TedPerkins**Tax News**

MID YEAR TAX UPDATE 2013

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PART I – TAX NEWS

IRS Targets Tea Party

The exemption applications of social welfare groups with the words “Tea Party,”“Patriots” or “9/12 Project” in their names were automatically pulled for a review of whether their primary purpose was social welfare or campaign intervention. Repercussions to follow.

Loving Case Rules IRS Regulation of Unenrolled Preparers Invalid

The IRS’ regulation scheme for return preparers is invalid, a court says. In its view, the Service lacks the power to regulate unenrolled preparers...those who aren’t attorneys, CPAs or enrolled agents. As a key part of its decision the court enjoined the agency from enforcing the regulations that require preparers to register, pass a competency test and take continuing education (Loving, D.C., D.C.).

PART II - LEGISLATION

AMERICAN TAXPAYER RELIEF ACT

The House and Senate passed H.R. 8, 112nd Cong., 2d Sess. (Jan. 1, 2013), the American Taxpayer Relief Act of 2012(the “TRA”). Here are the highlights

Individual Tax and Other Tax Rate Provisions -

- *Ordinary Tax Rates – Increased for Individuals, Estates, and Trusts* - Under the TRA after December 31, 2012, the income of individual taxpayers is subject to the following marginal tax rates: 10%, 15%, 25%, 28%, 33%, 35%, and 39.6%. The highest tax rate of 39.6% will apply to singles with taxable income in excess of $400,000, heads of households with taxable income in excess of $450,000, and taxable income in excess of $225,000, for marrieds filing separately. The TRA sets the income tax rates for estate and trusts at 15%, 25%, 28%, 33%, 36%, and 39.6% for income over $11,950.

- *Capital Gain Tax Rate Increased* - The TRA increases the top rate which applies net long-term capital gain and qualified dividends for high income taxpayers to 20%.

- *Accumulated Earnings Tax and Personal Holding Company Tax Rate* - The Accumulated Earnings Tax and the Personal Holding Company Tax are both increased from 15% to 20% for tax years beginning after December 31, 2012.

- *Reduced Rate for "Kiddie Tax"* - For 2012, the "kiddie tax" for parents who elected to report the unearned income of their children on their tax return was equal to the sum of (1) the tax on the parent's taxable income after taking into account the child's gross income over $1,900, plus (2) 10% of the lesser of (a) $950 ($1,000 for 2013), or (b) the excess of the child's income over $950 ($1,000 for 2013).

- *Gain Exclusion for "Qualified Business Stock" Extended* - The TRA restores retroactively and extends the 100% exclusion for QSBS for two years by changing the date *before* which eligible QSBS must be acquired from Jan. 1, 2012 to Jan. 1, 2014. Note, this makes the 100% exclusion available retroactively for tax year 2012.

- *Personal Exemption Phase-out Restored* - The TRA restores the personal exemption phaseout ("PEP") for tax years beginning after December 31, 2012. Under the prior law, the exemption amount of a taxpayer was reduced or "phased out" to the extent a taxpayer's adjusted gross income exceeded a certain threshold amount.

- *Overall Limitation on Itemized Deductions* - For tax years beginning after 2013, the TRA sets the phase-out for itemized deductions at the same threshold amounts set for the PEP $300,000, $275,000 for head of households; $250,000, for singles; half of the joint filer threshold for married filing separately.

- *Standard Deduction Marriage Penalty Relief* - In order to mitigate the so-called marriage penalty, the prior law allowed a standard deduction for married taxpayers filing jointly equal in amount to 200% of the dollar amount for single taxpayers; the standard deduction for married taxpayers filing separately which was made equal to the standard deduction for single taxpayers.

- *Interest Deduction for Mortgage Insurance Premiums is Extended -* Prior to 2012, premiums paid or accrued for qualified mortgage insurance premiums in connection with acquisition indebtedness was deductible, subject to a phase out. The TRA extends this provision to amounts paid or accrued after December 31, 2011, and before January 1, 2014.

- *Exclusion for Debt Discharge Income from Home Mortgage Forgiveness -* Under the prior law, forgiveness of "Qualified principal residence indebtedness" up to $2 million was excluded from income. The basis of the principal residence was reduced but not below zero, by an amount equal to the excluded income. This provision now applies to income discharged before January 1, 2014.

Alternative Minimum Tax Provisions

Under the TRA, the AMT Exemptions are set at $78,750 for married couples filing jointly and surviving spouses, $50,600 for single taxpayers, and $39,375, for married filing separately.

