Tax Practice Pro
2364 State Route 17A
Goshen, New York 10924
Ph: 800-943-1750
Fax:(845)206-0648
www.taxpracticepro.com

APPROVED
CONTINUING EDUCATION
PROVIDER

2017 & 2016 Tax Court Cases Which You Missed

August 28th, 2017

Novi, Michigan
A82BK-T-00079-17-I

Michigan Society of Enrolled Agents 2017 Annual Conference

We Help Tax Professionals Grow.

2017 & 2016 Tax Court Cases

Which You Missed

(and why they are

important to your tax practice)

August 28, 2017

Novi, Michigan

IRS Program No. A82BK-T-00079-17-I 2 credit hours of Federal Tax Law Approved for Enrolled Agents & Other Tax Return Preparers

Tax Practice Pro, Inc.
2364 State Route 17A
Goshen, NY 10924
800-943-1750
john@taxpracticepro.com

NOTICE: AUDIO AND VIDEO RECORDING OF ALL TAX PRACTICE PRO EVENTS IS PROHIBITED

As tax practitioners, we invariably end up, with our clients, before the examination branch of the Internal Revenue Service. Disagreements between taxpayers and the Examination branch can end up in the U.S. Tax Court.

"The United States Tax Court is a court of record established by Congress under Article I of the U.S. Constitution. When the Commissioner of Internal Revenue has determined a tax deficiency, the taxpayer may dispute the deficiency in the Tax Court before paying any disputed amount. The Tax Court's jurisdiction also includes the authority to predetermine transferee liability, make certain types of declaratory judgments, adjust partnership items, order abatement of interest, award administrative and litigation costs, re-determine worker classification, determine relief from joint and several liability on a joint return, review certain collection actions, and review awards to whistleblowers who provide information to the Commissioner of Internal Revenue on or after December 20, 2006."[1]

The U.S. Tax Court can issue three different types of opinions:

A. **Bench Opinion** - A Judge may issue a Bench Opinion during the trial session. In this situation, the Judge orally states the opinion in court during the trial session.

B. **Summary Opinion** - A Summary Opinion cannot be relied on as precedent, and the decision cannot be appealed.

C. **Tax Court Opinion or Memorandum Opinion** - The Chief Judge decides whether an opinion in a regular case will be issued as a Memorandum Opinion or as a Tax Court Opinion.

Generally, a Memorandum Opinion is issued in a regular case that does not involve a novel legal issue. A Memorandum Opinion addresses cases where the law is settled or factually driven. A Memorandum Opinion can be cited as legal authority, and the decision can be appealed. A Memorandum

[1] https://www.ustaxcourt.gov/about.htm

Opinion is cited as [Name of Petitioner] v. Commissioner, T.C. Memo. [year issued - #].

Generally, a Tax Court Opinion is issued in a regular case when the Tax Court believes it involves a sufficiently important legal issue or principle. A Tax Court Opinion can be cited as legal authority, and the decision can be appealed. A Tax Court Opinion is cited as [Name of Petitioner] v. Commissioner, [Volume of Tax Court Reports] T.C. [page of the volume] (year issued).

Whether the case can be cited as precedent or not, the case will help you to understand the Court's thinking in a matter. It never hurts to have relevant cases available when trying to make a point to an IRS examiner, colleague, or client.

1. Qualifying Education

Reg. 1.162-5(a) permits a current year tax deduction for education expenses that: (1) maintain or improve skills required by the taxpayer in his or her employment, or (2) meet the express requirements of the taxpayer's employer, or of applicable law or regulations, imposed as a condition to the retention by the taxpayer of an established employment relationship, status, or rate of compensation.

Reg. 1.162-2(5)(b) provides that educational expenses for education that is part of a program of study that will lead to qualifying the taxpayer in a new trade or business are not deductible.

Emmanuel Santos worked as an accountant and an enrolled agent. He held a master's degree in taxation. He found he wanted to better help his clients, so he entered law school. Upon graduation, he passed the bar.

