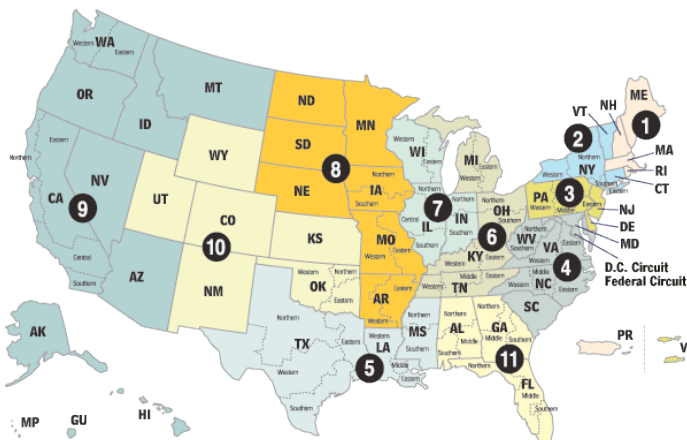


CURRENT FEDERAL TAX DEVELOPMENTS

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- Thomas, Zollars & Lynch, Ltd
Phoenix, Arizona
- Additional materials cited at:
<http://www.cpematerials.com>
- Also have Google Voice number link for calls
623-252-3189



2010 Inflation Adjustment

- Revenue Procedure 2009-50
 - Almost no changes
 - Same dependency exemption
 - Standard deduction
 - » Head of household up \$50 to \$8,400
 - » Others unchanged
 - Tax brackets barely moved
 - Annual present value gift limit left at \$13,000

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Regulation of Tax Practice

- Final Section 6694 Regulations may impose a penalty on the preparer for undisclosed return positions without “substantial authority”
 - Form 8275 required for disclosure
- IRC Sec. 7216(a)(2) prohibits even the use of taxpayer information, for any purpose other than return preparation, without specific consent.
 - Revenue Procedure 2008-35 establishes the exact form and required wording for taxpayer consents allowing preparer to disclose return information or use it for any other purpose.

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Form 8919

- New Form for reporting payments by employer to misclassified worker
 - Submitted by a worker who has been misclassified as an attachment to Form 1040
 - Must also file SS-8 or meet other enumerated pre-conditions
 - Worker pays employee portion of FICA and Medicare taxes
 - We have anecdotal evidence that IRS is then simply assessing employer for employer share

Disallowed “Medical” Expenses

- William Halby, T.C. Memo 2009-204, 9/14/09
 - Halby is a lawyer, practicing in New York
 - During 2004 and 2005, he spent tens of thousands of dollars on prostitutes and pornographic literature, which he claimed as “medical expenses” on his Forms 1040.
 - He had no prescription for such services ! ! !
 - There can be no tax deduction for illegal payments
 - Halby was also assessed a 20% Sec. 6662 penalty

Infant Formula Not Allowed As Medical Expense

- PLR 200941003, 10/9/09
 - Mother had double mastectomy
 - Formula for child
 - Replaced normal nutrients
 - Revenue Ruling 55-261

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Theft Loss Deduction by Individual

- Dominick J. Vicentini; T.C. Memo. 2008-271, 12/8/08
 - No theft loss deduction for tax fraud scheme
 - Theft loss is generally deductible in the year discovered, however
 - No deduction is allowed until there is “no reasonable prospect of recovery”
 - Dominick was a beneficiary of Court ordered restitution that had not been determined worthless in year he claimed loss

Home Mortgage Interest

- IRS Changes Mind on \$1,100,000 Acquisition Debt Issue, CCA200940030
 - Deduction allowed
 - Not capped at \$1,000,000
 - \$100,000 allowed as home equity
 - IRS Prior Wins on Opposite Position
 - *Pau v. Commissioner*, TC Memo 1997-43
 - *Catalano v. Commissioner*, TC Memo 2000-82

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Personal Goodwill

- Irwin Muskat; CA 1; No 08-1513, 1/29/09
- \$1 million was not a payment for personal goodwill to individual executive who negotiated corporation's asset sale
 - Contract specified payment was for Covenant Not to Compete . . . Martin Ice Cream decision is not good precedent . . . Different facts
 - Muskat intimately involved in negotiations and allocation of sales proceeds. . . He knew better !

