2014 National Income Tax Workbook Update

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TAX INCREASE PREVENTION ACT OF 2014  

The Tax Increase Prevention Act of 2014 (TIPA), division A of Pub. L. No. 113-295, was signed into law on December 19, 2014.

TIPA extends retroactively for 2014, at their 2013 levels, numerous taxpayer benefits that had expired at the end of 2013. For example, the maximum I.R.C. § 179 deduction for the 2014 tax year is $500,000 ($535,000 for enterprise zone property), and the dollar-for-dollar phaseout begins when the total amount of qualifying property placed in service by the taxpayer exceeds $2,000,000. All other provisions of I.R.C. § 179 that were effective for 2013 also remain in effect for 2014.

Expired Provisions

Only a few provisions were not extended. The expired provisions include three credits and three deadlines.

- The credits that are not available for 2014 are the I.R.C. § 30D credit for new plug-in electric drive motor vehicles, the I.R.C. § 35 health coverage tax credit, and the I.R.C. § 45 energy-efficient appliance credit for manufacturers.
- The deadlines that were not extended are the I.R.C. § 179C placed-in-service date for partial expensing of certain refinery property; the I.R.C. § 1400L ending date for issuance of New York Liberty Zone tax-exempt bond financing; and the Pub. L. No. 110-343 replacement period for nonrecognition of gain for areas damaged by 2008 Midwestern severe storms, tornados, and flooding.

Extended Tax Benefits

Figure 1.1 shows the federal tax law provisions that originally expired after 2013 and were reinstated for 2014. The first column lists the Internal Revenue Code section that was amended, and the second column lists the section of TIPA that extended the provision through December 31, 2014, for calendar year taxpayers. A few provisions (such as the I.R.C. § 179 deduction) are available to fiscal year taxpayers for the 2014 tax year.
## FIGURE 1.1 Provisions That Were Extended for 2014

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**Zone and Disaster Area Incentives**

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* This provision was not included in the Internal Revenue Code.
TIPA also includes numerous technical and clerical corrections to previously enacted tax legislation and eliminates some deadwood provisions in the Internal Revenue Code (that is, provisions that are not used in computing current tax liabilities provisions). The changes include the following clarifications and changes:

- The phaseout thresholds for married couples filing joint tax returns are increased and adjusted for inflation for all taxable years after 2009 (not just tax years beginning in 2010).
- For tax years beginning after 2008 and before 2018, the refundable portion of the child tax credit (the portion of the credit that exceeds the taxpayer’s liability) is equal to 15% of the taxpayer’s earned income in excess of $3,000 (not $10,000 indexed for inflation).
- The cost of course materials is included in qualifying expenses for the American opportunity credit (the renamed Hope credit) but not for the lifetime learning credit, unless the course materials cost is included in the costs that must be paid to the institution as a condition of enrollment or attendance.
- The IRS summary assessment procedures apply in the case of an omission of a correct valid identification number on a return claiming the 2008 recovery rebate credit.
- The enactment date of the Heroes Earnings Assistance and Relief Tax Act of 2008 applies for determining the limitation period during which retired pay for members of the uniformed services is reduced as a result of the award of disability compensation.
- A regulated investment company (RIC) may (1) delay the capital loss carryover provisions of the Regulated Investment Company Modernization Act of 2010 for 1 year for purposes of the excise tax on undistributed income, (2) exclude from its earnings and profits calculation such loss carryover amounts, (3) modify the required date for a declaration of a spillover dividend, (4) modify rules for the treatment of post-October net capital losses, and (5) defer certain gains and losses for excise tax purposes.
- The withholding requirements applicable to an RIC under the Foreign Investment in Real Property Tax Act (FIRPTA) exempt distributions made on or before October 4, 2008, from the required withholding requirements and exempt RICs from liability to a foreign shareholder for amounts withheld by the IRS.
- The tax treatment of wages eligible for the Indian employment tax credit must be coordinated with the work opportunity tax credit.
- The basis of any property eligible for the tax credit for alternative fuel vehicle refueling property expenditures is reduced by the allowed credit.
- Any aircraft that is a rotorcraft or propeller aircraft is excluded from the definition of jet aircraft for purposes of the excise tax exemption for transportation by aircraft.
- Coke and coke gas produced using fuel qualifying for a steel industry fuel credit are not eligible for the tax credit for producing fuel from a non-conventional source.
- Accelerated depreciation provisions for smart meters and smart grid systems do not apply to property with a recovery period of less than 16 years.
-Bonus depreciation for reuse and recycling property is not allowed if the taxpayer elects out of additional first-year depreciation for other property.
- Revenues for the excise tax on aviation fuel and gasoline credited to the Airport and Airways Trust Fund are not similarly credited to the Highway Trust Fund.
ACHIEVING A BETTER LIFE EXPERIENCE ACT OF 2014  

After states establish new I.R.C. § 529A programs, taxpayers will be able to open tax-exempt ABLE savings accounts for some individuals with disabilities that generally will not jeopardize the individuals’ eligibility for means-tested public assistance.

Only individuals who became blind or disabled before age 26 and are entitled to social security disability payments or supplemental security income benefits can be beneficiaries of ABLE accounts. Disability is defined in I.R.C. § 529A(e)(1) as “a medically determinable physical or mental impairment, which results in marked and severe functional limitations, and which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months.” An individual is considered blind if he or she possesses “central visual acuity of 20/200 or less in the better eye with the use of a correcting lens” [SSA § 1614(a)(2), codified as 42 U.S.C. § 1382c].

An individual may be a beneficiary of only one ABLE account, and that account generally must be established in the state where the individual is a resident. However, a state that does not establish its own ABLE program can contract with a state that does have a qualified program to provide its residents with access to a qualified program.

