procedure on the detail of making and revoking the election. (Rev. Proc. 2016-53)

#### Background

Under IRC §165, a casualty loss is generally allowed as a deduction only for the tax year in which the loss is sustained (disaster year). However, under IRC §165(i), an exception to the general timing rule allows a taxpayer to elect to treat an allowable loss attributable to a federally declared disaster as sustained in the tax year immediately prior to the tax year in which the disaster occurred.

Taxpayers make the election by clearly indicating on an original or amended return that the election has been made. The old regulations under IRC §165(i) provide that the original or amended return must be filed on or before the later of:

- The due date of the taxpayer's income tax return (determined without regard to any extension of time for filing the return) for the disaster year; or
- The due date of the taxpayer's income tax return (determined with regard to any extension of time for filing the return) for the preceding year.

Thus, taxpayers generally have until the original due date of the return for the disaster year to make the election.

The IRS noted that concerns had been raised that the due date for making the election does not always provide sufficient time for taxpayers affected by disasters to consider whether to make the election. As a result, the IRS has issued notices postponing the due date in the wake of a number of federally declared disasters in the last ten years (Notices 2006-17, 2013-15, 2014-20).

#### Time and manner of making the election

The temporary regulations extend the due date for making the election and generally provide that such due date is six months after the due date for filing the taxpayer's federal income tax return for the disaster year (determined without regard to any extension of time to file). (Temp. Treas. Regs. §1.165-11T(f))

A taxpayer makes an IRC §165(i) election by deducting the disaster loss on either an original or amended return for the preceding year and including an election statement indicating that the taxpayer is making the election. (Rev. Proc. 2016-53) The statement must contain the information required in Revenue Procedure 2016-53, including:

- The name or a description of the disaster and the date or dates of the disaster which gave rise to the loss; and
- The address where the damaged or destroyed property was located at the time of the disaster.



## Revoking an election

A taxpayer may revoke the election on or before the date that is 90 days after the due date for making the election. (Temp. Treas. Regs. §1.165-11T(g); Rev. Proc. 2016-53, §6.02) A taxpayer revokes a previously made IRC §165(i) election by filing an amended return for the preceding year that contains:

- A revocation statement clearly showing that the election is being revoked;
- The name or a description of the disaster and date or dates of the disaster for which the election was originally made; and
- The address where the damaged or destroyed property was located at the time of the disaster and for which the taxpayer originally made the election.  
(Rev. Proc. 2016-53, §6.01)

## Effective date

The regulations and the Revenue Procedure apply to any IRC §165(i) elections, revocations, or other related actions that can be made or taken on or after October 13, 2016.



### California partial conformity

California conforms to IRC §165(i). The following points are notable for California purposes:

- An election is allowed for disasters for which only the California Governor has declared a state of emergency (R&TC §§17207.14, 24347.14);
- Taxpayers may be able to obtain four years of immediate tax benefit: the current year, throwback to the immediately preceding year, and, if an NOL is created or increased, an additional two years of carryback attributable to the NOL. Plus any remaining loss can also be carried forward; and
- Individuals may transfer the base-year value of a property that has been substantially damaged or destroyed (more than 50% of FMV) by a Governor-declared disaster to a comparable replacement property. The replacement property must be purchased within five years after the disaster, and the assessed value of the replaced property in excess of 120% of the damaged property's assessed value will be assessed at FMV.



## Declared disasters in California — January 2017

On January 23, 2017, California Governor Jerry Brown declared a state of emergency in 50 of California's 58 counties due to severe rain storms.

If your clients experienced disaster losses from the most recent storms, then you may be able to elect to deduct those losses on their 2016 income tax returns.

The state of emergency was declared for the following counties:

- Alameda
- Alpine
- Butte
- Calaveras
- Contra Costa
- Del Norte
- El Dorado
- Fresno
- Humboldt
- Inyo
- Kern
- Kings
- Lake
- Lassen
- Los Angeles
- Madera
- Marin
- Mendocino
- Merced
- Modoc
- Monterey
- Napa
- Nevada
- Orange
- Placer
- Plumas
- Sacramento
- San Benito
- San Bernardino
- San Diego
- San Francisco
- San Luis Obispo
- San Mateo
- Santa Barbara
- Santa Clara
- Santa Cruz
- Shasta
- Sierra
- Siskiyou
- Solano
- Sonoma
- Stanislaus
- Sutter
- Tehama
- Trinity
- Tulare
- Tuolumne
- Ventura
- Yolo
- Yuba

---



---

## ESTATES AND TRUSTS

---



---

### NEW GUIDANCE ON QTIP ELECTIONS

#### Rev. Proc. 2016-49

A qualified terminable interest property (QTIP) election can have the benefit of reducing a decedent's taxable estate and increasing the deceased spouse's unused exclusion (DSUE) available to the surviving spouse. For this reason, the executor of a decedent's estate may want to make a QTIP election regardless of whether the election is necessary to reduce the estate tax to zero.

Since the enactment of the portability provisions, some practitioners have been concerned about the effect of Rev. Proc. 2001-38 on nontaxable estates wishing to make QTIP elections.

Rev. Proc. 2001-38 allowed the IRS to treat QTIP elections as null and void for estate and transfer tax purposes if the election was not necessary to reduce estate tax liability. Would the IRS recognize the election for what would otherwise be an unnecessary QTIP election to maximize the DSUE?

Rev. Proc. 2016-49 clarifies that the executor can use the QTIP election to maximize the unused exclusion amount. It also provides procedures to continue to disregard unnecessary QTIP elections, which was the original purpose of Rev. Proc. 2001-38.

### Why use the QTIP?

QTIP trusts provide all the income to the surviving spouse but allow the decedent to designate who inherits the property after the death of the surviving spouse. Assets in a QTIP trust qualify for the estate tax marital deduction and get a step-up in basis at the death of the surviving spouse.

Prior to the portability provisions, many estates used QTIP trusts to provide for a surviving spouse, while maximizing the estate tax exclusion at the death of the first spouse.

Portability eliminates the needs for the QTIP to avoid estate tax in many situations, but passing the assets outright to the surviving spouse allows the survivor to designate the beneficiaries when the surviving spouse dies. This removes protection for the children of a prior marriage and is contrary to the wishes of most first spouses, as the first spouse usually wants to control the disposition.

The QTIP continues to be beneficial for controlling assets after the death of the second spouse and allows the added benefit of maintaining the DSUE.

#### *Example of QTIP*

Frank and Betty are married. Frank has two children from a prior marriage. The couple has assets of approximately \$8 million (\$3 million are his separate property, and \$5 million are community property assets).

That means that Frank's total estate is approximately \$5.5 million:

Frank's separate assets	\$3 million
Frank's half of the community assets	<u>\$2.5 million</u>
Frank's total estate	\$5.5 million

Because of the portability provisions and the DSUE, even if all of Frank's assets went to Betty, she would not be subject to estate tax at her death. Their total estate is less than \$10,900,000, which is the combined exclusion amount for a couple in 2016.

However, if all of the assets are passed directly to Betty, there is no guarantee that any of them will be passed to Frank's children at Betty's death.

Under their estate plan, if Frank predeceases Betty, \$3 million will go into a QTIP trust. Betty will receive income from the trust for her life (and principal if necessary), and after her death the assets will go to Frank's children.

The remaining \$2.5 million will pass to Betty outright, so the estate tax marital deduction will apply to all of the assets in his estate, and the entire DSUE (\$5,450,000 in 2016) will be preserved for Betty to use at her death.

## THEFT LOSS DEDUCTION ALLOWED FOR ESTATE TAX RETURN

### Bernie Madoff Ponzi scheme is still making waves

The Tax Court has held that an estate was entitled to deductions relating to theft losses incurred by an LLC, of which the estate was a member, during the settlement of the estate. (*Estate of Heller v. Comm.* (September 26, 2016) 147 TC 11) The decision is significant because it is the first time the Tax Court has addressed whether an estate is entitled to a theft loss deduction under IRC §2054 relating

to property held by an LLC. IRC §2054 allows a theft loss deduction for estate tax purposes much the same way individuals may deduct theft losses as itemized deductions.

### **Ponzi scheme losses**

The decedent, James Heller, owned an interest in an LLC whose only asset was an account with Bernie L. Madoff Investments Securities, LLC (Madoff Securities). After the decedent's death, Bernie Madoff was arrested and charged with securities fraud relating to his infamous multibillion-dollar Ponzi scheme, from which the decedent's LLC suffered losses.

On the decedent's estate tax return, the estate reported a \$5.2 million theft loss deduction related to the Ponzi scheme.

The IRS determined that the estate was not entitled to the theft loss deduction because the estate did not incur a theft loss during the settlement of the estate. The IRS obviously conceded that Madoff Securities defrauded the decedent's LLC, but the IRS contended that the estate was not entitled to the deduction because it was the LLC that incurred the loss.

### **Estate tax deductions and the net estate**

The estate tax is imposed on the value of property transferred to beneficiaries. (IRC §§2001, 2031(a), 2051) In that context, a loss refers to a reduction of the value of property held by an estate. While the LLC lost an asset as a result of the Ponzi scheme, the estate, during its settlement, also incurred a loss because the value of its interest in the LLC decreased from \$5.2 million to zero.

The purpose of the estate tax is to impose a tax on the value of property transferred to beneficiaries, and estate tax deductions are designed to ensure that the tax is imposed on the net estate, which is the real value that passes from the dead to the living. (See *Jacobs v. Comm.* (1936) 34 BTA 594) The Ponzi scheme theft extinguished the value of the estate's LLC interest, thereby diminishing the value of property available to the decedent's heirs. Thus, according to the court, the estate's entitlement to an IRC §2054 theft loss deduction is consistent with the overall statutory scheme of the estate tax.

---

---

## **BUSINESS**

---

---

### **RELIEF FOR HRAs**

#### **Relief from \$100-per-day penalty would be permanent**

On December 13, 2016, the President signed the 21st Century Cures Bill (HR 34). Among its almost 1,000 pages of provisions, the bill exempts certain employers who operate Health Reimbursement Accounts (HRAs) from penalties imposed by the Affordable Care Act (ACA).

#### **Background**

Businesses have long relied on Revenue Ruling 61-146. Under that ruling, reimbursements to an employee for the employee's share of premiums for medical insurance were treated as contributions by the employer to the health plan. Therefore, they were deductible by the employer and excluded from income much like the direct payments by the employer to the insurance company. The ruling required that the employee provide proof to the employer that the insurance is in force.

However, the IRS issued Notice 2013-54, which stated that health reimbursement plans that cover more than one employee are considered "group health plans" and are subject to the requirements of the ACA. Under the ACA, group health plans are required to provide certain minimum essential

benefits. By their very nature, health reimbursement plans cannot meet some of the requirements, including prohibitions on annual limits and preventive care rules.

Employers were shocked to learn that if they continued using such arrangements, starting in 2014 they risked a penalty of \$100 per day per participating employee. (IRC §4980D)

The IRS issued Notice 2015-17 providing relief from the penalties but only for employers that are not applicable large employers and only through June 30, 2015.

### **HR 34**

HR 34 amends the Internal Revenue Code to allow qualified HRAs to operate for small businesses without penalty. The rules require adherence to certain limits, including:

- Funding solely by employer contributions; no salary reduction contributions;
- Benefits capped at \$4,950 per year (\$10,000 for families);
- Proration of benefits for partial years; and
- Notification and reporting requirements.

HR 34 retroactively extends the relief provided to small businesses in Notice 2015-17 to any plan year beginning on or before December 31, 2016. The provisions of the bill are effective for years beginning after December 31, 2016.

### **HRA ineligibility for 2% S corporation shareholder**

For purposes of applying employee fringe benefit rules, S corporations are treated as partnerships and S corporation shareholders are treated as partners if they own (or are treated as owning), on any day during the taxable year:

- More than 2% of the S corporation's outstanding stock; or
- More than 2% of the total combined voting power of the S corporation.  
(IRC §1372)

HRAs are only available to "employees," which does not include self-employed individuals. S corporation shareholders that own more than 2% of a corporation's stock are considered to be self-employed for fringe benefit purposes.

### **Reporting health insurance of 2% S corporation shareholder**

S corporations that pay health insurance premiums on behalf employees that own more than 2% of the corporation must include the premiums paid on the employee's W-2 as gross income. The employee, in turn, may deduct the premiums as self-employed health insurance as an above-the-line deduction.