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IRC Sec. 104 Exclusion

- Daniel J. Stadnyk, et ux; T.C. Memo. 2008-289, 12/22/08
 - Received \$49,000 in settlement of claim for emotional distress from arrest of Mrs. Stadnyk
 - No physical injury or physical illness
 - Payment must be included in taxable income. IRC Sec. 104 only allows exclusion for payments that compensate for physical injury or physical illness
 - IRS Issued Proposed Regulations for Section 104 on September 14, 2009

Section 104 Exclusion (2)

- Jon Hellesen; T.C. Memo 2009-143
 - No portion of settlement was excludable under IRC Sec. 104(a) because there was no original claim of physical injury or sickness and no record of medical treatment
- Emblez Longoria; T.C. Memo 2009-162
 - No part of award was for physical injury
 - Sec. 6662(a) accuracy penalty not assessed because taxpayer reasonably relied on CPA

Tuition to Religious School

- Michael Sklar, et ux; CA 9, No 06-72961, 12/12/08
 - Tuition paid for children to attend a religious school that provided a secular education with religious emphasis is not deductible
 - No charitable intent
 - Personal benefit . . . Quid pro quo
 - No proof that payments exceeded value of a secular education

Casual Gambler Guidance

- AM 2008-011, 12/5/08
 - Gambling gains or losses are measured at the end of each gambling “session”
 - Amount of gain or loss is determined by comparing the amount put into play with the amount cashed out at the session’s end
 - Gambler is still required to have a contemporaneous record of winnings and losses
 - Income reported on Form 1040 page 1, losses on Schedule A, no netting

Tax Avoidance Scheme

- Howard Pate; T.C. Memo 2008-272, 12/9/08
 - Tax avoidance scheme fails !
 - Schedule C taxpayer paid “royalties” to his S corporation that eliminated any Schedule C profit
 - S corporation made distributions to taxpayer, but paid no wages
 - Court found the transactions to be shams, without economic substance
 - Substantial understatement penalty sustained

Modification of Student Loan

- Plotinsky; TC Memo 2008-244, 10/29/08
 - \$3,000 discharge of student loan debt was a bargained for benefit and therefore taxable
 - Rebate was offered as incentive for consolidating student loans and making 36 timely payments
 - Could not be a gift, as Plotinsky claimed
 - Business motivated, no intent to make a gift
 - Plotinsky was solvent at all times relevant

Who Is a Dependent Child ?

- Danita J. Leonard; T.C. Summ. 2008-141, 11/4/08
 - Dependency exemptions allowed for friend and friend’s two grandchildren
 - All three lived in Ms. Leonard’s home for the entire year and she provided more than one-half their support
 - Children were not “qualifying children” of Ms. Leonard, and therefore no child credit was allowed

Documentation Requirements for Non-Custodial Parent

- ILM 200925041, 5/11/09 (**Only for 2008 & Earlier**)
- Claim of Dependency Deduction can be sustained by properly executed Form 8332 or copy of divorce decree or separation agreement
- Decree or agreement that allows noncustodial parent to claim dependent only if condition is met will **not** be accepted as equivalent to Form 8332
- Decree or agreement can only be used in lieu of Form 8332 if it contains all information needed to identify the child and the custodial parent, and is unconditional
- Form 8332 was revised in February 2009

New Dependency Regulations

- Reg §1.152-4
 - Years beginning after July 2, 2008
 - Release must be unconditional
 - Form
 - 8332
 - Substitute - all same info
 - **Not** the decree

