As part of the divorce decree, the taxpayer agreed to liability for half of any award required to be paid by the former spouse, but only after the former spouse threatened to withhold alimony and other divorce payments. The taxpayer's divorce became final in August 2005 and the former spouse settled the fiduciary lawsuit in 2007, agreeing to a payment of $600,000 in excess compensation. The former spouse paid the settlement and the taxpayer reimbursed the former spouse half of the payment. Although the former spouse was allowed a deduction for $300,000, the IRS disallowed the taxpayer's similar deduction. The trial court agreed with the IRS and the taxpayer appealed.

Did the Amount of Restored Taxed Income Exceed $3000? The parties agreed that the amount in question exceeded $3,000.

Did Taxpayer Have Unrestricted Right to the Income? The IRS argued that the former spouse did not have an unrestricted right to the original income because the former spouse misappropriated the money. However, the court found that the IRS presented no evidence of the former spouse knowingly misappropriating the money and the spouse expressly denied any wrongdoing in the settlement agreement; therefore, the former spouse had an unrestricted right to the income during the tax year it was reported.

As to the taxpayer, the court looked to the filing of the joint return and Ohio law to find that the taxpayer reasonably believed that the taxpayer had a right to a one-half share of the former spouses income (and was liable for one-half of any tax due) in the tax year involved. The court thus held that the taxpayer had the same unrestricted right to at least half of the income during the tax year it was reported as the former spouse.

Did the Taxpayer Later Not Have an Unrestricted Right to the Income? The court stated that to meet this requirement, the taxpayer must demonstrate that the taxpayer involuntarily gave away the relevant income because of some obligation, and the obligation had a substantive nexus to the original receipt of the income. Here the court found that the taxpayer involuntarily agreed to liability for the settlement payment under the divorce decree under pressure from the former spouse who threatened to withhold alimony and other divorce payments unless the taxpayer agreed to be liable. That divorce agreement also provided the substantive nexus needed to connect the taxpayer's $300,000 payment to the marital income which was the subject of the fiduciary lawsuit settlement.

Was the Restored Taxed Income Eligible for a Deduction? Although this requirement is not separately stated in Section 1341, Section 1341 states that once the income becomes restricted and repaid, a deduction must be allowable for the amount claimed.[9] Here the court held that the taxpayer could claim the $300,000 as a loss from a trade or business under I.R.C. § 165(c)(1).[10]

In Conclusion

Thus, the court held that the taxpayer was entitled to deduct the $300,000 repayment of the original compensation under Section 1341. The court was able to look through the indirect nature of the source of the compensation as marital property, the taxpayer's divorce agreement, and the taxpayer's reimbursement of the former spouse to focus on the taxpayer's actual liability for the settlement payment and actual payment of the $300,000 as part of the settlement and divorce agreement. The court noted that the taxpayer and former spouse were jointly liable for the original taxes on the income and thus should receive the joint benefit of Section 1341.

ENDNOTES

[1] Mihelick v. United States, 2019 U.S. App. LEXIS 18205 (11th Cir. 2019), *rev'g* 2017 U.S. Dist. LEXIS 167897 (M.D. Fla. 2017).

[2] United States v. Lewis, 340 U.S. 590 (1951).

[3] A claim for relief under Section 1341 is to be made on Form 1045, *Application for Tentative Refund*.

[4] I.R.C. § 1341(a)(1).

[5] I.R.C. § 1341(a)(2).

[6] I.R.C. § 1341(a)(3).

[7] I.R.C. § 1341(a)(2).

[8] 2019 U.S. App. LEXIS 18205 (11th Cir. 2019), *rev'g* 2017 U.S. Dist. LEXIS 167897 (M.D. Fla. 2017).

[9] I.R.C. § 1341(a)(2).

[10] See Butler v. Comm'r, 17 T.C. 679 (1951) (corporate officer may deduct amount to settle *bona fide* suit alleging mismanagement of corporate affairs, where allegations directly connected with business activity).

