Current Federal Tax Developments

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SECTION: 36B
TAXPAYER HAD TO REPAY EXCESS PREMIUM CREDIT DESPITE EXCHANGE NOT REACTING TO NOTICE OF CHANGE IN INCOME

Citation: McGuire v. Commissioner, 149 TC No. 9, 8/29/17

The taxpayers in the case of *McGuire v. Commissioner*, 149 TC No. 9, were asking the Tax Court to find that they did not owe $7,805 in excess advance premium credit they had received under the Affordable Care Act (ACA). However, the Court found that it lacked the ability to grant the relief the taxpayers were requesting.

The taxpayer originally had obtained insurance from Covered California, an ACA health care exchange, for 2014. Based on the household income reported, Covered California computed that the taxpayers were eligible for an advance premium credit of $591 per month, for a total credit of $7,092. The taxpayers enrolled in a plan with a gross monthly premium of $1,181.97 per month. Due to the credit, the net premium they paid each month was $590.97.

After the determination was made, but before the beginning of 2014, Mrs. McGuire began working at a job that paid her $600 per week. The taxpayers notified Covered California indicating that the amount should be included in their income. That additional income pushed the taxpayers' income above 400% of the Federal poverty line for a family of two living in their locale. Thus, they no longer would qualify for any premium credit.

Despite giving notice to the exchange, Covered California never adjusted the taxpayers' premiums. Even worse, the taxpayers attempted to get their address updated with the exchange, but the exchange never updated its records. Thus, the Form 1095-A that the exchange issued at the end of the year never was delivered to the taxpayers.

When the taxpayers prepared their 2014 income tax return, they noted that they had full-year coverage for purpose of the shared responsibility payment, but they did not prepare or fill out Form 8962 to compute their premium tax credit.

The IRS did notice the issue and notified the taxpayer that they were required to pay back the entire $7,902 credit. The taxpayers argued that they should not be required to pay back that credit, because they would not have purchased the insurance policy that covered them in 2014 for the full, unsubsidized premium. As the Court quoted Mrs. McGuire:

> [The Commissioner argues] that if Petitioners are liable for the deficiency, then they would be no worse off financially than if the APTC had been terminated in early 2014. This is simply untrue and does not alter the fact that it was Covered California's responsibility to ensure clients only received the Advance Premium Tax Credit for which they qualified. We would never have committed to paying for medical coverage in excess of $14,000 per year. We cannot afford it and would have continued to shop in the private sector to purchase the minimal, least expensive coverage or gone without coverage completely and suffered the penalties. * * *
>
> * * * If we are deemed responsible for paying back this deficiency, it would be devastating and completely unjust. We hope and pray you are convinced that we have made every single

> effort to get Covered California to make proper adjustments to our reported income and subsequently to the Advance Premium Tax Credit we were qualified to receive without success. The whole purpose of the Affordable Care Act was to provide citizens with just that, affordable healthcare. This has been an absolute nightmare and we hope you will rule fairly and justly today.

Essentially, the taxpayers position was that if Covered California had considered the information the agency was provided before the year began, the taxpayers would have searched for other coverage. In the end, Covered California never adjusted their monthly charges and thus denied the taxpayers the ability to seek other, more affordable, coverage.

The Tax Court noted that they are not a court of equity and cannot "ignore the law to achieve an equitable end." As the Court concludes:

> Although we are sympathetic to the McGuires' situation, the statute is clear; excess advance premium tax credits are treated as an increase in the tax imposed. Sec. 36B(f)(2)(A). The McGuires received an advance of a credit to which they ultimately were not entitled. They are liable for the $7,092 deficiency.

SECTION: 73
LOSS FROM COMPETING IN PAGEANTS REPORTABLE ON RETURN OF MINOR DAUGHTER, NOT PARENTS

Citation: Lopez v. Commissioner, TC Memo 2017-171, 8/30/17

The daughter of the taxpayers in the case of *Lopez v. Commissioner*, TC Memo 2017-171 competed in several beauty pageants beginning at the age of nine. She won several events and received cash prizes, totaling $1,325 and $1,850 in the two years at issue in the case and her parents deposited her winnings in a savings account for her future college education expenses.

Competing in such contests require incurring many expenses, as the parents discovered. The taxpayers paid $21,732 and $15,445 of such expenses in the two years under examination. The parents did not take reimbursement for any of the expenses from their daughter's savings accounts.

When it came time to have their tax return prepared for the years in question, the taxpayers filled out an organizer provided to them by an enrolled agent (EA) who had over 40 years of experience preparing returns. The EA, based on his understanding of Indiana's child labor laws, determined that the income and expenses were allocable to the parents rather than their daughter and reported the income and expenses on the parents' return.

The EA may have been right about Indiana law treating such income as that of the parents—but, unfortunately, the analysis does stop there. The Internal Revenue Code has a provision that deals with income for the services a child. IRC §73(a) provides:

> (a) Treatment of amounts received
>
> Amounts received in respect of the services of a child shall be included in his gross income and not in the gross income of the parent, even though such amounts are not received by the child.

