Current Federal Tax Developments

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SECTION: TAX REFORM
CONGRESSIONAL AND ADMINISTRATION OFFICIALS RELEASE STATEMENT ON TAX REFORM

Citation: Joint Statement on Tax Reform, 7/27/17

A Joint Statement on Tax Reform was released on July 27, 2017 by House Speaker Paul Ryan (R-WI), Senate Majority Leader Mitch McConnell (R-KY), Treasury Secretary Steven Mnuchin, National Economic Council Director Gary Cohn, Senate Finance Committee Chairman Orrin Hatch (R-UT), and House Ways and Means Committee Chairman Kevin Brady (R-TX). The statement provides a very basic outline of the basic ideas that the "Big 6" (a reference to the above group that has cropped up in the tax press) have determined to attempt to include in the tax reform bill that Congress expects to begin work on shortly.

One key item of note in the joint statement is the abandonment of the border-adjustable tax, an item that had been a key component of the House GOP "Better Way" blueprint issued last year. The statement's information on that provision reads as follows:

> While we have debated the pro-growth benefits of border adjustability, we appreciate that there are many unknowns associated with it and have decided to set this policy aside in order to advance tax reform.

The statement broad a broad outline, but few specifics, on items to be included in the program. The statement provides:

> Above all, the mission of the committees is to protect American jobs and make taxes simpler, fairer, and lower for hard-working American families. We have always been in agreement that tax relief for American families should be at the heart of our plan. We also believe there should be a lower tax rate for small businesses so they can compete with larger ones, and lower rates for all American businesses so they can compete with foreign ones. The goal is a plan that reduces tax rates as much as possible, allows unprecedented capital expensing, places a priority on permanence, and creates a system that encourages American companies to bring back jobs and profits trapped overseas. And we are now confident that, without transitioning to a new domestic consumption-based tax system, there is a viable approach for ensuring a level playing field between American and foreign companies and workers, while protecting American jobs and the U.S. tax base.

As always, the devil continues to be in the details—and those are yet to come. Some key details to be filled in include:

- What exactly will make up "tax relief for American families" at the heart of the plan
- Exactly how significant will the tax rate cuts be
- What will the definition be of a "small business" that qualifies for a lower rate
- What will the limits be on expensing and will it allow expensing for items currently not eligible for Section 179 treatment by small business taxpayers

We will continue to follow developments in this area and, if a law is passed, provide analysis of the law here as well as offering continuing education options to get professionals up to speed.

SECTION: APPEALS
APPEALS TO BEGIN OFFERING WEB-BASED CONFERENCES IN PILOT PROGRAM

Citation: News Release IR-2017-122, 7/24/17

The IRS Office of Appeals announced in News Release IR-2017-122 that will begin a pilot program using web-based conferencing software to offer a virtual conference option for taxpayers and representatives. This option will be in addition to the current conferencing options.

Currently taxpayers and representatives can meet with an Appeals Officer:

- In person;
- By phone; or
- Through a video conference system located at a limited number of local IRS offices.

Under the new program, taxpayers and representatives will use a yet unspecified web based video conferencing system to interact with the Appeals Officer in a conference. This will allow a face to face communication between the parties, something not possible via a phone call, without the taxpayer and representative having to travel to an IRS office.

Web based conferencing has become increasingly popular, both for business and personal use. Various systems exist for conducting such conferences which use a computer with a broadband internet connection, along with a camera and microphone attached to or built into the computer. Most readers have probably made use of such technologies for various purposes, including obtaining continuing education, having conferences with employees or clients and communicating with family members.

The news release describes the IRS web based conferencing system as follows:

> While a phone call works well for most taxpayers, others prefer face-to-face interaction. Appeals' pilot program will use a secure, web-based screen-sharing platform to connect with taxpayers face-to-face from anywhere they have internet access. Similar to popular screen-sharing programs used on phones and home computers, this technology may also be a way for the IRS to provide greater access, efficiency and flexibility to taxpayers. This web-based model is more convenient and has more features than the existing video-conferencing technology.

The pilot program will start on August 1, 2017. Appeals will assess the results, including taxpayer satisfaction with the technology.

Until the actual program begins it's difficult to assess the impact of this program, as the news release does not indicate how the IRS will choose who to offer pilot access to, what the capabilities of the system they plan to use are and what the system requirements will be for the computer system to be used by the taxpayer.

