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Highlights

Final Regulations Allow Truncated Social Security Numbers on Form W-2: The IRS has issued final regulations (TD 9861) that permit employers to voluntarily truncate Social Security Numbers (SSNs) on copies of Form W-2 (Wage and Tax Statement) furnished to employees. An SSN may appear in the form of a Truncated Taxpayer Identification Number (TTIN), which replaces the first five digits of the SSN with Xs or asterisks. However, the final rules do not allow truncation on any return, statement, or other document that is required to be filed with the Social Security Administration (SSA). The final regulations, which adopt without substantive changes regulations proposed in 2017, apply to returns, statements, and other documents required to be filed or furnished after 12/31/20 (except for Reg. 31.6051-2, which applies to statements required to be filed after 7/3/19). Regs. 1.6052-2 , 31.6051-1, 31.6051-2, 31.6051-3, and 301.6109-4.

IRS Provides Additional Guidance on Qualified Opportunity Zones: The IRS has released guidance that amplifies Notice 2018-48, which lists the population census tracts that the IRS designated as Qualified Opportunity Zones (QOZs). Specifically, the agency has added two additional census tracts in Puerto Rico that have been designated as QOZs under IRC Sec. 1400Z-1(b)(3). Also, the IRS has published a Frequently Asked Question (FAQ) that clarifies that a taxpayer can make a valid deferral election on Section 1231 gain invested in a Qualified Opportunity Fund (QOF) if (1) the amount was invested before the last day of the 2018 tax year, but during the 180-day period beginning with the realization event and (2) the amount invested was

less than the taxpayer's 2018 net Section 1231 gain. This FAQ is in response to regulations proposed in April 2019, which implemented a Section 1231 netting rule. The FAQ can be accessed at www.irs.gov/newsroom/opportunity-zones-frequently-asked-questions. Notice 2019-42 .

President Trump Signs the Taxpayer First Act: President Trump has signed the Taxpayer First Act of 2019 (the Act), which alters the management and oversight of the IRS with the aim of improving customer service and the appeals process. The Act also provides new confidentiality safeguards as taxpayers interact with the IRS. An important provision of the Act requires the Treasury Department to submit to Congress by 9/30/20 a comprehensive written plan to redesign the IRS. The plan must (1) streamline the structure of the agency, including minimizing the duplication of services and responsibilities; (2) best position the IRS to combat cybersecurity and other threats to the agency; and (3) address whether the IRS's Criminal Division should report directly to the Commissioner. Beginning one year after the plan is submitted, the IRS's current structure, which features operating units that serve particular groups of taxpayers with similar needs, will cease to apply. H.R. 3151. See NTA-1065 in this issue for a table summarizing key provisions of the Act.

Other Current Releases

Employee Benefits—IRS Issues Proposed Regulations on Multiple Employer Plans: In August 2018, President Trump issued an Executive Order (EO) that directed the IRS to consider issuing guidance on when a Multiple Employer Plan (MEP) satisfies the tax qualification requirements under the Code. In response to this, the IRS has released proposed regulations (REG-121508-18) that would provide an exception, if certain requirements are met, to the application of the unified plan rule for a defined contribution MEP in the event of a failure by an employer participating in the plan to satisfy a qualification requirement or to provide information needed to determine compliance with a qualification requirement. Among other things, the proposed regulations would require a defined contribution MEP to spin off the employee accounts and plan assets of an unresponsive participating employer. The regulations are proposed to apply on or after they are published as final. Until then, taxpayers may not rely on the proposed rules. Prop. Reg. 1.413-2.

Employment Tax—Partners of Partnership Owning Disregarded Entity Subject to SE Tax: Reg. 301.7701-2(c)(2)(iv)(B) generally provides that a disregarded entity is treated as a corporation for employment tax purposes. However, this rule does not apply for Self-employment (SE) tax purposes. Therefore, the owner of a disregarded entity treated as a sole proprietorship is subject to tax on SE income. The IRS has issued final regulations (TD 9869) clarifying this rule by providing that partners of a partnership that owns a disregarded entity are not employees of the disregarded entity and are therefore subject to SE tax. The final regulations, which adopt without substantive changes temporary and proposed regulations issued in 2016, apply on the later of (1) 8/1/16 or (2) the first day of the latest-starting plan year beginning after 5/4/16, and on or before 5/4/17, of an affected plan—certain qualified, health, and Section 125 cafeteria plans—(based on

the plans adopted before, and the plan years in effect as of, 5/4/16) sponsored by a disregarded entity. Reg. 301.7701-2 .

