Current Federal Tax Developments

Week of June 4, 2018

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Section: Security
Fact Sheet Outlines Steps IRS Takes to Contact Taxpayers

Citation: Fact Sheet FS-2018-12, 5/31/18

Clients who get scam phone calls from parties claiming to be the IRS demanding immediate payment are often calling advisers in a panic after such a call. While we will assure them that the IRS doesn't handle these issues the way the caller they talked to is suggesting, we can now also point them to an IRS document regarding what the IRS will and will not with regard to a tax issue.

In Fact Sheet FS-2018-12 the IRS describes how the agency does and does not contact taxpayers.

The sheet notes that normally the IRS will not contact taxpayer by phone or a visit to the taxpayers' home. But it does note:

> *However, there are special circumstances in which the IRS will call or come to a home or business, such as:*
>
> - *When a taxpayer has an overdue tax bill,*
> - *To secure a delinquent tax return or a delinquent employment tax payment, or*
> - *To tour a business, for example, as part of an audit or during criminal investigations.*
>
> *Even then, taxpayers will generally first receive a letter or sometimes more than one letter, often called notices, from the IRS in the mail.*

The notice goes on to outline some things that scammer often demands, but which the actual IRS will never do:

- *Demand that people use a specific payment method, such as a prepaid debit card, gift card or wire transfer. The IRS will not ask for debit or credit card numbers over the phone. For people who owe taxes, make payments to the U.S. Treasury or review IRS.gov/payments for IRS online options.*
- *Demand immediate tax payment. Normal correspondence begins with a letter in the mail and taxpayers can appeal or question what they owe. All taxpayers are advised to know their rights as a taxpayer.*
- *Threaten to bring in local police, immigration officers or other law enforcement agencies to arrest people for not paying. The IRS also cannot revoke a license or immigration status. Threats like these are common tactics scam artists use to trick victims into believing their schemes.*

The fact sheet notes that, in some cases (such as due to an investigation or audit), an employee may make an official and unannounced visit to the taxpayer or the taxpayer's place of business. The IRS provided the following information to help taxpayers assure that such visitors are truly acting for the IRS:

- *All IRS representatives will always provide their official credentials, called a pocket commission and a HSPD-12 card. The HSPD-12 card is a government-wide standard form of reliable identification for federal employees and contractors. Taxpayers have the right to see these credentials. IRS employees can provide an additional method to verify their identification. Upon request, they're able to provide a toll-free employee verification telephone number.*

- *Collection employees won't demand immediate payment to a source other than "U.S. Treasury."*
- *IRS employees may call taxpayers to set up appointments or discuss audits but not without first attempting to notify taxpayers by mail.*
- *IRS employees conducting criminal investigations are federal law enforcement agents and will never demand money.*

Another way taxpayers can legitimately be contacted related to an IRS debt is when the IRS refers an account to a collection agency. The IRS notes the following about legitimate private collection agency referrals from the agency:

- *The IRS will send a letter to the taxpayer letting them know the IRS has turned their case over to one of the four PCAs. The PCA will also send the taxpayer a letter confirming assignment of the taxpayer's account to the agency.*
- *The IRS will assign a taxpayer's account to only one of these agencies, never to all four. The IRS authorizes no other private groups to represent the IRS.*
- *It's important to know that PCA representatives:*
    - *Will identify themselves and will ask for payment to "U.S. Treasury,"*
    - *Will not ask for payment on a prepaid debit or gift card, and*
    - *Will not take enforcement action.*

Unfortunately, that list will likely overwhelm clients if you send the information out in a general mailing—and, in fact, that long list might make them more likely to believe a fraudulent call as they recall there were "lots of potential contacts" in that list. But the fact sheet can be very useful to direct a client towards when they are faced with a specific fraudulent call—then the taxpayer can be directed to the one or two lines that tell them the IRS would not do what the caller did.

Section: 408
IRS Issues Ruling Providing for Withholding on Transfer of IRA Funds to State Unclaimed Property Funds and Filing of Forms 1099R

Citation: Revenue Ruling 2018-17, 5/29/18

The various states have laws on their books that require an entity holding "unclaimed property" to turn that property over to the state. Generally, this transfer takes place when the account owner fails to take any action with regard to the property and the holder of the property is unable to locate that owner.

Such property can include individual retirement accounts. In Revenue Ruling 2018-77 the IRS rules on circumstances when the payor will or will not be required to withhold taxes from the transfer to the state as well as the reporting requirements on a Form 1099R when such a distribution takes place.

