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# Federal Tax Weekly

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# Organizations May Apply To Regain Tax-Exempt Status After Automatic Revocation; Small Exempts Eligible For Transitional Relief

◆ *IR-2011-63, Rev. Proc. 2011-63, Notice 2011-43, Notice 2011-44, Ann. 2011-35, FAQs*

Organizations whose tax-exempt status has been automatically revoked by law may apply for reinstatement of their status, the IRS has announced. The agency provided guidance for organizations seeking retroactive reinstatement as well as transitional relief for small exempt organizations. The IRS has also posted the names of previously exempt organizations on its web site, issued a fact sheet and updated its online frequently asked questions (FAQs).

■ ***CCH Take Away.*** Many organizations, especially small organizations, are surprised that the revocation in these cases is by operation of law, Janice Ratica, CPA, director of nonprofit tax services, Cherry, Bekaert & Holland, LLP, Charlotte, N.C., told CCH. The relief is welcomed, Ratica added.

## Background

The *Pension Protection Act of 2006 (PPA)* requires all tax-exempt organizations, with the exception of churches and church-related organizations, to file an information return with the IRS. An organization that fails to file for three consecutive years automatically loses its tax-exempt status. The *PPA* also mandated that small tax-exempt organizations file Form 990-N (e-Postcard).

## Reinstatement

An organization whose tax-exempt status was automatically revoked must apply to obtain reinstatement of its status. If the application for reinstatement of tax-exempt status is approved, the effective date of the organization's reinstated tax-exempt status generally will be the date the organization filed its application for reinstatement. At the discretion of the IRS, the organization's tax-exempt status may be reinstated effective from the date of the revocation. Organizations seeking reinstatement of their tax-exempt status must:

- File Form 1023 or Form 1024;
- Pay a user fee; and
- Apply for reinstatement within 15 months of revocation of tax-exempt status.

■ ***Comment.*** "Some in the exempt community had been hoping for a less complicated approach to reinstatement," Ratica told CCH. However, the IRS is requiring organizations to file Form 1023 rather than a streamlined approach, Ratica explained.

Organizations, other than small organizations, seeking retroactive reinstatement of their tax-exempt status must submit a request for retroactive reinstatement in addition to their application. Organizations must explain, among other things, why they failed to file the required returns and what safeguards they have put in place to ensure compliance in future years. Additionally, organizations must file all required returns that they failed to file. Requests for retroactive reinstatement

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Route to: _____ _____ _____ _____ _____

# IRS Describes Reliance On Publication 78 And Business Master File When Making Contributions

◆ *Rev. Proc. 2011-33*

The IRS has provided guidance on the extent to which donors to tax-exempt organizations can rely on *Publication 78, Cumulative List of Organizations described in Section 170(c) of the Internal Revenue Code of 1986* (Pub 78) or on the agency's Business Master File (BMF) extract. The IRS also clarified that it may give notice of revocation of an organization's tax-exempt status through an appropriate public announcement, such a posting on the agency's web site.

■ ***CCH Take Away.*** At the same time the IRS issued Rev. Proc. 2011-33, the agency posted on its web site the names of organizations that automatically lost their tax-exempt status by law *(see the article on page 277 in this newsletter)*. If an organization's application for reinstatement of its exempt status is accepted by the IRS, the agency reported it will include the organization in the next update of Pub 78 and the BMF extract.

## Background

Generally, Pub 78 lists organizations that have received a ruling or determination letter from the IRS stating that contributions by grantors or contributors to the listed organization (or to the listed central (or parent) organization and those local (or subordinate) units covered by the group exemption letter) are tax-deductible. Similar information is available on the BMF extract.

In certain cases, the IRS will allow deductions for contributions to organizations that have lost their exempt status but are listed in or covered by Pub 78 or the BMF extract. Additionally, private foundations and sponsoring organizations of donor-advised funds generally may rely on an organization's foundation status (or supporting organization type) set forth in Pub. 78 or the BMF extract for grant-making purposes.

## Third party information

Generally, donors may rely on information about an organization from the BMF extract that is obtained from a third party. The IRS explained that the third party must provide a report that identifies, among other things, the organization's name, whether contributions to the organization are tax-deductible, and a statement that the information is from the most current update of the BMF extract.

*References: FED ¶46,387; TRC EXEMPT: 12,252.15.*

## Tax-Exempts

*Continued from page 277*

of tax-exempt status must be submitted within 15 months of revocation.

Organizations must show that their failure to file was reasonable to obtain retroactive reinstatement of their tax-exempt status. The IRS reported it will take into account all of the facts and circumstances leading up to revocation. Factors that weigh in favor of reasonable cause include, but are not limited to, good faith reliance on erroneous written information from the IRS; events beyond the organization's control; and compliance with any other reporting requirements.

## Small organizations

Generally, small organizations must follow the steps for reinstatement applicable to all previously tax-exempt organizations. However, the IRS has provided transitional relief to help small organizations regain their tax-exempt status. A small organization for purposes of the transitional relief is an organization that normally has annual gross receipts of not more than $50,000 in its most recently completed tax year.

The IRS will treat a small organization as having established reasonable cause for failing to file if the organization was eligible to file the e-Postcard and the organization applies for reinstatement of tax-exempt status before 2013. The tax-exempt status of small organizations meeting these requirements will be retroactively reinstated to the date of revocation, the IRS explained. Small organizations are also eligible for a reduced user fee of $100.

■ ***Comment.*** "Although the new relief provided by Notice 2011-43 can assist numerous small organizations, questions remain unanswered," Andrew Grumet, partner, Edwards Angell Palmer & Dodge, LLP, New York, told CCH. "For example, organizations whose exempt status has been revoked are required to disclose to donors that contributions are not tax deductible. However, organizations may wait until December 31, 2012 to apply for retroactive relief. As such, it is possible that an organization will be required to advise its donors that contributions are not tax deductible, but then later be permitted to tell the same donors that contributions made are tax deductible."

■ ***Comment.*** "The IRS appears to recognize that many small organizations are very local-orientated, issue-specific and are often operated by volunteers," John Christopher, partner, Dinsmore & Shohl LLP, Cincinnati, told CCH. Even though the organizations are small and led by volunteers, the exemption rules still apply, Christopher noted.

