

2008 National Income Tax Workbook™ Update

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RULINGS AND CASES



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AGRICULTURAL ISSUES

Notice 2008-86

I.R.C. § 1033

The IRS issued a list of counties that had exceptional, extreme, or severe drought during the 12-month period ending August 31, 2008. The period for replacing livestock sold because of drought is extended at least until the end of 2009 for these counties.

Background

I.R.C. § 1033(a) generally provides for nonrecognition of gain when property is involuntarily converted and replaced timely with property that is similar or related in service or use. I.R.C. § 1033(e)(1) provides that a sale or exchange of livestock (other than poultry) held for draft, breeding, or dairy purposes is treated as an involuntary conversion if the livestock is sold or exchanged solely on account of drought, flood, or other weather-related conditions, and the sale is in excess of the number that would be sold following the taxpayer's usual business practices.

I.R.C. § 1033(a)(2)(A) generally provides that gain from an involuntary conversion is recognized only to the extent the amount realized exceeds the cost of replacement property purchased during the replacement period. If the weather-related conditions causing the involuntary conversion of livestock result in the area being designated as eligible for assistance by the federal government, I.R.C. § 1033(e)(2)(A) provides that the replacement period ends 4 years after the close of the first tax year in which any part of the gain from the conversion is realized. However, I.R.C. § 1033(e)(2)(B) allows the IRS to extend this replacement period on a regional basis if the weather-related conditions that resulted in the area being designated as eligible for assistance by the federal government continue for more than 3 years.

If a sale or exchange of livestock is treated as an involuntary conversion on account of **drought**, Notice 2006-82 extends the replacement period under I.R.C. § 1033(e)(2)(B) until the end of the taxpayer's first tax year ending after the first drought-free year for the applicable region. For this purpose, the first drought-free year for the applicable region is the first 12-month period that ends on August 31 in or after the last year of the taxpayer's 4-year replacement period determined under I.R.C. § 1033(e)(2)(A). The 12-month drought-free period cannot include any weekly period for which exceptional, extreme, or severe drought is reported for any location in the *applicable region*. The applicable region is the county that experienced the drought conditions on account of which the livestock was sold or exchanged and all counties that are contiguous to that county.

Extension for 2009

The Appendix to Notice 2008-36 lists the counties for which exceptional, extreme, or severe drought was reported during the 12-month period ending August 31, 2008. Under Notice 2006-82, the 12-month period ending on August 31, 2008, is not a drought-free year for an applicable region that includes any county on this list.

Accordingly, the replacement period for a taxpayer whose 4-year replacement period was scheduled to expire at the end of 2008 (or, in the case of a fiscal year taxpayer, at the end of the tax year that includes August 31, 2008) is extended under I.R.C. § 1033(e)(2), and Notice 2006-82 if the applicable region includes any county on this list. This extension will continue until the end of the taxpayer's first tax year ending after a drought-free year for the applicable region.

[Notice 2008-86, 2008-42 IRB 925]

AUTOMOBILES

Rev. Proc. 2009-12

I.R.C. § 61

☞ The IRS provides the 2009 maximum vehicle values for using two special valuation rules to determine the value of personal use of an employer-provided vehicle.

The cents-per-mile special valuation rule and the fleet-average special valuation rule can be used by an employer to value an employee's personal use of an employer-provided vehicle only if the vehicles satisfy dollar limitations that are adjusted annually by reference to the Consumer Price Index.

1. If the cents-per-mile rule provided in Treas. Reg. § 1.61(e) is used, the maximum value of vehicles first made available to employees for personal use in calendar year 2009 cannot exceed \$15,000 for a passenger automobile and \$15,200 for a truck or van.
2. If the fleet-average rule provided in Treas. Reg. § 1.61(d) is used, the maximum value of vehicles first made available to employees for personal use in calendar year 2009 cannot exceed \$19,900 for a passenger automobile and \$19,900 for a truck or van.

[Rev. Proc. 2009-12, 2009-3 I.R.B. 321]

BUSINESS ENTITIES

Limited Liability Companies

Kandi v. United States

I.R.C. §§ 6330, 7701, and 7805

☞ The sole owner of a limited liability company (LLC) that is taxed as a disregarded entity is liable for the LLC's unpaid employment taxes.

Facts

The taxpayer was the sole owner of an LLC during the first 2 quarters of 2001. The LLC failed to pay more than \$216,000 of employment tax during those 2 quarters. The IRS determined that the taxpayer was personally liable for the LLC's employment taxes because he had not elected to have the LLC taxed as a corporation.

The taxpayer moved for redetermination of his tax liability in the U.S. District Court for the Western District of Washington, and the court granted the IRS's motion for summary judgment.

On appeal, the taxpayer challenged the validity of Treas. Reg. §§ 301.7701-1, 301.7701-2, and 301.7701-3.

Analysis

I.R.C. § 7805(a) grants authority to the Treasury Department to "prescribe all needful rules and regulations for the enforcement of this title." The regulations the taxpayer challenges provide for

the taxation of certain business entities, including LLCs. The taxpayer concedes that Congress has not clearly addressed how LLCs should be taxed. Where Congress has not directly addressed the question at issue, courts defer to an agency's interpretation of the statute if it is reasonable. [*Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 844 (1984)].

The court concluded that the agency's interpretation of the Internal Revenue Code was reasonable. The I.R.C. defines person, partnership, and corporation, but it does not state whether an LLC fits under any of these definitions (I.R.C. § 7701). The regulations at issue were a reasonable attempt by the Treasury Department to fill in gaps left in the statute regarding the taxation of LLCs and other new forms of business entities. See *McNamee v. Dept. of Treasury*, 488 F.3d 100, 109 (2d Cir., 2007) and *Littriello v. United States*, 484 F.3d 372, 378 (6th Cir., 2007).

Holding

Because the agency's attempt to fill in gaps in the Internal Revenue Code was reasonable, the court affirmed the district court's decision granting summary judgment to the IRS.

[*Kandi v. United States*, 102 A.F.T.R. 2d 2008-6373 (9th Cir., 2008)]



Practitioner Note

New Regulations

While the *Kandi* case was being decided, the IRS issued new regulations (T.D. 9356, 2007-39 I.R.B. 675) regarding employment taxes for single-member LLCs that are effective beginning January 1, 2009. The court in the *Kandi* case specifically noted that the agency's decision to adopt this alternative approach does not mean that the regulations challenged in that case are incompatible with the statute. Either approach is permissible under the statute because the statute is silent on how LLCs should be taxed.

The new regulations treat a disregarded entity as a corporation for purposes of employment taxes and collection of income tax [Treas. Reg. § 301.7701-2(c)(2)(iv)]. Consequently, a single-member LLC that has employees is separately liable for income tax withholding, FICA taxes, and FUTA taxes on the wages paid to those employees. The LLC must file under its own name and employer identification number (EIN) the applicable forms in the 94X series (for example, Form 941, Employer's Quarterly Employment Tax Return, and Form 940, Employer's Annual Federal Unemployment Tax Return) and make timely employment tax deposits. It must also file Forms W-2, Wage and Tax Statement, with the Social Security Administration and furnish copies of the Forms W-2 to its employees.

Because the new regulations treat a disregarded entity as a corporation for purposes of employment taxes, the owner of a single-member LLC is apparently not personally liable (i.e., treated as a sole proprietor) for employment taxes owed by the LLC beginning January 1, 2009. However, the IRS may assert the I.R.C. § 6672 trust fund recovery penalty against responsible persons when their companies have failed to pay the taxes.

Form 720 Instructions

I.R.C. §§ 1361 and 7701

The Form 720 instructions remind taxpayers that certain disregarded entities for income tax purposes are treated as separate entities for excise tax purposes.

Qualified subchapter S subsidiaries (QSubs) and eligible single-owner disregarded entities (such as single-member LLCs) are treated as separate entities for excise tax and reporting purposes. QSubs and eligible single-owner disregarded entities must

pay and report excise taxes [other than IRS Nos. 31 (obligations not in registered form); 51 (alcohol sold as but not used as fuel); and 117 (biodiesel sold as but not used as fuel)], register for excise tax activities, and claim any refunds, credits, and payments under the entity's EIN. These actions cannot take place under the owner's taxpayer identification number (TIN), effective for periods beginning on or after January 1, 2008.

Generally, QSubs and eligible single-owner disregarded entities will continue to be treated as disregarded entities for federal tax purposes other than excise and employment taxes.

[Form 720 Instructions (Revised October 2008)]

S Corporations

Nathel v. Commissioner

I.R.C. §§ 1366 and 1367

Capital contributions to two S corporations increased the shareholders' tax basis in their stock in the corporations, rather than restoring their basis in loans they had made to the corporations. Subsequent loan repayments from the corporations thus resulted in additional ordinary income.

Facts

Three S corporations owned by two brothers (each a 25% shareholder) and a third party (a 50% shareholder) operated food distribution businesses in New York, California, and Florida. In a 2001 reorganization, the brothers acquired 100% of one corporation, the third party acquired 100% of the second corporation, and the third corporation was dissolved.

As part of the reorganization, the brothers contributed \$1,437,248 to the second and third S corporations and were released of their obligations for those corporations' debts. As a result of losses realized in prior years, each of the brothers had a zero basis in stock and a \$116,150 basis in open account loans to those two corporations as of January 1, 2001. During the 2001 tax year, they received \$1,622,050 in loan repayments from the two corporations. They received no payments in return for the redemption or liquidation of their stock in the two corporations.

The brothers' contributions were treated as capital contributions in the two corporations' books and records, but in preparing their own returns the brothers treated the contribu-

tions as income to the corporations under I.R.C. § 1366(a)(1), albeit excluded from gross income under I.R.C. § 118, and thus as restoring loan basis under I.R.C. § 1367(b)(2)(B). They then used the restored loan basis to offset the otherwise reportable ordinary income arising from their receipt of the \$1,622,050 loan repayments.

On audit, the IRS determined that the capital contributions increased their stock basis in the S corporations, rather than restoring debt basis, resulting in ordinary income from the loan repayments. The brothers petitioned the Tax Court, also asking, if the IRS position were upheld, whether the \$1,074,456 of capital contributions they made to the second corporation could be deducted as ordinary losses under I.R.C. § 165(c)(1) or (2).

Analysis

Generally, an S corporation shareholder has a beginning tax basis in stock equal to the amount of the shareholder's contributions to the corporation's capital, and the capital contributions are not included in the S corporation's income. An S corporation shareholder also has a beginning tax basis in loans the shareholder makes to the S corporation equal to the amount of the loan. The shareholder's tax bases in the stock and loans are adjusted to reflect the shareholder's share of income, losses, deductions, and credits of the S corporation.

If the stock basis is reduced to zero by S corporation losses, any further share of the S corporation's losses decreases (but not below zero) the shareholder's basis in outstanding loans. Thus, the tax basis in shareholder loans may be lower than their face amount because of downward adjustments caused by losses of the S corporation that are passed through to the shareholder. Any net income from the S corporation is applied first to restore or increase the shareholder's basis in loans (to the extent the loan basis was reduced in prior years) and is then applied to increase the basis in stock.

The basis adjustments affect the amount of gain or loss realized by a shareholder on a subsequent sale, redemption, or liquidation of the shareholder's stock in the S corporation, as well as the amount of ordinary income realized through the S corporation's repayments of loans made by the shareholder.

In support of the treatment of the \$1,437,248 capital contributions as income to the two corporations, the taxpayers cited *Gitlitz v. Commissioner*, 531 U.S. 206 (2001), in which the Supreme Court held that income received by an insolvent S corporation from discharge of indebtedness, excluded from gross income under I.R.C. § 108(a), is to be treated as an item of income to the corporation for purposes of I.R.C. § 1366(a)(1). They argued that the *Gitlitz* holding should also apply to other items of income that are specifically excluded from gross income of an S corporation, such as I.R.C. § 118.

The Tax Court declared that treating the capital contributions as income to the corporations would undermine the following three cardinal and long-standing principles of tax law:

1. That contributions to the capital of a corporation increase the basis of the shareholder's stock in the corporation;
2. That equity (a shareholder's contribution to the capital of a corporation) and debt (a shareholder's loan to the corporation) are distinguishable and are treated differently by both the Internal Revenue Code and the courts; and
3. That contributions to the capital of a corporation do not constitute income to the corporation.

The brothers alternatively contended that their capital contributions to the second corporation were made exclusively to obtain a release of their personal guarantees of the corporation's bank loans and thus should be deductible as ordinary losses under I.R.C. § 165(c). I.R.C. § 165(c)(1) provides that a taxpayer may deduct losses incurred in a trade or business, and I.R.C. § 165(c)(2) provides that a taxpayer may deduct losses incurred in a transaction entered into for profit.

The brothers stipulated that they were not in the trade or business of providing loan guarantees, that they did not receive any compensation for guaranteeing the bank loans, and that they received no salary or wages from that corporation.

Holding

The Tax Court concluded that shareholder capital contributions are not to be treated as items of income to an S corporation and are not to be treated as items of income for restoring or increasing basis in loans made by a shareholder

to an S corporation. It also found that there was no credible evidence that the shareholders guaranteed the bank loans for the purpose of making a profit, so that they were not entitled to an ordinary loss deduction under I.R.C. § 165(c) relating to their capital contributions.