The IRS[2] ruled that these expenses qualified Santos for a new trade or business (attorney), different from the trade of being an accountant or enrolled agent. The Court quoted an example in the regulations "A, a self-employed individual practicing a profession other than law, for example, engineering, accounting, etc., attends law school at night and after

[2] Emmanuel A. Santos v. Commissioner of Internal Revenue, T.C. Memo. 2016-100

completing his law school studies receives a bachelor of laws degree. The expenditures made by A in attending law school are nondeductible because this course of study qualifies him for a new trade or business."

Ever diligent, Santos tried to argue the underlying regulation was not valid. In short, the regulation was added in 1967 and had already been challenged in 1969. The court refused to review the matter and stated that the precedents and law are valid and stand.

Takeaway: Even if Santos attended law school to broaden his tax knowledge, the fact that the program of study qualified him for a new occupation, however tangential to his current one, seems to stymy the tax deduction.

2. Self-Employment Income from Outside the US

While a US Citizen or resident is required to report their world-wide income subject to taxation on a federal income tax return each year, the earned income of an individual who is a bonafide resident of Puerto Rico for the entire year is exempt from federal income tax. [3]

However, similar to self-employed US Citizens living outside the US, the self-employed resident of Puerto Rico is required to file a US income tax, claim the exemption from income tax, and pay self-employment tax on their earnings.[4]

In the case of Jose M. Curet,[5] the taxpayer represented himself in tax court, and argued that "…he was not subject to any U.S. tax for 2010 because he was a resident of Puerto Rico". It constantly amazes the author that pro se litigants, after ignoring all other correspondence, show up at Tax Court thinking they will win their case. Further, it amazes the author the Court entertains these cases.

Takeaway: (1) Income tax exclusions do not always apply other taxes, and careful research should be done. (2) Income tax exclusions are often elections, requiring a US Citizen to timely file a tax return in order to obtain the exclusion.

---

[3] Internal Revenue Code 933(1)
[4] Section 1401; Reg. 1.1402(a)-9)
[5] Jose M. Curet v. Commissioner of Internal Revenue TC Memo 2016-138

3. Home Mortgage Interest Deduction Limits are per Person, not per Home.

Prior to this case, the home mortgage interest deduction was limited to the interest on $1,000,000 of qualified home mortgage indebtedness, plus the interest on $100,000 of home equity indebtedness. In the case of joint, unmarried owners, this limit was traditionally split between the owners.

On August 1, 2016, the Service recommended acquiescence in Voss v. Comm., CA-9, 2015. The Ninth Circuit held that the deduction for qualified residence interest is determined on a per taxpayer basis and not on a per residence basis. This meant that Voss and his registered domestic partner EACH were entitled to deduct interest on up to $1,100,000 of qualified residence mortgage indebtedness and were not limited to sharing a single $1,100,000 mortgage cap.

Takeaway: In light of the Service's acquiescence, this issue, if raised by an agent, now should be conceded at the agent level by a reference to the Voss case.

Author's note: In the New York City area and suburbs, the author's home base, the Service conducts multi-year letter audits of these issues. A copy of the forms 1098 and the allocation calculation are mailed or faxed to the examiner. Frequently if more than one owner is listed, the question as to how much was claimed by the other owner comes up. I have not had one of these situations post-Voss.

4. IRC 162(a) Medical Expense Reimbursement Plans

The case of Milo and Sharlyn Shellito[6] is a schedule F case, but the issues are exactly the same for a sole proprietor.

There are companies who promote medial reimbursement plans which can 'save you $5000 per year' in taxes. Essentially, the sole proprietor legitimately hires their spouse to provide services to the company. The spouse participates in a medical reimbursement plan, where the employer/spouse reimburses the employee/spouse for out-of-pocket medical expenses.

[6] Shellito v. Commissioner of Internal Revenue, T.C. No. 10223-06

The Tax Court affirmed the IRS position that the wife was not a bonafide employee of the family farm because her purported compensation as an employee was illusory and only served to generate the tax deduction.

