Texas Tax Lawyer

A Tax Journal

Fall 2019 • Vol. 47 • No. 1

TAX SECTION
STATE BAR OF TEXAS

www.texastaxsection.org

TABLE OF CONTENTS

FROM OUR LEADER:

SPECIAL ATTENTION

ARTICLES:

- Recent Developments in Federal Income Taxation: "Recent developments are just like ancient history, except they happened less long ago" First Wednesday Tax Update, September 4, 2019
  Bruce A. McGovern, Professor of Law and Director, Tax Clinic, South Texas College of Law Houston

- Recent Developments in Federal Income Taxation: "Recent developments are just like ancient history, except they happened less long ago" First Wednesday Tax Update, October 2, 2019
  Bruce A. McGovern, Professor of Law and Director, Tax Clinic, South Texas College of Law Houston

PRACTITIONER'S CORNER:

- 60 Day IRA Rollovers – The Bookkeeping Exception
  Jim Griffin, Scheef & Stone, L.L.P.
  PREVIOUSLY PUBLISHED ON LINKEDIN

- U.S. Supreme Court finds in-state beneficiary inadequate for trust tax
  Alan Spigelman, RSM US LLP
  Brian Kirkell, RSM US LLP
  Mo Bell-Jacobs, RSM US LLP
  Cindy Hull, RSM US LLP

- U.S. Supreme Court denies Fielding petition after Kaestner
  Carol Warley, RSM US LLP
  Brian Kirkell, RSM US LLP
  Eric Manus, RSM US LLP
  Mo Bell-Jacobs, RSM US LLP

Committee On Government Submissions:

- Comments on Proposed Regulations Concerning the Deferral of Gain Recognition on Amounts Reinvested in Qualified Opportunity Funds
  July 1, 2019
  General Tax Committee
  Partnership and Real Estate Tax Committee

Section Information:

- Tax Section Council Roster
- Tax Section Committee Chair and Vice Chair Roster
- 2019 – 2020 Calendar

Dear Fellow Tax Section Members,

Welcome to a new year of the Texas Tax Section! I am this year's chair. I have boutique tax controversy law firm in Austin, Texas, where we assist taxpayers with resolving state and federal tax controversies and litigation. I earned my accounting degree and my law degree both from the University of Texas at Austin, and I have lived here ever since. When I'm not helping clients, making presentations, or doing volunteer work, I enjoy bicycling and dancing with my husband, Dan, and we enjoy hiking with our dogs through a myriad of local trails, and picnicking at summer concerts with friends. I first got involved in the Texas Tax Section starting right out of law school, as the 2001-2002 vice chair of the CLE committee. Since then the Tax Section has kept growing and doing more and more to serve its members. I have met some of my dearest friends and colleagues as a result of my membership in the Tax Section and have run into some of the best professional opportunities through those relationships. I hope each of you finds your involvement in the Texas Tax Section just as rewarding.

I am honored to deliver the following report for our fall edition of the *Texas Tax Lawyer*. A huge thank you to our Editor, **Michelle Spiegel**, for her continued commitment and hard work in delivering an outstanding *Texas Tax Lawyer* publication three times every year. This year, Aaron Borden will assist as vice-chair.

Recap of Our Busy Summer

The summer started with our Planning Retreat, which was held in conjunction with the Annual Meeting, in my home town of Austin, Texas, on Thursday, June 13, 2019. The new officers met up in Dallas over the weekend of August 8-9, 2019, to begin planning for the upcoming year. In addition, the Tax Section held its first meeting of the incoming Chairs, Vice Chairs, and Council on Friday, August 23, 2019, at the Houston offices of Norton Rose Fulbright. Since I am from Austin and many of our leaders are from Houston and Dallas, we are splitting the meetings this year, with the first two being in Houston and the latter two being in Dallas.

As a result of these meetings, we approved a few of our governing documents for the year:

1. The Calendar for the 2019-2020 Fiscal Year;
2. The List of Chairs and Vice Chairs for the committees;
3. The 2019-2020 Fiscal Year budget; and the
4. 2019-2020 Statement of Direction.

Leadership Academy

The Leadership Academy, chaired by **Rob Morris**, also met in conjunction with the Annual Meeting at the Austin offices of Norton Rose Fulbright. The Leadership Academy focuses on training and developing the future leaders of the Tax Section. The current class has twenty members. The evaluations from the programs, which focus on both technical tax issues and leadership training, have been outstanding!

Committee on Governmental Submissions

Sam Megally has graciously taken over leadership of the Committee on Governmental Submissions (COGS) with the help of **Jason Freeman** and **Jeff Blair**. COGS and the substantive committees of the Tax Section have been extremely busy throughout the summer issuing comments to the Internal Revenue Service and State Comptroller and testifying on proposed regulations in Washington DC. .

A set of comments issued July 1, 2019, through the Federal eRulemaking Portal, was on Proposed Regulations Concerning the Deferral of Gain Recognition on Amounts Reinvested in Qualified Opportunity Funds (REG-120186-18). This was a joint project between the COGS committee, the General Tax Committee, and the Partnership and Real Estate Tax Committee. The principal drafters were **Chris Goodrich,** Vice Chair of the General Tax Committee and **Nate Smithson,** Co-Chair of the Partnership and Real Estate Tax Committee. **Argy Saccopoulos** reviewed the comments and made substantive suggestions. **Jeff Blair** also reviewed the comments and made suggestions on behalf of COGS.

Argy Saccopoulos then traveled to Washington DC on July 9, 2019, to represent the Texas Tax Section in a public hearing on the proposed regulations.

The monthly COGS conference calls are now scheduled for the third Friday of each month at 11:00 a.m. The calls are very brief and efficient. It is very important for at least one representative of each substantive committee to dial in to the monthly COGS call, even if there have been no specific projects identified by the committee. It is critical for us to be able to collaborate with other committees, like the Partnership and Real Estate and General Tax Committee did for the Qualified Opportunity Funds comments, to ensure various stakeholders' interests are addressed.

First Wednesday Tax Updates

The Tax Section is excited to announce that the successful webcast series "**First Wednesday Tax Update**" will continue to be offered the first Wednesday of each month with a focus on Recent Developments in Federal Income Taxation. The webcast is presented by **Prof. Bruce McGovern**, Professor of Law and Director, Tax Clinic, South Texas College of Law Houston (and may occasionally include other guest speakers). We hope you will make plans to watch the webcast each month, but if you miss it, the webcast will be available on the Tax Section's 24/7 online library within a couple of weeks. Watch your email for registration details. The webcast is **free** to Tax Section Members.

Pro Bono Dockets

The Pro Bono Committee Co-Chaired by **Prof. Bob Probasco** and **Rachael Rubenstein** and vice-chaired by **Jaime Vasquez**, assisted taxpayers in El Paso on September 9, 2019, and the Lubbock Regular and Small Tax Case docket on September 12, 2019. The Texas Tax Court Pro Bono Program was established by past Chair and now sitting **U.S. Tax Court Judge Elizabeth A. Copeland**. The Texas Pro Bono Program is now used as a model for other state bars.

The Texas Tax Section's work in the Adopt-A-Base training program was recognized at the 2019 Annual Meeting in Austin with an award presented by IRS senior tax analyst **Rawlin Tate** from Atlanta, Georgia**.** Certificates of appreciation were presented to the Tax Section members who presented the training on their own during the government shutdown at Fort Hood, Goodfellow Air Force Base, Fort Bliss, Fort Sam Houston and Lackland Air Force Base.

The Pro Bono committee is in the process of working on an attorney application and revised guidelines for the program. The Pro Bono Program is an excellent opportunity for tax lawyers, including young tax lawyers, to gain hands-on courtroom experience assisting taxpayers. Please contact Bob, Rachael or Jaime if you are interested in participating.

Meeting with the Texas Comptroller's Office

Our annual meeting with the Texas Comptroller of Public Accounts office occurred on **November 20, 2019** in **Austin, Texas**. The program presented collaborative panels including speakers from the Texas Comptroller's Office and the State Bar Tax Section. Many thanks to the Texas Comptroller of Public Accounts, **Glenn Hegar,** his staff, and the State and Local Tax Committee Chaired by **Stephen Long** for their hard work and efforts to plan this program and make it available to members of the Tax Section.

Law School Outreach Program

Would you like to visit your law school alma mater or local law school and chat with today's students about how great it is to practice as a tax lawyer? The Tax Section's law school outreach efforts are well underway. The Tax Section met with students at Texas Tech on September 17, 2018, Texas A&M School of Law on September 26, 2019; Southern Methodist University Dedman School of Law on October 30, 2019, and The University of Houston Law Center on November 14, 2019. Other law school programs are in the process of being scheduled. Thanks to **IRS Liaison Audrey Morris** for heading up the Law School Outreach for the Tax Section and to **Abbey Garber** for his continued stewardship and support as vice-chair of the Law School Outreach Program. Please contact them if you are interested in serving on one of the law school panels.

Law School Student Scholarships

The application period for law school scholarships is scheduled to open in January of 2020. Applications will be available on our website, so law students and professors will want to be on the lookout for the application! Thanks to **Prof. Alyson Outenreath**, past chair of the Tax Section, for taking up the leadership of the law school scholarship program this year. Please contact Alyson if you would like to help.

The 24/7 Free Online CLE Library

The Tax Section offers a 24/7 Free Online Library thanks to **Michael Threet**. It continues to be free to members of the Tax Section. It includes over 100 audio and video programs, along with PowerPoint presentations and outlines. Please let us know if you have a topic or speaker you suggest for the 24/7 library. Each substantive committee is challenged with presenting at least one basic and one advanced topic each year, which helps keep our educational opportunities growing.

CLE Task Force

The State Bar Tax Section offers numerous CLE programs throughout the year. **Abbey Garber** has agreed to chair a task force to review those programs and find ways to make our process of planning, presenting, and marketing CLE programs even more streamlined and effective. Please contact Abbey if you're interested in participating in the task force.

Nominations Committee

As directed under the Bylaws, I have recently appointed members of the Nominations Committee. These members include: **Catherine C. Scheid** (Immediate Past Chair); **Andrius Kontrimas** (2014-2015 Chair); and **Prof. Alyson Outenreath** (2015-2016 Chair)

As the current Chair, I will serve on the Nominations Committee as an Ex-Officio member.

Open positions beginning in July 2020 include Treasurer and three council members.
To nominate someone to be considered for one of these positions, or to express interest, please contact any Nominating Committee Member.

I would like to extend a special thanks to our past chairs for their continued willingness to serve and support the Tax Section of the State Bar; their time and interest is greatly appreciated.

Deadline for the Winter Edition of the *Texas Tax Lawyer*

The deadline for submitting articles and other items for the winter edition of the *Texas Tax Lawyer* is January 25, 2020. Any members interested in submitting articles or other items should contact **Michelle Spiegel** at Michelle.Spiegel@nortonrosefulbright.com or **Aaron Borden** at aborden@meadowscollier.com.

Upcoming Events

The **21st International Tax Symposium** happened on **November 21 and 22** in Houston, Texas at the Crowne Plaza River Oaks Hotel located at 2712 Southwest Freeway. There was a half day of Basic International Tax and a day and a half of Advanced International Tax. The International Tax Committee is Chaired by **John Strohmeyer**. Many thanks to John for his work on this wonderful event.

Tax Law in a Day is being scheduled for **2020** in **Houston, Texas**. Tax Law in a Day is an annual all-day survey of tax law basics given under the stewardship of **Renesha Fountain** with the assistance of **Harriet Wessel**. If you have speaker or topic ideas for Tax Law in a Day, or are interested in helping with the planning, please contact Renesha or Harriet.

The annual **Property Tax** continuing legal education program will be held in **March 2020** in Austin. The Property Tax CLE is always a wonderful success and we congratulate the Property Tax Committee on having discovered the key to CLE magic. More details will soon follow. The Property Tax Committee is chaired by **Rick Duncan** and vice-chaired by **Daniel Richard Smith**.

Advanced Tax CLE Deep Dive Workshop - More details to come. We are extremely grateful for **Dan Baucum's** leadership of this innovative world class program.

The **2020 Annual Meeting** will be held in **Dallas, Texas** on **June 25th** and **26th** at the **Hilton Anatole.** The Tax Section's annual business meeting and CLE will be on **Friday, July 26, 2020**. Please mark your calendars and plan to attend.

Join a Committee

We have an active set of committees, both substantive and procedural, as in previous years. Our substantive committees include: Corporate Tax, Employee Benefits, Energy and Natural Resources Tax, Estate and Gift Tax, General Tax Issues, International Tax, Partnership and Real Estate, Property Tax, State and Local Tax, Tax Controversy, Tax-Exempt Finance, and Tax-Exempt Organizations. In addition, our facilitator committees include: the Committee on Governmental Submissions, Solo and Small Firm, Continuing Legal Education Committee, Newsletter Committee, Law School Outreach and Scholarship, Annual Meeting Planning Committee, and Tax Law in a Day Committee. Any members interested in joining a committee can do so by visiting our web site at www.texastaxsection.org. Joining a committee is the best way to develop long-term relationships with members of the Texas Tax Section, which result in learning, leadership, and business development, as well as many lifetime friendships.

We Need a Volunteer Website Curator

We need a Tax Section member or task force of members to help curate our website. We have a beautiful Texas Tax Section website redesigned several years ago under the leadership of **Prof. Alyson Outenreath**. We also have vendors in place to make the periodic changes we need. However, we also need someone to help us figure out the best way to communicate our message to our members and to the public and effectively and efficiently employ the tools we have in place. Please e-mail me at cmondrik@mondriklaw.com if you are interested in participating.

Sponsorships

We are very grateful to our many sponsors of the Tax Section and our events. If your organization would like to become a sponsor, please contact **Jim Roberts** at jvroberts@gpm-law.com.

Contact Information

I look forward to future communications with our members! In the meantime, below is my contact information as well as the contact information for our Tax Section Administrator, Anne Schwartz, if you have any questions or would like additional information:

Christi Mondrik
Mondrik & Associates
11044 Research Blvd Ste B-400
Austin, Texas 78759
cmondrik@mondriklaw.com

Anne Schwartz
Tax Section Administrator
annehschwartz@gmail.com
Houston, Texas

Texas Tax Section provides training for military VITA volunteers

SPEC thanks tax attorneys for teaching VITA certification classes during the partial government shutdown

Senior tax analyst **Rawlin Tate** (third from left) presented certificates to the attorneys who trained Military VITA volunteers.

While members of the armed forces are serving our nation, the last thing they should be worrying about is taxes. Thankfully, Military Volunteer Income Tax Assistance (VITA) volunteers become experts with the tax law so they can prepare tax returns for service members.

Every year, attorneys participate in the Adopt-A-Base Program. The attorneys partner with Stakeholder Partnerships, Education and Communication (SPEC) to provide training to military VITA volunteers. This year was unique because SPEC employees could not participate.

"In the past, SPEC employees assisted Adopt-A-Base attorneys," explained senior tax analyst **Rawlin Tate**. "However, due to the partial government shutdown, SPEC employees were not available. The attorneys taught the classes without SPEC to ensure that military personnel were certified to participate in VITA."

Attorneys from the Texas Tax Section, a member of the Texas Bar Association, taught VITA for three days during January. They adopted Fort Hood, Goodfellow Air Force Base, Fort Bliss, Fort Sam Houston and Lackland Air Force Base.

SPEC recently recognized the Texas Tax Section attorneys for their participation. Rawlin presented each attorney with an appreciation certificate.

Contributed byRawlin Tate.

2020
CALL FOR NOMINATIONS FOR OUTSTANDING TEXAS TAX LAWYER AWARD

The Council of the State Bar of Texas Tax Section is soliciting nominees for the Outstanding Texas Tax Lawyer Award. Please describe the nominee's qualifications using the form on the next page. Please attach additional sheets if needed.

Nominees must: (i) be a member in good standing of the State Bar of Texas or an inactive member thereof; (ii) a former full time professor of tax law who taught at an accredited Texas law school; or (iii) a full time professor of tax law who is currently teaching at an accredited Texas law school. In addition, nominees must have (1) devoted at least 75% of his or her law practice to taxation law, and (2) been licensed to practice law in Texas or another jurisdiction for at least ten years.[1] The award may be granted posthumously.

In selecting a winner, the Council will consider a nominee's reputation for expertise and professionalism within the community of tax professionals specifically and the broader legal community; authorship of scholarly works relating to taxation law; significant participation in the State Bar of Texas, American Bar Association, local bar associations, or legal fraternities or organizations; significant contributions to the general welfare of the community; significant pro bono activities; reputation for ethics; mentoring other tax professionals; experience on the bench relating to taxation law; experience in academia relating to taxation law; and other significant contributions or experience relating to taxation law.

Nominations should be submitted to Dan G. Baucum, Tax Section Secretary by email to dbaucum@baucumlaw.com no later than April 1, 2020.

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[1] "Law practice" means work performed primarily for the purpose of rendering legal advice or providing legal representation, including: private client service; service as a judge of any court of record; corporate or government service if the work performed was legal in nature and primarily for the purpose of providing legal advice to, or legal representation of, the corporation or government agency or individuals connected therewith; and the activity of teaching at an accredited law school; and "Taxation law" means but is not limited to "Tax Law" as defined by the Texas Board of Legal Specialization's standards for attorney certification in Tax Law; tax controversy; employee benefits and executive compensation practice; criminal defense or prosecution relating to taxation; taxation practice in the public and private sectors, including the nonprofit sector; and teaching taxation law or related subjects at an accredited law school.

NOMINATION FOR 2020 OUTSTANDING TEXAS TAX LAWYER AWARD

Nominee Name: ______________________________

Nominee Mailing Address, Phone, and Email:

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Description of Nominee's Contributions/Experience Relating to Taxation Law (please attach additional sheets if needed):

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Nominator Name: ______________________________

Nominator Mailing Address, Phone, and Email:

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TAX SECTION
State Bar of Texas

Law Students Pursuing Tax Law Scholarship Application

The Tax Section of the State Bar of Texas annually awards up to three $2,000 scholarships to students demonstrating academic excellence and commitment to the study and practice of tax law. Any student who is enrolled in an ABA accredited law school at the time the application is submitted, and who intends to practice tax law in Texas, is eligible to apply. Thus, persons who have been accepted to law school, but have not yet started classes at the time the application is filed, are ineligible to apply. However, persons who have recently graduated at the time the scholarship is awarded are eligible to apply.

The purpose of this scholarship is to facilitate and encourage students to enter the practice of tax law in Texas, and to become active members of the State Bar Tax Section, by assisting these students with their financial needs. Selection criteria of the scholarships include: merit, scholarship performance, financial need, and demonstrated experience and interest in the field of tax law. Consideration is also given to extracurricular activities both inside and outside law school, including but not limited to legal externships or internships with state or federal taxing authorities such as the Internal Revenue Service, Office of the Texas Comptroller of Public Accounts, or Texas-based legal aid societies and clinics.

A completed application must be returned by email to Alyson Outenreath at Alyson.Outenreath@ttu.edu.

All information, including supporting documentation such as letters of recommendation and transcripts, must be included in a single submission. Transcripts do not need to be in original or certified form. Please scan all of the documents and attach the scan to an email as a single document in PDF form. Incomplete applications will not be accepted.

Applications must be time stamped by no later than **April 4, 2020**. The scholarships will be awarded at the State Bar Annual Meeting in June 2020 in Dallas, Texas. Winners need not be present to accept the award.

Please print or type.

I. GENERAL INFORMATION

NAME: ____

E-MAIL ADDRESS: ________________________

MAILING ADDRESS: ______________________________________
____

CELL PHONE: ____________________ ALTERNATE PHONE: ____________________

II. EDUCATIONAL INFORMATION

LAW SCHOOL NAME: ____

GPA (cumulative): ______________ EXPECTED GRADUATION DATE: __________

CLASS RANK: __________

UNDERGRADUATE COLLEGE NAME: ____

DEGREE: ____ MAJOR: ___________ GPA: ______ GRADUATION DATE: _______

GRADUATE DEGREES including LL.M. Programs (College, Degree, Date):

____

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Please attach a copy of all college, graduate school (if any), and most recent law school transcripts. If your law school transcript does not include your grades for the most recent closed grading term, please separately provide information on all grades you have received to date and supplement your application with remaining grades as soon as possible after you receive them.

LAW SCHOOL ACTIVITIES AND/OR HONORS:

COMMUNITY ACTIVITIES:

Responses regarding law school activities and/or honors and community activities may be made in typewritten form of no more than one page in length.

III. RECOMMENDATIONS AND ESSAY

Please attach (1) one or more letters of recommendation and (2) a typewritten essay of no more than two pages in length (double spaced) addressing the following:

- Why you plan to pursue a career in tax law in Texas;
- What are your long-term career goals;
- List of the tax courses you have completed and grade received, and tax courses you are currently taking; and
- Any qualifications that you believe are relevant for your consideration for this scholarship. For example, students may describe relevant research, published articles, clubs, competitions, clinics, community service, job or internship or externship experience.

- (Optional) Any issues of financial need that you would like the Committee to consider.

AFFIRMATION OF APPLICANT: By signing below, I certify that all the information provided as part of this application is true and correct. I understand that the Tax Section's Scholarship Selection Committee reserves the right to investigate all information stated in this application.

Applicant's Signature: ___________________________________ Date: _______________

IRS FINAL REGULATIONS ELIMINATE BOTTOM-DOLLAR GUARANTEES

by Lee Meyercord and Jessica Kirk*

On October 4, 2019, the IRS released final regulations under section 752 that ended the viability of bottom-dollar guarantees.[1] The final regulations substantially adopt the temporary regulations issued on October 5, 2016.[2] Bottom-dollar guarantees have long been a tax-planning technique to increase a partner's basis in her partnership interest and defer gain recognition. The IRS has been critical of bottom-dollar guarantees because it views them as lacking a substantial business purpose and economic significance.[3] This Article summarizes bottom-dollar guarantees, their use in tax-planning, and the temporary and final regulations.

