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How Hurricane & Natural Disasters Affect Tax Return

By Frank Agostino, Esq.
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Hurricanes and other natural disasters can happen suddenly and almost always cause destruction. These natural disasters claim lives, destroy homes, and cripple businesses. For example, Hurricane Matthew struck the Southeast coast from Florida to North Carolina in 2016, causing more than $10 billion in damage and taking 49 lives. In 2012, Superstorm Sandy caused a staggering $68.3 billion in damage and 159 deaths. Recovery from devastating natural disasters can include help provided by Congress and the IRS, which comes in the form of tax relief to taxpayers living in "federally declared disaster areas." The IRS publishes a comprehensive guide to disaster relief, Publication 2194 (Disaster Resource Guide). The article below summarizes the relief available to taxpayers after a natural disaster, including: deductions, interest and penalty abatements, and the relaxation of the heightened substantiation requirements when a taxpayer's records are lost or destroyed.

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I. Types of Tax Relief for Victims of Natural Disasters

A. Relief Provided By Congress

When a major natural disaster occurs, Congress may pass specific legislation providing relief to affected taxpayers. This relief may be in the form of tax relief or appropriations for direct aid. The focus of this article will be Congressional relief in the form of I.R.C. § 7508A and how it provides relief to taxpayers.

B. Postponement of Filing Deadlines, Penalty and Interest Accrual

Section 7508A of the Internal Revenue Code provides relief for taxpayers affected by "federally declared disasters."[2] The IRS has independent authority to grant taxpayers additional time to file, pay, and perform certain time sensitive acts (the "postponement period"). The postponement period includes up to 1 year during which the IRS may toll any filing deadlines or the accrual of interest and penalties. The Secretary is given broad discretion as to what actions can be postponed. These typically include: filing income tax, estate tax, gift tax, or other tax returns; payment of the tax obligation for such returns; contributions to a qualified retirement plan; filing a petition with the United States Tax Court or for review of a decision rendered by the Tax Court; filing a claim for credit or refund of any tax; and, bringing suit upon a claim for credit or refund of any tax. These actions are neither all-inclusive nor guaranteed and the Secretary may postpone any other act within his discretion.[3]

The abovementioned allows for the postponement of filing, and payment connected with, Individual Tax Returns (Form 1040), Corporate Tax Returns (Form 1120), Partnership Tax Returns (Form 1065), Estate Tax Returns (Form 706), and Gift Tax Returns (Form 709). Aside from these acts, there are a variety of other acts that can be postponed by the Secretary. Those acts can be found in Revenue Procedure 2007-56.

Some penalties are not included in the relief provided by § 7508A. § 301.7508A-1(c)(1)(ii) specifically states that the postponement of the payment of taxes does not apply to deposits of taxes pursuant to I.R.C. § 6302 and its accompanying regulations. Thus, Form 940, 941, and 944 deposits are not covered by the postponement period, if any, under section 7508A. These Forms are subject to the standard abatement procedure, which requires a reasonable cause and the filing of Form 863.

Any identified act falling within the postponement period is automatically extended to the end of the postponement period, including the accrual of interest and penalties.[4] Only acts required to be performed within the postponement period will be postponed to the end of the period.[5] For example, if a return is due to be filed on April 15, 2017 and the postponement period is January 1, 2017 through March 31, 2017, the filing date will not be extended. Conversely, if the postponement period is January 1, 2017 through June 1, 2017, the filing deadline is extended to the end of the period, June 1, 2017. When an original due date precedes the first day of the postponement period, but an extended

deadline falls within the postponement period, the affected taxpayer will benefit from the postponement and the extension will be honored until the end of the postponement period.[6] In other words, if a taxpayer timely requests an automatic extension to file Form 1040, and a postponement period runs from August 1, 2017 through December 31, 2017, the filing deadline is extended to December 31, 2017.

Under Treas. Reg. § 301.7508A-1(c)(2), the time in which the IRS must perform certain actions may also be extended, including: assessing any tax; giving or making any notice or demand for the payment of any tax; collecting any tax; bringing suit by the United States, or any officer on its behalf, in respect of any tax liability; and, allowing a credit or refund. Again, this list is not exhaustive.

The postponement provisions apply to "affected taxpayers," which are defined as: taxpayers whose principal residence is in a "covered disaster area;"[7] any business entity or sole proprietor whose principal place of business is located in a covered disaster area; any individual who is a relief worker affiliated with a government or philanthropic organization and is assisting in a covered disaster area; any individual or business entity whose residence or primary place of business is not within the covered disaster area but whose necessary records are maintained in a covered disaster area; any estate or trust that has necessary tax records maintained within a covered disaster area; the spouse of an affected taxpayer (solely with regard to a joint return of the husband and wife); any individual who was visiting a covered disaster area and was injured or killed as a result of the disaster; and, any other person determined to be an affected person by the IRS.[8] A taxpayer who does volunteer work outside of the prescribed disaster area, even if it is for relief in connection with the disaster, is not an affected taxpayer.[9]

Affected taxpayers will be systematically identified by the IRS (by zip code) for the automatic application of any postponement period. The system is not perfect, however, and all affected taxpayers may not be automatically identified. The IRS suggests that taxpayers in this situation call the number on any correspondence indicating a return, interest or a penalty is due, and request the postponement and/or abatement over the phone. Alternatively, taxpayers can file Form 843 (Claim for Refund and Request for Abatement) to formally request abatement. Previously, the IRS instructed taxpayers to write, in red ink, at the top of the Form 1040, information that identified the particular disaster; this is no longer required. Taxpayers filing a Form 1040X in order to claim a disaster casualty loss (see below), should still include this information.

Taxpayers being audited, and filing protests with the IRS Appeals Office should routinely request that the IRS verify whether any relief is available under Section 7508A. Taxpayers responding to notices of deficiency or IRS interest computations should also verify whether any relief is applicable to any of the additions to tax set for in the notice of deficiency. Finally, IRC § 6330(c)(1) requires an Appeals Officer to obtain verification that the requirements of any applicable law or administrative procedure have been met. There-

fore, affected taxpayers filing requests for Collection Due Process hearings should include a request for verification by the Appeals Officer that the IRS provided the taxpayer with all the relief and benefits available for any applicable federally declared disaster. This way a taxpayer who has not received such benefits can be provided with relief.

C. IRS Notice of Postponement to Taxpayers

If a tax related deadline is postponed under sections 7508A and Treas. Reg. § 301.7508A-1, the IRS will publish a revenue ruling, revenue procedure, notice, announcement, news release, or other guidance (see Treas. Reg. § 601.601(d)) describing the acts postponed, the duration of the postponement period, and the location of the covered disaster area. This guidance will be published as soon as practicable[10] and is generally available at www.irs.gov.

Federally declared disaster relief is not as uncommon as one might imagine. As of February 15, 2017, there have already been four IRS news releases providing guidance and relief for taxpayers affected by natural disasters. Recently, on February 13, 2017 an IRS news release, (LA-2017-1), acknowledging the President's declaration of a federal disaster area in the State of Louisiana, caused by severe storms, tornadoes, and straight-line winds that took place on February 7, 2017 was published. Filings due from affected taxpayers between February 7, 2017 and June 30, 2017 are postponed until June 30, 2017. The IRS listed the specific disaster areas as Livingston and Orleans parishes. Affected taxpayers who are not automatically identified by the IRS must call the IRS disaster hotline at (866) 562-5227 in order to request tax relief (also available at https://www.irs.gov/uac/tax-relief-for-victims-of-severe-storms-tornadoes-and-straightline-winds-in-louisiana). Three prior news releases were published on January 26, 2017 (parts of Georgia), January 27, 2017 (parts of Mississippi), and January 30, 2017 (parts of Georgia).