The rules for tax-free distributions will be similar to those for I.R.C. § 529 plans, but qualifying expenses will also include the disabled person’s housing; transportation; employment training and support; assistive technology and personal support services; health, prevention, and wellness costs; financial management and administrative services; legal fees; expenses for oversight and monitoring; and funeral and burial expenses. Other eligible expenses can be approved in Treasury regulations. Nonqualifying distributions will be subject to a 10% excise tax to the extent they are allocable to investment gains under I.R.C. § 72.

An ABLE account can be rolled over once in 12 months or transferred to a new qualifying beneficiary who is a member of the same family.

When an ABLE beneficiary dies, the state is entitled to recoup the net amount of Medicaid benefits paid after the account was established from any amounts remaining in the ABLE account.

Special Needs Trusts

ABLE accounts will not necessarily replace special needs trusts in all cases. There is no limit on funding of special needs trusts, but income earned within such trusts is taxable in the year it is earned, rather than tax-deferred and potentially tax-exempt when it is distributed. A special needs trust generally is exempt from Medicaid payment recoupment.

IRS Has 6 Months to Issue Regulations

Act § 102(f) requires the IRS to issue regulations under new I.R.C. § 529A by June 19, 2015 (6 months after the December 19, 2014, enactment date). The individual states can then establish their programs.

Some amounts contributed to an ABLE account are excludable from a debtor’s bankruptcy estate. The criteria are that

- the designated beneficiary was a child, stepchild, grandchild, or step-grandchild of the debtor;
- the funds were not pledged or promised to any entity in connection with any extension of credit;
the total contribution does not exceed $6,225 during a specified time period (720 days to 365 days before the date of the bankruptcy petition).

### Civil Penalties

ABLE Act § 208 amends sections of the Internal Revenue Code to require an annual inflation adjustment (generally in $5 increments, rounded down) to tax penalty amounts for five civil penalties:

1. Failure to file a tax return [I.R.C. § 6651]
2. Failure to file certain information returns or registration statements [I.R.C. § 6652]
4. Failure to file partnership or S corporation returns [I.R.C. §§ 6698 and 6699]
5. Failure to file correct information returns or correct payee statements [I.R.C. §§ 6721 and 6722]

These changes are effective for returns required to be filed after December 31, 2014.

### Professional Employer Organizations

ABLE Act § 206 adds I.R.C. §§ 3511 and 7705, which allow the IRS to certify professional employer organizations (PEOs) as employers for employment tax purposes, effective for services performed in 2016. The certification will allow a PEO to pay wages and collect and remit payroll taxes on behalf of an employer. The IRS can charge an annual user fee not to exceed $1,000 for the certification.

Qualifying PEOs will be required to have annual independent financial audits. Each PEO must post a bond each year equal to the greater of $30,000 or 5% of the PEO’s liability during the preceding calendar year (not exceeding $1,000,000).

### REVENUE PROVISIONS

Some provisions in the ABLE Act will increase federal revenues.

Several civil penalties are now subject to cost-of-living adjustments, and the IRS may certify professional employer organizations (PEOs) that pay annual user fees as employers for employment tax purposes.

### Other Changes

#### Worker Compensation Offset

When an individual receives both social security disability benefits and workers’ compensation benefits, the individual’s social security disability benefits (but not retirement benefits) are usually reduced or offset by the amount of the workers’ compensation payments [42 U.S.C. § 424a(a)]. ABLE Act § 201 changes the age at which disability benefits are no longer subject to reductions from 65 to full retirement age. This will decrease the amount of social security disability benefits payable to certain recipients.

#### Medicare Provider Levy

I.R.C. § 6331(h) provides for a continuous levy when a Medicare provider or supplier owes overdue taxes. ABLE Act § 209 increases the levy rate from 15% to 30%, effective 180 days after the date of the enactment.

#### Personal Holding Company Income

ABLE Act § 207 excludes controlled foreign corporation dividends from the I.R.C. § 543 definition of personal holding company income for tax years ending after December 19, 2014.

#### Waterways Fuel Tax

ABLE Act § 205 amends I.R.C. § 4042 to increase the Inland Waterways Trust Fund financing rate to 29¢ per gallon for fuel used after March 31, 2015. The tax is charged on fuel used in commercial transportation on inland waterways.
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RULINGS AND CASES  This chapter contains a selection of court cases, Treasury regulations, revenue rulings, revenue procedures, IRS announcements and notices, letter rulings, and IRS chief counsel advice memoranda issued since the publication of the 2014 National Income Tax Workbook.

These items have been edited and appear in a condensed form. They should not be used as substantial authority until the entire text of the authority has been read.

Accounting
REG-109187-11
I.R.C. § 453B

Proposed regulations provide that a transferor must recognize gain or loss on the disposition of an installment obligation if the obligation is transferred to the issuer in return for an equity interest.
Proposed regulations under I.R.C. § 453B generally provide that gain of loss is not recognized on the disposition of an installment obligation if such gain or loss is not recognized under another provision of the Internal Revenue Code. The proposed regulations also provide that this general rule does not apply to the satisfaction of an installment obligation, such as when the holder of an installment obligation transfers the obligation to the issuer for an equity interest in the issuer.

I.R.C. § 453B(a) provides that gain or loss is recognized when an installment obligation is satisfied at other than its face value or when the obligation is distributed, transmitted, sold, or otherwise disposed of.

Existing Treas. Reg. § 1.453-9(c)(2) states that if gain or loss for certain dispositions is not recognized under the Internal Revenue Code, then the gain or loss is not recognized on the disposition of an installment obligation that qualifies for that exception. Exceptions identified in Treas. Reg. § 1.453-9(c)(2) include certain transfers to corporations under I.R.C. §§ 351 and 361, contributions to partnerships under I.R.C. § 721, and distributions by partnerships to partners under I.R.C. § 731 (except as provided by I.R.C. §§ 736 and 751).

The proposed regulations republish in Treas. Reg. § 1.453B-1(c) the general rule in Treas. Reg. § 1.453-9(c)(2) under which gain or loss is not recognized upon certain dispositions.

