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

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Note: This outline was prepared jointly with Cassady V. ("Cass") Brewer, Associate Professor of Law, Georgia State University College of Law, Atlanta, GA.

I. ACCOUNTING

II. BUSINESS INCOME AND DEDUCTIONS

A. Income

B. Deductible Expenses versus Capitalization

C. Reasonable Compensation

D. Miscellaneous Deductions

1. Tax Court holds that, although struggling business owner never used two properties in his trade or business, mortgage interest paid with respect to the properties was not subject to limitations on investment interest and was deductible on Schedule C. Pugh v. Commissioner, T.C. Summ. Op. 2019-2 (2/28/19). The taxpayer, who holds a Bachelor of Science degree in electrical engineering, operated a sole proprietorship, Pi Integrated Systems (Pi), which was engaged in software development. Pi operated from an office in the taxpayer's home. He borrowed money to purchase two vacant lots in 2005 and 2006 and paid interest on the loans. He purchased two steel buildings, disassembled them, and stored some of the components on one of the properties. He planned to reassemble the buildings on the vacant lots, as reflected in a site plan prepared by an architect in 2007, and to use the buildings as the headquarters of Pi. Pi experienced the loss of a major customer, a loss of revenue, and a loss of employees, and the plans to reassemble the buildings never took place. As of the date of trial in 2017, the lots remained vacant and some of the building components had been sold for scrap metal. On his federal income tax returns for 2010 and 2011, which were submitted to the IRS long after they were due and apparently never processed by the IRS, the taxpayer claimed several deductions on Schedule C, including a deduction for the mortgage interest paid on the loans used to finance the acquisition of the vacant lots and a deduction for legal fees. The IRS allowed all but a small amount of the legal fees as deductions but disallowed the deductions for mortgage interest. The IRS argued that, because the properties were never actually used in the taxpayer's trade or business, the interest was not deductible as it was either "personal interest" within the meaning of § 163(h) or was "investment interest" within the meaning of § 163(d) and therefore deductible only to the extent of net investment income, which the taxpayer did not have. The Tax Court (Judge Carluzzo) first concluded that the interest paid by the taxpayer was not "investment interest," which is defined in § 163(d)(3)(A) as deductible interest paid or accrued on indebtedness properly allocable to property held for investment. The term "property held for investment" is defined in § 163(d)(5)(A) as property that produces income of a type described in § 469(e)(1), which generally describes passive investment income such as interest, dividends, rents, and royalties. According to the court, the land the taxpayer purchased was not property held for investment and therefore the interest he paid on the loans used to finance the purchase could not be investment interest. The Tax Court also held that the interest was not nondeductible "personal interest" as defined in § 163(h)(2) because it fit into one of the categories excluded from the definition of personal interest. One of those categories, set forth in § 163(h)(2)(A), is interest paid or accrued on indebtedness properly allocable to a trade or business (other than the trade or business of performing services as an employee). The Tax Court concluded that "the properties were not actually used in petitioner's trade or business during the years in issue. Nevertheless, we are satisfied that the properties were certainly 'allocable' to that business." The Tax Court disallowed the taxpayer's deduction of the small amount of remaining legal fees that the IRS had not allowed. "Because [the taxpayer] has failed to establish the nature of the legal services involved, how those services relate to his trade or business, or the amounts actually paid or incurred for those services, he is not entitled to a deduction for legal fees in excess of the amount already allowed by [the IRS] for each year in issue."

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. The taxpayer materially participated in an activity even when though some of his hours were not hours when he was physically present at the business location. Barbara v. Commissioner, T.C. Memo. 2019-50 (5/13/19). The taxpayers, a married couple, resided in Florida. The husband had owned and managed Barbara Trucking, a Chicago-area garbage-collection and waste-management business, which he sold for millions of dollars. He used the proceeds of the sale to start a lending business. The business had an office in Chicago with two full-time employees. Mr. Barbara divided his time between Florida and Chicago, spending 40 percent of his time in Chicago and 60 percent in Florida. He performed all executive functions for the lending business and worked 200 days per year. While in Chicago, he devoted 5.75 hours per day to the business and while in Florida devoted 2 hours per day. The IRS proposed various adjustments for the returns filed by the taxpayers for 2009 through 2012. One issue in the cases was whether Mr. Barbara had materially participated in the lending business during these years. The Tax Court (Judge Morrison) held that he had materially participated. The court framed the question as whether Mr. Barbara had materially participated in the business under the seventh test in Reg. § 1.469-5T(a), which requires that the taxpayer participate more than 100 hours in the activity during the year and that the taxpayer's participation be "regular, continuous, and substantial." The court calculated that Mr. Barbara had devoted 460 hours per year while in Chicago (200 days * 40 percent * 5.75 hours) and 240 hours per year while in Florida (200 days * 60 percent * 2.0 hours), or a total of 700 hours, which more than met the 100-hour requirement. The court also concluded that his participation was regular, continuous, and substantial.