The provision goes on to deal with expenses incurred that are attributable to those expenses as well:

> (b) Treatment of expenditures
>
> All expenditures by the parent or the child attributable to amounts which are includible in the gross income of the child (and not of the parent) solely by reason of subsection (a) shall be treated as paid or incurred by the child.

The opinion begins by noting that the Tax Court has previously ruled that pageant-related income is income for services:

> In the past, we have specifically treated pageant-related remunerations — even those named as scholarships — as compensation for services. See *Miss Ga. Scholarship Fund, Inc. v. Commissioner*, 72 T.C. 267, 269-271 (1979) (holding that a pageant's "scholarship award" was compensation because it was a payment for the contestant's agreement to perform the requirements of the pageant contract).

In this case the child received payments related to the pageants she competed in. As such, the Court held:

> The record reflects that the gross receipts reported on petitioners' Schedules C relate solely to C.P.'s pageant winnings. These winnings were clearly earned by C.P.9 It was C.P. who performed in the pageants, and C.P. was the direct recipient of the pageant winnings. See *Fritschle v. Commissioner*, 79 T.C. at 156. Because prize winnings earned by C.P. are compensation for her services in the pageant, see *Robertson v. United States*, 343 U.S. at 713-714, they are includable in her gross income under section 73(a). Accordingly, only C.P. may deduct petitioners' pageant-related expenses. See sec. 73(b). We therefore sustain respondent's disallowance of petitioners' Schedule C loss deductions pertaining to C.P.'s pageant expenses.

One item of good news was that the parents were not subject to penalties on this underpayment. They had sought the advice of an experienced tax professional on whom they had relied for tax advice for years without incident and provided him with all of the relevant information. Despite the fact that his advice was ultimately found to be in error, the taxpayers had acted reasonably to attempt to determine the proper amount of tax due and thus were not held subject to penalty under IRC §6662.

From a practical standpoint, this is one major advantage to taxpayers of using an experienced and licensed tax professional. Other cases suggest that had the taxpayers claimed these losses on a self-prepared return, the penalties likely would not have been so easily escaped. The seeking of professional advice in good faith was key in this case to the taxpayer's ability to avoid having to pay penalties on top of the tax assessed.

SECTION: 401
IRS ALLOWS RETIREMENT PLANS TO ALLOW THOSE AFFECTED BY HURRICANE HARVEY TO RECEIVE LOANS AND/OR HARDSHIP DISTRIBUTIONS UNDER SIMPLIFIED PROCEDURES

Citation: Announcement 2017-11, 8/31/17

In Announcement 2017-11 the IRS has provided special provisions to allow qualified employer retirement plans to make Hurricane Harvey related distributions and/or loans.

The general relief is described in the notice as follows:

> …[A] qualified employer plan will not be treated as failing to satisfy any requirement under the Code or regulations merely because the plan makes a loan, or a hardship distribution for a need arising from Hurricane Harvey, to an employee or former employee whose principal residence on August 23, 2017, was located in one of the Texas counties identified for individual assistance by the Federal Emergency Management Agency ("FEMA") because of the devastation caused by Hurricane Harvey or whose place of employment was located in one of these counties on that applicable date or whose lineal ascendant or descendant, dependent, or spouse had a principal residence or place of employment in one of these counties on that date.

The counties identified for assistance covered by this announcement can be found at https://www.fema.gov/diasters. Since Harvey continues to impact additional areas, the announcement also provides that any new areas added by FEMA to that list will also be eligible for relief, though with the date that the relief begins changed from August 23, 2017 to the date those new areas are added as of the beginning of the "incident period" noted in the FEMA documents.

The announcement provides for liberal rules on hardship distributions. The distribution amount would be limited to the maximum amount that would be available for a hardship distribution under the Code and regulations. However, the distribution is available to eligible individuals adversely affected by Hurricane Harvey who wish to use assets in qualified employer plans to alleviate hardships caused by Hurricane Harvey. This means that such a distribution applies to any hardship of the employee, not just the types listed in the regulations. As well, no post-distribution contribution restrictions are required. Normally an employee taking a hardship distribution is prohibited from making contributions for at least 6 months after the distribution, but that rule will not apply for Harvey related hardship distributions.

The plan administrator can rely upon the representations of the participant about the need for and amount of the Harvey related hardship distribution unless the administrator has actual knowledge to the contrary.

While the plan must be of a type that would be eligible to offer hardship distributions, the plan language does not need to provide currently for hardship distributions to make them under this relief. So, for instance, a profit sharing or stock bonus plan could make a hardship distribution under this relief regardless of whether it contained hardship distribution language. However, plans prohibited from making hardship distributions by the law cannot make them under this rule—that would include a defined benefit or money purchase pension plan except for assets in such a plan that

are in a separate account within the plan containing employee contributions or rollover contributions.

