Current Federal Tax Developments

Week of July 29, 2019

Edward K. Zollars, CPA
(Licensed in Arizona)

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CURRENT FEDERAL TAX DEVELOPMENTS
WEEK OF JULY 29, 2019

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SECTION: 506
FINAL REGULATIONS ISSUED ON REQUIRED NOTICE BY ORGANIZATION OF OPERATION AS A §501(C)(4) ORGANIZATION

Citation: TD 9873, 7/23/19

The IRS has released final regulations[1] regarding the notice requirement for organizations planning to operate as §501(c)(4) organizations that as added by the Protecting Americans from Tax Hikes (PATH) Act of 2015.

Organizations exempt from tax under §501(c)(4) include the following:

> Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.[2]

However, the exemption does not apply unless no part of its earnings inures to the benefit of any private shareholder or individual.[3]

IRC §506, added by the PATH Act, requires organizations described in IRC §501(c)(4) to notify the IRS within 60 days after the entity is established, notify the IRS that it is operating as that type of organization.[4]

The statute provides the notice is to contain the following items:

- The name, address, and taxpayer identification number of the organization.
- The date on which, and the State under the laws of which, the organization was organized.
- A statement of the purpose of the organization.[5]

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[1] TD 9873, Publication date 7/23/19, https://s3.amazonaws.com/public-inspection.federalregister.gov/2019-15614.pdf, Retrieved July 21, 2019

[2] IRC §501(c)(4)(A)

[3] IRC §501(c)(4)(B)

[4] IRC §506(a)

[5] IRC §506(b)

The IRS is directed to acknowledge the receipt of this notice within 60 days.[6] As the well, the IRS is directed to impose a user fee for this submission.[7]

A penalty of $20 per day, up to $5,000 maximum, is imposed on an organization that does not timely file this notice, measured from the due date of the notice until the date the organization finally files the notice.[8]

Following the addition of this section to the law in December of 2015, the IRS issued the following interim guidance:

- Notice 2016-09, which provided that the notice was to be due no earlier than 60 days after implementing regulations are finally issued. As well, entities that are looking for a ruling that they qualify as a §501(c)(4) organization (something not provided by the IRS when the basic notice is filed) were directed to continue to file Form 1024, *Application for Recognition of Exemption Under Section 501(a)*, until further guidance was issued. This Notice as issued in January of 2016.

- Temporary[9] and identical proposed regulations[10] were released on July 8, 2016 and published on July 12, 2016 with regard to these additions to the law. The temporary regulations provided that the notice was to be submitted to the IRS on Form 8976, *Notice of Intent to Operate Under Section 501(c)(4)*, or its successor. The Form 8976 is to be submitted electronically via the IRS website.[11] The temporary regulations were effective and applicable on July 8, 2016.

- At the same time as the temporary and proposed regulations were issued the IRS issued Revenue Procedure 2016-41. The procedure contained detailed information on filing the notice with the IRS and an example of what would qualify for a reasonable cause exception under IRC §506(d) to the penalty for a failure to timely file the form.

The final regulations adopt the proposed regulations without any significant revision.

The regulations provide that the notice must be provided via Form 8976 prepared in accordance with the instructions for the form, as well as with guidance provided in the

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[6] IRC §506(c)

[7] IRC §506(e)

[8] IRC §6652(c)

[9] TD 9775

[10] REG-101689-16

[11] https://www.irs.gov/charities-non-profits/electronically-submit-your-form-8976-notice-of-intent-to-operate-under-section-501c4, Retrieved July 21, 2019

Internal Revenue Bulletin—which, at this point, would be Revenue Procedure 2016-41.[12]

The regulations define the "date of organization" as the date on which the entity was formed as a legal entity.[13] Note that even if the organization does not actually initially begin operating as a §501(c)(4) organization, even if it decides to begin operating that way months or years later, the notice date still will refer back to the date of organization. The IRS rejected a request found in comments to change the date to the date the change in status is accomplished.

