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# Tax Hints

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## Perils of Relying on IRS Guidance

### Changes to IRA Rollover Rules

We knew it all along. Relying on IRS guidance may not always be worth the paper it is written on.

The Internal Revenue Code says that any amount distributed from an IRA is includible in gross income. It allows as an exclusion from gross income amounts that are subsequently paid ("Rolled Over") into a qualified IRA or retirement plan within 60 days of the distribution. The code limits the taxpayer from performing more than one non-taxable rollover in a 1-year period.

IRS Guidance, as reflected in Publication 590, indicated that this applied on an IRA-by-IRA basis.

In the Bobrow case, TC Memo 2014-21, the Tax Court held that the limitation was on an aggregate, not an IRA-by-IRA basis. This meant that even if the taxpayer didn't roll over funds from a particular IRA, they were unable to do so without the amounts

being included in gross income, if they had done a rollover with ANY of their IRAs within a 1-year period.

The Tax Court stated that the IRS guidance in their publication and in proposed regulations did not qualify as a "binding precedent" and that reliance by a taxpayer on the guidance is "at their own peril." In addition to disallowing the exclusion, the Court also upheld the IRS's imposition of penalties for accuracy-related substantial understatement.

The Tax Court has previously indicated that IRS publications aren't an authoritative source. Bobrow reminds us that they really mean it.

The IRS will begin following the Bobrow case, however, they will not apply the case to rollovers prior to January 1, 2015.

Please note: This applies to rollovers where a distribution is made and then rolled to another account. The rules

for direct IRA rollovers from one financial institution to another financial institutions are not affected by this change.



## Taxpayer Advocate Criticizes IRS's Increasing Use of FAQs for Significant Guidance

National Taxpayer Advocate, Nina Olson, spoke at a recent accounting conference, addressing the IRS's practice of increasingly providing significant guidance in the form of Frequently Asked Questions (FAQs) and other formats that aren't published guidance. There are a number of ways that this can be problematic, including the fact that such guidance can be changed without notice. It is also unclear who writes FAQs (i.e., no contact name is listed,

which is typically provided in published guidance), what type of vetting process they are subject to prior to online publication, and the extent (if any) to which taxpayers can rely on them, which is especially problematic when the FAQs are the primary guidance available on a topic.



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- IRS phone scams on the rise (see page 4)
- Tax Court disallows deductions (see Expense Substantiation—page 2)

### Expense Substantiation

The IRS means business on substantiation. We want to remind everyone that substantiation includes a document showing what the expense was, documentation of what the business purpose of the expense was and that the expense was paid for during the tax year. The record-keeping for meals and entertainment and for automobiles requires even more details.

In *Marcus O. Crawford*, TC Memo 2015-156, the Tax Court disallowed most of a taxpayer's deductions.

The taxpayer was employed in the telecommunications business and those expenses were covered by the

employer. He also was a self-employed nutritional supplement salesman and deducted expenses for his car, travel, and meals and entertainment relating to his business.

He kept a calendar with mileage, however, it didn't include information showing how the mileage was related to his business and also didn't include information on where he was for some of the days. For travel, his receipts didn't show that they were actually paid or how they related to his business. For meals and entertainment, the taxpayer produced a spreadsheet, however every entry for business purpose

showed "Interview/team training". Unfortunately, the taxpayer also admitted that most of the meals were eaten alone.

The Tax Court decided that the records were too unreliable to be "adequate records" or "sufficient evidence corroborating the taxpayer's own statement", and most of the deductions were disallowed.

One of the most common discussions we have is about adequate records. We can't stress their importance strongly enough.



### IRS Issues Revised Form 2848

Form 2848 (Power of Attorney and Declaration of Representative) is used to grant authority to an individual to represent a taxpayer before the IRS and to receive tax information. In 2013, the IRS policy changed. The July 2014 Form 2848 and instructions reflect the following changes: (1) the form may no longer be filed electronically, (2) certain taxpayer representatives are now required to provide a valid

Preparer Tax Identification Number (PTIN), (3) the number of representatives that a taxpayer can authorize on a single form has been expanded from three to four, (4) clarification that representatives are not authorized to endorse or otherwise negotiate any check or electronic payment, (5) representation with respect to a Shared Responsibility Payment must be specifically authorized, (6) representatives may

obtain a list of their powers of attorney on file, and (7) new fax numbers that the Form 2848 can be faxed to are listed.

