RECENT DEVELOPMENTS IN FEDERAL INCOME TAXATION

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

By

Bruce A. McGovern
Professor of Law and Director, Tax Clinic
South Texas College of Law Houston
Houston, Texas 77002
Tele: 713-646-2920
e-mail: bmcgovern@stcl.edu

State Bar of Texas Tax Section
First Wednesday Tax Update
December 6, 2017

Note: This outline was prepared jointly with Professor Cassady V. ("Cass") Brewer of the Georgia State University College of Law, Atlanta, GA. Martin J. McMahon, Jr., James J. Freeland Eminent Scholar in Taxation and Professor of Law Emeritus, University of Florida Levin College of Law, Gainesville, FL, also contributed to this outline.

I. ACCOUNTING

II. BUSINESS INCOME AND DEDUCTIONS

A. Income

B. Deductible Expenses versus Capitalization

C. Reasonable Compensation

D. Miscellaneous Deductions

E. Depreciation & Amortization

F. Credits

G. Natural Resources Deductions & Credits

H. Loss Transactions, Bad Debts, and NOLs

I. At-Risk and Passive Activity Losses

1. **IRS says the District Court for the Western District of Arkansas got it all wrong by allowing a taxpayer to claim passive losses against trade or business income due to taxpayer's "real estate professional" status.** A.O.D. 2017-07, 2017-42 I.R.B. 311 (10/16/17). In this action on decision, the IRS announced that it will not follow in two separate respects the decision of the U.S. District Court for the Western District of Arkansas in the unreported decision of *Stanley v. United States*, 116 A.F.T.R.2d 2015-6766 (W.D. Ark. 11/12/15). First, the IRS will not follow the District Court's holding that S corporation stock subject to a substantial risk of forfeiture counts for purposes of the "5-percent owner" exception in § 469(c)(7)(D)(ii), which allows the personal services of certain owner-employees of real estate management companies to qualify as material participation with respect to rental real property. The taxpayer in *Stanley* held a restricted share certificate for 10 percent of the outstanding stock of an S corporation real estate management company in which he was an employee, but apparently his stock was not considered outstanding for subchapter S purposes because it was subject to a substantial risk of forfeiture under § 83 and he had not made a § 83(b) election with respect to the stock. Second, the IRS disagreed with the District Court's decision that a § 469(c)(7) "real estate professional" who meets the material participation test by grouping rental real estate activities with real estate management activities also may group rental real estate activities and those same real estate management activities for determining passive income and passive losses. The taxpayer in *Stanley* was permitted by the District Court to group his non-passive income from his employer, a real estate management company, with his passive rental real estate holdings, in order to claim excess passive losses that otherwise would be disallowed by § 469.

III. INVESTMENT GAIN

A. Gains and Losses

1. **Pyrrhotite cracking the foundation of your house? IRS to the rescue!** Rev. Proc. 2017-60, 2017-50 I.R.B. ___ (11/23/17). Pyrrhotite is a naturally occurring mineral in stone aggregate used to produce concrete. Pyrrhotite oxidizes in the presence of water and oxygen, leading to expansion that cracks and deteriorates concrete foundations prematurely. As discovered and reported by the Connecticut Department of Consumer Protection, some homeowners in New England have suffered premature deterioration in their concrete foundations due to pyrrhotite. This had led taxpayers to inquire of the IRS whether the damage to their concrete foundations caused by phrrhotite may be claimed as a personal casualty loss under § 165. Normally, a § 165 casualty loss is limited to an identifiable event that is sudden, unexpected, or unusual and that causes damage to property. The amount of a taxpayer's casualty loss ordinarily is the decrease in the fair market value of the property (less any insurance reimbursement) as a result of the casualty, not to exceed the taxpayer's adjusted basis in the damaged property. On the other hand, damage or loss resulting from progressive deterioration of property through a steadily operating cause generally is not considered a casualty loss within the meaning of § 165. *Matheson v. Commissioner*, 54 F.2d 537 (2d Cir. 1931). If a § 165

casualty loss is sustained for personal use property, a deduction is allowable only for (i) the amount of the loss that exceeds $100 per casualty and (ii) the net amount of all of the taxpayer's personal casualty losses (in excess of personal casualty gains, if any) that exceeds 10 percent of the taxpayer's adjusted gross income for the year. In Rev. Proc. 2017-60, the IRS concludes that damage to concrete foundations caused by pyrrhotite may qualify as a § 165 casualty loss if the loss is determined and reported in compliance with the guidance provided by the revenue procedure. Specifically, the revenue procedure creates a safe harbor under which a taxpayer who pays to repair damage to the taxpayer's personal residence caused by pyrrhotite may treat the amount paid as a casualty loss in the year of payment. To qualify for the safe harbor, an affected taxpayer must obtain either (1) a written evaluation from a licensed engineer indicating that the foundation was made with defective concrete and obtain a reassessment report that shows the reduced value of the property based on the written evaluation from the engineer and an inspection pursuant to Connecticut Public Act No. 16-45, or (2) a written evaluation from a licensed engineer indicating that the foundation was made with defective concrete containing the mineral pyrrhotite. The amount of the casualty loss is the amount paid by the taxpayer to repair the damage (limited by the taxpayer's basis in the property and reduced by any insurance proceeds received for the damage). The revenue procedure also specifies other guidelines for claiming a pyrrhotite casualty loss, including reporting the loss on IRS Form 4684 with "Revenue Procedure 2017-60" typed at the top of the form. The revenue procedure is effective for federal income tax returns (including amended returns) filed after November 21, 2017.

B. Interest, Dividends, and Other Current Income

C. Profit-Seeking Individual Deductions

D. Section 121

E. Section 1031

F. Section 1033

G. Section 1035

H. Miscellaneous

IV. COMPENSATION ISSUES

A. Fringe Benefits

1. The IRS provides guidance on the application of the Affordable Care Act's market reforms to HRAs, EPPs, FSAs, and EAPs — it's the bee's knees! Notice 2013-54, 2013-40 I.R.B. 287 (9/13/13), *supplemented by* Notice 2015-87, 2015-52 I.R.B. 889 (12/16/15). The Patient Protection and Affordable Care Act amended the Public Health Service Act to implement certain market reforms for group health plans, including requirements that: (1) group health plans not establish any annual limit on the dollar amount of benefits for any individual, and (2) non-grandfathered group health plans provide certain preventive services without imposing any cost-sharing requirements for the services. The notice provides guidance, in Q&A format, on the application of these market reforms to: (1) health reimbursement arrangements (including HRAs integrated with group health plans), (2) group health plans under which employers reimburse employees for premium expenses incurred for an individual health insurance policy (referred to in the notice as "employer payment plans"), and (3) health flexible spending arrangements. The notice also provides guidance on employee assistance programs and on § 125(f)(3), which generally provides that a qualified health plan offered through a health insurance exchange established under the Affordable Care Act is not a qualified benefit that can be offered through a cafeteria plan. The notice applies for plan years beginning on and after 1/1/14, but taxpayers can apply the guidance provided in the notice for all prior periods. The Department of Labor has issued guidance in substantially identical form (Technical Release 2013-03) and the Department of Health and Human Services is issuing guidance indicating that it concurs.

a. The obvious solution has a great big catch in it. In a Q&A issued on 5/13/14, available on the IRS's web site (https://perma.cc/FK5A-FRF2), the IRS states:

Q1. What are the consequences to the employer if the employer does not establish a health insurance plan for its own employees, but reimburses those employees for premiums they pay for health insurance (either through a qualified health plan in the Marketplace or outside the Marketplace)?

