Current Federal Tax Developments

Nichols Patrick CPE a Division of the Loscalzo Institute

January 2, 2017

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SECTION: 501
NARROW SCHOLARSHIP CRITERIA FOUND TO LIMIT BENEFITS TO FOUNDER'S SON, EXEMPT STATUS DENIED

Citation: PLR 201652029, 12/23/16

In PLR 201652029 the IRS was asked to grant an organization a tax exemption under §501(c)(3). The organization was one formed to grant annual scholarships to graduating seniors of a particular high school who met certain criteria.

Initially this seems like a reasonable request since the organization's purpose was to further education, and it was going to grant scholarships based on merit-based criteria. But it turns out that criteria caught the IRS's attention when the IRS looked at applying those criteria to what had actually taken place in the past.

The governing board members were a husband and wife. The organization had two members of a selection committee who expected to spend about one hour per year operating the scholarship program—because it turns out it wouldn't be that difficult to identify qualifying recipients.

The criteria for obtaining a scholarship from this organization were outlined as follows in the ruling:

> To qualify for a scholarship, an applicant must be a graduating senior from B high school who has been selected as a National Merit Finalist and are newly admitted to C College. C College is approximately 3000 miles from B high school.
>
> The scholarship may be awarded for four years of undergraduate studies or completion of baccalaureate degree requirements, whichever occurs first. Recipients must enter C College no later than the fall following graduation from B high school. Scholars must remain in good academic and disciplinary standing at C College. Transfer students are not eligible.

But the IRS took a look at how many graduating seniors from this high school would meet these criteria and discovered that they could only identify a single senior who would meet these criteria.

> B high school has a graduating class which fluctuates yearly but is usually approximately 500 students. Two years ago there were four individuals graduating from B high school that were National Merit Finalists. You do not know if any attended C College. Last year there were two individuals graduating from B high school who were National Merit Finalists. One was F, the son of founders D and E. The other individual was not related to the founders. F went on to attend C College and was awarded your scholarship. The other individual did not attend C College and, therefore, did not meet the qualifications for your scholarship.
>
> This year there was one individual graduating from B high school who was a National Merit Finalist. It is unknown if he will attend C College. If he attends C College, he will be awarded a scholarship.
>
> Based on historical data, you said that between 1-4 students annually will be National Merit Finalists graduating from B high school, of which 0-1 will apply to C College. You said that C College historically admits about 10% of their applicants. Therefore, there will be between 0-1 eligible applicants annually.

The source of funding for the organization was also of interest to the IRS:

> You are funded by your founders, D and E. You will only exist as long as the donors, in their discretion, fund the award; it is not a perpetual fund. As was indicated earlier all your funds were paid out last year for the scholarship awarded to F.

Looking at these facts, the IRS declined to grant a §501(c)(3) exemption status to this organization. The ruling concludes:

> Based on the facts presented, you are operating for the substantial non-exempt purpose of operating a scholarship program with selection criteria which are too narrow to benefit the general public. Your

scholarship program was set up to benefit the founders, as their son was the only recipient since your inception. Therefore, your earnings inure to the benefit of your founders and you do not qualify for exemption as an organization described in Section 501(c)(3) of the Code.

SECTION: 1297
FINAL REGULATIONS PUBLISHED RELATED TO DETERMINING OWNERSHIP OF PFICS AND REPORTING REQUIREMENTS

Citation: TD 9806, 12/28/16

The IRS adopted final regulations (TD 9806) on determining the ownership of a passive foreign investment company (PFIC), reporting requirements for shareholders of PFICs to file Form 8621, *Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund* and on an exception to the requirement for certain shareholders to file Form 5471, *Information Return of U.S. Persons with Respect to Certain Foreign Corporations*.

These regulations adopt proposed regulations that were issued in December of 2013 with certain changes. As well, the related temporary regulations are removed. The changes are effective December 28, 2016.

