NATIONAL SOCIETY *of* TAX PROFESSIONALS

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Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act)

In December 2019 the House of Representatives and the Senate passed the SECURE Act which was subsequently sent to President Trump for signature. The final bill was signed on December 20, 2019 which is the official enactment date. The SECURE Act made many changes to how you save money for retirement, how you use your money in retirement, and how you can better use your Section 529 plans. Regardless of your age these changes will impact every person.

Following are some of the more significant changes you need to know. For a complete analysis of the new 2019 acts check out our new webinar, "*Congress Passes 2019 Year-End Tax Legislation: SECURE Act & Disaster Act,*" available on NSTP.org.

- No age limit on Traditional IRA contributions: a contribution can be made to a traditional IRA at any age, similar to the Roth IRA.
- Coordination with Qualified Charitable Distribution (QCD) rules: for those taxpayers who plan to make a QCD from their traditional IRA then the distribution is reduced by:
  - The total traditional IRA contribution deductions taken after age 70 1/2, less
  - All prior reductions you made to your QCDs before the current tax year.

EXAMPLE: Shauna turns 70½ in 2020. She continues to work and makes pre-tax contributions to her traditional IRA as follows: $5,000 in 2020; $5,000 in 2021; and $5,000 in 2022. Shauna then makes direct charitable contributions that would previously be tax-free QCDs, as follows: $10,000 in 2023 and $10,000 in 2024. In total she has made $15,000 in pre-tax contributions to her traditional IRA after she turned 70½ which will reduce the amount of tax-free QCD in subsequent years. Therefore, in 2023 all of the QCD will be taxable income on her Form 1040 and in 2024, $5,000 will be taxable income and the remaining $5,000 can be treated as a tax-free QCD.

- Required Minimum Distributions (RMDs) start at age 72: for those who turn age 70½ after December 31, 2019, the minimum age for distributions from IRAs and qualified pensions is 72 years of age.
  - For employer-sponsored retirement plans, §401(a)(9)(C)(i)(I) provides that for a non-5% owner the distribution is required by April 1 after the calendar year the employee turns 72 or retires from service with the employer (whichever is later).
  - If the employee is a 5% owner, then §401(a)(9)(C)(ii)(I) provides than the minimum distribution is the same as for traditional IRAs even if the employee continues to work past age 72.
- Penalty relief for birth/adoption withdrawals: §(72)(t)(H) provides that for distributions made after December 31, 2019, penalty-free withdrawals will be allowed from retirement plans for a qualified birth or adoption distribution. This is only a penalty exception – the income tax must still be paid on the distribution.
  - The exception for a qualified birth or adoption is on a distribution from an IRA or a qualified plan if made during the one-year period beginning on:
    - The date of birth of a child, *or*
    - The date a legal adoption of an eligible adoptee is final
  - An "eligible adoptee" is any individual (other than a child of your spouse) who is:
    - Under age 18, *or*
    - Physically or mentally incapable of self-support

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FROM THE **EDITOR**

As we run headfirst into the 2020 tax filing season, be sure to take steps to take care of yourselves. Keep realistic hours, plan when and what to eat for healthy mealtimes, plan time to walk, for yoga, or other actions that keep you moving, and get plenty of sleep. Schedule massages, manicures, and time with your hair stylist to feel good about yourself. I know you are all saying – sure, maybe next year. But there may be no next year if you are not taking care of yourself now.

And I have not yet mentioned time to be with your family and friends. I moved from Arizona to Florida to be closer to my family – I forgot how much time family can expect when you are within driving distance. I realize that family support is critical for the success of your business. My husband learned to cook when he realized I would not be around to cook the nightly dinners he had come to enjoy.

Include your family in planning for tax season and who will be responsible for cleaning the house (we eventually hired a housekeeper when I realized I could not keep up with the house and he absolutely hated cleaning), grocery shopping, and other tasks around your home.

Include your family in planning for tax season and who will be responsible for cleaning the house, grocery shopping, and other tasks around your home.

NSTP is busy planning for the upcoming seminar schedule in Cabo San Lucas, MX in May; Williamsburg, VA in June: and Napa, CA in July. This summer also sees the return of six (6) IRS Tax Forums in Dallas, New Orleans, Atlanta, Washington DC, San Diego and Orlando (see complete schedule on page 11).

We look forward to seeing you in a future NSTP event. We invite you to bring colleagues, staff and business partners with you for both the education and social events.