In addition, the proposed regulations incorporate and expand the holding of Rev. Rul. 73-423, 1973-2 C.B. 161, to provide that a transferor recognizes gain or loss under I.R.C. § 453B(a) when the transferee disposes of an installment obligation in a transaction that results in the satisfaction of the installment obligation, including when a corporation’s or partnership’s installment obligation is contributed to the corporation or partnership in exchange for an equity interest in the corporation or partnership.

[REG-109187-11, 2015-2 I.R.B. 277]
under examination were not including any labor costs in their ending inventories. Instead, the ending inventories consisted entirely or almost entirely of raw materials: the ingredients that had not yet entered the restaurant’s production process. LB&I requested advice from the IRS chief counsel as to whether it was appropriate to impose the simplified production method in these cases.

In general, the restaurants treated kitchen-related costs (back-of-the-house costs) as capitalizable production costs under I.R.C. § 263A and costs related to the serving area (front-of-the-house costs) as noncapitalizable costs. However, some of the restaurants did not capitalize some back-of-the-house costs they incurred to produce food, including kitchen labor (the wages paid to cooks and food preparation staff).

**Law and Analysis**

I.R.C. § 263A(a) and Treas. Reg. § 1.263A-1(a)(3)(ii) provide, in part, that taxpayers that produce real or tangible personal property must capitalize

- all direct costs of producing the property, and
- the property’s properly allocable share of indirect costs.

Direct costs include the costs of labor that can be identified or associated with particular units or groups of units of specific property produced. Indirect costs are all costs other than direct costs. Indirect costs are properly allocable to property produced when the costs directly benefit or are incurred by reason of the performance of production activities. The I.R.C. § 263A costs that are allocable to items that remain on hand at the end of the tax year generally must be capitalized.

Facts and circumstances methods that may be used to allocate costs include a specific identification method, a standard cost method, a burden rate method, and any other reasonable allocation method defined under the principles of Treas. Reg. § 1.263A-1(f)(4).

Treas. Reg. § 1.263A-1(f)(1) allows producers to use the simplified production method [see Treas. Reg. § 1.263A-2(b)] to allocate direct and indirect costs, but the simplified production method is generally less precise than a facts and circumstances method. If kitchen labor costs are treated as additional I.R.C. § 263A costs under the simplified production method, a significant amount of kitchen labor costs will be capitalized to the ending inventory, even though those costs typically relate almost entirely to the production of food that is no longer on hand.

Alternatively, if a more precise facts and circumstances method is used or if kitchen labor costs are treated as an I.R.C. § 471 cost under the simplified production method, these kitchen labor costs will be allocated to the cost of food that is included in the cost-of-goods-sold deduction.

**Ruling**

The advice memorandum states that the IRS Office of Chief Counsel will generally not support the imposition of the simplified production method in examination or litigation if a taxpayer is willing to develop and implement a reasonable facts and circumstances method instead.

The memo also advised LB&I that if the IRS imposed the simplified production method, the restaurant could request approval of a change in its method of accounting to (1) treat kitchen labor as an I.R.C. § 471 cost or (2) use a more precise facts and circumstances method, and the memo stated that counsel generally would grant such changes.

The memo also concluded that counsel would support allowing a restaurant that uses the simplified production method to treat all of its direct production costs (including kitchen labor) as I.R.C. § 471 costs under that method rather than as additional I.R.C. § 263A costs.


**Ltr. Rul. 2014-47-027**

I.R.C. § 199

A 52-53-week tax year is deemed to end on December 31, 2017, for purposes of the domestic production activities deduction.

I.R.C. § 199(b)(2) provides that the amount of the domestic production activities deduction (DPAD) allowable for any tax year shall not exceed 50% of the Form W-2, Wage and Tax Statement, wages the taxpayer paid with respect to employment during the calendar year ending during the tax year.

I.R.C. § 441(f)(2)(A) provides that when the effective date or the applicability of any provision of the Internal Revenue Code is expressed in terms of tax years beginning, including, or ending with reference to a specified date that is the first or last day of a month, a tax year shall be treated as beginning with the first day of the calendar month beginning nearest to the first day of the tax year, or as ending with the last day of the calendar month ending nearest to the last day of the tax year.

In the case at issue, the taxpayer computes its taxable income on the basis of a 52-53-week tax year ending on the last Saturday in December. The taxpayer’s 2015 tax year began December 28, 2014, and will end on December 26, 2015. The taxpayer’s 2016 tax year will begin December 27, 2015, and end on December 31, 2016. The taxpayer’s 2017 tax year will begin January 1, 2017, and end on December 30, 2017. Thus,
the taxpayer’s 2017 tax year literally does not include December 31, and there is potentially no calendar year that ends during the 2017 tax year.

The IRS ruled that the taxpayer’s 2017 tax year will be deemed to end on December 31, 2017 for purposes of I.R.C. § 199.


**Employees**

**T.D. 9696**

I.R.C. §§ 162 and 262

**Employees**

**T.D. 9696**

I.R.C. §§ 162 and 262

☞☞ Final regulations provide a safe harbor for treating local lodging expenses incurred for attendance at a business function as ordinary and necessary business expenses.

**Background**

Local lodging expenses for an individual are generally personal, living, or family expenses that are not deductible [I.R.C. § 262(a)]. However, local lodging expenses may be deductible under I.R.C. § 162 as ordinary and necessary business expenses [Treas. Reg. § 1.162-32]. Whether local lodging expenses are paid or incurred in carrying on a taxpayer’s trade or business is determined under all the facts and circumstances.

For example, a professional sports team may require its coaches and players to stay at a local hotel the night before a home game to conduct last-minute training and ensure the physical preparedness of the players. The facts and circumstances test is met because the overnight stays are a bona fide condition or requirement of employment, the employer has a noncompensatory business purpose for paying the lodging expenses, the employer is not paying the lodging expenses primarily to provide a social or personal benefit to the employees, and the lodging is not lavish or extravagant under the circumstances.

