

Current Federal Tax Developments

Week of January 14, 2019

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ACCOUNTING
CONTINUING EDUCATION

CURRENT FEDERAL TAX DEVELOPMENTS
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Table of Contents

Section: Various Income Verification and Certain Other User-Fee Programs Reopened by IRS	1
Citation: IRS Statement - IRS Reopens IVES, Some Fee-based Programs, IRS Website, 1/9/19	1
Section: 163 Syndicate Rules May Create Problems for Small Businesses and §163(j) Interest Limits.....	1
Citation: "Tax Shelter Rules Tee Up Tough Decisions for Smaller Businesses", Tax Notes Today, 1/11/19.....	1
Section: 199A Second Draft Version of Publication 535 Removes Real Estate and Insurance Agents/Brokers from SSTB Category	5
Citation: Draft Publication 535, 1/7/2019	5
Section: 6012 Filing Season Set to Begin on January 28, Refunds to Be Issued Even if Partial Government Shutdown Continues	6
Citation: IR-2019-01, 1/7/19	6
Section: 6018 New Addresses to Be Used to File Estate and Gift Tax Returns	6
Citation: Instructions to Forms 706 and 709, 1/1/19.....	6

Section: Various
Income Verification and Certain Other User-Fee Programs Reopened by IRS

Citation: IRS Statement - IRS Reopens IVES, Some Fee-based Programs, IRS Website, 1/9/19

The IRS announced that the agency will reopen the Income Verification Express Program and some user-fee based program ([IRS Statement - IRS Reopens IVES, Some Fee-based Programs](#), www.irs.gov). These programs had been suspended during the government shutdown.

The IRS statement notes the reasons why the agency is reopening these programs:

While the IRS remains closed during the partial government shutdown, the agency recognizes the immediate hardship incurred if information is not available through the Income Verification Express Service (IVES) program as well as by taxpayers who have been unable to certify their residency in the United States for certain tax treaty benefits or by those who have been unable to obtain photocopies of tax returns.

The statement notes that processing requests under the IVES program, used primarily to verify income to mortgage lenders, on January 7. The IRS warns that turnaround time will be longer than normal as the agency works the backlog of requests.

It will take time to bring this service up to normal operating status. The IRS advises IVES participants that it may initially take longer than the standard 72-hour turnaround time for the IRS to process these requests. This is due to employees being brought back to work to begin processing backlogged requests since the funding lapse began on Dec. 22.

The IRS also noted other user-fee based programs that will again begin to function:

The IRS also will start other user-fee-based services such as providing a letter needed by some taxpayers to certify their residency in the United States for certain tax treaty benefits and responding to requests for photocopies of tax returns. The IRS notes that tax transcripts – which show most of the information from a tax return – are easily obtained online more quickly, are free and sufficient for most purposes. Taxpayers who still need a paper copy of their actual tax return may submit a Form 4506 along with a \$50 fee for a copy of each return. It may take 75 calendar days to process a request for a copy of a return.

Section: 163
Syndicate Rules May Create Problems for Small Businesses and §163(j) Interest Limits

Citation: "Tax Shelter Rules Tee Up Tough Decisions for Smaller Businesses", Tax Notes Today, 1/11/19

An exception to the general rule that small businesses are exempt from the §163(j) limits on the deduction for business interest applies to any entity that is a “tax shelter.” The most likely problem to arise that many may not initially notice is that the organization might meet the definition of a syndicate.

2 Current Federal Tax Developments

In an article published on January 11, 2019, *Tax Notes Today* had a story that featured comments from Tony Nitti, CPA that discussed the potential issues that may arise with the interest deduction limitation under §163(j) and the syndicate rules.¹

Getting to what is a syndicate involves bouncing through various cross-references in the tax law—and even then finding out what Congress did with a provision they cross-referenced but later moved without updating the cross-reference.

