

I. INCOME TAX CASES

A. Shareholders' Basis in S corp Stock Increased by Contribution of Related S corp's Receivables

The Tax Court has determined that a distribution of one S corporation's accounts receivable to its shareholders, followed by their contribution of the receivables to a related S corporation, increased the shareholders' basis in the second S corporation's stock and allowed them to deduct its losses. The Court rejected IRS's argument that the transaction didn't amount to their making an economic outlay, finding that the financial positions of both the shareholders and the companies were altered by the shareholders' actions. *Maguire, TC Memo 2012-160*.

B. Reliance on Tax Advisers Failed to Avoid Accuracy-related Penalties

The Tax Court has determined that a taxpayer claiming a partnership-level defense to Code Sec. 6662(a) accuracy-related penalties failed to show that reliance on tax advisers established a reasonable cause and good faith defense under Code Sec. 6664(c)(1). One advisor was a promoter who benefited financially from the transaction, and the other wasn't provided full and accurate information. *SAS Investment Partners, Schmidt Financial Group, Inc., Tax Matter Partner, TC Memo 2012-159*

The Tax Court has determined that a taxpayer failed to show that under Code Sec. 6664(c)(1) his reliance on persons he thought to be tax professionals established a reasonable cause and good faith defense to the Code Sec. 6662(a) accuracy-related penalties. One expert lacked the necessary expertise and wasn't provided full and accurate information, while the other was a promoter who benefited financially from the transaction. *Hristov, TC Memo 2012-147*

C. CA4 Affirms: No Transferee Liability for Former Shareholders in Intermediary Transaction

The Court of Appeals for the Fourth Circuit, in a 2-1 decision, has affirmed a Tax Court decision that former shareholders of a trucking company that engaged in a so-called "intermediary transaction" weren't transferees under state law. The shareholders sold the company's sole asset for cash then sold the stock to an investment company that didn't make good on its promise to pay the trucking company's tax liabilities arising from the asset sale. *Starnes v. Comm., (CA4 05/31/2012) 109 AFTR 2d ¶¶2012-829*

D. \$18.5 million Charitable Deduction Wholly Denied for Lack of Proper Appraisals

The Tax Court has denied outright a real estate appraiser's charitable contribution deduction for millions of dollars worth of properties donated to a charitable remainder unitrust (CRUT). Although the Court acknowledged that the donations were made, and speculated that his self-appraisals actually undervalued the real estate, the deductions were denied because he failed to satisfy the substantiation requirements under Code Sec. 170 and its regs. *Mohamed, TC Memo 2012-152*.

E. No Charitable Deduction for Facade Easement No Stricter than Landmark Preservation Rules

The Tax Court has held that taxpayers weren't entitled to charitable contribution deductions for their donation of a conservation easement on the facade of a building located in an historic district. The taxpayers' appraisals failed to show that the restrictions under the facade easement were more restrictive than those under the city's landmark preservation rules, so as to diminish the fair market value (FMV) of the building and support a deduction. However, the Court allowed the taxpayers' deductions for cash *Dunlap*, *TC Memo 2012-126*

F. IRS proved Deficiency Notice for One year but not for Another

The Court of Appeals for the Federal Circuit, reversing the Court of Federal Claims, has allowed a married couple's over \$725,000 refund claim for '95 because, under a test put forth by the Court, IRS did not prove that it timely mailed a notice of deficiency for that year. Applying a variation of the same test, the Federal Circuit held that IRS proved it timely mailed a notice of deficiency for '92 and so affirmed the lower court with respect to that year. Joshua Welsh and Alejandra De Losada (CA FC 05/18/20120) 109 AFTR 2d ¶ 2012-785

G. Taxpayers Can't Claim Homebuyer Credit for Residence Bought by their S corporation

In a case of first impression, the Tax Court has held that a married couple couldn't claim the first time homebuyer tax credit (FTHTC) for a principal residence bought by their wholly owned S corporation. The entity wasn't an "individual" for FTHTC purposes and the home wasn't its "principal residence." *Trugman*, (2012) 138 TC No. 22