Passive Foreign Investment Companies are defined at IRC §1297(a) as follows:

> (a) In general For purposes of this part, except as otherwise provided in this subpart, the term "passive foreign investment company" means any foreign corporation if—
>
> > (1) 75 percent or more of the gross income of such corporation for the taxable year is passive income, or
> >
> > (2) the average percentage of assets (as determined in accordance with subsection (e)) held by such corporation during the taxable year which produce passive income or which are held for the production of passive income is at least 50 percent.

IRC §§1291-1298 provide three different methods for taxing PFIC shareholders:

- Under IRC §1291's excess distribution rules under which a special tax and interest charge are imposed on a U.S. shareholder that receives an "excess distribution" or recognizes gain from a distribution of stock in a PFIC that is classified as an excess distribution pursuant to IRC §1291(a)(2).
- Under IRC §1293's qualified electing fund (QEF) rules where a shareholder must include in income his/her share of the PFIC's earnings and profits (with certain adjustments). The fund's ordinary income and net capital gain are passed through to the shareholder and retain their normal tax treatment.
- Under IRC §1293's mark to market rules (MTM) where an electing shareholder includes in income each year an amount equal to the excess (if any) of the fair market value of the stock over the shareholder's adjusted basis of the stock, computed as of the end of the year. A deduction is allowed for the excess of the stock basis over the FMV at the end of the year or the unreversed inclusions with respect to the stock. These amounts, along with any gain or loss on the disposition of the PFIC stock are taxed as ordinary income/loss.

Below are described some of the more significant provisions of these regulations.

The regulations provide that a person is not treated as a shareholder of a PFIC to the extent the shares are owned through a tax-exempt entity or an account described in Reg. §1.1298-1(c)(1). That provision reads:

> (1) Exception if shareholder is a tax-exempt entity. A shareholder that is an organization exempt under section 501(a) to the extent that it is described in section 501(c), 501(d), or 401(a), a state college or university described in section 511(a)(2)(B), a plan described in section 403(b) or 457(b), an individual retirement plan or annuity as defined in section 7701(a)(37), or a qualified tuition program described in

> section 529, a qualified ABLE program described in 529A, or a Coverdell education savings account described in section 530 is not required under section 1298(f) and these regulations to file Form 8621 (or successor form) with respect to a PFIC unless the income derived with respect to the PFIC stock would be taxable to the organization under subchapter F of Subtitle A of the Code.

The final regulations also address the concern that the rules for attribution of ownership via domestic corporation could cause a duplication of ownership when applied mechanically. The IRS gives the following example of both how the rule was supposed to apply and how it could create duplication in the preamble:

> For example, assume that A, a United States person, owns 49 percent of the stock of FC1, a foreign corporation that is not a PFIC, and separately all the stock of DC, a domestic corporation that is not an S corporation. DC, in turn, owns the remaining 51 percent of the stock of FC1, and FC1 owns 100 shares of stock in a PFIC (which is not a controlled foreign corporation within the meaning of section 957(a)). DC is an indirect shareholder with respect to 51 percent of the PFIC stock held by FC1 under § 1.1291-1T(b)(8)(ii)(A). Absent the application of § 1.1291-1T(b)(8)(ii)(C), because A directly or indirectly owns less than 50 percent of the value of the stock of FC1 and thus § 1.1291-1T(b)(8)(ii)(A) does not apply, A would not be treated as an indirect shareholder with respect to any of the PFIC stock directly owned by FC1 when, from an economic perspective, A indirectly owns all the PFIC stock held by FC1. Therefore, without a rule treating A as owning DC's stock in FC1, the remaining 49 percent of the PFIC stock held by FC1 would not be treated as owned by any United States person.
>
> On the other hand, the literal language of § 1.1291-1T(b)(8)(ii)(C) could have been interpreted to create overlapping ownership by two or more United States persons in the same stock of a section 1291 fund. Thus, in the foregoing example, A may have been considered as owning 100 percent of the stock of FC1, and therefore as indirectly owning all 100 shares of the PFIC stock held by FC1, even though 51 of those shares are considered indirectly owned by DC, a United States person. This outcome is inconsistent with the intended purpose of the rule to attribute stock through a domestic C corporation in certain circumstances if, absent such attribution, the stock of a PFIC would not be treated as owned by any United States person.