Foreign Reporting—IRS Will Not Challenge Creditability of Certain French Taxes: In general, taxes paid to a foreign country in accordance with a Social Security totalization agreement are not eligible for the foreign tax credit. In *Eshel* (142 TC 197), the Tax Court held that the French Contribution Sociale Generalisee (CSG) and Contribution au Remboursement de la Dette Sociate (CRDS) taxes were not creditable because they were within the scope of the U.S.-France Totalization Agreement. However, the D.C. Circuit reversed and remanded the case (118 AFTR 2d 2016-5375). Recently, the IRS released a statement that the U.S. and France had memorialized through diplomatic communications an understanding that CSG and CRDS taxes are not social taxes covered by the totalization agreement. Therefore, the IRS will not challenge the creditability of those taxes. Taxpayers have ten years to file a claim for refund of U.S. tax with respect to a foreign credit. More information is available at www.irs.gov/individuals/international-taxpayers/foreign-tax-credit .

Identity Theft—Security Summit Releases "Taxes-Security-Together" Checklist: The Security Summit—a group that includes the IRS, state tax authorities, and members of the private-sector tax community—has released a new "Taxes-Security-Together" checklist to help tax professionals review their current security practices, enhance safeguards where necessary, and take steps to protect their businesses from cybercriminals. Among other things, the checklist encourages practitioners to (1) deploy six security measures to protect their systems; (2) create a data security plan; (3) stay alert to key email scams; (4) recognize the signs of client data theft; and (5) create a data theft recovery plan. The checklist can be accessed at www.irs.gov/tax-professionals/tax-security-20-the-taxes-security-together-checklist . News Release IR 2019-122 .

Income Tax—Horse Breeding and Racing Activity Was a Hobby:A programmer and his wife formed a partnership to breed and race world class thoroughbred horses. During its almost 30 years of existence, the partnership never yielded a profit. Also, for the years at issue, the taxpayers didn't breed, race, or sell any of their six horses. For federal income tax purposes, the couple deducted significant losses from the horse activity. The IRS disallowed the losses, arguing that the taxpayers didn't engage in the activity for profit within the meaning of IRC Sec. 183. The Tax Court agreed, concluding that eight of the nine factors listed in Reg. 1.183-2(b) favored the IRS. Among other things, the Court found that the taxpayers didn't conduct the activity is a businesslike manner, seek the advice of experts, or devote the necessary time and effort to establish they had a profit-making objective. *James and Elaine Donoghue* , TC Memo 2019-71 (Tax Ct.).

Income Tax—Independent Contractor Fined $1,000 for Frivolous Arguments: The taxpayer, an independent contractor, received commissions from a marketing company. The company recorded each commission as an advance payment that was offset by a debit. As customers made payments to the company, each debit would be reduced. If customers didn't pay, any remaining debit would reduce future commissions to the taxpayer. The taxpayer claimed the commissions

weren't taxable because Congress hasn't enacted a law making it mandatory for him to either file a return or pay federal income tax. He also argued that the commissions were loans. The Tax Court quickly dismissed these arguments, holding that the payments weren't loans because the taxpayer was never obligated to repay (nor did he ever repay) amounts received from the marketing company. The Court also imposed a penalty of $1,000 under IRC Sec. 6673(a)(1) for making frivolous arguments. *Paul Staples*, TC Memo 2019-75 (Tax Ct.).

Income Tax—IRS Removes Final Regulation on Advance Payments: The Tax Cuts and Jobs Act (TCJA) added IRC Sec. 451(c), which allows accrual method taxpayers to elect to defer a portion of the income associated with certain advance payments. The new provision largely adopts the approach in Rev. Proc. 2004-34, which requires an advance payment to be included in income in the earlier of the tax year in which it's included in the taxpayer's Applicable Financial Statement (AFS), or the tax year following the year of receipt. Recognizing that this approach overrides the deferral method found in current regulations, the IRS has issued final regulations that remove Reg. 1.451-5 . In addition, the final regulations remove references to Reg. 1.451-5 that are found in other regulations. The final regulations, which adopt without change regulations proposed in October 2018, apply to tax years ending on or after 7/15/19. TD 9870.