D. Casualty Losses

According to Publication 547 Casualties, Disasters, and Thefts[11], "a casualty is the damage, destruction, or loss of property resulting from an identifiable event that is sudden, unexpected, or unusual." Natural disasters such as tornados and hurricanes are often sudden, unexpected, or unusual, and the losses they cause are considered casualty losses for tax purposes. Thus, the damage to a taxpayer's property that is not covered by insurance or other reimbursement should qualify for a casualty loss deduction. Taxpayers generally must deduct a casualty loss in the year in which it occurred. Under IRC § 165(i), taxpayers may elect to deduct a casualty loss from a federally declared disaster on the return or amended return for the tax year immediately preceding the tax year in which the disaster occurred. If the election is made, the loss is treated as having occurred in the tax year for which the deduction is claimed (i.e. the tax year preceding the disaster). Claiming a disaster loss on the prior year's return may result in a lower tax and therefore refund (or larger refund). The purpose of this election is to provide victims early access to anticipated refunds in order to rebuild and re-

pair their homes and businesses. Keep in mind that waiting to claim the loss on the disaster year's return could result in a greater tax saving, depending on other income factors.

In order to deduct a disaster related casualty loss in the preceding year, a statement should be appended to the return specifying the date or dates of the disaster, and the city, town, county, and state where the damaged or destroyed property was located. The IRS issued temporary regulations, Treas. Reg. § 1.165-11T(f), which provide that the due date for making the IRC § 165(i) election is six months after the due date for filing the taxpayer's federal income tax return for the disaster year.[12] In addition, the temporary regulations provide that the taxpayer may only revoke a previously-made § 165(i) election on or before the date that is 90 days after the due date for making the election. Under Treas. Reg. § 1.165-11T(d), if a taxpayer already claimed a disaster related casualty loss for the disaster year, and later elects to make a § 165(i) election with respect to such loss, the taxpayer must file an amended return to remove the previously deducted loss on or before the date that the taxpayer makes the § 165(i) election for such loss.[13] The converse is also required; where a taxpayer wishes to cancel a § 165(i) election, he must file an amended return removing the previously claimed loss. For example: if a disaster occurred in February 2017 and the taxpayer qualifies as an "affected taxpayer," then she can take an applicable loss deduction for either 2016 or 2017 (but not for both). If the taxpayer decides to claim the loss for the 2016 tax year then she would have to make that election by October 15, 2018. If the taxpayer decided later to revoke that election, she would have until January 13, 2019 to make the revocation under § 165(g).

It is important to note that taxpayers seeking to deduct a casualty loss must substantiate the deduction, inter alia, by disclosing whether a claim for reimbursement exists for which there is a reasonable expectation of recovery (i.e. insurance or Federal Emergency Management Agency (FEMA) claims). If a taxpayer has a reasonable expectation of reimbursement for some part (or all) of a casualty loss, the amount of the casualty loss claimed must be reduced by the amount of the expected reimbursement. If a taxpayer cannot claim a loss in the year of the disaster (because he has a reasonable expectation of reimbursement), the loss may be claimed in a later year if there is no longer a reasonable expectation of reimbursement. If a taxpayer is reimbursed, but in an amount less than the amount of his loss, the taxpayer may only deduct the amount by which his actual loss exceeds the amount of his reimbursement.

II. Reconstructing Business Records Lost in a Hurricane

When a major natural disaster occurs, loss or destruction of records is a common problem. Taxpayers who do not have access to their records often have issues receiving federal assistance and insurance reimbursement because they lack the evidence necessary to prove their losses. Thus, the most important thing taxpayers (especially businesses) can do proactively is to maintain adequate record back-ups. Absent back-ups, taxpayers may need to reconstruct destroyed records.

The IRS acknowledges and addresses that the loss of records in a natural disaster are due to circumstances beyond the control of the taxpayer.[14] Temporary Treas. Reg. § 1.274-5T allows taxpayers to substantiate deductions by reasonable reconstruction of their expenditures where failure to produce adequate records is due to circumstances beyond their control, such as natural disasters, fire, flood, earthquake, or other casualty.[15]

This reasonable reconstruction is allowed even where there is a heightened substantiation requirement, such as the one found in I.R.C. § 274(d), which requires the taxpayer to provide corroborating documentation for deductions taken for entertainment or travel, etc. Thereby, affected taxpayers will be allowed to satisfy the heightened substantiation requirements by reasonably reconstructing their records with regard to expenditures and use.[16] The IRS also provides detailed tips to taxpayers seeking to reconstruct lost records. This guidance is broken down by type of property:[17]

Personal Residence/Real Property

• Be sure to take photographs as quickly as possible after the casualty to establish the extent of the damage.

• Contact the Title Company, Escrow Company, or bank that handled the purchase to obtain copies of escrow papers. Your real estate broker may also be able to help.

• Use the current property tax statement for land vs. building ratios, if available; if not available, get copies from the county assessor's office.

• Check with appraisal companies to locate a library of old multiple listing books. These can be used for "comps" to establish a basis or fair market value. "Comps" are comparable sales within the same neighborhood.

• Check with your mortgage company for copies of any appraisals or other information they may have about cost or fair market value.

• Tax records – Immediately after the casualty, file Form 4506, Request for Copy of Tax Return, to request copies of the previous four years of federal income tax returns. To obtain copies of the previous four years of transcripts you may file a Form 4506 - T, Request for Transcripts of a Tax Return. Write the appropriate disaster designation, such as "HURRICANE KATRINA," in red letters across the top of the forms to expedite processing and to waive the normal user fee.

• Improvements – Call the contractor (s) to see if records are available. If possible, get statements from the contractors verifying their work and cost.

• If a home improvement loan was obtained, obtain paperwork from the institution issuing the loan. The amount of the loan may help establish the cost of the improvements.

• Inherited Property – Check court records for probate values. If a trust or estate existed, contact the attorney who handled the estate or trust.

• No other records are available – Check at the county assessor's office for old records about the property. Look for assessed value and ask for the percentage of assessment to value at the time of purchase. This is a rough guess, but better than no records at all.

Vehicles

• Kelly's Blue Book, NADA, and Edmunds are available online and at most libraries. They are good sources for the current fair market value of most vehicles on the road.

• Call the dealer and ask for a copy of the contract. If not available, give the dealer all the facts and details and ask for a comparable price figure.

• Use newspaper ads for the period in which the vehicle was purchased to determine cost basis. Use ads for the period when it was destroyed for fair market value. Be sure to keep copies of the ads.

• If you are still making payments, check with your lien holder.

Personal Property

• The number and types of personal property may make it difficult to reconstruct records. One of the best methods is to draw pictures of each room. Draw a floor plan showing where each piece of furniture was placed. Then show pictures of the room looking toward any shelves or tables. These do not have to be professionally drawn, just functional. Take time to draw shelves with memorabilia on them. Do the same with kitchens and bedrooms. Reconstruct what was there, especially furniture that would have held items — drawers, dressers, and shelves. Be sure to include garages, attics, and basements.

• Get old catalogs. These catalogs are a great way to establish cost basis and fair market value. Check the prices on similar items in your local thrift stores to establish fair market value. Walk through the stores and look at comparable items, especially items such as kitchen gadgets. Look for odds and ends you may have had but have forgotten because of infrequent use.

• Use your local "advertiser" as a source for fair market value. Keep copies of the issues handy and copy pages used for specific items to put with your tax records file on the disaster.

