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IRS Describes Application Process For Certified Professional Employer Organizations

Rev. Proc. 2016-33, *IR-2016-83*

In anticipation of a July 1 start date, the IRS has released details on the application process for professional employer organizations (PEOs) to become certified PEOs (CPEOs). The *Tax Increase Prevention Act of 2015* (TIPA) created the voluntary CPEO program.

Take away. The IRS issued a package of CPEO guidance in May. "The regulations establish the certification process. To become and remain certified, PEOs must meet requirements that are described in the regulations and cover areas such as tax status, background, experience, business location, financial reporting and bonding," Eddie Adkins, partner, Washington National Tax Office; National Compensation and Benefits Tax Technical Practice Leader, Grant Thornton, LLP, told Wolters Kluwer.

•COMMENT

Rev. Proc. 2016-33 describes the procedures for applying to be certified as a CPEO. A future revenue procedure will address requirements for a CPEO to remain certified and the procedures relating to suspension and revocation of CPEO certification, the IRS explained.

Background

TIPA provided that PEOs will be able to apply to be certified to act - for purposes of the employment tax provisions - as the employer of service providers they lease to their customers. A CPEO is a person that has been certified by the IRS as meeting the new requirements. *For more details about the new requirements, see the May 12, 2016 issue of this newsletter.*

Application process

All applications must be made electronically. The IRS will post the application on its website. Paper submissions will not be accepted and will be treated as an incomplete application, the IRS explained. Each of the applicant's responsible individuals must electronically submit a properly completed and executed online Responsible Individual Personal Attestation (RIPA) form and must also provide a FD-258, Fingerprint Card. If more than one member of a controlled group seeks to be certified as a CPEO, each such member must submit a separate application.

User fee. A $1,000 nonrefundable user fee must be paid when applying for CPEO status. The user fee will be paid through www.pay.gov.

Surety letter. Applicants must provide a letter from a qualified surety confirming that the surety agrees to issue a bond to the applicant if and when it is certified as a CPEO. If the IRS approves the application, the applicant will submit Form 14751, Certified Professional Employer Organization Surety Bond.

Financial statements. With their applications, applicants must submit copies of their annual audited financial statements for the most recently completed fiscal year. Additionally, applicants must provide an opinion of a certified public accountant (CPA) that the financial statements are presented fairly and in accordance with generally accepted accounting principles (GAAP) and that the applicant computes its taxable income using an accrual method of accounting, among other criteria. The CPA opinion cannot be a qualified opinion, an adverse opinion, or a disclaimer of opinion. Special provisions apply to newly established applicants and applicants that are members of controlled groups.

Background checks. Background checks may include checks on tax compliance, criminal background, professional experience, credit history, professional sanctions, and other relevant facts, the IRS explained. The agency added that it may request additional information from an applicant due to the results of a background check. Applicants must notify the IRS of any material changes relevant to their applications, such as changes in tax compliance, professional license or criminal background.

Notice of certification. The IRS will issue electronically or by mail a notice of certification to an applicant that has been approved for certification. The effective date of certification for an applicant that submits a complete and accurate application before September. 1, 2016, and is certified, will be January 1, 2017, even in situations where the certification letter is not issued until after that date. The IRS will publish a list of CPEOs on its website, and the list will be updated quarterly.

Denials. If an application is rejected, the IRS will explain the reasons for denial. In some cases, applicants may request review.

References: FED ¶¶46,336, 46,337; TRC PAYROLL: 3,058.05.

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Tax Preparer Only Liable For Accuracy Penalty; IRS Fails To Prove Fraudulent Intent

Ericson, TC Memo 2016-107

The Tax Court has held that although a tax preparer and his wife were properly assessed a negligence penalty, the IRS did not prove that the preparer had fraudulent intent in preparing the return. Although the preparer as taxpayer was held to a certain level of knowledge to hold himself out as a preparer, the court did not find that his actions could only indicate an intent to defraud rather than the misguided actions of a taxpayer without the high degree of sophistication claimed by the IRS.

Take away. When the IRS assesses fraud penalties, it must prove by clear and convincing evidence that a taxpayer underpaid their tax and at least some part of the underpayment was due to fraud. Where, such as in *Ericson*, the IRS fails in its burden to show that a taxpayer filed a return intending to conceal, mislead or otherwise prevent the collection of tax, fraud penalties are improper.

