

2017 POST-FILING SEASON UPDATE

April 24, 2017

Special Report

HIGHLIGHTS

- Tax Reform Options
- ACA Compliance
- Guidance Logjam
- Changes In Tax Policy
- IRS Audit Campaigns
- International Efforts

Individuals and Businesses Impacted by Filing Season Developments

The individual filing season has ended with few reports of disruptions or slowdowns in return processing by the IRS. Some early filers experienced delayed refunds due to new requirements under the *Protecting Americans from Tax Hikes Act of 2015* (PATH Act) which kicked-in for this filing season. The IRS reported no major breaches of its primary systems by cybercriminals, although one secondary system, the Data Retrieval Tool (DRT), appeared to have been compromised. While tax professionals were busy with clients during the filing season, the IRS, other federal agencies, and the courts issued important new guidance and rulings. Congress and the Trump Administration, too, were busy trying to muster consensus on tax reform as well as dealing with fallout from a bill that unsuccessfully tried to repeal and replace the *Affordable Care Act* (ACA). *This Briefing highlights some of the key developments during the filing season that will impact taxpayers of all types for the rest of 2017.*

COMMENT. *Tax-related identity theft continued to surge during the filing season, but the IRS expressed confidence that it has been getting ahead of the problem. According to the IRS, the number of individuals who reported that they were victims of identity theft declined from 698,700 in calendar year (CY) 2015 to 376,500 in CY 2016, with expectations of a continued decline for 2017.*

TAX REFORM

Tax reform proposals continued to grab headlines during the filing season. Both the White House and Congress have floated ideas to overhaul the Tax Code.

COMMENT. *At the time this Briefing was prepared, the timeline for tax reform appears fluid. On April 21, President Trump indicated that a tax reform proposal could come as early as April 26 from the White House.*

IMPACT. *The longer it takes Congress to agree on and pass a tax reform package, it is more likely that any tax cuts will not be made retroactive to January 1, 2017. As a result, year-end tax planning strategies may prove useful later this year.*

White House

President Trump campaigned on tax reform and since taking office has said tax reform remains a priority. The President’s plans may reflect some of his proposals during the campaign, such as reducing the individual income tax rates, eliminating the federal estate tax and creating new child and elder care initiatives, among others.

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IMPACT. *In January, President Trump signed Executive Order 13771, which generally requires federal agencies to remove two existing regulations/rules for every new regulation/rule issued. In April, President Trump signed Executive Order 13789, Identifying and Reducing Tax Regulatory Burdens. The IRS has reported it is studying the effect of Executive Order 13771 on its guidance. IRS Commissioner John Koskinen said that some “sub-regulatory” guidance may be outside the scope of Executive Order 13771. Nevertheless, the lack of the usual flow of tax guidance from the IRS and Treasury continues to challenge taxpayers who must “go blind” into certain transactions without a clear picture of how the IRS will react.*

COMMENT. Treasury Secretary Mnuchin has indicated that the White House plan will focus on middle income tax cuts with the wealthy being left in pretty much the same tax position overall – lower rates but loss of tax breaks. Trump’s campaign tax proposals, however, included significant benefits going to higher-income “job creators.”

IMPACT. On the business side, the President’s proposals are expected to call for lowering the corporate income tax rate to 15 percent and abolishing the corporate AMT. Some proposals are also expected to be targeted to small businesses, possibly allowing owners of pass-through entities to elect to be taxed at a flat rate of 15 percent on their pass-through income retained within the business, rather than be taxed under regular individual income tax rates. One strategy calls for quick action in the House, with further discussions to take place in the Senate.

IMPACT. Many Capitol Hill observers predict that lowering the corporate income tax from its current 35 percent level to 25 percent would be a difficult challenge, no less to the 15 percent level that President Trump has mentioned. Broadening the tax base by eliminating some deductions and credits that create wide swings in the current effective tax rate can only provide so much relief, especially as lobbying efforts for those industries with low effective tax rates start to ramp up.

House

House Republicans unveiled a tax reform “blueprint” in 2016, which continues to be their framework for tax reform in 2017. The “blueprint” calls for consolidating and reducing the individual income tax rates, lowering the corporate tax rate, and more.