The final regulations adopt an anti-duplication rule described as follows in the preamble:

> To address this concern, the final regulations include a non-duplication rule. Specifically, the final regulations provide under § 1.1291-1(b)(8)(ii)(C)(1) that, solely for purposes of determining whether a person owns 50 percent or more in value of the stock of a foreign corporation that is not a PFIC under § 1.1291-1(b)(8)(ii)(A), a person who directly or indirectly owns 50 percent or more in value of the stock of a domestic corporation is considered to own a proportionate amount (by value) of any stock owned directly or indirectly by the domestic corporation. However, the non-duplication rule in § 1.1291-1(b)(8)(ii)(C)(2) states that a United States person will not be treated, as a result of applying § 1.1291-1(b)(8)(ii)(C)(1), as owning (other than for purposes of determining whether a person satisfies the ownership threshold of § 1.1291-1(b)(8)(ii)(A)) stock of a PFIC that is directly owned or considered owned indirectly under § 1.1291-1(b)(8) by another United States person (determined without regard to § 1.1291-1(b)(8)(ii)(C)(1)).
>
> Applying the non-duplication rule to the example above, to the extent that the 51 shares of PFIC stock are indirectly owned by DC (a United States person) under § 1.1291-1(b)(8)(ii)(A), those shares are not also treated as indirectly owned by A (other than for purposes of determining whether A satisfies the ownership threshold of § 1.1291-1(b)(8)(ii)(A)). Only the remaining 49 shares of PFIC stock are considered to be indirectly owned by A.

The final regulations also add the following two clarifications to the rule as described in the preamble:

> First, the final regulations clarify, under § 1.1291-1(b)(8)(ii)(C)(3), that the ownership rule of § 1.1291-1(b)(8)(ii)(C)(1) does not apply to stock owned directly or indirectly by an S corporation; rather, the indirect ownership rule under § 1.1291-1(b)(8)(iii)(B) applies in those instances. Second, the final

> regulations clarify that the attribution rule in § 1.1291-1(b)(8)(ii)(C) applies to all PFICs and not only section 1291 funds, in order to ensure that United States persons who are treated as indirect shareholders of PFICs are permitted to make qualified electing fund elections under section 1295.

The final regulations make changes to the exceptions to the reporting requirements under IRC §1298(f) for filing Form 8621, *Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund*.

The final regulations adopt the relief from reporting for certain PFIC stock marked to market under other provisions. As the preamble notes:

> The final regulations, in accordance with Notice 2014-51, add § 1.1298-1(c)(3), which provides that United States persons that own PFIC stock that is marked to market under a non-section 1296 MTM provision are not subject to section 1298(f) reporting unless they are subject to section 1291 under the coordination rule in § 1.1291-1(c)(4)(ii). Generally, under § 1.1291-1(c)(4)(ii), when a United States person's PFIC stock is marked to market under a non-section 1296 MTM provision in a taxable year after the year in which the United States person acquired the stock, the United States person is subject to section 1291 for the first taxable year in which the United States person marks to market the PFIC stock. Thus, the United States person is subject to section 1291 with respect to any unrealized gain in the stock as of the last day of the first taxable year in which the stock is marked to market, as if the person disposed of the stock on that day. See § 1.1291-1(c)(4)(ii) and § 1.1296-1(i)(2) and (3).
>
> Also consistent with Notice 2014-51, the final regulations add § 1.1298-1(c)(2)(ii)(C), pursuant to which a United States person's PFIC stock that is marked to market under a non-section 1296 MTM provision is not taken into account in determining whether the person qualifies for the exceptions from section 1298(f) reporting set forth in § 1.1298-1(c)(2)(i)(A)(1) or (c)(2)(iii), provided that the rules of § 1.1296-1(i)(2) and (3) do not apply with respect to the PFIC stock pursuant to § 1.1291-1(c)(4)(ii) for the taxable year. See Section B.7 of this preamble for a description of these exceptions.