The IRS outlines the facts to be used in this ruling as follows:

> I*ndividual C has an interest in IRA O, a traditional IRA trusteed by Trustee Y. Individual C, a U.S. person under § 7701(a)(30)(A) with a calendar year taxable year, has not made a withholding election with respect to her interest in IRA O. State J law requires Trustee Y to pay Individual C's*

> *interest in IRA O to the State J unclaimed property fund under which a claim for property may be made by the owner.1 In 2018, Trustee Y pays Individual C's interest in IRA O, which has a value of $1,000, to the State J unclaimed property fund.*

The first question the IRS addresses is whether the holder of the account is required to withhold federal tax on the payment.

The ruling finds the answer is yes. The ruling turns to IRC §3405 which provides withholding rules for "designated distributions" with distributions from an IRA being one such category of designated distributions. While a designated distribution does not include any portion of a distribution that is reasonable to believe is not subject to tax, IRC §3405(e)(1)(B) provides that any distribution from an IRA (other than a Roth IRA) is treated as a taxable distribution for these purposes.

IRC §3405(b)(1) provides a general rule that a payor is to withhold 10% by default from any nonperiodic distribution from an IRA. An individual can elect, under IRC §3405(b)(1), not to have any withholding apply to the distribution. But since the taxpayer in this case did not make such an election (presumably because the institution has been unable to contact her), the IRS ruled that withholding was required:

> *The payment of Individual C's interest in IRA O, a traditional IRA, to the State J unclaimed property fund, as required by State J law, is a payment from an IRA that is treated as includible in gross income (pursuant to the flush language of § 3405(e)(1)(B)) for purposes of § 3405(e)(1)(B)(ii). Thus, the payment is a designated distribution for purposes of § 3405. The payment from IRA O is not an annuity or similar periodic payment under § 3405(e)(2). Thus, it is a nonperiodic distribution as defined in § 3405(e)(3). Because Individual C has not made a withholding election with respect to the payment, a 10 percent withholding rate applies to the payment pursuant to § 3405(b)(1), and Trustee Y must withhold federal income tax of $100 (10% of Individual C's $1,000 interest in IRA O).*

The ruling in this area most likely was issued because some states likely were complaining when custodians attempted to withhold funds from such transfers, arguing that their statutes require turning over the entire balance. But the IRS has now ruled that federal law would override that provision, with the federal government getting 10% of the balance of the account.

Another issue that would cause concern for a custodian is whether a Form 1099R needs to be issued. The funds are no longer being held in an IRA account, but they also did not end up in the hands of the taxpayer. The IRS, citing Reg. §1.408-7(a), held that such information reporting is required for any distribution, even one that is being made to a governmental agency rather than the beneficiary of the account.

The ruling holds:

> *Section 1.408-7(a) provides that the trustee of an individual retirement account or the issuer of an individual retirement annuity who makes a distribution during any calendar year shall make a report of the distribution for such year. Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., is used to satisfy this reporting obligation.*
>
> *Pursuant to § 408(i), Trustee Y must report the $1,000 distribution from IRA O ($900 of which is paid to the State J unclaimed property fund and $100 of which is remitted as federal income tax withholding) on a 2018 Form 1099-R identifying Individual C as the recipient.*

Given that the IRS had not previously issued guidance in this area, and it's very likely that custodians (perhaps under pressure from state agencies) had not been withholding funds and, similarly, had not been issuing Forms 1099R, the IRS is granting conditional transition relief to custodians.

The ruling provides:

> *A person will not be treated as failing to comply with the withholding and reporting requirements described in this revenue ruling with respect to payments made before the earlier of January 1, 2019, or the date it becomes reasonably practicable for the person to comply with those requirements.*

Note the use of the "earlier" test in the relief—it would appear to put the burden on the custodian who fails to withhold or file Forms 1099R for payments made before January 1, 2019 to show why compliance was not "practicable" for the period after this ruling was issued on May 29, 2018.

Section: 3121
Taxpayer Was a Statutory Employee, Expenses Deductible on Schedule C

Citation: Fiedziuszko v. Commissioner, TC Memo 2018-75, 5/31/18

One of the issues in the case of *Fiedziuszko v. Commissioner*, TC Memo 2018-75, was whether the taxpayer, who received a Form W-2 for his work for 2012, was a "statutory employee."