H. CA-7 affirms: Indirect Payments to Accounting Firm Founders Were Disguised Dividends

The Court of Appeals for the Seventh Circuit has affirmed a Tax Court decision that an accounting firm wasn't entitled to deduct "consulting" payments made to related entities that were subsequently passed on to the firm's founders. The entities didn't provide any services to the firm during the years at issue, and the firm's argument that the payments were actually compensation for services provided by its founders failed where the structure of the payments showed that they were profit distributions intended to reduce the firm's taxable income. *Mulcahy, Pauritsch, Salvador & Co., Ltd.*, (CA 7 05/17/2012) 109 AFTR 2d ¶2012-782

I. Married filing Separately Taxpayer Couldn't Deduct Residence Interest on \$1 million of Debt

The Tax Court has held that a taxpayer who obtained a \$1 million mortgage on the purchase of a home and filed her returns as married filing separately was only allowed to deduct home mortgage interest on a total of \$550,000 of indebtedness—\$500,000 in acquisition indebtedness under Code Sec. 163(h)(3)(B)(ii), plus \$50,000 of home equity indebtedness under Code Sec. 163(h)(3)(C)(ii). She couldn't deduct the interest paid on the entire \$1 million of indebtedness. *Bronstein*, (2012) 138 TC No. 21

J. Taxpayer Couldn't Use Age 55 Early Withdrawal Exception After Rollover to IRA

The Seventh Circuit has held that an individual who would have been able to withdraw funds penalty-free from his former employer's qualified retirement plan because of the age 55 exception was subject to a 10%

early withdrawal penalty upon receiving a distribution from an IRA to which he rolled over the plan funds. His argument that the penalty scheme for distributions from qualified plans and IRAs was illogical did not help. In fact, the Court also found that his failure to pay the early withdrawal penalty triggered an accuracy-related penalty. *Young Kim, (CA 7 05/09/2012) 109 AFTR 2d 2012-2067*

II. ESTATE TAX CASES

A. Gifts of Limited Partnership Interests Qualified for Gift Tax Annual Exclusions

The Tax Court has held that gifts of limited partnership interests made by the decedent during life were gifts of present interests that qualified for annual exclusions. While the donees did not receive unrestricted and noncontingent rights to immediate use, possession or enjoyment of the limited partnership interests themselves, the gifts nonetheless qualified as present interests because the donees received such rights in the income from the limited partnership interests. *Estate of George H. Wimmer, TC Memo 2012-157*

B. Mixed Results for IRS in seeking to Collect Unpaid Estate Tax from Decedent's Heirs

In an action brought by the government to collect a decedent's unpaid estate tax from her heirs, a district court has held that some heirs who received trust distributions were not liable as beneficiaries or transferees, others who received life insurance proceeds were liable as beneficiaries, and others were liable under 31 USC 3713 as personal representatives of the estate. *U.S. v. Mary Carol S. Johnson, (DC UT 05/23/20)*

C. Gross-up Rule Reaches Gift Tax Paid by Donees on Deemed QTIP Transfer

The Court of Appeals for the Ninth Circuit, affirming the Tax Court, has held that the gift tax gross-up rule of Code Sec. 2035(b) applies to gift tax paid under Code Sec. 2519 on a deemed transfer of qualified terminable interest property (QTIP). *Estate of Anne W. Morgens, (CA 9 05/03/2012) 109 AFTR 2d ¶ 2012-736*

D. Court Allows Estate Tax Marital Deduction for Decedent's Same-Sex Spouse

A district court has ruled in favor of a surviving same-sex spouse's constitutional challenge to section 3 of the Defense of Marriage Act, which denies recognition of same-sex marriages for purposes of administering Federal law. The court found that this provision violates the equal protection clause of the Constitution. As a result, it allowed a marital deduction to the estate of the deceased same-sex spouse for the amount she left to the spouse who brought this suit. *Edith Schlain Windsor v. U.S. (DC NY 6/6/2012) 109 AFTR 2d ¶ 2012-870*