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February 1 – April 15
Monday, Tuesday & Thursday

6:00 AM	–	2:00 PM PST
7:00 AM	–	3:00 PM MST
8:00 AM	–	4:00 PM CST
9:00 AM	–	5:00 PM EST

February 1 – April 15
Wednesday & Friday

9:00 AM	–	5:00 PM PST
10:00 AM	–	6:00 PM MST
11:00 AM	–	7:00 PM CST
12:00 PM	–	8:00 PM EST

March 1 – April 15
Saturday

8:00 AM	–	12:00 PM PST
9:00 AM	–	1:00 PM MST
10:00 AM	–	2:00 PM CST
11:00 AM	–	3:00 PM EST

April 16 – January 31
Monday, Wednesday & Friday

9:00 AM	–	2:00 PM PST
10:00 AM	–	3:00 PM MST
11:00 AM	–	4:00 PM CST
12:00 PM	–	5:00 PM EST

Technical Tax advice provided by NSTP Helpline staff is based upon specific information conveyed by the member. Members should take special care in relying upon recommendations and opinions that reflect the understanding of the Helpline staff member. NSTP and the Helpline staff are not responsible for misapplication of information given. Members are responsible for the ultimate verification and application of any information provided by NSTP.

- The maximum penalty-free distribution is $5,000 per individual per birth or adoption. As a result, on a joint return, each spouse may separately receive a $5,000 distribution.
- For this purpose, a qualified plan does not include a defined benefit plan.

- IRA contributions for graduate and postdoctoral students:
  - Before the SECURE Act, certain taxable stipends and non-tuition fellowship payments received by graduate and postdoctoral students were included in taxable income but not considered compensation for IRA purposes.
  - The new law states: "The term 'compensation' shall include any amount which is included in the individual's gross income and paid to the individual to aid the individual in the pursuit of graduate or postdoctoral study."
  - This change enables students to begin saving for retirement and to accumulate tax-favored retirement savings.
- Difficulty-of-care payments treated as compensation for retirement plan contributions:
  - The Code provides that income received by a foster care provider is not includable in gross income. A "difficulty-of-care" payment is compensation for providing additional care needed for "qualified foster individuals" who have a physical, mental, or emotional disability for which it has been determined that:
    - There is a need for additional compensation to care for the individual,
    - The care is provided in the home of the foster care provider, and
    - The payments are designated by the payer as compensation for such purpose.
  - The SECURE Act now allows for non-taxable income received by home healthcare workers, "difficulty-of-care" payments, to be treated as compensation for purposes of contributing to defined contribution plans and IRAs.
    - §415(c)(8) now provides for contributions to defined contribution plan for years beginning after December 31, 2015.
    - §408(o)(5) now provides that for IRA contributions made after December 20, 2019.
- Kiddie Tax reverts to tax law prior to the Tax Cuts and Jobs Act (TCJA): this repeals the provision in the TCJA that the estate and trust rates would be applied to the tax returns of minors subject to the Kiddie Tax. Taxpayers can amend their 2018 income tax returns if the estate and trust rates were assessed.
- Expanded tax-free §529 plan distributions now include:
  - Fees, books, supplies, and equipment for the designated beneficiary's participation in an apprenticeship program registered and certified with the Secretary of Labor under Section 1 of the National Apprenticeship Act
  - Principal or interest payments on any qualified education loan of the designated beneficiary or their siblings up to $10,000. The deduction for interest paid by the taxpayer during the tax year on a qualified education loan is disallowed to the extent the interest was paid from a tax-free distribution from a §529 plan.
- RMDs on inherited accounts revised:
  - Under the SECURE Act, the beneficiary of a defined contribution plan or an IRA must fully distribute the balances of these plans by the end of the 10th calendar year following the year of death. There is no longer a requirement to take out a minimum amount each year. This eliminates the ability to 'stretch' out the account and take RMDs each year to deplete the account over many years.
  - There is an exception for an eligible designated beneficiary, defined as:
    - A surviving spouse
    - A child who has not reached the age of majority
    - Disabled as defined in §72(m)(7)
    - A chronically ill individual as defined in §7702B(e)(2) with modification, or
    - Not more than 10 years younger than the deceased
  - This change applies to distributions for plan owners who die after December 31, 2019
- Increase failure to file penalty: for returns due after December 31, 2019, the penalty is the lesser of:
  - $400, or
  - 100% of the amount of the tax due
- Disaster tax relief: for those who suffer casualty losses in areas designated as a Presidentially-declared disaster area occurring between January 1, 2018 and 60 days following the date of enactment (December 20, 2019) are provided with several tax-favored benefits:
  - An exception to the 10% penalty for funds withdrawn from a retirement plan, not to exceed $100,000, in qualified hurricane distributions cumulatively.
  - Allows for the re-contribution of retirement plan withdrawals for home purchases cancelled due to an eligible disaster.
  - Temporarily suspends the limitations on the deduction for charitable contributions associated with qualified disaster relief, therefore, the 60% AGI limitation is not applicable.
  - Grants any individual with a principle home or any taxpayer with a principal place of business in a disaster area an automatic 60-day extension with regard to any tax filing.

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The Confidentiality of a Client's Tax Return Information

Internal Revenue Code (IRC) section 7216 govern when a tax return preparer may disclose or use a taxpayer's tax return information without first obtaining the taxpayer's consent. Because it is a federal crime to violate section 7216 and its regulations, Circular 230 practitioners should familiarize themselves with these provisions.