In order to deduct health insurance in this manner, the medical plan must be established by the S corporation. A plan is deemed to be established by the S corporation if:

- The S corporation directly makes the health insurance premium payments; or
- The employee/2% shareholder pays the premiums, and the S corporation reimburses the employee upon showing of proof that the payments were made.

## **PROCEEDS FROM SALE TERMINATION ORDINARY INCOME**

### **IRC §1231 property is not a capital asset for purposes of IRC §1234A**

Forfeited deposits from a terminated sale agreement of business property are taxed as ordinary income even though the deposits would have been applied to the full sale price if the sale had been

completed and the gain would have been classified as capital gain. (*CRI-Leslie, LLC v. Comm.* (September 7, 2016) 147 TC 8)

## Background

In February 2005, the taxpayer-LLC acquired the Radisson Bay Harbor Hotel in Tampa, Florida, for \$13.8 million. In July 2006, it entered into an agreement to sell the hotel for \$39 million. The sale did not close, and the agreement was terminated in 2008. Pursuant to the terms of the agreement, the LLC was entitled to keep the buyer's deposited funds totaling \$9.7 million.

The IRS audited the LLC's 2008 income tax return and reclassified the deposits from capital gain to ordinary income. The LLC and the IRS agreed on the key facts:

- The hotel was real property used in the LLC's business within the meaning of IRC §1221(a)(2);
- The hotel constituted "property used in a trade or business," as defined by IRC §1231(b)(1); and
- Had the sale proceeded in 2008 as agreed, the gain from the sale would have resulted in net IRC §1231 gain (capital gain).

## What is a capital asset?

A capital asset is "property held by the taxpayer (whether or not connected with his trade or business), but does not include property used in his trade or business that is subject to the allowance for depreciation, or real property used in his trade or business." (IRC §1221)

If there is net gain from the sale or exchange of depreciable property – or real property – used in a trade or business and held for more than one year, (IRC §1231(b)(1)) such gain is treated as long-term capital gain. (IRC §1231(a)(1))

In other words, depreciable property used in a taxpayer's trade or business is not a capital asset even though the sale of the property is taxed as capital gain if it is held for longer than one year.

## Character of gain or loss from terminations

IRC §1234A provides that gain or loss attributable to the cancellation, lapse, expiration, or other termination of a right or obligation with respect to property which is a capital asset in the hands of the taxpayer shall be treated as gain or loss from the sale of a capital asset. (IRC §1234A) The court in the present case held that IRC §1234A applies to the transaction at issue. The issue is whether "capital asset" as used in IRC §1234A extends to depreciable property used in a taxpayer's trade or business (IRC §1231 property).

The court rejected the LLC's argument that the purpose of IRC §1234A is to ensure that taxpayers received the same tax characterization of gain or loss whether the property is sold or the contract to which the property is subject is terminated. The LLC leaned heavily on congressional committee reports and congressional intent to support its reasoning that it would be inconsistent to treat termination payments on a contract as ordinary income where a sale of the underlying property would have been taxed at capital gain rates.

The court stated: "Regardless of any potential intellectual inconsistency in this disparate treatment, the plain meaning of IRC §1234A remains inescapable." IRC §1234A expressly refers to property that is a capital asset in the hands of the taxpayer, and IRC §1231 property is explicitly excluded from the definition of capital asset in IRC §1221. Since "[i]t is emphatically the province and duty of the judicial department to say what the law is," (*Marbury v. Madison* (1803) 5 U.S. 137) the court decided that it could not and would not apply a contrary interpretation where the law is otherwise valid and clear.

### *Comment*

CRI-Leslie, LLC has appealed the Tax Court's decision, so we must wait and see how this case plays out in the next couple of years.

## **AVOIDING RELATED-PARTY LIKE-KIND EXCHANGE RULES**

### **Proving tax avoidance through calculation can add value for your clients**

The Tax Court struck down a related-party like-kind exchange because the two parties were able to sell their real estate investment virtually tax-free through a transaction that had tax avoidance as its primary purpose. (*The Malulani Group, Ltd. and Sub. v. Comm.*, TCM 2016-209)

#### **Related-party exchange rules**

Nonrecognition treatment is disallowed for direct exchanges between related persons where any property involved in the exchange is then sold or disposed of within two years of the exchange. (IRC §1031(f)(1)) Related parties could easily sidestep the direct exchange rule by using an exchange intermediary if it weren't for IRC §1031(f)(4), which provides that nonrecognition treatment does not apply to any exchange which is part of a transaction or series of transactions structured to avoid the related-party exchange rules.

The purpose of allowing nonrecognition treatment for like-kind exchanges is to allow taxpayers flexibility to merely change the form of their investment. (See *Ocmulgee Fields, Inc. v. Comm.* (2009) 132 TC 105, *Aff'd* 613 F.3d 1360 (11th Cir.) (2010)) If a related party exchange is followed shortly thereafter by a disposition of the property, the related parties have, in effect, cashed out of the investment. This is the purpose of the related-party exchange rules under IRC §1031(f).

#### **Exception to the exception**

Any disposition of an exchanged property within two years of a related-party exchange may still be afforded nonrecognition treatment if the taxpayer can establish that neither the exchange nor the disposition had tax avoidance as one of its principal purposes. (IRC §1031(f)(2)(C))

In the recent *Malulani Group* case, the Tax Court held that the inquiry into whether a transaction has been structured to avoid the related-party exchange rules must focus on the actual tax consequences of the transaction to the taxpayer and related party, in the aggregate, as compared to the hypothetical tax consequences of a direct sale of the property at issue. Where the aggregate tax liability of the taxpayer and the related party arising from their like-kind exchange and sale transaction is significantly less than the hypothetical tax that would have arisen from the taxpayer's direct sale of the relinquished property, the Tax Court has previously inferred that a taxpayer structured the transaction with a tax avoidance purpose. (See *Ocmulgee Fields, Inc. v. Comm.* (2009) 132 TC 105; *Teruya Bros., Ltd. & Subs. v. Comm.* (2005) 124 TC 45, *aff'd* 580 F.3d 1038 (9th Cir.) (2009))

#### **The case at issue**

The taxpayer unsuccessfully argued that it did not have tax avoidance as one of its principal purposes because it diligently sought to find a replacement property from unrelated parties before settling on the exchange with a related party.

Unlike the previous Tax Court cases dealing with this issue, the related parties in *Malulani Group* cleverly utilized net operating losses to generate significant tax savings, after which the parties avoided roughly \$650,000 in federal income tax.

The taxpayer also argued that the transaction lacked a tax avoidance purpose because it did not involve the exchange of low-basis property for high-basis property. In fact, the disposition of the property at issue after the related-party exchange resulted in more gain than had the property been sold outright instead of exchanged. However, the party that sold the property was able to offset the gain recognized with net operating losses, resulting in net tax savings as an economic unit. According to the court, net tax savings achieved through use of the related party's NOLs may demonstrate the presence of a tax avoidance purpose notwithstanding a lack of basis shifting.

 **Practice Pointer**

The *Malulani Group* case helps clarify when tax avoidance is a principal purpose of the related-party like-kind exchange rules. The determination is based on strict tax calculations and not the intent of the parties. Practitioners can add value for their clients, and create additional billable hours, by preparing side-by-side calculations showing the tax effects from the disposition of a property acquired within the last two years through a related-party like-kind exchange and the tax effects if the property was sold outright instead of exchanged.

If the net tax result, after considering all tax attributes such as NOLs, is significantly less tax because the exchange took place, the exchange will be disregarded and will be treated as a fully taxable transaction.

## CALIFORNIA FORM 3840 REMINDER

For like-kind exchanges occurring in tax years starting January 1, 2014, and later, taxpayers who complete an exchange of California property for property located out of state must file an information return with the FTB on Form FTB 3840, California Like-Kind Exchanges. Form 3840 must be filed each year after that until the California deferred gain is fully realized.

For taxpayers who are not required to file a California income tax return but meet the requirements to file Form 3840, the form must be filed as a stand-alone form.

If the taxpayer fails to report the exchange in the year of the transaction or any subsequent year, the FTB may, in the year the form was not filed, estimate net income — using any available information — and issue a Notice of Proposed Assessment on the previously deferred gain plus applicable penalties and interest in the year:

- The taxpayer fails to file an information return; or
- A required tax return is not filed.

## RELYING ON THIRD PARTY TO REMIT PAYROLL TAXES

### The taxpayer must pay both penalties and tax

A McDonald's franchisee in Los Angeles sued the IRS for a refund of its penalties for failure to pay or deposit employment taxes because of its third-party payroll provider's embezzlement. (*Kimdun, Inc. v. U.S.* (August 15, 2016) U.S. District Court, Central Dist. of California, Case Nos. 2:16-cv-01500-CAS(RAOx); 2:16-cv-01558-CAS(RAOx); 2:16-cv-01766-CAS(RAOx); 2:16-cv-02160-CAS(RAOx)) The U.S. District Court for the Central District of California rejected the taxpayer's argument that once its funds left its bank account, the taxpayer had no control or ability to ensure that the payroll company made the required employment tax deposits. It would appear from the facts of the case that the total penalties and interest were in excess of \$300,000.



## Reasonable cause

A taxpayer who fails to timely file, pay, and deposit employment taxes is assessed a penalty, unless such failure is due to reasonable cause and not due to willful neglect. (IRC §§6651(a), 6656(a)) The Supreme Court has held that the taxpayer “bears the heavy burden” of proving both:

- That the failure did not result from “willful neglect”; and
- That the failure was “due to reasonable cause.”  
(*United States v. Boyle* (1985) 469 U.S. 241)

According to *Boyle*, willful neglect may be interpreted as “a conscious, intentional failure or reckless indifference.” Reasonable cause requires the taxpayer “to demonstrate that he exercised ordinary business care and prudence but nevertheless was unable to file the return within the prescribed time.”

The court accepted the IRS’s argument and its reliance on another employment tax case decided by the Ninth Circuit Court of Appeals that a taxpayer cannot avoid responsibility by simply relying on a person under their control to comply with the law. (*Conklin Bros. v. U.S.* (1993) 986 F.2d 315) In *Conklin Bros.*, an employee committed fraud, altered records, and intercepted IRS notices that employment taxes were not being deposited, but the court held the employer liable for penalties because the employee was not beyond the employer’s control, and they could have discovered and prevented the employee from committing her bad acts.

The court rejected the taxpayer’s reliance on a Third Circuit Court of Appeals decision where a corporation’s penalties for failure to pay and deposit employment taxes were abated because the embezzlers were the corporation’s CEO and CFO, who were also the chairman of the board of directors and the corporate treasurer, respectively. (*Matter of American Biomaterials Corp.* (1992) 954 F.2d 919) The court held that the corporation was not liable because of factors outside its control. In other words, the corporation, as an entity separate and apart from the CEO and CFO, was helpless to prevent the embezzlement of its officers and directors.

Of course, it didn’t help the taxpayer’s cause in the present case that it first learned in 2009 that its payroll tax deposits to the IRS and EDD had been embezzled, but it continued using the payroll provider through the third quarter of 2012! Talk about “reckless indifference.”

## The distinguishing factor

It is important for practitioners and their clients to understand the distinction between the cases cited here. The question is whether the party seeking to be relieved of penalties has the ability to discover and take action against the bad actor. If the taxpayer could have stopped or discovered the embezzlement, then mounting a challenge to the penalties will be an uphill battle.

## LLC MANAGER PERSONALLY LIABLE FOR FAILURE TO COMPLY WITH IRS LEVY ON MEMBER

### Member distributions and licensing fees constitute income for levy purposes

The manager of an LLC was held personally liable for failing to turn over to the IRS a member’s distributions and licensing fees after receiving an IRS notice of levy ordering him to turn over wages, salary, and “other income that you have now or for which you are obligated.” (*U.S. v. Dent* (2016) U.S. Court of Appeals, Ninth Circuit, Docket No. 14-35293) The issue turned on what property is subject to a wage and income levy (garnishment) from the IRS.

## Personal liability

Any person who fails or refuses to surrender any property or rights to property subject to an IRS levy is personally liable for the amount of the property that should have been turned over. (IRC §6332(d)(1)) A typical wage and income garnishment is processed fairly easily by an employer's payroll department, but what about an LLC or partnership that receives a garnishment for a partner? What payments must be withheld from a member or partner?

What about an LLC member who also owns a building or equipment that is leased by the LLC, loan guarantee fees, or board of director fees? Does a wage and income garnishment apply to those payments as well? The short answer is yes.