*References: FED ¶¶46,382, 46,383, 46,384, 46,385, 46,386; TRC EXEMPT: 12,252.*

***Reference Key***

**FED** references are to *Standard Federal Tax Reporter*
**USTC** references are to *U.S. Tax Cases*
**CCH Dec** references are to *Tax Court Reports*
**TRC** references are to *Tax Research Consultant*

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# Final Regs Explain Election And Calculation Of Alternative Simplified Research Credit

◆ *TD 9528*

The IRS has released final regs describing how taxpayers may elect the alternative simplified research credit. The final regs generally track proposed regs issued in 2008.

■ ***CCH Take Away.*** "Earlier this year, the Obama administration issued a special report extolling the research credit," David Click, director, RSM McGladrey, Inc., Denver, told CCH. "The regulations, however, needlessly complicate the credit. On the one hand, the administration is promoting the credit and on the other Treasury is making it very restrictive."

## Background

Code Sec. 41 allows taxpayers a credit against tax for increasing research activities. Generally, the credit is an incremental credit equal to the sum of 20 percent of the excess (if any) of the taxpayer's qualified research expenses for the tax year over the base amount, and 20 percent of the taxpayer's basic research payments.

The *Tax Relief and Health Care Act of 2006 (2006 Tax Relief Act)* provides that taxpayers may, at their election, compute their research credit under the alternative simplified credit method. A taxpayer can claim an amount equal to 12 percent of the amount by which qualified research expenses exceeds 50 percent of the average qualified research expenses for the preceding three tax years. If the taxpayer has no qualified research expenses for any of the preceding three tax years, the credit is equal to six percent of the qualified research expenses for the current tax year.

■ ***Comment.*** Taxpayers may also elect to compute the research tax credit using the alternative incremental research credit method.

The IRS issued proposed and temporary regs on the alternative simplified method in 2008. The 2008 regs extended the election procedures for the alternative incremental research credit method to the alternative simplified credit method. The 2008 regs also provided that extensions of time to make or revoke the election for both methods would not be granted under Reg. 301.9100-3.

## Final regs

The final regs carry forward the same election procedures for the alternative simplified credit as for the alternative incremental credit. The IRS explained that tax administration and fairness are best served by adopting the same election procedures. The election may be made or revoked each tax year by obtaining the consent of the IRS by filing Form 6765, Credit for Increasing Research Activities, relating to the alternative simplified credit or alternative incremental credit and attaching the form to the taxpayer's timely filed original return for the year to which it applies.

However, the alternative simplified credit election may not be made or revoked on an amended return, the IRS advised. The final regs also provide that an extension of time to make or revoke an election will not be granted under Reg. 301.9100-3.

Under the final regs, a taxpayer may calculate the alternative simplified credit for a short tax year on a daily rather than monthly basis. This calculation, the IRS explained, provides a more accurate calculation and removes uncertainty as to whether and how to include a partial month in making the monthly calculation. Returns filed for tax years ending after December 31, 2006 and before June 9, 2011, and for which the period of limitations has not expired, may be amended to apply the daily calculation for short tax years in lieu of the monthly calculation for short tax years.

*References: FED ¶47,024; TRC BUSEXP: 54,158.*

# IRS Updates Regs For Filing Credit Or Refund Claims

◆ *NPRM REG-137128-08*

The IRS has issued proposed reliance regs governing the filing of claims for credits or refunds. The proposed regs are intended to perform a housekeeping function. Among other actions, the proposed regs clarify where and how to file credit or refund claims.

■ ***CCH Take Away.*** The regs will apply to claims for credit or refund filed on or after the date that the regs are finalized. In the meantime, taxpayers may rely on the proposed regs when making claims for credit or refund until the final regs are issued.

## Background

Under current regs, a claim for credit or refund needs to be filed with the IRS service center serving the internal revenue district in which the tax was paid. The proposed regs clarify that taxpayers should file a claim for credit or refund with the same IRS service center where the taxpayer files a return for the type of tax to which the claim relates.

## Place to file

Generally, taxpayers should follow the instructions on the respective form required to be filed to claim a credit or refund. If filing instructions are not provided on the form or elsewhere, the proposed regs clarify that the credit or refund claim should be filed with the IRS service center at which the taxpayer would be required to file a current tax return for the type of tax to which the claim relates. Claims for refunds or credits, the IRS explained, should not be filed at a different location where the tax was paid or was required to have been paid.

## Forms

The IRS has developed many forms to use to claim various credits and refunds.

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# IRS Eliminates Duplicate Filing Requirement For Form 5472 Information Return

◆ *TD 9529, NPRM REG-101352-11*

The IRS has issued temporary and proposed regs that eliminate the duplicate filing requirement for Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business. The change is effective immediately and applies to filings for tax years ending on or after June 10, 2011.

## Background

Since 1991, Code Sections 6038A and 6038C have required a domestic corporation that is 25 percent foreign-owned, or a foreign corporation engaged in a trade or business within the U.S. at any time during the year, to report certain monetary and non-monetary transactions between the corporation and a related party.

Form 5472 must be filed with the corporation's timely-filed income tax return for the year. If the income tax return is not timely filed, Form 5472 must still be filed with the appropriate service center. In either circumstance, a duplicate Form 5472 must also be filed with the IRS service center in Philadelphia.

■ ***Comment.*** Regs issued in 2004 eliminated the duplicate filing requirement if Form 5472 is timely filed electronically. The duplicate filing requirement was not eliminated for untimely filings because Form 5472 could only be filed electronically as an attachment to an e-filed income tax return.

## Duplicate filing eliminated

As a result of advances in electronic processing and data collection, the duplicate filing requirement is no longer necessary, the IRS reported. Under the new, temporary regs, duplicate filing will not be needed whether the corporation files a paper or an electronic income tax return.

While a timely filed electronic Form 5472 would satisfy the untimely filing requirement, there still are no procedures currently for e-filing Form 5472 independently of an e-filed income tax return. Thus, a reporting corporation that does not timely file an income tax return must timely file a paper Form 5472 to satisfy the requirements.