IRC section 7216 and its regulations are set up as a blanket prohibition on a preparer's disclosure or use of a taxpayer's return information without the taxpayer's prior consent. Treasury Regulations section 301.7216-2, however, provides for numerous exceptions to this rule.

For disclosures or uses not permitted thereunder, IRC section 7216 makes it a crime for a tax return preparer to knowingly or recklessly—

- disclose any information furnished to the tax return preparer in connection with preparing a client's tax return, or
- use tax return information other than to prepare or assist in preparing a client's tax return.

Civil monetary penalties may be imposed under IRC section 6713. Willful unauthorized disclosure of tax return information may also subject a preparer to discipline under Treasury Department Circular 230.

Who is a tax return preparer?

Section 7216 broadly defines a tax return preparer as any person who is engaged in the business of preparing or assisting in preparing tax returns, who is employed by such person, or who provides auxiliary services in connection with the preparation of tax returns, such as an e-file provider [Treasury Regulations section 301.7216-1(b)(2)].

What constitutes tax return information?

Tax return information is "any information, including, but not limited to, a taxpayer's name, address, or identifying number, that is furnished in any form or manner for, or in connection with, the preparation of a tax return" [Treasury Regulations section 301.7216-1(b)(3)]. Tax return information includes—

- information that the taxpayer furnishes to a tax return preparer,
- information furnished to the tax return preparer by a third party, and
- information that the tax return preparer derives from tax return information.

What constitutes disclosure and use of tax return information?

Disclosure of tax return information is "the act of making tax return information known to any person in any manner whatever" [Treasury Regulations section 301.7216-1(b)(4)]. For example, a tax return preparer discloses tax return information when providing client tax documents to another person in the firm.

Use of tax return information is "any circumstance in which a tax return preparer refers to, or relies upon, tax return information as the basis to take or permit an action" [Treasury Regulations section 301.7216-1(b)(5)]. A tax return preparer uses tax return information when making any recommendation or offers services to a taxpayer client based on the client's tax return information. For example, a tax return preparer would be using tax return information if, during the preparation of a client's tax return, the preparer determines that the client is eligible to make a contribution to an IRA and discusses this option with the client.

Exceptions

Treasury Regulations section 301.7216-2 contains an extensive list of disclosures and uses of tax return information that a tax return preparer may make without the taxpayer's prior consent. IRC section 7216 itself specifically states that the regulations will govern. Disclosure is permitted in the following cases:

- To others in a return preparer's firm who will assist in the preparation of a tax return
- If a tax return preparer provides software to a taxpayer for use in preparing or filing the taxpayer's tax return to address changes in IRS forms, changes in e-file specifications, or new administrative, regulatory, or legislative guidance, and to test and ensure the software's technical capability [Treasury Regulations section 301.7216-2(c)].

The regulations are stringent regarding the sharing of information with tax return preparers outside of the United States. A tax return preparer may not send any tax return information outside the United States without the client's prior consent—period. Conversely, a U.S. tax return preparer may use or disclose tax return information gained from a tax return preparer outside the United States only if the taxpayer initially furnished the information to the non-U.S. tax return preparer, the U.S. tax return preparer is a member of a U.S. branch of the non-U.S. tax return preparer's firm, and the disclosure or use is made to assist in the preparation of tax returns [Treasury Regulations section 301.7216-2(c)(3)].

The regulations are strict about a tax return preparer's disclosure or use of tax return information for marketing purposes. A tax return preparer may use and maintain a list of client contact information for limited marketing purposes, but there are various requirements for and limitations on this use. The main restriction is that the list may be used only to provide tax return advice or offer additional tax return preparation services to the client, and not to offer other services or products [Treasury Regulations section 301.7216-2(n)].

A tax return preparer may maintain a statistical compilation of tax return information related to internal management or in support of his tax return preparation business, or for bona fide research or public policy discussions.

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The Confidentiality of a Client's Tax Return Information

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This statistical compilation may also be used in marketing and advertising so long as it—

- is anonymous,
- does not disclose aggregate data from fewer than 10 taxpayers, and
- is not false or misleading.

A tax return preparer cannot, however, use any statistical compilations that identify dollar amounts or percentages relating to dollar amounts, such as amounts of refunds obtained for clients [Treasury Regulations section 301.7216-2(o)].

The following disclosures and uses are also permissible without a taxpayer's consent:

- Disclosure pursuant to other provisions of the IRC, or to an officer or employee of the IRS
- Disclosure pursuant to a court order, subpoena, or similar requirement, or to report the commission of a crime
- Disclosure to contractors in connection with the programming, maintenance, or procurement of equipment used in return preparation
- Disclosure to an attorney in order to obtain legal advice, or in connection with Treasury investigations or court proceedings
- Disclosure to an individual taxpayer's fiduciary, such as the executor of the taxpayer's estate
- Disclosure or use in an audit under the law of any state or local tax authority
- Disclosure or use, if necessary, for a tax return preparer to collect payment for tax preparation services
- Disclosure or use to conduct quality, peer, or conflict reviews, but disclosure is permitted only to the reviewer and the preparer [Treasury Regulations sections 301.7216-2(a), (d), (f), (g), (j), (l), (p), and (q)].

