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IRS Reviews Individual Mandate, Exemptions And More For 2014 Tax Year Filing

◆ *Pub. 5187, Health Care Law: What's New for Individuals & Families*

As the filing season nears, the IRS has reminded taxpayers of the individual shared responsibility requirement under the *Patient Protection and Affordable Care Act* (PPACA). Individuals, unless exempt, must carry minimum essential health coverage or make a shared responsibility payment, applicable to tax years starting in 2014.

■ **Take Away.** "After having four years to implement the ACA, we are coming to the start of the filing season with many open questions about the law," Stephen Mankowski, CPA, Chair of the Tax Policy Committee and National Secretary for the National Conference of CPA Practitioners (NCCPAP), told Wolters Kluwer. "The greatest challenge for CPAs will be the exemptions to the individual shared responsibility requirement because they are so widespread," Mankowski predicted.

Minimum essential coverage

Minimum essential coverage is a health care plan or arrangement specifically identified in the PPACA as minimum essential coverage, the IRS explained. Employer-sponsored coverage under a group health plan (including self-insured plans) and individual market coverage, such as a qualified health plan purchased through the PPACA Marketplace, are treated as minimum essential coverage. Medicare, TRICARE and CHIP are generally treated

as minimum essential coverage. Individuals who carry minimum essential coverage have been instructed by the IRS to check a box on their 2014 return.

■ **Comment.** Our organization has predicted problems with unscrupulous return preparers who will merely check the box for their clients, reporting coverage that the client actually does not have, Mankowski said.

Exemptions

Individuals may seek an exemption to the individual shared responsibility requirement. In some cases, exemptions are only available through the PPACA Marketplace. The IRS recommended that individuals make their requests to the Marketplace for an exemption as soon as possible. Other exemptions are claimed only on a tax return, and some exemptions may be obtained from the Marketplace or claimed on a return, the IRS explained.

An individual may qualify for an exemption if, among other reasons, household income is below the return filing threshold, the individual went without coverage for less than three consecutive months during the year, or the individual was a member of a health care sharing ministry. An individual may also seek an exemption based on hardship.

Payment

The IRS explained that for 2014, the individual shared responsibility payment is

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Tax Court Reversed; Foundation May Be Liable For Taxes As Transferee

◆ *Salus Mundi Foundation, CA-9,*
December 22, 2014

Reversing the Tax Court, the Ninth Circuit Court of Appeals has found that a foundation may be liable for taxes under Code Sec. 6901 as the transferee of a transferee. The Ninth Circuit remanded the case to the Tax Court to determine whether the taxpayer actually was a transferee of a transferee, and whether the IRS satisfied the statute of limitations for assessing liability.

■ **Take Away.** The Ninth Circuit declined to recharacterize the transactions under federal law but still concluded that the transactions could be recast and collapsed under state law, because of the parties' constructive knowledge of the fraudulent tax avoidance scheme at the heart of the transaction.

Background

An individual set up a holding company that owned low-basis assets worth \$319 million. Sale of the assets would have triggered tax liability of approximately \$81 million. The holding company stock was transferred to a marital trust for the individual's wife. The wife wished to make cash gifts to her three children (by making gifts to their trusts).

To avoid the marital trust's tax liability from the sale of the assets, and to satisfy both seller and purchaser, the wife's advisors proposed an intermediary or Midco transaction, in which the marital trust (and a foundation also holding 1/3 of the stock) would sell stock for cash to a newly-formed intermediary, who would sell the assets (not the stock) to a purchaser. The marital trust would then make cash distributions to foundations benefitting the children. The intermediary would ordinarily be liable for taxes on the asset sale, but would claim sufficient tax losses to avoid the taxable gain.

Case history

The parties implemented a Midco transaction. The intermediary sold the assets and claimed offsetting losses. However, the Tax Court disallowed the losses as artificial, resulting from a Son-of-BOSS transaction.

The IRS attempted to collect taxes from the holding company, by recasting the stock sale as a sale of the company's assets, followed by a liquidating distribution to its shareholders (*Diebold, TC, 2010, CCH Dec. 58,374(M)*). Since the holding company no longer had any assets, the IRS attempted to collect from the shareholders as transferees under Code Sec. 6901.