CASES, RULINGS, REGULATIONS AND STATUTES

BANKRUPTCY

GENERAL

AUTOMATIC STAY. The debtors, husband and wife, filed for Chapter 13 bankruptcy protection in November 2012. Under Section 362(a), the automatic stay blocks creditors from collection attempts outside of court-supervised reorganization proceedings. The parties agreed that the IRS violated the automatic stay four times: (1) in December 2013, the IRS sent the first of four notices to the debtors demanding payment for back taxes. The notice bore the headlines "Final Notice" and "Notice Of Intent to Levy And Notice Of Your Right To A Hearing." The IRS sent three similar notices in February 2014, September 2014, and December 2014. Each notice violated the automatic stay. After each notice, the debtors contacted their attorney and the attorney contacted the IRS notifying it of the automatic stay. The debtors alleged the violations caused them significant emotional harm. The Bankruptcy Court awarded the debtors monetary damages for emotional distress. On appeal, the District Court reversed on the grounds that the damage award was barred by sovereign immunity of the IRS. On further appeal the Ninth Circuit Court of Appeals reversed and remanded the case, holding that the claim was not barred by sovereign immunity. On remand, the District Court reviewed the Bankruptcy Court's findings as to whether damages for emotional distress were warranted. The test for such damages is whether the debtor (1) suffered significant harm, (2) clearly established the significant harm, and (3) demonstrated a causal connection between that significant harm and the violation of the automatic stay, distinct from the anxiety and pressures inherent in the bankruptcy process. The court found that the four repeated IRS notices created significant concern by the debtors that the IRS collection efforts would prevent a feasible bankruptcy plan. In addition, the court found that the debtors credibly testified as to the emotional and physical damages they suffered over an extended period of time. The court held that the Bankruptcy Court did not err in assessing $4,000 in emotional distress damages against the IRS. **Hunsaker v. United States, 2019 U.S. Dist. LEXIS 104433 (D. Or. 2019),** ***on rem. from*** **902 F.3d 963 (9th Cir. 2018),** ***vac'g and rem'g*** **2016-2 U.S. Tax Cas. (CCH) ¶ 50,517 (D. Or. 2016)**.

EXEMPTIONS

IRA. In 2012, the debtor opened a self-directed IRA with an IRA services company. The debtor used the IRA funds in several impermissible ways, including purchasing two personal automobiles, a condo, and repairs for the vehicles. The debtor agreed that these were prohibited transactions under I.R.C. § . The debtor filed for Chapter 7 in February 2015 and claimed the IRA as exempt under Fla. Stat. § 222.21. The Bankruptcy Court and the reviewing District Court both held that the Florida exemption did not cover IRAs in violation of federal law. On further appeal, the debtor argued that the exemption was allowed so long as the IRA trust instrument was valid. Fla. Stat. § 222.21(2)(a)(2) provides that an IRA is eligible for the exemption if "[m]aintained in accordance with a plan or governing instrument that has been determined by the Internal Revenue Service to be exempt from taxation under § 401(a), § 403(a), § 403(b), § 408, § 408A, § 409, § 414, § 457(b), or § 501(a) of the Internal Revenue Code of 1986, as amended, unless it has been subsequently determined that the plan or governing instrument is not exempt from taxation in a proceeding that has become final and nonappealable." I.R.C. § 408(e)(2) sets out rules for how an IRA must be operated in order to keep its tax-exempt status. One way an IRA can lose its tax-exempt status is for the IRA owner to engage in prohibited transactions, a category that includes abuses placing the plan at risk of loss before retirement, as well as various acts of self-dealing. The court found that, prior to the debtor's bankruptcy petition date, no final and nonappealable proceeding before the IRS or any court had determined that the IRA's governing instrument was no longer exempt under the tax code. However, the court found that the debtor's IRA was not "[m]aintained in accordance with a plan or governing instrument;" therefore, the IRS no longer qualified for the Florida exemption once the debtor violated the terms of the IRA agreement by engaging in prohibited transactions. ***In re*** **Yerian, 2019 U.S. App. LEXIS (11th Cir. 2019),** ***aff'g*****, 2017 U.S. Dist. LEXIS 171176 (M.D. Fla. 2017)**.