[*Nathel v. Commissioner*, 131 T.C. No. 17 (2008)]

T.D. 9428

I.R.C. § 1367

Final regulations relating to the definition of open account debt between S corporations and their shareholder, and adjustments to the shareholder's basis in any loans to an S corporation, became effective October 20, 2008. The proposed regulations generally were retained.

Background

Treas. Reg. § 1.1367-2 provides specific rules for required adjustments (reductions and restorations) to basis in any indebtedness of an S corporation to a shareholder. It also provides that shareholder advances that are not evidenced by separate written instruments and repayments on the advances (open account debt) are treated as a single indebtedness. All advances to an S corporation by a shareholder are subject to the general tax principles for debt, whether evidenced by a written instrument or not.

In *Brooks v. Commissioner*, T.C. Memo 2005-204, the Tax Court held "that the basis of the open account indebtedness is properly computed by netting at the close of the year advances of open account debt during the year and repayments of open account debt during the year." This allowed the taxpayer in *Brooks* to indefinitely defer the recognition of income on any repayment of open account debt over the several years during which the taxpayer and the S corporation made advances and repayments, respectively.

On April 12, 2007, the Treasury Department and the IRS proposed amendments to the regulations relating to the treatment of open account debt between S corporations and their shareholders. After consideration of comments, the final regulations generally retain the provisions of the proposed regulations, with a few modifications.

Explanation of Revisions

The proposed regulations defined *open account debt* as shareholder advances not evidenced by

separate written instruments for which the principal amount of the aggregate advances (net of repayments on advances) did not exceed \$10,000 per shareholder at the close of any day during the S corporation's tax year. Shareholders were required to determine whether advances and repayments on the advances exceeded the \$10,000 aggregate principal threshold on any day during the S corporation's tax year.

Commentators suggested that the aggregate principal threshold of \$10,000 was too low for most businesses. After considering the comments, the Treasury Department and the IRS concluded that the aggregate principal threshold dollar amount for open account debt should be increased to \$25,000. Thus, an S corporation with 10 shareholders could receive up to \$250,000 of open account debt as long as no single shareholder advanced more than \$25,000. If a shareholder's aggregate principal balance exceeds the \$25,000 aggregate principal threshold amount as of the applicable determination date, those advances will no longer constitute open account debt, but instead will be treated as debt evidenced by a separate written instrument subject to the basis adjustment and repayment accounting rules applicable to S corporation shareholder debt generally.

Despite the \$25,000 threshold amount for open account debt in these final regulations, the provisions under I.R.C. § 7872 and related regulations for corporate-shareholder loans in excess of \$10,000 separately apply to open account debt in excess of \$10,000 for each advance if the corporation is not obligated to pay a market rate of interest on the advances.

The proposed regulations effectively required day-to-day monitoring of open account debt, so that the shareholder was required to maintain a daily running balance of shareholder advances and repayments on such advances, and the outstanding principal amount of the open account debt. Some commentators suggested that the daily monitoring requirement would impose an unreasonable burden on shareholders and recommended that the running balance requirement be tested quarterly, annually, or when the corporation maintains and updates its other books and records. After careful consideration of these comments, the Treasury Department and the IRS have concluded that extending the period for which a shareholder determines whether share-

holder advances and repayments exceed the aggregate principal threshold dollar amount for open account debt would reduce both the complexity of the regulations and any perceived burden on shareholders in making such determinations.

Therefore, the final regulations provide that a determination of whether the threshold balance of \$25,000 is exceeded generally will be made at the end of the S corporation's tax year. If open account debt is disposed of in whole or in part before the end of the S corporation's tax year, the

determination of whether the advances and repayments have exceeded the designated aggregate principal threshold amount must be made immediately before the disposition of the debt. Moreover, if a shareholder with open account debt is no longer a shareholder at the end of the S corporation's tax year, the determination must be made immediately before the shareholder's interest in the S corporation is terminated.

[T.D. 9428, 2008-47 I.R.B. 1174]

BUSINESS ISSUES

Deductions

Wellpoint, Inc., f.k.a. Anthem, Inc., v. Commissioner

I.R.C. §§ 162 and 263

Under the *origin of the claim doctrine*, settlement payments made to three states by the Indiana parent corporation of Blue Cross/Blue Shield subsidiaries were capital expenditures and therefore not deductible as business expenses.

Facts

Anthem merged with Kentucky, Ohio, and Connecticut Blue Cross/Blue Shield (BCBS) plans between 1993 and 1997. The attorneys general of the states, looking into the corporate and legal history of the subsidiaries, brought *cy-pres* (charitable trust) actions, each claiming that the state's BCBS entity had a charitable purpose, had received beneficial treatment under state and federal law, and held assets impressed with a charitable trust. They asserted that the charitable purposes were no longer being met and that the accumulated charitable assets should be taken from Anthem's control and redirected to similar charitable purposes.

Anthem paid \$113,837,500 in 1999 to resolve pending and potential claims in the three lawsuits, and the funds were used to establish a charitable organization in each state to serve its citizens' health needs. Anthem then deducted the \$113,837,500 settlement amount in 1999 and deducted \$819,201 in 1999 and \$8,394 in 2000 for legal and professional fees incurred in connec-

tion with the lawsuits. The IRS disallowed the deductions and Anthem filed a Tax Court petition. The parties agreed that the *origin of the claim* doctrine controls the outcome.

Analysis

The *origin of the claim* test looks at the substance of the transaction from which a payment arose to determine whether it is a deductible expense or a capital expenditure, regardless of the motives of the payor or the consequences that may result. It requires consideration of all facts related to the litigation, including the purpose for which the amounts claimed as deductions were expended. The predominant claim in each of the lawsuits was a *cy-pres* claim, which authorizes a state attorney general to initiate a proceeding when the particular charitable purpose for which property has been dedicated in trust is not being carried out. The goal is to carry out the charitable purpose in a way that is as near as possible to the original purpose.

A deduction is generally allowed for expenses incurred in defending a business and its policies from attack. Settlement payments and legal fees expended to resolve disputes over ownership of assets may be capital expenses. The costs incurred in litigating title to property are capital expenditures. Defending or perfecting title to property encompasses not only disputes over legal title but also disputes over beneficial interests of trusts, including contests over whether a trust exists.

Anthem denies the existence of a charitable trust obligation and asserts that it settled only to avoid interruption of business or loss of good will.

The record shows that none of the lawsuits was brought to enjoin or change Anthem's business practices. No prayer for relief demanded a change in business behavior, and none of the testimony of the attorneys who worked on these cases for the Kentucky, Ohio, and Connecticut attorneys general suggested that they sought to change Anthem's business practices or shut them down.

In each case, the origin of the claim was a dispute over the equitable ownership of assets allegedly impressed with charitable trust obligations. In each case, the settlement provided that the assets Anthem relinquished were transferred to an I.R.C. § 501(c)(3) organization with the same charitable purpose that the attorneys general claimed the charitable trust assets benefited.

Legal and professional expenses, such as settlement payments, are analyzed under the origin of the claim doctrine. Moreover, legal expenses incurred in defending against claims challenging a taxpayer's ownership of assets may be capital expenditures. Anthem's legal and professional fees arose from defending against claims that had their origin in equitable ownership of assets.

Holding

The settlement payments and litigation and professional fees are capital expenditures that are not deductible under I.R.C. § 162(a).

[*Wellpoint, Inc., f.k.a. Anthem, Inc., v. Commissioner*, T.C. Memo. 2008-236]

Ruiz v. Commissioner

I.R.C. §§ 162 and 274

☞ A high school softball coach could not deduct expenses incurred in providing food for the players after tournaments because the expenses were not ordinary and necessary. His mileage deduction for driving players home after games was limited because the mileage was not properly substantiated. Donations of equipment and uniforms were deductible as business expenses.

Facts

During 2005, the taxpayer was a high school mathematics teacher who coached the girls' softball team as part of his official school duties. The school system provided \$1,500 for the softball program, which did not cover all of its expenses. The students were financially unable to purchase uniforms and equipment. The coach used the \$1,500 to purchase safety items such as the

catcher's equipment and batting helmets, and he and other staff members personally purchased and donated other equipment and uniform items for the team.

Items donated to the team by the coach included uniforms (\$1,083.37), and balls, bats, practice tees, and related softball equipment (\$1,092.78). In addition, he pitched in with other staff members and parents to purchase food for the team after all-day tournaments. During 2005 he paid \$1,643.40 for food and related items for the team members after games.

The coach claimed \$8,115 for business automobile mileage, maintaining a log reflecting the total miles for each month of 2005 along with a breakdown of the distances and the places to which he drove. The mileage included driving his automobile to games when the school bus was not available and transporting team members from the game sites to their homes, which was necessary because it was late in the evening and safety issues dictated that the team members be accompanied home.

None of these expenditures was reimbursed by the school district.

Analysis

Taxpayers are required to maintain records sufficient to permit the verification of income and expenses. As a general rule, if the trial record provides sufficient evidence that the taxpayer has incurred a deductible expense, but the taxpayer is unable to fully substantiate the precise amount of the deduction, the court may estimate the amount of the deductible expense and allow a deduction to that extent [*Cohan v. Commissioner*, 39 F.2d 540 (2d Cir., 1930)]. Such estimates are to be made bearing heavily against the taxpayer whose inexactitude in substantiating the amount of the expense is of his own making.

The high school system provided a limited budget for the athletic program that was insufficient to minimally operate the program. The taxpayer purchased supplies and athletic equipment that were used in the program, and when he left his teaching and coaching position at that school, he left all of the unused equipment and supplies. His purchases of these items were sufficiently substantiated.

The substantiation of the use of listed property, such as an automobile, is subject to more rigorous requirements and is not allowable without adequate records [I.R.C. §§ 274(d)(4)

and 280F(d)(4)(A)(i)]. Because the games and events were repetitive, the taxpayer was able to show the round trip mileage to each location, then account for the trips to each location on a month-by-month basis. His methodology with respect to the mileage for driving team members' home was less exact, making it difficult to ascertain the correctness of the mileage claimed.

Holding

The taxpayer sufficiently substantiated the purchase of the uniform and equipment items for the softball program. He was not reimbursed for any of these items, and they were necessary to the basic operation of the program. Accordingly, he is entitled to claim, subject to the 2%-of adjusted-gross-income threshold, an employee business expense itemized deduction for those costs.

Although he substantiated the food expenditures, the court determined that holding banquets after games was not necessary to the operation of the softball program. The court complimented the coach's generosity but held that the expenditures were not ordinary and necessary expenses within the meaning of I.R.C. § 162.

The taxpayer's mileage log reflected more than 17,000 miles for 2005. Almost 13,000 of the miles claimed were connected with the daily transportation of team members to their homes. The court held that his substantiation was sufficient to permit the allowance of 4,500 miles as ordinary and necessary business miles.


[*Ruiz v. Commissioner*, T.C. Summary Opinion 2009-1]

Employees

University of Chicago Hospitals v.

United States

I.R.C. § 3401

 A case-by-case analysis is required to determine whether the student exception to FICA taxes applies to medical residents.

Facts

University of Chicago Hospitals (UCH) is a not-for-profit corporation affiliated with the University of Chicago. UCH administers graduate medical education programs for residents in various specialties. Residents are generally recent graduates of medical schools who perform services at

hospitals as the last step in their medical training for the purpose of gaining expertise in patient care and in their chosen specialty. A standard residency lasts 3 to 7 years, depending upon the specialty. Most teaching hospitals require their residents to take classes in the form of lectures and demonstrations and to submit to regular evaluations by senior doctors.

UCH filed timely requests for refunds of the FICA taxes it had paid on behalf of its medical residents for the years 1995 and 1996, citing the student exception under I.R.C. § 3121(b)(10). The IRS took no action and UCH filed a refund action in U.S. District Court. The court rejected the government's argument that residents were *per se* precluded from qualifying as students under I.R.C. § 3121(b)(10), and the IRS appealed.

Issue

Whether UCH's medical residents are students under I.R.C. § 3121(b)(10)

Analysis

I.R.C. § 3121(b)(10) provides in part that employment for FICA tax purposes does not include service performed in the employment of a school (including a college, or university) or of an organization that is controlled by the school and that is organized and operated exclusively to carry out the purposes of the school, if the service is performed by a student who is enrolled and regularly attending classes at the school.

The IRS argued that medical residents are not students because they already have earned their medical school degrees and have entered a post-medical school residency program at a hospital. The IRS maintained that a hospital is not a school, college, or university in the common sense of those words. Further, the IRS argued that when Congress repealed the intern exception from the FICA tax in 1965, it intended to make both interns and medical residents ineligible for the student exception.

The Eleventh Circuit Court of Appeals previously held in *Mount Sinai Medical Center*, 486 F.3d 1248 (2008), that the student exception is not *per se* inapplicable to medical residents as a matter of law and that a case-by-case analysis is required to determine whether medical residents qualify for the statutory exemption from FICA taxation.