Advisers who have only used web based conferencing at their office to consume continuing programs should be aware that somewhat more bandwidth is necessary to carry on an effective two way conference. As well, advisers should consider the quality of the cameras and microphone systems they have available, since most likely the adviser and client will share a single computer, camera and microphone for participation in such a conference.

Given budgetary constraints and the increasing prevalence of the use of this technology in business, advisers likely should consider the need to set up a conferencing environment in their offices that will be appropriate for such uses. It seems likely that such virtual conferences will become the norm, and not the exception, in a few years—and not just for dealing with IRS Appeals.

SECTION: SECURITY
IRS OUTLINES STEPS TO BE TAKEN TO BATTLE INCREASE IN BUSINESS RELATED TAX IDENTITY THEFT

Citation: IRS News Release IR-2017-123 and Fact Sheet FS-2017-10, 7/24/17

The IRS has issued a news release (IR-2017-123) updating what is happening with both individual and business related identity theft, as well as a fact sheet (FS-2017-10) outlining steps to be taken to combat an increase the agency has noted in identity theft from businesses and estates.

The good news is that the IRS has had a dramatic drop in reported individual tax related identity theft cases. As the news release notes:

> So far for 2017, individuals reporting identity theft have declined sharply compared to the same time in 2016 and 2015. In the first five months of 2017, about 107,000 taxpayers reported being victims of identity theft, compared to the same period in 2016, when 204,000 filed victim reports. That's about 97,000 fewer victims – representing a drop of 47 percent. For comparison, there were nearly 297,000 identity theft victims during the first five months of 2015.

However, as is often the case, when it becomes more difficult to commit fraud in one area, criminals shift their focus and the IRS has noticed a significant increase in business related identity theft.

As the release continues:

> So far for 2017, the IRS has identified approximately 10,000 business returns as potential identity theft through June 1, compared to about 4,000 for calendar year 2016 and 350 for calendar year 2015. While the number of businesses affected was relatively low, the potential dollar amounts were significant: $137 million for 2017, $268 million for 2016 and $122 million for 2015.
>
> The affected returns included corporate returns (Forms 1120 and 1120S) and estate and trust returns (Form 1041). There also was an increase in identity theft related to the Schedule K-1 filings made by partnerships.

The fact sheet issued by the IRS outlines indicators of potential business related identity theft that business taxpayers (including decedent's estates) should be aware of. The fact sheet notes:

> Business, partnerships and estate and trust filers should be alert to potential identity theft and contact the IRS if they experience any of these issues:
>
> - Extension to file requests are rejected because a return with the Employer Identification Number or Social Security Number already on file;
> - An e-filed return is rejected because of a duplicate EIN/SSN is already on file with the IRS;
> - An unexpected receipt of a tax transcript or IRS notice that doesn't correspond to anything submitted by the filer;
> - Failure to receive expected and routine correspondence from the IRS because the thief has changed the address.

The fact sheet also has information that those preparing business returns (including estates and trusts) will need to be aware of for the upcoming filing season. The fact sheet notes:

> Also for 2018, the IRS will ask those tax professionals preparing business-related returns to step up the "know your customer" procedures. Tax preparation software for business-related returns will ask the following questions:
>
> - The name and SSN of the company executive authorized to sign the corporate tax return. Is this person authorized to sign the return?
> - Payment history — Were estimated tax payments made? If yes, when were they made, how were they made, and how much was paid?
> - Parent company information — Is there a parent company? If yes, who?
> - Additional information based on deductions claimed
> - Filing history — Has the business filed Form(s) 940, 941 or other business-related tax forms?
>
> These questions also will help identify suspicious returns.

SECTION: 72
DEEMED DISTRIBUTION TOOK PLACE ON LAST DAY OF PRIOR YEAR, NOT DATE PLAN ADMINISTRATOR SENT LETTER OF DISTRIBUTION TO PARTICIPANT

Citation: Gowen v. Commissioner, TC Summ Op 2017-57, 7/24/17

There was no question that the taxpayer in the case of *Gowen v. Commissioner*, TC Summ. Op. 2017-57 had defaulted on the loan he received from his former employer's 401(k) plan and, as well, that he did not correct the default prior to the cure period allowed under the plan. But the taxpayer argued that the actual deemed distribution did not take place in 2012, the year the deemed distribution was reported by the plan custodian on a Form 1099R, but rather at some point in 2013.