### Things You Should Know: If Disaster Strikes!

Disasters happen! In an instant everything you have could be gone; your valuables, things of sentimental value, and your paperwork and records. In the past few years we have seen Hurricane Sandy, wildfires, tornados, and other natural disasters. What will you do if all your possessions are destroyed?

Having documentation in a safe place can make the task of recovering easier. It can help with insurance claims and help speed up the process of filing claims and replacing damaged or lost property.

There are both high-tech and low-

tech solutions. Either way you proceed, having a list of what you own is extremely important. It is helpful if the list is accompanied by pictures of unusual, expensive, important or rare items.

**Make a list:** If you want to go low-tech, get a notebook, index cards or loose-leaf binder and make a list of your possessions. If you are comfortable with spreadsheets, keep your records in digital form on a spreadsheet. Either way, make sure your list is thorough and organized. Most importantly, the list should be kept in a safe place. Remember to update your records periodically by

deleting items you have disposed of and adding any new items you have obtained.

**Photograph your possessions:** Use a digital camera or a smartphone and take a close up of rare, expensive or important items. Also take a wider-angle picture to show their position in your home. Take pictures of the contents of closets, drawers and each wall. Code or number each close up so that you can identify the location (wall, closet or drawer) that it belongs to.

**Store the records safely:** Keep in mind that the records don't help if they are lost or destroyed. Make sure to keep them in a safe place.

For paper copies, or for that matter a USB or CD backup of digital records, store it away from your home. You may want to consider using a bank's safe deposit box. For digital records, many internet-based providers offer digital storage, online backups or cloud storage.

**Most Important:** Forgetting possessions for a moment, it is crucially important to store digital copies of your important financial and personal documents (wills, birth certificates, marriage certificates, tax records, to name a few). Using a cloud-based online backup helps improve your chances of being able to quickly recover your information should a disaster strike.

## Required Retirement Plan Distributions

A **last minute reminder** and a head start for 2015.

If you were born before *July 1, 1944*, make sure that you have taken the Required Minimum Distributions (RMD) by December 31, 2014. If you were born before July 1, 1945, you must begin taking your RMD in 2015.

The RMD is a mandatory distribution required to be made from certain retirement plans including traditional IRAs. Normally a RMD must be made by December 31st each year, beginning with the year a person turns 70 1/2. A special rule allows first-year individuals (turning 70 1/2 during the year) to wait until April 15th of the following year to take the first RMD. Keep in mind that in the following year you will then be taking the first distribution for the

prior year and the distribution for the current year.

The amount of the RMD is based upon the value of the account on December 31st of the year preceding the RMD. An IRA trustee must report the amount of the RMD or offer to calculate it for the owner of the IRA. Often the amount is shown in box 12 of Form 5498, which is the form that trustees must use to report the December 31st IRA value.

The RMD is based on the value of the account and the life expectancy tables that can be found in IRS Publication 590. There are three different tables, depending on the person who is required to take the RMD. There is a table that is generally used when a beneficiary inherits a retirement account, a table for a person who has a spouse that is the

sole beneficiary and more than 10 years younger, and a table that is used when the other tables don't apply.

The rules apply to owners of traditional IRAs, but not Roth IRAs. They also apply to workplace retirement plans such as 401(k), 403(b) and 457 (b) plans. Some people in the workplace can wait longer to receive their RMDs. Usually employees who are still working, if their plan allows, can wait until April 1 of the year after they retire to start receiving these distributions.

It is very important to pay attention to the RMD rules. There is an "excise tax" on amounts not timely distributed. The "excise tax" penalty is 50% of the required amount that is not distributed.



## Surprise Tax Problems with IRAs

We are looking at a potential ticking time bomb that can have major tax consequences if it blows up.

Over the past few years we have seen a rapid increase in the number of partnership K-1s that our clients have received for investments held in their IRAs. Some of these partnerships can explode into tax and penalty situations if an unexpected 1099-R for an IRA distribution suddenly appears.

So where did this problem come from?

It seems investment advisers started recommending that clients invest their IRAs in limited partnerships. These were sold as a way to increase returns, diversify the portfolio and improve liquidity. This issue is as a result of Internal Revenue Code Section 511. This section applies a 39.6% tax on unrelated business income (UBI) when an IRA earns income from a trade or business that generates more than \$1,000 of income.

Normally IRAs are exempt from the

tax on interest, dividends, royalties, rents, and few other items. The problem is that many of the limited partnerships operate business and finance operations with debt. Much of this may be subject to the tax.