Holding

The Seventh Circuit Court of Appeals agreed with the Eleventh Circuit Court's conclusion, and it affirmed the district court's holding that UCH's medical residents are students under I.R.C. § 3121(b)(10) and, therefore, exempt from FICA tax.

[*University of Chicago Hospitals v. United States*, 545 F.3d 564 (7th Cir., 2008)]



Practitioner Note

Facts Must Be Determined

In a similar case in Massachusetts, *United States v. Partners Healthcare System, Inc.*, 2008-2 U.S.T.C. ¶150,619 (CCH) and 102 A.F.T.R.2d 6886 (RIA), the U.S. District Court declined to issue summary judgment on whether wages paid to medical residents qualified for the I.R.C. § 3121(b)(10) student exception to FICA taxes. The court concluded that whether the residents were students was a matter of fact to be resolved in a trial.

McWhorter v. Commissioner

I.R.C. §§1401, 1402, 6651, and 6654

☞ A project manager treated as an independent contractor by the IRS is held by the Tax Court to be an employee.

Facts

The taxpayer was hired as a project manager by an energy company because of his expert knowledge of power plants and industrial piping. He worked for the company on a project-by-project basis for a 4-year period. He supervised personnel hired by the company and its clients, but he did not have hiring or firing authority. He held a credit card in the name of the energy company and a business card with the company logo on it. He invoiced the company per project, billing \$500 a day. No time sheets were provided. The company issued a Form 1099-MISC, Miscellaneous Income, to him for each of the 4 years 2001-2004. No taxes were withheld.

The taxpayer did not file an income tax return or pay estimated taxes for 2002, although his Form 1099 reported \$126,760 as non-employee compensation. The IRS prepared a substitute for return under I.R.C. § 6020(b). The notice of deficiency included a liability for self-

employment tax on the income he received from the energy company.

Issue

Whether the taxpayer was an independent contractor or an employee

Analysis

The taxpayer argued that he was an employee of the energy company and not an independent contractor. The IRS argued that the taxpayer met the definition of an independent contractor set out in *Breaux & Daigle, Inc. v. United States*, 900 F.2d 49 (5th Cir., 1990), which cited the following factors:

1. Degree of control
2. Opportunities for profit or loss
3. Investment in facilities
4. Permanency of relationship
5. Skill required in the operation in question.

The IRS claimed that the degree of control by the energy company, the lack of permanency in the relationship, and the skill required in the taxpayer's work supported their contention that he was an independent contractor. The IRS conceded that there were factors supporting the taxpayer's contention that he was an employee, such as his lack of opportunity for profit or loss, and lack of investment in facilities. Because of the close case, the IRS argued that weight should be given to the understanding between the parties, and that the taxpayer had acquiesced to his status as an independent contractor by continuing to work for a number of years under this arrangement.

The Tax Court was not persuaded that either the degree of control exercised by the company or the amount of skill possessed by the taxpayer distinguished his situation from that of a supervisory employee. The court also did not view a job that continued for 4 years as impermanent.

Holding

The taxpayer was an employee rather than an independent contractor, and his income from services provided was not subject to self-employment tax.

[*McWhorter v. Commissioner*, T.C. Memo 2008-263]

Notice 2008-74

I.R.C. § 132

☞ The effective date of guidance on using electronic cards to provide qualified transportation fringes is delayed for another year.

This notice delays the effective date of Rev. Rul. 2006-57, 2006-2 C.B. 911, which provides guidance to employers on the use of smartcards, debit or credit cards, or other electronic media to provide qualified transportation fringes under I.R.C. § 132(a)(5) and 132(f). The ruling's effective date was originally set for January 1, 2008, but it had been delayed until January 1, 2009, because certain transit systems needed additional time to modify their technology and make it compatible with the ruling's requirements for vouchers.

Because certain transit systems continue to experience technology barriers, this notice delays the effective date again until January 1, 2010. However, employers and employees may rely on the ruling for transactions occurring prior to January 1, 2010.

[Notice 2008-74, 2008-38 I.R.B. 718]

T.D. 9440

I.R.C. §§ 6011 and 6302

☞ New regulations change the requirement for filing an annual employment tax return to a voluntary election by qualifying employers, and they explain the changed de minimis deposit rule for employers filing quarterly returns.

Temporary and final regulations make filing an annual Form 944, Employer's Annual Federal Tax Return, an option for qualifying employers, so that they may choose to file a quarterly Form 941, Employer's Quarterly Federal Tax Return, instead, beginning in tax year 2010. The employment tax liability reported on Forms 941 and 944 includes social security, Medicare, and withheld federal income taxes. Prior regulations made use of the annual Form 944 mandatory for qualifying employers (those with an estimated annual employment tax liability of \$1,000 or less).

Deposits of taxes reported on Form 941 are generally due monthly or semiweekly. If an employer fails to make timely deposits of employment taxes, absent reasonable cause, the employer is subject to an I.R.C. § 6656 penalty for failure to deposit. The frequency of required deposits gener-

ally is based on the employer's liabilities in a prior year lookback period.

The regulations will continue to permit most employers who file Form 944 to pay accumulated employment taxes annually when they file their returns, applying a modified lookback period and de minimis deposit rule for these employers. For Form 941 filers, the lookback period for determining whether the employer is a monthly or semiweekly depositor is the 12-month period ending on June 30 of the prior year. However, if Form 944 was filed in either of the two prior years, the lookback period is the second preceding calendar year.

For example, if an employer filed Form 944 in 2006 but not in 2007, the lookback period for 2008 is calendar year 2006. Because the employer did not file quarterly returns for July through December 2006, it is impossible for the employer to use the July 2006-June 2007 lookback period for 2008 that otherwise is used for quarterly filers.

In addition, the regulations provide an additional method for employers who file Form 941 to determine whether the amount of accumulated employment taxes is considered de minimis, for deposit periods beginning after 2009. Treas. Reg. § 31.6302-1(f)(4) currently provides that if the aggregate amount of employment taxes for a return period is less than \$2,500 and that amount is deposited or paid with a timely filed return, the amount is deemed to have been timely deposited and the employer is not subject to the penalty for failure to deposit. For deposit periods beginning on or after January 1, 2010, employers may pay their employment taxes when they timely file their quarterly returns if the amount of the taxes due for the current quarter or the prior quarter is less than \$2,500.

[T.D. 9440, 73 FR 79354 (December 29, 2008)]

Rev. Proc. 2009-13

I.R.C. § 6011

☞ Guidance is provided on electing the annual filing option for employment taxes for 2009.

Employers who previously received notification of their qualification to file Form 944, Employer's Annual Federal Tax Return, must continue to file Form 944 unless they opt out.

Eligible employers who have not been notified of their qualification to file the annual return

may request the notification by calling the IRS at 1-800-829-4933 on or before the first day of the month that their first required Form 941 is due (i.e., on or before April 1, 2009, July 1, 2009, October 1, 2009, or January 1, 2010).

For 2009, an eligible employer may opt out of filing the annual return if it timely notifies the IRS that it satisfies one of the following conditions:

1. It anticipates that its employment tax liability for the tax year will be more than \$1,000.
2. It wants to file quarterly Forms 941 electronically for the tax year.

A new employer must call the IRS at 1-800-829-4933 on or before the first day of the month that their first required Form 941 is due, or send written correspondence postmarked on or before the 15th day of the month preceding the month the first required Form 941 is due (i.e., correspondence postmarked on or before March 15, 2009, June 15, 2009, September 15, 2009, or December 15, 2009).

Employers who previously filed a Form 941 or Form 944 who want to opt out must call the IRS on or before April 1, 2009, and written correspondence must be post-marked on or before March 15, 2009.

[Rev. Proc. 2009-13, 2009-3 I.R.B. 323]

Like-Kind Exchange

P.L.R. 2008-42-019

I.R.C. § 1031

Leasehold interests in office space are like-kind property. Grade or quality of the space is not a relevant factor.

Facts

The taxpayer leases its principal office space in a building owned by Corporation A, a wholly-owned subsidiary of Corporation B. Both the taxpayer and Corporation B need more office space. Corporation B wants to move into the space currently occupied by the taxpayer, and the taxpayer is negotiating to lease space in a building being constructed. The taxpayer's new landlord will also construct and install leasehold improvements and office equipment to be used by the taxpayer in the new space. Corporation B and the new landlord agreed to cooperate in structuring the exchange through a qualified intermediary.

Issues

1. Whether the new and old leasehold interests are like-kind and whether the new and old office equipment are like-kind
2. Whether build-to-suit construction affects the application of I.R.C. § 1031
3. How the basis of the replacement property is determined
4. How gain is determined upon the receipt of boot

Analysis

The words *like kind* refer to the nature or character of the property and not to its grade or quality [Treas. Reg. § 1.1031(a)-1(b)]. A leasehold interest in an office building at one location, with permanent improvements to the leased space within that building, is of like kind to a leasehold interest in an office building at a different location that includes permanent improvements to the leased space within that building. If the two leased locations vary in value or desirability or in lease terms, those factors relate only to the grade or quality of the properties exchanged and not to their kind or class.

Conclusions

1. The leasehold interest in the old office is like kind to the replacement leasehold interest in the new office, and the office equipment at the old office is like kind to the office equipment at the new office.
2. The exchange will not fail to qualify for non-recognition of gain or loss under I.R.C. § 1031 merely because the owner of the replacement property is constructing improvements to the replacement property at the time such property is identified as replacement property.
3. The basis of the acquired property is the same as that of the property exchanged, decreased in the amount of any money received by the taxpayer, and either increased in the amount of gain or decreased in the amount of loss to the taxpayer that is recognized on such exchange.
4. If a taxpayer receives money or property that is not like-kind property, realized gain is recognized to the extent of the sum of the money and the fair market value of the other property received by the taxpayer.

[P.L.R. 2008-42-019 (July 15, 2008)]

FINANCIAL DISTRESS

IR-News Rel. 2008-141 I.R.C. § 6323

☞ The IRS reminded homeowners of the options available to them if a tax lien may impede or delay the refinancing or sale of a home, including a request for subordination or discharge of the lien.

An expedited IRS process will make it easier for financially distressed homeowners to avoid having a federal tax lien block refinancing of mortgages or the sale of a home. If taxpayers are planning to refinance or sell a home, and there is a federal tax lien on the home, the taxpayer or his or her representative may request that the IRS make the tax lien secondary to a lien placed by the lending institution that is refinancing or restructuring a loan. If the home is being sold for less than the amount of the existing mortgage lien, taxpayers may request that the IRS discharge its claim under certain circumstances.

Obtaining the discharge or subordination of a tax lien takes approximately 30 days after the submission of the completed application, but the IRS will work to speed those requests in the wake of the economic downturn.

There is no form to apply for a *certificate of lien subordination*, but taxpayers must follow directions in IRS Publication 784, How to Prepare an Application for a Certificate of Subordination of a Federal Tax Lien. A typed letter of request and certain documentation should be mailed to one of 40 IRS Collection Advisory Groups nationwide. IRS Publication 4235, Collection Advisory Group Addresses, contains address information.

Homeowners may apply for a *certificate of discharge of a tax lien* if they are giving up ownership of the property (such as selling the property) for an amount that is less than the mortgage lien, if the mortgage lien is senior to the tax lien. A certificate of discharge may also be obtained in other circumstances, if the taxpayer has sufficient equity in other assets, can substitute other assets, or is able to pay the IRS its equity in the property.

There is also no form to apply for a tax lien discharge, but applicants must follow directions in IRS Publication 783, Instructions on How to Apply for a Certificate of Discharge of Property From Federal Tax Lien. A typed letter of request

and certain documentation should be mailed to the appropriate Collection Advisory Group listed in IRS Publication 4235.

The IRS urges homeowners to contact the Collection Advisory Group early in the home sale or refinancing process so that it can begin work on their requests. A delay in informing the lender of the tax lien serves only to delay the transaction.

Currently, there are more than 1,000,000 federal tax liens outstanding, tied to both real and personal property. The IRS issues more than 600,000 federal tax lien notices annually. [IR-News Rel. 2008-141 (December 16, 2008)]

T.D. 9430 I.R.C. § 6050P

☞ Temporary and final regulations limit application of the 36-month rule for reporting discharges of debt to financial institutions, credit unions, and federal executive agencies.

Background

In general, I.R.C. § 6050P requires certain entities to file information returns with the IRS, reporting discharges of indebtedness of \$600 or more, and to furnish information statements to the debtors. The regulations that implement I.R.C. § 6050P include a rebuttable presumption that an applicable financial entity must file Form 1099-C, Cancellation of Debt, if the entity has not received a payment for 36 months.

As originally enacted, I.R.C. § 6050P applied solely to financial institutions, credit unions, and federal executive agencies. Subsequent legislative changes expanded the reporting requirement to cover any executive, judicial, or legislative agency, as well as any organization “a significant trade or business of which is the lending of money.”

Reason for Change

The 36-month rule of Treas. Reg. § 1.6050P-1(b)(2)(iv) was drafted at a time when I.R.C. § 6050P applied only to financial institutions, credit unions, and federal executive agencies. Since the publication of the 2004 regulations, commentators have raised a concern that the application of the 36-month rule to entities “with

a significant trade or business of lending money” might trigger a reporting requirement even when the entity has not legally or practically discharged the debt.