Estate/Transfer Tax Provisions

- *Unified Credit and GST Exemption* - The law permanently continues to set the exemption equivalent of the unified credit at $5 million[1], indexed for inflation after 2011. This applies for both estate and gift tax purposes. The GST exemption will permanently be the same as the estate tax exemption.
- *Top Tax Rate Set* - The top estate and gift tax rate will be 40%, for transfers over $1 million after 2013. Thus, the estate and gift taxes continue to be a single flat rate, once the donor or decedent's transfers exceed the applicable exclusion amount. The GST tax rate is set permanently at 40%.
- *Portability* - Portability is made permanent. A technical correction is made to the portability rules to clarify how the deceased spouse's unused exemption amount is calculated. This is consistent with what Treasury already included in the temporary regulations.
- *State Death Tax Credit* - The state death tax credit remains history, and the state death tax deduction is made permanent.
- *The Technical Provisions of the Economic Growth and Taxpayer Relief Reconciliation Act of 2001 are made permanent -* These include (a)

[1] In Rev Proc 2013-15, 2013-5 IRB 444 (Jan. 28, 2013), the IRS announced an increase in the applicable exclusion amount to $5.25 million for gifts and deaths in 2013.

liberalization of the rules on the estate tax deduction for conservation easements under Code Sec. 2031(c); (b) automatic allocation of GST exemption to transfers to GST trusts; (c) permitting certain retroactive allocations of GST exemption; (d) permitting qualified severance of trusts for GST tax purposes; (e) permitting the IRS to allow late allocations of GST exemption; (f) adopting substantial compliance rules for allocation of GST exemption; (g) slight easing of the rules on the deferred payment of estate taxes on closely held business interests under Code Sec. 6166; and (h) waiver of the statute of limitations on certain special use valuation of farm real estate under Code Sec. 2032A.

- *IRA Direct Distribution* - The new law extends the rule permitting a direct distribution from an IRA to a qualified charity on or after the participant has reached 70 1/2 years of age, to distributions after November 30, 2012, and before January 1, 2014; such amounts are treated as part of the required minimum distribution.

Business Provisions

- *Code 179 Expensing -* The TRA extends the Increased 2010 and 2011 Code Sec. 179 dollar limitation and $2,000,000 phase-out threshold, and the treatment of qualified real property as Code Sec. 179 property, to 2012 and 2013.

- *First –Year Depreciation Cap for Cars -* Under prior law, passenger cars which are “qualified property” as defined in Code Sec. 168(k)(2), qualify for an $8,000 increase in the first-year depreciation limit if placed in service before December 31, 2012. TRA extends the placed in service deadline to December 31, 2013.

- *Bonus Depreciation for Qualified Property -* The TRA extends bonus depreciation and AMT depreciation relief for qualified property placed in service through Dec. 31, 2013.

- *15-year MACRS Depreciation* **-** 15-year MACRS depreciation for certain building improvements and restaurants is extended to apply to property placed in service before Jan. 1, 2014.

Other Provisions Which Impact

- *The Child Care Credit, Dependent Care Credit, Adoption Credit, and EIC Simplification and Phase- Out*

- *The Research Credit and the Work Opportunity Credit*
- *Built in Gains Period*
- *Child Care Credit*
- *Charitable Contributions*
- *Education provisions*
- *Roth Rollovers and Conversions*
- *Tax Exempt Bonds and Development Incentives*
- *Energy provisions*

See Special Tax News Supplement – January, 2013 for a Complete Summary of the American Taxpayer Relief Act

MARKETPLACE FAIRNESS ACT OF 2013

On May 6, the Senate passed the Marketplace Fairness Act of 2013 which allows states to tax “remote’ sellers.
The bill would require online sellers to collect state sales taxes from buyers living in states with sales taxes, unless a seller had Web sales of $1 million or less. The measure also creates a simplified structure for satisfying states’ varying tax rules and rates. Even though the Senate favors the bill by a wide margin and President Obama endorses it, the House isn’t in a hurry to act. Detractors are asserting that the measure represents a tax increase on individuals, and that it will be a compliance burden on businesses, especially Web retailers in states with no sales tax. They’ll have to start collecting other states’ sales taxes.