The issue of an otherwise “small” taxpayer being subject to the interest limits arises because §163(j) uses a cross-reference to the §448(a)(3) to define organizations exempt from the application of the limit. IRC §163(j)(3) provides:

(3) Exemption for certain small businesses

In the case of any taxpayer (other than a tax shelter prohibited from using the cash receipts and disbursements method of accounting under section 448(a)(3)) which meets the gross receipts test of section 448(c) for any taxable year, paragraph (1) shall not apply to such taxpayer for such taxable year. In the case of any taxpayer which is not a corporation or a partnership, the gross receipts test of section 448(c) shall be applied in the same manner as if such taxpayer were a corporation or partnership.

IRC §448(a)(3) itself merely says a tax shelter cannot use the cash method of accounting. However, further down in §448 a definition of a tax shelter is found at IRC §448(d)(3)

(3) Tax shelter defined

The term “tax shelter” has the meaning given such term by section 461(i)(3) (determined after application of paragraph (4) thereof). An S corporation shall not be treated as a tax shelter for purposes of this section merely by reason of being required to file a notice of exemption from registration with a State agency described in section 461(i)(3)(A), but only if there is a requirement applicable to all corporations offering securities for sale in the State that to be exempt from such registration the corporation must file such a notice.

Again the IRC does not provide a definition, but rather provides a cross-reference, this time to IRC §461(i)(3). When we follow that cross-reference, we end up with the following list of tax shelters which, not surprisingly, contains additional cross-references:

(3) Tax shelter defined

For purposes of this subsection, the term “tax shelter” means—

(A) any enterprise (other than a C corporation) if at any time interests in such enterprise have been offered for sale in any offering required to be registered with any Federal or State agency having the authority to regulate the offering of securities for sale,

(B) any syndicate (within the meaning of section 1256(e)(3)(B)), and

(C) any tax shelter (as defined in section 6662(d)(2)(C)(ii)).

¹ Eric Yauch, “Tax Shelter Rules Tee Up Tough Decisions for Smaller Businesses,” *Tax Notes Today*, 2019 TNT 8-1, January 11, 2019

Our primary interest is in the second set of definitions. Ignoring the fact that IRC §461(i)(3)(C) literally defines a tax shelter as a tax shelter, that cross-reference does provide an endpoint. For these purposes, a tax shelter which, even with revenue of less than \$25 million, that will be subject to the §163(j) business interest limits would include:

(ii) Tax shelter

For purposes of clause (i), the term “tax shelter” means—

- (I) a partnership or other entity,*
- (II) any investment plan or arrangement, or*
- (III) any other plan or arrangement,*

if a significant purpose of such partnership, entity, plan, or arrangement is the avoidance or evasion of Federal income tax.

In “IRC-speak” tax avoidance is what we’d normally call tax planning while “tax evasion” is what lands the taxpayer in prison. However, the key term is “significant purpose” under this test. Generally, that means a tax benefit that is a major reason for the arrangement. Most simple partnerships that own real estate are not likely to run afoul of this test.

However, there is still the issue of a syndicate referenced at IRC §461(i)(3)(B). Again, the IRC uses a cross-reference for this definition, this time sending the reader to IRC §1256(e)(3)(B). That section reads as follows:

(B) Syndicate defined

For purposes of subparagraph (A), the term “syndicate” means any partnership or other entity (other than a corporation which is not an S corporation) if more than 35 percent of the losses of such entity during the taxable year are allocable to limited partners or limited entrepreneurs (within the meaning of section 464(e)(2)).

We generally know what a limited partner is, but what is a limited entrepreneur? You’d think that the answer would be found by following the cross-reference. But here the reader hits a problem—there no longer is an IRC §464(e)(2).

In 2014 Congress repealed IRC §464(e)(2). Or, actually, moved the material to IRC §461(k)(4). In reality, initially a second IRC §461(j) was added in the Act, with no §461(k). Eventually, in the 2018 Consolidated Appropriations Act, the provision we are concerned with moved to the empty slot at §461(k)(4).

