

## **Federal Tax Update**

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## **Today's Presentation**

- Overview of Major Law Changes
- Top Developments
- Other Rulings and Cases
- Slides at <http://www.edzollars.com>

## **Tax Update Podcast**

- Free weekly update on tax matters (at least until tax season)
- Found at <http://www.edzollarstaxupdate.com>
- Audio files to listen to along with materials in most cases
- Archives have more detailed discussions on some issues in today's presentation

## **Budget Reconciliation Process**

- House and Senate Have Very Different Bills
- Some Items Common to Both
- Special Provisions in Each

### **Budget Reconciliation Bill— Extenders**

- Expiring 2005
  - Research Tax Credit
  - Work Opportunity Credit
  - Welfare-to-Work Credit
  - Individual AMT Relief
  - State Sales Tax Deduction
  - Pension Funding Relief
  - Leasehold Improvements
  - Except for AMT Relief, both bills extend these by one year (House passed stand alone AMT relief)

### **Budget Reconciliation Bill— Extenders**

- Expiring 2006
  - Active Financing Income
  - 2 Year Extension in House, Not in Senate Bill
- Expiring 2007
  - Internet Tax Moratorium
  - Small Business Expensing
  - Small Business Expensing Extended 3 years in House Bill, 2 years in Senate bill

### **Budget Reconciliation Bill— Extenders**

- Expiring 2008
  - Capital Gains Relief
  - Dividend Relief
  - 2 Year Extension in House Bill, Not in Senate (but Senate expects it back in)
  - Major "hot button" item

### **Budget Reconciliation Bill**

- Katrina Relief in Senate Bill, Not in House Bill (House passed stand-alone bill)
- Senate Bill Has A Number of Revenue Raiser
  - Include higher of fair value or fully loaded cost for aircraft use by any employee in W-2 (would be effective as of date of enactment)
  - One year move up the estimated tax safe harbor at 120% of prior year tax for 2006 (budget smoothing strikes again)

## Major Law Changes

- Katrina Emergency Tax Relief Act of 2005
- Energy Tax Incentives Act of 2005
- Highway Reauthorization Act of 2005
- American Jobs Creation Act of 2004
- Working Families Tax Relief Act of 2004

## Katrina Emergency Tax Relief Act of 2005

- Charitable Contributions (p. 8)
  - Individual
  - Corporate
- Work Opportunity Credit Expansion (p. 8)
- Relief Directed at Affected Area (pp. 6-10)

## Energy Tax Incentives Act of 2005

- Residential Credits (p. 11)
  - Energy Conservation Property
  - Energy Efficient Property
- Clean Fuel Vehicles (p. 12)
- §197 Recapture (p. 12)

## Highway Reauthorization Act of 2005

- Generally non-income tax provisions (p. 13)
- See summary in materials

### **Working Families Tax Relief Act of 2004**

- Uniform Definition of a Child (p. 14 )
  - Simplification of Definitions
  - Change for Divorced Parents
- Extension of Various Provisions

### **American Jobs Creation Act of 2004**

- Major Tax Act
- Tax Shelter Provisions
- Solve ETI problem with European Union
- Impacts Many Clients for Good and Ill

### **AJCA 2004 – Shelter Provisions**

- Reportable Transaction Disclosure Penalties (p. 16)
  - Harshly Penalize Playing the Audit Lottery Odds
  - Penalty on Failure to Disclose
  - Limited IRS Ability to Waive
  - Cannot Waive if Involve Listed Transactions
  - See list of listed transactions on page 60 of materials
  - Also guidance on reporting on p. 35 and late reporting on p. 36 (though that deals with statute and not penalty issue)

### **AJCA 2004 – Shelter Provisions**

- Nonqualified Deferred Compensation (NQDC) (p. 17)
  - New §409A
  - Harsh Penalty on recipient if NQDC not in compliance with §409A
  - Broad definition of NQDC
  - For termination solution—must pay out by 12/31/05
  - Documentation in place by 12/31/06

## AJCA 2004 – Shelter Provisions

- Other Loophole Closers
  - Foreign Bank Account Reporting (p. 18)
  - Five Year Waiting Period for §121 exclusion if property obtained in §1031 exchange (p. 19)
  - Charitable contributions of automobiles (p. 20)