IMPACT. The House GOP “blueprint” also proposes a controversial border adjustment tax. Generally, under a tax system implementing a border adjustment, U.S. businesses would no longer be effectively permitted a deduction based on the cost of imports.

COMMENT. The GOP’s initial attempt at repealing and replacing the ACA contained repeal of the net investment income tax and the additional Medicare tax. Adding repeal of those taxes in general tax reform may prove difficult if not impossible not only because of their cost in terms of offsetting lost revenues but also due to procedural “reconciliation” rules for passage.

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Senate

Senate Republicans have not developed a “blueprint” for tax reform. Members of the Senate Finance Committee have indicated that they are working on tax reform proposals but have released few details.

COMMENT. Some Senators have inferred that the border adjustment tax, which is a key funding provision within the House “blueprint,” is unacceptable. Senators from both parties, however, have signaled support for small business tax reform, as well as reform of the tax whistleblower rules.

AFFORDABLE CARE ACT

In March, Republican leaders in the House pulled their ACA repeal and replacement bill (the American Health Care Act) from consideration. As a result, the ACA remains, at the time this Briefing was prepared, in effect. President Trump has expressed interest in brokering a deal on Capitol Hill on health care before turning to tax reform, but no breakthroughs have been reported at press time.

Individual Shared Responsibility

In February, the IRS announced on its website that it would not reject returns that fail to indicate coverage, an exemption or a shared responsibility payment. This continues a policy the IRS has had in place. Taxpayers may, however, be contacted later, the IRS cautioned.

COMMENT. The ACA generally requires individuals to maintain minimum essential coverage or make a shared responsibility payment, unless exempt. Most employer-provided coverage is minimum essential coverage.

Qualified Small Business HRAs

The IRS announced in March that small employers will have more time to inform employees about qualified small employer health reimbursement arrangements (QSEHRAs) (Notice 2017-20). The agency extended the initial written notice period until no earlier than 90-days after the IRS issues guidance with respect to the contents of such a notice. Employers that provide written notice earlier may rely on a reasonable good faith interpretation of Code Sec. 9831(d)(4).

IMPACT. Congress intended QSEHRAs to be a means by which small employers could avoid the premium reimbursement plan ban under the ACA’s market reforms.

ACA Repeal and Replacement

The American Health Care Act (AHCA), as unveiled in early March, would have repealed the ACA’s taxes, including the net investment income (NII) tax, additional Medicare tax, and the medical device excise tax, among others. The AHCA also would have repealed changes made to the medical expense deduction and would have expanded health savings accounts (HSAs). In place of the Code Sec. 36B premium assistance credit, the AHCA would have created a new advanceable, refundable health care credit.

IMPACT. If not considered this year, legislation to at least change aspects of the ACA are likely due to the Marketplace

structure in many states, as well as current administrative actions by the Trump Administration, such as tightening the period within which individuals can sign up for full 2018 coverage.

COMMENT. There is still outstanding litigation about the ACA. A federal court has stayed a challenge to the ACA's cost-sharing reductions. Opponents have argued that no funds have been appropriated by the law for the cost-sharing payments to insurers.

TRENDING ISSUES

Certain issues that have been gaining traction during tax season will likely only grow during the remainder of 2017. These include the following audit and guidance concerns.

Executive Orders

Executive Orders 13771 and 13789 impact tax regulations. Executive Order 13771 generally affects future regulations. Executive Order 13789 directs the Treasury Department to identify, within the next 60 days, regulations issued since January 2016 that impose an undue financial burden on taxpayers; add undue complexity to the federal tax laws; or exceed the statutory authority of the IRS.

IMPACT. The ultimate status of the following IRS/Treasury actions appear to be on hold, with their final outcome uncertain in large part because of their controversial positions:

- Code Sec. 6221 et seq. partnership regulations;
- Code Sec. 385 final and temporary debt-equity regulations;
- Code Sec. 2704 proposed regulations on business valuation discounts; and
- Code Sec. 7874 final inversion regulations.