The case is an interesting read. The highlights are these:

1. Taxpayer was a farmer since 1978.
2. They owned the equipment used at the farm.
3. They leased 2,300 acres and owned 47 acres of land. The leased land was only in the taxpayer's name. The owned land was in both names.
4. Spouse worked at the farm full time since 1982.
5. Taxpayer directed spouse's work.
6. On the advice of their tax professional, starting in 2001 they adopted the medial reimbursement plan:
    a. They purchased a complete package from the promotor.
    b. They used a third-party administrator to handle payments.
    c. Spouse signed an employment agreement.
    d. Spouse opened her own checking account and paid the medical bills not covered by insurance, and their premiums, through it.
    e. She was paid a salary and issued a form W2.

The matter ended up in Circuit Court. In the end, the taxpayers prevailed.

The author suspects that the legal fees to take this to Court were funded by the promoter of the program.

<u>Takeaway:</u> I wanted to take the opportunity to revisit the use of medical reimbursement programs under IRC 162(a). Although the Affordable Care Act limits the ability to reimburse premiums when there is more than one plan participant, the balance of the program is still useful. Note too, that the small tax practitioner's single largest competitor today is TAX SOFTWARE. It is the tax practitioner's ability to review client's situation and facts and recommend tax saving strategies to help business owners. Those skills set us apart from lower cost automated and do-it-yourself solutions.

5. Trust but Verify – What's in Your Permanent File?

When a new client comes in, they often purport to have a certain business structure. Practitioners should consider whether they wish to obtain evidence of the structure for their permanent file – and potentially help a client correct any errors before they are detected.

In Richland[7], the Court held that a married couple's business was a corporation, even though they did not 'use' the corporation.

The taxpayer husband started a business through which he bought and resold sporting, concert, and other event tickets. The taxpayers' son, without permission and while he was still a minor, incorporated this business using an online legal service. The son was unaware of the tax differences between sole proprietorships and corporations. When the paperwork arrived, the taxpayer husband asked the son about it, but did nothing to stop or unwind the incorporation process. Thereafter, the taxpayers filed corporate annual reports for the business with the Michigan Department of Energy, Labor & Economic Growth.

The taxpayers and their sons traveled to various locations to buy and resell tickets. The taxpayers used their personal credit cards to make all business-related purchases because they did not have a business credit card. All business expenses were paid from and business income was deposited into their personal bank accounts. Although the business did have its own bank account at one point, the taxpayers had closed it because they never used it.

The taxpayer husband prepared and timely filed the couple's Forms 1040, U.S. Individual Income Tax Return. Attached to each return was a Schedule C, Profit or Loss from Business that identified their business as one that sold goods and tickets. The taxpayers reported losses for 2008 and 2009.Their business expenses included the business use of their home; supplies expenses; office expenses; legal and professional expenses; advertising expenses and travel expenses, among several other

[7] TC Memo 2015-174

expenses. The taxpayers did not keep records of any expenses. They reconstructed expenses by using credit card statements.

The IRS adjusted the taxpayers' liabilities to reflect the removal of the Schedules C. The Service asserted that the business was a corporation. The taxpayers argued that the corporate form of their business should be disregarded. [**Author's note**: short of trying to deduct the cost of establishing the corporation, how did the IRS become aware of its existence?].

When a taxpayer adopts a corporate form, as long as the business purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation is a separate taxable entity. To determine whether a corporation is organized for a business purpose, the court has said that "the degree of corporate purpose and activity requiring recognition of the corporation as a separate entity is extremely low." Also, the determination that a corporation is doing business is not necessarily dependent on the "quantum of business." To be recognized as a corporation, a business does not need to keep account books or records, maintain separate bank accounts or credit cards, or own any assets.[8] When a corporate form is adopted, taxpayers are not permitted to claim individual deductions for the corporate expenses.

The court said that an entity formed as a state-law corporation is treated as a corporation for federal tax purposes. There was no issue with the entity's business purpose. It was organized for the bona fide business purpose of buying and reselling event tickets. The issue for the court was whether the business was a corporation for federal tax purposes.