**Safe Harbor**

In addition to the facts and circumstances test, the new final regulations provide a safe harbor for local lodging expenses to qualify as ordinary and necessary business expenses. An individual’s local lodging expenses are ordinary and necessary business expenses if all four of the following criteria are met:

1. The lodging is necessary for the individual to participate fully in or be available for a bona fide business meeting, conference, training activity, or other business function.
2. The lodging is for a period that does not exceed 5 calendar days and does not recur more frequently than once per calendar quarter.
3. If the individual is an employee, the individual’s employer requires the employee to remain at the activity or function overnight.
4. The lodging is not lavish or extravagant under the circumstances and does not provide any significant element of personal pleasure, recreation, or benefit.

**Deductions and Exclusions**

- Qualifying local lodging expenses are deductible by the individual if incurred directly without reimbursement.
- If the qualifying expenses are incurred by an employer on behalf of an employee, the value is excludable from the employee’s income as a working condition fringe benefit under I.R.C. § 132.
- If the employer reimburses the employee for qualifying expenses, the reimbursement is excludable from the employee’s gross income if the expense allowance arrangement satisfies the requirements of an accountable plan under I.R.C. § 62(c) and the applicable regulations.
- Qualifying expenses that are paid or reimbursed by the employer are also deductible by the employer as ordinary and necessary business expenses.

The final regulations contain several examples to illustrate the new rules.


**Ltr. Rul. 2014-41-004**

I.R.C. §§ 104 and 3121

☞☞ Disability payments under a county ordinance qualify as workers’ compensation payments that are excludable from gross income.

A county ordinance provides disability benefits for county employees who suffer personal injury or sickness in the line of duty. An eligible employee’s disability benefits are determined as a percentage of the employee’s compensation before the employee suffered personal injury or sickness in the line of duty, defined as a disability or death resulting (directly or indirectly) from an act occurring, or a thing done, or a risk taken that was required of the employee in the performance of his or her duty. The county code that was amended by the ordinance further requires the county’s disability benefits to be reduced by the amounts of social security disability benefits, workers’ compensation benefits, and earned income during disability the disabled employee receives.
**Ruling**
The private letter ruling concluded that

1. the county code, as amended by the ordinance, is a statute in the nature of a workers’ compensation act;
2. the disability benefits are not considered taxable income to the employee under I.R.C. § 104(a)(1); and
3. the disability benefits are excluded from the definition of “wages” under I.R.C. § 3121(a)(2)(A).

[Ltr. Rul. 2014-41-004 (issued June 10, 2014; released October 10, 2014)]

**Central Motorplex, Inc. v. Commissioner**
I.R.C. §§ 61 and 6050P

☞☞ The officers of a corporation are statutory employees.

**Facts**
A C corporation was engaged in the business of buying, repairing, reconditioning, and reselling used automobiles. The corporation’s president, who was its sole shareholder, managed the business, including hiring and firing employees. The corporation’s secretary-treasurer was in charge of repair and maintenance of the cars in its inventory. Another worker was in charge of picking up and delivering automobiles, including obtaining and delivering license plates and title certificates.

Whether an individual is an employee or an independent contractor under the common law test is a question of fact. The Tax Court considered the following factors:

- The degree of control the principal had over the worker
- The worker’s opportunity for profit or loss
- The worker’s investment in facilities
- The permanence of the relationship
- The skill required in the operation

**Holding**
The president and secretary-treasurer both performed more than minor services and were statutory employees for employment tax purposes. The third worker was a common law employee in that (1) the president of the corporation exercised control over the worker’s activities, (2) the worker was not in a position to increase profits through his own efforts, (3) the worker did not employ his own tools, (4) the worker received compensation categorized as wages every month, and (5) the work performed by the worker was integral to the corporation’s regular business.

[Central Motorplex, Inc. v. Commissioner, T.C. Memo. 2014-207]

**Individual Issues**

**Estate of Menges v. Commissioner**
I.R.C. § 36

☞☞ The beneficiary of estate could not claim the first-time homebuyer credit after disclaiming her interest and then acquiring the inherited home from the other beneficiaries.

**Facts**
The taxpayer was a beneficiary of her grandmother’s estate that included an interest in the grandmother’s residence. The taxpayer’s father was the executor of the estate, and he entered into a written agreement with the taxpayer that would result in the taxpayer assuming the responsibility for paying the taxes on the property. The taxpayer was not required to pay any taxes on the property, and the estate did not receive any income from the property.

The taxpayer treated all three persons as independent contractors, although none of the employees had employment contracts with the taxpayer. The taxpayer did not withhold any income, FICA, or FUTA taxes, nor did it issue Forms W-2, Wage and Tax Statement.

**Analysis**
An officer of a corporation who performs more than minor services and receives remuneration for such services is a statutory employee for employment tax purposes. An officer can escape statutory employee status only if he or she performs no services (or only minor services) for the corporation and neither receives nor is entitled to receive any remuneration, directly or indirectly, for services performed [Treas. Reg. §§ 31.3121(d)-1(b), 31.3306(i)-1(e), and 31.3401(c)-1(f)].

Whether an individual is an employee or an independent contractor under the common law test is a question of fact. The Tax Court considered the following factors:

- The degree of control the principal had over the worker
- The worker’s opportunity for profit or loss
- The worker’s investment in facilities
- The permanence of the relationship
- The skill required in the operation

[Central Motorplex, Inc. v. Commissioner, T.C. Memo. 2014-207]
the estate. Prior to accepting the inheritance, the taxpayer disclaimed her interest in the residence, causing the interests in the home to pass to only her father and her two brothers. Her brothers and father then executed deeds to transfer the home to the taxpayer in exchange for liens on the property to secure loans to the taxpayer. However, the taxpayer did not actually borrow any money. She claimed the first-time homebuyer credit for the “purchase” of the home. She subsequently died, and the IRS assessed her estate for income taxes resulting from disallowance of the credit.