Bottom-Dollar Guarantees

In a bottom-dollar guarantee, the partner (guarantor) is only obligated to repay the guaranteed portion of the debt if the creditor collects less than a guaranteed minimum amount. For example, partner A guarantees $100,000 of the partnership's $1 million debt in a bottom-dollar guarantee. If the partnership repays only $50,000 on the debt and defaults on the balance, A is obligated to pay $50,000—the difference between the bottom-dollar guarantee of $100,000 and the $50,000 recovered from the partnership. If the partnership repays $500,000 and defaults on the balance, A does not have to pay any part of the debt because the bottom-dollar amount of $100,000 was collected.

Use of Bottom-Dollar Guarantees in Tax Planning

Prior to the temporary regulations released in 2016, bottom-dollar guarantees were a common tax-planning technique to increase a partner's basis. A partner's basis in her partnership interest includes her share of partnership liabilities.[4] A partnership liability is allocated to a partner if that partner bears the economic risk of loss for the liability.[5] A partner bears the economic risk of loss to the extent that the partner would be obligated to pay the liability in a constructive

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[1] T.D. 9877, 84 Fed. Reg. 54,014 (Oct. 9, 2019).

[2] *Id*. at 54,015.

[3] T.D. 9788, 2016-52 I.R.B. 889, 892.

[4] I.R.C. §§ 752(a); 722.

[5] Treas. Reg. §§ 1.752-1(a)(1), 1.752-2(a).

liquidation.[6] The determination of whether a partner bears the economic risk of loss is based on the facts and circumstances and takes into account statutory and contractual obligations such as guarantees, indemnifications, and reimbursement agreements.[7] In the example above, if A's bottom-dollar guarantee was respected for tax purposes, A would bear the economic risk of loss for $100,000 of the $1 million liability and the guaranteed amount would increase her basis in her partnership interest.[8]

This increase in basis would increase the amount of distributions that A could receive tax-free and increase the amount of partnership losses that A can use.[9] Bottom-dollar guarantees have also been used to avoid gain recognition when new partners enter a partnership. New partners may be allocated a share of existing partnership liabilities, which would reduce the existing partners' share of liabilities. The reduction in liabilities would be treated as a deemed distribution that would be taxable to the extent it exceeds the partner's basis in the partnership.[10] An existing partner could enter into a bottom-dollar guarantee to avoid a deemed distribution in excess of her basis.

Temporary and Final Regulations

On October 5, 2016, the IRS and Treasury issued temporary regulations on bottom-dollar guarantees under section 752 that, in effect, ended the viability of the bottom-dollar guarantee as a planning technique.[11] On October 4, 2019, the IRS released final regulations which were published in the Federal Register on October 9, 2019.[12] The final regulations substantially adopt the temporary regulations with some changes.[13]

<u>Not a Payment Obligation</u>. Generally, as explained above, under the section 752 regulations, recourse partnership liabilities are allocated to the partners who bear the economic

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[6] Treas. Reg. § 1.752-2(b)(1); Treas. Reg. § 1.752-2(b)(5) ("A partner's or related person's obligation to make a payment with respect to a partnership liability is reduced to the extent that the partner or related person is entitled to reimbursement from another partner or a person who is a related person to another partner."); Treas. Reg. § 1.752-2(j)(3) ("An obligation of a partner to make a payment is not recognized if the facts and circumstances evidence a plan to circumvent or avoid the obligation.").

[7] Treas. Reg. § 1.752-2(b)(3).

[8] *See* Treas. Reg. §§ 1.752-1(b), 1.722-1. Even prior to issuance of the temporary regulations, a guarantee would need to satisfy certain requirements to be respected for tax purposes. *See, e.g., Canal Corp. v. Comm'r*, 135 T.C. 9 (2010) (disregarding WISCO's indemnity under the anti-abuse rule of Treasury Regulations Section 1.752-2(j) because it lacked economic substance for a number of reasons, including that it was not required by the indemnified party, only covered principal and not interest, did not require WISCO to maintain a certain net worth, and WISCO would receive an increased interest in the LLC if it made payment on the indemnity).

[9] *See* Treas. Reg. § 1.731-1(a)(1)(i); I.R.C. § 704(d)(1).

[10] I.R.C. §§ 752(b); 731(a)(1).

[11] T.D. 9788, 2016-52 I.R.B. 889.

[12] T.D. 9877, 84 Fed. Reg. 54,014.

[13] *Id*. at 54,015.

risk of loss.[14] Both the temporary and final regulations provide that a "bottom dollar payment obligation" is disregarded when determining whether a partner bears the economic risk of loss.[15] Thus, in the example above, the full $100,000 'guaranteed' amount would not be allocated to A or increase A's basis by a corresponding amount. Instead, such liability would be allocated among A and the other partners in the partnership as required by the other section 752 regulations.[16]

<u>Definition of Bottom Dollar Payment Obligation</u>. The temporary regulations defined a "bottom dollar payment obligation" as any partnership liability where the guarantor partner does not have liability up to the full amount of that partner's share of the debt.[17] In response to a commentator's concern that the temporary regulations provided no guidance on the issue, the final regulations expand this definition by expressly including any situation where a partner is not required to make the full amount of her capital contribution or to restore the full amount of her deficit capital account.[18]

<u>Exceptions</u>. The final regulations adopted the temporary regulations' exceptions to the bottom dollar payment obligation rules. Under these exceptions, a bottom-dollar guarantee will not be disregarded merely because it has a maximum amount, is stated as a fixed percentage of every dollar (a vertical slice guarantee), or because there is a right of proportionate contribution from the other partners who each are jointly and severally liable.[19] In addition, a bottom dollar payment obligation is not disregarded if the partner is liable for at least 90 percent of an otherwise qualifying payment obligation.[20] Thus, a partner may obtain reimbursement for up to 10 percent of its payment obligation and avoid having its payment obligation disregarded for section 752 economic risk of loss purposes.

The vertical slice guarantee is a reasonable alternative to the bottom-dollar guarantee by which a partner can increase its basis in its partnership interest without guaranteeing the entire partnership liability. For example, if A guarantees 10% of the partnership's $1 million debt in a vertical slice guarantee and the partnership repays only $50,000 of the debt, A is obligated to repay $95,000 (10% of the $950,000 remaining balance). In this situation, A would be allocated 10% (or $100,000) of the debt.

As noted above, the final regulations describe and maintain an exception for vertical slice guarantees.[21] However, this exception does not guarantee that a vertical slice guarantee will

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[14] *See* Treas. Reg. §§ 1.752-1(a)(1), 1.752-2(a).

[15] Treas. Reg. §§ 1.752-2T(b)(3)(ii)(A); 1.752-2(b)(3)(ii)(A).

[16] *See* Treas. Reg. § 1.752-3.

[17] Treas. Reg. §§ 1.752-2T(b)(3)(ii)(C)(1); 1.752-2(b)(3)(ii)(C)(1).

[18] Treas. Reg. § 1.752-2(b)(3)(ii)(C)(1)(iii).

[19] Treas. Reg. §§ 1.752-2T(b)(3)(ii)(C)(2); 1.752-2(b)(3)(ii)(C)(2).

[20] Treas. Reg. §§ 1.752-2T(b)(3)(ii)(B); 1.752-2(b)(3)(ii)(B).

[21] Treas. Reg. § 1.752-2(b)(3)(ii)(C)(2).

otherwise be respected as a payment obligation for section 752 purposes.[22] Therefore, any vertical-slice guarantee should be carefully structured as to not run afoul of the anti-abuse rules in section 752.[23]

Anti-Abuse Rule. The temporary regulations included an anti-abuse rule under which the IRS, at its discretion and under certain circumstances, may treat a partner as bearing the economic risk of loss regardless of the form of a contractual obligation.[24] The preamble to the final regulations reaffirms the importance of this provision because, with it, the regulations not only prevent a payment obligation that does not represent a real economic risk of loss, but also "an agreement that purposefully creates the appearance of a bottom dollar payment obligation" even if that taxpayer truly bears the economic risk of loss.[25] Thus, the final regulations maintain this anti-abuse provision but remove the discretionary language to make it more consistent with the anti-abuse rule under the old section 752 regulations.[26]

Disclosure Requirements. The temporary and final regulations impose a disclosure requirement on taxpayers who enter into or modify bottom dollar payment obligations.[27] Taxpayers must disclose any bottom dollar payment obligation, including bottom dollar payment obligations meeting the 90% exception discussed above, by attaching a Form 8275, *Disclosure Statement*, to their partnership tax return for the year in which the bottom dollar payment obligation is undertaken or modified.[28] Under the temporary regulations, the disclosure was required to: (1) identify itself as a disclosure of a bottom dollar obligation under section 752, (2) identify the relevant payment obligation, (3) identify the amount of the payment obligation, (4) identify the parties to the payment obligation, (5) state whether the payment obligation is subject to the 90% exception and, therefore, recognized for purposes of determining whether a partner bears the economic risk of loss, and (6) the facts and circumstances establishing the 90% exception.[29] The final regulations clarified that such disclosure must, in addition to identifying the relevant payment obligation, identify whether the bottom dollar payment obligation is a guarantee, a reimbursement, an indemnity, or deficit restoration obligation.[30] The disclosure requirements will make it easier for the IRS to identify and audit bottom-dollar guarantees.

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[22] *See id.* ("A payment obligation is not a bottom dollar payment obligation merely because a . . . payment obligation is stated as a fixed percentage of every dollar of the partnership liability to which such obligation relates.").

[23] Treas. Reg. § 1.752-2(j).

[24] Treas. Reg. § 1.752-2T(j)(2).

[25] T.D. 9877, 84 Fed. Reg. 54,014, 54017.

[26] Treas. Reg. § 1.752-2(j)(2).

[27] Treas. Reg. §§ 1.752-2T(b)(3)(ii)(D); 1.752-2(b)(3)(ii)(D).

[28] *Id.*

[29] *Id.*

[30] Treas. Reg. § 1.752-2(b)(3)(ii)(D)(2).

Effective Dates and Transitional Rule. The temporary and final regulations apply to liabilities and payment obligations occurring on or after October 5, 2016, unless such liabilities or payment obligations were pursuant to a written binding contract effective before that date.[31] Therefore, if a debt entered into before October 5, 2016 is not modified or refinanced, the final regulations do not apply to such debt. But, if a pre-October 5, 2016 debt is modified or refinanced, then the final regulations will apply.

The final regulations clarified that a partner may choose to apply a "transitional rule" for seven years after October 5, 2016 to the portion of any modified or refinanced amounts for which the partner bore the economic risk of loss immediately before October 5, 2016 that exceeds a partners outside basis (grandfathered amount).[32] Thus, such grandfathering is limited to an amount that was actually "protecting" a negative capital account on the effective date of the temporary regulations. For example, if on October 5, 2016, A has a basis of $60,000 in her partnership interest and is allocated $100,000 of partnership liabilities due to a bottom-dollar guarantee, the grandfathered amount is $40,000—the amount of the bottom-dollar guarantee that is "protecting" a negative capital account.

Conclusion

Partners with bottom-dollar guarantees should determine the grandfathered amount and evaluate the impact of the transition rules if the debt is modified or refinanced during the seven-year transition period. Partners may want to consider restructuring their bottom-dollar guarantees prior to the end of the transition period. For those considering an alternative to the bottom-dollar guarantee, the vertical-slice guarantee may accomplish the parties' objectives if structured correctly.

[31] Treas. Reg. § 1.752-2(l)(2).

[32] Treas. Reg. § 1.752-2(l)(3).

Virtual Currency Holders Should Be Seeking Legal Counsel as IRS Begins Issuing Warning Letters
By: David E. Colmenero and Anthony P. Daddino

In July of this year, the IRS announced it has started the process of issuing warning letters to more than 10,000 cryptocurrency holders. There are three variations of the letters sent depending apparently on the holder's particular situation. *See* IRS Announcement, *IRS Has Begun Sending Letters to Virtual Currency Holders Advising Them to Pay Back Taxes, File Amended Returns; Part of Agency's Larger Efforts* (July 26, 2019) *available at* https://www.irs.gov/newsroom/irs-has-begun-sending-letters-to-virtual-currency-owners-advising-them-to-pay-back-taxes-file-amended-returns-part-of-agencys-larger-efforts. The three letters are available on the IRS's website and at least one requests a response under penalties of perjury. *See* IRS Letter 6173 *available at* https://www.irs.gov/pub/notices/letter_6173.pdf. IRS Commissioner Chuck Rettig was quoted as stating, "Taxpayers should take these letters very seriously by reviewing their tax filings and when appropriate, amend past returns and pay back taxes interest and penalties …."

These letters reflect the most recent development in the IRS's efforts to identify and tax gain on virtual currency transactions. In 2014, the IRS issued IRS Notice 2014-21 which directs taxpayers to treat virtual currency as property. *See* IRS Notice 2014-21. The apparent intent of this treatment is to treat transactions involving virtual currency as taxable for federal income tax purposes, even where one virtual currency is exchanged for another.

The IRS separately issued a summons against Coinbase, a market exchange for Bitcoin, Ethereum and other virtual currencies, seeking information about its customers. Although Coinbase resisted, a federal district court eventually forced Coinbase to disclose to the IRS the taxpayer ID, name, birth date, address, and historical transaction records of approximately 13,000 customers in early 2018. That same year, the IRS Large Business and International Division added cryptocurrency transactions to its list of compliance campaigns. *See* IRS Announcement, *IRS Announces the Identification and Selection of Five Large Business and International Compliance Campaigns* (July 2, 2018). The IRS Criminal Investigations Division similarly stated it intends to seek criminal charges in certain cases involving virtual currency transactions. *See* CCN Markets, *US Justice Department & IRS Are In Hot Pursuit of Bitcoin Tax* Evaders (June 25, 2019). And for those taxpayers that owe money to the IRS, in December 2018 IRS Collections successfully seized virtual currency from a delinquent taxpayer, and later revised the Form 433-A Collection Information Statement in February 2019 to add a specific question about the taxpayer's virtual currency holdings. *See* IRS Form 433-A *available at* https://www.irs.gov/pub/irs-pdf/f433a.pdf.

This recent round of letters shows that the IRS has been successful in identifying many investors of virtual currency and is ready to take the next significant step in pursuing them. Because of the increase in value for many virtual currencies, the potential tax implications for many taxpayers can be significant. Bitcoin, for example, was selling at under $50.00 in 2013. As of the date this article was submitted for publication, Coinbase reports the value of Bitcoin at over $8,200.00, and at one point it was trading at over $13,000.00. *See* Crypto.com, *Historical Data for Bitcoin*, *available at* https://coinmarketcap.com/currencies/bitcoin/historical-data/. For investors who have merely held virtual currency as an investment in its initially acquired form without exchanging it, there may be little or no tax consequences to report - much like buying most other investment properties and simply holding them. But for taxpayers who have exchanged virtual currency in any manner, including for example exchanging it into cash or from one virtual currency into another, or who acquired virtual currency in exchange for property or services, the IRS may view the transactions as generating taxable income. Moreover, to date, the IRS has not announced any intention of offering amnesty to virtual currency holders. For now, they can expect the IRS to assess tax and potentially penalties as well.

Complicating matters for at least some taxpayers, is the fact that the IRS may seek to go back further than the general 3-year statute of limitations in making assessments. While the IRS generally has three years from the filing of a return to make an assessment, there are exceptions where there is a substantial omission of income or where a taxpayer commits fraud. *See* IRC sec. 6501(c), (e). Because the IRS may allege either of these in certain cases, it could seek to go back more than 3 years in some cases.

There may be a limited window of opportunity for some taxpayers to request a voluntary disclosure from the IRS before receiving a letter to potentially avoid criminal prosecution.   That window could close after the IRS issues a letter to a particular taxpayer. For taxpayers who are assessed penalties, it may also be possible to request waiver of penalties on the basis of reasonable cause depending on their particular circumstances.

Of course, the IRS letter campaign does not necessarily resolve the ultimate question: How should virtual currency be treated for federal income tax purposes? More specifically, is the IRS treatment of virtual currency correct? Should the exchange of virtual currency be treated as taxable transactions for federal income tax purposes, particularly where it is exchanged for other virtual currency? These are all questions that may ultimately be addressed by the federal courts.

Last week, on October 9, 2019, the IRS followed up its July announcement by issuing a Revenue Ruling and several frequently asked questions pertaining to virtual currencies. *See Virtual currency: IRS issues additional guidance on tax treatment and reminds taxpayers of reporting obligations* (Oct 9, 2019)*,* https://www.irs.gov/newsroom/virtual-currency-irs-issues-additional-guidance-on-tax-treatment-and-reminds-taxpayers-of-reporting-obligations. The Revenue Ruling addresses the tax consequences of “hard forks” and “air drops” with respect to new cryptocurrency while the FAQs address a myriad of questions pertaining to the taxation of cryptocurrencies. But this new guidance continues to espouse the IRS’s view that these transactions can and do trigger tax in virtually every instance (no pun intended). The IRS’s public announcement on this newly issued guidance also requests public comments on additional guidance in this area, but it remains to be seen how receptive the IRS will be to outside viewpoints. To date the IRS has rolled out guidance seemingly designed to bolster its enforcement efforts rather than meaningfully address practical concerns and issues faced by virtual currency holders, investors, and users.   One thing is sure: Further IRS publications on the tax treatment of virtual currencies will likely be issued soon.

For now, anyone who has received or anticipates receiving an IRS letter or who has otherwise engaged in unreported virtual currency transactions should seek legal counsel. Some questions that should be addressed include: (i) How much exposure does the taxpayer have under the IRS treatment of virtual currency transactions; (ii) What actions should the taxpayer take to mitigate exposure to penalties; (iii) How should the taxpayer respond to the IRS letter, particularly where a response is requested; and (iv) What actions should the taxpayer take to preserve their rights under federal law, particularly if the taxpayer seeks to challenge an IRS assessment or denial of a refund claim?

Virtual currency holders and tax practitioners should also keep in mind there may be state tax consequences as well. Because many state income and business taxes are tied to federal income tax amounts, there may be reporting and payment obligations at the state level as well. There could be other tax consequences as well. Many states offer voluntary disclosure or amnesty programs that may benefit taxpayers. The full effect of state tax implications for virtual currency transactions remains to be seen, given the limited guidance currently available.

RECENT DEVELOPMENTS IN FEDERAL INCOME TAXATION

"Recent developments are just like ancient history, except they happened less long ago."

By

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State Bar of Texas Tax Section
First Wednesday Tax Update
May 1, 2019

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I. ACCOUNTING

II. BUSINESS INCOME AND DEDUCTIONS

A. Income

B. Deductible Expenses versus Capitalization

C. Reasonable Compensation

D. Miscellaneous Deductions

E. Depreciation & Amortization

1. The IRS comes to the rescue to allow depreciation of passenger automobiles that qualify for 100 percent bonus depreciation under § 168(k). Rev. Proc. 2019-13, 2019-9 I.R.B. (2/13/19). Under § 280F(a)(1)(B)(i), the "unrecovered basis" of a passenger automobile that is subject to the § 280F limits on depreciation is treated as an expense for the first taxable year after the automobile's recovery period. For passenger automobiles eligible for 100 percent first year depreciation under § 168(k), the amount by which the cost of the vehicle (before any § 179 deduction) exceeds the first year § 280F limitation is the "unrecovered basis" for purposes of § 280F(a)(1)(B)(i). In other words, if a taxpayer does not elect out of 100 percent first-year bonus depreciation, then the taxpayer can deduct in the year the vehicle is placed in service the maximum amount allowed under § 280F(a)(1)(A) and then cannot deduct any additional portion of the vehicle's cost until after the recovery period has passed, at which point the taxpayer can deduct the unrecovered cost as an expense, subject to the annual $5,670 limitation specified in § 280F(a)(1)(B)(ii). The revenue procedure gives the following example:

> For example, if a calendar-year taxpayer places in service in December 2018 a passenger automobile that costs $50,000 and is qualified property for which the 100-percent additional first year depreciation deduction is allowable, the 100-percent additional first year depreciation deduction and any § 179 deduction for this property is limited to $18,000 under § 280F(a)(1)(A)(i) (see Table 2 of Rev. Proc. 2018-25) and the excess amount of $32,000 is recovered by the taxpayer beginning in 2024, subject to the annual limitation of $5,760 under § 280F(a)(1)(B)(ii).

To avoid this result, the revenue procedure provides a safe harbor method of accounting for determining depreciation deductions for passenger automobiles that qualify for 100 percent bonus depreciation under § 168(k). The safe harbor method permits taxpayers to deduct a portion of the vehicle's cost in each year of the recovery period. The IRS issued a similar ruling, Rev. Proc. 2011-26, 2011-16 I.R.B. 664, in response to Congress's enactment of 100 percent bonus depreciation for 2010.

Bonus Depreciation Under § 168(k) as Amended by the 2017 Tax Cuts and Jobs Act. The 2017 Tax Cuts and Jobs Act, § 13201, amended Code § 168(k)(1) and 168(k)(6) to permit taxpayers to deduct 100 percent of the cost of qualified property for the year in which the property is placed in service. This change applies to property *acquired and placed in service* after September 27, 2017, and before 2023. The percentage of the property's adjusted basis that can be deducted is reduced from 100 percent to 80 percent in 2023, 60 percent in 2024, 40 percent in 2025, and 20 percent in 2026. (These periods are extended by one year for certain aircraft and certain property with longer production periods). Property *acquired before September 28, 2017* and placed in service on or after that date is eligible for bonus depreciation of 50 percent if placed in service before 2018, 40 percent if placed in service in 2018, 30 percent if placed in service in 2019, and is ineligible for bonus depreciation if placed in service after 2019. The legislation also amended Code § 168(k)(2)(A) and (E) to make used property eligible for bonus depreciation under § 168(k).