## AJCA 2004 – ETI Solution

- New §199 – Qualified Domestic Production Deduction (p. 20)
  - Affects Domestic Enterprises
  - Entity with “Qualified Domestic Production Income”
    - Includes “qualified” manufacturing, construction, architectural services, engineering services, movie production, sound recordings...
    - Check the definition
  - Complexity for entities with “mixed” operations

## AJCA 2004 – Other Issues

- Change in Treatment for Start-up and Organizational Expenses (p. 22)
  - Expensing for “small” enterprises (phased out as amount rises)
  - 15 Year (rather than 60 month) amortization for items not allowed to be expensed
  - Covers §§195, 248 and 709 expenses

## AJCA 2004 – Other Issues

- Legal Fees Netted Against Award in Some Cases (p. 23)
  - Gives partial relief from USSC’s *Banks* and *Banaitis* decision (p. 70)
  - Only applies to specified federal causes of action
  - Other causes of action may not net fees against expenses (USSC settled the matter)

## Key Practice Management Developments

- **IRS Releases Updated Circular 230 Written Advice Standards**  
*(Revisions to Circular 230 §§10.33, 10.35, 10.36 and 10.37, Effective June 20, 2005) p. 30*
  - Effective June 30, 2005 new rules apply to written advice provided by CPAs on tax matters
  - Covered Opinions
  - Disclaimers (when effective and when not)
  - Other written advice
  - Best practices rules

## Key Practice Management Developments

- **IRS Proposes Specific "Opt-In" Consents for Information Disclosure**  
*(Proposed Regulations §301.7216-1, 2 and 3, IRS Notice 2005-93, 12/7/05) in new matters download*
  - Would redefine consents under §7216 (violation of which is a criminal offense)
  - Aimed at forcing disclosure of offshore outsourcing and officially enabling e-filing (undisclosed) domestic outsourcing
  - Note that applies to any third party disclosures (including mortgage applications)
  - Effective 30 days after final regulations published (probably sometime next summer)

## Key Business Developments

- **S Corporation Compliance Study**  
*(IRS News Release IR-2005-76) p. 51*
  - "Lucky 5,000" 2003 and 2004 S Corporation Returns Subjected to Detailed Exam
  - Likely Issues
    - Owner Compensation (FICA evasion)
    - Number and type of Shareholders
    - Built-in gain
    - Excess passive income

## Key Business Developments

- **IRS Announces Settlement Initiative with 1/23/06 Deadline**  
*(Announcement 2005-80, 10/27/05) p. 53*
  - The IRS has announced an offer to enter into settlements for tax matters related to a number of specified transactions
  - Transactions include
    - Certain §412(i) plans
    - Certain §419 structures
    - Certain S Corporation/ESOP structures
    - Parking expense reimbursement plans

## Key Business Developments

- **IRS Extends Deadline to Participate in §1441 Compliance Program**

*(IRS Revenue Procedure 2005-71, 11/3/05) p. 25*

- Deadline extended from 12/31/05 to 3/31/06
- Relates to withholding required for payments to foreign persons
- Normally a program like this means the IRS expects to play hardball with those who fail to come forward now

## Key Business Developments

- **Final §179 Regulations Contain Good News**

*(Regulations §§1.179-2, 1.179-4, 1.179-5, 1.179-6, 7/12/05) p. 25*

- IRS regulations explaining the increased 179 election were issued
- Dealt with provision allowing taxpayers to change a 179 election
  - Taxpayers can change both ways, allowing taxpayers to add items to the 179 election during an exam
  - Can only remove an item once—one you amend to undo a 179 election, you can't put it back

## Key Business Developments

- **IRS Announces 2006 Mileage Rates**

*(Revenue Procedure 2005-78, 12/2/05) p. 46*

- Business rate is 44¢ a mile
- Medical and moving goes to 18¢ a mile
- Charitable fixed by statute (but note special Katrina rates)

## Key Business Developments

- **Mileage Reimbursement Rate Raised for Last Four Months of 2005**

*(IRS Announcement 2005-71, 9/12/05) p. 47*

- In response to the increase in fuel prices due to Hurricane Katrina, the IRS has raised the standard mileage rates that are not specifically set in the IRC
- Standard mileage rate 48.5¢ a mile
- Moving and medical rate 22¢ a mile
- Charitable does not change except for Katrina related rates found

