RECENT DEVELOPMENTS IN FEDERAL INCOME TAXATION

"Recent developments are just like ancient history, except they happened less long ago."

By

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I. ACCOUNTING

A. Accounting Methods

B. Inventories

C. Installment Method

1. Can an installment sale between related parties ever *not* have the proscribed tax avoidance purpose requisite for denying installment reporting? Vest v. Commissioner, T.C. Memo. 2016-187 (10/6/16). The taxpayers owned 85 percent of Truebeginnings, LLC, which was an accrual basis partnership for federal tax purposes. According to the reported opinion, Truebeginnings in turn owned 100 percent interests in two other partnerships, H.D. Vest Advanced Systems, LLC (VAS), and Metric, LLC (Metric). (We do not understand how a 100 percent owned LLC can be a partnership rather than a disregarded entity or a corporation, but the opinion says they were partnerships and the issue could not have arisen if they were disregarded entities.) In consideration of 10-year promissory notes, Truebeginnings sold computer equipment to VAS and Metric and sold zero-basis intangible assets with an appraised value of $2,885,175 to VAS. Truebeginnings reported over $3 million of gain on the § 453 installment method. The Tax Court

(Judge Lauber) upheld the IRS's conclusion that the sales did not qualify for installment sale treatment pursuant to § 453(g)(1), which disallows installment reporting for installment sales of depreciable property between related persons unless "it is established to the satisfaction of the Secretary that the disposition did not have as one of its principal purposes the avoidance of Federal income tax." I.R.C. § 453(g)(2). TB, VAS, and Metric were clearly "related persons," and the computer equipment and intangible assets that TB sold to VAS and Metric were "depreciable property." The taxpayer failed to carry the burden of proof that tax avoidance "was not among the principal purposes of the asset sale transaction." Judge Lauber reasoned that § 453(g)(2) "resembles other Code sections providing that certain tax treatment will be available only if the taxpayer establishes that the plan or transaction did not have 'as one of its principal purposes the avoidance of Federal income tax,' and that" Tax Court precedent establishes that "a taxpayer in such cases can satisfy his burden of proof only by submitting 'evidence [that] clearly negate[s] an income-tax-avoidance plan.'" *Tecumseh Corrugated Box Co. v. Commissioner*, 94 T.C. 360, 381-382 (1990) (addressing § 453(e)(7)), *aff'd*, 932 F.2d 526 (6th Cir. 1991). The taxpayer's burden in such cases is "a heavy one." *Pescosolido v. Commissioner*, 91 T.C. 52, 56 (1988) (addressing § 306(b)(4)), *aff'd*, 883 F.2d 187 (1st Cir. 1989). In ascertaining the true purpose of the transaction, Judge Lauber stated, the Tax Court accords "more weight to objective facts than to the taxpayer's 'mere denial of tax motivation.'" The enhanced depreciation deductions available to the related buyer is relevant in deciding whether the seller had a principal purpose of avoiding tax. *Guenther v. Commissioner*, T.C. Memo. 1995-280. In this case, the court stated, "[t]he substance of the transaction at issue clearly reveals a principal purpose of tax avoidance."

> Notwithstanding the asset sale, petitioner through TB retained full control over the ad-optimization business. By use of installment reporting, TB aimed to defer for 10 years virtually all the tax on its $3.2 million gain, while VAS and Metric would receive stepped-up bases in, and be able to claim correspondingly large depreciation or amortization deductions on, the assets transferred. ... This tax-avoidance purpose is particularly clear with respect to the intangible assets sold to VAS. Those assets had a zero cost basis in TB's hands, thus yielding zero amortization deductions to it. But VAS claimed a stepped-up basis in those assets of $2,885,175, yielding amortization deductions of $192,345 annually. The enhanced amortization deductions claimed by VAS and Metric, totaling $644,772 for 2008-2010 alone, dwarf the $29,798 gain that TB reported for 2008.

a. The Fifth Circuit affirms. Vest v. Commissioner, ___ Fed. Appx. ___ (5th Cir. 6/2/17). In a per curiam opinion, the U.S. Court of Appeals for the Fifth Circuit affirmed. In response to the taxpayer's argument that the sale of assets from Truebeginnings to the related partnerships had a business purpose, the court stated:

> Even if the sale was motivated by a business purpose, this fact would not necessarily mean that the sale did not also have a principal purpose of tax avoidance. Merely arguing that the sale had a business purpose is not inconsistent with it also having tax avoidance as one of its principal purposes. Accordingly, Vest has failed to demonstrate clear error on the Tax Court's part

D. Year of Inclusion or Deduction

1. Almost as rare as a total solar eclipse: a cash-method taxpayer is entitled to deduct estimated, future expenses. Gregory v. Commissioner, 149 T.C. No. 2 (7/11/17). The taxpayers, a married couple, held 80 percent of the stock of a cash-method S corporation that owned and operated a landfill in Texas. All landfills, regardless of size, must clean up and restore the site upon their inevitable closing. Closing a landfill and complying with federal, state, and local environmental regulations is an expensive endeavor. For this reason, § 468 generally permits a "taxpayer" owning and operating a landfill to deduct currently estimated "qualified reclamation or closing costs" anticipated in a future year or years. When the future costs actually are paid in a future year, § 468 disallows a deduction to the extent the costs do not exceed the taxpayer's previously established and annually calculated § 468 reserve. (Of course, § 468 is more complicated than the foregoing statements might lead one to believe, but the essence of the statute is to allow landfill owners like the taxpayers' S corporation to take a current deduction for future reclamation and clean-up costs.) From 1996 through 2007, the taxpayers' S corporation had utilized § 468 without challenge by the IRS. For tax years 2008 and 2009, however, the IRS contested the S corporation's § 468 deduction on the grounds that the term "taxpayer" in § 468 refers only to accrual-method taxpayers, not cash-method taxpayers. In a case of first impression, the Tax Court unanimously disagreed with the IRS. In a reviewed (and surprisingly long) opinion by Judge Holmes, the Tax Court held that the term "taxpayer" in § 468 does indeed refer to both accrual-method and cash-method taxpayers. The court relied primarily on the statutory language of § 468, which does not distinguish between cash-method and accrual-method taxpayers. The court also examined several other sources of guidance, including § 7701(a)(14), which defines the term "taxpayer" simply as "any person subject to any internal revenue tax," as well as the legislative history of § 468. Apparently, this was news to the IRS, which argued voluminously to the contrary, but to no avail. In a lengthy concurring opinion, Judge Lauber (joined by Judges Marvel, Gale, Nega, and Ashford) traced the legislative history of § 468 (and § 468A regarding nuclear decommissioning costs), which appeared in preliminary bills as exceptions to the § 461(h) economic performance requirement, and concluded that Congress likely had intended § 468 to be available only to accrual-method taxpayers. Judge Lauber also suggested that, if Treasury had issued regulations that defined "taxpayer" for purposes of § 468 as meaning an accrual-method taxpayer, the result in the case might have been different. In the absence of regulations, Judge Lauber concluded, the court "reasonably concludes that nothing in the text of section 468 necessitates giving the term "taxpayer" a meaning less comprehensive than the ordinary meaning it has elsewhere in the Code."

II. BUSINESS INCOME AND DEDUCTIONS

III. INVESTMENT GAIN

A. Gains and Losses

B. Interest, Dividends, and Other Current Income

C. Profit-Seeking Individual Deductions

D. Section 121

E. Section 1031

1. The Tax Court confirms that § 1031 is an exception to the principle that substance controls over form. Estate of Bartell v. Commissioner, 147 T.C. No. 5 (8/10/16). This case involved a reverse like-kind exchange structured before the promulgation of Rev. Proc. 2000-37, 2000-2 C.B. 308 (effective for qualified exchange accommodation arrangements entered into by an exchange accommodation titleholder on or after September 15, 2000). In 1999, Bartell Drug (an S corporation) entered into an agreement to purchase a property (Property #2). To further structuring the disposition of another property already owned by Bartell Drug (Property #1) as a § 1031 like-kind exchange, Bartell Drug assigned its rights in the purchase agreement to a third-party exchange facilitator (EPC) and entered into an agreement with EPC that provided for EPC to purchase Property #2 and gave Bartell Drug a right to acquire Property #2 from EPC for a stated period and price. EPC purchased Property #2 on August 1, 2000, with bank financing guaranteed by Bartell Drug. Bartell Drug then supervised construction of a drugstore on Property #2 using proceeds of the EPC financing guaranteed by Bartell Drug. Upon substantial completion of the construction in June 2001, Bartell Drug leased the store from EPC until Bartell Drug acquired Property #2 on December 31, 2001. In late 2001, Bartell Drug contracted to sell Property #1 to another party. Bartell Drug thereupon entered an exchange agreement with intermediary SS and assigned to SS its rights under the sale agreement and under the earlier agreement with EPC. SS sold Property #1, applied the proceeds of that sale to the acquisition of Property #2 from EPC and transferred Property #2 to Bartell Drug on December 31, 2001. The Tax Court (Judge Gale) held that the transactions qualified as a § 1031 like-kind exchange of Property # 1 for Property #2. The Court rejected the IRS's argument that under a "benefits and burdens" analysis Bartell Drug was the owner of Property #2 long before the formal transfer of title on December 31, 2001 and treated EPC as the owner of Property #2 during the period it held title to the property. *Alderson v. Commissioner*, 317 F.2d 790 (9th Cir. 1963), *rev'g* 38 T.C.

215 (1962), and *Biggs v. Commissioner*, 69 T.C. 905 (1978), *aff'd*, 632 F.2d 1171 (5th Cir. 1980), were cited as precedent for the proposition that § 1031 is formalistic, and that the exchange facilitator does not bear the benefits and burdens of ownership during the period it holds title to the property for the purpose of facilitating a like kind exchange on behalf of a taxpayer who contractually does bear the benefits and burdens of ownership does not preclude § 1031 nonrecognition for the deferred exchange. "[G]iven that the caselaw has countenanced a taxpayer's pre-exchange control and financing of the construction of improvements on the replacement property while an exchange facilitator held title to it, *see J.H. Baird Publ'g. Co. v. Commissioner*, 39 T.C. 608, 610-611 (1962), we see no reason why the taxpayer's pre-exchange, temporary possession of the replacement property pursuant to a lease from the exchange facilitator should produce a different result."

a. **If you wish to engage in a reverse like-kind exchange in which the exchange accommodation titleholder holds title to the replacement property for more than 180 days, proceed at your own peril, says the IRS.** A.O.D. 2017-06, 2017-33 I.R.B. 194 (8/23/17). The IRS has nonacquiesced in the Tax Court's decision in *Bartell*. In its nonacquiescence, the IRS emphasized Rev. Proc. 2000-37, 2000-2 C.B. 308, which provides a safe harbor for reverse like-kind exchanges in which replacement property is parked with an exchange accommodation titleholder if certain requirements are met. If all of the requirements are met, then the exchange accommodation titleholder is considered the owner of the property to which it holds title regardless of who bears the benefits and burdens of ownership. One requirement is that the exchange accommodation titleholder must not hold the property for more than 180 days. If the requirements of the revenue procedure are not met, then the determination whether the taxpayer or the exchange accommodation titleholder is the owner of the property is made without regard to the provisions of the revenue procedure. In *Bartell*, the exchange accommodation titleholder held title to the property for 17 months. In this action on decision, the IRS stated:

> [I]in determining whether a reverse exchange outside the scope of Rev. Proc. 2000-37 meets the requirements of § 1031, the Service will not follow the principle in the court opinions that an exchange facilitator may be treated as the owner of property regardless of whether it possesses the benefits and burdens of ownership. … Taxpayers that use accommodating parties outside the scope of Rev. Proc. 2000-37 have not engaged in an exchange if the taxpayer, rather than the accommodating party, acquires the benefits and burdens of ownership of the replacement property before the taxpayer transfers the relinquished property. The Service will not follow the Tax Court's opinion in *Bartell* to the extent the opinion provides otherwise.