The maximum hardship distribution is limited to the maximum amount that would be allowed under the law if the plan had language allowing for a hardship distribution.

While the language allowing for hardship distributions or loans does not need to be in the plan document currently, the plan must be amended to provide for them no later than the end of the first plan year beginning after December 31, 2017. A hardship distribution under this relief provision must be made:

- Because a hardship arising from Hurricane Harvey
- Be made on or after August 23, 2017 and
- Be made no later than January 31, 2018

Plan loans under this provision must satisfy the requirements of IRC §72(p). Thus, the loans must meet the $50,000 maximum amount rule found at IRC §72(p)(2)(A)(i), taking into account any other plans loans taken out by the participant during the relevant one-year period or, if less, the greater of ½ of the present value of the employee's nonforfeitable accrued benefit or $10,000 per IRC §72(p)(2)(A)(ii).

Special relief is granted for procedural rules as described below:

> In addition, a retirement plan will not be treated as failing to follow procedural requirements for plan loans (in the case of retirement plans other than IRAs) or distributions (in the case of all retirement plans, including IRAs) imposed by the terms of the plan merely because those requirements are disregarded for any period beginning on or after August 23, 2017, and continuing through January 31, 2018, with respect to loans or distributions to individuals described in the first paragraph under "Relief", above, provided the plan administrator (or financial institution in the case of distributions from IRAs) makes a good-faith diligent effort under the circumstances to comply with those requirements. However, as soon as practicable, the plan administrator (or financial institution in the case of IRAs) must make a reasonable attempt to assemble any forgone documentation. For example, if spousal consent is required for a plan loan or distribution and the plan terms require production of a death certificate if the employee claims his or her spouse is deceased, the plan will not be disqualified for failure to operate in accordance with its terms if it makes a loan or distribution to an individual described in the first paragraph under "Relief" in the absence of a death certificate if it is reasonable to believe, under the circumstances, that the spouse is deceased, the loan or distribution is made no later than January 31, 2018, and the plan administrator makes reasonable efforts to obtain the death certificate as soon as practicable.

Note that the taxation of such distributions to the participant is not changed by these rules. As the announcement warns:

> Taxpayers are reminded that in general the normal spousal consent rules continue to apply, and, except to the extent the distribution consists of already-taxed amounts, any distribution

> made pursuant to the relief provided in this announcement will be includible in gross income and generally subject to the 10-percent additional tax under § 72(t).

Similarly, if the participant takes out a loan, the same rules that lead to a deemed distribution equal to the balance of the loan based on certain uncorrected failures to comply with the loan requirements would also continue to apply.

The announcement concludes by noting that the Department of Labor that it will not treat any person as violating the provisions of Title I of the Employment Retirement Income Security Act because that person complied with the provisions of this announcement.

SECTION: 6512
TAXPAYER'S REFUND ON UNFILED RETURN FALLS INTO "BLACK HOLE" BASED ON DATE IRS ISSUED DEFICIENCY NOTICE

Citation: Borenstein v. Commissioner, 149 TC No. 10, 8/30/17

Taxpayers who fail to timely their tax returns will sometimes tell advisers that it doesn't matter because they are sure they are overpaid. That's fine—except that any overpayment can be lost if the taxpayer waits too long to timely file the return.

In the case of *Borenstein v. Commissioner*, 149 TC No. 10, the taxpayer discovered a way to lose a refund that probably will be new to most readers.

A taxpayer who has a claim for refund, including that overpayment on that not yet prepared late return, must file the claim for refund (which would be the original return in the case of a late filed return) by the time period found in IRC §6511.

A taxpayer must ask for a refund by:

- The later of
  - Three years from the time the return was filed (assuming a return was timely filed) *or*
  - Two years from the time the tax was paid. *Or*
- If no return was filed, within two years from the time the tax was paid.[1]

What happens if the IRS discovers the failure and issues a notice of deficiency before that late return is filed? For instance, if the IRS were to issue a notice of deficiency more than two years after the return should have been filed, but before the three-year period would have expired had a return been filed.

To deal with that time period where an IRS assessment could cause a taxpayer to lose the right to the refund before the three year period expired, Congress added a special provision to IRC §6512(b)(3) in its final sentence—it provides that if the "date of the mailing of the notice of deficiency is during the third year after the due date (with extensions) for filing the return of tax and no return was filed

[1] IRC §6511(a)

before such date, the applicable period under subsections (a) and (b)(2) of section 6511 shall be 3 years."

The provision appears meant to allow the taxpayer who receives a notice of deficiency issued in that third year but who is overpaid to be able to claim that refund in Tax Court—and, since the Tax Court would be able to award the refund, to claim that refund during the examination process.

