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Five-Minute Tax Briefing®

James A. Keller, CPA, J.D. and Brian Martin, CPA
Five-Minute Tax Briefing Editors

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Highlights

Collection against Sole Owner of LLC: The Tax Court sustained the IRS's efforts to collect employment taxes owed by taxpayer's single member Limited Liability Company (LLC) from taxpayer rather than from the LLC. Although the IRS assessed the tax liability against the LLC under its Employer Identification Number (EIN) rather than under taxpayer's Social Security Number (SSN), the court noted that an individual who is an employer is instructed to apply for and use an EIN for use in the employment context. Taxpayer "put the LLC's EIN on the returns, thereby inducing the IRS to record the employment tax assessments under that number. She could not, by that act, frustrate the principle that a disregarded entity's employment tax liability is the liability of the LLC's sole member . . . . Consequently, when the IRS assessed the employment taxes under the LLC's EIN, [taxpayer] became liable." *Medical Practice Solutions LLC*, TC Memo 2010-98 (Tax Ct.).

Dependent Health Coverage of Children: Temporary regulations under new IRC Sec. 9815 (see TD 9482), issued in conjunction with regulations issued by the Depts. of Labor and Health And Human Services, implement provisions of the Patient Protection and Affordable Care Act governing dependent coverage of children. According to Temp. Reg. 54.9815-2714T, for tax years beginning after 9/22/10, a group health plan or issuer offering dependent coverage of children must make the coverage available until the attainment of age 26. For children who have not attained age 26, a plan or issuer cannot define eligibility for dependent coverage of children other than in terms of a relationship between a child and the participant. Thus, a plan or issuer cannot deny or restrict coverage for a child who has not attained age 26 based upon the child's financial dependency, residency with the participant or any other person, student status, and/or employment. The temporary regulation provides transitional relief to children whose coverage ended or was denied before the attainment of age 26 (which, under these provisions, is no longer permissible). They must be given an opportunity to enroll for a minimum 30-day period no later than the first day of the first plan year or policy year beginning on or after 9/23/10.

NOL Carryback and PAL Rules: According to IRC Sec. 469(e)(2), the passive losses of a closely-held C corporation can offset passive activity income and active business income, but cannot offset portfolio income. The taxpayer in this letter ruling was a closely-held C corporation for the first three years of its existence and earned portfolio income. Taxpayer generated a Net Operating Loss (NOL) in Year 4. Due to an ownership change in Year 4, taxpayer ceased to be closely held (i.e., was no longer owned by five or fewer individuals holding more than 50% in value either directly or indirectly). Nevertheless, IRC Sec. 469 did not prevent taxpayer from carrying back the NOL from a year when it was not a closely-held C corporation to offset portfolio income earned in years when it was closely held. Ltr. Rul. 201017007.

Small Business Healthcare Tax Credit: The Patient Protection and Affordable Care Act authorized a new tax credit (IRC Sec. 45R) to encourage small businesses employing low and moderate income workers to offer health insurance coverage. For tax years beginning in 2010, the credit generally equals 35% (25% for tax-exempt employers) of the lesser of the (1) employer's contributions during the tax year to a health arrangement to purchase qualifying health coverage, or (2) contributions the employer would have made during the tax year if each employee had enrolled in a plan with a premium equal to the average premium for the small group market in the state where the employer is offering coverage. The IRS has published the average premiums for the small group market in each state for the 2010 tax year. [**Editor's Note:** For more on the credit, see TAM-1417 in this issue.] Rev. Rul. 2010-13, 2010-21 IRB.

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MANAGING EDITOR
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FIVE-MINUTE TAX BRIEFING EDITORS
James A. Keller, CPA, J.D.
Brian Martin, CPA

LEAD TYPESETTER
Katie Tweedell

LEAD COPY EDITOR
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Other Current Releases

Income Tax—Biological Parent as Foster Care Provider: IRC Sec. 131(a) authorizes an exclusion from gross income for amounts received by a foster care provider as qualified foster care payments. In program manager technical assistance, the IRS concluded that a biological parent who receives payments (from an unnamed payer) for the care of a disabled child cannot qualify as a *foster care provider* for Section 131 purposes. According to Black's Law Dictionary 727 (9th ed. 2009)], to *foster* is to give parental care to a child who is not one's natural or legally adopted child. More on point, in *Dorothy Bannon* [99 TC 59 (1992)], the Tax Court held that payments to the mother of an adult disabled daughter for providing in-home supportive services were taxable income. PMTA 2010-007.

Income Tax—Dependency Exemption Deduction: The Tax Court held that taxpayer could not claim dependency exemption deductions and the child tax credit for his sons from a former marriage. Under IRC Sec. 152(e)(2), taxpayer (as the noncustodial parent) could claim the dependent exemption if the custodial parent (his ex-wife) signed Form 8332 (Release of Claim to Exemption for Child of Divorced or Separated Parents) and taxpayer attached the form to his tax return. Although the Tax Court was "sympathetic to [taxpayer's] difficulties in acquiring a signed Form 8332, especially during those years when the children's whereabouts were unknown, the statutory language clearly controls this case . . . . Neither [his] faithful payments of child support nor [his ex-wife's] failure to comply with her divorce decree and state law is sufficient to release the deduction." Because taxpayer failed to satisfy the dependency exemption requirements under IRC Sec. 152(e)(2), he was ineligible for the child tax credit authorized by IRC Sec. 24(a). *Leslie Himes,* TC Memo 2010-97 (Tax Ct.).