## Key Business Developments

- Per Diem Rates Updated for Final Three Months of 2005

*(Revenue Procedure 2005-67, 10/4/05) p. 48*

- Simplified High Low Rates Raised Effective 10/1/05
- High cost facility rate goes to \$226
- Low cost facility rate goes to \$141
- Employers can elect to continue to use old rates
- Cannot switch methods mid year (from high low to GSA per diem)

## Key Business Developments

- Prohibited Transaction with Loans to Non-controlled Entities

*(Joseph R. Rollins, T.C. Memo 2004-260, 11/15/04) p. 83*

- CPA trustee of his company's 401(k) loaned to entities in which had minority investment
- Prohibited Transaction under §4975
- Consider impact on IRA transactions with clients "pushing the envelope"

## Key Business Developments

- Reasonable Compensation Determined by Comparables Even with Adequate Return

*(Menard, Inc., TC Memo 2004-207, 9/16/04, TC Memo 2005-3, 1/6/05) p. 84*

- Tax Court denied deduction for \$13 million of \$20 million
- Return to investors was shown to be better than competitors (Home Depot and Lowe's)
- Court ruled that wasn't the exclusive test—comparable CEOs paid less (though their companies earned less)
- Issue will be if appellate court views independent investor test as sole test

## Key Business Developments

- Royalty Payments to Related Party Deemed Excessive and Disallowed

*(Chickie's and Pete's, Inc., TC Memorandum 2005-243, 10/18/05) p. 79*

- Taxpayer paid a royalty from controlled corporation to self for use of trade name and menu
- Rate was greater than amount paid by unrelated third party for the same rights (Court did not find differences in actual rights granted significant)
- It's not just compensation that is a problem!

## Key Business Developments

- **Brother to Brother Sale Triggered Limitation on Use of NOLs**

*(Garber Industries Holding Co. Inc., 124 T.C. No. 1, 1/25/05) p. 82*

- A sale from one brother to another brother triggered the application of §382
- Shares not deemed owned by brothers via attribution rules of §318

## Key Business Developments

- **Section 1031 Matters**

- Cannot use parking to qualify pre-owned real estate as replacement property for §1031 exchange

*(Revenue Procedure 2004-51, 7/20/04) p. 52*

- Using an intermediary didn't move exchange outside related party rules

*(Teruya Brothers, Ltd, 124 TC 45, 2/9/05) p. 65*

- However, IRS rules sale of timber by related party after exchange of timberland did not trigger gain recognition

*(PLR 200541037, 10/14/05) p. 63*

## Key Business Developments

- **Section 1031 Matters**

- IRS ruling on interaction of §121 and §1031 (you can use both)

*(Revenue Procedure 2005-14, 2/3/05) p. 27*

## Key Business Developments

- **Filing Form 2553 by LLC Will "Check the Box"**

*(TD 9203, 5/20/05) p. 45*

- An LLC can elect corporate status by filing a 2553 only per final regulations
- Will no longer need to separately file to elect corporate status
- Can be applied retroactively

## Key Business Developments

- **2006 Limits on Compensation for Plans**  
*(IRS News Release IR-2005-120, 10/17/05, Notice 2005-75, 11/7/05) p. 37*
  - Compensation limit rises to \$220,000 for 2006
  - 401(k) Maximum Deferral \$15,000
  - Maximum "Catch Up" \$5,000

## Key Business Developments

- **Social Security FICA Wage Limits for 2006**  
*(SSA website: <http://www.ssa.gov/OACT/COLA/cbk.html>)  
(IRS Notice 2005-46, 11/14/05) p. 56*
  - \$94,200 for 2006, up from \$90,000 for 2005
  - Domestic employee threshold \$1,600 for 2006, up from \$1,500 for 2005

## Key Business Developments

- **Fringe Benefit Issues**
  - Calling it a "tool allowance" no better than calling it an "auto allowance" (well, unless you are a rig welder...)  
*(Revenue Ruling 2005-52, 8/3/2005) p. 41*
  - Gift certificates don't qualify as *de minimus* fringe even if \$35  
*(IAM 200437030) p. 41*