F. Section 1033

G. Section 1035

H. Miscellaneous

IV. COMPENSATION ISSUES

A. Fringe Benefits

1. **The Tax Court ices the IRS by allowing the Boston Bruins' 100% deduction for away-game meals as a *de minimis* fringe, while the winning slap shot may be that hotel and banquet facilities can be "leased."** Jacobs v. Commissioner, 148 T.C. No. 24 (6/26/17). The taxpayers, a married couple, own the S corporation that operates the Boston Bruins professional hockey team. When the Bruins travel to away games, the team provides the coaches, players, and other team personnel with hotel lodging as well as pre-game meals in private banquet rooms. Game preparation (e.g., strategy meetings, viewing films, discussions among coaches and players) also takes place during these team meals. The Bruins enter into extensive contracts with away-game hotels, including terms specifying the food to be served and how the banquet rooms should be set up. The taxpayers' S corporation spent approximately $540,000 on away-game meals at hotels over the years 2009 and 2010, deducting the full amount thereof pursuant to §§ 162, 274(n)(2)(B), and 132(e). Section 274(n) generally disallows 50 percent of meal and entertainment expenses, but § 274(n)(2)(B) provides an exception if the expense qualifies as a *de minimis* fringe benefit under

§ 132(e). Under Reg. § 1.132–7, employee meals provided on a nondiscriminatory basis qualify under § 132(e) if (1) the eating facility is owned or leased by the employer; (2) the facility is operated by the employer; (3) the facility is located on or near the business premises of the employer; (4) the meals furnished at the facility are provided during, or immediately before or after, the employee's workday; and (5) the annual revenue derived from the facility normally equals or exceeds the direct operating costs of the facility. The IRS argued that the Bruins' expenses do not qualify under § 132(e) and thus should be limited to 50 percent under § 274(n) because meals at away-game hotels are neither at facilities "operated by the employer," nor "owned or leased by the employer," nor "on or near the business premises of the employer." After easily determining that the other requirements for *de minimus* fringe benefit treatment were met, the Tax Court (Judge Ruwe) focused upon whether, for purposes of § 132(e) and Reg. § 1.132-7, the Bruins' away-game hotels can be considered facilities that are "operated by the employer," "leased by the employer," and "on or near the business premises of the employer." Judge Ruwe held that because away-game travel and lodging are indispensable to professional hockey and because the Bruins' contracts with the hotels specify many of the details regarding lodging, meals, and banquet rooms, the meal expenses are 100 percent deductible as a *de minimis* fringe. The hotel facilities are "operated by the employer" because the regulations expressly construe that term to include being operated under contract with the employer. The hotel facilities also should be considered "leased" by the employer, the court concluded, due to the extensive contracts and the team's exclusive use and occupancy of designated hotel space. Further, the court concluded that, because away-game travel and lodging is an indispensable part of professional hockey, the hotel facilities should be considered the business premises of the employer.

- **The slap shot to the IRS:** The Tax Court's holding that the Bruins' "lease" the hotel facilities is somewhat at odds with regulations under § 512. Reg. § 1.512(b)-1(c)(5) provides that amounts received for the use or occupancy of space where personal services are rendered to the occupant (e.g., hotel services) does not constitute rent for purposes of the § 512 exclusion from unrelated business taxable income. *See also* Rev. Rul. 80-298, 1980-2 C.B.197 (amounts received by tax-exempt university for professional football team's use of playing field and dressing room along with maintenance, linen, and security services is not rental income for purposes of § 512 exclusion from UBTI). Judge Ruwe's decision may embolden tax-exempt organizations seeking to exclude so-called "facility use fees" (e.g., payments made to an aquarium for exclusive use of its space for corporate events) from UBTI.

2. There are no adverse tax consequences for employers or employees if employees forgo their vacation, sick, or personal leave in exchange for the employer's contributions to charitable organizations providing disaster relief for those affected by Hurricanes Harvey and Irma. Notice 2017-48, 2017-39 I.R.B. 254 (9/5/17) and Notice 2017-52, 2017-40 I.R.B. 262 (9/14/17). In these notices, the IRS has provided guidance on the tax treatment of cash payments that employers make pursuant to leave-based donation programs for the relief of victims of Hurricanes Harvey and Irma (as well as the Tropical Storm forms of these hurricanes). Under leave-based donation programs, employees can elect to forgo vacation, sick, or personal leave in exchange for cash payments that the employer makes to charitable organizations described in § 170(c). The notices provide that the IRS will <u>not</u> assert that: (1) cash payments an employer makes before January 1, 2019, to charitable organizations for the relief of victims of Hurricanes Harvey and Irma in exchange for vacation, sick, or personal leave that its employees elect to forgo constitute gross income or wages of the employees; (2) the opportunity to make such an election results in constructive receipt of gross income or wages for employees; or (3) an employer is permitted to deduct these cash payments exclusively under the rules of § 170 as a charitable contribution rather than the rules of § 162 as a business expense. Employees who make the election cannot claim a charitable contribution deduction under § 170 for the value of the forgone leave. The employer need not include cash payments made pursuant to the program in Box 1, 3 (if applicable), or 5 of the employee's Form W-2

B. <u>Qualified Deferred Compensation Plans</u>

1. Retirement plans can make loans and hardship distributions to victims of Hurricanes Harvey and Irma. Announcement 2017-11, 2017-39 I.R.B. 255 (8/30/17) and

Announcement 2017-13, 2017-40 I.R.B. 271 (9/12/17). Section 401(k) plans and similar employer-sponsored retirement plans can make loans and hardship distributions to victims of Hurricanes Harvey and Irma. Participants in § 401(k) plans, employees of public schools and tax-exempt organizations with § 403(b) tax-sheltered annuities, as well as state and local government employees with § 457(b) deferred-compensation plans, may be eligible to take advantage of these streamlined loan procedures and liberalized hardship distribution rules. IRA participants are barred from taking out loans, but may be eligible to receive distributions under liberalized procedures. Pursuant to this relief, an eligible plan will not be treated as failing to satisfy any requirement under the Code or regulations merely because the plan makes a loan, or a hardship distribution for a need arising from Hurricanes Harvey or Irma, to an employee, former employee, or certain family members of employees whose principal residence or place of employment was in one of the Texas counties (as of August 23, 2017) or Florida counties (as of September 4, 2017) identified for individual assistance by the Federal Emergency Management Agency (FEMA) because of the devastation caused by Hurricanes Harvey or Irma. Similar relief applies with respect to additional areas identified by FEMA for individual assistance after August 23, 2017 (in the case of Harvey) or September 4, 2017 (in the case of Irma). To qualify for this relief, hardship withdrawals must be made by January 31, 2018. To facilitate access to plan loans and distributions, the IRS will not treat a plan as failing to follow procedural requirements imposed by the terms of the plan for plan loans or distributions merely because those requirements are disregarded for any period beginning on or after August 23, 2017 (in the case of Harvey) or September 4, 2017 (in the case of Irma) and continuing through January 31, 2018, provided the plan administrator (or financial institution in the case of IRAs) makes a good-faith diligent effort under the circumstances to comply with those requirements. As soon as practicable, the plan administrator (or financial institution in the case of IRAs) must make a reasonable attempt to assemble any forgone documentation.

- This relief means that a retirement plan can allow a victim of Hurricanes Harvey or Irma to take a hardship distribution or borrow up to the specified statutory limits from the victim's retirement plan. It also means that a person who lives outside the disaster area can take out a retirement plan loan or hardship distribution and use it to assist a son, daughter, parent, grandparent or other dependent who lived or worked in the disaster area.

- A plan is allowed to make loans or hardship distributions before the plan is formally amended to provide for such features. Plan amendments to provide for loans or hardship distributions must be made no later than the end of the first plan year beginning after December 31, 2017. In addition, the plan can ignore the reasons that normally apply to hardship distributions, thus allowing them, for example, to be used for food and shelter.

- Except to the extent the distribution consists of already-taxed amounts, a hardship distribution made pursuant to this relief will be includible in gross income and generally subject to the 10-percent additional tax of § 72(t).

C. Nonqualified Deferred Compensation, Section 83, and Stock Options

D. Individual Retirement Accounts

1. The form of the transaction was a mystery, but Judge Gustafson peers through the fog to find that the substance was what the taxpayer said it was. McGaugh v. Commissioner, T.C. Memo. 2016-28 (2/24/16). The taxpayer had a self-directed IRA of which Merrill Lynch was the custodian. Among its other assets, the IRA held stock in First Personal Financial Corp. The taxpayer asked Merrill Lynch to purchase additional stock in First Personal Financial Corp. for the IRA. Although the investment in First Personal Financial Corp. was not a prohibited investment for the IRA, Merrill Lynch, for reasons not reflected in the record, refused to purchase the stock directly. At the taxpayer's request, Merrill Lynch issued a wire transfer directly to First Personal Financial Corp., and more than 60 days thereafter, First Personal Financial Corp. issued the stock in the name of the taxpayer's IRA. Merrill Lynch attempted to deliver the stock certificate to the taxpayer, but at trial, the possession of the stock certificate issued in the name of the IRA was unclear. The record indicated that if the stock certificate had been received by Merrill Lynch within the 60-day period, it would have been accepted. Merrill Lynch reported the transaction on Form 1099-R as a taxable distribution because it had determined that the wire transfer was a distribution to the taxpayer that was not followed by a rollover investment within the 60-day period permitted under § 408(d)(3). The IRS determined that the wire transfer issued by Merrill Lynch constituted a "distribution" from the IRA and was includible in gross income under §§ 408(d) and 72 and that, because the taxpayer had not yet reached age 59-1/2, it was an "early distribution" subject to the § 72(t) 10 percent additional tax. The Tax Court (Judge Gustafson) held that there had not been a distribution from the IRA to the taxpayer and did not uphold the deficiency. The opinion noted that there was no evidence that the taxpayer requested an IRA distribution to himself. "No cash, check, or wire transfer ever passed through [the taxpayer's] hands, and he was therefore not a literal "payee or distributee" of any amount." The taxpayer "was, at most, a conduit of the IRA funds." The court distinguished *Dabney v. Commissioner*, T.C. Memo. 2014-108, which involved a similar wire transfer of self-directed IRA funds to purchase an asset and in which the court found a taxable distribution, on the basis that the asset purchased in *Dabney* (land) was one that the IRA custodian would not permit the IRA to hold. In contrast, the asset purchased in this case, stock of First Personal Financial Corp., was a permissible investment that the IRA already held.

a. The Seventh Circuit agrees. McGaugh v. Commissioner, 860 F.3d 1014 (7th Cir. 6/26/17), *aff'g* T.C. Memo. 2016-28 (2/24/16). In an opinion by U.S. District Judge DeGuilio (sitting by designation), the U.S. Court of Appeals for the Seventh Circuit affirmed the Tax Court's decision. The government argued on appeal that the taxpayer had constructively received the IRA proceeds and therefore had to include them in gross income. The court rejected this argument:

> McGaugh didn't direct a distribution to a third party; he bought stock. That is a prototypical, permissible IRA transaction. … Further, there is no indication that McGaugh orchestrated this purchase for the benefit of [First Personal Financial Corp.] or for any reason other than because he wished to obtain stock to be held by his IRA. Thus, there is no evidence that he constructively received funds, either in ordering Merrill Lynch to wire funds to [First Personal Financial Corp.], or in any other respect.

V. PERSONAL AND INDIVIDUAL INCOME AND DEDUCTIONS

A. Rates

B. Miscellaneous Income

C. Hobby Losses and § 280A Home Office and Vacation Homes

D. Deductions and Credits for Personal Expenses

1. Final regulations provide guidance on eligibility for the § 36B premium tax credit of married taxpayers who are victims of domestic abuse or spousal abandonment and do not file a joint return, allocation rules for reconciliation of advance credit payments and the credit, and guidance on the deduction for health insurance costs of self-employed individuals. T.D. 9822, Health Insurance Premium Tax Credit, 82 F.R. 34601 (7/26/17). The Treasury Department and the IRS have finalized, with only a minor change, proposed and temporary regulations (T.D. 9683, Rules Regarding the Health Insurance Premium Tax Credit, 79 F.R. 43622 (7/28/14)) regarding the premium tax credit authorized by § 36B for individuals who meet certain eligibility requirements and purchase coverage under a qualified health plan through an Affordable Insurance Exchange. The regulations generally apply to taxable years beginning after December 31, 2013.

Eligibility for the Premium Tax Credit of Married Taxpayers Who Are Victims of Domestic Abuse or Spousal Abandonment—To be eligible for the premium tax credit, an individual who is married within the meaning of § 7703 must, among other requirements, file a joint return. See I.R.C. § 36B(c)(1)(C). Married individuals who live apart can be treated as not married if they meet the requirements of § 7703(b), but victims of domestic abuse or spousal abandonment might not meet those requirements. Accordingly, absent relief, victims of domestic abuse or spousal abandonment who are married and do not file a joint return (e.g., because of the risk of injury arising from contacting the other spouse, a restraining order that prohibits contact with the other spouse, or inability to locate the other spouse) would be precluded from claiming the premium tax credit. The final regulations provide that a married taxpayer will satisfy the joint filing requirement of § 36B(c)(1)(C) if he or she uses a filing status of married filing separately and meets three requirements: (1) at the time the individual files the return, the individual lives apart from his or her spouse, (2) the individual is unable to file a joint return because he or she is a victim of domestic abuse or spousal abandonment, and (3) the individual certifies on the return in accordance with instructions that he or she meets the first two requirements. Reg. § 1.36B-2(b)(2)(iii). A taxpayer ceases to be eligible for this relief from the joint filing requirement if he or she qualified for the relief for each of the three preceding taxable years. Reg. § 1.36B-2(b)(2)(v). The final regulations generally define domestic abuse as including "physical, psychological, sexual, or emotional abuse, including efforts to control, isolate, humiliate, and intimidate, or to undermine the victim's ability to reason independently." Reg. § 1.36B-2(b)(2)(iii). A taxpayer is considered a victim of spousal abandonment "if, taking into account all facts and circumstances, the taxpayer is unable to locate his or her spouse after reasonable diligence." Reg. § 1.36B-2(b)(2)(iv).