• Check local newspaper want ads for similar items. Again keep a copy of

any you use for comparison with the tax file.

• If you bought items using a credit card, contact your credit card company.

• Check with your local library for back issues of newspapers. Most libraries keep old issues on microfilm. The sale sections of these back issues may help establish original costs on items such as appliances.

• Go to a used bookstore with a tape measure and the diagram of the destroyed property. Measure several rows of used books and count the number of books per shelf. Add up the prices of those books and determine an average cost per shelf. Then count the number of shelves you had in your home and multiply by the average cost per shelf. This will help determine the value of your books before the loss.

Business Records

• Inventories – Get copies of invoices from suppliers. Whenever possible, the invoices should date back at least one calendar year.

• Income – Get copies of bank statements. The deposits should closely reflect what the sales were for any given time period.

- Obtain copies of last year's federal, state, and local tax returns including sales tax reports, payroll tax returns and business licenses (from city or

county). These will reflect gross sales for a given time period.

• Furniture and fixtures – Sketch an outline of the inside and outside of the business location. Then start to fill in the details of the sketches. (Inside the building — what equipment was where; if a store, where were the products/inventory located. Outside the building — shrubs, parking, signs, awnings, etc.)

• If you purchased an existing business, go back to the broker for a copy of the purchase agreement. This should detail what was acquired.

• If the building was constructed for you, contact the contractor for building plans or the county/city planning commissions for copies of any plans.

In sum, if a taxpayer's records are lost in a natural disaster, the best course of action is to make every effort to obtain the records or information by other means. For businesses, this means contacting suppliers, banks, and credit card companies to request copies of each record. Taxpayers must provide a reasonable and credible reconstruction of their records to be able to obtain relief and reimbursement and also to deduct disaster related casualty losses. The more accurate and complete the records, the more likely it is that the taxpayer will receive adequate relief.

III. Conclusion

Practitioners should be familiar with IRS guidelines for assisting taxpayers affected by natural disasters. IRS publications identifying taxpayers affected by natural disasters and the IRS response can be found at www.irs.gov. If you believe one of your clients is or was affected by a natural disaster, they may be entitled to extended filing dead-

lines and the abatement of interest and penalties. Even if your client was not directly affected by the disaster (e.g. filed or paid late for other reasons), but qualifies as an "affected taxpayer," you will still be able to have late filing penalties and interest abated if that is within the scope of relief being offered by the IRS for that particular disaster.

The old cliché 'an ounce of prevention is worth a pound of cure' rings true when it comes to financial records. Clients, especially businesses, should safeguard their records by maintaining back-ups offsite or in the cloud. When disaster strikes, those taxpayers with backed-up records will have a much easier time obtaining insurance reimbursement and FEMA or other government sponsored relief. They will also be able to easily substantiate any casualty loss deductions for unreimbursed storm related damage. Those that are prepared for the storm are best able to weather the storm.

Endnotes:

1. Frank Agostino is Principal of, and Philip Colasanto is an Associate Attorney at Agostino and Associates, P.C.
2. Pursuant to IRC § 165(i), the term "federally declared disaster" means any disaster subsequently determined by the President of the United States to warrant assistance by the Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act.
3. Treas. Reg. § 301.7508A-1(c)(1).
4. Treas. Reg. § 301.7508A-1(b)(2); I.R.C. § 6404(i).
5. Khouri v. Comm'r, 84 T.C.M. (CCH) 44, 2002 WL 1488742 (2002).
6. Treas. Reg. § 301.7508A-1(b)(3)(ii).
7. The term "covered disaster area" refers to an area that is identified as a federally declared disaster area by the President of the United States. See IRS Publication 547 (*Casualties, Disasters, and Thefts)* and Treas. Reg. § 301.7508A-1(d)(2).
8. Treas. Reg. § 301.7508A-1(d)(1).
9. Scott v. Comm'r, 84 T.C.M. (CCH) 153, 2002 WL 1796833 (2002).
10. Treas. Reg. § 301.7508A-1(e).
11. IRS Publication 547 (*Casualties, Disasters, and Thefts).*
12. Temp. Treas. Reg. § 1.165-11T - Election to take disaster loss deduction for preceding year.
13. Temp. Treas. Reg. § 1.165-11T - Election to take disaster loss deduction for preceding year.
14. Temp. Treas. Reg. § 1.274-5A - Substantiation requirements.
15. Temp. Treas. Reg. § 1.274-5T - Substantiation requirements (temporary).
16. Temp. Treas. Reg. § 1.274-5T(c)(5) - Substantiation requirements.
17. Publication 2194 (*Disaster Resource Guide for Individuals and Businesses*).

THE "HOBBY LOSS" RULE

ACTIVITIES ENGAGED IN FOR PROFIT, DEDUCTIBILITY OF EXPENSES, AND IRS EXAMINATIONS

By Frank Agostino, Esq.
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The National Taxpayer Advocate has identified the deductibility of trade or business expenses as a Most Litigated Issue in every Annual Report sent to Congress. A sub-issue routinely implicated in these cases is whether a taxpayer engaged in an activity for profit. In for-profit activities, the related expenses are deductible pursuant to Code Sec. 162 or 212. In not for profit activities, the related expenses are limited to the amount of the income derived from the activity pursuant to Code Sec. 183. Anecdotally, the trade or business versus hobby issue is present at most calendars held by the United States Tax Court, and affects taxpayers of all socioeconomic statuses.

Many people have a hobby to which they devote their time, energy, and, more often than not, resources. These hobbies are usually engaged in as a pleasurable distraction from the monotony of every day life. For some, however, there is a fine line between what may be considered a pleasurable distraction and what constitutes a business engaged in for profit. Because hobbies can be expensive, and because the expenses related to a hobby are generally not deductible, it is important for the practitioner to understand the factors considered in differentiating hobbies from businesses and the deductions that can be taken for both.

I. Statute and Regulations

A. <u>IRC § 183 and Associated Treasury Regulations:</u>

Section 183, entitled *Activities not engaged in for profit*, is colloquially known as the "hobby loss rule" and governs whether deductions can be taken for expenses related to a hobby. The hobby loss rules are cumbersome, but it is important to understand them when defending an audit. The general rule is that no deduction is allowed for any expenditure attributable to an activity not engaged in for profit.[2] Deductions are allowed which (i) would be allowable without regard to whether the activity is engaged in for profit, and (ii) do not exceed the gross income derived from such activity.[3] Activities which are "not engaged in for profit" are circularly defined as activities for which deductions are not allowed under IRC §§ 162 (relating to trades or businesses) and 212 (1) and (2) (relating to expenses for the production or collection of income).[4] Section 183 applies to individuals, partnerships, S corporations, trusts and estates, but does not apply to C corporations because C corporations are presumptively engaged in a trade or business.[5]

Whether a taxpayer is engaged in an activity for profit can be nebulous in practice and § 183 therefore provides a safe-harbor presumption. Under § 183(d) and Treas. Reg. § 1.183-1(c), if the gross income derived from an activity exceeds the deductions

able to that activity for three or more taxable years during a consecutive five year period,

attributable to that activity for three or more taxable years during a consecutive five year period, the activity is presumed to be engaged in for profit. This three-out-of-five year presumption is altered to two years out of seven if the activity consists in major part of the breeding, training, showing, or racing of horses.[6]