III. INVESTMENT GAIN AND INCOME

A. Gains and Losses

1. Tax Court holds that individuals' amount realized from foreclosure sale of real property was bid price at foreclosure sale and, taking into account their basis in foreclosed properties, they realized a $4.3 million long-term capital loss. Breland v. Commissioner, T.C. Memo. 2019-59 (5/29/19). In both 2003 and 2004, Charles and Yvonne Breland a married couple, sold real property, deposited the proceeds with an intermediary, and acquired other real property. They treated the transactions in 2003 and 2004 as like-kind exchanges eligible for deferred recognition of gain under § 1031. One of the properties the taxpayers acquired in the like-kind exchange in 2004 was a lot on Dauphin Island, Alabama (Dauphin Island 1), for which they reported an adjusted basis of $6,689,113. In 2005, they acquired a second property on Dauphin Island (Dauphin Island 2) for $5,613,287. They financed the purchase of Dauphin Island 2 with a recourse mortgage loan from Whitney Bank in the amount of $11.2 million. The taxpayers used this loan, which was secured by both Dauphin Island 1 and Dauphin Island 2, not only to acquire Dauphin Island 2, but also to refinance indebtedness they had incurred with respect to Dauphin Island 1. In early 2009, the taxpayers defaulted on the loan from Whitney Bank, which had an outstanding balance at that time of $10.7 million. Whitney Bank foreclosed on the loan and held a foreclosure sale in 2009 at which Whitney Bank was the high bidder with a bid of $7.2 million. The taxpayers later filed for chapter 11 bankruptcy protection in federal court and Whitney Bank filed a proof of claim in that proceeding for $6.3 million. On their federal income tax return for 2009, the taxpayers initially reported a capital loss from the sale of Dauphin Island 1 and Dauphin Island 2 of $1.8 million, which they determined by treating the outstanding loan balance (approximately $10.7 million) as their amount realized and comparing it to their adjusted bases in the properties. They subsequently filed an amended return for 2009 on Form 1040X on which they reported a capital loss from the sale of Dauphin Island 1 and Dauphin Island 2 of $5.3 million, which they determined by treating the bid price at the foreclosure sale (approximately $7.2 million) as their amount realized and comparing it to their adjusted bases in the properties. The IRS challenged their determination of both their amount realized and their adjusted bases in the properties sold at the foreclosure sale. According to the IRS, the taxpayers had overstated the amount of their capital loss from the foreclosure sale.

The amount realized in the foreclosure sale was the $7.2 million bid price, not the full $10.7 million outstanding loan balance. The Tax Court (Judge Pugh) first concluded that the amount realized by the taxpayers from the 2009 foreclosure sale of Dauphin Island 1 and Dauphin Island 2 was the $7.2 million bid price for which the properties were sold, not the $10.7 million outstanding loan balance. Generally, under § 1001(b), a taxpayer's amount realized from the sale or exchange of property is the amount of money received plus the fair market value of any property received. According to Reg. § 1.1001-2(a)(1), a taxpayer's amount realized also includes the amount of any liabilities from which the taxpayer is discharged as a result of transferring the property. The Tax Court explained that this rule applies in the case of *nonrecourse debt*, i.e., the amount realized includes the full amount of the nonrecourse debt that is discharged by transferring property. In the case of *recourse debt* such as the debt in this case, however, the taxpayer's amount realized is limited to the fair market value of the property. The court relied for this proposition on Reg. § 1.1001-2(a)(2), which provides that "[t]he amount realized on a sale or other disposition of property that secures a recourse liability does not include amounts that are (or would be if realized and recognized) income from the discharge of indebtedness under section 61(a)(12)." The court also relied on its prior decisions, including *Frazier v. Commissioner*, 111 T.C. 243 (1998), and *Aizawa v. Commissioner*, 99 T.C. 197 (1992), *aff'd*, 29 F.3d 630 (9th Cir. 1994). The IRS argued that the $7.2 million bid price for the Dauphin Island properties at the foreclosure sale did not establish their fair market value because the sale was compelled and not a sale between a willing buyer and a willing seller. According to the court, however, "in the case of mortgaged property sold at a foreclosure sale, we presume fair market value to be the bid price, absent clear and convincing evidence to the contrary." In this case, the court concluded, there was no clear and convincing evidence to the contrary and therefore the bid price established the fair market value of the foreclosed properties and the amount realized by the taxpayers was $7.2 million. In reaching this conclusion, the court rejected the IRS's argument that, if the bid price is treated as the amount realized, then the taxpayers should have recognized discharge of indebtedness income of approximately $5.5 million, which was the remaining loan balance. According to the court, the preponderance of the evidence including Whitney Bank's filing of a proof of claim in the taxpayers' bankruptcy proceeding, suggested that the remaining loan balance had not been discharged.