The IRS and the Treasury Department agree that it is appropriate to limit the application of the 36-month rule to the entities for which it was originally intended, in order to avoid premature information reporting of cancellation of indebtedness income (CODI). This will reduce the information reporting burden on entities that were not originally within the scope of the 36-month rule and will protect debtors from receiving information returns that prematurely report CODI from such entities.

Explanation of Change

The temporary regulations and amendments to existing regulations limit the application of the 36-month rule to financial institutions, credit unions, and federal executive agencies. However, if an entity that was previously subject to the 36-month rule failed to file information returns due under the 36-month rule in a tax year prior to 2008, the date of discharge of indebtedness will be the first identifiable event (if any) described in Treas. Reg. § 1.6050P-1(b)(2)(i)(A) through (G) that occurs after 2007. Thus, an entity previously subject to the 36-month rule that has not filed an information return remains subject to the information-reporting requirement upon the occurrence of any of the other identifiable events. [T.D. 9430, 2008-48 I.R.B. 1205]

INDIVIDUAL TAXPAYER ISSUES

Sklar v. Commissioner

I.R.C. §§ 170, 6115, and 6662

☞ Taxpayers were again denied a charitable contribution deduction for any portion of tuition paid to religious schools.

Facts

The taxpayers are Orthodox Jews who send their five children to private orthodox Jewish day schools. In 1993, the taxpayers learned of a confidential closing agreement the IRS had executed with the Church of Scientology that purportedly allowed deductions for certain religious educational services such as auditing and training. The taxpayers subsequently amended their tax returns for 1991 and 1992, and filed a return for 1993, claiming charitable contribution deductions for a portion of the tuition they paid to their children’s schools. The IRS allowed these deductions, apparently under the impression the taxpayers were Scientologists. The taxpayers claimed similar deductions in 1994, but these were disallowed by the IRS. The disallowance was upheld by the Tax Court, and the Ninth Circuit Court of Appeals [*Sklar v. Commissioner*, 279 F.3d 697 (9th Cir., 2002)].

On their 1995 tax return, the taxpayers claimed \$15,000 in charitable contributions that comprised a portion of their children’s tuition.

The deduction was based on their estimate that 55% of the tuition payments were for purely religious education, and the estimate was supported by letters from the schools. The IRS disallowed the deduction and also determined the taxpayers had failed to meet the substantiation requirements of I.R.C. § 170(f)(8). The Tax Court affirmed the disallowance of the deduction and the taxpayers appealed.

Arguments

The taxpayers made three assertions:

1. Tuition and fee payments made to exclusively religious schools are charitable contributions under a dual payment analysis to the extent the payments exceed the value of the secular education received.
2. I.R.C. §§ 170(f)(8) and 6115, as enacted in 1993, authorized the deduction of tuition payments for religious education made to exclusively religious schools.
3. The 1993 closing agreement between the IRS and the Church of Scientology constitutionally and administratively requires the IRS to allow other taxpayers to take the same charitable deductions for tuition payments to their religious schools.

Conclusions

1. The court held that the taxpayers failed to satisfy either prong of the two-part test for a dual payment:
 - a. They could not prove their total payments exceeded the market value of the cost of a comparable secular education offered by private schools.
 - b. They could not prove they intended to make a gift of any portion of the tuition payment.
2. The Supreme Court's decision in a 1989 Scientology case, *Hernandez v. Commissioner*, 490 U.S. 680 (1989), held that payments made in exchange for religious educational services do not qualify as charitable contributions under I.R.C. § 170. The taxpayers argued that the 1993 amendments to I.R.C. §§ 170(f)(8) and 6115, referring to *intangible religious benefits*, overruled the *Hernandez* holding. As in the 2002 case, the Ninth Circuit Court of Appeals agreed that neither the plain language of the 1993 amendments nor the accompanying legislative history indicated any substantive change to *Hernandez*.
3. The fact that the IRS allowed a deduction to Scientology members is irrelevant and does not mean the IRS is administratively or constitutionally required to allow a deduction to taxpayers whose payments are made for combined secular and religious education and who thus are not similarly situated to Scientology members.

Holding

Affirming the Tax Court, the Ninth Circuit held the taxpayers were not entitled to a charitable contribution deduction for the tuition and fees charged by their children's religious schools. [*Sklar v. Commissioner*, 549 F.3d 1252 (9th Cir., 2008) *aff'g* 125 T.C. 281 (2005)]

Magdalin v. Commissioner

I.R.C. §§ 213 and 262

✎ An unmarried father was denied a medical expense deduction for costs he incurred to father children via in vitro fertilization with surrogate mothers.

Facts

The taxpayer was a medical doctor who had fathered twin sons during a former marriage. The

twins were born through natural processes and without the use of in vitro fertilization. In 2004 and 2005, the taxpayer entered into anonymous egg donor and gestational carrier agreements that resulted in the births of two children with different mothers. None of the egg donors or the carriers was a spouse or dependent of the taxpayer.

After applying the 7.5%-of-adjusted-gross income (AGI) threshold, the taxpayer took medical expense deductions for \$34,050 and \$28,230 in payments related to these procedures on his 2004 and 2005 tax returns. The IRS disallowed the deductions.

Issue

Whether expenses incurred in fathering children through a surrogacy arrangement using in vitro fertilization with an anonymous donor's eggs and the taxpayer's sperm are deductible medical expenses

Analysis

Medical care includes amounts paid "for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body" [I.R.C. § 213(d)(1)(A)]. The taxpayer argued it was his civil right to reproduce, that he should be free to choose the method of reproduction, and that allowing women but not men to choose how they will reproduce is sex discrimination.

The Tax Court found that there was no underlying medical condition or defect and the egg donor, fertilization, and surrogacy expenses were not incurred for the purpose of affecting a structure or function of the taxpayer's body. The taxpayer had no medical condition or defect, such as infertility, that required treatment or mitigation through in vitro fertilization procedures.

Holding

The taxpayer is not entitled to medical deductions for expenses incurred in fathering children through surrogacy arrangements.

[*Magdalin v. Commissioner*, T.C. Memo 2008-293]

Pavia v. Commissioner

I.R.C. §§ 1, 2, 24, 32, 151, and 152

☞ An unmarried taxpayer qualified as head of household, and her nieces were her qualifying children during the time the nieces and their mother shared a home with the taxpayer.

Facts

During 2005, the taxpayer was single and lived with her sister and her sister's two daughters, ages 7 and 11. The taxpayer's sister was divorced from the children's father, and he did not provide any support. The expenses of the household were paid by the taxpayer, the taxpayer's sister, and public aid. The taxpayer paid the mortgage, home insurance, and half the property taxes. The taxpayer's sister did not file a tax return for 2005. The taxpayer filed a tax return for 2005 as head of household, claiming her two nieces as qualifying children for dependency exemption deductions, the child tax credit, and the earned income tax credit. The IRS disallowed all of the child-related tax benefits, including head of household status.

Issue

Whether the taxpayer is entitled to claim her nieces as qualifying children

Analysis

A dependent may be either a *qualifying child* or *qualifying relative*. A qualifying child must meet four statutory requirements:

- **Relationship** – The child is a child of the taxpayer, descendant of a child of the taxpayer, a brother, sister, stepbrother, or stepsister of the taxpayer, or a descendant of any such relative.
- **Residence** – The child has the same principal place of abode as the taxpayer for more than half of the tax year.
- **Age** – The child has not yet attained the age of 19, the child is a student who has not yet attained the age of 24, or the child is permanently and totally disabled and is any age.
- **Support** – The child has not provided more than half of the child's own support.

The nieces indisputably met the relationship, residence, and age requirements. To meet the support test, a taxpayer must establish the total cost of monetary support expended on behalf of a claimed dependent from all sources for the relevant year. The term *support* includes food, shelter,

clothing, medical and dental care, education, and the like. The taxpayer credibly established the total cost of monetary support received by her two nieces and the sources of the support.

Holdings

Because her nieces were the taxpayer's qualifying children, the taxpayer could claim the dependency exemption deduction, the child tax credit, the earned income credit, and head of household filing status.

[*Pavia v. Commissioner*, T.C. Memo 2008-270]

A.M. 2008-11

I.R.C. §§ 61 and 165

☞ The IRS chief counsel's office advises that a casual gambler's wagering gains and losses from slot machine play are netted when a casino visit ends.

Facts

A cash-basis taxpayer visited a casino and played slot machines on 10 occasions during a tax year. She purchased \$100 of tokens on each visit. On half of the visits, she terminated play when she lost all of the tokens (a total of \$500). At the end of two other visits, she redeemed tokens in the amounts of \$20 and \$70, resulting in losses totaling \$110 for those visits compared to the \$200 of tokens purchased. On the remaining three visits, she redeemed tokens for \$150, \$200, and \$300, for total gains of \$350 over the \$300 of tokens purchased. She substantiated all of her gains and losses as required by Rev. Proc. 77-29, 1977-2 C.B. 538.

Analysis

I.R.C. § 61 provides that gross income means all income from whatever source derived. Rev. Rul. 54-339, 1954-2 C.B. 89, holds that wagering gains are included in gross income. I.R.C. § 165(a) generally allows a deduction for any loss sustained during the tax year and not compensated for by insurance or otherwise, but I.R.C. § 165(d) provides that losses from wagering transactions are allowed only to the extent of the gains from such transactions.

In ordinary parlance, a *wagering gain* means the amount won in excess of the amount bet (basis). The term *wagering loss* means the amount of the wager (basis) lost. Rev. Rul. 83-103, 1983-2 C.B. 148, holds that in calculating wagering gains, the cost (or basis) of the wager is excluded so that

the wagering gain is the total winnings less the amount of the wager.

Casual gamblers may not net their gains and losses from slot machine play throughout the year and report only the net amount as income for the year [*United States v. Scholl*, 166 F.3d 964 (9th Cir., 1999)]. They must report wagering gains even though their losses over a tax year exceed their gains. That increases a casual gambler's adjusted gross income (AGI) and has a significant tax impact, because many tax benefits phase out as AGI increases.

A key question in interpreting I.R.C. § 165(d) is the significance of the term *transactions* because the statute refers to gains and losses in terms of wagering transactions. If transaction means every single play in a game of chance or every wager made, a taxpayer would have to treat every play or wager as a taxable event and would have to trace and recompute the basis through all transactions to calculate the result of each play or wager. Courts considering that reading have found it unduly burdensome and unreasonable [*Green v. Commissioner*, 66 T.C. 538 (1976) and *Szkircsak v. Commissioner*, T.C. Memo 1980-129]. Moreover, the plural term *transactions* used in the statute implies that gain or loss may be calculated over a series of separate plays or wagers.

The better view is that a casual gambler recognizes a wagering gain or loss at the time she redeems her tokens. The fluctuating wins and losses left in play are not accessions to wealth until the taxpayer redeems her tokens and can definitively calculate the amount above or below basis (the wager) realized [*Commissioner v. Glen-shaw Glass Co.*, 348 U.S. 426 (1955)].

For example, a casual gambler who enters a casino with \$100 and redeems his or her tokens for \$300 after playing the slot machines has a wagering gain of \$200 (\$300 – \$100). This is true even though the taxpayer may have had \$1,000 in winning spins and \$700 in losing spins during the course of play. Likewise, a casual gambler who enters a casino with \$100 and loses the entire amount after playing the slot machines has a wagering loss of \$100, even though the casual gambler may have had winning spins of \$1,000 and losing spins of \$1,100 during the course of play.

I.R.C. § 6041 requires gambling businesses to report payments over certain dollar amounts (*gross receipts* reporting). However, such reported payments are not necessarily taxable wagering gains. A gambling business may issue an information return for a casual gambler's winning spin, but the gambler continues to play, wagering and losing that amount during slot machine play. The gambler's wagering gain or loss is determined at the time the casual gambler redeems his or her tokens at the end of slot machine play.

Conclusion

For the year, the taxpayer had total wagering gains of \$350 (\$50 + \$100 + \$200) and total wagering losses of \$610, (\$500 from losing the entire basis of \$100 on five occasions + \$80 and \$30 from two other occasions). Her wagering losses exceeded her wagering gains for the taxable year by \$260 (\$610 – \$350). She must report the \$350 of wagering gains as gross income under I.R.C. § 61. However, under I.R.C. § 165(d), she may deduct only \$350 of the \$610 wagering losses on Schedule A (Form 1040), Itemized Deductions. A casual gambler who takes the standard deduction rather than electing to itemize may not deduct any wagering losses (Rev. Rul. 54-339, 1954-2 C.B. 89).

[A.M. 2008-011 (Dec. 5, 2008)]



Practitioner Note

Effect on Other Taxpayers
This advice memo, issued to an IRS attorney in response to a request for guidance on recurring litigation, is not a judicial precedent for other taxpayers. However, following its interpretation can be beneficial to many taxpayers. It indicates that even when a Form W-2G, Certain Gambling Winnings, is received, a taxpayer who continued wagering and subsequently lost all or part of those winnings during the same gambling event is not required to report the entire payout as other income on Form 1040, U.S. Individual Income Tax Return. Instead, the net amount of gains and losses at the end of the event is the amount to be reported by the taxpayer. Detailed record keeping as required by Rev. Proc. 77-29, *supra*, is essential.