So we finally arrive at what probably (assuming the IRS and Courts agree that the reference has moved) is the definition of a limited entrepreneur at IRC §461(k)(4):

(4) Limited entrepreneur

For purposes of this subsection, the term “limited entrepreneur” means a person who --

- (A) has an interest in an enterprise other than as a limited partner, and*
- (B) does not actively participate in the management of such enterprise.*

4 Current Federal Tax Developments

While this provision has been in Code for quite a while, even if not always in the same location, there is not much guidance outside of private letter rulings on what constitutes such a “limited entrepreneur” under the law. As well, most of those letter rulings date from the 1990s.

IRC §1256(e)(3)(C) provides some “safe harbors” that exclude certain interests as being treated as held by a limited partner or limited entrepreneur:

(C) Holdings attributable to active management

For purposes of subparagraph (B), an interest in an entity shall not be treated as held by a limited partner or a limited entrepreneur (within the meaning of section 464(e)(2))—

(i) for any period if during such period such interest is held by an individual who actively participates at all times during such period in the management of such entity,

(ii) for any period if during such period such interest is held by the spouse, children, grandchildren, and parents of an individual who actively participates at all times during such period in the management of such entity,

(iii) if such interest is held by an individual who actively participated in the management of such entity for a period of not less than 5 years,

(iv) if such interest is held by the estate of an individual who actively participated in the management of such entity or is held by the estate of an individual if with respect to such individual such interest was at any time described in clause (ii), or

(v) if the Secretary determines (by regulations or otherwise) that such interest should be treated as held by an individual who actively participates in the management of such entity, and that such entity and such interest are not used (or to be used) for tax-avoidance purposes.

For purposes of this subparagraph, a legally adopted child of an individual shall be treated as a child of such individual by blood.

In PPC’s *Limited Liability Companies* volume of its Tax and Financial Planning Library, the authors reference a series of letter rulings where various entities have been held not to be tax shelters under the limited entrepreneur provision. These cases include rulings where:

- All members of the LLC were engaged in the profession of the LLC (referencing PLRs 9432018, 9422034, 9350013, and 9602018);
- Management was vested in an executive or management committee or the like (PLRs 9501033, 9321047, and 9328005);
- The LLC always reports income and is not expected to report losses (PLRs 9452024 and 9415005; and
- The LLC had non-equity members where less than 35% of the losses would be allocated to such non-equity members (PLR 9426030).²

The dearth of guidance on the topic is becoming especially trouble now that the provision takes on a special significance for §163(j)’s limitations.

² PPC *Tax and Financial Planning Library, Limited Liability Companies*, 2019, ¶805.24

The Tax Adviser published an article in September of 2018 that looked at this in a bit more detail, authored by Bruce Redmond, CPA of Denver.³ As that article points out, Reg. §1.448-1T(b)(3) follows the definition found at IRC §1256(e)(3)(B) *except* the regulation changes “losses allocable” to “losses allocated.” As the article notes “[t]his would indicate that if there were no losses allocated to limited partners or limited entrepreneurs in any given year, an entity would not be considered a syndicate for that year.”⁴

Advisers this year will need to remember that, before deciding the interest rules don’t apply to the taxpayer due to the gross income limits, that the adviser must also be able to defend why the entity is not a tax shelter under these rules. Because if the entity is a tax shelter, regardless of how little revenue it may have, the §163(j) business interest deduction limitations would apply to the entity.

Section: 199A Second Draft Version of Publication 535 Removes Real Estate and Insurance Agents/Brokers from SSTB Category

Citation: Draft Publication 535, 1/7/2019

In an updated draft revision (January 7, 2019) of the §199A section of [Publication 535](#), the IRS removed the language that had previously included real estate agents and insurance agents as specified service trades or businesses from the full publication.