RETIREMENT BENEFITS. In 2017, the debtors, husband and wife, sold several items of real and personal property and purchased an annuity in December 2018 which provided for early withdrawals, albeit with fees, mandatory distributions at age 95 and distributions at death within five years. The debtors then filed for Chapter 7 in January 2018. The debtors claimed an exemption for the annuity under Wis. Stat. § 815.18(3)(j)2. The statute requires that an exempt retirement account be tax deferred under federal law. Under I.R.C. § 72(s) an annuity contract is tax deferred if the annuity provides for distribution of any remaining amount at the owners' date of death at least as rapidly as the distributions prior to death and within five years after the date of death. The court found that the annuity complied with the I.R.C. § 72(s) requirements. Under Wis. Stat. § 815.18(3)(j)1, an annuity qualifies for the exemption only if it provides benefits "by reason of age, illness, disability, death or length of service and payments made to the debtor therefrom." The court found that the annuity provided for mandatory distributions by age 95 and distributions at the death of the annuitant. Therefore, the court held that the retirement annuity qualified for the Wisconsin exemption. The court also looked at Wis. Stat. § 815.18(10) which allows a court to disallow an exemption if ". . . the debtor procured, concealed or transferred assets with the intention of defrauding creditors." The court noted that "exemption planning," involving the sale of non-exempt assets and the purchase of exempt assets, is not *per se* fraudulent. The court noted that some factors of fraudulent intent include any misleading contacts with creditors while converting non-exempt assets to exempt assets; the purpose of the conversion of assets; and conveyance for less than fair market value. However, the court found that under the evidence presented so far in the case, no fraudulent intent was shown but allowed the trustee an opportunity to present further evidence on this issue. ***In re*** **Kluck, 2019 Bankr. LEXIS 1834 (Bankr. W.D. Wis. 2019)**.

FEDERAL ESTATE AND GIFT TAXATION

ALTERNATE VALUATION DATE. In a Chief Counsel Advice letter, the IRS stated: "It seems to me that the rule of § 2032(c) controls. This means that alternate valuation date values can only be used if it results in a lower gross estate and a lower combined estate and GST tax. If, for whatever reason, that is not the case, the taxpayer must use date of death values, even though the 2032 election remains completely valid. In your situation, the taxpayer made the election with the assumption that based on the values that he reported, the taxes at alternate valuation date would be less than the taxes at date of death. However, after taking into account your examination and adjustments, the date of death value actually results in the lower value of combined estate and GST taxes. The date of death value must be used. To some extent, this is analogous to the situation in Treas. Reg. § 20.2032-1 which mentions protective elections. There, an executor can make a protective election to use the alternate valuation date, even though the date of death value produces the lower combined taxes. The purpose of the protective election is to allow for the alternate valuation date to be used if it is subsequently determined that the combined taxes will be lower based on the alternate valuation date than based on the date of death. This certainly contemplates lower values that result after an IRS examination." **CC A 201926013, June 28, 2019**.