PART III – CASES AND RULINGS

INCOME TAX

Sergio Wins

Pro golfer Sergio Garcia, a Swiss resident, argued that 85% of the money from his worldwide endorsement agreement was a royalty for the right to use his name and likeness. Under the U.S.-Switzerland tax treaty, royalties aren’t taxed in the U.S. IRS claimed that he was paid primarily for his personal services, such as playing golf, and none of the funds were royalties. The Tax Court treated 65% of the endorsement money as tax free royalties. (K 3/29)

Taxpayer's Reasonable Reliance on CPA Protected Him from Penalties - Michael Thomas, TC Memo 2013-60

The Tax Court has concluded that a taxpayer's failure to include unreported income on his return was reasonable because he relied in good faith on his tax adviser. Under Code Sec.6664(c), no accuracy-related penalty was imposed. The test applied : (1) *competent professional; (2) necessary and accurate information, and (3) good faith reliance.*

Innocent Spouse Could Not Recover Attorney's Fees After IRS Concession

The Tax Court in Knudsen, TC Memo 2013-87, RIA TC Memo ¶2013-087 , held that the taxpayer was not entitled to recover litigation fees and costs from the IRS under Section 7430 because its concession that it would not apply two-year limitation period to the taxpayer's case was a settlement so the qualified offer rule did not apply.

Key facts leading to the court's finding that the parties settled the case for the purpose of Section 7430(c)(4)(E)(ii)(I) include: (1) the IRS informed the taxpayer that it was conceding that she was entitled to her requested relief; (2) she never challenged the concession after hearing it and accepted the accompanying benefits in full, and (3) the court would enter

No Charitable Deduction for Taxpayers Who Provides Appraisals of Wrong Property

The Tax Court in *Evenchik*, TC Memo 2013-34, RIA TC Memo ¶2013-034, 105 CCH TCM 1231 , held that the taxpayers were not entitled to a deduction for their donation of their corporation's stock to a charity because they provided appraisals of buildings that the corporation owned rather than an appraisal of the stock.

Partner Could Not Avoid Gross Valuation Misstatement

The Tax Court in *AHG Investments, LLC*, 140 TC No 7, Tax Ct Rep (CCH) 59485, Tax Ct Rep Dec (RIA) 140.7, 2013 WL 999916 , held that the taxpayer could not avoid application of the 40% gross valuation misstatement penalty under Section 6662(h) merely by conceding the IRS's adjustments to income on grounds unrelated to valuation or basis.

Part of "Catchup" Payments to Previously Undercompensated Employees wasUnreasonable - Thousand Oaks Residential Care Home I, Inc., et al, TC Memo 2013 10.

The Tax Court has found that a portion of the amounts paid from a corporation to its owner and his wife, both in the form of salary and pension plan contributions, was unreasonable and couldn't be deducted by the corporation. Although these "catchup" payments were largely intended to compensate them for prior years in which they received little to no wages for their work, the payments essentially depleted the corporation's assets.

The Tax Court arrived at its decision by applying the following five factors: (1) Role in company; (2).comparison with other companies; (3) character and condition of the company; (4) conflict of interest(3) Internal consistency of compensation, and (5) the independent investor test

Retained Rights Don't Prevent Guarantor from Being "At-risk" but co-guarantors do - Chief Counsel Advice 201308028

In Chief Counsel Advice (CCA), IRS has determined that the guarantor of debt of a limited liability company (LLC) may be "at risk" under Code Sec. 465 with respect to the guaranteed debt, even if he doesn't waive his rights of subrogation and reimbursement from the LLC. However, the CCA went on to conclude that the guarantor was not at risk to the extent that others co-guaranteed the debt. These conclusions apply whether the LLC is treated as a partnership or as a disregarded entity but they are subject to certain conditions. The Code Sec. 465 at-risk rules are designed to ensure that a taxpayer deducts losses only to the extent he is economically or actually at risk for the investment. A taxpayer isn't considered at-risk with respect to any amount protected against loss by nonrecourse financing, guarantees, stop loss agreements, or other similar arrangements. Thus there are two requirements that must be met for a taxpayer to be considered at risk for borrowed amounts: the taxpayer must be personally liable for the debt, and the taxpayer must not be otherwise protected against loss. The personal liability prong is generally determined by analyzing whether the taxpayer is ultimately liable for repayment as the "payor of last resort." There are a number of different approaches in determining whether the "otherwise protected" prong has been satisfied. The majority approach (used by the 2nd, 8th, and 11th Circuit Courts of Appeal) considers whether, based on the "economic realities" present at the end of the tax year, an arrangement protects the taxpayer from loss. The minority view (used by the 6th Circuit) applies the same “payor of last resort” analysis as is used for the first prong.