The aggregate basis the taxpayers had in the properties sold at the foreclosure sale was $11.5 million and therefore they realized a capital loss of $4.3 million. The Tax Court concluded that the taxpayers had not adequately substantiated their basis in the Dauphin Island 1 property. Specifically, the court concluded that they had not adequately substantiated their basis in the property they had exchanged in like-kind exchanges for Dauphin Island 1 and therefore had not adequately substantiated the basis that carried over to Dauphin Island 1. Accordingly, the court reasoned, their basis in Dauphin

Island 1 was $5.9 million, which was the amount of money they had paid for it plus the amount of indebtedness they had incurred to purchase it, less the amount of liabilities satisfied in the transaction in which they acquired Dauphin Island 1. Their basis in Dauphin Island 2 was $5.6 million, the amount they had paid for the property. Therefore, their aggregate basis in the two properties was $11.5 million. Their capital loss from the foreclosure sale therefore was the amount by which their $11.5 million adjusted basis in the properties exceeded their $7.2 million amount realized, or $4.3 million. Because they had held both properties for more than one year, the loss was a long-term capital loss.

- As the Tax Court pointed out in *Breland*, if the debt secured by foreclosed properties is nonrecourse debt, then the taxpayers' amount realized from the foreclosure sale generally will be the full amount of the nonrecourse debt. In determining whether debt is nonrecourse, it is necessary to consider so-called state anti-deficiency statutes, which prohibit lenders from holding borrowers responsible for the difference between the amount of the mortgage loan secured by the property and the price for which the property is sold at the foreclosure sale. If a state anti-deficiency law applies, then the debt will be treated as nonrecourse debt and the taxpayers' amount realized from the foreclosure sale generally will be the full amount of the debt. For an example of a case reaching this result, see *Simonsen v. Commissioner*, 150 T.C. No. 8 (2018), in which the Tax Court held that debt secured by real property sold by the taxpayers in a short sale was nonrecourse debt when California's anti-deficiency statute precluded the lender from pursuing the taxpayers for the balance of the loan that was not satisfied by the short sale. For this reason, the court in *Simonsen* treated the full amount of the mortgage loan as the taxpayers' amount realized in the short sale.

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

V. PERSONAL INCOME AND DEDUCTIONS

A. Rates

B. Miscellaneous Income

1. Only a portion of more than $350,000 of cancelled debt was excluded from an individual's gross income because only a small portion was qualified principal residence indebtedness and the individual was insolvent by approximately $43,000, says the Tax Court. Bui v. Commissioner, T.C. Memo. 2019-54 (5/21/19). Mary Bui ultimately acquired sole ownership of real property in San Jose, California, known as the Red River property, which she used as her principal residence until it was sold in a short sale on March 14, 2011. After the sale of the Red River property in 2011, the taxpayer moved into other real property she owned in San Jose, known as the Cedar Grove property, and made it her principal residence. Prior to the date she moved in, the Cedar Grove property had been a rental property. In 2007, the taxpayer obtained three home equity lines of credit from Wells Fargo, one of which was secured by the Red River property and two of which were secured by the Cedar Grove property. The taxpayer spent $10,000 in 2007 for custom drapes and $12,000 in 2008 for driveway repair and expansion work at the Red River property and testified to a number of other improvements to the property but provided no documentation of those other expenditures. She provided no evidence of improvements to the Cedar Grove property. In 2011, Wells Fargo cancelled the three home equity lines of credit and issued Forms 1099-C reporting total cancelled indebtedness of $355,488. On her federal income tax return for 2011, the taxpayer excluded all of the cancelled debt from gross income as qualified principal residence indebtedness pursuant to § 108(a)(1)(E) (a provision that expired at the end of 2017). The IRS took the position that she had to include all of the cancelled debt in her gross income.

Only $12,000 of the cancelled debt was qualified principal residence indebtedness. The Tax Court (Judge Goeke) first concluded that, of the $355,488 of cancelled debt, only $12,000 met the definition of "qualified principal residence indebtedness." That term is defined in § 108(h)(2), which provides that a taxpayer can treat up to $2 million as qualified principal residence indebtedness if the debt is "acquisition indebtedness (within the meaning of section 163(h)(3)(B) ... with respect to the principal residence of the taxpayer." The term "acquisition indebtedness," as defined in § 163(h)(3)(B), means indebtedness "incurred in acquiring, constructing, or substantially improving any qualified residence of the taxpayer" that is "secured by such qualified residence." The Tax Court held that the two Wells Fargo lines of credit secured by the Cedar Grove property could not be qualified principal residence indebtedness because the taxpayer had not incurred the debt to acquire or improve that property. (Although not discussed by the court, another reason those lines of credit could not be qualified principal residence indebtedness was that, even if the taxpayer had used the loan proceeds to make improvements to the Cedar Grove property prior to 2011, that property was not her principal residence at that time.) With respect to the Red River property, the court held that $10,000 the taxpayer had spent on custom drapes was not a "substantial improvement" to the property, but the $12,000 she had spent on driveway expansion and repair was a substantial improvement. The taxpayer had not substantiated any other improvements to the Red River property. The court also concluded that the taxpayer had used the line of credit loan proceeds to pay this $12,000 spent on driveway expansion and repair. Therefore, of the one Wells Fargo line of credit secured by the Red River property, only $12,000 was qualified principal residence indebtedness.