The final regulations also add a provision exempting certain partnerships from having to file a Form 8621 when none of the partnership's direct or indirect partners are subject to the PFIC rules. As the preamble notes:

> Requiring reporting under section 1298(f) by a domestic partnership when none of its direct and indirect owners are subject to the PFIC rules may result in undue compliance costs and burdens. Accordingly, consistent with the exception in § 1.1298-1(c)(1), the final regulations adopt and expand upon this comment and provide a final rule in § 1.1298-1(c)(6) that exempts a domestic partnership from section 1298(f) reporting with respect to an interest in a PFIC for a taxable year when none of its direct or indirect partners are required to file Form 8621 (or successor form) with respect to the PFIC interest under section 1298(f) and these regulations because the partners are not subject to the PFIC rules.
>
> Thus, for example, if all the partners of a domestic partnership are tax-exempt organizations exempt from PFIC taxation under § 1.1291-1(e) with respect to PFIC stock held by the partnership, and accordingly are exempt from reporting pursuant to § 1.1298-1(c)(1), the partnership, in turn, is exempt from filing Form 8621 under section 1298(f) with respect to the PFIC stock held by the partnership. Likewise, if all the partners of a domestic partnership are foreign corporations that are not considered to be shareholders under § 1.1291-1(b)(7) of PFIC stock held by the partnership, and no United States person is an indirect shareholder of the PFIC stock under § 1.1291-1(b)(8), the partnership, in turn, is exempt from filing Form 8621 under section 1298(f) with respect to the PFIC stock held by the partnership.
>
> In contrast, a domestic partnership is not exempt from filing Form 8621 under § 1.1298-1(c)(6) with respect to stock it holds in a section 1291 fund when some or all of its partners are exempt from filing Form 8621 with respect to that stock but otherwise would be subject to tax on distributions on, or dispositions of, that stock. PFIC information reporting by the domestic partnership in these circumstances is appropriate because it furthers PFIC tax compliance and enforcement.

The regulations also contain provisions related to the filing of Form 8621. If a taxpayer who is required to file Form 8621 is not otherwise required to file an income tax return, the final regulations provide that the taxpayer is to file the Form 8621 in accordance with the instructions for the form.

The final regulations also have provisions dealing with statements to be filed by individuals exempted from filing Form 5471, *Information Return of U.S. Persons With Respect to Certain Foreign Corporations*.

The first provision makes as revision to Reg. §1.6038-2(j)(3) that provides that if a person is exempted from being required to file a Form 5471 due to Reg. §1.6038-2(j)(1) (that is, another person is required to furnish the information on the foreign corporation and a joint return is filed with that person's return) must "file a statement with his income tax return indicating that such requirement has been (or will be) satisfied and identifying the return with which the information was or will be filed and the place of filing." This provision applies to returns filed on or after December 31, 2013.

The final regulations also provide at Reg. §1.6046-1(e)(5) that if a person is required to file a Form 5471 of which he is an officer or director "may, if such item of information is furnished by another person having an equal or greater stock interest (measured in terms of either the total combined voting power of all classes of stock of the foreign corporation entitled to vote or the total value of the stock of the foreign corporation) in such foreign corporation, satisfy such requirement by filing a statement with his return on Form 5471 indicating that such requirement has been satisfied and identifying the return in which such item of information was included."

The rules generally apply to returns filed on or after December 31, 2013, which is the date the temporary regulations were published. As well, Notices 2014-28 and 2014-51 are both obsoleted as of December 28, 2016.

SECTION: 1401
INCOME EARNED BY FINANCIAL ADVISER AND NOT S CORPORATION, NET EARNINGS SUBJECT TO SELF-EMPLOYMENT TAX

Citation: Fleischer v. Commissioner, TC Memo 2016-238, 12/29/16

Nontax rules often require that those performing certain services (such as selling investment products) be licensed to do so. Quite often that license is held in the name of an individual. In the case of *Fleischer v. Commissioner*, TC Memo 2016-238 a person in just such a position wanted to form an S corporation in which to conduct his investment advisory business in order to reduce his exposure to self-employment taxes.