Income Tax—Medical Expense Deduction for Blood Banking: According to an IRS information letter, courts have interpreted the phrase "cure, mitigation, and treatment" in IRC Sec. 213(d) as actions that address an existing or imminently probable disease, physical or mental defect, or illness. Thus, expenses for banking umbilical cord blood to treat an existing or imminently probable disease may qualify as deductible medical expenses. Conversely, banking cord blood as a precaution to treat a disease that might possibly develop in the future does not satisfy the standard that a disease must be imminently probable. [**Editor's Note:** The end of the letter cites proposed legislation that would allow a medical expense deduction for the costs of such blood banking services.] INFO 2010-0017.

Income Tax—Production Credits: The IRS published the inflation adjustment factors and reference prices for the 2010 renewable electricity production credit, the refined coal production credit, and the Indian coal production credit under IRC Sec. 45. These numbers apply to 2010 sales of (1) kilowatt-hours of electricity produced in the U.S. or a possession thereof from qualified energy resources, and (2) refined coal and Indian coal produced in the U.S. or a possession thereof. Notice 2010-37, 2010-18 IRB 654.

Income Tax—S Corporation Built-in Gains Tax: The maximum built-in gain an S corporation must recognize under IRC Sec. 1374(d)(1) is the excess of the aggregate FMV over the aggregate

adjusted basis of all assets on hand as of the first day the S election is effective. In this case, taxpayer sold a 25% partnership interest that it valued on the 1/1/00 S election date at $2,600,000, the amount determined by its CPA's 2/00 valuation report. The IRS countered that the interest's value was the $5,220,423 sales price of the interest on 11/27/00. In reaching a $3,727,141 value [based on an equal weighting of a business enterprise analysis ($2,718,000), a distribution yield analysis ($3,243,000), and the sale price ($5,220,423)], the Tax Court reduced the sales price to reflect the likelihood that the buyer viewed the partnership interest as a strategic acquisition and was willing to pay a premium to avoid an exercise of first refusal rights by the other partners. *Ringgold Telephone Company*, TC Memo 2010-103 (Tax Ct.).

IRS Offers Discount for Tax Forum Early Registration: The IRS urges tax practitioners to make their reservations soon for one of six tax forums to be held this summer. The forums last three days and offer the opportunity to receive up to 18 continuing education credits through a variety of seminars and workshops. The cost for those who preregister is $206 per person, a savings of $129 off the late or on-site registration price of $335. Pre-registration ends two weeks prior to the start of each forum, as follows: Atlanta: 6/8 deadline for 6/22–6/24 forum; Chicago: 6/29 deadline for 7/13–7/15 forum; Orlando: 7/13 deadline for 7/27–7/29 forum; New York City: 7/27 deadline for 8/10–8/12 forum; Las Vegas: 8/10 deadline for 8/24–8/26 forum; and San Diego: 8/17 deadline for 8/31–9/2 forum. For more information, or to register online, visit **www.irstaxforum.com**. News Release IR-2010-60.

IRS Oversight Board Releases 2009 Report: On 5/12/10, the IRS Oversight Board released its 2009 report to Congress, which evaluates the IRS's performance during the past year and its ability to meet strategic goals in the future (see **www.treas.gov/irsob/board-reports.shtml**). While enforcement activity was generally stable compared to 2008, more audits of individuals were conducted in 2009 for taxpayers with income over $1 million, where audits increased by 29%. Audits of corporations with assets over $10 million increased slightly, but because more corporate tax returns were filed, the coverage rate for all corporations decreased by almost 1%. The report also focuses on the Customer Account Data Engine program, which would provide for 140 million individual account records to be stored in a modern database with the capability to update account information on a daily basis. The plan is to implement key components of this program by 2012 resulting in efficiency and taxpayer service gains.

Penalties—Accuracy-related Penalty on Underpayments: This program manager technical assistance looks at whether the accuracy-related penalty of IRC Sec. 6662 applies to a tax year when the taxpayer claims a first-time homebuyer credit (FTHBC) or earned income credit (EIC) to which he or she is not entitled. It discusses the computation of the "underpayment" for penalty purposes, and notes that the annual revenue procedure describing when proper completion of the required tax form is treated as adequate disclosure [currently Rev. Proc. 2010-15 (2010-7 IRB 404)] does not mention the FTHBC, EIC, or other tax credits that can be claimed on a Form 1040. Therefore, disclosure of these items is adequate only if the taxpayer attaches a properly completed Form 8275 (Disclosure Statement) or Form 8275-R (Regulation Disclosure Statement). PMTA 2010-001.