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Residential Rental Property

- IRS Publication 527, 2/4/2009 (for 2008 returns)
 - Comprehensive discussion of rental rules:
 - Rental of vacation home
 - Depreciation
 - Sec. 1031 exchange of rental property also used for personal purposes
 - At-risk and Passive Activity limitations
 - Basis of property changed to rental use

Attorney Fees Paid From Settlement Proceeds

- LTR 200906012, released 2/6/09
 - Fees paid to lawyers representing employees in a class action lawsuit are not treated the same as fees paid in connection with an individual claim
 - No express liability exists between class members and the lawyers, so the payment is not assignable to any claimant
 - Successful class action plaintiff only accounts for money received.

Reasonable Compensation

- Menard Inc. v. Comm.; CA 7; No. 08-2125; 3/10/09 . . . Reasonable Compensation
 - Tax Court’s reasoning was flawed !
 - 1991 sales \$788 million . . . 1998 \$3.4 billion
 - 1991 profit \$59 million . . . 1998 \$315 million
 - Return on equity 18.8 % AFTER \$17 million bonus
 - Menard worked 12 – 16 hours per day
 - Full amount of \$20.6 million annual compensation was reasonable

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Ponzi Guidance Issued 3/17/2009

- Revenue Ruling 2009-9
 - Revenue Ruling 71-381 is obsolete
 - Identifies type of loss by criminal actions of promoter
 - Explains how to determine year and amount of loss
 - Describes tax attributes of loss
- Revenue Procedure 2009-20
 - Optional safe harbors to claim deduction in 2008
 - Procedure to use safe harbor
 - Taxpayer statement to attach to return
 - What to expect if you don’t use safe harbor

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Compensation From Indian Tribe

- John Barrett, Jr., CA 10, No. 08-6017, 4/6/09
 - Salary paid to chairman of Potawatomi Tribe cannot be attributed to trust fund and excluded from his taxable income.
 - Purpose of trust fund was tribal development and improvement, not to pay routine administrative expenses.
 - Tenth Circuit upheld a section 6662 accuracy penalty against Barrett in addition to tax assessed.

LLC Members Not “Limited Partners” for Passive Activity Loss Limitation

- Paul Garnett; 132 T.C. 19; 6/30/09
 - Couple owned interests in and participated in running the business of several LLCs
 - IRC Sec. 469(h)(2) does not apply to LLC member interest, which is not, by definition, a limited partnership interest
 - It is therefore necessary to inquire as to the level of involvement in the LLC’s business attributable to each of the Garnetts

LLC Members Not “Limited Partners” for Passive Activity Loss Limitation

- James Thompson; Ct Fd Clms; 7/20/09
 - Individual did not hold a “limited partnership interest” in an LLC
 - “. . . the tax code and the applicable regulations literally cannot be read to transfigure plaintiff’s member interest in (the) LLC into one of a limited partnership.”
 - IRS Conceded that Thompson would have been a general partner if LLC was a partnership

Profit From Regular Property Sales Treated as Capital Gain

- Bruce Rice; T. C. Memo 2009-142; 6/16/09
 - Rices bought larger than needed piece of property on which to build their “dream home”
 - Subdivided 14.4 acres into lots and created a homeowners association
 - Sold one lot in 2000, three lots in 2004, built their own home on two lots
 - Court held sales were to dispose of excess lots and taxpayer was not a real estate developer

Sec. 183: Not-For-Profit Activity

- Nora E. Keating, CA8, 10/14/08
 - Horse breeding activity was not conducted with objective of making a profit
 - Never had a profit
 - Taxpayers had substantial income against which to deduct losses
 - Taxpayers had no business plan, didn’t change methods when losses mounted, etc.
 - IRC Sec. 183 limits claimed losses

Section 183: Not-For-Profit Activity

- Charles Beasley v. Comm.; T.C. Summ 2009-93
 - Charter fishing activity was not-for-profit
 - +/- 20 trips per year didn’t justify \$150,000 boat
 - “Business” records were comingled with personal information
 - Tax losses from charter activity offset taxable income from other sources
 - Taxpayer could not claim presumption of correctness due to losses three years in a row