## Key Business Developments

- **IRS Changes Position on Signing Bonus and Termination Payments for FICA Purposes**  
*(Revenue Rulings 2004-109 and 2004-110, 11/23/04) p. 54*
  - Signing bonus represents FICA Wages (reverses position in Revenue Ruling 58-145)
  - Termination payment represents FICA wages (reverses Revenue Rulings 55-520 and 58-301)
  - However, see *University of Pittsburgh* case decided in October that held payments for tenure rights were not FICA wages

## Key Business Developments

- **Use It or Lose It Rules Relaxed**  
*(Notice 2005-42, 5/18/05) p. 63*
  - For health and dependent care reimbursement plans
  - Gives 60 days into following year to incur additional expenses to use up any unused portion of prior year deferral
  - Employer must amend plan before this can be used, and amendment must be in place by 12/31/05 for 2005

## Key Business Developments

- **IRS Issues Tightened Regulations on Valuing Life Insurance in Qualified Plans**  
*(TD 9223 and Revenue Procedure 2005-25) p. 64*
  - IRS was concerned "not springing value" policies that, essentially, still sprung
  - Cash surrender value is not the equivalent of fair market value
  - Aimed at policies designed to have "magic restorative powers" after being distributed
  - Defined benefit plans may now be overfunded

## Key Business Developments

- **Mandatory Efile for "Large" Entities and Procedure to Ask for Permission to File on Paper**  
*(TD 9175, 1/12/05, Notice 2005-88, 11/10/05) p. 37*
  - Certain entities will be required to efile 2005 returns (see list)
  - Must request permission to file on paper will be deemed not to have filed
  - Can be turned down

## Key Business Developments

- **IRS Rules on Development Activities that Did not Create UBIT**  
*(PLR 200510029, 3/11/05, PLR 200532057, 8/12/05, PLR 200530029, 7/29/05) p. 27*
  - IRS ruled on fact patterns where charities activities to enable the sale of parcels of land did not rise to the level to trigger UBIT
  - Provides potential guidance in §1031 situations (can't trade inventory)

## Key Business Developments

- IRS Proves to be a Sore Loser
  - Changed S Corporation Built-In gain regulations to reverse 10<sup>th</sup> Circuit result in *Colorado Gas Compression* case  
*(TD 9270, 12/21/04) p. 29*
  - On phone excise tax, announced will continue to collect even in circuit with loss (and then lost twice more)  
*(American Bankers Insurance Group, CA11, 408 F3d 1328, 5/10/05; Notice 2005-79, 10/20/05; OfficeMax, Inc., CA6, 2005-2 USTC ¶70,246, 11/2/05, National Railroad Passenger Corporation, CA-DC, 12/9/05) p. 79*

## Key Business Developments

- Trust Must Apply 2% of AGI Limitation to Investment Advisory Fees  
*(Rudkin Testamentary Trust, 124 TC 304, 6/27/05) p. 86*
  - The Tax Court reaffirmed, in an 18-0 decision, their position that investment fees paid by a trust are subject to the 2% limit
  - This is so despite the legal duty imposed on the fiduciary
  - At variance with Sixth Circuit's *O'Neill Trust* decision

## Key Individual Developments

- Fifth Circuit Affirms Tax Court's Second Try at Resolving *Strangi* Case But Skips Big Issue  
*(Albert Strangi, Deceased, Rosalie Gulig, Independent Executrix v. Commissioner, 417 F3d 468, 7/15/05) p. 76*
  - Addressed only §2036(a)(1) failure (implied retention of life estate)
  - Did not decide applicability of §2036(a)(2) (*Byrum* applicability)
  - What CPAs should be doing

## Key Individual Developments

- Estate Gets Discounts on Highly Liquid Partnership  
*(Estate of Kelley, TC Memorandum 2005-235) p.78*
  - In a case decided after *Strangi*, an estate received a 32% discount on a partnership
  - Assets consisted of cash and certificates of deposit—about as liquid as you can get
  - IRS dropped §2036 arguments at trial (don't know why)

## Key Individual Developments

- Tax Liability Implicit in IRA Does Not Reduce Value for Estate Tax Purposes

*(D. F. Kahn Estate, 125 TC No. 11, 11/18/05) p. 74*

- Tax Court reaffirms its position that this is not the same as closely held stock
- Emphasized that
  - Willing buyer would not take over the tax attributes
  - §691(c) provides relief from double taxation (albeit far from perfect relief)

