Current Federal Tax Developments

Nichols Patrick CPE, Incorporated

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SECTION: 61
PAYMENTS RECEIVED BOTH FROM CHARITIES AND INDIVIDUALS BY VICTIMS OF ORLANDO SHOOTINGS ARE NONTAXABLE GIFTS TO THE RECIPIENT

Citation: IRS Commissioner Letter to Rep. Patrick Murphy, 9/23/16

In a letter to Representative Patrick Murphy dated September 23, 2016 the IRS Commissioner stated to payments made to victims of the Orlando mass shootings at the Pulse nightclub in June by charities do not represent taxable income to those victims.

Rather, the Commissioner states:

> In general, individuals must pay federal tax on all income from whatever source derived. However, property received by gift is not taxable. A gift is generally defined as a transfer made out of detached and disinterested generosity.
>
> Payments that individuals receive from a charitable organization as a result of a disaster or emergency hardship are considered to be gifts and are excluded from the gross income of the recipients. Individuals may also help victims of disaster or hardship by making gifts directly to them. These gifts would also be non-taxable.

While payments made directly to victims of this tragedy would not be taxable to the recipient, the Commissioner did not note that those making such payments would not receive a charitable contribution and, if the amount was more than $14,000 to an individual, would result in a reportable gift for the donor.

The treatment described would apply to payments made to provide relief to victims of various tragedies so long as the "detached and disinterested generosity" standard is met.

SECTION: 61
SIFL RATES FOR 2016 PUBLISHED

Citation: Revenue Ruling 2016-10, 4/8/16, Revenue Ruling 2016-24, 9/26/16

The IRS has published the Standard Industry Fare Level (SIFL) rates and terminal charges for 2016. The first six months of 2016 are found in Revenue Ruling 2016-10 and the second six months in Revenue Ruling 2016-24.

The rate is used to value employer provided aircraft flights under the base aircraft valuation formula found at Reg. §1.61-21(g)(7). Generally the value of the flight is computed as follows:

$$Flight\ Value = SIFL\ mileage\ rate\ \times\ miles + Terminal\ Charge$$

The table of rates and and values for the first six months are:

Period During Which Flight is Taken	Terminal Charge	SIFL Mileage Rate
1/1/16 to 6/30/16	$39.19	Up to 500 miles = $0.2144 per mile
		501-1500 miles = $0.1635 per mile
		Over 1500 miles = $0.1572 per mile

The table of rates and values for the final six months are:

Period During Which Flight is Taken	Terminal Charge	SIFL Mileage Rate

7/1/16 to 12/31/16	$37.68	Up to 500 miles = $0.2061 per mile
		501-1500 miles = $0.1572 per mile
		Over 1500 miles = $0.1511 per mile

SECTION: 274
IRS PUBLISHES REVISED SPECIAL PER DIEM RATES FOR PERIOD FROM OCTOBER 1, 2016 TO SEPTEMBER 30, 2017

Citation: Notice 2016-58, 9/27/16

The IRS in Notice 2016-58 provided updated special per diem effective for the period from October 1, 2016 to September 30, 2017. These special rates include the rate for the special transportation industry meals and incidental expenses (M&IE) rate, the rate for the incidentals-only deduction and the rates and list of high-cost localities for purposes of the high-low substantiation method.

The special transportation industry rates for 2016-2017 are $63 for any locality of travel in the continental United States and $68 for any locality of travel outside the continental United States. The general rules for qualifying to use these rates and how to use them are found in Section 4.04 of Revenue Procedure 2011-47.

The incidentals only rate for 2016-2017 is set at $5. The provisions applicable to using this rate are found in Section 4.05 of Revenue Procedure 2011-47.

The high-low rates for 2016-2017, to be used in lieu of the rates described in Notice 2014-57, are $282 for any high-cost locality and $189 for travel to any other locality within the continental United States. The portion of the above amounts treated as paid for meals are $68 for travel to a high-cost locality and $57 for any other location within the continental United States.