## Taxpayer's failed arguments

In *Dent*, the LLC manager did not turn over licensing fees or distributions of a member subject to a wage and income garnishment. The IRS sought to hold the manager personally liable for his failure to comply with the levy. The manager made two arguments to support his decision to not comply with the levy:

- A member's right to licensing fees and member distributions were property rights and not "income," so they were not subject to the garnishment; and
- An LLC is not obligated to pay distributions to members, so a levy requiring future earnings does not apply.

The Ninth Circuit Court of Appeals dispensed with both of the taxpayer's arguments fairly quickly. First, the court held that the term "income" is broad and includes payments other than wages and salary, including money or any other form of payment that one receives from employment, business, investments, royalties, gifts, property, and the like. As such, both the licensing fees and distributions are subject to the wage and income garnishment.

The taxpayer's second argument was that in contrast to a levy on wages and salary, which has a continuing effect until the levy is released, a levy on other payment obligations extends only to property possessed and obligations existing at the time of the levy. (IRC §6331) However, obligations exist when the liability of the obligor is fixed and determinable, although the right to receive payment may be deferred until a later time. (Treas. Regs. §301.6331-1(a)(1)) The court held that although the actual sum of future distributions, if any, paid to the member was uncertain at the time the levy was served, the uncertainty does not defeat the fact that the LLC's obligation was determinable. The term "determinable" requires only that the sum be capable of precise measurement in the future. (*U.S. v. Hemmen* (1995) 51 F.3d 883 (9th Cir. 1995))

## NO GOOD DEED GOES UNPUNISHED

### Noble business owner feels the tax man's bite

A Texas district court held a doctor liable for \$4.3 million in penalties after the doctor discovered the long-time CFO of his family medical practice embezzled payroll and other withholding taxes over a 14-year period. (*McClendon v. U.S.*, U.S. District Court, Southern Dist. of Texas, Civil Action No. H-15-2664 (11/17/2016)) Upon discovering the embezzlement, the good doctor shuttered his practice and remitted its remaining receivables to the IRS to pay toward the tax liability. However, the practice was left with no funds for its remaining payroll, so the doctor loaned \$100,000 to the practice and paid his employees, which left him holding the bag for the entire \$4.3 million trust fund penalty.

### The bite of the trust fund recovery penalty

IRS §6672 imposes a penalty equal to the total amount of payroll and withholding taxes required to be collected and paid to the IRS on any person that meets the following two requirements:

- That the taxpayer was a “responsible person”; and
- That the taxpayer willfully failed to collect, account for, or pay over such taxes.

Dr. McClendon conceded that he was a responsible person but argued that he did not meet the second requirement that he willfully failed to pay over such taxes.

Willfulness under IRC §6672 requires only a voluntary, conscious, and intentional act, not a bad motive or evil intent. (*Barnett v. Internal Revenue Service*, 988 F.2d 1449, 1457 (5th Cir. 1993)) A considered decision not to fulfill one's obligation to pay the taxes owed, evidenced by payments made to other creditors in the knowledge that the taxes are due, is all that is required. Willfulness is normally proved by evidence that the responsible person paid other creditors with knowledge that withholding taxes were due at the time to the United States.

Payment of wages to employees counts as a payment to a creditor for purposes of this principal. (*Logal v. United States*, 195 F.3d 229, 232 (5th Cir. 1999)) “If a responsible person knows that taxes are delinquent, and uses corporate funds to pay other expenses, even to meet the payroll out of personal funds he lends to the corporation,” he has acted willfully within the meaning of the statute. (*Phillips v. U.S. I.R.S.*, 73 F.3d 939, 942 (9th Cir. 1996))

### Encumbered funds

The doctor argued his \$100,000 loan to the corporation was encumbered because he lent it with the understanding that the funds could only be used to cover payroll. The court rejected the doctor's argument because funds are encumbered when the taxpayer's discretion in the use of the funds is subject to restrictions imposed by a creditor holding a security interest in the funds that is superior to any interest claimed by the IRS. (*Barnett v. I.R.S.*, 998 F.2d 1449, 1458 (5th Cir. 1993)) Further, a taxpayer cannot simply shield himself from liability by entering into preferential lending arrangements in which the person voluntarily assumes a contractual obligation to pay some set of creditors before paying the government. (*Bell v. United States*, 355 F.3d 387, 396 (6th Cir. 2004))

The court held that it did not matter that the doctor's intentions were noble. The doctor's decision to pay even \$100,000 to the employees before paying the back payroll taxes, knowing that the payroll taxes were owed, made him liable for the entire \$4.3 million trust fund penalty.

#### Comment

This is the type of case that gives practitioners nightmares. You have a noble client that just wants to make payroll after discovering his trusted, long-time CFO has embezzled millions of dollars of payroll tax withholding. The client loans \$100,000 to his business just to make payroll for his employees and finds that by using those funds to pay his employees over the IRS, he is now liable for millions of dollars in penalties.

Payroll tax penalties are so harsh and severe that practitioners should tell the tale of Dr. McClendon over an open flame with a flashlight under their chin.

## CALIFORNIA LLCs

A California appellate court ruled that an out-of-state corporation whose only connection with California was its 0.2% ownership interest in a California LLC, with no right of control over the

business affairs of the LLC, was not “doing business” in California. Therefore, the taxpayer was entitled to a refund of the \$800 annual franchise tax, interest, and penalties imposed by the FTB. (*Swart Enterprises, Inc. v. California Franchise Tax Board* (January 12, 2016) California Court of Appeal, Fifth District, Case No. F070922)

### *Comment*

It is likely the FTB will appeal this case because the court rejected the FTB's expansive definition of “doing business” adopted in Legal Ruling 2014-01.

### **Practice Pointer**

If you haven't filed a refund claim yet, we suggest you file a claim on behalf of non-California corporations or LLCs who have filed and paid tax to California based on their investment in a California LLC.

---



---

## PRACTICE AND PROCEDURES

---



---

### E-MAIL SCHEMES TARGETING TAX PROFESSIONALS

The IRS and state taxing agencies are alerting tax professionals of a new e-mail scam from cybercriminals who pose as prospective clients soliciting their services. The scheme's objective is to collect sensitive information that will allow criminals to prepare fraudulent tax returns.

The latest phishing e-mails typically come in two stages:

- The first e-mail is the solicitation, which asks tax professionals if they can prepare their tax return; and
- If the tax professional responds, the cybercriminal sends a second e-mail that either has an embedded web address or contains a .PDF attachment that has an embedded web address.

In some cases, the phishing e-mails have come from a legitimate sender or organization (perhaps a friend or colleague) whose e-mail has been hijacked.

The IRS advises that you should never click on an unsolicited e-mail or PDF attachment from an unknown sender.

### W-2 FRAUD NOTICES BEGINNING IN 2017

Starting in January 2017, the IRS will notify taxpayers who the IRS believes have been victims of employment-related identity theft. (“Processes are not sufficient to assist victims of employment-related identity theft” (August 10, 2016) TIGTA Report No. 2016-40-065) Affected taxpayers will be issued a notice. The IRS will monitor the success of this program to determine its effectiveness.

Employment-related identity theft occurs when an identity thief uses the identity of a taxpayer to gain employment. Taxpayers may not realize they are a victim of employment-related identity theft until they receive an IRS notice of a discrepancy in the income they reported on their tax return.

## IDENTITY THEFT: STAY VIGILANT

### Knowing what's out there helps protect you and your clients' information

With tax season approaching, the IRS is stepping up its efforts to inform practitioners about recent identity theft scams that are targeting both taxpayers and tax practitioners. While it seems like new scams crop up every week, it's important for practitioners to stay informed because these scams aren't going anywhere: The IRS saw a 400% increase in phishing and malware incidents during the 2016 tax season.

#### **E-services scam**

For tax professionals who use IRS e-Services, the IRS sent out a warning that there's a scam e-mail circulating. The e-mail asks the tax professional to update his or her account and directs them to a fraudulent website.

The subject line for these e-mails is "Security Awareness for Tax Professionals," and the "From" line says "Your e-Services Team." The e-mail has an IRS logo and an e-Services logo that hyperlinks to a URL that has been verified as a phishing site posing as an IRS e-Services registration page.


#### *Comment*

This scam is not new; a similar scam e-mail circulated in early 2015.

Tax professionals who received this e-mail and provided their username and password should perform a deep security scan on their computer and contact the IRS e-Services help desk at:

 **Telephone**  
(866) 255-0654

If you receive one of these e-mails, forward it to the IRS at:

 **E-mail**  
phishing@irs.gov

In response to this scam, the IRS is sending letters to e-Services users that ask the user to validate their identity either online using Get Transcript or by calling the IRS e-Services Help Desk. The preferred option is to use Get Transcript Online, which uses Secure Access to authenticate your identity.

The letters started going out November 28 to any e-Services user who can access the transcript delivery service and who has been active in their e-Services account within the last year. If you received one of these letters, you have 30 days to respond or your e-Services account will be suspended for security purposes until you can verify your identity.

For more information, go to:

 **Website**  
[www.irs.gov/individuals/important-update-about-your-eservices-account](http://www.irs.gov/individuals/important-update-about-your-eservices-account)

### CP2000 scam

The IRS is warning taxpayers and practitioners that a new scam uses fraudulent CP2000s to solicit money from taxpayers. The fraudulent forms look convincing and show balances due that are small enough that taxpayers just might pay rather than arguing the point.

However, upon closer inspection, these forms have telltale signs of fraud:

- The instructions direct the taxpayer to make out a check to "I.R.S." rather than to "United States Treasury"; and
- The return address is "Austin Processing Center, P.O. Box 15264, Austin, TX 78761-5264," which does not match the address listed on the IRS website for the Austin Processing Center.

Tax practitioners should advise clients to contact them if any unexpected balance due arrives from the IRS so that the correspondence can be verified.

For more information, go to:



**Website**

[www.irs.gov/uac/irs-and-security-summit-partners-warn-of-fake-tax-bill-emails](http://www.irs.gov/uac/irs-and-security-summit-partners-warn-of-fake-tax-bill-emails)

### *Rigorous verification for online tools*

For identity verification purposes, taxpayers using the Get Transcript service or the Get an IP PIN tool will need to provide a number from one financial account when registering, in addition to their basic personal information. The following financial accounts may be used:

- Credit card;
- Mortgage or home equity loan;
- Home equity line of credit; or
- Auto loan.

Taxpayers only need to provide the loan account number or a few digits from a credit card number. If using a credit card number, the credit card will not be charged.

Last, taxpayers will need their mobile phone to register. For identity protection purposes, the IRS will send a text message to the taxpayer's mobile phone. This service won't work on phones using pay-as-you-go (prepaid) plans or landlines, or virtual phones such as Skype or Google Voice. The phone number must be a U.S.-based number that accepts text messages. Without a text message-enabled mobile phone, a taxpayer won't be able to register online and must call or register by mail.

Taxpayers who have a credit freeze with Equifax will need to temporarily lift the freeze in order to use Get Transcript; otherwise, the IRS will not be able to verify the taxpayer's identity.

For information on how to lift a credit freeze temporarily, go to:



**Website**

[https://help.equifax.com/app/answers/detail/a\\_id/161/related/1](https://help.equifax.com/app/answers/detail/a_id/161/related/1)

## Tips for staying protected

A list of current scams is available on the IRS's website at:



**Website**

[www.irs.gov/uac/tax-scams-consumer-alerts](http://www.irs.gov/uac/tax-scams-consumer-alerts)

Also, keep in mind the following:

- Protect all devices and accounts with strong passwords, and do not use the same password for everything;
- Consider using two-factor authentication, if the option is available, to protect any of your accounts. This involves a security code being sent to your registered mobile phone. If a thief manages to steal your username and password, he will be blocked from accessing your accounts;
- Remember that the IRS does not correspond with taxpayers via e-mail, nor will it request personal or financial information over the phone;
- Watch out for look-alike e-mails and webpages that mention "USA.gov" or "IRScgov" (no period before "gov"), or checks directed to be written out to "I.R.S." instead of the U.S. Treasury;
- The IRS will never request payment via any form of gift card or prepaid debit card;
- The IRS will never threaten deportation or to immediately bring in law enforcement for not paying; and
- The IRS does not demand payment without first sending a bill.