Allocation Rules for Reconciliation of Advance Credit Payments and Premium Tax Credit—An individual who enrolls in coverage through a health insurance exchange can seek advance payment of the premium tax credit authorized by § 36B. The exchange makes an advance determination of eligibility for the credit and, if approved, the credit is paid monthly to the health insurance issuer. An individual who receives advance credit payments is required by § 36B(f)(1) to reconcile the amount of the advance payments with the premium tax credit calculated on the individual's income tax return for the year. If the taxpayer's advance credit payments exceed the actual premium tax credit allowed, then the taxpayer owes the excess as a tax liability. A taxpayer must reconcile the advance credit payments for coverage of all members of the taxpayer's family (defined as the taxpayer, spouse, and dependents) with the premium tax credit the taxpayer is allowed for the taxable year. To compute the premium tax credit and perform the required reconciliation, a taxpayer must know the advance credit payments, the actual premiums paid, and the premiums for the second lowest cost silver plan (the benchmark plan) for all family members. The final regulations provide rules for allocating advance credit payments, premiums, and benchmark plan premiums among family members. This allocation is necessary when: (1) married individuals file separate returns, (2) married individuals become divorced or legally separated during the year, or (3) an individual such as a child is enrolled in a qualified health plan by one taxpayer but another taxpayer claims a personal exemption deduction for the individual. In the latter two situations, the taxpayers can agree on an allocation percentage and, if the taxpayers do not agree, a default allocation percentage is provided.

Deduction for Health Insurance Costs of Self-Employed Individuals—A self-employed individual who is enrolled in a qualified health plan and eligible for the premium tax credit may also be allowed a deduction under § 162(*l*) for premiums paid for health insurance covering the taxpayer, the taxpayer's spouse, the taxpayer's dependents, and any child of the taxpayer who has not attained age 27. The final regulations provide rules for taxpayers who claim a § 162(*l*) deduction and also may be eligible for a § 36B credit for the same qualified health plan or plans. Under the final regulations, a taxpayer is allowed a § 162(*l*) deduction for "specified premiums" not to exceed an amount equal to the lesser of (1) the specified premiums less the premium tax credit attributable to the specified premiums, and (2) the sum of the specified premiums not paid through advance credit payments and the additional tax imposed under § 36B(f)(2)(A) and Reg. § 1.36B-4(a)(1) with respect to the specified premiums after the application of the limitation on additional tax in § 36B(f)(2)(B) and Reg. § 1.36B-4(a)(3). See Reg. § 1.162(*l*)-1T(a)(1). The term "specified premiums" generally is defined as premiums for which the taxpayer can otherwise claim a deduction under § 162(*l*) for a qualified health plan covering the taxpayer or another member of the taxpayer's family for a month that a premium tax credit is allowed for the family member's coverage.

E. Divorce Tax Issues

F. Education

G. Alternative Minimum Tax

VI. CORPORATIONS

A. Entity and Formation

1. The "Bell" did not save this taxpayer in a faulty attempt to convert ordinary income to capital gain. Bell v. Commissioner, 120 A.F.T.R.2d 2017-5152 (9th Cir. 7/12/17), *aff'g* T.C. Memo. 2015-111 (6/15/15). In this relatively easy case for the Ninth Circuit to affirm, the taxpayers, a married couple, attempted to sell contracts into which Mr. Bell had entered to their newly-formed S corporation. The contracts were between Mr. Bell and various lenders and entities and provided that Mr. Bell, a licensed real estate broker who operated as a sole proprietor, would assist them with real estate owned properties (properties acquired by the lenders through foreclosure). Mr. Bell sold these real estate owned contracts in exchange for the S corporation's contractual obligation to pay $10,000 per month plus 10 percent interest. Weeks after the purchase agreement, the S corporation's board of directors resolved to issue 250 shares to each of the taxpayers in exchange for $500. The S corporation had no equity capital and no operating history. Therefore, the IRS argued, and the Tax Court (Judge Haines) and the Ninth Circuit agreed, that the purported sale was in substance a contribution of the real estate owned contracts to the S corporation in a § 351 nonrecognition transaction. The taxpayer's right to payments of $10,000 per month plus 10 percent interest, the courts held, should be recharacterized as additional stock, not indebtedness, issued in the incorporation transaction.

- **Note:** You might be wondering, "*Why on earth would Bell have wanted the transfer of the real estate owned contracts to his S corporation to be taxable instead of being nontaxable under § 351?*" *Here's why:* Taxpayers occasionally structure sales of assets (land before subdividing into lots; apartments before converting to condominiums) to their newly-formed S corporations with the goal of converting what otherwise would be ordinary income into capital gain. Often, the newly-formed S corporation issues a promissory note to a shareholder-taxpayer for the fair market value of the taxpayer's capital asset or § 1231 asset. The taxpayer reports the capital gain or quasi-capital gain realized from the sale over time on the installment method. Meanwhile, the S corporation obtains a cost basis in the asset. The asset then will be subdivided (land into lots) or converted (apartments to condominiums) to ordinary income property to be sold by the S corporation. The sales of the ordinary income property by the S corporation are used to repay the note issued to the shareholder-taxpayer who reports capital or § 1231 gain on the repayments. Any residual ordinary income generated by the S corporation's sales is reported by the taxpayer as flow-through income from the S corporation. Hence, future ordinary income has been converted to capital gain. A variation of this strategy was employed successfully by the taxpayer in *Gyro Engineering Corp. v. United States*, 417 F.2d 437 (9th Cir. 1969). If, however, the newly-formed S corporation is thinly capitalized, the IRS challenges these transactions by asserting that the purported sale of the asset to the newly-formed S corporation is in substance a § 351 nonrecognition transaction. The promissory note issued to the shareholder-taxpayer is recharacterized as stock issued in the § 351 transaction. This is what happened in *Bell*. Had the taxpayer in *Bell* adequately capitalized his S corporation with other assets, his strategy might have had a better chance of success.

B. Distributions and Redemptions

C. Liquidations

D. S Corporations

1. A § 267 "looptrap" snares an accrual-method subchapter S corporation with an ESOP shareholder. Petersen v. Commissioner, 148 T.C. No. 22 (6/13/17). The taxpayers, a married couple, owned stock in an accrual-method S corporation with many employees. As permitted by § 1361(c)(7), an ESOP benefitting the employees also owned stock in the S corporation. The S corporation had accrued and deducted the following amounts with respect to its ESOP participants as of the end of its 2009 and 2010 tax years: for 2009, unpaid wages of $1,059,767 (paid by January 31, 2010) and vacation pay of $473,744 (paid by December 31, 2010); for 2010, unpaid wages of $825,185 (paid by January 31, 2011) and vacation pay of $503,896 (paid by December 31, 2011). Notwithstanding the fact that the S corporation was an accrual-method taxpayer, the IRS asserted under § 267(a)(2) (forced-matching) that the corporation was not entitled to deduct the foregoing accrued amounts until the year of actual payment and inclusion in gross income by the ESOP's employee-participants. In a case of first impression, the Tax Court (Judge Lauber) agreed with the IRS based upon a plain reading of §§ 67(a)(2), (b), and (e), as well as a determination that the S corporation's ESOP is a "trust" within the meaning of § 267(c). Specifically, § 267(a)(2) generally requires so-called "forced matching" of an accrual-method taxpayer's deductions with the gross income of a cash-method taxpayer to whom a payment is to be made if the taxpayer and the person to whom the payment is to be made are related persons as defined by § 267(b). For an S corporation, pursuant to § 267(e), all shareholders are considered related persons under § 267(b) regardless of how much or how little stock such shareholders actually *or constructively* own. Furthermore, under § 267(c) beneficiaries of a trust are deemed to own any stock held by the trust. Because the assets held by an ESOP are owned by a trust (as required by ERISA, *see* 29 U.S.C. § 1103(a)), the participating employees of the ESOP are treated as shareholders of the S corporation. Hence, the forced-matching rule of § 267(a)(2) applies to accrued but unpaid wages and vacation pay owed to the S corporation's ESOP participants at the end of the year. Judge Lauber noted that this odd situation probably was a "drafting oversight"—in our words, a *looptrap*—because § 318, which defines related parties for certain purposes under subchapter C, excepts tax-exempt employee trusts from its constructive ownership rules. Nevertheless, Judge Lauber wrote, the Tax Court is "not at liberty to revise section 267(c) to craft an exemption that Congress did not see fit to create." Mercifully, however, the Tax Court declined to impose § 6662 negligence or substantial understatement penalties on the taxpayers because the case was one where "the issue was one not previously considered by the Court and the statutory language was not clear" (even though the court obviously relied upon the plain language of § 267 to reach its decision).

E. <u>Mergers, Acquisitions and Reorganizations</u>

F. <u>Corporate Divisions</u>

G. <u>Affiliated Corporations and Consolidated Returns</u>

1. The Tax Court invokes a "common law" doctrine to disallow a double deduction for the same economic loss. <u>Duquesne Light Holdings, Inc. v. Commissioner</u>, T.C. Memo. 2013-216 (9/11/13). Duquesne Light Holdings, Inc. was the common parent of a consolidated group of corporations. Duquesne held 1.2 million shares of AquaSource, Inc., which until 2001 was a wholly-owned member of the group. In 2001, Duquesne sold 50,000 shares of AquaSource to Lehman Brothers—remember them—and claimed a capital loss of approximately $199 million ("2001 stock loss"). Duquesne filed an application for tentative refund, in which it carried back to 2000 a portion of the 2001 stock loss, and the IRS paid a tentative refund of $35 million. In 2002 and 2003, AquaSource, while still a member of the group, sold all of its assets (stock in its wholly-owned subsidiaries) and recognized aggregate capital losses of $252 million ("2002 and 2003 assets losses"), which were claimed on Duquesne's consolidated return, carried back to 2000, and resulted in the IRS paying a tentative refund of $52 million. The IRS determined that the 2001 stock loss on the disposition of 50,000 shares of AquaSource stock (approximately 4% of the stock) recognized by the common parent was a loss attributable to the fact that there was built-in loss in the underlying assets of AquaSource, and that the group was not permitted to take the duplicative portion ($199 million) of the 2002 and 2003 asset losses upon the subsequent sale of AquaSource's assets under the doctrine of *Charles Ilfeld Co. v. Hernandez*, 292 U.S. 62 (1934). The Tax Court (Judge Chiechi) upheld the IRS's determination, relying in part on its prior opinion in *Thrifty Oil v. Commissioner*, 139 T.C. 198 (2012). In doing so, the court rejected the taxpayer's argument that *Rite Aid Corp. v. United States*, 255 F.3d 1357 (Fed. Cir. 2001), which held invalid the loss disallowance rule of former Reg. § 1.1502-20, supported allowing deduction of the 2002 and 2003 assets losses, and that the disallowance of double deductions could be effected only through the promulgation of valid regulations. Although the court acknowledged that former Temp. Reg. § 1.1502-35T, which was in effect for the years in question, did not disallow the losses, the court concluded that nothing prohibited it from disallowing duplicate deductions for the same economic loss under *Charles Ilfeld Co.* Finally, the court held that even though the limitations period on assessment had expired for 2000–the year to which losses had been carried back–the period was still open pursuant to § 6501(h) and § 6501(k), thereby allowing the IRS to assess a deficiency attributable to the disallowance of the loss carryback.

a. The *Ilfeld* doctrine is alive and well in the Third Circuit, which concluded that the failure of the consolidated return regulations to disallow a loss is not clear authorization for the taxpayer to take a double deduction for the same economic loss. Duquesne Light Holdings, Inc. v. Commissioner, 861 F.3d 396 (3d Cir. 6/29/17), *aff'g* T.C. Memo. 2013-216 (9/11/13). In an opinion (2-1) by Judge Ambro, the Third Circuit affirmed the Tax Court's decision. The majority opinion construed *Charles Ilfeld Co. v. Hernandez*, 292 U.S. 62 (1934), as standing for the proposition that there is a presumption that statutes and regulations do not allow a double deduction for the same economic loss, and "[t]his presumption must be overcome by a clear declaration in statutory text or a properly authorized regulation." The majority acknowledged that there is some uncertainty whether the *Ilfeld* doctrine applies to taxpayers not filing consolidated returns, but concluded that it "remains good law in the consolidated-return context." The court held that neither the text of § 165, nor the combination of the statutory text with the applicable regulations, authorized the taxpayer to deduct the same economic loss twice. According to the court, the language of § 165(a), which authorizes a deduction for "any loss sustained during the taxable year and not compensated for by insurance or otherwise," is broad and does not meet the *Ilfeld* doctrine's "requirement of explicit approval for duplicating the underlying economic loss." The regulations in effect during the years in question did not preclude Duquesne from deducting the 2002 and 2003 asset losses. One regulation, Reg. § 1.1502-35T, precluded deduction of a loss recognized on the disposition of subsidiary stock to the extent of the duplicated loss if, immediately after the disposition, the subsidiary remained a member of the consolidated group. This regulation did not apply to the 2002 and 2003 asset losses because the subsidiaries that AquaSource sold were not members of the consolidated group after their disposition. Duquesne relied on Reg. § 1.337(d)-2T as authority for its deduction of the 2002 and 2003 asset losses. Paragraph (a)(1) of Reg. § 1.337(d)-2T provided a general rule that "[n]o deduction is allowed for any loss recognized by a member of a consolidated group with respect to the disposition of stock of a subsidiary loss." Paragraph (c)(2) provided that a loss on the disposition of subsidiary stock "is not disallowed" by the general rule "to the extent the taxpayer establishes that the loss or basis is not attributable to the recognition of built-in gain … on the disposition of an asset (including stock and securities)." Although Reg. § 1.337(d)-2T did not disallow Duquesne's 2002 and 2003 asset losses, the court held that the regulation was insufficient to overcome the presumption of *Ilfeld* because "there is no mention in the regulation of approval for a loss deduction that duplicates another already taken for the same underlying economic loss." The court emphasized that Reg. § 1.337(d)-2T "has nothing to do with loss duplication" because it was accompanied by Notice 2002-18, 2002-1 C.B. 644, which stated that "the IRS and Treasury believe that a consolidated group should not be able to benefit more than once from one economic loss" and would issue another regulation addressing that issue. That other regulation, issued in 2003 retroactive to 2002, was Reg. § 1.1502-35T which, as previously discussed, did not preclude the 2002 and 2003 asset losses. The majority also affirmed the Tax Court's ruling that the IRS's assessment of a deficiency attributable to the disallowance of the loss carryback was not barred by the limitations period on assessment.