Taxpayers can elect to postpone the determination of whether or not their activity is engaged in for profit until after they have engaged in the activity for five years (or seven years if the activity consists in major part of the breeding, training, showing, or racing of horses); the starting point for such period is the first taxable year in which the taxpayer engages in the activity.[7] This postponement election is made by filing with the Internal Revenue Service ("IRS") a Form 5213, *Election to Postpone Determination as to Whether the Presumption Applies That an Activity is Engaged in for Profit*.[8] Form 5213 generally can be filed within three years after the due date of the return for the first year of the activity (without regard to extensions), but not later than 60 days after the taxpayer receives written notice from the IRS regarding disallowance of deductions.[9] For example: if a taxpayer engages in a yachting activity in 2017 and wants to postpone the determination of whether or not this activity was engaged in for profit, he has until April 15, 2021 to make the election. However, if the IRS sends the taxpayer a notice of deficiency, he would have only 60 days after the date of the notice of deficiency to make the election. If the election is made by an S corporation or partnership, it is binding on all shareholders and partners.[10] The obvious benefit of making the election is that the IRS may not immediately question whether the activity is engaged in for profit and will therefore not restrict deductions. However, if the activity does not meet the three-out-of-five-year test, deduction limits will be applied retroactively to any year within the five–year period. The election also automatically extends the period of limitation on assessment for the IRS to retroactively limit deductions until two years after the due date for the tax return for the <u>last</u> year of the five–year period.[11]

B. <u>Determining Whether an Activity is Engaged in For Profit:</u>

Absent reliance on the safe-harbor presumption of IRC § 183(d), whether an activity is engaged in for profit is a question of fact. The taxpayer bears the burden to show that he was engaged in the activity with an actual and honest objective of making a profit.[12] The expectations of profit need not be reasonable, but the profit-motive objective must be in good-faith.[13] The requisite profit objective is determined from all of the facts and circumstances and both the IRS and the court will give more weight to objective facts than the subjective intent of the taxpayer.[14] Additionally, this profit objective must be based on the profit potential of the activity, and not on the tax benefits expected to be derived from the activity.[15]

It should be noted that profit objective determined in an earlier year does not automatically translate into profit motive in later years. This is because each tax year stands on its own.[16] An activity may change from being engaged in for profit in one year to not engaged in for profit in later years, and vice versa.[17] Each activity and each tax year should be independently examined to make-

the profit motive determination.

When determining whether or not an activity is engaged in for profit, the following factors are considered:[18]

1. Manner in which the taxpayer carried on the activity. This factor focuses on how the taxpayer carries on the activity. If the taxpayer treats the activity like a business then it is more likely that profit motive exists. Examples of businesslike manner include maintaining complete and accurate books and records; conducting the activity in the same manner as a comparable business that is profitable; and, making changes and adopting new techniques or abandoning non-profitable techniques to become more profitable.[19] Similarly, records that can be used for the purpose of cutting expenses, increasing profits, and evaluating the overall performance of the business are indicative of having a profit motive.[20] Conversely, the lack of a bookkeeping system that would make it difficult for the taxpayer to monitor losses and expenses of the activity supports a lack of profit motive.[21] Thus, an ongoing effort to maintain proper records and to increase profitability will be a strong indicator that the activity was engaged in for profit.

For example, in Hylton v. Comm'r, the petitioner engaged in the breeding, training, showing, and selling of horses. The activity was determined not to be engaged in for profit and one of the main considerations was that the petitioner's books and records consisted of a check register and hard copies of third-party documents, such as invoices, bills, etc. Further, petitioner's accountant created financial statements which were only used for tax purposes. Petitioner's activity was deemed not to be engaged in for profit because she did not keep track of expenses, did not utilize financial statements for the company, and did not even have a roster of the horses she maintained.[22]

Conversely, in Metz v. Comm'r, the petitioners bred, raised, and sold Arabian horses. Despite the activity having losses from its inception in 1991 through 2009, the Court found that it was engaged in for profit because the petitioners not only kept their records in a businesslike manner, but also hired a knowledgeable law firm to draft contracts on their behalf and reviewed monthly Quickbooks reports prepared by their CPA firm. The petitioners also went to great lengths to improve the profitability and viability of their activity, including moving from Florida to California because California was better suited and had a market for Arabian horses. Therefore, despite the activity's not being profitable for 18 years, the Court still found that it was engaged in for profit based on how the petitioners treated the activity.[23]

Additionally, in Main v. Comm'r, the petitioner was engaged in the restoration and sale of Plymouth automobiles. Petitioner kept very simple records in this case but he was active in advertising his motor vehicles, would look country-wide for better deals on purchasing Plymouths, and would abandon activities or plans that were not financially sound. For these reasons, the Court found that the petitioner's activity was engaged in for profit.[24]

2. Expertise of the taxpayer or his advisors. This factor focuses on the preparation and study by the taxpayer or a hired advisor, re-

garding the business, scientific, and economic practices of the activity.[25] If a taxpayer studies or follows an expert's advice on the economics of an activity and carries on such activity in accordance with this knowledge, these facts support that the taxpayer engaged in the activity for profit.[26] Taxpayers who study the economics of their activity and perform the activity in accordance with what they have learned will more likely be deemed to have a profit motive.

For example, in Savello v. Comm'r the petitioner was engaged in selling model airplanes. Petitioner had no expertise regarding model airplanes but she did have knowledge in retail sales. Also, petitioner had a volunteer who had expertise in model airplanes. These factors, among others, contributed to the court's finding that she was engaged in a for-profit activity.[27]

3. Time and Effort expended by the taxpayer in carrying on the activity. When a taxpayer devotes a substantial portion of his personal time and effort to carrying on an activity (especially activities without personal enjoyment or recreational aspects) this fact tends to show the taxpayer intended to earn a profit.[28] Related facts should also be considered, including whether the taxpayer withdrew from a previous occupation to engage in the activity and whether the taxpayer employed qualified persons to carry on the activity on his behalf.[29] The devotion of time and effort as well as employing qualified individuals to carry on an activity tends to show profit motive.

Although time devoted to the activity is an important factor, the Court will accept appropriate substitutes if the taxpayer is not directly involved. In Savello, the petitioner was not always at the shop but she did make arrangements to have a knowledgeable volunteer at the shop, which was satisfactory.

4. Expectation that assets used in the activity will appreciate in value. This factor looks to the collective profit-making motives of the taxpayer. Even if a taxpayer does not expect ordinary income from an activity, profit motive may still exist if the taxpayer expects that property used in connection with the activity will appreciate in value.[30] Expected appreciation alone, however, is generally insufficient to show that the activity was engaged in for profit.[31] Appreciation in value will only be indicative of profit motive when such appreciation exceeds the activity's operating expenses for the current year and its accumulated losses from prior years.[32]

5. Success of the taxpayer in carrying on other similar or dissimilar activities. Whether a taxpayer successfully engaged in a similar activity in the past for profit is indicative of profit motive, even if the current activity is not yet profitable. Similarly, where a taxpayer successfully engaged in a prior, different activity for profit, this may also be indicative that the current activity is also engaged in for profit.[33]

6. Taxpayer's history of income or losses with respect to the activity. Many activities do not become profitable until after the initial start-up phase and early losses may not be a proper indicator of whether an activity was engaged in for profit. Continued losses, however, may be indicative of lack of a profit motive unless they are otherwise attributable to

facts and circumstances outside the taxpayer's control.[34] Activities that may not be profitable currently, but which may be profitable over a period of time, offer strong evidence that the activity is engaged in for profit. It is therefore imperative to focus on the income and loss pattern of the activity and to be able to explain why continued losses have occurred.