In the preamble, the IRS states:

> The section 506(a) notification requirement applies no later than 60 days after the organization is established. Section 506(b)(2) further provides that the 506(a) notification shall include the date on which, and the state under the laws of which, the organization was organized. Section 506 did not indicate that any difference was intended between the use of "established" in section 506(a) and the reference to "organized" in section 506(b). Accordingly, the temporary regulations provided that, except as provided in paragraph (b) of the section, an organization (whether domestic or foreign) described in section 501(c)(4) must, no later than 60 days after the date the organization is organized, notify the Commissioner that it is operating as an organization described in section 501(c)(4) by submitting a completed Form 8976. See § 1.506-1T(a)(1). Following the longstanding approach on forms used to apply for exemption and for entering data into the IRS system, the temporary regulations in § 1.506-1T(a)(2)(ii) clarify that the date an organization is "organized" for section 506 purposes is the date on which it is formed as a legal entity.[14]

This creates a problem if the organization decides more than 60 days after the date of formation to operate as a §501(c)(4) organization—the application would be late even if filed on the date the organization began operating as a §501(c)(4) organization.

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[12] Reg §1.506-1(a)

[13] Reg. §1.506-1(b)

[14] https://s3.amazonaws.com/public-inspection.federalregister.gov/2019-15614.pdf, Retrieved July 21, 2019, Preamble, pp. 16-17

The IRS concludes this problem can be dealt with by the organization seeking reasonable cause relief under §506(d). In Revenue Procedure 2016-41 the IRS provided the following example of a case that would allow for reasonable cause relief:

EXAMPLE

Reasonable Cause Under §506(d) per Revenue Procedure 2016-41

Organization O is formed under the laws of a foreign country and operates for a number of years during which it conducts no activities in the United States and has no income from U.S. sources. In October 2016, O commences operations in the United States from which it anticipates income that will be reported on a Form 990 (or require the filing of a Form 990-N) and promptly notifies the IRS of its intent to operate as a section 501(c)(4) organization by submitting Form 8976. Because the date of submission of Form 8976 is more than 60 days after its Date of Organization, O receives a penalty letter from the IRS. Based on these facts, O's failure is due to reasonable cause, and O may obtain relief from the penalty described in section 8.01(1) of this revenue procedure by submitting a request in accordance with the instructions in the correspondence from the IRS regarding the penalty.

The IRS explains why the agency believes a request for reasonable cause relief should be adequate based on the example found in the Revenue Procedure:

> Although the final regulations do not provide for a procedure for automatic reasonable cause relief, organizations (including organizations formed before December 18, 2015, foreign organizations, small organizations, and organizations that originally operated under sections other than section 501(c)(4)) may seek reasonable cause relief by following the instructions in the penalty letter, as provided in Rev. Proc. 2016-41. Rev. Proc. 2016-41 includes an example of a situation in which reasonable cause relief would be appropriate regarding foreign organizations. The reasonable cause example included in Rev. Proc. 2016-41 is just one example of reasonable cause for purposes of section 506 only. Similar to the foreign organization discussed in the example provided in Rev. Proc. 2016-41, an organization (other than a section 501(c)(3) organization) that did not originally intend to operate under section 501(c)(4) is subject to the requirement to submit Form 8976 once it begins to operate as a section 501(c)(4) organization. Such an organization that files a Form 8976 within 60 days of amending its organizing document to be described in section 501(c)(4) would have reasonable cause for not filing a Form 8976 within 60 days of formation.[15]

Unfortunately the IRS notes that this request is to be made *after* the IRS sends correspondence regarding a penalty.[16] Considering that correspondence will come with

[15] *Ibid*, p. 19

[16] *Ibid*

a penalty already stated on the notice (most likely $5,000 if the organization has been in existence for any significant period of time), advisers aren't likely to consider this the best approach the IRS could have taken with regard to this issue.

The final regulations continue to require any organization that wants a ruling on its qualification for §501(c)(4) status to file Form 1024, *Application for Recognition of Exemption Under Section 501(a)* separate from the Form 8976. Note that the filing of the Form 1024 *does not* serve as the required notice under §506, so the Form 8976 must be timely filed even if the organization is looking for a determination on their qualification for §501(c)(4) status.

SECTION: 903
REFUNDS GOING BACK TO 2009 MAY BE AVAILABLE TO CERTAIN TAXPAYERS WHO PAID FRENCH TAXES

Citation: "Totalization Agreements," IRS Website, July 19, 2019 Revision, 7/19/19

The IRS posted a clarification on its website that the IRS has changed its position with regard to certain taxes paid to France, holding that these taxes are not covered by the Agreement on Social Security between the two countries.[17] Thus, these taxes will be retroactively treated as income taxes for which a foreign tax credit is available.