■ ***Comment.*** If the IRS is able to provide procedures for separately e-filing Form 5472, reporting corporations will no longer have to file a paper Form 5472 when filing the form separately from an income tax return.

*References: FED ¶¶47,025, 49,483; TRC INTL: 3,754.05.*

## Research Credit

*Continued from page 279*

The proposed regs explain that taxpayers must use the form prescribed for filing a particular claim for credit or refund. In cases where no alternative form is prescribed, a claim for credit or refund should be filed on a Form 843, Claim for Refund and Request for Abatement.

## *Part Of 2010 Form 990 Schedule H Is Optional For Hospitals*

Part V, Section B of Schedule H, Hospitals, of Form 990, Return of Organization Exempt From Income Tax, is optional for the 2010 tax year, the IRS recently announced. Filers, however, must complete all other sections of Schedule H.

The *Patient Protection and Affordable Care Act (PPACA)* imposes new requirements on charitable hospitals. Charitable hospitals must conduct a community needs assessment and adopt an implementation strategy. Additionally, charitable hospitals must adopt, implement and publicize a financial assistance policy. The *PPACA* also places limits on charges for patients who qualify for financial assistance and bars certain collection activities.

The IRS explained it is making Part V, Section B of Schedule H optional to give hospitals time to become familiar with the *PPACA's* new requirements. The agency also provided limited penalty abatement.

■ ***Comment.*** In Ann. 2011-20, the IRS instructed hospital organizations not to file the 2010 Form 990 before July 1, 2011 and granted hospital organizations with return due dates prior to August 15, 2011, an automatic three-month extension of time to file a Form 990 for 2010. Ann. 2011-20 is unaffected by Ann. 2011-37.

*Ann. 2011-37, FED ¶46,388; TRC EXEMPT: 12,250.*

## Employment taxes

The IRS has developed a group of "X" amended return forms for taxpayers to use to report adjustments to employment taxes and to claim refunds of overpaid employment taxes. These forms correspond and relate line-by-line to the employment tax return(s). The proposed regs clarify that taxpayers should use the "X" amended return forms whenever appropriate. Additionally, the proposed regs provide that when filing a claim for employment taxes, a separate claim must be made for each tax period.

## More changes

Code Sec. 6405 requires the advance referral of a report to the Joint Committee on Taxation regarding specified types of refunds or credits in excess of a threshold amount. The proposed regs would remove the reference to a specific threshold amount. The proposed regs also eliminate obsolete references to certain committees and to old IRS titles.

*References: FED ¶49,482; TRC IRS: 33,150.*

# Tax Court Upholds Accuracy-Related Penalty For Years Preparer Was Employee Of Closely-Held Corporations

◆ *Seven W. Enterprises, Inc. & Subsidiaries, 136 TC No. 26*

The Tax Court has upheld an accuracy-related penalty where the certified public accountant (CPA) preparing the challenged returns was an employee of two closely-held corporations. The CPA did not qualify under the regs as a person other than the taxpayer with respect to the returns he signed on behalf of the corporate groups. However, one group of closely-held corporations was not liable for the penalty during the time the CPA was not an employee.

■ ***CCH Take Away.*** The IRS may impose an accuracy related penalty on any underpayment attributable to a substantial understatement of income tax. For purposes of the penalty, an understatement is defined as the excess of the taxpayer's actual tax liability over the amount shown on the return. No accuracy-related penalty may be imposed on any portion of an underpayment if it is shown that there was reasonable cause for, and the taxpayer acted in good faith with respect to, the underpayment. Reliance on professional tax advice can constitute reasonable cause under IRS regs. However, that reliance is subject to limitations as the taxpayers learned in this case.

## Background

In 1990, the taxpayers, two closely-held corporations (A and B), hired the CPA as its tax manager. One year later, the CPA was promoted to vice president of taxes. In 2001, the CPA resigned as vice president of taxes and worked as a consultant for the taxpayers. The corporations rehired the CPA in 2002.

The IRS subsequently launched an examination of the taxpayers. According to the IRS, the CPA had incorrectly determined that the taxpayers were not liable for personal holding company taxes. Consequently, the taxpayers understated their income. The IRS also imposed accuracy related penalties under Code Sec. 6662(a).

## Court's analysis

The court first looked at A's 2000 return. The court found that when the CPA prepared A's 2000 return, the CPA was no longer an employee but was an independent contractor. The consulting agreement between A and the CPA specifically provided that the CPA was not subject to A's supervision. Therefore, it was reasonable for A to rely on the CPA to prepare its 2000 return and A would not be liable for the Code Sec. 6662(a) accuracy-related penalty relating to 2000.

Turning to the 2001 to 2004 returns of A and B, the court found that the CPA was an employee of the taxpayers during the years the returns were prepared and signed. Unlike the 2000 return of A, which the CPA had signed as a paid preparer, the 2001 to 2004 returns of A and B were signed by the CPA as an employee of the two closely-held corporations. The court concluded that the taxpayers did not have reasonable cause for their underpayments and they did not rely on the advice of a preparer who was a person other than the taxpayer.

*References: CCH Dec. 58,650; TRC PENALTY: 3,108.*

# Tax Court Allocates Foreign Golfer's Endorsement Income To Royalties And Personal Services; Partially U.S. Source

◆ *Goosen, 136 TC No. 27*

The Tax Court has held that a foreign golfer's endorsement income should be allocated partially to personal services, partially to royalties. Some of the royalty income was effectively connected to a U.S. trade or business; some was not.

■ ***CCH Take Away.*** The court had to characterize the nature of the endorsement income and the source of the income. The court stated that it had to provide a reasonable allocation of the amounts, despite the lack of statistical evidence for some amounts.

## Background

The taxpayer was a professional golfer. He was a native of South Africa and a resident of the United Kingdom. He played in golf tournaments in both the U.S. and abroad.

The taxpayer's management company marketed his name and likeness to sponsors for negotiated fees. He entered into endorsement agreements with six companies that manufactured golf items, clothing, sports cards, watches and video games. The (three) on-course endorsement agreements required taxpayer to wear or use specific products during golf tournaments. The (three) off-course endorsement agreements did not have this requirement.