GENERATION-SKIPPING TRANSFERS. The settlor established an inter vivos irrevocable trust with three separate trust shares for the benefit of each of the settlor's and spouse's three children. The trust was funded with shares of an limited partnership and provided that the trustee shall pay to or apply for the benefit of the beneficiary so much of the income and principal of the beneficiary's share as the trustee determines necessary for the beneficiary's support, health, maintenance and education. After the beneficiary attains the age of 30 years, the trustee shall pay to or apply for the benefit of the beneficiary the entire net income of the beneficiary's share. The beneficiary shall have a limited power to appoint, upon the beneficiary's death, all or any part of the balance of the share set aside for the beneficiary, outright or in trust, in favor of any person or persons other than the beneficiary, the beneficiary's estate, the creditors of the beneficiary or the creditors of the beneficiary's estate, provided that the power may only be exercised by the beneficiary after he or she has attained the age of 34 years. If the beneficiary is survived by issue of the settlor's parents and the distribution of principal from the share of such issue upon the death of the beneficiary would result in the imposition of generation-skipping transfer taxes, the beneficiary shall have a general power to appoint the balance of the share, effective upon the beneficiary's death, to or for the benefit of any one or more of the beneficiary's creditors. Upon the beneficiary's death, any portion of the remaining balance for which the beneficiary has not exercised such power of appointment effectively shall be divided into separate shares, by representation, among the issue of the beneficiary who survive the beneficiary, or if there are no such issue who survive the beneficiary, the balance shall be divided into separate shares, by representation, among the living issue (who are also the living issue of the settlor) of the nearest ancestor of such beneficiary. The settlor and spouse retained tax professionals to prepare their Forms 709, *United States Gift (and Generation-Skipping Transfer) Tax Returns*, which were timely filed. Settlor and spouse consented to treat the gift as made by both of them. The date of the transfers to each child's trust were incorrectly reported on Forms 709, Schedule A, Part 1-Gifts Subject Only to Gift Tax instead of on Schedule A, Part 3-Indirect Skips. In addition, the automatic allocation of the GST exemption was not reported on Schedule C, Computation of Generation-Skipping Transfer Tax. I.R.C. § 2632(c)(1) provides that if any individual makes an indirect skip during such individual's lifetime, any unused portion of such individual's GST exemption shall be allocated to the property transferred to the extent necessary to make the inclusion ratio for such property zero. If the amount of the indirect skip exceeds such unused portion, the entire unused portion shall be allocated to the property transferred. I.R.C. § 2632(c)(3)(A) provides that the term "indirect skip" means any transfer of property (other than a direct skip) subject to the tax imposed by chapter 12 made to a GST trust. I.R.C. § 2632(c)(3)(B) provides, in relevant part, that the term "GST trust" means a trust that could have a generation-skipping transfer with respect to the transferor unless the trust falls within any of six enumerated exceptions. Treas. Reg. § 26.2632-1(b)(2)(i) provides that an indirect skip is a transfer of property to a GST trust as defined in I.R.C. § 2632(c)(3)(B) provided that the transfer is subject to gift tax and does not qualify as a direct skip. In the case of an indirect skip made after December 31, 2000, to which I.R.C. § 2642(f) does not apply, the transferor's unused GST exemption is automatically allocated to the property transferred (but not in excess of the fair market value of the property on the date of the transfer). The automatic allocation is effective whether or not a Form 709 is filed reporting the transfer, and is effective as of the date of the transfer to which it relates. An automatic allocation is irrevocable after the due date of the Form 709 for the calendar year in which the transfer is made. The IRS ruled that the terms of the trust satisfy the definition of a GST trust under I.R.C. § 2632(c)(3)(B); therefore, the transfers that the settlor and spouse made to each child's trust satisfy the definition of indirect skips under I.R.C. § 2632(c)(3)(A) and Treas. Reg. § 26.2632-1(b)(2)(i). Pursuant to I.R.C. § 2632(c)(1), the GST exemption of the settlor and spouse was automatically allocated to the transfers that they made to each child's trust in Year.

FEDERAL FARM PROGRAMS

CROP INSURANCE. The FCIC has adopted as final regulations amending the Catastrophic Risk Protection Endorsement, the Area Risk Protection Insurance Basic Provisions, and the Common Crop Insurance Policy Basic Provisions to implement the changes mandated by the Agriculture Improvement Act of 2018. The final regulations revise the provisions regarding the catastrophic administrative fee, actual production history yield, crop production on native sod, and the definition of veteran farmer or rancher. The regulations also changes the provisions for premium offsets, electronic delivery of policy changes, and assigned yields. The changes to the policy made in this rule are applicable for the 2020 crop year for crops with a contract change date on or after June 30, 2019. For all crops, the changes to the policy made in this rule are applicable for the 2021 and succeeding crop years. **84 Fed. Reg. 30857 (June 28, 2019)**.

DAIRY. The CCC and FSA have adopted as final regulations implementing the requirements of the Dairy Margin Coverage (DMC) Program, as authorized by the Agriculture Improvement Act of 2018 (2018 Farm Bill), which replaces the Margin Protection Program (MPP-Dairy) for dairy producers and retains much of the structure of MPP-Dairy. DMC is a margin-based support program for dairy producers that provides risk management coverage that will pay producers when the difference between the national price of milk and the national estimated cost of feed (the margin) falls below a certain level. The rule also extends the Dairy Indemnity Payment Program (DIPP) through 2023 and amends the regulations to incorporate a specific period of time for which claims for the same loss will be eligible for indemnification under DIPP. **84 Fed. Reg. 28171 (June 18, 2019)**.

SWINE. The APHIS has issued proposed regulations amending the regulations under the Swine Health Protection Act by removing the state status lists from the regulations in order to maintain these lists on the APHIS website. **84 Fed. Reg. 28774 (June 20, 2019)**.