7. Amount of occasional profits, if any, which have been earned. This factor compares the profits and losses incurred in the activity, the ratio of profits to the amount of the taxpayer's investment, and the value of the assets used in the activity. Occasional minimal profits obtained from an activity that has relatively high losses or requires a large investment would indicate the activity was not engaged in for profit. Conversely, where occasional profits are substantial, or have an opportunity to be substantial compared to losses and investments, that may be indicative of profit motive. Where the opportunity to make a substantial profit exists, even if never realized, it is still indicative of the intention to make a profit.[35]

In Metz v. Comm'r, the Court found that the activity was for profit even though it had not earned a profit in 18 years.[36] Contrast that with Kantchev v. Comm'r, where the lack of gross receipts from 2004-2009 was one factor leading the Court to determine that the taxpayer's activity was not engaged in for profit. Taxpayer in Kantchev was selling prints of panoramic landscapes that he had photographed. Despite the taxpayer's receiving gross receipts in 2010, his activity was deemed to be not for profit.[37]

8. Financial status of the taxpayer. This factor focuses on the taxpayer's other sources of income. If the taxpayer has no other source of income and depends on the income from the activity for his livelihood, then it is likely that the activity is meant to be engaged in for profit. On the other hand, if the taxpayer has other sources of income and the income from the activity is not meaningful, this fact tends to show the activity is not engaged in for profit. Stated another way, the more the taxpayer relies on income from the activity, the more likely it is that the taxpayer has engaged in the activity with the requisite profit motive.[38]

Where the activity is a primary source of income then it is more likely to be deemed for profit. In Main v. Comm'r, the petitioner was engaged in two separate activities: buying, restoring, and selling Plymouth automobiles; and, creating prototypes, inventing electronics, and filing patent applications. During the year in issue, Petitioner's patent activity business was no longer financially viable and the Court used this factor to support the contention that the Plymouth restoration activity was engaged in for profit. The Court's rationale was that if one activity isn't producing income then the taxpayer is more likely to rely upon the other activity for its income production.[39] Similarly, in Savello v. Comm'r, although the petitioner did have outside income it was not substantial, where she had income from her art teaching activities and from a pension plan.[40]

9. Personal pleasure or recreation. This factor focuses on the enjoyment aspects of the activity. If a taxpayer derives personal pleasure from an activity or it is recreational, this does not necessarily negate profit objective.

A taxpayer need not engage in an activity with the exclusive intention of earning or maximizing a profit.[41] The taxpayer's pleasure in the act is but one factor to be weighed against and compared to the other factors. This factor, unlike the above-mentioned factors, is mostly subjective and, therefore, is reliant on the other factors for support. Enjoyment is subjective and what is recreation for some may not be recreation for others. That being said, some activities are universally deemed unpleasant or not recreational and such activities are more likely to be treated as being entered into for profit.

None of these foregoing factors alone is determinative and they are not meant to be tallied. In other words, five factors indicating intent to make a profit and four that do not does not automatically mean that the taxpayer entered into the activity for profit.[42] These factors, along with the taxpayer's subjective statement of intent and financial status, must be taken together and analyzed as a whole. Although subjective intent of the taxpayer is important, more weight will be given to objective facts.[43] The focal point of this analysis is not the activity itself but how the activity is treated by the taxpayer.

C. Taxpayers Engaged in Multiple Activities:

Taxpayers who engage in multiple activities may treat them as one activity if they are sufficiently interconnected. This analysis is fact sensitive. When determining the interconnectivity of the activities, the following facts and circumstances are relevant: degree of organizational and economic interrelationship of the various undertakings; the business purpose which may be served by carrying on the various undertakings separately or together in a trade or business or in an investment setting; and the similarity of the various undertakings. The IRS will generally accept the taxpayer's characterization of the interconnected activities as long as it is not an artificial determination and can be reasonably supported by the facts and circumstances of the case.[44]

II. Preparation of the Return

A. Due Diligence:

When initially preparing a return, it is incumbent on preparers to make sure they are not filing returns that run afoul of Circular 230 and I.R.C. § 6694. Circular 230 prohibits the signing of a return, or advising to sign a return, that contains a position that: lacks a reasonable basis; that is an unreasonable position under I.R.C § 6694(a)(2); or, is a willful attempt to understate the tax liability or a reckless disregard of rules or regulations as defined by § 6694(b)(2).[45]

The reasonable basis standard requires that a position not be frivolous or patently improper, but it most be more than merely arguable. The reasonable basis standard will generally be satisfied if the preparer's position is based upon one or more authorities set forth in § 1.662-4(d)(3)(iii),[46] which include: applicable provisions of the I.R.C.; regulations; revenue rulings; revenue procedures; tax treaties; court cases; private letter rulings and technical advice memoranda; and, IRS information, press releases, notices, announcements, and other pronouncements published in the Internal Revenue Bulletin.[47]

An unreasonable position, pursuant to § 6694(a)(2), is a position that is not supported by substantial authority; is a disclosed position, pursuant to § 6662(d)(2)(B)(ii)(I), in which subparagraph (C) does not apply, that does not have a reasonable basis; and, with respect to tax shelters (as defined by § 6662 (d)(2)(C)) and reportable transactions to which § 6662A applies, a position is unreasonable unless it is reasonable to believe that the position would more likely than not be sustained on its merits.[48]

Section 6694 penalizes tax preparers and it is for this reason that preparers must be ever vigilant and be thorough in their due diligence. Generally speaking, tax preparers may rely in good faith on information furnished by their client without further verification. However, preparers cannot ignore information that they know or can imply from other facts to be incorrect, inconsistent, or incomplete. If this were to arise, it is the duty of the preparer to make a reasonable inquiry into the discrepancy.[49]

Preparers should, therefore, question clients regarding any information that is inconsistent or incomplete because failure to do so may result in both the taxpayer and tax preparer being penalized. Therefore, with regards to a § 183 activity, the preparer must inquire as to the motive of the taxpayer and should inquire about the nine factors enumerated in Treas. Reg. § 1.183-2(b). Preparers need not request supporting documentation so long as there is a good faith basis to verify the taxpayer's position.

B. Form 8275:

Since §§ 6662 and 6694 penalties can be assessed against the taxpayer and preparer, respectively, it may be in both of their interests to include a Form 8275 *Disclosure Statement* with the return. Form 8275 allows the taxpayer and preparer to be proactive and to detail their position regarding an activity and why it constitutes a trade or business. This disclosure coupled with substantial authority may be able to save the taxpayer and preparer from an understatement of income penalty and, therefore, should be considered.

C. To Include or Not to Include:

Whether or not to argue that an activity is for profit will be based on the comfort of the preparer. The test itself requires a preparer to determine the subjective intent of the taxpayer from objective factors, which is not always an easy task. Preparers should not forego their common sense when determining whether or not to include an activity as a hobby or a trade or business.

Preparers should be comfortable that they could argue their client's position without issue. Preparers should avoid signing returns with "business" deductions that they do not believe can be taken in good faith. Unfortunately, this may be more of a 'I know it when I see it' situation. Preparers should primarily focus upon the way in which the activity is operated and the relationship between the taxpayer and the activity. Taxpayers who operate an activity as if it were a business and that continuously try to improve that business, are more likely than not engaged in the activity for a profit. Similarly, the financial status of the taxpayer is important because as a matter of common sense those who are in need of income will most likely be engaged in an activity for the income and not merely for the enjoyment.

