Current Federal Tax Developments

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SECTION: SECURITY
NEW PHISHING EMAIL MASQUERADES AS E-SERVICES SECURITY NOTICE AND THEN STEALS THE PROFESSIONAL'S CREDENTIALS

Citation: IRS News Release IRS-2016-145, 11/4/16

Scams to steal information from tax professionals just keep coming, and the latest is a phishing email detailed in IRS News Release IR-2016-145. This phishing scam is looking to obtain e-services credentials for tax professionals and, like most good phishing scams, the email looks just credible enough to get someone not paying attention (or simply not aware of how email and phishing works) to provide the requested information.

A good phishing email must look like something the recipient would expect to see—and often takes advantage of a mark's awareness that something has changed, relating the email to that change. In recent years that's quite often been to cloak the email scam in the guise of increased security (and, yes, I'm sure the scammers find the irony amusing).

This new one is of that type. As the IRS notes:

> The scammers are attempting to exploit current IRS efforts to strengthen the e-services authentication process and its ongoing communications with tax professionals about their accounts. Scammers are attempting to steal e-services usernames and passwords or even more personal data through a registration page.

More specifically, the email exploits news stories regarding leakage of data from the IRS (even though it was never e-services data) and goes on and throws in the "state-sponsored actor" source of the attack (for those who have heard such vague statements regarding various other attacks in the news recently), as wells the fact that IRS is making changes to e-services to increase security. As the IRS notes:

> The scammer email tells recipients that information was stolen from certain user accounts in 2015 from a state-sponsored actor. It says users are being asked to upgrade their e-service account to ensure protection of their information. It asks them to click on the login to access their accounts for security upgrade.
>
> The IRS is in the process of upgrading e-services security and has been in communication with tax professionals about updating their accounts.

The IRS notes details on this email:

> The subject line for the fraudulent email is "Security Awareness for Tax Professionals." The "From" line is "Your e-Services Team." It has both an IRS logo and an e-services logo that hyperlinks to a URL verified as a phishing site. The spoofing site poses as an e-services registration page.

Clearly, if this email arrives in your inbox it should be deleted immediately and not acted upon. As well, all other members of your firm with access to e-services should be notified of this scam.

If a professional has already fallen for the scam, the IRS gives the following advice:

> If e-services users have already clicked on the fake logo and provided their username and password, they should contact the e-services help desk to reset their accounts. If the same password is used for other accounts, these should be changed as well. As an extra precaution, users should perform a deep

security scan on their computers, re-evaluate their security controls and be alert to any other signs of identity theft or data compromise.

Advisers should never go the IRS e-services page (or any other important page) by clicking on a link in an email. A link in an email can send the user anywhere—and certainly doesn't need to send the user to the site it claims to be sending you to, even if it shows a full website URL as the link. It's also trivial to format an email to look just like the official emails send from any organization (including your firm, or that of one of your clients).

Put simply, your email client and browser (or, more specifically the HTML code they are displaying) can be easily made to lie to you.

The IRS then goes on to remind professionals of the recommendations that came out of this year's security summit:

> The IRS, state tax agencies and tax industry partners working together through the Security Summit have an awareness campaign underway called Protect Your Clients; Protect Yourself. The objective is to remind tax professionals they increasingly are the targets of identity thieves seeking ever larger amounts of taxpayer data to file fraudulent tax returns.
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> Security Summit partners recommend tax professionals:
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> - Always use robust security software
> - Use encryption software to protect taxpayer data
> - Use strong passwords and change them often
> - Learn to recognize phishing emails attempting to steal data
> - Never click on links or download attachments from suspicious emails
> - Beware of any communications claiming to be the IRS that are outside normal channels

I would modify that advice as follows:

- Never download attachments from any email until you confirm with the purported source that an attachment was sent (preferably clients should upload data via a secured portal)
- Never click links on emails, period. (That simple step would stop most phishing emails from being effective)
- Be suspicious of any purported communications from the IRS, your tax software vendor, current or prospective client

SECTION: 409A
ADDITION OF 25% EMPLOYER MATCH TO DELAY RECEIPT OF SALARY FOUND TO CREATE SUBSTANTIAL RISK OF FOREFEITURE

Citation: Chief Counsel Advice 201645012, 11/4/16

Does the fact that a taxpayer, by agreeing to defer receiving compensation in a year, earned the right to a 25% employer match in three years conditioned on the employee continuing to provide substantial services until that date mean the taxpayer now had a "substantial risk of forfeiture"? The question arises when looking at whether, under Reg. §1.409A-1(d)(1), this is an allowable deferral of income under IRC §409A.