IN THE NEWS

Taxpayer Certainty and Disaster Tax Relief Act of 2019 (DISASTER Act)

In addition to the SECURE Act, the DISASTER Act was also signed by President Trump on December 20, 2019 and was included as part of the omnibus spending package, called the "Further Consolidated Appropriations Act, 2020."

The DISASTER Act extends over 30 provisions of the Internal Revenue Code and is effective generally through December 31, 2020. The tax provisions are effective retroactively to January 1, 2018. The bill extends certain individual and business-related tax provisions, provides tax incentives for energy production and green economy jobs, eliminates the increase in the estate and tax unified credit after 2022 and provides disaster relief.

Following are some of the more significant changes you need to know. For a complete analysis of the new 2019 acts check out our new webinar, "*Congress Passes 2019 Year-End Tax Legislation: SECURE Act & Disaster Act,*" available on NSTP.org.

- Exclusion from gross income of discharge of qualified principal residence indebtedness: the DISASTER Act extends the exclusion of up to $2,000,000 of debt relief for three years, retroactive to January 1, 2018.
- Treatment of mortgage insurance premiums as qualified residence interest: the eligible deduction is extended for three years retroactive to January 1, 2018. An eligible deduction is:
  - A maximum of $1,000 (reduced to $500 for married taxpayers filing a separate return)
  - The deduction is not allowed if the taxpayer's AGI exceeded $110,000 (reduced to $55,000 for married taxpayers filing a separate return)
  - In order to qualify the taxpayers must elect to file Schedule A, Itemized Deductions
- Reduction in medical expense deduction floor: the DISASTER Act extends the threshold of 7.5% of AGI for tax years beginning after December 31, 2018 and before January 1, 2021.
- Deduction of qualified tuition and related expenses: this provision is extended through 2020. There is an AGI limitation for either the $4,000 or $2,000 deduction amount.
- Nonbusiness energy property: there is a lifetime cap of $500 (which is applicable to those who had previously met the cap) for qualified energy improvements to the building envelope.
  - The building envelope includes:
    - Windows
    - Doors
    - Skylights, and
    - Roofs
  - Energy efficient property includes:
    - Furnaces
    - Boilers
    - Biomass stoves
    - Heat pumps
    - Water heaters
    - Center air conditioners, and
    - Circulating fans

A TIMELY TIP
from
ENNIS T. PEA

What Expenses are Deductible on the 2019 Income Tax Returns?

The Tax Cuts and Jobs Act (TCJA) changed the way individuals and businesses were able to deduct certain expenses on their income tax returns. Following is a reminder of items no longer deductible and those tax items still deductible on the taxpayer's returns. While not a comprehensive list, it includes those items which have caused confusion with taxpayers in the past.

Medical Expenses which are still deductible:

- Alcoholism Treatment: payments for inpatient treatment at a therapeutic center for alcohol addiction, including meals and lodging provided by the center during treatment.
- Fertility Treatments: the cost of the following treatments:
  - In vitro fertilization, including the temporary storage of eggs or sperm
  - Surgery, including the reversal of prior surgery to prevent pregnancy
- Guide Dog and Service Animals: the cost of buying, training and maintaining a guide dog or other service animal to help a person who is visually impaired, hearing disabled, or has other physical disability. Expenses include food, grooming, and veterinary care.
- Stop Smoking Programs: this does not include the cost of treatment that does not require a prescription such as the nicotine gum or patches.
- Weight Loss Programs: only if the expense is for a specific disease diagnosed by a doctor such as obesity, hypertension, or heart disease. However, weight loss programs for appearance or general health are not deductible.

Medical Expenses which are <u>not</u> deductible:

- Nonprescription Drugs or Medicine: in order to be deductible, the drug must be prescribed by a doctor (with the exception of insulin).
- Health Club Dues: this includes the cost to improve your general health, relieve physical or mental discomfort, and is not related to a medical condition.
- Cosmetic Surgery: includes procedures mainly to improve one's appearance such as face lifts, hair transplants, hair removal or liposuction. Some expenses may be deductible if it is necessary to improve a deformity arising from a congenital abnormality, personal injury, or disfiguring disease.