[A1]. Under IRS Notice 2013-54, such arrangements are described as employer payment plans. An employer payment plan, as the term is used in this notice, generally does not include an arrangement under which an employee may have an after-tax amount applied toward health coverage or take that amount in cash compensation. As explained in Notice 2013-54, these employer payment plans are considered to be group health plans subject to the market reforms, including the prohibition on annual limits for essential health benefits and the requirement to provide certain preventive care without cost sharing. Notice 2013-54 clarifies that such arrangements cannot be integrated with individual policies to satisfy the market reforms. Consequently, such an arrangement fails to satisfy the market reforms and may be subject to a $100/day excise tax per applicable employee (which is $36,500 per year, per employee) under section 4980D of the Internal Revenue Code.

b. Good news (?) for some employers: the IRS reiterates prior guidance and clarifies issues related to employer payment plans and provides transition relief from the § 4980D excise tax. Notice 2015-17, 2015-14 I.R.B. 845 (2/18/15). This notice reiterates the conclusion in prior guidance, including Notice 2013-54, 2013-40 I.R.B. 287, that employer payment plans are group health plans that will fail to comply with the market reforms that apply to group health plans under the Affordable Care Act. The notice provides guidance, in Q&A format, on several issues, including the treatment of: (1) an S corporation's payment or reimbursement of premiums for individual health insurance coverage covering a 2-percent shareholder, (2) an employer's reimbursement of an employee's Medicare premiums or payment of medical expenses for employees covered by TRICARE, (3) an employer's increase of an employee's compensation to assist with payments for individual coverage, and (4) an employer's provision of premium assistance on an after-tax basis. The notice also provides a transition rule under which the IRS will not assert the excise tax imposed by § 4980D for any failure to satisfy the market reforms by employer payment plans that pay, or reimburse employees for individual health policy premiums or Medicare part B or Part D premiums: (1) for 2014 for employers that are not applicable large employers for 2014, and (2) for 1/1/15 through 6/30/15 for employers that are not applicable large employers for 2015. Generally, applicable large employers are those that employed an average of at least 50 full-time employees on business days during the preceding calendar year. Employers eligible for this transition rule are not required to file Form 8928 (Return of Certain Excise Taxes Under Chapter 43 of the Internal Revenue Code) solely as a result of having employer payment plans for the period for which the employer is eligible for the relief.

c. Final regulations provide guidance on many issues under the Affordable Care Act and incorporate prior guidance issued in forms other than regulations. T.D. 9744, Final Rules for Grandfathered Plans, Preexisting Condition Exclusions, Lifetime and Annual Limits, Rescissions, Dependent Coverage, Appeals, and Patient Protections Under the Affordable Care Act, 80 F.R. 72192 (11/18/15). The Treasury Department and the IRS have issued final regulations regarding grandfathered health plans, preexisting condition exclusions, lifetime and annual dollar limits on benefits, rescissions, coverage of dependent children to age 26, internal claims and appeal and external review processes, and patient protections under the Affordable Care Act. Among many other changes, the final regulations provide guidance on integration of health reimbursement arrangements with other group health plan coverage and modify Notice 2015-17 by providing a special rule for employers with fewer than 20 employees who offer group health plan coverage to employees who are not eligible for Medicare but do not offer coverage to employees who are eligible for Medicare. If such an employer is not required by the applicable Medicare secondary payer rules to offer group health plan coverage to employees who are eligible for Medicare coverage, then the employer's reimbursement of Medicare part B or D premiums may be integrated with Medicare and deemed to satisfy the annual dollar limit prohibition and the preventive services requirements if the employees who are not offered other group health plan coverage would be eligible for that group health plan but for their eligibility for Medicare. The regulations are effective on 1/19/16 and apply to group health plans and health insurance issuers beginning on the first day of the first plan year (or, in the individual market, the first day of the first policy year) beginning on or after 1/1/17.

d. **Just in time for Christmas! The IRS continues to prove that the Affordable Care Act, like the jelly-of-the-month club, is, as cousin Eddie put it, "the gift that keeps on giving [guidance] the whole year."** Notice 2015-87, 2015-52 I.R.B. 889 (12/16/15). This notice, in Q&A format, provides guidance on the application of various provisions of the Affordable Care Act to employer-provided health coverage. The notice supplements the guidance in Notice 2013-54, 2013-40 I.R.B. 287 (9/13/13) and T.D. 9744, Final Rules for Grandfathered Plans, Preexisting Condition Exclusions, Lifetime and Annual Limits, Rescissions, Dependent Coverage, Appeals, and Patient Protections Under the Affordable Care Act, 80 F.R. 72192 (11/18/15). The notice (1) provides guidance on the application of the Affordable Care Act's market reforms for group health plans to various types of employer health care arrangements, including health reimbursement arrangements and group health plans under which an employer reimburses an employee for some or all of the premium expenses incurred for an individual health insurance policy; (2) clarifies certain aspects of the employer shared responsibility provisions of § 4980H; (3) clarifies certain aspects of the application to government entities of § 4980H, the information reporting provisions for applicable large employers under § 6056, and application of the rules for health savings accounts to persons eligible for benefits administered by the Department of Veterans Affairs; (4) clarifies the application of the COBRA continuation coverage rules to unused amounts in a health flexible spending arrangement carried over and available in later years, and conditions that may be put on the use of carryover amounts; and (5) addresses relief from penalties under §§ 6721 and 6722 that has been provided for employers that make a good faith effort to comply with the requirements under § 6056 to report information about offers made in calendar year 2015. The guidance provided in the notice generally applies for plan years beginning on and after 12/16/15, but taxpayers can apply the guidance provided in the notice for all prior periods.

e. **Colleges and universities providing health insurance premium reductions to students who perform services might have employer payment plans that violate the Affordable Care Act's market reforms, and may need to look at alternatives.** Notice 2016-17, 2016-9 I.R.B. 358 (2/5/16). Colleges and universities often provide students, especially graduate students, with health coverage at greatly reduced or no cost as part of a package that includes tuition assistance and a stipend for living expenses. Some of these students perform services for the school (such as teaching or research), which raises the issue whether these premium reduction arrangements might be viewed as employer-sponsored group health plans that are employer payment plans that violate the market reform provisions of the Affordable Care Act. The notice concludes that whether such arrangements constitute group health plans will depend on all of the facts and circumstances, and that they might or might not be viewed as employer payment plans. To give colleges and universities time to examine this issue and adopt suitable alternatives if necessary, the notice provides that Treasury (and the Department of Labor and the Department of Health and Human Services) will not assert that a premium reduction arrangement fails to satisfy the Affordable Care Act's market reforms if the arrangement is offered in connection with other student health coverage (either insured or self-insured) for a plan year or policy year beginning before 1/1/17. Thus, colleges and universities have relief for plan years or policy years that are roughly coterminous with academic years beginning in the summer or fall of 2016 and ending in 2017. This notice applies for plan years beginning before 1/1/17.

f. **Congress provides relief from the § 4980D excise tax for small employers offering health reimbursement arrangements, imposes new reporting requirements, limits the exclusion from gross income under § 106, and coordinates HRAs with the § 36B premium tax credit.** The 21st Century Cures Act ("Cures Act"), Pub. L. No. 114-255, was signed by the President on 12/13/16. Among other changes, the Cures Act made several modifications to the rules related to health reimbursement arrangements.