## RESPONDING TO FORM FTB 4734D

### FTB suspects identity theft

When the FTB receives a tax return for processing, it is analyzed via the new return analysis system, and if the return looks suspicious, it is put on hold and the FTB contacts the taxpayer by mail. The FTB sends Form FTB 4734D, Request for Tax Return Information and Documents, when there is a question as to the taxpayer's identity. If, however, the FTB highly suspects identity theft, Form FTB 3904, Request to Confirm Tax Return Filing, is sent (see below).

Form FTB 4734D requests copies of:

- The taxpayer's Social Security card(s);
- W-2 and 1099-R forms; and
- Paycheck stubs.

According to the FTB, the best way to answer the notice is to fax the requested information to the number on the notice. Information may also be mailed to the address on the notice. Or, you can call the number on the notice. If you call, have a copy of the client's current and prior-year returns. Do not call the practitioner hotline or the toll free number, as it is the employees in this particular unit who can help you.

### Caution

Verify the address on the notice by going to the FTB's website to ensure that the notice your client has was actually sent by the FTB (see below).

For security reasons, a sample of this notice and other notices are not available on the FTB's website. However, the FTB provides details on its website regarding the letters, including the

address, phone, and fax numbers. This information allows you and your clients to ensure it is a valid FTB request and not a criminal requesting the information.

To confirm the contact information, go to:

 **Website**

[www.ftb.ca.gov/Bills\\_and\\_Notices/notices.shtml](http://www.ftb.ca.gov/Bills_and_Notices/notices.shtml)

### *Comment*

According to the FTB, they do not receive a response on the majority of the 4734Ds sent. This is an indication that there could truly have been an identity theft or refund fraud situation, as a thief is unlikely to respond, often because the taxpayer does not live at the address shown on the return.

However, the FTB will continue to follow up if the taxpayer fails to respond so the taxpayer's return can be validated and processed. This is done by notifying the taxpayer that they did not receive a response or by reaching out to the employer. The FTB will not process the return until they can validate the taxpayer's identity.

### **Other verification notices**

Form FTB 3904, Request to Confirm Tax Return Filing, is sent when the FTB highly suspects ID theft. The FTB generates this letter to the last good address on file for the taxpayer (not the address on the return). This is a higher threshold of concern than the Form FTB 4734D referred to above. Contact the FTB to confirm you filed the return. While waiting for the taxpayer to confirm that he or she filed the return, the return is on hold. Again, confirm the FTB fax number and mailing address online.

Form FTB 4502, Additional Documentation Required – Refund Pending, is sent to taxpayers when the FTB does not have enough information to approve the claimed California Earned Income Tax Credit prior to issuing a refund.

Form FTB 4579, Demand to Furnish Information, is sent to employers when the FTB is unable to validate wages and withholding claimed based on historical information and/or other third-party data sources.

## **APPEALS CONFERENCES WILL NOW TAKE PLACE VIA PHONE**

The IRS announced that virtually all appeals conferences will be conducted over the telephone and only rarely in person if certain conditions exist. (IRM 8.6.1.4.1) An in-person conference will be held if there are substantial books and records to review that cannot be easily referenced with page numbers or indices; the appeals officer cannot judge the credibility of the taxpayer's oral testimony without an in-person conference; the taxpayer has special needs; there are numerous participants, and breach of confidentiality would be compromised; or the situation otherwise calls for an in-person conference. Taxpayers or the appeals team may suggest an in-person conference, and both must agree.



## IRS WANTS TO INCREASE FEES

### Installment agreements

The IRS is proposing to increase the user fees charged for an installment agreement. (IR-2016-108) The proposed fees are:

- \$225 for entering into a regular installment agreement;
- \$107 for a direct debit agreement;
- \$149 for an online payment agreement; and
- \$31 for an online direct debit agreement.

Under current rules, the user fee is \$120 for a regular installment agreement and \$52 for a direct debit installment agreement.

Qualified lower-income taxpayers may be eligible for a reduced rate of \$43 notwithstanding the method of payment. The reduced user fee will continue to be available to qualified lower-income taxpayers.

### Offers in compromise

The IRS is considering increasing the fee for submitting an offer-in-compromise from \$186 to \$300. Even with this increase, the IRS claims that the fee doesn't cover the administrative expenses of the OIC service, which they estimate to be \$2,450.

---

---

## MISCELLANEOUS

---

---

### DEADLINE FOR FURNISHING HEALTH COVERAGE FORMS EXTENDED

The IRS has extended the deadline for providers of health coverage to furnish individual taxpayers Form 1095-B, Health Coverage, and Form 1095-C, Employer-Provided Health Insurance Offer and Coverage. (Notice 2016-70) Generally, the due date is January 31. However, for the 2016 season, the IRS has extended the due date to March 2, 2017.

### EMPLOYER STATE ID NUMBERS NO LONGER TRANSFER IN MANY SOFTWARE PROGRAMS

Practitioners are reporting that their tax software programs are not transferring employer state ID numbers from their 2015 to their 2016 programs. This is intentional and done at the request of most states that are asking the software companies to not transfer the ID numbers. The primary reason for the change is based on a large amount of incorrect data received by states in prior years. By requiring the information to be re-entered by practitioners, the data is more likely to be correct.

---



---

## TAX REFORM — WHAT TO TELL CLIENTS

---



---

### COMPARING TAX PLANS OF PRESIDENT TRUMP AND HOUSE REPUBLICANS

The most often-asked questions over the last four months have revolved around President Trump and the House Republicans' tax reforms. No one has a crystal ball, but everyone seems certain that certain changes will take place, including the elimination of the individual and corporate alternative minimum tax.

Our analyses and comparison of both plans will arm you with the tools necessary to prepare your clients for the big changes that are certain to come.

#### The President's tax plan

Donald Trump's election victory, along with Republican control of both houses of Congress, means that there will likely be big changes in tax law coming soon. Trump was inaugurated on January 20, and considering the "100-day rule" (i.e., much of what a President accomplishes is done in the first 100 days), we can expect the tax law changes to be swift. It's unknown, at this time, whether those changes will be effective in the 2017 or 2018 tax years, but it's likely that the effective dates of any changes will be spread over those two years.

In reviewing Trump's tax plans, two points should be kept in mind:

- His tax plans are largely broad-brush, with few specifics. The plan is briefly stated on his website ([www.donaldjtrump.com/policies/tax-plan](http://www.donaldjtrump.com/policies/tax-plan)), and he didn't fill in many details in his campaign speeches; and
- The House GOP has its own "A Better Way" tax reform blueprint. While that blueprint shares some similarities with Trump's proposals, there are also many differences. ([http://abetterway.speaker.gov/\\_assets/pdf/ABetterWay-Tax-PolicyPaper.pdf](http://abetterway.speaker.gov/_assets/pdf/ABetterWay-Tax-PolicyPaper.pdf)) There will likely need to be compromise if a quick consensus cannot be reached.

#### Basic individual tax changes

Trump's plan would collapse the current seven tax brackets to three brackets:

<b>Proposed Tax Brackets</b>		
<b>Tax rate</b>	<b>Married filing joint</b>	<b>Single</b>
12%	Less than \$75,000	Less than \$37,500
25%	\$75,000-\$225,000	\$37,500-\$112,500
33%	More than \$225,000	More than \$112,500

#### *Comment*

These rates correspond somewhat closely to current rates, with the exceptions of the current 35% and 39.6% rates. For example, the current 25% rate for married filing joint kicks in at taxable income of \$75,300, whereas under the Trump plan it would be \$75,000. The 33% rate under current law begins at \$231,400, versus \$225,000 under the Trump plan. However, under current law there's an in-between rate of 28% that starts at \$151,900.

Further changes to basic individual taxation are:

- Personal and dependent exemptions are eliminated;
- The head of household filing status is eliminated; and
- The standard deduction is increased to \$30,000 for joint filers and \$15,000 for single filers.

*Comment*

The increase in the standard deduction means that about 60% of taxpayers who currently itemize will no longer itemize. This is likely to remain true as long as mortgage interest rates are low and taxpayers pay relatively little in home mortgage interest.

However, considering that Californians have large state income tax deductions, the percentage of itemizers going to standard deduction could be lower.

Also, the increase in the standard deduction will likely mean that most low- to mid-income taxpayers will have a slightly reduced tax burden. However, with the loss of head of household filing status and the loss of exemptions, a single parent will likely pay more, especially if that single parent has more than one dependent child.

*Example of tax increase for single parent*

Bruce is a single parent who has two dependent children. He files as head of household and has salary income of \$70,000 and takes the standard deduction. He is in the 15% tax bracket. Under the Trump tax plan, his taxable income is \$55,000 and he is in the 25% tax bracket. For 2016, his taxable income and tax liability are calculated as follows:

	<b>Current law</b>	<b>Trump tax plan</b>
Income	\$70,000	\$70,000
Exemptions (\$4,050 × 3)	12,150	0
Standard deduction	- 9,300	- 15,000
Taxable income	48,550	55,000
Tax liability	\$ 6,620	\$ 8,875

**Example of loss of itemized exemptions**

Kelly and James are married with no dependents, have enough deductions to itemize, and are in the 15% tax bracket. Below is Kelly and James' 2016 tax calculation compared to what it might look like under President Trump's proposed tax plan where Kelly and James are in the 12% tax bracket and do not have enough deductions to itemize.

	<b>Current law</b>	<b>Trump tax plan</b>
Income	\$90,000	\$90,000
Exemptions (\$4,050 × 2)	8,100	0
Standard deduction	12,600	30,000
Itemized deductions:		
State income taxes	4,000	4,000
Property taxes	3,000	3,000
Mortgage interest	8,000	8,000
Charitable contributions	<u>2,000</u>	<u>2,000</u>
Total itemized deductions	\$17,000	\$17,000
Taxable income	\$64,900	\$60,000
Tax bracket	<u>15%</u>	<u>12%</u>
Tax liability	\$ 8,808	\$ 7,200

**Other individual tax changes**

Other individual tax changes occurring under the Trump tax plan include:

- Itemized deductions will be capped at \$200,000 for joint filers and \$100,000 for singles;
- The alternative minimum tax will be eliminated;
- The tax plan specifically eliminates the 3.8% Net Investment Income Tax. However, under other portions of his platform, Trump intends to repeal the Affordable Care Act (ACA). This will presumably also eliminate the 0.9% Additional Medicare Tax, the penalty for not having insurance, the Premium Tax Credit, and other taxes under the ACA; and
- The existing capital gains rate structure (maximum rate of 20%) will be retained "with new tax brackets."

**Comment**

It is not clear what capital gains rates will be associated with what new tax brackets. Under current law, capital gains are taxed at a 0% rate for taxpayers in the 10% and 15% tax brackets, 15% for the 25%–35% brackets and 20% for taxpayers in the 39.6% tax bracket. Obviously, those tax brackets do not correspond to the tax brackets under Trump's plan.

**Child and elder care**

The Trump plan puts a great deal of emphasis on child care and elder care, replacing the current Child and Dependent Care Credit with a more complex but broader system.

Eligible taxpayers will get an above-line deduction for child care for children under age 13 and for elder care for a dependent parent.

The deduction would be available to families who "use" stay-at-home parents or grandparents to provide the child care.

There are several limitations on the deduction:

- No deduction is available to taxpayers with "total income" over \$500,000 for joint filers or \$250,000 for single filers;
- The deduction for child care is limited to four children per taxpayer;
- The deduction for child care is limited to the "state average for a child of the child's age"; and
- For elder care, the deduction is capped at \$5,000 per year, indexed for inflation.

For lower-income individuals who would not benefit from the deduction, the plan would offer spending rebates for child care expenses through the Earned Income Tax Credit. The rebate would be equal to 7.65% of "remaining" eligible child care expenses subject to a cap of half of the payroll taxes paid by the taxpayer; in a two-earner household, the cap would be based on the lower-earning parent. This rebate would be available to joint filers earning \$62,400 or less, or single taxpayers earning \$31,200 or less.

*Comment*

The child care benefits might significantly offset the increase in tax for single parents noted in the previous discussion and example.

In addition, the plan will create a new Dependent Care Savings Account (DCSA) for the benefit of specified individuals including unborn children. Total annual contributions are limited to \$2,000 per year. When established for children, funds remaining in the account when the child reaches age 18 can be used for education expenses.

*Comment*

It is not clear if there will be a deduction for contributions or whether income in the account will be tax-deferred or tax-free. It seems likely that the accounts will work much like Health Savings Accounts.

To encourage lower-income families to establish DCSAs for their children, the government will provide a 50% match on parental contributions of up to \$1,000 per year. Apparently, this government match will be made in the form of a refundable tax credit administered through the Earned Income Tax Credit.