Accountants hit with trust fund penalty tax for failure to remit client's payroll taxes- Erwin, (DC NC 02/05/2013) 111 AFTR 2d ¶2013-426

A district court has concluded that two brothers in an accounting firm are each liable for over $325,000 in trust fund recovery penalties due to their failure to remit a financially troubled client's unpaid withholding taxes to IRS. It illustrates that company owners, principals, or directors aren't the only ones who can get hit with the Code Sec. 6672 tax.

Sole shareholder and CFO's compensation was largely unreasonable - Aries Communications Inc. & Subs, TC Memo 2013-97

The Tax Court has determined how much of the amount paid by a corporation in the radio broadcasting business to its chief financial officer (CFO) and sole shareholder (including “catchup” payments for undercompensated prior years) was reasonable compensation deductible by the corporation under Code Sec. 162.

The Ninth Circuit Court of Appeals (to which an appeal of this case would lie) uses five factors to determine the reasonableness of compensation, with no single factor being determinative: (1) the employee's role in the company; (2) comparison with other companies; (3) the character and condition of the company; (4) potential conflicts of interest; and (5) internal consistency in compensation.

IRS waives 60-day rollover rule for individual seeing doctor for multiple conditions - PLR 201315036

In a private letter ruling (PLR), IRS has waived the 60-day rollover requirement for a taxpayer who withdrew funds from her IRA and failed to timely roll them over due to medical conditions that impaired her ability to manage her financial affairs.

Tax Court largely denies taxpayers' deductions for aircraft, vineyard & shopping activities - Heinbockel, TC Memo 2013-125

The Tax Court has largely denied the deductions claimed by a married couple in association with the husband's airplane chartering business, property that they purportedly intended to turn into a vineyard but didn't, intra-family loan costs, and the wife's personal shopping business. The Court found that the husband's airplane activity wasn't entered into for profit, that their “lending activities” weren't a bona fide trade or business, and that their vineyard costs should be capitalized into the property's basis. The Court further denied many of the personal shopping business costs for inadequate substantiation.

Couple couldn't deduct mortgage interest added to principal - Hargreaves, TC Summary Opinion 2013-37

In a summary opinion, the Tax Court has held that a married couple could not deduct mortgage interest that was added to the principal of their negative amortization loan. Since they were on the cash basis, they couldn't deduct this interest because they did not pay ivt. However, the Court refused to impose an accuracy-related penalty.

Severance Pay Not Subject to FICA- In Re Quality Stores, Inc., et al, 110 AFTR 2d 2012-5827

IRS loses again on levying FICA taxes on severance pay for laid off workers. The 6th Circuit Court of Appeals has refused to reconsider a 2012 decision that payments made in conjunction with a reduction in force aren’t subject to FICA. Odds favor a Supreme Court appeal. A different Appeals Court OK’d the tax.

IRS Attempt to Reclassify Payments to S Corporation Shareholder Rebuffed - Thousand Oaks Residential Care Home I, TC Memo. 2013-10).

An IRS attempt to reclassify payments to an S firm owner is partially rebuffed. An S corporation paid its co-owner $60,000, but treated only $2,400 of it as wages. The balance was ostensibly reimbursement for cash advances he made to employees to cover their business expenses. IRS classified $55,000 as salary subject to FICA.

Fraud not Shown, Taxpayers Saved by Expired Limitations Period - Bohannon, TC Memo 2013-122

The Tax Court has held that a married couple was not liable for deficiencies and fraud penalties for several years because IRS did not issue the notice of deficiency within the period of limitations. The Court rejected IRS's assertion that the limitations period had remained open because the taxpayers filed false or fraudulent returns with the intent to evade tax.

Trust were Shams, Doctor Socked with Tax and Penalties - Steven E. Vlach and Nancy Vlach, TC Memo 2013-116

The Tax Court has held that trusts established for asset protection by a doctor were shams. As a result, the trusts were disregarded and the doctor and his professional corporations owed taxes and penalties.

Case Remanded to Tax Court to Determine Transferee Tax Liability

The First Circuit in *Frank Sawyer Trust of May 1992*, 111 AFTR2d 2013-xxxx, reversed the Tax Court's decision that a trust was not liable as a transferee for four corporations' unpaid federal taxes and penalties and remanded the case to the Tax Court to determine whether a fraudulent transfer occurred because the purchasers of the corporations did not receive reasonably equivalent value from the trust for the corporations.