Health Reimbursement Arrangements Offered by Small Employers—Section 18001(a)(1) of the Cures Act amends Code § 9831 by adding subsection (d), which provides that, for purposes of title 26 (other than the Cadillac Tax of § 4980I), a "qualified small employer health reimbursement arrangement" (QSEHRA) is not treated as a group health plan. The effect of this amendment is to allow employers to offer health reimbursement arrangements that meet the definition of a QSEHRA without becoming subject to the excise tax of § 4980D. An arrangement is a QSEHRA if it (1) is offered by an "eligible employer;" (2) subject to certain exceptions, is provided to all "eligible employees" on the same terms, (3) is funded solely by the employer and does not call for contributions through salary reduction; (4) provides for the payment or reimbursement of documented expenses for medical care (as defined in § 213(d)) incurred by the employee or the employee's family members; and (5) the amount of payments and reimbursements for the year do not exceed $4,950 ($10,000 in the case of an arrangement that also provides for payments or reimbursements for family members of the employee). These dollar limitations will be adjusted for inflation after 2016. An "eligible employer" is an employer that is not an applicable large employer as defined in § 4980H(c)(2) and does not offer a group health plan to any of its employees. An "eligible employee" generally is any employee of the employer, but the terms of the arrangement may exclude from consideration certain employees, such as those who have not completed 90 days of service, those who have not attained age 25, and part-time or seasonal employees. This relief from the § 4980D excise tax applies for years beginning after 12/31/16, which means that employers may begin offering QSEHRAs beginning in 2017.

New Reporting Obligations—The Cures Act imposes two new reporting requirements related to health reimbursement arrangements. **First**, Code § 9831(d)(4), as added by § 18001(a)(1) of the Cures Act, provides that an employer funding a QSEHRA for any year must provide to each eligible employee a written notice not later than 90 days before the beginning of the year (or, if later, the date on which the employee becomes an eligible employee). The notice must include the following information: (1) a statement of the amount of the employee's permitted benefit under the arrangement for the year; (2) statement that the employee should provide the amount of his or her permitted benefit to any health insurance exchange to which the employee applies for advance payment of the premium tax credit; and (3) a statement that, if the employee is not covered under minimum essential coverage for any month, the employee may be subject to tax under section § 5000A for that month and reimbursements under the arrangement may be includible in gross income. An employer that fails to provide the required notice is subject to a $50 penalty per employee for each incident of failure, subject to a $2,500 calendar year maximum for all failures. **Second**, new Code § 6501(a)(15), as added by § 18001(a)(6) of the Cures Act, requires an employer to report on Form W-2 the amount of each employee's permitted benefit under a QSEHRA. These rules regarding reporting apply to years beginning after 12/31/16. However, the legislation provides that a person shall not be treated as failing to provide the written notice required by § 9831(d)(4) if the notice is provided not later than 90 days after the date of the enactment of the Cures Act.

Extension of Relief Provided by Notice 2015-17—Notice 2015-17, 2015-14 I.R.B. 845 (2/18/15), provided a transition rule under which the IRS would not assert the excise tax imposed by § 4980D for any failure to satisfy the market reforms by employer payment plans that pay or reimburse employees for individual health policy premiums or Medicare part B or Part D premiums: (1) for 2014 for employers that are not applicable large employers for 2014, and (2) for 1/1/15 through 6/30/15 for employers that are not applicable large employers for 2015. Section 18001(a)(7)(B) of the Cures Act provides that the relief under Notice 2015-17 shall be treated as applying to any plan year beginning on or before 12/31/16. This means that employers that are not applicable large employers will not be subject to the § 4980D excise tax as a result of offering an employer payment plan for plan years beginning on or before 12/31/16.

Limitation on the Exclusion of Code § 106—New Code § 106(g), as added by § 18001(a)(2) of the Cures Act, provides that, for purposes of Code §§ 105 and 106, payments or reimbursements to an individual for medical care from a QSEHRA shall not be treated as paid or reimbursed under employer-provided coverage for medical expenses under an accident or health plan if, for the month in which the medical care is provided, the individual does not have minimum essential coverage within the meaning of § 5000A(f). The effect of this amendment is that payments or reimbursements under a QSEHRA are included in an individual's gross income if the individual does not have minimum essential coverage.

Coordination with the § 36B Premium Tax Credit—Code § 36B(c)(4), as added by § 18001(a)(3) of the Cures Act, makes an individual ineligible for the § 36B premium tax credit for any month if the individual is provided a QSEHRA for the month that constitutes affordable coverage. If the QSEHRA does not constitute affordable coverage, then the employee remains eligible for the premium tax credit for the month, but the amount of the credit is reduced by the 1/12 of the employee's permitted benefit under the QSEHRA for the year. A QSEHRA constitutes affordable coverage for a month (and therefore makes an employee ineligible for the premium tax credit) if the *excess of* (1) the premium for the month for self-only coverage under the second lowest cost silver plan offered in the relevant individual health insurance market, *over* (2) 1/12 of the employee's permitted benefit under the QSEHRA, *exceeds* 1/12 of 9.69 percent (for 2017) of the employee's household income. (Note that this calculation requires using the cost of self-only coverage, even for employees with insured family members.) The statutory rules provide for adjusting the calculation in the case of employees employed for less than a full year. An employee must provide the amount of his or her permitted benefit to any health insurance exchange to which the employee applies for advance payment of the premium tax credit.

Application of the Cadillac Tax—Generally, § 4980I, which was enacted as part of the Affordable Care Act, imposes a 40 percent excise tax on the amount by which the cost of group health coverage provided by an employer (referred to as "applicable employer-sponsored coverage") exceeds a specified dollar limit. Subsequent to the enactment of the Affordable Care Act, Congress in 2015 delayed the effective date of the Cadillac Tax to taxable years beginning after 12/31/19. Section 18001(a)(4) of the Cures Act amends Code § 4980I(d)(2)(D) to provide that a QSEHRA is considered "applicable employer-sponsored coverage" for purposes of the Cadillac Tax. Accordingly, the cost of a QSEHRA to the employer must be taken into account in determining the applicability of the Cadillac Tax.

g. Employers offering Qualified Small Employer Health Reimbursement Arrangements in 2017 need not provide the initial written notice to employees until after the IRS provides guidance. Notice 2017-20, 2017-11 I.R.B. 1010 (2/27/17). The 21st Century Cures Act, signed by the President on 12/13/16, added Code § 9831(d)(4), which requires each employer that funds a QSEHRA to provide each eligible employee a written notice with specified information not later than 90 days before the beginning of the year (or, if later, the date on which the employee becomes an eligible employee). For 2017, the legislation provides that employers will be treated as complying with this requirement if they provide the notice not later than 90 days after the date of enactment of the Cures Act. The 90th day was 3/13/17. An employer that fails to provide the required notice is subject to a $50 penalty per employee for each incident of failure, subject to a $2,500 calendar year maximum for all failures. Because employers might have difficulty complying with the notice requirement in the absence of guidance, the IRS has announced that employers funding QSEHRAs in 2017 need not provide the initial written notice until after the IRS issues such guidance.

h. Guidance on issues related to Qualified Small Employer Health Reimbursement Arrangements, including required reporting by employers. Notice 2017-67, 2017-47 I.R.B. 517 (10/31/17). In this notice, the IRS has provided guidance to employers offering Qualified Small Employer Health Reimbursement Arrangements, which are described in Code § 9831(d). Among other guidance, the notice clarifies that a QSEHRA can be provided only to current employees, not to retirees. The notice provides that employers ofering a QSEHRA in 2017 or 2018 must provide the required written notice to employees by the later of (1) 90 days before the first day of the QSEHRA plan year, or (2) February 28, 2018. The notice contains sample language and provides requirements for the notice. An employer must report payments and reimbursements that an employee was entitled to receive (i.e., without regard to the amounts the employee actually received) in Box 12 of Form W-2 using code FF.