*Comment*

Eliminating dependent exemptions and the head of household filing status has the potential to eliminate the complex rules that determine who is a dependent and who gets to claim the dependent. However, with the EITC and the child care rules, that difficult determination is still in play. It is not clear at this time whether IRC §152 (Dependent Defined) will be retained along with all of the regulations, rulings, and court cases under that provision.

### **Business provisions**

There are several provisions benefitting business taxpayers. Chief among those provisions is that the plan will lower the "business tax rate from 35% to 15%." Further, this provision provides that "this rate is available to all businesses, both large and small, that want to retain the profits within the business."

*Comment*

As broad-brush as many of the plan's provisions are, this one is causing considerable speculation. The provision is simple when applied to a C corporation. But the phrase "is available" seems to imply that other business entities may elect to be treated like a C corporation. It would seem to mean that a partnership, for example, may elect to pay a 15% tax at the partnership level with the partners paying tax on distributions. It is not clear at all whether any such election would be made on an annual basis or whether the election, once made, is in effect for all future years.

Moreover, the phrase "all businesses" would seem to indicate that even sole proprietors operating a Schedule C business can take advantage of the 15% rate.

### **Business tax incentives**

The Trump plan will raise the IRC §179 expensing cap from \$500,000 (adjusted for inflation) to \$1 million. Moreover, businesses engaged in manufacturing in the U.S. could make an election to expense all equipment purchases and lose the deductibility of interest expense. The election can only be revoked within the first three years of making the election.

The plan eliminates "most corporate tax expenditures," except for the Research and Development Credit. The phrase "most corporate tax expenditures" is not defined.

The plan also greatly enhances tax benefits for on-site child care expenses and for businesses that pay a portion of an employee's child care expenses.

### **Death taxes**

The Trump plan states: "The Trump Plan will repeal the death tax, but capital gains held until death and valued over \$10 million will be subject to tax to exempt small businesses and family farms."

*Comment*

It is impossible to interpret that sentence because of its many grammatical errors. The final clause beginning with "to exempt" implies that that final clause is the *result of* what precedes it but there's nothing in what precedes it that leads to the conclusion of the final clause. And, strictly read, "valued over \$10 million" refers to the amount of capital gains, not the value of the estate. So, does that mean that an estate with built-in gain of \$10 million will be taxed and, if so, at what rate and when?

The most common interpretation is that if an estate has a valuation of more than \$10 million, the estate will be taxed on its built-in gains at the capital gains rate of 20%. It appears to be a cliff test. It is assumed that after paying the tax, the heirs will receive the assets at a stepped-up basis.

Another interpretation is that if the estate has a value of more than \$10 million, the heirs will pay tax when they sell the assets. This interpretation means that the heirs receive the assets without a stepped-up basis.

Apparently, if the estate has a value of under \$10 million, the heirs receive the assets with a stepped-up basis.

## **The GOP's "A Better Way" tax plan**

In addition to the President's tax plan, house Republicans have produced their own tax blueprint as part of their "A Better Way" plan for the country. ([http://abetterway.speaker.gov/\\_assets/pdf/ABetterWay-Tax-PolicyPaper.pdf](http://abetterway.speaker.gov/_assets/pdf/ABetterWay-Tax-PolicyPaper.pdf))

## **GOP tax reform goals**

The GOP's plan states that one of its primary goals is simplification of the tax code to the point where most Americans can prepare their own taxes "on a form as simple as a postcard" (see the box on page 44).

### **Tax rates for individuals**

Like Trump's plan, the GOP plan consolidates the seven current individual tax brackets into three at 12%, 25%, and 33%. The blueprint does not define at what taxable income each rate kicks in, but we can expect the tax rates to largely follow current taxable income amounts:

- 12% rate will replace the current 10% and 15% rates;
- 25% rate will replace the current 25% and 28% rates; and
- 33% rate will replace the current 33%, 35%, and 39.6% rates.

According to the GOP plan, because of the increased standard deduction (discussed below), taxpayers who are currently in the 10% bracket "always will pay lower taxes than under current law."

### **Reduced tax on investment income**

The GOP blueprint reduces taxes on investment income by allowing taxpayers to exclude 50% of their net capital gains, dividends, and interest income, leading to effective rates of 6%, 12.5%, and 16.5% on investment income. The purpose is to reduce the double-taxation burden.

### **Shifting family tax deductions**

The tax code currently includes five basic family tax deductions and credits:

- Basic standard deduction;
- Additional standard deduction;
- Personal exemptions for taxpayer and spouse;
- Personal exemptions for dependents; and
- Child Tax Credit.

The GOP plan consolidates these deductions and credits into a larger standard deduction and an enhanced Child Tax Credit. The stated purpose is to simplify these deductions and credits while achieving the same policy and distributional goals as current law. The GOP proposed standard deductions are:

Married filing joint	\$24,000
Single with child in household	\$18,000
Single	\$12,000

The Child Tax Credit is currently \$1,000 and phases out for individual taxpayers earning over \$75,000 and for joint filers earning over \$110,000. To the extent the Child Tax Credit exceeds the taxpayer's tax liability, the taxpayer is eligible for a refundable credit equal to 15% of earned income in excess of \$3,000. Taxpayers are not required to provide the child's Social Security number to claim the refundable portion of the credit, which has led to substantial fraud.

The GOP plan increases the Child Tax Credit to \$1,500 with only the first \$1,000 refundable. A new nonrefundable \$500 credit will also be allowed for nonchild dependents. Additionally, married couples would not see either of these credits phased out until their earnings reach \$150,000. By

increasing the phase-out threshold to double the individual threshold of \$75,000, the GOP's plan will eliminate the marriage penalty as it applies to the Child Tax Credit.

### **Tax benefits for higher education**

The GOP blueprint consolidates the different education credits and deductions into a single higher education credit and expands qualified expenditures to include vocational training. The plan also includes savings incentives for §529 plans and other tax relief targeted at helping low- and middle-income taxpayers but does not provide details.

### **Itemized deductions**

In conjunction with the increased standard deduction, the GOP plan eliminates all itemized deductions except the home mortgage interest deduction and the charitable contribution deduction. The stated reasons for keeping these two deductions are to promote a strong housing market and to encourage charitable giving.

Even though the GOP plan keeps these two deductions, many taxpayers who currently itemize will not have enough charitable contributions and mortgage interest to overcome the larger standard deduction. For homeowners on the lower end of the tax scale, tax practitioners and real estate professionals may find themselves performing more rent versus buy analyses for their clients.

Elimination of other itemized deductions will mean:

- No deductions for medical expenses;
- Elimination of state and local income tax, which will negatively impact Californians;
- No deduction for personal investment interest; and
- Elimination of miscellaneous itemized deductions and casualty and disaster losses.

#### *Comment*

Eliminating the deduction for state income tax will be a tax increase for many Californians who still itemize deductions.



**Example of loss of itemized exemptions**

Kelly and James are married with no dependents, have enough deductions to itemize, and are in the 25% tax bracket. Below is Kelly and James' 2016 tax calculation compared to what it might look like under the GOP's proposed tax plan where Kelly and James are also in the 25% tax bracket and lose most itemized deductions.

	<b>Current law</b>	<b>GOP tax plan</b>
Income	\$120,000	\$120,000
Exemptions (\$4,050 × 2)	8,100	0
Standard deduction	12,600	24,000
Itemized deductions:		
State income taxes	4,000	disallowed
Property taxes	3,000	disallowed
Mortgage interest	15,000	15,000
Charitable contributions	<u>4,000</u>	<u>4,000</u>
Total itemized deductions	\$ 26,000	\$ 19,000
Taxable income	\$ 85,900	\$ 96,000
Tax bracket	<u>25%</u>	<u>25%</u>
Tax liability	\$ 13,808	\$ 14,211

**Affordable Care Act**

The GOP has made repeal of the ACA one of its priorities, including repeal of the:

- 3.8% Net Investment Income Tax;
- 0.9% additional Medicare surcharge;
- Excise tax on medical devices;
- Tax on Cadillac health plans; and
- Penalties associated with individual and employer mandates.

**Other individual provisions**

The GOP plan also:

- Eliminates the alternative minimum tax (AMT);
- Continues the Earned Income Tax Credit (EITC);
- Continues incentives for retirement savings, such as current structure for contributions to IRAs, 401(k) plans, and all other retirement savings arrangements; and
- Completely repeals the estate and generation-skipping transfer taxes (aka the "death tax").

### Sample "postcard" tax form

The GOP blueprint contains a simple, 14-line postcard tax form as an example of the sweeping simplification it creates.

## SIMPLE, FAIR "POSTCARD" TAX FILING

1	Wage and compensation income	1	
2	Add 1/2 of investment income	2	
3	Subtract contributions to specified savings plans	3	
4	Subtract standard deduction OR	4	
5	Subtract mortgage interest deduction	5	
6	Subtract charitable contribution deduction	6	
7	Taxable income	7	
8	Preliminary tax (from tax table)	8	
9	Subtract child credit	9	
10	Subtract earned income credit	10	
11	Subtract higher education credit	11	
12	Total tax	12	
13	Subtract taxes withheld	13	
14	Refund due / taxes owed	14	

### Tax rates for small businesses

For businesses, the GOP plan creates a new 25% maximum tax rate for small businesses that are organized as sole proprietorships or passthrough entities, which means that small business income will no longer be subject to the proposed top individual tax rate of 33%.

However, similar to S corporations that are required to pay reasonable compensation, the GOP blueprint will treat sole proprietors and partners as having paid themselves reasonable compensation, which would be subject to the individual rates, before the maximum business rate of 25% takes over. It is unclear how this provision would be implemented or enforced, or whether there would be any changes to self-employment taxes.

### Tax rates for large businesses

For large businesses, the GOP blueprint reduces the tax rate for C corporations to a flat 20%. Earnings distributed from C corporations will still be double-taxed, but the burden will be severely diminished with the 50% exclusion on investment income of individuals, discussed earlier.

### Full and immediate write-off of tangible and intangible assets

In addition to reducing tax rates for businesses, the GOP blueprint allows businesses the benefit of full and immediate write-offs of investments in both tangible and intangible assets. According to the GOP plan, this approach to cost recovery is equivalent to a 0% tax rate on new investment and will be a move toward taxation based on business cash flow.

### Interest expense

Interest expense will be allowed against interest income, but no current deduction will be allowed for net interest expense. This is a trade-off for allowing full and immediate write-offs for investments. The GOP plan states that it will work to develop special rules with respect to interest

expense for financial services companies, such as banks, insurance, and leasing, which will take into account the role of interest income and expense in their business models.

### **Net operating losses**

Net operating losses will carry forward indefinitely and will be increased by an interest factor that compensates for inflation and a real return on capital to maintain the value of amounts that are carried forward. NOL carrybacks will not be permitted, and the deduction allowed with respect to an NOL carryforward in any year will be limited to 90% of the net taxable amount for such year determined without regard to the carryforward.

### **Business deductions and credits**

Without much detail, the GOP blueprint states that the tax code contains too many special interest deductions and credits that are designed to encourage particular business activity and that those provisions create incentives for businesses to make decisions because of the tax consequences rather than because of the underlying economics. The blueprint states that it feels the special interest provisions are a source of both complexity and controversy because such provisions adversely affect the public's confidence in the fairness of the tax system.

Even though not many details were provided, the blueprint does single out the domestic production activities deduction of IRC §199 as no longer necessary under the GOP plan. However, the blueprint would continue research and development credits.

### **Other business provisions**

The plan also:

- Eliminates corporate alternative minimum tax (AMT); and
- Preserves the last in, first out (LIFO) method of accounting.



### **California conformity**

What will happen with California's tax system if Congress follows the Trump tax plan or the GOP's "A Better Way" tax plan, or a combination of the two?

In California we like to make our own decisions, not necessarily following federal tax changes. At first blush, California would likely not conform to a major federal tax overhaul. But there does appear to be some interest in at least partial conformity.

Although the Legislature is talking about circumventing federal policies in the areas of immigration and the environment, comments made by those in the know appear to open the door for at least some tax conformity.

For example, state Finance Director Michael Cohen said that California can't just go its own way and ignore the federal tax changes. He has stated that state officials must be nimble reacting to whatever comes out of Washington.

In general, we believe California will conform to some provisions, but conformity would not likely happen right away, so we would potentially have a year or two of big differences, depending on what really happens in Washington.