But in this case the meaning of the parenthetical statement "with extensions" was in dispute among the parties. The timeline, which is the key factor in this matter, was as follows:

- January 17, 2013-Taxpayer makes her final estimated tax payment for her 2012 return, with total estimates of $72,000.
- April 15, 2013-Taxpayer files for an extension of time to file her return, and encloses a $40,000 payment with the extension. Thus, as of the due date of the return (April 15, 2013) she had paid in $112,000.
- October 15, 2013-The extended due date for the taxpayers return passes without her filing her return.
- June 15, 2015-The IRS issues a notice of deficiency on the 2012 return, which remained unfiled at this time. Not unexpectedly the IRS included only items of income they were aware of, including substantial sales of securities for which the IRS assumed a zero basis. Thus, the IRS determined a total deficiency of over $1,600,000
- August 29,2015-Taxpayer finally files her return for 2015, including the deductions and basis that were not present on the IRS's notice of deficiency. That return showed that her total tax just under $80,000 and showed a refund of over $38,000 due to her.

The parties all agree that the return the taxpayer prepared has the correct amount of tax due, and that the payments she had paid more than $38,000 in excess of what was due. However, the IRS claimed that because of when the agency had issued the notice of deficiency, the two year rather than three rule applied.

In the IRS's view, the notice of deficiency (which is treated as the date she filed a refund claim for these purposes) was issued more than two years after the tax was paid. Since she had not filed a return by that time, she did not qualify for the three-year period under the provisions of §6511.

But what about that special rule that says if the IRS issues the notice in the third year when no return had been filed, then a three statute applies. The IRS argues that its notice was not issued in that one-year period.

As the Court explains the IRS position:

> Respondent offers what he believes to be a "plain language" interpretation of the final sentence of section 6512(b)(3). In his view, the parenthetical phrase "with extensions" modifies "due date." Here, the "due date (with extensions) for filing the return of tax" was October 15, 2013, pursuant to the automatic extension petitioner received to file her 2012 return.

> The "third year" after that date began on October 15, 2015. But the notice of deficiency was mailed on June 19, 2015. That date was during the second year, not during the third year, "after the due date (with extensions) for filing the return," as the 1997 amendment requires. Respondent accordingly contends that the exception set forth in the final sentence of section 6512(b)(3) does not apply, with the result that a refund or credit of petitioner's $32,411 overpayment is barred by the two-year lookback rule generally applicable to nonfilers.

The taxpayer argues that this interpretation can't be correct—since it meant that by filing for extension of time to file her 2012, she created a six-month "black hole" into which refunds would fall if the IRS gets its notice of deficiency out during that period.

In her case, the IRS view would provide for the following results:

- Up to April 15, 2015 taxpayer would be allowed a refund since she would be filing her claim within 2 years of the date the tax was deemed paid;
- April 16, 2015 to October 15, 2015- The taxpayer's claim would be filed more than two years after the tax was paid. If a notice of deficiency is issued during this period, it is still less than two years after the *extended* due date for her 2012 return, the special rule on notices of deficiency would not apply.
- October 16, 2015 to April 15, 2016-If no notice of deficiency had been issued before this date, the taxpayer may either file a return and claim the refund under the general three-year rule or, if the IRS issues a notice of deficiency, that would be issued in the third year following the extended due date and the taxpayer could obtain the refund.

In the view of the taxpayer, clearly Congress could not have meant to create an absurd six month period during which a notice of deficiency would block any refund, followed by another six month period that, if the taxpayer made to that date without IRS action, would again allow claiming the refund.

But, the Tax Court notes, there really is no ambiguity in what Congress said. And, as the Court concludes:

> Anyone who has managed to plod thus far through this Opinion will understand that the statutory provisions we are construing are extremely technical and complex. It is possible that the drafters of the 1997 amendment did not think through all of the ramifications of Congress' decision to "inject filing extensions into the lookback period mechanism," as petitioner puts it. But wittingly or unwittingly Congress placed the words "with extensions" in the text of the statute immediately after "due date." We must give meaning to those words.
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> The text enacted by Congress makes syntactic sense and has an unambiguous meaning. Construing that text according to its plain meaning does not produce a result "so gross as to shock the general moral or common sense." *Harrelson*, 282 U.S. at 60. "Our unwillingness to soften the import of Congress' chosen words even if we believe the words lead to a harsh

outcome is longstanding. It results from 'deference to the supremacy of the Legislature.'" *Lamie*, 540 U.S. at 538 (quoting *United States v. Locke*, 471 U.S. 84, 95 (1985)).

SECTION: 6698
IRS GRANTS RELIEF TO CERTAIN PARTNERSHIPS WHO FAILED TO NOTICE CHANGE IN RETURN DUE DATES

Citation: Notice 2017-47, 9/1/17

Due dates for tax returns don't change very often—so rarely that most taxpayers likely assume they simply won't. But Congress in 2015 proved that such dates can be changed and that Congress is willing to do so, changing several dates. Matters are tougher when Congress moves the due date forward, as they did for partnerships.

Many partnerships, unaware of that requirement, either filed their Form 1065 or their request for an extension on Form 7004 after March 15, but on or before April 15, this year. Notice 2017-47 provides relief from late filing penalties for partnerships in that situation who meet the requirements provided for in the notice.