2. Ministers pray this "crabby" case gets reversed (again!) on appeal. Gaylor v. Mnuchin, ___ F. Supp. 3d ___, 120 A.F.T.R.2d 2017-6128 (W.D. Wis. 10/6/17). In a case that previously was overturned on appeal to the Seventh Circuit, the U.S. District Court for the Western District of Wisconsin (Judge Crabb) held that § 107(2) is unconstitutional because it violates the First Amendment's establishment clause. Section 107(2) excludes from gross income a "rental allowance" paid to a minister as part of his or her compensation. Section 107(1) excludes the "rental value of a home" furnished to a minister as part of his or her compensation. For technical reasons, only § 107(2)'s "rental allowance" exclusion was at issue in this case. The named plaintiff, Gaylor, is co-president of the true plaintiff, Freedom from Religion Foundation, Inc. ("FFRF"). In a prior iteration of the case, *Freedom from Religion Foundation, Inc. v. Lew*, 773 F.2d 815 (7th Cir. 2014), the Seventh Circuit vacated Judge Crabb's prior ruling striking down § 107(2) by determining that FFRF lacked standing to sue; however, the Seventh Circuit essentially instructed FFRF on how it might obtain standing. FFRF dutifully followed the Seventh Circuit's directions and then refiled its claim with Judge Crabb that § 107(2) violates the First Amendment's establishment clause because it "demonstrates a preference for ministers over secular employees." Look for the IRS and Treasury to appeal this one yet again.

B. Qualified Deferred Compensation Plans

1. **Some inflation-adjusted numbers for 2018**. Notice 2017-64, 2017-45 I.R.B. 486 (10/19/17).

- Elective deferral in §§ 401(k), 403(b), and 457 plans are increased from $18,000 to $18,500 with a catch up provision for employees aged 50 or older that remains unchanged at $6,000.

- The limit on contributions to an IRA will be unchanged at $5,500. The AGI phase out range for contributions to a traditional IRA by employees covered by a workplace retirement plan is increased to $63,000 to $73,000 (from $62,000-$72,000) for single filers and heads of household, increased to $101,000-$121,000 (from $99,000-$119,000) for married couples filing jointly in which the spouse who makes the IRA contribution is covered by a workplace retirement plan, and increased to $189,000-$199,000 (from $186,000-$196,000) for an IRA contributor who is not covered by a workplace retirement plan and is married to someone who is covered. The phase-out range for contributions to a Roth IRA is increased to $189,000-$199,000 (from $186,000-$196,000) for married couples filing jointly, and increased to $120,000-$135,000 (from $118,000-$133,000) for singles and heads of household.

- The annual benefit from a defined benefit plan under § 415 is increased to $220,000 (from $215,000).

- The limit for defined contribution plans is increased to $55,000 (from $54,000).

- The amount of compensation that may be taken into account for various plans is increased to $275,000 (from $270,000), and is increased to $405,000 (from $4005,000) for government plans.

- The AGI limit for the retirement savings contribution credit for low- and moderate-income workers is increased to $63,000 (from $62,000) for married couples filing jointly, increased to $47,250 (from $46,5005) for heads of household, and increased to $31,500 (from $31,000) for singles and married individuals filing separately.

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

D. Individual Retirement Accounts

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. **Excess advance premium tax credits are treated as an increase in tax, and we do not have equitable power to change that result, says the Tax Court.** McGuire v. Commissioner, 149 T.C. No. 9 (8/28/17). The taxpayers, a married couple, purchased health insurance for 2014 through Covered California, a health insurance exchange created under the Affordable Care Act. At the time they applied for coverage in 2013, their only income was that of Mr. McGuire. Based on this income, they qualified for an advance payment of the premium tax credit authorized by § 36B. Later in 2013, Mrs. McGuire became employed and the couple's income increased. They informed the exchange of the increase in income and of their change of address. The exchange did not update their

address. The exchange sent them a letter informing them that they no longer qualified for the premium tax credit, but they never received the letter. Similarly, they never received from the exchange Form 1095-A, which taxpayers use to calculate their premium tax credit for the year. During 2014, the exchange made monthly payments to the health insurance issuer of $591, for an annual total of $7,092. The taxpayers worked with a CPA to prepare their 2014 return. Because they had received advance credit payments, they were required by § 36B(f)(1) to reconcile the amount of the advance payments with the premium tax credit calculated on their return. The taxpayers did not report their advance credit payments on their return. The IRS ultimately issued a notice of deficiency disallowing the entire credit. Because they did not qualify for any premium tax credit and had received $7,092 in advance credit payments, they owed the entire $7,092 as a tax liability. The taxpayers argued that the exchange had a responsibility to ensure that only those eligible for advance credit payments receive them, and that they never would have enrolled in the health insurance coverage they had chosen without the assistance of the credit for which the exchange had told them they qualified. They asked the court to rule "fairly and justly." The Tax Court (Judge Buch) held that it had no ability grant relief to the taxpayers. The court reiterated that it is not a court of equity and "cannot ignore the law to achieve an equitable end."

> Although we are sympathetic to the McGuires' situation, the statute is clear; excess advance premium tax credits are treated as an increase in the tax imposed. Sec. 36B(f)(2)(A). The McGuires received an advance of a credit to which they ultimately were not entitled. They are liable for the $7,092 deficiency.

The court declined to impose accuracy-related penalties on the basis of negligence because the IRS had presented no evidence of negligence. The court also declined to impose such penalties on the basis of substantial understatement of income because the taxpayers had established a reasonable cause, good faith defense based on their reliance on a third party (the exchange) to fulfill their obligations, their failure to receive Form 1095-A, and their reliance on a CPA to prepare their return.

2. Standard deduction for 2018. Rev. Proc. 2017-58, 2017-45 I.R.B. 489 (10/19/17). The standard deduction for 2018 will be $13,000 for joint returns and surviving spouses (increased from $12,700), $6,500 for unmarried individuals and married individuals filing separately (increased from $6,350), and $9,550 for heads of households (increased from $9,350).

E. Divorce Tax Issues

F. Education

G. Alternative Minimum Tax

VI. CORPORATIONS

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

E. Inside Basis Adjustments

F. Partnership Audit Rules

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.

b. **Further penalty relief for partnerships and certain other entities that missed the new accelerated due date.** Notice 2017-71, 2017-51 I.R.B. ___ (11/30/17). The IRS has expanded the penalty relief provided by Notice 2017-47, 2017-38 I.R.B. 232 (9/1/17), in two ways: (1) penalty relief is available not only with respect to filing or furnishing of returns, but also to taking other actions, such as making elections, contributing to an employee pension plan, or paying tax, by the due date of a partnership return, and (2) penalty relief is available not only to entities classified as partnerships for federal tax purposes, but also to real estate mortgage investment conduits (REMICs) and certain other entities that are required to file partnership returns. This notice provides that the IRS will treat acts of a partnership, REMIC, or any entity that may properly file a Form 1065 (such as a bank with respect to the return of a common trust fund or a religious or apostolic association or corporation) as timely if the entity took the act 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). This relief is available only for the first taxable year that began after December 31, 2015, and ended before January 1, 2017. Despite the penalty relief, the notice cautions that the entity will be liable for any interest due under § 6601 from the date prescribed for payment until the date of payment.

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. This notice amplifies, clarifies, and supersedes Notice 2017-47.