**Analysis**

For purposes of the first-time homebuyer credit, I.R.C. § 36(c)(3)(A) defined the term *purchase* as “any acquisition, but only if . . . the property is not acquired from a person related to the person acquiring such property.” The definition of related persons includes an executor of an estate and a beneficiary of such estate except in the case of a sale or exchange in satisfaction of a pecuniary bequest [I.R.C. §§ 36(c)(3) and 267(b)(13)].

The estate argued that the taxpayer’s disclaiming the interest in her grandmother’s home removed the taxpayer from designation as a beneficiary of the estate.

**Holdings**

The US district court rejected the characterization of the set of transactions as a transfer to a nonbeneficiary of the estate. It held that the substance of the transactions was a transfer of a portion of the decedent’s estate from the executor to the taxpayer who was a beneficiary of the estate. Therefore, the court held that the credit was properly disallowed.


**Deductions**

**Copeland v. Commissioner**

I.R.C. § 163

A chief counsel advice letter discusses three scenarios involving the deductibility of mortgage interest.

In the first scenario the taxpayers were a married couple who were jointly and severally liable on a mortgage. One spouse died during the tax year, and the bank issued a Form 1098, Mortgage Interest Statement, under the deceased spouse’s social security number. Federal tax law directs that if the surviving spouse filed a separate return for the year of death, the decedent’s return should include income and deductions to the time of death. IRS counsel advised that if the decedent paid the mortgage interest from a joint account before death, the decedent’s return should reflect one-half of the interest paid from the joint account before the time of death in the absence of evidence that the payment was made with the decedent’s separate funds.

In the second scenario the taxpayers were an unmarried couple who were jointly and severally liable on a mortgage. The bank issued a Form 1098 under either only one social security number or both. One or both taxpayers claim the mortgage interest deduction on their individual returns. IRS counsel advised that because both taxpayers are liable on the mortgage, both are entitled to claim the mortgage interest deduction to the extent of the mortgage interest paid by either taxpayer. If the mortgage interest is paid from separate funds, each taxpayer may claim the mortgage interest deduction paid from each one’s separate funds. If the mortgage interest is paid from a joint bank account in which each has an equal interest, Rev. Rul. 59-66, 1959-1 C.B. 60, provides that each taxpayer is presumed to have paid an equal amount absent evidence to the contrary, and each is entitled to a deduction for one-half of the interest.

In the third scenario various combinations of two relatives co-own a house, with one or both liable on a mortgage. A bank may issue a Form 1098 under the name of one or both of the co-owners. The IRS ruled that a co-owner may deduct a share of the interest

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**Co-owners of a residence and a joint bank account may deduct equal shares of the mortgage interest payments made from the joint account if they file separately.**

Cash basis taxpayers purchased a residence in 1991 with a mortgage loan. In 2010 the loan was modified, and unpaid but due interest on the original loan was added to the principal of the new loan. The taxpayers claimed the unpaid but due interest as part of their total deduction for qualified mortgage interest, but the IRS denied the deduction for the interest added to the loan principal.

The Tax Court held that the accrued interest was not eligible for the deduction because the taxpayers did not actually pay that interest. The court noted that the interest will be deductible when the mortgage loan is paid off. The court also discussed the rule that if the interest had been paid by the taxpayers after obtaining a loan from a third party, the interest would be deductible, but because the interest in this case was added to the same loan, it was not currently deductible.

>[Copeland v. Commissioner, T.C. Memo. 2014-226]

**Chief Counsel Advice 2014-51-027**

I.R.C. § 163
payments even though the co-owner was not directly liable on the mortgage [Treas. Reg. § 1.163-1(b)]. [C.C.A. 2014-51-027 (issued October 1, 2014; released December 19, 2014)]

**Van Malssen v. Commissioner**  
I.R.C. § 280A

- Losses from renting a vacation condominium were not deductible because personal use of the property exceeded 14 days per year.

**Facts**

The taxpayers owned a vacation condominium that they occupied for 81 days in 2008, 59 days in 2009, and 45 days in 2010. The taxpayers said they used the condominium for personal purposes for 14 days in each of the years 2008 and 2010 and for 15 days in 2009. The husband’s brother rented the condominium for 7 days in 2008, and the taxpayers also rented the condominium to vacationers through a rental management company. The average rental period of the condominium was approximately 10 days in 2008, 8 days in 2009, and 7 days in 2010.

The taxpayers maintained logbooks detailing the personal and business use of the condominium and the days spent performing work on the condominium. The husband made several trips to the condominium to make repairs, purchase furniture, and perform maintenance.

The taxpayers claimed losses from the condominium for all 3 years.

**Analysis**

I.R.C. § 280A(a) generally provides that no deduction is allowed for costs associated with a personal residence. Under I.R.C. § 280A(d)(1), a dwelling unit is treated as a personal residence if the taxpayer uses the dwelling for personal purposes for the greater of 14 days or 10% of the number of days during the year for which the unit is rented at a fair rental value. The issue was whether the brother’s rental of the condominium was attributable to the taxpayers because the taxpayers failed to prove that the brother paid full market rental value and the 7-day rental did not make the condo the brother’s main home. In addition, the court added several days as personal use days where the husband had more personal use of the condominium than time spent working on it during visits. Therefore, the losses were not allowed under I.R.C. § 280A.

**Ruling**

The Tax Court held that the brother’s use of the condominium was attributable to the taxpayers because the taxpayers failed to prove that the brother paid full market rental value and the 7-day rental did not make the condo the brother’s main home. In addition, the court added several days as personal use days where the husband had more personal use of the condominium than time spent working on it during visits. Therefore, the losses were not allowed under I.R.C. § 280A.