The penalties for the late filing of a partnership return have become much more onerous in recent years, being set at $195 per partner per month late (not to exceed 12 months), with the amount being adjusted for inflation.[2] If the partnership has very many partners and/or is multiple months late the penalties can quickly add up to a significant amount being due.

The relief covers partnerships who filed the following forms by their pre-2017 due dates:

- Form 1065, "U.S. Return of Partnership Income"
- Form 1065-B, "U.S. Return of Income for Electing Large Partnerships"
- Form 8804, "Annual Return for Partnership Withholding Tax (Section 1446)"
- Form 8805, "Foreign Partner's Information Statement of Section 1446 Withholding Tax"
- Form 7004, "Application for Automatic Extension of Time to File Certain Business Income Tax, Information, and Other Returns"
- Form 5471, "Information Return of U.S. Persons With Respect to Certain Foreign Corporations"

For the last two forms listed, it's important to note the relief only applies to an affected tax law partnership—other filers who file these returns late will not be eligible for relief under this notice.

The notice provides that relief will be granted if either of the following two conditions are satisfied:

- The partnership filed the Form 1065, 1065-B, 8804, 8805, 5471, or other return required to be filed with the IRS and furnished copies (or Schedules K-1) to the partners (as appropriate) by the date that would have been timely under section 6072 before amendment by the Surface Transportation Act (April 18, 2017 for calendar-year taxpayers, because April 15 was a Saturday and April 17 was a legal holiday in the District of Columbia), *or*

[2] IRC §6698

- The partnership filed Form 7004 to request an extension of time to file by the date that would have been timely under section 6072 before amendment by the Surface Transportation Act and files the return with the IRS and furnishes copies (or Schedules K-1) to the partners (as appropriate) by the fifteenth day of the ninth month after the close of the partnership's taxable year (September 15, 2017, for calendar-year taxpayers). If the partnership files Form 1065-B and was required to furnish Schedules K-1 to the partners by March 15, 2017, it must have done so to qualify for relief.

The IRS indicates that partnerships will not have to take action to obtain this relief. If the penalty has not yet been assessed, the IRS indicates that the relief will be granted automatically. If the penalty has already been assessed against the taxpayer, the notice provides that the partnership will receive a letter within the next several months notifying them that the penalties have been abated.

If a partnership that previously had the penalty assessed that qualifies for relief under this notice does not receive abatement by February 28, 2018, the partnership should contact the IRS at the number listed in the letter that assessed the penalty and state that the partnership qualifies for relief under Notice 2017-47.

Another piece of good news is that the notice also provides that this will not count as receiving relief under the IRS's first time abatement administrative penalty waiver program.

Note that the notice does not provide relief to a taxpayer that failed to timely request an extension by March 15, became aware of that due date before April 15, and did not file either a Form 7004 or the tax return itself by April 15. Such taxpayers would need to ask for abatement from the IRS for reasonable cause.

One key factor to note is that the fact that the tax adviser wasn't aware of the change of due date would likely not be found to be a reasonable cause, but the fact the partnership was not aware of the change in due date and was not advised of the change by the tax adviser would likely qualify, especially given the issuance of this notice. While the difference in those two statements may seem to many to be utterly insignificant, it is an important distinction given IRS guidance to agents about what constitutes reasonable cause and what case law has held in these cases.

Another issue not discussed in this notice is whether such partnerships will be deemed to have received a grant of extension of time to file a return for purposes of funding a retirement plan or for making any elections due by the due date (including extensions). A waiver of the penalties by itself would not cure these problems.

SECTION: 7502
TAXPAYER UNABLE TO ESTABLISH EXTENSION REQUEST TIMELY FILED

Citation: Laidlaw, et ux. et al v. Commissioner, TC Memo 2017-167, 8/28/17

One of the traditions of tax season for advisers is filing extensions for taxpayers on April 15. The case of *Laidlaw, et ux. et al v. Commissioner*, TC Memo 2017-167 deals with a problem when the IRS claimed not to have received an extension that the taxpayer's adviser claimed to have filed.

The taxpayers filed their tax returns for 2005 at the extended due date of October 16, 2006. The taxpayers had filed Forms 4868 for each of the prior three years—but the IRS did not have a record of receiving one for 2005. The forms were not sent by certified or registered mail, but rather the taxpayer's adviser testified that he sent them in by regular mail.

The question was whether the taxpayer is liable for a failure to timely penalty under IRC §6651(a). The taxpayer would not be liable if either an extension request had been timely filed or the taxpayer had reasonable cause for the late filing.

Under IRC §7502(a)(1) a document is deemed to be timely delivered to the IRS if the document is delivered by the U.S. Postal Service and the document bears a postmark made by the Postal Service on or before the due date. Under IRC §7502(c) the taxpayer may establish that postmark date using either registered or certified mail.

