



## Other Important Issues



Center for Agricultural Law and Taxation



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## Alternative Positions

- Whether or not it is determined that an activity is engaged in for profit, the examiner should consider whether other Internal Revenue Code sections apply and treat as alternative positions
- Substantiation of all large, unusual or questionable items should be performed on each examination

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## Development of Other Non § 183 Issues

- IRC § 704 partnership loss limitations
- IRC § 1366 S corporation stock or debt basis limitations
- IRC § 465 at-risk limitations
- IRC § 469 passive activity loss limitations
- IRC § 162 ordinary and necessary
- IRC § 274(d) record keeping requirements
- IRC § 179 election to expense certain depreciable assets
- IRC § 167 and 168 depreciation
- IRC § 212 expenses for production of income
- IRC § 280A disallowance of certain expenses in connection with business use of the home, rental of vacation homes, motor homes, houseboats, yachts and more
- IRC § 195 start up expenses

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### What is the Examiner Looking For?

- Taxpayers may use the activity to claim personal expenses
- Examiners will be on the alert for any one or a combination of the following:
  - Deducting all or most of the cost of maintaining a personal residence
  - Taxpayers sometimes erroneously claim that the “exclusive use” restriction of IRC § 280A can be avoided by placing business related items in any given room of the house
  - The taxpayers sometimes cite the IRC § 280A(c)(2) exception for storage use (storage on a regular basis of inventory or product samples)
    - For example, the taxpayer may erroneously claim that if a poster, calendar, desk, file cabinet, telephone or other business item is placed in a room that secures the room’s business status without regard to the fact that the room is used for personal purposes as a kitchen, bathroom, child’s bedroom, etc

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### What is the Examiner Looking For?

- Paying children and/or family members for household duties that are not ordinary and necessary to the operation of any business (e.g. disposing of trash, mowing the lawn, answering the telephone, washing cars)
- Also, the payment may be excessive for the services performed
- Deducting family education expenses by claiming an Education Assistance Program for family members claimed as employees

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### What is the Examiner Looking For?

- Deducting excessive car and truck expenses when the vehicle was used for both personal and business use
- Taxpayers sometimes claim a business purpose for every trip, whether it is to commute to a regular job or a trip to the grocery store, golf course, church, etc
- Taxpayers sometimes erroneously argue that the trips are deductible given that there is always a potential of recruiting new clients

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### What is the Examiner Looking For?

- Deducting personal furniture, home entertainment equipment, children's toys, etc
- Deducting personal travel, meals, and entertainment under the guise that since everyone is a potential client, these are deductible, not personal expenses
- Deducting 100% of personal medical expenses merely by "employing" a family member who is not a bona fide employee and creating a medical reimbursement plan

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### Inadequate Books and Records

- IRC § 6001 contains the requirements for taxpayers to maintain and keep records
- Treas. Regs. § 1.6001-1(a) provides that taxpayers must keep permanent books of account or records, including inventories, as are sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown in the taxpayer's returns
- Treas. Regs. § 1.6001-1(e) provides that the books or records required by this section shall be kept at all times available for inspection by authorized internal revenue officers or employees, and shall be retained so long as the contents thereof may become material in the administration of any internal revenue law
- If the taxpayer has not kept adequate books and records this will be documented by the examiner
- It is relevant in the nine factor regulatory analysis

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### Sample Information Document Request Racing Example – Not All Inclusive

- Statement of taxpayer's racing experience
- Copies of experience profiles submitted by potential sponsors or supporters
- Applications to enter a race
- Purchase agreement, Bill of Sale and Invoice, and all canceled checks showing verification of auto purchase
- Statement of actions taken to investigate racing business before entering into this business
- Name and address of all sponsoring agreements or other 3<sup>rd</sup> party agreements
- Schedule of fees or charges billed to business
- Copies of original loan agreements/promissory notes on financed portion of property

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### Sample Information Document Request

- Insurance policy(s) on car and driver (collision and liability, life)
- Promotional materials
- Invoices and ad copies for advertisements
- Copies of any management agreements or management contracts, maintenance, or operation agreements
- Contacts with racing venues
- Maintenance records and service check performance records
- Copy of any prospectus, private placement memorandum or other promotional material received
- Operating budgets

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### Sample Information Document Request

- Break-even point calculations for the activity
- All books and records pertaining to the business
- Copies of the federal tax return for XXXX though XXXX (including any amendments)
- Asked to complete a Schedule of Racing and Schedule of Taxpayer/Shareholder/ Partner Time Spent to Operate the Activity