Unused Basis from the Past Couldn't be Restored to Deduct Current Pass Through Losses - Barnes, (CA DC 04/05/2013) 111 AFTR 2d ¶ 2013-611

The Court of Appeals for the District of Columbia, affirming the Tax Court, has held that S corporation shareholders weren't entitled to fully deduct passthrough losses because they didn't have sufficient basis in their stock. The taxpayers' past failure to take into account suspended losses that became available didn't operate to restore the unused basis for use in the year at issue. This was so even though the taxpayers never claimed a deduction for those suspended losses, and they were now barred by the statute of limitations from doing so.

ESTATE TAX

Assets from Terminated QTIP trusts Transferred for a Private Annuity Triggered Gift Tax - Estate of Kite, TC Memo 2013-43

The Tax Court has held that termination of qualified terminable interest property (QTIP) trusts followed by an immediate sale of the QTIP trust assets to the decedent's children in exchange for a private annuity was, in effect, a disposition of the decedent's lifetime interest in the QTIP trusts. As a result, the Court found that the decedent was liable for a gift tax under Code Sec. 2519 on the entire value of the QTIP trust property, less the value of the lifetime interest.

Final regs Clarify Reduced 2009 Estimated Tax Payments for Individuals with Small Businesses - T.D. 9613, 02/26/2013; Reg. § 1.6654-2

IRS has issued final regs on who is eligible for the Code Sec. 6654(d)(1)(D) reduced estimated income tax payments for qualified individuals with small business income for a tax year beginning in 2009 only. This provision was added by the American Recovery and Reinvestment Act of 2009 (ARRA, P.L. 111-5, 2/17/2009).

Only the Activities of a Trustee Performed in a Fiduciary Capacity are Considered in Determining "Material Participation" - In a Technical Advice Memorandum (TAM), IRS has concluded that only the activities of a trustee with respect to a company that were performed in a fiduciary capacity are included for purposes of establishing whether the trust materially participated in the company's activities under Code Sec. 469(h). Since the trustee's non-fiduciary activities are excluded, the trust didn't materially participate and thus was subject to the alternative minimum tax (AMT) adjustment for the company's research and experimental (R&E) expenditures.

Trusts Converted to Unitrusts without adverse Tax Consequences - PLR 201320009

IRS has privately ruled that the conversion of two trusts into unitrusts won't cause the trusts to lose their grandfathered status from generation-skipping transfer (GST) tax, won't result in any beneficiaries being charged with making gifts, and won't trigger any gain or loss to the trusts or their beneficiaries.

Taxpayer's Bargain Sale of Land to County Produces Income Tax Deduction, Despite Lack of Qualified Appraisal

In Crimi v. Comm'r, T.C. Memo 2013-51 (Feb. 14, 2013), the Tax Court sustained over $1 million in income tax deductions for a bargain sale of land to a county and its conservation partnership, despite the lack of a qualified appraisal. The court agreed that the taxpayer's appraisal was not a qualified appraisal for several reasons, but noted that the taxpayer's CPA had made diligent inquiries to other accountants in his firm, and had concluded that the appraisal was sufficient, and that the taxpayers had relied on the CPA's opinion in this matter.

Income Recognized on Cancellation of Insurance Policy for Nonpayment of Premiums

In Jarvis v. Comm'r, T.C. Summ. Op. 2013-11 (Feb. 19, 2013), the Tax Court, in a Summary Opinion, held that a taxpayer who had paid premiums on a life insurance policy by borrowing against its cash surrender value, must recognize income when that debt was discharged because of the cancellation of the policy for nonpayment of premiums.

No Deduction for Gift of Conservation Easement That Did Not Reduce Value of the Property

In Scheidelman v. Comm'r, T.C. Memo. 2013-18 (Jan. 16, 2013), on rem'd, 682 F.3d 189 (2d Cir., 2012), vac'g & rem'g T.C. Memo. 2010-151, the Tax Court held that a façade easement contributed by the taxpayers to a charitable preservation organization had no value and produced no income tax deduction. The taxpayers' appraisal stated that it was extremely difficult to estimate the impact of a façade easement on the subject property, but that the IRS usually accepted 11 – 11.5% of the total value of the property, for easements on properties in this section of New York. The IRS argued that this was not a qualified appraisal, and the Tax Court agreed, finding that the appraisal lacked "independent or reliable methodology." The Second Circuit (Chief Judge Jacobs) vacated and remanded the decision, holding that the appraisal was a "qualified appraisal," and noting that an appraisal need not be good or sound, in order to be "qualified." On remand, the Tax Court (Judge Cohen) held that the façade easement had no value for tax purposes. The court stated that the testimony of two experts presented on behalf of the taxpayers was based on insufficient facts and data, was not the product of a reliable methodology, and was not reliably applied to the facts of the case. For those reasons, the court concluded, the report was not credible, and one expert's factual and calculation mistakes "undermined the reliability of his report." The court held that the evidence supported the conclusion of the IRS expert—that the easement did not affect the value of the property, considering the otherwise desirable location and nature of the property and the local real estate market.