III. Obligations and Best Practices for Preparation

A. Activities That May Trigger Audit:

Although there are a plethora of activities that can fall into the hobby versus business debate, the most likely to trigger IRS attention are: fishing; farming; horse racing; horse breeding; farming; motocross racing; auto racing; craft sales; bowling; stamp collections; dog breeding; yacht charters; artists; gambling; direct sales photography; writing; entertainers; rentals; and, airplane charter.[50] This list is obviously non-exhaustive and in addition to the abovementioned, many restaurants and rental properties have been flagged for IRS attention and are being swept-up into this hobby loss litigation. These two activities clearly seem to tip in favor of being a trade or business but some taxpayers have been using them as deductible havens for reducing their taxable income.

When looking for activities that may not be for profit, the examiner will focus on the following indicators: are there large expenses with little or no income; are losses offsetting other income on the return; does the activity result in a large tax benefit to the taxpayer; and, does the history of the activity show that it is generating any profit in any years.[51] Tax preparers should be aware of what activities and factors the examiners will be looking for and should be prepared for potential litigation.

B. Examiner Activity During Audit:

Examiners are instructed to conduct extensive research regarding the issues and the taxpayer. They are also given authority to request further information through Information Document Requests ("IDRs") and interviews. Preparers should be mindful of the examiner's authority to request interviews, pursuant to I.R.C. § 7602, and the preparer's ability to appear as the taxpayer's representative, pursuant to I.R.C. § 7521(c). The taxpayer's presence will not be required so long as the preparer, or other authorized representative, has first hand knowledge of the taxpayer's business, business practices, bookkeeping methods, accounting practices, and daily operations.

Preparers should also be aware of the examiner's authority to physically examine the taxpayer's place of business. Treas. Reg. § 301.7605-1(d)(2)(iii) allows the Service to visit the taxpayer's place of business or residence regardless of where the examination takes place. Examiners will do so when they need to establish facts that can only be established with a direct visit. This also allows examiners to: identify any assets that may be claimed on the return; acquire an overview of the operation; establish that books and records accurately reflect operations; observe and test internal controls; clarify information obtained through interviews or responses to document requests; and identify potential audit issues.

An examiner has the authority to visit the taxpayer's place of business but is not mandated to do so. An examination can be held in the IRS office closest to the taxpayer or where the taxpayer's books and records are kept. Preparers should be aware that the taxpayer or her authorized representative may request to change the place of the examination pursuant to Treas. Reg. § 301.7605-1(e).

C. Factual Development and Examiner Report:

Examiners will obtain copies of the taxpayer's returns from the inception of the activity and will create a detailed analysis of the activity's income and loss history. During this investigation, examiners will be looking for: manipulated profits by the taxpayer; whether the deductions being claimed are personal in nature; and, whether the deductions being claimed run afoul of other Code provisions. These claimed deductions will be scrutinized with regard to the following suggested Code provisions: : § 704 partnership loss limitation; § 1366 S corporation stock or debt basis limitations; § 465 at-risk limitations; § 469 passive activity loss limitations; § 162 ordinary and necessary, as opposed to personal, expenses; § 274(d) record keeping requirements; § 179 election to expense certain depreciable assets; §§ 167 and 168 depreciation; § 212 expenses for production of income; § 280A disallowance of certain expenses in connection with business use of the home, rental of vacation homes, motor homes, houseboats, yachts, etc; and, § 195 start up expenses.

Now that preparers are aware of the extent and thoroughness of the examiner's investigation, it is incumbent upon them to be prepared for an audit. Once an audit has begun, the preparer should request supporting documents from the taxpayer and together they should go over the nine factors and decide how they can prevail on each factor. Then the preparer should go over each deduction claimed and make sure that it is not personal in nature and does not violate any other provision of the Code. This preparation will be necessary to properly contest the audit.

D. Examiner's Report and Preparer's Response:

Upon completion of the audit the examiner will provide a detailed report stating: the facts, the law and argument, the taxpayer's position, and the conclusion. This report will not only make the determination regarding whether or not the activity was entered into for profit but it will also provide which deductions are valid, how to re-calculate the deductions based on the report's findings, and any alternative theories the examiner may have regarding the activity or the deductions. In deciding whether or not the activity was for profit, the examiner must detail and discuss every factor enumerated in Treas. Reg. § 1.183-2(b).

The examiner's determination can be protested (either by going to a supervisor, Appeals, or protesting 30 day letter) and the strongest arguments for taxpayers to make are: that alternative arguments were not addressed; that the nine factors in Treas. Reg. § 1.183-2(b) were not addressed; no mention was made of history of the activity; no mention was made of whether or not there would ever be a realistic possibility of a profit; lack of factual development; and, disallowed expenses were not first verified as to whether they were deductible or personal in nature. These issues are the best way to attack an examiner's investigation and report. Preparers should be familiar with each of these issues if they're handling an audit and should focus on them in their protests, if applicable.

IV. How to Report Hobby Losses on Tax Returns

Activities that are not engaged in for profit should still be reported on the tax return. For individuals, deductions may only be taken if they are itemized and may be taken on Schedule A of Form 1040.[52] Deductions for not-for-profit activities must be taken in the following prescribed order.

A. Category 1:

Deductions a taxpayer may otherwise take for personal as well as business expenses can be taken in full. For individuals, all non-business deductions belong in this category, such as: home mortgage interest, taxes, and casualty losses. These items should be deducted on the appropriate lines of Schedule A on their 1040. The deductions for casualty loss and for home mortgage interest must follow the guidelines and limitations per Publications 547 and 936, respectively.

B. Category 2:

Deductions that do not result in an adjustment to the basis of property are allowed next, but only to the extent that the gross income from the activity is more than the deductions under Category 1. Most business deductions belong in this category, such as: advertising, insurance premiums, interest, utilities, and wages.

C. Category 3:

Business deductions that decrease the basis of property are allowed in this final category, but only to the extent that the gross income from the activity exceeds the deductions taken in Categories 1 and 2. Depreciation, amortization, and the remainder, if any, of a casualty loss are allowed at this level. Where more than one depreciable asset is involved, depreciation and other deductions must be allocated proportionally.

Deductions taken under Category 2 and 3 must be claimed as miscellaneous deductions on Schedule A and they are subject to the 2%-of-adjusted-gross-income limit, which is found in Publication 529 and IRC § 67, and the overall limitation on itemized deductions found in § 68.

Where the taxpayer engages in several activities, each may be a separate activity or the activities may be combined. As noted above, the IRS will generally accept the taxpayer's characterization of whether the activities are separate or combined, so long as this characterization is reasonably supported by the facts and circumstances.

D. Example of Hobby Loss Deduction Calculation:

James enjoys playing fantasy football; he plays fantasy football as a not-for-profit hobby. James makes $4,500 from his fantasy football activities in 2016. James' deductions are as follows:

Real Estate Taxes	$ 900
Home Mortgage Interest	$1,200
Insurance	$ 500
Utilities	$ 800
Maintenance	$ 400
Depreciation on Automobile	$ 600
Depreciation on Machine	$ 300

James' total deductions amount to $4,700, which leaves James with a $200 loss. James, however, must limit his loss to his gross income of $4,500. This basic calculation provides the maximum amount that James can deduct. The actual calculation must be made systematically starting from Category 1 and moving down to Category 3.

Category 1 deductions are: $2,100 (taxes and interest).

Category 2 deductions are: $1,700 (insurance, utilities, and maintenance).

After exhausting Categories 1 and 2, James can only absorb another $700 of deductions.

Category 3 deductions are therefore limited to $700 because that is the remainder of the gross income after fully deducting Categories 1 and 2.

Category 3 deals with the depreciable assets and there must be an allocation of the deductions. $900 is the combined depreciation of the two assets and the remainder of the gross income is $700. Since the depreciation must be allocated proportionately:

Automobile = 600/900 x 700 (remainder available for deduction) = $467

Machine = 300/900 x 700 = $233.

