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IRS—Is It Really You?

Cross References

- IR-2017-86, April 19, 2017

The IRS has created a special new page on www.irs.gov to help taxpayers determine if a person visiting their home or place of business claiming to be from the IRS is legitimate or an imposter. With continuing phone scams and in-person scams taking place across the country, the IRS reminds taxpayers that IRS employees do make official, sometimes unannounced, visits to taxpayers as part of their routine casework. Taxpayers should keep in mind the reasons these visits occur and understand how to verify if it is the IRS knocking at their door.

Visits typically fall into three categories:

- IRS revenue officers will sometimes make unannounced visits to a taxpayer's home or place of business to discuss taxes owed or tax returns due. Revenue officers are IRS civil enforcement employees whose role involves education, investigation, and when necessary, appropriate enforcement.

- IRS revenue agents will sometimes visit a taxpayer who is being audited. That taxpayer would have first been notified by mail about the audit and set an agreed-upon appointment time with the revenue agent. Also, after mailing an initial appointment letter to a taxpayer, an auditor may call to confirm and discuss items pertaining to the scheduled audit appointment.
- IRS criminal investigators may visit a taxpayer's home or place of business unannounced while conducting an investigation. However, these are federal law enforcement agents, and they will not demand any sort of payment. Criminal investigators also carry law enforcement credentials, including a badge.

How to know it's really the IRS calling or knocking on the door. The IRS initiates most contacts through regular mail delivered by the United States Postal Service. However, as outlined above, there are special circumstances in which the IRS will call or come to a home or business. Even then, taxpayers will generally first receive several letters from the IRS in the mail.

Note that the IRS does not call to demand immediate payment using a specific payment method such as a pre-paid debit card, gift card, or wire transfer. Generally, the IRS will first mail a bill to any taxpayer who owes taxes. Tax payments should be made payable to the "United States Treasury." Specific guidelines on how to make a tax payment are also listed at www.irs.gov/payments.

The IRS also does not demand that the individual pay taxes without the opportunity to question or appeal the amount the IRS says is owed. The IRS should also advise the taxpayer of his or her rights.

The IRS will never threaten to bring in local police, immigration officers, or other law-enforcement to have the

individual arrested for not paying. The IRS also cannot revoke an individual's driver's license, business licenses, or immigration status. Threats like these are common tactics scam artists use to trick victims into buying into their schemes.

Note: IRS Pub. 1, *Your Rights as a Taxpayer*, states taxpayers have the right to retain an authorized representative, such as an Enrolled Agent, CPA, or an Attorney to represent them in their dealings with the IRS. This right of representation includes unannounced visits by IRS employees. If a taxpayer is not sure whether someone claiming to be from the IRS is legitimate, the taxpayer should call an authorized representative for help. A quick way to find an authorized representative is to type the taxpayer's zip code into the online lookup tool at <https://irs.treasury.gov/rpo/rpo.jsf>. If an IRS criminal investigator shows up at the taxpayer's door, call an Attorney.

If an IRS representative does visit a taxpayer, he or she will always provide two forms of official credentials called a pocket commission and a HSPD-12 card. HSPD-12 is a government-wide standard for secure and reliable forms of identification for federal employees and contractors. A taxpayer has the right to see these credentials when an IRS employee visits a taxpayer in person.

Private debt collection. IRS collection employees may call or come to a home or business unannounced to collect a tax debt. They will not demand that the taxpayer make an immediate payment to a source other than the "United States Treasury." The IRS can also assign certain cases to private debt collectors but only after giving the taxpayer and his or her representative written notice. Private collection agencies will not ask for payment on a prepaid debit card or gift card. Taxpayers can learn about the IRS payment options on www.irs.gov/payments. Payment by check should be payable to the "United States Treasury" and sent directly to the IRS, not the private collection agency.