- In a dissenting opinion, Judge Hardiman disagreed with several aspects of the majority's reasoning. He took issue with the majority's conclusion that *Ilfeld* requires an explicit authorization of a double deduction:

> That means even if the Code separately allows Deduction A and Deduction B, the taxpayer could not take both deductions unless a provision authorized them both to be taken simultaneously. This triple-authorization requirement, I believe, goes above and beyond any rule envisioned by the Supreme Court.

Judge Hardiman emphasized that *Ilfeld* requires only that a provision of the statute or regulations can "fairly be read to authorize" the double deduction. He concluded that Reg. § 1.337(d)-2T can fairly be read to authorize Duquesne's deduction. "When the IRS writes that a deduction is 'not disallowed,' we should accept that it is not. And without that ambiguity, it is not our place to investigate the structure and purpose of the scheme in order to restyle the language of the regulation." Regarding the interplay of the regulations and the *Ilfeld* doctrine, Judge Hardiman stated:

> [I]t seems unnatural for the IRS to write a regulation that literally authorizes a specific action, only to expect taxpayers to appreciate that the regulation is undermined by common-law doctrines lurking in the shadows.

2. Better be careful in drafting those tax allocation agreements! A subsidiary member of a consolidated group was entitled to a refund produced by the subsidiary's loss because the group's tax allocation agreement was ambiguous and provided that any ambiguity must be resolved in favor of the subsidiary. In re United Western Bancorp, Inc., ___ F. Supp. 3d ___, 2017 WL 2928031 (D. Colo. 7/10/17). United Western Bancorp, Inc. ("Holding Company") was the common parent of a consolidated group. One member of the consolidated group was a wholly-owned subsidiary, United Western Bank ("Bank"). The Holding Company received a refund of $4.8 million that was produced by carrying back a 2010 consolidated net operating loss (produced by the Bank's loss) to 2008, a year in which the consolidated group had paid tax on income of the Bank. According to the court, "[t]here is no dispute that, to whatever extent a refund was due, it was entirely the result of revenue generated by the Bank in 2008 and losses incurred by the Bank in 2010 …." In the same year the 2010 consolidated return was filed, the Bank was placed into receivership with the FDIC as its receiver. Subsequently, the Holding Company became a debtor in a chapter 7 bankruptcy proceeding. The bankruptcy trustee asserted that the refund was an asset of the bankruptcy estate, and the FDIC asserted that the refund was an asset of the Bank. In a thorough and thoughtful opinion, the District Court (Judge Martinez) held that the Bank was entitled to the refund. The court noted that, in *Barnes v. Harris*, 783 F.3d 1185 (10th Cir. 2015), the Tenth Circuit, relying on *In re Bob Richards Chrysler-Plymouth Corp., Inc.*, 473 F.2d 262 (9th Cir. 1973), had held that, in the absence of a contrary agreement, "a tax refund due from a joint return generally belongs to the company responsible for the losses that form the basis of the refund." In this case, however, the consolidated group members had entered into a tax allocation agreement. The District Court ultimately framed the issue as whether, under the tax allocation agreement, the Holding Company was acting as the agent of the Bank or instead had a standard commercial relationship with the Bank. If the former, then the Holding Company was acting as a fiduciary of the Bank and the refund would belong to the Bank; if the latter, then the Bank was a creditor of the Holding Company and the refund would be an asset of the Holding Company's bankruptcy estate. The court concluded that the tax allocation agreement was ambiguous on this point, which triggered a provision in the agreement that required any ambiguity in the agreement to be resolved in favor of the Bank. Accordingly, the court concluded, the Bank had equitable title to the refund. The Holding Company had only legal title to the refund and the refund was not part of the Holding Company's bankruptcy estate.

H. Miscellaneous Corporate Issues

1. Due date of corporate income tax returns: temporary and proposed regulations address the filing date chaos created by Congress. T.D. 9821, Return Due Date and Extended Due Date Changes, 82 F.R. 33441 (7/20/17). Treasury and the IRS have issued proposed, temporary, and final regulations regarding the due date and extended due date of corporate income tax returns. The Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, § 2006(a), amended Code § 6072(b) to require C corporations to file their income tax returns by the 15th day of the fourth month after the close of their taxable year (by subjecting them to § 6702(a)), thus deferring the due date by one month. On the other hand, under amended § 6072(b), S corporations continue to be required to file their tax returns by the 15th day of the third month (March 15 for calendar year S corporations). Pursuant to this statutory directive, Temp. Reg. § 1.6072-2T(a)(1) provides that the income tax return of a C corporation is due on the 15th day of the fourth month following the close of its taxable year and that the income tax return of an S corporation is due on or before the 15th day of the third month following the close of its taxable year. However, pursuant to Temp. Reg. § 1.6072-2T(a)(2), the income tax return of a C corporation that has a taxable year that ends on June 30 is due on the 15th day of the *third* month following the close of its taxable year for taxable years beginning before January 1, 2026. (Yes, that's correct, a ten-year deferred effective date only for C corporations with a fiscal year ending on June 30.) For this purpose, a return for a short period ending on any day in June is treated as a return for a taxable year that ends on June 30. This special rule for C corporations using a June 30 taxable year implements the effective date rule enacted by § 2006(a)(3) of the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015.

- The extended due dates for C corporation returns were changed by § 2006(c) of the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 through amendments to Code § 6081(b). The temporary regulations reflect these changes. Pursuant to Temp. Reg. § 1.6081-3T, a C corporation is allowed an automatic six-month extension of the due date. However, for periods beginning before January 1, 2026, the automatic extension is 7 months for a C corporation with a taxable year that ends on June 30. Code § 6081(b), as amended by the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, provides that the automatic extension is only 5 months for a calendar-year C corporation for periods ending before January 1, 2026. Nevertheless, the temporary regulations provide an automatic 6-month extension for calendar-year C corporations pursuant to § 6081(a), which authorizes the Secretary of the Treasury to grant reasonable extensions of not more than 6 months.

- The temporary regulations apply to corporate returns and extension requests filed on or after July 20, 2017, but the statutory amendments made by the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 apply to returns for corporate taxable years that begin after December 31, 2015. Accordingly, the preamble to the temporary regulations provides that taxpayers can elect to apply the regulations to returns filed for periods beginning after December 31, 2015.

VII. PARTNERSHIPS

A. Formation and Taxable Years

B. Allocations of Distributive Share, Debt, and Outside Basis

C. Distributions and Transactions Between the Partnership and Partners

D. Sales of Partnership Interests, Liquidations and Mergers

1. The Tax Court gives the IRS a lesson on the intersection of partnership and international taxation: subject to the exception in § 897(g), a foreign partner's gain from the redemption of its interest in a U.S. partnership was not income effectively connected with the conduct of a U.S. trade or business. Grecian Magnesite Mining, Industrial & Shipping Co., S.A. v. Commissioner, 149 T.C. No. 3 (7/13/17). The taxpayer, a corporation organized under the laws of Greece, held a 15 percent interest (later reduced to 12.6 percent) in Premier Chemicals, LLC, an LLC organized under Delaware law and classified for federal tax purposes as a partnership. The taxpayer accepted Premier's offer to redeem its partnership interest and received a total of $10.6 million, half of which was paid in 2008 and half in January 2009. The taxpayer and Premier agreed that the payment in January 2009 was deemed to have been paid on December 31, 2008, and that the taxpayer would not share in any profits or losses in 2009. The taxpayer realized $1 million of gain from the 2008 redemption payment and $5.2 million from the 2009 redemption payment. The taxpayer filed a return on Form 1120-F for 2008 on which it reported its distributive share of partnership items, but did not report any of the $1 million realized gain from the 2008 redemption payment. The taxpayer did not file a U.S. tax return for 2009 and thus did not report any of the $5.2 million realized gain from the 2009 redemption payment. The IRS issued a notice of deficiency in which it asserted that all of the $6.2 million of realized gain was subject to U.S. tax because it was U.S.-source income effectively connected with the conduct of a U.S. trade or business. The taxpayer conceded that $2.2 million of the gain was subject to U.S. taxation pursuant to § 897(g), which treats amounts received by a foreign person from the sale or exchange of a partnership interest as amounts received from the sale or exchange of U.S. real property to the extent the amounts received are attributable to U.S. real property interests. The taxpayer's concession left $4 million of realized gain in dispute. The Tax Court (Judge Gustafson) held that the $4 million of disputed gain was not income effectively connected with the conduct of a U.S. trade or business and therefore was not subject to U.S. taxation. (The court found it unnecessary to interpret the tax treaty in effect between the U.S. and Greece because U.S. domestic law did not impose tax on the gain and the IRS did not contend that the treaty imposed tax beyond U.S. domestic law.) In reaching this conclusion, the court addressed several issues.

The court first analyzed the nature of the gain realized by the taxpayer. Under § 736(b)(1), payments made in liquidation of the interest of a retiring partner that are made in exchange for the partner's interest in partnership property are treated as a distribution to the partner. Treatment as a distribution triggers § 731(a)(1), which provides that a partner recognizes gain from a distribution to the extent the amount of money received exceeds the partner's basis in the partnership interest and directs that the gain recognized "shall be considered as gain or loss from the sale or exchange of the partnership interest of the distributee partner." Pursuant to § 741, gain recognized from the sale or exchange of a partnership interest is "considered as gain or loss from the sale or exchange of a capital asset" except to the extent provided by § 751. (The IRS did not contend that § 751 applied.) The taxpayer asserted that these provisions lead to the conclusion that the taxpayer's gain must be treated as arising from the sale of a single asset, its partnership interest, which is a capital asset. The government argued that the taxpayer's gain must be treated as arising from the sale of separate interests in each asset owned by the partnership. Otherwise, the government argued, the rule in § 897(g), which imposes U.S. tax to the extent amounts received from the sale of a partnership interest are attributable to U.S. real property interests, would be rendered inoperable. The court agreed with the taxpayer. Section 897(g), the court explained,

> actually reinforces our conclusion that the entity theory is the general rule for the sale or exchange of an interest in a partnership. Without such a general rule, there would be no need to carve out an exception to prevent U.S. real property interests from being swept into the indivisible capital asset treatment that section 741 otherwise prescribes.

The court noted that this conclusion is consistent with the court's prior decision in *Pollack v. Commissioner*, 69 T.C. 142 (1977).

The court next addressed whether the $4 million of disputed gain was effectively connected with the taxpayer's conduct of a U.S. trade or business. Pursuant to § 875(1), the taxpayer was considered to be engaged in a U.S. trade or business because the partnership of which it was a partner, Premier, was engaged in a U.S. trade or business. Accordingly, the issue was narrowed to whether the disputed gain was effectively connected with that trade or business. Because foreign-source income is considered effectively connected with a U.S. trade or business only in narrow circumstances, which the IRS acknowledged were not present, the taxpayer's disputed gain could be considered effectively connected income only if it was U.S.-source income. Pursuant to the general rule of § 865(a), income from the sale of personal property by a nonresident is foreign-source income. The IRS asserted that an exception in § 865(e)(2) applied. Under this exception, if a nonresident maintains an office or other fixed place of business in the United States, income from a sale of personal property is U.S.-source if the sale is attributable to that office or fixed place of business. The court assumed without deciding that Premier's U.S. office would be attributed to the taxpayer under § 864(c)(5). Accordingly, the issue was whether the gain was attributable to Premier's U.S. office. Under § 864(c)(5)(B), income is attributable to a U.S. office only if the U.S. office is a material factor in the production of the income and the U.S. office "regularly carries on activities of the type from which such income, gain, or loss is derived." The court concluded that neither of these requirements was satisfied. The court examined Reg. § 1.864-6(b)(2)(i) and concluded that, although Premier's business activities might have had the effect of increasing the value of the taxpayer's partnership interest, those business activities did not make Premier's U.S. office a material factor in the production of the taxpayer's gain. Further, the court concluded, even if the U.S. office was a material factor, Premier did not regularly carry on activities of the type from which the gain was derived because "Premier was not engaged in the business of buying or selling interests in itself and did not do so in the ordinary course of business." Because the disputed gain was not U.S.-source income, it was not effectively connected with the conduct of a U.S. trade or business and therefore not subject to U.S. taxation.

