12-4-2015

Cases, Regulations and Statutes

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EXAMPLE: A financially troubled taxpayer borrows $100,000 from a bank on May 1, 2015 at 10 percent interest with interest and principal due November 1, 2015. Because of low prices, the borrower and the lender, hoping commodity process will strengthen in 2016, agree to defer payments on the loan until November 1, 2016, with the interest continuing to accrue at the 10 percent interest rate. That makes the loan have a term of “more than one year” so that the OID amount of interest totaling $15,500 for the 18 month term would make it possible to deduct part of the interest in 2015 and part of the interest in 2016.

Of course, some borrowers in financial difficulty may not need (or be able to use) a deduction in 2015.

The OID rules require that payments must first be allocated to OID and then to principal.  It is also important to note that a commercial bank on cash accounting is not required to use original issue discounting (OID) rules for short-term loans. Banks are allowed to automatically change to cash accounting for stated interest on short-term loans.

ENDNOTES


FOOD LABELING. The FDA has announced the availability of a draft guidance for industry entitled “Voluntary Labeling Indicating Whether Food Has or Has Not Been Derived From Genetically Engineered Atlantic Salmon: Guidance for Industry.” The FDA developed the draft guidance to assist food manufacturers that wish to voluntarily label their food product or ingredients (for humans or animals) derived from Atlantic salmon as either containing or not containing products from genetically engineered (GE) Atlantic salmon. 80 Fed. Reg. 73193 (Nov. 24, 2015).

FOOD SAFETY. The FDA has adopted as final regulations establishing science-based minimum standards for the safe growing, harvesting, packing, and holding of fruits and vegetables grown for human consumption. These standards do not apply to produce that is rarely consumed raw, produce for personal or on-farm consumption, or produce that is not a raw agricultural commodity. In addition, produce that receives commercial processing that adequately reduces the presence of microorganisms of public health significance is eligible for exemption from the requirements of this rule. The rule sets forth procedures, processes, and practices that minimize the risk of serious adverse health consequences or death, including those reasonably necessary to prevent the introduction of known or reasonably foreseeable biological hazards into or onto produce and to provide reasonable assurances that the produce is not adulterated on account of such hazards. 80 Fed. Reg. 74353 (Nov. 27, 2015).
ABLE ACCOUNTS. The IRS has issued proposed regulations implementing a new federal law authorizing states to offer specially-designed tax-favored ABLE (Achieving a Better Life Experience) accounts to people with disabilities who became disabled before age 26. The new law authorizes any state to offer its residents the option of setting up an ABLE account. Alternatively, a state may contract with another state that offers such accounts. See IR-2015-91. The IRS has issued a notice which makes three changes to the proposed rules. (1) Categorization of distributions not required: ABLE programs need not include safeguards to determine which distributions are for qualified disability expenses, nor are they required to specifically identify those used for housing expenses. Commenters on the proposed regulations had noted that such a requirement would be unduly burdensome and that, in any case, the eventual use of a distribution may not be known at the time it is made. Designated beneficiaries will still need to categorize distributions when determining their federal income tax obligations. (2) Contributors’ TINs not required: ABLE programs will not be required to request the taxpayer identification numbers (TINs) of contributors to the ABLE account at the time when the contributions are made, if the program has a system in place to reject contributions that exceed the annual limits. However, if an excess contribution is deposited into a designated beneficiary’s ABLE account, the program will need to request the contributor’s TIN. For most people, the TIN is their Social Security number. (3) Disability diagnosis certification permitted: Designated beneficiaries can open an ABLE account by certifying, under penalties of perjury, that they meet the qualification standards, including their receipt of a signed physician’s diagnosis if necessary, and that they will retain that diagnosis and provide it to the program or the IRS upon request. This means that eligible individuals with disabilities will not need to provide the written diagnosis when opening the ABLE account, and ABLE programs will not need to receive, retain, or evaluate detailed medical records. Until the final regulations are issued, taxpayers may rely on the guidance in the new notice. The payments are also excluded from FICA taxes, FUTA taxes, and federal income tax withholding. The fact that the insured group health plan is provided by the spouse’s employer and not the taxpayer’s employer does not change the result under these facts. In the next situation, the amount paid for the insured health coverage by the the taxpayer’s spouse) through salary-reduction under an I.R.C. § 125 cafeteria plan has been excluded from the spouse’s gross income. An employer may not exclude from gross income under I.R.C. § 106 an amount paid to an employee for insured health coverage that has already been excluded from gross income as employer-provided coverage (including salary-reduction amounts pursuant to an I.R.C. § 125 cafeteria plan). In the next situation, the taxpayer’s employer’s HRA pays the taxpayer for all of the substantiated cost of insured health coverage paid by the taxpayer’s spouse on an after-tax basis under the taxpayer’s employer’s group health plan. These amounts are excluded from the taxpayer’s gross income under I.R.C. § 106 because the taxpayer’s employer is paying the premium on a group health plan covering one or more employees, the employee’s spouse and dependents. The payments are also excluded from FICA taxes, FUTA taxes, and federal income tax withholding. The fact that the insured group health plan is provided by the spouse’s employer and not the taxpayer’s employer does not change the result under these facts. In another situation, the amount paid for the insured health coverage by the taxpayer’s spouse through salary-reduction under an I.R.C. § 125 cafeteria plan has been excluded from the spouse’s gross income. An HRA may not reimburse an amount paid to an employee for insured health coverage that has already been excluded from gross income as employer-provided coverage (including salary-reduction amounts pursuant to an I.R.C. § 125 cafeteria plan). In the next situation, the amount paid for the insured health coverage by the taxpayer’s spouse through salary-reduction under an I.R.C. § 125 cafeteria plan has been excluded from the spouse’s gross income. An HRA may not reimburse an amount paid to an employee for insured health coverage that has already been excluded from gross income as employer-provided coverage (including salary-reduction amounts pursuant to an I.R.C. § 125 cafeteria plan).
and plan meet various conditions. Rather than being required to measure its ALE status based on the number of full-time employees, including full-time equivalent employees, for all twelve months of 2014, employers may instead base their 2015 ALE status on any consecutive six-month period – as chosen by the employer – during 2014. For an employer with a non-calendar plan year, the first four types of transition relief listed above also apply for the months in 2016 that are part of the 2015 plan year. **Health Care Tax Tip 2015-77.**

