RPT
CPA, PLLC
BUSINESS & TAX CONSULTING

If you have questions, please contact us
O: 704-496-2625
rtrautwein@rptconsulting.com

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Reboot Your Home Office Router

Cross References

- Alert No. I-052518-PSA, May 25, 2018

The FBI issued a Public Service Announcement (PSA) on May 25 recommending that any owner of small office and home office routers power cycle (reboot) their devices. Foreign cyber criminals have compromised hundreds of thousands of home and office routers and other networked devices worldwide. The criminals used VPN Filter malware to target small office and home office routers. The malware is able to perform multiple functions, including possible information collection, device exploitation, and blocking network traffic.

The malware targets routers produced by several manufacturers and network-attached storage devices. The malware is able to render small office and home office routers inoperable. The malware can potentially collect information passing through the router.

The FBI recommends rebooting the routers to temporarily disrupt the malware and aid the potential identification of infected devices. Owners are advised to consider disabling remote management settings on devices and secure with strong passwords and encryption when enabled. Network devices should also be upgraded to the latest available versions of firmware.

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Mileage Logs Required to Deduct Business Mileage

Cross References

- *Edwards,* T.C. Memo. 2018-44

A recent tax court case once again illustrates the point that written contemporaneous mileage logs are virtually a requirement to claim a deduction for business mileage. The taxpayer's job required him to respond to emergencies, such as floods and hurricanes that could adversely affect the state's transportation system. He was responsible for supervising communications and for assigning personnel and equipment to disaster locations. For a second job, the taxpayer in his capacity as president of a local union was responsible for arranging meetings, conferences, and social events. He was required to travel to various locations throughout the state. He also traveled to national conventions. During an audit, the IRS allowed some, but not all of his claimed mileage for business.

The court noted that IRC section 274(d) imposes relatively strict substantiation requirements for deductions claimed for listed property. Listed property includes any passenger automobile. No deduction is allowed without adequate records or by sufficient evidence corroborating the amount, time, place, and business purpose for each expenditure.

The taxpayer claimed 10,500 business miles out of 14,000 total miles driven for his vehicle (75% business use). He also claimed $800 in expenses for parking and tolls. The IRS allowed 1,088 business miles, and no expense for parking and tolls.

The court said to satisfy the substantiation requirements, the taxpayer must keep a contemporaneous mileage log or a similar record.

Note: Contemporaneous means reconstructed mileage logs after the IRS initiates an audit are not good enough.

A mileage log or a similar record can include a diary or trip sheet that substantiates the extent to which the vehicle was actually used for business rather than personal purposes. Lacking contemporaneous records, the taxpayer must produce other credible evidence sufficient to corroborate his own statements concerning business use.

The court said the taxpayer failed to submit any form of documentation, such as mileage logs, odometer readings, diaries, or trip sheets, to substantiate the extent to which the vehicle was actually used for business rather than personal purposes. The court ruled the taxpayer did not meet the substantiation requirements.

Note: In reality, any other credible evidence sufficient to corroborate a taxpayer's claimed business mileage means some type of contemporaneous written record. Verbal statements and estimates, such as claiming that the vehicle is used a certain percentage for business is not good enough. Even though the regulations do not require a specific format for keeping a mileage log, some type of contemporaneous written record like a mileage log is required. Estimated business mileage is always rejected by the courts.

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New Guidance on Qualifying Relative Rules

Cross References

• Notice 2018-70

The IRS has announced that it intends to issue proposed regulations clarifying the definition of a qualifying relative in IRC section 152(d) for purposes of the new $500 Credit for Other Dependents and the Head of Household filing status for years in which the personal exemption amount is zero.

Under the Tax Cuts and Jobs Act (TCJA), the personal exemption amount is reduced to zero for tax years 2018 through 2025. Prior to the passage of TCJA in December 2017, the inflation adjusted personal exemption amount for 2018 was set to be $4,150.

Although the personal exemption deduction is reduced to zero, other provisions in the Internal Revenue Code (IRC) that are determined based upon whether a person is a dependent of the taxpayer are still applicable. The Conference Report for TCJA states that the reduction of the personal exemption to zero "should not alter the operation of those provisions of the IRC which refer to a taxpayer allowed a deduction under IRC section 151."