Estate Cannot Argue that Decedent Made No Taxable Gifts

In Estate of Sommers v. Comm'r, T.C. Memo 2013-8 (Jan. 10, 2013), the Tax Court held that a decedent's estate was collaterally estopped from arguing that gifts the decedent had made within three years of his death were actually revocable transfers, because courts in two different states had already held that they were completed transfers. The decedent had sued unsuccessfully in one state court to have the gifts declared revocable, and his executor had sued in another state court to have them declared includible in his estate because of a retained power to revoke. Both suits had resulted in determinations that the transfers were completed when made. The Tax Court held that the state court decisions made conclusions about the completion of the transfers based on facts and analysis that was the same as that applied for tax purposes, and that these findings were “essential” to the state court decisions.

No Income Tax Deduction for Contribution of Conservation Easement on Property with Unsubordinated Mortgage

In Minnick v. Comm'r, T.C. Memo. 2012-345 (Dec. 17, 2012), the Tax Court denied nearly $1 million in charitable deductions for the contribution of a conservation easement on mortgaged property. The mortgage did not, on the date of the gift, subordinate the rights of the lender to those of the charitable donee. Five years after the gift, the bank agreed to subordinate the mortgage to the rights of the holder of the conservation easement. The court held that no deduction is allowed for a conservation easement of property that is subject to a mortgage, unless the mortgagee subordinates its rights to those of the donee at the time of the gift; the intentions of the parties ultimately to subordinate the mortgage were immaterial.

Advice of CPA That No Penalties Would Apply Does Not Excuse Late Filing of Estate Tax Return

In Estate of Young v. United States, 2012 WL 6585327 (D. Mass. Dec. 17, 2012), the executor paid part of the estimated estate tax after the original date for filing the estate tax return, though before the extended filing date. A U.S. District Court imposed penalties for failure to file a timely estate tax return, even though the executor's accountants told him that no penalties would be imposed were the return filed late. That advice, the court noted, did not constitute reasonable cause, because the executor knew when the return was required to be filed, and intentionally filed it later than that date.

Supreme Court Grants Will Decide Marital Deduction Under DOMA

In Windsor v. United States, 2012 WL 4937310 (2d Cir., 2012), aff'g 833 F.Supp.2d 394 (S.D. N.Y. June 6, 2012), cert. granted (Dec. 7, 2012), the U.S. Supreme Court has agreed to decide whether the Defense of Marriage Act (DOMA) constitutionally denies the estate tax marital deduction to a same-sex couple whose marriage was valid in the state in which they were domiciled. The court will review the decision of the U.S. Court of Appeals for the Second Circuit, which held that the Federal Defense of Marriage Act was unconstitutional, to the extent that it denied the estate tax marital deduction to a couple who were legally married under applicable state law (New York). The court held that homosexuals are a quasi-suspect classification and that the act was subject to intermediate scrutiny, so that it must be substantially related to an important government interest. The court held that DOMA did not meet this standard and was, therefore, unconstitutional. One judge dissented.

Appeals Court States That Defense of Marriage Act Unconstitutionally Denies Marital Deduction

In Windsor v. United States, ___ F.3d ___, 2012 WL 4937310 (2d Cir. Oct. 18, 2012), aff'g 833 F.Supp.2d 394 (S.D. N.Y., 2012), cert. requested, 136 DTR K-1, 2012 TNT 185-24 (July 16, 2012), the U.S. Court of Appeals for the Second Circuit held that the Federal Defense of Marriage Act was unconstitutional, to the extent that it denied the estate tax marital deduction to a couple who were legally married under applicable state law (New York). The court held that homosexuals are a quasi-suspect classification and that the act was subject to intermediate scrutiny, so that it must be substantially related to an important government interest. The court held that DOMA did not meet this standard and was, therefore, unconstitutional. One judge dissented.

