Recent Developments in Federal Income Taxation

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A.O.D. 2017-07
2017-42 I.R.B. 311 (10/16/17)
Outline: item I.1, page 3

- Under Code § 469(c)(2), rental activities are automatically passive.
  - This rule does not apply to a rental real estate activity if the taxpayer meets the requirements of § 469(c)(7), commonly known as a "real estate professional" (REP).
  - In determining whether a person is a REP, services performed as an employee do not count, except for a "5 percent owner."
- In *Stanley v. United States*, 116 A.F.T.R.2d 2015-6766 (W.D. Ark. 11/12/15), the court held, among other things, that:
  1. Taxpayer, who held 10 percent of an S corporation's stock but was required to surrender it upon leaving employment, was a 5 percent owner. Court rejected government arguments based on § 83.
  2. Taxpayer could group the rental real estate activity with non-rental business activities (such as real estate construction or development) to determine material participation in the grouped activities.
- IRS has <u>nonacquiesced</u> in both holdings.

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Rev. Proc. 2017-60
2017-50 I.R.B. ___ (11/23/17)
Outline: item A.1, 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.
- Pyrrhotite is a naturally occurring mineral in stone aggregate used to produce concrete.
  - Homeowners in New England, especially Connecticut, have suffered premature deterioration in their concrete foundations due to pyrrhotite.
- This 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.

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Health Reimbursement Arrangements Offered by Small Employers
Outline: item A.1.f, page 6

- Prior IRS guidance on health reimbursement arrangements:
  - Notice 2013-54 (outline item 1, page 4)
    - HRAs are group health plans that violate certain provisions of the Affordable Care Act
    - Triggers the § 4980D excise tax
  - Notice 2015-17 (outline item 1.b, page 5)
    - IRS will not assert the § 4980D excise tax against employers that are not applicable large employers through June 30, 2015.

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Outline: item A.1.f, page 6

- The 21st Century Cures Act, § 18001(a) (12/13/16):
  - Allows eligible employers to offer health reimbursement arrangements that meet the definition of a "qualified small employer health reimbursement arrangement" (QSEHRA) <u>without</u> becoming subject to the § 4980D excise tax.
    - An eligible employer is one that is not an applicable large employer and does not offer a group health plan.
    - The payments and reimbursements under the QSEHRA cannot exceed $4,950 ($10,000 for HRA covering family).
    - Effective for years beginning after 2016. (But relief in Notice 2015-17 extended to plan years beginning before 2017.).
  - Imposes new reporting obligations on employers.
  - Recent guidance: Notice 2017-67, 2017- 47 I.R.B. 517 (10/31/17)

Health Reimbursement Arrangements Offered by Small Employers
Outline: item A.1.h, page 8

- Highlights of Notice 2017-67, 2017-47 I.R.B. 517 (10/31/17):
  - A QSEHRA can be provided only to current *employees*. Cannot be provided to retirees or non-employee owners (2 percent shareholders).
  - Written notice to employees.
    - Employers offering a QSEHRA during 2017 or 2018 must provide written notice to employees by the later of (1) 90 days before the first day of the QSHEHRA plan year, or (2) February 18, 2018.
    - Notice 2017-67 provides requirements and sample language for the notice.
    - Employers encouraged to provide employees with information regarding the QSEHRA ASAP so they can make informed decisions about health coverage (even if not the full notice).
  - Employer must report amount of payments/reimbursements that employee is entitled to receive in box 12 of Form W-2 using code FF, without regard to amounts employee actually received.

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Gaylor v. Mnuchin, 120 A.F.T.R.2d 2017-6128 (W.D. Wis. 10/6/17)
Outline: item A.2, page 8

- A minister can exclude from gross income:
  - Rental value of a home provided to the minister. § 107(1).
  - "Rental allowance" provided as part of minister's compensation. § 107(2).
- Issue: is the exclusion provided by § 107(2) unconstitutional?
- Held: Yes. The exclusion provided by § 107(2) violates the First Amendment's establishment clause because it "demonstrates a preference for ministers over secular employees."
  - **Note:** court's opinion does not address the exclusion provided by § 107(1).