In Chief Counsel Advice 201645012 the issue was considered.

Reg. §1.409A-1(d)(1) provides, in part:

> An amount will not be considered subject to a substantial risk of forfeiture beyond the date or time at which the recipient otherwise could have elected to receive the amount of compensation, unless the present value of the amount subject to a substantial risk of forfeiture (disregarding, in determining the present value, the risk of forfeiture) is materially greater than the present value of the amount the recipient otherwise could have elected to receive absent such risk of forfeiture.

In this case, the facts were outlined as follows:

> On November 1, 2014, an employee entered into an agreement to defer $15,000 of the employee's salary that would otherwise have been paid during 2015, with payment of the deferred amount to be made as a lump-sum payment on January 1, 2018, but only if the employee continues to provide substantial future services until December 31, 2017. Under the agreement the employee's salary is reduced by $600 each biweekly pay period (so 26 x $600 or $15,600) and the employer credits matching amounts to the employee's deferred compensation account of 25% of each salary reduction (so 26 x ($600 / 4) or $3,900) for a total amount deferred of $19,500. The matching amounts are credited each time a salary reduction amount is credited, which is the time the salary reduction amount would otherwise be paid as salary.

So, did the IRS judge this 25% "sweetener" sufficient to create the substantial risk of forfeiture? Because, as was noted above, the general rule is that if you volunteer to not take salary today that doesn't create a substantial risk of forfeiture unless you show you will get a "materially greater" amount, measured on a present value basis in the future.

In this case, the memo concludes this 25% addition with the 3-year delay does create a materially greater amount. As the memo notes:

> Generally, under Treas. Reg. § 1.409A-1(d), the addition of a risk of forfeiture is disregarded. However, the addition of a substantial risk of forfeiture is respected if the present value of the amount subject to the substantial risk of forfeiture is "materially greater" than the present value of the amount the service provider otherwise could have elected to receive absent such risk of forfeiture. Under the facts here, the present value of the amount deferred by the employee is 25% greater than the amount the employee otherwise could have received absent the addition of the substantial risk of forfeiture. A 25% increase in the present value of the amount a service provider could have received absent the risk of forfeiture is a material increase. Accordingly, the combined deferred amount of 2015 salary ($15,600) plus the deferred amount of the employer's matching contribution ($3,900) is subject to a substantial risk of forfeiture for purposes of section 409A until December 31, 2017.

SECTION: 415
IRS ANNOUNCES 2017 RETIREMENT PLAN INFLATION ADJUSTED LIMITS

Citation: Notice 2016-62, 10/27/16

The IRS announced in Notice 2016-62 the inflation adjusted limitations imposed on qualified plans for 2016.

Type	2017 Amounts	2016 Amounts
Maximum annual benefit-DB Plan (§415)	$ 215,000	$ 210,000
Contribution limit DC Plan (§415)	54,000	53,000
Annual Compensation Limit (§404(l))	270,000	265,000
Catch up Contributions to Employer Plan	6,000	6,000
Elective Deferrals (§402(g))	18,000	18,000
Highly Compensated Employee (§414(q))	120,000	120,000
Key Employee Compensation (§416(i))	175,000	170,000
SIMPLE Deferral Limitation (§408(p))	12,500	12,500
SIMPLE Catch Up Contribution (414(v)(2)(B))	3,000	3,000
SEP Compensation Limit (§408(k))	600	600
IRA Limitations		
Maximum IRA Contribution (before catch-up) (§219(b)(5)(A))	5,500	5,500
Deduction phases out for individuals that are an active participant in an employer plan for adjusted gross income between	Single and Head of Household - $62,000 to $72,000	Single and Head of Household - $61,000 to $71,000
	Married Filing Joint - $99,000 - $119,000	Married Filing Joint - $98,000 - $118,000
	Married Filing Separate - $0 - $10,000	Married Filing Separate - $0 - $10,000
Deduction phases out for individuals whose spouse is an active participant in a an employer plan phases out between	$186,000 - $196,000	$184,000 - $194,000
Roth IRA Maximum Contribution Phaseout Begins:		
Married filing joint	186,000	184,000
Other except married filing separate	118,000	117,000

SECTION: 6213
CORPORATION SUSPENDED BY STATE OF CALIFORNIA UNABLE TO CHALLENGE IRS COLLECTION DETERMINATION IN TAX COURT

Citation: Urgent Care Registries, Inc. v. Commissioner, TC Memo 2016-198, 11/2/16

No longer possessing a valid charter can create a situation where the entity is unable to file in Tax Court to dispute an IRS finding. That was the situation for the corporation in the case of *Urgent Care Registries, Inc. v. Commissioner*, TC Memo 2016-198.