Therefore, $467 and $233 are the proportional depreciation amounts and the basis of each asset should be reduced accordingly.

James should report his gross fantasy football income on Line 21 (other income) of his Form 1040. The $2,100 from Category 1 is deductible in full and should be recorded on the appropriate lines of Schedule A. The remaining $2,400 which is deducted from Categories 2 and 3 should be recorded as miscellaneous deductions on Schedule A and will be subject to the 2%-of-adjusted-gross-income limit.[53]

E. Partnerships, S Corporations, and Trusts and Estates:

As mentioned earlier, § 183 applies to these entities at the entity level. These same rules apply on an activity by activity basis, but activities cannot be combined. If one of these entities is engaged in a not-for-profit activity then the income for that activity should be removed from ordinary income and reclassified as separately stated income (other income). All expenses should be classified by category (see above), separately stated, and limited to the gross income from that activity. Deductions that are not allowed will be used to reduce the basis of the shareholder/ partner.[54]

V. Conclusion

Hobby losses are a continual source of tax controversies.[55] The existence of a trade or a business is highly fact-specific and often open to interpretation. Practitioners who understand the rules under Code Sec. 183 and how the IRS audits potential hobby activities can limit their clients' audit risk and secure advantages in cases that proceed to litigation.

Review of recent "hobby loss" litigation shows that taxpayers who continuously maintain proper records and try to improve profitability are often the taxpayers that prevail. Therefore, taxpayers should know that the better they maintain records and the more innovative and willing to change they are, the more likely that activity will be deemed to be engaged in for profit.

Case law clearly shows that there are different methods of showing that your activity is engaged in for profit. The Court seemingly seems to favor taxpayers who maintain adequate records, engage in a business plan, advertise their activity; and, maybe most importantly, are willing to make changes to improve the economic efficiency and productivity of the activity.

Endnotes:

1. Frank Agostino is Principal of, and Philip Colasanto is an Associate Attorney at Agostino and Associates, P.C.
2. I.R.C. § 183(a).
3. I.R.C. § 183(b).
4. I.R.C. §§ 162 and 212 deal with expenses from a trade or business or from the production of income. The analysis for what constitutes a trade or business is similar to the profit motive analysis found in § 183 and Treas. Reg. § 1.183-2(b).
5. I.R.C. § 183(a) specifically applies to individuals and S corporations; Treas. Reg. § 1.183-1(f) provides that § 183 applies when determining deductions of an electing small business corporation; Rev. Rul. 77-320 provides that § 183 applies to the activities of a partnership and are applied at the partnership level; and Treas. Reg. § 1.183-1(a) applies § 183 to estates and trusts.
6. I. R.C. § 183(d).
7. IRS § 183 ATG (2009), P. 8.
8. IRS § 183 ATG (2009), P. 8.
9. IRS § 183 ATG (2009), P. 8.
10. IRS § 183 ATG (2009), P. 8.
11. IRS § 183 ATG (2009), P. 10.
12. Mitchell v. Comm'r, 82 T.C.M. (CCH) 732 (2001).
13. King v. Comm'r, 116 T.C. 198 (2001).
14. Parker v. Comm'r, 83 T.C.M. (CCH) 1400 (2002).
15. Kuberski v. Comm'r, 84 T.C.M. (CCH) 178 (2002).
16. Comm'r v. Sunnen, 333 U.S. 591, 598-599 (1948).
17. *See* Daugherty v. Comm'r, 45 T.C.M. (CCH) 1224 (1983); Dennis v. Comm'r, 47 T.C.M. (CCH) 815 (1984).
18. Kantchev v. Comm'r, 110 T.C.M. (CCH) 533 (2015); Treas. Reg. § 1.183-2(b).
19. Treas. Reg. § 1.183-2(b)(1).
20. Filios v. Comm'r, 77 T.C.M. (CCH) 1589, aff'd, 224 F.3d 16 (1st Cir. 2000); Treas. Reg. § 1.183-2(b)(1).
21. Medlin v. Comm'r, 86 T.C.M. (CCH) 141 (2003), citing Burger v. Comm'r, 809 F.2d 355 (7th Cir. 1987); Treas. Reg. § 1.183-2(b)(1).
22. Hylton v. Comm'r, 112 T.C.M. (CCH) 701 (2016).
23. Metz v. Comm'r, 109 TC.M. (CCH) 1248 (2015).
24. Main v. Comm'r, 112 T.C.M. (CCH) 1 (2016).
25. Treas. Reg. § 1.183-2(b)(2).
26. Treas. Reg. § 1,183-2(b)(2).
27. Savello v. Comm'r, 109 T.C.M. (CCH) 1125 (2015).
28. Treas. Reg. § 1.183-2(b)(3).
29. Treas. Reg. § 1.183-2(b)(3).
30. Treas. Reg. § 1.183-2(b)(4).
31. Magassy v. Comm'r, 87 T.C.M. (CCH) 791 (2004), aff'd, 140 Fed. Appx. 450 (4th Cir. 2005).
32. Dirkse v. Comm'r, 80 T.C.M. (CCH) 717 (2000); Kahla v. Comm'r, 79 T.C.M. (CCH) 1846 (2000), aff'd, 273 F.3d 1096 (5th Cir. 2001).
33. See Schwartz v. Comm'r, 85 T.C.M. (CCH) 1058 (2003); Treas. Reg. § 1.183-2(b)(5).
34. Treas. Reg. § 1.183-2(b)(6).
35. Treas. Reg. § 1.183-2(b)(7).
36. Main v. Comm'r, 112 T.C.M. (CCH) 1 (2016).
37. Kantchev v. Comm'r, 110 T.C.M. (CCH) 533 (2015).
38. Treas. Reg. § 1.183-2(b)(8).
39. Main v. Comm'r, 112 T.C.M. (CCH) 1 (2016).
40. Savello v. Comm'r, 109 T.C.M. (CCH) 1125 (2015).
41. Treas. Reg. § 1.183-2(b)(9).
42. Busbee v. Comm'r, 79 T.C.M. (CCH) 2131 (2000).
43. Baldwin v. Comm'r, 83 T.C.M. (CCH) 1915 (2002); Treas. Reg. § 1.183-2(a).
44. Treas. Reg. § 1.183-1(d); IRS § 183 ATG (2009), P. 5.
45. IRS Circular 230, 10.34(a).
46. Treas. Reg. § 1.662-3(b)(3).
47. Treas. Reg. § 1.6662-4(d)(3)(iii).
48. I.R.C. § 6694(a)(2).
49. IRS Circular 230 10.34(d).
50. IRS § 183 ATG (2009), P. 11.
51. IRS § 183 ATG (2009), P. 11.
52. See IRS Publication 535 (*Business Expenses*) (2016).
53. The 2% rule allows an individual to take a deduction only to the extent that it exceeds 2% of the adjusted gross income. Miscellaneous expenses must be itemized to be deductible. See Publication 529 (*Miscellaneous Deductions*)(2016).
54. IRS § 183 ATG (2009), PP. 28, 29.
55. See 1 Nat'l Taxpayer Advocate, 2015 Annual Report to Congress, 462 (Dec. 31, 2015).