Background

The husband operated a tax-related business for over 30 years, and worked preparing returns as part of that business for at least 20 years. In the beginning years of his business, he attended college courses covering concepts of income and deductions, as well as seminars on tax preparation. In addition, in the business's initial years, he worked a second job helping a certified public account prepare client tax returns; he also maintained another job as an accountant for two other businesses.

As part of his business, the husband prepared hundreds of income tax returns for his clients between 2006 and 2008. He also prepared his and his wife's joint tax return.

The couple's return claimed a number of deductions for business expenses. The IRS determined that the taxpayer had failed to report $4,905 and $5,552 in business income in 2006 and 2008, respectively. The IRS assessed both fraud and accuracy-related penalties against the taxpayer.

Court's analysis

The court found that the husband's education, work as an accountant, and his profession as a tax preparer were not enough to establish a finding of fraud. The court stated that the record was unpersuasive in establishing the husband as the sophisticated tax preparer that the IRS made him out to be. In addition, the court determined that the husband was misguided in his understanding of several areas of tax law, specifically the requirements for taxpayers to maintain records for their businesses and sufficient documents to support claims for deductions.

In addition, the court concluded that the couple failed to maintain adequate business records and documentation as evidence to support claims for business deductions. However, the court did not find that the failure to do so was done as part of a plan to conceal, mislead, or otherwise prevent the collection of tax. As such, the court disallowed the deductions and the fraud-related penalty.

References: Dec. 60,621(M); TRC PENALTY: 3,106.20.

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Neither Taxpayer Nor IRS Agent Properly Calculated Discharged Real Property Business Debt Excluded From Income

CCA 201623009

IRS Chief Counsel has explained how to determine the amount of discharge of indebtedness income that a taxpayer can exclude with respect to qualified real property business indebtedness (QRPBI). In making its determination, Chief Counsel disagreed with both the taxpayer's and the IRS examiner's interpretations of the law.

Take away. A discharge of indebtedness is treated as taxable income, unless the taxpayer can exclude the income under Code Sec. 108. If the debt is qualified real property business indebtedness, Code Sec. 108(c)(1) requires that the taxpayer reduce the basis of the depreciable real property that secured the discharged debt, by applying the amount excluded from income under Code Sec. 108(a)(1)(D). Here, the IRS determined the amount of income that the taxpayer can exclude; the taxpayer must reduce its basis in the property by the amount excluded. This allows the excluded income to be recaptured when the property is sold.

•COMMENT

For real property, qualified acquisition debt is debt incurred or assumed to acquire, construct, reconstruct, or substantially improve the property.

Background

A taxpayer owned two pieces of real property used in a trade or business. Property A was security for Debt C. Property B was security for Debt D. The proceeds from Debt C were used to improve Property A and were not used for Property B. The proceeds from Debt D were used to improve Property B and were not used for Property A. Furthermore, Property A also secured Debt D, and Property B also secured Debt C.

Debt C was reduced, so that part of Debt C was discharged. In calculating the exclusion amount, the taxpayer reduced the fair market value of Property A by Debt D, but did not add the value of Property B to the value of Property A. This increased the amount of discharged debt that the taxpayer could exclude. As a result, the taxpayer claimed that the entire amount of discharged debt could be excluded.

Law and analysis

The amount of QRPBI that can be excluded under Code Sec. 108(c)(2)(A) is limited to (1) the excess of the outstanding debt principal (just before discharge); over (2) the fair market value of the "real property described in Code Sec. 108(c)(3)(A)," reduced by the outstanding principal of any other QRPBI secured by "such property."

Chief Counsel concluded that the real property described in Code Sec. 108(c)(3)(A) referred only to the single item of property for which the discharged debt was QRPBI (here, Property A and Debt C), and does not include any other real property (such as Property B). Furthermore, the phrase "such property" refers (again) only to the same item of property for which the discharged debt was QRPBI, and does not include the principal of any other debt that may have been QRPBI with respect to a different property (here, Debt D).

Conclusion

Because the proceeds of Debt C were used to improve Property A but not Property B, Debt C was qualified acquisition debt (and QRPBI) only for Property A. Similarly, because the proceeds of Debt D were used to improve Property B but not Property A, Debt D was qualified acquisition debt (and QRPBI) only for Property B.

Debt C was the debt discharged, and Debt C was QRPBI only with respect to Property A. Therefore, the fair market value of Property A is not reduced by any amount relating to Property B or Debt D. As a result, the taxpayer may exclude no more than the amount by which the principal of Debt C exceeds the fair market value of Property A. The taxpayer could not exclude from income the entire amount of debt that was discharged.