Miscellaneous Deductions which are still deductible:

- Gambling Losses to the Extent of Gambling Winnings: are still reported on the Schedule A, therefore, the taxpayer must be able to itemize in order to claim the losses.
- Casualty and Theft Losses on Income-Producing Property: investment property includes stocks, notes, bonds, gold, silver, vacant lots and works of art. The limitation on casualty and theft losses applies to personal losses. Under the TCJA losses are limited to those in a federally declared disaster area. If the taxpayer is not able to itemize the allowed losses will add to the standard deduction.
- Federal Estate Tax on Income In Respect of a Decedent: this is gross income the decedent would have received if the death had not occurred and was not included on the decedent's final tax return.
- Fines and Penalties: in general, fines and penalties paid to a government or specified non-government entity for violation of the law are disallowed, except for in the following situations:
  - Amounts paid for restitution
  - Amounts paid to come into compliance with the law
  - Taxes due
  - Certain court orders where no government agency is a party
- Home Office: the deduction is still allowable on the Schedule C, Profit or Loss From Business, as long as you use your home regularly and exclusively for business purposes.
- Club Dues: the following are deductible as business expenses:
  - Boards of trade
  - Business leagues
  - Chambers of commerce
  - Civic or public service organizations
  - Professional organizations
  - Real estate boards
  - Trade associations
- Losses from Ponzi-Type Investment Schemes: they are deductible as theft losses arising from income-producing property.

Miscellaneous Deductions which are <u>not</u> deductible:

- Unreimbursed Employee Expenses: if they fall into one of the following categories, they may still be deductible:
  - Armed Forces reservist
  - Qualified performing artist
  - Fee-basis state or local government official
  - Employee with impairment-related work expense
- Campaign Expenses: this applies to a candidate for any office and includes qualification fees, registration fees, and legal fees.
- Commuting Expenses: the transportation cost going from your home to your main or regular workplace is not deductible. There is an exception for:
  - Armed Forces reservist
  - Qualified performing artist

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What Expenses are Deductible on the 2019 Income Tax Returns

..continued from page 6

- Fee-basis state or local government official
- Employee with impairment-related work expense

They are still able to deduct the additional cost of hauling tools, instruments, or other items in their car to and from work.

- Fines and Penalties: these include:
  - Amounts paid to settle actual or potential liability for a fine or penalty (civil or criminal)
  - Parking tickets
  - Tax penalties
  - Restitution paid to come into compliance with the law (unless the amounts are specifically identified in the settlement agreement or court order)
  - Reimbursement to the government for the cost of an investigation or litigation
- Lobbying Expenses:
  - Influence legislation
  - Participate or intervene in any political campaign for or against any candidate for public office
  - Attempt to influence the general public about elections and legislative affairs
  - Communicate directly with executive branch officials to try to influence official actions
- Political Contributions:
  - Political contributions made to a political candidate, campaign committee, or newsletter fund
  - Advertisement in convention bulletins, dinners, or programs that benefit a political party or candidate
- Club Dues: generally, in any club organized for pleasure, recreation or a social purpose. Examples include athletic, luncheon, sporting, airline, hotel, and country club.

GROWING YOUR FIRM IN 2020: Think Like a New Client

If you are looking to grow your practice, the best way is to take advantage of the technology and resources available to your business. A balance of providing 'tried and true' services to your existing client base and developing new strategies to attract upcoming clients takes practice. It is true that our comfort level is in providing services to our long-time client base. However, if that is our only focus then we will miss the innovative opportunities to attract a new client. Following are some ideas to explore. Pick those that make the most sense and initiate action. Other strategies can be added as you build and refine your marketing strategies.

1. Get Google reviews from your clients – put your firm on the Google free business listing and ask your clients to post Google reviews.
2. Start a Facebook group – pick a niche (industry or profession) that you provide specialized services. Start regularly, once a week, by posting useful content on the Facebook page.
3. Get more referrals – one strategy recommends that you draft a letter for your clients to send to their business contacts. Have the letters printed, signed by your clients, and mailed by you at your cost.
4. Get on the cloud – cloud-based technology has progressed rapidly and has returned significant productivity and efficiency gains.
5. Use the phone more – return to more human-to-human interactions to improve customer satisfaction. Establish a time to chat by email and keep the appointment!
6. Be on social media – where are your clients participating online? Direct messaging through LinkedIn, Facebook, or Twitter may get you faster responses.
7. Work on branding your firm as a business advisory firm – the future of this industry is not in preparing the Form 1040, but in providing ancillary services that will benefit your business clients. Rework your message to clients and potential clients of the positive impact of your advisory services.
8. Do customer surveys – identify the most common positive and negative comments to improve your marketing and customer experience.
9. Blog – create a blog on your website which can also be published on LinkedIn. Include content that is useful for current and potential clients.
10. Take control of your practice – decide which tools you are going to use, create the client experience you want to exhibit, and what resources you are going to provide with the best possible service. Learn from others in your industry and from your clients by:
    a. Partnering with someone who sells to your clients and prospects such as financial services
    b. Read at least one sales book each quarter
    c. Follow some influencers in the accounting field through Twitter or LinkedIn
    d. Identify the words that your clients use – use their 'lingo,' not always accounting terms.