TCJA created a new $500 tax credit for certain dependents of a taxpayer other than a qualifying child for whom the Child Tax Credit is allowed. The $500 credit applies to two categories of dependents:

1) Qualifying children for whom a Child Tax Credit is not allowed (for example, a qualifying child who is age 17 or older), and
2) Qualifying relatives as defined in IRC section 152(d).

The Conference Report explains that this $500 nonrefundable credit is intended for dependents other than qualifying children who are eligible for the Child Tax Credit, and that generally the provision retains the present-law definition of a dependent.

The Head of Household (HOH) filing status also uses IRC section 151 to determine if the taxpayer can file as HOH. A qualifying individual for purposes of the HOH filing status includes a qualifying relative if the taxpayer is entitled to a personal exemption deduction for the qualifying relative.

Proposed regulations. Notice 2018-70 states that the IRS intends to issue proposed regulations that state the reduction of the exemption amount to zero for tax years 2018 through 2025 will not be taken into account in determining whether a person is a qualifying relative under IRC section 152(d). Accordingly, in defining a qualifying relative for purposes of other various provisions of the IRC that refer to the definition of a dependent, the personal exemption amount under IRC section 151(d) will be treated as if it were $4,150 (2018 amount, adjusted annually for inflation) for each year the personal exemption amount is zero.

Qualifying relative. Among other requirements, a qualifying relative must have gross income of less than the personal exemption amount, which was $4,050 for the 2017 tax year. Even though the personal exemption amount is reduced to zero for 2018, the proposed regulations will provide that a qualifying relative must have gross income of less than $4,150 for 2018 (the 2018 inflation adjusted amount prior to TCJA), rather than zero.

This rule will apply for purposes of both the new $500 tax credit and for purposes of the Head of Household filing requirement.

Note: Notice 2018-70 only mentions the new $500 tax credit and the HOH filing status. However this same rule will likely apply to other tax provisions that use the personal exemption amount in defining the provision. For example, taxpayers can claim a medical expense deduction for amounts paid for individuals who would otherwise be considered the taxpayer's dependent, except for the fact that the individual received gross income of $4,050 or more for 2017 [IRC §213(a)]. Presumably, this tax provision will also use the $4,150 amount for tax year 2018 in its definition.

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Veterans Owed Refunds for Overpayments Attributable to Disability Severance

• IR-2018-148, July 11, 2018

The IRS is advising certain veterans who received disability severance payments after January 17, 1991, and included that payment as income that they should file Form 1040X, *Amended U.S. Individual Income Tax Return,* to claim a credit or refund of the overpayment attributable to the disability severance payment. This is a result of the Combat-Injured Veterans Tax Fairness Act passed in 2016.

Most veterans who received a one-time lump-sum disability severance payment when they separated from their military service will receive a letter from the Department of Defense (DoD) with information explaining how to claim tax refunds they are entitled to. The letters include an explanation of a simplified method for making the claim. The IRS has worked closely with the DoD to produce these letters, explaining how veterans should claim the related tax refunds.

The amount of time for claiming these tax refunds is limited. However, the law grants veterans an alternative timeframe. The statute of limitations is extended to one year from the date of the letter from DoD. Veterans making these claims have the normal 3-year statute of limitations period for claiming a refund or one year from the date of their letter from the DoD, whichever expires later. This alternative time frame is provided for those who have claims for refund of taxes paid as far back as 1991.

Veterans can submit a claim based on the actual amount of their disability severance payment by completing Form 1040X. They also have the choice of using a simplified method. The simplified method is a standard refund amount based on the calendar year in which they received the severance payment. Write "Disability Severance Payment" on line 15 of Form 1040X and enter on lines 15 and 22 the standard refund amount listed below that applies:

- $1,750 for tax years 1991 – 2005
- $2,400 for tax years 2006 – 2010
- $3,200 for tax years 2011 – 2016

Claiming the standard refund amount allows veterans to not have to access their original tax return for the year of their lump-sum disability severance payment.

