

Recent Developments in Federal Income Taxation

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State Bar of Texas Tax Section
First Wednesday Tax Update
August 7, 2019

To obtain today's outline and slides:

<https://tinyurl.com/outline0819>

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Eligibility for Cash Method of Accounting

Outline: item A.1, page 2

- TCJA: enacted several simplifying provisions that are available to a business if the business's average annual gross receipts, measured over the three prior years, do not exceed \$25 million. These include:
 - Ability of C corporations or partnerships with a C corporation as a partner to use the cash method of accounting (§ 448(b)(3))
 - Ability to be excluded from applying the uniform capitalization rules of § 263A (§ 263A(i))
 - Ability to be excluded from the § 163(j) limit on deducting business interest (§ 163(j)(3))
- Absent relief, many small businesses are ineligible for these simplifying provisions enacted as part of the 2017 TCJA because the businesses meet the definition of a "tax shelter" that is prohibited from using the cash method of accounting.

Mihelick v. United States

123 A.F.T.R.2d 2019-2251 (11th Cir. 6/18/19)

Outline: item H.1, page 3

- Holds that a taxpayer, while married, had received \$600,000 of income (her husband's earnings) under a claim of right, and therefore, when she repaid paid \$300,000 in 2009 to settle a suit brought against her husband for breach of fiduciary duty, she could determine her tax liability for the year of repayment under § 1341.

CCA 201912001 (3/22/19)

Outline: item A.1, page 5

- Concludes that an individual who was treated as a 2-percent S corporation shareholder because the stock of a family member was attributed to the individual under the constructive ownership rules of § 318 could deduct the amounts paid by the S corporation under a group health plan and included in the individual's gross income.

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Doyle v. Commissioner

T.C. Memo. 2019-8 (2/6/19)

Outline: item B.1, page 6

- Holds that \$250,000 received by the taxpayer, a terminated employee, "for his alleged emotional distress damages," which his employer reported on Form 1099-MISC, was includible in the taxpayer's gross income pursuant to the language of § 104(a), which provides that "emotional distress shall not be treated as a physical injury or physical sickness."

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Feigh v. Commissioner
152 T.C. No. 15 (5/15/19)
Outline: item D.1, page 8

- Holds that “Medicaid waiver payments” that individuals received and excluded from gross income under Notice 2014-7 are “earned income” for purposes of the earned income credit and the additional child tax credit.

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Deduction of State and Local Taxes
Outline: item D.2, page 9

- TCJA: An individual’s itemized deductions on Schedule A for state taxes cannot exceed \$10,000.
 - Applies to aggregate of property taxes, and sales or income taxes.
 - Limit applies both to single individuals and married individuals filing jointly
 - Applies 2018 through 2025
- Some states have adopted workarounds, e.g., New Jersey gives a credit against property taxes for contributions to certain charitable funds designated by the state.
- Notice 2018-54 (5/23/18): proposed regulations will “make clear that the requirements of the Internal Revenue Code, informed by substance-over-form principles, govern the federal income tax treatment of such transfers.”

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Deduction of State and Local Taxes

Outline: item D.2.d, page 11

- Final regulations: 84 Fed. Reg. 27,513 (6/13/19).
 - Apply to contributions *after* 8/27/18.
- The regulations:
 - Generally require taxpayers to reduce the amount of any federal income tax *charitable contribution deduction* by the amount of any corresponding state or local tax *credit*.
 - Provide an exception: a taxpayer's federal charitable contribution deduction is *not* reduced if the corresponding state or local credit does not exceed 15 percent of the taxpayer's federal deduction.
 - Example: T contributes \$1,000 to state charity and gets 10% state tax credit.
 - Provide that a *state or local tax deduction* normally will *not* reduce a taxpayer's federal *deduction* (provided the state and local deduction does not exceed the taxpayer's federal deduction).

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Notice 2019-12

2019-27 I.R.B. 57 (6/11/19)

Outline: item D.2.e, page 12

- Announces that the Treasury Department and the IRS intend to publish a proposed regulation that will amend Reg. § 164-3 to provide a safe harbor for individuals who itemize deductions and make a payment to or for the use of an entity described in § 170(c) in return for a state or local tax credit.
- Under this safe harbor, an individual who itemizes deductions and who makes a payment to a section 170(c) entity in return for a state or local tax credit may treat as a payment of state or local tax for purposes of section 164 the portion of such payment for which a charitable contribution deduction under section 170 is or will be disallowed under final regulations.

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Kerns v. Commissioner
T.C. Memo. 2019-14 (3/4/19)
Outline: item D.3, page 13

- Holds that the Tax Court does not have equitable power to change the statutory treatment of excess advance premium tax credits as an increase in tax.
- See also *McGuire v. Commissioner*, 149 T.C. 254 (8/28/17).

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Petersen v. Commissioner,
924 F.3d 1111 (10th Cir. 5/15/19)
Outline: item D.1.a, page 16

- The taxpayers were shareholders of an S corporation that had established an Employee Stock Ownership Plan (ESOP).
 - The ESOP owned shares for the benefit of employees.
- The S corporation used the accrual method of accounting and accrued deductions for > \$1 million in wages and vacation pay.
- Issue: were the S corporation's deductions disallowed by the forced matching rule of § 267(a)(2)?
 - This rule defers deductions of an accrual method taxpayer for items payable to a related cash-method taxpayer until the cash-method taxpayer includes the item in gross income.
- Held: Yes. The shares held by the ESOP trust are attributed to the employees who, as shareholders, are related to the S corp. pursuant to § 267(e).

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Notice 2019-20 and IRS FAQ
2019-14 I.R.B. 927 (3/7/19)
Outline: item G.1, page 17

- The updated 2018 Instructions for Form 1065 and accompanying Schedule K-1 now require a partnership that does not report tax basis capital accounts to its partners to report, on line 20 of Schedule K-1 (Form 1065) using code AH, the amount of a partner's tax basis capital both at the beginning of the year and at the end of the year if either amount is negative.
- This Notice and the FAQ on the IRS website provide guidance on tax capital accounts.

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Baldwin v. Commissioner,
921 F.3d 836 (9th Cir. 4/16/19)
Outline: item E.1, page 22

- Held: regulations issued under § 7502 displace the common-law mailbox rule.
 - Thus, taxpayer could not prove timely mailing of amended return through testimony of employees who mailed it at the Post Office.

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Other Recent Developments

1. Kears v. Commissioner, T.C. Memo. 2019-53 (5/20/19) (p. 23, item F.1)
2. Jordan v. Commissioner, T.C. Memo. 2019-15 (3/4/19) (p. 25, item H.1)
3. Slaughter v. Commissioner, T.C. Memo. 2019-65 (6/4/19) (p. 25, item B.1)
4. T.D. 9869, Self-Employment Tax Treatment of Partners in a Partnership That Owns a Disregarded Entity, 84 F.R. 3178 (7/2/19) (p. 26, item B.2)