VIII. TAX SHELTERS

A. Tax Shelter Cases and Rulings

1. You better hope that your HP computer works better than HP's tax planning strategies. Hewlett-Packard Co. v. Commissioner, 875 F.3d 494 (9th Cir. 11/9/17) *aff'g* T.C. Memo. 2012-135 (5/14/12). In an opinion by Judge Kozinski, the U.S. Court of Appeals for the Ninth Circuit affirmed the Tax Court's decision (Judge Goeke) denying millions in foreign tax credits claimed by Hewlett-Packard Co. (HP) from 1997 through 2003. The Ninth Circuit also affirmed the Tax Court's disallowance of a capital loss on the sale of the preferred stock by virtue of which HP had claimed the foreign tax credits. The transaction expressly was designed by AIG-Financial Products to generate foreign tax credits. HP purchased preferred stock in a Dutch company called Foppingadreef Investments (FOP) that purchased contingent interest notes. The transaction was structured to take advantage of asymmetric treatment of contingent interest in the U.S. and the Netherlands. The Netherlands taxes contingent interest prior to actual payment thereof while the U.S. taxes such interest only upon payment. In some cases, the contingent interest might never be paid. Thus, the transaction generated foreign tax credits without any actual U.S. tax on the contingent interest, which allowed HP to use the foreign tax credits against U.S. taxes on other foreign income. HP treated FOP as a controlled foreign corporation through its ownership of the preferred stock and warrants to acquire additional stock and claimed foreign tax credits for Dutch taxes on contingent interest. The transaction was pre-arranged to terminate in 2003 through the exercise of put options held by HP that allowed HP to transfer the preferred stock back to the common stockholder of FOP (a Dutch bank) for a price that resulted in a $16 million loss to HP. Judge Kozinski noted that the Courts of Appeals differ in their standard of review on the question whether an investment is debt or equity. Some Courts of Appeals view the question as one of fact, other view it as a question of law, and still others as a mixed question of law and fact. In the Ninth Circuit, the debt-equity distinction is a question of fact and therefore a trial court's conclusion on this issue cannot be overturned on appeal unless clearly erroneous. The Ninth Circuit concluded that the Tax Court committed no clear error in finding that the preferred stock was in reality debt not equity, thereby disqualifying HP from claiming foreign tax credits. Moreover, the Ninth Circuit agreed with the Tax Court that HP's claimed $16 million § 165 loss on the sale of the preferred stock back to the common stockholder of FOP was in effect a nondeductible fee paid to AIG in order to participate in a tax shelter. The Tax Court previously had held, and the Ninth Circuit previously had agreed, that fees spent for the generation of artificial tax losses are not deductible. *See Enrici v. Commissioner*, 813 F.2d 293, 296 (9th Cir. 1987); *see also New Phoenix Sunrise Corp. v. Commissioner*, 132 T.C. 161, 186 (2009), *aff'd,* 408 Fed. Appx. 908 (6th Cir. 2010) (holding payments made in a transaction that lacked economic substance nondeductible).

B. Identified "tax avoidance transactions"

C. Disclosure and Settlement

D. Tax Shelter Penalties

IX. EXEMPT ORGANIZATIONS AND CHARITABLE GIVING

A. Exempt Organizations

B. Charitable Giving

1. Certain syndicated conservation easement transactions entered into after 2009 are listed transactions and taxpayers who have invested in them must disclose them for each tax year in which they participated. Notice 2017-10, 2017-4 I.R.B. 544 (12/23/16). This notice identifies certain syndicated conservation easement transactions entered into after 2009 as listed transactions. In these transactions, a promoter typically markets interests in a pass-through entity that owns real property. The pass-through entity grants a conservation easement on the real property based on an appraisal that, in the IRS's view, greatly inflates the value of the conservation easement based on unreasonable conclusions about the development potential of the real property. The charitable contribution deduction resulting from the grant of the conservation easement flows through to the investors in the pass-through entity. The effect of these transactions is that an investor in the pass-through entity receives a charitable contribution deduction that significantly exceeds the amount invested. The IRS plans to challenge these transactions based on the overvaluation of the conservation easement and also may challenge them based on the partnership anti-abuse rule, economic substance, or other rules or doctrines. Transactions that are the same as, or substantially similar to, the transactions described in § 2 of the notice are identified as "listed transactions" for purposes of Reg. § 1.6011-4(b)(2) and §§ 6111 and 6112 effective 12/23/16. A person entering into these transactions on or after 1/1/10 must disclose the transactions as described in Reg. § 1.6011-4 for each taxable year in which the person participated in the transactions, provided that the period of limitations for assessment of tax has not expired on or before 12/23/16.

a. **Participants in listed syndicated conservation easement transactions have until October 2, 2017, to disclose their participation in years for which returns were filed before December 23, 2016.** Notice 2017-29, 2017-20 I.R.B. 1243 (4/27/17). This notice extends the due date for participants to disclose their participation in the syndicated conservation easement transactions described in Notice 2017-10, 2017-4 I.R.B. 544 (12/23/16). Generally, under Reg. § 1.6011-4(e)(2)(i), if a transaction becomes a transaction of interest or a listed transaction after a taxpayer has filed a return reflecting the taxpayer's participation in the transaction, then the taxpayer must disclose the transaction for any year for which the limitations period on assessment was open on the date the transaction was identified as a listed transaction or transaction of interest within 90 calendar days after the date on which the transaction was identified. Notice 2017-10 extended this period to 180 days for listed syndicated conservation easement transactions, which meant that disclosures were due (for years for which returns already had been filed) on 6/21/17. In this notice, the IRS has extended the due date from 6/21 to 10/2/17. The notice cautions that the due date for disclosure with respect to returns filed after the date Notice 2017-10 was issued (12/23/17) and for disclosure by material advisors is unchanged and remains 5/1/17. The notice also provides that donees in these syndicated conservation easement transactions are not considered material advisors under § 6111.

b. **Those affected by Hurricanes Harvey, Irma, or Maria have until October 31, 2017, to disclose their participation in syndicated conservation easement transactions for years for which returns were filed before December 23, 2016.** Notice 2017-58, 2017-42 I.R.B. 326 (9/27/17). For participants in syndicated conservation easement transactions that are "affected participants," this notice extends the due date for disclosing their participation in the syndicated conservation easement transactions described in Notice 2017-10, 2017-4 I.R.B. 544 (12/23/16). Disclosure was due on October 2, 2017, for years of participation for which a return had already been filed by December 23, 2016 (the date Notice 2017-10 was issued). Affected participants now have until October 31, 2017 to file disclosures. An affected participant is "any participant whose principal residence or principal place of business was located in a Hurricane Harvey, Hurricane Irma, or Hurricane Maria covered disaster area, as defined in [Reg.] § 301.7508A-1(d)(2), or whose records necessary to meet the disclosure obligation were maintained in such a covered disaster area."

2. **Tax Court Not Giving in to First Circuit?** Palmolive Building Investors, LLC v. Commissioner, 149 T.C. No. 18 (10/10/17). In this TEFRA partnership audit case, the Tax Court refused to follow the First Circuit's opinion in *Kaufman v. Shulman*, 687 F.3d 21 (1st Cir. 2012), regarding the § 170(h)(5)(A) "protected in perpetuity" requirement for deducting conservation easements. In particular, the taxpayer, a limited liability company classified for federal tax purposes as a partnership, contributed a $33.41 million facade conservation easement to a § 501(c)(3) qualified organization in 2004 by executing a deed in favor of the donee organization. The building subject to the façade easement was encumbered by two mortgages; however, before executing the façade easement deed, the taxpayer obtained mortgage subordination agreements from the two mortgagee banks. Unfortunately, though, the subordination agreements provided that if the façade easement was extinguished through a condemnation proceeding, the claims of the mortgagee banks to the condemnation proceeds would take priority over the claims of the qualified donee organization. On the other hand, the subordination agreements contained a "savings clause" providing that the mortgagee's rights "shall be deemed amended to the extent necessary" to comply with applicable regulations

governing conservation easements. The IRS argued that due to the failure of the subordination agreements to elevate the rights of the qualified donee organization over the mortgagee's rights upon condemnation of the building, the façade easement was not "protected in perpetuity" and did not grant the donee an adequate "property right," as required by § 170(h)(5)(A) and Reg. § 1.170A-14(g)(2) and (g)(6). To rebut the IRS's contentions, the taxpayer relied upon the First Circuit's decision in *Kaufman*, which allowed a charitable contribution deduction for a façade easement subject to similar mortgage subordination rights. Furthermore, the taxpayer argued that the "savings clause" cured any problem with the subordination agreements. Noting that the case presumably was appealable to the Seventh Circuit, the Tax Court, in a unanimous reviewed opinion by Judge Gustafson, was not persuaded and not only refused to follow the First Circuit's decision in *Kaufman*, but also held that the "savings clause" did not cure the problem with the subordination agreements. (Judge Lauber did not participate in consideration of the opinion.) In the view of the Tax Court, the requirements of § 170(h)(5)(A) and Reg. § 1.170A-14(g)(2) and (g)(6) must be met at the time of the contribution of the easement to the qualified donee and retroactive reformation of a deed contingent upon a condition subsequent (such as with a "savings clause") will not be respected. The court cited several cases for this proposition, including *Belk v. Commissioner,* 774 F.3d 221 (4th Cir. 2014).