The facts leading up the default were summarized in the opinion as follows:

> On March 8, 2012, petitioner borrowed $50,000 from his KPMG section 401(k) retirement plan account administered by Merrill Lynch (a unit of Bank of America N.A.). The terms of the loan required petitioner to make 120 semimonthly payments of $451.72, beginning on March 30, 2012, and ending on March 15, 2017. Petitioner initially made the required payments, but after he lost his job at KPMG, he stopped making payments, beginning with a missed payment due on August 30, 2012. Merrill Lynch sent petitioner a notice dated October 23, 2012, stating: "Our records indicate that your loan payment is past due. Your loan is in danger of being defaulted."

The plan administrator's notice also informed Mr. Gowen that the administrator was required to treat the defaulted loan balance as a distribution to Mr. Gowen unless he corrected the default before the end of the cure period. The period for curing this default would be the end of the calendar quarter following the calendar quarter when the payment was missed.

Merrill Lynch sent Mr. Gowen additional notices on November 26 and December 26, reminding him he was in default and warning him that if the issue was not corrected he would be subject to tax on the deemed distribution. Mr. Gowen took no action regarding those notices.

Merrill Lynch processed the deemed distribution shortly after what they regarded to be the expiration date of the period to fix the default, December 31, 2012. As the default took place in August 2012, the administrator treated the default as occurring in the calendar quarter ended September 30, 2012. Thus, the end of the calendar quarter following the quarter when the payment as missed would be December 31, 2012.

Merrill Lynch reported a deemed distribution of $46,703, the defaulted portion of the $50,000 loan, on a Form 1099R that was sent to both the IRS and the taxpayer. Mr. Gowen claims he never actually received that Form 1099R, but admitted he did receive a distribution statement sent by Merrill Lynch dated January 7, 2013 that reported the $46,703 deemed distribution.

When he filed his return for 2012 he did not include the deemed distribution on that return. He claimed he did so because he did not receive the Form 1099R from Merrill Lynch for 2012 and, per the statement sent by Merrill Lynch, the distribution took place on January 7, 2013.

The taxpayer argued the amount was not properly taxable in 2012. The opinion notes:

> Petitioner concedes that the balance of the loan outstanding as of the expiration of the cure period is deemed to be a taxable distribution. However, petitioner maintains that the cure period expired in 2013 and thus the distribution is deemed a taxable event for that year, not for 2012 as respondent asserts. Petitioner maintains that the loan notices sent on October 23, November 26, and December 26, 2012, informed him "that your loan was 'in danger of being in default'" and that it was not until January 7, 2013, that Merrill Lynch issued him a distribution information statement reporting the deemed distribution from his default.

The taxpayer argued that the regulations did not establish a maximum cure period and that since he was told by Merrill Lynch the cure period was six months he could not have failed to cure the

default, triggering the distribution, until well into 2013. As well, he reasonably relied upon the notice from Merrill Lynch that he claimed showed an actual deemed distribution date of January 7, 2013.

First, the Court notes that Mr. Gowen is in error that the regulations do not provide for a maximum cure period. As the opinion notes:

> Petitioner's position is not correct. The applicable regulation does, in fact, designate a "maximum cure period". Section 1.72(p)-1, Q&A-10(a), Income Tax Regs., provides:
>
> > Failure to make any installment payment when due in accordance with the terms of the loan violates section 72(p)(2)(C) and, accordingly, results in a deemed distribution at the time of such failure. However, the plan administrator may allow a cure period and section 72(p)(2)(C) will not be considered to have been violated if the installment payment is made not later than the end of the cure period, which period cannot continue beyond the last day of the calender *[sic]* quarter following the calendar quarter in which the required installment payment was due.

The Court rejected Mr. Gowen's interpretation of the regulation to allow a full six-month cure period. He had argued that the period to cure the default should not depend on when you lost your job—so a participant defaulting on September 30 should not end up with nearly three months less time to correct a default than a participant defaulting on June 1. In his view, the quarter of default was made up of August, September, and October, with the quarter following the quarter of default being November, December, and January. The Court found this interpretation clearly at odds with the plain language of the regulation—that calendar quarters means quarters based on staring with quarter one on January 1 of the year in question.