## Key Individual Developments

- Buy/Sell Agreement Failed to Set Price of Redemption Even Though Control Went to Employees

*(Blount v. Commissioner, 2005-2 USTC ¶60,509 (CA11)) p. 68*

- A taxpayer owned a corporate with one other owner and the firm's ESOP
- First owner died and was redeemed
- Remaining owner reduced buyout amount because of concern about company
- Court held he had unilateral right to modify and it no longer set the value

## Key Individual Developments

- Decedent, and not Partnership, Owner of Real Estate Despite 1065s Filed for Over 20 Years

*(Estate of Marie A. Maniglia v. Commissioner, TC Memorandum 2005-247, 10/26/05) p. 83*

- Key lesson—Formalities count when taxpayer controls them
- Next lesson—Don't hire an accountant who had a "tax evasion problem" and a bad memory

## Key Individual Developments

- IRS Announces 2006 Inflation Adjusted Figures

*(Revenue Procedure 2005-70, October 28, 2005) p. 42*

- Standard deduction will be \$10,300 for joint return filers, \$7,550 for head of household and \$5,150 for those filing single and married filing separately.
- Personal exemption \$3,300
- Gift tax exclusion for present interest rises to \$12,000
- HSA Limits also announced

## Key Individual Developments

- **Single Six Month Extension in 2005**  
*(TD9229, 11/07/05) p. 47*
  - Eliminate the 2688 and the 4868 will be good for six months
  - Applies to virtually all noncorporate entities
  - Form 7004 will be used by filers other than individuals (not just limited to corporations)

## Key Individual Developments

- **No Medical Deduction for Prescription Drugs Brought in from Canada**  
*(IRS Information Letter 2005-0011, 3/14/05) p. 46*
  - Such importation is illegal, per the FDA's position
  - Regulations deny deduction for illegal drugs
  - Same logic should apply for reimbursements from FSAs

## Key Individual Developments

- **In Private Ruling, IRS Allows a Taxpayer to Divide Unallocated Arbitration Award Between IRA and Taxable Account**  
*(PLR 200534026, 7/1/05) p. 28*
  - Taxpayer received arbitration award covering taxable and IRA accounts
  - Amount computed for IRA by taxpayer's method allowed to be rolled back into IRA account
  - Note, this is a private letter ruling but suggests the possibility is there to get the funds back into the IRA and escape current tax

## Key Individual Developments

- **IRS Believes Spouse's Right to Elect Against CRT Invalidates CRT**  
*(Revenue Procedure 2005-24, 4/18/05) p. 33*
  - The IRS "discovered" that if a spouse has a state granted right to claim an elective share of a CRT, that right, even if never exercised, invalidates the CRT
  - Must get a waiver valid under state law within time limits
  - Taxpayer can stumble into this by moving from one state to another
  - Pre 6/28/05 trusts grandfathered (sort of)

## Key Individual Developments

- **New York Can Tax All Wages of Employee Who Mainly Telecommuted from Tennessee**  
*(Huckaby v. Tax Appeals Tribunal, New York State Court of Appeals, US Supreme Court cert. Denied 10/31/05) p. 86*
  - US Supreme Court denied cert in the case on 10/31/05
  - New York's highest court held that location in Tennessee was for convenience of employee, not employer
  - Therefore, wages taxable to New York

## Key Individual Developments

- **IRS Clarifies AMT Treatment of Refinanced Home Mortgage Debt**  
*(Revenue Ruling 2005-11, 3/17/05) p. 44*
  - The IRS clarified that a second refinancing doesn't change home acquisition debt to something else for AMT purposes
  - Code section worded "awkwardly" to say the least
  - Came out late in tax season

## Key Individual Developments

- **"Borrowing" from an IRA Proves to Be a Dangerous Practice**  
*(IRS Letter Ruling 200544022, 11/7/05) p. 26*
  - Taxpayer bought home, using funds from IRA to temporarily get down payment
  - Planned to refinance shortly after, but Hurricane hit and was unable to timely complete
  - IRS denied relief since was using outside designed purpose of rollover

