Current Federal Tax Developments

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SECTION: APPEALS
IRS ANNOUNCES FAST TRACK MEDIATION COLLECTION PROGRAM, REPLACING PRIOR COLLECTIONS MEDIATION PROGRAM

Citation: Revenue Procedure 2016-57, 11/18/16

In Revenue Procedure 2016-57 the IRS has announced a new fast-track mediation program for small businesses and self-employed individuals, replacing the Small Business/Self-Employed Division Appeals FTM program found in Revenue Procedure 2003-41). The new program, the SB/SE fast-track mediation collection program (FTMC), replaces the old FTM program.

As the IRS explains:

> …[T]he IRS is replacing FTM with FTMC. Taxpayer requests for FTM have been infrequent throughout the life of the program, and became increasingly so after Fast Track Settlement (FTS) was implemented nationwide. See Ann. 2011-5, 2011-4 IRB 430 and I.R.S. News Release IR-2013-88 (November 6, 2013). FTS, however, is only available to taxpayers in Examination and does not provide an expedited Appeals alternative dispute resolution opportunity for taxpayers in Collection. Rather than eliminate FTM, the IRS determined that it would replace FTM with FTMC, which will ensure that taxpayers in Collection continue to be afforded an early opportunity for expedited resolution of their cases via mediation, but limited to certain OIC and TFRP issues and cases worked by Collection, as described in section 3 of this revenue procedure. Other alternative dispute resolution programs, such as FTS, remain available to taxpayers whose cases are being worked in Examination. Similar to FTM, FTMC allows taxpayers the opportunity to resolve certain case and issue disputes on an expedited basis with an Appeals mediator acting as a neutral party. Moreover, the Appeals mediator in FTMC, as in FTM, does not have settlement authority and cannot render a decision regarding any issue in dispute.

The program is meant to solve particular disputed issues where the taxpayer and the IRS have resolved all other outstanding issues. As the procedure notes:

> FTMC may be used only when all other collection issues are resolved but for the issue(s) for which FTMC is being requested. The issue(s) to be mediated must be fully developed with clearly defined positions by both parties so the unagreed issues can be resolved quickly (usually within 30 or 40 calendar days). Participation in FTMC is optional for both Collection and the taxpayer.

Since is mediation, the Appeals mediator has no authority at this point to force a settlement—rather the goal is to get the parties to each consent to an agreement by using the Appeals mediator to assist the parties at arriving at such an agreement.

The procedure notes that the following issues are generally appropriate for the use of FMTC:

> (1) Legal and factual issues;
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> (2) The following OIC cases or issues, provided all relevant facts are known by both parties:
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> > a. The value of a taxpayer's assets, including those held by a third party;
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> > b. The amount of dissipated assets that should be included in the overall determination of reasonable collection potential (RCP) (as described in IRM 5.8.5, Financial Analysis);
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> > c. Whether the taxpayer meets the criteria for deviating from national and/or local expense standards;
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> > d. Determination of a taxpayer's proportionate interest in jointly held assets;
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> > e. Projections of future income based on calculations other than current income;
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> > f. The calculation of a taxpayer's future ability to pay when living expenses are shared with a non-liable person;

g. Doubt as to liability cases worked by Collection; and

h. Other factual determinations, such as whether a taxpayer's contributions into a retirement savings account are discretionary or mandatory as a condition of employment;

(3) The following TFRP cases or issues, provided all relevant facts are known by both parties:

a. Whether a person was required to collect, truthfully account for, and pay over income, employment or excise taxes;

b. Whether a responsible person willfully failed to collect, truthfully account for, and pay over such tax, or willfully attempted in any manner to evade or defeat payment of such tax;

c. Whether a taxpayer properly designated a payment to the trust fund portion of the unpaid tax; and

d. Whether the taxpayer provided sufficient corporate payroll records to establish that a corporate tax deposit was in the amount required by Treas. Reg. § 31.6302-1(c) and thus was considered a designated payment to be applied to both the trust fund and non-trust fund portions of the employment taxes associated with that specific payroll.

