

Recent Developments in Federal Income Taxation

Bruce A. McGovern

Professor of Law and Director, Tax Clinic

South Texas College of Law Houston

Houston, Texas

State Bar of Texas Tax Section

First Wednesday Tax Update

October 2, 2024

1

CLE Number for Today's Webcast:

174252937

2

Anderson v. Commissioner
133 A.F.T.R.2d 2024-1551 (10th Cir. 5/17/24)

Outline: item D.1, page 2

- The taxpayer, a doctor who researched gene therapy, had his own business.
- He was convicted of sexually abusing the minor daughter of his research assistant.
- He paid legal fees in 2013 (\$292,175) and 2014 (\$68,120) and deducted them as business expenses.
 - The taxpayers asserted that they had paid the legal fees for an investigation of the doctor's former colleague, who allegedly had filed false accusations of molestation against the doctor in an effort to steal his intellectual property.
- Under *United States v. Gilmore*, 372 U.S. 39, 48-49 (1963):
 - the deductibility of legal fees depends on the origin and character of the claim for which the expenses were incurred and whether the claim has a sufficient connection to the taxpayer's business or income-producing activities.
- Issue: are the legal fees deductible as business expenses under § 162??
- Held: No. As the Tax Court held, only \$3,000 of the 2014 fees were paid for an investigation related to the business. The remaining fees were personal.
 - The expenses the taxpayer attempted to deduct were primarily related to his ineffective assistance of counsel claim in his criminal case and a later proceeding in which he filed a state habeas corpus petition seeking his release from prison.

3

Section 1014(f)/Final Regulations

Outline: item A.1, page 3

- Generally, under § 1014(a), an individual who inherits property takes a basis in the property equal to FMV on date of death.
- The Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, § 2004(a) (7/31/15):
 - Enacted new § 1014(f)
 - Requires that heir's § 1014 basis in property not exceed value as finally determined for estate tax purposes.
 - Applies only if estate tax return is required to be filed.
 - Does not apply if a return is filed solely to enable surviving spouse to claim the deceased spouse's unused credit under portability rules.
 - Enacted new § 6035, which requires executor to report to IRS and heir the value of the property.
 - IRS issued final Form 8971 on 1/29/16.
- Final regulations issued 9/17/24: 89 F.R. 76356
 - Eliminate the "zero basis" rule for property omitted from the return.

4

Varian Medical Systems Inc. v. Commissioner,
163 T.C. No. 4 (8/26/24)
Outline: item H.1, page 6

- In the TCJA of 2017, Congress added a Mandatory Repatriation Tax (MRT) to Subpart F of the Code. See IRC § 965(a)(1), (c), (d).
 - The MRT imposed on United States shareholders a one-time pass-through tax on the accumulated but undistributed income of certain foreign corporations, including controlled foreign corporations (CFCs).
- The taxpayer, a U.S. corporation, was subject to the MRT and had a deemed dividend for its TY ending September 30, 2018.
- The taxpayer increased the amount of the dividend pursuant to § 78 by the foreign tax paid on the dividend.
- Issue: could the taxpayer deduct the additional deemed dividend amount required by § 78 under § 245A, which authorized a deduction for a US corporation that receives a dividend from a “specified 10% owned foreign corporation”?
- Held: Yes. Although Congress likely did not intend this, the result is required by the relevant statutory language.

5

5

Notice 2024-54
2024-28 I.R.B. 24 (6/17/24)
Outline: item E.1, page 11

- Announces that the IRS will issue proposed regulations regarding certain basis-shifting transactions involving partnerships and related parties.
- REG-124593-23, Certain Partnership Related-Party Basis Adjustment Transactions as Transactions of Interest, 89 F.R. 51476 (6/17/24).
- Example 2 in the preamble to REG-124593-23: DEF Partnership is owned by partners D, E and F. The partners are related to each other within the meaning of proposed § 1.6011-18(b)(8) and (b)(9)(i). D’s outside basis is \$7 million. E and F each have an outside basis of \$1 million. DEF Partnership owns only two properties, Property 1 and Property 2, both of which it uses in its trade or business. For Federal income tax purposes, Property 1 is depreciable property and Property 2 is nondepreciable property. DEF Partnership has an adjusted basis in Property 1 of zero, and an adjusted basis in Property 2 is \$9 million. DEF Partnership distributes Property 1 to D in liquidation of D’s partnership interest. Under section 732(b), D’s basis in distributed Property 1 is equal to \$7 million. As a result, D claims depreciation deductions based on a \$7 million basis in Property 1.

6

6

Final Regulations on Conservation Easements

89 F.R. 54284 (6/28/24)

Outline: item B.1.b, page 18

- Final regulations implement the rule of Code § 170(h)(7) that disallows deductions for conservation easements by pass-through entities that exceed 2.5 times the sum of each partner's outside basis.

7

7

United States v. Schwarzbaum,

__ F.4th __ (11th Cir. 8/30/24)

Outline: item H.1, page 21

- Held: the FBAR penalties imposed on the taxpayer for willful failure to file an FBAR were fines and therefore subject to the Eighth Amendment's prohibition against excessive fines.
 - Contrary to First Circuit's decision in *Unites States v. Toth* (2022).
- Requires an account-by-account analysis.
- However, of the \$13 million in penalties, only \$300,000 were excessive.

8

8