Arrests Made in IRS Phone Scam

On April 8, 2017, police in Mumbai, India arrested 24-year-old Sagar 'Shaggy' Thakker, who is alleged to be the mastermind behind Mumbai call centers that scammed millions from U.S. taxpayers. Thakker was extradited from Dubai where he was reported to have fled after his call centers were raided by police in October 2016. In the October raids, Indian authorities arrested some 75 call center employees in the Thane suburb of Mumbai. Charges included conspiracy to commit identity theft, impersonation of an officer of the United States, wire fraud, and

money laundering. A Mumbai newspaper reported that Thakkar's call centers were also involved with banking, pharmacy, grant, and other scams.

In one account, a woman in California received a voice message saying she was in trouble with the IRS over tax evasion. She called the number from the voice message and told a man who said he was from the IRS that she could pay \$500, which was half the amount demanded from the voice message. The man told her she could pay \$500 today, and that the lawyers would look at her accounts and work out a monthly payment plan. The man told her to keep the phone line open and drive to a nearby grocery store where she bought \$500 worth of iTunes gift cards. She then gave the scammer the redemption codes for the gift cards.

The U.S. Justice Department estimates at least 15,000 people in the U.S. have lost more than \$300 million in these types of phone scams since 2013.

Training materials and taped conversations, which investigators claim were made by call center instructors, revealed how the operation worked. Callers would pose as IRS officers and threatened their victims, often newly-arrived immigrants and the elderly, into paying fictitious tax penalties electronically. Usually, the victims were instructed to buy gift cards and turn over the redemption codes. Calls were typically made using voice over internet protocol technology that allowed the scammers to spoof the phone numbers, making it appear that the calls were coming from the IRS or some other government agency. Call center employees would tell their victims that they would be arrested, jailed, and their homes would be seized and their passports confiscated if they did not pay up.

One call center employee said that on a good day, they extracted as much as \$20,000 from a single U.S. citizen. Another call center worker said there was one instance where an old lady was crying, but the caller kept insisting that she pay up. Call center employees were taught to be tough. Another call center employee said that for every dollar they brought in, they earned 2 rupees, which is around one third of a U.S. penny.

The Mumbai newspaper also reported that Thakker bought a special script which was used by his call center employees to sound more authentic while posing as IRS officials. Authorities say that after he bought the script, it was sent to multiple call centers. Thakkar is alleged to have personally made over \$155,000 a day, or over \$1 million per week during the peak of the scam.

The Department of Justice, the IRS, and the Department of Homeland Security has also announced the arrest of 20 individuals in the United States in connection with these phone scams. The U.S. said that it would be

seeking extradition of individuals from India involved with the phone scams.



Earned Income Credit Allowed Even Without Business Records

Cross References

- *Lopez*, T.C. Summary Opinion 2017-16, March 16, 2017

The taxpayer was a single mother with two minor daughters who rented a three-bedroom apartment. The taxpayer claimed to be a self-employed cosmetologist, specializing in hairstyling. She operated her unlicensed cosmetology business from her residence and met with at least 12 of her customers regularly, charging anywhere from \$10 to \$50 per appointment. Most of her customers consisted of her neighbors and friends.

The taxpayer did not maintain a bank account, nor did she maintain any contemporaneous business records showing the income and expenses attributable to her business. Her customers paid her in cash, and she did not provide receipts for those payments.

The taxpayer timely filed her federal income tax return which was prepared by a paid income tax return preparer. Each year she reported her cosmetology income and expenses on a Schedule C, *Profit or Loss From Business*. For 2012, she reported gross income of \$17,800 and \$2,015 of expenses resulting in a net profit of \$15,785. For 2013, she reported \$17,581 of gross income with no expenses.

For each year, she claimed two dependency exemption deductions for her children, an Earned Income Credit, and an Additional Child Tax Credit.