In this case, the Court described the following about the adviser's actions right around the original, unextended due date:

> On April 17, 2006, the due date for filing tax returns for the preceding tax year, Mr. Morgan decided to apply for extensions of time to file petitioners' 2005 Federal income tax returns because he did not yet have Schedules K-1, Partner's Share of Income, Deductions, Credits, etc., for that year. That day, Mr. Morgan and his staff prepared corresponding extension requests and estimates. Mr. Morgan's tax preparation business' billing records show that on April 17, 2006, he worked on "extensions" for Jarold and Diane Laidlaw and for Brent and Rebecca Laidlaw. In preparing the tax estimates for 2005, Mr. Morgan had in his possession Jarold Laidlaw's 2005 Forms W-2, Wage and Tax Statement, one from Laidlaw's Harley Davidson Sales, Inc., and the other from Laidlaw's Rental Center, Inc., which together showed wage income of $468,244. Mr. Morgan also had Brent Laidlaw's 2005 Forms W-2 from the same payors, together showing wage income of $501,149. Mr. Morgan was aware that petitioners had received partnership distributions reportable on Schedules K-1, which for Jarold and Diane Laidlaw were reported on their 2005 Form 1040, U.S. Individual Income Tax Return, as $124,455, and for Brent and Rebecca Laidlaw were reported as $124,162.
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> …The 2005 Forms 4868 provided by petitioners to respondent on November 22, 2016, but ostensibly prepared by Mr. Morgan on April 17, 2006, reported zero amounts for estimated total tax liability, total 2005 payments, balance due, and amount being paid presently. The 2005 forms were not sent by certified mail, and respondent claims not to have received them. Mr. Morgan avers that both Forms 4868 were mailed in the same envelope. There is no copy of the envelope in which the forms were mailed.

The IRS argued that the taxpayers did not have proof of actual filing of the extension to the level required under the regulations and prior case law in the Ninth Circuit, which is the court that would hear an appeal of this decision.

As the Court notes:

> Respondent maintains, first, that petitioners do not have proof of mailing or a copy of the envelope in which the extension requests purportedly were mailed and, second, that he has introduced account transcripts rebutting any presumption that he received the Forms 4868. Petitioners' case relies on the testimony of their tax preparer, Mr. Morgan. Respondent does not believe Mr. Morgan to be credible because (1) the reliability of Mr. Morgan's recollections about mailing an envelope over a decade ago is dubious, (2) Mr. Morgan had many clients, (3) Mr. Morgan's billing records indicate that he began work on petitioners' extension requests and tax estimates on the day of the filing deadline, and (4) Mr. Morgan failed to verify that the envelope ostensibly containing petitioners' Forms 4868 had proper postage. Respondent further contends that petitioners' timely filing of their extension requests and tax returns in prior years does not prove timely filing for tax year 2005.

The IRS argues that the taxpayer's case is different from two prior cases the taxpayers cite where it was held the taxpayer had shown timely mailing, the case of *Anderson v. United States*, 966 F.2d 487 (9th Cir. 1992) and *Lewis v. United States*, 144 F.3d 1220 (9th Cir. 1998). The Court notes:

> Respondent distinguishes *Anderson* and *Lewis* by claiming that those taxpayers presented corroborating evidence in addition to their self-serving testimony, and this evidence was judged credible by the trial courts. Respondent further distinguishes Lewis by pointing out that the copies of the California extension request forms and checks presented by petitioners are meaningless without Mr. Morgan's testimony that the forms and checks were timely sent to and received by the State of California. Respondent also distinguishes Lewis by the fact that there the IRS had received the request for extension of time and deemed it late, whereas here respondent never received the request. In short, respondent asserts that absent any extrinsic evidence corroborating timely filing, Mr. Morgan's testimony stands alone, and no rebuttable presumption of timely mailing exists.

The Tax Court, examining the evidence of timely filing, sided with the IRS. First, the Court noted that the adviser in question did not testify, but rather the case was submitted by the parties under Rule 122 where there is no trial. The Court found that this meant it was missing a key item necessary to rule in favor of the taxpayers—the ability to judge the credibility of the adviser as a witness.

> In evaluating extrinsic evidence to establish a document's timely mailing where the only proof thereof is a witness' testimony, the Court of Appeals for the Ninth Circuit instructs us that the witness' credibility is key. *Anderson*, 966 F.2d at 492. We ascertain credibility by observing the witness' candor, sincerity, and demeanor during his testimony. See, e.g., *Gerdau Macsteel, Inc. v. Commissioner*, 139 T.C. 67, 155 (2012). However, because the parties submitted this case under Rule 122, we had no opportunity to observe Mr. Morgan's credibility as a witness. The reliability of a witness' testimony hinges on his credibility. We were not provided a full opportunity — so critical to our being able to find the witness reliable — to evaluate Mr. Morgan's credibility on the issue of timely filing because petitioners never offered his live testimony in a trial setting. Instead, petitioners merely

> offered to the Court a transcript of the witness' deposition. While we can learn much from reading the testimony, it is not the same as a firsthand observation of the witness' demeanor and sincerity, both essential aspects of credibility and reliability.