III. IRS ANNOUNCEMENTS AND RULINGS

A. RM Guidance Details Application of the Failure to Report Reportable Transactions Penalty

IRS has provided an updated Internal Revenue Manual (IRM) §4.32.4, "Abusive Transactions, IRC 6707A Penalty for Failure to Include Reportable Transaction Information With Return," which sets out guidance for

IRS personnel on the application of the Code Sec. 6707A penalty, including identification of reportable transactions, the basis for asserting the penalty, and the statute of limitations for assessment. The Code Sec. 6707A penalty applies to failures to include on a return or statement any information required to be disclosed under Code Sec. 6011 with respect to a reportable transaction.

B. IRS Explains Reporting and Withholding Issues for Post-2013 0.9% Medicare Tax Increase

An IRS payroll industry conference call that took place on June 7 shed some light on the higher Medicare tax rate that high wage earners will pay beginning in 2013. Among other issues, the call addressed how the tax will be reported and how certain employees may increase their withholding to avoid large liabilities at filing time.

C. PLR 201222004 Perpetual Conservation Easement Given for Mitigation Credits is Sale or Exchange

IRS has ruled privately that the conveyance of a perpetual conservation easement on part of a taxpayer's property in exchange for mitigation credits was a sale or exchange for federal income tax purposes. Agreeing to Taxpayer's request, IRS ruled that the conveyance of the perpetual conservation easement on Parcel in exchange for mitigation credits is a sale or exchange of property under Code Sec. 1001.

D. Proposed Reliance Regs Would Make it Harder to Defer Tax on Compensatory Property Transfers

IRS has issued proposed reliance regs that would make it more difficult for taxpayers who receive property in connection with the performance of services to defer tax on the value of the property received. They would do so by clarifying and tightening certain rules relating to whether a taxpayer's rights to property are subject to a substantial risk of forfeiture. *Prop Reg § 1.83-3*

E. How COD Insolvency Exception Applies to Partnership Excess Nonrecourse Debt

In a Revenue Ruling, IRS has explained how the amount by which a discharged partnership nonrecourse debt exceeds the fair market value of the property securing the debt (excess nonrecourse debt) is taken into account in measuring the partners' insolvency for purposes of the Code Sec. 108(a)(1)(B) insolvency exception. To the extent discharged excess nonrecourse debt generates cancellation of debt (COD) income that is allocated under Code Sec. 704(b) and its regs, each partner treats its part of the discharged excess nonrecourse debt related to the COD income as a liability in measuring insolvency under Code Sec. 108(d)(3). *Rev Rul 2012-14, 2012-24 IRB*

F. IRS liberalizes Offer in Compromise Terms under "Fresh Start" Initiative

IRS has expanded its "Fresh Start" initiative, which is designed to help struggling taxpayers who owe taxes by offering more flexible terms in its offer in compromise (OIC) program. These changes may allow some taxpayers to resolve their tax problems in as little as two years, as compared to four or five years in the past. Specifically, IRS has revised the calculation for the taxpayer's future income and expanded the

allowable living expense allowance category and amount. IRS will also allow taxpayers to repay their student loans and state and local delinquent taxes. These changes have also been reflected in the Internal Revenue Manual (IRM). *IR 2012-53*

G. IRS Revises Internal Guidance on Return Preparer Penalties & Updates Penalty Amounts

IRS has revised the portion of the Internal Revenue Manual (IRM) dealing with preparer, promoter, and material advisor penalties. Among other things, the IRM revision expands access to pre-assessment Appeals rights under Reg. § 1.6694-4(a)(1) to also apply to other types of penalties beyond those asserted under Code Sec. 6694, and updates current penalty amounts imposed under Code Sec. 6694 and Code Sec. 6707A.