FEDERAL INCOME TAXATION

DISASTER LOSSES. On May 1, 2019, the President determined that certain areas in California were eligible for assistance from the government under the Disaster Relief and Emergency Assistance Act (42 U.S.C. § 5121) as a result of severe winter storms, mudslides and flooding which began on February 13, 2019. **FEMA-4431-DR**. On May 2, 2019, the President determined that certain areas in Oregon were eligible for assistance from the government under the Act as a result of severe winter storms, landslides and flooding which began on February 23, 2019. **FEMA-4432-DR**. On May 17, 2019, the President determined that certain areas in California were eligible for assistance from the government under the Act as a result of severe winter storms, mudslides and flooding which began on February 24, 2019. **FEMA-4434-DR**. On May 20, 2019, the President determined that certain areas in Missouri were eligible for assistance from the government under the Act as a result of severe storms and flooding which began on March 11, 2019. **FEMA-4435-DR**. On May 24, 2019, the President determined that certain areas in Montana were eligible for assistance from the government under the Act as a result of flooding which began on March 20, 2019. **FEMA-4437-DR**. Accordingly, taxpayers in these areas may deduct the losses on their 2018 or 2019 federal income tax returns. See I.R.C. § 165(i).

GAMBLING INCOME AND LOSSES. The taxpayer was employed full time and spent a good portion of the taxpayer's non-working hours gambling at casinos. The taxpayer claimed gambling income and losses on Schedule C and included non-wager expenses such as travel, insurance, depreciation and supplies. The issue in the case was whether the taxpayer was a professional gambler entitled to report income and losses, including non-wager expenses, on Schedule C. The court examined the taxpayer's activities under the nine factors of Treas. Reg. 1.183-2(b) used to determine whether an activity is engaged in with the intent to make a profit. The court held that the taxpayer was not engaged in gambling with the intent to make a profit because (1) the taxpayer did not maintain complete records of the activity except for player records maintained by the casinos which did not provide daily records nor include any of the non-wager expenses; (2) the taxpayer did not consult with experts as to how to make the gambling profitable; (3) the taxpayer did not withdraw from employment in order to spend more time on the gambling activity; (4) the taxpayer received recreational pleasure from the gambling; (5) the taxpayer had no history of success at similar activities; (6) the taxpayer's gambling produced only losses over several years; (7) the taxpayer's gambling produced no profits over several years; and (8) the gambling losses offset wages from other activities. Thus, the court held that the taxpayer was entitled to deduct losses from the gambling activity equal only to the income from gambling. The appellate court affirmed in a decision designated as not for publication. **Boneparte v. Comm'r, 2019 U.S. App. LEXIS 18732 (4th Cir. 2019),** ***aff'g,*** **T.C. Memo. 2017-193**.

IDENTITY THEFT. The IRS has published information for tax professional to report any breach of client data to the IRS. Tax preparers who efile must follow the six security and privacy standards in Publication 1345, *Handbook for Authorized IRS e-file Providers of Individual Income Tax Returns*. IRS Publication 4557, *Safeguarding Taxpayer Data*, provides guidance for tax return preparers on ways to safeguard their client's tax data from identity theft. Tax professionals who notice any signs of identity theft should contact their state's IRS Stakeholder Liaison immediately. The Stakeholder Liaison will notify the IRS Criminal Investigation division and others within the agency on the preparer's behalf. If reported quickly, the IRS can take steps to block filing of fraudulent returns using the stolen data.Tax preparers who have identified a data breach should also contact local police to file a report on the data breach. A police report will probably be needed to make an insurance claim if the preparer has data breach coverage. If directed by the IRS, the tax preparer should contact their local office of the FBI and the Secret Service. Once a tax preparer has contacted the government, the preparer should contact a security expert to determine the cause and scope of the breach, stop the breach and prevent future breaches. If the preparer has insurance that covers data breaches, the preparer will need to report the breach to the insurance company to determine if the policy covers breach mitigation expenses. The preparer should send letters to all clients to inform them of the breach after notifying law enforcement. A preparer may want to contact the FTC. The FTC has resources to help businesses victimized by data thefts, including providing resources on notifying clients that a data loss has occurred. In addition, the tax professional may want to contact an identity-theft protection service to see if free identity-theft protection is available to the clients. Finally, tax professionals also will need to contact the credit bureaus about the data breach because the clients may seek credit monitoring. **E-mail from IRS Return Preparer Office, Checkpoint Daily Update, June 24, 2019**.