Partnership Audit Regime

The IRS issued guidance to implement the new centralized audit regime under the Bipartisan Budget Act of 2015 (2015 Budget Act) (NPRM REG-136118-15). The guidance described the new audit regime,



including its elective use for tax years before 2018, when it goes into full force for all partnerships, with an opt-out provision for partnerships with 100 or fewer partners.

IMPACT. These proposed regulations were covered by a White House Memorandum generally freezing regs until Trump Administration appointees can review them. Without official guidance, many partnerships are placed in a difficult position. This action impacts not only those who may consider an immediate opt-in election into the new audit regime but also those who must start planning for post-2107 years by amending partnership agreements well in advance. Some practitioners criticized portions of these withdrawn regulations but few have denied the need for guidance in this area.

Audit Coverage

The IRS reported in March that the audit coverage rate for individuals for fiscal year (FY) 2016 was 0.7 percent (IR-2017-69). The audit coverage rate for corporations (excluding S corps) for FY 2016 was 1.1 percent. For partnerships, the audit coverage rate for FY

2016 was 0.4 percent. The audit coverage rate for S corps for FY 2016 was 0.3 percent.

IMPACT. According to the IRS, the audit coverage rate for individuals fell 16 percent from FY 2015 to FY 2016. The 0.7 percent audit coverage rate for individuals was the lowest coverage rate in more than a decade, the agency added.

IRS budget. Intertwined with audit coverage are the shrinking resources available to the IRS to conduct audits. President Trump has proposed a \$239 million reduction in the IRS's budget for fiscal year (FY) 2018 (White House Budget Blueprint, March 16, 2017).

Audit campaigns. The IRS Large Business and International (LB&I) Division has revealed new corporate compliance campaigns. The campaigns, as explained by LB&I, offer "a holistic response to an item of either known or potential compliance risks." The campaigns currently address:

- Code Sec. 48C energy credit;
- Offshore voluntary disclosure program declines and withdrawals;

- Code Sec. 199 domestic production activities deductions;
- Micro-captive insurance;
- Related-party transactions;
- Deferred variable annuity reserves and life insurance reserves;
- Basket transactions;
- Completed contract method of accounting;
- TEFRA linkage plan strategy;
- S corporation losses claimed in excess of basis;
- Repatriation;
- Form 1120-F Nonfiler.

IMPACT. Whether “audit campaigns” will be initiated within the other major IRS divisions in part will depend upon the success of the LB&I division’s rollout. So far, IRS leadership appears optimistic over its benefits.

Private Tax Collection

The IRS announced in April that private collection agencies will soon start to work some taxpayer accounts (IR-2017-74). The IRS has contracted with four private collection agencies.

IMPACT. Private collection agencies will only work certain accounts, including accounts removed from the active inventory for lack of resources or inability to locate the taxpayer. Private collection agencies will not work, among other accounts, accounts that are currently under examination, litigation, criminal investigation, or levy.

COMMENT. Before a private collection agency works a taxpayer’s account, the taxpayer will be contacted by the IRS by letter.

The Sharing Economy

The IRS is taking notice of the sharing, or gig, economy. It has opened a Sharing Economy Tax Center on its website, as well as educating agents on relevant examination techniques.

IMPACT. Basically, the sharing economy involves individuals selling goods or

services as self-employed persons. These activities might include, for example, selling goods online, advertising or other revenue from a website or blog, creating a crowdfunding site, short-term renting out a residence, or driving others for hire.

“Tax reform proposals continued to grab headlines during the filing season.”

COMMENT. More of these activities have come to the attention of the IRS as new Form 1099-K reporting requirements emerged for online and credit card transactions, as well as the use of Form 1099-MISC by large facilitators for service or goods providers. In turn, litigation over whether someone is an employee or independent contractor has increased, as well as the development of audit issues involving hobby-loss rules, the home office deduction, and the use of tax benefits through self-employed retirement and health insurance plans.

Challenges to Substance-Over-Form

Reversing the Tax Court, the Sixth Circuit Court of Appeals held that a DISC-Roth IRA arrangement that allowed a Roth IRA to sidestep annual Roth contribution limits must be respected (*Summa Holding, Inc.*, CA-6, February 16, 2017). Congress created both a Domestic International Sales Corporation (DISC) and Roth Individual Retirement Accounts (Roth IRAs) to lower taxes, reasoned the court; any unintended text-driven consequence by combining the two was up to Congress to remedy rather than through the application of the substance-over-form doctrine.