FMTC is not deemed appropriate for the following issues:

(1) Issues requiring assessment of the hazards of litigation or use of the Appeals mediator's delegated settlement authority;

(2) Cases referred to the Department of Justice;

(3) Cases worked at an SB/SE Campus site;

(4) Collection Appeals Program (CAP) cases;

(5) Collection Due Process (CDP) cases;

(6) Frivolous issues, such as, but not limited to, those identified in Rev. Proc. 2016-2 § 4.04, 2016-1 I.R.B. 102, or any succeeding revenue procedure;

(7) Collection cases in which the taxpayer has failed to respond to IRS communications or failed to submit documentation to Collection for consideration;

(8) The following OIC cases:

a. Cases in which the unadjusted financial information submitted by the taxpayer demonstrates the taxpayer has the ability to pay in full, except where an Effective Tax Administration OIC is based on economic hardship and the assessed liability is less than $250,000. See Delegation Order 5-1, To Accept, Reject, Return, Terminate or Acknowledge Withdrawals of Offers in Compromise;

b. Cases in which the taxpayer declines to amend or increase the offer despite having no specific disagreement with the valuations, figures, or methodology used by Collection in determining RCP;

c. Cases in which the disputed issue is explicitly addressed by IRS guidance or authority, including but not limited to regulations, published guidance, the Internal Revenue Manual, forms or instructions. For example, the Form 656 Offer in Compromise Booklet explicitly states that the IRS will not consider expenses for tuition for private schools, college expenses, charitable contributions, and other unsecured debt payments as part of the OIC expense calculation. Therefore, FTMC is not available with respect to whether any of these expenses will be considered in evaluating the taxpayer's offer; and

d. Cases in which Delegation Order 5-1 requires a level of approval higher than that of the Collection Group Manager;

(9) Issues for which mediation would be inconsistent with sound tax administration; and

(10) Issues that have otherwise been identified in subsequent published guidance issued by the IRS as excluded from FTMC.

The procedure provides that FMTC should be requested after an issue has been fully developed but before Collections has made a final determination on the issue.

The ruling provides the following on how to request FMTC:

(1) Signed Form 13369. To request FTMC, a Form 13369 must be signed by both the Collection Group Manager and the taxpayer, or the taxpayer's authorized representative, if applicable. If the Form 13369 is signed by a person pursuant to a power of attorney (Form 2848, Power of Attorney and Declaration of Representative), the power of attorney executed by the taxpayer must be attached to the Form 13369.

(2) Completing the FTMC request. A FTMC request includes the following:

a. One Form 13369 for all OIC or TFRP issues in a taxpayer's case that are being submitted for FTMC, signed by both parties.

b. The taxpayer's written summary of his or her position with respect to the disputed issues. This summary is not treated as a formal protest, and a formal protest is not required.

c. Collection's written summary of its position with respect to the disputed issues, as well as a full RCP computation for an OIC case, which will generally consist of the Income/Expense and Asset/Equity Tables (IET and AET), or a full trust fund computation in a TFRP case.

The Appeals Team Manager will review the request and decide to approve or decline the request for FTMC. If approved, the Appeals Team Manager will select the mediator from Appeals employees who have been trained in mediation. The taxpayer will not be able to select the mediator in this process.

Section 6 of the Revenue Procedure outlines the procedures for the mediation sessions. Both sides must have at least one person at each session that has decision making authority for the party.

Either party can withdraw from the mediation process at any time prior to a settlement being reached.

The general prohibition with regard to *ex parte* communications between Appeals employees and other employees found in Section 1001(a) of the Internal Revenue Restructuring and Reform Act of 1998 does not apply in this case. However, communications with the Appeals mediator initiated by either party outside the mediation session are prohibited. As the Revenue Procedure provides:

> The prohibition prevents the Appeals mediator from receiving information or evidence from one party that the other party is unaware of and is unable to respond to or rebut. This provision does not prevent the Appeals mediator from contacting a party outside the mediation session, or a party from answering a question or request posed by the Appeals mediator outside the mediation session. Upon receiving information from one party, the Appeals mediator must make the information available to the other party so that no party is unaware of or unable to respond to or rebut the information.

Section 7 outlines post-session procedures for both those cases that are resolved and those that are not. If no settlement is reached, the taxpayer retains his/her right to request a regular Appeals hearing using the traditional Appeals process.

Mediation sessions may not be recorded by either party and any settlement reached through FMTC will not be binding on either party for years or issues not covered by the agreement. As well, unless provided for in the agreement, neither party may use the settlement as precedent.

Revenue Procedure 2003-41 is obsoleted by this procedure. The procedure is effective November 18, 2016.

