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AUDIT ACTIVITY FOR INDIVIDUAL TAXPAYERS DEDUCTING HOBBY LOSSES MAY INCREASE

An April 12, 2016**,** TIGTA report may result in more audits of "hobby loss." The audit was a follow up to a 2007 study to discover if IRS had improved its Form 1040 Schedule C loss audits resulting in an overall loss of revenue to the government.

Years 2011-2014 were reviewed and the findings identified high income taxpayers who may be offsetting income with "business losses." Generally a business must show a profit in three out of five years or the burden of proof falls to the taxpayer to prove the "business" is a legitimate profit motive enterprise or IRS may deem it a "hobby." The overall estimated loss of income to the government was estimated at $70.9 million for the tax year 2013.

Two recommendations were made and IRS agreed to both suggestions and plans to take corrective action.

1. Use IRS research to identity high income taxpayers with multi-year Schedule C losses
2. Emphasis the importance of requiring filing checks when making the initial determination to audit the return for "hobby loss" issues

- *You could be a kid for as long as you want when you play baseball*. – ***Cal Ripken, Jr.***

IRS NOTICE AND LETTERS: UNDERSTANDING YOUR ROLE

IRS uses the term "standard paragraphs" to create notices and letters sent to taxpayers. Basically, someone sits down at a computer and pulls together a group of written "standards" that have been approved. The paragraphs when combined create the letter or notice. Sometimes a paragraph is forgotten and does not provide the taxpayer with the information needed to respond. Other times a paragraph has been added that does not make any sense.

Letter 12C has been recently used for identity theft and now for inquiries concerning Form 1040 and the lack of Form 8962 attached to the return. Other identity theft letters include Letter 5071C and Letter 4883C.

IRS has over the last few years attempted to improve the standard paragraph notices and letters in an attempt to provide clearer guidance and to assist in the understanding of what information IRS needs. That has been successful in some aspects, but it still boils down to picking out the right paragraphs to coordinate with the information requested. In addition, some letters and notices are set in stone and change very little. But someone still has to pick the right date or right year to place on the notice.

Internally IRS does have a system to identify systemic notice issues, like the one in late December 2015 and early January 2016 when the IP PIN notices were sent for the tax year 2014, when the actual date was for the 2015 year. There is a system in place, but once the notice is released, there is not much that can be done with the errors.

Dates on Notices
Many of you have noticed that the notices are sometimes dated quite far in advance of the date received. IRS will print a "run" of notices 2-3 weeks before they are to be mailed. Recently we had a string of notices concerning the retrieval of an IP PIN when the

IP PIN system had been shut down weeks before. Preprinting of notices or letters is pretty standard, so do not be overly concerned with the dates in making the determination of whether the notice is a valid notice from IRS or a scam.

Notices and Scams
As identity theft grips the IRS, more and more questions have been raised about the validity of IRS notices.

Recent notices have come out of Austin, Texas or Fresno, CA and have been valid. But notices can come from any IRS Campus.

IRS has a tool you can use that provides more information about some of the notices for individuals and business. https://www.irs.gov/Individuals/Understanding-Your-IRS-Notice-or-Letter.

Notice/Letter Looks Suspicious?
The following characteristics are good indicators that the letter is a fraud:

- Spelling and English is poor
- The correspondence is choppy
- The letter looks cut and pasted and does not make sense
- There is a sense it looks copied and worn

You Play an Important Role in this Process
Ask questions or send a copy of the notice to us if things don't add up. You are also the first line of defense when dealing with tax return identity theft. The worst thing you can do is pay the amount due out of fear or because you assumed it must be correct. That is what the criminals are counting on and those that continue to take this approach serve to keep it profit enough for the bad guys to continue to prey on others.

- People ask me what I do in winter when there's no baseball. I'll tell you what I do. I stare out the window and wait for spring. – ***Rogers Hornsby***

IRS PROVIDES SIMPLIFIED PROCEDURES FOR TAXPAYERS MISSING 60-DAY IRA ROLLOVER DEADLINE

On Monday, August 24, 2016, it became a lot easier for taxpayers and plan administrators to deal with the all-too-common missed 60-day IRA rollover window.