When he did so he did not attempt to have the corporation he formed become licensed to perform the services in question. He already had entered into an agreement with Linsco/Private Ledger Financial Services (LPL) as a representative prior to forming the corporation. He did not have his contract with LPL revised to recognize his S corporation, Fleischer Wealth Plan (FWP), although he began treating the income he received from LPL as corporate income.

He later entered into an agreement with MassMutual Financial Group (MassMutual). Although the corporation was in existence at this time, he still signed the contract in his personal capacity and the contract made no mention of FWP.

In neither case did Mr. Fleischer produce any evidence that either LPL or MassMutual were aware of FWP.

Mr. Fleischer took a salary from the S corporation for each of the years in question, but larger sums flowed out on his K-1s as income from the S corporation. While FICA was paid on the wages he took from the S corporation, he reported no self-employment income nor did he pay any self-employment tax for the years in question.

The IRS argued that the arrangement represented an impermissible assignment of income by Mr. Fleischer to the S corporation and that, in fact, all the income and expenses should have been reported on Mr. Fleischer's Schedule C, with the net earnings subject to self-employment tax.

The Tax Court noted that determining the owner of income between a corporation and an employee that owns 100% of its stock is not a simple "who earned the income test" and points out:

> Because it is impractical to apply a simplistic "who earned the income" test when the Court's choices are a corporation and its service-provider employee, the question has evolved to one of "who controls the earning of the income." *Johnson v. Commissioner*, 78 T.C. 882, 891 (1982) (citing *Vercio v. Commissioner*, 73 T.C. 1246, 1254-1255 (1980)), *aff'd without published opinion*, 734 F.2d 20 (9th Cir. 1984). For a corporation, not its service-provider employee, to be the controller of the income, two elements must be found: (1) the individual providing the services must be an employee of the corporation whom the corporation can direct and control in a meaningful sense, id. (citing *Vnuk v. Commissioner*, 621 F.2d 1318, 1320-1321 (8th Cir. 1980), *aff'g* T.C. Memo. 1979-164); and (2) "there must exist between the corporation and the person or entity using the services a contract or similar indicium recognizing the corporation's controlling position", id. (citing *Pacella v. Commissioner*, 78 T.C. 604 (1982), and *Keller v. Commissioner*, 77 T.C. 1014 (1981), *aff'd*, 723 F.2d 58 (10th Cir. 1983)). These elements can be found in the employment tax regulations. Sec. 31.3121(d)-1(c)(2), Employment Tax Regs.; see *Sargent v. Commissioner*, 929 F.2d 1252, 1256 (8th Cir. 1991) ("Accordingly, within Regulation § 31.3121(d)-1(c)(2), two necessary elements must be met before the corporation * * * may be considered the true controller of the service-provider."), *rev'g* 93 T.C. 572 (1989).

In this case the second prong of the test would prove to be the taxpayer's undoing—he needed to show that there was a recognition by those using the services (LPL and MassMutual) of the FWP's controlling position in this matter.

With regard to LPL the Court noted:

> On February 2, 2006, petitioner individually entered into a representative agreement with LPL. There is no mention of FWP in the representative agreement. Moreover, FWP was not incorporated until February 7, 2006, meaning it did not exist as a separate entity when petitioner entered into the representative agreement with LPL. Additionally, petitioner did not enter into an agreement that purportedly created an employer-employee relationship with FWP until approximately three weeks later. Therefore, there was no indicium that LPL was aware that FWP controlled petitioner.

With regard to MassMutual the Court noted similarly:

> There is also no mention of FWP in the broker contract petitioner signed with MassMutual. Petitioner did enter into the broker contract after FWP was incorporated on February 7, 2006, but he still signed the contract in his individual capacity. The contract expressly states that there is no employer-employee relationship between MassMutual and petitioner. There is no mention of FWP in the contract and no evidence in the record that MassMutual was aware of whether FWP had any degree of meaningful control over petitioner.