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### Review




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Examination Adjustments Three Categories
<ul style="list-style-type: none"> <li>• If an activity is <u>not</u> engaged in for profit, deductions are allowable under IRC § 183(b) in the following order on the Schedule A and only to the following extent:</li> <li>• Category 1                             <ul style="list-style-type: none"> <li>– First, deduct expenses that are allowable without regard to the taxpayer's profit motive from the gross income produced by the activity                                     <ul style="list-style-type: none"> <li>• For example, taxes, mortgage interest, casualty and theft losses, and contributions</li> </ul> </li> <li>– These expenses are not limited by gross income from the activity since they are allowable under other sections of the Internal Revenue Code regardless of whether or not such activity is engaged in for profit</li> <li>– These expenses should appear in the proper places on the Schedule A and be allowed in full after taking into account any limitations such as the limitation on excess investment interest</li> </ul> </li> </ul>

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Examination Adjustments Three Categories
<ul style="list-style-type: none"> <li>• Category 2</li> <li>• Deduct expenses that would be allowable if the activity were to be engaged in for profit</li> <li>• For example, rent, labor, wages, travel, transportation, etc</li> <li>• These expenses are limited to the amount of gross income less the expenses in Category 1</li> </ul>

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Examination Adjustments Three Categories
<ul style="list-style-type: none"> <li>• Category 3                             <ul style="list-style-type: none"> <li>– Allow deductions which lead to basis adjustments (e.g. depreciation, amortization and the portion of casualty losses that is not deductible in Category 1)</li> <li>– These expenses are limited to the amount of gross income from the activity less the expenses in Categories 1 and 2</li> <li>– If there is any gross income remaining after Category 1 and 2 items, the depreciation must be allocated to each depreciable asset</li> </ul> </li> </ul>

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### Example

- Schedule C has gross receipts of \$13,000 from a direct sales activity which has been determined by the examiner that it is not engaged in for profit
- After expenses of \$50,000, the per return ordinary loss is \$37,000

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### Correct Way to Recalculate Income

- Remove the \$13,000 of gross receipts from the Schedule C;
- Reclassify the \$13,000 of gross receipts from Schedule C, to other income (line 21 of the Form 1040);
- Remove all \$50,000 in expenses from the Schedule C;
- Allow \$2,000 as a Schedule A (mortgage expense deduction) (Category 1 item); and
- Allow \$11,000 (Category 2 items) as Schedule A miscellaneous itemized deductions subject to the 2% AGI limitation
- Deductions up to earnings

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### Development of the Case

- In cases where the IRS has been unsuccessful on IRC § 183 issues it is largely due to inadequate development and/or application of the tax law by the tax examiner
- Some of the reasons mentioned in Appeals feedback include:
  - Alternative arguments were not addressed
  - Disallowed expenses were not first verified as to whether they would be deductible at all or were personal in nature
  - The nine factors in Treas. Reg. §1.183-2(b) were not addressed
  - No mention was made of whether there would ever be a realistic possibility of a profit
  - No mention was made documenting the history of the activity including losses incurred and taxes saved in the prior period
  - Lack of factual development

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### Tax Savings Benefit Analysis

Tax Period	Tax with Loss	Tax Without Loss	Tax Savings
2008			
2009			
2010			
2011			
2012			
2013			
2014			
2015			
2016			

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### Tax Savings Benefit Analysis

Year	2012	2013	2014	2015	2016
Income					
Gross Receipts					
Cost of Goods Sold					
Other Income					
Gross Income					

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### Tax Savings Benefit Analysis

Year	2012	2013	2014	2015	2016
Advertising					
Car and Truck					
Commissions and Fees					
Contact Labor					
Depreciation					
Employee Benefit Programs					
Insurance					
Legal and Professional Fees					
Office Expense					
Pension and Profit Sharing Plans					
Rent or Lease					
Supplies					

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### Taxpayer Penalties

- The IRS asserts the accuracy related penalty under IRC § 6662 for negligence or disregard of rules or regulations and/or a substantial understatement of income tax in appropriate cases
- Whether the accuracy related penalty applies to the activity must be determined on a case-by-case basis and will depend on the specific facts and circumstances of each case
- It is the examiner's responsibility to develop the facts and circumstances
- IRC § 6662 imposes an accuracy related penalty in the amount equal to 20% of the portion of an underpayment attributable to, among other things:
  - IRC § 6662(b)(1) -negligence or disregard of rules or regulations
  - IRC § 6662(b)(2)-any substantial understatement of income tax
  - IRC § 6662(b)(3) for substantial or gross valuation misstatement
  - IRC § 6662A for accuracy-related penalty on understatements with respect to reportable transactions

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### Taxpayer Penalties

- The penalty applies only when a tax return is filed
- There is no stacking of the accuracy-related penalty components
- The maximum accuracy-related penalty imposed on any portion of an underpayment is 20% (40% in the case of a gross valuation misstatement), even if that portion of the underpayment is attributable to more than one type of misconduct (e.g. negligence and substantial valuation misstatement) Treas. Reg. § 1.6662-2(c)