Section 280F $8,000 increase in first-year depreciation. For passenger automobiles that qualify, § 168(k)(2)(F) increases by $8,000 in the first year the § 280F limitation on the amount of depreciation deductions allowed. The 2017 Tax Cuts and Jobs Act continues this $8,000 increase for passenger automobiles *acquired and placed in service after* September 27, 2017, and before 2023. (For passenger automobiles acquired *before* September 28, 2017, and placed in service on or after that date, the previously scheduled phase-down of the $8,000 increase applies as follows: $6,400 if placed in service in 2018, $4,800 if placed in service in 2019, and $0 after 2019.) According to Rev. Proc. 2018-25, 2018-18 I.R.B. 543 (4/17/18), the § 280F depreciation limits for business use of small vehicles placed in service during 2018 are as follows:

Passenger Automobiles acquired before 9/28/18 and placed in service during 2018 with § 168(k) first year recovery:

1st Tax Year	$16,400
2nd Tax Year	$16,000
3rd Tax Year	$ 9,600
Each Succeeding Year	$ 5,760

Passenger Automobiles acquired after 9/27/17 and placed in service during 2018 with § 168(k) first year recovery:

1st Tax Year	$18,000
2nd Tax Year	$16,000
3rd Tax Year	$ 9,600
Each Succeeding Year	$ 5,760

Passenger Automobiles placed in service during 2018 with no § 168(k) first year recovery:

1st Tax Year	$10,000
2nd Tax Year	$16,00
3rd Tax Year	$ 9,600
Each Succeeding Year	$ 5,760

Safe Harbor of Rev. Proc. 2019-13. The revenue procedure provides a safe harbor method of accounting for determining depreciation deductions for passenger automobiles (other than leased vehicles) that are acquired after September 27, 2017, qualify for 100 percent bonus depreciation under § 168(k), have a cost (before any § 179 deduction) that exceeds the first-year § 280F limitation, and for which the taxpayer does *not* elect to take a § 179 deduction. A taxpayer adopts this safe harbor method by applying it on its federal tax return for the first taxable year succeeding the year in which a passenger automobile is placed in service. To use the safe harbor, a taxpayer must: (1) use the appropriate optional depreciation table (available in IRS Publication 946) to calculate depreciation deductions for the passenger automobile, (2) deduct the § 280F first-year limitation amount in the year the vehicle is placed in service (a figure published annually by the IRS), (3) calculate depreciation for the passenger automobile for each succeeding taxable year in the recovery period by multiplying the remaining adjusted depreciable basis (the vehicle's cost before any § 179 deduction less the § 280F first-year limitation amount) by the percentage specified in the appropriate optional depreciation table, subject to the § 280F limitation amounts, and (4) deducting any remaining basis of the vehicle in the first taxable year succeeding the end of the recovery period, subject to the limitation of § 280F(a)(1)(B)(ii) ($5,760 in the tables above) and carrying forward any excess to the succeeding taxable year to deduct in a similar manner. If § 280F(b) applies to the vehicle, i.e., if it is not predominantly used in a qualified business use, then the safe harbor ceases to apply in the first taxable year in which § 280F(b) applies. The revenue procedure is effective on February 13, 2019.

Examples. The revenue procedure gives the following examples.

> <u>Example 1 - Application of § 280F(a) safe harbor method of accounting</u>. In 2018, X, a calendar-year taxpayer, purchased and placed in service for use in its business a new passenger automobile that costs $60,000. The passenger automobile is 5-year property under § 168(e), is qualified property under § 168(k) for which the 100-percent additional first year depreciation deduction is allowable, and is used 100 percent in X's trade or business. X does not claim a § 179 deduction for the passenger automobile and does not make an election under § 168(b), (g)(7), or (k). X depreciates the passenger automobile under the general depreciation system by using the 200-percent declining balance method, a 5-year recovery period, and the half-year convention. X adopts the safe harbor method of accounting provided in section 4.03 of this revenue procedure. As a result:
>
> > (a) X must use the applicable optional depreciation table that corresponds with the 200-percent declining balance method of depreciation, a 5-year recovery period, and the half-year convention, for determining the depreciation deductions for the passenger automobile (see Table A-1 in Appendix A of IRS Publication 946);
> >
> > (b) For 2018, X deducts depreciation of $18,000 for the passenger automobile, which is the depreciation limitation for 2018 under § 280F(a)(1)(A)(i) (see Table 2 in Rev. Proc. 2018-25). As a result, the remaining adjusted depreciable basis of the passenger automobile as of January 1, 2019, is $42,000 ($60,000 unadjusted depreciable basis less $18,000 depreciation deduction claimed for 2018);
> >
> > (c) For 2019 through 2023, the total depreciation allowable for the passenger automobile for each taxable year is determined by multiplying the annual depreciation rate in the applicable optional depreciation table by the remaining adjusted depreciable basis of $42,000, subject to the limitation under

§ 280F(a)(1)(A) for that year. Accordingly, for 2019, the total depreciation allowable for the passenger automobile is $13,440 (32 percent multiplied by the remaining adjusted depreciable basis of $42,000). Because this amount is less than the depreciation limitation of $16,000 for 2019 (see Table 2 in Rev. Proc. 2018-25), X deducts $13,440 as depreciation on its federal income tax return for the 2019 taxable year. For 2020, the total depreciation allowable for the passenger automobile is $8,064 (19.20 percent multiplied by $42,000). Because this amount is less than the depreciation limitation of $9,600 for 2020 (see Table 2 in Rev. Proc. 2018-25), X deducts $8,064 as depreciation on its federal income tax return for the 2020 taxable year. Below is a table showing the depreciation allowable for the passenger automobile under the safe harbor method of accounting for the 2018 through 2023 taxable years. X deducts these amounts.

Taxable Year	Depreciation limitations under Table 2 of Rev. Proc. 2018-25	Depreciation deduction under the safe harbor
2018	$18,000	$18,000
2019	$16,000	$13,440 ($42,000 x .32)
2020	$9,600	$8,064 ($42,000 x .1920)
2021	$5,760	$4,838 ($42,000 x .1152)
2022	$5,760	$4,838 ($42,000 x .1152)
2023	$5,760	$2,419 ($42,000 x .0576)
TOTAL		$51,599

(d) As of January 1, 2024 (the beginning of the first taxable year succeeding the end of the recovery period), the adjusted depreciable basis of the passenger automobile is $8,401 ($60,000 unadjusted depreciable basis less the total depreciation allowable of $51,599 for 2018-2023 (see above table)). Accordingly, for the 2024 taxable year, X deducts depreciation of $5,760 for the passenger automobile (the lesser of the adjusted depreciable basis of $8,401 as of January 1, 2024, or the § 280F(a)(1)(B)(ii) limitation of $5,760).

(e) As of January 1, 2025, the adjusted depreciable basis of the passenger automobile is $2,641 ($8,401 adjusted depreciable basis as of January 1, 2024, less the depreciation claimed of $5,760 for 2024). Accordingly, for the 2025 taxable year, X deducts depreciation of $2,641 for the passenger automobile (the lesser of the adjusted depreciable basis of $2,641 as of January 1, 2025, or the § 280F(a)(1)(B)(ii) limitation of $5,760).

<u>Example 2 – Section 179 deduction claimed</u>. The facts are the same as in <u>Example 1</u>, except X elects to treat $18,000 of the cost of the passenger automobile as an expense under § 179. As a result, this passenger automobile is not within the scope of this revenue procedure pursuant to section 3.01(4) of this revenue procedure. Accordingly, the safe harbor method of accounting in section 4.03 of this revenue procedure does not apply to the passenger automobile. For 2018, the 100-percent additional first year depreciation deduction and the § 179 deduction for this passenger automobile is limited to $18,000 under § 280F(a)(1)(A)(i) (see Table 2 of Rev. Proc. 2018-25). Therefore, for 2018, X deducts $18,000 for the passenger automobile under § 179, and X deducts the excess amount of $42,000 beginning in 2024, subject to the annual limitation of $5,760 under § 280F(a)(1)(B)(ii).

<u>Example 3 – Section 168(k)(7) election made</u>. The facts are the same as in <u>Example 1</u>, except X makes an election under § 168(k)(7) to not claim the 100-percent additional first year depreciation deduction for 5-year property placed in service during 2018. As

a result, the 100-percent additional first year depreciation deduction is not allowable for the passenger automobile. Accordingly, the passenger automobile is not within the scope of this revenue procedure pursuant to section 3.01(2) of this revenue procedure, and the safe harbor method of accounting in section 4.03 of this revenue procedure does not apply to the passenger automobile. For 2018 and subsequent taxable years, X determines the depreciation deductions for the passenger automobile in accordance with the general depreciation system of § 168(a), subject to the § 280F(a) limitations.

F. Credits

G. Natural Resources Deductions & Credits

H. Loss Transactions, Bad Debts, and NOLs

I. At-Risk and Passive Activity Losses

III. INVESTMENT GAIN AND INCOME

IV. COMPENSATION ISSUES

A. Fringe Benefits

B. Qualified Deferred Compensation Plans

C. Nonqualified Deferred Compensation, Section 83, and Stock Options

D. Individual Retirement Accounts

V. PERSONAL INCOME AND DEDUCTIONS

A. Rates

B. Miscellaneous Income

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

A. Entity and Formation

B. Distributions and Redemptions

C. Liquidations

D. S Corporations

1. In line with the continuing expansion of eligible shareholders of subchapter S corporations, ESBTs now may have non-U.S. individuals as current beneficiaries. The 2017 Tax Cuts and Jobs Act, § 13541, makes a technical change to § 1361(c)(2)(B)(v) such that for 2018 and future years an "electing small business trust" (an "ESBT," as particularly defined in § 1361(e)) may have as a current beneficiary of the ESBT a "nonresident alien" individual. Under § 7701(b)(1)(B), a nonresident alien individual is someone who is neither a citizen nor a resident of the U.S. This change to § 1361 is permanent.

a. Proposed regulations address the treatment of ESBTs that are S corporation shareholders and have nonresident aliens as beneficiaries. REG-117062-18, Electing Small Business Trusts With Nonresident Aliens as Potential Current Beneficiaries, 84 F.R. 16415 (4/19/19). The Treasury Department and the IRS have issued proposed regulations addressing the treatment of electing small business trusts that are S corporation shareholders and have nonresident aliens as beneficiaries. The preamble to the proposed regulations notes the apparent assumption in the legislative history of the 2017 Tax Cuts and Jobs Act that an ESBT is subject to tax and therefore would be subject to tax on the ESBT's share of the S corporation's income. The preamble notes, however, that ESBTs can be grantor trusts for federal tax purposes with the result that the beneficiaries of the ESBT, not the ESBT itself, are subject to tax on the S corporation's income. If a nonresident alien is a beneficiary of an ESBT, this could lead to the S corporation's income not being subject to U.S. taxation (e.g., if the income is foreign-source). Therefore, according to the premable, the proposed regulations generally

> would modify the allocation rules under § 1.641(c)-1 to require that the S corporation income of the ESBT be included in the S portion of the ESBT if that income otherwise would have been allocated to an NRA deemed owner under the grantor trust rules. Accordingly, such income would be taxed to the domestic ESBT by providing that, if the deemed owner is an NRA, the grantor portion of net income must be reallocated from the grantor portion of the ESBT to the ESBT's S portion.

The proposed regulations are proposed to apply to all ESBTs after December 31, 2017.

E. Mergers, Acquisitions and Reorganizations

F. Corporate Divisions

G. Affiliated Corporations and Consolidated Returns

H. Miscellaneous Corporate Issues

1. Cash grants from the State of New Jersey were nontaxable contributions to capital, says the Tax Court. Brokertec Holdings, Inc. v. Commissioner, T.C. Memo. 2019-32 (4/9/19). The taxpayer in this case was the common parent of a consolidated corporate group. Two members of the group were inter-dealer brokers with offices in or near the World Trade Center in New York City on September 11, 2001. Following the destruction of the World Trade Center in the September 11 terrorist attack, these members searched for new office space. They both applied for and received cash grants from the State of New Jersey's Economic Development Plan. Both members relocated to areas of New Jersey adjacent to New York City. On the consolidated group's returns for 2010 through 2013, a total of approximately \$55.7 million of the cash grants were treated as nontaxable, nonshareholder contributions to capital under § 118. The IRS asserted that the group was required to include the grants in gross income. The Tax Court (Judge Jacobs) held that the grants were nontaxable contributions to capital. The court engaged in a lengthy review of prior cases that had addressed the issue of what constitutes a contribution to capital, including the U.S. Supreme Court's decision in *Brown Shoe Co. v. Commissioner*, 339 U.S. 583 (1950), and the Third Circuit's decision in *Commissioner v. McKay Prods. Corp.*, 178 F.2d 639 (3d Cir. 1949). Based on this review, the court concluded that "the key to determining whether payments from a nonshareholder (here the State of New Jersey) are taxable to the recipient (here petitioner's affiliates) or nontaxable as a contribution to capital is the intent or motive of the nonshareholder donor." In this case, the court concluded, the intent of the State of New Jersey in making the grants was not to pay for services, but rather to induce the consolidated group members to establish their offices in a targeted area (known as an urban-aid municipality) both to bring in new jobs and to revitalize the area. "The facts in this case fall squarely within the four corners of section 1.118-1, Income Tax Regs., and are strikingly similar to those of Brown Shoe Co. and McKay Prods. Corp. …" Accordingly, the court held, the grants were nontaxable, nonshareholder contributions to capital.

- The 2017 Tax Cuts and Jobs Act, § 13312, amended Code § 118 effective after December 22, 2017, such that nonshareholder contributions to the capital of corporations made by governmental entities or civic groups no longer are excludable from the recipient corporation's gross income. Accordingly, the result in this case would have been different if the years involved were subject to amended § 118.

- Any appeal of the Tax Court's decision by the government will be heard by the U.S. Court of Appeals for the Third Circuit, the same court that issued the opinion in *McKay Prods. Corp.*

VII. PARTNERSHIPS

A. Formation and Taxable Years

B. Allocations of Distributive Share, Partnership Debt, and Outside Basis

C. Distributions and Transactions Between the Partnership and Partners

D. Sales of Partnership Interests, Liquidations and Mergers

E. Inside Basis Adjustments

F. Partnership Audit Rules

1. The partnership audit rules do not apply to special enforcement matters. Notice 2019-6, 2019-3 I.R.B. (12/20/18). In this notice, the Treasury Department and the IRS announced that proposed regulations will be issued to address certain "special enforcement matters" under § 6241(11). The notice also requests comments regarding other special enforcement matters that could be the subject of future proposed regulations. Congress added § 6241(11) to the Code as part of the Consolidated Appropriations Act, 2018, Pub. L. No. 115-141, Division U, Title II, §§ 201-207, ("CAA 2018"), signed by the President on March 23, 2018, which enacted a number of technical corrections to the partnership audit rules that became effective for partnership taxable years beginning after 2017.

Section 6241(11). Section 6241(11) provides that, in the case of partnership-related items that involve special enforcement matters, the Secretary of the Treasury may issue regulations providing that (1) the partnership audit rules (or a portion of the rules) do not apply to the partnership-related items, and (2) the partnership-related items are subject to special rules (including rules related to assessment and collection) that the Secretary of the Treasury determines to be necessary for the effective and efficient enforcement of the Code. Section 6241(11) lists several specific special enforcement matters, including criminal investigations, indirect methods of proof of income, and foreign partners or partnerships, and also provides in § 6241(11)(vi) that special enforcement matters include "other matters that the Secretary determines by regulation present special enforcement considerations."

Notice 2019-6. The notice provides that proposed regulations will be issued under § 6241(11)(vi) regarding two matters that present special enforcement considerations. The **first** matter is when an adjustment during an examination of a person other than the partnership requires a change to a partnership-related item. Specifically, the proposed regulations will provide that the IRS may determine that the partnership audit rules do not apply if the following three conditions are satisfied: (1) the examination being conducted is of a person other than the partnership, (2) a partnership-related item must be adjusted (or a determination regarding a partnership-related item must be made) as part of an adjustment to a non-partnership-related item of the person whose return is being examined, and (3) the treatment of the partnership-related item on the return of the partnership (or in the partnership's books and records) was based in whole or in part on information provided by, or under the control of, the person whose return is being examined. The notice provides that this rule

> will allow the IRS to effectively and efficiently focus on a single partner or a small group of partners with respect to a limited set of partnership-related items without unduly burdening the partnership and avoiding procedural concerns about the appropriate level at which such items must be examined.

The **second** matter is when a qualified subchapter S subsidiary (QSub) is a partner in a partnership. According to the notice, the proposed regulations will provide that the ability of partnerships with 100 or fewer partners to elect out of the partnership audit regime under § 6221(b) generally does not apply to a partnership with a QSub as a partner. Nevertheless, under the forthcoming proposed regulations, a partnership with a QSub as a partner will be able to elect out of the partnership audit regime if it meets certain requirements. The rule concerning the ability to elect out will be similar to the rule of § 6221(b)(2)(A) that currently applies to a partnership with an S corporation as a partner. Section 6221(b)(2)(A) provides that a partnership with an S corporation as a partner can elect out of the partnership audit regime only if it discloses with its return for the year the name and taxpayer identification number of each person with respect to whom the S corporation is required to furnish a Schedule K-1 and counts each of the S corporation's Schedule K-1s in determining whether the partnership has 100 or fewer partners. Accordingly, the forthcoming proposed regulations will provide that, for purposes of determining whether a partnership has 100 or fewer partners for purposes of electing out under § 6221(b), the partnership must include (1) the statement (Schedule K-1) the partnership is required to furnish to the QSub partner under § 6031(b), and (2) each statement (Schedule K-1) the S corporation that holds 100 percent of the stock of the QSub partner is required to furnish to its shareholders under § 6037(b).

Effective Date. The notice provides that Treasury and the IRS intend to issue the proposed regulations within eighteen months of the enactment of Consolidated Appropriations Act, 2018, Pub. L. No. 115-141, which was enacted on March 23, 2018. Pursuant to § 7805(b)(2), the effect of issuing the proposed regulations in this period will be that the regulations will apply to all partnership taxable years beginning after 2017. The notice also provides that, if the proposed regulations are not issued within this eighteen-month period, then the regulations will apply to partnership taxable years beginning after 2017 and ending after December 20, 2018, the date on which the notice was issued to the public.

G. Miscellaneous

1. Nonowner contributions to the capital of partnerships and LLCs taxed as partnerships are not excludable, and the common law contribution to capital doctrine is on life support if not dead. The 2017 Tax Cuts and Jobs Act, § 13312, amended Code § 118 effective after December 22, 2017, such that nonshareholder contributions to the capital of corporations made by governmental entities or civic groups no longer are excludable from the recipient corporation's gross income. Previously, such capital contributions were nontaxable, and they occasionally were made to incentivize corporations either to locate in particular communities or to acquire or redevelop distressed property in a community (or do both). In addition, the Conference Report accompanying the changes to § 118, along with the cases summarized below, probably leads to the conclusion that similarly-motivated capital contributions to *noncorporate entities* (i.e., partnerships and LLCs taxed as partnerships) no longer are excludable from gross income (if they ever were), even though such contributions are outside the purview of either old or amended § 118.

a. No good deed goes unpunished. Ginsburg v. United States, 136 Fed. Cl. 1 (1/31/18). In this decision, the Court of Federal Claims held that the State of New York's payment of approximately $1.8 million to an LLC (taxed as a partnership) to incentivize and reward redevelopment of brownfield property is includable in the taxpayer-member's gross income. The taxpayer owned 90% of an LLC taxed as a partnership for federal income tax purposes. The taxpayer's LLC participated in New York's Brownfield Development Tax Credit program in connection with acquiring an abandoned shoe factory in 2004 and eventually restoring it as a 134-unit residential building by 2011. New York's Brownfield Tax Credit program allows certain credits against state income taxes based upon investment in qualifying brownfield property. Further, if the credit is fully used by a taxpayer to offset applicable New York state income taxes, the excess of the credit over the amount used against state income taxes is paid to the taxpayer. Accordingly, after certifying that the taxpayer's LLC had complied with the terms of the Brownfield Development Tax Credit program, in 2013 New York paid the taxpayer's LLC approximately $1.8 million in satisfaction of the taxpayer's excess credit amount. The taxpayer took the position on his 2013 federal income tax return that his 90% allocable share of the $1.8 million payment was excludable from gross income as a nontaxable capital contribution to the LLC. (New York law allowed exclusion of the payment for New York income tax purposes.) Upon audit, the Service determined that the payment constituted gross income to the LLC and thus to the taxpayer as part of his allocable share of partnership income. This adjustment resulted in additional gross income to the taxpayer for 2013 and a corresponding underpayment of approximately $602,000. The taxpayer paid the underpayment, filed a refund claim, and then brought this action in the Court of Federal Claims.

Analysis: Upon cross-motions for summary judgment, Court of Federal Claims (Judge Hodges) agreed with the government that the $1.8 million constituted gross income to the taxpayer's LLC and thereby to the taxpayer. The government had argued, and the court agreed, that the payment was includable by the broad terms of § 61(a) (gross income from whatever source derived) and that no statutory exclusions or exceptions applied. The taxpayer argued unsuccessfully that the $1.8 million payment was (i) a nontaxable contribution to the LLC's capital, (ii) a nontaxable recovery of the LLC's investment in the Brownfield project owned by the LLC, or (iii) a nontaxable state "general-welfare" grant to the LLC. The taxpayer acknowledged that under any of the above theories the taxpayer's basis in the brownfield project would be adjusted downward by the amount excludable. Judge Hodges reasoned that, because the taxpayer could not point to an express provision of the Code to support his nontaxable contribution to capital theory, no such exclusion applied. Furthermore, Judge Hodges reasoned that the payment to the partnership could not be a recovery of the LLC's investment in the project because the payment came from a third party (the State of New York), not from the seller of the property. Judge Hodges expressed the view that the recovery of capital doctrine applies only in the context of buyers and sellers of "goods," and in that context, a payment can be nontaxable as a purchase price adjustment. (We believe the court was wrong about basis recovery being limited to sales of "goods." Regardless, the taxpayer's "recovery of investment" argument probably was not a winner anyway. For instance, see the court's analysis in *Uniquest Delaware*, discussed immediately below.) Finally, Judge Hodges determined that New York's payment to the taxpayer's LLC did not qualify for the "general-welfare" exclusion recognized in Rev. Rul. 2005-46, 2005-2 C.B. 120 (state disaster relief grants) because the tax credit in question was not conditioned on a showing of need.