Section 5.2 of the notice provides the 2016-2017 list of high-cost localities. Some localities are high-cost only for a portion of the year, with this fact noted in the listing. Section 5.3 provides a list of localities that were added and removed from the high cost list, as well as those where the time period during the year the high rate is applicable has been modified.

SECTION: 2056
IRS REVISES UNNECESSARY QTIP ELECTION REVENUE PROCEDURE TO ALLOW FOR PORTABILITY PLANNING

Citation: Revenue Procedure 2016-49, 9/27/16

The IRS, as promised in the regulations issued to implement the portability election under IRC §2010, has now issued a revised Revenue Procedure (Revenue Procedure 2016-49) which modifies the conditions under which a QTIP election will be deemed invalid that were contained in Revenue Procedure 2001-38.

The qualified terminable interest property (QTIP) election under IRC §2056(b)(7) is designed to allow a trust to be created to hold property passing to a surviving spouse with an interest that terminates at his/her death, with ultimate disposition controlled by the trust document itself. When the election is made, the surviving spouse agrees to treat the property as part of his/her estate despite having an interest that normally would be considered solely a life estate. With that election in place, the property qualifies for the unlimited marital exclusion at the first death.

In 2001 the IRS issued Revenue Procedure 2001-38 to provide automatic relief when an estate erroneously made a QTIP election for an estate where it was not necessary to reduce the estate tax to zero. The IRS had

noted that some estates would accidentally make the elections on such trusts, which would cause them to be included in the surviving spouse's estate. In such a case, the mistaken election could very lead to the estate of the surviving spouse owing estate tax when none would have been due had the election not been made.

In the old ruling, a QTIP election would be considered wholly or partially invalid automatically to the extent the election did not reduce the estate tax at the first death.

The arrival of the portability provisions under IRC §2010 created a situation where it very often would be desired to be able to put assets in a trust that insured the ultimate disposition at the second death would continue to be as it existed at the first death (giving assurance to each spouse that the other spouse could not redirect the assets following the first death), but to still have those assets included in the estate of the second spouse to die in order to obtain the income basis adjustment under IRC §1014 at the second death.

When a portability election has been made, the surviving spouse's estate is allowed to add to the decedent's normal estate tax exclusion any unused exclusion (DSUE amount) for the last predeceased spouse of the decedent (assuming that estate made the portability election). Thus, a total of well over $10,000,000 worth of assets can be passed tax free at the second death—and those assets included in the estate of the second to die will obtain a basis equal to fair market value at that second death.

Under the new Revenue Procedure, the IRS will treat QTIP elections that do not reduce the estate tax as void if the estate takes certain actions unless the estate has made a portability election under IRC §2010.

Specifically, the new ruling provides that an election will continue to be treated as void if the following conditions are met:

- The estate's federal estate tax liability was zero, regardless of the QTIP election, based on values as finally determined for federal estate tax purposes, thus making the QTIP election unnecessary to reduce the federal estate tax liability;
- The executor of the estate neither made nor was considered to have made the portability election as provided in § 2010(c)(5)(A) and the regulations thereunder; and
- The requirements of section 4.02 of this revenue procedure are satisfied (requiring the estate to file a revised Form 706 and notify the IRS the election should be treated as void)

The election will not be treated as void if:

- A partial QTIP election was required with respect to a trust to reduce the estate tax liability and the executor made the election with respect to more trust property than was necessary to reduce the estate tax liability to zero;
- A QTIP election was stated in terms of a formula designed to reduce the estate tax to zero. See, for example, § 20.2056(b)-7(h), Examples 7 and 8;
- The QTIP election was a protective election under § 20.2056(b)-7(c);
- The executor of the estate made a portability election in accordance with § 2010(c)(5)(A) and the regulations thereunder, even if the decedent's DSUE amount was zero based on values as finally determined for federal estate tax purposes; or
- The requirements of section 4.02 of this revenue procedure are not satisfied (the revised Form 706 and notice regarding the election being void are not followed).