IRA. In 2010, at age 42, the taxpayer was a full-time student at a state university and received a distribution from an defined benefit plan from prior employment. The distribution was deposited in a personal bank account and a portion was used for college tuition and living expenses. The taxpayer did not include the distribution in taxable income and did not pay the 10 percent penalty for an early withdrawal under I.R.C. § 72(t)(2)(A). The taxpayer originally claimed that the distribution was rolled over to another retirement account but presented no evidence that the distribution was deposited into a qualifying account within 60 days after the distribution. The taxpayer also claimed that the distribution was exempt from the 10 percent early withdrawal penalty under the qualified higher education expenses exemption under I.R.C. § 72(t)(7). In general, "qualified higher education expenses" means qualified higher education expenses (as defined in I.R.C. § 529(e)(3)) for education furnished to the taxpayer, the taxpayer's spouse, or any child of the taxpayer or the taxpayer's spouse, at an eligible educational institution. These expenses include tuition, fees, books, supplies, and equipment. In the case of an individual who is an eligible student (as defined in I.R.C. § 25A(b)(3)) for any academic period, the term also includes reasonable costs for the period (as determined under the qualified tuition program) for room and board while attending an eligible educational institution. See I.R.C. § 529(e)(3)(B)(i). In general, the term "eligible student" means, with respect to any academic period, a student who is enrolled at least half time in a degree or certificate program at an eligible institution of higher education. The court found, however, that the taxpayer only used a portion of the distribution for higher eduction purposes and held that only that portion used for higher education expenses was exempt from the 10 percent early withdrawal penalty. The court also held that the entire distribution was taxable income. **McCree v. Comm'r, T.C. Memo. 2019-67**.

INFORMATION RETURNS. The IRS has adopted as final amendments to the regulations under I.R.C. §§ 6051 and 6052 to permit employers to voluntarily truncate employees' social security numbers (SSNs) on copies of Forms W-2, *Wage and Tax Statement*, that are furnished to employees so that the truncated SSNs appear in the form of IRS truncated taxpayer identification numbers (TTINs). The final regulations also amend the regulations under I.R.C. § 6109 to clarify the application of the truncation rules to Forms W-2 and to add an example illustrating the application of these rules. Treas. Reg. § 301.6109-4(b) generally provides that a TTIN may be used to identify any person on any statement or other document that the internal revenue laws require to be furnished to another person. Under Treas. Reg. § 301.6109-4(a), a TTIN is an individual's SSN, IRS individual taxpayer identification number (ITIN), IRS adoption taxpayer identification number (ATIN), or IRS employer identification number (EIN) in which the first five digits of the nine-digit number are replaced with Xs or asterisks. Prior to enactment of the PATH Act of 2015, Publ. L. No. 114-113, div. Q, title IV, 129 Stat. 2242 (2015), I.R.C. § 6051(a)(2) specifically required employers to include their employees' SSNs on copies of Forms W-2 that are furnished to employees. In addition, existing Treas. Reg. § 31.6051-1, as well as forms and instructions, require employers to include their employees' SSNs on copies of Forms W-2 that are furnished to employees. Section 409 of the PATH Act amended I.R.C. § 6051(a)(2) by striking "his social security account number" from the list of information required on Form W-2 and inserting "an identifying number for the employee" instead. The final regulations will be applicable for statements required to be filed and furnished under I.R.C. §§ 6051 and 6052 after December 31, 2020. **T.D. 9861, 84 Fed. Reg. 31717 (July 3, 2019)**.

MEMBERS OF MILITARY. The IRS has published information for members of the military and their families who may qualify for special tax benefits. *Combat pay exclusion*. If someone serves in a combat zone, part or all of their combat pay is tax-free. This also applies to people working in an area outside a combat zone when the Department of Defense certifies that area is in direct support of military operations in a combat zone. There are limits to this exclusion for commissioned officers. *Deadline extensions*. Some members of the military, such as those who serve overseas, can postpone most tax deadlines. Those who qualify can get automatic extensions of time to file and pay their taxes. *Earned income tax credit*. Military members who get nontaxable combat pay may choose to include it in their taxable income. One reason they might do this is to increase the amount of their earned income tax credit *Joint return signatures*. Both spouses must normally sign a joint income tax return. However, if military service prevents that from happening, one spouse may be able to sign for the other or get a power of attorney. *Military Volunteer Income Tax Assistance program*. The Armed Forces Tax Council directs the military tax programs offered worldwide. Staff at military VITA sites receive training on military tax issues, such as tax benefits for service in a combat zone. *Reserve and National Guard travel*. Members of a reserve component of the Armed Forces may be able to deduct their unreimbursed travel expenses on their return. In order to do so, they must travel more than 100 miles away from home in connection with their performance of services as a member of the reserves. *ROTC allowances*. Some amounts paid to ROTC students in advanced training are not taxable, including allowances for education and subsistence. On the other hand, active duty ROTC pay is taxable, including pay for summer advanced camp. For more information, see Pub. 3, *Armed Forces' Tax Guide*. **IRS Tax Tip 2019-79**.