The clarification states:

> In 2019, the United States and the French Republic memorialized through diplomatic communications an understanding that the French Contribution Sociale Generalisee (CSG) and Contribution au Remboursement de la Dette Sociate (CRDS) taxes are not social taxes covered by the Agreement on Social Security between the two countries. Accordingly, the IRS will not challenge foreign tax credits for CSG and CRDS payments on the basis that the Agreement on Social Security applies to those taxes.

Individuals who paid these taxes in prior years are now able to file a claim for refund to the extend a foreign tax credit would now be available to the taxpayer. But what some taxpayers may not be aware of is that they can go back much further than the normal 3 year statute for claiming a refund of taxes.

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[17] "Totalization Agreements," IRS Website, https://www.irs.gov/individuals/international-taxpayers/totalization-agreements, Revised July 19, 2019, Retrieved July 21, 2019

As the IRS notes:

> Generally individual taxpayers have ten (10) years to file a claim for refund of U.S. income taxes paid if they find they paid or accrued more creditable foreign taxes than what they previously claimed. The 10-year period begins the day after the regular due date for filing the return (without extensions) for the year in which the foreign taxes were paid or accrued. This means that amended returns may be filed, using Form 1040-X to include accompanying Form 1116, going back to tax year 2009.

The IRS provides the following instructions for preparing the Forms 1040X to claim refunds due to this change:

> Individual taxpayers should write "French CSG/CRDS Taxes" in red at the top of Forms 1040-X, file them with accompanying Forms 1116 in accordance with the instructions for these forms. U.S. employers may not file for refunds claiming a foreign tax credit for CSG/CRDS withheld or otherwise paid on behalf of their employees.

This particular situation is a reminder that care must taken when clients ask about "how far back should I keep records" for tax related items. The foreign tax credit is not the only item in the tax law where issues may arise necessitating reference to documents that go back well beyond the traditional three year statute on assessments and refund claims.

SECTION: 1374
LB&I ANNOUNCES 6 NEW COMPLIANCE CAMPAIGNS, INCLUDING S CORPORATION BUILT-IN GAIN AND COMPLIANCE AMONG OVDP PARTICIPANTS

Citation: LB&I New Compliance Campaigns, 7/19/19

The IRS Large Business and International Division has approved six new compliance initiatives, bringing the total number of approved campaigns to 59.[18]

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[18] "The IRS Large Business and International Division (LB&I) Announces the Approval of Six Additional Compliance Campaigns," IRS Website, https://www.irs.gov/businesses/corporations/the-irs-large-business-and-international-division-lbi-announces-the-approval-of-six-additional-compliance-campaigns, July 19, 2019, Retrieved July 21, 2019

Note that the IRS is concerned those who "came in from the cold" under the Offshore Voluntary Disclosure Program are falling back in their old habits, likely feeling the heat is now off—so a new program is addressed at that group.

The newly approved campaigns and the IRS reason behind the campaigns are:

- **S Corporations Built in Gains Tax** – "C corporations that convert to S corporations are subjected to the Built-in Gains tax (BIG) if they have a net unrealized built-in gain and sell assets within 5 years after the conversion. This tax is assessed to the S corporation. LB&I has found that S corporations are not always paying this tax when they sell the C corporation assets after the conversion. LB&I has developed comprehensive technical content for this campaign that will aid revenue agents as they examine the issue. The goal of this campaign is to increase awareness and compliance with the law as supported by several court decisions. Treatment streams for this campaign will be issue-based examinations, soft letters, and outreach to practitioners"

- **Post OVDP Compliance** – "U.S. persons are subject to tax on worldwide income. This campaign addresses tax noncompliance related to former Offshore Voluntary Disclosure Program (OVDP) taxpayers' failure to remain compliant with their foreign income and asset reporting requirements. The IRS will address tax noncompliance through soft letters and examinations."

- **Expatriation** – "U.S. citizens and long-term residents (lawful permanent residents in eight out of the last 15 taxable years) who expatriated on or after June 17, 2008, may not have met their filing requirements or tax obligations. The Internal Revenue Service will address noncompliance through a variety of treatment streams, including outreach, soft letters, and examination."

- **High Income Non-filer** – "U.S. citizens and resident aliens are subject to tax on worldwide income. This is true whether or not taxpayers receive a Form W-2 Wage and Tax Statement, a Form 1099 (Information Return) or its foreign equivalents. Through an examination treatment stream, this campaign will concentrate on bringing into compliance those taxpayers who have not filed tax returns."