Estate Cannot Deduct Debt Allegedly Existing Between Spouses Without Proof of Legal Enforceability

In Estate of Derksen v. United States, 2012 WL 5465002 (E.D. Pa. 2012), a U.S. District Court denied an estate tax deduction under Code Sec. 2053 for a debt that was allegedly owed to the estate of the decedent's late husband under an informal agreement between the spouses to maintain equal estates, and late filing penalties were imposed.

Tax Court Limits Deduction for Contribution of Façade Easement and Imposes Gross Overvaluation Penalty

In Whitehouse Hotel Limited Partnership v. Comm'r, 139 TC No. 13 (Oct. 23, 2012), on rem'd from 615 F.3d 321 (5th Cir., 2010), rev'g and rem'g 131 T.C. 112 (2008), the Tax Court, in a case remanded by the Fifth Circuit, held that the value of a façade easement on an historic luxury hotel property should be valued based on comparable sales, resulting in a deduction of $1.8 million, rather than the $7.5 million claimed by the taxpayer, and a gross overvaluation penalty.

Conservation Easement Upheld Due to Proper Documentation

The Tax Court sustained a charitable contribution deduction for a bargain sale of a conservation easement, finding that (a) the easement provisions requiring remittance of proceeds from any extinguishment of the easements to the federal, state, and local conservation agencies that provide grants for the easement purchase, was allowed because the charity would receive and retain a proportionate share of the proceeds; (b) the appraisal was qualified because it contained all of the required information; and (c) the contemporaneous acknowledgement requirement was satisfied by the combination of parts of several different documents. (Irby v. Comm'r, 139 TC No. 14 (Oct. 25, 2012))

Health Problems Did Not Constitute Reasonable Cause for Failing to File Timely Gift Tax Return

In Stine v. United States, ___ F.Cl. ___, 2012 WL 5207502 (Ct. Fed. Cl. Oct. 23, 2012), the U.S. Court of Federal Claims held that a taxpayer's health problems, though not inconsequential, did not constitute reasonable cause for filing late 2007 gift tax returns and paying gift taxes late. The taxpayer had made taxable gifts to her daughter in early 2007, and filed her return after the due date, resulting in a $450,000 late filing and late payment penalty and $21,500 in interest. The taxpayer claimed that her health problems, including pneumonia, recurrent upper respiratory infections, knee pain, knee replacement surgery, a thyroid growth, heart palpitations, and cataract surgery, prevented her from filing a timely return. The court disagreed, noting that the problems resulted in only one night in the hospital, and that during this same period the taxpayer transferred real property to her revocable trust, authorized her lawyers to pay her income taxes electronically, filed timely state income tax returns, and filed timely state estimated tax vouchers.

Estate Cannot Deduct Amounts, Including Payments to Settle Possible Beneficiary's Claims to Estate

In Estate of Bates v. Comm'r, TC Memo. 2012-314 (Nov. 7, 2012), the Tax Court held that a decedent's estate could not deduct payments made to a caregiver who had been named a beneficiary under the decedent's instruments, because they were made to settle the right to the caregiver's beneficial interests, rather than claims against the estate. In addition, amounts paid by the decedent's son to a private investigator were not deductible because it was not clear what services were actually rendered. The court sustained late filing penalties despite some confusion that existed on whether the executor could legally file the estate tax return.

PART IV - IRS ANNOUNCEMENTS

News & Events From the IRS

Management Veterans Selected to Assist New IRS Acting Commissioner Werfel; Maloy, Grams, Fisher Named to Senior Posts - IR-2013-59, June 3, 2013 — The IRS today announced the selection of several senior leaders to assist new Acting Commissioner Danny Werfel.

Spring 2013 Statistics of Income Bulletin Now Available - IR-2013-58, May 31, 2013 — The spring 2013 issue of the IRS Statistics of Income Bulletin, which features information on high-income individual income tax returns filed for tax year 2010, is now available on IRS.gov

IRS Accepting Applications for Low Income Taxpayer Clinic Grants - IR-2013-57, May 30, 2013 — The IRS announced the opening of the 2014 Low Income Taxpayer Clinic (LITC) grant application process.

Prepare for Hurricanes, Natural Disasters by Safeguarding Tax Records - IR-2013-56, May 29, 2013 — With the start of this year's hurricane season, the IRS encourages individuals and businesses to safeguard their records by taking a few simple steps.