**INNOCENT SPOUSE RELIEF.** The IRS has issued proposed regulations which implement changes to the innocent spouse relief regulations based on changes in the Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432, § 408, 120 Stat. 3061 (2006) and litigation. The amendments include: Prop. Treas. Reg. § 1.6015-1(h)(6) defines “unpaid tax” for purposes of Treas. Reg. § 1.6015-4 to have the same meaning as “underpayment.” The unpaid tax or underpayment on a joint return is the balance shown as due on the return reduced by the tax paid with the return or paid on or before the due date for payment (without considering any extension of time to pay) after applying withholding credits, estimated tax payments, payments with an extension, and other credits applied against the total tax reported on the return. The determination of the existence and amount of unpaid tax is made as of the date the joint return is filed, or as of the due date for payment if payments are made after the return is filed but on or before the due date. If the payments made with the joint return, including any payments made on or before the due date for payment (without considering any extension of time for payment), completely satisfy the balance due shown on the return, then there is no unpaid tax for purposes of Treas. Reg. § 1.6015-4. Under Treas. Reg. § 1.6015-4, a requesting spouse can only get relief from the unpaid tax on the return, and if refunds are available, from any payments made on the liability after the later of the date the joint return was filed or the due date for payment (without considering any extension of time for payment). Prop. Treas. Reg. § 1.6015-1(h)(8) adds a definition of deficiency, by reference to I.R.C. § 6211 and the regulations, to clarify that the term deficiency has the same meaning throughout the regulations. Prop. Treas. Reg. § 1.6015-1(k)(5) sets forth the general rule that a requesting spouse who is entitled to relief is generally not eligible for a credit or refund of joint payments made with the nonrequesting spouse. Under the proposed rule, a requesting spouse, however, may be eligible for a credit or refund of the requesting spouse’s portion of the requesting and nonrequesting spouse’s joint overpayment from another tax year that was applied to the joint income tax liability to the extent that the requesting spouse can establish his or her contribution to the overpayment. Prop. Treas. Reg. § 1.6015-1(o) provides a definition of abuse for purposes of Prop. Treas. Regs. § § 1.6015-2(b) and 1.6015-3(c)(vi). The definition of abuse is taken directly from Rev. Proc. 2013-34, § 4.03(2)(c)(iv), 2013-2 C.B. 397. 80 Fed. Reg. 72649 (Nov. 20, 2015).

The taxpayer was employed as an elementary school teacher and the spouse ran a chicken farm business owned by both taxpayers. The spouse managed the family and business financial accounts with minimal input from the taxpayer but...
the taxpayer had access to the family checking account. The taxpayer did not claim any spouse abuse. The couple filed joint tax returns for two tax years for which a deficiency was assessed and the taxpayer signed both returns knowing that the chicken farm was not profitable and the spouse would not be able to pay the taxes owed. The taxpayer requested equitable innocent spouse relief from the assessed taxes. The court noted that Rev. Proc. 2013-34, 2013-2 C.B. 403 provides seven factors to be considered in granting equitable relief: (1) marital status; (2) possible economic hardship if relief is not granted; (3) knowledge or reason to know that the tax liability would or could not be paid; (4) legal obligation to pay the outstanding federal income tax liability; (5) receipt of a significant benefit from the unpaid income tax liability; (6) compliance with income tax laws; and (7) mental or physical health at the time of filing. The court found that factors (2), (3), (5), and (6) were not in dispute and did not favor providing relief. The court held that the IRS properly denied equitable innocent spouse relief in that the taxpayer knew the spouse would not be able to pay the taxes and that the taxpayer would not suffer economic hardship from being required to pay the assessed taxes. Hall v. Comm’r, T.C. Memo. 2015-221.