- In reaching its conclusion that the taxpayer's gain was not effectively connected with the conduct of a U.S. trade or business, the court rejected the IRS's contrary conclusion in Rev. Rul. 91-32, 1991-1 C.B. 107. In that ruling, according to the court, the IRS concluded

> that gain realized by a foreign partner from the disposition of an interest in a U.S. partnership should be analyzed asset by asset, and that, to the extent the assets of the partnership would give rise to effectively connected income if sold by the entity, the departing partner's pro rata share of such gain should be treated as effectively connected income.

The court characterized the analysis in the ruling as "cursory" and declined to follow it.

- The taxpayer should have reported some of its gain in 2008, should have filed a 2009 U.S. tax return reporting gain in 2009, and should have paid tax with respect to both years because all of the gain realized from the 2008 distribution and some of the gain realized from the 2009 distribution was attributable to U.S. real property interests held by the U.S. partnership, Premier. Nevertheless, the court declined to impose either the failure-to-file penalty of § 6651(a)(1) or the failure-to-pay penalty of § 6651(a)(2) because the taxpayer had relied on the advice of a CPA and therefore, in the court's view, established a reasonable cause, good faith defense.

E. Inside Basis Adjustments

F. Partnership Audit Rules

1. Bye bye TEFRA! The Bipartisan Budget Act of 2015 § 1101, Pub. L. No. 114-74, signed by the President on 11/2/15, made sweeping changes to the partnership audit rules. The TEFRA rules (in §§ 6221-6231) and Electing Large Partnership rules (in §§ 6240-6242, 6245-6248, 6251-6252, and 6255) have been repealed and replaced in new §§ 6221-6223, 6225-6227, 6231-6235, and 6241, with an entity-level audit process that allows the IRS to assess and collect the taxes against the partnership unless the partnership properly elects out. The new rules will simplify the current complex procedures on determining who is authorized to settle on behalf of the partnership and also avoid the IRS's need to send various notices to all of the partners. Under the new provisions the IRS may reduce the potential tax rate assessed against the partnership to take into account factors such as tax-exempt partners and potential favorable capital gains tax rates. The new rules should significantly simplify partnership audits. As a result, the audit rate of partnerships might increase. Although partnerships with 100 or fewer partners can elect out of the new rules, § 6221(b), such election is not available if there is another partnership as a partner. Implementation of the new rules is deferred; the new rules apply to partnership taxable years beginning after 12/31/17. Partnership agreements should be amended to take into account these changes.

a. The early bird catches the worm (or is that eats the worm at the bottom of the tequila bottle?). T.D. 9780, Election into the Partnership Audit Regime Under the Bipartisan Budget Act of 2015, 81 F.R. 51795 (8/5/16). The Treasury and IRS have promulgated Temp. Reg. § 301.9100-22T dealing with the time, form, and manner for making an election to have the new partnership audit regime, §§ 6221-6223, 6225-6227, 6231-6235, and 6241, enacted in the Bipartisan Budget Act of 2015, apply to returns filed for tax years beginning after 11/2/15 and before 1/1/18. Under Temp Reg. § 301.9100-22T(b) an election to have the new partnership audit regime apply must be made within 30 days of the date of the written notice from the IRS that the partnership return has been selected for examination. The election must be in writing, signed by the tax matters partner, and must include the name, taxpayer identification number, address, and telephone number of the individual who signs the statement, as well as the partnership's name, taxpayer identification number, and tax year to which the statement applies. The statement must include representations that the partnership is not insolvent and does not reasonably anticipate becoming insolvent, the partnership is not currently and does not reasonably anticipate becoming subject to a title 11 bankruptcy petition, and the partnership has sufficient assets, and reasonably anticipates having sufficient assets, to pay the potential imputed underpayment that may be determined during the partnership examination. The election must designate the partnership representative (§ 6223). An election may not be revoked without the IRS's consent. Temp. Reg. § 301.9100-22T(c) allows a partnership that has not been issued a notice of selection for examination to make an election with respect to a partnership return for the purpose of filing an administrative adjustment request under § 6227 (as amended); this election may only be made after 12/31/17. The temporary regulation is effective on 8/5/16.

b. The "thawed" version of the centralized partnership audit rules is here, and all 277 pages of the new rules still stink for partnerships and partners (but at least the regs didn't change much, and the Federal Register version is only 69 pages)! REG-136118-15, Centralized Partnership Audit Regime, 82 F.R. 27334-01 (6/14/17). As we all know by now, effective for tax years beginning after December 31, 2017, the old TEFRA partnership audit rules (in §§ 6221-6231) and Electing Large Partnership rules (in §§ 6240-6242, 6245-6248, 6251-6252, and 6255) have been repealed and replaced by a new "Centralized Partnership Audit Regime" contained in §§ 6221-6223, 6225-6227, 6231-6235, and 6241. The IRS originally released proposed regulations under the new regime in January 2017, but the Trump administration's regulatory freeze forced those regulations to be withdrawn just two days after they were released. The Treasury Department has now reissued the proposed regulations in substantially the same form as the version released in January. Only two minor changes were made from the original version of the proposed regulations issued in January: (i) an example with respect to netting ordinary income and depreciation was deleted (see the January version of Prop. Reg. § 301.6225-1(f) Ex. 3), and (ii) the portion of the regulations seeking comments concerning tiered partnership "push-out" adjustments (discussed below) was expanded. The scope and complexity of the new "Centralized Partnership Audit Regime" preclude in-depth coverage here, but the highpoints are summarized below.

The Practical Effect. Virtually all partnership agreements (including, of course, most LLC operating agreements) should be amended to reflect the new Centralized Partnership Audit Regime. The new regime cannot be ignored because it fundamentally alters the obligations of the partnership and the partners to each other and to the IRS.

Overview. The new rules implement an entity-level audit process that allows the IRS to assess and collect the taxes from the partnership unless the partnership properly elects out of the regime or properly "pushes out" the tax liability to its partners. Under the new centralized process, the IRS audits the partnership's items of income, gain, loss, deduction, and credit, and the partners' distributive shares thereof, for a partnership's taxable year (the "reviewed year"). Then, the IRS sends the partnership a "notice of proposed partnership adjustment" ("NOPPA"). *See* § 6221; Prop. Reg. § 301.6221(a)-1. Thereafter, the partnership has a 330-day period (subject to agreed-upon extensions) to respond to the IRS's proposed adjustments, including the ability to request modifications (discussed below) to any proposed tax liability imposed upon the partnership. Next, at the conclusion of the audit process the IRS sends a "final notice of partnership adjustment" ("FPA") to the partnership (the "adjustment year"). Absent filing a petition in the Tax Court, the tax liability (including penalties) of the partners relating to the reviewed year must be satisfied by the partnership in the adjustment year. *See* § 6231; Prop. Reg. § 301.6231-1. The partnership, not the partners, is liable for any finally determined underpayment of tax (an "imputed underpayment" as defined by the regulations) by the partners from the reviewed year even if those partners are not the same as the partners in the adjustment year. *See* § 6225(a)-(b); Prop. Reg. 301.6225-1.

Modifications to Partnership Level Adjustment. Modifications to a proposed partnership-level adjustment can be asserted by the partnership based upon mitigating factors (e.g., tax-exempt partners, amended returns filed by partners from the reviewed year, lower tax rates applied to some partners, etc.). To assert such modifications, the partnership must submit a "request for modification with respect to a partnership adjustment" to the IRS within 270 days (subject to consensual extension) of the date of the NOPPA. *See* § 6225(c); Prop. Reg. § 301.6225-2. The purpose of allowing partnership-asserted modifications is to determine as accurately as possible the amount of tax owed by the partners as a result of the partnership-level adjustment without requiring the IRS to assess and collect the tax separately from each partner (as was the case under TEFRA). Accordingly, as compared to TEFRA, the new regime substantially eases the IRS's administrative burden with respect to partnership audits and collection of taxes, but correspondingly increases the administrative burden imposed upon partnerships and their partners. Expect the audit rate of partnerships to increase under the new regime.

"Push-Out" Election. As an alternative to assessment and collection of tax from the partnership, the partnership may elect to "push out" the imputed underpayment to the appropriate partners from the reviewed year. The affected partners then become liable for the tax attributable to the imputed underpayment rather than the partnership itself. The push-out election must be made by the partnership representative within 45 days (not subject to extension) of the mailing of the final partnership adjustment ("FPA") under § 6231. *See* § 6226; Prop. Reg. § 301.6226-1.

Some Finer Points. Special rules govern the treatment of adjustments from a reviewed year that do not result in an imputed underpayment and are therefore otherwise taken into account by the partnership and the partners in the adjustment year. *See* Prop. Reg. § 301.6225-3. Moreover, the impact of the adjustments on capital accounts and outside basis across reviewed years and adjustment years is reserved under the proposed regulations. See Prop. Reg. § 301.6225-4. The new regime also imposes tougher rules on partners who treat items inconsistently with the partnership's treatment of such items. *See* § 6222; Reg. § 301.6222-1.

Partnership Representatives. Unlike the familiar "tax matters partner" designation under TEFRA, the new regime permits any person (even a non-partner) with a substantial presence in the U.S. to be designated the "partnership representative" in the audit, assessment, and collection process. The partnership representative is designated by the partnership for each tax year on its annual information return (Form 1065). Moreover, any action taken by the partnership representative vis-à-vis the IRS is binding upon the partnership regardless of the partnership agreement or state law to the contrary. See § 6223; Prop. Reg. §§ 301.6223-1, 301.6223-2.

Election Out of the New Regime for Small Partnerships. Partnerships with 100 or fewer partners may elect out of the new regime, but not if the partnership has another partnership or certain other flow-through entities as a partner, possibly including single-member LLCs (the effect of which currently is unknown under the proposed regulations). Depending upon certain special rules, S corporations may or may not disqualify a partnership from electing out of the new regime. *See* § 6621(b); Prop. Reg. § 301.6621(b)-1. Eligible partnerships that elect out of the new regime will subject their partners to pre-TEFRA audit procedures (i.e., partners will be audited and assessed separately and possibly inconsistently).

Pre-2018 Election Into the New Regime. The reissued proposed regulations do not affect the ability of partnerships to elect into the new regime for tax years beginning before January 1, 2018, but after November 2, 2015. See T.D. 9780, Election into the Partnership Audit Regime Under the Bipartisan Budget Act of 2015, 81 F.R. 51795 (8/5/16).

2. A disregarded LLC is a pass-thru partner for purposes of the small partnership exception to the TEFRA audit rules. Seaview Trading, LLC v. Commissioner, 858 F.3d 1281 (9th Cir. 6/7/17). Seaview Trading, LLC, a Delaware limited liability company that was classified as a partnership for federal tax purposes, had two members, each of which was a single-member LLC. One of these was AGK Investments LLC, which was wholly owned by Robert Kotick, and the other was KMC Investments LLC, wholly owned by Mr. Kotick's father. The IRS audited Mr. Kotick's 2001 return and disallowed certain deductions with respect to his investment in Seaview, but did not disallow his share of a loss passed through from Seaview, which arose from Seaview's investment in a common trust fund. After the limitations period on assessment for 2001 with respect to Mr. Kotick had expired, the IRS audited Seaview and issued a Final Partnership Administrative Adjustment (FPAA) in which the IRS disallowed Seaview's loss from its trust investment. Mr. Kotick challenged the FPAA by filing a petition in the Tax Court. AGK, Mr. Kotick's wholly owned LLC, filed a separate petition. Mr. Kotick argued that the FPAA was invalid because Seaview was not subject to the TEFRA audit rules pursuant to the small partnership exception of § 6231(a)(1)(B)(i). The Tax Court (Judge Foley) dismissed Mr. Kotick's petition on the grounds that (1) Seaview did not fall within the § 6231(a)(1)(B)(i) small partnership exception to the TEFRA audit rules, and (2) AGK, rather than Mr. Kotick, was the TMP of Seaview and therefore the court lacked jurisdiction to consider the petition filed by Mr. Kotick. In an opinion by Judge Smith, the U.S. Court of Appeals for the Ninth Circuit affirmed. Absent a contrary election by the partnership, the § 6231(a)(1)(B)(i) small partnership exception excludes from the TEFRA audit rules "any partnership having 10 or fewer partners each of whom is an individual (other than a nonresident alien), a C corporation, or an estate of a deceased partner." However, pursuant to Reg. § 301.6231(a)(1)-1(a)(2), the small partnership exception does not apply "if any partner in the partnership during the taxable year is a pass-thru partner" as defined in § 6231(a)(9). Section 6231(a)(9) defines a pass-thu partner as "a partnership, estate, trust, S corporation, nominee, or other similar person through whom other persons hold an interest in the partnership …." The court acknowledged that the two single-member LLCs, AGK and KMC, were disregarded for federal tax purposes pursuant to the check-the-box regulations. Nevertheless, the court held, these LLCs were pass-thru partners. In reaching this conclusion, the court gave *Skidmore* deference to Rev. Rul. 2004-88, 2004-2 C.B. 165. *See Skidmore v. Swift & Co.*, 323 U.S. 134 (1944). In Rev. Rul. 2004-88, the IRS ruled that, because a disregarded LLC held legal title to a partnership interest it was "a similar person through whom other persons hold an interest in the partnership" and therefore a pass-thru partner. The court also held that Mr. Kotick lacked standing to file a Tax Court petition on behalf of Seaview because he was not Seaview's TMP. Seaview had failed to designate a TMP for 2001, and therefore AGK, as the holder of the largest profits interest, was the TMP pursuant to § 6231(a)(7)(B). Accordingly, the court upheld the Tax Court's dismissal of Mr. Kotick's petition for lack of jurisdiction.