## TAX PLAN COMPARISON CHART

Tax Plan Comparison Chart						
	Trump			House GOP		California
<b>Individuals</b>						
	Tax rate	Joint	Single	Tax rate	Current brackets replaced	California tax rates are not tied to federal rates, and California does not have a reduced capital gain rate
	12%	< \$75,000	< \$37,500	12%	10% / 15%	
	25%	\$75,000– \$225,000	\$37,500– \$112,500	25%	25% / 28%	
	33%	> \$225,000	> \$112,500	33%	33% / 35% / 39.6%	
Filing status	Eliminates head of household and contemplates two filing statuses: <ul style="list-style-type: none"> <li>• Married filing joint; and</li> <li>• Single</li> </ul>			Contemplates three filing statuses: <ul style="list-style-type: none"> <li>• Married filing joint;</li> <li>• Single with child in household; and</li> <li>• Single</li> </ul>		California generally conforms to federal filing statuses. We believe California would not eliminate the head of household filing status
Personal and dependent exemptions	Eliminates in lieu of higher standard deduction			Eliminates in lieu of higher standard deduction		California has exemption and dependent credits. These could possibly be reduced or eliminated if done in conjunction with a higher standard deduction
AMT	Eliminates			Eliminates		We don't believe California would eliminate the AMT
Investment income	Maintains capital gain structure with new tax brackets			50% excluded from gross income (presume elimination of capital gain rates as trade-off for 50% exclusion)		We don't believe California would conform here
Standard deduction	Increased to: <ul style="list-style-type: none"> <li>• \$30,000 joint return; and</li> <li>• \$15,000 single</li> </ul>			Increased to: <ul style="list-style-type: none"> <li>• \$24,000 married filing joint;</li> <li>• \$18,000 single with child in household; and</li> <li>• \$12,000 single</li> </ul>		California could increase the standard deduction, possibly in conjunction with changes in exemption credits
Itemized deductions	Maintains current deductions but caps them at: <ul style="list-style-type: none"> <li>• \$200,000 joint return; and</li> <li>• \$100,000 single</li> </ul>			Eliminates all itemized deductions except home mortgage interest and charitable contributions		California could cap the itemized deductions. Note that if only mortgage interest and charitable contributions were allowed, Californians would suffer an increase in federal tax due to the loss of the state income tax deduction
<i>(continued)</i>						

## Tax Plan Comparison Chart (continued)

	Trump	House GOP	California
<b>Individuals (continued)</b>			
Children and dependents	<ul style="list-style-type: none"> <li>• Replaces Child and Dependent Care Credit with broader system;</li> <li>• Creates above-line deduction for child care for children under age 13 and for elderly dependents;</li> <li>• Makes deduction available where stay-at-home parent or grandparent is caregiver;</li> <li>• Phase out when income is over \$250,000 (\$500,000 for joint filers);</li> <li>• Limited to four children;</li> <li>• Limited to the "state average" for the child's age; and</li> <li>• Elder care deduction capped at \$5,000 annually, indexed for inflation</li> </ul>	<ul style="list-style-type: none"> <li>• Increases Child Tax Credit to \$1,500 (only \$1,000 refundable);</li> <li>• Creates \$500 nonrefundable credit for nonchild dependents; and</li> <li>• Increases phase out threshold for joint filers to eliminate marriage penalty</li> </ul>	California does not have a child credit. However, if dependent credits were eliminated, the state could enact a child credit
Earned income credits	Modifies and expands	Silent	We believe California could expand the EITC
Higher education expenses	Mostly silent, but adds Dependent Care Savings Account (DCSA) to help save for education – government-provided matching contributions available for low income taxpayers	Simplifies and consolidates various deductions and credits into a single credit and expands eligible expenditures to include vocational training	California has not conformed in the past
Retirement savings	Silent	Maintains current tax benefits for contributions to 401(k)s, IRAs, and all other retirement savings arrangements	California automatically conforms to federal law in these areas
Estate taxes	Repeals (sort of) – exception for capital gains held until death in excess of \$10,000,000	Full repeal	N/A
ACA provisions	Repeal, including: <ul style="list-style-type: none"> <li>• 3.8% NIIT;</li> <li>• 0.9% Medicare tax;</li> <li>• Cadillac tax;</li> <li>• Medical expense excise tax; and</li> <li>• Penalties for individual and business mandates</li> </ul>	Repeal, including: <ul style="list-style-type: none"> <li>• 3.8% NIIT;</li> <li>• 0.9% Medicare tax;</li> <li>• Cadillac tax;</li> <li>• Medical expense excise tax; and</li> <li>• Penalties for individual and business mandates</li> </ul>	N/A
<i>(continued)</i>			

## Tax Plan Comparison Chart (continued)

	Trump	House GOP	California
<b>Businesses</b>			
Tax rates (Schedule C and flow-throughs)	15% maximum rate, including flow-throughs and sole proprietors	25% maximum rate, but caveat that flow-throughs and sole proprietors deemed to pay reasonable compensation (prevents partners/sole proprietors from totally avoiding 33% tax rate)	We doubt California would conform to any of the business changes, except as noted
Tax rates (C corporations)	15% maximum rate	20% flat rate	See above
AMT	Eliminated	Eliminated	See above
Depreciation	<ul style="list-style-type: none"> <li>Increased IRC §179 to \$1,000,000; and</li> <li>Available election for manufacturers for immediate expensing of 100% of equipment</li> </ul>	100% immediate expensing of all tangible and intangible property (unclear if includes real property and probably does not include land)	See above
Interest expense	If manufacturer elects 100% immediate expensing of equipment, then no interest deduction is allowed	Only deductible to the extent of interest income (trade-off for allowing 100% immediate expensing of property)	See above
NOLs	Silent	<ul style="list-style-type: none"> <li>Carry forward indefinitely;</li> <li>No carryback;</li> <li>Utilization limited to 90% of net taxable income; and</li> <li>Annual inflation adjustments</li> </ul>	California could eliminate the carryback and California has suspended NOLs in the past
Inventory	Silent	Preserves LIFO inventory method	California conforms to LIFO inventory method
Other deductions	Eliminates "most corporate tax expenditures," but does not define what that means	Eliminates most "special interest" deductions. Does not define what "special interest" deductions are, but does single out domestic production activities deduction (DPAD) as an example	We believe California could conform to these provisions
Credits	Continues R&D credit, but expect elimination of most others	Continues R&D credit, but expect elimination of most others	California will likely retain its own credits
On-site child care	Enhanced benefits for employers that pay child care expenses for employees	Silent	California let child care credits expire
Repatriation of corporate profits	10% tax on deemed repatriation of corporate profits	Silent	N/A
<b>Note:</b> Where either plan is silent, it can be assumed that it does not seek to change current law			

---



---

## CASE STUDY — WHAT'S AN 8867?

---



---

I must admit that the Form 8867 is somewhat foreign to my practice. The Form 8867 is the Paid Preparer's Due Diligence Checklist. Before this filing season, tax preparers were required to complete this form and follow its requirements for any client claiming the EITC. Starting this filing season, the form is also required for any clients claiming the Child Tax Credit (CTC), the Additional Child Tax Credit (ACTC), or the American Opportunity Tax Credit (AOTC).

In other words, I must now complete this form for most of my young professional clients that have children, as well as most clients that have children in college. Let's tackle the 8867 together by way of this case study.

### THE FACTS

John has been a client of yours for two years. He is married and has two children, ages 18 and 12. You have never met John's wife or children because John comes to his appointments by himself. John decides to mail in his documents this year, and his income appears roughly the same as the last couple years:

Taxable wages	\$ 80,000
Interest and dividends	1,000
Capital gains	18,000
Schedule C (spouse)	<u>5,000</u>
Total income	\$104,000

John represents an average client scenario for you. His income is too high for the EITC, but he has one child young enough to qualify for the CTC and one child that started college this year and is eligible for the AOTC. Among the documents provided to you, John has a Form 1098-T for his older child's college tuition that was billed and paid in 2016, but John says the 1098-T does not reflect an additional \$3,000 of spring 2017 tuition he paid on December 31, 2016, and he provides you a copy of the cancelled check.

### THE FORM

You prepare John's income tax return as you do every year, and when you are finished, your tax software informs you that you need to complete Form 8867 because both the CTC and the AOTC are present on John's return. You look at the form and notice that your software has already answered the questions for you. "Great! That was easy," you think to yourself, until you notice the following sentence in bold at the bottom of page two:

**If you have not complied with all due diligence requirements for all credits claimed, you may have to pay a \$510 penalty for each credit for which you have failed to comply.**

This sentence gives you reason to pause because you are claiming two credits and may be subject to preparer penalties of \$1,020 for not properly filling out a checklist on a return that you charge \$475 to prepare.

So, you start reading the form, and the following questions jump out at you:

<b>Case Study: Questions About Form 8867</b>		
<b>Line</b>	<b>Text</b>	<b>Comments</b>
3	Did you satisfy the knowledge requirement? Answer "Yes" only if you can answer "Yes" to both 3a and 3b.	Okay. Let's look at 3a and 3b.
3a	Did you interview the taxpayer, ask adequate questions, and document the taxpayer's responses to determine that the taxpayer is eligible to claim the credits?	No, you didn't interview the taxpayer. He mailed in his documents. How should you answer the question? Are the questions in your organizer sufficient to meet this requirement?
3b	Did you review adequate information to determine that the taxpayer is eligible to claim the credits and in what amount?	Well, you reviewed the income documents he provided and the 1098-T for AOTC. Is that enough? The instructions provide little guidance.
4	Did any information provided by the taxpayer, a third party, or reasonably known to you in connection with preparing the return appear to be incorrect, incomplete, or inconsistent? (If "Yes," answer questions 4a and 4b.)	Yes, the 1098-T does not match what John paid for his child's college tuition. But John provided evidence to prove the 1098-T is wrong. Do you still have to answer "Yes" that there is inconsistent information? Will that unnecessarily open your client up for audit, even if questions 4a and 4b are answered positively?
4a	Did you make reasonable inquiries to determine the correct or complete information?	Yes? Again, John provided a copy of the cancelled check for the extra tuition.
4b	Did you document your inquiries? (Documentation should include the questions you asked, whom you asked, when you asked, the information that was provided, and the impact the information had on your preparation of the return.)	Document in your notes and keep in client file.
5	In addition to your notes from the interview with the taxpayer, list those documents, if any, that you relied on.	Really? Well, there was the 1098-T and the cancelled check. Why do you have to list each document and why is this taking 30 minutes to get through 5 questions? What about the CTC? You didn't rely on any documents other than John's assertions. Do you need copies of birth certificates and Social Security cards?
11	Did the taxpayer provide substantiation such as a Form 1098-T and receipts for the qualified tuition and related expenses for the claimed AOTC?	Well, you have the 1098-T and the cancelled check from December 31. Do you need copies of all receipts and cancelled checks? The form instructions don't provide any further guidance.



## THE DILEMMA

The IRS is particularly vigilant when it comes to auditing refundable credits, especially the EITC, the ACTC, and the AOTC. As practitioners, we want to head off audit issues for our clients ahead of time. But what about question 4? It appears an answer of "Yes" is the correct answer but will make the client more susceptible to audit. On the other hand, an answer of "No" may subject us to preparer penalties.

For most of us, Form 8867 will be a new tax season annoyance that will affect many of our clients (remember the new Schedule D disclosure requirements a few years ago?) and will be yet another bureaucratic burden on our time that will be difficult to pass along to our clients in the form of higher fees.

Practitioners should take some time before busy season really kicks in to review the 8867 and look for ways to streamline it in their practice, and modify their document requests and document retention policies if they don't currently fall in line with the requirements of the 8867.