Of the $12,000 of qualified principal residence indebtedness, the taxpayer could exclude only $5,299 from her gross income. The Tax Court held that, of the $12,000 that was qualified principal residence indebtedness, the taxpayer could exclude from her gross income only $5,299 because of the limitation in § 108(h)(4). Section 108(h)(4) provides that, if only a portion of cancelled debt is qualified principal residence indebtedness, then a taxpayer can exclude from gross income only "so much of the amount discharged as exceeds the amount of the loan (as determined immediately before such discharge) which is not qualified principal residence indebtedness." In this case, the total amount of the loan secured by the Red River property was $250,000, of which $243,299 was cancelled. Of the total $250,000 loan amount, $238,000 ($250,000-$12,000) was not qualified principal residence indebtedness. Therefore, under § 108(h)(4), the limit on the amount the taxpayer could exclude from gross income was $5,299 ($243,299 cancelled debt-$238,000). The effect of the § 108(h)(4) limitation is to treat the taxpayer as having paid a portion of the loan that was qualified principal residence indebtedness and to treat Wells Fargo as having cancelled the portion of the loan that was not qualified principal residence indebtedness. Of the $250,000 loan amount, Wells Fargo cancelled $243,299, which means that $6,701 of the loan was paid from the proceeds of the short sale of the Red River property. In effect, § 108(h)(4) treats this payment of $6,701 as having been made on the $12,000 portion of the loan that was qualified principal residence indebtedness, which leaves only $5,299 ($12,000-$6,701) of qualified principal residence indebtedness that was cancelled.

The taxpayer was insolvent by $42,852 and therefore could exclude this amount of cancelled debt from her gross income. Under § 108(a)(1)(B), a taxpayer can exclude cancelled debt from gross income if the taxpayer is insolvent, and § 108(a)(3) limits the exclusion to the amount by which the taxpayer is insolvent. For this purpose, the term "insolvent" is defined in § 108(d)(3), which provides that a taxpayer is insolvent to the extent that, immediately before the cancellation of indebtedness, the taxpayer's liabilities exceed the fair market value of the taxpayer's assets. As part of their preparation for trial in the Tax Court, the taxpayer and the IRS had stipulated that the taxpayer was insolvent to the extent of $42,852. Accordingly, the Tax Court held that the taxpayer could exclude this amount of the cancelled debt from gross income (in addition to the $5,299 she could exclude from gross income as a cancellation of qualified principal residence indebtedness).

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

D. Deductions and Credits for Personal Expenses

E. Divorce Tax Issues

F. Education

G. Alternative Minimum Tax

VI. CORPORATIONS

VII. PARTNERSHIPS

VIII. TAX SHELTERS

IX. EXEMPT ORGANIZATIONS AND CHARITABLE GIVING

A. Exempt Organizations

B. Charitable Giving

X. TAX PROCEDURE

A. Interest, Penalties, and Prosecutions

B. Discovery: Summonses and FOIA

C. Litigation Costs

D. Statutory Notice of Deficiency

E. Statute of Limitations

1. The taxpayers missed an opportunity to challenge the Tax Court's decision in *Allen v. Commissioner,* which held that the fraud exception to the three-year limitations period on assessment is triggered by a return preparer's fraudulent intent. Finnegan v. Commissioner, 962 F.3d 1261 (11th Cir. 6/11/19), *aff'g* T.C. Memo. 2016-118 (6/16/16). Generally, under § 6501(a), the Service must assess additional tax within three years after the return for the year in question is filed. Before assessing additional tax, the Service generally must issue a notice of deficiency, which provides the taxpayer with ninety days within which to file a petition in the Tax Court. In this case, the Service issued a notice of deficiency with respect to the returns of the taxpayers, a married couple, for the years 1994 through 2001 more than three years after the returns were filed. The IRS argued that the notice of deficiency was timely under the fraud exception of § 6501(c)(1), which provides that tax may be assessed at any time "[i]n the case of a false or fraudulent return with the intent to evade tax." The IRS's theory was that the taxpayers' return preparer had filed false or fraudulent returns for the taxpayers. Their returns included inappropriate items such as losses from a partnership of which they had never heard. According to the court, the taxpayers "apparently were oblivious" to the inappropriate items on their returns. An IRS investigation of the return preparer revealed that he and his associates had filed 750 to 800 fraudulent returns every year for eleven years. The return preparer was indicted and pled guilty to conspiring to defraud the United States and to interfering with the administration of the internal revenue laws. The IRS relied on *Allen v. Commissioner*, 128 T.C. 37 (2007), in which the court had held that "[n]othing in the plain meaning of the statute [§ 6501(c)(1)] suggests the limitations period is extended only in the case of the taxpayer's fraud. The statute keys the extension to the fraudulent nature of the return, not to the identity of the perpetrator of the fraud." At trial in the Tax Court, the IRS introduced prior testimony of the return preparer in which the preparer stated that every return he prepared during the relevant period had been fraudulent. The IRS also presented an affidavit of the return preparer in which he swore that he had knowingly prepared fraudulent returns for the taxpayers. The taxpayers conceded at trial that, if their returns were fraudulent, then pursuant to § 6501(c)(1) the IRS could assess tax at any time. The Tax Court (Judge Wells) held that the fraud exception was triggered and ruled in favor of the IRS. With the assistance of new counsel, the taxpayers filed a motion for reconsideration and argued for the first time that the fraudulent intent of a return preparer (rather than of the taxpayer) cannot trigger the fraud exception. In other words, the taxpayers asked the Tax Court to reconsider its decision in *Allen*. The Tax Court declined to consider this argument because it had been raised for the first time in the taxpayers' motion for reconsideration. In an opinion by Judge Tjoflat, the U.S. Court of Appeals for the Eleventh Circuit affirmed the Tax