## Taxing nonresidents

The United States taxes U.S. residents on their worldwide income, but taxes nonresident aliens (such as the taxpayer in this case) only if they engage in a U.S. trade or business or receive U.S. source fixed and determinable income. The IRS and the taxpayer agreed that taxpayer's playing golf in the U.S. was engaging in a U.S. trade or business. Effectively connected income is taxed at U.S. graduated rates. Other income, such as royalties, is taxed at a flat 30-percent withholding rate, unless a treaty applies and reduces the withholding amount.

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# IRS Allows Overpayment Interest From Date of Overpayment To Date of Tentative Refund

◆ *TAM 201123029*

In a just-released technical advice memorandum (TAM), the IRS determined that overpayment interest was allowable under Code Sec. 6611 from the date of the overpayment to the date of the tentative refund, subject to administrative adjustments. The overpayment was attributable to the IRS's general adjustment to the taxpayer's federal income tax liability and the overpayment was effectively refunded to the taxpayer.

■ ***Comment.*** The IRS released the TAM, dated July 29, 2010, on June 10, 2011. The IRS did not explain the delay in publication. In Program Manager Technical Advice (PMTA) 2011-008, the IRS instructed examiners that they should apply the general rules of Code Sections 6601 and 6611 and each overpayment interest case must be evaluated based on the facts presented. The IRS appears to have followed that approach in this TAM.

## Background

The taxpayer timely filed its TY1 return reporting a liability (Amount 1) which it paid before the due date of the return. The IRS issued a tentative refund (Amount 2) as a result of an NOL carryback from another tax year. No overpayment interest was paid under Code Sec. 6611(e)(2).

The IRS disallowed the entire NOL carryback and assessed the amount previously refunded. At the same time, the IRS made a general adjustment decrease to the taxpayer's TY 1 liability that reduced the liability by Amount 3 from Amount 1 to Amount 4 and it abated an additional amount (Amount 5) resulting from the carryback from another tax year. The combination of these two amounts was more than the disallowed carryback (Amount 6).

The IRS allowed interest on the Amount 3 overpayment for the period of the filing and payment due date for TYI to the due date of the taxpayer's liability for TY 2. The taxpayer countered that the overpayment interest on Amount 3 is allowable to when the IRS issued the tentative refund.

## IRS analysis

Under Code Sec. 6611(b)(2), interest runs from the date of the overpayment to a date (to be determined by the IRS) preceding the date of the refund check by not more than 30 days." The IRS administratively establishes an end date of less than 30 days. When an overpayment is credited to another tax liability, interest on the overpayment runs from the overpayment date to the due date of the liability to which the overpayment is credited. The due date of the liability credited is the last day fixed by law or regulations for the payment of the tax (determined without regard to any extension of time). Under Code Sec. 6611(e)(3), interest on an overpayment that results from an IRS-initiated adjustment is computed by subtracting 45 days from the period for which interest is allowable.

The IRS determined that because Code Sec. 6611(b)(2) would control, the period in Code Sec. 6611(b)(1) for interest on an overpayment that is credited to a liability would not apply in the case, as the overpayment was not credited to a liability. Also, the rules for determining the interest period in cases of NOL carrybacks would not apply.

Although the IRS tentatively refunded an overpayment claimed by taxpayer based on an NOL carryback, there was no overpayment, the IRS determined. The actual overpayment is based on an adjustment to taxpayer's liability for the tax year and is not the result of an NOL carried back from another tax year, the IRS concluded.

*References: FED ¶47,406; TRC PENALTY: 9,102.05.*

## Income

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### On-course fees

According to the court, the characterization of taxpayer's on-course endorsement fees depended on whether sponsors paid primarily for services, for taxpayer's name and likeness, or for both. The court found that sponsors paid for both services provided and the right to use taxpayer's name and likeness. While sponsors valued the taxpayer's image, the performance of services requirement was not de minimis.

The court found that the performance of services was equally important with the use of name and likeness. Thus, 50 percent of the on-course fees were royalty income and 50 percent were personal service income.

### Royalty income

The court agreed that the percentage of sales of trading cards and video games in and outside of the U.S. should determine the source of those endorsement fees. For the on-course and watch endorsement agreements, the court's best judgment was that 50 percent of the royalty income was U.S. source income. Although the taxpayer had a global image, the U.S. golf market was the largest golf market in the work and was one of the largest markets for the taxpayer's endorsements.

The court found that royalty income from the on-course endorsement agreement was effectively connected with playing golf in the U.S. However, royalty income from the off-course golf agreements did not depend on whether he played in any tournaments and was not effectively connected with a U.S. trade or business.

■ ***Comment.*** The court also found that the taxpayer was not entitled to any treaty benefits under the U.S.-U.K. treaty, because he failed to prove whether any of the U.K. income was endorsement income also taxed in the U.S.

*References: CCH Dec. 58,655; TRC INTL: 3,200.*

# Tax Briefs

*Internal Revenue Service*

The IRS has awarded nearly $10 million in matching grants to Low Income Taxpayer Clinics for the 2011 grant cycle.

*IR-2011-65, FED ¶46,389; TRC IRS: 12,380.*

The IRS has made available the grant application package and guidelines for organizations interested in applying for a low-income taxpayer clinic matching grant for the 2012 grant cycle.

*Notice, FED ¶46,390; TRC IRS: 12,380.*

The IRS has extended return-filing and payment deadlines for victims of severe storms beginning May 22, 2011, in Oklahoma counties of Canadian, Delaware, Grady, Kingfisher, Logan and McClain being declared a federal disaster area.

*Oklahoma Disaster Relief Notice (OK-2011-08), FED ¶46,381; TRC FILEIND: 15,204.25.*

The IRS has extended return-filing and payment deadlines for victims of severe storms beginning April 19, 2011, in Illinois counties of Alexander, Franklin, Gallatin, Hardin, Jackson, Lawrence, Massac, Perry, Pope, Pulaski, Randolph, Saline, White and Williamson being declared a federal disaster area.