All veterans claiming refunds for overpayments attributable to their lump-sum disability severance payments should write either "Veteran Disability Severance" or "St. Clair Claim" across the top of the front page of the Form 1040X. Mail the completed Form 1040X, with a copy of the DoD letter, to:

Internal Revenue Service
333 W. Pershing Street, Stop 6503, P5
Kansas City, MO 64108

Veterans eligible for a refund who did not receive a letter from DoD may still file Form 1040X to claim a refund but must include both of the following to verify the disability severance payment:

- A copy of documentation showing the exact amount of and reason for the disability severance payment, such as a letter from the Defense Finance and Accounting Services (DFAS) explaining the severance payment at the time of the payment or a Form DD-214, and
- A copy of either the VA determination letter confirming the veteran's disability or a determination that the veteran's injury or sickness was either incurred as a direct result of armed conflict, while in extra-hazardous service, or in simulated war exercises, or was caused by an instrumentality of war.

Veterans who did not receive the DoD letter and who do not have the required documentation showing the exact amount of and reason for their disability severance payment will need to obtain the necessary proof by contacting the Defense Finance and Accounting Services (DFAS).

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Medical Marijuana Business Organized as an S Corporation

Cross References

- *Loughman,* T.C. Memo. 2018-85, June 18, 2018

IRC section 280E disallows a deduction for any expense in connection with the illegal sale of drugs. Courts have ruled that this applies to a medical marijuana business where the sale of marijuana is legal under state law, but illegal under federal law. Courts have also ruled that IRC section 280E does not apply to the cost of goods sold deduction.

The taxpayers in this case argued that IRC section 280E results in discriminatory treatment of S corporation owners. The taxpayers argued that if their wage income as officers in the S corporation is an expense subject to IRC section 280E, then it causes the same income to be taxed twice, once as wages, and a second time as S corporation income. The taxpayers argued that this treatment is contrary to the purpose and legislative intent of subchapter S. Being required to pay a reasonable wage as a salary results in discriminatory treatment as other entities are not subject to this reasonable wage requirement. This reasonable wage requirement results in double taxation.

The court said the taxpayer's contention that the application of IRC section 280E results in disparate treatment is misplaced. As an example, if the taxpayers had hired a third party to perform the officer duties that they performed, and they paid that third party an amount equal to that included as wages in the taxpayer's gross income, the taxpayer's gross income would not include the wages paid to the third party. The taxpayers would ultimately have less income, but they would not owe federal income tax on the wages paid to the third party. However, IRC section 280E would still disallow the S corporation's wage expense deductions not attributable to cost of goods sold. The taxpayer's flow through income would be the same. Thus, the application of IRC section 280E to deny a deduction for S corporation wages expenses is not discriminatory. It applies equally regardless of whether the taxpayer's pay themselves or a third party receives the wages.

To the extent that the taxpayers believe they received disparate tax treatment as a result of organizing their marijuana business as an S corporation, the taxpayers were free to operate as any business entity and in other trades. The taxpayers chose to operate as an S corporation in the marijuana business. The taxpayers are responsible for the tax consequences of their decision.

Defendants Sentenced in India-Based Call Center Scam

Cross References

- www.justice.gov (July 20, 2018)

The U.S. Department of Justice has announced that 21 members of a massive India-based fraud and money laundering conspiracy that defrauded thousands of U.S. residents of hundreds of millions of dollars were sentenced this week to terms of imprisonment up to 20 years. Three other conspirators were sentenced earlier this year for laundering proceeds for the conspiracy, which was operated out of India-based call centers that targeted U.S. residents in various telephone fraud schemes.

"The stiff sentences imposed this week represent the culmination of the first-ever large scale, multi-jurisdiction prosecution targeting the India call center scam industry," said Attorney General Sessions. "This case represents one of the most significant victories to date in our continuing efforts to combat elder fraud and the victimization of the most vulnerable members of the U.S. public. The transnational criminal ring of fraudsters and money launderers who conspired to bilk older Americans, legal immigrants and many others out of their life savings through their lies, threats and financial schemes must recognize that all resources at the Department's disposal will be deployed to shut down these telefraud schemes, put those responsible in jail, and bring a measure of justice to the victims."

Taxpayers must remain wary of unsolicited telephone calls from individuals claiming to be IRS employees. If any taxpayer believes they or someone they know is a victim of an IRS impersonation scam, they should report it to TIGTA at www.tigta.gov or by calling 1-800-366-4484.