The Tax Court, however, held that the shareholders lacked actual or construc-

tive knowledge under state law of the tax avoidance scheme (*Salus Mundi, TC Memo. 2012-61, CCH Dec. 58,969(M)*). Since the shareholders were not liable as transferees, the children's foundations were not liable as transferees of a transferee. The IRS appealed.

Court's analysis

The application of transferee liability requires a two-prong test: is the party a transferee under federal tax law; and is the party substantively liable for the transferor's unpaid taxes under state law. The Ninth Circuit agreed with the taxpayer that the two prongs were separate; therefore, the IRS's recast of the transaction, to determine who is a transferee, does not apply to determine transferee liability under state law. However, the Second Circuit, in addressing the same facts, issues, and applicable law in a case involving another of the children's foundations, concluded that the holding company's shareholders had constructive knowledge of the tax avoidance scheme and were therefore liable under state law. The Second Circuit vacated the Tax Court's decision and remanded to the Tax Court the issues of the foundation's transferee status under federal law and the application of the statute of limitations.

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Affordable Care Act

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the greater of: one percent of household income that is above the tax return filing threshold for the individual's filing status; or the individual's flat dollar amount, which is \$95 per adult and \$47.50 per child, limited to a family maximum

of \$285, but capped at the cost of the national average premium for a bronze level health plan available through the Marketplace in 2014. For 2014, the annual national average premium for a bronze level health plan available through the Marketplace is \$2,448 per individual (\$204 per month per individual), but

\$12,240 for a family with five or more members (\$1,020 per month for a family with five or more members).

Code Sec. 36B credit

Individuals who obtain health insurance coverage through the Marketplace may qualify for the Code Sec. 36B premium assistance tax credit. The IRS explained that to claim the credit, generally a taxpayer must have household income of at least 100 percent but not more than 400 percent of the Federal poverty line (FPL) for the family size, and cannot be claimed as a dependent.

Reference: TRC HEALTH: 3,000.

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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*

IRS Issues Final Regs On PPACA Requirements For Tax-Exempt Hospitals, Including “CHNAs ”/Financial Policies

◆ TD 9708

The IRS has issued final regs under Code Sec. 501(r) on the additional requirements for nonprofit hospitals to maintain their tax-exempt status under Code Sec. 501(c)(3). The regs address the requirements for hospitals to conduct a community health needs assessment (CHNA) every three years, to adopt an implementation strategy to meet these needs, and to adopt financial policies that benefit needy individuals.

■ **Take Away.** “The final regulations are well conceived and well written,” Nancy Ortmeyer Kuhn, director, Jackson and Campbell, P.C., Washington, D.C., told Wolters Kluwer. “They follow the legislative intent and give hospitals the tools they need to objectively satisfy the CHNA and financial policy requirements. I was concerned that the regulations would include a lot of facts and circumstances tests that allow for subjective determinations by the IRS, but they didn’t do that.”

New requirements

The *Patient Protection and Affordable Care Act* (PPACA) imposed additional requirements on charitable hospitals to maintain their tax-exempt status. These requirements include conducting a CHNA; establishing and disclosing financial assistance policies (FAPs); limiting charges to needy individuals; and following reasonable billing and collection policies.

Transferee

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In this case, the Ninth Circuit acceded to the Second Circuit’s decision (“absent a strong reason to . . . create a direct conflict with other circuits”), and similarly remanded the case to the Tax Court to determine the same transferee and statute of limitations issues.

*References: 2015-1 USTC ¶50,120;
TRC IRS: 60,052.*

Effective dates

The CHNA requirement first applied to tax years beginning after March 23, 2012. The other requirements first applied to tax years beginning after March 23, 2010. The final regs generally will not take effect until the hospital’s first tax year beginning after December 29, 2015. For tax years beginning on or before that date, a hospital may rely on a reasonable good faith interpretation of the statutory requirements. Complying with either the proposed regs or the final regs will satisfy the good faith requirement.