In a previous version of the document the IRS, issued on December 19, 2018, the IRS had provided the following definition of a brokerage business:

*Brokerage services, including arranging transactions between a buyer and a seller for a commission or fee such as stock brokers, **real estate agents and brokers, insurance agents and brokers.** (emphasis added) and intellectual property brokers;*

The January 7, 2019 version has now reverted to language that duplicates that in the proposed regulations issued in August. The same paragraph now reads:

*Brokerage services, including services in which a person arranges transactions between a buyer and a seller with respect to securities for a commission or fee including services provided by stock brokers and other similar professionals, **but not real estate agents and brokers, or insurance agents and brokers.** (emphasis added)*

We may never know what prompted the change in position in the December 19 version, or the reversion to the proposed regulation language in this version. However, at least for now, real

³ Bruce Redmond, “Sec. 163(j) places renewed importance on tax shelter status”, *The Tax Adviser*, September 2018, <https://www.thetaxadviser.com/issues/2018/sep/sec-163j-renewed-importance-tax-shelter-status.html>

⁴ Bruce Redmond, “Sec. 163(j) places renewed importance on tax shelter status”, *The Tax Adviser*, September 2018, <https://www.thetaxadviser.com/issues/2018/sep/sec-163j-renewed-importance-tax-shelter-status.html>

6 Current Federal Tax Developments

estate agents and brokers and insurance agents and brokers with taxable income above the threshold amount can relax a bit.

Section: 6012

Filing Season Set to Begin on January 28, Refunds to Be Issued Even if Partial Government Shutdown Continues

Citation: IR-2019-01, 1/7/19

In [News Release IR-2019-01](#) the IRS announced that it will begin processing tax returns this year on January 28, 2019 and, despite the partial government shutdown, will issue refunds that may be due on returns filed this year.

The release notes:

As in past years, the IRS will begin accepting and processing individual tax returns once the filing season begins. For taxpayers who usually file early in the year and have all of the needed documentation, there is no need to wait to file. They should file when they are ready to submit a complete and accurate tax return.

In previous shutdowns the IRS had been directed not to pay refunds during a lapse in appropriations. However, the release notes:

Congress directed the payment of all tax refunds through a permanent, indefinite appropriation (31 U.S.C. 1324), and the IRS has consistently been of the view that it has authority to pay refunds despite a lapse in annual appropriations. Although in 2011 the Office of Management and Budget (OMB) directed the IRS not to pay refunds during a lapse, OMB has reviewed the relevant law at Treasury's request and concluded that IRS may pay tax refunds during a lapse.

The IRS announced that a significant number of IRS employees will be recalled back to work:

The IRS will be recalling a significant portion of its workforce, currently furloughed as part of the government shutdown, to work. Additional details for the IRS filing season will be included in an updated FY2019 Lapsed Appropriations Contingency Plan to be released publicly in the coming days.

"IRS employees have been hard at work over the past year to implement the biggest tax law changes the nation has seen in more than 30 years," said Rettig.

The news release also reminds taxpayers of the due dates for the 2018 income tax returns:

The filing deadline to submit 2018 tax returns is Monday, April 15, 2019 for most taxpayers. Because of the Patriots' Day holiday on April 15 in Maine and Massachusetts and the Emancipation Day holiday on April 16 in the District of Columbia, taxpayers who live in Maine or Massachusetts have until April 17, 2019 to file their returns.

Section: 6018

New Addresses to Be Used to File Estate and Gift Tax Returns

Citation: Instructions to Forms 706 and 709, 1/1/19

The IRS is changing the addresses to be used to file estate and gift tax returns, as documented in the instructions for [Form 706](#) and [Form 709](#).

The change in filing estate tax returns (Form 706) will take place for returns filed after June 30, 2019. As of that date, returns filed via the US Postal Service will be sent to:

Department of the Treasury
Internal Revenue Service Center
Kansas City, MO 64999

Forms 706 filed via an approved private delivery service will be sent to:

Internal Revenue Service
333 W. Pershing Road
Kansas City, MO 64108

For returns filed prior to that date, the addresses in Ohio (for USPS delivery) and Kentucky (for PDS delivery) will continue to be used.

The same addresses will be used to file Form 709 for gift tax returns, but returns filed on or after January 1, 2019 are to be sent to the Missouri addresses.