In this case the taxpayer argued he could have had the corporation enter into an agreement with MassMutual but did it personally to retain the ability to expand into selling other products. As the opinion continues:

> Additionally, petitioner testified that FWP could have signed the broker contract with MassMutual because fixed insurance products were the only products that would be sold. He chose to sign the broker contract in his individual capacity because of the possibility of selling variable insurance products in the future. Although the contract with MassMutual allowed petitioner to sell variable insurance products, he neither testified, nor offered any other evidence, that that possibility had come to fruition.

While the taxpayer argued that he structured matters this way because the corporation could not have been registered, the Court noted that he failed to show that was true and, in fact, the taxpayer conceded that while it would have been possible it just wasn't practical.

As the opinion continues:

> Petitioner testified that it would be overly burdensome and "would cost millions and millions of dollars" for FWP to register under the Act, but he offered no other evidence to corroborate his testimony. The fact that FWP was not registered, thus preventing it from engaging in the sale of securities, does not

allow petitioner to assign the income he earned in his personal capacity to FWP. See *Jones v. Commissioner*, 64 T.C. 1066 (1975) (holding that a court reporter improperly assigned income to his personal service corporation because a court reporter was legally required to be an individual, and although the corporation was a valid entity, by law it could not perform such services).

Or, to put it more simply, if the taxpayer wanted this result he would have needed to qualify FWP to sell securities—and if it was barred from doing so (either because he did not go through the process to qualify it or it simply was barred from qualifying) then he would not be allowed to simply assign his income to the corporation.

This case is, unfortunately, not that unusual—and often taxpayers enter into the arrangement at the behest of their tax advisers looking to use S status to reduce exposure to self-employment taxes. Telling a client (or potential client) that this structure simply doesn't work (and it clearly does not) is not likely going to make the client happy. But our job is to advise the client on the reality of the law, no matter how unfair the client may believe that law is.

SECTION: 6011
CERTAIN SYNDICATED CONSERVATION EASEMENT TRANSACTIONS IDENTIFIED AS LISTED TRANSACTIONS

Citation: Notice 2017-10, 12/23/16

In Notice 2017-10 the IRS has identified certain syndicated conservation easement transactions as listed transactions for purposes of Reg. §1.6011-4(b)(2) and IRC §§6011 and 6112.

Participants in a listed transaction (or a transaction similar to an identified listed transaction) are required file Form 8886, *Reportable Transaction Statement,* with each return on which the effects of the listed transaction is reported. A taxpayer who fails to include that disclosure with his/her income tax return faces the special statute of limitation rule on assessments under IRC §6501(c)(10). That provision provides:

> (10) Listed transactions If a taxpayer fails to include on any return or statement for any taxable year any information with respect to a listed transaction (as defined in section 6707A(c)(2)) which is required under section 6011 to be included with such return or statement, the time for assessment of any tax imposed by this title with respect to such transaction shall not expire before the date which is 1 year after the earlier of—
>
> > (A) the date on which the Secretary is furnished the information so required, or
> >
> > (B) the date that a material advisor meets the requirements of section 6112 with respect to a request by the Secretary under section 6112(b) relating to such transaction with respect to such taxpayer.

The taxpayer also faces a failure to disclose penalty under IRC §6707A. The penalty imposed is computed under the provisions of IRC §6707A(b) which reads:

> (b) Amount of penalty
>
> (1) In general
>
> Except as otherwise provided in this subsection, the amount of the penalty under subsection (a) with respect to any reportable transaction shall be 75 percent of the decrease in tax shown on the return as a result of such transaction (or which would have resulted from such transaction if such transaction were respected for Federal tax purposes).
>
> (2) Maximum penalty The amount of the penalty under subsection (a) with respect to any reportable transaction shall not exceed—
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> > (A) in the case of a listed transaction, $200,000 ($100,000 in the case of a natural person), or

(B) in the case of any other reportable transaction, $50,000 ($10,000 in the case of a natural person).

(3) Minimum penalty

The amount of the penalty under subsection (a) with respect to any transaction shall not be less than $10,000 ($5,000 in the case of a natural person).