## Key Individual Developments

- **IRA Early Distribution Tax Exception Only Applies to Current Year Education Expenses**  
*(Linda Louise Loddler-Beckert and Timothy Beckert, TC Memo 2005-162, 7/5/05) p. 73*
  - Taxpayer wanted to roll from plan to IRA and take distribution for education expense—but discovered might get more in plan if she waited
  - Charged education expenses and paid off credit cards in later year after getting extra money in plan
  - No exception for prior year expenses

## Key Individual Developments

- **Transfer of Third Party Debt Does Not Qualify as Alimony**

*(Lofstrom, 125 TC No. 13, 11/22/05) p. 65*

- Taxpayer transferred note from son to his former spouse in satisfaction of past and future alimony
- Fails “cash or cash equivalent” requirement—is ruled not to be a cash equivalent
- As well, payments from debtor would not cease on death of recipient

## Other Cases and Developments

- **IRS Releases Audit Statistics**

*(IRS Commissioner Presentation, 11/3/05) p. 28*

- **Individuals**
  - FY2005 examined 0.93% of returns (FY2004 examined 0.77%)
  - \$100K and up examined 1.58% in FY2005 vs. 1.25% in FY2004)
- Small business corporations (< \$10 million) FY 2005 0.79% vs FY 2004 0.32%

## Other Cases and Developments

- **Extension of Time Denied to Make Election on Forgiveness of Debt**

*(Ltr 200543038, 7/20/05) p. 40*

- Taxpayer’s preparer did not file Form 982 to notify of reduction of tax attributes under §108, but rather used 8082 (Notice of Inconsistent Treatment)
- As well failed to reduce basis in later years
- Denied relief under Regulation §301.9100-3

## Other Cases and Developments

- **Do It Yourself Will Transfer Found, Despite Language Problems, to Qualify for Marital Deduction**

*(Estate of Sowder, 2005-2 USTC ¶60,512, 11/10/05) p. 81*

- Taxpayer wrote his own will, and included in it a clause that provided the residual would go to his wife, but only if she survived long enough after his death to receive the distribution—otherwise it transferred *per stirpes*
- Court held, based on specific provisions in state law, that decedent’s intent caused problematical provisions to be stricken from will for state law purposes

## Other Cases and Developments

- IRS Warns of Potential Consequences to Issuer of 1099 Apparently Issued to “Get Even”  
*(IRS Information Letter 2005-0123, 9/30/05) p. 44*
  - IRS ruled a 1099-INT issued by car dealer due to an unfavorable (to the dealer) resolution of a financing dispute should not have been issued
  - Commented on consequences under §7434 to issuer

## Other Cases and Developments

- Expanded Access to E-services for Preparers Who File More than 5 Returns  
*(IR-2005-33, 3/21/05) p. 39*
  - Dropped from old floor of 100
  - Offers a number of features
  - Demands password change quite often

## Other Cases and Developments

- S Corporation Disproportionate Distribution Correction Allowed to Avert Termination Due to Second Class of Stock  
*(PLR 200524020, 6/17/05) p. 51*
  - Corporation paid income tax liabilities of shareholders directly to governmental entities resulting in disproportionate distribution
  - CFO made corrective distributions once made aware of the problem
  - S election not terminated, rules IRS

## Other Cases and Developments

- Nonrefundable Mortgage Purchase Commitment Fees Were Properly Classified as Options  
*(Federal Home Loan Mortgage Corporation, 125 TC No. 12, 11/21/05) p. 82*
  - Taxpayer received 0.5% nonrefundable fee to enter into a contract to purchase a mortgage at the lender's option
  - Tax Court found the contract had economic substance as option and the earnings process was not complete

## Other Cases and Developments

- Changes to EIN Requirements for Disregarded Entities Proposed

*(REG-114371-05, Issued October 17, 2005) p. 32*

- Would require disregarded entity to obtain its own EIN for payroll and excise tax purposes
- Could no longer use EIN of owner
- Would be effective year after year regulations go final

## Other Cases and Developments

- Proposed Regulations to Make Registered/Certified Mail Sole Method for Prima Facie Proof of Filing

*(Proposed Regulation §301.7502-1, 9/21/04) p. 50*

- Meant to resolve a split in circuits (6<sup>th</sup> already adopts this position)
- Even if the client is in a circuit that doesn't go along with this, still makes sense to use these methods