Tax Relief for Victims of Severe Storms and Tornadoes in Oklahoma - OK-2013-3, May 23, 2013 — Victims of severe storms and tornadoes that began on May 18, 2013 in parts of Oklahoma may qualify for tax relief.

Interest Rates Remain the Same for the Third Quarter of 2013- IR-2013-55, May 23, 2013 — The IRS has announced that interest rates will remain the same for the calendar quarter beginning July 1, 2013.

IRS Reminds Those with Foreign Assets of U.S. Tax Obligations - *IR-2013-54, May 23, 2013* — The IRS reminds U.S. citizens and resident aliens, including those with dual citizenship who have lived or worked abroad during all or part of 2012, that they may have a U.S. tax liability and a filing requirement in 2013. The filing deadline is Monday, June 17, 2013, for U.S. citizens and resident aliens living overseas, or serving in the military outside the U.S. on the regular due date of their tax return.

IRS Gives Tax Relief To Oklahoma Tornado Victims; Return Filing and Tax Payment Deadlines Extended to Sept. 30 - IR-2013-53, May 21, 2013 — After Monday's devastating tornado in Moore and Oklahoma City, the IRS today provided tax relief to individuals and businesses affected by this and other severe storms occurring in parts of Oklahoma.

MoreTaxpayers e-file from Home in 2013 - *IR-2013-52, May 20, 2013* — New statistics show continued growth in electronic filing of tax returns.

IRS Finalizes Regs on Disclosure or Use of Information by Return Preparer- T.D. 9608, 12/26/2012; Reg. § 301.7216-2

IRS has issued final regs providing rules relating to the disclosure or use of tax return information by tax return preparers. Specifically, they provide updated guidance affecting tax return preparers regarding the use of information related to lists for solicitation of tax return business; the disclosure or use of statistical compilations of data by a preparer in connection with, or in support of, his return preparation business; and the disclosure or use of information for the purpose of performing conflict reviews. The regs adopt the proposed regs (which also were issued as temporary regs) with minor clarifications and revisions.

IRS Provides Revised Guidance on 2013 Withholding to Reflect 2012 Taxpayer Relief Act- IR 2013-1

In an Information Release, IRS announced that it has issued revised income tax withholding tables for 2013 that reflect the new tax rates in effect for that year under the 2012 Taxpayer Relief Act, which was signed into law on Jan. 2, 2013. The updated tables supersede the tables previously issued by IRS on Dec. 31, 2012.

Taxpayers not Entitled to refund of Amounts that were Untimely assessed but Timely Paid- Chief Counsel Advice 201252015

In Chief Counsel Advice (CCA), IRS's Office of Chief Counsel determined that IRS's assessment of the additional tax shown on taxpayers' amended returns for two years, which were filed while the limitations periods on assessment for both years remained open, was untimely. However, the CCA held that the amounts that the taxpayers paid with their amended returns weren't refundable overpayments because they didn't exceed the amounts owed, and they weren't statutory overpayments because they were credited to the taxpayers' account within the applicable limitations periods on assessment.

Proposed Regs Designate Third-party Payor as Employer's Agent Liable for Employment Taxes- Preamble to Prop Reg01/25/2013, Prop Reg § 31.3504-2

IRS has issued proposed regs that would generally designate a third-party payor as an agent to perform the acts required of an employer under Code Sec. 3504 and render the payor liable for employment taxes for wages or compensation that the payor pays to individuals performing services for the client under a service agreement. The proposed regs would be effective when finalized and applicable to wages or compensation paid by a payor in quarters beginning on or after the effective date to individuals performing services for its client under a service agreement.

Proposed Reliance Reg Clarifies Material Advisor Penalty & Allows for Extensions- Preamble to Prop Reg03/07/2013, Prop Reg § 301.6708-1

IRS has issued a proposed reg that would clarify aspects of the Code Sec. 6708 penalty for material advisors' failure to make available upon IRS's request lists of advisees with respect to reportable transactions, and permit IRS to grant a discretionary extension of the 20-day period to produce the list if certain requirements are met. The proposed reg would apply to all written requests made after the date that it is published as final, but material advisors may rely on it before that time.

Substance Over Form Doctrine Defeats Dividend Distribution Deduction- Chief Counsel Advice 201320014

In Chief Counsel Advice (CCA), IRS has concluded that under the substance over form doctrine a common parent wasn't eligible for the Code Sec. 245 dividends received deduction (DRD) for funds distributed from a regulated investment company (RIC) to it via a foreign corporation.