X. TAX PROCEDURE

A. Interest, Penalties and Prosecutions

1. Pouring salt on an already mortal wound, the IRS revoked this taxpayer's exempt status and charged ten year's worth of interest on retroactively determined, unpaid taxes of the formerly-exempt taxpayer. Creditguard of America, Inc. v. Commissioner, 149 T.C. No. 17 (10/10/17). The IRS initiated an examination of the taxpayer in 2003 to determine if it qualified for tax-exempt status under § 501(c)(3). The examination concluded on February 1, 2012, when the IRS issued an adverse determination letter revoking the taxpayer's exempt status retroactively from 2002. As a non-exempt corporation, the taxpayer would have been obligated to file a 2002 IRS Form 1120, U.S. Corporate Income Tax Return, by March 17, 2003. Consequently, after the adverse determination was final, the IRS subsequently issued a notice of deficiency to the taxpayer asserting unpaid corporate taxes for 2002. The taxpayer filed a petition in the Tax Court contesting the deficiency for 2002. The Tax Court entered a stipulated decision that determined a deficiency for 2002 of $216,547. In connection with the Tax Court's determination of the deficiency, the taxpayer and the IRS entered into a stipulated decision that underpayment interest on the deficiency would be assessed later "as provided by law." That later day came on March 13, 2013, when the IRS assessed the $216,547 in unpaid taxes as well as $142,185 in underpayment interest against the taxpayer dating back to 2002. The taxpayer did not timely pay either the $216,547 in taxes or the $142,185 in interest. The taxpayer's nonpayment ultimately led the IRS to issue a Notice of Federal Tax Lien Filing and Your Rights to a [Collection Due Process] Hearing to the taxpayer in 2013. The taxpayer timely requested a collection due process hearing in response to the notice. Subsequently, after settlement and collection discussions collapsed, the IRS issued the taxpayer a final notice of determination in December 2015 sustaining the collection action for $216,547 in unpaid taxes and $142,185 in interest relating to 2002. In response to the notice of determination, the taxpayer timely petitioned the Tax Court; however, the taxpayer contested only the $142,185 of interest assessed by the IRS. The taxpayer argued that the interest should be calculated from February 1, 2012, the date of the IRS's adverse determination letter revoking the taxpayer's exempt status, not March 17, 2003, the date the taxpayer's corporate tax return would have been due as a non-exempt corporation. In a case of first impression responding to cross-motions for summary judgment, the Tax Court (Judge Lauber) upheld the IRS's determination that underpayment interest against the taxpayer should be calculated from March 17, 2003, not February 1, 2012, when the IRS revoked the taxpayer's tax-exempt status. The taxpayer had argued that although the general rule of § 6601(b) requires interest to be calculated "from the last date prescribed for payment" (which for 2002 was March 17, 2003), in the unusual circumstances of this case § 6601(b)(5) should apply. Section 6601(b)(5) provides that "[i]n the case of taxes payable by stamp and in all other cases in which the last date for payment is not otherwise prescribed, the last date for payment shall be deemed to be the date the liability for the tax arises." The taxpayer's position was that the unpaid taxes for 2002 did not "arise" until the IRS's issuance of the adverse determination letter revoking the taxpayer's exempt status. The Tax Court rejected the taxpayer's argument on the grounds that this was not a case where "the last date for payment is not otherwise prescribed" because the taxpayer, being treated (albeit retroactively) as a taxable corporation for 2002 and subsequent years, was required to file a Form 1120 and pay its tax liability as of March 17, 2003. Furthermore, the Tax Court held that the taxpayer's liability for unpaid taxes did not "arise" on February 1, 2012, when the IRS revoked the taxpayer's exempt status, but instead arose as of March 17, 2003, when the taxpayer should have filed a corporate tax return. The taxpayer's filing of an IRS Form 990 in 2003 on the assumption that it was tax-exempt for 2002 did not prevent the IRS from assessing back taxes and interest for 2002 when the taxpayer later was found not to have qualified for exemption. Finally, the Tax Court held that the purpose of interest is to put the IRS in the same position that it would have occupied had the taxpayer properly and timely paid its tax liability; therefore, the court concluded that it was proper to assess interest against the taxpayer from March 17, 2003, when the corporate income tax should have been paid.

B. Discovery: Summons and FOIA

C. Litigation Costs

D. StatutoryNotice of Deficiency

E. Statute of Limitations

1. Those seeking to toll the limitations periods on seeking tax refunds based on financial disability must strictly comply with Rev. Proc. 99-21, says this U.S. District Court. Estate of Kirsch v. United States, ___ F. Supp. 3d ___, 120 A.F.T.R.2d 2017-5211 (W.D.N.Y. 7/13/17). The taxpayer filed her 2008 federal income tax return on June 5, 2014. Her return indicated that she had paid approximately $51,000 in tax and owed roughly $10,000 and therefore asserted a claim for refund of $41,000. All of the tax had been paid or was deemed to have been paid on April 15, 2009. Section 6511(a) provides that a claim for refund must be filed within the later of two years from the time tax was paid or three years from the time the return was filed. Her claim for refund was filed within three years of the time the return was filed (and therefore was timely under § 6511(a)) because she had submitted it simultaneously with her return. However, § 6511(b)(2)(A) provides that, when a claim for refund is timely under the three-years-from-filing period of § 6511(a), the taxpayer can recover only the portion of the tax paid within the three-year period ending on the date the claim for refund was filed (plus the period of any extension the taxpayer obtained). In this case, § 6511(b)(2)(A) barred the taxpayer from obtaining a refund because the taxpayer had paid all of the tax more than three years before she filed her claim for refund. The taxpayer asserted that, notwithstanding the normal limitations periods, she was entitled to relief under § 6511(h), which suspends the running of the periods in § 6511(a), (b), and (c) during any period that the taxpayer is "financially disabled." The term "financially disabled" is defined as being "unable to manage … financial affairs by reason of a medically determinable phyiscal or mental impairment of the individual which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months." The taxpayer submited to the IRS a statement from her physician that the taxpayer had been diagnosed with a cognitive mental impairment that had lasted more than twelve months, had begun in 2007 and become progessively worse, and that had prevented the taxpayer from managing certain aspects of her financial affairs. The taxpayer's son submitted to the IRS a statement describing a durable power of attorney that appointed him as the taxpayer's agent effective after April 1, 2009 (shortly after the death of the taxpayer's husband on March 28, 2009). The son's statement indicated that he did not live near his mother and was unaware she needed his assistance until her symptoms became more pronounced in a later year. The District Court (Judge Wolford) held that the taxpayer was not entitled to relief under § 6511(h). The IRS's guidance on § 6511(h) is set forth in Rev. Proc. 99-21, 1999-1 C.B. 960. The revenue procedure requires, among other things, that the taxpayer submit (1) a physician's statement attesting to the specific time period during which the physical or mental impairment prevented the taxpayer from managing his or her financial affairs, and (2) a statement that no person was authorized to act on the taxpayer's behalf in financial matters during the specified period of disability. The items the taxpayer submitted, the court held, did not comply with these requirements. The statement of the taxpayer's physician did not identify the specific period of time during which the taxpayer was unable to manage her financial affairs, and her son's statement indicated that he was, in fact, authorized to act on her behalf in financial matters. Accordingly, the court held, the taxpayer's refund action had to be dismissed for lack of subject matter jurisdiction.