LASSEK, TC MEMO 2019-145

The Tax Court held that a wife was entitled to innocent spouse relief that was related to the understatement of tax when her husband reported a 401(k) distribution on a tax return as nontaxable. Although the IRS has conceded that the wife was entitled to the relief, the husband, acting as intervenor, challenged that concession.

BACKGROUND: In general, married taxpayers who file a joint federal income tax return are jointly and severally liable for the tax reported or reportable on the tax return. (Code Sec. 6013(d)(3))

But, an election by one spouse under Code Sec. 6015(c) treats former spouses that filed a joint return as if they had filed separate returns, and each spouse's liability is limited to that portion of the deficiency properly allocable to that spouse. (Code Sec. 6015(c)(1), Code Sec. 6015(d)(3)) Such an allocation is not permitted, however, if IRS demonstrates that the individual electing relief had actual knowledge, at the time the return was signed, of any item giving rise to a deficiency (or portion thereof) which is not allocable to that individual. (Code Sec. 6015(c)(3)(C))

FACTS: Petitioner (wife) and husband (intervenor) were married in 1989. Intervenor filed for divorce in August 2013 and their divorce became final in December 2013. The husband and wife filed a joint tax return for 2011 and 2012. The returns showed that the husband had taken a distribution from his 401(k) plan, and he filed that the distributions was not taxable. The Petitioner had also taken a distribution from her 401(k), for the years in question, which were reported correctly on their joint tax return. The funds from the Petitioner's distribution were deposited into their joint account, however, the intervenor's distributions were not.

This resulted in an understatement.

The IRS issued a notice of deficiency since the distribution was taxable.

The wife sought relief from joint and several liability under Code Sec. 6015(c), explaining that she was not involved in preparing the return other that providing her tax documents. She further explained that:

a. She did not review the joint return before it was filed because the husband "never asked * * * [her] to" and

b. That she had no knowledge of the erroneous item.

Prior to trial, the IRS conceded that the wife was entitled to relief under Code Sec. 6015(c). But the husband challenged the wife's entitlement to the relief.

The husband contended that the wife knew about his 401(k) plan distribution and her knowledge of it disqualified her from Code Sec. 6015(c) relief. He also contended that the wife may have had "reason to know" about the understatement of tax shown on the return.

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NEW On-Demand Webinar from NSTP!

On-Demand Webinar 2G

Congress Passes 2019 Year-End Tax Legislation
SECURE ACT & DISASTER ACT

In December, 2019, Congress passed The Further Consolidated Appropriations Act, HR 1865, that included many year-end tax changes, among them pension and IRA reform provisions, extenders, disaster relief, and the repeal of a few ACA taxes. The Setting Every Community up for Retirement Enhancement [the SECURE ACT] is the first pension and IRA overhaul since the 2006 Pension Protection Act.

As tax professionals helping clients plan for their retirements for years to come, awareness of the substantive changes in the legislation is crucial. In addition, there are notable non-retirement provisions attached to the SECURE Act including a repeal of the TCJA-introduced Kiddie Tax changes, adjustments to the medical expense deduction threshold, expanded provisions for 529 college savings plans, and a series of Tax Extenders.

Ultimately, each Tax Professional needs to be knowledgeable about changes in this Tax Legislation, and this NEW NSTP Webinar provides that knowledge.

INSTRUCTOR: **Paul La Monaca, CPA, MST**
CREDITS: **2 CPE**
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Course Description:
This course includes new and retroactive changes to the Internal Revenue Code addressing Individual, Business, and Energy Provisions of the 2019 Year-End Tax Extender Legislation.

Learning Objectives:
At the completion of this Webinar, the participant will be up to date on the year-end 2019 Tax Extender Legislation as well as the changes and improvements made to Retirement plans under the SECURE Act as it pertains to individuals and businesses. The Course will help the Tax Professional be knowledgeable for preparing 2019 returns and beyond. In addition, the participant will be able to discuss opportunities with clients concerning amending 2018 tax returns resulting in potential refund of tax.

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DECISION: The Court agreed with the IRS that the wife was entitled to relief under Code Sec. 6015(c).

First, the Court pointed out that an issue arises where the burden of proof shifts to the IRS (under Code Sec. 6015(c)(3)(C)) in cases when the IRS favors granting relief and the nonrequesting spouse intervenes to oppose it. The Court has previously resolved this issue of burden shifting by deciding the case on a preponderance of the evidence as presented by all three parties (the wife, the husband, and the IRS).

OBSERVATION: The Court does not delve into the procedural issues involved in having the husband, acting as intervenor, effectively argue on behalf of the IRS. Regardless, the husband is an interested party because when the wife received innocent spouse relief, he became 100% liable for all taxes due regarding the 401(k) issue.

The Court said that a requesting spouse's "reason to know" of an item on a tax return is not sufficient to deny relief under Code Sec. 6015(c). If, as here, all of the other requirements of that section have been satisfied, then the burden of proof is shifted to the IRS and relief is denied to the requesting spouse only if the IRS demonstrates that the requesting spouse had actual knowledge, at the time she signed the return, of the item giving rise to a deficiency.