■ **Comment.** “The rules provide charitable hospitals with adequate time to fully update their policies and programming to implement the changes,” McMahon said.

However, the regs on CHNA reporting violations and excise taxes, which merely clarified or confirmed requirements already in effect, apply December 29, 2014.

Financial assistance policies

One concern for hospitals was the requirement to adequately communicate their FAPs to patients. According to Treasury, the regs revise the notification require-

ments to protect patients while easing the burden on hospitals. General notifications must appear on bills and conspicuously in the hospital. However, individual notifications are only required when a hospital plans to use extraordinary collection actions such as reporting a debt to a credit bureau, selling the debt to a third party, or garnishing wages.

■ **Comment.** Kuhn expressed a concern that there are no minimum standards for financial assistance policies. “There is nothing in the statute or regulations,” Kuhn said. “A hospital could provide a narrow standard. The requirements don’t accomplish anything for middle-income people; hospitals can still bill at high rates and take aggressive financial collection actions. But you can’t expect the IRS to draft regulations that are tougher than the statute.”

Reporting and penalties

If a hospital fails to meet the consumer protection standards, the IRS could revoke

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IRS Extends Deadline For Withholding Entities To Apply Joint Account Options

In an email, the IRS announced that it has extended the deadline from June 30, 2014, to June 30, 2015 for qualified intermediaries (QIs), withholding foreign partnerships (WPs), and withholding foreign trusts (WTs) to apply the joint account option to a partnership or trust. The notification states that QIs, WPs, and WTs that have entered into an agreement with a partnership or trust to apply the joint account option may now continue to apply simplified joint account treatment until June 30, 2015.

Documentation. The email applies to entities that have entered into or that may apply to enter into the QI Agreement described in Rev. Proc. 2014-39, the WP Agreement described in Rev. Proc. 2014-47, or the WT Agreement also described in Rev. Proc. 2014-47. The email informs relevant withholding entities that the QI, WP and WT agreements are modified to allow the withholding entities to continue to document a joint account through June 30, 2015, consistent with the requirements in the prior QI, WP or WT agreements.

Withholding. The email also explained that a QI, WP or WT must withhold under Chapter 4 (FATCA) with respect to a partnership or trust if required (for example, if the withholding entity has actual knowledge that the partnership or trust is a nonparticipating foreign financial entity).

QI Joint Account Extension Email; TRC INTL: 33,054.25.

IRS Unveils Voluntary Closing Agreement Program For 501(c)(3) Bond Issuers Where Entity Loses Exempt Status

◆ *Announcement 2015-02*

The IRS has unveiled a simplified process for issuers of qualified Code Sec. 501(c)(3) bonds to request a closing agreement where the borrower of the proceeds of the bonds had its exempt status revoked and then had it reinstated but not retroactively. Generally, bondholders will not be required to include interest on the bonds in gross income if they satisfy the simplified process.

■ **Take Away.** In Rev. Proc. 2011-36 the IRS provided procedures for reinstating the tax-exempt status of organizations that have had their tax-exempt status automatically revoked. A 501(c)(3) organization has its exempt status automatically revoked if it fails to file an annual return for three consecutive years.

Background

Under Code Sec. 145, interest on qualified Code Sec. 501(c)(3) bonds is generally exempt from tax. All the property financed with the net proceeds of the bonds must be owned by a 501(c)(3) organization or a state or local government entity, and the property financed with the

net proceeds of the bonds must be used almost exclusively by 501(c)(3) organizations in their related trade or business or state or local government entities. If the 501(c)(3) organization fails to qualify as a tax-exempt organization while bonds are outstanding, the bonds fail to qualify under Code Sec. 145. A 501(c)(3) organization may seek retroactive reinstatement of its exempt status.

■ **Comment.** The IRS noted that often the effective date of a reinstated exemption will be the date that the organization's exemption application was submitted to the agency. However, organizations may choose to request that reinstatement be retroactive to the effective date of revocation.