As well, material advisers must file a report regarding such transactions with the IRS and must maintain a list of clients involved in the transaction.

This particular listed transaction relates to certain programs being marketed that purport to qualify for a deduction as a qualified conservation easement. The notice describes the general provisions of the IRC for a conservation easement as follows:

> Section 170(f)(3)(B)(iii) of the Code allows a deduction for a qualified conservation contribution. A qualified conservation contribution is a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes. Section 170(h)(1) through (5); § 1.170A-14. A qualified real property interest includes a restriction, granted in perpetuity, on the use that may be made of real property. Section 170(h)(2)(C).

Listed transactions are generally those that the IRS has determined is a potential tax avoidance transaction that merits special disclosure. In this regard the IRS noted:

> The Treasury Department and the IRS have become aware that some promoters are syndicating conservation easement transactions that purport to give investors the opportunity to claim charitable contribution deductions in amounts that significantly exceed the amount invested. In such a syndicated conservation easement transaction, a promoter offers prospective investors in a partnership or other pass-through entity ("pass-through entity") the possibility of a charitable contribution deduction for donation of a conservation easement.

The IRS goes on to describe the transaction in more detail:

> The promoters (i) identify a pass-through entity that owns real property, or (ii) form a pass-through entity to acquire real property. Additional tiers of pass-through entities may be formed. The promoters then syndicate ownership interests in the pass-through entity that owns the real property, or in one or more of the tiers of pass-through entities, using promotional materials suggesting to prospective investors that an investor may be entitled to a share of a charitable contribution deduction that equals or exceeds an amount that is two and one-half times the amount of the investor's investment. The promoters obtain an appraisal that purports to be a qualified appraisal as defined in § 170(f)(11)(E)(i) but that greatly inflates the value of the conservation easement based on unreasonable conclusions about the development potential of the real property. After an investor invests in the pass-through entity, either directly or through one or more tiers of pass-through entities, the pass-through entity donates a conservation easement encumbering the property to a tax-exempt entity. Investors who held their direct or indirect interests in the pass-through entity for one year or less may rely on the pass-through entity's holding period in the underlying real property to treat the donated conservation easement as long-term capital gain property under § 170(e)(1). The promoter receives a fee or other consideration with respect to the promotion, which may be in the form of an interest in the pass-through entity. The IRS intends to challenge the purported tax benefits from this transaction based on the overvaluation of the conservation easement. The IRS may also challenge the purported tax benefits from this transaction based on the partnership anti-abuse rule, economic substance, or other rules or doctrines.

The specific listed transaction is described in Section 3 of the notice as follows:

> A transaction described in this section is a listed transaction. An investor receives promotional materials that offer prospective investors in a pass-through entity the possibility of a charitable contribution

> deduction that equals or exceeds an amount that is two and one-half times the amount of the investor's investment. The promotional materials may be oral or written. For purposes of this notice, promotional materials include, but are not limited to, documents described in § 301.6112-1(b)(3)(iii)(B) of the Regulations. The investor purchases an interest, directly or indirectly (through one or more tiers of pass-through entities), in the pass-through entity that holds real property. The pass-through entity that holds the real property contributes a conservation easement encumbering the property to a tax-exempt entity and allocates, directly or through one or more tiers of pass-through entities, a charitable contribution deduction to the investor. Following that contribution, the investor reports on his or her federal income tax return a charitable contribution deduction with respect to the conservation easement.

If a taxpayer has already filed a return (including an amended return) containing a transaction described in the notice, under Reg. §1.6011-4(e)(2) a disclosure statement would generally be required to be filed with the Office of Tax Shelter Analysis within 90 days after the date the IRS identified the transaction as one of interest (which was on December 23, 2016).