Income Tax—Payment to Former Spouse to Settle Lawsuit Deductible: The taxpayer filed for divorce from her husband, who was the CEO and majority shareholder of a family-owned business. While the divorce was pending, the husband's sister sued the business for wrongful depletion of company assets. As part of the divorce settlement, the taxpayer agreed to pay half of any liability her former husband might incur in the lawsuit. After paying $300,000 to settle the lawsuit, the taxpayer sought a deduction under IRC Sec. 1341 . A Florida district court disallowed the deduction, holding that the payment had nothing to do with a business venture. The 11th Circuit reversed and remanded the case, finding that the taxpayer met all elements of IRC Sec. 1341 because (1) she genuinely believed she had an unrestricted right to her husband's income, (2) her $300,000 payment was involuntary, and (3) she could deduct her payment under IRC Sec. 165(c). *Nora Mihelick*, 123 AFTR 2d 2019-2251 (CA 11).

Penalties—Preparer Penalty for Willful Conduct Doesn't Include Recklessness:A practitioner prepared returns for two individuals and their three closely-held corporations. The IRS assessed preparer penalties under IRC Sec. 6694(b)(2)(A) for willfully understating the tax liabilities of the three corporations. The agency also assessed preparer penalties under IRC Sec. 6694(b)(2)(B) for recklessly understating the tax liabilities of the two individuals. A California district court sustained the penalties, and the practitioner appealed to the Ninth Circuit. The Ninth Circuit held that the district court applied the wrong definition of *willful* in IRC Sec. 6694(b)(2)(A) . According to the Court, willfulness requires a conscious act or omission made in the knowledge that a duty isn't being met (i.e., it doesn't include reckless or intentional disregard). Therefore, the Court remanded the case and instructed the district court to determine whether the penalties were justified under the correct definition. However, the Court affirmed the Section 6694(b)(2)(B) penalties for the individual returns. *John Q. Rodgers*, 123 AFTR 2d 2019-2294 (CA 9).

Taxpayer Advocate Nina Olson Releases Final Report to Congress: National Taxpayer Advocate (NTA) Nina Olson has released her 37th and final report to Congress in advance of her retirement on 7/31/19. The report reviews the 2019 filing season, identifies key challenges faced by the IRS, and lists 12 priority issues the Taxpayer Advocate Service (TAS) will address during the upcoming fiscal year. Overall, the 2019 filing season went smoothly for most taxpayers. However, service levels declined for taxpayers who required assistance from the IRS. In fact, the NTA concluded that poor taxpayer service remains the biggest challenge taxpayers face when dealing with the IRS. The report also voices concern about appropriate uses of IRS self-service applications and the agency's treatment of financially vulnerable taxpayers. A copy of the report can be accessed at taxpayeradvocate.irs.gov/2020ObjectivesReport . News Release IR 2019-119 .

Taxpayer Advocate Releases Report on Earned Income Tax Credit: National Taxpayer Advocate (NTA) Nina Olson has released a special report on the Earned Income Tax Credit (EITC). The report examines the strengths and weaknesses of the EITC and makes legislative and administrative recommendations to improve it. Among other things, the report suggests that (1) Congress redesign the EITC to reduce fraud by separating the worker component of the credit from the family-size component and by revising the definition of *qualifying child*; (2) Congress authorize the IRS to establish minimum standards for tax return preparers and software providers to protect taxpayers and improve the accuracy of EITC claims; and (3) Congress and the IRS take steps to ensure EITC compliance procedures are consistent with due process norms and fundamental taxpayers' rights. The full report can be accessed at taxpayeradvocate.irs.gov/objectivesreport2020-v3 . News Release IR 2019-123 .

Tax-exempt Organizations—Proposed Regulations on Excise Tax on Certain Private Colleges and Universities: The IRS has issued proposed regulations (REG-106877-18) under IRC Sec. 4968, which imposes a 1.4% excise tax on the net investment income of certain private colleges and universities. The proposed rules generally look to regulations issued under IRC Secs. 25A (American Opportunity and Lifetime Learning credits) and 4942 (taxes on failure to distribute private foundation income) to define many of the terms needed to calculate the excise tax. In addition, the proposed regulations clarify how to determine net investment income (including the net investment income of related organizations) and how to compute an institution's basis in property (following interim guidance provided in Notice 2018-55). The proposed regulations would apply to tax years beginning after the date they are adopted as final in the Federal Register. However, institutions may rely on the rules pending their finalization. Prop. Reg. 53.4968-1.

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