INVESTMENT ISSUES

Notice 2008-116

I.R.C. §§ 67 and 642

☞ Interim guidance on the treatment of *bundled fiduciary fees* under I.R.C. § 67 is extended to tax years that begin before January 1, 2009.

A bundled fee is an integrated commission or fee paid by an estate or a nongrantor trust to the trustee or executor that includes investment advisory costs and other costs that generally are subject to the 2%-of-adjusted-gross-income floor (2% floor) on deductions. This notice modifies and supersedes Notice 2008-32, 2008-11 I.R.B. 593, extending its interim guidance to tax years beginning in 2008.

On January 16, 2008, in *Knight v. Commissioner*, 128 S. Ct. 782 (2008), the U.S. Supreme Court held that costs paid to an investment advisor by a nongrantor trust or estate generally are subject to the 2% floor for miscellaneous itemized deductions under I.R.C. § 67(a). The IRS and the Treasury Department expect to issue regulations consistent with that holding. The regulations also will address the issue raised when a nongrantor trust or estate pays a bundled fiduciary fee for costs incurred in-house by the fiduciary, some of which are subject to the 2% floor and some of which are fully deductible without regard to the 2% floor. The regulations will not be issued in time to be applicable to the 2008 taxable year.

Notice 2008-32 provided that taxpayers were not required to determine what portion of a bundled fiduciary fee was subject to the 2% floor for any tax year beginning before January 1, 2008. This notice extends that guidance to any tax year beginning before January 1, 2009. For those tax years, taxpayers may deduct the full amount of a bundled fiduciary fee without regard to the 2% floor. However, payments made by the fiduciary to third parties for expenses subject to the 2% floor are readily identifiable and must be treated separately from the otherwise bundled fiduciary fee.

[Notice 2008-116, 2008-52 I.R.B. 1372]

Notice 2009-1

I.R.C. § 529

☞ A qualified tuition program may permit a participant to change investment strategies twice during calendar year 2009.

This notice sets forth a special rule under which a qualified tuition program may permit more frequent changes of investments in an I.R.C. § 529 account than are permitted under current rules. I.R.C. § 529 prohibits any contributor to, or designated beneficiary under, a qualified tuition program from directing the investment of contributions to the program (or earnings thereon).

Proposed regulations issued in 1998 provide that a program can permit the person who establishes a qualified account to select among different investment strategies designed by the program only at the time the initial contribution is made establishing the account. In response to comments on those proposed regulations, Notice 2001-55, 2001-2 C.B. 299, was issued, acknowledging that a number of situations might warrant a change in the investment strategy. It stated that final regulations are expected to permit a change in the selected investment strategy once per calendar year and also upon a change in the designated beneficiary. However, a special rule in the notice restricts participants' investment options to a selection of broad-based investment strategies designed exclusively by the program. In addition, a qualified program must establish procedures to prevent a change in investment options from occurring more frequently than once per calendar year or upon a change in the designated beneficiary of the account.

Citing the recent condition of financial markets, commentators have requested more flexibility, expressing concern that the inability to make more frequent changes may interfere with the preservation of the value of a qualified tuition program account. Accordingly, this notice provides that a program does not violate the investment restriction under I.R.C. § 529(b)(4) for calendar year 2009 if it permits a change in the investment strategy selected for an account twice during the calendar year, as well as upon a change in the designated beneficiary of the

account (subject to the program requirements as detailed in Notice 2001-55).
[Notice 2009-1, 2009-2 I.R.B. 250]

Fisher v. United States

I.R.C. §§ 1001, 1011, 1012, 61, 358, and 7422

☞ The proceeds realized from choosing the cash option in an insurance company demutualization plan were not a taxable gain to the policyholder.

Facts

A trust purchased a life insurance policy in 1990 from Sun Life Assurance Company (Sun Life), a Canadian mutual life insurance and financial services company. In 1999, Sun Life's policyholders approved a demutualization plan in which they retained their insurance coverage at premiums that were not affected by the demutualization and also received shares of stock in a new holding company. Policyholders did not have to accept stock in exchange for their ownership rights: They could make a cash election authorizing Sun Life to sell the shares in connection with an initial public offering

In response to a request from Sun Life, the IRS issued a letter ruling [P.L.R. 2000-20-048 (Feb. 22, 2000)] dealing with various tax aspects of the demutualization. The IRS noted that policyholder ownership rights "cannot be obtained by any purchase separate from an insurance contract issued by [Sun Life]" and it ruled that, under I.R.C. § 354(a)(1), "No gain or loss will be recognized by the eligible policyholders on the deemed exchange of their ownership rights solely for company stock." The IRS further opined that the "basis of the company stock deemed received by the eligible policyholders in the exchange will be the same as the basis of the ownership rights surrendered in exchange for such company stock," that is, zero. The IRS did not rule on the tax treatment to be afforded cash received in lieu of shares exchanged for ownership rights.

At the time of the demutualization, the trust had paid premiums of more than \$194,000, and it received 3,892 shares of stock. Opting for the cash election, the trust permitted Sun Life to sell those shares on the open market for \$31,759. It reported the \$31,759, unreduced by any portion

of its basis for premiums paid, on its federal income tax return for 2000 and paid the resulting tax of \$5,725. It subsequently filed a claim for refund, which the IRS denied.

Issue

Whether the policyholder realized any income from the sale of stock

Analysis

The expert witnesses testifying for the two sides differed on whether basis should be assigned to the ownership rights. The trust's witness took the position that the ownership rights had no separate value and were inextricably tied to the policy, so that the policyholder should be able to use its basis in the policy to offset the proceeds. The IRS's witness testified that the fair market value of the ownership rights was zero because none of the premium was specifically dedicated to acquiring ownership rights, there was no available market for ownership rights, and it was highly unlikely at the time the policy was acquired that a demutualization would occur.

Treas. Reg. § 1.61-6 provides that when a taxpayer transfers only a part of an asset, the basis of the entire asset is apportioned between the portion disposed of and the portion retained. An exception called the *open transaction doctrine* has been applied by the courts when the values assigned to each portion of a property cannot be separated. The emphasis is on return of capital: If the entire property has not been sold, the deferred payments reduce basis as they are received, and there is a taxable gain only when the amount received exceeds the basis of the entire property.

The claims court agreed that there was no way to determine the value of ownership rights that were transferred, but said it was clear the value was not zero, as put forth by the IRS's expert. Thus, the court said, applying a variation of the open transaction doctrine was appropriate.

Holding

The taxpayer did not realize any income from the sale of stock because it could use its basis in the contract to offset the proceeds from the sale.

[*Fisher v. United States*, 82 Fed. Cl. 780 (2008)]

RESTAURANT AND HOSPITALITY BUSINESSES

C.C.A. 2008-45-052

I.R.C. § 45B

Employers may claim the I.R.C. § 45B tip credit in the tax year they receive an I.R.C. § 3121(q) notice and demand for the tax on prior year employee tips.

Tips received by an employee in the course of the employee's employment are considered compensation and are deemed to have been paid by the employer for purposes of the employer portion of the social security and Medicare taxes. Qualified food and beverage establishment employers may claim a nonrefundable business tax credit equal to the employer share of social security and Medicare taxes paid on the portion of tips that are not treated as wages to meet the Fair Labor Standards Act (FLSA) requirement. The Small Business Work Opportunity Tax Act of 2007, Pub. L. No.

110-28, froze the federal minimum wage at the \$5.15 hourly rate for purposes of this credit. The tip credit is claimed on Form 8846, Credit for Employer Social Security and Medicare Taxes on Certain Employee Tips. It is used to offset both regular income tax liability and alternative minimum tax liability.

Employers who receive a notice and demand for these taxes on employee tips for a prior year must make timely deposits of these amounts. The previously unreported tip amounts are deemed to have been paid by the employer at the time of the notice and demand for purposes of the I.R.C. § 45B tip credit. However, the social security tax liability is still computed using the wage base for the year in which the employee actually received the tip income.

[C.C.A. 2008-45-052 (September 19, 2008)]

RETIREMENT PLANS

P.L.R. 2008-46-028

I.R.C. § 401

An IRA had no designated beneficiary when the beneficiary was named only with the phrase "as stated in will."

Facts

The owner of an individual retirement account (IRA) died at age 65 before his required beginning date for taking minimum required distributions. He had executed a will and a trust on the same day that he opened the IRA, and he designated as his primary beneficiary on the IRA application "as stated in will." No contingent or other beneficiaries were listed on the IRA form. The will stated that the taxpayer could leave a memorandum identifying individual bequests and that all remaining property was to be transferred to the trust. The trust became irrevocable after the death of the taxpayer. The trust instrument directed the distribution of certain assets without mentioning the IRA, and it provided that the remainder of the trust assets were to be distributed to eight named individuals in specified percentages.

After the taxpayer's death, at the request of his representative, a state court issued an order declaring that the beneficiary designation phrase "as stated in will" is a specification of the trust as beneficiary and that the eight named beneficiaries of the residual assets of the trust were to be treated as the beneficiaries of the IRA.

Issue

Whether the state court order results in the trust beneficiaries being treated as designated beneficiaries under I.R.C. § 401(a)(9)(E) and Treas. Reg. § 1.401(a)(9)-4

Analysis

I.R.C. § 408(a)(6) provides that rules similar to the rules of I.R.C. § 401(a)(9) apply to IRA distributions. I.R.C. § 401(a)(9)(A) requires an employee's entire interest in a qualified retirement plan to be distributed to the employee not later than the required beginning date, or to be distributed (beginning not later than the required beginning date) over the life of the employee or the lives of the employee and a designated beneficiary, or over a period not extending beyond the life expectancy of the employee or the life expectancy

of the employee and a designated beneficiary. I.R.C. § 401(a)(9)(E) defines *designated beneficiary* as an individual designated as a beneficiary by the employee.

Treas. Reg. § 1.401(a)(9)-4, Q&A 1, generally provides that an individual may be designated as a beneficiary under the plan either by the terms of the plan or, if the plan provides, by an affirmative election by the employee that specifies the beneficiary. A designated beneficiary need not be specified by name as long as the individual who is the beneficiary is identifiable under the plan. The members of a class of beneficiaries capable of expansion or contraction are treated as being identifiable if it is possible to identify the class member with the shortest life expectancy. The Q&A further provides that the passing of an employee's interest to an individual under a will or otherwise under applicable state law does not make that individual a designated beneficiary under I.R.C. § 401(a)(9)(E) unless that individual is designated as a beneficiary under the plan.

Treas. Reg. § 1.401(a)(9)-4, Q&A 3, provides that only individuals may be designated beneficiaries for purposes of I.R.C. § 401(a)(9). A person who is not an individual, such as employee's estate, may not be a designated beneficiary. If a person other than an individual is designated as a beneficiary, the employee is treated as having no designated beneficiary for purposes of I.R.C. § 401(a)(9).

However, Treas. Reg. § 1.401(a)(9)-4, Q&A 5, states that if a trust is named as the account beneficiary, the beneficiaries of the trust are treated as designated beneficiaries if four requirements are met:

1. The trust is a valid trust under state law, or would be but for the fact that there is no corpus.
2. The trust is irrevocable or will by its terms become irrevocable upon the death of the employee.
3. The beneficiaries of the trust who are beneficiaries of the trust's interest in the retirement account are identifiable, within the meaning of Treas. Reg. § 1.401(a)(9)-4 Q&A-1, from the trust instrument.
4. The trust documentation is provided to the plan administrator, as provided in Treas. Reg. § 1.401(a)(9)-4, Q&A 6.

If all four of these requirements are met, the beneficiaries of the trust may be considered designated beneficiaries for purposes of determining the distribution period for payment of benefits from the IRA under I.R.C. § 401(a)(9).

Conclusion

The language "as stated in wills" did not result in the trust or the individuals named in the trust instrument being treated as designated beneficiaries of the IRA. At the time of the taxpayer's death, his estate was his beneficiary. The state court's retroactive order naming the residuary beneficiaries of the trust as designated beneficiaries of the IRA is inconsistent with the requirements of I.R.C. § 401(a)(9). The taxpayer must be treated as having no designated beneficiary as of his death for purposes of determining required distributions from the IRA.

[P.L.R. 2008-46-028 (August 20, 2008)]

TAX PRACTICE

T.D. 9436

I.R.C. §§ 6017, 6109, 6694, 6695, and 7701

Final regulations implement amendments to the I.R.C. §§ 6694 and 6695 tax return preparer penalties.

The Small Business and Work Opportunity Tax Act of 2007 (SBWOTA, Pub. L. No. 110-28), extended the application of the income tax return preparer penalties to all tax return preparers, increased the I.R.C. § 6694(a) penalty for unrea-

sonable positions, increased the I.R.C. § 6694(b) penalty for willful or reckless conduct, and amended I.R.C. § 6695(b) to impose a per failure penalty on all tax return preparers who fail to sign a return when required, unless the failure is due to reasonable cause. It also heightened the tax return preparer standard for avoiding an I.R.C. § 6694(a) understatement penalty for undisclosed positions to a reasonable belief that the position would more likely than not be sustained on its merits and the standard for a dis-

closed position to reasonable basis. On June 17, 2008, the IRS released proposed regulations to clarify the penalties.