The husband argued that the wife was aware of his 401(k) distribution because the husband used it to pay the mortgage and household expenses for the family home and vacations. However, the record did not support the husband's position. Neither did it establish that the wife had actual knowledge or a clear awareness at the time of filing their 2011 or 2012 return, that the husband took a distribution in 2011 or 2012 and that his distribution was used to pay those household expenses. Although the returns reported the distribution in full, it did not report it as taxable. The Court found that the record did not establish that the wife and the husband discussed the items reported on the joint return or that the wife had a meaningful opportunity to review the return before it was filed.

The Court concluded that the wife did not have actual knowledge of the husband's 401(k) distributions. Therefore, she was entitled to relief from joint and several liability under Code Sec. 6015(c) for 2011, however, was not entitled to relief for 2012. Although many factors for equitable relief either favor petitioner or are neutral, petitioner could not reasonably believe that intervenor would or could pay the tax liability on their 2012 return. The knowledge factor weighs too heavily against her for the Court to allow relief for 2012.

Weighing all the facts and circumstances, the Court concludes that petitioner is not entitled to relief from joint and several liability for section 6015(f) for 2012. However, she is entitled to relief under section 6015(c) for 2011.

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BRADLEY M. McGUIGAN AND SHIRLEY W. McGUIGAN, *Petitioners v.* COMMISSIONER OF INTERNAL REVENUE, *Respondent*

The issues for decision are whether: (1) petitioner husband was an independent contractor or a statutory employee entitled to report expenses on Schedules C, Profit or Loss From Business, or a common law employee whose expenses were reportable on Schedules A, Itemized Deductions, (2) petitioners are entitled to deductions for legal and professional services, insurance (other than health), and rent for vehicles, machinery, or equipment, and (3) petitioners are liable for the section 6662(a) accuracy-related penalty for 2015.

Background

During the years at issue petitioner Bradley M. McGuigan worked as a diesel technology specialist. Before then Mr. McGuigan had worked off and on for John Knerr for approximately 20 years. In or around 2012 Mr. Knerr partnered with Chad Pardee to form Pardee Excavating, LLC, which later became MontanaDakota Services, Inc. (MDS). Mr. Knerr invited Mr. McGuigan to work for MDS, and he accepted.

Pursuant to an oral agreement with Mr. Knerr, Mr. McGuigan performed gas recovery services for MDS at multiple oil well sites across Montana and North Dakota. His duties included moving gas recovery equipment between oil well sites, setting up and maintaining the equipment to recapture gas, and training oil company employees to ensure continued plant operations. Much of the equipment was leased directly to MDS, which entrusted it to Mr. McGuigan. Whenever Mr. McGuigan needed assistance on a job, MDS sent additional workers to help him. Mr. McGuigan worked at the oil sites without direct supervision. He set his own hours, which varied with the task at hand. Each day Mr. McGuigan filled out reports entitled "Montana-Dakota Services, Inc. Daily Production Reporting."

Under his agreement with MDS, Mr. McGuigan was responsible for work related expenses including food, lodging, travel, and insurance. He was also responsible for any expenses arising from damage to the equipment during transport. MDS did not reimburse him for these expenses. Additionally, he drove his own truck to the various worksites and took his tools with him. In 2014 Mr. McGuigan paid $2,000 to rent a forklift, which he used to move certain equipment. MDS offered him a rollback truck to perform this task, but he opted to use the forklift instead because it would make the job easier. MDS did not reimburse him for the forklift expense.

Petitioners timely filed joint Forms 1040, U.S. Individual Income Tax Return, for both tax years at issue. Mr. McGuigan reported on the Forms 1040 that MDS paid him wages of $93,360 and $96,615 in 2014 and 2015, respectively. Likewise, MDS issued Mr. McGuigan Forms W-2, Wage and Tax Statement, and withheld Federal income tax.

Petitioners used a computer program to prepare their returns and file them electronically. They did not hire a tax preparer or an accountant. On the returns Mr. McGuigan declared himself a "mechanic" and petitioner Shirley W. McGuigan declared herself "retired". Mrs. McGuigan also listed herself as a proprietor of "Jaws Northwest Corp." on petitioners' Schedules C for 2014 and 2015. Petitioners used these Schedules C to report the expenses related to Mr. McGuigan's employment with MDS under the premise that he was a statutory employee.

On February 17, 2017, respondent mailed petitioners a notice of deficiency with respect to tax years 2014 and 2015, disallowing their Schedule C deductions for legal and professional fees, insurance (other than health), and rent expenses. Respondent also recharacterized petitioners' remaining Schedule C deductions as unreimbursed employee expenses and moved them to Schedule A for each year at issue.