## GLOSSARY

**American Opportunity Tax Credit (AOTC):** a credit for qualified education expenses for eligible students for the first four years of higher education. The credit is for up to \$2,500 of the cost of tuition, fees, and course materials paid during the tax year

**Capital asset:** per IRC §1221, "property held by the taxpayer (whether or not connected with his trade or business), but does not include property used in his trade or business that is subject to the allowance for depreciation, or real property used in his trade or business"

**Child Tax Credit:** a credit that is potentially worth up to \$1,000 per qualifying child depending on whether they meet the following criteria: age, relationship, support, dependent, citizenship, and residence

**Closely held corporation:** a corporation in which five or fewer shareholders own more than 50% of the corporation's stock during the last half of the tax year

**CP-2000 notice:** a computer-generated notice informing the recipient that information reported to the IRS by other parties does not match the information on the individual's income tax return

**Deceased spouse's unused exclusion (DSUE):** the amount of the decedent's exclusion that was not needed to protect the first spouse's estate from estate tax

**Due diligence:** the care taken by a reasonable person to avoid harm to himself and others including the research and analysis necessary when preparing for a business transaction

**Earned Income Tax Credit (EITC):** a tax credit for low-income workers depending on the taxpayer's income and whether the taxpayer has one, more than one, or no qualifying children. Not available for married individuals filing separate returns

**e-Services for Business:** an online 24/7 service of the Employment Development Department that allows employers, payroll agents, and tax practitioners to file returns, make payments, and manage payroll tax accounts

**FATCA:** Foreign Account Tax Compliance Act, which requires foreign financial institutions and other nonfinancial foreign entities to report on foreign assets held by U.S. account holders. Under FATCA, a U.S. taxpayer who holds an interest in a specified foreign financial asset is required to attach Form 8938 to their income tax return for each asset if the aggregate value of all the individual's specified foreign financial assets exceeds \$50,000 on the last day of the tax year or \$75,000 at any time during the tax year

**FBAR:** Report of Foreign Bank and Financial Accounts, filed on FinCEN Form 114, used to report an interest in or signature authority over a foreign financial account including, but not limited to, a bank or brokerage account, mutual fund, or trust. The filing due date has been moved from June 30 to April 15 for taxable years beginning after December 31, 2015

**FinCEN:** a bureau of the Department of Treasury – Financial Crimes Enforcement Network – whose mission it is to safeguard the U.S. financial system from "illicit use" and to promote national security through the collection and analysis of financial intelligence

**Get Transcript:** an IRS online service where taxpayers can get transcripts of tax returns, tax accounts, record of accounts, wages and income, and verification of nonfiling letters online or through the mail. Whether a refund or balance is due and how the return was filed affects when a current year transcript is available

**Head of household:** a filing status that provides a lower tax rate and a higher deduction than either the single or married/RDP filing separately status. To qualify, the taxpayer must be unmarried or considered unmarried at the end of the tax year, must have a qualifying child or qualifying relative living with them for more than half of the year, and must pay more than half of the cost of maintaining their home

**IP PIN:** Identity Protection Personal Identification Number used by tax-related identity theft victims who have had their identities verified by the IRS. The IP PIN will prevent the misuse of the taxpayer's Social Security number and help to avoid delays in processing the victim's tax return

**IRC §1031 exchange:** provides an exception to taxation on gain upon the sale of business or investment property, allowing taxpayers to postpone paying taxes if the proceeds of the sale are reinvested in similar property in a qualifying like-kind exchange

**Like-kind exchange:** a transaction or series of transactions that allows for the reciprocal transfer of property without generating a current tax liability when the first asset is sold

**Net investment income tax (NIIT):** a 3.8% Medicare surtax on certain net investment income of individuals, estates, and trusts that have income above a statutory threshold amount. A child's income is included in the parent's computation of NIIT

**Passive income:** earnings from enterprises in which an individual does not materially participate, e.g., rental income, limited partnership income

**Phishing:** a scam to lure in potential victims and prompt them to provide personal and financial information usually with the help of unsolicited e-mails or a fake website

**Private letter ruling (PLR):** a written statement in response to a taxpayer's request for the purpose of interpreting and applying tax laws to the taxpayer's specific set of facts. A PLR does not set precedent and cannot be relied upon by other taxpayers or by IRS personnel

**Qualified terminable interest property trust (QTIP):** a type of trust that takes advantage of the unlimited marital deduction while still controlling the distribution of assets after the death of the surviving spouse. The surviving spouse must be a U.S. citizen at the time the estate tax return is filed

**Refundable tax credit:** reduces tax liability dollar for dollar. A refundable credit is subtracted from the amount of taxes an individual owes after deductions and can reduce tax liability to below zero. If the credit exceeds the amount of taxes due, the difference is refunded to the taxpayer. Refundable credits include, for example, the Earned Income Tax Credit and the Additional Child Tax Credit

**Taxpayer identification number (TIN):** an ID number used by the IRS to administer tax laws. It is issued either by the Social Security Administration (Social Security number) or the IRS (EIN (Employer Identification Number), ITIN (Individual Taxpayer Identification Number), ATIN (Taxpayer Identification Number for Pending U.S. Adoptions), or PTIN (Preparer Taxpayer Identification Number))

## INDEX

**A**

<i>A Better Way</i> .....	36, 40, 45
ACA .....	22, 38, 43, 47
Affordable Care Act.....	22, 38, 43
American Opportunity Tax Credit (AOTC) .....	6, 7, 49-51
Appraisal.....	17

**B**

Bad debt.....	16, 17
Bernie Madoff Ponzi scheme .....	21

**C**

California conformity .....	4, 13, 45
California Form 3840 .....	26
California LLCs .....	29
California partial conformity.....	3, 19
Child Tax Credit (CTC).....	6, 7, 41, 47-50

**D**

<i>De minimis</i> .....	4
Death taxes.....	40
Disaster losses.....	18, 20, 42
Due dates for business returns.....	1
Due diligence requirements .....	7

**E**

Earned Income Tax Credit (EITC).....	6, 7, 39, 43, 47-51
E-mail schemes.....	30

**F**

FATCA .....	11
Foreign asset disclosure.....	11
Foreign bank and financial accounts .....	10
Form 8867 .....	7- 9, 49-51
Form 8938 .....	11-13

**H**

HRA.....	23
----------	----

**I**

Identifiable event.....	15, 16
Identity theft.....	31

**N**

Net operating losses .....	45
----------------------------	----

**P**

Passive income.....	12
PATH Act .....	3, 6, 7
Payroll taxes .....	26, 29, 39
Postcard .....	41, 44
President Trump.....	36, 38

**Q**

QTIP elections .....	20, 21
----------------------	--------

**R**

Rebates .....	14
---------------	----

**S**

Sears.....	14
------------	----

**W**

Workers' compensation.....	13
----------------------------	----

Get the most practical CPE without leaving your office.

## 2017 Capitalization and Repair Regulations

Presented by: *Mark Seid, CPA, EA, USTCP*

Friday, February 3 — 10:00 a.m. to Noon Pacific Time  
— Or order on-demand and watch anytime —

### With this two-hour webinar, you will:

- Get detailed info on repair regulations elections and how to make them
- Use the IRS audit technique guide to understand repair regulations
- Compare the advantages and disadvantages of using the simplified method
- Take advantage of repair regulations to reduce client tax bills
- Simplify your work with a Tangible Property Flowchart
- Uncover Rev. Proc. 2015-20: the “do nothing” approach
- Get a sample capitalization policy
- See when you might file a “protective” Form 3115
- Learn about betterments, restorations, and rotatable parts



**\$97 Webinar — Add CPE for only \$19 per additional attendee**

**You must have computer speakers to listen to this webinar**

### About the presenter:



#### Mark Seid, CPA, EA, USTCP

After graduating from Cal Poly — San Luis Obispo, Mark accepted employment with the Internal Revenue Service as a field agent in the San Jose District headquarters office. After a few years, he moved to the San Luis Obispo post of duty where he completed the full training for general program Revenue Agents. He founded the firm in Paso Robles in 1996 dedicated to serving clients with the knowledge he had obtained spending nearly 10 years at the IRS. In 2000 he passed the examination for non-attorneys to practice before the U.S. Tax Court, a distinction earned by fewer than 300 individuals nationwide. He is uniquely qualified to represent our clients before the various taxing authorities due to his experience and knowledge. He is a member of the National Association of Enrolled Agents, California Society of Enrolled Agents and California Society of Certified Public Accountants.



Spidell Publishing, Inc. is registered with the National Association of State Boards of Accountancy (NASBA) as a sponsor of continuing professional education on the National Registry of CPE Sponsors. State boards of accountancy have final authority on the acceptance of individual courses for CPE credit. Complaints regarding registered sponsors may be submitted to the National Registry of CPE Sponsors through its website: [www.learningmarket.org](http://www.learningmarket.org). This course is designed to meet the requirements for 2 hours of continuing education for the California Board of Accountancy. Level: Basic. Field of Study: Taxation. Delivery method: Group Internet-Based and Self-Study. For more information regarding administrative policies, such as complaints or refunds, contact Spidell Publishing at (714) 776-7850. There are no prerequisites or advanced preparation required.

**SPIDELL PUBLISHING, INC.<sup>®</sup>**

P.O. Box 61044 • Anaheim, CA 92803-6144 • E-mail: [webinars@spidell.com](mailto:webinars@spidell.com)

Phone: (714) 776-7850 • Fax: (714) 776-9906 • website: [caltax.com](http://caltax.com)

# 2017 Capitalization and Repair Regulations

Presented by: *Mark Seid, CPA, EA, USTCP*

Friday, February 3 — 10:00 a.m. to Noon Pacific Time

— Or order on-demand and watch anytime —

**\$97 webinar includes:**

- CPE for one attendee: 2 hours for CPAs, 2 federal tax hours for EAs and CRTPs (CTEC), and 1.5 General MCLE for attorneys
- Reference manual and PDF of PowerPoint slides
- Add CPE for only \$19 per additional attendee (Must complete exam for credit)

**Additional CPE Cost: \$19 per attendee**

This webinar is designed to meet the requirements for the specified number of hours of continuing education. This self-study has been designed to meet the requirements of the IRS Return Preparer Office; including sections 10.6 and 10.9 of Department of Treasury's Circular No. 230 (Provider No. CRA7E); the California State Board of Accountancy; the California Bar Association; and the California Tax Education Council. This does not constitute an endorsement by these groups. The state boards of accountancy have final authority on the acceptance of individual courses for CPE credit. For more information regarding administrative policies such as complaints or refunds, contact Spidell Publishing at 714-776-7850. There are no prerequisites required. Spidell Publishing, Inc. has been approved by the California Tax Education Council to offer continuing education courses that count as credit towards the annual "continuing education" requirement imposed by the State of California for CTEC Registered Tax Preparers. A listing of additional requirements to renew tax preparer registration may be obtained by contacting CTEC at P.O. Box 2890, Sacramento, CA 95812-2890, or by phone at 877-850-2832, or on the internet at www.CTEC.org.



Fill out and fax to (714) 776-9906 today!

## 2017 Capitalization and Repair Regulations

**2017 Capitalization and Repair Regulations ... \$97.00\***

- Live:** Friday, February 3 — 10:00 a.m. to Noon Pacific Time\*
- On-Demand:** Watch anytime! (Available February 10, 2017)

- Payment enclosed. Check # \_\_\_\_\_
- Charge my:  MC  Visa  AmEx  Discover

Card Number \_\_\_\_\_

Billing ZIP \_\_\_\_\_ Exp. Date \_\_\_\_\_ Security Code \_\_\_\_\_

Signature \_\_\_\_\_

\*No refunds will be given after noon on February 2, 2017.

CPE @ \$19 per additional attendee per webinar QTY: \_\_\_\_\_  
This course qualifies for up to 2 hours of CPE for one attendee.

**TOTAL \$** \_\_\_\_\_

Name \_\_\_\_\_

Company Name \_\_\_\_\_

Address \_\_\_\_\_

City/State/ZIP \_\_\_\_\_

Phone \_\_\_\_\_ Fax \_\_\_\_\_

E-mail \_\_\_\_\_

We need your professional license/registration number(s) for continuing education credit.

CPA No.	PTIN	
EA No.	CRTP (CTEC) No.	Bar No.

**source code: WEB17**

**Additional Attendee CPE Information:**

Name	E-mail address	License/Registration number
Register by fax (714) 776-9906 or phone (714) 776-7850	Register by mail P.O. Box 61044 • Anaheim, CA • 92803-6144	Register online www.caltax.com

Get the most practical CPE without leaving your office.