OVERPAYMENT INTEREST. In tax years 1 through 4, the taxpayer's spouse was married to a prior spouse and they incurred joint tax liability. That couple was divorced in year 6 but the joint liability remained unpaid. The taxpayer and spouse were married in year 8 and they purchased real property in Year 10. The IRS filed a Notice of Federal Tax Lien against the house for the unpaid taxes from the first marriage. The property was sold in year 12 and the IRS issued a Letter 403, *Conditional Commitment to Discharge Certain Property from Federal Tax Lien*, which sought and obtained remittance of the full sale proceeds, although the sale proceeds exceeded the unpaid tax liability. The taxpayer filed a Form 843, *Claim for Refund and Request for Abatement*, which requested a refund of one-half of the proceeds (the taxpayer's interest in the property) from the sale of the property plus interest. However, the IRS applied the overpayment to income tax liabilities of the taxpayer and husband incurred in years 11 and 12 and refunded the rest. The issue was whether and to what extent the taxpayer was entitled to interest on the overpayment. In a Chief Counsel Advice letter, the IRS broke the interest due into four dates - the date the total refund was due, the date the year 11 taxes were due, and the date the year 12 taxes were due and the date the remaining refund was paid. I.R.C. § 6611(a) provides that interest shall be allowed and paid upon any overpayment in respect of any internal revenue tax at the overpayment rate established under I.R.C. § 6621. Under I.R.C. § 6611(b)(1), in the case of a credit, interest shall be allowed and paid from the date of the overpayment to the due date of the amount against which credit is taken. I.R.C. § 6611(b)(2) provides that in the case of a refund, overpayment interest shall be allowed and paid from the date of the overpayment to a date preceding the date of the refund check by not more than 30 days. Thus, the IRS held that the date of the initial overpayment occurred on the date the full proceeds (instead of only the husband's one-half interest) of the property sale were remitted to the IRS in error. Interest was payable for the amount owed by the taxpayer and spouse for year 11 to the date that the

IRS applied the overpayment to the year 11 taxes owed. Similarly, interest was payable for the amount owed by the taxpayer and spouse for year 12 to the date that the year 12 taxes were owed and because the year 12 taxes arose prior to the overpayment, no interest was to be paid on that amount. The IRS was required to pay interest on the remaining overpayment to the date it is applied to any other tax liability or not more than 30 days before the date the amount is refunded to the taxpayers. **C.C.A. 201926001, March 21, 2019**.