SECTION: 3121
FAILURE OF EMPLOYERS TO FOLLOW TERMS OF SUPPLEMENTAL UNEMPLOYMENT BENEFIT PLAN CAUSED PAYMENTS TO BE SUBJECT TO FICA

Citation: Chief Counsel Email 201639015, 9/23/16

Despite the fact that a SUB Trust plan summary description indicated that benefits it would pay would be limited to those who qualified for state unemployment benefits, the failure of the employers submitting lists of employees to be paid under the plan to confirm the employees had received stated unemployment meant the payments were not treated as FICA-exempt supplementation unemployment benefits (Chief Counsel Email 201639015).

In this case a multiple employer plan had been established which was funded via a trust to pay benefits to certain employees who worked less than a specified number of hours in the prior month. As a condition of receiving such benefits, the plan provided that an employee must qualify for state unemployment benefits.

However, in operation the employers simply submitted a list of employees who worked less than the stated number of hours in the prior month. No attempt was made to confirm that the employees actually qualified for state unemployment benefits.

The email summarized the law in this area as follows:

> Law: Section 3121(a) and Treasury Regulation section 31.3121(a)-1(b) provide that, for purposes of the FICA tax, all remuneration for employment is wages, unless a specific exception applies. The IRS created an administrative exception for certain payments that are designed to supplement state unemployment compensation and that are actually tied to the receipt of state unemployment benefits. This limited exception is explained in Revenue Ruling 56-249; Revenue Ruling 90-72 adds clarification regarding lump sum payments.

While a plan operated in accordance with the stated terms would likely have qualified for exemption from FICA, the failure of employers to follow the terms of the plan eliminated the tax benefit.

As the email holds:

> Conclusion: We agree with your conclusion that these "short-week benefits" are not excluded from wages for purposes of FICA tax because they do not satisfy the requirements set forth in Rev. Rul. 56-249 and Rev. Rul. 90-72. Your conclusion is also consistent with PLRs 200322012 and 9734035, which stated that Automatic Short Week Benefits are wages for FICA and FUTA purposes, unless the benefits are made to individuals who otherwise qualify for excludable Regular Benefits (i.e., if the Automatic Short Week Benefits immediately precede or follow a week in which an employee receives Regular Benefits).

SECTION: 6502
IRS ANNOUNCES BEGINNING OF CONGRESSIONALLY MANDATED USE OF PRIVATE COLLECTION AGENCIES IN SPRING 2017

Citation: News Release IR-2016-125, 9/26/16

The IRS in News Release IR-2016-125 provided information regarding the use of private debt collectors to pursue unpaid taxes mandated by Congress in the Protecting Americans from Tax Hikes Act of 2015.

The IRS had been mandated to begin using the private agencies earlier this year, but the IRS has delayed the beginning of the program and will, per the announcement, begin using the agencies in the spring of 2017, though an exact date for the start was not announced.

The four contractors who will be handling these collections are:

- CBE Group of Cedar Falls, IA

- Conserve of Fairport, KY
- Performant of Livermore, CA
- Pioneer of Horseheads, NY

One key area of concern involves the potential (or, in this author's view, virtual certainty) that those perpetrating telephone frauds will begin claiming to be collection agencies working with the IRS. The IRS has provided the following procedures that will be followed under the program to attempt to address these issues:

> The IRS will give each taxpayer and their representative written notice that their account is being transferred to a private collection agency. The agency will then send a second, separate letter to the taxpayer and their representative confirming this transfer.

The IRS goes on to claim:

> The IRS will do everything it can to help taxpayers avoid confusion and understand their rights and tax responsibilities, particularly in light of continual phone scams where callers impersonate IRS agents and request immediate payment.

Advisers likely need to give specific information to their clients regarding these procedures, since they only will serve to protect individuals who are aware of these procedures. That includes those who owe no taxes, since obviously those make fraudulent calls are not simply going to call delinquent taxpayers.

The news release goes on to note:

> Private collection agencies will be able to identify themselves as contractors of the IRS collecting taxes. Employees of these collection agencies must follow the provisions of the Fair Debt Collection Practices Act and must be courteous and respect taxpayer rights.