- The holding of the Court of Federal Claims regarding the unavailability of the general welfare exclusion is consistent with the Tax Court's holding in *Maines v. Commissioner*, 144 T.C. 123 (2015). In *Maines*, the Tax Court held that the refundable portions of certain New York targeted economic development credits that remained after first reducing state tax liability were accessions to the taxpayers' wealth and were includable in gross income under § 61 for the year in which the taxpayers received payment or, under the constructive receipt doctrine, were entitled to receive payment, even if they elected to carry forward the credit. The Tax Court concluded that the taxpayers could not exclude the payments under the general welfare exclusion because the payments were not conditioned on a showing of need.

b. Yet again, no good deed goes unpunished. But perhaps there could have been a workaround? Uniquest Delaware, LLC v. United States, 294 F. Supp. 3d 107 (W.D.N.Y. 3/27/18). In this decision, the U.S. District Court for the Western District of New York held that a grant paid by the New York State Empire State Development Corporation (which appears to have been a government-funded corporation) to an LLC taxed as a partnership was not excludable from the LLC's gross income as a contribution to capital. The taxpayer in this case was the LLC (unlike *Ginsburg v. United States*, 136 Fed. Cl. 1 (1/31/18), in which the taxpayer was a partner-member of the LLC). The LLC, a TEFRA partnership, had two equal members, each of which was a disregarded single-member LLC, that in turn were each wholly-owned by separate subchapter S corporations. The case arose in connection with a TEFRA partnership audit of the LLC, a fact which was important to the court's ultimate decision (as explained further below). In 2009, the LLC received an $11 million grant from the New York State Empire State Development Corporation for the restoration of a building in Buffalo. The original grant proposal expressly stated that "[t]here is no element of compensation of specific, quantifiable or other services to the government agencies involved; the grants contemplated by this offer are being offered solely for the purpose of obtaining an advantage for the general community." The LLC did not include the $11 million grant in its income on its partnership tax return for 2009. During the audit and at Service Appeals, the Service asserted that the $11 million grant was included in the LLC's gross income in 2009 and ultimately issued an FPAA accordingly. The taxpayer-LLC then sought judicial review of the FPAA in the U.S. District Court for the Western District of New York.

Analysis: As in *Ginsburg*, the Service's argument in this case was simple: § 61(a) requires inclusion of the $11 million grant in gross income, and no exception or exclusion in the Code provides otherwise. The taxpayer-LLC, similar to the taxpayer in *Ginsburg*, argued alternatively that the $11 million grant was either (i) excludable under the "common law contribution to capital doctrine" or (ii) akin to a "rebate" that resulted in an adjustment to the taxpayer-LLC's basis in the building, but which was not includable in gross income. [As to this latter "rebate" argument, see Rev. Rul. 76-96, 1976-1 C.B. 23 (rebates paid by car manufacturers, but not the dealer who sold the car, are not income but instead reduce the purchaser's basis in the car). Rev. Rul. 76-96 has been suspended in part on other grounds by Rev. Rul. 2005-28, 2005-1 C.B. 997.] Judge Wolford ruled against the taxpayer-LLC with respect to both arguments. Regarding the taxpayer-LLC's "common law contribution to capital doctrine" argument, the court reasoned that the cases supporting the doctrine involved corporate taxpayers only, and the holdings in these cases were codified by § 118 (the pre-TCJA version), which expressly does not apply to noncorporate entities. Regarding the taxpayer-LLC's "rebate" argument, Judge Wolford ruled that the $11 million grant is distinguishable, stating "unlike a retail customer who purchases a car with the knowledge that a rebate is forthcoming, [the taxpayer] purchased the [Buffalo Building] and then subsequently sought and received the [$11 million grant]. Therefore, the [$11 million grant] cannot be considered a discount or reduction in the purchase price of the building."

Indirect §§ 118/702 Argument: The taxpayer-LLC argued that, even if § 118 applies only to corporations, the court should indirectly rule it applicable to resolve the dispute with the Service because the ultimate owners of the taxpayer-LLC were subchapter S corporations. The taxpayer further argued in this regard that § 118 (pre-TCJA) would have allowed the S corporation members of the taxpayer-LLC to exclude the grant from gross income. Therefore, the taxpayer-LLC argued, if the S corporation members could have excluded the grant under § 118, then the grant ultimately should be held nontaxable by virtue of § 702's distributive share approach to partner-level income. With respect to this final argument, Judge Wolford ruled that because TEFRA audit procedures treat the taxpayer-LLC as an entity separate from its owners, the partner-level treatment by the ultimate owners of the LLC was not within the court's subject-matter jurisdiction. *See* § 6226(f) and *American Boat Co., LLC v United States*, 583 F.3d 471, 478 (7th Cir. 2009) ("A court does not have jurisdiction to consider a partner-level defense in a partnership-level proceeding.")

Planning pointer: Had the subchapter S corporations first received the $11 million grant from New York and then contributed the funds to the taxpayer-LLC as additional capital contributions, we believe the grant would not have been taxable pursuant to the pre-TCJA version of § 118 and § 721, respectively. On the other hand, perhaps the terms of the grant would not allow the funds to be paid to the S corporation members because the acquisition and development was performed by the taxpayer-LLC, not the S corporation members.

c. The Federal Circuit has affirmed the Claims Court's decision that an LLC classified as a tax partnership could not exclude from gross income a cash payment received from the State of New York. Ginsburg v. United States, 123 A.F.T.R.2d ¶ 2019-652 (Fed. Cir. 4/25/19), *aff'g* 136 Fed. Cl. 1 (1/31/18). In an opinion by Judge Wallach, the U.S. Court of Appeals for the Federal Circuit has affirmed the decision of the U.S. Court of Federal Claims granting summary judgment to government and held that an LLC classified as a partnership had to include in gross income a cash payment received from the State of New York. As a result, the members of the LLC, including the taxpayers in this case, had to include their distributive shares of the payment in gross income. The taxpayer owned 90% of an LLC taxed as a partnership for federal income tax purposes. The taxpayers held 90 percent of the memebrship interests in an LLC that participated in New York's Brownfield Development Tax Credit program in connection with acquiring an abandoned shoe factory in 2004 and eventually restoring it as a 134-unit residential building by 2011. Under this program, if the credit is fully used by a taxpayer to offset applicable New York state income taxes, the excess of the credit over the amount used against state income taxes is paid to the taxpayer. After certifying that the taxpayers' LLC had complied with the terms of the Brownfield Development Tax Credit program, in 2013 New York paid the taxpayer's LLC approximately $1.8 million in satisfaction of the taxpayer's excess credit amount. The taxpayers took the position on their 2013 federal income tax return that their 90% allocable share of the $1.8 million payment was excludable from gross income as a nontaxable capital contribution to the LLC. Following an audit, the taxpayers paid the underpayment asserted by the IRS of approximately $602,000, filed a refund claim, and then brought a refund action in the Court of Federal Claims, which held that the payment constituted gross income. On appeal, the Federal Circuit first concluded that the funds received were an economic gain over which the taxpayers had complete dominion and therefore constituted gross income under the taxpayers had gross income under *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955). The court rejected all of the taxpayer's arguments that the payments were excludable from income, including the arguments that: (1) the payment for the excess amount was a nontaxable return of capital, and (2) the brownfield redevelopment tax credit was "'indistinguishable from . . . inducement payments, rebates, and reimbursements that' have historically been treated as 'not includable in gross income.'"

VIII. TAX SHELTERS

IX. EXEMPT ORGANIZATIONS AND CHARITABLE GIVING

X. TAX PROCEDURE

A. Interest, Penalties, and Prosecutions

1. All hardship exemptions, including a general hardship exemption, from the requirement to maintain minimum essential coverage can be claimed on an individual's tax return for 2018. Notice 2019-5, 2019-2 I.R.B. 283 (12/21/18). Under § 5000A, for months beginning after December 31, 2014, an individual must maintain minimum essential coverage and must pay a penalty (the individual shared responsibility payment) for failure to do so unless the person qualifies for an exemption. Some exemptions can be claimed only if an individual has obtained a hardship exemption certification from the Health Insurance Marketplace. Others can be claimed on the individual's federal income tax return. This notice supplements Notice 2014-76, 2014-50 I.R.B. 946, as supplemented by Notice 2017-14, 2017-6 I.R.B. 783, both of which provided that certain hardship exemptions could be claimed on an individual's tax return. Specifically, this notice reflects guidance issued by the Department of Health and Human Services on September 12, 2018, which provides that all hardship exemptions available under 45 C.F.R. § 155.605(d)(1), including a general hardship exemption, can be claimed on an individual's federal income tax return. These hardship exemptions are:

1. "He or she experienced financial or domestic circumstances, including an unexpected natural or human-caused event, such that he or she had a significant, unexpected increase in essential expenses that prevented him or her from obtaining coverage under a qualified health plan;"
2. "The expense of purchasing a qualified health plan would have caused him or her to experience serious deprivation of food, shelter, clothing, or other necessities; or"
3. "He or she has experienced other circumstances that prevented him or her from obtaining coverage under a qualified health plan."

- The 2017 Tax Cuts and Jobs Act, § 11081, amended Code § 5000A(c) to reduce to zero the penalty enacted as part of the Affordable Care Act for failing to maintain minimum essential coverage. This change applies to months beginning after 2018.

2. No addition to tax under § 6654 will be made for farmers and fisherman for failure to make estimated income tax payments for 2018 if they file their 2018 returns and pay the total tax due by April 15, 2019 (April 17 for those in Maine and Massachusetts). Notice 2019-17, I.R.B. 907 (2/28/19). Under § 6654, individuals are required to make advance payments of their estimated income tax liability. Normally, individuals are required to make these payments in equal quarterly installments. Section 6654(a) imposes an addition to tax for failure to pay a sufficient amount of estimated income tax. Those who qualify as farmers or fishermen (generally, those for whom two-thirds of gross income is from farming or fishing) are subject to special rules under which they make only one payment, due on January 15, 2019, for the 2018 tax year, but no addition to tax is imposed for 2018 if a farmer or fisherman files a 2018 return and pays the tax shown due on the return by March 1, 2019. Because of the magnitude of the changes enacted as part of the 2017 Tax Cuts and Jobs Act and the resulting difficulty farmers and fishermen encountered in estimating their income tax liability for 2018, the IRS has waived the addition to tax of § 6654 for a qualifying farmer or fisherman who files his or her 2018 income tax return and pays in full any tax due by April 15, 2019 (or by April 17, 2019, for those taxpayers who live in Maine or Massachusetts). To request this waiver, farmers and fishermen must attach Form 2210-F, Underpayment of Estimated Tax by Farmers and Fishermen, to their 2018 tax return, which the taxpayer can do whether the return is filed electronically or on paper. The notice provides that a taxpayer should enter his or her name and identifying number at the top of the form, and should check the waiver box (Part I, Box A). The rest of the form should be left blank.

3. No addition to tax under § 6654 will be made for failure to make estimated income tax payments if total withholding and estimated tax payments exceed 80 percent of tax shown due on the 2018 return. Notice 2019-25, 2019-15 I.R.B. (3/22/19). Under § 6654, individuals are required to make advance payments of their income tax liability either through withholding or quarterly estimated tax payments. Section 6654(a) imposes an addition to tax for failure to pay a sufficient amount of estimated income tax. No addition to tax is imposed if an individual makes payments equal to the lesser of (1) 90 percent of the tax shown on the return for the taxable year, or (2) 100 percent of the tax shown on the taxpayer's return for the preceding taxable year (110 percent if the individual's adjusted gross income on the previous year's return exceeded $150,000), as long as the preceding taxable year was a full twelve months. Because of the magnitude of the changes enacted as part of the 2017 Tax Cuts and Jobs Act and the resulting difficulty taxpayers encountered in estimating their income tax liability for 2018, the IRS previously issued Notice 2019-11, 2019-5 I.R.B. 430 (1/16/19), which waived any addition to tax under § 6654 for an individual whose total withholding and estimated tax payments made on or before January 15, 2019, equal or exceed 85 percent of the tax shown on that individual's 2018 return. In this notice, the IRS has reduced this percentage to 80 percent. Accordingly, no addition to tax under § 6654 will be made with respect to an individual whose total withholding and estimated tax payments made on or before January 15, 2019, equal or exceed 80 percent of the tax shown on that individual's 2018 return. To request this waiver, an individual must file Form 2210, Underpayment of Estimated Tax by Individuals, Estates, and Trusts, with his or her 2018 income tax return. The form can be filed with a return filed electronically or on paper. The notice provides further instructions regarding completion of Form 2210. Taxpayers who are eligible for a waiver and who already have paid the addition to tax can seek a refund by filing Form 843, Claim for Refund and Request for Abatement and including the statement "80% Waiver of estimated tax penalty" on line 7. This notice supersedes Notice 2019-11.

B. Discovery: Summonses and FOIA

C. Litigation Costs

D. Statutory Notice of Deficiency

E. Statute of Limitations

F. Liens and Collections

G. Innocent Spouse

1. Even a Johnny Cash song couldn't have told a story like this. A taxpayer prevails in her quest for innocent spouse relief. Contreras v. Commissioner, T.C. Memo. 2019-12 (2/26/19). The taxpayer sought innocent spouse relief under § 6015(f) with respect to the years 2006 through 2009. The taxpayer married her husband in August of 2000. He had his own home construction business and she stayed home to care for their two children and her husband's two children from a prior relationship. They lived in a mobile home on property in Liberty County, Texas (Lot 12) and planned to build a home on the lot next door, Lot 13. When they applied for financing to assist with construction, the taxpayer learned that Lot 13 was owned by her husband and the woman with whom he had previously been in a relationship. She and her husband were advised by an attorney that her husband was still in a common law marriage with the other woman and that, to remove the other woman's name from the title to Lot 13, her husband would have to go through a divorce proceeding, which he did. This necessarily meant that, when the taxpayer had married her husband, he was already married and therefore the taxpayer had never been legally married to her husband. Ultimately, her husband built the house on Lot 13, largely using materials left over from various jobs of his home construction company, and the family moved into the home. During the course of their relationship, the taxpayer's husband was abusive and routinely came home in a drunken state. The police were called to their home on several occasions. When the taxpayer's husband came home in a drunken state, she and her husband argued and on various occasions her husband kicked in a bedroom door, damaged property, threw the taxpayer's possessions out outside the home, and committed other aggressive acts. On these occasions, the taxpayer often left the home with her children to go to the home of her grandmother. The taxpayer's husband had at least one affair with another woman during their marriage. Her husband handled filing of their federal income tax returns. No returns were filed for the year 2006 through 2009. She was divorced from her husband in 2011. The decree of divorce awarded each spouse as separate property a one-half interest in Lots 12 and 13. In addition, the divorce decree awarded the taxpayer $127,050 and authorized the taxpayer to foreclose on her ex-husband's interest in Lots 12 and 13 if he did not pay this amount by a specified date. Her ex-husband failed to pay this amount and voluntarily transferred to the taxpayer his interests in Lots 12 and 13. The deed transferring title was prepared with the assistance of an attorney and recorded in the public land records. Just prior to their divorce, the IRS filed a notice of lien against her husband and, just after the divorce, the U.S. Department of Justice brought an action in the U.S. District Court seeking to reduce tax liabilities to judgment and to foreclose on the home in which the taxpayer lived with her two children. Following their divorce, the taxpayer's ex-husband filed returns for 2008 and 2009 with the filing status of head-of-household. In 2013, in connection with an IRS audit of the years 2006 through 2009, the taxpayer signed joint returns for 2006 and 2007 as well as amended returns for 2008 and 2009 that were joint returns. She placed the words "as to form" next to her signature on the 2006 and 2007 returns. She repeatedly expressed that she did not understand the returns and did not understand why she had to sign a joint return with her ex-husband. She was represented in the course of the audit by an attorney whose fees were paid by her ex-husband. The IRS sought to hold the taxpayer liable for nearly $300,000 in taxes, penalties and interest for the years 2006 through 2009. The taxpayer filed an administrative request for innocent spouse relief, which the IRS denied. The taxpayer then filed a petition in the Tax Court. The Tax Court (Judge Paris) held that the taxpayer was entitled to innocent spouse relief under § 6515(f) (equitable relief) with respect to all of the years at issue. The taxpayer and the IRS agreed that the taxpayer met all threshold requirements for equitable relief under Rev. Proc. 2013-34, 2013-43 I.R.B. 397 except for one. The IRS asserted that assets (Lots 12 and 13) had been transferred between the spouses as part of a fraudulent scheme. The court rejected this argument largely on the basis that the transfer was made pursuant to rights granted to the taxpayer in the divorce decree and that the taxpayer and her husband had recorded the transfer in the public land records and therefore had not attempted to conceal the transfer. The court also rejected the IRS's arguments that the taxpayer was not entitled to streamlined relief under Rev. Proc. 2013-34. The IRS argued that the taxpayer would not suffer economic hardship if relief were not granted, which the court rejected on the basis that the taxpayer's only source of income consisted of child support payments, which were not reliable, and government assistance. The IRS also argued that the taxpayer was not entitled to streamlined relief because she had knowledge that her ex-husband would not or could not pay the liabilities in question. The court rejected this argument based on the taxpayer's credible testimony (as well as that of her daughter) regarding her ex-husband's abusive and controlling behavior.

- The taxpayer was represented by the Low Income Taxpayer Clinic at South Texas College of Law Houston.

H. <u>Miscellaneous</u>

XI. <u>WITHHOLDING AND EXCISE TAXES</u>

XII. <u>TAX LEGISLATION</u>

XIII. <u>TRUSTS, ESTATES & GIFTS</u>

RECENT DEVELOPMENTS IN FEDERAL INCOME TAXATION

"Recent developments are just like ancient history, except they happened less long ago."

By

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

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

A. Accounting Methods

1. Many small businesses will not qualify for several simplifying provisions enacted in the 2017 Tax Cuts and Jobs Act, such as use of the cash method of accounting, because they meet the definition of a "tax shelter." In a letter to the IRS dated February 13, 2019, the American Institute of Certified Public Accountants has brought to the attention of the IRS the concern of many small businesses that, absent relief, they are ineligible for certain simplifying provisions enacted as part of the 2017 Tax Cuts and Jobs Act (TCJA) because the businesses meet the definition of a "tax shelter." 2019 TNT 31-16 (2/13/19). The letter requests appropriate relief.

Certain simplifying provisions enacted by the TCJA are available to businesses with average annual gross receipts not exceeding $25 million. The TJCA 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 the following: **(1)** the ability of C corporations or partnerships with a C corporation as a partner to use the cash method of accounting (§ 448(b)(3)), **(2)** the ability to use a method of accounting for inventories that either treats inventories as nonincidental materials and supplies or conforms to the taxpayer's financial accounting treatment of inventories (§ 471(c)(1)), **(3)** the ability to be excluded from applying the uniform capitalization rules of § 263A (§ 263A(i)), **(4)** the small construction contract exception that permits certain taxpayers not to use the percentage-of-completion method of accounting for certain construction contracts (§ 460(e)(1)(B)), and **(5)** the ability to be excluded from the § 163(j) limit on deducting business interest (§ 163(j)(3)).

The simplifying provisions enacted by the TCJA generally are not available to a "tax shelter." The simplifying provisions for small businesses listed above each state that they are not available to "a tax shelter prohibited from using the cash receipts and disbursements method of accounting under section 448(a)(3)." Section 448(a)(3) provides that a "tax shelter" cannot compute taxable income under the cash receipts and disbursements method of accounting, and according to § 448(d)(3), the term "tax shelter" for this purpose is defined in § 461(i)(3). Section 461(i)(3) defines the term "tax shelter" as "(A) any enterprise (other than a C corporation) if at any time interests in such enterprise have been offered for sale in any offering required to be registered with any Federal or State agency having the authority to regulate the offering of securities for sale, (B) any syndicate (within the meaning of section 1256(e)(3)(B)), and (C) any tax shelter (as defined in section 6662(d)(2)(C)(ii))."

Many small businesses will meet the definition of a "syndicate" and therefore will be considered tax shelters. As discussed, the term "tax shelter" includes "any syndicate (within the meaning of section 1256(e)(3)(B))." The term "syndicate," according to § 1256(e)(3)(B), is "any partnership or other entity (other than a corporation which is not an S corporation) if more than 35 percent of the losses of such entity during the taxable year are allocable to limited partners or limited entrepreneurs." Many small businesses will meet this definition and will be precluded from using the simplifying provisions enacted by the TCJA. Businesses that fluctuate between having income and having losses could be in the position of having to change accounting methods.

The AICPA has requested relief. The AICPA has asked the IRS to exercise its authority, granted by § 1256(e)(3)(B), to treat an interest in an entity as not being held by a limited partner or a limited entrepreneur if certain conditions are met.

