Recent Developments in Federal Income Taxation

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To obtain today's outline and slides:
https://tinyurl.com/outline-sept18

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Rev. Proc. 2018-14
2018-9 I.R.B. 378 (2/7/18)
Outline: item A.1.a, page 3

- Normally, a § 165 personal casualty loss is limited to damage from an identifiable event that is sudden, unexpected, or unusual.
  - In contrast, damage or loss resulting from progressive deterioration of property through a steadily operating cause generally is not considered a deductible casualty loss under § 165.
- Homeowners in New England, especially Connecticut, have suffered premature deterioration in their concrete foundations due to pyrrhotite, a naturally occurring mineral that can appear in concrete.
- This revenue procedure:
  - Extends the safe harbor announced in Rev. Proc. 2017-60.
  - Taxpayers who pay for pyrrhotite damage to a personal residence after 2017 and on or before October 15, 2018, can treat the amount paid as a casualty loss arising in 2017.
  - Without this relief, the TCJA disallowance of personal casualty losses would adversely affect these homeowners.

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Sun v. Commissioner,
880 F.3d 173 (5th Cir. 1/18/18)
Outline: item B.1, page 4

- The taxpayer served as CEO of a corporation and also devoted a significant amount of time to investment activities.
- The taxpayer and his business acquaintance and friend, a resident of Hong Kong, orally agreed the taxpayer would invest his friend's funds.
  - Over a period of two years, the friend sent $19 million to be invested.
- The taxpayer:
  - Used several million of the funds for personal purposes, including the purchase of a Mercedes Benz automobile and for gambling.
  - The taxpayer informed his friend that he had lost approximately $2 million of the friend's funds through gambling.
- Issue: did either the corporation or the taxpayer have gross income?
- Held:
  1. Yes as to the taxpayer. Taxpayer's misappropriation of the funds gave rise to gross income under James v. U.S. (U.S. 1961).
  2. No as to the corporation, which was a mere conduit.

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Rev. Proc. 2018-12
2018-6 I.R.B. 349 (1/24/18)
Outline: item A.1, page 5

- To qualify as a tax-free reorganization under § 368, the shareholders of a target corporation must have a substantial proprietary interest in the acquiring corporation.
  - Whether target shareholders have sufficient “continuity of interest” is determined by comparing the aggregate value of stock held by the target shareholders *before* to the aggregate value of stock they hold *after*.
  - The required level of continuity of interest varies according to the type of reorg (e.g., 50% for straight mergers vs. 80% for reverse triangular)
- This revenue procedure:
  - Permits the use of certain average trading price valuation methods for COI purposes (rather than actual value on closing or signing date)
  - This applies to A, B, C, and G reorganizations.
  - Generally, if one of the specified valuation methods is used to determine stock consideration paid to target shareholders, the same method can be used for COI purposes.

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2017 Tax Cuts and Jobs Act § 13312
Outline: item I.1, page 6

- Section 13312 of the 2017 TCJA amended Code § 118.
- New § 118(b)(2) provides:
  - Non-shareholder contributions to the capital of a corporation made after 12/22/17 by any governmental entity or civic group are *not* excluded from the corporation’s gross income.
- The legislative history of this amendment states:
  - “The conferees intend that section 118, as modified, continue to apply only to corporations.”

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Ginsburg v. United States, 136 Fed. Cl. 1 (1/31/18)
Outline: item G.1.a, page 7

- The taxpayer held 90% of the membership interests in an LLC classified as a partnership for federal tax purposes.
- The LLC participated in New York State's Brownfield Development Tax Credit program.
  - In return for acquiring an abandoned shoe factory and restoring it as residential property, the LLC received state tax credits.
  - Any credit in excess of state tax liability is paid in cash.
  - The LLC received $1.8 million from New York State as an "excess" credit payment.
- Issue: is $1.8 million payment included in the LLC's (and therefore its partners') gross income?
- Held: Yes. The payment was an accession to wealth (*Glenshaw Glass* (U.S. 1955). The court rejected arguments that the payment was a nontaxable (1) contribution to capital, (2) recovery of investment, or (3) general welfare grant.