- **U.S. Territories – Erroneous Refundable Credits** – "Some bona fide residents of U.S. territories are erroneously claiming refundable tax credits on Form 1040, U.S. Individual Income Tax Return. This campaign will address noncompliance through a variety of treatment streams including outreach and traditional examinations.

- **Section 457A Deferred Compensation Attributable to Services Performed before January 1, 2009** – "This campaign addresses compensation deferred from nonqualified entities attributable to services performed before January 1, 2009. In general, Internal Revenue Code (IRC) Section 457A requires that any compensation deferred under a nonqualified deferred compensation plan shall be includible in gross income when there is no substantial risk of forfeiture of the rights to such compensation. The campaign objective is to verify taxpayer

compliance with the requirements of IRC Section 457A through issue-based examinations."

SECTION: 6032
IRS GRANTS RELIEF TO CPAR PARTNERSHIPS THAT DID NOT APPLY FOR AN EXTENSION AND NOW WISH TO FILE A SUPERSEDING RETURN

Citation: Revenue Procedure 2019-32, 7/25/19

One of the features of the new centralized partnership audit regime that was enacted as part of the Bipartisan Budget Act of 2015 is that once a partnership return is filed that is covered by the program, any later change does not lead to the partners amending their return for the year of change. Rather, after the return is filed the partnership files an administrative adjustment request (AAR) and either:

- Pays tax with the request, computed under the CPAR rules to compute tax due on the imputed adjustment or

- If the partnership elects the alternative to the imputed adjustment, the partners report the additional tax, penalties and interest on their return for the year the AAR is filed.[19]

As the IRS explains in Revenue Procedure 2019-32, issued to relax this rule somewhat in this first year of filing CPAR covered partnership returns as described later in this article:

> A partnership that files its Form 1065 and furnishes Schedules K-1 to its partners prior to the deadline for filing the Form 1065 (including extensions) may file a superseding Form 1065 and furnish corresponding Schedules K-1 to its partners prior to the deadline, including extensions. Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in 2015* (March 2016) (JCT Bluebook), JCS-1-16, at 82 ("Schedules K-1 . . . may not be amended after the due date of the partnership return . . . [but] [t]he due date takes into account the permitted extension period."). A timely filed superseding Form 1065 is considered the original return of the partnership. See, e.g., *Haggar Co. v. Helvering,* 308 U.S. 389, 395-96 (1940); Rev. Rul. 78-256, 1978-1 C.B. 438 (amended corporate return filed before due date including extensions is the corporation's return for that taxable year for purposes of estimated tax penalties).

[19] IRC §6226

But the superseding return option isn't going to be available any longer if a partnership filed its return without filing for an extension of time to file its return. Now some of those partnership realize there are issues on their returns and would like to provide their partners with revised K-1s that could be used to prepare the individual partners' returns, rather than going down the AAR route.

The IRS has issued this Revenue Procedure primarily to allow those partnerships that filed by March 15, 2019 and did not request an extension the right to file a superseding return by September 15, 2019, though it does cover additional fiscal years.

The ruling applies to the following partnership tax years:

> The filing and furnishing extensions provided in this revenue procedure apply only to partnership taxable years that ended prior to the issuance of this revenue procedure and for which the extended due date for such partnership taxable year is after July 25, 2019.

Thus, the ruling would cover not only calendar year returns, but also short year fiscal year returns ending after October 31, 2018 that began in 2018.

The relief granted is described as follows:

> The IRS will treat the timely filing of Form 1065 by a BBA partnership described in section 3.03 of this revenue procedure as a timely and appropriately filed request for a six-month extension of the deadline to file the Form 1065. BBA partnerships that timely filed a Form 1065 and timely furnished all required Schedules K-1 (without regard to the extensions of time provided by this revenue procedure) may file a superseding Form 1065 and furnish corresponding Schedules K-1 before the expiration of the extended deadline.

Eligible partnerships are described as follows:

> The filing and furnishing extensions provided in section 3.02 of this revenue procedure are available only to BBA partnerships that timely filed Form 1065 and timely furnished Schedules K-1 prior to application of this revenue procedure and also file a superseding Form 1065 and furnish corresponding Schedules K-1 on or before the date that is six-months after the non-extended deadline. For purposes of section 6222, the superseding return replaces any prior return for the taxable year for purposes of determining the partnership's treatment of partnership-related items.