Penalties—Married Couple's Joint and Several Liability: Under IRC Sec. 6676, a 20% penalty applies to the excessive amount of a claim for credit or refund. In program manager technical assistance, the IRS concluded that married couples who file a joint claim for refund or credit have joint and several liability for any Section 6676 penalty arising from the claim. Because liability is joint and several, a spouse will not qualify for the reasonable basis exception if the other spouse does not. Whether a claim has a reasonable basis is not dependent on the subjective state of mind of the taxpayer presenting the claim or the actions of the taxpayer in determining the appropriateness of the claim. The statute requires an examination of the claim itself to determine whether it has a reasonable basis. PMTA 2010-003.

Penalties—TurboTax Problems: Taxpayers' 2004 and 2005 joint Forms 1040 were self-prepared using TurboTax preparation software. The wife reported expenses for her real estate business as well as unrelated losses on a single Schedule C. Adjustments to this schedule resulted in most of taxpayers' income tax deficiencies and the resulting Section 6662 accuracy-related penalties. At trial, the wife argued that they consistently filled out their tax returns using TurboTax and she consistently confused capital gains and losses with ordinary income and expenses. In rejecting taxpayers' misuse of TurboTax, even if unintentional or accidental, as a defense to the penalties, the Tax Court noted that "tax preparation software is only as good as the information one inputs into it." While reliance on the advice of a tax professional can establish reasonable cause and good faith for avoiding a penalty, taxpayers did not rely on a professional preparer but prepared the returns themselves. *Aileen Yat Muk Lam*, TC Memo 2010-82 (Tax Ct.).

Procedure—Extended Limitations Period for Partnership Items: The dispute in this supplemental opinion centered on whether an overstatement of basis constitutes an omission from gross income for triggering the extended six-year limitations period under IRC Sec. 6501(e)(1)(A) (taxpayer) and IRC Sec. 6229(c)(2) (partnership). In *Bakersfield Energy Partners* [128 TC 207 (2007), *aff'd.* 103 AFTR 2d 2009-2712 (9th Cir. 2009)], the Tax Court held that a basis overstatement was not an omission from gross income for Section 6501(e)(1)(A) and 6229(c)(2) purposes. The court followed *Bakersfield Energy* when it issued its original opinion in this case on 9/1/09, but on 9/24/09, the Treasury Dept. issued temporary regulations stating that an "understated amount of gross income resulting from an overstatement of unrecovered cost or other basis constitutes an omission from gross income" [Temp. Regs. 301.6501(e)-1T and 301.6229(c)(2)-1T]. Finding that the Supreme Court's opinion in *Colony, Inc.* [1 AFTR 2d 1894 (1958)] displaced the temporary regulations, the Tax Court majority opinion invalidated the temporary regulation (with two concurring opinions reaching the same result, but on narrower grounds). *Intermountain Insurance Service of Vail LLC*, 134 TC No. 11 (Tax Ct.).

Procedure—Levy on Education Savings Accounts: According to Internal Revenue Manual 5.11.6.2 (which deals with funds in pension or retirement plans), the taxpayer "may be able to withdraw money in a lump sum from a plan. If the taxpayer has the right to do so, a levy can reach that right." Following this same logic, a recent emailed chief counsel advice states that "as a legal matter, Coverdell ESAs and 529s are not exempt from levy. But [there] are differences between the two types of accounts, so the [revenue officer] needs to be mindful of who the taxpayer is and what property rights, if any, he has." For example, a person setting up a Coverdell ESA lacks the right to withdraw the funds, while the same person setting up a 529 can withdraw the funds (with tax consequences). CCA 201017044.

Procedure—Levy on Partnership Draw: Taxpayer was the managing partner of a law firm organized as a partnership under New York law. Taxpayer wrote checks to himself and the other partner that were characterized as draws or advances "taken against whatever the [firm's] profits were going to be at the end of the year." To collect taxpayer's unpaid taxes, the IRS served tax levies on the firm. In affirming a New York District Court's conclusion that the firm unlawfully failed to honor the levies, the 2nd Circuit rejected the firm's argument that the payment of partnership draws to taxpayer did not constitute "salary or wages" for Section 6331(e) purposes because (1) the time when taxpayer was required to recognize income from the draws for income tax purposes (the partnership's year end) was irrelevant, and (2) Reg. 301.6331-1(b)(1) provides that a continuing levy "attaches to . . . advances on salary or wages made subsequent to the date of the levy." *U.S. v. Moskowitz, Passman & Edelman*, 105 AFTR 2d 2010-2126 (2nd Cir.).

Procedure—Return Preparers' Identification Number: The IRS's Tax Return Preparer Review recommended, in part, that tax return preparers be required to register and obtain a Preparer Tax Identification Number (PTIN). Under recently proposed revisions to Reg. 1.6109-2 (found in REG-134235-08), preparers would be required to use a PTIN as their identifying number on tax returns or refund claims filed after 12/31/10, except as provided in any transitional period. The IRS announced that it selected Accenture National Security Services, LLC, as the vendor to establish an online registration system. While the current target date for the online system is 9/1/10, an "official system launch date will be one of the initial determinations made in the weeks ahead . . ."