The court considered whether the taxpayers were bound by their son's unauthorized act of registering the business as a corporation. It said that the evidence was clear that the son was not instructed by the taxpayer to register the business as a corporation. However, when the taxpayer

[8] Moline Properties Inc. v. Comm., (S Ct 1943) 30 AFTR 1291

learned that it had been registered, he did nothing to undo what his son had done. The taxpayer ratified his son's act.

The court said that under Michigan law, unauthorized acts may be explicitly or implicitly ratified. Such acts are ratified if the principal accepts the acts with knowledge of the material facts. The court found that the taxpayer respected, at least in part, the corporate form by filing annual reports with the Michigan Department of Energy, Labor & Economic Growth. By doing so, he recognized and ratified the corporate form. Because their business was a corporation, the taxpayers were not entitled to deduct its losses on their personal returns. Their adoption of the corporate form required the acceptance of its tax disadvantages. In the Court's opinion, they reference that "...the Rochlanis point us to the failure to maintain corporate books or accounts", to which the Court mentioned that the Supreme Court addressed the significance of such facts in Moline Properties, Inc., where the Court determined that the corporate existence could not be ignored as merely fictitious even though the corporation "kept no books and maintained no bank account during its existence and owned no other [significant] assets".

Takeaway # 1 – a new business client should be asked questions similar to refundable credit due diligence: do you have a business bank account, is your business registered with the State, County, etc. In such an interview, it might have been determined that these taxpayers had a corporation, and that it should have been closed – or maybe utilized for the business based on the expectation of losses.

Takeaway #2 – I frequently encounter taxpayers who have formed LLC or Corporations but 'not started using (them)'. It's clear that we need to look to state laws to see about ratification; but in the case where the taxpayer personally formed the entity it may not matter. Clearly, we need to encourage the client, in writing, to decide to either keep and use or dissolve the entity and move on.

Further, some states will dissolve an entity if annual reports are not filed, the so-called 'die on the vine'. Considering this Tax Court case and the Moline Properties case mentioned, practitioners should be careful to advise clients in writing of the need to dissolve entities when they decide they won't use them.

6. The Author's Favorite for 2016 – Clothing is Optional Under IRC 162

Mr. Barnes began working as a salesman for Ralph Lauren Corp. (Ralph Lauren) in 2010. Ralph Lauren designs, markets, and distributes, among other products, men's apparel, such as polo shirts, casual shirts, T-shirts, sweatshirts, sweaters, dress shirts, suits, sports coats, and pants, all of which are suitable for general or personal wear.

Ralph Lauren required all employees who worked in corporate sales positions to wear Ralph Lauren apparel while representing the company. Consequently, Mr. Barnes purchased Ralph Lauren shirts, pants, ties, and suits, the costs of which he deducted as unreimbursed employee expenses on Schedule A, Itemized Deductions.

The Court has established three criteria for the cost of clothing to be deductible as an ordinary and necessary business expense: (1) the clothing is required or essential in the taxpayer's employment; (2) the clothing is not suitable for general or personal wear; and (3) the clothing is not so worn.[9]

Although Mr. Barnes was required to wear Ralph Lauren clothing while representing the company, Ralph Lauren clothing is suitable for general or personal wear. Thus, Mr. Barnes' costs to acquire and maintain his Ralph Lauren clothing is not deductible.

Takeaway: For 30 years, clients have wanted to write off their 'business clothes'. I keep a PDF of this case and the Forbes article explaining it. I e-mail it to clients who want to argue the point of deducting the expenses.

7. When Officer's Compensation is TOO Reasonable

In Brinks, Gilson, & Leone, A Professional Corporation v. Comm., TCM 2016-20 (02/10/16), a large C corporation cash method law firm that "zeroed out" its book income each year by paying large year-end bonuses to its shareholder-employees conceded that such bonuses were nondeductible dividends because they were paid in direct proportion to

[9] Hynes v. Commissioner, 74 T.C. 1266, 1290 (1980)

shareholder ownership. In and of itself, this is concerning since many fiscal-year C corporations do exactly this.