Court's decision. The taxpayers argued that they had not waived their challenge of the *Allen* decision because the issue of whether a statute of limitations applies is not waivable and because the Tax Court had actually considered their challenge and issued a decision. The Eleventh Circuit rejected these arguments and also declined to exercise its discretion to consider an issue raised for the first time on appeal. The Eleventh Circuit also rejected the taxpayers' challenge to the Tax Court's admission into evidence of the return preparer's prior testimony concerning his preparation of fraudulent returns and his affidavit regarding preparation of the taxpayers' returns. The Tax Court had concluded that these statements qualified for the statement-against-interest exception to the hearsay rule and the Eleventh Circuit agreed.

F. Liens and Collections

G. Innocent Spouse

H. Miscellaneous

1. IRS expands voluntary IP PIN program to a total of nine states and the District of Columbia. An Identity Protection Personal Identification Number (IP PIN) is a six-digit number assigned to eligible individuals that must be used on a tax return, in addition to the individual's Social Security number (SSN), to verify the individual's identity. The IP PIN helps prevent a taxpayer's SSN from being used on a fraudulent federal income tax return. The IRS assigns an IP PIN to taxpayers who are victims of identity theft or those who are suspected of being victims of identity theft. For the 2016 filing season, the IRS implemented a pilot program under which taxpayers who filed returns during the prior year from the District of Columbia, Florida and Georgia are eligible to obtain an IP PIN on a voluntary basis even though they have not experienced identity theft. FL-2016-03 (1/26/16). For the 2019 filing season, the IRS expanded this program to include California, Delaware, Illinois, Maryland, Michigan, Nevada, and Rhode Island. The IRS selected these nine states and the District of Columbia because they have higher levels of identity theft. Taxpayers who filed returns from these jurisdictions in the prior year can obtain an IP PIN by using the IRS's online Get An IP PIN tool. To obtain an IP PIN, taxpayers will need to complete successfully the IRS's identity verification secure access process. If its systems can handle the expansion, the IRS plans eventually to offer the voluntary IP PIN program to taxpayers in all states, a move that is supported by the AICPA.

2. IRS releases final regulations permitting use of truncated taxpayer identification numbers on Forms W-2 furnished to employees. T.D. 9861, Use of Truncated Taxpayer Identification Numbers on Forms W–2, Wage and Tax Statement, Furnished to Employees, 84 F.R. 31717 (7/3/19). These final regulations adopt, without substantive change, proposed regulations issued in 2017 under § 6051, § 6052, and § 6109 (REG 105004-16, Use of Truncated Taxpayer Identification Numbers on Forms W-2, Wage and Tax Statement, Furnished to Employees, 82 F.R. 43920 (9/20/17)) that permit employers voluntarily to truncate employees' social security numbers (SSNs) on copies of Forms W–2 that are furnished to employees (including Forms W-2 reporting payment of wages in the form of group-term life insurance) so that the truncated SSNs appear in the form of IRS truncated taxpayer identification numbers (TTINs). Employers are not permitted to truncate SSNs on Forms W-2 filed with the IRS or with the Social Security Administration. Similarly, TTINs may not be used on statements furnished to employers of a payee who received sick pay (such as a statement furnished to the employer of an employee by an insurance company making payments to an employee who is temporarily absent from work due to sickness or disability). According to Reg. § 301.6109-4(a), a TTIN "is an individual's social security number (SSN), IRS individual taxpayer identification number (ITIN), IRS adoption taxpayer identification number (ATIN), or IRS employer identification number (EIN) in which the first five digits of the nine-digit number are replaced with Xs or asterisks. The TTIN takes the same format of the identifying number it replaces, for example XXX-XX-1234 when replacing an SSN, or XX-XXX1234 when replacing an EIN." The final regulations apply to returns, statements, and other documents required to be filed or furnished after December 31, 2020, except for the rules regarding information returns filed with the Social Security Administration, which apply as of July 3, 2019.