In IRS Rev. Proc. 2016-47, IRS streamlined and simplified the waiver process for the 60-day rollover rule, eliminating the need in most cases for a costly ($10,000) and burdensome private letter ruling.

Under IRC §§ 402(c)(3) and 408(d)(3), distributions from a qualified IRA can be rolled-over, tax free, to another qualified retirement plan, as long as that roll-over occurs no more than 60 days following the receipt of the distribution. The law provides, however, that "the Secretary may waive the 60-day rollover requirement where the failure to waive such requirement would be against equity or good conscience, including casualty, disaster, or other events beyond the reasonable control of the individual subject to such requirement."

Historically, such a waiver could only be obtained by requesting a private letter ruling from the IRS. The new procedure eliminates this requirement and instead allows a taxpayer to self-certify that he or she meets the requirements for a hardship waiver. Acceptable "excuses" include:

- An error was committed by the financial institution making the distribution or receiving the contribution.
- The distribution was in the form of a check and the check was misplaced and never cashed.
- The distribution was deposited into and remained in an account that the taxpayer mistakenly thought was a retirement plan or IRA.
- The taxpayer's principal residence was severely damaged.
- One of the taxpayer's family members died.
- The taxpayer or one of his or her family members was seriously ill.
- The taxpayer was incarcerated.
- Restrictions were imposed by a foreign country.
- A postal error occurred.
- The distribution was made on account of an IRS levy and the proceeds of the levy have been returned to the taxpayer.
- The party making the distribution delayed providing information that the receiving plan or IRA required to complete the rollover despite the taxpayer's reasonable efforts to obtain the information

- Baseball is like a poker game. Nobody wants to quit when he's losing; nobody wants to quit when you're ahead. – ***Jackie Robinson***

IRS SPEAKS OUT ON CROWDFUNDING

If you are into social media it is likely you have been invited to check out a new trend in fundraising. Crowdfunding is the practice of funding a project or venture by raising monetary contributions from a large number of people, with each usually contributing a relatively small amount.

In 2015, it was estimated that worldwide over $34 billion was raised this way for just about anything from artistic and creative projects, medical expenses, business ventures to you name it. But the IRS has been silent on the ramifications for recipients-until now. On March 30, 2016, the IRS issued an Informational Letter, 2016-0036.

Although the guidance technically applies to only one taxpayer, it provides valuable insight into how the IRS will treat crowdfunding in other situations. Generally, unless a special exception applies, the IRS says that crowdfunding contributions constitute taxable income to recipients.

In the past, entrepreneurs mainly solicited funding for new business ventures through initial public offerings (IPOs). But crowdfunding can be an easier solution. It is handled online through portals such as Kickstarter, Fundable and CircleUp.

The IRS examined the law and related regulations for "constructive receipt" of funds in comparable situations. Essentially, if the funds are credited to a taxpayer's account or are otherwise set apart and made available to the taxpayer if he or she wants to gain access to them, the payments represent taxable income. Conversely, income isn't constructively received if the taxpayer's control is subject to substantial limitations or restrictions.

The difficulty is that crowdfunding campaigns can take on various forms. For instance, in exchange for putting up cash, a contributor might be awarded an equity interest in the company, qualify for certain products or services or merely receive a minimal gift in-kind. Or, if the venture is aimed at an environmental or altruistic cause, the contributor just gets the satisfaction of helping out without receiving any tangible benefit.

Depending on the setup, the contributor may also be entitled to a refund if the venture goes bust.

Faced with these considerations, the IRS determined that the taxation of money received by an entrepreneur is based on the particular "facts and circumstances," but should generally be treated as taxable income unless one of these three exceptions applies:

1. There is a loan that must be repaid.
2. A capital contribution is made in exchange for an equity interest in the business entity.
3. A gift is made out of the generosity without any quid pro quo. *Note:* A voluntary transfer without any quid pro quo isn't necessarily a gift for federal income tax purposes.