*Illinois Disaster Relief Notice (IL-2011-29), FED ¶46,380; TRC FILEIND: 15,204.25.*

A beneficiary of a decedent's estate and trust's motion to disqualify an out-of-circuit judge from presiding over her damages suit against the government for alleged unauthorized disclosures of the trust's return information was denied.

*Clark, DC Hawaii, 2011-1 USTC ¶50,413; TRC LITIG: 9,208.*

*Jurisdiction*

Taxpayers' suit challenging the IRS's right to assess and collect taxes from them was dismissed for lack of subject matter jurisdiction because the taxpayers' claims were frivolous.

*Kaufman, DC D.C., 2011-1 USTC ¶50,425; TRC IRS: 45,152.*

An individual's petition for redetermination of a deficiency for the year in issue was dismissed for lack of jurisdiction because it was filed more than 90 days after the mailing of the notice of deficiency.

*Lee, TC, CCH Dec. 58,656(M), FED ¶48,076(M); TRC LITIG: 6,210.*

*Tax Crimes*

A tax attorney's motion to vacate, set aside or correct his sentence for aiding and abetting tax evasion was denied. The sentence was reasonable.

*Jewell, DC Ark., 2011-1 USTC ¶50,426; TRC IRS: 66,204.*

A court's order compelling a promoter to provide the government with a list of customers violated his Fifth Amendment right because the information could lead to incriminating evidence in a subsequent criminal investigation.

*Sommerstedt, CA-9, 2011-1 USTC ¶50,422; TRC IRS: 6,200.*

The vice president of a corporation was properly convicted of failure to pay over federal payroll taxes and filing false tax returns. His request for a new trial based on newly discovered evidence was rejected because he failed to show that the evidence was material.

*Crabbe, CA-10, 2011-1 USTC ¶50,416; TRC IRS: 66,058.15 .*

A lawyer and two former employees of an accounting firm were properly convicted and sentenced for tax evasion in connection with their role in designing a tax shelter program. Their actions constituted willful evasion of tax because they had the requisite intent and were involved in the scheme to avoid taxes.

*Pfaff, CA-2, 2011-1 USTC ¶50,415; TRC IRS: 66,154.*

*Summons*

The IRS's *ex parte* petition for leave to serve a summons on the California Board of Equalization (BOE) seeking information about property that may be subject to federal gift tax was denied. The IRS failed to exhaust all its remedies within BOE.

*In the Matter of the Tax Liabilities of John Does, DC Calif., 2011-1 USTC ¶50,421; TRC IRS: 21,150.*

Jurisdiction was lacking over an individual's untimely petitions to quash IRS third-party summonses because the individual failed to challenge the validity of the summonses within 20 days of the government's notice.

*Foust, DC Calif., 2011-1 USTC ¶50,419; TRC IRS: 21,108.*

An IRS summons directing an individual to appear, testify and produce documents

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## *IRS Announces Inflation Adjustment For Code Sec. 45Q Carbon Dioxide Credit*

The IRS recently announced the 2011 inflation adjustment for the Code Sec. 45Q carbon dioxide sequestration credit.

Taxpayers may claim a credit of $20 per metric ton of qualified carbon dioxide that is captured at a qualified facility, disposed of by the taxpayer at a secure geological site and not used by the taxpayer as a tertiary injectant. For tax years beginning after December 31, 2009, the dollar amount in Code Sec. 45Q(a) must be adjusted for inflation.

For calendar year 2011, the inflation adjustment is 1.0187. The 45Q credit for calendar year 2011 is $20.37 per metric ton of qualified carbon dioxide under Code Sec. 45Q(a)(1) and $10.19 per metric ton of qualified carbon dioxide under Code Sec. 45Q(a)(2).

*Notice 2011-50FED ¶46,391; TRC BUSEXP: 55,600.*

## Tax Briefs

*Continued from page 283*

relating to an investigation of his unpaid taxes was ordered enforced.

*Wankel, DC N.M., 2011-1 USTC ¶50,418; TRC IRS: 21,300.*

IRS summonses directing the president and CFO of a company to appear, testify and produce documents relating to an investigation into the company's tax liabilities were ordered enforced.

*Swanson Flo-Systems, Co., DC Minn., 2011-1 USTC ¶50,414; TRC IRS: 21,300.*

*Income*

An individual was denied a dependency exemption for two years for children unrelated to her and was also denied head of household filing status, the child tax credit, and the earned income credit.

*Collier, TC, CCH Dec. 58,652(M), FED ¶48,072(M); TRC FILEIND: 6,168.10.*

A grandmother was not entitled to claim payments she received from her daughter for babysitting as gross receipts and she did not qualify for the earned income credit.

*Webb, TC, CCH Dec. 58,649(M), FED ¶48,069(M); TRC FILEIND: 6,152.*

An employee and sole shareholder of a corporation who received purported loan proceeds from a "death benefit only" welfare benefit fund established for employees received a taxable distribution from the fund. The evidence indicated a lack of intention by the parties that the loan be repaid.

*Todd, TC, CCH Dec. 58,648(M), FED ¶48,068(M); TRC INDIV: 6,056.*

*Deductions*

A real estate agent was not entitled to unsubstantiated deductions for travel, insurance, commissions and fees and a charitable contribution.

*Kirman, TC, CCH Dec. 58,654(M), FED ¶48,074(M); TRC BUSEXP: 12,108.*

*False Tax Returns*

An individual convicted of and sentenced for making and subscribing a false return was not entitled to relief because he failed to demonstrate prejudice due to ineffective assistance of counsel.

*Garofolo, CA-6, 2011-1 USTC ¶50,424; TRC IRS: 66,202.*

*Liens and Levies*

An individual's tax liabilities were reduced to judgment, and federal tax liens on real properties that were held by a trust as the individual's nominee or alter ego were foreclosed. The individual's transfer of properties to the trust was set aside as fraudulent.

*McKenzie, DC Iowa, 2011-1 USTC ¶50,427; TRC IRS: 45,158.*

A 10-year-old consent judgment lien against a couple was properly renewed. The government was entitled to renew its lien for an additional 20 years because it was unable to collect in full on the judgment and only frivolous arguments were raised on appeal.