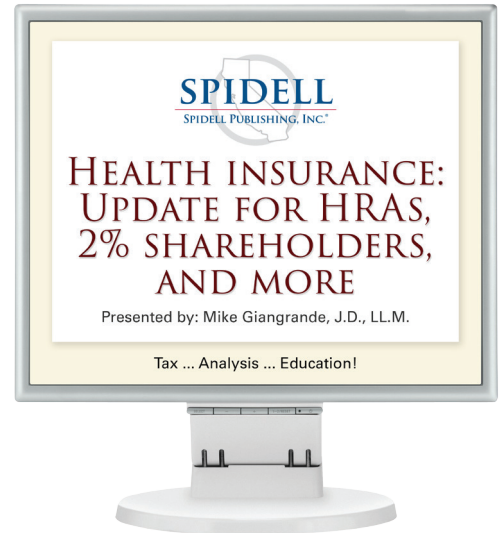
## Health insurance: Update for HRAs, 2% shareholders, and more

Presented by: *Mike Giangrande, J.D., LL.M.*

Friday, February 17 — Noon to 1:00 p.m. Pacific Time  
— Or order on-demand and watch anytime —

### With this one-hour webinar, you will:

- Learn the revised rules and limits for HRA plans
- Understand what an HRA can and can't reimburse
- See who can and who can't participate in an HRA plan
- See how to deduct health insurance for S corporation shareholders
- Compare benefits for employees, shareholders, partners, and members
- Use an employee benefit comparison chart to explain the rules to your clients
- Help your clients pick their Medicare plan



**\$59 Webinar — Add CPE for only \$19 per additional attendee**  
**You must have computer speakers to listen to this webinar**

### About the presenter:



#### **Mike Giangrande, J.D., LL.M.**

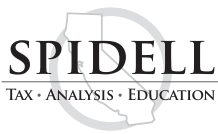
Mike Giangrande is a California licensed attorney, and has been a tax practitioner for over 15 years. He is licensed to practice before the United States Tax Court, has a B.S. in Accounting and an LL.M. (Tax) from Chapman University, and has a J.D. from Whittier Law School with a certificate of concentration in business law. Mike has spent time as an adjunct professor of law at Whittier Law School teaching various tax courses, he currently serves as a member of the Orange County Assessment Appeals Board, and he serves on the board of directors for two charitable organizations.



Spidell Publishing, Inc. is registered with the National Association of State Boards of Accountancy (NASBA) as a sponsor of continuing professional education on the National Registry of CPE Sponsors. State boards of accountancy have final authority on the acceptance of individual courses for CPE credit. Complaints regarding registered sponsors may be submitted to the National Registry of CPE Sponsors through its website: [www.learningmarket.org](http://www.learningmarket.org). This webinar is designed to meet the requirements for 1 hour of continuing education for the California Board of Accountancy. Level: Basic. Field of Study: Taxes. Delivery method: Group Internet-Based and Self-Study. For more information regarding administrative policies, such as complaints or refunds, contact Spidell Publishing at (714) 776-7850. There are no prerequisites or advanced preparation required.

**SPIDELL PUBLISHING, INC.®**

P.O. Box 61044 • Anaheim, CA 92803-6144 • E-mail: [webinars@spidell.com](mailto:webinars@spidell.com)  
Phone: (714) 776-7850 • Fax: (714) 776-9906 • website: [caltax.com](http://caltax.com)



# Health insurance: Update for HRAs, 2% shareholders, and more

Presented by: *Mike Giangrande, J.D., LL.M.*

Friday, February 17 — Noon to 1:00 p.m. Pacific Time  
— Or order on-demand and watch anytime —

## \$59 webinar includes:

- CPE for one attendee: 1 hour for CPAs, 1 federal update hour for EAs and CRTPs (CTEC), and .75 General MCLE for attorneys
- Reference manual and PDF of PowerPoint slides
- Add CPE for only \$19 per additional attendee (Must complete exam for credit)

### Additional CPE Cost: \$19 per attendee



This webinar is designed to meet the requirements for the specified number of hours of continuing education. This webinar has been designed to meet the requirements of the IRS Return Preparer Office; including sections 10.6 and 10.9 of Department of Treasury's Circular No. 230 (Provider No. CRA7E); the California State Board of Accountancy; the California Bar Association; and the California Tax Education Council. This does not constitute an endorsement by these groups. The state boards of accountancy have final authority on the acceptance of individual courses for CPE credit. For more information regarding administrative policies such as complaints or refunds, contact Spidell Publishing at 714-776-7850. There are no prerequisites required. A listing of additional requirements to renew tax preparer registration may be obtained by contacting CTEC at P.O. Box 2890, Sacramento, CA 95812-2890, or by phone at 877-850-2832, or on the internet at www.CTEC.org.



Fill out and fax to (714) 776-9906 today!



## Health insurance: Update for HRAs, 2% shareholders, and more

### Health insurance: Update for HRAs, 2% shareholders, and more ... \$59.00

- Live:** Fri., February 17 — Noon to 1:00 p.m. Pacific Time\*
- On-Demand:** Watch anytime! (Available by February 24, 2017)

Check # \_\_\_\_\_

Charge my:  MC  Visa  AmEx  Discover

Card Number \_\_\_\_\_

Billing ZIP \_\_\_\_\_ Exp. Date \_\_\_\_\_ Security Code \_\_\_\_\_

Signature \_\_\_\_\_

\*No refunds will be given after noon on February 16, 2017.

CPE @ \$19 per additional attendee per webinar QTY: \_\_\_\_\_

This course qualifies for up to 1 hour of CPE for one attendee.

TOTAL \$ \_\_\_\_\_

Name \_\_\_\_\_

Company Name \_\_\_\_\_

Address \_\_\_\_\_

City/State/ZIP \_\_\_\_\_

Phone \_\_\_\_\_ Fax \_\_\_\_\_

E-mail \_\_\_\_\_

We need your professional license/registration number(s) for continuing education credit.		
CPA No.	PTIN.	
EA No.	CRTP (CTEC) No.	Bar No.

source code: WEB16

### Additional Attendee CPE Information:

Name	E-mail address	License/Registration number
Register by fax (714) 776-9906 or phone (714) 776-7850	Register by mail P.O. Box 61044 • Anaheim, CA • 92803-6144	Register online www.caltax.com



Get the most practical CPE without leaving your office.

## FBAR: Filing Issues and Asking for Forgiveness

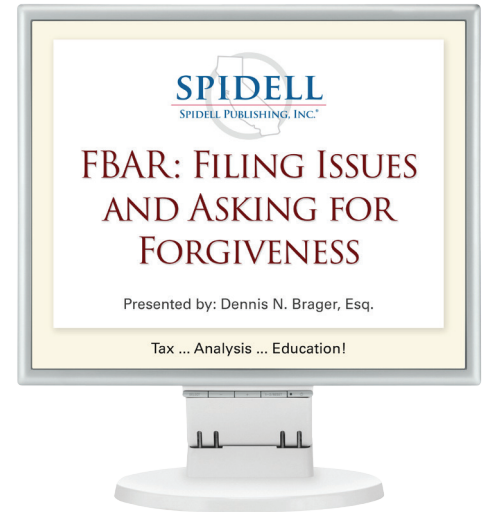
Presented by: *Dennis N. Brager, Esq.*

Friday, March 17 — 10:00 a.m. to Noon Pacific Time

— Or order on-demand and watch anytime —

### With this two-hour webinar, you will:

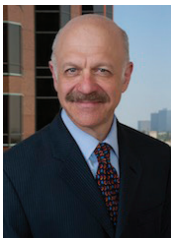
- Find out about the big due date changes that might make filing FBARs easier in your office
- See why you *still* shouldn't let your clients ignore the FBAR problem, even though we've talked about it for years
- Know how your clients can make voluntary disclosures when they want to come clean
- Understand when your clients will qualify for a streamlined voluntary compliance if they haven't been reporting
- Know what other forms you should be worried about that affect foreign transactions and accounts
- Define a "PFIC," and know why you should be wary of the rules even if you're filing FBARs for your clients



**\$97 Webinar — Add CPE for only \$19 per additional attendee**

**You must have computer speakers to listen to this webinar**

### About the presenter:



#### **Dennis N. Brager, Esq.**

Dennis Brager is a California State Bar Certified Tax Specialist and a former Senior Trial Attorney for the Internal Revenue Service's Office of Chief Counsel. In addition to representing the IRS in court, he advised the Service on complex civil and criminal tax issues.

Mr. Brager received his undergraduate degree from Pace University (B.B.A., magna cum laude, 1975, Accounting/ Finance) and his law degree from New York University (J.D., 1978). He is a former chair of both the Tax Compliance, Procedure, and Litigation Committee of the Los Angeles County Bar Association, and the California State Bar, Tax Procedure, and Litigation Committee. He is admitted to practice before the U.S. Supreme Court, the Ninth Circuit Court of Appeals, U.S. Claims Court, U.S. Tax Court, U.S. District Court, and the U.S. Bankruptcy Court.



Spidell Publishing, Inc. is registered with the National Association of State Boards of Accountancy (NASBA) as a sponsor of continuing professional education on the National Registry of CPE Sponsors. State boards of accountancy have final authority on the acceptance of individual courses for CPE credit. Complaints regarding registered sponsors may be submitted to the National Registry of CPE Sponsors through its website: [www.learningmarket.org](http://www.learningmarket.org). This course is designed to meet the requirements for 2 hours of continuing education for the California Board of Accountancy. Level: Basic. Field of Study: Taxation. Delivery method: Group Internet-Based and Self-Study. For more information regarding administrative policies, such as complaints or refunds, contact Spidell Publishing at (714) 776-7850. There are no prerequisites or advanced preparation required.

**SPIDELL PUBLISHING, INC.<sup>®</sup>**

P.O. Box 61044 • Anaheim, CA 92803-6144 • E-mail: [webinars@spidell.com](mailto:webinars@spidell.com)

Phone: (714) 776-7850 • Fax: (714) 776-9906 • website: [caltax.com](http://caltax.com)

# FBAR: Filing Issues and Asking for Forgiveness

Presented by: *Dennis N. Brager, Esq.*

Friday, March 17 — 10:00 a.m. to Noon Pacific Time

— Or order on-demand and watch anytime —

**\$97 webinar includes:**

- CPE for one attendee: 2 hours for CPAs, 2 federal tax hours for EAs and CRTPs (CTEC), and 1.5 General MCLE for attorneys
- Reference manual and PDF of PowerPoint slides
- Add CPE for only \$19 per additional attendee (Must complete exam for credit)

**Additional CPE Cost: \$19 per attendee**

This webinar is designed to meet the requirements for the specified number of hours of continuing education. This self-study has been designed to meet the requirements of the IRS Return Preparer Office; including sections 10.6 and 10.9 of Department of Treasury's Circular No. 230 (Provider No. CRA7E); the California State Board of Accountancy; the California Bar Association; and the California Tax Education Council. This does not constitute an endorsement by these groups. The state boards of accountancy have final authority on the acceptance of individual courses for CPE credit. For more information regarding administrative policies such as complaints or refunds, contact Spidell Publishing at 714-776-7850. There are no prerequisites required. Spidell Publishing, Inc. has been approved by the California Tax Education Council to offer continuing education courses that count as credit towards the annual "continuing education" requirement imposed by the State of California for CTEC Registered Tax Preparers. A listing of additional requirements to renew tax preparer registration may be obtained by contacting CTEC at P.O. Box 2890, Sacramento, CA 95812-2890, or by phone at 877-850-2832, or on the internet at www.CTEC.org.



Fill out and fax to (714) 776-9906 today!

## FBAR: Filing Issues and Asking for Forgiveness

**FBAR: Filing Issues and Asking for Forgiveness ...**  
**\$97.00\***

- Live:** Friday, March 17 — 10:00 a.m. to Noon Pacific Time\*
- On-Demand:** Watch anytime! (Available March 24, 2017)
- Payment enclosed. Check # \_\_\_\_\_
- Charge my:  MC  Visa  AmEx  Discover

**CPE @ \$19** per additional attendee per webinar **QTY:** \_\_\_\_\_  
This course qualifies for up to 2 hours of CPE for one attendee.

**TOTAL \$** \_\_\_\_\_

Card Number \_\_\_\_\_

Billing ZIP \_\_\_\_\_ Exp. Date \_\_\_\_\_ Security Code \_\_\_\_\_

Signature \_\_\_\_\_

Name \_\_\_\_\_

Company Name \_\_\_\_\_

Address \_\_\_\_\_

City/State/ZIP \_\_\_\_\_

Phone \_\_\_\_\_ Fax \_\_\_\_\_

E-mail \_\_\_\_\_

\*No refunds will be given after noon on March 16, 2017.

We need your professional license/registration number(s) for continuing education credit.

CPA No.	PTIN	
EA No.	CRTP (CTEC) No.	Bar No.

**source code: WEB16**

Additional Attendee CPE Information:		
Name	E-mail address	License/Registration number
Register by fax (714) 776-9906 or phone (714) 776-7850	Register by mail P.O. Box 61044 • Anaheim, CA • 92803-6144	Register online www.caltax.com