Section 183: Not-For-Profit Activity

- IRS Audit Technique Guide; 6/19/09
 - Explains how Sec. 183 and related regulations applies to limit losses from activities that are not conducted with a profit motive
 - Explains and illustrates the “Nine Factors” used by courts to analyze profit motive
 - Warns Revenue Agent against common schemes to claim expenses not justified by activity
 - Gives examples of how to prepare report

Section 10.27; Circular 230

- Proposed Regulation on contingent fees for tax services, 7/28/09
 - May not charge contingent fee except for defending a client under examination or who has been assessed a penalty.
 - Contingent fee includes, but is not limited to, any fee that depends on the specific tax result obtained in a given transaction

Section 10.29, Circular 230

- Conflict of interest rule effective 9/26/07
 - Actual or significant risk of conflict
 - To serve both must
 - Decide can do so
 - Get waiver
 - Waive before work done
 - Written confirmation 60 days

IRS Suspends Enforcement of Sec. 6707A Penalties

- Letter from IRS Commissioner; 9/24/09
 - Until December 31, 2009
 - IRS will not pursue collection action for IRC Sec. 6707A tax shelter penalties where tax benefit to taxpayer was relatively low value
 - Congress has promised legislation to give the IRS flexibility in dealing with the Sec. 6707A penalties which it does not now have
 - That does not mean penalties will disappear

Safe Harbor for Back-to-Back Loans For S Corporations ?

- AICPA Suggested, on May 29, 2009 that a safe harbor be adopted for determining whether a shareholder loan increased the shareholder's "at risk" basis in an S corporation
- There is no definition in the Code or Regulations of "indebtedness of the S corporation to the shareholder" and that has led to many misunderstandings with taxpayers who lost deductions for what they see as "technicalities"

Proposed Safe Harbor for Shareholder Loans to S Corporations

1. The note is a written unconditional promise by the corporation to pay the shareholder, on demand or on a specified date, a sum certain in money.
2. The interest rate specified in the instrument meets, at a minimum, the published applicable federal rate for the type of loan and for the time the loan is made.
3. Interest payment dates are specified in the instrument.
4. The instrument is legally enforceable under state law. That is, a transferee, under a voluntary or involuntary transfer, receiving the note would have the right to proceed against the corporation to enforce the terms of the note.
5. The S corporation is not an obligor or co-obligor on the note issued by the shareholder to the primary lender in a back-to-back situation. A guarantee or pledge of corporate assets is not to be considered as making the company an obligor with respect to the shareholder's loan from the primary lender.
6. Interest and principal payments are made pursuant to the agreement, i.e. the company pays the shareholder and the shareholder pays the primary lender (if mistakes are made and direct payment is made, the books and records are adjusted and appropriate information reporting forms are filed). A doctrine of substantial compliance as opposed to strict compliance would apply. *Routine use of offsetting accounting entries without actual payment would not be considered within the safe harbor.*
7. Loans are reported appropriately on tax returns and year-end financial statements, if any, of the company and shareholder.

Tax Home

- Alexander Senulis; T.C. Summ 2009-97
 - Taxpayer was working under contract on a job that was expected to last 12 months
 - Even though the project ultimately took 13 months, the taxpayer’s reasonable expectation was 12 months and he can deduct his expenses of living away from his tax home for that period
 - Employment at away location was temporary (had a start and stop within 12 months) not indefinite, so tax home wasn’t moved

Tax Home

- David Wilbert, CA 7, No. 08-2169, 1/21/09
- Tax home is where “major post of duty” is
 - Choosing to live in city near old job location is a personal choice and does not justify deduction for expenses of “living away from home”
 - Real estate sales business that produced \$2,000 of income was not Mr. Wilbert’s “major post of duty”