The litigated issue in the case was whether the C corporation should be subject to the 20% taxpayer accuracy-related penalty for substantial understatement of income tax liability or for negligence. The Tax Court held that the 20% penalty applied and that the C corporation did not have substantial authority for its position, had not relied on professional advice, and did not have reasonable cause for the underpayment and had not acted in good faith with respect to deducting the bonuses.

Takeaway: This case serves as a reminder that C corporations that render a professional service do not have an absolute right to zero out income that is generated partially by non-shareholder professionals and other employees. This is the reverse argument from S corporation reasonable compensation cases. In those cases, one argues that there are non-owner employees helping to generate revenue, which can be paid out to the shareholder outside of payroll.

8. FINALLY, Form 1098-T Does Not Control Your American Opportunity Tax Credit

During 2011 Angela Terrell was enrolled as a full-time student at Hampton University in Hampton, Virginia. In the fall of 2010 she registered for courses for the spring 2011 semester. On November 23, 2010, the university billed to her account tuition of $2,460 based on her preliminary selection of spring 2011 semester courses. On January 10, 2011, the university billed to her account additional tuition of $1,230 based on her final course selections for that semester.

Angela financed her education largely with student loans. Although the university billed tuition charges to her account, her student loans were not disbursed until January 20, 2011. The Form 1098-T filed with the IRS had no entry in box 1, captioned “Payments received for qualified tuition and related expenses.” It showed an entry of $1,180 in box 2, captioned “Amounts billed for qualified tuition and related expenses.” The $1,230 represented the amount billed to the taxpayer’s account on January 10, 2011, plus mandatory fees of $50, minus a tuition credit of $100 ($1,230 + $50 - $100 = $1,180).

On her timely fled 2011 tax return, she claimed an American Opportunity Credit of $2,500. She claimed $1,500 of this credit on line 48 as an education credit against the regular tax. She claimed the $1,000 balance on line 66 as a refundable credit and thus as a "payment."

The Service sent her a letter asking for confirmation of the tuition expense. Apparently, the taxpayer did not reply to any correspondence other than the 90-day letter (Statutory Notice of Deficiency).

At trial, Terrell presented an account statement from Hampton University, on official letterhead, showing an itemized schedule of tuition charges for the spring 2011 semester. This schedule shows a tuition charge of $2,460 on November 23, 2010, another tuition charge of $1,230 on January 10, 2011, a $50-degree fee on January 25, 2011, and a $100 tuition credit on February 9, 2011, for total net tuition and related charges of $3,640 for the spring 2011 semester.

Although the university charged a portion of petitioner's spring 2011 semester tuition to her account in November 2010, the loan proceeds that she used to pay those tuition charges were not disbursed and credited to her account until 2011. She is therefore treated as having paid those expenses in 2011. Since she is a cash basis taxpayer, this was the proper year for which to claim a credit for the tuition that she paid in 2011.

According to the trial record, the IRS argued that the $1,180 was the correct amount to be considered for the credit. The Court ruled that regardless of what the 1098-T states in box 2, the amount paid is what controls the amount of the credit.

Takeaway: It has been clear for the last several years that the Colleges and Universities are all failing to correctly prepare these forms. The IRS has no choice but to attempt to match them. In the author's practice, we have been asking for the actual transcripts from the bursar's office. Most colleges now provide online access to the student accounts. Having copies of these has proven helpful in replying to subsequent examination letters.

AUTHOR'S NOTE: The Protecting Americans against Tax Hikes act does rectify the ambiguities in the 1098-T preparation instructions so that most schools should be correctly reporting the tuition paid in box 2.

9. Children as Employees (Really?)[10]

It's important to note that this case is fun. Taxpayers are both lawyers, John & Lisa Fisher. As it turns out, the taxpayers live near where I grew up, at least according to the Tax Court records.