Part of the problem is that the broker who sold you the investment may not be aware or may not have informed you of the issues.

In particular oil and gas and real estate investments are likely to have a UBI problem. While the income in a partnership within an IRA is not reported on your tax return, if the UBI results in a loss, or it is greater than \$1,000, the IRA's trustee is required to file a Form 990-T. When the income is over \$1,000 there is also a tax that must be paid with the Form 990-T. When this tax is paid from the IRA it is generally treated as an early distribution making it subject to tax and possibly a 10% early withdrawal penalty if you have not yet reached 59 1/2 years old.

It gets even better! If the trustee doesn't file the Form 990-T when required, it could potentially dis-

qualify the whole IRA and the entire IRA balance would be considered a distribution.

We are also hearing that some brokers are amending their IRA trustee agreements to put the responsibility for filing back onto the beneficiary. This is disturbing because some IRA experts believe that this move could be considered self-dealing and disqualify the whole IRA.

The K-1 you receive is not part of your personal 1040. Because we are not your IRA trustee, nor do we prepare Form 990-T, we suggest you request a copy of the 990-T your broker may have been required to file for you so that you are aware of the additional tax and costs associated with this investment. If your K-1 shows a loss, or UBI greater than \$1,000 and your IRA trustee does not provide you with a copy of the 990-T, we strongly suggest you take steps to protect your IRA from the above worst-case scenarios.

Look on your K-1 for UBI. It is usually found on line 20 with a code "V".

**"We are looking at a potential ticking time bomb that can have major consequences if it blows up."**



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## IRS Notices

The IRS sends millions of notices and letters to taxpayers every year. The most important thing is DON'T PANIC!

Often the notice just requires a response clarifying an issue. Usually a notice is about a specific issue on your return. It may propose a change, ask for additional information, or tell you that you owe a payment.

The notices have specific instructions on what needs to be done and how to respond.

You should keep copies of these notices with your tax return.

We encourage you to contact a professional before responding to the notice. We find that more often than not, the notice is in error or the IRS jumped to the wrong conclusion and simply needs additional information.

More importantly, please remember that in today's environment, there are many attempts to secure your personal information. Remember

that the IRS will not contact you using email or social media to ask for your personal or financial information.

If you are unsure about a communication, check with your professional or please contact the IRS. Information on contacting the IRS can be found at IRS.Gov.

We understand that the first response is to panic and feel that you must immediately respond. We assure you that you need not panic and respond.

It is better to take a breath and make sure that the communication is actually from the IRS, rather than risk your personal information.

We recommend contacting your tax professional any time you receive government correspondence.

## IRS Warning about Phone Scams

The IRS and TIGTA (Treasury Inspector General for Tax Administration) report that they continue to hear from taxpayers who have received unsolicited calls from individuals who fraudulently claim to be from the IRS. TIGTA has identified approximately 1,100 victims who have lost an estimated \$5 million to these scammers.

**REMEMBER:** Your first contact will not be a call out of the blue, but rather through official correspondence sent through the mail. One big red flag is an angry, threatening call from someone claiming to be from the IRS and demanding immediate payment.

*The IRS NEVER:*

- Asks for credit card, debit card or

prepaid card information over the telephone.

- Never insists the taxpayer use a specific method of payment.
- Never requests immediate payment over the telephone and will not take enforcement action immediately following a telephone conversation.

*Other scam characteristics:*

- Scammers use fake names, generally common names, and fake IRS badge numbers.
- Scammers may be able to recite the last four digits of your social security number.
- They often spoof the IRS toll-free number on caller ID to make it look like it is the IRS calling.
- Sometimes they send bogus emails to support their bogus calls.

- There often is background noise to simulate other calls being made from a call site.
- They may threaten jail time or driver's license revocation and then call back claiming to be from the local police or DMV, again with caller ID spoofed to support their claim.

Be vigilant against phone and email scams that use the IRS as a lure.

The IRS will not initiate contact by email to request personal or financial information. This includes any type of electronic communication, such as text messages and social media channels.

The IRS also does not ask for PINs, passwords or similar confidential access information for credit card, bank or other financial accounts.

Finally, do not open any attach-

ments or click on any links contained in a message purporting to be from the IRS.

If you receive any communication from the Internal Revenue Service or any other taxing authority or governmental agency, it is important to contact a professional before responding.

Identity theft has become a major issue for the IRS and a word of warning is definitely in order.