B. Inventories

C. Installment Method

D. Year of Inclusion or Deduction

II. BUSINESS INCOME AND DEDUCTIONS

A. Income

B. Deductible Expenses versus Capitalization

C. Reasonable Compensation

D. Miscellaneous Deductions

E. Depreciation & Amortization

F. Credits

G. Natural Resources Deductions & Credits

H. Loss Transactions, Bad Debts, and NOLs

1. The Eleventh Circuit has reversed a federal district court and held that the government failed to establish that an individual who reimbursed her ex-husband for federal taxes could not determine her tax liability under § 1341 for the year she paid the reimbursement. Mihelick v. United States, 123 A.F.T.R.2d 2019-2251 (11th Cir. 6/18/19). The taxpayer, Nora Mihelick, and her former husband, Michael Bluso, divorced in 2005. During their marriage, they had both worked at Gotham Staple Company, a closely held Ohio corporation owned by her ex-husband's family and for which her ex-husband served as chief executive officer. While their divorce was pending, her ex-husband's sister, a minority shareholder in Gotham Staple Company, sued the taxpayer's ex-husband and asserted claims of breach of fiduciary duty on the basis that he had excessively compensated himself at Gotham's expense. Although the taxpayer initially resisted it, she and her ex-husband negotiated a provision in their separation agreement under which any liability arising from the litigation over her ex-husband's alleged breach of fiduciary duty would be a marital liability for which they would be jointly and severally liable because, if such a liability came into existence, it would arise from the acquisition of marital assets during their marriage. In 2007, the taxpayer's ex-husband settled the litigation pending against him and paid $600,000. The taxpayer resisted reimbursing her ex-husband but, after being advised by her attorney that she had an obligation to do so, she paid him $300,000 in 2009. Her ex-husband determined his liability for federal income tax for the year in which he made the $300,000 settlement payment by applying § 1341, which, if certain requirements are met, allows a taxpayer who must repay an amount previously included in income either to deduct the amount repaid or take a tax credit for the amount of tax overpaid in the year the income was included. On the taxpayer's federal income tax return for 2009, the year in which she reimbursed her former husband, she determined her tax liability by applying § 1341 and claimed a refund, which the IRS denied. Following the denial of her refund claim, the taxpayer brought this legal action seeking a refund in U.S. District Court. The District Court concluded that the taxpayer did not satisfy all requirements to determine her tax liability under § 1341, granted summary judgment for the government, and the taxpayer appealed. In an opinion by Judge Rosenbaum, the Eleventh Circuit held that the evidence supported the conclusion that the taxpayer satisfied all of the elements of § 1341 and that it was inappropriate for the District Court to grant summary judgment in favor of the government. The Eleventh Circuit remanded to the District Court to determine whether there was any genuine issue of material fact concerning any of the elements of § 1341 and, if not, to enter judgment in favor of the taxpayer. If the District Court concludes that there is a genuine issue of material fact, then the case must proceed to trial. In either case, if the taxpayer prevails, she will be entitled to determine her tax liability for 2009 by choosing whichever of the following will provide her with the better result: (1) deducting the $300,000 she paid to her former husband in 2009, or (2) hypothetically recalculating her tax liability for the prior year in which she included the $300,000 in gross income by omitting the $300,000 from gross income, determining the amount by which her tax liability would have been reduced in that year, and taking the amount of the reduction as a credit in 2009. To obtain the benefit of § 1341, four requirements must be satisfied. The court analyzed these requirements as follows:

1. The first requirement is that the taxpayer must have *included an item in gross income for a prior year* "because it *appeared that the taxpayer had an unrestricted right to such item*." The government argued that this requirement was not met because the taxpayer's former husband had no unrestricted right to the income in the year the couple included it in gross income because he had misappropriated the funds, and therefore she could not have had an unrestricted right to the income. The court rejected this argument because there was no proof her former husband had misappropriated the funds and the settlement agreement that resolved the litigation against him expressly disclaimed any wrongdoing. The court similarly rejected the argument that the taxpayer had no unrestricted right to her former husband's income under the provisions of Ohio law concerning marital property: "What matters is whether [the taxpayer] sincerely believed she had a right to Bluso's income, not the correctness of her belief." The court concluded that there was enough evidence in the record to support the taxpayer's sincere belief that she had an unrestricted right to his income in the years they were married.

2. The second requirement for a taxpayer to use § 1341 is that the *taxpayer must have later learned that she actually "did not have an unrestricted right" to that income*. According to the court, "[t]o make this showing, the taxpayer must demonstrate that she involuntarily gave away the relevant income because of some obligation, and the obligation had a substantive nexus to the original receipt of the income." The court concluded that both aspects of this requirement were satisfied. In doing so, the court rejected the government's argument that the fact that the taxpayer had reimbursed her former husband and had not paid her portion of the liability directly to the opposing party in the lawsuit precluded her from satisfying this requirement.

3. The third requirement of § 1341 is that *the amount the taxpayer did not have an unrestricted right to* and repays *must have exceeded $3,000.* The parties agreed that this requirement was satisfied.

4. The final requirement of § 1341 is that *the amount the taxpayer did not have an unrestricted right to* and repays *must be deductible under another provision of the Internal Revenue Code*. The court held that this requirement was met because her former husband was entitled to deduct the payment as a loss under § 165(c)(1) (losses incurred in a trade or business) and, by extension, the taxpayer was as well.

I. At-Risk and Passive Activity Losses

III. INVESTMENT GAIN AND INCOME

IV. COMPENSATION ISSUES

A. Fringe Benefits

1. IRS Chief Counsel says that an individual who is a 2-percent S corporation shareholder pursuant to the § 318 constructive ownership rules is entitled to a deduction under § 162(*l*) for amounts paid by the S corporation under a group health plan for all employees and included in the individual's gross income if the individual otherwise meets the requirements of § 162(*l*). CCA 201912001, 2019 WL 1573655 (12/21/18, released 3/22/19). In this Chief Counsel Advice, the IRS Office of Chief Counsel concluded 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.

Background. Under § 1372(a), an S corporation is treated as a partnership and a 2-percent shareholder of an S corporation is treated as a partner for purposes of applying the provisions of the Code relating to employee fringe benefits. For this purpose, a 2-percent shareholder is any person who owns (or is considered to own under the constructive ownership rules of § 318) on any day during the S corporation's tax year more than 2 percent of the corporation's outstanding stock or stock possessing more than 2 percent of the total combined voting power of all stock of the corporation. According to Rev. Rul. 91-26, 1991-1 C.B. 184, accident and health insurance premiums paid by an S corporation on behalf of a 2-percent shareholder-employee as compensation for services are treated like guaranteed payments to partners under § 707(c). Therefore, the S corporation can deduct the premiums and the 2-percent shareholder-employee must include an appropriate portion of the premiums in gross income. The S corporation must report the premiums on the 2-percent shareholder-employee's Form W-2, but according to IRS Announcement 92-16, such amounts are not wages subject to Social Security and Medicare taxes if the requirements of the exclusion in § 3121(a)(2)(B) are met. Section 162(*l*) authorizes an above-the-line deduction for a taxpayer who is an employee within the meaning of §401(c)(1) for an amount equal to the amount paid during the year for insurance that constitutes medical care for the taxpayer and the taxpayer's spouse, dependents, and children who have not attained the age of 27. This deduction is available to a 2-percent shareholder-employee of an S corporation if the plan is established by the S corporation. Guidance on when the plan is considered established by the S corporation is provided in Notice 2008-1, 2008-2 I.R.B. 251. The deduction is limited to the taxpayer's earned income from the trade or business with respect to which the plan providing medical care is established and is not available if the taxpayer is eligible to participate in a subsidized health plan maintained by an employer of the taxpayer or of the taxpayer's spouse or dependents.

Facts. An individual owned 100% of an S corporation, which employed the individual's family member. Because of the family relationship, the family member was considered to be a 2-percent shareholder pursuant to the attribution of ownership rules under § 318. The S corporation provided a group health plan for all employees, and the amounts paid by the S corporation under the group health plan were included in the family member's gross income. Chief Counsel was asked whether an individual who was a 2-percent shareholder of an S corporation pursuant to the constructive ownership rules of §318 by virtue of being a family member of the S corporation's sole shareholder was entitled to the deduction under §162(*l*) for amounts that were paid by the S corporation under a group health plan for all employees and included in the individual's gross income.

Chief Counsel's Conclusion. Chief Counsel concluded that "an individual who is a 2-percent shareholder of an S corporation pursuant to the attribution of ownership rules under §318 is entitled to the deduction under § 162(*l*) for amounts that are paid by the S corporation under a group health plan for all employees and included in the individual's gross income if the individual otherwise meets the requirements of section 162(*l*)."

B. Qualified Deferred Compensation Plans

1. They were just kidding! Treasury and the IRS no longer plan to amend the regulations under § 401(a)(9) to prohibit giving retirees receiving annuity payments the option to receive a lump sum payment. Notice 2019-18, 2019-13 I.R.B. 915 (3/6/19). A number of sponsors of defined benefit plans have amended their plans to provide a limited period during which certain retirees who are currently receiving lifetime annuity payments from those plans may elect to convert their annuities into lump sums that are payable immediately. These arrangements are sometimes referred to as retiree lump-sum windows. In Notice 2015-49, 2015-30 I.R.B. 79 (7/9/15), the IRS announced that Treasury and the IRS planned to amend the required minimum distribution regulations under § 401(a)(9) to provide that qualified defined benefit plans generally are not permitted to replace any joint and survivor, single life, or other annuity currently being paid with a lump sum payment or other accelerated form of distribution. With certain exceptions, the amendments to the regulations were to apply as of July 9, 2015. Notice 2019-18 provides that Treasury and the IRS no longer intend to propose the amendments to the regulations under § 401(a)(9) that were described in Notice 2015-49. The notice indicates that Treasury and the IRS will continue to study the issue of retiree lump-sum windows. The notice further provides:

> Until further guidance is issued, the IRS will not assert that a plan amendment providing for a retiree lump-sum window program causes the plan to violate § 401(a)(9), but will continue to evaluate whether the plan, as amended, satisfies the requirements of §§ 401(a)(4), 411, 415, 417, 436, and other sections of the Code. During this period, the IRS will not issue private letter rulings with regard to retiree lump-sum windows. However, if a taxpayer is eligible to apply for and receive a determination letter, the IRS will no longer include a caveat expressing no opinion regarding the tax consequences of such a window in the letter.

C. Nonqualified Deferred Compensation, Section 83, and Stock Options

D. Individual Retirement Accounts

V. PERSONAL INCOME AND DEDUCTIONS

A. Rates

B. Miscellaneous Income

1. "I think, therefore I am." The taxpayer argued that body and mind are inseparable, but the Tax Court gave effect to Internal Revenue Code's dualist view of body and mind and held that the damages received by the taxpayer were for emotional distress and therefore included in gross income. Doyle v. Commissioner, T.C. Memo. 2019-8 (2/6/19). The taxpayer was employed by a corporation in the technology sector but was fired after he brought to the Chief Executive Officer his concerns about the company's anticompetitive behavior. Following his termination, the taxpayer

> couldn't sleep, couldn't digest food properly, and had lots of other health problems. He struggled with chronic headaches, he couldn't concentrate, and he had neck, shoulder, and back pain. His relationship with his wife suffered, and he believes that he'll deal with some of these issues for the rest of his life.

The Tax Court (Judge Holmes) found that the taxpayer's ailments were the consequence of emotional distress he suffered when he was fired. The taxpayer and his former employer entered into a settlement agreement that provided for payment of $350,000 of "alleged unpaid wages," which his employer reported on Form W-2, and also provided for payment of $250,000 "for his alleged emotional distress damages," which his employer reported on Form 1099-MISC. His former employer paid the $250,000 in two equal installments in 2010 and 2011. The taxpayer's CPA, who had more than forty years' experience preparing tax returns, concluded that the $250,000 reported on Forms 1099-MISC were excluded from the taxpayer's gross income under § 104(a)(2), which excludes from gross income the amount of any damages received on account of personal physical injury or physical sickness. The taxpayer's returns for 2010 and 2011 each included a Schedule C on which the taxpayer reported income of $125,000, deducted some legal fees, and also deducted an amount for "personal injury" (2010) or "pain and suffering" (2011) in an amount sufficient to zero out the income on Schedule C. The taxpayer also deducted some legal fees for 2010 on Schedule A. The Tax Court held that the $250,000 received by the taxpayer 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." In reaching this conclusion, the court relied on both its prior decisions (such as *Pettit v. Commissioner*, T.C. Memo. 2008-87) and the legislative history of the 1996 amendments to § 104(a), both of which establish that, for purposes of § 104(a), "emotional distress" includes physical symptoms that result from emotional distress, such as insomnia, headaches, and stomach disorders. The court rejected the taxpayer's argument that his job termination caused stress, and that "one can't really distinguish symptoms of emotional distress from symptoms of other physical injuries or sicknesses because '[p]hysical relates to both the body and mind which are inseparable in a person.'" The court concluded that the taxpayer "may well be right ontologically, but not legally." The court also disallowed the deduction of legal fees on Schedule C (but not on Schedule A because the Service had not challenged those) and declined to impose accuracy related penalties under § 6662(a) because the taxpayer had relied in good faith on the advice of his CPA and also because the Service had not introduced any evidence that the penalties had been "personally approved (in writing) by the immediate supervisor of the individual making [the initial] determination" of the penalty as required by § 6751(b)(1).

- *Tax treatment of the amounts received for unpaid wages.* There apparently was no dispute between the parties that the taxpayer had to include in gross income the $350,000 of "alleged unpaid wages" that his former employer paid and reported on Form W-2 because the court does not separately discuss it. If the taxpayer had suffered a physical injury, however, and if his inability to earn the wages was the result of his physical injury, then he should have been able to exclude the unpaid wages from his gross income under § 104(a)(2) because the exclusion applies to all damages that flow from a physical injury.

- *Taxpayers have prevailed in some cases that are difficult to distinguish.* The Tax Court concluded in this case that, if a defendant's conduct causes a taxpayer to have emotional distress, then the taxpayer cannot exclude from gross income under § 104(a)(2) any damages or settlement payments received because emotional distress is not a physical injury. The court further concluded that this rule applies even if a taxpayer suffers physical symptoms of the emotional distress, such as insomnia or stomach disorders. In some cases, however, the line between a physical injury, on the one hand, and physical symptoms of emotional distress, on the other, has not been entirely clear. For example, in *Parkinson v. Commissioner*, T.C. Memo. 2010-142, the Tax Court concluded that a taxpayer who suffered a heart attack as a result of emotional distress he experienced in the workplace had suffered a physical injury. Similarly, in *Domeny v. Commissioner*, T.C. Memo. 2010-9, the Tax Court held that a taxpayer whose workplace stress resulted in a flare-up of her pre-existing multiple sclerosis condition could exclude from her gross income under § 104(a)(2) a settlement payment received from her former employer. The ambiguity in the law concerning this issue suggests that careful attention and research are required if a client receives damages or settlement payments in a context in which the client might have suffered from emotional distress.

- *Even if a taxpayer suffers only emotional distress, the taxpayer can exclude from gross income an amount of damages received to the extent of medical expenses incurred that were not deducted in prior years.* Although the statutory language of § 104(a) is clear that emotional distress is not considered a physical injury, the statutory language also states that this rule does "not apply to an amount of damages not in excess of the amount paid for medical care (described in subparagraph (A) or (B) of section 213(d)(1)) attributable to emotional distress." For example, in the case discussed above, if the taxpayer had incurred $10,000 in costs for psychological counseling as a result of his emotional distress, then he could have excluded from gross income $10,000 of the $250,000 in settlement payments received from his former employer provided that he had not deducted any portion of the medical expenses in a prior year. If the taxpayer had deducted in a prior year $4,000 of the $10,000 in medical expenses incurred, then he could have excluded $6,000 of the $250,000 in settlement payments received from his former employer.

2. A stockbroker could not assign income to his defunct corporation, says the Tax Court. Frey v. Commissioner, T.C. Memo. 2019-62 (6/3/19). The taxpayer, who began working as a stockbroker in 1962, was the chief operating officer of three firms, including Queen City Securities and Jettrade, Inc. During the years in question, 2012 and 2013, the taxpayer was the sole shareholder of Queen City Securities and served as president and chief executive officer of Jettrade, in which he held a majority equity interest. Following a series of financial crises, Queen City ceased to conduct business in 1990. The taxpayer claimed that Queen City had net operating losses or bad debt losses carried forward from years prior to 1991. During 2012 and 2013, the taxpayer received compensation from Jettrade of $214,150 and $205,300, respectively, and assigned all of the income to Queen City. He prepared his own federal income tax returns for 2012 and 2013 (in part because he had been dissatisfied with and fired professionals with whom he had worked in the past), which included a Schedule C, Profit or Loss from Business, on which he reported that he worked as a stockbroker as a sole proprietor. On Schedule C, the taxpayer included as income the compensation he received from Jettrade and deducted equal amounts as "commissions and fees" for amounts he allegedly paid to Queen City with the intent to utilize Queen City's loss carryforwards to offset the income. The IRS disallowed the deductions on Schedule C for the amounts paid to Queen City and, as a result, made computational adjustments to increase the taxable portion of the Social Security benefits received by the taxpayer and his wife. The Tax Court (Judge Cohen) agreed with the IRS and held that the taxpayer could not assign his income to Queen City. According to the court, it is well established by cases such as *Lucas v. Earl*, 281 U.S. 111 (1930), that income is taxable to the person who earns it. The proper taxpayer is the person or entity that controls the earning of the income, not the person or entity that ultimately receives it. The court rejected the taxpayer's rather confused arguments to the contrary, concluded that he had presented no evidence that he had actually transferred funds to Queen City, and also concluded that his testimony at trial was implausible and unreliable and not entitled to any weight. The court upheld the IRS's imposition of accuracy-related penalties under § 6662(a), (b)(1) and (b)(2) for both substantial understatement of income tax and negligence. The IRS established that there was a substantial understatement of income because the understatement exceeded the greater of 10% of the tax required to be shown on the return or $5,000. The court also held that the evidence established that the taxpayer and his wife were negligent because "they did not consult competent professionals or otherwise attempt to determine their correct tax liabilities." They did not establish a reasonable cause defense.

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

D. Deductions and Credits for Personal Expenses

1. Although the IRS treats Medicaid waiver payments as excludable from gross income, such payments are earned income for purposes of the earned income credit and the child tax credit, says the Tax Court. Feigh v. Commissioner, 152 T.C. No. 15 (5/15/19). Medicaid waiver payments are payments to individual care providers for the care of eligible individuals under a state Medicaid Home and Community-Based Services waiver program described in section 1915(c) of the Social Security Act. Generally, these payments are made by a state that has obtained a Medicaid waiver that allows the state to include in the state's Medicaid program the cost of home or community-based services (other than room and board) provided to individuals who otherwise would require care in a hospital, nursing facility, or intermediate care facility. In Notice 2014-7, 2014-4 I.R.B. 445, the Service concluded that Medicaid waiver payments qualify as "difficulty of care payments" within the meaning of § 131(c) and therefore can be excluded from the recipient's gross income under § 131(a), which excludes amounts received by a foster care provider as qualified foster care payments. Generally, difficulty of care payments are compensation for providing additional care to a qualified foster individual that is required by reason of the individual's physical, mental, or emotional handicap and that is provided in the home of the foster care provider. In this case, the taxpayers, a married couple, received Medicaid waiver payments in 2015 in the amount of $7,353, which were reflected on Form W-2, for the care of their disabled adult children. The taxpayers reported this amount as wages on their 2015 return but excluded the payments from gross income. They received no other income during 2015 that would qualify as earned income. The taxpayers claimed an earned income credit of $3,319 and an additional child tax credit of $653. The IRS asserted that the Medicaid waiver payment was not earned income and therefore disallowed the taxpayers' earned income credit and child tax credit. The Tax Court (Judge Goeke) held that the Medicaid waiver payments in the amount of $7,353 did qualify as earned income for purposes of both the earned income credit and the additional child tax credit. For this purpose, section 32(c)(2)(A)(i) defines "earned income" as

> wages, salaries, tips, and other employee compensation, but only if such amounts are includible in gross income for the taxable year.

The court reasoned that, even though the taxpayers did not *include* in gross income the Medicaid waiver payments they received, the payments were *includible* in gross income. The court engaged in a lengthy analysis of Notice 2014-7, in which the Service had concluded that such payments could be excluded from gross income under § 131(a) and determined that the notice was entitled to so-called *Skidmore* deference (*Skidmore v. Swift & Co.*, 323 U.S. 134 (1944)), under which a government agency's interpretation is accorded respect befitting "the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those facts which give it the power to persuade, if lacking power to control." The Tax Court concluded that Notice 2014-7 was "entitled to little, if any, deference." In other words, the court concluded that the Service got it wrong when it determined that the taxpayers' Medicaid waiver payments were excludable from gross income. Based on its analysis, the court accepted the taxpayers' argument that the Service could not reach a result contrary to the Code by reclassifying the taxpayers' earned income as unearned for purposes of determining eligibility for the tax credits in question. The Service argued that no statutory provision demonstrated that Congress intended to allow a double benefit, i.e., both an exclusion of the Medicaid waiver payment from gross income and eligibility for the earned income credit and child tax credit. The court responded: "Respondent's argument, however, misses that he, not Congress, has provided petitioners with a double tax benefit."

- The taxpayers were represented by the Low Income Taxpayer Clinic at the University of Minnesota Law School.