During summer school recesses the spouse often brought her children into her office, usually for approximately two hours a day, two or three days a week. She did this because at times other family members were not available to care for the children and because, according to her testimony, "day care was cost-prohibitive, so she had the children working for her in the office instead". She further testified that "...allowing the children to work in the office would help to teach them about the value of money and develop a healthy work ethic."

Keeping in mind the three children were under the age of 9 at the time, the spouse testified that they performed these tasks:

Shredded waste, mailed things, answered telephones, photocopied documents, greeted clients, and escorted clients to the office library or other waiting areas in the office complex. She further testified the children helped move files from a flooded basement in 2006; they helped remove files damaged in a bathroom flood in 2007, and they helped to move the office to a different office in the same building in 2008.

Some key numbers from Mrs. Fisher's schedule C for the law practice:

	2006	2007	2008
Gross	$ 5,500.00	$10,953.00	$12,273.00
Kids Wages	$10,435.00	$10,313.00	$ 8,022.00
Net loss	$39,073.00	$36,696.00	$29,220.00

[10] TC Summary Opinion 2016-10

Practitioner did not file form W2 or payroll reports for the years at issue. No payroll ledgers or other payroll related records were kept.

The Court reminded the taxpayer that deductions are a matter of legislative grace, and the taxpayer bears the burden of proof to establish entitlement to any claimed deduction.

While the Court conceded, that payments made to minor children by a related party for services rendered in connection with the payor's trade or business might very well qualify for a tax deduction[11], both the IRS and the Court need to closely scrutinize the facts and circumstances as normal supposition when payments are made to dependent children or when items are purchased by a parent for dependent children is that the money or items are in the nature of support and nondeductible.[12]

At trial, Mrs. Fisher stated that payments to her children for services rendered to her law practice were made in part by contributions into their section 529 accounts and in part in cash so that the children could purchase “books, things they needed, chachkies [sic], souvenirs, things of that nature”.

Mr. Fisher testified that payments to his children for services rendered to his wife’s law practice were made solely by contributions to their section 529 accounts although he testified that only portions of the contributions were reported as wages.

The CPA who prepared the returns testified that the deductions were not computed with reference to the children’s' section 529 account contributions.

The Court held that:

> “petitioners have failed to establish their entitlement to the deductions for wages to minor children as claimed on the 2006, 2007, and 2008 Schedules C relating to petitioner's law practice. We are satisfied, however, that each of petitioners' children performed services in connection with petitioner's law practice during each year in issue and each was compensated for doing so. Taking into account their

[11] Denman v. Commissioner, 48 T.C. at 448-451.
[12] Holtz v. Commissioner, T.C. Memo. 1982-436

ages, generalized descriptions of their duties, generalized statements as to the time each spent in the office, and the lack of records, we find that petitioners are entitled to a $250 deduction for wages paid to each child for each year."[13]

Takeaway:

- You can't believe everything you read on the internet, such as paying your kids to work in your sole proprietorship.
- The children should have opened IRA accounts.
- No one asked for the kid's tax returns.
- Aggressive positions require documentation.
- Of course, if you prepared this return you would have discussed documentation, and kept proper records to support deductions.

10. "Zeroing out Schedule C (or any other form)"

Many tax professionals favor the S-corporation as the vehicle for business ownership and self-employment. The use of the entity, where appropriate, has proven itself to legally reduce overall individual tax liability.

There are two situations where the 'zeroing out' of the schedule C comes up:

1. The S-Corp which was formerly taxed as a sole proprietorship.
2. Payer pays the individual and not the entity.

Converted Entity. In these cases, the taxpayer was a sole proprietor or SMLLC at some point, and forms 1099 were correctly issued in the taxpayer's social security number. At the point the entity converted to a corporation, all payers should have been provided with a revised W-9 and instructions for future payments.

When the first post-conversion payment arrives it might be payable to the wrong (former) payee. The client SHOULD return the check to the payer, remind them of the change, and ask for a corrected check. When this doesn't happen, or the client or their staff fails to notice the error, a 1099-MISC gets issued to the 'wrong' entity.