Note: The maximum EIC for a single taxpayer with two children in 2012 was \$5,236 and occurred when relevant income was somewhere between \$13,050 and \$17,100. The maximum EIC for a single taxpayer with two children in 2013 was \$5,372 and occurred when relevant income was somewhere between \$13,400 and \$17,550.

The IRS claimed that the taxpayer had no Schedule C gross receipts and disallowed the Earned Income Credit and the Additional Child Tax Credit for both years. The IRS also barred the taxpayer from claiming an earned income tax credit for certain future years under the provisions of IRC section 32(k).

The court said a taxpayer claiming the Earned Income Credit must establish that he or she had earned income and the amount of that income. Relying upon the absence of any bank or other contemporaneous records that support the taxpayer's claims, the IRS argued that she had no earned income from that business during those years.

Although she had no business records, the court ruled that she was engaged in a cosmetology business during the years at issue. She provided notarized written statements from her clients, each dated in March 2015 and provided to the IRS during the audit of her 2012 and 2013 tax returns. These notarized written statements corroborated her testimony that she was paid to provide cosmetology services to at least 12 regular customers.

The court said it appreciates the IRS' suspicions in situations seemingly designed to maximize the refundable credits, but the IRS did not introduce any direct evidence casting doubt on the taxpayer's claim to have been in the cosmetology business. While the court is not obligated to accept the taxpayer's testimony on her business practices, neither is the court obligated to reject it.

On the other hand, the IRS' presentation at trial raised questions regarding the legitimacy of the written statements that the taxpayer relied upon, but there was not sufficient evidence in the record to persuade the court to ignore those statements completely. In the absence of written records showing how the gross income on each Schedule C was actually computed, and taking into account the information shown on some of the written statements from customers, the court ruled that the taxpayer's gross receipts from her cosmetology business totaled \$10,000 for each year. Any inexactitude inherent in the court's findings is attributable to the taxpayer's lack of contemporaneous records. Accordingly, the taxpayer was entitled to a reduced Earned Income Credit and Additional Child Tax Credit for both years. The court made no comment or ruling concerning the application of IRC section 32(k) which allows the IRS to disallow the Earned Income Credit for certain future years.



Employee Discounts Taxable to Employee When Provided to Friends

Cross References

- Ltr. Rul. 20171202F, March 24, 2017

All benefits provided to an employee are taxable, unless the Internal Revenue Code specifically excludes from income or defers tax on the benefit. Under IRC section 132(c), the value of a price reduction given to employees on property or services offered to customers in the ordinary course of the line of business in which the employee performs substantial services is excluded from taxable wages. The exclusion does not apply to discounts on real property or discounts on personal property of a kind commonly held for investment, such as stocks or bonds. The exclusion is limited to:

- Discounts on services up to 20% of the price charged to customers,
- Discounts on merchandise or other property up to the price charged to customers times the gross profit percentage.

Example: *Jacob is employed as a sales manager for Gulf Coast Resorts located on the Gulf Coast in Texas. The resort has a hotel, swimming pool, a golf course, tennis courts, a number of bars and restaurants, and access to the resort's private beach on the ocean. Customers typically pay a lump-sum fee for an all-inclusive package deal, meaning all meals, accommodations, and amenities are included in the price of the package. Alcoholic beverages are extra. As an employee of Gulf Coast Resorts, Jacob is entitled to purchase a vacation package for himself and his family at the resort during the off-season at 20% off the going rate during the off-season for a paying customer. The 20% discount is a tax-free fringe benefit for Jacob.*

IRS letter ruling. In a recent letter ruling, the IRS was asked about whether an employer's discount program qualified under IRC section 132(c) as a tax-free fringe benefit. Under the employer's discount program, employees may designate a certain number of individuals, including themselves, to receive a discount off the published rates for the services provided by the employer. These individuals can include spouses, domestic partners, family members, and friends of the employee. Thus, the employee could designate any person to participate in the discount program, regardless of the employee's relationship with that person. The employee discount may not be combined with any other promotion and is subject to commercial blackout dates.