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Uniquest Delaware, LLC v. United States, 294 F. Supp. 3d 107 (W.D.N.Y. 3/27/18)
Outline: item G.1.b, page 8

- Held: An $11 million grant from New York State received by an LLC classified as a partnership for federal tax purposes was included in the LLC's (and therefore the partners') gross income.
  - The grant was for restoration of a building in Buffalo.
  - The court rejected the argument that the grant was a nontaxable contribution to capital because § 118 applies only to corporations.
  - Planning idea:
    - The LLC had two members, each of which was a disregarded LLC held by a subchapter S corporation.
    - Had the grant been paid to the S corporations and then contributed to the LLC, the S corporations could have excluded the grant from gross income (at least under the pre-TCJA version of § 118).

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McClendon v. United States, 892 F.3d 775 (6/14/18)

Outline: item A.1.a, page 10

- The CFO of a medical practice failed to pay withholding taxes to the government and embezzled a significant amount of funds.
- The government sought to hold Dr. McClendon (now deceased) liable for a trust fund recovery penalty under § 6672 equal to the unpaid withholding taxes.
- To demonstrate willful failure to pay employment taxes, the government focused on Dr. McClendon's $100,000 loan to the business to allow it to make payroll.
  - The loan occurred after discovery of the unpaid taxes.
- Held: the District Court erred in granting summary judgment to government.
  - Dr. McClendon came forward with sufficient evidence to raise an issue of material fact concerning the amount of unencumbered funds available to pay the taxes.

Duggan v. Commissioner, 879 F.3d 1029 (1/12/18)

Outline: item F.1, page 11

- Held: the 30-day period specified in § 6330(d)(1) for filing a petition in the Tax Court following an IRS Notice of Determination is jurisdictional and cannot be equitably tolled.
  - The taxpayer, who filed his petition 31 days after the Notice, argued that he was misled by the Notice of Determination and believed that the day after the date of the notice was day zero, the following day was day 1 etc.
  - *See also Cunningham v. Commissioner*, 716 Fed. Appx. 182 (4th Cir. 1/18/18) (item a page 12) (declining to address this issue because circumstances would not warrant equitable tolling).
  - *See also Guralnik v. Commissioner*, 146 T.C. 230 (6/2/16) (concluding, like the *Duggan* decision, that the 30-day period is jurisdictional and not subject to equitable tolling).

Nauflett v. Commissioner,
892 F.3d 649 (4th Cir. 6/14/18)
Outline: item G.2.b, page 14

- The IRS issued a notice of determination denying the taxpayer innocent spouse relief.
  - This triggered a 90-day period in which the taxpayer could file a petition in the Tax Court. This period expired on September 15.
- The taxpayer asserted she spoke with the IRS contact person on the Notice and with the Taxpayer Advocate Service.
  - Both of them, she asserted erroneously informed her the deadline was September 22, the date on which she filed her petition.
- Issue: did the Tax Court have jurisdiction to consider the taxpayer's petition, filed on September 22?
- Held: No. The 90-day limitations period is jurisdictional.
- *See also Rubel v. Commissioner*, 856 F.3d 301 (3d Cir. 5/9/17); *Matuszak v. Commissioner*, 862 F.3d 192 (2d Cir. 7/5/17)

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Other Developments

- AICPA v. IRS, 122 A.F.T.R.2d 2018-5507 (D.C. Cir. 8/14/18) (item H.1.c, page 15)
- United States v. Stein, 881 F.3d 853 (11° Cir. 1/31/18) (en banc) (item H.2, page 17)
- Annamalai v. Commissioner, 884 F. 3d 530 (5th Cir. 3/8/18) (item H.3 page 18)

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