[Van Malssen v. Commissioner, T.C. Memo. 2014-236]

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**Self-Employment Tax**

**Morehouse v. Commissioner**  
I.R.C. §§ 1401 and 1402

- The Eighth Circuit Court of Appeals ruled that conservation reserve program payments are not self-employment income.

**Facts**

The taxpayer inherited farmland in 1994 and rented the tillable portions of the land to individuals who farmed their rented portions. In 1997 the taxpayer enrolled the tillable lands in the federal Conservation Reserve Program (CRP), and he hired a local farmer to carry out the CRP contract obligations. These obligations generally required the taxpayer to establish and maintain specific types of grass and legume or perennial vegetative cover on the properties and to periodically engage in weed and pest control. The taxpayer performed some management duties, such as ordering seed and requesting emergency haying and grazing rights on the CRP acres.

For 2006 and 2007 the taxpayer reported his CRP payments as farm rental income on Schedule E (Form 1040), Supplemental Income and Loss. The IRS issued notices of deficiency, stating that the CRP payments should have been reported on Schedule F (Form 1040), Profit or Loss From Farming, and should be included in the taxpayer’s net earnings from self-employment.

The taxpayer argued that the CRP payments were not self-employment (SE) income because he did not derive the CRP payments from the operation of a trade or business. Alternatively, he claimed the CRP payments were not SE income under the rentals from real estate exclusion in I.R.C. § 1402(a)(1).

**Tax Court Analysis**

In the Tax Court hearing, the taxpayer contended that his work complying with the CRP contract requirements was de minimis and did not constitute farming. He said all physical labor necessary to plant, seed, weed, mow, and maintain the property in accordance with the CRP contracts was performed by a worker he hired and should not be attributed to him.

The Tax Court ruled that whether the property maintenance activities were carried out by someone else was immaterial, because a taxpayer may conduct his trade or business personally or through an agent. The Tax Court held further that the taxpayer was an active participant because the taxpayer regularly and continuously maintained his status as a CRP participant, maintained the eligibility status of his properties, made decisions regarding his obligations under the CRP contracts, and engaged in the activities for profit. Furthermore, because the CRP payments depended
on continued maintenance of the land in accordance with the CRP contracts, the taxpayer’s participation in the CRP was not merely a passive investment.

The Tax Court also said it did not matter whether the taxpayer’s activities constituted farming or simply continuous and regular participation in an activity for profit; the taxpayer was engaged in a trade or business as defined by I.R.C. § 162.

Rental payments constitute consideration paid for the use or occupancy of property. The Tax Court said that although the CRP restricted the taxpayer’s use of his properties and the CRP repeatedly referred to the payments as rentals, the payments did not qualify for the “rentals from real estate” exclusion because the government did not take possession of the properties or acquire the right to use the properties for its own purposes.

Appellate Court Analysis

On appeal the Eight Circuit Court of Appeals reversed the Tax Court and held that Rev. Rul. 60-32, 1960-1 C.B. 23, and Rev. Rul. 65-149, 1965-1 C.B. 434, controlled as the long-standing rule that land conservation payments made to nonfarmers were rental payments. The court noted that the CRP contracts provide a right for the USDA to physically inspect the acres enrolled in the program and to control the uses of the land, providing a right of physical possession similar to landlords.

The court said it “embrace[d] the agency’s long-standing position that land conservation payments made to non-farmers constitute rentals from real estate and are excluded from the self-employment tax.” It noted that “while CRP contracts may require farmers to conduct a small subset of activities similar to those used in a portion of their general farming operations, . . . the same cannot be said for non-farmers,” and it explained that “the only reason [nonfarmers] even indirectly engage in or arrange for any ‘tilling, seeding, fertilizing, and weed control’ activities on their CRP land is because the agreement with the government requires them to do so.”

Holding

The taxpayer was not liable for SE tax on the CRP payments.

[Morehouse v. Commissioner, 769 F.3d 616 (8th Cir. 2014), rev’g and rem’g 140 T.C. 350 (2013)]

Information Returns

REG-136676-13
I.R.C. §§ 61 and 6050P

Proposed regulations will remove a rule that a deemed discharge of indebtedness for which a Form 1099-C, Cancellation of Debt, must be filed occurs at the end of a 36-month nonpayment testing period.

Current Treas. Reg. § 1.6050P-1(b)(2) lists eight identifiable events that trigger information reporting obligations on the part of an applicable financial entity:

1. A discharge of indebtedness under the Bankruptcy Code
2. A cancellation or extinguishment of an indebtedness that renders the debt unenforceable in a receivership, foreclosure, or similar proceeding in a federal or state court, as described in I.R.C. § 368(a)(3)(A)(ii), other than a discharge under the Bankruptcy Code
3. A cancellation or extinguishment of an indebtedness upon the expiration of the statute of limitations for collection (but only if, and only when, the debtor’s statute-of-limitations affirmative defense has been upheld in a final judgment or decision in a judicial proceeding, and the period for appealing it has expired) or upon the expiration of a statutory period for filing a claim or commencing a deficiency judgment proceeding
4. A cancellation or extinguishment of an indebtedness pursuant to an election of foreclosure remedies by a creditor that statutorily extinguishes or bars the creditor’s right to pursue collection of the indebtedness
5. A cancellation or extinguishment of an indebtedness that renders a debt unenforceable pursuant to a probate or similar proceeding
6. A discharge of indebtedness pursuant to an agreement between an applicable entity and a debtor to discharge indebtedness at less than full consideration
7. A discharge of indebtedness pursuant to a decision by the creditor, or the application of a defined policy of the creditor, to discontinue collection activity and discharge debt
8. The expiration of a 36-month nonpayment testing period
When finalized, the proposed regulations will completely remove the testing period so that the expiration of the 36-month nonpayment period will no longer trigger the reporting requirements.