Cross-Reference

2008 Ethics Chapter

Key provisions of the proposed regulations (REG-129243-07, 2008-27 I.R.B. 32) are summarized on pages 524-527 of the *2008 National Income Tax Workbook*. Definitions of the confidence levels (standards for tax return positions) are provided on page 526.

On October 3, 2008, the Tax Extenders and Alternative Minimum Tax Relief Act of 2008 (Extenders Act, Pub. L. No. 110-343), generally modified the preparer standard for an undisclosed position to substantial authority, retroactive to tax returns prepared after May 25, 2007. A special rule for tax shelters and reportable transactions retains the more-likely-than-not standard for these positions for tax returns and refund claims prepared for tax years ending after October 3, 2008.

The following sections discuss changes incorporated into the final regulations in response to written comments and the enactment of the Extenders Act.

Copies of Tax Returns

A signing tax return preparer must furnish a copy of the completed tax return to the taxpayer and also retain a copy. Because many returns are filed electronically, the final regulations clarify that the copy furnished to the taxpayer may be in any medium acceptable to both the taxpayer and the return preparer. A completed copy of an electronically filed return includes all schedules, forms, attachments, and jurats filed with the IRS. The copy may be on a replica of an official IRS form or on an unofficial form that references the line numbers or descriptions on the official form. The copy need not contain the tax return preparer's identification number.

Signing Tax Return Preparer

A corporation, partnership, or other organization that employs a signing tax return preparer to prepare for compensation (or in which a signing tax return preparer is compensated as a partner or member to prepare) a tax return or refund claim is treated as the sole signing tax return preparer.

Furnishing Identification Number

The signing tax return preparer's identification number must be included only on the tax return or refund claim that is filed with the IRS. This modification will assist in maintaining the privacy of the tax return preparer's information.

Defining the Preparer within a Firm

Only one tax return preparer is considered primarily responsible for each position taken on the tax return or refund claim, and the signing tax return preparer is generally the person who is responsible for all positions on the return or refund claim that give rise to an understatement. If there is no signing tax return preparer within the firm, or if the signing tax return preparer is not primarily responsible for the position, then the nonsigning tax return preparer within the firm who has overall supervisory responsibility for the position(s) giving rise to the understatement is subject to I.R.C. § 6694.

If either the signing or the nonsigning tax return preparer is primarily responsible for the position(s) giving rise to the understatement, the IRS may assess the penalty against either one of the individuals within the firm, but not both, as the primarily responsible tax return preparer. The IRS is expected to assess the penalty to the tax return preparer with the greatest amount of responsibility for the position, based on the best information available.

Reliance on Information Provided

A tax return preparer may rely on advice furnished by another advisor, another tax return preparer, or other party, even if the advisor or tax return preparer is within the same firm as the tax return preparer.

Prop. Treas. Reg. § 1.6694-1(e) suggested that a tax return preparer could not rely on taxpayer-provided legal conclusions regarding federal tax issues. In response to commentator concerns that tax return preparers have long relied on information that involve mixed questions of fact and law furnished by the taxpayer (including legal conclusions), this proposal was deleted. However, a tax return preparer must meet a diligence standard to rely on the taxpayer-provided information: The preparer must have no reason to believe that the taxpayer is incompetent to make the conclusion, have no knowledge that the conclusion is incorrect or incomplete, and make reasonable inquir-

ies if the information as furnished appears to be incorrect or incomplete.

Adequate Disclosure

Disclosure of a position for which there is a reasonable basis, but for which there is not substantial authority, is adequate if it is made in one of three ways:

1. The position is disclosed on a properly completed and filed Form 8275, Disclosure Statement, or Form 8275-R, Regulation Disclosure Statement, or on the tax return in accordance with the applicable annual revenue procedure (see Rev. Proc. 2008-14, 2008-7 I.R.B. 435, for disclosure on 2007 returns).
2. The tax return preparer provides the taxpayer with a prepared tax return that appropriately includes the disclosure.
3. For tax returns or refund claims that are subject to penalties other than the accuracy-related penalty for substantial understatement, the tax return preparer advises the taxpayer of the penalty standards applicable to the taxpayer under I.R.C. § 6662.

When advice is provided for positions for which there is not substantial authority, a boilerplate disclaimer is not allowed. The advice given to a taxpayer with respect to each position must be particular to the taxpayer and tailored to the taxpayer's facts and circumstances, and the tax return preparer is required to contemporaneously document the fact that the advice was provided. However, tax return preparers may use standard language to describe the applicable law and may adopt a standard approach to disclosure issues

Adequate disclosure of advice given by a non-signing tax return preparer is documented confirmation that the affected taxpayer was advised of the potential penalties and the opportunity, if any, to avoid penalty through disclosure.

A tax return preparer is not considered to have recklessly or intentionally disregarded a rule or regulation if the position has a reasonable basis and is adequately disclosed. If a position is taken contrary to a revenue ruling or a notice, a tax return preparer is not considered to have recklessly or intentionally disregarded the ruling or notice if the position meets the substantial authority standard and is not a reportable transaction. This ensures that tax return preparers may advise

their clients to challenge an IRS ruling or notice under certain circumstances.

Burden of Proof

In response to a commentator's concern regarding burden of proof in tax return penalty litigation cases, the IRS removed Prop. Treas. Reg. §§ 1.6694-2(f) and 1.6694-3(g) from the final regulations. Both case law and other Internal Revenue Code sections provide substantive rules regarding burden of proof and burden of production for penalties.

Negotiation of Refund Check

A tax return preparer may not endorse or negotiate a refund check relating to a return that he or she prepared. Final Treas. Reg. § 1.6695-1(f)(1) clarifies that a tax return preparer is not prohibited from affixing the taxpayer's name on a refund check (typically using a mechanical stamp) for the purpose of depositing the check into the taxpayer's account.

Due Diligence for Earned Income Credit

A signing tax return preparer's due diligence requirements with respect to determining eligibility for the earned income credit were adopted with minor modifications. Example 3 in the proposed regulations, addressing the representation of married but separated individuals, was removed because it may raise conflict of interest issues. It is replaced with another example focusing on the tax return preparer's need to ask relevant questions if a taxpayer attempts to claim a niece or nephew as a qualifying child.

Definition of Tax Return Preparer

A signing tax return preparer is the individual who has the primary responsibility for the overall substantive accuracy of the preparation of the return or refund claim. Based on several commentators' suggestions, an anti-abuse rule is added to Treas. Reg. § 301.7701-15(b)(2)(i). The anti-abuse rule provides that time spent on advice given after events have occurred, even if it is less than 5% of the aggregate time spent by the individual on the position(s) giving rise to the understatement, will be taken into account if the facts and circumstances show that an individual

- Is primarily responsible for a position on the return,

- Gave advice on that position before events occurred primarily to avoid treatment as a tax return preparer subject to I.R.C. § 6694, and
- For purposes of preparing a tax return, the individual confirmed the advice after events had occurred.

The final regulations apply to returns and claims for refund filed, and advice provided, after December 31, 2008.

[T.D. 9436, 2009-3 I.R.B. 268]

Notice 2009-5

I.R.C. §§ 6662 and 6694

☞ Interim guidance is provided regarding implementation of the I.R.C. § 6694(a) tax return preparer penalty, as amended by the Tax Extenders and Alternative Minimum Tax Relief Act of 2008 (Extenders Act, Pub. L. No. 110-343).

I.R.C. § 6694(a) imposes a penalty on a tax return preparer who prepares a return or a claim for refund that reflects an understatement of liability due to an unreasonable position, if the tax return preparer knew (or reasonably should have known) the position was unreasonable. The Small Business and Work Opportunity Tax Act of 2007 (SBWOTA, Pub. L. No. 110-28) increased the standard for an undisclosed position to a reasonable belief that the position would more likely than not be sustained on its merits and the standard for a disclosed position to a *reasonable basis*. The IRS issued interim guidance in Notice 2007-54, 2007-27 I.R.B. 12; Notice 2008-11, 2008-3 I.R.B. 279; and Notice 2008-13, 2008-3 I.R.B. 282, to reflect these amendments.

The 2008 Extenders Act retroactively reduced the standard for undisclosed positions to *substantial authority* and it provided a special rule for tax shelters and reportable transactions to which the more-likely-than-not standard applies.

Notice 2009-5 provides interim guidance regarding the application of I.R.C. § 6694(a) as revised by the Extenders Act.

Effect on Prior Notices

Tax return preparers may continue to rely upon the transitional relief rules provided in Notices 2007-54 and 2008-11 for the 2007 and 2008 periods covered by those notices. Notice 2008-13 generally was effective for 2007 returns filed during 2008 and for advice provided during 2008. It generally held tax return preparers to the higher

more-likely-than-not standard. Accordingly, tax return preparers may apply the substantial authority standard consistent with the Extenders Act for positions other than those taken with respect to tax shelters and reportable transactions when preparing returns or refund claims for the periods covered by Notice 2008-13.

Substantial Authority

Substantial authority for purposes of the I.R.C. § 6694(a) penalty has the same meaning as in Treas. Reg. § 1.6662-4(d)(3)(i) and (ii), or any successor provisions that apply to the accuracy-related penalty. The authorities considered in determining whether there is substantial authority for a position are those described in Treas. Reg. § 1.6662-4(d)(3)(iii).

A written determination for the taxpayer is substantial authority for the tax return preparer unless the preparer should have known about a misstatement or omission of material fact in the written determination when the return or refund claim was filed. Application of court cases to the taxpayer's situation by reason of the taxpayer's residence in a particular jurisdiction is not substantial authority for a position. However, there is substantial authority for a position if it is supported by controlling precedent of a U.S. Court of Appeals to which the taxpayer has a right of appeal.

A tax return preparer who relies in good faith on the advice of another advisor, tax return preparer, or other party is considered to meet the substantial authority standard for purposes I.R.C. § 6694(a)(2)(A). The factors used in evaluating a tax return preparer's good faith reliance are found in Treas. Reg. § 1.6694-2(d)(5).

Conclusions reached in treatises, legal periodicals, or opinions rendered by tax professionals are not substantial authority. However, the underlying authorities may give rise to substantial authority for the position.

The substantial authority for a position must exist on the date the return or refund claim is deemed prepared [as prescribed by Treas. Reg. § 1.6694-1(a)(2)] or on the last day of the tax year for the related return.

Tax Shelter Transactions

Until further guidance is issued, a position with respect to a tax shelter described in I.R.C. § 6662(d)(2)(C)(ii) will not be deemed unreasonable for purposes of the I.R.C. § 6694(a)

penalty if there is substantial authority for the position, and the tax return preparer advises the taxpayer of the penalty standards applicable to the taxpayer should the IRS determine that the transaction has a significant purpose of tax avoidance or evasion. This advice must make three points:

1. The taxpayer must have, at a minimum, substantial authority for the position.
2. The taxpayer must possess a reasonable belief that the treatment was more likely than not the proper treatment to avoid the I.R.C. § 6662(d) accuracy-related penalty.
3. Disclosure will not protect the taxpayer from the accuracy-related penalty assessment if I.R.C. § 6662(d)(2)(C) applies to the position.

Additionally, the tax return preparer must document this advice in the preparer's files.

If a nonsigning tax return preparer provides advice to another tax return preparer regarding a tax shelter position, the position will not be deemed unreasonable if there is substantial authority for the position, the nonsigning preparer provides a statement to the tax return preparer about the applicable I.R.C. § 6694 penalty standards, and the nonsigning preparer documents this advice.

These compliance rules do not apply to a position described in I.R.C. § 6662A (a reportable transaction with a significant purpose of federal tax avoidance or evasion or a listed transaction).

Effective Date

For positions other than tax shelters and reportable transaction positions, Notice 2009-5 is effective for all advice rendered or returns, amended returns, and refund claims prepared after May 25, 2007. The interim guidance for tax shelters and reportable transaction positions is effective for tax years ending after October 3, 2008.

[Notice 2009-5, 2009-3 I.R.B. 309]

Rev. Proc. 2009-11

I.R.C. §§ 6694, 6695, and 7701

☞ The IRS identifies the tax returns and claims for refund to which the I.R.C. § 6694 understatement penalty and the I.R.C. § 6695(b) failure-to-sign penalty apply.

The Small Business and Work Opportunity Tax Act of 2007 (SBWOTA, Pub. L. No. 110-28) extended the application of the income tax return preparer penalties to all tax return preparers. It increased the I.R.C. § 6694(a) penalty for unreasonable positions from \$250 to the greater of \$1,000 or 50% of the income derived by the preparer, and it increased the I.R.C. § 6694(b) penalty for willful or reckless conduct from \$1,000 to the greater of \$5,000 or 50% of the income derived by the preparer. SBWOTA also amended I.R.C. § 6695(b) to impose a \$50 penalty per failure (annual maximum of \$25,000) on all tax return preparers who fail to sign a return when required, unless the failure is due to reasonable cause.