3. A federal district court concluded that Form 1099-A issued by a mortgage lender showed only that the lender had acquired the property serving as security for the loan, not that the loan had been cancelled, which would have been reported on form 1099-C, and

therefore dismissed borrower's claim that the lender caused him to owe more tax than he properly owed. Helmert v. Cenlar FSB, 123 A.F.T.R.2d 2019-2287 (D. Miss. 6/18/19). John Helmert, Jr., and his former wife financed the purchase of their home and executed a deed of trust in favor of the lender. They later refinanced their home loan with a different lender and executed a deed of trust in favor of the new lender. The new deed of trust ultimately was assigned to a lender that conducted a foreclosure sale. Mr. Helmert brought this legal action in which he asserted various claims against the lenders involved, including a claim for wrongful foreclosure. One of the claims he asserted was that the lender that foreclosed improperly issued two Forms 1099-A that caused his tax liability to be greater than the amount he actually owed. The lenders against whom the action was brought moved to dismiss his claims. The District Court (Judge Mills) dismissed some of Mr. Helmert's claims, including his claim that the lender's improper issuance of the Forms 1099-A had increased his tax liability. Mr. Helmert asserted that Form 1099-A is issued to reflect loan forgiveness. The court explained that Form 1099-C, not Form 1099-A, is issued to reflect cancellation of debt. Form 1099-A, the court stated, "merely shows that the lender has acquired the property serving as security for its loan, while also stating the balance owed and the fair market value of the property." Because Mr. Helmert had not submitted Form 1099-C or his individual income tax return to support his claim that the lender had caused him to have an increased tax liability, the court dismissed his claim.

- The instructions to Form 1099-A discuss the coordination of Forms 1099-A and 1099-C. The instructions state: "If, in the same calendar year, you cancel a debt of $600 or more in connection with a foreclosure or abandonment of secured property, it is not necessary to file both Form 1099-A and Form 1099-C, Cancellation of Debt, for the same debtor. You may file Form 1099-C only. You will meet your Form 1099-A filing requirement for the debtor by completing boxes 4, 5, and 7 on Form 1099-C. However, if you file both Forms 1099-A and 1099-C, do not complete boxes 4, 5, and 7 on Form 1099-C."

4. Even if the IRS violated certain rights enumerated in the Taxpayer Bill of Rights adopted by the IRS, the violations do not provide a basis for invalidating a notice of deficiency issued to the taxpayer. Moya v. Commissioner, 152 T.C. No. 11 (4/17/19). The IRS disallowed deductions the taxpayer had claimed with respect to a business activity on Schedule C of her 2011, 2012, and 2013 federal income tax returns. During those years she was a professor at the College of Southern Nevada. She subsequently moved to Santa Cruz, California. The IRS examination of the taxpayer's returns was conducted by the IRS office in Las Vegas, Nevada. Through written correspondence, the taxpayer requested that the examination of her returns be transferred to an IRS office near her home in Santa Cruz and that a hearing scheduled in Las Vegas take place instead in Santa Cruz. The IRS subsequently issued a notice of deficiency in which it disallowed the taxpayer's deductions on Schedule C. The taxpayer filed a petition in the Tax Court. In the petition, the taxpayer gave the following reasons for challenging the proposed disallowance:

> Although she requested that the examination of her returns be set near her home, in Santa Cruz, it was set in Las Vegas; her phone calls to the IRS went unreturned; she received contradictory information as to where the examination of her returns would take place; and she received inconsistent requests for information.

The taxpayer asserted that the Taxpayer Bill of Rights (TBOR) adopted by the IRS in 2014 (see IR-2014-72 (6/10/14) gave her the right to have her questions answered and the right to meet with an IRS representative at a time and place convenient to her, and that she had been accorded neither right. The taxpayer's position was that, in examining her returns, the IRS had violated her rights to be informed, to challenge the IRS position and be heard, and to a fair and just tax system. The IRS argued that, pursuant to the principle set forth in *Greenberg's Express, Inc. v. Commissioner*, 62 T.C. 324 (1974), a proceeding in the Tax Court to redetermine a deficiency is a proceeding de novo, and therefore the Tax Court generally is precluded from looking behind a notice of deficiency to examine the IRS's policy or procedures in making determinations. The Tax Court (Judge Halpern) ruled in favor of the IRS for two reasons. *First*, the court explained, the TBOR adopted by the IRS did not add to her rights. The court traced the history of the TBOR and concluded that it merely "consolidat[ed] and articulat[ed] in 10 easily understood expressions rights enjoyed by taxpayers and found in the Internal Revenue Code and in other IRS guidance." *Second*, the court reasoned, even if all of the taxpayer's claims were true, they did not provide a basis for invalidating the notice of deficiency because the taxpayer had a full opportunity to challenge the IRS's proposed adjustments in the Tax Court. Instead of taking advantage of this opportunity, the court stated, the taxpayer had instead challenged the IRS's right to make those determinations on the basis that it had violated unspecific statutory rights.