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McGuire v. Commissioner,
149 T.C. No. 9 (8/28/17)
Outline: item D.1, page 9

- 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 in 2013, they qualified for advance payment of the premium tax credit ($7,092) authorized by § 36B.
  - Later in 2013, Mrs. McGuire became employed. With this additional income they did not qualify for the PTC.
  - They informed the exchange about the income. They never received from the exchange correspondence or Form 1095-A.
- <u>Issue</u>: are the taxpayers liable for a deficiency of $7,092?
- <u>Held</u>: Yes. Excess advance premium tax credits are an increase in the tax imposed. Taxpayers received advance payments of a credit to which they were not entitled. Equitable relief unavailable.

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Rev. Proc. 2017-58
2017-45 I.R.B. 489 (10/19/17)
Outline: item D.2, page 10

- Standard deduction for 2018:
  - $13,000 for joint returns and surviving spouses (increased from 12,700)
  - $9,550 for head-of-household filers (increased from $9,350)
  - $6,500 for unmarried and married filing separately (increased from $6,350)
- The tax legislation pending in Congress, if enacted, would supersede these figures. For 2018, the legislation would <u>eliminate the personal exemption deduction</u> and increase the standard deduction to:
  - $24,000 for joint returns and surviving spouses ,
  - $18,000 for head-of-household filers, and
  - $12,000 for unmarried and married filing separately

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Notice 2017-71
2017-51 I.R.B. ___ (11/30/17)
Outline: item G.1.b, page 11

- The Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, § 2006(a) (7/31/15) , changed the due date of partnership returns.
- Final regulations (T.D. 9821) implement the changes and:
  - Accelerate the due date of partnership returns to the 15th day of the <u>third</u> month following the close of the taxable year (March 15 for calendar-year partnerships).
  - Generally apply to tax years beginning after 2015.
- Automatic extension is 6 months (if timely request filed).
- The IRS has waived late-filing penalties for partnerships and certain other entities that filed returns or extension requests, or took other required actions, by the old due date for the first tax year beginning after 2015. Notice 2017-47, 2017-38 I.R.B. 232 (9/1/17); Notice 2017-71, 2017-51 I.R.B. ___ (11/30/17).

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Hewlett-Packard, Inc. v. Commissioner,
875 F.3d 494 (9th Cir. 11/9/17)
Outline: item A.1, page 12

- Hewlett-Packard purchased preferred stock in a Dutch company that purchased contingent interest notes.
  - Contingent interest is subject to current taxation in the Netherlands, but not in the United States.
  - The transaction generated foreign tax credits for HP 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 also deducted a $16 million capital loss on the later sale of the stock.
- <u>Issue</u>: was the taxpayer able to use the foreign tax credits and to deduct the capital loss on the sale of the stock?
- <u>Held</u>: No.
  1. The Tax Court committed no clear error in finding that the preferred stock was debt rather than equity.
  2. The Tax our correctly concluded that capital loss really was a nondeductible fee paid to participate in a tax shelter.

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Palmolive Building Investors, LLC v. Commissioner, 149 T.C. No. 18 (10/10/17)
Outline: item B.2, page 13

- The taxpayer, an LLC classified as a partnership, granted a façade conservation easement to a § 501(c)(3) exempt organization.
- The easement was valued at $33.4 million, which was the amount of the taxpayer's charitable contribution deduction.
- The easement was subordinated to two mortgages on the property.
- Subordination agreement:
  - Gave mortgage holders priority over claims of exempt organization to proceeds if easement extinguished through condemnation.
  - Contained "savings clause" that modified mortgage holders' rights to extent necessary to comply with rules for conservation easements.
- <u>Held</u>: (1) the easement did not protect the property in perpetuity, as required, and (2) the savings clause did not cure the problem.
  - Declines to follow *Kaufman v Shulman*, 687 F.3d 21 (1st Cir. 2012).