G. Miscellaneous

1. Due date for partnership income tax returns: temporary and proposed regulations reflect Congress's belief that some partners might not need filing extensions any more. T.D. 9821, Return Due Date and Extended Due Date Changes, 82 F.R. 33441 (7/20/17). Treasury and the IRS have issued proposed, temporary, and final regulations regarding the due date and extended due date of partnership income tax returns (Form 1065). The Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, § 2006(a), amended Code § 6072(b) to require partnerships to file their income tax returns by the 15th day of the third month following the close of the taxable year (March 15 for calendar year partnerships), thus accelerating the due date by one month. Act § 2006(b) directs the Treasury to modify the regulations to provide that the maximum extension for a partnership return will be a 6-month period ending on September 15 for calendar year partnerships. Pursuant to this statutory directive, Temp. Reg. § 1.6031(a)-1T(e)(2) provides that "the return of a partnership must be filed on or before the date prescribed by § 6072(b)." (The temporary regulations do not explicitly address the due date of Form 8804—Annual Return for Partnership Withholding Tax—but the 2016 instructions for Form 8804 indicate that the due date is the 15th day of the third month following the close of the taxable year.) Pursuant to Temp. Reg. § 1.6081(a)-2T(a)(1), a partnership is allowed an automatic 6-month extension to file both Form 1065 and Form 8804 by filing a timely application. No extension beyond the automatic extension is permitted.

- The temporary regulations apply to returns and extension requests filed on or after July 20, 2017, but the statutory amendments made by the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 apply to returns for partnership taxable years that begin after December 31, 2015. Accordingly, the preamble to the temporary regulations provides that taxpayers can elect to apply the regulations to returns filed for periods beginning after December 31, 2015.

a. What, you weren't paying attention to the new accelerated due date for partnership returns? We've got your back, says the IRS. Late-filing penalties are waived, but don't let this happen again! Notice 2017-47, 2017-38 I.R.B. 232 (9/1/17). In this notice, the IRS has waived penalties for a partnership's failure to file or furnish to partners certain returns by the accelerated due date enacted as part of the Surface Transportation and Veterans Health

Care Choice Improvement Act of 2015. The penalty relief applies if one of the following two conditions is satisfied:

> (1) the partnership filed Form 1065, 1065-B, 8804, 8805, 5471, or other return required to be filed with the IRS and furnished copies (or Schedules K-1) to the partners (as appropriate) by the date that would have been timely under section 6072 before amendment by the Surface Transportation Act (April 18, 2017 for calendar-year taxpayers …), or
>
> (2) the partnership filed Form 7004 to request an extension of time to file by the date that would have been timely under section 6072 before amendment by the Surface Transportation Act and files the return with the IRS and furnishes copies (or Schedules K-1) to the partners (as appropriate) by the fifteenth day of the ninth month after the close of the partnership's taxable year (September 15, 2017, for calendar-year taxpayers). If the partnership files Form 1065-B and was required to furnish Schedules K-1 to the partners by March 15, 2017, it must have done so to qualify for relief.

This relief is available only for the partnership's first taxable year that begins after 2015. The IRS will grant this relief automatically. Taxpayers that have already had penalties assessed should receive a letter indicating that the penalty has been abated and are instructed to contact the IRS for abatement if they do not receive such a letter.

VIII. TAX SHELTERS

IX. EXEMPT ORGANIZATIONS AND CHARITABLE GIVING

A. Exempt Organizations

1. Is this good for procrastinators? Temporary regulations implement the six-month automatic extension of time to file returns of exempt organizations, including those in the Form 990 series. T.D. 9821, Return Due Date and Extended Due Date Changes, 82 F.R. 33441 (7/20/17). Treasury and the IRS have issued proposed, temporary, and final regulations that provide an automatic six-month extension of time for the filing of certain returns, including those in the Form 990 series filed by tax-exempt organizations. Previously, Reg. § 1.6081-9(a) provided an automatic three-month extension for most returns in the 990 series. The Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, § 2006(b)(4)-(8), directs the Treasury to modify relevant regulations to provide that the maximum extension of time for filing several types of returns, including those in the Form 990 series, is six months (ending on November 15 for calendar-year filers). Pursuant to this statutory directive, Temp. Reg. § 1.6081-9T(a) provides that entities required to file several types of returns, including those in the Form 990 series, are allowed an automatic six-month extension by filing a timely application (normally submitted on Form 8868 or Form 7004).

- The Form 990 returns eligible for this automatic extension are Form 990, Return of Organization Exempt from Income Tax; Form 990-EZ, Short Form Return of Organization Exempt from Income Tax; Form 990-PF, Return of Private Foundation; Form 990-T, Exempt Organization Business Income Tax Return; and Form 990-BL, Information and Initial Excise Tax Return for Black Lung Benefit Trusts and Certain Related Persons.

- The other returns eligible for this automatic extension are Form 1041-A, U.S. Information Return-Trust Accumulation of Charitable Amounts; Form 1120-POL, U.S. Income Tax Return for Certain Political Organizations; Form 4720, Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code; Form 5227, Split-Interest Trust Information Return; Form 6069, Return of Excise Tax on Excess Contributions to Black Lung Benefit Trust Under Section 4953 and Computation of Section 192 Deduction; and Form 8870, Information Return for Transfers Associated With Certain Personal Benefit Contracts.

- The temporary regulations apply to extension requests filed on or after July 20, 2017, but the statutory amendments made by the Surface Transportation and Veterans

Health Care Choice Improvement Act of 2015 apply to returns for taxable years that begin after December 31, 2015. Accordingly, the preamble to the temporary regulations provides that taxpayers can elect to apply the regulations to returns filed for periods beginning after December 31, 2015.

B. Charitable Giving

1. Form 1023-EZ regulations finalized. T.D. 9819, Guidelines for the Streamlined Process of Applying for Recognition of Section 501(c)(3) Status, 82 F.R. 29730 (6/30/17). Originally issued as proposed and temporary regulations in 2014 (T.D. 9674, Guidelines for the Streamlined Process of Applying for Recognition of Section 501(c)(3) Status, 79 F.R. 37630 (7/2/14)), these final regulations authorize without substantive change a streamlined process that certain small organizations may use to apply for recognition of tax-exempt status under § 501(c)(3). Essentially, the final regulations allow the IRS to promulgate Form 1023-EZ for "eligible organizations" to meet the notice requirements of § 508 for purposes of obtaining recognition of tax-exempt status under § 501(c)(3). Detailed annual or other guidance issued by the IRS defines "eligible organizations" allowed to file Form 1023-EZ. For 2017, Rev. Proc. 2017-5, § 6.05, 2017-1 I.R.B. 230, generally provides that an "eligible organization" is one that (1) has projected annual gross receipts of $50,000 or less in the current year and the next two years, (2) $50,000 or less of actual receipts for each of the past three years for which it was in existence, and (3) has total assets the fair market value of which does not exceed $250,000. For purposes of this last eligibility requirement, a good faith estimate of the fair market value of the organization's assets is sufficient. Notwithstanding the foregoing, Rev. Proc. 2017-5 contains a lengthy list of organizations that cannot submit Form 1023-EZ, including churches, schools, colleges, and hospitals. Form 1023-EZ must be submitted electronically and the user fee for doing so is $275, as opposed to the $850 user fee charged to organizations submitting a regular Form 1023. Organizations that submit Form 1023-EZ ordinarily will file an annual Form 990-N (e-postcard) instead of the regular Form 990 required of larger § 501(c)(3) organizations. The final regulations amend Reg. §§ 1.501(a)-1, 1.501(c)(3), and 1.508-1, and they are effective July 1, 2017.

2. The Eighth Circuit takes the "gimme" in yet another golf course conservation easement case, and a taxpayer learns the hard way that a retroactive effective date doesn't work. RP Golf, LLC v. Commissioner, 860 F.3d 1096 (8th Cir. 6/26/17), *aff'g* T.C. Memo 2016-80 (4/28/16). In this case, the Eighth Circuit quickly and easily dispensed with a taxpayer's $16.4 million deduction for a golf course conservation easement. The taxpayer had donated a conservation easement to a land trust on December 29, 2003 (which was recorded in county deed records on December 30, 2003); however, at the time of the donation two mortgages remained on the property. The mortgages were not subordinated to the conservation easement as required by Reg. § 1.170A-14(g)(2). Uh oh! To remedy this mistake, the taxpayer and the mortgage holders entered into a subordination agreement that purported to be effective as of December 31, 2003, although the subordination agreement was not executed until April 14, 2004. Huh, why April 14, 2004? The Tax Court (Judge Paris) disallowed the $16.4 million deduction on the same ground as the Ninth and Tenth Circuits (*Minnick v. Commissioner*, 796 F.3d 1156 (9th Cir. 2015) and *Mitchell v. Commissioner*, 775 F.3d 1243 (10th Cir. 2015)), both of which have held that mortgages must be subordinated to conservation easements at the time of the donation, not thereafter, to meet the "protected in perpetuity" requirement of the regulations. The taxpayer, though, argued that *Minnick* and *Mitchell* were distinguishable. In *Minnick* the gap between the donation and subordination was five years while in *Mitchell* the gap was two years. Thus, the taxpayer argued that a subordination agreement retroactively effective to the year of the donation and executed so soon after the conveyance complies with the "protected in perpetuity" requirement of the regulations. Moreover, the taxpayer argued that the mortgage holders had orally agreed to the subordination at the time of the donation. The Eighth Circuit, though, affirmed the Tax Court's holding that (i) a retroactive subordination agreement does not meet the "protected in perpetuity" requirement of the regulations, and (ii) there was insufficient evidence to support the existence of an oral subordination agreement at the time of the donation.

- **Notably, RP Golf, LLC won an earlier "match play" round with the IRS in this case:** In 2012, Judge Paris sided with RP Golf against the IRS over whether the conservation easement deed as accepted and signed by the donee land trust met the "contemporaneous written acknowledgement" requirement of § 170(f)(8). *See RP Golf, LLC v. Commissioner*, T.C. Memo. 2012-282. For charitable contributions of $250 or more, § 170(f)(8) generally requires the donee charity to provide the donor with a contemporaneous written acknowledgement regarding the property contributed, whether goods or services were provided in exchange therefor, and a good faith estimate of the value of the property contributed. Typically, charities provide short letters to donors acknowledging their contributions—so-called "goods and services" letters—by the end of the year in which any donation is made. In a number of cases involving contributions of conservation easements, however, the typical "goods and services" letter was not sent by the charity to the donor of the conservation easement. The IRS often latches on this technical deficiency as an argument (with mixed success) to disallow conservation easement deductions even when the done charity signs the deed acknowledging receipt of the conservation easement. *See, e.g., 15 West 17th Street LLC v. Commissioner*, 147 T.C. No. 19 (12/22/16) (taxpayer unfabvorable); *Averyt v. Commissioner*, T.C. Memo. 2012-198 (taxpayer favorable); *Simmons v. Commissioner*, T.C. Memo. 2009-208, *aff'd* 646 F.3d 6 (Fed. Cir. 2011) (taxpayer favorable); *Schrimsher v. Commissioner*, T.C. Memo. 2011-71 (taxpayer unfavorable). More recently, though, the Tax Court has ruled that a conservation easement deed acknowledged and signed by the done-charity meets the "contemporaneous written acknowledgment" requirement of § 170(f)(8). *See Big River Development, L.P. v. Commissioner*, T.C. Memo. 2017-166 (8/28/17); *310 Retail, LLC v. Commissioner*, T.C. Memo. 2017-164 (8/24/17).