SECTION: ENFORCEMENT
DEPARTMENT OF JUSTICE REQUESTS LIST OF ALL USERS OF BITCOIN EXCHANGE, CITING POTENTIAL FOR TAX EVASION

Citation: In the Matter of the Tax Liabilities of John Does; No. 3:16-cv-06658, USDC Northern California, 11/17/16

The Department of Justice has filed in the United States District for the Northern District of California for a "John Doe" summons to be issued to Coinbase, Inc. for a list of all United States persons who conducted transactions in a "convertible virtual currency" between January 1, 2013 and December 31, 2015 (In the Matter of the Tax Liabilities of John Does; No. 3:16-cv-06658, USDC Northern California). The key "convertible virtual currency" in question in this matter is Bitcoin.

Coinbase, Inc. is the largest Bitcoin exchange in the United States. An exchange allows holders of Bitcoin to convert their virtual currency into traditional currency, in this case primarily U.S. dollars.

In the memorandum filed in support of the John Doe summons the government writes:

> Since 2009, the use of virtual currency has increased exponentially. Some users value the relatively high degree of anonymity associated with virtual currency transactions because only a transaction in virtual currency, such as buying goods or services, is public and not the identities of the parties to the transaction. Because of that, virtual currency transactions are subject to fewer third-party reporting requirements than transactions in conventional forms of payment. However, due to this anonymity and lack of third-party reporting, the IRS is concerned that U.S. taxpayers are underreporting taxable income from transactions in virtual currencies. Further, because the IRS considers virtual currencies to be property, United States taxpayers can realize a taxable gain from buying, selling, or trading in virtual currencies. There is a likelihood that United States taxpayers are failing to properly determine and report any taxable gain from such transactions.

The memo goes on to describe Coinbase, Inc., the party to whom this summons would be issued:

> As of December 2015, Coinbase has four main products: (1) an exchange for trading bitcoin and fiat currency (fiat currency is legal tender that is backed by the government that issued it); (2) a wallet for bitcoin storage and transactions; (3) an application programming interface (API) for developers and merchants to build applications and accept bitcoin payments; and (4) "Shift Card," the first U.S.-issued bitcoin debit card. Id. at ¶ 42. The Shift Card is a VISA branded debit card that enables Coinbase users in the United States (that reside in one of twenty-four states and Washington, D.C.) to spend bitcoin anywhere VISA is accepted. *Id.*

The government is looking to be granted this summons under "John Doe" summons authority granted to the government under IRC §7609(f) which provides:

> Any summons . . . which does not identify the person with respect to whose liability the summons is issued may be served only after a court proceeding in which the Secretary establishes that --
>
> > (1) the summons relates to the investigation of a particular person or ascertainable group or class of persons,
> >
> > (2) there is a reasonable basis for believing that such person or group or class of persons may fail or may have failed to comply with any provision of any internal revenue law, and
> >
> > (3) the information sought to be obtained from the examination of the records or testimony (and the identity of the person or persons with respect to whose liability the summons is issued) is not readily available from other sources.

The key question will likely be the extent to which the IRS has limited the summons request to an "ascertainable class" under this provision. The request would have the agency receiving a list of all individuals who had entered

into Bitcoin transactions with Coinbase, Inc. The IRS position in support of the summons involves two cases involving Coinbase customers with millions of dollars in revenue.

CNET reported on November 21, 2016 that Coinbase, Inc. is likely to challenge this request (*Coinbase Fights IRS Efforts to Obtain Customer Records*, CNET, November 21, 2016). The article provides the following statement from Coinbase, Inc.:

> "Although Coinbase's general practice is to cooperate with properly targeted law enforcement inquiries, we are extremely concerned with the indiscriminate breadth of the government's request," the company said in a statement. "Our customers' privacy rights are important to us and our legal team is in the process of examining the government's petition."

SECTION: 965
TAX COURT, REVERSING PRIOR POSITION, DECIDES THAT RECEIVABLES CREATED AS PART OF TRANSFER PRICING CLOSING AGREEMENT IS NOT DEBT FOR §965 PURPOSES

Citation: Analog Devices Inc., et al, v. Commissioner, 147 TC No. 15, 11/22/16

A divided Tax Court has overruled its previous decision in the *BMC Software, Inc. v. Commissioner*, 141 TC No. 5, a case that was overturned on appeal by the Fifth Circuit, and found that accounts receivable established in a Revenue Procedure 99-32 closing agreement didn't create related party indebtedness in the case of *Analog Devices Inc., et al, v. Commissioner*, 147 TC No. 15. The Court therefore allowed the company's entire dividends received deduction under IRC §965.