a. But another U.S. District Court declines to dismiss a taxpayer's refund action despite the taxpayer's failure to submit the specific documentation required by Rev. Proc. 99-21. Stauffer v. IRS, 120 A.F.T.R.2d 2017-6119 (9/29/17). The taxpayer did not file federal icome tax returns for the years 2006 through 2012. Upon the taxpayer's death at the age of 90 in 2012, his son was appointed as adminstrator of the estate. As administrator, the son filed the missing returns and sought a refund of tax for the year 2006 of more than $137,000. The IRS denied the claim as untimely under § 6511. The son filed an administrative appeal and asserted that the limitations periods of § 6511 had been tolled because his father had been financially disabled within the meaning of § 6511(h). With the administrative appeal, the son submitted a statement from the taxpayer's psychologist attesting that the taxpayer had suffered from a variety of ailments that had affected his mental capacity and had prevented him from managing his financial affairs from at least 2006 until his death in 2012. The IRS concluded that the taxpayer had not complied with Rev. Proc. 99-21, which requires that the taxpayer submit the statement of a "physician," and denied the claim as untimely. The revenue procedure provides that the term "physician" has the same meaning as in § 1861(r)(1) of the Social Security Act, 42 U.S.C. § 1395x(r), which sets forth five categories of professionals considered to be physicians, none of which includes psychologists. The District Court (Judge Wolf) held that the IRS had failed to establish that its adoption of the Social Security Act's definiton of a physician in Rev. Proc. 99-21 was the product of reasoned decision making as required by Administrative Procedure Act § 706(2)(A) and *Motor Vehicle Manufacturers Association of the United States v. State Farm Mutual Automobile Insurance Co.*, 463 U.S. 29 (1983):

> The government … has not submitted any evidence of the IRS's rationale in adopting the definition in 42 U.S.C. § 1395x(r). … The IRS, therefore, has not provided any explanation for its decision, let alone a "rational connection between the facts found and the choice made." *State Farm*, 463 U.S. at 43. The IRS may conceivably view doctors without medical degrees to be generally unqualified to make the determination required under section 6511, and may have determined that, in view of the "need to fairly and efficiently process a potentially large number of [refund] claims," *Abston*, 691 F.3d at 996, a case-by-case determination of whether a given psychologist is nevertheless qualified is unwarranted. However, as explained earlier, at least where the IRS's reasoning is not obvious, the court may not supply an explanation for the IRS's choice that the agency itself has not given. *See State Farm*, 463 U.S. at 43.

The court also rejected the government's argument that the taxpayer was not entitled to relief under § 6511(h) because the taxpayer had submitted the psychologist's statement in the course of the administrative appeal, rather than with the claim for refund as required by Rev. Proc. 99-21. When refund claims are technically deficient, the court noted, courts generally accept the missing information at a later stage. Accordingly, the court denied the government's motion to dismiss without prejudice.

2. Shouldn't the limitations periods on seeking tax refunds be simpler? Another case in which a taxpayer loses the ability to obtain a refund because of a limit on the amount of tax recoverable. Borenstein v. Commissioner, 149 T.C. No. 10 (8/30/17). The taxpayer filed a timely extension request for her 2012 federal income tax return and paid a total of $112,000 towards her 2012 federal tax liability. All of her payments, which she made through estimated tax payments and a payment with her extension request, were deemed to be made on April 15, 2013. She did not file her 2012 until August 29, 2015, after she had received a notice of deficiency for 2012. Her return reflected a tax liability of $79,559, which the IRS agreed was correct. Thus, she had overpaid her 2012 federal tax liability by $38,447. In response to the notice of deficiency, the taxpayer filed a petition in the Tax Court. The issue before the court was whether the taxpayer was entitled to a credit or refund of the overpayment. The Tax Court (Judge Lauber) held that she was not. Under § 6512(b)(1), the Tax Court has jurisdiction to determine an overpayment if it has jurisdiction by virtue of a notice of deficiency. In this case, the court had deficiency jurisdiction because the IRS had issued a notice of deficiency and the taxpayer had filed a timely petition. Section 6512(b)(3), however, imposes a limit on the amount of tax that can be refunded. This provision states that only the portion of the tax paid within one of three specific time periods is allowed as a credit or refund. The parties agreed that the relevant period was that set forth in § 6512(b)(3)(B), which refers to tax paid

> within the period which would be applicable under section 6511(b)(2), (c), or (d), if on the date of the mailing of the notice of deficiency a claim had been filed (whether or not filed) stating the grounds upon which the Tax Court finds that there is an overpayment.

In other words, the court must treat the taxpayer as having filed a hypothetical claim for refund on the date the notice of deficiency was mailed. The question is what amount of tax the taxpayer could have recovered through this hypothetical refund claim taking into account the limits of § 6511(b)(2), (c), or (d). Of these, only § 6511(b)(2) was relevant. This provision states that a taxpayer can recover tax paid within either a two-year or a three-year period ending on the date the taxpayer filed the claim for refund. The three-year look-back period applies when the taxpayer files the refund claim "within 3 years from the time the return was filed." The two-year look-back period applies in all other cases. In this case, the court reasoned, § 6512(b)(3)(B) treats the hypothetical refund claim as having been filed on June 19, 2015, the date on which the notice of deficiency was mailed. This was *before* the taxpayer had filed her return for the year. Accordingly, the court held, the hypothetical refund claim could not be regarded as having been filed "within 3 years from the time the return was filed," and therefore the amount of tax recoverable was limited to the portion paid within the two-year period preceding June 19, 2015. All of the tax in question was deemed paid on April 15, 2013, and therefore the taxpayer was not entitled to a refund of any of the tax paid.

In reaching this conclusion, the court rejected arguments made by the taxpayer and by the Philip C. Cook Low-Income Taxpayer Clinic and the Harvard Federal Tax Clinic as amici curiae. They argued that a three-year look-back period applied by virtue of the final sentence of § 6512(b)(3)(B), which states:

> [W]here the date of the mailing of the notice of deficiency is during the third year after the due date (with extensions) for filing the return of tax and no return was filed before such date, the applicable period under subsections (a) and (b)(2) of section 6511 shall be 3 years.

The court agreed with the IRS that the parenthetical expression "(with extensions)" modifies the term "due date." The extended due date was October 15, 2013. The court reasoned that "the third year" referred to in § 6512(b)(3)(B) began on October 15, 2015. The IRS mailed the notice of deficiency on June 19, 2015, which was, the court concluded, during the second year after the extended due date, not the third year. Accordingly, this final sentence in § 6512(b)(3)(B), in the court's view, did not trigger a three-year look-back period.

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

G. <u>Innocent Spouse</u>

H. <u>Miscellaneous</u>

1. The Seventh Circuit's advice to law firms: don't wait until the last day to file a Tax Court petition and then mail an envelope without an official postmark! Nevertheless, the petition in this case was timely. Tilden v. Commissioner, 846 F.3d 882 (7th Cir. 1/13/17), *rev'g* T.C. Memo 2015-188 (9/22/15). The last day for the taxpayer, who was represented by counsel, to file a Tax Court petition was April 21, 2015. A member of the law firm's staff printed a label from Stamps.com dated April 21, 2015 and stated that she delivered the envelope to the Postal Service in Salt Lake City, Utah, on that date. The Tax Court received the petition on April 29. The Tax Court (Judge Armen) dismissed the petition as having been untimely filed by relying on Reg. § 301.7502-1(c)(1)(iii)(B)(3), which provides:

> If the envelope has a postmark made by the U.S. Postal Service in addition to a postmark not so made, the postmark that was not made by the U.S. Postal Service is disregarded, and whether the envelope was mailed in accordance with this paragraph (c)(1)(iii)(B) will be determined solely by applying the rule of paragraph (c)(1)(iii)(A) of this section [regarding envelopes nearing U.S. postmarks].