*Snyder, CA-3, 2011-1 USTC ¶50,417; TRC IRS: 48,054.*

An employee's complaint alleging that his employer violated his constitutional rights by honoring an IRS levy and remitting a portion of his wages to the IRS was properly dismissed. The employer did nothing more than comply with a valid levy.

*Stevens v. Jefferson, CA-7, 2011-1 USTC ¶50,412; TRC IRS: 51,060.05.*

*Collection Due Process*

An IRS Appeals officer did not abuse his discretion by denying a married couple a face-to-face Collection Due Process hearing because of frivolous arguments.

*Barry, TC, CCH Dec. 58,653(M), FED ¶48,073(M); TRC LITIG: 6,816.*

*Tax Assessments*

Tax assessments against a couple were reduced to judgment and federal tax liens were foreclosed. However, the government was not entitled to reduce to judgment their tax liabilities for one year since its action was not filed within the 10-year limitations period.

*Johnson, DC Mo., 2011-1 USTC ¶50,428; TRC IRS: 45,158.*

Tax assessments against an individual were properly reduced to judgment, and federal tax liens encumbering his interest in property held by a nominee trust were properly foreclosed. Forms 4340 were presumptive evidence of the validity of the IRS's reconstruction of the individual's unreported income.

*Alexander, CA-4, 2011-1 USTC ¶50,423; TRC IRS: 27,200.*

*Offer-in-Compromise*

An IRS settlement officer did not abuse his discretion in rejecting an attorney's offer-in-compromise because, among other reasons, the offer-in-compromise was not accompanied by a payment of tax.

*Shebby, TC, CCH Dec. 58,651(M), FED ¶48,071(M); TRC IRS: 42,120.*

*Bankruptcy*

A bankruptcy court lacked subject matter jurisdiction over a no asset Chapter 7 debtor's adversary complaint seeking a determination that his tax debts were discharged.

*Hinton, DC Ill., 2011-1 USTC ¶50,420; TRC IRS: 57,150.*

### *IRS Extends Transitional Relief On Code Sec. 833 Treatment Of Certain Health Organizations*

Interim guidance on the Code Sec. 833 treatment of certain health organizations has been extended.

*Under the Patient Protection and Affordable Care Act (PPACA),* Code Sec. 833 does not apply to an otherwise-eligible organization unless the organization's medical loss ratio (MLR) during the tax year is not less than 85 percent. The IRS issued Notice 2010-79 providing transitional relief and interim guidance on the computation of a taxpayer's MLR, which applied to the first tax year beginning after December 31, 2009. Now, the IRS has extended the transitional relief to any tax year beginning in 2010 and the first tax year beginning after December 31, 2010.

*Notice 2011-51, FED ¶46,392; TRC EXEMPT: 15,160.10.*


# Practitioners' Corner: New Opportunities For New Markets Tax Credit Investments

The new markets tax credit (NMTC) is designed to encourage investments in businesses in low-income communities. The Obama Administration strongly backs the NMTC program. Government officials touted the program's successes at the recent Spring New Markets Tax Credit Conference: $16 billion invested since the program began in 2009: 75 percent of the credits allocated to highly-distressed communities; and a multiplier effect of $14 of additional economic activity for every dollar invested.

At the urging of program recipients, the Obama administration on June 3 proposed several changes to stimulate increased investment in non-real estate businesses *(see discussion of IR-2011-61, Advance NPRM REG-114206-11, and NPRM REG-101826-11 in the June 9, 2011 issue of this newsletter).* The administration believes the changes will spur permanent job creation and economic revitalization in low-income communities.

■ ***Comment.*** The recent notices "are thought provoking exercises that I expect to yield significant long term results … because the IRS and Treasury have issued an expansive requesting for comments on this and other ways to increase the level of NMTC investment in non-real estate operation businesses," Michael Novogradac of Novogradac & Company, LLP, San Francisco, an advisor to NMTC investors, told CCH.

## Allocations of credit

The timing of the proposed changes may have been fortuitous, because Treasury's Community Development Financial Institutions (CDFI) Fund just announced the opening of the application period for allocations of NMTC credits to community development entities (CDEs). The Fund has authority to allocate $3.5 billion in credits to CDEs.

■ ***Comment.*** "I also expect that as the new round of application funding is being made available, more CDEs may apply with the goal of lending to non-real estate businesses," Novogradac said. "The release of these notices at this time is quite helpful."

*" The government asks whether these changes would facilitate greater investment in non-real estate businesses, Michael Novogradac of Novogradac & Company, LLP, San Francisco, an advisor to NMTC investors, told CCH. I believe they would."*

The administration hopes to increase this authority to $5 billion, the previous level at which the program operated, although persuading Congress to increase the allocation is clouded by the overall budget picture.

## Background

Congress enacted Code Sec. 45D, the NMTC, in the *Community Renewal Tax Relief Act of 2000*, for investments in 2001 and subsequent years. The maximum credit is claimed over the period of a seven-year investment, based on a total of 39 percent of the CDE's investments. The CDFI Fund awards and allocates credits to CDEs each year, which then pass through the credits to their investors. For 2010, the Fund allocated credits to 99 CDEs, an average of approximately $35 million per CDE, with total credits ranging from $10-77 million per CDE.

## Rationale

The preamble to the proposed regs indicates that only 35 percent of qualified investments are made in non-real estate trades or businesses, and that much of this 35 percent involves renting real estate to active trades or businesses.

■ ***Comment.*** Small businesses are the drivers of economic growth, Treasury and other government officials said at the NMTC conference. The administration wants to modify the credit to promote operating businesses, which historically cannot use the credit as well as real estate businesses. An IRS official indicated the government wants to encourage micro-lending – making small non-real estate loans of $250,000 or less.

## Proposed regs

The proposed regs and notice of public hearing (NPRM REG-101826-11) aim to facilitate non-real estate investments by changing the reinvestment rules. Currently, the NMTC program requires that a CDE that receives returns on investments (including principal repayments from loans) reinvest those proceeds into other QLICIs during the seven-year credit period.