The issue at hand was the impact of IRC §965(b)(3) on the entity's ability to claim a deduction for dividends received from a Controlled Foreign Corporation (CFC). As the Court explained:

> Although section 965 imposes several limitations on the availability and the amount of the DRD, this case concerns only the limitation provided by section 965(b)(3). Section 965(b)(3) reduces the amount of the eligible dividend by any increase in the amount of indebtedness of the CFC to any related party during the testing period (related party indebtedness). The testing period is generally the period between October 3, 2004, and the close of the taxable year for which the taxpayer makes the election. Sec. 965(b)(3)(A) and (B).

The issue at hand deals with the case where the IRS has required the taxpayer to book an adjustment under §482 for income from a related entity. In this case the IRS required the U.S. parent to report additional income and its CFC subsidiary to report less income. The issue becomes booking that adjustment, and the regulations allow for a choice of adjustments.

As the Court continues:

> Where, as here, a U.S. parent corporation's income has been increased and its CFC's income has been decreased as a result of a transfer pricing adjustment, the methods include: treating the allocated amount as a deemed dividend from the CFC to the U.S. parent; or "in appropriate cases, pursuant to such applicable revenue procedures as may be provided by the Commissioner * * * repayment of the allocated amount without further income tax consequences." Id.
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> The Commissioner promulgated Rev. Proc. 99-32, supra, pursuant to the above-quoted regulation. Rev. Proc. 99-32, supra, permits qualifying U.S. taxpayers to make secondary adjustments by establishing an interest-bearing account receivable from, or payable to, its CFC in the amount of the primary transfer pricing adjustment in lieu of treating the adjustment as a deemed dividend or a capital contribution. Rev. Proc. 99-32, secs. 1, 4.01, 1999-2 C.B. at 297, 299.

The Revenue Procedure describes the impact of making this election (which the taxpayer did make in this case):

> Rev. Proc. 99-32, sec. 4.01, describes the features of an account established under these procedures. The account may be established and paid "without the Federal income tax consequences of the

> secondary adjustments that would otherwise result from the primary adjustment." The account is deemed to have been created as of the last day of the taxable year for which the primary adjustment was made. It bears interest computed pursuant to section 1.482-2(a)(2), Income Tax Regs., from the day after the deemed establishment date. For purposes of section 1.482-2(a)(2)(iii), Income Tax Regs., dealing with safe haven interest rates, the account "shall be considered to be a loan or advance having a term extending from the day after the date the account is deemed to have been created through the expiration of" 90 days after execution of the closing agreement on behalf of the Commissioner. Rev. Proc. 99-32, secs. 4.01(2), 5.01(4)(e).
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> Rev. Proc. 99-32, sec. 4.03, clarifies that electing treatment under that revenue procedure does not affect the primary adjustment but affects the taxpayer's taxable income and credits to the extent indicated in Rev. Proc. 99-32, sec. 4.01.19 Rev. Proc. 99-32, sec. 4.03, further states that the election eliminates "the collateral effects of secondary adjustments, such as those described in section 2 [regarding deemed dividend treatment]."

While the IRS has not issued any statutory or regulatory guidance on how the election under Rev. Proc. 99-32 impacts the debt calculation under IRC §965, the IRS issued three notices in 2005 holding that the receivable established under a closing agreement and Rev. Proc. 99-32 election is debt for purposes of IRC §965 and, therefore, could result in a reduction of an otherwise allowable dividend exclusion for dividends received from a CFC.

Originally the Tax Court had agreed with the IRS that the establishment of this account receivable in prior years, and therefore sustained a downward adjustment in the amount of dividends that could be excluded. But on appeal, the Fifth Circuit Court of Appeals overturned the result (*BMC Software, Inc. v. Commissioner* (CA5), 780 F.3d at 674-675).

The Tax Court summarized the Fifth Circuit's ruling as follows:

> The Court concluded that: (1) because section 965(b)(3) provides that the final calculation of the amount of related party indebtedness is to be made "as of the close of the taxable year for which the election * * * is in effect" and (2) because BMC's accounts receivable did not exist until the parties executed the closing agreement in 2007, the accounts receivable were not related party indebtedness under section 965(b)(3). See id. at 675. Moreover, the Court of Appeals stated that "[t]he fact that the accounts receivable * * * [were] backdated does nothing to alter the reality that they did not exist during the testing period" because the accounts were secondary adjustments to correct cash account imbalances and not a correction of a prior year's accounts.

In this case the matter returned to the Tax Court—but an appeal in this case would go to the First Circuit and not the Fifth, so the Tax Court was not bound by the *Golsen* rule to respect the Fifth Circuit's decision. But the Court did reconsider its original decision, with a majority of the judges now deciding to reverse the Court's prior position outlined in a published decision—a decision the Court would normally respect under the doctrine of *stare decisis*.

