RPT
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Employer-Provided Vehicles

Cross References

• Notice 2016-12

If an employer provides an employee with a company-owned vehicle, and the employee uses the vehicle for personal purposes, then the value of that personal use must be included as taxable income on the employee's Form W-2. Under the general rule, the taxable amount equals the FMV of the total use, minus the amount the employee pays for the use, minus the amount excluded from income as a working condition fringe benefit. [Reg. §1.61-21(b)]

Cents-per-mile method. There are several methods allowed by the IRS to value the vehicle rather than using actual costs. One method is the cents-per-mile valuation method. Under this method, the taxable use is determined by multiplying the employee's personal miles by the current standard mileage rate. The standard mileage rate includes the cost of fuel. If the employee pays for the cost of fuel, the cents-per-mile rate can be reduced by up to 5.5¢ per mile [Reg. §1.61-21(e)(3)(ii)]. An employer can calculate the personal use value of a vehicle under this method if all of the following are true.

- The employer reasonably expects the vehicle will be used on a regular basis in the employer's trade or business. Regular use is determined under all facts and circumstances. The vehicle is considered regularly used if at least 50% of the vehicle's total annual mileage is for business, or the vehicle is used each workday to transport at least three employees to and from work in an employer-sponsored commuting vehicle pool.
- The vehicle is driven at least 10,000 miles per year and the vehicle is primarily used by the employee.
- The FMV of the vehicle at the time it is first made available to the employee for personal use does not exceed the luxury vehicle limits of section 280F.

New limits for 2016. There are two separate section 280F limits for passenger autos and trucks or vans first used by the employee for personal use in 2016. The limits are:

- $15,900 for a passenger automobile.
- $17,700 for a truck or van. (Notice 2016-12)

Fleet-average valuation rule for 2016. If an employer with a fleet of 20 or more vehicles uses a fleet-average value for purposes of calculating the annual lease values of the vehicles in the fleet, then the maximum value of employer provided vehicles first made available to employees for personal use in 2016 is limited to:

- $21,200 for a passenger automobile.
- $23,100 for a truck or van. (Notice 2016-12)

Horse Breeding Was a Hobby, Not a Business

Cross References

- *Stuller*, 7th Circuit Court of Appeals, January 26, 2016

The taxpayers lived in Illinois and owned several profitable restaurants. They also owned and bred horses on a farm in Tennessee. They hired an experienced horse trainer to train their horses and manage the farm. Under an agreement between the trainer and the taxpayers, the horse trainer received payments for training the horses, a 50% interest in horses born on the farm, prize money won by the horses at shows, the right to breed his own horses with the taxpayer's horses for free, and the right to trade his horses with the taxpayer's horses.

The horse breeding activity was organized as an S corporation that lost money in every year between 1994 and 2009, except for one year in which it earned a $1,500 profit. The taxpayers loaned some $1.5 million over the years to the S corporation to keep the horse breeding activity in business, with none of the money ever being paid back.

The IRS determined that the horse-breeding was not an activity engaged in for profit under IRC section 183, and therefore, the taxpayers could not use flow through S corporation losses to offset their income from other sources. The court used nine factors in Regulation section 1.183-2(b) to determine whether the activity was a hobby or a for-profit business. The non-exclusive list of relevant factors found in that regulation includes:

1) The manner in which the taxpayer carries on the activity,
2) The expertise of the taxpayer or his advisors,
3) The time and effort expended by the taxpayer,
4) The expectation that assets may appreciate in value,
5) The taxpayer's success in other similar or dissimilar activities,
6) The taxpayer's history of income or losses,
7) The amount of occasional profits, if any,
8) The financial status of the taxpayer,
9) Elements of personal pleasure or recreation.

No one factor is determinative. Instead, all relevant facts and circumstances are to be taken into account. More weight is given to objective facts than a taxpayer's statement of intent.

Expertise of advisors. One factor the taxpayers argued should be in their favor was that they had hired an experienced horse trainer to run their farm. This horse trainer had over 50 years of experience in training and breeding horses. However, the court said the trainer's expertise did not extend to the financial and business aspects of running a horse-breeding operation. The trainer himself testified that he did not breed horses to make money, and that it had been years since he sold a horse that he had bred, and that his income was largely derived from fees collected to train horses.

The court also noted that the taxpayer's agreement with the trainer made it difficult for the taxpayers to make a meaningful profit on any horse that was bred. The trainer automatically received half the sale proceeds, in addition to the right to breed his own horses for free, and to trade his horses with the taxpayer's horses, even though the taxpayers incurred all of the associated expenses with breeding and raising the horses. The trainer also received substantial payments for training the horses, which were additional expenses incurred by the taxpayers. Yet the taxpayers never considered re-negotiating the terms of their agreement with the trainer.

The taxpayer also tried to argue that they received advice from their accountant. The accountant, however, testified that while he provided advice related to the creation of the S corporation, prepared its tax returns, and generated annual reports of its assets and liabilities, he was not capable of providing advice specific to the horse-breeding industry.

Financial status of the taxpayer. The taxpayers were financially successful with their restaurants. They also owned profitable rental properties and other investments. Money from these activities was used to finance the horse breeding activity over the years. The court said the best objective indicator that their horse-breeding was a hobby and not a business was their high tolerance for losses. Some $1.5 million was loaned to the S corporation, interest free, in order to keep the horse-breeding operation afloat.