COMMENT. Although the facts of this particular case are unlikely to be applicable to many other taxpayers, limiting

the application of form vs. substance may be helpful to many tax planning strategies combining two Tax Code provisions to achieve unforeseen tax benefits. The Chevron doctrine giving deference to IRS regulatory interpretations of Tax Code provisions may also be under challenge.

COMMENT. Not all courts will likely fall in line with *Summa Holding*. In March, the Court of Appeals for the Federal Circuit upheld the disallowance of nearly \$50 million in purported losses, finding that the transactions giving rise to the purported losses lacked economic substance (*Russian Recovery Fund Limited, CA-FC*, March 16, 2017).

Immediate Expensing

One of the more important proposals under tax reform would be a game-changer for many businesses—the immediate expensing of most business assets. The House GOP blueprint would allow all types of businesses full and immediate “expensing” as a write-off of the cost of investments for tangible property and intangible assets. Variations on this proposal have included immediate expensing for pass-through businesses of all investment in equipment; and, more modestly, an increase in the annual cap on Code Sec. 179 expensing from \$500,000 to \$1 million.

IMPACT. Some businesses are looking at current purchasing plans with some concern over missing out on an effective date that may be delayed until 2018, or even phased in.

COMMENT. At the same time, practitioners continue to deal with issues raised within past legislation that involve Section 179 expensing and bonus depreciation. The IRS recently issued guidance to clarify the application of several changes made to the expensing allowance and the Code Sec. 168(k) bonus depreciation deduction by the Protecting Americans From Tax Hikes Act of 2015 (PATH Act) (Rev. Proc. 2017-33). The clarifications involve, among other things, components

of a central air conditioning or heating system, Section 179 elections on amended returns, and the eligibility of qualified improvement property and qualified restaurant property for bonus depreciation, as well as the election out of bonus depreciation and alternative minimum tax.

OTHER TAX-ADMINISTRATION TRENDS/ISSUES

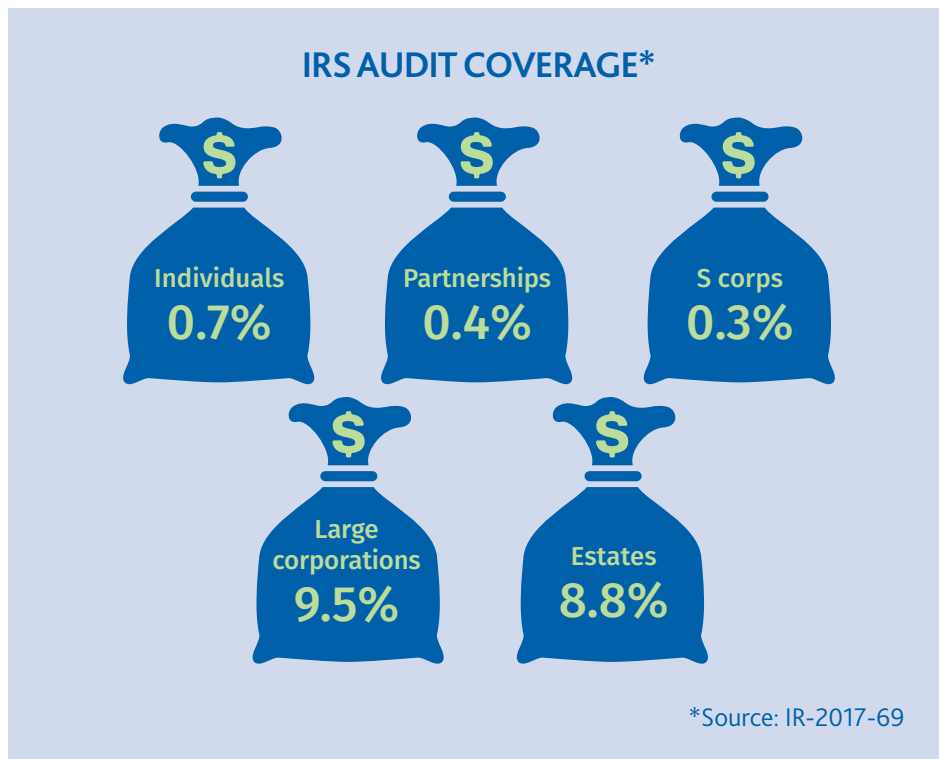
Fast track settlement. The IRS released updated procedures for the Small Business/Self-Employed Fast Track Settlement (FTS) program in April (*Rev. Proc. 2017-25*). The agency reiterated that its goal is to have the FTS process completed within 60 days of a taxpayer's acceptance into the program.