The Court also found concerns with the testimony that was submitted from the adviser:

> Moreover, we have reservations about the content of Mr. Morgan's testimony. While petitioners claim that Mr. Morgan's recollections have remained fresh because petitioners are significant clients who have undergone an audit and undertaken litigation in this Court, respondent casts doubt on whether Mr. Morgan could remember specific details of mundane events that transpired over a decade ago. Mr. Morgan has many clients and prepares between 215 and 250 income tax returns annually, in addition to filing between 75 and 100 extension requests. Multiple filing deadlines have passed since April 17, 2006, and we agree that it is incredible that Mr. Morgan would specifically remember filing petitioners' extension requests on that busy day. Indeed, he admitted in his deposition that he did not recall the days on which he filed Jarold and Diane Laidlaw's 2004 and 2006 extension requests, nor the days on which he filed Brent and Rebecca Laidlaw's 2004 and 2006 tax returns.

The Court noted that these concerns with the submitted testimony might have been overcome had the Court been able to evaluate the adviser's testimony in person.

As well, the Court noted that the adviser was not a disinterested party regarding this matter.

> [Mr. Morgan's] timeliness in mailing necessary documents reflects upon his accountancy practice and affects his professional relationship with his clients. While self-serving testimony is not invariably untrustworthy, a contrary determination requires that we find the witness credible and forthright, cf. *Herman v. Commissioner*, 84 T.C. 120, 136 (1985) ("Though such testimony is arguably self-serving, we found the witnesses credible and forthright and accept their testimony on its face."), something that we cannot do here — again, because of the parties' decision to submit this case under Rule 122. The burden of proof falls upon petitioners, and this is a burden not satisfied by the testimony of a tax preparer whose credibility is at best a toss-up.

At trial the taxpayers claimed that, regardless of the issue with the mailing of the extension, they should qualify for relief from the penalty under the IRS's First Time Abate policy. The policy, found at Internal Revenue Manual 20.1.1.3.6.1, provides that a taxpayer requesting reasonable cause relief from late filing and certain other penalties can obtain an administrative waiver of the penalty if the taxpayer has no penalties for the three preceding years and has filed all currently required tax returns and paid all tax due.

But the Court found that the taxpayers had no basis on which to raise that issue at trial. The Court noted:

> This policy, appearing in the IRM, is a form of administrative relief. Its location at IRM pt. 20.1.1.3.6.1 places it under the "Reasonable Cause Assistant" category in IRM pt. 20.1.1.3.6, which refers to a tool used by the IRS to consider reasonable cause penalty relief.

> As we noted above, petitioners have not argued reasonable cause. Moreover, since there is no evidence that petitioners have requested any abatement or that respondent has denied such, we find no basis upon which to entertain petitioners' argument.

Advisers should take note of the significant risks involved when extension requests are not filed in a manner that provides acceptable evidence of timely filing (certified mail, registered mail or via electronic filing).

As well, it's important in any dispute to assert all available remedies. The Court sidestepped whether a taxpayer could have been deemed to have reasonable cause outside of an abatement request by simply noting the taxpayer hadn't argued for reasonable cause.

SECTION: 7508A
FEDERAL AND TEXAS TAX RELATED RELIEF FOR TAXPAYERS AFFECTED BY HURRICANE HARVEY

Citation: IRS News Release IR-2017-135, Texas Comptroller of Public Accounts "Declared Natural Disasters and Emergencies Tax Help", 8/28/17

The IRS and the Texas Comptroller have announced forms of due date and other relief for individuals impacted by Hurricane and Tropical Storm Harvey in Houston and surrounding areas.

The IRS has announced information related to relief provided under IRC §7508A for performing certain acts in News Release IR-2017-135. IRC §7805A provides that the IRS may authorize a delay of up to one year to allow taxpayers to perform certain acts when the taxpayer is affected by a federally declared disaster or terroristic or military action.

As of the date the news release was issued, the counties in Texas affected by the disaster and which were granted relief were:

- Aransas,
- Bee,
- Brazoria,
- Calhoun,
- Chambers,
- Fort Bend,
- Galveston,
- Goliad,
- Harris,
- Jackson,
- Kleberg,
- Liberty,
- Matagorda,
- Nueces,
- Refugio,
- San Patricio,

- Victoria and
- Wharton.

The IRS relief is automatically granted to any taxpayer with an address of record located in the disaster area. Those who live outside the disaster area but whose records are located within the disaster area and relief workers working with a recognized organization need to contact the IRS at 866-562-5227 to discuss relief.