**Penalties**

**Notice 2014-58**

I.R.C. §§ 6662 and 7701

Transaction and similar rule of law are defined for purposes of the economic substance doctrine.

**Background**

I.R.C. § 7701(o) provides that, in the case of any transaction to which the economic substance doctrine is relevant, the transaction shall be treated as having economic substance only if

1. the transaction changes in a meaningful way (apart from federal income tax effects) the taxpayer's economic position, and
2. the taxpayer has a substantial purpose (apart from federal income tax effects) for entering into the transaction.

I.R.C. § 7701(o)(5)(A) states that the term economic substance doctrine means the common law doctrine under which income tax benefits with respect to a transaction are not allowable if the transaction does not have economic substance or lacks a business purpose.

I.R.C. § 7701(o)(5)(C) states that the determination of whether the economic substance doctrine is relevant to a transaction shall be made in the same manner as if I.R.C. § 7701(o) had never been enacted. With respect to individuals, however, I.R.C. § 7701(o)(5)(B) states that the two-pronged analysis in I.R.C. § 7701(o)(1) shall apply only to a transaction entered into in connection with a trade or business or an activity engaged in for the production of income.

In addition, I.R.C. § 7701(o)(5)(D) states that the term transaction as used in I.R.C. § 7701(o) includes a series of transactions.

I.R.C. § 7701(o)(2)(A) provides that a transaction’s potential for profit shall be taken into account in determining whether the requirements of I.R.C. § 7701(o)(1) are met only if the present value of the reasonably expected pretax profit is substantial in relation to the present value of the claimed net tax benefits.

I.R.C. § 6662(b)(6) provides that the accuracy-related penalty imposed under I.R.C. § 6662(a) applies to any underpayment attributable to any disallowance of a claimed tax benefit because of a transaction lacking economic substance or failing to meet any similar rule of law [collectively, an I.R.C. § 6662(b)(6) transaction].

I.R.C. § 6662(i) increases the accuracy-related penalty from 20% to 40% for any portion of an underpayment attributable to one or more I.R.C. § 6662(b)(6) transactions with respect to which the relevant facts affecting the tax treatment are not adequately disclosed in the return or in a statement attached to the return. I.R.C. § 6662(i)(3) provides that certain amended returns or any supplement to a return shall not be taken into consideration for purposes of I.R.C. § 6662(i).

**New Guidance**

For purposes of determining whether the codified economic substance doctrine applies, transaction generally includes all the factual elements relevant to the expected tax treatment of any investment, entity, plan, or arrangement and any or all of the steps that are carried out as part of a plan. Facts and circumstances determine whether a plan’s steps are aggregated or disaggregated when defining a transaction.

For purposes of I.R.C. § 6662(b)(6), similar rule of law means a rule or doctrine that disallows income tax benefits related to a transaction because the transaction does not change a taxpayer's economic position in a meaningful way [apart from federal income tax effects], or because the taxpayer did not have a substantial purpose [apart from federal income tax effects] for entering into the transaction.


**Retirement**

**Individual Retirement Accounts**

**Announcement 2014-32**

I.R.C. § 408

IRA rollover distributions from 2014 to 2015 do not count as 2015 rollovers for the one-rollover-per-year rule.

The IRS has announced further guidance under Bobrow v. Commissioner, T.C. Memo. 2014-21, which concluded that an individual receiving an IRA distribution cannot roll over any portion of the distribution if the individual has received and rolled over a distribution from any IRA in the preceding 1-year period.

As a transition rule for distributions in 2015, a distribution occurring in 2014 that was rolled over is disregarded for purposes of determining whether a 2015 distribution can be rolled over, provided that the 2015...
distribution is from a different IRA that neither made nor received the 2014 distribution. The Bobrow aggregation rule, which takes into account all distributions and rollovers among an individual’s IRAs, applies to distributions from different IRAs only if each of the distributions occurs after 2014. A rollover distribution from 2014 to 2015 is not a 2015 rollover.

A rollover from a traditional IRA to a Roth IRA (a conversion) is not subject to the one-rollover-per-year limitation, and such a rollover is disregarded in applying the one-rollover-per-year limitation to other rollovers. However, a rollover between an individual’s Roth IRAs would preclude a separate rollover within the 1-year period between the individual’s traditional IRAs, and vice versa.

Similar rules apply to a simplified employee pension described in I.R.C. § 408(k) and a SIMPLE IRA described in I.R.C. § 408(p).

The one-rollover-per-year limitation also does not apply to a rollover to or from a qualified plan (and such a rollover is disregarded in applying the one-rollover-per-year limitation to other rollovers), nor does it apply to trustee-to-trustee transfers.

IRA trustees are encouraged to offer IRA owners who request a distribution for rollover the option of a trustee-to-trustee transfer from one IRA to another IRA. IRA trustees can accomplish a trustee-to-trustee transfer by transferring amounts directly from one IRA to another or by providing the IRA owner with a check made payable to the receiving IRA trustee.


Cross-Reference

Bobrow Discussion


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**Tax Practice**

**Annual Filing Season Program**

I.R.C. § 7701(a)(36)

The IRS posted information on the Annual Filing Season Program on its website.

Information about the new, voluntary Annual Filing Season Program (AFSP) for tax return preparers is accessible in question-and-answer form on the IRS website. One question addressed is the continuing education (CE) requirements for registered tax return preparers (RTRPs). Anyone who passed the RTRP test offered between November 2011 and January 2013 needs to meet only his or her original 15-hour CE requirement each year to obtain an AFSP record of completion. Those who passed the RTRP test and certain other recognized national and state tests are exempt from the 6-hour federal tax law refresher course and test.

Another question addressed is the representation rights of AFSP participants. The IRS stated that attorneys, CPAs, and enrolled agents (EAs) will continue to be the only tax professionals with unlimited representation rights, which means they can represent their clients on any matters including audits, payment/collection issues, and appeals.