3. It took some time, but finally we "gotcha," says the IRS, in this infamous charitable contribution case involving billionaire and Miami Dolphins' owner Stephen Ross and the University of Michigan. RERI Holdings I, LLC v. Commissioner, 149 T.C. 1 (7/3/17). In a TEFRA case that has gone on for some time and has produced at least one other noteworthy holding (see below), the IRS prevailed in denying a $33 million charitable contribution deduction to a partnership in which Stephen Ross, owner of the Miami Dolphins, was a partner. The property was donated to the University of Michigan, Mr. Ross's alma mater. The partnership had paid only $2.95 million for the property a little over a year prior to its donation. In fact, at some point after the donation the University of Michigan sold the property for only $1.94 million. These facts, of course, displeased the IRS greatly, and the IRS convinced the Tax Court to deny the partnership's charitable contribution deduction on technical grounds (as discussed below). Moreover, contrary to decisions of the Fifth and Ninth Circuits, the Tax Court (Judge Halpern) determined that the partners of the partnership potentially are liable for aggregate gross valuation misstatement penalties of about $11.8 million.

The facts of the case are complicated, but essentially reveal that for tax year 2003 the partnership claimed a $33 million charitable contribution deduction under § 170(a)(1) for a donation to the University of Michigan. The donated property consisted of a remainder interest in a disregarded single-member LLC that the partnership owned and that held underlying real property. On its Form 8283, Noncash Charitable Contributions, the partnership failed to report its "cost or adjusted basis" for the donated property as required by Reg. § 1.170A-13(c)(4)(ii)(E), instead leaving the line on the form completely blank. Judge Halpern ruled that this failure to comply either strictly or substantially with the regulations is fatal to a claimed charitable contribution deduction, thereby denying the deduction in full. Lastly, for purposes of determining potential penalties, the Tax Court held that the correct value of the property at the time of the donation was approximately $3.5 million.

Regarding the IRS's assertion of the 40 percent penalty under § 6662(h) for "gross valuation misstatements" (valuation of 400 percent or more of correct value), the partnership argued that § 6662 should not apply because the $33 million charitable contribution deduction was completely disallowed and hence was not "attributable to" a valuation misstatement. *See, e.g., Heasley v. Commissioner*, 902 F.2d 380 (5th Cir. 1990), *rev'g* T.C. Memo. 1988-408; *Gainer v. Commissioner*, 893 F.2d 225 (9th Cir. 1990), *aff'g* T.C. Memo. 1988-416. Judge Halpern's opinion, however, relies upon the Tax Court's more recent decision in *AHG Investments, LLC v. Commissioner*, 140 T.C. 73 (2013), in which the court declined to follow *Heasley* and *Gainer*. Judge Halpern noted that both the Fifth and Ninth Circuits have expressed reservations about *Heasley* and *Gainer*, and because any appeal by the partnership (due to its dissolution in 2004) would be to the U.S. Court of Appeals for the Federal Circuit, the Tax Court was free to follow its decision in *AHG Investments*. Judge Halpern then determined that the correct fair market value of the donated property should have been roughly $3.5 million, i.e., $29.5 million less than the value claimed by the partnership. Therefore, subject to partner-level § 6662(e)(2) calculations ($5,000 underpayment threshold per partner), the partners of the partnership potentially are liable for penalties aggregating as much as $11.8 million (40 percent of the $29.5 million valuation overstatement).

- The IRS probably thought it should have won this case previously on a similar technicality. In *RERI Holdings I, LLC v. Commissioner*, 143 T.C. 41 (2014), the IRS had cleverly argued on a summary judgment motion that the partnership's "qualified appraisal" (*see* § 170(f)(11)) of the property was fatally flawed. Specifically, the IRS had argued that although the partnership obtained an otherwise qualified appraisal, the partnership's appraisal valued a remainder interest in the underlying real property, not the remainder interest in the disregarded single-member LLC that held the real property. The remainder interest in the disregarded single-member LLC was the property the partnership donated to the University of Michigan, not the real property itself. Thus, argued the IRS, the partnership's otherwise qualified appraisal was for *the wrong property* (even though under § 7701 the single-member LLC was completely disregarded for all other tax purposes)! But, in 2014 Judge Halpern did not let the IRS win so easily. Judge Halpern accepted the IRS's argument that a charitable contribution of an interest in a disregarded single-member LLC should be viewed differently (and perhaps valued differently) than a charitable contribution of the underlying asset(s). Judge Halpern so held even while acknowledging that a single-member LLC otherwise is ignored for federal tax purposes. Judge Halpern's opinion relied heavily on the Tax Court's earlier decision in a gift tax case involving a disregarded single-member LLC. *See Pierre v. Commissioner*, 133 T.C. 24 (2009), *supplemented by* T.C. Memo. 2010-106. Nevertheless, perhaps to avoid so-easily granting summary judgment against the taxpayer and in favor of the IRS in 2014, Judge Halpern reasoned that there was an unresolved issue of material fact whether a valuation of the real property held by the partnership's disregarded single-member LLC could "stand proxy" for the otherwise required "qualified appraisal." Surprisingly, though, Judge Halpern's decision in the earlier *RERI* ruling raises the prospect of a disregarded single-member LLC interest being regarded and valued separately for purposes of determining charitable contributions under § 170.

X. <u>TAX PROCEDURE</u>

A. <u>Interest, Penalties and Prosecutions</u>

B. <u>Discovery: Summons and FOIA</u>

C. <u>Litigation Costs</u>

D. <u>StatutoryNotice of Deficiency</u>

E. <u>Statute of Limitations</u>

F. <u>Liens and Collections</u>

1. The Tax Court has jurisdiction to review the IRS's determination to uphold an accuracy-related penalty in a CDP hearing, even though it would not have deficiency jurisdiction over the penalty, which related to adjustments to partnership items of a TEFRA partnership. McNeill v. Commissioner, 148 T.C. No. 23 (6/19/17). The taxpayer invested in a distressed asset/debt (DAD) tax shelter by purchasing an 89.1 percent interest in GUISAN, LLC , which was classified for federal tax purposes as a partnership. GUISAN was a member of LABAITE, LLC, a TEFRA partnership. LABAITE claimed a large loss in 2003 from the DAD transaction, of which the taxpayer's share was more than $10 million. In a partnership-level audit of LABAITE, the IRS issued to LABAITE's partners a notice of final partnership administrative adjustment (FPAA) that reflected an adjustment to LABAITE's partnership items and imposed an accuracy-related penalty under § 6662 with respect to the claimed loss. GUISAN was not the tax matters partner (TMP) of LABAITE. Nevertheless, the taxpayer, as TMP of GUISAN, caused GUISAN to bring an action in a U.S. District Court for review of the FPAA. The taxpayer made a deposit of $4.9 million, which was sufficient to satisfy the taxpayer's liability only for the asserted deficiency and interest related to the disallowed loss; it did not satisfy the taxpayer's liability for the asserted accuracy-related penalty. The U.S. District Court subsequently dismissed the action on the taxpayer's own motion and, in doing so, declined to adjudicate any partner-level defenses. Because the accuracy-related penalty had not been paid, the IRS assessed the penalty and ultimately issued both a final notice of intent to levy and a notice of federal tax lien filing. In response, the taxpayer requested a collection due process hearing. In the CDP hearing, the IRS settlement officer (1) took the position that the taxpayer could not raise partner-level defenses to the accuracy-related penalty because the taxpayer had had a prior opportunity to contest the liability, and (2) issued a notice of determination upholding the proposed collection action. The taxpayer filed a petition in the Tax Court. Pursuant to §§ 6221 and 6230(a)(2)(A)(i), the Tax Court's deficiency jurisdiction does not extend to penalties that relate to adjustments to partnership items. The regulations issued under § 6221 provide that "[p]artner-level defenses to such items can only be asserted through refund actions following assessment and payment." Reg. § 301.6221-1(c). Because the asserted accuracy-related penalty in this case was based on an adjustment to partnership items, the Tax Court would not have jurisdiction in a deficiency proceeding to rule on the taxpayer's claimed partner-level defenses to the penalty. Nevertheless, the Tax Court (Judge Paris) held that it had jurisdiction to review the IRS's notice of determination. In 2006, Congress amended § 6330(d)(1) to make the Tax Court the only court in which a taxpayer can seek review of an IRS notice of determination issued after a CDP hearing. As amended, § 6330(d)(1) provides that "the Tax Court shall have jurisdiction with respect to such matter." In prior decisions, the court explained, it had interpreted this amendment as conferring jurisdiction on the court to review collection determinations even when the court lacked original jurisdiction over the underlying liability. "With respect to petitioner's section 6662(a) accuracy-related penalty, this penalty is another example of an item not subject to the Court's deficiency jurisdiction under section 6221 but nonetheless reviewable by the Court in the context of its section 6330 jurisdiction." The court ruled only on the question of jurisdiction and will issue a separate opinion on the merits.

- The taxpayer invested in a DAD tax shelter during 2002 as well, and successfully asserted partner-level defenses to the accuracy-related penalty for that year in a refund action. See *McNeill v. United States*, 119 A.F.T.R.2d 2017-943 (D. Wyo. 2/24/17).

G. Innocent Spouse

1. Never, ever, never rely upon IRS correspondence concerning the law, and school your students and junior colleagues about the harsh reality that there is no equitable relief in tax from jurisdictional requirements. Rubel v. Commissioner, 856 F.3d 301 (3d Cir. 5/9/17), *aff'g Rubel v. Commissioner*, No. 9183-16 (U.S. Tax Court 7/11/16). In a case that went all the way to the U.S. Court of Appeals for the Third Circuit, the taxpayer, admirably represented by the Federal Tax Clinic at the Harvard Legal Services Center, claimed innocent spouse relief under § 6015 for the years 2005 through 2008. The IRS had denied the taxpayer's requests for each year via four separate notices of determination issued in January 2016. Section 6015(e)(1)(A) provides that a taxpayer who seeks innocent spouse relief may petition the Tax Court and that the Tax Court "shall have jurisdiction" if the petition is filed within specified time limits and no later than 90 days after the date the IRS mails the notice of determination. For the years 2006 through 2008, the taxpayer's petition in Tax Court was due by April 4, 2016. For 2005, the taxpayer's petition was due by April 12, 2016. Meanwhile, after receiving the notices, the taxpayer submitted additional information to the IRS concerning her claim for innocent spouse relief. The IRS again denied the taxpayer's claim via letter dated March 3, 2016; however, the letter misrepresented the due date for filing a petition in the Tax Court stating: "Please be advised this correspondence doesn't extend the time to file a petition with the U.S. Tax Court. Your time to petition the U.S. Tax Court began to run when we issued you our final determination [in January] and will end on Apr. 19, 2016. However, you may continue to work with us to resolve your tax matter." The taxpayer subsequently filed a petition in the Tax Court on April 19, 2016, and the IRS moved the Tax Court to dismiss the taxpayer's claim for lack of jurisdiction (because the petition was outside the 90-day period). The Tax Court agreed with the IRS and dismissed the petition. The taxpayer appealed to the Third Circuit arguing for equitable relief and estoppel against the IRS due to the misrepresentation in the March 3, 2016, IRS letter. The Third Circuit affirmed the Tax Court's dismissal of the case stating: "[T]he ninety-day deadline is jurisdictional and cannot be altered 'regardless of the equities' of the case."

a. Another case confirming that you cannot rely on what the IRS tells you about the filing deadline! The 90-day period for filing a Tax Court petition seeking review of an IRS determination denying innocent spouse relief is jurisdictional and not subject to equitable tolling. Matuszak v. Commissioner, 862 F.3d 192 (2d Cir. 7/5/17), *aff'g Matuzak v. Commissioner*, No. 471-15 (U.S. Tax Court 12/29/15). The IRS issued a notice of determination denying the taxpayer's request for innocent spouse relief. Under § 6015(e)(1)(A), the taxpayer then had 90 days from the date of mailing of the notice of determination to file a petition in the Tax Court. The taxpayer filed her petition in the Tax Court one day late. The Tax Court (Judge Marvel) granted the government's motion to dismiss the petition. The Tax Court subsequently denied the taxpayer's motion to vacate. See *Matuszak v. Commissioner*, No. 471-15 (7/29/16). In doing so, the Tax Court rejected the taxpayer's argument that the 90-day period for filing the petition could and should be equitably tolled because she had relied on erroneous verbal advice from IRS agents concerning the deadline for filing the petition. The taxpayer argued that recent developments in jurisdictional jurisprudence warranted overruling *Pollock v. Commissioner*, 132 T.C. 21 (2009), in which the court had concluded that the 90-day period of § 6015(e)(1)(A) is jurisdictional and not subject to equitable tolling. The Tax Court, however, declined to do so. The Tax Court noted that, in *Guralnik v. Commissioner*, 146 T.C. 230 (6/2/16), it had recently rejected a similar argument for changing its view on the jurisdictional nature of the 30-day period in § 6330(d)(1) for seeking review in the Tax Court of an IRS notice of determination following a CDP hearing. In a per curiam opinion, the U.S. Court of Appeals for the Second Circuit affirmed the Tax Court's decision. The Second Circuit acknowledged that recent decisions from the U.S. Supreme Court have distinguished between jurisdictional rules, which are not subject to equitable tolling, and non-jurisdictional claim-processing rules, which are. Nevertheless, the Second Circuit concluded that the 90-day period specified in § 6015(e)(1)(A) is jurisdictional. The court emphasized that the language of the statute provides that "the Tax Court shall have jurisdiction" if the petition is filed within the 90-day period. The court also noted that, in *Maier v. Commissioner*, 360 F.3d 61 (2d Cir. 2004), it had previously recognized the jurisdictional nature of § 6015 by concluding that the statute did not confer jurisdiction on the Tax Court over petitions seeking review of innocent spouse determinations filed by the non-electing spouse.