The statutory employee definition is found at IRC §3121(d)(3). The first requirement to be a statutory employee is that the individual *not* be a common-law employee of the service recipient. Next, the taxpayer must perform services for pay in one of the following four categories:

- As an agent-driver or commission-driver engaged in distributing meat products, vegetable products, fruit products, bakery products, beverages (other than milk), or laundry or dry-cleaning services, for his principal;
- As a full-time life insurance salesman;
- As a home worker performing work, according to specifications furnished by the person for whom the services are performed, on materials or goods furnished by such person which are required to be returned to such person or a person designated by him; or
- As a traveling or city salesman, other than as an agent-driver or commission-driver, engaged upon a full-time basis in the solicitation on behalf of, and the transmission to, his principal (except for side-line sales activities on behalf of some other person) of orders from wholesalers, retailers, contractors, or operators of hotels, restaurants, or other similar establishments for merchandise for resale or supplies for use in their business operations.

Finally, IRC §3121 provides the following additional conditions:

> *…[T]he contract of service contemplates that substantially all of such services are to be performed personally by such individual; except that an individual shall not be included in the term "employee" under the provisions of this paragraph if such individual has a substantial investment in facilities used*

> *in connection with the performance of such services (other than in facilities for transportation), or if the services are in the nature of a single transaction not part of a continuing relationship with the person for whom the services are performed…*

In Revenue Ruling 90-93 the IRS provided that such individuals are treated as employees only for certain withholding taxes. The taxpayers are not treated as employees with regard to deduction of expenses related to the trade or business of the individual under IRC §§62 and 67.

As a consequence, the Revenue Ruling notes:

> *Therefore, A may use Schedule C of the Form 1040 to determine A's net profit or loss from doing business as a full-time life insurance salesman. Further, A's trade or business expenses related to being a full-time life insurance salesman are not subject to the 2-percent floor for miscellaneous itemized deductions.*

In this case, the Court was faced with the following facts:

> *In 2012 Mr. Fiedziuszko was a semiretired aerospace engineer and worked as a consultant for Space Systems Loral (Loral). Mr. Fiedziuszko found work as a consultant by attending conferences and traveling to visit potential clients. He entered a contract to provide consulting services to Loral through West Valley Engineering Co. (West Valley), a temporary employment agency used by Loral to hire consultants. Mr. Fiedziuszko's contract with Loral began in 2011 and ended in July 2012. He worked primarily from home on a satellite development project, Flexible Satellite, producing reports and components for Loral. West Valley made weekly deposits into petitioners' checking account under the entry "West Valley Engi Payroll", which included a date that was two days before the actual deposit and the last four digits of Mr. Fiedziuszko's Social Security number. Thus, the deposit made on January 13, 2012, included a date "120111". Most weeks the deposit was $2,649, although there was some variation. The last deposit was made on August 3, 2012.*
>
> *West Valley processed Mr. Fiedziuszko's pay for his work for Loral and withheld Federal income tax as well as Social Security and Medicare taxes. West Valley did not offer medical or dental insurance, paid vacation leave, or reimbursement of Mr. Fiedziuszko's expenses, but it did offer a deferred compensation plan.*
>
> *West Valley checked the statutory employee box on Mr. Fiedziuszko's 2011 Form W-2, Wage and Tax Statement, to indicate that he was a statutory employee for 2011. But West Valley did not check the box on Mr. Fiedziuszko's 2012 Form W-2 to indicate that he was a statutory employee for 2012.*

The IRS challenged the taxpayers' above the line deduction of expenses related to the work for West Valley in 2012, pointing out that his W-2 did not indicate that he was a statutory employee. The taxpayers argued this was a mistake by West Valley in preparing the W-2s and that, in fact, he was just as much a statutory employee in 2012 as he was in 2011.

The taxpayer was doing the "home work" described in IRC §3121(d)(3)(C), so the only issue was whether he was a common-law employee. If he was a common law employee, then he would be an employee for purposes of IRC §§62 and 67, and he could not deduct such expenses in computing has adjusted gross income.

Rather such expenses would have to be treated as employee business expenses, a miscellaneous itemized deduction. Such expenses would be subject to the then-applicable 2% of adjusted gross income limitation and would not be deductible at all for computing alternative minimum taxable income.