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Errors in SECA Tax

- Alan Beane; T.C. Memo 2009-152; 6/25/09
 - Taxpayer built a successful company, but didn’t handle income tax reporting of his stock options well . . . actually overpaid income and SECA tax
 - Tax court was powerless to net overpayment from a year not under examination, and not part of the dispute before it, against amounts owed
 - Taxpayer’s “misunderstanding of the scope of this case extended the proceedings unnecessarily”

Retirement Plans and Bankruptcy

- In Re: Lloyd Rucker; CA 9; 8:06-cv-01022
 - Bankruptcy court was correct in ruling that transfers of assets to retirement plans were attempts to defeat a civil judgment
 - Plans were not “designed and used for the primary purpose of providing retirement benefits”
 - Contributions exceeded statutory limits
 - “Repeatedly failed to accurately disclose” in IRS filings, the amounts contributed to the plans
 - Secretly funded from offshore accounts

IRS Can Seize and Sell Stock Options

- ILM 200926001; released 6/26/09
 - Transferability restrictions on taxpayer’s nonqualified stock options were contractual, not statutory, and Sec. 6334(c) trumps transferability restrictions of Sec. 422 on incentive options
 - IRC Sec. 6331(a) gives IRS broad powers to levy on all property or rights belonging to taxpayer
 - Stock options are not included in Sec. 6334(a) list of property exempt from levy

First-Time Homebuyer Credit

- INFO 2009-0087; released 6/26/09
- Neither husband nor wife can qualify for the first-time homebuyer credit if either had any ownership interest in a principal residence within 3 years prior to purchase of new home
 - Contrast this interpretation with the provisions allowing credit to be apportioned between two unmarried persons who purchase a home, explained in Notice 2009-12; 1/15/09

Innocent Spouse

- Diane S. Harris, T.C. Memo 2009-26, 2/5/09
- Innocent spouse relief denied
 - Couple had failed to pay taxes on time for a number of years, so she knew taxes were not likely to be paid
 - Court refused to consider economic hardship
 - She was living with another person
 - Submitted no evidence of hardship

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Innocent Spouse

- Sunleaf v. Comm., T.C. Memo. 2009-52; 3/11/09
- Equitable Innocent spouse relief granted
 - Rejected IRS argument that only the administrative record could be considered
 - Deceased husband concealed financial condition from wife . . . Filed returns, but didn't pay tax . . . All mail was delivered to his office
 - She was 70 years old, disabled, and had negative cash flow

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Innocent Spouse

- Cathy Marie Lantz v. Comm.; 132 T.C. No. 8; 4/7/09
 - Innocent spouse regulations imposing 2 year statute of limitations on requests for equitable relief held invalid
 - No support for time limit in statute or Committee Reports

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Innocent Spouse: Equitable Relief

- CC-2009-021; 6/30/2009, sets out IRS response to changed standard of IRC Sec. 6015(f) review
 - Following its 2008 decision in *Suzanne L. Porter*; 132 T.C. 115, when considering requests for equitable relief under IRC Sec. 6015(f), the Tax Court will not rely solely on evidence in the administrative record, but will consider evidence introduced at trial
 - Together with rejection of 2 year statute of limitations in *Cathy Marie Lantz*, 132 T.C. 8, the Court has made it much easier for innocent spouse to obtain relief
 - IRS plans to insist it has exclusive “discretion”

Claim for Fees

- Stephen Trollope, T.C. Memo 2009-177, 7/30/09
 - Individual failed to provide full information about a transaction to IRS
 - IRS assessed tax based on information it had.
 - Taxpayer is ineligible for award of fees, because the IRS conceded all issues when they got the right information.

FLP Fails To Secure Discounted Gifts

- William Linton, USDC W WA, 7/1/09
 - Professional advisors . . . Attorney and accountant . . . Screwed up and got transactions out of order
 - Mr. and Mrs. Linton organized a partnership, gave interests to their children, then
 - Transferred property to the partnership.
 - U.S. District Court ruled the Lintons made indirect gifts in a step-transaction.
 - Doubled amount of reported taxable gifts, from \$1,450,000 to \$3,100,000.