Ann. 2015-02

The IRS explained that an issuer of may apply for a closing agreement under Ann. 2015-02 if certain requirements are satisfied: the 501(c)(3) has received prospective reinstatement of its exempt status; the organization's exempt status has not been previously revoked since the issue date of the bonds; and, the bonds are not under examination.

Issuers must request a closing agreement within 12 months of the date of the reinstatement letter, the IRS explained. If the reinstatement letter is dated before December 30, 2014, the issuer has 12 months from December 30, 2014 to submit a closing agreement, the IRS explained. The issuer also must pay the closing agreement amount for each bond issue covered by the closing agreement. A copy of the reinstatement letter also must be included with the request for a closing agreement.

*References: FED ¶46,207;
TRC EXEMPT: 12,252.15.*

Hospitals

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its tax-exempt status. If a hospital fails to properly conduct a CHNA and adopt an implementation strategy, a \$50,000 excise tax will apply. If a hospital's failure is neither willful nor egregious, the hospital can correct and disclose the error. This will avoid revocation, but the excise tax will still apply to CHNA violations. The final regs also require that a hospital disclose its FAPs, its CHNA, and its implementation strategy for the CHNA.

■ **Comment.** "The CHNA and the FAP are both public documents," Kuhn said. "The information provided will assist the IRS and nonprofits involved in 'policing' hospitals, to see if they are really charitable. Public involvement will help the IRS's enforcement efforts."

The regs impose an income tax on hospital organizations that operate more than one hospital facility with one of its facilities fails to satisfy Code Sec. 501(r). The overall organization would retain its tax-exempt status but would have to pay taxes on its income.

■ **Comment.** Kuhn said it is unusual for regs to impose a tax that is not in the statute.

*References: FED ¶47,006;
TRC EXEMPT: 3,154.*

IRS Wins Court Approval For John Doe Summonses In Offshore Investigation

The IRS has been authorized by a federal district court to serve John Doe summonses on eight entities in an investigation into a target that allegedly facilitated offshore tax evasion, the U.S. Department of Justice (DOJ) recently announced. DOJ reported that the entities were directed to produce records that will assist the IRS in identifying U.S. taxpayers who allegedly used the target's services.

Offshore entities. The IRS launched an investigation into the target. According to the government, some taxpayers allegedly had used the services of the target to establish, among other allegations, anonymous corporations and foundations in Panama as well as offshore entities. The taxpayers could allegedly control assets without appearing to own them.

■ **Comment.** "The IRS remains committed to continuing our priority efforts to stop offshore tax evasion wherever it is found," Commissioner John Koskinen said in a statement. "We have made tremendous progress in this area, working cooperatively with other agencies. The John Doe summons remains an important tool in our efforts to find international tax evaders and those who help them."

U.S. DOJ News Release, December 19, 2014.

IRS Releases 2015 Updates For Ruling Requests, Technical Advice, And No-Rule Procedures

◆ *Rev. Procs. 2015-1 through 2015-8*

The IRS has issued its annual revisions to the general procedures for ruling requests, technical advice memoranda (TAM), determination letters, and user fees, as well as areas on which the Associate Chief Counsel offices will not rule. The new and revised procedures are generally effective beginning January 2, 2015. Some updated user fees are effective February 2, 2015.

- **Take Away.** These procedures are updated annually by the IRS at the beginning of each calendar year. They are comprehensive and supersede the prior year's revenue procedures on these issues, including those announced throughout the past year.

Annual updates

The revenue procedures include the following guidance on:

- **Rev. Proc. 2015-1:** letter rulings, closing agreements, determination letters, information letters, and oral advice issued by the offices of the Associate Chief Counsel;
- **Rev. Proc. 2015-2:** technical advice issued by the offices of Associate Chief Counsel to a director or an appeals area director;
- **Rev. Proc. 2015-3:** areas for which the Associate Chief Counsel offices will not issue letter rulings or determination letters;
- **Rev. Proc. 2015-4:** general procedures for employee plans and exempt organizations letter rulings requests;
- **Rev. Proc. 2015-5:** procedures for applying for and for issuing determination letters on the exempt status under §501(c)(3) using Form 1023-EZ, Streamlined Application for Recognition of Exemption;
- **Rev. Proc. 2015-6:** determination letters on the qualified status of certain pension, profit-sharing, stock bonus, annuity and employee stock ownership plans (ESOPs) and on the status for exemption of any related

trusts or custodial accounts under Code Sec. 501(a);