2. Has the federal deduction for your high property or state income taxes made them easier to bear? Brace yourself! The deduction for state and local taxes not paid or accrued in carrying on a trade or business or an income-producing activity is limited to $10,000. The 2017 Tax Cuts and Jobs Act, § 11042, amended Code § 164(b) by adding § 164(b)(6). For individual taxpayers, this provision generally (1) eliminates the deduction for foreign real property taxes, and (2) limits to $10,000 ($5,000 for married individuals filing separately) a taxpayer's itemized deductions on Schedule A for the aggregate of state or local property taxes, income taxes, and sales taxes deducted in lieu of income taxes. This provision applies to taxable years beginning after 2017 and before 2026. The provision does *not* affect the deduction of state or local property taxes or sales taxes that are paid or accrued in carrying on a trade or business or an income-producing activity (i.e., an activity described in § 212) that are properly deductible on Schedules C, E, or F. For example, property taxes imposed on residential rental property will continue to be deductible. With respect to income taxes, an individual can deduct only *foreign* income taxes paid or accrued in carrying on a trade or business or an income-producing activity. As under current law, an individual cannot deduct state or local income taxes as a business expense even if the individual is engaged in a trade or business as a sole proprietor. *See* Reg. § 1.62-1T(d).

a. The Service is not going to give blue states a pass on creative workarounds to the new $10,000 limitation on the personal deduction for state and local taxes. Notice 2018-54, 2018-24 I.R.B. 750 (05/23/18). In response to new § 164(b)(6), many states—including Connecticut, New Jersey, and New York—have enacted workarounds to the $10,000 limitation. For instance, New Jersey reportedly has enacted legislation giving property owners a special tax credit against otherwise assessable property taxes if the owner makes a contribution to charitable funds designated by local governments. Connecticut reportedly has enacted a new provision that taxes the income of passthrough entities such as S corporations and partnerships, but allows the shareholders or members a corresponding tax credit against certain state and local taxes assessed against them individually. Notice 2018-54 announces that the Service and Treasury are aware of these workarounds and that proposed regulations will be issued to "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." In other words, blue states, don't bank on a charitable contribution or a flow-through income tax substituting for otherwise assessable state and local taxes to avoid new § 164(b)(6). The authors predict that this will be an interesting subject to watch over the coming months.

b. The availability of a business expense deduction under § 162 for payments to charitable organizations is not affected by any state tax credits received for the payments, says the Service. IRS News Release IR-2018-178 (9/5/18). This news release clarifies that the availability of a deduction for ordinary and necessary business expenses under § 162 for businesses that make payments to charities or government agencies and for which the business receives state tax credits is not affected by the proposed regulations issued in August 2018 (that became final in June 2019, see below) that generally disallow a federal charitable contribution deduction under § 170 for charitable contributions made by an individual for which the individual receives a state tax credit. Thus, if a payment to a government agency or charity qualifies as an ordinary and necessary business expense under § 162(a), it is not subject to disallowance in the manner in which deductions under § 170 are subject to disallowance. This is true, according to the news release, regardless of whether the taxpayer is doing business as a sole proprietor, partnership or corporation. According to a "frequently asked question" posted on the Service website, "a business taxpayer making a payment to a charitable or government entity described in § 170(c) is generally permitted to deduct the entire payment as an ordinary and necessary business expense under § 162 if the payment is made with a business purpose."

c. Safe harbors for C corporations and "specified passthrough entities" allow payments made with a business purpose to charities to qualifiy as ordinary and necessary business expenses even if the payors receive state tax credits for the payments. Rev. Proc. 2019-12, 2019-04 I.R.B. 401 (12/29/18). Treasury and the Service obviously have continued to receive questions regarding the deductibility of business expenses that may indirectly bear on the taxpayer's state and local tax liability. In response, Rev. Proc. 2019-12 provides certain safe harbors. For C corporations that make payments to or for the use of § 170(c) charitable organizations and that receive or expect to receive corresponding tax credits against state or local taxes, the C corporation nevertheless may treat such payment as meeting the requirements of an ordinary and necessary business expense for purposes of § 162(a). A similar safe harbor rule applies for entities other than C corporations, but only if the entity is a "specified passthrough entity." A specified passthrough entity for this purpose is one that meets four requirements. First, the entity must be a business entity other than a C corporation that is regarded for all federal income tax purposes as separate from its owners under Reg. § 301.7701-3 (i.e., it is not single-member LLC). Second, the entity must operate a trade or business within the meaning of § 162. Third, the entity must be subject to a state or local tax incurred in carrying on its trade or business that is imposed directly on the entity. Fourth, in return for a payment to a § 170(c) charitable organization, the entity receives or expects to receive a state or local tax credit that the entity applies or expects to apply to offset a state or local tax imposed upon the entity. The revenue procedure applies to payments made on or after January 1, 2018.

- *C corporation example state and local income tax credit:* A, a C corporation engaged in a trade or business, makes a payment of $1,000 to a § 170(c) charitable organization. In return for the payment, A receives or expects to receive a dollar-for-dollar state tax credit to be applied to A's state corporate income tax liability. Under the revenue procedure, A may treat the $1,000 payment as meeting the requirements of an ordinary and necessary business expense under § 162.

- *C corporation example state and local property tax credit:* B, a C corporation engaged in a trade or business, makes a payment of $1,000 to a § 170(c) charitable organization. In return for the payment, B receives or expects to receive a tax credit equal to 80 percent of the amount of this payment ($800) to be applied to B's local real property tax liability. Under the revenue procedure, B may treat $800 as meeting the requirements of an ordinary and necessary business expense under § 162. The treatment of the remaining $200 will depend upon the facts and circumstances and is not affected by the revenue procedure. (In other words, the $200 could be a charitable contribution deductible under § 170, or the $200 could be a business expense deductible under § 162.)

- *Specified passthrough example state and local excise tax credit:* P is a limited liability company (LLC) classified as a partnership for federal income tax purposes under Reg. § 301.7701-3 and is owned by individuals A and B. P is engaged in a trade or business within the meaning of § 162 and makes a payment of $1,000 to a § 170(c) charitable organization. In return for the payment, P receives or expects to receive a dollar-for-dollar state tax credit to be applied to P's state excise tax liability incurred by P in carrying on its trade or business. Under applicable state law, the state's excise tax is imposed at the entity level (not the owner level). Under the revenue procedure, P may treat the $1,000 payment as meeting the requirements of an ordinary and necessary business expense under § 162.

- *Specified passthrough example state and local property tax credit:* S is an S corporation engaged in a trade or business and is owned by individuals C and D. S makes a payment of $1,000 to a § 170(c) charitable organization. In return for the payment, S receives or expects to receive a state tax credit equal to 80 percent of the amount of this payment ($800) to be applied to S's local real property tax liability incurred by S in carrying on its trade or business. Under applicable state and local law, the real property tax is imposed at the entity level (not the owner level). Under the revenue procedure, S may treat $800 of the payment as meeting the requirements of an ordinary and necessary business expense under § 162. The treatment of the remaining $200 will depend upon the facts and circumstances and is not affected by this revenue procedure. (In other words, the $200 could be a charitable contribution deductible under § 170 by the owners of the specified passthrough entity, or the $200 could be a business expense deductible at the entity level under § 162.)

d. And like Rameses II in The Ten Commandments, Treasury says, "So let it be written; so let it (finally!) be done." T.D. 9864, Contributions in Exchange for State or Local Tax Credits, 84 F.R. 27513 (6/13/19). The Treasury Department and the IRS have finalized, with only minor changes, proposed amendments to the regulations under § 170 that purport to close the door on any state-enacted workarounds to the $10,000 limitation of § 164(b)(6) on a taxpayer's itemized deductions on Schedule A for the aggregate of state or local property taxes, income taxes, and sales taxes deducted in lieu of income taxes. (*See* REG-112176-18, Contributions in Exchange for State and Local Tax Credits, 83 F.R. 43563 (8/27/18).) Reg. § 1.170A-1(h)(3) generally requires taxpayers to reduce the amount of any federal income tax charitable contribution deduction by the amount of any corresponding state or local tax *credit* the taxpayer receives or expects to receive. The final regulations further provide that a corresponding state or local tax *deduction* normally will not reduce the taxpayer's federal deduction provided the state and local deduction does not exceed the taxpayer's federal deduction. To the extent the state and local charitable deduction exceeds the taxpayer's federal deduction, the taxpayer's federal deduction is reduced. Finally, the final regulations provides an exception whereby the 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. Pursuant to an amendement to Reg. § 1.642(c)-3(g), these same rules apply in determining the charitable contribution deductions of trusts and estates under § 642(c). Three examples illustrate the application of these rules:

- *Example 1*. A, an individual, makes a payment of $1,000 to X, an entity listed in section 170(c). In exchange for the payment, A receives or expects to receive a state tax credit of 70% of the amount of A's payment to X. Under paragraph (h)(3)(i) of this section, A's charitable contribution deduction is reduced by $700 (70% × $1,000). This reduction occurs regardless of whether A is able to claim the state tax credit in that year. Thus, A's charitable contribution deduction for the $1,000 payment to X may not exceed $300.

- *Example 2*. B, an individual, transfers a painting to Y, an entity listed in section 170(c). At the time of the transfer, the painting has a fair market value of $100,000. In exchange for the painting, B receives or expects to receive a state tax credit equal to 10% of the fair market value of the painting. Under paragraph (h)(3)(vi) of this section, B is not required to apply the general rule of paragraph (h)(3)(i) of this section because the amount of the tax credit received or expected to be received by B does not exceed 15% of the fair market value of the property transferred to Y. Accordingly, the amount of B's charitable contribution deduction for the transfer of the painting is not reduced under paragraph (h)(3)(i) of this section.

- *Example 3*. C, an individual, makes a payment of $1,000 to Z, an entity listed in section 170(c). In exchange for the payment, under state M law, C is entitled to receive a state tax deduction equal to the amount paid by C to Z. Under paragraph (h)(3)(ii)(A) of this section, C is not required to reduce its charitable contribution deduction under section 170(a) on account of the state tax deduction.

The final regulations are effective for charitable contributions made after August 27, 2018.

- The final regulations do not discern between abusive "workarounds" enacted in response to § 164(b)(6) and legitimate state and local tax credit programs such as the Georgia Rural Hospital Tax Credit that preceded the 2017 Tax Cuts and Jobs Act. The Georgia Rural Hospital Tax Credit program was enacted in 2017 to combat the closure of many rural hospitals in Georgia due to financial difficulties. Under the program, individuals and corporations making contributions to designated rural hospitals receive a 90 percent dollar-for-dollar tax credit against their Georgia state income tax liability. Is the Georgia Rural Hospital Tax Credit program adversely affected by proposed regulations under § 164(b)(6)? In our view, the answer is "yes" and a Georgia taxpayer's federal charitable contribution deduction for a donation to a Georgia rural hospital is reduced by 90 percent. Treasury and the IRS have adopted this view, which is reflected in the preamble to the final regulations:

> The regulations are based on longstanding federal tax law principles that apply equally to all taxpayers. To ensure fair and consistent treatment, the final regulations do not distinguish between taxpayers who make transfers to state and local tax credit programs enacted after the [Tax Cuts and Jobs] Act and those who make transfers to tax credit programs existing prior to the enactment of the Act. Neither the intent of the section 170(c) organization, nor the date of enactment of a particular state tax credit program, are relevant to the application of the *quid pro quo* principle.

We note, however, that it may be possible under state or local law for a taxpayer to waive any corresponding state or local tax credit and thereby claim a full charitable contribution for federal income tax purposes. *See* Rev. Rul. 67-246, 1967-2 C.B. 104. In the preamble to the final regulations, Treasury and the IRS noted that taxpayers might disclaim a credit by not applying for it if the credit calls for an application (or applying for a lesser amount) and requested comments as to how taxpayers may decline state or local tax credits in other situations. It is also possible, pursuant to a safe harbor established in Notice 2019-12, 2019-27 I.R.B. ___ (see below), for an individual who itemizes deductions to treat as a payment of state or local tax on Schedule A a payment made to a charitable organization for which the individual receives a state or local tax credit.

e. Down the rabbit-hole we go. A safe harbor allows individuals who itemize to treat as payments of state or local tax any payments to § 170(c) charitable organizations that are disallowed as federal charitable contribution deductions because the individual will receive a state or local tax credit for the payment. Notice 2019-12, 2019-27 I.R.B. 57 (6/11/19). This notice 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. Until the proposed regulations are issued, taxpayers can rely on the safe harbor as set forth in the notice. Section 3 of the notice provides as follows:

> 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. This treatment as a payment of state or local tax under section 164 is allowed in the taxable year in which the payment is made to the extent the resulting credit is applied, consistent with applicable state or local law, to offset the individual's state or local tax liability for such taxable year or the preceding taxable year. … To the extent the resulting credit is not applied to offset the individual's state or local tax liability for the taxable year of the payment or the preceding taxable year, any excess credit permitted to be carried forward may be treated as a payment of state or local tax under section 164 in the taxable year or years for which the carryover credit is applied, consistent with applicable state or local law, to offset the individual's state or local tax liability.

The safe harbor does not apply to a transfer of property and does not permit a taxpayer to treat the amount of any payment as deductible under more than one provision of the Code or regulations. The safe harbor applies to payments made after August 27, 2018. Three examples illustrate the application of these rules:

- *Example 1*. In year 1, Taxpayer A makes a payment of $500 to an entity described in section 170(c). In return for the payment, A receives a dollar-for-dollar state income tax credit. Prior to application of the credit, A's state income tax liability for year 1 was $500 or more; A applies the $500 credit to A's year 1 state income tax liability. Under section 3 of this notice, A treats the $500 payment as a payment of state income tax in year 1 for purposes of section 164. To determine A's deduction amount, A must apply the provisions of section 164 applicable to payments of state and local taxes, including the limitation under section 164(b)(6).

- *Example 2*. In year 1, Taxpayer B makes a payment of $7,000 to an entity described in section 170(c). In return for the payment, B receives a dollar-for-dollar state income tax credit, which under state law may be carried forward for three taxable years. Prior to application of the credit, B's state income tax liability for year 1 was $5,000; B applies $5,000 of the $7,000 credit to B's year 1 state income tax liability. Under section 3 of this notice, B treats $5,000 of the $7,000 payment as a payment of state income tax in year 1 for purposes of section 164. Prior to application of the remaining credit, B's state income tax liability for year 2 exceeds $2,000; B applies the excess credit of $2,000 to B's year 2 state income tax liability. For year 2, B treats the $2,000 as a payment of state income tax for purposes of section 164. To determine B's deduction amounts in years 1 and 2, B must apply the provisions of section 164 applicable to payments of state and local taxes, including the limitation under section 164(b)(6).

- *Example 3*. In year 1, Taxpayer C makes a payment of $7,000 to an entity described in section 170(c). In return for the payment, C receives a local real property tax credit equal to 25 percent of the amount of this payment ($1,750). Prior to application of the credit, C's local real property tax liability in year 1 was $3,500; C applies the $1,750 credit to C's year 1 local real property tax liability. Under section 3 of this notice, for year 1, C treats $1,750 as a payment of local real property tax for purposes of section 164. To determine C's deduction amount, C must apply the provisions of section 164 applicable to payments of state and local taxes, including the limitation under section 164(b)(6).

3. The Tax Court reiterates that it does not have equitable power to change the statutory treatment of excess advance premium tax credits as an increase in tax. Kerns v. Commissioner, T.C. Memo 2019-14 (3/4/19). The taxpayers, a married couple, purchased health insurance for 2014 through Covered California, a health insurance exchange created under the Affordable Care Act. Based on their projected household income, they qualified for an advance payment of the premium tax credit authorized by § 36B. During 2014, the exchange made total payments to the health insurance issuer of $8,402. Generally, under §36B(c)(1), the premium tax credit is available to taxpayers whose household income is at least 100 percent but not more than 400 percent of the federal poverty line. For this purpose, § 36B(d)(2)(A) provides that household income is the sum of the modified adjusted gross income (MAGI) of the taxpayer and all family members required to file a tax return who are taken into account in determining family size. MAGI is defined in relevant part by § 36B(d)(2)(B) as adjusted gross income (AGI) increased by certain items. The AGI and MAGI for 2014 of the taxpayers, who had no dependents, was $97,061. This amount exceeded 400 percent of the federal poverty line, and therefore the taxpayers were not eligible for the § 36B premium tax credit. Because they had received advance credit payments, they were required by § 36B(f)(1) to reconcile the amount of the advance payments with the premium tax credit calculated on their return. The taxpayers did not report their advance credit payments on their 2014 return. The IRS ultimately issued a notice of deficiency disallowing the entire credit. Because they did not qualify for any premium tax credit and had received $8,402 in advance credit payments, they owed the entire $8,402 as a tax liability. The taxpayers asserted various state law claims against the health insurance issuer (Blue Shield) and Covered California, including false advertising, unfair business practices, and breach of duty. They argued that this alleged malfeasance nullified any tax liability arising from the excess advance premium tax credit payments. The Tax Court (Judge Lauber) held that it had no ability grant relief to the taxpayers. The court relied on its prior decision in *McGuire v. Commissioner*, 149 T.C. 254 (8/28/17), for the proposition that the statutory mandate of § 36B(f)(2)(A), which provides that tax liability "shall be increased" by the amount of any excess advance premium tax credit payments, is not subject to equitable exceptions.

4. Although the Tax Court found it more likely than not that the taxpayer's compulsive gambling was a side effect of his physician-prescribed Pramipexole, his gambling losses were not casualty losses. Mancini v. Commissioner, T.C. Memo. 2019-16 (3/4/19). The taxpayer earned good money and was a successful real estate investor who gambled occasionally, but never more than $100 at a time. When he was diagnosed with Parkinson's disease, his neurologist prescribed Pramipexole (the generic name for Mirapex). Although his symptoms improved, the taxpayer started doing "odd things."

> He vacuumed a lot and became compulsive about his cleanliness. He spent a week researching and obsessing over which mattress to buy. He started falling asleep suddenly while driving. He had suicidal thoughts. And he started gambling--a lot.

Over the next two years the taxpayer depleted all of his bank accounts and all but $10,000 of his retirement savings. He also sold his real estate for less than fair market value and used the proceeds to pay gambling debts. On the taxpayer's 2008 and 2009 returns, for which he retained a return preparer, he reported gambling winnings and deducted gambling losses up to the amount of his gambling winnings. He prepared his 2019 return himself and deducted gambling losses up to the amount of his gambling winnings, and also deducted a $603,000 casualty loss for "Investment Portfolio and Home." He later amended his 2008 and 2009 returns to claim large casualty losses. The IRS issued a notice of deficiency for 2010. The Tax Court (Judge Holmes) first concluded, based on expert testimony, that it was more likely than not that the taxpayer's compulsive gambling was a side effect of the Pramipexole he was taking. Nevertheless, the court held, the taxpayer's gambling losses were not casualty losses for two reasons. First, the court reasoned, physical damage to property is a prerequisite of a casualty-loss deduction, and the taxpayer had not suffered physical damage to property. "Mancini's depleted bank accounts, and the money he left on the table when he made bad real-estate deals, didn't suffer any physical damage. Second, the manner in which casualty losses are calculated demonstrates that the taxpayer had not suffered a casualty loss. The amount of a casualty loss is the amount by which the fair market value of the property before the casualty exceeds the fair market value of the property after the casualty, reduced by the amount of any insurance proceeds recovered. In this case, the court reasoned, the taxpayer's losses occurred over three years, which is not "sudden" as required for a casualty loss, and it would be difficult or impossible to apply a before-and-after test to determine the amount of his loss because his "losses were necessarily the result of dozens or hundreds of individual gambling sessions and probably thousands of separate wagers." The court also held that, even if the losses were casualty losses, the taxpayer had failed to substantiate them. Finally the court declined to impose accuracy-related penalties under by § 6662(a) because the Service had not introduced any evidence that the penalties had been "personally approved (in writing) by the immediate supervisor of the individual making [the initial] determination" of the penalty as required by § 6751(b)(1).

E. Divorce Tax Issues

F. Education

G. Alternative Minimum Tax

VI. CORPORATIONS

A. Entity and Formation

B. Distributions and Redemptions

1. Now, this is "fake news" if we've ever heard it: The IRS has ruled that a redemption which does not qualify under § 302 is a distribution under § 301. Duh! Rev. Rul. 2019-13, 2019-20 I.R.B. 1179 (5/9/19). For reasons we're apparently too dense to understand, the IRS has found it necessary to rule that a redemption by a C corporation which does not qualify under § 302 is treated as a distribution under § 301. Okay, to be fair, the ruling also holds (not surprisingly) that if the C corporation's nonqualifying redemption takes place during the corporation's "post-termination transition period" (as defined in § 1377(b)) after converting from subchapter S status, the distribution reduces the former S corporation's accumulated adjustment account ("AAA") before reducing earnings and profits ("E&P") accumulated from prior C corporation years.

Facts. The facts set forth in Rev. Rul. 2019-13 are as follows: X once was a C corporation and later elected S status under § 1362(a). Then, X's S election terminated under § 1362(d), such that it is now a C corporation. A, an individual, owns all 100 shares of the outstanding stock of X. At the time of its conversion to an S corporation, X had accumulated E&P of $600x and no current E&P. At the time of the termination of its S election, X's AAA was $800x and its accumulated E&P was still $600x. During X's post-termination transition period, X redeems 50 of A's 100 shares of X stock for $1,000x. X makes no other distributions during the post-termination transition period. For the taxable period that includes the redemption, X has current E&P of $400x.

Law and Analysis: Recall that because A still owns 100 percent of the stock of X after the redemption, the transaction does not qualify for sale or exchange treatment under § 302 and therefore is treated as distribution under § 301. Further recall that the "post-termination transition period" under § 1377(b) generally is the one-year period following the termination of a corporation's subchapter S status. Under § 1371(e), any distribution of cash by a former S corporation with respect to its stock during the post-termination transition period ordinarily is applied against and reduces the adjusted basis of the recipient's stock to the extent the distribution does not exceed the corporation's AAA (within the meaning of § 1368(e)).

Held, the redemption of 50 of A's 100 shares of X stock for $1,000x is characterized as a reduction of X's $800x of AAA with the remaining $200x characterized as a dividend under § 301(c)(1).