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### Return Preparer Penalties

- The primary purpose of return preparer penalties is to bring non-compliant tax return preparers into compliance
- In preparer penalty cases, the IRS focuses on the conduct of the preparer rather than the taxpayer
- All examiners should consider if any of the following preparer penalties are applicable
  - IRC § 6694(a) Understatements Due to Unreasonable Positions
  - IRC § 6694(b) Understatement Due to Willful or Reckless Conduct
  - IRC § 6701 Aiding and Abetting Understatement of Tax Liability

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## Return Preparer Penalties

- The IRS recognizes that the vast majority of return preparers and practitioners are ethical, honest and serve their clients' best interests by preparing complete and accurate tax returns
- Taxpayers are sometimes advised by preparers to claim activities which are not engaged in for profit or are sham
- Examiners should consider preparer penalties if deductions claimed are not ordinary and necessary expenses incurred during the taxable year in carrying on a trade or business or for profit activity
- Examiners should also consider whether an attempt has been made to characterize personal expenses as business expenses

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## Due Diligence

- The preparer:
  - May not ignore the implications of information furnished to the preparer or actually known by the preparer
  - Must make reasonable inquiries if the information as furnished appears to be incorrect or incomplete
  - Must make appropriate inquiries to determine the existence of facts and circumstances required by a Code section or regulation as a condition to the claiming of a deduction

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## Comparative Schedule of Income and Losses (Expenses)

Year	XXXX12	XXXX12	XXXX12	XXXX12	XXXX12
Gross Income					
Expenses (Other than Depreciation)					
Depreciation					
(Losses) or Gains					

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### CALT Website

<http://www.calt.iastate.edu/>




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### Tour of the CALT Website




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### Changes to the Iowa Farm and Urban Tax Schools

- It has been a season of change – this is good
- Our Fall and Winter Tax Schools are changing – this is good
- September 9, 2016 – Farm Tax Seminar
- All Farm issues All day
- For the winter tax schools, farm issues may come up but we will center on other issues important to your practice, including ethics for early bird attendees at all sessions

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## Please Welcome Phil Harris

- Professor, Agricultural and Applied Economics – University of Wisconsin- Madison
  - J.D., University of Chicago, 1977
  - M.A., Economics, University of Chicago, 1975
  - B.S., Economics, Iowa State University, 1973
- His research program focuses on business and tax planning for agricultural producers
- The program includes information on the choice of entity for organizing a farm business and for transferring a farm business to the next generation
- Income, estate and gift tax consequences as well as non-tax issues

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## Phil Harris

**Phil Harris**



**CALT Speaker**

- September 9, 2016 Farm Tax Seminar
- The session will also be available via webinar
- Instructor – Farm and Urban Tax School
- November 21 – 22 – Waterloo
- December 12 – 13 - Ames

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## Fall Tax Schools

- Though they are named the Farm and Urban Tax Schools the schools cover more than farm issues
- Common return issues for all kinds of returns are covered
- All kinds of business entities
- Problematic issues
- Sometimes we even get into to issues that you many encounter only once or twice a year or tax season
- The Tax Schools are a blend of diverse topics of interest to all tax professionals
- This year: New instructors with diverse backgrounds
- Your adventure awaits at Iowa State's Center for Agricultural Law and Taxation

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## Farm and Urban Tax Schools 2016

- November 2, 2016 to December 13, 2016
- 8 Locations in Iowa and Online Webinar
- Save the Date for the 2016 Annual Farm and Urban Income Tax Schools
- The program is intended for tax professionals and is designed to provide up-to-date training on current tax law and regulations
  - November 2-3: Maquoketa
  - November 7-8: Red Oak
  - November 9-10: Sheldon
  - November 14-15: Mason City
  - November 17-18: Ottumwa
  - November 21-22: Waterloo
  - December 5-6: Denison
  - December 12-13: Ames and Live Webinar

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## September Farm Tax School Navigating Changing Times

- September 8, 2016 to September 9, 2016, Ames, Iowa and Online
- Attend any one day or both days, either in-person or online! Company discount for 3 or more individuals from the same employer!
- **Ag Law Seminar, September 8**
- Our Thursday seminar will offer practical, interesting information you can immediately apply in your practice or ag-related business. You'll leave with forms and other tools to help you more efficiently serve your ag clients.
- **Farm Tax Workshop, September 9**
- Our Friday seminar will be a comprehensive one-day farm tax workshop designed to equip tax practitioners with the tools they need to prepare farm income tax returns, from the simple to the complex.
- Online Registration: <https://goo.gl/pdTK5>