The corporation in this case had filed some income and employment tax returns for 2009 through 2013 but enclosed no payments. As well, some returns that it should have filed were never filed and the IRS prepared substitutes for returns (SFR). The IRS assessed the taxes and penalties, and send the taxpayer a Final Notice of Intent to Levy.

The corporation requested a Collection Due Process (CDP) hearing. The opinion notes:

> In June 2015 the SO informed petitioner's representative: "The revenue officer's case history indicates that Urgent Care Nurses Registry, Inc. may no longer be in business. You/your representative told the revenue officer that the business is now being operated under the EIN of [a] sole proprietorship." The SO requested copies of documents "confirming the dissolution of the corporate entity." Petitioner's representative submitted a copy of Form 966, Corporate Dissolution or Liquidation, and a certificate of dissolution of petitioner.

The settlement officer determined that the IRS's actions in this matter should be sustained. The taxpayer filed a petition with the Tax Court to review the decision.

The IRS eventually moved to have the case dismissed, arguing that the petition was filed by a party that lacked the capacity to sue.

Tax Court Rule 60(c) provides that the capacity of a corporate to litigate in the Tax Court is determined by reference to state law, which in this case was the state of California.

The opinion points out that, in general:

> In California, the board may suspend the "powers, rights[,] and privileges of a domestic taxpayer" if the corporation fails to pay "any tax, penalty, or interest, or any portion thereof, that is due and payable" at specified times. Cal. Rev. & Tax Code sec. 23301 (West 2015); *Grell v. Laci Le Beau Corp*., 87 Cal. Rptr. 2d 358, 362 (Ct. App. 1999) (citing *Reed v. Norman*, 309 P.2d 809, 812 (Cal. 1957)). Once a corporation's powers have been suspended, it "may not prosecute or defend an action." *Reed*, 309 P.2d at 812.

In the case of this corporation the Court noted:

> Petitioner's corporate powers were suspended in August 2008, and it has supplied no evidence that it has since received a certificate of revivor or become current on its California tax obligations. The California secretary of state confirmed in July 2016 that petitioner's corporate powers "remain suspended." Documentation submitted to the SO by petitioner's representative indicates that petitioner has been formally dissolved and that the business it formerly conducted is now being conducted by a sole proprietorship. For these reasons, we find that petitioner lacked the capacity to litigate at the time it filed its petition in this case. See *David Dung Le, M.D., Inc.*, 114 T.C. at 276 (holding that suspended California corporation lacked capacity to sue).

SECTION: 6672
DESPITE SIGNING PAYROLL CHECKS, WIFE OF CO-OWNER FOUND NOT TO BE RESPONSIBLE PERSON

Citation: Fitzpatrick v. Commissioner, T.C. Memo. 2016-199, 11/2/16

To most practitioners, at first glance the facts in the case of *Fitzpatrick v. Commissioner*, T.C. Memo. 2016-199 would appear to doom Christina Fitzpatrick to being liable for the 100% trust fund penalty related to unpaid payroll taxes for the wine bar that was partially owned by her husband and for which she worked.

These "bad facts" included the fact that:

- Christina had signature authority over the bar's checking account
- Christina signed payroll checks regularly
- Christina selected and arranged to hire Paychex to handle the restaurant's payroll

However, despite that apparent level of control, the Tax Court found that Christina was not a responsible party based on other facts in the case.

First, although Christina had some involvement with the bar, most of her time was spent caring for her son. As the Court notes:

> Petitioner's primary responsibility during the periods at issue was to serve as caregiver to her disabled son Evan,6 who suffers from a rare metabolic disorder called citrullinemia. As a result of the disorder, Evan has severe autism, cerebral palsy, and limited mobility. Evan is also speech impaired and needs assistance to perform many basic functions such as eating and going to the bathroom. He has a low IQ and a life expectancy of 33 years. He is required to take over 50 pills a day and cannot be left for any significant amount of time without adult supervision. Because of the substantial amount of attention Evan required, petitioner was unable to devote significant effort to any business enterprise.

Day to day operations of the restaurant fell the general manager, Mr. Chislett. As the Court noted:

> Mr. Chislett, the general manager of the Grape, was responsible for carrying out the day-to-day business operations. He managed the employees, paid creditors, and oversaw purchases from vendors. He was responsible for hiring and firing personnel. Mr. Chislett was also Paychex's main contact during the periods at issue, and he maintained control over the payroll process. On his résumé, Mr. Chislett stated that his responsibilities included:
>
>> Management and oversight of all restaurant, with duties including; recruitment and selection of personnel, training, purchasing, inventory, sales strategies and yield management, reviewing financial statements, P&L, product mix, budgeting, forecasting revenues and expenses, and management of individual department managers/ supervisors. Supplier relations including; price negotiation, negotiation of payment terms and utilisation [sic] of key industry contacts in order to complete tasks.