C. Liquidations

D. S Corporations

1. A § 267 "looptrap" snares an accrual-method subchapter S corporation with an ESOP shareholder. Petersen v. Commissioner, 148 T.C. 463 (6/13/17). The taxpayers, a married couple, owned stock in an accrual-method S corporation with many employees. As permitted by § 1361(c)(7), an ESOP benefitting the employees also owned stock in the S corporation. The S corporation had accrued and deducted the following amounts with respect to its ESOP participants as of the end of its 2009 and 2010 tax years: for 2009, unpaid wages of $1,059,767 (paid by January 31, 2010) and vacation pay of $473,744 (paid by December 31, 2010); for 2010, unpaid wages of $825,185 (paid by January 31, 2011) and vacation pay of $503,896 (paid by December 31, 2011). Notwithstanding the fact that the S corporation was an accrual-method taxpayer, the IRS asserted under § 267(a)(2) (forced-matching) that the corporation was not entitled to deduct the foregoing accrued amounts until the year of actual payment and inclusion in gross income by the ESOP's cash-method, employee-participants. In a case of first impression, the Tax Court (Judge Lauber) agreed with the IRS based upon a plain reading of §§ 67(a)(2), (b), and (e), as well as a determination that the S corporation's ESOP is a "trust" within the meaning of § 267(c). Specifically, § 267(a)(2) generally requires so-called "forced matching" of an accrual-method taxpayer's deductions with the gross income of a cash-method taxpayer to whom a payment is to be made if the taxpayer and the person to whom the payment is to be made are related persons as defined by § 267(b). For an S corporation, pursuant to § 267(e), all shareholders are considered related persons under § 267(b) regardless of how much or how little stock such shareholders actually *or constructively* own. Furthermore, under § 267(c) beneficiaries of a trust are deemed to own any stock held by the trust. Because the assets held by an ESOP are owned by a trust (as required by ERISA, *see* 29 U.S.C. § 1103(a)), the participating employees of the ESOP are treated as shareholders of the S corporation. Hence, the forced-matching rule of § 267(a)(2) applies to accrued but unpaid wages and vacation pay owed to the S corporation's ESOP participants at the end of the year. Judge Lauber noted that this odd situation probably was a "drafting oversight"—in our words, a *looptrap*—because § 318, which defines related parties for certain purposes under subchapter C, excepts tax-exempt employee trusts from its constructive ownership rules. Nevertheless, Judge Lauber wrote, the Tax Court is "not at liberty to revise section 267(c) to craft an exemption that Congress did not see fit to create." Mercifully, however, the Tax Court declined to impose § 6662 negligence or substantial understatement penalties on the taxpayers because the case was one where "the issue was one not previously considered by the Court and the statutory language was not clear" (even though the court obviously relied upon the plain language of § 267 to reach its decision).

a. This accrual-method S corporation was properly snared, says the Tenth Circuit. Petersen v. Commissioner, 924 F.3d 1111 (10th Cir. 5/15/19), *aff'g* 148 T.C. 463 (6/13/17). In an opinion by Judge Hartz, the U.S. Court of Appeals for the Tenth Circuit has affirmed the Tax Court's decision that an accrual-method S corporation's deductions for amounts payable to cash-method participants in an ESOP that held shares of the S corporation were deferred by the forced matching rule of § 267(a)(2). Section 267(a)(2) provides that the deductions of an accrual-method taxpayer for amounts payable to a related cash-method taxpayer must be deferred until the year in which the amounts are included in the related taxpayer's gross income. Under § 267(c), beneficiaries of a trust are treated as constructively owning any stock held by the trust. Further, under § 267(e), all shareholders of an S corporation are treated as "related persons" within the meaning of § 267(b) regardless of how much or how little stock such shareholders actually *or constructively* own. The Tenth Circuit agreed with the Tax Court that the effect of these provisions is that employees of an S corporation who participate in an ESOP that holds shares of the S corporation are "related persons" with respect to the S corporation within the meaning of § 267(b), and therefore an accrual-method S corporation's deductions for amounts payable to such employees are subject to deferral under the forced-matching rule of § 267(a)(2). In reaching this conclusion, the court rejected several arguments made by the taxpayers and held that an ESOP is a "trust" within the meaning of § 267(c), and therefore the ESOP's participants are treated as constructively holding proportionately the stock held by the ESOP.

E. **Mergers, Acquisitions and Reorganizations**

F. **Corporate Divisions**

G. **Affiliated Corporations and Consolidated Returns**

H. **Miscellaneous Corporate Issues**

VII. PARTNERSHIPS

A. **Formation and Taxable Years**

B. **Allocations of Distributive Share, Partnership Debt, and Outside Basis**

C. **Distributions and Transactions Between the Partnership and Partners**

D. **Sales of Partnership Interests, Liquidations and Mergers**

E. **Inside Basis Adjustments**

F. **Partnership Audit Rules**

G. **Miscellaneous**

1. Relief for not reporting negative tax capital accounts. Notice 2019-20, 2019-14 I.R.B. 927 (3/7/19). 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. Aware that some taxpayers and their advisors may not have been prepared to comply with this new requirement for 2018 returns, the IRS, in Notice 2019-20, has provided limited relief. Specifically, the IRS will waive penalties (1) under § 6722 for failure to furnish a partner a Schedule K-1 (Form 1065) and under § 6698 for failure to file a Schedule K-1 (Form 1065) with a partnership return, (2) under § 6038 for failure to furnish a Schedule K-1 (Form 8865), and (3) under any other section of the Code for failure to file or furnish a Schedule K-1 or any other form or statement, for any penalty that arises solely as a result of failing to include negative tax basis capital account information provided the following conditions are met:

1. The Schedule K-1 or other applicable form or statement is timely filed, including extensions, with the IRS; is timely furnished to the appropriate partner, if applicable; and contains all other required information.

2. The person or partnership required to file the Schedule K-1 or other applicable form or statement files with the IRS, no later than one year after the original, unextended due date of the form to which the Schedule K-1 or other applicable form or statement must be attached, a schedule setting forth, for each partner for which negative tax basis capital account information is required: (a) the partnership's name and Employer Identification Number, if any, and Reference ID Number, if any; (b) the partner's name, address, and taxpayer identification number; and (c) the amount of the partner's tax basis capital account at the beginning and end of the tax year at issue.

The above-described supplemental schedule should be captioned "Filed Under Notice 2019-20" in accordance with instructions and additional guidance posted by the IRS on www.IRS.gov. The due date for this supplemental schedule is determined without consideration of any extensions, automatic or otherwise, that may apply to the due date for the form itself. Furthermore, the schedule should be sent to the address listed in the Notice, and the penalty relief applies only for taxable years beginning after December 31, 2017, but before January 1, 2019.

a. The IRS has issued FAQ guidance on negative tax basis capital account reporting. The IRS has issued guidance on the requirement to report negative tax basis capital account information in the form of frequently asked questions (FAQs) on its website. The FAQs are available at https://www.irs.gov/businesses/partnerships/form-1065-frequently-asked-questions.

Definition and calculation of tax basis capital accounts. In the FAQs, the IRS explains that "[a] partner's tax basis capital account (sometimes referred to simply as 'tax capital') represents its equity as calculated using tax principles, not based on GAAP, § 704(b), or other principles." The FAQs provide guidance on the calculation of a partner's tax basis capital account. A partner's tax basis capital account is *increased by the amount of money and the adjusted basis of any property contributed* by the partner to the partnership (less any liabilities assumed by the partnership or to which the property is subject) and is *decreased by the amount of money and the adjusted basis of any property distributed by the partnership to the partner* (less any liabilities assumed by the partner or to which the property is subject). The partner's tax basis capital account is increased by certain items, such as the partner's distributive share of partnership income and gain, and is decreased by certain items, such as the partner's distributive share of partnership losses and deductions. The FAQs make clear that a partner's tax basis capital account is not the same as a partner's basis in the partnership interest (outside basis) because outside basis includes the partner's share of partnership liabilities, whereas a partner's tax basis capital account does not.

Effect of § 754 *Elections and Revaluations of Partnership Property.* If a partnership has a § 754 election in effect, then it increases or decreases the adjusted basis of partnership property pursuant to § 743(b) when there is a transfer of a partnership interest or pursuant to § 734(b) when there is a distribution by the partnership. These adjustments can also be triggered when the partnership does not have a § 754 election in effect but has a substantial built-in loss and a transfer of a partnership interest occurs (§ 743(b) basis adjustment) or experiences a substantial basis reduction in connection with a distribution (§ 734(b) basis adjustment). The FAQs clarify that a partner's tax basis capital account *is increased or decreased by a partner's share of basis adjustments under § 743(b) and § 734(b).* In contrast, according to the FAQs, *revaluations of partnership property* pursuant to § 704 (such as upon the entry of a new partner) *do not affect the tax basis of partnership property or a partner's tax basis capital account.*

Examples. The FAQs provide the following examples of the calculation of a partner's tax basis capital account:

> *Example 1:* A contributes $100 in cash and B contributes unencumbered, nondepreciable property with a fair market value (FMV) of $100 and an adjusted tax basis of $30 to newly formed Partnership AB. A's initial tax basis capital account is $100 and B's initial tax basis capital account is $30.
>
> *Example 2:* The facts are the same as in Example 1, except B contributes nondepreciable property with a FMV of $100, an adjusted tax basis of $30, and subject to a liability of $20. B's initial tax basis capital account is $10 ($30 adjusted tax basis of property contributed, less the $20 liability to which the property was subject).
>
> *Example 3:* The facts are the same as in Example 1, except in Year 1, the partnership earns $100 of taxable income and $50 of tax-exempt income. A and B are each allocated $50 of the taxable income and $25 of the tax-exempt income by the partnership. At the end of Year 1, A's tax basis capital account is increased by $75, to $175, and B's tax basis capital account is increased by $75, to $105.
>
> *Example 4:* The facts are the same as in Example 3. Additionally, in Year 2, the partnership has $30 of taxable loss and $20 of expenditures which are not deductible in computing partnership taxable income and which are not capital expenditures. A and B are each allocated $15 of the taxable loss and $10 of the expenditures which are not deductible in computing partnership taxable income and which are not capital expenditures. At the end of Year 2, A's tax basis capital account is decreased by $25, to $150, and B's tax basis capital account is decreased by $25, to $80.
>
> *Example 5:* On January 1, 2019, A and B each contribute $100 in cash to a newly formed partnership. On the same day, the partnership borrows $800 and purchases Asset X, qualified property for purposes of §168(k), for $1,000. Assume that the partnership properly allocates the $800 liability equally to A and B under §752. Immediately after the partnership acquires Asset X, both A and B have tax basis capital

> accounts of $100 and outside bases of $500 ($100 cash contributed, plus $400 share of partnership liabilities under §752). In 2019, the partnership recognizes $1,000 of tax depreciation under §168(k) with respect to Asset X; the partnership allocates $500 of the tax depreciation to A and $500 of the tax depreciation to B. On December 31, 2019, A and B both have tax basis capital accounts of negative $400 ($100 cash contributed, less $500 share of tax depreciation) and outside bases of zero ($100 cash contributed, plus $400 share of partnership liabilities under § 752, and less $500 of share tax depreciation).

Tax Basis Capital Account of a Partner Who Acquires the Partnership Interest from Another Partner. A partner who acquires a partnership interest from another partner, such as by purchase or in a non-recognition transaction, has a tax basis capital account immediately after the transfer equal to the transferring partner's tax basis capital account immediately before the transfer with respect to the portion of the interest transferred. However, any §743(b) basis adjustment the transferring partner may have is not transferred to the acquiring partner. Instead, if the partnership has a §754 election in effect, the tax basis capital account of the acquiring partner is increased or decreased by the positive or negative adjustment to the tax basis of partnership property under §743(b) as a result of the transfer.

Safe Harbor Method for Determining a Partner's Tax Basis Capital Account. The FAQs provide a safe harbor method for determining a partner's tax basis capital account. Under this method, "[p]artnerships may calculate a partner's tax basis capital account by subtracting the partner's share of partnership liabilities under §752 from the partner's outside basis (safe harbor approach). If a partnership elects to use the safe harbor approach, the partnership must report the negative tax basis capital account information as equal to the excess, if any, of the partner's share of partnership liabilities under §752 over the partner's outside basis."

Certain partnerships are exempt from reporting negative tax basis capital accounts. Partnerships that satisfy four conditions (those provided in question 4 on Schedule B to Form 1065) do not have to comply with the requirement to report negative tax basis capital account information. This is because a partnership that satisfies these conditions is not required to complete item L on Schedule K-1. The four conditions are: **(1)** the partnership's total receipts for the tax year were less than $250,000; **(2)** the partnership's total assets at the end of the tax year were less than $1 million; **(3)** Schedules K-1 are filed with the return and furnished to the partners on or before the due date (including extensions) for the partnership return; and **(4)** the partnership is not filing and is not required to file Schedule M-3.

VIII. TAX SHELTERS

IX. EXEMPT ORGANIZATIONS AND CHARITABLE GIVING

A. Exempt Organizations

B. Charitable Giving

1. It took some time, but finally we "gotcha," says the IRS, in this infamous charitable contribution case involving billionaire and Miami Dolphins' owner Stephen Ross and the University of Michigan. RERI Holdings I, LLC v. Commissioner, 149 T.C. 1 (7/3/17). In a TEFRA case that has gone on for some time and has produced at least one other noteworthy holding (see below), the IRS prevailed in denying a $33 million charitable contribution deduction to a partnership in which Stephen Ross, owner of the Miami Dolphins, was a partner. The property was donated to the University of Michigan, Mr. Ross's alma mater. The partnership had paid only $2.95 million for the property a little over a year prior to its donation. In fact, at some point after the donation the University of Michigan sold the property for only $1.94 million. These facts, of course, displeased the IRS greatly, and the IRS convinced the Tax Court to deny the partnership's charitable contribution deduction on technical grounds (as discussed below). Moreover, contrary to decisions of the Fifth and Ninth Circuits, the Tax Court (Judge Halpern) determined that the partners of the partnership potentially are liable for aggregate gross valuation misstatement penalties of about $11.8 million.

The facts of the case are complicated, but essentially reveal that for tax year 2003 the partnership claimed a $33 million charitable contribution deduction under § 170(a)(1) for a donation to the University of Michigan. The donated property consisted of a remainder interest in a disregarded single-member LLC that the partnership owned and that held underlying real property. On its Form 8283, Noncash Charitable Contributions, the partnership failed to report its "cost or adjusted basis" for the donated property as required by Reg. § 1.170A-13(c)(4)(ii)(E), instead leaving the line on the form completely blank. Judge Halpern ruled that this failure to comply either strictly or substantially with the regulations is fatal to a claimed charitable contribution deduction, thereby denying the deduction in full. Lastly, for purposes of determining potential penalties, the Tax Court held that the correct value of the property at the time of the donation was approximately $3.5 million.

Regarding the IRS's assertion of the 40 percent penalty under § 6662(h) for "gross valuation misstatements" (valuation of 400 percent or more of correct value), the partnership argued that § 6662 should not apply because the $33 million charitable contribution deduction was completely disallowed and hence was not "attributable to" a valuation misstatement. *See, e.g.*, *Heasley v. Commissioner*, 902 F.2d 380 (5th Cir. 1990), *rev'g* T.C. Memo. 1988-408; *Gainer v. Commissioner*, 893 F.2d 225 (9th Cir. 1990), *aff'g* T.C. Memo. 1988-416. Judge Halpern's opinion, however, relies upon the Tax Court's more recent decision in *AHG Investments, LLC v. Commissioner*, 140 T.C. 73 (2013), in which the court declined to follow *Heasley* and *Gainer*. Judge Halpern noted that both the Fifth and Ninth Circuits have expressed reservations about *Heasley* and *Gainer*, and because any appeal by the partnership (due to its dissolution in 2004) would be to the U.S. Court of Appeals for the Federal Circuit, the Tax Court was free to follow its decision in *AHG Investments*. Judge Halpern then determined that the correct fair market value of the donated property should have been roughly $3.5 million, i.e., $29.5 million less than the value claimed by the partnership. Therefore, subject to partner-level § 6662(e)(2) calculations ($5,000 underpayment threshold per partner), the partners of the partnership potentially are liable for penalties aggregating as much as $11.8 million (40 percent of the $29.5 million valuation overstatement).

- The IRS probably thought it should have won this case previously on a similar technicality. In *RERI Holdings I, LLC v. Commissioner*, 143 T.C. 41 (2014), the IRS had cleverly argued on a summary judgment motion that the partnership's "qualified appraisal" (*see* § 170(f)(11)) of the property was fatally flawed. Specifically, the IRS had argued that although the partnership obtained an otherwise qualified appraisal, the partnership's appraisal valued a remainder interest in the underlying real property, not the remainder interest in the disregarded single-member LLC that held the real property. The remainder interest in the disregarded single-member LLC was the property the partnership donated to the University of Michigan, not the real property itself. Thus, argued the IRS, the partnership's otherwise qualified appraisal was for *the wrong property* (even though under § 7701 the single-member LLC was completely disregarded for all other tax purposes)! But, in 2014 Judge Halpern did not let the IRS win so easily. Judge Halpern accepted the IRS's argument that a charitable contribution of an interest in a disregarded single-member LLC should be viewed differently (and perhaps valued differently) than a charitable contribution of the underlying asset(s). Judge Halpern so held even while acknowledging that a single-member LLC otherwise is ignored for federal tax purposes. Judge Halpern's opinion relied heavily on the Tax Court's earlier decision in a gift tax case involving a disregarded single-member LLC. *See Pierre v. Commissioner*, 133 T.C. 24 (2009), *supplemented by* T.C. Memo. 2010-106. Nevertheless, perhaps to avoid so-easily granting summary judgment against the taxpayer and in favor of the IRS in 2014, Judge Halpern reasoned that there was an unresolved issue of material fact whether a valuation of the real property held by the partnership's disregarded single-member LLC could "stand proxy" for the otherwise required "qualified appraisal." Surprisingly, though, Judge Halpern's decision in the earlier *RERI* ruling raises the prospect of a disregarded single-member LLC interest being regarded and valued separately for purposes of determining charitable contributions under § 170.

a. Fumble? Touchdown IRS? Game over? Pick your pun, but it might be time for this taxpayer to admit defeat. Fiddlesticks!!! RERI Holdings I, LLC v. Commissioner, 924 F.3rd 1261 (Fed. Cir. 5/24/19). The Court of Appeals for the Federal Circuit (Judge Ginsburg) has affirmed the holding of the Tax Court that the taxpayer's failure to report its "cost or adjusted basis" for donated property on Form 8283, Noncash Charitable Contributions, as required by Reg. § 1.170A-13(c)(4)(ii)(E), is fatal to the taxpayer's claimed $33 million charitable contribution deduction. The Court of Appeals for the Federal Circuit also upheld the Tax Court's imposition of a 40 percent gross valuation misstatement penalty under § 6662(h) even though the claimed charitable contribution deduction ultimately was disallowed. After summarizing the facts and procedural posture of the case, the Federal Circuit explained that, even assuming for the sake of argument that the requirements of Reg. § 1.170A-13(c)(4)(ii)(E) can be met by substantial compliance as the taxpayer had claimed in the Tax Court and on appeal, the taxpayer had not in fact substantially complied with the regulations because it left a blank line on the Form 8283 instead of providing any information whatsoever as to its cost or adjusted basis in the donated property. The Federal Circuit also rejected all four of the taxpayer's arguments (one of which was new) and upheld the Tax Court's imposition of the 40 percent gross valuation misstatement penalty under § 6662(h). With regard to this latter ruling upholding the Tax Court, the Federal Circuit reasoned as follows. *First*, the taxpayer argued *de novo* that the IRS failed to obtain the supervisory approval required under § 6751(b) before imposing a penalty under § 6662. *See Chai v. Commissioner*, 851 F.3d 190 (2017). The Federal Circuit rejected this new argument by the taxpayer, however, because the argument had not been raised previously in the Tax Court (notwithstanding the fact that *Chai* had not been decided at the time the taxpayer was before the Tax Court). Responding to the taxpayer's contention that it did not raise the argument in Tax Court because *Chai* had not been decided and the Tax Court's prior position at the time was that supervisory approval was not required under § 6751(b) until assessment, *see Graev v. Commissioner*, 147 T.C. 460 (2016) *supplemented and overruled in part by Graev v. Commissioner*, 149 T.C. 485 (2017), the Federal Circuit wrote: "Fiddlesticks. The fact is that when RERI was before the Tax Court, it 'was free to raise the same, straightforward statutory interpretation argument the taxpayer in *Chai* made' there." *Second*, the Federal Circuit agreed with the Tax Court's rejection of the taxpayer's "attributable to" argument which previously had been addressed by Judge Halpern. *Third*, the Federal Circuit rejected the taxpayer's argument that Judge Halpern failed to properly value the donated property for purposes of determining the gross valuation misstatement penalty. *Finally*, the Federal Circuit rejected the taxpayer's argument that it had met the "reasonable cause" exception for avoiding the gross valuation misstatement penalty of § 6662(h). Judge Halpern similarly had ruled that the taxpayer did not meet the "reasonable cause" exception; however, Judge Halpern concluded the IRS had met its burden of proof under Rule 142 that reasonable cause was lacking whereas the Federal Circuit reasoned that, regardless, the taxpayer did not show reasonable cause and did not qualify for the exception irrespective of whether the IRS must show a lack of reasonable cause under Rule 142.

2. Personally evangelizing for "BSDM" — pay attention; we didn't write "BDSM" — doesn't allow you to take charitable contribution deductions for your unreimbursed expenses. Oliveri v. Commissioner, T.C. Memo 2019-57 (5/28/19). Although expenses incurred "for the use of" a charitable organization can be deductible under § 170, the Tax Court held that this taxpayer took things a little too far. (Sometimes you really can't help but wonder, "What were they thinking?" when reading certain Tax Court cases. This is one of those cases.) The taxpayer was a former U.S. Air Force pilot who upon his retirement from the Air Force became very active in the Catholic Church. The taxpayer frequently attended church-related meetings, participated in community outreach efforts, and assisted various church officials. In 1987, the taxpayer was certified as a teacher and trainer for the Catholic Church following his completion of a 16-week Catholic evangelization trainer's program. Since that time, the taxpayer has devoted his life to evangelism on behalf of the Catholic Church. The taxpayer considered all of his contact with the public an opportunity for evangelism, and he would wear a large and visible crucifix at all times. The taxpayer evangelized and discussed his faith with friends, members of his extended family, and members of the religious organization that he founded, The Brothers and Sisters of the Divine Mercy ("BSDM"). (*No, we're not kidding. The acronym used by the Tax Court really was "BSDM."*) The taxpayer incurred significant expenses in connection with his BSDM and Catholic Church evangelism activities in 2012, including costs for piloting and flying a leased airplane, commercial airfare, other transportation, lodging, meals, gifts for needy individuals and members of BSDM, etc. The taxpayer's 2012 unreimbursed expenses in this regard totaled at least $39,979, all of which he deducted as charitable contributions. None of the taxpayer's activities or expenses, however, were expressly authorized by the Catholic Church, and the Catholic Church did not provide the taxpayer with contemporaneous written acknowledgments for his expenses. After restating the general rule that to be deductible under § 170 unreimbursed expenses must be subject to coordination, supervision, or oversight by a charitable organization, *see Van Dusen v. Commissioner*, 136 T.C. 515 (2011), the Tax Court (Judge Colvin) had little trouble denying the taxpayer's claimed deductions in this case. The Tax Court reasoned that not only did the unreimbursed expenses fail to meet the *Van Dusen* standard, but most of the taxpayer's expenses were incurred in whole or in part for personal purposes. Furthermore, with respect to unreimbursed expenses of $250 or more attendant to rendering services on behalf of a charity, a taxpayer must obtain a contemporaneous written acknowledgment to comply with Reg. § 1.170A-13(f)(10). The taxpayer did not, even from BSDM, the organization he founded. Perhaps, though, divine intervention did play a role in this case. The Tax Court held that the IRS could not impose accuracy-related penalties against the taxpayer because prior, written supervisory approval had not been obtained as required by § 6751(b)(1). *See Chai v. Commissioner*, 851 F.3d 190 (2d Cir. 2017); *Graev v. Commissioner*, 149 T.C. 485 (2017).