PASSIVE ACTIVITY LOSSES. The taxpayer was a lawyer who worked full time as an officer and 10 percent owner of a property management company. The taxpayer and spouse owned interests in up to 100 entities which owned or operated rental properties and a golf course adjoining the properties. The taxpayer claimed the income and losses from the interests as non-passive income and losses, treating all the interests as one activity. The IRS disallowed the non-passive-treatment of the income and losses because the taxpayer did not have at least a 5 percent interest in the company, did not spend at least 750 hours on the activity, and did not properly group all the activities into one activity. The court disagreed noting that the taxpayer had provided evidence that the taxpayer owned 10 percent of the stock in the company. The IRS had argued that the taxpayer’s ownership was less than 5 percent because the taxpayer was not liable for any company losses and had not made any capital contributions. The court held that the taxpayer’s share of losses was only speculation because the company had never incurred any losses and the lack of capital contribution did not disprove any ownership in the company. The court also found that the taxpayer substantiated at least 750 hours spent on the rental activities and the various business interests were properly grouped in that they all were under common control and managed by the same company. Stanley v. United States, 2015-2 U.S. Tax Cas. (CCH) ¶ 50,560 (W.D. Ark. 2015).

PLUG-IN ELECTRIC DRIVE MOTOR VEHICLE TAX CREDIT. The taxpayers, husband and wife, ordered a plug-in electric car on December 21, 2009 through the car dealer’s web site. The order was accompanied by full payment and the taxpayers obtained car insurance on the vehicle on December 28, 2009. The vehicle was delivered to the taxpayers on June 8, 2010. The dealer had obtained certification of the eligibility of the vehicle for the Plug-in Electric Drive Motor Vehicle tax credit (PEVC) under I.R.C. § 30D but the certification expired on December 31, 2009 when I.R.C. § 30D no longer was available for slow-moving vehicles such as the one purchased by the taxpayers. The taxpayers claimed the PEVC for the vehicle on their 2009 tax return after consulting with the dealer, a tax professional and the tax return preparer, an accountant. The IRS rejected the credit because the vehicle was not placed in service in 2009. The court looked at the various definitions of “placed in service” and focused on Brown v. Comm’r, T.C. Memo. 2013-275 which held that a plane delivered to the buyer was not eligible for the additional depreciation deduction in the tax year of delivery because the buyer had required several modifications which were not completed until the following tax year. In this case, the court held that, because the car was not delivered to the taxpayers until June 2010, the vehicle was not available to the taxpayers for its intended use until that time and therefore was not placed in service until delivered. Podraza v. Comm’r, T.C. Summary Op. 2015-67; Trout v. Comm’r, T.C. Summary Op. 2015-66.

SAFE HARBOR INTEREST RATES

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REPAIRS. Under Treas. Reg. § 1.263(a)-1(f)(1)(ii)(D), a taxpayer without an applicable financial statement (AFS) (as defined in Treas. Reg. § 1.263(a)-1(f)(4)) may elect to apply a de minimis safe harbor if, in addition to other requirements, the amount paid for the property subject to the de minimis safe harbor does not exceed $500 per invoice (or per item as substantiated by the invoice). In contrast, under Treas. Reg. § 1.263(a)-1(f)(1)(i) (D), a taxpayer with an AFS may elect to apply the de minimis safe harbor if, in addition to other requirements, the amount paid for the property does not exceed $5,000 and the taxpayer treats the amount paid as an expense on its AFS in accordance with its written accounting procedures. The de minimis safe harbor does not limit a taxpayer’s ability to deduct otherwise deductible repair or maintenance costs that exceed the amount subject to the safe harbor. Consistent with longstanding federal income tax rules, a taxpayer may continue to deduct all otherwise deductible repair or maintenance costs, regardless of amount. The IRS has announced an increase in the de minimis safe harbor limit for taxpayers without an AFS to $2500. Notice 2015-82, I.R.B. 2015-50.

The IRS has issued a revenue procedure which provides certain taxpayers engaged in the trade or business of operating a retail establishment or a restaurant with a safe harbor method of accounting for determining whether expenditures paid or incurred to remodel or refresh a qualified building (as defined in section
4.02) are deductible under I.R.C. § 162(a), must be capitalized as improvements under I.R.C. § 263(a), or must be capitalized as the costs of property produced by the taxpayer for use in its trade or business under I.R.C. § 263A. “Qualified building” means each building unit of property used by a qualified taxpayer primarily for selling merchandise to customers at retail or primarily for preparing and selling food or beverages to customer order for immediate on-premises and/or off-premises consumption. For these purposes, selling merchandise to customers at retail includes the sale of identical goods to resellers if the sales to resellers are conducted in the same building and in the same manner as retail sales to non-reseller customers (for example, warehouse clubs, home improvement stores). For purposes of this revenue procedure, a building unit of property is comprised of each building, as defined in Treas. Reg. § 1.48-1(e)(1), and its structural components, as defined in Treas. Reg. § 1.48-1(e)(2). The revenue procedure also provides procedures for obtaining automatic consent to change to the safe harbor method of accounting permitted by this revenue procedure. Rev. Proc. 2015-56, I.R.B. 2015-49.

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