- In the Protecting Americas from Tax Hikes (PATH) Act of 2015, Congress amended § 7803(a)(3), which provides that, "[i]n discharging his duties, the Commissioner shall ensure that employees of the Internal Revenue Service are familiar with and act in accord with taxpayer rights as afforded by other provisions of this title, including" ten specific rights. These include "the right to be informed" and "the right to a fair and just tax system." In *Facebook, Inc. v. Internal Revenue Service*, 121 A.F.T.R.2d 2018-1752 (N.D. Cal. 5/14/18), the court held that the statutory TBOR in § 7803(a)(3) did not grant taxpayers new, enforceable rights.

XI. WITHHOLDING AND EXCISE TAXES

A. Employment Taxes

B. Self-employment Taxes

1. IRS announces that payroll tax compliance is a top priority. IR-2019-71 (4/11/19). The IRS is making payroll tax compliance a top priority. As part of its efforts in this area, in March and April 2019, the IRS conducted a national two-week education and enforcement campaign to combat employment tax crimes. During these two weeks, the IRS visited nearly 100 businesses showing signs of potential serious noncompliance and the IRS Criminal Investigation (CI) Division indicted 12 individuals, executed four search warrants and saw six individuals or businesses sentenced for crimes associated with payroll taxes. The IRS announcement indicated that payroll taxes withheld by employers account for nearly 72 percent of all revenue collected by the IRS. Because of the importance of payroll taxes to the tax system, said IRS Commissioner Chuck Rettig, "[t]he IRS is committed to compliance in the payroll tax arena, which helps ensure fairness and faith in our tax system." According to Don Fort, Chief of IRS Criminal Investigation, "[e]mployers know the rules—they must deposit and report employment taxes accurately—this is non-negotiable." To bolster payroll tax compliance, the IRS has several tools, including "educational outreach, data analytics, civil investigations by highly trained revenue officers, as well as harsher measures such as lawsuits, seizures and criminal referrals to IRS CI." Resources on complying with and managing payroll tax obligations are available on the IRS website.

2. An author's trade or business included both writing and developing her brand and therefore all income she received under publishing contracts, including any portion paid for her name and likeness, was subject to self-employment tax. Slaughter v. Commissioner, T.C. Memo. 2019-65 (6/4/19). Karin Slaughter, an author of crime fiction, worked since the 1990s to establish herself as a "brand author," one who provides prestige or reliable profits to a publishing house. She worked with an agent to obtain a contract with a New York publishing house and with a media coach and publishers to develop her name and likeness into a successful brand. During the years in question, 2010 and 2011, she spent 12 to 15 weeks writing in Georgia, her state of residence, and also "spent time meeting with publishers, agents, media contacts, and others to protect and further her status as a brand author." During 2010 and 2011, she received two types of payments under contracts she had entered into during the years 1999 through 2011: nonrefundable advance payments and royalties based on the sales generated by her manuscripts. The contracts gave the publishers not only the right to print, publish, distribute, sell, and license the works and manuscripts written by the taxpayer, but also the right to use her name and likeness in advertising, promotion, and publicity for the contracted works and the right to advertise other works in her books. The publishing contracts also required the taxpayer to provide photographs and appear at promotional events and contained various forms of noncompete clauses. The publishing contracts did not allocate the taxpayer's compensation in any way, i.e., did not specify a portion allocable to acquiring the right to print, publish, and license her works and did not specify a portion allocable to acquiring the right to use her name and likeness.

On her 2010 and 2011 federal income tax returns, the taxpayer deducted as business expenses the cost of leasing a vehicle to attend media interviews and promotional events, the cost of hosting her own promotional events, and the rent she paid on an apartment in New York City, which she maintained to facilitate her professional activities there. The taxpayer's federal income tax returns for

2010 and 2011 were prepared by a CPA who concluded that the taxpayer's earned income was the compensation she received for actually writing but that any income she received under the contracts beyond compensation for writing was paid for use of her name and likeness, which was "payment for an intangible asset beyond that of her trade or business as an author" and therefore not subject to self-employment tax. On the taxpayer's 2010 and 2011 returns, all of the advances and royalties she received were reported on Schedule E, Supplemental Income and Loss, and the portion relating to her trade or business of writing was subtracted and reported on Schedule C, Profit or Loss from Business. The CPA who prepared Ms. Slaughter's returns allocated her advance payments and royalties to Schedule C based on the portion of the year that she told the CPA was the amount of time she spent writing, which was 12 to 15 weeks. The 2010 and 2011 returns took the position that only the portion of the advance payments and royalties allocated to Schedule C was subject to self-employment tax. The IRS argued that all of Ms. Slaughter's income was directly or indirectly tied to the selling of her books and therefore was subject to self-employment tax.