The majority opinion notes:

> This case presents issues on which a Court of Appeals has reversed our prior decision. In such a scenario, "[c]learly * * * [we] must thoroughly reconsider the problem in the light of the reasoning of the reversing appellate court and, if convinced thereby, the obvious procedure is to follow the higher court." *Bayer v. Commissioner*, 98 T.C. 19, 22 (1992) (quoting *Lawrence v. Commissioner*, 27 T.C. 713, 716-717 (1957), *rev'd* on other grounds, 258 F.2d 562 (9th Cir. 1958)); see also *Trout v. Commissioner*, 131 T.C. 239, 245 n.6 (2008) ("But nothing in *Golsen* or in *Lawrence* precludes us from revisiting an issue, as we do here, when the issue on which there has been an intervening reversal arises anew."). By revisiting the issues in *BMC Software I*, we are not capriciously disregarding our prior analysis but rather examining the issues in the light of a Court of Appeals' opinion, which deserves careful attention and reflection.

So the majority concludes, in deciding to revisit the matter:

> On balance, we conclude that the importance of reaching the right result in this case outweighs the importance of following our precedent. But cf. *Burnet v. Coronado Oil & Gas Co.,* 285 U.S. at 406 (Brandeis, J., dissenting) ("[I]n most matters it is more important that the applicable rule of law be settled than that it be settled right."). We therefore conclude that stare decisis does not prevent us from reconsidering *BMC Software I*, and we do so below.

First, the majority found that the parties had not resolved the treatment of IRC §965 in the closing agreement, noting:

> Because the parties enumerated in considerable detail the tax consequences of the closing agreement, we find that these specific clauses must be interpreted to limit the phrase "for all Federal income tax purposes". We therefore hold that when the parties signed the closing agreement they did not manifest an intent with respect to section 965(b)(3). Instead we find that the parties' intent was to reconcile the cash accounts of petitioner and ADBV with their adjusted tax positions as a result of the section 482 primary adjustment. This was completely unrelated to the section 965 DRD.

While the taxpayer may have known about the IRS's position, the IRS also knew the taxpayer took the opposite position—but the agreement didn't deal with this matter. As the opinion notes:

> Under Federal common law, one party is bound to the other party's understanding of an ambiguous term only if the other party did not know or have reason to know of the first party's understanding of that term. Even assuming that petitioner knew of respondent's interpretation of the closing agreement, respondent had reason to know of petitioner's understanding as well. Both parties were aware before the execution of the closing agreement that section 965(b)(3) was an issue, yet the closing agreement did not include any provision addressing it. The extrinsic evidence shows that the parties did not reach an agreement with respect to section 965(b)(3), and we will not read a term into the closing agreement to which the parties did not agree.

Having concluded that the parties had not agreed that these amounts were to be treated as retroactive accounts receivable, the majority decided to adopt the Fifth Circuit's view of the law in this area to decide the proper applicable.

The majority concludes:

> Upon consideration, we agree with the Court of Appeals' analysis that, under the plain meaning of section 965(b)(3), a CFC has an increase in related party indebtedness only if the indebtedness existed "as of" the close of the election year. Petitioner's testing period closed long before the execution of its Rev. Proc. 99-32 closing agreement, and the accounts receivable did not exist before the closing agreement. Respondent concedes that ADBV would not have an increase in related party indebtedness if petitioner did not make an election under Rev. Proc. 99-32, supra, and did not execute the closing agreement. Therefore, the only way in which the accounts receivable could have been established "as of" the close of petitioner's election year is if the closing agreement's deemed established dates applied to the application of section 965(b)(3). We held supra that the parties did not reach an agreement in their Rev. Proc. 99-32 closing agreement with respect to section 965(b)(3), and we do not take the deemed establishment dates of the accounts to alter subsection (b)(3).
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> We also find, as the Court of Appeals did, that Notice 2005-64, sec. 10.06, in which the IRS states that "accounts payable" are treated as debt under section 965(b)(3), is wholly unpersuasive because it lacks any analysis and runs counter to the plain meaning of subsection (b)(3). See BMC Software II, 780 F.3d at 676. It also conflicts with Notice 2005-38, sec. 7.05(b), 2005-1 C.B. at 1112, which comports with the statute, stating: "A U.S. shareholder determines the amount of the related party indebtedness of its CFC on the last measurement date"