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## Registration Fees

- **Early Rate - Registered on/by August 31**
  - Attend in person or watch from your computer
  - Any one day: \$200
  - Both days: \$350
  - Company Discount: \$10 discount per individual if 3 or more are registered from the same employer - this is available for either on-site or online attendance
- **Late Rate - Registered after August 31**
  - Attend in person or watch from your computer
  - Any one day: \$220
  - Both days: \$370
  - Company Discount: \$10 discount per individual if 3 or more are registered from the same employer - this is available for either on-site or online attendance

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## Continuing Education

- **Ag Law Seminar (September 8)**
  - Continuing Legal Education (CLEs) - 7 hours (including one hour of ethics)
  - Others Professional Education (CPEs) - 7-8 hours (including one hour of ethics)
- **Farm Tax Workshop (September 9)**
  - Continuing Legal Education (CLEs) - 7 hours (including one hour of ethics)
  - Others Professional Education (CPEs) - 7-8 hours (including one hour of ethics)

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## Speakers

- **Ag Law Seminar**
  - Shannon Ferrell, Associate Professor, Agricultural Economics, Oklahoma State University
  - Eldon McAfee, Shareholder, Brick Gentry P.C.
  - Erin Herbold-Swalwell, Shareholder, Brick Gentry P.C.
  - Julia Vyskocil, Shareholder, Brick Gentry P.C.
  - Pat Dillon, Dillon Law P.C.
  - Professor Neil Hamilton, Director of Drake Law School Agricultural Law Center
  - John Baker, Iowa State's Beginning Farmer Center Administrator
  - Jennifer Zwagerman, Associate Director of Drake Law School Agricultural Law Center
  - Kristine Tidgren, Assistant Director for the Center for Agricultural Law & Taxation
- **Farm Tax Workshop**
  - Philip E. Harris, JD, University of Wisconsin professor
  - Kristy Maitre, Tax Specialist with the Center for Agricultural Law & Taxation

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## Farm Tax Seminar Topics

Legislative Update: The Protecting Americans from Tax Hikes Act of 2015 (PATH Act) and the Consolidated Appropriations Act, 2016 (CAA of 2016)

Income Issues

- Constructive Receipt
- Installment Sales of Livestock
- Hedging and Other Marketing Transactions
- Farm Income Averaging
- Farm vs. Nonfarm Income
- Easements
- Sale vs. Lease of Equipment by a Retiring Farmer
- Conservation Reserve Program Payments
- Income in Respect of a Decedent
- Reporting Property as Self-rental on Schedule E (Form 1040)

Deduction Issues

- Tangible Property Regulations
- Lease vs. Purchase of Farm Equipment
- Segregating Fertilizer Costs
- Domestic Production Activity Deduction
- Start Up Expenses

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## Farm Tax Seminar Topics

- Entity Issues
- Partnership Formation and Contributed Assets with Debt in Excess of Tax Basis
- Guaranteed Payments
- Qualified Joint Ventures
- Issues for Farmers with Multiple Entities
- Miscellaneous Farm Issues
- Material Participation
- Capitalization of Preproduction Expenses
- Farm Inventory
- Hobby Losses
- Gift of Commodities
- Valuation of growing crops
- Cases and Rulings: A summary of rulings and cases from the past year that affect farmers

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## Accommodations

- Quality Inn & Suites Starlite Village Conference Center
- 2601 East 13th Street, Ames, Iowa
- Discounted overnight rooms are available for \$89.00 per night (for the dates of September 7, 8 and 9)
- Call the hotel at 515-232-9260 and mention you are attending the Iowa State University September Seminars

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## Summer Webinars

- Net Operating Losses
- The Portability Election
- IRS Representation
- ACA – 2 Years later Update for the 2017 tax Season
- Tax Research with Limited Resources
- Start Up Costs
- Miscellaneous Income
- New Developments – Tax Update
- Tax Research with Limited Resources

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### Beginning Tax Preparers Class

- CALT is working on offering a basic class for NEW tax preparers this fall in October
- The week long webinar will cover the basics an individual needs to know such as:
  - Requirement to file and Filing Status
  - Dependents
  - Itemized deductions
  - Child and Dependent care
  - Education Credits
- Other issues a first or second year preparer needs to know as well as a refresher for others who need to brush up on issues
- The class will be a week long or more and will be offered at a special rate

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### The Scoop

- Throughout the filing season two Scoops will be held on Scoop Dates
  - 8:00 – 8:30 am Central time
  - 12:00 – 12:30 Central time
- This assists with accommodating our west coast practitioners
- The same information will be shared at both sessions
- You have the option of registering for whatever session suits your schedule
- <https://www.calt.iastate.edu/calendar-node-field-seminar-date/month>

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### Future Scoop Dates

- September 7, 2016
- October 5, 2016
- October 19, 2016
- November 16, 2016
- December 14, 2016
- <http://www.calt.iastate.edu/calendar-node-field-seminar-date/month>

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