PARTNERSHIPS

DISREGARDED ENTITIES. The IRS has adopted as final regulations that clarify the employment tax treatment of partners in a partnership that owns a disregarded entity. The regulations also affect partners in a partnership that owns a disregarded entity. Treas. Reg. § 301.7701-2(c)(2)(i) states that, except as otherwise provided, a business entity that has a single owner and is not a corporation under Treas. Reg. § 301.7701-2(b) is disregarded as an entity separate from its owner (a disregarded entity). However, Treas. Reg. § 301.7701-2(c)(2)(iv)(B) provides that an entity that is a disregarded entity is treated as a corporation for purposes of employment taxes imposed under subtitle C of the Code. Therefore, the disregarded entity, rather than the owner, is considered to be the employer of the entity's employees for purposes of employment taxes imposed by subtitle C. While Treas. Reg. § 301.7701-2(c)(2)(iv)(B) treats a disregarded entity as a corporation for employment tax purposes, this rule does not apply for self-employment tax purposes. Specifically, Treas. Reg. § 301.7701-2(c)(2)(iv)(C)(2) provides that the general rule of Treas. Reg. § 301.7701-2(c)(2)(i) applies for self-employment tax purposes. The regulations apply this rule in the context of a single individual owner by stating that the owner of an entity that is treated in the same manner as a sole proprietorship is subject to tax on self-employment income. Treas. Reg. § 301.7701-2(c)(2)(iv)(D), also includes an example that specifically illustrates the mechanics of the rule. In the example, the disregarded entity is subject to employment tax with respect to employees of the disregarded entity. The individual owner, however, is subject to self-employment tax on the net earnings from self-employment resulting from the disregarded entity's activities. The regulations do not include a separate example in which the disregarded entity is owned by a partnership. Even though the regulations set forth a general rule that an entity is disregarded as a separate entity from the owner for self-employment tax purposes, some taxpayers may have read the current regulations to permit the treatment of individual partners in a partnership that owns a disregarded entity as employees of the disregarded entity because the regulations did not include a specific example applying the general rule in the partnership context. Under this reading, which the IRS says was not intended, some taxpayers have permitted partners to participate in certain tax-favored employee benefit plans. The Treasury Department and the IRS note that the regulations did not create a distinction between a disregarded entity owned by an individual (that is, a sole proprietorship) and a disregarded entity owned by a partnership in the application of the self-employment tax rule. Rather, Treas. Reg. § 301.7701-2(c)(2)(iv)(C)(2) provides that the general rule of Treas. Reg. § 301.7701-2(c)(2)(i) applies for self-employment tax purposes for any owner of a disregarded entity without carving out an exception regarding a partnership that owns such a disregarded entity. In addition, the Treasury Department and the IRS do not believe that the regulations alter the holding of *Rev. Rul. 69-184, 1969-1 CB 256*, which provides that: (1) *bona fide* members of a partnership are not employees of the partnership within the meaning of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages, and (2) such a partner who devotes time and energy in the conduct of the trade or business of the partnership, or in providing services to the partnership as an independent contractor, is, in either event, a self-employed individual rather than an individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee. The rule that the entity is disregarded for self-employment tax purposes applies to partners in the same way that it applies to a sole proprietor owner. Accordingly, the partners are subject to the same self-employment tax rules as partners in a partnership that does not own a disregarded entity. The final regulations clarify that a disregarded entity that is treated as a corporation for purposes of employment taxes imposed under subtitle C of the Code is not treated as a corporation for purposes of employing its individual owner, who is treated as a sole proprietor, or employing an individual that is a partner in a partnership that owns the disregarded entity. Rather, the entity is disregarded as an entity separate from its owner for this purpose. Existing regulations already provide that the entity is disregarded for self-employment tax purposes and specifically note that the owner of an entity treated in the same manner as a sole proprietorship under Treas. Reg. § 301.7701-2(a) is subject to tax on self-employment income. The final regulations apply this existing general rule to illustrate that, if a partnership is the owner of a disregarded entity, the partners in the partnership are subject to the same self-employment tax rules as partners in a partnership that does not own a disregarded entity. While the final regulations provide that a disregarded entity owned by a partnership is not treated as a corporation for purposes of employing any partner of the partnership, these regulations do not address the application of *Rev. Rul. 69-184* in tiered partnership situations. In order to allow adequate time for partnerships to make necessary payroll and benefit plan adjustments, the final regulations will apply on the later of: (1) August 1, 2016, or the first day of the latest-starting plan year beginning after May 4, 2016, and on or before May 4, 2017, of an affected plan (based on the plans adopted before, and the plan years in effect as of, May 4, 2016) sponsored by an entity that is disregarded as an entity separate from its owner for any purpose under Treas. Reg. § 301.7701–2. For these purposes, an affected plan includes any qualified plan, health plan, or section 125 cafeteria plan if the plan benefits participants whose employment status is affected by these regulations. **T.D. 9869, 84 Fed. Reg. 31478 (July 2, 2019)**.

PENSION PLANS. For plans beginning in July 2019 for purposes of determining the full funding limitation under I.R.C. § 412(c)(7), the 30-year Treasury securities annual interest rate for this period is 2.57 percent. The 30-year Treasury weighted average is 2.93 percent, and the 90 percent to 105 percent permissible range is 2.63 percent to 3.07 percent. The 24-month average corporate bond segment rates for July 2019, *without adjustment* by the 25-year average segment rates are: 2.76 percent for the first segment; 3.95 percent for the second segment; and 4.43 percent for the third segment. The 24-month average corporate bond segment rates for July 2019, taking into account the 25-year average segment rates, are: 3.74 percent for the first segment; 5.35 percent for the second segment; and 6.11 percent for the third segment. **Notice 2019-44, I.R.B. 2019-31**.