Christina's role was far more limited:

> Petitioner did not have a significant role at the Grape. While she was directed to establish the business' bank account and contract with Paychex during the preopening phase of the business, she became decidedly less involved once the business was operational. Petitioner's main responsibilities were delivering checks, relaying electronic bank account balances to Mr. Chislett, and delivering the business' mail that was sent to her private mailbox. Petitioner occasionally transferred funds to and from the corporate bank account at the direction of Mr. Stamps or Mr. Fitzpatrick. Petitioner also issued checks at the direction of Mr. Stamps or Mr. Fitzpatrick for some of the business' recurring monthly expenses. Petitioner made no operational decisions. Indeed, she did not have the proper education, training, or experience to hold a management position at the Grape.

Payroll checks were delivered to the Fitzpatricks' residence since there generally weren't employees at the restaurant at the time early on Tuesday mornings when Paychex delivered the paychecks. Christina would sign the checks when they were delivered by Paychex and then deliver them to the restaurant that same afternoon. She had to sign the checks because Tuesday and Mr. Chislett's day off and so he wasn't available to sign the checks.

However, Mr. Chislett was the primary contact with Paychex aside from the delivery of the checks, compiling the information and transmitting the information to Paychex each week. Christina was not responsible for and did not review the statements included in the Paychex package.

Mr. Chislett had big plans for the restaurant—big and expensive and not cleared with the owners. These expensive plans drained the company of cash and checks began to bounce, forcing Mr. Chislett to scramble via various means to pay vendors, many of whom demanded cash or certified checks.

Eventually Paychex became a victim of the insufficient funds problems for the enterprise. In November 2008, Paychex was turned down by the bank when it attempted to charge the restaurant's account $1,809.88 for taxes and $328.35 for an invoice. Not surprisingly, that the was last time that Paychex attempted an electronic withdraw for taxes.

While Paycheck continued to create payroll checks and take its fees from the account, it no longer handled tax deposits—a fact not known to Christina. The restaurant continued to operate from that date in 2008 until early 2011 when the operations of the restaurant were turned back over to the franchisor. Christina was not aware there were unpaid payroll taxes at any point from the cessation of Paycheck's handling payroll tax deposits until the restaurant ceased operations.

The IRS turned to Christina as a responsible party from which to collect the unpaid trust fund taxes. The opinion notes:

> Respondent argues that petitioner possessed all the recognized indicia of responsibility and was therefore a responsible person within the meaning of section 6672. Respondent further asserts that petitioner exercised substantial financial control over Dey Corp. and that at all times petitioner was a de facto officer of the corporation because she opened two corporate bank accounts, had signatory authority on both accounts, and signed checks on behalf of the corporation.

Despite all those facts, the Court found Christina was not a responsible person. The Court noted:

> Petitioner lacked the authority to control the financial affairs of the business or exercise any significant authority over the disbursement of Dey Corp.'s funds. Notwithstanding petitioner's signatory authority and her spousal relationship to one of the corporation's owners, the substance of petitioner's position was largely ministerial and she lacked actual authority. The credible testimony and the documentary evidence introduced at trial demonstrate that Mr. Stamps and Mr. Chislett exercised control over the financial affairs of the corporation and that petitioner served only support functions. We are in fact puzzled that Mr. Stamps, the president of the corporation and a hands-on owner, and Mr. Chislett, the day-to-day manager, successfully evaded in the administrative phase any personal liability for these TFRPs.
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> … Moreover, even though petitioner signed most of the payroll checks prepared by Paychex, the duty was ministerial and done only for the convenience of the corporation. She had no duty to, and did not, oversee the employees, collect payroll information, compile payroll information, or remit the payroll information to Paychex on behalf of the corporation. Mr. Chislett was responsible for carrying out those duties.

One important point that distinguishes this case from others where the taxpayer was found to be a responsible party is likely the fact that Christina both was never aware of the actual nonpayment of taxes. The case might have turned out very differently had the IRS visited Christina before the restaurant operations were transferred back to the franchisor.

While the Court was confused about why the IRS did not go after other parties for the trust fund recovery penalty, it seems likely that the Fitzpatricks may have been the “money partners” in this enterprise—and thus the parties most likely to have the resources to pay the penalty. It’s also not unusual that the IRS often focuses on anyone with signature authority—especially when that person is signing checks at the time the trust fund payments remain outstanding.