Offers in compromise. The IRS reminded taxpayers and tax professionals about its updated policy covering Offer in Compromise (OIC) applications in a post on its website in March. OIC applications received on or after March 27, 2017, will be returned without further consideration in instances where the taxpayer has not filed all required tax returns. The application fee will be returned but any required initial payment submitted with the OIC will be applied to outstanding tax debt.

COMMENT. *This new policy, however, does not apply to current year tax returns if there is a valid extension on file.*

Whistleblowers. IRS Chief Counsel described in April the procedures for its staff to disclose the existence or identity of a whistleblower (*CC-2017-005*). Before any disclosure may be made, Chief Counsel personnel must submit a detailed memorandum.

Students. The IRS Data Retrieval Tool (DRT) is offline, the agency announced in March on its website. The DRT provides tax data that automatically fills in information for part of the Free Application for Federal Student Aid (FAFSA) as well as the Income-Driven Repayment (IDR) plan application.



COMMENT. *Individuals filling out the FAFSA or applying for an IDR plan can manually provide the requested financial information from copies of their tax returns.*

Passports. On its website in February, the IRS described revocation or denial of a U.S. passport in cases of seriously delinquent tax debt. New Code Sec. 7345 authorizes the IRS to certify to the U.S. State Department if a taxpayer has seriously delinquent tax debt.

IMPACT. *Seriously delinquent tax debt for this purpose is defined as a taxpayer's unpaid, legally enforceable tax debt totaling more than \$50,000, including interest and penalties, for which a Notice of Federal Tax Lien has been filed and all administrative remedies under Code Sec. 6320 have lapsed or been exhausted; or levy has been issued, subject to certain exceptions and inflation adjustment, the IRS explained.*

Tax practice rules. The IRS Office of Professional Responsibility (OPR) announced online in February that it is continuing to use so-called "soft" notices to alert practitioners

about problems (*IRS Office of Professional Responsibility, February 28, 2017*). A "soft" notice, the IRS explained, is intended to inform the practitioner about apparent violations of Circular 230 and that OPR does not intend to take any further action.

NEW-FOR-2017 FILING SEASON RULES

Filing extensions were particularly critical to some taxpayers this filing season since some major deadlines had changed in 2017 for the first time:

- For tax years beginning after December 31, 2015, the *2015 Surface Transportation Act* provided that the due date for a partnership to file Form 1065 is changed to the 15th day of the third month after the close of the tax year (March 15 for a calendar-year partnership);
- For C corporations, the due date to file Form 1120 was also generally changed to the 15th day of the fourth month following the close of the tax year (April 18 this year for a calendar-year corporation)

(with an exemption for a corporation with a fiscal year ending on June 30).

COMMENT. *In coordination with the change in the partnership due date, the IRS provided a maximum six-month extension (previously five months) for partnerships filing Form 1065 (ending on September 15 for calendar-year taxpayers).*

C corporation six-month extensions. The IRS confirmed in a post on its website that a new revision of the Instructions for Form 7004 correctly reflects that calendar year C corporations are eligible for an automatic six-month extension. There was some concern that the language of Code Sec. 6081(b) would prohibit a change from a five-month limit. The six-month extension is granted under Code Sec. 6081(a), the IRS explained.

AMT/bonus depreciation clarification. The IRS announced, also in a post on its website, that the instructions for various 2016 forms relating to the Alternative Minimum Tax (AMT) would be amended to provide that property for which a taxpayer elects out of bonus depreciation is not subject to an AMT depreciation adjustment, effective for property placed in service after 2015.