- **Rev. Proc. 2015-7:** subject areas on which the Associate Chief Counsel (International) will not issue advance letter rulings or determination letters without unique and compelling circumstances;
- **Rev. Proc. 2015-8:** user fees for advice on matters under the jurisdiction of the Commissioner, Tax Exempt and Government Entities Division.

Changes

Highlights among the changes that the IRS has made to its annual procedures include:

Rev. Proc. 2015-1. A new schedule of user fees is provided in Appendix A. The new user fee schedule is effective February 2, 2015.

Rev. Proc. 2015-2. The IRS updated Rev. Proc. 2015-2 to reflect that authority to issue TAMs on matters within the jurisdiction of the Commissioner, Tax Exempt and

Government Entities Division, has been delegated to Associate Chief Counsel.

Rev. Proc. 2015-3. The IRS revised its list of areas under the jurisdiction of the various offices of Associate Chief Counsel for which it will not issue advance letter rulings or determination letters. The IRS added a number of areas, including:

- Whether a plan is a governmental plan under Code Sec. 414(d);
- Whether a joint venture between a tax-exempt organization and a for-profit organization affects the organization's exempt status or results in unrelated business taxable income;
- Whether unrelated business taxable income tax issues arise when charitable lead trust assets are invested with charitable organizations; and
- Whether a compensation or property transaction satisfies the rebuttable presumption that the transaction is not an excess benefit transaction under Code Sec. 4958;

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IRS Reaffirms FATCA Requirement For Reporting Model 1 Foreign Financial Institution To Provide GIIN To Withholding Agent

The IRS, in a Q&A on its website, has reaffirmed the requirement under the *Foreign Account Tax Compliance Act* (FATCA) that a foreign financial institution (FFI) must provide a Global Intermediary Identification Number (GIIN) to a withholding agent for payments made on or after January 1, 2015. The withholding agent must have a withholding certificate that identifies the recipient of the payment (the payee) as a registered deemed-compliant FFI. Furthermore, the certificate must include a GIIN for the payee. These requirements must be met for the payee to avoid withholding on the payment.

Announcement 2014-38. The issue arose because Announcement 2014-38 allows a foreign jurisdiction to treat its intergovernmental agreement (IGA) with the U.S. as being in effect after December 31, 2014, even though the IGA is not yet in effect. Under a Model 1 IGA, an FFI may report account information to its own government. Since the IGA as treated as being in effect, the reporting Model I FFI must provide certain required information to the withholding agent, including the GIIN. A reporting Model I FFI that has not yet obtained a GIIN must inform its withholding agent that it has applied for the GIIN. This gives the withholding agent 90 days to verify the GIIN against the IRS list.

The IRS similarly affirmed that Announcement 2014-38 does not change the timing of any other due diligence or reporting requirements under FATCA.

FATCA General FAQs, IGA Registration Q&A-8 (December 22, 2014), www.irs.gov; TRC INTL: 36,052.

Tax Debts Not Discharged When Return Filed Late, Appeals Court Affirms

◆ *Mallo, CA-10, December 29, 2014*

The Tenth Circuit Court of Appeals has affirmed a federal district court decision that a debtor who obtained a general discharge in bankruptcy was not entitled to a discharge of tax liabilities where the debtor filed a late return. The Tenth Circuit, noting contrary decisions by some other courts, applied Bankruptcy Code (BC) §523(a)(1)(B), which provides an exception to discharge for a debtor's tax liabilities where a tax return was not filed.

■ **Take Away.** BC §523 provides that a "return" is a return that satisfies "the requirements of applicable nonbankruptcy law (including applicable filing requirements)". The appeals court held that under this definition, a return technically was not a "return" if it was filed late.