---

[13] Cohan v. Commissioner, 39 F.2d at 543-544

From the payer's perspective, they made the payment to a payee and sent a matching 1099. They probably won't correct the 1099-MISC to show $0, but the client should ask and document it.

In many cases, the tax professional fails to address the issue with the client, and may simply 'zero out' the schedule C or E. This is really improper and tends to carry on for years without correction.

The correct treatment is to NOT zero out the schedule, and to NOT report the income on the 1040 at all, since you contend that the income belongs to someone else.

<u>Assignment of income</u>. It can be common for a person to receive income in their name which they share with others. Often a 'nominee' 1099 is issued by the tax professional to 'zero out' the schedule C.

The tax professional needs to look through the reporting to understand a transaction and determine correct reporting, irrespective of the tax reporting documents issued.

In some cases, the payer won't make payment to an entity due to legal or licensing requirements.

For example, in many states, if not all, commission payments from real estate sales can be made only to a licensed real estate sales person. The sales person cannot receive payment in their name as the licensee, then deposit the income into a corporate bank account, and report the income and expenses through that entity. Rather, the corporation needs to be licensed to be eligible to receive payments. The 'zero out the schedule C', also called the 'assignment of income' doctrine, doesn't fly here.

Of importance to tax professionals is Fleisher v. Commissioner (TC memo 2016-238).

Fleischer held various security and insurance licenses and operated as a financial planner. Both FINRA and the various state insurance departments allow insurance companies and broker/dealers to pay commissions only to licensed individuals[14]. Licensed individuals can only share commissions with other licensed individuals, among other requirements.

---

[14] 15 U.S.C. sec. 78o(a)(1) (2006)

The Tax Court previously established a two-prong test in Johnson v. Commissioner[15] for determining if an entity was the correct entity to report income:

1. First, the service performer/employee must be just that—an employee of the corporation whom the corporation has the right to direct or control in some meaningful sense.

2. Second, there must exist between the corporation and the person or entity using the services a contract or similar indicium recognizing the corporation's controlling position (Note: the user or the service in this context is the payer, the insurance company or broker/dealer).

In this case, Fleisher signed a contract with LPL Financial as his broker/dealer, and Mass Mutual for insurance business. The contracts where in his name, and not the corporation, Fleisher Wealth Plan (FWP). FWP was not licensed. Further, FWP was formed a few days after he signed the contracts with the providers.

Fleischer introduced the issue that it's expensive to license a broker/dealer, stating "(it) would cost millions and millions of dollars" to register the corporation, as a justification of why he did not license the entities.

Takeaways:

1. One cannot simply assign income to other entities

2. Form over substance should be considered by tax professionals. If a 1099 is issued to the wrong entity, ask WHY and then research the matter. A 'wrong' 1099 should not recur year-after year.

11. Affordable Care Act Cases

<u>What is a Qualifying Policy?</u>

Politics aside, and the uncertain future of the law aside, for tax years 2014 - 2017 taxpayers needed to comply with the affordable care act. Tax considerations of the law are now winding their way through Tax Court.

[15] 78 T.C. 882, 891 (1982)

In Nelson v. Commissioner (April 2017), the Court applied a straight forward application of the code: in order to qualify for the Premium Tax Credit, the underlying insurance policy needs to be purchased on "the exchange"[16]

In this case, the taxpayers purchased a health insurance policy from Kaiser Permanente outside of the government exchange. The taxpayers argued they purchased their policy on the insurance "market". The Service disallowed their claim. As required, the Tax Court upheld the deficiency.

What is confusing here – and the take-away for practitioners – is that in many states taxpayers CAN purchase an exchange qualified plan directly from the insurance carriers. This is allowed under 45 C.F.R. § 156.1230 when arranged for by the state exchange and insurer. The idea is to allow for a more streamlined experience for taxpayers.

While it is important here for the insurers to communicate to the insureds exactly what type of policy they have purchased, the practitioner must complete their due diligence and obtain a form 1095-A for any PTC qualifying policy.