Information returns. The IRS described the *de minimis* safe harbor for information return penalties created by the *Protecting Americans from Tax Hikes Act of 2015* (PATH Act) in a post on its website. The IRS also clarified that the safe harbor does not apply to intentional errors and in cases where the payor fails to file an information return or furnish a payee statement.

Payroll tax credit election. Interim guidance describes for small businesses the new payroll tax credit election for increasing research expenses (*IR-2017-70, Notice 2017-23*). The IRS also provided a special rule for small businesses that did not claim the credit but want to claim the credit before year-end 2017.

IMPACT. *Before passage of the PATH Act, the research credit was only available as a credit against income tax liability. Congress created the employment tax*

credit to encourage research activities by small businesses.

INFLATION ADJUSTMENTS

Vehicle depreciation caps. First-year passenger automobile depreciation for 2017 remains the same as in 2016: \$3,160 (\$11,160 with additional first-year depreciation for automobiles) and \$3,560 (\$11,560, with additional first-year depreciation) for trucks and vans (*Rev. Proc. 2017-29*). Only the third-year limitation for light trucks and vans increased, from \$3,350 in 2016 to \$3,450 in 2017.

Cents-per-mile. The maximum 2017 FMV amounts for use of the cents-per-mile valuation rule are \$15,900 for a passenger automobile (unchanged from 2016) and \$17,800 (up from \$17,700 for 2016) for a truck or van (including SUVs, etc. built on a truck chassis) (*Notice 2017-3*).

IRS interest rates. The interest rates on overpayments and underpayments of tax for the calendar quarter beginning April 1, 2017 remain unchanged (*IR-2017-53; Rev. Rul. 2017-6*).

INTERNATIONAL DEVELOPMENTS

The IRS will continue to focus on the international tax arena as an area in which new rules are generating increased revenues that have previously escaped collection. During tax season, the IRS made headway through the following actions.

Anti-inversion regulations. The IRS released final inversions regulations under Code Sec. 7874 to identify certain stock of a foreign acquiring corporation that should be disregarded in calculating the stock ownership percentage for purposes of determining “surrogate foreign corporation” status (*TD 9812*).

IMPACT. *These regulations were issued in early January, prior to the Trump Administration putting a hold on*

additional regulations. Businesses now wait to see what changes the Trump Administration and Congress may make in addressing corporate inversions in the future.

QI and FFI agreements. The IRS issued final specifications for qualified intermediary (QI) agreements, as well as an update for foreign financial institution (FFI) agreements, that may be entered into to simplify certain obligations under the *Foreign Account Tax Compliance Act* (FATCA) (*Rev. Procs. 2017-15, 16*).

U.S. source dividends. The IRS issued amendments to regulations that provide guidance to nonresident alien individuals and foreign corporations that hold certain financial products referenced to U.S. source dividend payments (*TD 9815, NPRM REG-135122-16*). Guidance was also provided to withholding agents with respect to a dividend equivalent and certain other parties to Section 871(m) transactions.

Transfer pricing. The Tax Court rejected the IRS’s use of a discounted cash-flow (DCF) methodology to determine a U.S. parent’s determination of the value of a “buy-in payment” by a foreign subsidiary for use of pre-existing intangible assets (*Amazon.Com, Inc. & Subsidiaries, 148 TC No. 8*). In holding for a taxpayer in the second case to come before it on virtually the same issue, the Tax Court allowed use of the more taxpayer-favorable comparable uncontrolled transaction (CUT) method.

QI/WP/WT extensions. The IRS announced on its website that it was extending for two months, from March 31 to May 31, 2017, the time allowed for a qualified intermediary (QI), foreign withholding partnership (WP), and foreign withholding trust (WT) application for renewal as well as for submitting a new application. In addition, the IRS will grant a retroactive effective date of January 1, 2017 for all properly submitted and approved renewal applications, including renewals containing a request for qualified derivatives dealer (QDD) status, submitted by May 31, 2017.

"Where are veterinarians subject to sales and use tax?"



Where are veterinarians subject to sales and use tax?



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