Miteshkumar Patel, 42, of Illinois, was sentenced to serve 240 months in prison followed by three years of supervised release on the charge of money laundering conspiracy. According to the factual basis of his plea agreement, Patel served as the manager of a Chicago-based crew of "runners" that liquidated and laundered fraud proceeds generated by callers at India-based call centers. Those callers used call scripts and lead lists to target victims throughout the United States with telefraud schemes in which the callers impersonated U.S. government employees from the IRS and U.S. Citizenship and Immigration Services (USCIS). The callers duped victims into believing that they owed money to the U.S. government and would be arrested or deported if they did not pay immediately. After the victims transferred money to the callers, a network of U.S.-based runners moved expeditiously to liquidate and launder fraud proceeds through the use of anonymous stored value cards. In addition to recruiting, training, and tasking runners in his crew, Patel also coordinated directly with the Indian side of the conspiracy about the operation of the scheme. Patel was held accountable for laundering between $9.5 and $25 million for the scheme.

Hardik Patel, 31, of Illinois, was sentenced to serve 188 months in prison followed by three years of supervised release on the charge of wire fraud conspiracy. Hardik consented to removal to India upon completion of his prison term. According to the factual basis of his plea agreement, Patel was a co-owner and manager of an India-based call center involved in the conspiracy. In addition to managing the day-to-day operations of a call center, Patel also processed payments and did bookkeeping for the various call centers involved in the fraud scheme. One of the India-based co-defendants with whom Patel communicated about the scheme was Sagar "Shaggy" Thakar, a payment processor that Indian authorities arrested in April 2017 in connection with call center fraud. After moving to the United States in 2015, Patel continued to promote the conspiracy by recruiting runners to liquidate fraud proceeds. Patel was held accountable for laundering between $3.5 and $9.5 million dollars for the scheme.

Sunny Joshi, aka Sharad Ishwarlal Joshi and Sunny Mahashanker Joshi, 47, of Texas, was sentenced to serve 151 months in prison on the charge of money laundering conspiracy, and 120 months in prison on the charge of naturalization fraud to run concurrent followed by three years of supervised release. According to the factual basis of his plea agreement, Joshi was a member of a Houston-based crew of runners that he co-managed with his brother, co-defendant Mike Joshi, aka Rajesh Bhatt. Sunny Joshi communicated extensively with India-based co-defendants about the operations of the scheme, and was held accountable for laundering between $3.5 and $9.5 million. Additionally, in connection with his sentence on the immigration charge, the judge entered an order revoking Joshi's U.S. citizenship and requiring him to surrender his certificate of naturalization.

Twenty-two of the defendants sentenced were held jointly and severally liable for restitution of $8,970,396 payable to identified victims of their crimes. Additionally, the court entered individual preliminary orders of forfeiture against 21 defendants for assets that were seized in the case, and money judgments totaling over $72,942,300.

According to various admissions made in connection with the defendants' guilty pleas, between 2012 and 2016, the defendants and their conspirators perpetrated a complex fraud and money laundering scheme in which individuals from call centers located in Ahmedabad, India, frequently impersonated officials from the IRS or USCIS in a ruse designed to defraud victims located throughout the United States. Using information obtained from data brokers and other sources, call center operators targeted U.S. victims who were threatened with arrest, imprisonment, fines or deportation if they did not pay alleged monies owed to the government. Victims who agreed to pay the scammers were instructed how to provide payment, including by purchasing stored value cards or wiring money. Once a victim provided payment, the call centers turned to a network of runners based in the United States to liquidate and launder the extorted funds as quickly as possible by purchasing reloadable cards or retrieving wire transfers. In a typical scenario, call centers directed runners to purchase these stored value reloadable cards and transmit the unique card number to India-based co-conspirators who registered the cards using the misappropriated personal identifying information (PII) of U.S. citizens. The India-based co-conspirators then loaded these cards with scam funds obtained from victims. The runners used the stored value cards to purchase money orders that they deposited into the bank account of another person. For their services, the runners would earn a specific fee or a percentage of the funds. Runners also received victims' funds via wire transfers, which were retrieved under fake names and through the use of using false identification documents, direct bank deposits by victims, and Apple iTunes or other gift cards that victims purchased.

The indictment in this case also charged 32 India-based conspirators and five India-based call centers with general conspiracy, wire fraud conspiracy, and money laundering conspiracy.

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