The IRS describes the affected tax deadlines as follows:

> The tax relief postpones various tax filing and payment deadlines that occurred starting on Aug. 23, 2017. As a result, affected individuals and businesses will have until Jan. 31, 2018, to file returns and pay any taxes that were originally due during this period. This includes the Sept. 15, 2017 and Jan. 16, 2018 deadlines for making quarterly estimated tax payments. For individual tax filers, it also includes 2016 income tax returns that received a tax-filing extension until Oct. 16, 2017. The IRS noted, however, that because tax payments related to these 2016 returns were originally due on April 18, 2017, those payments are not eligible for this relief.
>
> A variety of business tax deadlines are also affected including the Oct. 31 deadline for quarterly payroll and excise tax returns. In addition, the IRS is waiving late-deposit penalties for federal payroll and excise tax deposits normally due on or after Aug. 23 and before Sept. 7, if the deposits are made by Sept. 7, 2017. Details on available relief can be found on the disaster relief page on IRS.gov.

The news relief also reminds taxpayers that suffered uninsured disaster-related losses may claim elect to claim the losses on their return for the year of loss (2017) or the previous year (2016). See IRC §165(I) and Temporary Reg. §1.165-11T for information on this option. Advisers should point to affected clients that even personal casualty losses may be used in the computation of a federal net operating loss available for carryback (IRC §172(d)(4)(C)).

Similarly, a three year net operating loss carryback period (rather than the standard two year periods) is available for

- Casualty losses of an individual (IRC §172(b)(1)(E)(ii)(I)) and
- Net operating losses of a "small business" attributable to a federally declared disaster (IRC §172(b)(1)(E)(ii)(II).

For this purpose, a "small business" is generally one that has average gross receipts for the prior three years of less than $5,000,000. (IRC §172(b)(1)(E)(iii) ; IRC §448(c))

The Comptroller of the State of Texas has also announced various forms of tax relief available to affected taxpayers related to various state taxes. The information is found in a page containing frequently asked questions on disaster relief on the agency's website.

The page notes that, unlike the IRS relief, affected who cannot timely file taxes with the Comptroller's office will need to contact the agency. The page states:

> Some taxpayers may be unable to file taxes timely due to damage caused by a declared natural disaster. The Comptroller can grant an extension of up to 90 days to file tax returns to a business affected by a declared disaster. An affected business must request the extension. These types of extension requests are handled on a case-by-case basis. For more information or to request a tax filing extension, call the Comptroller's tax assistance line at 800-252-5555.

The page also notes that the Governor of Texas has issued certain proclamations on exemptions for certain sales and other taxes. The FAQ page has information on this relief, which at the time this article was written included certain relief from hotel taxes and sales taxes, as well as relief for out of state businesses performing disaster or emergency related work in Texas.

In the past, such relief has often covered an expanded area in the case of storms such as Harvey, as the storm affects additional areas as it continues to move. Advisers should be sure to continue to monitor developments with the various taxing agencies to see if clients may qualify for some form of relief.

SECTION: 7701
IRS RECOGNIZED COMMON LAW MARRIAGE BASED ON STATE RULING

Citation: Technical Advice Memorandum 201734007, 8/25/17

Federal tax law doesn't itself contain a definition of what constitutes a marriage, rather deferring to state law. As Reg. §301.7701-18(b)(1) provides:

> (b) Persons who are lawfully married for federal tax purposes.
>
> > (1) In general.
> >
> > Except as provided in paragraph (b)(2) of this section regarding marriages entered into under the laws of a foreign jurisdiction, a marriage of two individuals is recognized for federal tax purposes if the marriage is recognized by the state, possession, or territory of the United States in which the marriage is entered into, regardless of domicile.
> >
> > (2) Foreign marriages.
> >
> > Two individuals who enter into a relationship denominated as marriage under the laws of a foreign jurisdiction are recognized as married for federal tax purposes if the relationship would be recognized as marriage under the laws of at least one state, possession, or territory of the United States, regardless of domicile.

Technical Advice Memorandum 201734007 answers a question regarding whether the IRS had to recognize a "common law" marriage.

A minority of states recognize a common law marriage, which is a legally recognized marriage between two individuals who did not obtain a marriage license and did not have a recognized marriage ceremony.

The National Conference of State Legislatures published a list of states that recognize common law marriages in a web article published in August of 2014.[3] Per that list, the following states have common law marriages currently:

- Colorado
- Iowa
- Kansas
- Montana
- New Hampshire
- South Carolina
- Texas
- Utah

As well, the site lists the following states that previously recognized common law marriages and continue to recognize those old marriages in their state as valid:

- Pennsylvania
- Ohio
- Indiana
- Georgia
- Florida

In the case in question, there was some concern about whether an arrangement qualified as a common law marriage under state law, so a state agency was consulted. As the facts provide:

> In an Order dated Date 2, the State Board of Finance and Revenue concluded that Decedent and X had entered into a common-law marriage under State law and that "based on the specific facts and circumstances presented, Decedent and X were common-law spouses" when Decedent died on Date 1.

As the ruling noted, in this case the state's ruling is binding on the IRS.

[3] http://www.ncsl.org/research/human-services/common-law-marriage.aspx