However, the Notice provides an extended due date for filing such notices that either were required to be filed in the 90 day period, or where a return is being filed shortly after the Notice was published. The relief reads as follows:

> However, if, under § 1.6011-4(e)(1), a taxpayer is required to file a disclosure statement with respect to a transaction described in this notice after December 23, 2016, and prior to May 1, 2017, that disclosure statement will be considered to be timely filed if the taxpayer alternatively files the disclosure with the Office of Tax Shelter Analysis by May 1 (because April 30 is a Sunday). In addition, for purposes of disclosure of transactions described in this notice, the 90-day period provided in § 1.6011-4(e)(2)(i) is extended to 180 days. Further, if under § 301.6111-3(e), a material advisor is required to file a disclosure statement with respect to the listed transaction described in this notice by January 31, 2017, that disclosure statement will be considered to be timely filed if the taxpayer files the disclosure with the Office of Tax Shelter Analysis by May 1, 2017 (because April 30 is a Sunday).

Advisers must remember that the disclosure is required regardless of whether or not the transaction is eventually found to achieve its claimed tax benefits and that the penalties would apply even if the taxpayer is found not to have understated his/her income.

SECTION: 6501
USE OF WRONG FORM DID NOT INVALIDATE CONSENT TO EXTEND STATUTE, BUT SINCE ONLY HUSBAND SIGNED EXTENSION ONLY VALID FOR HIM

Citation: Chief Counsel Email 201652023, 12/23/16

Sometimes things just aren't quite handled as they should be, even by the IRS in attempting to obtain a consent to extend the statute of limitations under IRC §6501(c)(4). In Chief Counsel Email 201652023 an attorney in the IRS National Office outlined what she saw as the impact of the failure to use the proper form to obtain the consent.

As most advisers are aware, it's not unusual for an examination of a taxpayer's return to take considerable time and, in many cases, the exam is not near begin completed as the deadline for the IRS to assess tax under IRC §6501 approaches. When that happens, the IRS will ask a taxpayer to agree to extend the time to assess tax under the provisions of §6501(e)(4).

IRC §6501(e)(4) provides:

> (4) Extension by agreement
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> (A) In general
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> Where, before the expiration of the time prescribed in this section for the assessment of any tax imposed by this title, except the estate tax provided in chapter 11, both the Secretary and the taxpayer have

consented in writing to its assessment after such time, the tax may be assessed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

(B) Notice to taxpayer of right to refuse or limit extension

The Secretary shall notify the taxpayer of the taxpayer's right to refuse to extend the period of limitations, or to limit such extension to particular issues or to a particular period of time, on each occasion when the taxpayer is requested to provide such consent.

As is noted above, a taxpayer is not required to consent to extend the statute. However, as most advisers understand, a failure to do so will generally result in the agent concluding the exam immediately by resolving all remaining open issues against the taxpayer. That does not mean that consent should always be given, but rather that the impact of being forced to move beyond the agent level if consent is withheld must be considered. That impact is both with regard to the likely eventual outcome on the outstanding issues and the costs that will be incurred.

In this case, for reasons not explained in the email, the IRS agent apparent filled out Form 872-H (which generally grants consent to extend the statute by a trust) instead of Form 872 (which would be used for most other cases including, in this case, a married couple filing a joint return). The husband signed the Form 872-H. As there was no "spouse" line on that form, the wife did not sign the form and the agent accepted the form as filed.

Sometime later, likely after the regular statute under IRC §6501 had expired, the fact that the wrong form had been used to extend the statute and the fact that only the husband had signed the form was discovered. The email is a response to what appears to be a simple question—was the statute extended when the husband signed the Form 872-H?

The email concludes that, despite using the wrong form, that the Form 872-H should serve to extend the statute of limitations. While the email does not explain the rationale for this decision, it seems to this author an appropriate decision. In the case of *Hartland Management Services, et al v. Commissioner*, TC Memo 2015-8 the Tax Court found the key question to be decided was whether there was intent to extend the statute even when the Form 872 was not properly completed. In that case the wrong dates were entered by the agent on Form 872, but the Court found that the taxpayer was aware of the purpose of the form and the intended extension, thus the form served to extend the statute. Presumably the same argument would apply here.

But the memo concludes that because the wife did not sign the form, the statute is only extended with regard to the husband. Again, this makes sense, since there is no evidence that the wife consented to an extension of the statute.