Background

A married couple did not file timely federal income tax returns for 2000 and 2001. The IRS issued deficiency notices. The taxpayers did not challenge the determinations, and the IRS assessed taxes for each year. In 2007,

the taxpayers filed joint returns for each of the two years. Based on the returns the IRS adjusted the tax liabilities and assessments.

In 2010, the taxpayers filed for bankruptcy. The bankruptcy court issued a general order discharging their debts. The taxpayers then sought a determination that their tax debt was discharged, which the bankruptcy court denied. A federal district court affirmed the bankruptcy court decision.

Court's analysis

The Tenth Circuit first found that some courts have interpreted applicable non-bankruptcy law as treating a submission as a return where the return satisfies the four elements of the test in *Beard (CA-6, 1986)* (the return provides sufficient data to calculate tax liability; purports to be a return; is an honest and reasonable attempt to satisfy the tax law; and includes a penalties of perjury statement).

However, courts disagree whether a late return satisfies the third element requiring an "honest and reasonable" return. Some concluded that a late return that provides accurate information is helpful to the IRS.

However, the Bankruptcy Code as amended requires that the return also satisfy "applicable filing requirements."

Based on the plain language of this phrase and on the requirements of the Tax Code, the Tenth Circuit concluded that the deadline for filing a return was part of the applicable filing requirements for a tax return. The court cited *In re McCoy (CA-5, 2012)* as agreeing with this conclusion.

■ **Comment.** The court rejected the taxpayers' argument that the Bankruptcy Code language was ambiguous and that filing late is not a requirement for a valid return. The court also rejected the IRS's analysis that once the IRS assesses the liability, the subsequent filing of a return is irrelevant, even though it agreed with the IRS's conclusion. The debt arose by operation of law; assessment was not relevant. If Congress had wanted a different result, it would have used different language, the court concluded.

References: 2015-1 USRC ¶(to be reported); TRC IRS: 57,150.

Rulings

Continued from page 5

Rev. Proc. 2015-4. The IRS realigned the Tax Exempt and Government Entities Division (TE/GE) and the technical responsibility for issuing technical advice and letter rulings has shifted from EO Technical to the Office of Associate Chief Counsel (Tax Exempt and Government Entities). The IRS explained that EP Rulings and Agreements will continue to issue letter rulings only on certain matters specified in this Rev. Proc. 2015-4.

Rev. Proc. 2015-5. Rev. Proc. 2015-5 sets forth procedures for applying for and for issuing determination letters on the exempt status under Code Sec. 501(c)(3) of the Internal Revenue Code (Code) using Form 1023-EZ, Streamlined Application for Recognition of Exemption Under Section

501(c)(3) of the Internal Revenue Code. The IRS explained that it may merge the procedures under Code Sec. 2015-5 with the procedures for issuing determination letters on exempt status for organizations applying on Form 1023 in the 2016 annual update. Additionally, the IRS explained that general procedures for technical advice for matters within the jurisdiction of the Commissioner, Tax Exempt and Government Entities, are now handled by the Associate Chief Counsel (Tax Exempt and Government Entities).

Rev. Proc. 2015-6. The IRS made minor reference updates and clarifications, include reflecting changes related to the transfer of technical work from the Tax Exempt and Government Entities Division (TE/GE) to the Office of Associate Chief Counsel (Tax Exempt and Government Entities), adding a summary

of the new procedures for processing incomplete applications, and clarifying the submission requirements for applications involving merged plans.

Rev. Proc. 2015-7. The IRS updated the areas in which ruling or determination letters will not ordinarily be issued include whether a taxpayer, withholding agent, or intermediary has properly applied the requirements of the *Foreign Account Tax Compliance Act (FATCA)* or of an applicable intergovernmental agreement to implement FATCA.

Rev. Proc. 2015-8. Rev. Proc. 2015-8 reflects changes related to the realignment of technical work from the Tax Exempt and Government Entities division to the Office of Associate Chief Counsel.

References: FED ¶¶46,209, 46,210, 46,211, 46,212, 46,213, 46,214, 46,215, 46,216; TRC IRS: 12,200.