Liability for APTC Errors

Many a client has been burdened with repayment of the advanced premium tax credits (APTC) at year end. The author recommends clients NOT take the APTC if at all possible. In many repayment cases, the blame can be placed on an overzealous (or incompetent) Navigator, clients who misrepresent their forward year income, or the client's failure to notify the exchange of a change to income or family status.

In Walker v. Commissioner[17], the facts suggest that Covered California simply miscalculated their eligibility – resulting in a $13,000 repayment at year end. Sadly, the taxpayers had $63,000 of AGI that year. Had it been $62,000 (the 400% FPL for 2014), the repayment would have been capped at $2,500.

At trial, the taxpayers told the Court they would have gone without insurance had they understood they did not qualify for the PTC. Their

[16] I.R.C. § 36B(c)(2)(A)(i)
[17] T.C. Summary Opinion 2017-50

individual shared responsibility payment for 2014 would have been $431, had they failed to purchase health insurance.

12. Documentation of Non-Cash Charitable Contributions

In Ohde v. Commissioner the Court addresses a problem practitioners see multiple times each year – the client with thousands of dollars of non-cash charitable deductions given to Good Will and similar organizations, with dubious or lacking contemporaneous documentation.

In 2011, the year at issue, the taxpayers deducted $145,250 of non-cash charitable contributions for donating more than 20,000 distinct items of property to Goodwill Industries in Fredrick, Maryland.

More than half the dollar value of items were generated from clothing: 811 items of girls clothing, 658 items of mens clothing and 945 items of womans clothing. For furniture, the taxpayers donated 115 chairs, 36 lamps, 22 bookshelves, 20 desks, 20 chests of drawers, 16 bedframes and 14 filing cabinets. Let's not forget the bookmobile – 3,153 books were donated.

The court record shows that for each of the dozens of trips they made to Goodwill, the taxpayers received a one page receipt. The receipt stated that Goodwill received items from the appropriate category. The receipts did not describe the quantity, condition or further description.

At trial, the petitioners produced a spreadsheet generated by Turbo Tax's "Its Deductible" program. The spreadsheet listed for each trip: the number of items, a description and their quality. All 20,000 items were of 'high' quality.

The Court did not find this documentation persuasive.

The Court recapped the donations in this table:

Category	Amount
Clothing and accessories	$71,434
Books/music	25,026
Furniture	23,370
Toys/gaming	9,719
Bedding/linens	4,840
Kitchen items	3,079
Electronic equipment	2,960
Baby items	2,136
Lawn/patio	1,485
Sporting goods	810
Health/beauty	593
Pet supplies	443
Luggage	378
Tools	189
Musical instruments	149
Total	146,611

Charitable deductions are allowed “only if verified under regulations prescribed by the Secretary” [18]. Contributions of property require written records with respect to each item donated. The record needs to include the donee, the date, and location of the contribution, plus description of the property “in detail reasonable under the circumstances (including the value of the property”[19]. The taxpayer must also maintain records to establish the fair market value of the property at the time the donation was made, and the method utilized in determining the fair market value.

Additional substantiation is required when claimed items exceed $5,000 in fair market value. Further, similar items of property must be aggregated in determining whether the gifts exceed the $5,000 threshold. The term “similar items of property” is defined to mean “property of the same generic category or type,” such as clothing, jewelry, furniture, electronic equipment, household appliances, toys, or kitchenware. [20] [21] [22]

[18] IRC 170(a) and Reg. Sec. 1.170a-13.
[19] Reg. Sec. 1.170A-13(b)(2)(ii)(A)-(C),
[20] Reg. Sec. 1.170A-13(c)(7)(iii)
[21] Kunkel v. Commissioner, T.C. Memo 2015-71

Lastly, for property or similar items valued in excess of $5,000, the taxpayer must obtain a qualified appraisal of the property [23]

Most clients likely fail to have adequate documentation for their non-cash charitable deductions. This case further emphasis the need for grouping of similar items for appraisal purposes, which is misunderstood by tax practitioners.

[22] Smith v. Commissioner, T.C. Memo 2014-203
[23] IRC Sec. 170(f)(11)(C)