Successful AFSP participants will have limited representation rights, which means they can represent clients whose returns they prepared and signed but only before revenue agents, customer service representatives, and similar IRS employees, including the Taxpayer Advocate Service.

PTIN holders without an AFSP record of completion or other professional credential will be permitted to prepare tax returns but will not be allowed to represent clients before the IRS.

[www.irs.gov/Tax-Professionals/Annual-Filing-Season-Program]
UPDATES AND CORRECTIONS

UPDATES
Chapter 17, Tax Rates and Useful Tables
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Chapter 17, Tax Rates and Useful Tables

642 Standard Mileage Rates: Fill in the blanks in the 2015 column as follows:
   Business 57.5¢
   Medical/moving 23.0¢

642 Depreciation Included in Standard Mileage Rate: The 2015 depreciation rate per mile is 24.0¢.

643 Depreciation Limits under I.R.C. § 280F: Add the following row at the bottom of the table:
   2014 additional first year depreciation 8,000

657

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[Rev. Rul. 2015-1, 2015-4 I.R.B. 331, Table 1]

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[Rev. Rul. 2015-3, 2015-6 I.R.B. 580, Table 1]

Future monthly applicable federal rates (AFR) can be found at www.irs.gov/taxpros/lists/0,,id=98042,00.html.
AFR for Determining the Present Value of An Annuity or Interest in a Property (I.R.C. § 7520). Add the following after the last row of the table.

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<td>[Rev. Rul. 2014-6, 2014-7 I.R.B. 263, Table 5]</td>
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Interest Rates for Overpayments and Underpayments of Tax: Add a row to the bottom of the table with rates for the period Jan. 1, 2015—Mar. 31, 2015 the same as the rates for all the periods reported in the table [Rev. Rul. 2014-29, 2014-52 I.R.B. 960].

Retirement Plan Contribution Limits. Fill in the blanks in the 2015 row as follows.

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Age 50 Catch-Up Contribution Limit. Fill in the blanks in the 2014 row as follows.

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<th>SIMPLE Plans</th>
<th>All Other Plans</th>
</tr>
</thead>
<tbody>
<tr>
<td>2,500</td>
<td>5,500</td>
</tr>
</tbody>
</table>

Social Security and Medicare Information. Fill in the blanks in the 2015 column as follows.

<table>
<thead>
<tr>
<th>OASDI tax maximum earnings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic employee wage threshold</td>
</tr>
<tr>
<td>Earnings required to earn one quarter of social security coverage</td>
</tr>
<tr>
<td>Earnings ceiling for social security Below full retirement age (FRA)</td>
</tr>
<tr>
<td>Monthly maximum earnings before FRA for full benefits</td>
</tr>
</tbody>
</table>
CORRECTIONS

<table>
<thead>
<tr>
<th>Page</th>
<th>Correction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Front Matter</td>
<td>Greg Bouchard’s e-mail address is <a href="mailto:gregory.bouchard@cornell.edu">gregory.bouchard@cornell.edu</a>.</td>
</tr>
</tbody>
</table>
| 29 | First column, seventh line of text after Figure 1.13. Replace “$1,411” with “$1,498.”  
Figure 1.14. Replace amounts as shown in the following table.  
SE Tax on $200,000 Sole Proprietor Profits  
Social security tax on $117,000 wage base  
($117,000 × 0.124)  
$14,508  
Medicare tax on $200,000  
Net earnings from self-employment  
($200,000 × 0.9235 = $184,700  
Medicare tax ($184,700 × 0.029)  
5,356  
Total  
$19,864  
FICA and FUTA Taxes on $120,000 Wages  
Employer share of social security tax on $117,000 wage base  
($117,000 × 0.062)  
$7,254  
Employee share of social security tax on $117,000 wage base  
($117,000 × 0.062)  
7,254  
Employer share of Medicare tax on $120,000 wages  
($120,000 × 0.0145)  
1,740  
Employee share of Medicare tax on $120,000 wages  
($120,000 × 0.0145)  
1,740  
FUTA tax ($7,000 × 0.054)  
378  
Total  
(18,366)  
Difference  
$ 1,498 |
<p>| 57 | Figure 2.17. Replace “30,000” on lines 24 and 30 with “120,000.” |
| 75 | Second column, Income from Self-Rentals, second paragraph, first line. Delete “or loss.” |
| 203 | Answer 3. Replace the answer with, “As shown in Figure 6.14, Jack reports the $160 amortization on line 42 of Form 4562. Figure 6.15 shows the support schedule for that line. Jack reports the $5,000 deduction and the $160 amortization as Other Expenses in Part V of Schedule C (Form 1040) shown in Figure 6.13.” |</p>
<table>
<thead>
<tr>
<th>Page</th>
<th>Correction</th>
</tr>
</thead>
<tbody>
<tr>
<td>323</td>
<td>Second column, first full paragraph, first line. Replace “applied the 2011 temporary” with “choose to apply the 2014 final.”</td>
</tr>
<tr>
<td>370</td>
<td>Second column, Value at Time of Settlement, second paragraph, third line. Replace “$782,750 ($2,348,250 ÷ 3)” with “$762,750 ($2,288,250 ÷ 3).”</td>
</tr>
<tr>
<td>443</td>
<td>Figure 14.4, lines 12 and 14. Replace “278.09” with “278.59.”</td>
</tr>
<tr>
<td>448</td>
<td>Example 14.10. Second paragraph, fourth line from the end. Replace “$5,000” with “$6,000.”</td>
</tr>
<tr>
<td>558</td>
<td>Second column. Delete the second sentence. Several rulings and cases are repeated in the chapter.</td>
</tr>
<tr>
<td>603</td>
<td>Kamieneski v. Commissioner. Statutory references should be “I.R.C. §§ 61, 64, and 1222.”</td>
</tr>
</tbody>
</table>