Chief Counsel Applies Substance Over Form Doctrine To Forward Contract

◆ CCA 201501012

IRS Chief Counsel has determined that the agency may disregard the form of a purported forward contract. Chief Counsel explained that the loan could be disregarded as lacking genuine indebtedness. The IRS also could disregard the form of the forward contract.

■ **Take Away.** In applying the substance-over-form doctrine, the U.S. Supreme Court has looked to the objective economic realities of a transaction rather than to the particular form the parties employed, *Frank Lyon Co.*, 78-1 USTC ¶9370. Where a transaction involves a purported loan that is offset by another element within the transaction, courts have addressed whether the loan is genuine indebtedness, or whether the form of the purported loan should be either disregarded or recast to reflect the objective economic realities of the transaction, Chief Counsel noted.

Background

Chief Counsel explained that the transaction consisted of two legs: a loan obligation and prepaid derivative contracts. The contracts would require the quarterly delivery of a specified bond, or its cash equivalent, in exchange for a predetermined price. The bonds, specified as LIBOR-based variable-rate certificates of deposit, would be subject to a protected minimum floor rate.

The promoter purchased both the loan and contract elements in Year 5 and Year 6, and marketed the transaction to individuals. An investor could sign a subscription agreement and become a limited partner. Alternatively, investors could invest in the transaction by owning a ratable share of the contract and assuming a ratable portion of the loan's liability.

Chief Counsel's analysis

Chief Counsel determined that the IRS could use the substance-over-form doctrine to recast the form of the transaction to disregard the loan and the portion of the contract that offset the loan. Here, Chief Counsel de-

termined that the taxpayers never incurred genuine indebtedness for tax purposes. The loan and contracts were netted as bookkeeping entries with no cash actually being exchanged and no proceeds actually borrowed. The loan and the contracts were circular. There was no risk of default on the loan. Additionally, Chief Counsel determined that the loan and the contracts added needless complexity to a transaction that could have provided the parties with identical results in a cheaper and more straightforward fashion. Consequently, the taxpayers could not claim interest deductions on the loan.

Further, Chief Counsel determined that the form of the contracts, styled as forward contracts, should not be respected. A forward contract, Chief Counsel explained, is an executory contract calling for the delivery of property at a future date in exchange for a payment at that time. A forward contract does not result in a taxable event until the future sale referenced in the contract is actually executed. The contracts here failed to function as forward contracts.

Reference: TRC SALES: 48,056.

Proposed Amendment To Floor-Offset Arrangement Does Not Violate Rule Against Reducing Accrued Benefits

◆ LTR 201501025

The IRS has determined that a company was not hindered by the requirements of Rev. Rul. 76-259, which sets forth guidance for pension plan benefits that are offset by profit-sharing plan benefits ("floor-offset arrangements"), from amending its floor-offset arrangement to freeze accruals to affected plan participants. Neither did this proposed freeze amendment violate the requirements under Code Sec. 411(d)(6): The amendment did not retroactively reduce benefits that had been accrued as of the date of the plan amendment.

■ **Take Away.** Code Sec. 411(d)(6)(A) prohibits a qualified plan from decreasing the accrued benefit of

a plan participant by an amendment of the plan (other than an amendment described in Code Sec. 412(d)(2) or section 4281 of the Employee Retirement Income Security Act of 1974).

Background

A company provided retirement benefits to certain employees under a "floor-offset arrangement" under which participants may receive a normal retirement benefit equal to (i) the participant's "gross" benefit under a pension plan payable at normal retirement age, less (ii) the annuity value of the participant's vested profit sharing plan balance, determined as of the participant's termination of employment converted to an actuarially equivalent annual annuity payable for the

life of the participant commencing at the participant's normal retirement date.

The company sought a private letter ruling on whether its proposed amendment to freeze benefit accruals for certain participants under the pension plan and cease discretionary contributions for those participants under the profit sharing plan would violate Rev. Rul. 76-259 or Code Sec. 411(d)(6). The freeze transaction, the IRS determined, would not change the manner or time in which a participant's benefits would be calculated. It would only affect the amounts of the pension floor and profit sharing offset benefits beyond the freeze date.