The opinion notes the following example from Reg. §1.72-1 Q&A-10(c) supports the interpretation of the plan administrator:

> (i) On August 1, 2002, a participant has a nonforeitable account balance of $45,000 and borrows $20,000 from a plan to be repaid over 5 years in level monthly installments due at the end of each month. After making all monthly payments due through July 31, 2003, the participant fails to make the payment due on August 31, 2003 or any other monthly payments due thereafter. The plan administrator allows a threemonth [sic] cure period.
>
> (ii) As a result of the failure to satisfy the requirement that the loan be repaid in level installments pursuant to section 72(p)(2)(C), the participant has a deemed distribution on November 30, 2003, which is the last day of the three-month cure period for the August 31, 2003 installment. The amount of the deemed distribution is $17,157, which is the outstanding balance on the loan at November 30, 2003. Alternatively if the plan administrator had allowed a cure period through the end of the next calendar quarter, there would be a deemed distribution on December 31, 2003 equal to $17,282, which is the outstanding balance of the loan at December 31, 2003.

What about that statement from Merrill Lynch? The court noted that while the letter was dated January 7, 2013, nowhere on the statement did it indicate the date the distribution occurred.

As the Court concluded:

> In sum, petitioner received a taxable retirement distribution of $46,703 in 2012.

SECTION: 162
TAXPAYER FAILED TO ESTABLISH WORK LOCATION OUTSIDE METROPOLITAN AREA OR THAT HE WAS AWAY FROM HOME

Citation: Wooten v. Commissioner, TC Summ. Op. 2017-58, 7/24/17

Even though it may appear to taxpayers that mileage and meals are clearly related to their job, only in limited circumstances may deductions be claimed for such items. In the case of *Wooten v. Commissioner*, TC Summ. Op. 2017-58, the taxpayers discovered that none of the expenses they had claimed met the requirements to be deductible.

In this case the taxpayer was employed as a plumber/pipefitter for a contractor. In his job he had to work at various locations, some in Gulfport or Biloxi, Mississippi, which were 20-25 miles from his home and two in Hattiesburg, Mississippi which was about 56 miles from his home. Mr. Wooten kept logs of his travel to/from his home to these locations. He claimed a deduction for this mileage, along with a deduction for meals he consumed at these locations.

Commuting expenses are not generally deductible, as the place where a taxpayer lives is deemed to be a personal choice—so the fact that a taxpayer lives 30 miles from his workplace is a personal choice and the expense of getting to that workplace is deemed to be a non-deductible personal expense under IRC §262(a). As Reg. §1.262-1(b)(5) states "The taxpayer's costs of commuting to his place of business or employment are personal expenses and do not qualify as deductible expenses."

However, the opinion notes one exception to this rule involves travel to a temporary work location.

> One exception to this general rule, as petitioners argue, involves commuting to a temporary work location. See *Bogue v. Commissioner*, T.C. Memo. 2011-164, 102 T.C.M. (CCH) 41, 46 (2011), *aff'd*, 522 F. App'x 169 (3d Cir. 2013). This exception permits a taxpayer to deduct transportation expenses incurred in traveling between a taxpayer's residence and a temporary work location outside the metropolitan area where the taxpayer normally lives and works. See id.; Rev. Rul. 99-7, 1999-1 C.B. 361. The term "metropolitan area" is ill defined, and we therefore consider the facts and circumstances in deciding whether particular commuting expenses were incurred in traveling to a worksite unusually distant from the area where the taxpayer lives and normally works.

Mr. Wooten testified that Gulfport was his normal work area—thus, any commuting to or from locations in Gulfport and Biloxi failed to qualify for deduction under this exception. The Court also found that due to his recurring employment in Hattiesburg that it was also not outside the metropolitan area where he normally worked—thus, no commuting expenses could be deducted by Mr. Wooten.

Somewhat different rules cover the meals, being treated as traveling expenses that may be deducted by a taxpayer who was away from home due to his/her trade or business pursuant to IRC §162(a)(2). To be deductible the taxpayer will need to establish all the following:

- The taxpayer was away from his/her tax home at the time the expense was incurred;
- The expense was both reasonable and necessary; and
- The expense was incurred in pursuit of a trade or business.

Mr. Wooten's expenses met the last two criteria—but was he truly away from home where the expense was incurred? To be away from home, a taxpayer must show he/she is on a trip that will require the taxpayer to stop and take time to sleep or rest for a substantial period. In this case, Mr. Wooten did not show that he was "away from home" under this criterion, thus he was not able to claim any deduction for the meals.