Along the same lines, crowdfunding money is generally taxable to the extent it is received for services rendered or if it results from selling property to a seller. The IRS also suggests that a recipient can obtain a private letter ruling if they are unsure of how their particular circumstances will be viewed against the new guidelines.

> *- It took me seventeen years to get three thousand hits in baseball. I did it in one afternoon on the golf course. – **Hank Aaron***

SOCIAL SECURITY BENEFITS TO INCREASE .3% IN 2017

The Social Security Administration just announced that social security benefits will increase by .3% beginning in January 2017. The increases for the last couple of years have been less than 1% and although this is a low increase, it is still an increase. A person currently collecting $1,500 per month will see a $4.50 increase in their payments.

The news regarding the wage base for 2017 is much worse. It will increase from $118,500 to $127,200. This means an additional $8,700 of wages will be subject to the 12.4% FICA tax or a possible increase of $1,078.80 for self-employed farmers or $539.90 for employees/employers.

The quarters of coverage levels has also increased from $1,260 to $1,300. This is the amount of wages or earned income to receive one quarter of credit. For many farmers facing losses this year that want to receive at least some social security credit should elect the optional farm self-employment method. Under this option, even if you have a loss, you can elect to pay social security for a minimum of four quarters of coverage. The self-employment tax associated with this option would be less than $800 for the year, but will gain you four quarters credit for social security benefits.

> *- Baseball is a game of race, creed, and color. The race is to first base. The creed is the rules of the game. The color? Well, the home team wears white uniforms, and the visiting team wears gray. – **Joe Garagiola***

PROPOSED ESTATE TAX REGULATIONS

In August newly proposed regulations under section 2704 of the Internal Revenue Code would permanently change estate planning for families that own a controlling interest in a privately held entity. The concern from agricultural groups and representatives is that it could discourage farmers from continuing to desire to grow their business and represents a significant tax hit in the process.

Historically, taxpayers could reduce the value of their taxable estates or the value of taxable gifts by placing assets in family-owned partnerships, LLCs or closely held corporations and claiming lack of marketability and/or lack of control discounts. The combined discounts typically reduced the value of the ownership interests by 25% to 45%.

For example, under current tax law, by placing $10 million worth of assets inside a closely held entity, a taxpayer might reduce the value of his/her estate by $2.5 million to $4.5 million. Given the current 40% estate tax rate, they could achieve a reduction in the estate tax payable by $1 million to $1.8 million.

In two separate letters to Treasury Secretary Jacob Lew, members of Congress and thousands of organizations expressed opposition to the new estate tax regulations proposed in August and asked for their withdrawal.

The letter from 41 Senate Republicans explained that the proposed regulations eliminate or greatly reduce the discounts for lack of control and lack of marketability for family farms and businesses and will, thus, discourage families from continuing to operate and build their businesses.

“We ask that the proposed regulations not be finalized in their current form as they directly contradict long-standing legal precedent, create new uncertainty for taxpayers and put family-owned businesses at a disadvantage relative to other types of businesses,” according to the senators’ letter, led by Sens. John Thune, R-S.D., and Orrin Hatch, R- Utah, chairman of the tax-writing Senate Finance Committee.

“The proposed guidance is one of the most sweeping changes to estate tax policies in the last 25 years and would be detrimental to active enterprises and family-owned businesses that employ millions of workers throughout the nation,” another letter sent on behalf of 3,800 organizations and family-owned enterprises pointed out. “In particular, these rules would impose significant new tax costs on family-owned businesses, diverting capital from business investment, costing jobs and threatening the ability of families to pass businesses on to the next generation of owners.”

Lawmakers are taking steps to block the regulations from being finalized and several small-business and agricultural groups have come out opposing the regulations.

Farmers and small-business owners are asked to contact their representatives voicing their opposition to the proposed rules.

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