Reference: TRC SALES: 12,152.20.

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IRS Reminds Small Employers About Code Sec. 45R Credit

The IRS has reminded small employers about the Code Sec. 45R health insurance tax credit. The credit rewards qualified small employers that offer health insurance coverage to their employees.

•COMMENT

To be eligible, qualified employers must cover at least 50 percent of the cost of employee-only (not family or dependent) health care coverage for each employee. Coverage generally must be through the Small Business Health Options Program (SHOP) Marketplace.

The *Affordable Care Act* (ACA) created the Code Sec. 45R credit. A qualified small employer may claim a 50 percent credit (35 percent in the case of a tax-exempt eligible small employer) for premiums it pays toward health insurance coverage for its employees in tax years beginning after 2013. In tax years beginning in 2010 through 2013 the credit rate was 35 percent (25 percent for tax-exempt employers). An eligible small employer is an employer that has no more than 25 full-time equivalent (FTE) employees for the tax year. Employees must have average annual wages of less than $50,000 per FTE (adjusted for inflation after 2013). Certain employees are excluded from the definition of FTEs.

HCTT-2016-54; TRC HEALTH: 9,200.

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Tax Refund Facilitator Not Obligated For Code Sec. 6050W Reporting

LTR 201622011

The IRS has determined that a business engaged in facilitating the disbursement of tax refunds did not have a reporting obligation under Code Sec. 6050W. The taxpayer also did not have a reporting obligation under Code Sec. 6041.

Take away. In the third party network context under Code Sec. 6050W, a payment settlement entity is a third party settlement organization (TPSO). Generally, a TPSO is the central organization that has the contractual obligation to make payments to the participating payees of third party network transactions.

Background

The taxpayer and several financial institutions partnered to offer various methods by which clients could receive tax refunds. These included prepaid cards, direct deposit into a personal bank account, and paper check. Each method was priced differently.

When the taxpayer learned of an upcoming transfer of funds on behalf of a client, the taxpayer calculated the appropriate fees and compiled disbursement components. When the transfer was made to the client's account, the taxpayer would send electronic instructions to the bank for disbursement of the refund. The banks collected and received all revenue from the program. The taxpayer generated revenue solely through its receipt of a monthly marketing fee from the banks.

IRS analysis

Code Sec. 6050W requires payment settlement entities to file an information return for each calendar year with respect to payments made in settlement of reportable payment transactions. The IRS explained that two types of transactions are covered by Code Sec. 6050W: (1) payment card transactions and (2) third party network transactions. A payment settlement entity in the payment card context is a merchant acquiring entity.

Here, the IRS determined that the taxpayer was not a TPSO. Generally, a TPSO, as part of its payment agreement, guarantees payments to the providers of goods and services in settlement of transactions with the purchasers of the goods and services. The taxpayer did not guarantee any payments for the services provided to clients. Additionally, the IRS determined that the taxpayer did not agree to settle any transactions. Rather, the taxpayer merely provided instructions to the banks about where to deposit a client's refund.

The IRS further determined that the taxpayer was not an aggregated payee. The aggregated payee rules require reporting under Code Sec. 6050W if a person receives payments from a payment settlement entity on behalf of participating payees, and then distributes the payments to participating payees. In this case, the taxpayer did not receive payments from a payment settlement entity nor did it distribute payments to participating payees. The taxpayer did not receive clients' refunds and did not disburse clients' refunds. Similarly, the IRS determined that the electronic payments facilitator rules did not apply to the taxpayer as the taxpayer was not contracting with or making payments on behalf of a payment settlement entity.

Code Sec. 6041 reporting

Under Code Sec. 6041(a), all persons engaged in a trade or business and making payment in the course of the trade or business to another person of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income of $600 or more in any tax year must file an information return. Reg. §1.6041-1(e)(1) provides that when a person makes a payment in the course of a trade or business on behalf of another person, the payor is required to file an information return if the payor (1) performs management or oversight functions with respect to the payment, or (2) has significant economic interest in the payment.

Here, the IRS determined that the taxpayer was not making any payments in the course of a trade or business. The taxpayer merely submitted instructions on the disbursement of the refunds.

Reference: TRC FILEBUS: 9,204.