TAX COURT CALENDAR

All Calendar Calls Are Held at:

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26 Federal Plaza
Rooms 206, 208
New York, NY 10278

April 3, 2017

April 17, 2017

FIRM NEWS

On March 20, 2017, the United States Court of Appeals for the Second Circuit issued its opinion in *Chai v. Commissioner*, Docket Nos. 15-1653; 15-2414. In Chai Petitioner argued, among other issues, that he was not liable for the negligence penalty under IRC 6662(a) because the Commissioner failed to demonstrate compliance with IRC 6751(b), which requires written approval of non-mechanically applied penalties. The Second Circuit reversed the Tax Court, holding that demonstrating compliance with IRC 6751(b) is part of the Commissioner's burden of proof, and that the written approval must occur not later than the date the notice of deficiency determining such penalty is issued or the date penalty is asserted by way of an answer in Tax Court. See the full opinion at: http://caselaw.findlaw.com/us-2nd-circuit/1853407.html

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June 6, 2017

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October 3, 2017

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The Tax Consequences of the Choice of Entity Decision
December 12, 2017

If you have any questions, please contact Joann Kozlowski at (201) 488-5400 ext. 100, or jkozlowski@agostinolaw.com

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Seminar

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Panelists:

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Topic: Taxation of gifts and bequests given to an immigrant by foreign relatives.

Frank Agostino, Esq.

Agostino & Associates

Topic: Common tax issues relating to undocumented workers

Eunkyong Choi, Esq.

NYC Department of Finance Taxpayer Advocate's Office

Topic: How NYC local taxes impact immigrants?

Brenda Stuart-Luke

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Darol Tucker

Brooklyn Local Taxpayer Advocate

Topic: How do the new IRS regulations impact the ESL community?

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Registration includes the downloadable course handbook and associated course materials. They will be available several days prior to the program start for your review.

Why You Should Attend

The number of accuracy-related penalties assessed against individual taxpayers increased from 58,366 in 2005 to 553,184 in 2015. That is nearly a 1,000% increase over the past decade! Are there more bad taxpayers? Or, is the IRS just getting more aggressive about asserting penalties? Regardless of the answer, responsible tax practitioners must understand what triggers a penalty assessment and how to protect their clients and themselves against such assessments. Unfortunately, accounting and law school tax classes rarely focus on penalties, leaving practitioners to pick up the relevant standards and procedures from the trial and error of daily practice.

This one-day seminar is a unique opportunity to review the various tax penalties that can be imposed, the standards and transactions that can trigger penalties and sanctions, the procedures the Internal Revenue Service must follow to assess penalties and the defenses that can be asserted. We have assembled an expert faculty of experienced private practitioners and government representatives to explain how penalties work, why they are assessed and how you can protect yourself and your clients.

What You Will Learn

- Understand why penalties are assessed, which penalties apply to what types of conduct, and who can be subject to penalties, the taxpayer, the preparer, or both
- Find out how certain you have to be before you can advise a client to take a tax position on a return
- Learn to recognize when you can rely on your client for information and when you have to dig deeper
- Explore the difference between professional ethical standards of conduct, Circular 230 standards and tax penalties
- Examine situations where conduct is so egregious that it can trigger a fraud penalty
- Discover what turns a civil penalty case into a criminal tax prosecution
- Get tips on approaching tax situations that involve potentially criminal conduct

Who Should Attend

Law firm and accounting firm professionals who advise clients on structuring transactions and who represent clients in tax controversies; in-house tax professionals involved in tax planning, FIN 48 determinations and tax audits and appeals; and government agents and attorneys who want a primer on tax penalties and ethical standards.

PLI Group Discounts

Groups of 4-14 from the same organization, all registering at the same time, for a PLI program scheduled for presentation at the same site, are entitled to receive a group discount. For further discount information, please contact **membership@pli.edu** or call (800) 260-4PLI.

PLI Can Arrange Group Viewing to Your Firm

Contact the Groupcasts Department via email at **groupcasts@pli.edu** for more details.

Cancellations

All cancellations received 3 business days prior to the program will be refunded 100%. If you do not cancel within the allotted time period, payment is due in full. You may substitute another individual to attend the program at any time.

CREDIT INFORMATION

CLE Credits for:
New York

CLE-NY Credits
Credit Status: Approved
Transitional: Newly admitted NY attorneys **CAN** earn ethics, professional practice, law practice management, and skills credits in this format.
Total Credits: 7.50
Ethics: 1.00
Professional Practice: 6.50

CPE (NASBA) Credits
Notes: PLI is registered with the National Association of State Boards of Accountancy (NASBA), as a sponsor of continuing professional education on the National Registry of CPE Sponsors.
Credit Status: Approved
Total Credits: 7.00
Regulatory Ethics: 1.00
Taxes: 6.00

CPD-UK (SRA) Credits
Notes: PLI is an authorised external provider of CPD credit in the United Kingdom by the Solicitors Regulation Authority (SRA).
Credit Status: Approved
Total Credits: 6.25
General: 6.25

CPD-BC Credits
Credit Status: Approved
Total Credits: 6.25
General: 5.25
Ethics: 1.00

CPD-ON Credits
Notes: Practising Law Institute has been approved as an Accredited Provider of Professionalism Content by The Law Society of Upper Canada.
Credit Status:
Total Credits: 6.25
General: 5.25
Ethics: 1.00

CPD-QC Credits
Credit Status: Approved

RELATED ITEMS

EMPLOYMENT TAX CONTROVERSIES INCLUDING WORKER CLASSIFICATION & TRUST FUND PENALTIES

THREE FREE NY & NJ CLE*, CPE†, and EA CE CREDITS

WHERE:

Bergen Community College
Ciarco Learning Center
355 Main Street
Room 102/103
Hackensack, NJ 07601

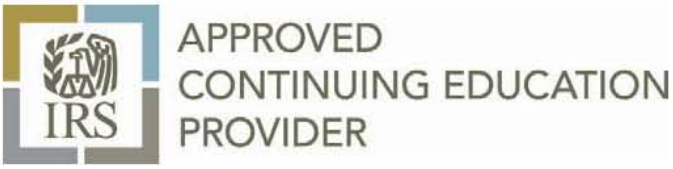
WHEN:

Tuesday, May 2 , 2017
6:00 PM – 9:00 PM

TOPICS INCLUDE:

1. Determining Whether Your Service Provider is an Independent Contractor or Employee
2. Completion of Form SS-8 – Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding
3. Representing Employers
   - A. Agreements with Independent Contractors
   - B. IRS Form 4669
   - C. The IRS Audit
   - D. Voluntary Worker Classification Settlement Program
4. Representing Misclassified Employees
   - A. Preparing Refund Claims
   - B. Preparing the Reward Application
   - C. Lawsuit for Damages Against the Employer and Others – IRC § 7434(a)
5. The Trust Fund Recovery Penalty
   - A. Preparing the IRS Form 4180 - Report of Interview with Individual Relative to Trust Fund Recovery Penalty or Personal Liability for Excise Taxes

REGISTER @
conta.cc/2iWJRwv



* This program has been approved by the Board on Continuing Legal Education of the Supreme Court of New Jersey for 3 hours of total CLE credit. Of these, 0 qualify as hours of credit for ethics/professionalism, and 0 qualify as hours of credit toward certification in civil trial law, criminal trial law, workers compensation law and/or matrimonial law.
This course or program has been approved in accordance with the requirements of the New York State Continuing Legal Education Board for a maximum of 3 credit hours.
† Based upon our interpretation of the regulations by the New York and New Jersey State Boards of Accountancy, this event will qualify for CPE credit. Our New Jersey CPE Sponsorship number is 20CE00213700. Our New York CPE Sponsorship number is 002405. Our Office of Professional Responsibility Sponsor Number is QVGWD. ‡CFP CE Credit will be provided.