Rev. Proc. 2009-11 identifies the tax returns and refund claims that are subject to the penalties for understatement of a taxpayer's liability by return preparer under I.R.C. § 6694 and those that are subject to the penalties for the tax return preparer's failure to sign the return or refund claim under I.R.C. § 6695(b). It is effective for all forms, tax returns, amended tax returns, and refund claims filed on or after January 1, 2009, and it modifies and supersedes the list of forms provided in Notice 2008-13, 2008-3 I.R.B. 282. [Rev. Proc. 2009-11, 2009-3 I.R.B. 313]

T.D. 9437

I.R.C. § 7216

☞ Final regulations adopt a limited exception for the disclosure of a taxpayer's social security number to a tax return preparer located outside the United States.

Treas. Reg. § 301.7216-3(b)(4)(i) generally provides that an income tax return preparer located in the United States (including any territory or possession of the United States) may not disclose a taxpayer's social security number (SSN) to a tax return preparer located outside the United States, even with the taxpayer's consent. However, a tax return preparer in the United States who receives a


taxpayer's SSN from a tax return preparer outside the United States may retransmit, without the taxpayer's consent, the taxpayer's SSN to the tax return preparer outside the United States. For purposes of applying this regulation, a tax return preparer outside of the United States does not include a preparer who is continuously and regularly employed in the United States (or any territory or possession of the United States) and is in a temporary travel status outside the United States.

A limited exception to this rule allows the tax return preparer to obtain consent and disclose of the taxpayer's SSN if (1) the disclosure is through an adequate protection safeguard as described in the Internal Revenue Bulletin and (2) the preparer verifies the maintenance of the safeguards in the request for the taxpayer's consent pursuant to the specifications described in the Internal Revenue Bulletin.

[T.D. 9437, 2009-4 I.R.B. 341]

Rev. Proc. 2009-14

I.R.C. § 7121

 The IRS has made permanent the prefilling agreement (PFA) program for large and mid-size business taxpayers to resolve tax return-related issues.

Rev. Proc. 2001-22, 2001-1 C.B. 745, allowed large and mid-size business division (LMSB) taxpayers to request a prefilling IRS examination of specific tax return issues relating to current or prior tax years for returns that were not yet due (including extensions) or filed. The prefilling agreement (PFA) program was designed to resolve issues related to completed transactions that were likely to be disputed in post-filing audits prior to filing the tax return. Rev. Proc. 2005-12, 2005-1 C.B. 311, expanded the scope of the PFA program to include tax return issues covering a limited number of future tax years. In Rev. Proc. 2007-17, 2007-4 I.R.B. 368, the IRS clarified the PFA processing procedures and user fee requirements and renewed the PFA program until December 31, 2008.

Rev. Proc. 2009-14 makes the PFA program permanent for LMSB taxpayers. LMSB taxpayers may request a PFA for prior, current, and up to 4 future tax years.

Taxpayers selected to participate in the PFA program are required to pay a user fee (\$50,000 or as provided by Rev. Proc. 2008-1, 2008-1 I.R.B. 1, and its successors) prior to the orientation meeting with the IRS.

[Rev. Proc. 2009-14, 2009-3 I.R.B. 324]

NEW LEGISLATION

2

THE WORKER, RETIREE, AND EMPLOYER RECOVERY ACT OF 2008	31	Airline Bankruptcy Payments for Lost Retirement Income	34
Required Minimum Distributions	31	Unemployment Benefits	34
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THE WORKER, RETIREE, AND EMPLOYER RECOVERY ACT OF 2008 Emergency legislation signed by President Bush on December 23, 2008, provides temporary relief to businesses from the stricter pension funding requirements established by the 2006 Pension Protection Act (PPA, Pub. L. No. 109-280) and makes technical corrections to that act. It also includes relief for retirees whose retirement savings have diminished by suspending some required minimum distribution rules for 2009. The revenue provisions in the act include an increase in late filing penalties for partnership and S corporation returns.

The Worker, Retiree, and Employer Recovery Act of 2008 (Recovery Act, Pub. L. No. 110-458) made more than 130 changes to the Internal Revenue Code. This chapter focuses on the changes directly affecting individual taxpayers, rather than on the employer plan funding and administration provisions. The Joint Committee on Taxation's Technical Explanation of H.R. 7327 (JCX-85-08, December 11, 2008) is the primary resource, along with the act itself, for preparation of this summary.

Required Minimum Distributions

Act § 201; I.R.C. § 401(a)(9)

Effective for calendar year 2009

Background

Employer-provided qualified retirement plans and individual retirement accounts and annuities (IRAs) are subject to required minimum distribution (RMD) rules. Qualified retirement plans for this purpose are tax-qualified plans described in I.R.C. § 401(a), employee retirement annuities described in I.R.C. § 403(a), tax-sheltered annuities described in I.R.C. § 403(b), and plans described in I.R.C. § 457(b) that are maintained by a governmental employer.

Required minimum distributions from IRAs must begin by April 1 of the calendar year following the calendar year in which the IRA owner reaches age 70½. However, the required beginning date (RBD) for distributions from an employer-provided qualified retirement plan generally can be delayed to April 1 of the year following the year the individual retires unless the individual is a 5% owner of the employer maintaining the plan.

For IRAs and employer plans that are defined contribution plans, the RMD for each year generally is determined by dividing the account balance as of the end of the prior year by a distribution period, generally a number in the uniform lifetime table. Special rules apply to annuity payments from an insurance contract.

Failure to take an RMD triggers a 50% excise tax. The tax may be waived if the failure resulted from a reasonable error and reasonable steps were taken to remedy the violation.

The value of many retirement accounts has decreased substantially in the past year, and retirees are concerned about depleting their remaining balances through RMDs.

Explanation of Change

No minimum distribution is required for calendar year 2009 from individual retirement accounts and employer-provided qualified retirement plans that are defined contribution plans. A defined contribution plan is a plan that provides an individual account for each participant, with benefits based on the amount contributed to the participant's account and on any income, expenses, gains, losses, and forfeitures of accounts of other participants that may be allocated to the participant's account [I.R.C. § 414(i)].

The relief provision means that the annual RMD for 2009 that is otherwise required by federal tax law for these plans (a distribution determined by dividing the 2008 year-end account balance by a distribution period) is not required to be made, whether this is the individual's first distribution or a subsequent distribution. The next RMD will be for calendar year 2010.

If an individual's required beginning date (RBD) is April 1, 2010 (e.g., the individual attains

age 70½ in 2009), the first year for which an RMD is otherwise required is 2009. The law change suspends this requirement, so that no distribution need be taken for 2009. Thus, no distribution is required to be taken by April 1, 2010. However, the provision does not change the individual's RBD for determining the RMD for calendar years after 2009. An individual whose RBD is April 1, 2010, must take an RMD for 2010 no later than the last day of calendar year 2010.



Practitioner Note

Deferred Distributions for 2008

The relief does not apply to distributions required for the 2008 tax year, including distributions for 2008 that were delayed until the first 3 months of 2009 by individuals who attained age 70½ during 2008. These distributions must still be taken by April 1, 2009, and will be taxable income for 2009. However, the second distribution for the calendar year 2009 is not required—the next RMD will be during 2010 for the year 2010.

Effect on Beneficiaries

The relief does apply to after-death distributions to beneficiaries. If an individual whose RBD is April 1, 2010, dies on or after that date, the RMD for the individual's beneficiary will be determined using the rule for death on or after the individual's RBD.

Under the 5-year rule that applies to some beneficiaries, no distributions are required for the 4 years immediately following the owner's death. However, the entire account balance must be distributed no later than December 31 of the calendar year containing the fifth anniversary of the individual's death. If the 5-year rule applies, the 5-year period will be determined without regard to calendar year 2009. Thus, for example, if the owner died in 2007, the 5-year period will end in 2013 instead of 2012.



Practitioner Note Early Distribution Penalty Exception Not Changed

RMDs generally begin at age 70½. A 10% early distribution penalty generally applies to distributions taken before age 59½ unless an exception provided by I.R.C. § 72(t) applies. The new law did not amend I.R.C. § 72(t) with regard to the early distribution penalty exception for substantially equal payments. This exception requires substantially equal payments to be taken over a minimum of 5 years or until the recipient is age 59½, if longer. Thus, the new law suspending RMDs does not permit individuals using this exception to skip their required distributions for 2009.

Rollover Is Permitted

If all or part of a distribution during 2009 becomes an eligible rollover distribution (because under the new law it is no longer an RMD), that portion is exempt from the rules for eligible rollover distributions. These include requirements for a written explanation of the direct rollover requirements and the mandatory 20% income tax withholding for eligible rollover distributions. If a defined contribution plan distributes an amount that would have been an RMD for 2009, the plan is permitted but not required to offer the employee a direct rollover of that amount and provide the employee with a written explanation. If the employee receives the distribution, the distribution is not subject to mandatory 20% income tax withholding, and the employee can roll over the distribution by contributing it to an eligible retirement plan within 60 days of the distribution.

Nonspouse Beneficiary

Act § 108(f); I.R.C. § 402(c)(11), (f)(2)(A)
Effective for plan years beginning after 2009

Background

The tax-free rollover rules applicable to employees also apply to rollovers by surviving spouses. Distributions from a qualified retirement plan received by the surviving spouse of a deceased employee can be rolled over by the spouse into a qualified retirement plan or a traditional IRA in the surviving spouse's name. A distribution paid to a benefi-

ciary other than the employee's surviving spouse is generally not an eligible rollover distribution.

However, if the deceased employee's plan includes a special provision, the designated beneficiary (other than a surviving spouse) of a deceased employee can have the plan's benefit transferred through a direct trustee-to-trustee transfer to a traditional IRA set up to receive the distribution. The receiving IRA is subject to the inherited IRA rules.

Explanation of Change

Effective for plan years beginning after December 31, 2009, plans must permit nonspouse beneficiaries to roll over distributions from qualified plans and similar arrangements by means of a trustee-to-trustee transfer to an IRA that is treated as an inherited IRA. The 20% mandatory withholding will apply to distributions that are not rolled over.

Roth Account Rollovers

Act § 108(d); I.R.C. § 408A(c)(3)(B), (d)(3)(B)
Effective for distributions after 2007

Background

The 2006 PPA permits certain distributions from employer plans to be rolled over directly from the plan into a Roth IRA. The distribution is included in gross income, except to the extent it represents a return of the employee's after-tax contributions. The Roth rollover option is limited to individuals who are eligible to convert a traditional IRA to a Roth IRA—those whose modified adjusted gross income (AGI) does not exceed \$100,000 and who are not married filing separately.

Explanation of Change

A rollover from a designated Roth account in a tax-qualified retirement plan or tax-sheltered annuity to a Roth IRA is not included in gross income and it is not subject to the AGI and filing status limitations.

Airline Bankruptcy Payments for Lost Retirement Income

Act § 125; no change to I.R.C.

Effective for Roth contributions made after December 23, 2008

Background

Contributions (other than rollover contributions) to Roth IRAs are generally limited to the lesser of:

1. A dollar amount (\$5,000 for 2008), or
2. The amount of the individual's compensation that is includible in gross income for the year.

The maximum contribution to a Roth IRA is phased out for taxpayers with AGI that exceeds certain indexed levels. For 2008, the AGI phaseout ranges are \$101,000 to \$116,000 for single taxpayers; \$159,000 to \$169,000 for married taxpayers filing joint returns; and \$0 to \$10,000 for married taxpayers filing separate returns.

These contribution limitations do not apply to rollover contributions.

Explanation of Change

A qualified airline employee is an employee or former employee of a commercial passenger airline carrier who was a participant in a defined benefit plan maintained by the carrier that is qualified under I.R.C. § 401(a) and was either terminated or subject to benefit accrual and other restrictions under the 2006 PPA.

An airline payment amount is a payment of money or other property by a commercial passenger airline to a qualified airline employee that meets two criteria:

1. It is made under a federal bankruptcy court order in a case filed after September 11, 2001, and before January 1, 2007; and
2. It is in respect of the employee's interest in a bankruptcy claim against the airline carrier, the carrier's note (or amount paid in lieu of a note being issued), or any other fixed obligation of the carrier to pay a lump sum amount.

An airline payment amount is intended to replace lost retirement income. It does not include any amount payable on the basis of the carrier's future earnings or profits.

A qualified airline employee may contribute any portion of an airline payment amount to a Roth IRA within 180 days of its receipt or, if later, within 180 days after enactment of the 2008 Recovery Act. The contribution is treated as a qualified rollover contribution to the Roth IRA, so that it is included in gross income to the extent that it would be included if it were not a rollover contribution. In determining the eligible contribution, any reduction in the airline payment amount for employment tax withholding is disregarded.

The change is effective with respect to contributions to a Roth IRA made after enactment (December 23, 2008) with respect to airline payment amounts paid before, on, or after that date.

Unemployment Benefits

Act § 111; no change to I.R.C.

Effective retroactively to weeks beginning on or after August 17, 2006

Background

Federal law generally requires that a state must reduce unemployment compensation payable to an individual by the amount of retirement benefits received by the individual. The 2006 PPA provided that states could exclude retirement payments that were rolled over when reducing unemployment compensation. However, states were not prohibited from reducing unemployment compensation by the rollover contributions.