## Other Cases and Developments

- Legal Settlement Divided Between Deductible and Nondeductible Based on Amounts Paid by Partnership vs. Partner

*(Haug, TC Memorandum 2005-276, 11/29/05) p. 80*

- Taxpayer was involved in litigation on farm loan defaulted upon by deceased spouse's family
- Records not clear on how settlement was paid
- Court held deductible to extent paid by partnership (§162) but must be capitalized for amount paid by partner

## Other Cases and Developments

- IRS Provides Guidance for Aircraft Expense Limitation Coverage

*(IRS Notice 2005-24, 5/27/05) p. 39*

- Guidance for implementing the limitation on deduction of aircraft related expense from AJCA 2004
- Provides computational support

## Other Cases and Developments

- IRS Seeks to Limit Applicability of *Amdahl* Decision on Employer Home Sale Benefit to Relocating Employees

*(Revenue Ruling 2005-74, 11/30/05) p. 41*

- IRS outlines three fact patterns
- Emphasizes that blank deed alone will not be deemed to trigger *Amdahl* result
- Evaluates burdens and benefits of ownership rather than technical title status.

## Other Cases and Developments

- Assignment of Income to S Corporation Not Valid

*(Arnold v. Commissioner, T.C. Memo. 2005-256, 10/31/05) p. 66*

- Customers need to acknowledge they are dealing with the corporation
- Clients who cannot get customers to pay to corporation have a problem

## Other Cases and Developments

- IRS Releases Guidance on Election to Create Family Group for S Corporation Qualification Purposes

*(Notice 2005-91, 11/22/05) p. 46*

- Describes method to be used to make the election to treat as a family group
- Defines the common ancestor and entities that can be included in family group
- Can be relied upon until regulations are issued

## Other Cases and Developments

- Claim of Right Theory Did Not Serve to Delay Stock Sale Despite Shareholder's Dispute of Sale

*(Hightower, T.C. Memo. 2005-274, 11/28/05) p. 71*

- Shareholder forced out under terms of shareholder agreement, but attempted to dispute arbitration decision
- Placed funds "in trust" and then unsuccessfully litigated all the way to state's top court
- Was income in year of receipt
- Also had to pick up S corporation income—was beneficial owner prior to sale

## Other Cases and Developments

- Taxpayer's Still Has to Produce Some Evidence to Invoke Cohan Rule

*(Kolbeck v. Commissioner, TC Memorandum 2005-253, 10/31/05) p. 75*

- Taxpayer had records confiscated and destroyed by employer
- However, offered no evidence to support deduction and did not take obvious steps to give court a basis for estimating

## Other Cases and Developments

- Gift of Real Estate Valued Based on Purchase Price Paid 17 Months Earlier

*(Wortmann v. Commissioner, TC Memorandum 2005-227, 9/29/05) p. 86*

- Taxpayers purchased property that had been a financially unsuccessful monastery
- Leased to a charity for 17 months, then donated
- Taxpayer's appraisal not believed by court

## Other Cases and Developments

- Disaster Relief Payments from State Not Excludable from Income

*(Revenue Ruling 2005-46, 7/1/05) p. 32*

- Came out before Hurricanes of 2005
- Can use §1033 to defer gain if property is replaced

## Other Cases and Developments

- Payments From Supplier to Help Finance Expansion Were Income and Not a Loan

*(Kams Prime & Fancy Food, Ltd. v. Commissioner, TC Memorandum 2005-233, 10/5/05) p. 83*

- Taxpayer received advance from supplier and signed note
- Court ruled that even though the form was a loan, the reality was an advance payment of a rebate and taxable as income in year of receipt

## Other Cases and Developments

- IRS Publishes Cost Segregation Audit Guide  
*(Cost Segregation Audit Guide, 2004) p. 33*
  - IRS guide to auditors on evaluation cost segregation studies
  - Should study this if you are involved in this

## Other Cases and Developments

- IRS Updates Audit Guide for Construction Contractors  
*(MSSP Audit Guide - Construction Industry, 2/22/05) p.45*
  - Details tax issues for contractors
  - Useful reference for construction clients