SECTION: 6651
ATTORNEY'S MALPRACTICE IN MISLEADING ESTATE REGARDING HAVING FILED FOR AN EXTENSION WAS NOT REASONABLE CAUSE TO AVOID LATE FILING PENALTY

Citation: Specht v. United States, USDC SD Ohio, Case No. 1:13-cv-00705, 115 AFTR 2d ¶ 2015-315, 1/6/15, affirmed CA6, 118 AFTR 2d ¶ 2016-5243, 9/22/16

In the case of the *Specht v. United States* (115 AFTR 2d ¶ 2015-315, USDC SD Ohio, Case No. 1:13-cv-00705, 2015 TNT 5-12, *affirmed*, CA6, 118 AFTR 2d ¶ 2016-5243) the issue involved whether a taxpayer should be found to have reasonable cause for the late filing of a tax return if the client's attorney misled the estate into believing the attorney had filed an extension for filing the return.

The numbers in question are not small—the estate had been hit with penalties and interest of $1,198,261.38 due to the late filing of the estate tax return.

When Virginia Escher died her estate was worth over $12 million. Her cousin was appointed executor of the estate. Her cousin had never previously served as an executor, did not own any stock (Virginia's estate consisted principally of stock in UPS) and had never actually been in an attorney's office. She therefore decided to select Virginia's attorney to assist her due to her lack of experience in financial and probate matters.

The attorney appeared more than qualified to handle the matter. She had over 50 years of experience in estate planning and had handled Virginia's planning. However she was privately battling brain cancer, a fact she did not disclose to the executor. Very likely due to issues related to that illness, the quality of the attorney's representation of the estate was well below the quality she had previously evidenced in her practice.

The attorney indicated to the executor that she had filed for an extension of time to file the estate tax return though, in fact, no extension had been filed. The opinion notes that it's not clear whether she intentionally misled the estate on this issue or not, but eventually the attorney voluntarily relinquished her law licensed following

malpractice claims. As well, she has since been incompetent and is subject to a guardianship over her person and estate.

The attorney had informed the executor that the estate tax return was due on September 30, 2009. She also informed the executor that the estate would owe approximately $6 million in estate tax. In order to pay the tax the estate would need to sell UPS stock, the asset that made up the bulk of the estate.

The executor testified that she was aware that the filing deadline was important and that negative consequences would take place if the deadline was missed. Prior to the September 30 date the executor had received multiple notices from the probate court warning that counsel for the estate was failing to perform her duties and the estate had missed various deadlines.

When she asked the attorney about the missed estate tax return filing deadline, the attorney assured the executor that an extension had been filed and that the attorney was handling the matters related to the estate. The executor accepted this statement, though she never asked to see the extension in question.

However, notices continued to come from the probate court about missed deadlines. As well another family that had hired this attorney to handle an estate contacted the executor to warn her that they were seeking to have this attorney removed from handling their estate because she was incompetent. The attorney again assured the executor that all was going well and there were no issues.

However, now the executor began to get notices from the state warning that the estate's state tax return had not been filed and was late, and alerted her that the state had not received any responses in letters to the attorney for the estate regarding this matter. The letter also informed her that additional amounts might be due because of the tardiness of the filing.

As well, she received additional warnings from the other family regarding the attorney's lack of competence. Eventually she did consult with another attorney to consider if the estate's counsel's performance was a problem. This attorney advised her that she needed to hire an attorney other than the one she had retained to handle the estate. However, she still did not terminate the services of the attorney.

Finally she received another letter from the state regarding the delinquent filings. At this point she contacted UPS and discovered that, despite having given the attorney documents many months earlier to arrange for a sale of the UPS stock (a sale that had to take place in order to pay the tax), UPS had never received a request to sell the stock.

A few days later she terminated the services of the original attorney, hiring the attorney she had consulted (and who had advised her, it appears very correctly, to terminate the original attorney) to handle estate matters. Within a month the UPS stock was sold and on January 26, 2011 the estate filed its now very delinquent estate tax return.

The estate now sought relief from the penalties imposed due to the late filing, arguing that the failure to file met the requirements for relief found at IRC §6651(a)(1). Those requirements are to show that the failure was:

- Due to reasonable cause *and*
- Was not due to willful neglect.