H. Ruling addresses how trust power affects S corporation election and estate taxes

IRS has privately ruled that (a) a trust beneficiary's power to withdraw trust contributions will cause him to be treated as the owner of that part of the trust over which his withdrawal power has not lapsed, (b) the beneficiary may be treated as the owner of the balance of the trust, and (c) the trust will be a permissible S corporation shareholder if the facts warrant treating the beneficiary as owning the entire trust. IRS also ruled that the beneficiary's estate will include the amount he may withdraw in the year of his death less any amount previously withdrawn in that year.

I. UPDATED IRS GUIDANCE ON REPORTING OF SPECIFIED FOREIGN FINANCIAL ASSETS ON FORM 8938

IRS has released an updated series of questions and answers (Q&As) on assets that must be reported on Form 8938, Statement of Specified Foreign Financial Assets, and those assets that don't have to be revealed on this form. This form is used for reporting under Code Sec. 6038D, and is part of a crackdown on taxpayers with undisclosed foreign assets.

IV. Important Dates to Remember

A. Estate Tax Return

Notice 2012-21 grants to qualifying estates (see below), for the purpose of making a portability election, a six-month extension of time for filing Form 706. The extension applies when the executor of a qualifying estate did not file a Form 4768 within nine months after the decedent's date of death, and therefore the estate did not receive the benefit of the automatic six-month extension.

An executor of a qualifying estate that wants to obtain the extension must file Form 4768 no later than 15 months after the decedent's date of death. With the extension granted by Notice 2012-21, the Form 706 of a qualifying estate will be due 15 months after the decedent's date of death. (Notice 2012-21, Sec.1).

B. WOTC

Employers need to act soon. IRS now reminds employers that those who hired unemployed veterans during late 2011 and early 2012 had an expanded period to request the required certification for claiming the expanded WOTC. That expanded period ends on Tuesday, June 19.

Normally, an eligible employer must file Form 8850, Pre-Screening Notice and Certification Request for the Work Opportunity Credit, with their state workforce agency within 28 days after an eligible worker starts work. But under the special rule, employers have until June 19, 2012, to file this form for veterans hired on or after Nov. 22, 2011, and before May 22, 2012. The 28-day rule for timely filing applies for eligible veterans hired on or after May 22, 2012, and before Jan. 1, 2013.

Form 8850 can be faxed or electronically transmitted to the state workforce agency, if the agency is able to receive the certification forms that way.

Applicable Federal Rates (AFR) for June 2012

	Period for Compounding			
	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Month</i>
Short-Term				
AFR	.23%	.23%	.23%	.23%
110% AFR	.25%	.25%	.25%	.25%
120% AFR	.28%	.28%	.28%	.28%
130% AFR	.30%	.30%	.30%	.30%
Mid-term				
AFR	1.07%	1.07%	1.07%	1.07%
110% AFR	1.18%	1.18%	1.18%	1.18%
120% AFR	1.28%	1.28%	1.28%	1.28%
130% AFR	1.39%	1.39%	1.39%	1.39%
150% AFR	1.62%	1.61%	1.61%	1.60%
175% AFR	1.88%	1.87%	1.87%	1.86%
Long-term				
AFR	2.64%	2.62%	2.61%	2.61%
110% AFR	2.90%	2.88%	2.87%	2.86%
120% AFR	3.16%	3.14%	3.13%	3.12%
130% AFR	3.44%	3.41%	3.40%	3.39%

Adjusted AFR for June 2012

	Period for Compounding			
<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>	
Short-term				
adjusted AFR	.26%	.26%	.26%	.26%
Mid-term				
adjusted AFR	1.16%	1.16%	1.16%	1.16%
Long-term				
adjusted AFR	3.06%	3.04%	3.03%	3.02%

Rates Under Section 382 for June 2012

Adjusted federal long-term rate for the current month	3.06%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months)	3.26%

Appropriate Percentages Under Section 42(b)(2)** for June 2012

Appropriate percentage for the 70% present value low-income housing credit	7.43%
Appropriate percentage for the 30% present value low-income housing credit	3.18%

Rate Under Section 7520 for June 2012

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	1.2%
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