As a practical matter, this makes it difficult for CDEs to provide working capital and equipment loans to non-real estate businesses, because these loans usually have a term of five years or less. The proposed regs would allow a CDE to invest returns of capital from a non-real estate investment into unrelated community development financial institutions that provide credit and financial services to underserved populations and that are certified as CDEs.

*Continued on page 287*

# Washington Report

*by the CCH Washington News Bureau*

## President open to extension of payroll tax holiday

President Obama recently said he is open to continuing certain tax breaks that he believes could help to move the U.S. economy forward. The president singled out the one-year payroll tax cut for possible extension, which was put in place for 2011 in the *Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010.*

"One of the things that I'm going to be interested in exploring with the members of both parties in Congress is how do we continue some of these policies to make sure that we get this recovery up and running in a robust way," Obama said in answer to a question on whether any measures can be taken to address the faltering economy.

In related news, a group of House Democrats wrote to Obama on June 10 and asked him not to support renewal of the Bush-era tax cuts for higher-income taxpayers. "We urge you to push for a fiscal 2012 budget deal that makes responsible short-term choices that do not threaten our fragile recovery. We also urge that this deal provide a long-term fiscal solution that includes an expiration of the Bush tax cuts for the wealthy, a step which, by itself, will stop the growth of the deficit over the next decade."

## Senators introduce domestic partners' tax parity bill

Senators Susan Collins, R-Maine, and Charles Schumer, D-N.Y. recently introduced legislation to put the tax treatment of health benefits provided to domestic couples on par with the tax treatment of similar benefits provided to married couples. The Tax Parity for Health Plan Beneficiaries Act of 2011 enjoys bipartisan support.

"In order to remain competitive and keep and attract good employees, more than half of the largest and most successful companies in our country currently provide health coverage to their employees' domestic partners," Senator Collins said in a statement. "Our legislation would simply prevent these benefits from being unfairly taxed."

## Tax patent ban may be on House floor shortly

Legislation to ban the patenting of tax strategies is expected to come before the House before July 4. The House Rules Committee may meet soon to set the parameters of debate over the *America Invents Act (H.R. 1249)*, which includes a tax patent provision. The Senate has already approved a similar ban on tax strategy patents in its version of comprehensive patent reform *(Sen. 23)*.

## e-File marks milestone

The IRS announced on June 10 that IRS e-File has passed the one-billion mark for individual tax returns processed safely and securely since 1986. The IRS's electronic filing program began as a pilot project in 1986 and became available nationally in 1990. "The one billion milestone means e-File has delivered real services to taxpayers, including faster refunds and more accurate tax returns. And because an electronically filed return costs us 20 times less to process than a paper return, this program means a more efficient government that has saved America's taxpayers hundreds of millions of dollars," IRS Commissioner Douglas Shulman said in a statement.

## Business groups urge repeal of government withholding

A coalition of business groups and trade associations recently called on lawmakers to repeal three percent government withholding. The provision was enacted as part of the *Tax Increase Prevention and Reconciliation Act of 2005,* which mandates federal agencies, states, and certain local governments withhold three percent of nearly all of their contract payments, Medicare payments, and farm payments. "With the withholding mandate scheduled to take effect on January 1, 2013, businesses and governments are expending limited resources now in order to make the major system and process changes needed to implement this provision," the business groups told Congress.

## IRS reminds taxpayers of June 30 FBAR filing deadline

Taxpayers, including tax-exempt organizations, with foreign accounts whose aggregate value exceeded $10,000 at any time during 2010 must file Treasury Department Form TD F 90-22.1 (known as the FBAR), the IRS is reminding taxpayers. This form is due June 30, 2011 and is filed with the Treasury Department. Because it is not a tax form, the June 30 deadline applies, even if a taxpayer obtains a tax-filing extension. The IRS also noted that small subset of filers with only signature authority required to file the Report of Foreign Bank and Financial Accounts (FBARs) will receive a one-year extension beyond the upcoming filing date of June 30, 2011 "(see the June 9, 2011 issue of this newsletter for details about the extension)."

## U.S.-Switzerland reportedly engaged in tax settlement talks

Swiss media are reporting that Switzerland and the U.S. are discussing how to resolve allegations of the country's banks facilitating tax evasion by Americans. The U.S. and Switzerland reached a landmark settlement involving Swiss banking giant UBS AG in 2009. Top IRS officials have indicated that the U.S. is investigating reports of tax evasion by Americans with accounts at other financial institutions. The negotiations between the U.S. and Switzerland reportedly involve a number of Swiss banks. The IRS is expected to press the Swiss authorities to agree to the full disclosure of accountholder information.

# Questions Continue Regarding Reliance On Retroactive IRS Regs

*In Salman Ranch, Ltd., 2011-1 ustc ¶50,405 (discussed in Federal Tax Weekly No. 23), the Tenth Circuit Court of Appeals upheld the application of the six-year statute of limitations to an overstatement of basis, citing recent IRS regs issued after the IRS lost several court cases (see the June 9, 2011 issue of this newsletter). Matthew Lerner of Steptoe & Johnson LLP, Washington, D.C., provided the following additional comments to CCH on the decision.*

"After the latest *Salman Ranch* decision, the state of the law remains muddled, although the trend appears to be in the IRS' favor. One must wonder whether the fact that these decisions are coming out of cases involving tax shelters is influencing their outcome."

"In any event, the most recent cases in the Federal and Tenth Circuits (*Grapevine, 2011-1 ustc ¶50,264* and *Salman Ranch*) are consistent with *Mayo Foundation, 2011-1 ustc ¶50,143*, in indicating that *Chevron* deference is appropriate to notice-and-comment IRS regulations. That conclusion is not, as a general proposition, surprising."

"The most troubling element of this case and *Grapevine* is the not the deference given to the regulations but to the courts' willingness to apply them to previously pending cases arising from facts that occurred before the new regulations were promulgated. The *Salman Ranch* court dismissed an argument that this was inappropriate without much analysis. This conclusion causes me great concern. It hardly cultivates respect for the fairness of the tax law and its administration to allow the rules of the game to be changed after the game has begun, or here, after it was over. I have no problem with litigation being the trigger that causes the IRS to feel like a law needs to be changed or clarified prospectively, but in a case about the meaning of a law, to let one of the two litigants decide what the ambiguous law in question says and have the court give deference to that decision represents an abrogation of the court's independence and allows the regulator to become the judge and jury as well."