IRC section 61(a)(1) states that gross income includes all income, from whatever source derived, including fringe benefits. Regulation section 1.61-21(a)(4) states that a taxable fringe benefit is included in the income of the person performing the services in connection with which the fringe benefit is furnished. Thus, a fringe benefit may be taxable to a person even though that person did not actually receive the fringe benefit.

IRC section 132(c) excludes from gross income the fringe benefit of qualified employee discounts. For purposes of this code section, an employee is defined as:

- An individual currently employed by the employer,
- An individual who retired from the employer, or became disabled while working for the employer, or a widow or widower of any one of these,
- Spouses and dependent children of any of the above mentioned people. A dependent child is defined as a child who is a dependent of any of the above, or both of whose parents are deceased and who has not attained age 25.

In the letter ruling, the IRS said that only individuals meeting the definition of an employee qualify for a non-taxable fringe benefit of a qualified employee discount. Other individuals, such as friends of the employee who qualify for a discount under the employer's discount program, are not considered employees of the employer. Thus, the value of discounts provided to any person not considered an employee under IRC section 132 is taxable as income to the employee who designated such individual.



The Wrong Way to Transfer S Corporation Stock

Cross References

- Dalton, T.C. Memo. 2017-43, March 13, 2017

In 1994, the taxpayer and his brother organized a construction company as an S corporation. Each brother was a 50% shareholder of the S corporation. In 2007, the taxpayer told his brother that he wanted to resign from the company and turn in his stock. Consequently, relations between the brothers deteriorated. The taxpayer's brother changed the locks to the corporation's offices and withheld books and records from the taxpayer. In 2008 the taxpayer filed a lawsuit against his brother and the corporation seeking dissolution of the corporation and an accounting.

After participating in mediation, the brothers agreed to settle the lawsuit. In a written mediation agreement, the taxpayer agreed to transfer his shares of stock in the S corporation to his brother. The mediation agreement said that the transfer of stock would be effective no earlier than January 1, 2008, and no later than July 24, 2008, as determined by the defendant's (the brother's) sole discretion.

The brother then filed a final Form 1120S for its short tax year beginning January 1, 2008, and ending July 24, 2008. The final S corporation return reported \$903,063 of ordinary income and indicated that it was using the completed contract method of accounting. The S corporation then issued a Schedule K-1 to the taxpayer showing ordinary business income of \$451,531.

In court, the taxpayer argued that he should not have to report the income shown on the final Schedule K-1 because he did not receive a distribution and was not otherwise enriched by the S corporation in 2008. The IRS said the taxpayer failed to establish that the final corporate return and the taxpayer's Schedule K-1 were inaccurate.

The court said the taxpayer was a 50% shareholder until July 24, 2008, the last day of the S corporation's final short tax year return. 50% of its income flowed through to the taxpayer. The taxpayer was required to report this income on his 2008 Form 1040, even if he did not receive a distribution that year. The taxpayer could not explain why the final corporate return and his Schedule K-1 were incorrect without resorting to speculation. The court noted that under the completed contract method, the S corporation could have received a payment in a prior year that was reportable as income in 2008. Therefore, it is possible for income to be allocated to the taxpayer as an S corporation shareholder in a tax year without any cash flow through the corporation to the shareholder for that year.

Note: The court did not address the issue of stock basis. In an S corporation, when income is allocated to a shareholder on a Schedule K-1, the income increases the shareholder's basis in stock. Thus, in this case, the taxpayer's basis was increased by the \$451,531 of allocated ordinary income. Assuming there was no corresponding distribution for that amount, the taxpayer then had a potential \$451,531 capital loss deduction when he transferred his stock to his brother. The problem with this scenario is the Schedule K-1 ordinary income was taxable in the year allocated, while his net capital losses were limited to \$3,000 per year, with the excess carried forward to future years until used up.