Partnerships taking advantage of this procedure take the following steps:

> To take advantage of the relief provided by section 3 of this revenue procedure, file a superseding Form 1065 and furnish corresponding

Schedules K-1 in the same manner as the original return and Schedules K-1 and write on the top of the superseding Form 1065 "SUPERSEDING FORM 1065 PURSUANT TO REVENUE PROCEDURE 2019-32."

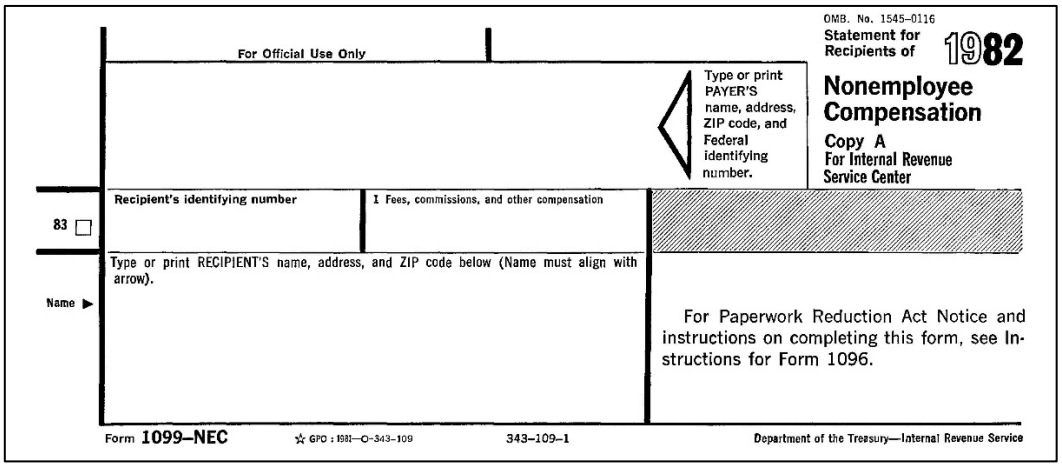
The relief is better than nothing, but it's important to note that it's only good for one year and it does nothing for partnerships that filed an extension—just those who rushed to file without an extension.

SECTION: 6041
IRS TO BRING BACK FORM 1099-NEC, LAST USED IN 1982

Citation: Draft 2020 Form 1099-NEC, 7/24/19

It's back to the future time—the IRS is bringing back a form last used in the early 1980s when Ronald Reagan was President—Form 1099-NEC, to be used beginning with 2020 information returns. The draft 2020 version of the form has been posted by the IRS to the agency's website.

The 1982 version of the form looked like this, harkening back to a much simpler time for tax information reporting:


OMB. No. 1545-0116
For Official Use Only
Statement for Recipients of 1982
Nonemployee Compensation
Copy A For Internal Revenue Service Center
Type or print PAYER'S name, address, ZIP code, and Federal identifying number.
Recipient's identifying number
1 Fees, commissions, and other compensation
83 ☐
Type or print RECIPIENT'S name, address, and ZIP code below (Name must align with arrow).
Name ▶
For Paperwork Reduction Act Notice and instructions on completing this form, see Instructions for Form 1096.
Form 1099–NEC ☆ GPO : 1981—O-343-109 343–109–1 Department of the Treasury—Internal Revenue Service

The IRS moved the information on the Form 1099-NEC to Form 1099-MISC beginning with payments made in 1983.

However, Congress decided in the Protecting Americans from Tax Hikes Act of 2015 (PATH Act), in an attempt to help reduce refund fraud, to require information returns

containing non-employee compensation to be filed with the IRS by January 31. Thus, the due date for your 1099-MISCs are:

- March 31 if filed electronically so long the forms do not contain any nonemployee compensation reporting[20] but
- January 31 if there is nonemployee compensation to be reported.[21]

EXAMPLE

Different Due Dates

M Enterprises paid Larry $1,000 for non-employee compensation and Denise $14,000 in rent for 2019. While both Forms 1099-MISC must be given to the recipients by January 31, the one issue to Larry for non-employee compensation must be sent to the IRS by January 31 as well. The 1099-MISC for rent paid to Denise can be held until March 31 just in case an error is found—then only the recipient copy will need to be revised, and no erroneous report would be in the hands of the IRS.