## Practitioners' Corner

*Continued from page 285*

- ***Comment.*** "Repayments would need to be reinvested with a certified CDFI within 30 days,"" Novogradac said. "There does not appear to be any NMTC related limits on the use of the money by the certified CDFIs. However, this reinvestment option is limited. Only a rising portion of investment repayments can be so reinvested, specifically 0 percent of the QEI in Year 1; 15 percent in Year 2; 30 percent in Year 3; 50 percent in Year 4, and 85 percent in Years 5 and 6."

Treasury and the IRS requested comments on whether this change would accomplish this purpose. They also asked whether to permit reinvestments in other entities and whether to apply the rules to existing investments.

- ***Comment.*** "This proposal would help CDEs who want to provide amortizing five to seven year financial to non-real estate operating businesses," Novogradac said. "Such financing would be helpful, for example, to non-real estate operating businesses seeking longer lived equipment financing."

### Advance rulemaking notice

The purpose of an advance notice (ANPRM REG-114206-11) is to obtain comments and provide an outline of suggested changes in the tax regs. The government indicated that the NMTC advance notice was suggesting changes that could facilitate greater investments in non-real estate businesses without disrupting the success real estate investments.

The primary suggestion is to streamline the substantiation requirements for second-tier CDEs that make small loans (potentially $250,000 or less) to non-real estate businesses. A QLICI includes an investment in or loan to a second CDE by a primary CDE, provided the second CDE uses the funds for a qualified investment.

The net effect of these rules, the IRS indicated, is that the primary CDE must ensure that the second CDE ultimately invests the proceeds in a qualified manner. "This added layer of substantiation has placed constraints on the ability of a primary CDE to invest funds in a second CDE – particularly in instances where the second CDE intends to make smaller sized loans to non-real estate businesses, because transaction and compliance monitoring costs are higher relative to the size of smaller loans than they are for larger, real estate-secured transactions," the IRS said.

- ***Comment.*** The government asks whether these changes would facilitate greater investment in non-real estate businesses, Novogradac said. "I believe that they would."

For this change, the government also asked:

- Should there be a cap and how would it work?
- What are the appropriate minimum substantiation requirements?
- What other limitations should apply (for example, should the second CDE be a nonprofit entity)?

The advance notice also asked whether (and how) the government should consider changing the reasonable expectations test in Reg. Sec. 1.45D-1(d)(6)(i). This provision treats a business as qualified "if the CDE reasonably expects," at the time of the investment, that the business will be qualified throughout the entire period of the investment (or loan).

### Future action

This is a dynamic time for investors and companies involved in the NMTC program. "I expect the broader NMTC community to focus on the specific ideas in the notices and to also expand the discussion to other areas," Novogradac told CCH.

IRS officials indicated that the government will strive to issue the NMTC regs by the end of 2011, but she cautioned that action may not be completed until mid-year 2012. Novogradac cautioned that until the proposed regs are adopted, "[they] will not have much of an effect on investing in non-real estate operating businesses," but he expects significant long-term benefits from the changes.

# Compliance Calendar

**June 17**
Employers deposit Social Security, Medicare, and withheld income tax for June 11, 12, 13, and 14.

**June 22**
Employers deposit Social Security, Medicare, and withheld income tax for June 15, 16, and 17.

**June 24**
Employers deposit Social Security, Medicare, and withheld income tax for June 18, 19, 20 and 21.

**June 29**
Employers deposit Social Security, Medicare, and withheld income tax for June 22, 23, and 24.

**June 30**
U.S. persons with financial interests in or signature authority over foreign financial accounts generally must file Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (FBAR) if, at any point during the 2010 calendar year, the aggregate value of the accounts exceeds $10,000. Deadline is measured when Form is received, not when mailed.

# TRC Text Reference Table

*The cross references at the end of the articles in CCH Federal Tax Weekly (FTW) are text references to CCH Tax Research Consultant (TRC). The following is a table of TRC text references to developments reported in FTW since the last release of New Developments.*

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# From the Helpline

The following questions have been answered recently by our "CCH Tax Research Consultant" Helpline (1-800-449-8114).

**Q** How do Section 1603 grants figure into the depreciable basis of energy property?

**A** Code Sec. 50(c)(1) states that "the basis of such property shall be reduced by the amount of the credit." But Code Sec. 50(c)(3) contains a special rule applicable to "any energy credit" stating that "only 50 percent of such credit shall be taken into account under paragraph (1)." Since a 1603 Treasury grant (see Section 1603 of Division B of the American Recovery and Reinvestment Act of 2009 adding Code Sec. 48(d)) is a grant given for specified energy property (in lieu of a tax credit under Code Sec. 48), the special rule of Code Sec. 50(c)(3) applies to 1603 Treasury grants. Therefore, recipients of a 1603 Treasury grant must reduce the basis in the specified energy property for which they received the grant by 50 percent of the amount of the grant. *See TRC BUSEXP: 51,056.*

**Q** Are engagement letters required for tax services, or simply recommended?

**A** Engagement letters are not legally required for federal tax practice, but can of course be advisable. Reg. §301.7216-3(a)(3)(iii)-(iv) specifically mentions engagement letters as one possible method for a practitioner to obtain a taxpayer's consent to disclose or use that taxpayer's information. This information disclosure issue is the context around which most discussion of engagement letters occurs for tax practitioners. However, it also arises in the area of attorney-client privilege, particularly in criminal prosecutions. In this context, engagement letters can be especially critical for an attorney who engages an accountant to assist with preparation of the defense to the criminal charges, because the engagement letter can demonstrate that the accountant's work is part of the attorney's preparation for trial and therefore should fall under the privilege *See Kovel, 296 F2d 918, TRC IRS: 6, 114.10 and TRC IRS: 21,402.15.*