The envelope with the taxpayer's petition was entered into the Postal Service's tracking system for certified mail on April 23, which the Tax Court treated as a postmark and therefore the date of filing. In an opinion by Judge Easterbrook, the Seventh Circuit reversed and remanded. The regulation applied by the Tax Court, the Seventh Circuit reasoned, applies only when the envelope bears both a U.S. Postal Service postmark and a non-U.S. Postal Service postmark, which was not the case here. In the court's view, the Tax Court should have applied the rules of Reg. § 301.7502-1(c)(1)(iii)(B)(1)-(2), which address situations in which an envelope bears only a non-U.S. Postal Service postmark. Generally, these rules treat the date of the private postmark as the date of mailing if the item is received by the relevant agency not later than the time when a properly addressed and mailed envelope sent by the same class of mail would ordinarily be received if it were postmarked at the same point of origin by the U.S. Postal Service. The court also held that the time limit set forth in § 6213(a) for filing a Tax Court petition is jurisdictional. Finally, the court admonished the law firm for its handling of the situation:

> [W]e have to express astonishment that a law firm (Stoel Rives, LLP, of Salt Lake City) would wait until the last possible day and then mail an envelope without an official postmark. A petition for review is not a complicated document; it could have been mailed with time to spare. And if the last day turned out to be the only possible day (perhaps the firm was not engaged by the client until the time had almost run), why use a private postmark when an official one would have prevented any controversy? A member of the firm's staff could have walked the envelope to a post office and asked for hand cancellation. The regulation gives taxpayers another foolproof option by providing that the time stamp of a private delivery service, such as FedEx or UPS, is conclusive.

a. **Wouldn't it be less stressful just to go to the Post Office counter and get a hand-stamped certified mail receipt? In a reviewed opinion, the Tax Court has adopted the Seventh Circuit's approach in *Tilden* to determining the filing date of petitions mailed and bearing a private postmark.** Pearson v. Commissioner, 149 T.C. No. 20 (11/29/17). The facts in this case were substantially the same as those in *Tilden v. Commissioner*, 846 F.3d 882 (7th Cir. 1/13/17). The last day for the taxpayer to file a Tax Court petition was April 22, 2015. An administrative assistant at the law firm representing the taxpayer deposited an envelope containing the petition at a U.S. Post Office with sufficient postage prepaid through Stamps.com with a Stamps.com postage label bearing the date April 21, 2015. The envelope was sent by certified mail but did not bear a U.S. Postal Service postmark. The U.S. Postal Service entered the envelope into its tracking system for certified mail on Apr. 23, 2015. The Tax Court received the petition on April 29, 2015. In a reviewed opinion (13-1-2) by Judge Lauber, the Tax Court held that the petition had been timely filed and denied the IRS's motion to dismiss. The Tax Court agreed with the Seventh Circuit that the date appearing on "a Stamps.com postage label, like the output of a private postage meter, is a 'postmark[] not made by the United States Postal Service'" for purposes of § 7502(b). Accordingly, the court held, the governing regulation is Reg. § 301.7502-1(c)(1)(iii)(B)(1), which addresses situations in which an envelope bears only a non-U.S. Postal Service postmark. Under this provision, the date of the private postmark is treated as the date of mailing if the item is received by the relevant agency not later than the time when a properly addressed and mailed envelope sent by the same class of mail would ordinarily be received if it were postmarked at the same point of origin by the U.S. Postal Service. In this case, the court reasoned, the regulation was satisfied because the Stamps.com postage label bore a date that was on or before the filing deadline and the item had been received by the court within the time it would have been received had it been postmarked at the same point of origin by the U.S. Postal Service. Alternatively, the court held, the petition was timely under Reg. § 301.7502-1(c)(1)(iii)(B)(2). This provision states that an item bearing only a private postmark is treated as mailed on the postmark date, even if it is received after the date when it would ordinarily have been received had it been mailed with an official postmark, if the taxpayer establishes that (1) the item "was actually deposited in the U.S. mail … on or before the last date … prescribed for filing the document," (2) "the delay in receiving the document … was due to a delay in the transmission of the U.S. mail," and (3) the cause of the delay. The court also reaffirmed that the 90-day period of § 6213(a) during which a taxpayer can file a petition with the court is jurisdictional.

- Judge Buch wrote a concurring opinion joined by Judges Marvel, Foley, Vasquez, Goeke, Holmes, Paris, Lauber, Nega, Pugh, and Ashford. Judge Buch reviewed the various methods of affixing postage to an item and concluded that this review "makes clear that there is no practicable difference among 'official' U.S. Postal Service mailing labels, postage meters, and internet-based postage." He reasoned that the risk a person might print a label on one day and mail the item on another day is no different regardless of the method of affixing postage.

- Judge Gustafson dissented in an opinion joined by Judge Morrison. In Judge Gustafson's view, a postage label that an individual prints on his or her own printer through the means of an internet vendor such as Stamps.com and places on an item is not a "'postmark[] not made by the United States Postal Service" within the meaning of § 7502(b). The dissenting opinion relies in part on the definition of the term "postmark" in Webster's Third New International Dictionary, which defines the term as "an official postal marking on a piece of mail; specif: a mark showing the name of the post office and the date and sometimes the hour of mailing and often serving as the actual and only cancellation." Although the dissenting opinion is not clear on this point, presumably Judge Gustafson viewed the item in question as not bearing a postmark, which would preclude it from being timely filed under § 7502(b) and the implementing regulations.

2. **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.

a. **The IRS has provided similar extensions of filing and payment due dates for those affected by California wildfires.** In news release IR-2017-172 (10/31/17), the IRS has extended to January 31, 2018, several filing and payment due dates that occurred beginning on October 8, 2017, for those in areas affected by California wildfires. The relief is available to individuals and businesses in the counties of Butte, Lake, Mendocino, Napa, Nevada, Sonoma and Yuba, as well as firefighters and relief workers who live elsewhere. The due dates extended include the October 16, 2017, due date for 2016 individual returns for individuals who filed timely extension requests, the October 31, 2017, due date for quarterly payroll and excise tax returns, and the January 16, 2018, due date for quarterly estimated tax payments. 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.

3. A portion of the anti-inversion regulations must be set aside because of the government's failure to comply with the Administrative Procedure Act, says a federal district court. Chamber of Commerce v. IRS, 120 A.F.T.R.2d 2017-5967 (W.D. Tex. 9/29/17). The U.S. District Court for the Western District of Texas (Judge Yeakel) ruled upon cross-motions for summary judgment that the IRS did not comply with the Administrative Procedure Act ("APA") with respect to a portion of the anti-inversion regulations issued under § 7874 (see T.D. 9761, 81 F.R. 20858 (4/8/16)). In particular, Judge Yeakel determined that Temp. Reg. § 1.7874-8T (which provides a computational rule for determining a "surrogate foreign corporation") is a substantive or legislative regulation, not an interpretive regulation. Therefore, the District Court determined that the IRS should have complied with the APA's 30-day notice-and-comment procedure before declaring the rule effective immediately as a temporary regulation. Judge Yeakel thus held as "unlawful and set aside" Temp. Reg. § 1.7874-8T over the IRS's objection that the Chamber of Commerce lacked standing and that the lawsuit violated the Anti-Injunction Act. Where this leaves the IRS with respect to the anti-inversion regulations and Temp. Reg. § 1.7874-8T is anyone's guess.

- On November 27, 2017, the government filed a notice of appeal in the U.S. Court of Appeals for the Fifth Circuit.

XI. WITHHOLDING AND EXCISE TAXES

XII. TAX LEGISLATION