■ **Comment.** Rev. Rul. 76-259 provides that a floor-offset arrangement

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Tax Briefs



Internal Revenue Service

An individual was not permitted to recover administrative costs. The United States' position was substantially justified because the IRS Appeals office conceded the case. When the IRS finally took a position with respect to the taxpayer's claim, it allowed the claim.

Milligan, TC, CCH Dec. 60,104(M), FED ¶47,910(M); TRC LITIG: 3,154.05

Income

The Tax Court properly held that a bonus payment made as part of an oil and gas lease was ordinary income, not capital gain. The couple was properly liable for substantial understatement component of the accuracy-related

penalty in the absence of evidence that the taxpayers acted with good cause and in good faith.

Dudek, CA-3, 2015-1USTC ¶50,124; TRC FARM: 15,204

Deductions

A married couple did not have an "economic interest" in oil and gas deposits and, therefore, were not entitled to depletion deductions. The husband's employment agreement did not convey an interest in the minerals but specifically provided that the husband would receive only bonuses, not any ownership interest in the properties. Therefore, the agreement did not convey a depletable economic interest or capital gain income.

Gaudreau, DC Kan., 2015-1USTC ¶50,126; TRC FARM: 15,052

Anti-Injunction Act

The Anti-Injunction Act barred an individual's suit seeking to enjoin the IRS from issuing levy notices and for refund of the monies seized pursuant to the levy because he sought to restrain the collection of tax, and none of the exceptions to the Act applied. The individual failed to establish that the government would not ultimately prevail on the merits or that he lacked an adequate remedy at law. Rather, he had an adequate remedy at law because he could pay his tax liabilities and then sue for a refund under Code Sec. 7422.

Taliaferro v. Freeman, CA-11, 2015-1USTC ¶50,125; TRC IRS: 45,152

Benefits

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must satisfy certain requirements in order to be qualified under Code Sec. 401(a). For example, a defined benefit plan in this type of arrangement must provide "definitely determinable" benefits. Benefits will not be considered definitely determinable unless the benefit offset by the profit sharing plan is determined in a manner that precludes discretion on the part of the employer with respect to the calculation and the timing of the offset. In addition, the accrued benefit under the defined benefit plan determined without regard to the offset derived from the profit sharing plan must satisfy the requirements of Code Sec. 411(b)(1).

IRS analysis

The IRS determined that the floor-offset arrangement satisfied the criteria outlined in Rev. Rul. 76-259. Both the pension and profit sharing plans had received favorable

determination letters in the past, there was no employer discretion with respect to the offset calculation or the timing with which it is applied, and the pension plan benefit accruals satisfied Code Sec. 411(b)(1) without regard to the offset from the profit-sharing plan.

Further, the IRS determined that the proposed freeze amendment to the floor-

offset arrangement would not retroactively reduce benefits that had accrued as of the amendment date and therefore would not violate Code Sec. 411(d)(6). Neither would the amendment eliminate or reduce an early retirement benefit or a retirement-type subsidiary or eliminate an optional form of benefit, the IRS noted.

Reference: TRC RETIRE: 6,054.05.

IRS Permitted To Reconstruct Couple's Unreported Income From Annual Spending Statistics

The Tax Court has found that the IRS used a permissible method to reconstruct the unreported income of a married couple who did not file federal income tax returns for six tax years. Because the IRS showed sufficient evidence that the taxpayers had unreported income and because the IRS had no accurate records with which to reconstruct the taxpayers' income, it was permissible and reasonable for the agency to reconstruct the unreported income by using statistics published by the Bureau of Labor Statistics (BLS).

■ **Comment.** The couple was also liable for additions to tax under Code Secs. 6651 and 6654 for failure to file returns, for failure to pay the tax shown on the returns, and for failure to pay estimated tax penalties. They had operated a business organizing conferences on how to avoid paying federal income taxes that advocated using cash and minimizing financial records.

Mottahedeh, TC Memo. 2014-258, CCH Dec. 60,103(M); TRC ACCTNG: 3,150.