Unfortunately, the court found that the estate could not meet either criteria.

Generally the requirement to timely file a tax return cannot be delegated. As the court noted:

> Treasury Regulations require the estate to demonstrate that it "exercised 'ordinary business care and prudence' but nevertheless was 'unable to file the return within the prescribed time.'" *Boyle*, 469 U.S. at 246 (quoting 26 C.F.R. § 301.6651(c)(1)). In *Boyle*, the Supreme Court held that "[t]he failure to make a timely filing of a tax return is not excused by the taxpayer's reliance on an agent, and such reliance is not 'reasonable cause' for a late filing under Section 6651(a)(1)." 469 U.S. at 248. In *Boyle*, the Supreme

> Court recognized a distinction between a taxpayer who "has relied on the erroneous advice of counsel concerning a question of law," and a taxpayer who has retained an attorney to attend to "an unambiguous, precisely defined duty to file" a return by a certain time. *Id.* at 250. Although a taxpayer may reasonably rely on advice received from an attorney "on a matter of tax law . . . one does not have to be a tax expert to know that tax returns have fixed filing dates and that taxes must be paid when they are due." *Id.* at 251.

The opinion concludes:

> Accordingly, even though Plaintiff hired counsel to handle the estate, reliance on counsel cannot constitute reasonable cause for the late filing and payment of taxes. Even if Backsman's *[the attorney]* medical condition led her to malpractice in the course of representing the Estate, this did not render Mrs. Specht *[the executor]* "disabled."

Rather, to put it simply, the executor had a duty to confirm that filing deadlines had been met rather than simply accepting the word of her attorney.

The court also found that there was evidence of willful neglect. The court notes that mere carelessness is enough to deny relief under this standard.

And, unfortunately, there are plenty of items that came to the executor's attention that suggested there might be major problems with the adviser she had hired. As the opinion summarized:

> Mrs. Specht was aware that the Estate's federal tax return needed to be filed and paid nine months after Ms. Escher's death on September 30, 2009; that the tax liability was approximately $6,000,000; and that the Estate would need to sell its UPS stock to cover the tax liability. Mrs. Specht further understood that the September 30, 2009 deadline was important, and that missing the deadline would result in consequences. In the months prior to the estate tax deadline, Mrs. Specht received at least four notices from the probate court informing her that the estate was missing probate deadlines. After the deadline, Mrs. Specht received at least two additional noticed from the probate court warning that Backsman had failed to file a first accounting of the Estate's assets; numerous calls from the Rotterman family informing Specht that Backsman was incompetent; two letters from the Ohio Department of Taxation informing Specht that the state tax return was delinquent; and a warning from another attorney -- whom she eventually hired to replace Backsman -- informing her that she needed to hire another attorney.

The court did close by noting that the result certainly seems harsh and unfair. But as the opinion notes:

> Serving as the executor of a probate estate is clearly not an easy task, which is why Mrs. Specht trusted an attorney to guide her through the process. While this Court finds it difficult to hold that Plaintiffs are ultimately responsible for Ms. Backsman's malpractice, that is what binding precedent requires. Notably, in light of Ms. Backman's malpractice, the State of Ohio refunded the late filing and payment penalties for Ohio estate taxes without the Estate filing a refund suit. (Doc. 16, Ex. 2 at ¶14). It is truly unfortunate that the United States did not follow the State of Ohio's lead.

Given the amounts involved, not surprisingly the estate appealed this decision to the Sixth Circuit Court of Appeals—but the appellate panel found that executor has not shown reasonable cause for her failure to insure the return was timely filed. The medical condition of the attorney, and its effect on her ability to competently conduct her practice weren't relevant as the opinion notes "the relevant question is whether the executor, not the attorney, was reasonable in missing the deadline."

Had the attorney been the executor, it's very possible the court would have found reasonable cause for the late filing—but timely filing cannot be delegated by a taxpayer to a third party. The taxpayer may have reasonable cause relief for cases where the taxpayer received erroneous advice on a matter of law (such as being told no return was required when, in fact, it was) but not for what the courts see as the simple matter of seeing if a document was actually filed on a specific date.