Explanation of Change

Unemployment compensation payable by a state to an individual may not be reduced by the amount of any retirement plan rollover distributions.

Penalty Provisions

Penalties for failure to file timely partnership and S corporation returns are increased.

Partnership Returns

Act § 127; I.R.C. § 6698

Effective for returns required to be filed after 2008

Background

A partnership is treated as a pass-through entity, and income earned by a partnership, whether distributed or not, is taxed to the partners. A partnership is required to file a tax return for each tax year that includes the names and addresses of the partners who are entitled to share in the partnership's taxable income and the amount of each partner's distributive share.

In addition to criminal penalties, a civil penalty applies for failure to timely file a partnership return. The penalty of \$85 per partner is assessable for each month (or fraction of a month) that the failure continues, up to a maximum of 12 months, for returns required to be filed after December 20, 2007.

Explanation of Change

The civil penalty for failure to file partnership returns is increased by \$4 per partner, to \$89 per partner per month, for returns required to be filed after December 31, 2008.

S Corporation Returns

Act § 128; I.R.C. § 6699

Effective for returns required to be filed after 2008

Background

In general, an S corporation is not subject to corporate-level income tax on its items of income

and loss. Instead, an S corporation passes through its items of income and loss to its shareholders, who take their shares of these items into account on their individual income tax returns.

S corporations are required to file a tax return for each tax year that includes the names and addresses of all persons owning stock in the corporation at any time during the tax year; the number of shares of stock owned by each shareholder at all times during the tax year; the amount of money and other property distributed by the corporation during the tax year to each shareholder (and the date of the distributions); and each shareholder's pro rata share of each item of the corporation for the taxable year.

A civil penalty is assessable for failure to timely file an S corporation return or to provide the information required to be shown on the return. The monthly penalty is \$85 times the number of shareholders in the S corporation during any part of the tax year for which the return was required. It is assessable for the number of months (including a fraction of a month) the failure continues, up to a maximum of 12 months.

Explanation of Change

The penalty for failure to file S corporation returns timely is increased by \$4 per shareholder, to \$89 a month, for up to 12 months, for returns required to be filed after December 31, 2008.

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UPDATES

Page Update

Chapter 17. Tax Rates and Useful Tables

637 The AMT Exemption Amounts were increased for 2008 by the Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, as follows:
 Married filing jointly or surviving spouse \$69,950
 Single or head of household 46,200
 Married filing separately 34,975

638 Last line. The earnings amount required to earn one quarter of social security coverage for 2009 is \$1,090.

Add the following below the last line:

	2007	2008	2009
Lower limit for optional SE tax methods	\$1,600	\$4,200	\$4,360
Upper limit for optional SE tax methods	2,400	6,300	6,540

639 **RETIREMENT PLAN CONTRIBUTION LIMITS**

	SIMPLE	457	401(k); 403(b); & SARSEP	Defined- Contribution Plan and SEP	Defined- Benefit Plan	Compensation Limit
2009	\$11,500	\$16,500	\$16,500	\$49,000	\$195,000	\$245,000

AGE 50 CATCH-UP CONTRIBUTION LIMIT

	SIMPLE Plans	All Other Plans
2009	\$2,500	\$5,500

640 **2009 Earned Income of AGI Range for Taxpayers Not Filing as Married Filing Jointly**

Qualifying Children	Credit Rate (%)	Income for Maximum Credit	Phaseout	Phaseout Rate	Maximum Credit
None	7.65	\$5,970–7,470	\$7,470–13,440	7.65	\$457
One	34.00	\$8,950–16,420	\$16,420–35,463	15.98	\$3,043
Two or more	40.00	\$12,570–16,420	\$16,420–40,295	21.06	\$5,028

2009 Earned Income of AGI Range for Taxpayers Filing as Married Filing Jointly

Qualifying Children	Credit Rate (%)	Income for Maximum Credit	Phaseout	Phaseout Rate	Maximum Credit
None	7.65	\$5,970–10,590	\$10,590–16,560	7.65	\$457
One	34.00	\$8,950–19,540	\$19,540–38,583	15.98	\$3,043
Two or more	40.00	\$12,570–19,540	\$19,540–43,415	21.06	\$5,028

[Rev. Proc. 2008-66, 2008-45 I.R.B. 1107]

640 For the calendar quarter beginning January 1, 2009, interests rates are as follows:

Noncorporate Overpayments and Underpayments	Corporate Overpayment	Corporate Underpayments	Corporate Overpayments That Exceed \$10,000	Large Corporate Underpayments (Generally Over \$100,000)
5%	4%	5%	2.5%	7%

[Rev. Rul. 2008-54, 2008-52 I.R.B. 1352]

642 **November 2008
Period for Compounding**

	Annual	Semiannual	Quarterly	Monthly
Short-Term AFR	1.63%	1.62%	1.62%	1.61%
Mid-Term AFR	2.97%	2.95%	2.94%	2.93%
Long-Term AFR	4.24%	4.20%	4.18%	4.16%

[Rev. Rul. 2008-50, 2008-45 I.R.B. 1098]

**December 2008
Period for Compounding**

	Annual	Semiannual	Quarterly	Monthly
Short-Term AFR	1.36%	1.36%	1.36%	1.36%
Mid-Term AFR	2.85%	2.83%	2.82%	2.81%
Long-Term AFR	4.45%	4.40%	4.38%	4.36%

[Rev. Rul. 2008-53, 2008-49 I.R.B. 1231]

**January 2009
Period for Compounding**

	Annual	Semiannual	Quarterly	Monthly
Short-Term AFR	0.81%	0.81%	0.81%	0.81%
Mid-Term AFR	2.06%	2.05%	2.04%	2.04%
Long-Term AFR	3.57%	3.54%	3.52%	3.51%

[Rev. Rul. 2009-1, 2009-2 I.R.B. 248]

646 **Standard Mileage Rate for Automobiles, Vans, Pickups, and Panel Trucks for 2009**

Allowance Per Mile

Business	55¢
Charity Work	14¢
Medical/moving	24¢

Inflation-adjusted Amounts for 2009:

Credit	Filing Status	Credit Amount	AGI or MAGI Phaseout
Adoption Credit (special needs)	All	\$12,250	\$182,180–\$222,180
Adoption Credit (other adoptions)	All	Up to \$12,250	\$182,180–\$222,180
Hope Credit	MFJ	Up to \$1,800	\$100,000–\$120,000
	S, HH, or QW	Up to \$1,800	\$50,000–\$60,000
Lifetime Learning Credit	MFJ	Up to \$2,000	\$100,000–\$120,000
	S, HH, or QW	Up to \$2,000	\$50,000–\$60,000
Savers Credit	MFJ	50% of up to \$2,000	Up to \$33,000
	HH	50% of up to \$2,000	Up to \$24,750
	MFS, S, or QW	50% of up to \$2,000	Up to \$16,500
	MFJ	20% of up to \$2,000	\$33,001–\$36,000
	HH	20% of up to \$2,000	\$24,751–\$27,000
	MFS, S, QW	20% of up to \$2,000	\$16,501–\$18,000
	MFJ	10% of up to \$2,000	\$36,001–\$55,500
HH	10% of up to \$2,000	\$27,001–\$41,625	
MFS, S, or QW	10% of up to \$2,000	\$18,000–\$27,750	

Inflation-adjusted Amounts for 2009:

Item	Filing Status	Maximum Amount	AGI or MAGI Phaseout
Adoption Assistance Exclusion	All	Up to \$12,250	\$182,180–\$222,180
IRA Deduction if taxpayer covered by an employer plan	MFJ or QW	\$2,000	\$89,000–\$109,000
	S or HH	\$2,000	\$55,000–\$65,000
IRA Deduction if taxpayer NOT covered by an employer plan but spouse is covered	MFJ or QW	\$5,000	\$166,000–\$176,000
Roth IRA Contribution	MFJ or QW	\$5,000	\$166,000–\$176,000
	S or HH	\$5,000	\$105,000–\$120,000
Itemized Deductions	All except MFS MFS		\$166,800–varies \$83,400–varies
Personal and Dependent Exemptions Deduction	MFJ or QW	\$3,650	\$250,000–\$372,700
	HH	\$3,650	\$208,000–\$331,000
	S	\$3,650	\$166,800–\$289,300
	MFS	\$3,650	\$125,100–\$186,350
Student Loan Interest Deduction	MFJ	\$2,500	\$120,000–\$150,000
	S, HH, or QW	\$2,500	\$60,000–\$75,000
U.S. Savings Bond Education Interest Exclusion	MFJ	Qualifying expenses	\$104,900–\$134,900
	S or HH	Qualifying expenses	\$68,960–\$84,950

Corrections

Page Correction

Front Matter

- xiii Add Dennis Kauppila to the contributors. Dennis Kauppila is an Associate Extension Professor at the University of Vermont. He is a regional farm business management specialist. He started with Extension in 1983 and began helping with the UVM Tax Schools in 1989. This is his eighth year of co-leadership of the schools in Vermont, and his fourth year as a contributor to the Workbook.

Chapter 2. Military Issues

- 32 Under "Child and Dependent Care Credit" in the first column, the second paragraph should read:
"Nontaxable combat pay can be included in earned income when calculating the child and dependent care credit. If the child attends boarding school to enable the parent to serve in a combat zone, the portion of the fee that is for room and board is a qualifying expense [Treas. Reg. § 1.21-1(d)(12), Example 2]."

Chapter 3. Retirement Plans

- 50 Example 3.1. Replace the first paragraph with the following:
The profit on line 31 of Otto Mulligan's Schedule C (Form 1040), Profit or Loss from Business (Sole Proprietorship), is \$86,081. His net earnings from self-employment on line 4 of Schedule SE (Form 1040) Self-Employment Tax, are \$79,496 ($\$86,081 \times 92.35\%$), and his self-employment tax is \$12,163 ($\$79,496 \times 15.3\%$). The income tax deduction for half his self-employment tax reduces his business income to \$80,000 ($\$86,081 - \$6,081$).
- 56 Figure 3.3. In line 5, 3rd and 4th columns, "3,210" should be "3,310." In line 6, the first column, "(4%)" should be "(4% or 3.5%)."

Chapter 5. Individual Taxpayer Issues

- 112 First column, first bullet under "Limits on Exclusion," line 3. Change "age 18" to "age 19."
141 Example 5.18, penultimate line. Add a "\$" in front of "50,000."

Chapter 6. Loss and Deduction Limits

- 193 Between lines 9 and 10 of Form 1045, insert years: 3rd preceding tax year ended 12-31-04; 2nd preceding tax year ended 12-31-05; 1st preceding tax year ended 12-31-06.

Chapter 7. New Legislation

- 220 Example 7.18. Change "100-acre tract of land" to "painting" throughout the example. Change "land trust commission" to "art museum." [The provision applies only to tangible personal property, not real property.]

Chapter 9. Automobiles

- 283 Form 4797, line 31 should be "843" and line 32 should be "0."
311 The last line in column 1 should be the penultimate line in column 2.

Chapter 10. Restaurant and Hospitality Businesses

- 351 Under "Eligible Small Business," the first two lines of the second paragraph. Change "30 hours per year" to "30 hours per week."

Chapter 11. Financial Distress

- 387 First column, third line. Change "\$40,000" to "\$50,000."

Chapter 12. Agricultural Issues

6 Page 6 of the update to the Chapter 12 that was printed separately and distributed at some of the tax school. The last sentence in the third full paragraph should read, "The 2007 DPAD should be \$553. The DPGR is \$100,000 (\$650,000 – \$100,000). Expenses allocated to DPGR are \$90,769 [$\$590,000 \times (\$100,000 \div \$650,000)$]. Therefore QPAI is \$9,231 ($\$100,000 - \$90,769$) and the DPAD is \$553 ($\$9,231 \times 6\%$).

Chapter 13. Business Entities

459 Figure 13.8. The last two lines should be:

	Total	George	Linda	Kenda
Remaining I.R.C. § 1231 gain	<u>555,000</u>	<u>283,400</u>	<u>178,400</u>	<u>93,200</u>
Total real estate gain allocation	<u>\$ 665,000</u>	<u>\$361,400</u>	<u>\$202,400</u>	<u>\$101,200</u>

460 Figure 13.9. the sixth and last lines of the table should be:

	George	Linda	Kenda	Total
Real Estate (Figure 13.8)	283,400	178,400	93,200	555,000
Total	<u>\$814,680</u>	<u>\$655,680</u>	<u>\$327,840</u>	<u>\$1,798,200</u>

Chapter 17. Tax Rates and Useful Tables

636 Under "Standard Deductions," "Additional for elderly/blind—married or head of household" should be "Additional for elderly/blind—married."

639 In the "Retirement Plan Contribution Limits" table, the heading for the fifth column should be, "401(k); 403(b); & SARSEP." The heading for the sixth column should be, "Defined-Contribution Plan & SEP."

Chapter 18. New Legislation Supplement

(Update that was printed separately and distributed at some of the tax schools.)

24 Second column, third paragraph. In the second line, "leasehold" should be "retail."