The Tax Court (Judge Wells) held that the taxpayer's brand was part of her trade or business and that all of her income under the publishing contracts therefore was subject to self-employment tax. The court reasoned that she had devoted significant efforts over many years to develop her brand. These efforts included meeting with publishers, agents, media contacts, and others to protect and further her status as a brand author, attending interviews and promotional events, and using social media, websites, and a newsletter to maintain her brand with her readership. The court concluded that "[s]uch sales-focused work is sufficiently routine that we consider it part of petitioner's trade or business." The court also reasoned that the taxpayer's treatment of her expenses on the returns supported treating payments received for her brand as part of her trade or business. She had deducted as business expenses the cost of leasing a vehicle to attend media interviews and promotional events, the cost of hosting her own promotional events, and the rent she paid on an apartment in New York City. The court concluded that, if brand-related expenditures are deductible on Schedule C, then the income derived from the brand is also income derived from a trade or business. The court declined to impose accuracy-related penalties for negligence or disregard of rules or regulations because she reasonably relied in good faith on a professional adviser. The court reasoned that she had satisfied the three factors required to establish a reasonable cause defense: (1) the adviser was a competent professional with sufficient expertise to justify reliance because the adviser was a CPA with many decades of experience; (2) the taxpayer had provided necessary and accurate information to the preparer; and (3) the taxpayer, who had no background in finance, law, or tax, actually relied in good faith on the preparer's judgment.

3. Partners are self-employed, even if they are employees of a disregarded entity owned by the partnership. T.D. 9869, Self-Employment Tax Treatment of Partners in a Partnership That Owns a Disregarded Entity, 84 F.R. 3178 (7/2/19). Treasury and the IRS have finalized, with only minor changes, proposed and temporary amendments to the check-the-box regulations under § 7701 (T.D. 9766, Self-Employment Tax Treatment of Partners in a Partnership That Owns a Disregarded Entity, 81 F.R. 26693 (5/4/16).) The amendments clarify that a partner in a partnership is considered self-employed even if the partner is an employee of a disregarded entity owned by the partnership. Prior to amendment, the check-the-box regulations provided that (1) a single-member business entity that is not classified as a corporation under Reg. § 301.7701-2(b) is disregarded as an entity separate from its owner; (2) such a disregarded entity nevertheless is treated as a corporation for employment tax purposes, which means that the disregarded entity, rather than its owner, is considered to be the employer of the entity's employees for employment taxes purposes; and (3) the rule that the disregarded entity is treated as a corporation for employment tax purposes does not apply for self-employment tax purposes. The regulations state that the owner of a disregarded entity that is treated as a sole proprietorship is subject to tax on self-employment income and provide an example in which the disregarded entity is subject to employment tax with respect to employees of the disregarded entity, but the individual owner is subject to self-employment tax on the net earnings from self-employment resulting from the disregarded entity's activities. Reg. § 301.7701-2(c)(2)(iv)(C)(2), -2(c)(2)(iv)(D), Ex. The IRS's longstanding position has been that a partner is self-employed and that any remuneration the partner receives for services rendered to the partnership are not wages subject to FICA, FUTA, and income tax withholding. Rev. Rul. 69-184, 1969-1 C.B. 256. Nevertheless, some taxpayers apparently have taken the position that, because the regulations do not include an example illustrating how the rules apply to a disregarded entity owned by a partnership, an individual partner in a partnership that owns a disregarded entity can be treated as an employee of the disregarded entity and therefore can participate in certain tax-favored employee benefit plans. The final amendments clarify that a disregarded entity is not treated as a corporation for purposes of employing either its individual owner, who is treated as a sole proprietor, or employing an individual that is a partner in a partnership that owns the disregarded entity. Instead, the entity is disregarded as an entity separate from its owner for this purpose and is not the employer of any partner of a partnership that owns the disregarded entity. A partner in a partnership that owns the disregarded entity is subject to the normal self-employment tax rules.

- The IRS's position that a partner cannot be an employee of a disregarded entity owned by the partnership means that compensation to the partner for services rendered to the disregarded entity cannot be reported on Form W-2 and instead must be reported on a Schedule K-1 issued by the partnership. This position also means that such a partner cannot participate in tax-favored employee benefit plans such as cafeteria plans and flexible spending accounts.

- The final regulations apply on the later of (1) August 1, 2016, or (2) the first day of the latest-starting plan year beginning after May 4, 2016, and on or before May 4, 2017, of an affected plan sponsored by a disregarded entity. An affected plan includes any qualified plan, health plan, or §125 cafeteria plan if the plan benefits participants whose employment status is affected by these regulations.

- The final regulations do not address the application of Rev. Rul. 69-184, 1969-1 C.B. 256 (setting forth the IRS's position that a partner is not an employee of the partnership) to either tiered partnerships or publicly traded partnerships. The preamble to the final regulations indicates that the IRS will continue to consider these issues.

XII. TAX LEGISLATION

XIII. TRUSTS, ESTATES & GIFTS