To make matters worse, Tax Analysts reported in March that the IRS computers were unable to apply two different due dates to a batch of Forms 1099-MISC submitted. So a single Form 1099-MISC in a batch submitted after January 31 that had an entry in box 7 for non-employee compensation on it would cause a notice to be issued charging late payment fees on every Form 1099-MISC submitted.[22]

To deal with these complications, the IRS has released a draft of Form 1099-NEC that would first be used to report non-employee compensation paid in 2020. Note that the tax world as it relates to non-employee compensation has grown complex—while the last Form 1099-NEC released by the IRS (the 1982 version) had only one information box in addition to identifying information, the new form has 6 boxes for non-

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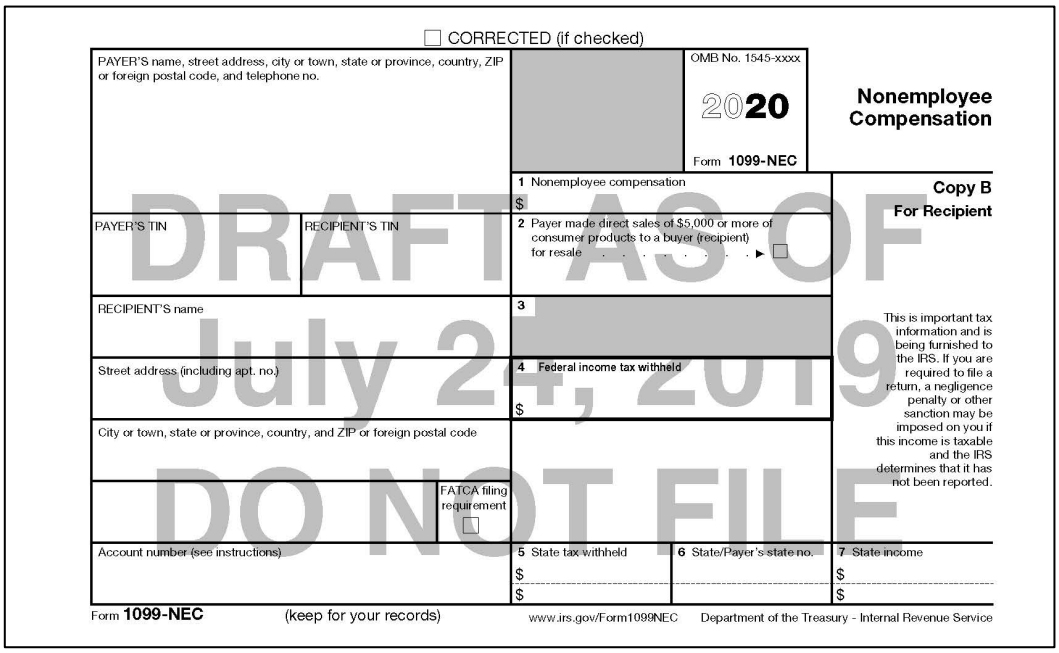
[20] IRC §6071(b)

[21] IRC §6071(c)

[22] William Hoffman, "IRS May Revive Form 1099-NEC to Reduce Employer Filing Trouble," *Tax Notes Today Federal*, March 26, 2019, 2019 TNT 58-6, https://www.taxnotes.com/tax-notes-today-federal/information-reporting/irs-may-revive-form-1099-nec-reduce-employer-filing-trouble/2019/03/26/2996z, (subscription required)

identifying information and added an extra box for state identifying information that was not on the form from nearly 40 years ago.



☐ CORRECTED (if checked)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.

OMB No. 1545-xxxx

2020

Form 1099-NEC

Nonemployee Compensation

1 Nonemployee compensation
$

Copy B
For Recipient

PAYER'S TIN | RECIPIENT'S TIN

2 Payer made direct sales of $5,000 or more of consumer products to a buyer (recipient) for resale ▶ ☐

RECIPIENT'S name

3

Street address (including apt. no.)

4 Federal income tax withheld
$

This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

City or town, state or province, country, and ZIP or foreign postal code

FATCA filing requirement ☐

Account number (see instructions)

5 State tax withheld
$
$

6 State/Payer's state no.

7 State income
$
$

Form 1099-NEC (keep for your records) www.irs.gov/Form1099NEC Department of the Treasury - Internal Revenue Service

Thus, after one more year of having a dual due date for Forms 1099-MISC, payors will have one due date for each type of 1099 form again.