## Other Cases and Developments

- Undocumented Advances Not Treated as Loans to Corporation  
*(Indmar Products Co. Inc., T.C. Memo 2005-32, 2/23/05) p. 85*
  - Taxpayers advanced loans to corporation—received interest at 10% despite corporation's ability to borrow at a lower rate
  - Did not pay dividend to avoid Tennessee tax

## Other Cases and Developments

- Taxpayer Granted Redemption Treatment Despite Spouse's Continued Involvement with Corporation  
*(Hurst, 124 TC 16, 3/3/05) p. 84*
  - Taxpayer was redeemed in his shares, however kept a number of interests, including wife had a 10 year employment agreement
  - Note that the Court declined to look at an alternative attack because the IRS raised it too late—so be very careful with this case

## Other Cases and Developments

- No adjustment for AMT for subtraction for targeted jobs credit

*(Ventas, Inc., Fed. Cir., 2003-2 USTC ¶50,613, 8/24/2004) p. 65*

- Another case, this time for the Federal Circuit, holds that the AMT is not a “pure” second tax system
- Even though no benefit for AMT purposes, still have to do the addback for §51 credit

## Other Cases and Developments

- Qualified Amended Return for Accuracy Related Penalties Defined

*(Regulation Section 1.6664-2(c), T.D. 9186, 3/2/05) p. 48*

- Amendment filed before IRS contacts taxpayer is “qualified amended return”
- Meant to encourage voluntary compliance

## Other Cases and Developments

- Wage Payments to Former Spouse to Compensate for Retirement Income Not Taken Taxable to Former Spouse

*(Dunkin, 124 TC 180, 3/31/05) p. 87*

- Taxpayer continued to work, therefore former spouse was not being paid her ½ of pension
- Paid share of wages in lieu of that payment
- Not considered an impermissible assignment of income

## Other Cases and Developments

- IRS Clarifies Impact of Spouse’s Non-HDHP Coverage on HSA Eligibility

*(Revenue Ruling 2005-25, 4/13/05) p. 42*

- The IRS outlined the impact of
  - Spouse who has non-HDHP coverage
  - Spouse with no coverage
- Outlines when you can have “family” coverage even if the spouse is not covered

## Other Cases and Developments

- IRS Answers Questions on Their Views on Specified Liability NOLs

*(Notice 2005-20, 2/10/05) p. 56*

- Specified liability NOLs get 10 year carryback
- IRS gives questions and answers on what qualifies for this purpose

## Other Cases and Developments

- IRS Rules that Merger Termination Fees Are Ordinary Income

*(TAM200438038) p. 63*

- IRS Ruled Fees are Ordinary Income and Not a Return of Capital
- Represents Fee Received to Avoid Litigation

## Other Cases and Developments

- Forming Nevada Corporation to Own REIT Shares Did Not Allow Income to Escape State Taxation

*(Bridges V. Autozone, S. Ct. Louisiana, 3/24/05) p. 81*

- AutoZone formed a REIT that owned real property in Louisiana and rented to their stores
- REIT owned 100% by a Nevada corporation formed solely to hold REIT shares
- Louisiana Supreme Court rules income still subject to Louisiana tax

## Other Cases and Developments

- IRS Rules on Classification of Assets of Outdoor Entertainment Venture

*(TAM 200508015, 12/2/04) p. 33*

- IRS ruled the assets were not "Theme or Amusement Park" class 80.0 assets
- Be sure to check out IRS Publication 946

## Other Cases and Developments

- Distribution of Partnership Valued by Reference to Underlying Assets per IRS  
*(TAM200443032, 7/13/04, Released 10/22/04) p. 36*
  - IRS Ruled that a corporation may not discount the value of what it is distributing by first placing the assets into a partnership
  - Not surprising given IRS views of family limited partnerships

## Other Cases and Developments

- IRS Establishes Standards for Treating Foreign Adoptions as Final  
*(Revenue Procedure 2005-31, 6/15/05) p. 41*
  - Finalized Guidance in Notice 2003-15
  - Provides rules for adoptions subject to Intercompany Adoption Act of 2000 certification and for those not subject to those provisions

## Other Cases and Developments

- Simplified Low Income Housing Credit Filings  
*(TD 9228, 11/7/05) p. 55*
  - Simplified Filing for Form 8609
  - File once rather than 15 times