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Creditguard of America, Inc. v. Commissioner, 149 T.C. No. 17 (10/10/17)
Outline: item A.1, page 14

- The IRS examined the taxpayer in 2003 to determine if it qualified for tax-exempt status under § 501(c)(3).
- In 2012, the IRS revoked the taxpayer's exempt status retroactively to 2002.
  - Accordingly, the taxpayer was a taxable corporation that should have filed a corporate income tax return (Form 1120) for 2002 on March 17, 2003.
  - The IRS determined a deficiency of over $216,000 in tax.
- In the Tax Court, the parties entered a stipulated decision concerning the deficiency plus interest "as provided by law."
- <u>Issue</u>: does interest accrue from March 17, 2003 (over $142,000 of interest), or only from 2012 when the IRS revoked exempt status?
- <u>Held</u>: by statute, interest accrues from the date the corporate income tax was due, March 17, 2003.

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Estate of Kirsch v. United States, 120 A.F.T.R.2d 2017-5211 (W.D.N.Y. 7/13/17)

Outline: item E.1, page 15

- The taxpayer filed her 2008 federal income tax return on June 5, 2014.
  - The return claimed a refund of approximately $41,000.
  - All of the tax was considered paid on April 15, 2009.
- Under § 6511(b)(2)(A), the taxpayer could recover only tax paid within 3 years preceding the refund claim.
- Section 6511(h) suspends the normal limitations periods during any period the taxpayer is "financially disabled."
  - "Unable to manage … financial affairs by reason of a medically determinable physical or mental impairment which can be expected to result in death or … to last for a continuous period of not less than 12 months."
- Issue: did the taxpayer qualify for relief under § 6511(h)?
- Held: No. Taxpayer did not strictly comply with Rev. Proc. 99-21. Doctor's certification did not specify the period of disability; son was authorized to act on her behalf. *Compare Stauffer v. IRS*, 120 A.F.T.R.2d 2017-6119 (D. Mass. 9/29/17).

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Borenstein v. Commissioner, 149 T.C. No. 10 (8/30/17)

Outline: item E.2, page 16

- The taxpayer filed her 2012 federal income tax return on August 29, 2015, after she had received a notice of deficiency for 2012.
  - The return claimed a refund of approximately $38,000.
  - All of the tax was considered paid on April 15, 2013.
- Under § 6512(b)(3), the taxpayer could recover only tax she could have recovered had she filed a refund claim on June 19, 2015, the date the IRS mailed a notice of deficiency.
- Under § 6511(b)(2), the taxpayer could recover only tax paid within either 2 years or 3 years preceding the refund claim.
- Issue: did the 2-year or 3-year look-back period of § 6511(b)(2) apply?
- Held: Two-year look-back period. Therefore, taxpayer could not obtain a credit or refund of any of the $38,000.
  - The court's decision turned on the interpretation of the last sentence of § 6512(b)(3)(B). Effectively, taxpayer could not obtain a refund because she had filed a timely extension request for her 2012 return.

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Pearson v. Commissioner,
149 T.C. No. 20 (11/29/17)
Outline: item H.1.a, page 18

- The last day for the taxpayer to file a Tax Court petition was April 22, 2015.
- The Tax Court received the petition on April 29, 2015.
  - The envelope containing the petition had been deposited 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 did not bear a USPS postmark.
  - The USPS entered the envelope into its tracking system for certified mail on Apr. 23, 2015.
- Issue: was the petition timely filed?
- Held: Yes. *Tilden v. Comissioner* (7^{th} Cir. 2017) followed.

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Chamber of Commerce v. IRS,
120 A.F.T.R.2d 2017-5967 (W.D. Tex. 9/29/17)
Outline: item H.3, page 20

- Held:
  1. The IRS did not comply with the Administrative Procedure Act with respect to a portion of the anti-inversion regulations issued under § 7874.
  2. This portion of the regulations is invalid.
- On November 27, 2017, the government filed a notice of appeal in the U.S. Court of Appeals for the Fifth Circuit.

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