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Spring 2016 SOI Bulletin Shows AGI, Taxable Income Increases

The IRS has posted its Spring 2016 Statistics of Income Bulletin on its website, featuring statistics on tax year (TY) 2014 outlining preliminary data pulled from over 148 million individual income tax returns filed for that year. The IRS reported that the number of individual income tax returns filed for tax year 2014 increased by 0.6 percent from the previous year.

AGI. In its report, the IRS stated that overall, adjusted gross income (AGI) increased from $9.1 trillion to $9.7 trillion, with taxable income rising to $6.9 trillion. Total income tax and total tax liability both experienced a 10 percent increase to $1.4 trillion.

Preliminary data presented by the SOI bulletin reflect an eight percent increase for taxable income. The IRS reported that the average AGI on individual income tax returns for TY 2014 was $65,021, with average taxable income amounting to $61,328.

Taxes owed. More than 101 million returns reflected taxes owed. Even though total tax liability increased for all income categories, those taxpayers with AGI of $250,000 or more experienced the steepest percent change in tax liability, with $721.2 billion owed for 2014 in comparison to the $622.2 billion owed for 2013.

IR-2016-80; FED ¶46,356; TRC IRS: 12,350.

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Tax Court Extends Limitations Period For "Snow-Day" Where Clerk's Office Is Inaccessible

Guralnik, 146 TC No. 15

In cases where its Clerk’s Office is inaccessible on the last date of a limitations period, the limitations period will be extended to the next day that is not a Saturday, Sunday or holiday, the Tax Court has held. The court also reaffirmed that the 30-day filing period in Code Sec. 6330(d)(1) for collection due process (CDP) appeals is jurisdictional and equitable tolling does not apply.

Take away. "The Tax Court's decision reflects a rational if not equitable outcome, even where equitable principles are not expressly available. Dismissing a petition because of the Court's self-imposed closure would have defied justice for the petitioner, and the court properly utilized the available tools in its rules to achieve the correct result," Mark Allison, member, Caplin & Drysdale, Chartered, New York, told Wolters Kluwer.

> **•COMMENT**
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> The court acknowledged that its rules do not address how time should be computed when its clerk’s office is inaccessible because of government closures, inclement weather, or other reasons. The court looked to the rules of other federal courts for guidance. The court also observed in a footnote that electronic-filing of petitions has been proposed by the court but was not allowed in the case of the taxpayer, implying that the availability of e-filing in the future may make equitable tolling in these cases unnecessary.

Background

February 17, 2015 was the last day to file a petition with the Tax Court in the taxpayer’s case. The Tax Court was closed on February 17, 2015 because of Winter Storm Octavia. The court reopened on February 18, 2015. The taxpayer sent his petition to the court via overnight express delivery. The petition was delivered to the court on February 18, 2015.

Court’s analysis

The court found that federal rules describe how to compute time when a district court clerk’s office is unexpectedly closed. Generally, if the clerk’s office is inaccessible on the last day for filing, the time for filing is extended to the first accessible day that is not a Saturday, Sunday, or legal holiday. The court found no reason why its litigants should not be able to avail themselves of a similar rule.

The court held that in the absence of its own rule, the principles of Fed. R. Civ. P. 6(a)(3) were "suitably adaptable to govern the matter at hand." Because the taxpayer’s petition was filed on February 18, 2015, the first accessible day that was not a Saturday, Sunday, or legal holiday, the court concluded it was timely filed.

The court also revisited the 30-day filing period under Code Sec. 6330(d) for CDP cases. The court rejected the taxpayer’s argument that filing periods are subject to a rebuttable presumption of equitable tolling. The filing period under Code Sec. 6330(d), like the 90-day period under Code Sec. 6213(a) for filing a petition in a deficiency case, sets forth a jurisdictional requirement, the court held. If a deadline is jurisdictional, a court may not use equitable tolling to extend it.

The court also found that the taxpayer could not take advantage of Code Sec. 7502’s "timely mailed, timely filed" rule. The taxpayer’s delivery method was not on the list of designated private delivery services.

References: Dec. 60,622; TRC LITIG: 6,106.

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Chief Counsel Holds Determination Must Involve Substantive Decision For Mitigation Provision To Apply

IRS Chief Counsel has determined that an estate’s refund claim was untimely because mitigation provisions were not properly invoked. The estate relied on a prior decision by the Tax Court, which reflected a settlement between the estate and the IRS. Because the value of the asset was determined through settlement negotiations