FLP Transfers Deemed Bona Fide Sale for Consideration

- *Estate of Murphy*, 2009-2 U.S.T.C. ¶60,583, USDC WD Arkansas, 10/2/09
 - LLC general partner funded
 - Dad not bankrupted
 - Escapes §2036(a)(1) and (2)
 - Bona fide
 - Full and adequate consideration

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HSA Not Exempt From Levy

- ILM 200927019; released 7/2/09
 - IRC Sec. 6331 Levy may extend to taxpayers HSA account
 - Liquidation of account to satisfy Levy will be fully taxable transaction, including 10% addition to tax imposed by IRC Sec. 223(f)(4) on withdrawals not used for medical expenses by person under age 65
 - While IRC Sec. 72(t) excludes distributions on account of Levy from the 10% addition to tax, Sec. 223(f)(4) does not

Reasonable Cause

- Katherine Humes; T.C. Summ 2009-100; 7/6/09
 - Reasonable cause is a defense to the IRC Sec. 6651(a)(1) and (2) additions to tax for failure to file on time and failure to pay
 - Sec. 6654(e)(3)(A) allows relief from Sec. 6654(a) penalty for underpayment of estimated tax
 - Taxpayer who was hospitalized with emotional problems when 2003 return was due, has “reasonable cause” for late filing of that return
 - For 2004 failure to file, there was no such compelling evidence, just the taxpayer’s testimony

Surrender of Life Insurance Policy

- Alex Giannaris; T.C. Summ 2009-114; 7/22/09
 - Cash value of policy was \$150,664
 - Total loan balance (\$149,872) plus cash received upon surrender (\$792) is policy proceeds
 - Amounts borrowed, plus accrued interest, make up loan balance
 - Even though loan balance includes accrued interest (\$111,727) it is not deductible against the taxable gain of \$105,190 in the policy cash value

Sale of Life Insurance Policies

- Rev. Ruls. 2009-13 and 14, 5/1/09
- 2009-13 explains tax rules that apply to proceeds of sale of a life insurance policy
 - ordinary income under “replacement” theory
- 2009-14 explains tax rules that apply to receipt of proceeds or sale by a purchaser
 - Death benefit is ordinary income
 - Profit on sale is capital gain

Education Expenses – Deductible ?

- Corrine Ortega, T.C. Summ, 2009-120,8/3/09
 - Mental health practitioner’s expenses to obtain a PhD in psychology are not deductible as job related expenses.
 - After securing the PhD, she was qualified to do different work and, in fact, got a new job with different responsibilities . . . Supervising people who only had the credentials she had before going back to school.

Taxable Income From Foreclosure

- Steed Martin, T.C. Summ 2009-121, 8/4/09
 - Taxpayer not liable for COD income because amount of 1099C could not shown to be in excess of FMV of property foreclosed
 - Bank repossessed car . . . Taxpayer contends car was worth the debt amount
 - Neither bank nor IRS could show otherwise
 - Taxpayer’s basis in personal use asset was deemed (by the judge) to be equal to debt.

Roth IRA Conversion In 2010

- Special rule for conversions after 2009
 - Taxable amount is included in individual returns under a “two-year inclusion rule” that has the taxpayer pay one half the tax on an eligible rollover in each of two tax years
 - \$100,000 modified AGI limitation does not apply after 2009
 - Joint return limitation does not apply after 2009

Reduced Estimated Tax Payments

- Don’t forget . . . Qualified Small Business owners can take advantage of special safe-harbor for 2009 estimated tax payments.
 - Only 90% of liability required to be paid-in if:
 - More than half of gross income is from business with fewer than 500 employees in 2008, and
 - AGI was less than \$500,000 in a 2008 joint return