Burden of Proof

Generally, the Commissioner's determination of a deficiency is presumed correct, and the taxpayer has the burden of proving it incorrect. However, under section 7491(a), the burden of proof may shift to the Commissioner as to any factual issue relevant to a taxpayer's liability for tax if the taxpayer meets certain preliminary conditions.

Employment Classification

A. General Rules

An individual performing services as an employee may deduct expenses incurred in the performance of services as an employee as miscellaneous itemized deductions on Schedule A to the extent the expenses exceed 2% of the taxpayer's adjusted gross income.

"An individual who performs services as an independent contractor is entitled to deduct expenses incurred in the performance of services on Schedule C and is not subject to limitations imposed on miscellaneous itemized deductions." Feaster v. Commissioner, T.C. Memo. 2010-157.

Petitioners argue that Mr. McGuigan was an independent contractor or a statutory employee during the years at issue and was thereby entitled to deduct business expenses on Schedules C. Respondent contends that Mr. McGuigan was a common law employee who could deduct his unreimbursed employee expenses on Schedules A only, subject to the 2% of adjusted gross income limitation.

B. Common Law Employee

The term "employee" is not defined for purposes of the income tax issue before us; therefore, common law rules must be applied to determine whether an individual is an employee.

This Court has enumerated the following factors in determining whether an employer-employee relationship exists: (1) the degree of control exercised by the principal over the details of the work; (2) which party invests in the facilities used in the work; (3) the opportunity of the taxpayer for profit or loss; (4) whether the principal has the right to discharge the taxpayer; (5) whether the work is part of the principal's regular business; (6) the permanency of the relationship; and (7) the relationship the parties believe they are creating.

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Schedule A Deductions

We next determine whether petitioners are entitled to deductions for unreimbursed employee business expenses that respondent disallowed for lack of substantiation.

A. General Rules

Deductions are a matter of legislative grace, and the taxpayer generally bears the burden of proving entitlement to any deduction claimed. A taxpayer claiming a deduction on a Federal income tax return must demonstrate that the deduction is allowable pursuant to a statutory provision and must further substantiate that the expense to which the deduction relates has been paid or incurred.

If the taxpayer is able to establish that he paid or incurred a deductible expense but is unable to substantiate the precise amount, the Court generally may approximate the deductible amount, but only if the taxpayer presents sufficient evidence to establish a rational basis for making the estimate (Cohan rule).

B. Legal and Professional Services

For 2014 and 2015, respectively, petitioners claimed deductions of $1,500 and $2,500 for legal and professional services. Respondent disallowed these deductions in full for lack of substantiation.

It is well established that legal fees stemming from a taxpayer's employee status are deductible on Schedule A. The deductibility depends on the "origin and character" of the claim for which the legal fees were incurred and whether the claim bears a sufficient nexus to the taxpayer's business or income-producing activities.

Mr. McGuigan's testimony, which the Court found credible and forthright, establishes that he sought legal advice on avoiding trade secret infringement after an oil company representative advised him to do so. More specifically, the oil company was MDS' client, and MDS expected Mr. McGuigan to bear the cost of his employment-related expenses. As a result, Mr. McGuigan paid $1,500 and $2,500 in 2014 and 2015, respectively, to protect his employment as an oil mechanic. Taking into account the record as a whole, the Court concludes that these expenses originated in Mr. McGuigan's conduct as an employee of MDS. Therefore, petitioners are entitled to Schedule A deductions of $1,500 and $2,500, respectively, for tax years 2014 and 2015.

C. Rent of Vehicles, Machinery, or Equipment

For 2014 and 2015, respectively, petitioners claimed deductions of $9,856 and $3,600 for rent of vehicles, machinery, or equipment. Respondent disallowed these expenses in full for lack of substantiation.

A portion of this reported expense for 2014 arises from Mr. McGuigan's renting a forklift. Mr. McGuigan testified at trial that "[he] had a choice to use a rollback truck that * * * [MDS] would have paid for", but he opted instead to rent a forklift for $2,000 "to make * * * [his] job a hundred percent easier and quicker." Respondent argues that petitioners are precluded from deducting the forklift rental expense because MDS offered other equipment for Mr. McGuigan to use in the course of his employment.

As discussed above Mr. McGuigan must establish that MDS either required or expected him to pay for the expense of renting vehicles, machinery, or equipment. The record, however, shows that MDS neither required nor expected Mr. McGuigan to rent the forklift. Accordingly, petitioners are not entitled to deduct the forklift rental expense.

Conclusion

Several of the factors indicate that Mr. McGuigan was a common law employee whereas other factors are neutral. After weighing these factors, the Court concludes that Mr. McGuigan was a common law employee of MDS for the 2014 and 2015 taxable years. Therefore, he is precluded from claiming Schedule C deductions as a statutory employee under section 3121(d) and the underlying regulations.

The court, therefore, upheld that petitioners are liable for the underlying tax as well as the section 6662(a) and (b)(2) accuracy-related penalty to the extent the Rule 155 computations show there is an underpayment attributable to a substantial understatement of tax.

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