The Court concluded that, in fact, the taxpayer was not a common-law employee:

> *We find on the record before us that Mr. Fiedziuszko was not a common law employee of Loral and that he is instead a statutory employee. While his Form W-2 for 2012 did not indicate that he was a statutory employee, we believe this to be a mistake. Mr. Fiedziuszko's Form W-2 for 2011 indicated that he was a statutory employee. Nothing changed between 2011 and 2012: Mr. Fiedziuszko was providing services under the same consulting contract with Loral in 2012 as he was in 2011. Further, Mr. Fiedziuszko worked primarily from his home office rather than Loral's offices and produced reports and patents according to his assignments from Loral. We therefore find that Mr. Fiedziuszko's employment status did not change from 2011 to 2012.*
>
> *We also conclude that both Mr. Fiedziuszko and Loral intended to form an independent consulting relationship rather than a common law employee-employer relationship. Mr. Fiedziuszko advertised his services to several satellite companies and was hired by Loral through the temporary employment agency, West Valley, with which Loral works. Their relationship was a temporary assignment that terminated in July 2012.*
>
> *The evidence in the record weighing against statutory employee status appears consistent with an error by West Valley in classifying Mr. Fiedziuszko. The weekly payroll deposits into his checking account and West Valley's withholding Federal and State income taxes and Social Security and Medicare taxes from Mr. Fiedziuszko's pay are consistent with a consulting contract for services. We conclude, therefore, that the totality of the circumstances indicates that Mr. Fiedziuszko was a statutory employee pursuant to section 3121(d)(3) for the 2012 tax year. Thus, petitioners were entitled to report business income and expenses on Schedule C of their Form 1040.*

For 2018 this issue will become even more significant—statutory employees will continue to be able to deduct the expenses related to their work, while common-law employees will no longer be able to claim any benefit from such expenses.

Section: 6011
Proposed Regulations Issued That Would Require Aggregating All Information Returns to Determine if Required to File Electronically

Citation: REG-102951-16; 83 F.R. 24948-24950, 5/30/18

The IRS has issued proposed regulations in REG-102951-16; 83 F.R. 24948-24950 that will require a larger number of taxpayers to fill all information returns electronically.

Currently Reg. §301.6011-2(c) provides that the following taxpayers do not have to file information returns electronically:

> *(c) Exceptions*
>
> *(1) Low-volume filers/250-threshold*
>
> > *(i) In general.*
> >
> > *No person is required to file information returns on magnetic media unless the person is required to file 250 or more returns during the calendar year. Persons filing fewer than 250 returns during the calendar year may make the returns on the prescribed paper form, or, alternatively, such persons may make returns on magnetic media in accordance with paragraph (b) of this section.*

> *(ii) Machine-readable forms.*
>
> *Returns made on a paper form under this paragraph (c)(1) shall be machine-readable if applicable revenue procedures provide for a machine-readable paper form.*
>
> *(iii) No aggregation.*
>
> *Each type of information return described in paragraphs (b)(1) and (2) of this section is considered a separate return for purposes of this paragraph (c)(1). Therefore, the 250-threshold applies separately to each type of form required to be filed.*

The IRS originally included the "no aggregation" rule in the regulation to reduce the burden and cost of complying with the regulation by small taxpayers. But the IRS now appears to have concluded with electronic filing of various types of returns becoming the norm that there is not a significant burden to require taxpayers that file more than 250 information returns of all types to file those returns electronically.

The IRS is going to remove the above "no aggregation" rule and a new required aggregation rule will be added at Reg. §301.6011-2(b)(4) which will read as follows:

> *(4) Aggregation of returns. For purposes of determining whether the number of returns a person is required to file meets the 250-return threshold under paragraph (c)(1)(i) of this section, all types of returns covered by paragraphs (b)(1) and (2) of this section required to be filed during the calendar year are aggregated. Corrected returns are not taken into account in determining whether the 250-return threshold is met.*

The proposed regulation would also require corrected returns to be filed electronically for taxpayers who are required to file information returns electronically.

The regulations, if adopted as final, are scheduled to apply as noted below in the preamble:

> *These proposed regulations will be effective on the date of the publication of the Treasury Decision adopting these rules as final in the Federal Register. However, to give information-return filers sufficient time to comply with these regulations, these proposed regulations will not apply to information returns required to be filed before January 1, 2019. Accordingly, these proposed regulations provide that §§ 301.6011-2(b)(4) and 301.6721-1(a)(2)(ii), as amended, will be effective for information returns required to be filed after December 31, 2018. Section 301.6011-2(b)(5), as amended, will be effective for corrected information returns filed after December 31, 2018.*