- The taxpayer was represented on the appeal by the Federal Tax Clinic at the Harvard Legal Services Center.

H. Miscellaneous

1. The D.C. Circuit found that registered (?) tax return preparers were entitled to be unqualified. The IRS had de gall to require character, competence, and continuing education for "independent" tax return preparers who only needed PTINs to continue preparing error-laden tax returns for their unsophisticated clientele. Loving v. IRS, 742 F.3d 1013 (D.C. Cir. 2/11/14), *aff'g* 920 F. Supp. 2d 108 (D. D.C. 2/1/13). The D.C. Circuit (Judge Kavanaugh) held that regulations issued in 2011 under 31 U.S.C. § 330 that imposed new character, competence, and continuing education requirements on tax return preparers were "foreclose[d] and render[ed] unreasonable" by the statute, and thus failed at the *Chevron* step 1 standard. They would have also failed at the *Chevron* step 2 standard because they were "unreasonable in light of the statute's text, history, structure, and context."

- Judge Kavanaugh's opinion found six problems with the 2011 regulations: (1) tax return preparers were not "representatives" because they are not "agents" and, thus, lack "legal authority to act on the taxpayer's behalf"; (2) the preparation and filing of a tax return did not constitute "practice … before the Department of the Treasury" because that term implies "an investigation, adversarial hearing, or other adjudicative proceeding"; (3) the history of the statutory language originally enacted in 1884 "indicated that the statute contemplated representation in a contested proceeding"; (4) the regulation was inconsistent with the "broader statutory framework," (?!) in which Congress had enacted a number of statutes specifically directed at tax-return preparers and imposing civil penalties, which would not have been necessary if the IRS had authority to regulate tax-return preparers; (5) the statute would have been clearer had it granted power "for the first time to regulate hundreds of thousands of individuals in the multi-billion dollar tax-preparation industry" ["the enacting Congress did not intend to grow such a large elephant in such a small mousehole"]; and (6) the IRS's past approach showed that until 2011 it never maintained that it had authority to regulate tax return preparers.

- Judge Kavanaugh concluded: "The IRS may not unilaterally expand its authority through such an expansive, atextual, and ahistorical reading of Section 330."

- The DOJ is mulling over whether to seek *en banc* review.

a. In light of the IRS loss in *Loving v. IRS*, a new, voluntary Annual Filing Season Program to give tax return preparers the ability to claim they hold "a valid Annual Filing Season Program Record of Completion" and that they have "complied with the IRS requirements for receiving the Record of Completion." Rev. Proc. 2014-42, 2014-29 I.R.B. 192 (6/30/14). In order to encourage unenrolled tax return preparers, i.e., those who are not attorneys, CPAs or EAs, to complete continuing education courses in order to get a better understanding of federal tax law, the carrot of being able to claim superiority to the ordinary run-of-the-mill slob tax return preparers is offered. The requirements for this voluntary program include a six-hour refresher course, with a 100-question test at the end, plus other continuing education of two hours of ethics and ten hours of federal tax law topics. Holders of the Record of Completion may not use the terms "certified," "enrolled," or "licensed" to describe the designation.

b. The AICPA's challenge to the Annual Filing Season Program fails, but the court signals that others might successfully challenge it. American Institute of Certified Public Accountants vs. Internal Revenue Service, 118 A.F.T.R.2d 2016-5350 (D.D.C. 8/3/16). The AICPA challenged as unlawful the voluntary Annual Filing Season Program established by the IRS in Rev. Proc. 2014-42, 2014-29 I.R.B. 192 (6/30/14), and the U.S. Court of Appeals for the District of Columbia ruled that the AICPA had standing to bring the challenge. *American Institute of Certified Public Accountants vs. Internal Revenue Service*, 804 F.3d 1193 (D.C. Cir. 10/30/15). In that opinion, the D.C. Circuit declined to address an issue raised by the IRS for the first time on appeal: that the AICPA's grievance does not "fall within the zone of interests protected or regulated by the statutory provision it invokes." On remand, the District Court (Judge Boasberg) held that the AICPA failed the zone of interests test because its grievance (which the court characterized as the grievance of the AICPA's members) is neither regulated nor protected by the relevant statute. Accordingly, the court granted the IRS's motion to dismiss. The court characterized the grievance of the AICPA and its members as competitive injury from brand dilution, i.e., that the AFS Program would dilute the credentials of the AICPA's members by introducing a government-backed credential and government-sponsored public listing. The relevant statute, the court concluded, is 31 U.S.C. § 330(a), which authorizes the Secretary of the Treasury to regulate the practice of representatives of persons before the Treasury Department and to require that certain conditions be satisfied, such as good character, before admitting a person to practice. The AICPA is not a representative of persons within the zone of interests *regulated* by the statute, the court concluded, because to satisfy this requirement the party must be regulated by the particular regulatory action being challenged. To demonstrate that it is in the zone of interests *protected* by the statute, the AICPA would have to demonstrate either that it is an intended beneficiary of the statute or that it is a "suitable challenger" to enforce the statute. The AICPA did not contend that it was an intended beneficiary of the statute, and the court concluded that the AICPA was not a suitable challenger. The court reasoned that the purpose of 31 U.S.C. § 330(a) is consumer protection, and that the AICPA's interest in avoiding intensified competition as a result of the AFS Program was not congruent with that purpose. "On the contrary, AICPA members' competitive interests are on a collision course with Congress's interest in safeguarding consumers."

- Although it dismissed the AICPA's challenge, the court added:

> A final word. While AICPA does not have a cause of action under the APA to bring this suit, the Court has little reason to doubt that there may be other challengers who could satisfy the rather undemanding strictures of the zone-of-interests test.

c. Although the IRS can require the use of PTINs, it cannot charge for them. The IRS needs to pay the fees back, says a federal district court. Don't spend the money just yet, though. The government likely will appeal, and the class action lawyers will ask for their cut. Steele v. United States, 119 A.F.T.R.2d 2017-2065 (D.D.C. 6/1/17). In this class action lawsuit, the court (Judge Lamberth) held that, although the IRS has statutory authority to require the use of PTINs by those who prepare tax returns for compensation, it cannot charge fees for issuing PTINs. Charging fees, the court reasoned, is "equivalent to imposing a regulatory licensing scheme and [under *Loving v. IRS*, 742 F.3d 1013 (D.C. Cir. 2/11/14)] the IRS does not have such regulatory authority."

- In a subsequent order, the court declared all fees charged by the IRS for issuing PTINs unlawful, permanently enjoined the United States from charging such fees, and ordered the United States to refund all PTIN fees paid from September 1, 2010 to the present. *See Steele v. United States*, 120 A.F.T.R.2d 2017-5145 (D.D.C. 7/7/17).

2. Due date of Forms W-2, W-3, and 1099-MISC that report nonemployee compensation: temporary and proposed regulations address the revised due date. T.D. 9821, Return Due Date and Extended Due Date Changes, 82 F.R. 33441 (7/20/17). Treasury and the IRS have issued proposed, temporary, and final regulations regarding the due date for forms in the Form W-2 series, Form W-3 series, and Forms 1099-MISC that report nonemployee compensation. The Protecting Americans from Tax Hikes Act of 2015 ("2015 PATH Act"), § 201, amended Code § 6071(c) to require that Forms W-2 and W-3 and any returns or written statements required to report nonemployee compensation (such as Form 1099-MISC) be filed by January 31 of the year after the calendar year to which the returns relate. The effect of this change was to require these information returns to have the same due date as employee and payee statements and to eliminate the extended filing date for electronically filed returns under § 6071(b). These regulations implement this statutory directive and provide that these information returns must be filed by January 31 of the calendar year for which the information is being reported, regardless of whether the returns are filed on paper or electronically.

- Information returns on Form 1099-MISC that do not report nonemployee compensation are not affected by this change and are due on February 28 of the year following the calendar year for which the information is being reported, or on March 31 if filed electronically.

- The temporary regulations apply to information returns filed on or after July 20, 2017, but the statutory amendments made by the 2015 PATH Act apply to information returns relating to calendar years beginning in 2016. Thus, the changes to the due date were effective for information returns filed in 2017 with respect to calendar year 2016.

3. Temporary regulations implement the 5-½ month automatic extension of time to file income tax returns of trusts and non-bankruptcy estates. T.D. 9821, Return Due Date and Extended Due Date Changes, 82 F.R. 33441 (7/20/17). Treasury and the IRS have issued proposed, temporary, and final regulations that provide an automatic 5-½ month extension of time for trusts and non-bankruptcy estates to file an income tax return on Form 1041. Previously, Reg. § 1.6081-6(a)(1) provided an automatic 5-month extension. The Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, § 2006(b)(2), directs the Treasury to modify relevant regulations to provide that the maximum extension of time for the returns of trusts filing Form 1041 is 5-½ months (ending on September 30 for calendar-year taxpayers). Pursuant to this statutory directive, Temp. Reg. § 1.6081-6T(a)(1) provides that trusts and non-bankruptcy estates required to file an income tax return on From 1041 are allowed an automatic 5-½ month extension by filing a timely application. No extension beyond the automatic extension is permitted.

- The temporary regulations apply to applications for an automatic extension of time to file an estate or trust income tax return on or after July 20, 2017, but the statutory amendments made by the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 apply to returns for taxable years that begin after December 31, 2015. Accordingly, the preamble to the temporary regulations provides that taxpayers can elect to apply the regulations to returns filed for periods beginning after December 31, 2015.

- The temporary regulations do not amend the rule for income tax returns on Form 1041 for bankruptcy estates of individuals proceeding under chapters 7 or 11, provided by Reg. § 1.6081-6T(a)(2), which provides an automatic 6-month extension.

4. The IRS has provided extensions of filing and payment due dates for those in areas affected by Hurricanes Harvey, Irma, and Maria. In news release IR-2017-160 (9/26/17), the IRS has summarized the relief announced in a series of prior news releases for those in areas affected by Hurricanes Harvey, Irma, and Maria. The relief is available to individuals and businesses anywhere in Florida, Georgia, Puerto Rico, and the Virgin Islands, as well as parts of Texas. (Parts of Puerto Rico qualify for the Hurricane Irma relief, and all of Puerto Rico qualifies for the Hurricane Maria relief. Hurricane Maria struck Puerto Rico just after September 15, 2017, so in theory there are parts of Puerto Rico that do not qualify for relief from September 15 due dates.) The prior news releases are IR-2017-135 (8/28/17) (relief in Texas for Harvey), VI-2017-01 (9/8/17) (relief in Virgin Islands for Irma), PR-2017-01 (9/12/17) (relief in Puerto Rico for Irma), IR-2017-150 (9/12/17) (relief in Florida for Irma), IR-2017-155 (9/15/17), (expanded relief in Florida for Irma), IR-2017-156 (9/19/17) (expanding Irma relief to all of Georgia).

Deadlines extended to January 31, 2018. For those in affected areas, the following due dates have been extended to January 31, 2018: (1) the September 15, 2017, and January 16, 2018, due dates for quarterly estimated tax payments; (2) the September 15, 2017, due date for certain returns, such as those for calendar-year partnerships that filed timely extension requests for 2016; (3) the October 16, 2017, due date for 2016 individual returns for individuals who filed timely extension requests; (4) the October 31, 2017, due date for quarterly payroll and excise tax returns; and (5) the November 15, 2017, due date for 2016 returns of calendar-year tax-exempt organizations that filed timely extension requests. **Note:** individuals who filed a timely request for an extension of time to file their 2016 returns do not obtain any relief for tax payments related to the 2016 return because those payments were due on April 18, 2017.

Waiver of late-deposit penalties for federal payroll and excise taxes. For those in affected areas, the IRS has waived late-deposit penalties for federal payroll and excise taxes due during the first fifteen days of the disaster period. The specific dates vary according to the location.

Relief provided automatically. The IRS will automatically provide filing and penalty relief to any taxpayer with an address of record in one of these disaster areas. Taxpayers in one of these areas who receive a notice from the IRS regarding a late-filing or late-payment penalty should contact the IRS at the number listed on the notice to have the penalty abated.

XI. WITHHOLDING AND EXCISE TAXES

XII. TAX LEGISLATION

XIII. TRUSTS, ESTATES & GIFTS