Expectation that assets may appreciate. The taxpayers also argued that there was evidence that the Tennessee farmland might appreciated in value. By 1999 the farm had a house and 332 acres with some 30 horses at the farm.

The court said this expectation of appreciation did not offset the combination of other objective facts showing that the S corporation was not run with the intent to profit. For one thing, the farm house and land, assets with the most potential for appreciation, was not owned by the S corporation but rather directly by the taxpayers.

Considering the poor recordkeeping, the lack of business practices directed at making a profit, its substantial annual losses, and the significant tax benefits to the taxpayers, there is no clear error in finding that the totality of facts and circumstances showed the S corporation was not run as an activity with the intent to profit.

Therefore, the flow through losses were not allowed to offset the taxpayer's other income.

IRS Audit Rates

Cross References

- *IRS Fiscal Year 2015 Enforcement and Service Results*

The IRS recently announced the audit coverage rates for fiscal year 2015. The audit coverage rates are based upon the percentage of tax returns in a particular category that were audited during the 2015 fiscal year. The table below reflects a summary of these audit rates as they compare with the percentage of returns that were audited during the 2014 fiscal year.

Type of Tax Return Audited	Fiscal Year 2015	Fiscal Year 2014
All individual tax returns	0.84%	0.86%
Individual tax returns reporting income of $1 million and higher	9.55%	7.50%
Individual tax returns reporting income of $200,000 and higher	2.61%	2.71%
Individual tax returns reporting income of less than $200,000	0.76%	0.78%
Partnership tax returns	0.51%	0.43%
S corporation tax returns	0.40%	0.36%
Large corporation tax returns	11.15%	12.23%

Tax Court Judge Indicted for Tax Evasion

Cross References

- www.justice.gov
- Dept. of Justice Press Release dated April 4, 2016

A former U.S. Tax Court Judge and her husband have been indicted for conspiracy to commit tax evasion and obstruction of an IRS audit. The couple are accused of trying to evade more than $400,000 in federal taxes during a time when the defendant was a sitting U.S. Tax Court Judge.

On April 4, 2016, U.S. Attorney Andrew M. Luger for the District of Minnesota announced a federal indictment charging Diane L. Kroupa, 60, and her husband, Robert E. Fackler, 62, with conspiring with each other to evade assessment of taxes. Each defendant is charged with conspiracy, tax evasion, making and subscribing false tax returns and obstruction of an Internal Revenue Service (IRS) audit.

"The allegations in this indictment are deeply disturbing," said U.S. Attorney Andrew Luger. "The tax laws of this country apply to everyone, and those of us appointed to federal positions must hold ourselves to an even higher standard."

"As a former tax court judge, Kroupa dealt regularly with individuals who cheated on their taxes, which makes these allegations particularly troubling," said Chief Richard Weber of the IRS-Criminal Investigation. "Reporting personal expenses as business expenses on your tax returns is not tolerated, regardless of your job or position. We expect all taxpayers to follow the law—whether you are a business owner, individual, or government official—we all must play by the same rules and pay our fair share."

According to the indictment and documents filed in court, between 2004 and 2012, Kroupa and Fackler conspired to evade their tax obligations. Kroupa was appointed to the U.S. Tax Court on June 13, 2003, for a term of 15 years, but she retired on June 16, 2014. During the same period, Fackler was a self-employed lobbyist and political consultant who owned and operated a business known as Grassroots Consulting. From 2004 to 2013, Kroupa and Fackler owned a home in Minnesota. From 2007 to 2013, they also leased a second residence in Maryland.

According to the indictment and documents filed in court, as part of the conspiracy to defraud the United States, Kroupa and Fackler fraudulently claimed personal expenses as Grassroots Consulting business deductions. They fraudulently claimed the following personal expenses as deductible business expenses: rent and utilities for the Maryland home; utilities, upkeep and renovation expenses of the Minnesota home; pilates classes; spa and massage fees; jewelry and personal clothing; wine club fees; Chinese language tutoring; music lessons; personal computers; and expenses for vacations to Alaska, Australia, the Bahamas, China, England, Greece, Hawaii, Mexico and Thailand.

According to the indictment and documents filed in court, Kroupa and Fackler made a series of other false claims on their tax returns, including failing to report approximately $44,520 that Kroupa received from a 2010 land sale in South Dakota. The defendants falsely claimed financial insolvency to avoid paying tax on $33,031 on cancellation of indebtedness income.

According to the indictment and documents filed in court, in 2006, Kroupa and Fackler concealed documents from their tax preparer and an IRS Tax Compliance Officer during an audit. During a second audit in 2012, Kroupa and Fackler caused misleading documents

to be delivered to an IRS employee in order to convince the IRS employee that certain personal expenses were actually business expenses of Grassroots Consulting.

According to the indictment and documents filed in court, between 2004 and 2010, Kroupa and Fackler purposely understated their taxable income by approximately $1 million and purposely understated the amount of tax they owed by at least $400,000.

This case is the result of an investigation conducted by the IRS-Crimination Investigation and the United States Postal Inspection Service.

Assistant U.S. Attorneys Benjamin Langner and Timothy Rank are prosecuting the case.