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 common-law mailbox rule has been displaced by regulations, says the Ninth Circuit. Baldwin v. United States, 921 F.3d 836 (9th Cir. 4/16/19). The taxpayers, a married couple, filed a return for 2007 that reflected a net operating loss. They wished to carry this loss back to 2005 and, under the relevant statutory provisions (§ 6511(b)(1), (d)(2)(A)), in order to obtain a refund of taxes paid with respect to 2005, were required to file a claim for refund by October 5, 2011. The taxpayers asserted that they had filed an amended return seeking a refund for 2005 in June 2011. The IRS, however, never received that amended return. The IRS did receive an amended return for 2005 from the taxpayers in 2013, after the limitations period for seeking a refund had expired, and the IRS therefore denied their refund claim. The taxpayers brought this action for a refund in the U.S. District Court. Under § 7422(a), the jurisdiction of both U.S. District Courts and the U.S. Court of Federal Claims to hear tax refund actions is limited to those cases in which the taxpayer has "duly filed" a claim for refund with the Service. The issue in this case was how the taxpayers could prove that they had filed the necessary timely refund claim. Under the common-law mailbox rule developed and applied by some courts,

> proof of proper mailing—including by testimonial or circumstantial evidence—gives rise to a rebuttable presumption that the document was physically delivered to the addressee in the time such a mailing would ordinarily take to arrive.

At trial, the taxpayers introduced the testimony of two of their employees, who testified that they had deposited the amended 2005 return in the mail at the post office in Hartford, Connecticut, on June 21, 2011. The District Court credited the testimony of the two employees, applied the common-law mailbox rule, and held that the taxpayers were entitled to a refund of approximately $167,000 plus litigation costs of $25,000. In an opinion by Judge Watford, the U.S. Court of Appeals for the Ninth Circuit reversed. The common-law mailbox rule, the court held, has been displaced by § 7502. Under § 7502(a), the postmark stamped on the cover in which a return or claim is mailed is deemed to be the date of delivery if the return or claim (1) is deposited in the mail in the United States within the time prescribed for filing in a properly addressed, postage prepaid envelope or other appropriate wrapper and bears a postmark date that falls within the time prescribed for filing, and (2) is delivered by United States mail after the prescribed time for filing to the agency with which it is required to be filed. The statute also provides that, if the return or claim is mailed by United States registered mail, the date of registration is treated as the postmark date and the registration is prima facie evidence that the return or claim was delivered to the agency to which it was addressed. Section 7502(c)(2) authorizes the Secretary of the Treasury to issue regulations providing the same treatment of returns or claims sent by certified mail, which Treasury and the IRS have done. *See* Reg. § 301.7502-1(c)(2). Section 301.7502-1(e)(2)(i) of the regulations further provides that, except for direct proof of actual delivery, proof of proper use of registered or certified mail (or a designated private delivery service) is the *exclusive means* to establish prima facie evidence of delivery and that "[n]o other evidence of a postmark or of mailing will be prima facie evidence of delivery or raise a presumption that the document was delivered." The Ninth Circuit assessed the validity of the regulation by applying the two-step analysis of *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). The court concluded in *Chevron* step one that the statute, § 7502, is silent as to whether it displaces the common-law mailbox rule with respect to items sent by regular mail, and in step two that Reg. § 301.7502-1(e)(2)(i) is a permissible interpretation of the statute. Accordingly, the court deferred to the regulatory interpretation of the statute and held that, because § 7502 displaces the common-law mailbox rule, the taxpayers could not rely on the testimony of their employees to raise a presumption that their refund clam was delivered.

- The Ninth Circuit previously had held in *Anderson v. United States*, 966 F.2d 487 (9th Cir. 1992), that § 7502 did not displace the common-law mailbox rule. Despite that prior decision, the court upheld the validity of the regulation by applying the rule of *National Cable & Telecomm. Association v. Brand X Internet Services*, 545 U.S. 967 (2005), which held that a court's prior judicial construction of a statute trumps an agency construction that is entitled to *Chevron* deference only if the prior court decision holds that its construction follows from the unambiguous terms of the statute and leaves no room for agency discretion. The Ninth Circuit's decision in *Anderson* did not express such a holding. Prior to Treasury's issuance of Reg. § 301.7502-1(e)(2)(i), other federal courts of appeal had split on the issue whether § 7502 displaced the common-law mailbox rule. It seems likely that, if the issue arises in these courts with respect to a year subject to the regulation, they will follow the Ninth Circuit in giving *Chevron* deference to the regulation.

F. Liens and Collections

1. "The Freak" might no longer have a 40-inch vertical leap, but he managed to take down the IRS's notice of federal tax lien following a collection due process hearing on the basis that the Appeals Officer did not properly verify mailing of the notice of deficiency. Kearse v. Commissioner, T.C. Memo. 2019-53 (5/20/19). The taxpayer in this case, Jevon Kearse, who played for more than a decade in the NFL for the Tennessee Titans and the Philadelphia Eagles, took a business bad debt deduction of $1.36 million on his 2010 federal income tax return. The IRS disallowed the deduction and assessed tax in the amount of more than $400,000. In response to the IRS's notice of federal tax lien, the taxpayer requested a collection due process hearing. In the CDP hearing, the taxpayer submitted an offer in compromise based on doubt as to liability and offered to pay $1. He disputed the IRS's proper mailing and his receipt of the statutory notice of deficiency. The IRS Appeals Office issued a notice of determination sustaining the collection action, and the taxpayer sought review by filing a petition in the Tax Court. The Tax Court (Judge Ashford) held that it was an abuse of discretion for the IRS Appeals Officer to sustain the collection action. Sections 6320(c) and 6330(c) require the Appeals Officer conducting the CDP hearing to verify that the requirements of applicable law and administrative procedure have been met. The Appeals Officer was unable to secure United States Postal Service From 3877 to show proof of mailing of the notice of deficiency. She also did not request the statutory notice of deficiency. She instead examined the IRS's Integrated Data Retrieval System (IDRS) to verify that the notice of deficiency had been mailed. In the Tax Court, the IRS stipulated that the IRS was unable to produce USPS Form 3877. The court held that "the Appeals officer had failed to properly perform the verification mandated by section 6330(c), i.e., to properly verify that the assessment of petitioner's 2010 income tax liability was preceded by a duly mailed notice of deficiency." Specifically, the court stated:

> Where a taxpayer alleges that the notice of deficiency was not properly mailed to him, he has "alleged an irregularity" … thereby requiring the Appeals officers, according to further IRS guidance, to do more than "rely solely" on IDRS; they must review: (1) a copy of the notice of deficiency and (2) the USPS Form 3877 or equivalent IRS certified mail list bearing a USPS stamp or the initials of a postal employee. …[T]he Appeals officer here acknowledges that she did not secure (and accordingly review) either of these documents before the notice of determination was issued to petitioner.

The court also rejected the IRS's belated production of USPS Form 3877 because the IRS had stipulated that it could not produce this form.

G. Innocent Spouse

H. Miscellaneous

1. The D.C. Circuit has reversed a federal district court and held that the IRS can charge fees for issuing PTINs. Montrois v. United States, 916 F.3d 1056 (D.C. Cir. 3/1/19). A group of tax return preparers filed a class action lawsuit in a U.S. District Court challenging the IRS's practice of charging a fee for issuing preparer tax identification numbers (PTINs). The tax return preparers argued that the IRS lacked authority under the Independent Offices Appropriations Act to charge a fee for issuing and renewing PTINs and that the IRS's decision to charge fees was arbitrary and capricious in violation of the Administrative Procedure Act. The U.S. District Court held that, although the IRS had statutory authority to require the use of PTINs by those who prepare tax returns for compensation, it lacked legal authority to charge fees for issuing PTINs. *Steele v. United States*, 119 A.F.T.R.2d 2017-2065 (D.D.C. 2017). The U.S. District Court declared all fees charged by the IRS for issuing PTINs unlawful, permanently enjoined the United States from charging such fees, and ordered the United States to refund all PTIN fees paid from September 1, 2010 to the present. *Steele v. United States*, 120 A.F.T.R. 2d 2017-5145 (D.D.C. 2017). The government appealed the U.S. District Court's decision to the U.S. Court of Appeals for the District of Columbia Circuit. In an opinion by Judge Srinivasan, the D.C. Circuit reversed the District Court's decision. As discussed in more detail below, the court held that the IRS acted within its authority under the Independent Offices Appropriations Act in charging tax return preparers a fee to obtain and renew PTINs and also concluded that the IRS's decision to charge a fee was not arbitrary and capricious. The court remanded the case to the U.S. District Court for further proceedings, including a determination of whether the amount of the PTIN fee unreasonably exceeds the costs to the IRS to issue and maintain PTINs.

The Independent Offices Appropriations Act provides the IRS with legal authority to charge a fee for issuing PTINs. The D.C. Circuit reviewed its own prior decisions and those of the U.S. Supreme Court and, based on this review, reasoned that the Independent Offices Appropriations Act does not authorize federal agencies to tax, which is a legislative power, but rather to impose reasonable fees for benefits conferred on identifiable beneficiaries. According to the court, "[t]o justify a fee under the [Independent Offices Appropriations] Act, then, an agency must show (i) that it provides some kind of service in exchange for the fee, (ii) that the service yields a specific benefit, and (iii) that the benefit is conferred upon identifiable individuals." The IRS, the court concluded, had met all of these requirements with respect to the fee charged for issuing a PTIN. The service provided by the IRS is the issuance of the PTIN, a unique identifying number for each tax-return preparer, and the maintenance of the database of PTINs, which enables preparers to use those numbers in place of their Social Security numbers on tax returns. This service yields a specific benefit, the court concluded, because it protects a tax-return preparer's identity by allowing the preparer to list the PTIN on returns rather than the preparer's social security number. The court also determined that this benefit is conferred upon identifiable individuals because tax-return preparers qualify as identifiable recipients for this purpose. Although practically anyone can obtain a PTIN, the benefit of PTINs is conferred upon identifiable individuals (those who apply for them), just as the benefit of the State Department's fee for issuing a passport is conferred upon identifiable individuals (those who apply for passports).

The IRS's decision to charge a fee for issuing PTINs was not arbitrary and capricious. Under relevant provisions of the Administrative Procedure Act, 5 U.S.C. § 706(2)(A), an agency's decision must be the product of reasoned decision-making. The tax return preparers challenging the PTIN fees argued that this requirement was not met because the 2010 regulations that originally established the PTIN fee stated that the fee would pay for the registered tax-return preparer program, which was ruled invalid in *Loving v. IRS*, 742 F.3d 1013 (D.C. Cir. 2014). The D.C. Circuit held, however, that the IRS had given adequate reasons for its decision to impose a fee independent of those rejected in *Loving*. Specifically, the court stated, "[w]hen the IRS reissued the PTIN fee regulations after *Loving*, it explained that PTINs would benefit preparers by protecting their confidential information and would improve tax compliance and administration."

- On May 24, 2019, the tax return preparers who challenged the IRS's ability to charge fees for issuing PTINs filed a petition for a writ of certiorari with the U.S. Supreme Court. The petition asks the Court to review the decision of the U.S. Court of Appeals for the District of Columbia

Circuit. *Montrois v. United States*, Docket No. 18-1493 (U.S. 5/24/19).

2. Another lesson on mailing a petition to the Tax Court: the date printed on a postage label purchased through the internet will be disregarded if the envelope also bears a U.S. Postal Service postmark. Jordan v. Commissioner, T.C. Memo. 2019-15 (3/4/19). The last day for the taxpayer to file a Tax Court petition was March 6, 2018. The taxpayer, who represented herself, printed a label from Endicia.com, an online postage provider, dated March 6, 2018. The envelope containing the petition also bore two U.S. Postal Service postmarks dated March 7 and March 20, 2018. The Tax Court received and filed the petition on March 26, 2018 which was twenty days after the date shown on the Endicia.com label. The Tax Court (Judge Buch) dismissed the petition as having been untimely filed by relying on Reg. § 301.7502-1(c)(1)(iii)(B)(3), which provides:

> If the envelope has a postmark made by the U.S. Postal Service in addition to a postmark not so made, the postmark that was not made by the U.S. Postal Service is disregarded, and whether the envelope was mailed in accordance with this paragraph (c)(1)(iii)(B) will be determined solely by applying the rule of paragraph (c)(1)(iii)(A) of this section [regarding envelopes nearing U.S. postmarks].

The court noted that, in *Pearson v. Commissioner*, 149 T.C. 424 (11/29/17), a majority of the court had held that internet-purchased postage may qualify as a postmark not made by the U.S. Postal Service under § 7502(b). Because the envelope with the taxpayer's petition bore a private postmark of March 6, 2018, and later U.S. Postal Service postmarks, the court gave effect to the U.S. Postal Service postmarks. Because both of the U.S. Postal Service postmarks were dated after the last day of the 90-day period for filing a petition with the Tax Court, the court granted the government's motion to dismiss for lack of jurisdiction. The court further held that, even if it were to give effect to the March 6 date of the private postmark, it would still have to dismiss for lack of jurisdiction because, under Reg. § 301.7502-1(c)(1)(iii)(B)(1)(ii), in order to treat the date on a private postmark as the date of mailing for purposes of the timely-mailed-is-timely-filed rule, the item must have been received by the relevant agency not later than the time when a properly addressed and mailed envelope sent by the same class of mail would ordinarily be received if it were postmarked at the same point of origin by the U.S. Postal Service. In this case, the court noted, "[a]ccording to USPS delivery standards, an item sent by First Class mail from Detroit should arrive in Washington, D.C., in three days," but the taxpayer's petition had arrived twenty days after the date of the private postmark.

- For a case in which the envelope sent by the taxpayer bore only a private postmark and the taxpayer prevailed, see *Tilden v. Commissioner*, 846 F.3d 882 (7th Cir. 1/13/17), *rev'g* T.C. Memo 2015-188 (9/22/15).

XI. WITHHOLDING AND EXCISE TAXES

A. Employment Taxes

B. Self-employment Taxes

1. 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.

2. 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

RECENT DEVELOPMENTS IN FEDERAL INCOME TAXATION

"Recent developments are just like ancient history, except they happened less long ago."

By

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State Bar of Texas Tax Section
First Wednesday Tax Update
September 4, 2019

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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

RECENT DEVELOPMENTS IN FEDERAL INCOME TAXATION

"Recent developments are just like ancient history, except they happened less long ago."

By

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State Br of Texas Tax Section
First Wednesday Tax Update
October 2, 2019

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I. ACCOUNTING

II. BUSINESS INCOME AND DEDUCTIONS

A. Income

1. What are a professional sports team's player contracts really worth? Nothing, says the IRS. Rev. Proc. 2019-18, 2019-18 I.R.B. 1077 (4/11/19). In this revenue procedure, the IRS has provided a safe harbor for a professional sports team to treat certain personnel contracts (including those of players, managers, and coaches) and rights to draft players as having a zero value for purposes of determining gain or loss to be recognized for federal income tax purposes from the trade of a personnel contract or a draft pick. The IRS provided this safe harbor in recognition of the fact that the value of professional sports personnel contracts fluctuates and is highly subjective. The safe harbor is designed to "avoid highly subjective, complex, lengthy, and expensive disputes between professional sports teams and the IRS regarding the value of personnel contracts" and the resulting amount of gain or loss from their disposition. The revenue procedure apples to trades after April 10, 2019, but teams can choose to apply the revenue procedure to any open year. To be eligible for the safe harbor, a professional sports team's trade of personnel contracts and draft picks must meet four requirements: **(1)** all parties to the trade that are subject to federal income tax in the U.S. must treat the trade in a manner consistent with the revenue procedure; **(2)** each team that is a party to the trade must trade a personnel contract or a draft pick and no party to the trade may transfer property other than a personnel contract, draft pick, or cash; **(3)** no personnel contract or draft pick traded is an amortizable § 197 intangible; and **(4)** the financial statements of the teams that are parties to the trade do not reflect assets or liabilities resulting from the trade other than cash. If the safe harbor applies to a trade, then the following five principles govern the tax treatment of the trade:

1. *Gain or loss generally not recognized.* Except the extent required by the fifth principle (below), a team making a trade within the safe harbor does not recognize gain or loss from the trade. (As described below, a team must recognize any gain or loss realized if it receives cash in the trade.)
2. *Only cash received is included in a team's amount realized.* A team that receives cash in a trade must include the cash in amount realiz d. Because personnel contracts and draft picks are treated as having a value of zero, a team that receives only these assets has an amount realized of zero.
3. *A team's basis in personnel contracts and draft picks received includes only cash provided.* A team that provides cash in exchange for personnel contracts or draft picks has a basis in the assets acquired equal to the cash provided. A team that provides only personnel contracts or draft picks has a basis in the assets received of zero.
4. *Cash provided must be allocated equally to personnel contracts or draft picks received.* A team that provides cash and receives more than one personnel contract or draft pick must determine its basis in the assets acquired by allocating the cash equally among the assets acquired.
5. *A team determines its gain or loss recognized by comparing its amount realized with the unrecovered basis of any personnel contracts and draft picks provided.* A team making a trade within the safe harbor must recognize gain or loss to the extent its amount realized (as determined under the second principle) exceeds or falls below its unrecovered basis in the personnel contracts and draft picks it provides. The character of any gain or loss recognized is determined under the normal rules, e.g., a team's gain or loss might be a § 1231 gain or loss and any gain a team recognizes might be ordinary under § 1245.

The revenue procedure provides the following four examples:

Example 1—Trade with no cash.

1. In 2018, Team A trades Player Contract 1 to Team B for Player Contract 2. The teams apply the safe harbor in this revenue procedure.
2. Neither Team A nor Team B has an amount realized or gain on the trade because neither team received cash in the trade. Team A has a $0 basis in Player Contract 2, and Team B has a $0 basis in Player Contract 1.

Example 2—One team provides cash in the trade.

1. The facts are the same as in Example 1, except Team A trades Player Contract 1 and $10x to Team B for Player Contract 2.
2. Team A has no amount realized or gain on the trade because Team A did not receive cash in the trade. Team A has a $10x basis in Player Contract 2, the amount of cash Team A provided to Team B in the trade. Team A's $10x basis is recovered through depreciation under Reg. § 1.167(a)-3(a) over the life of Player Contract 2.
3. Team B has a $10x amount realized on the trade because Team B received $10x from Team A in the trade. Team B must recognize $10x of gain, the excess of Team B's $10x amount realized over its $0 basis in the Player Contract 2 it traded. Team B's $10x gain is subject to the rules of §§ 1231 and 1245. Team B has a $0 basis in Player Contract 1 because Team B provided no cash to Team A in the trade.

Example 3—No cash in the trade, one team has unrecovered basis.

1. In 2019, Team C signs Player 3 to a contract (Player Contract 3) for 5 years. Under the terms of Player Contract 3, Team C pays Player 3 a $25x signing bonus in 2019. In each of 2019 and 2020, Team C takes a depreciation deduction under Reg. § 167(a)-3(a) of $5x for the $25x it paid to Player 3. In 2021, Team C trades Player Contract 3 to Team D for Player Contract 4, and the teams apply the safe harbor in this revenue procedure.

2. Neither Team C nor Team D has an amount realized or gain on the trade because neither team received cash in the trade. Because neither team provided cash in the trade, each team has a $0 basis in the contract it received in the trade.

3. Team C may deduct in 2021 a $15x loss under §§ 165 and Reg. § 1.167(a)-8, the excess of its unrecovered basis in Player Contract 3 over its amount realized of $0. Team C's $15x loss is subject to the rules of § 1231.

Example 4— One team provides cash and one team has an unrecovered basis.

1. The facts are the same as in Example 3, except Team D trades Player Contract 4 and $20x to Team C for Player Contract 3.

2. Team C has a $20x amount realized on the trade because Team C received $20x from Team D in the trade. Team C must recognize $5x of gain, the excess of Team C's $20x amount realized over its $15x basis in the Player Contract 3 it traded. Team C's $5x gain is subject to the rules of §§ 1231 and 1245. Team C has a $0 basis in Player Contract 4 because Team C provided no cash to Team D in the trade.

3. Team D has no amount realized or gain on the trade because Team D did not receive cash in the trade. Team D has a $20x basis in Player Contract 3, the amount of cash Team D provided to Team C in the trade. Team D's $20x basis is recovered through depreciation under Reg. § 1.167(a)-3(a) over the life of Player Contract 3.

Example 5—Allocation of basis among multiple contracts.

1. In 2019, Team E trades Player Contract 5 and $30x to Team F for Player Contract 6, Player Contract 7,and Player Contract 8. The teams apply the safe harbor in this revenue procedure.

2. Team E has no amount realized or gain on the trade because Team E did not receive cash in the trade. Under section 4.02(3), Team E has a $30x basis in Player Contract 6, Player Contract 7, and Player Contract 8, collectively. Team E has a basis of $10x in Player Contract 6, $10x in Player Contract 7, and $10x in Player Contract 8 because Team E allocates the $30x cash provided to Team F in the trade by dividing the basis equally among the three player contracts received in the trade. Team E's $10x basis of each player contract is recovered through depreciation under Reg. § 1.167(a)-3(a) over the life of the respective player contract.

3. Team F has a $30x amount realized on the trade because Team F received $30x from Team E in the trade. Team F must recognize $30x of gain, the excess of Team F's $30x amount realized over its $0 basis in the Player Contract 5 it traded. Team F's $30x gain is subject to the rules of §§ 1231 and 1245. Team F has a $0 basis in Player Contract 5 because Team F provided no cash to Team E in the trade.

B. Deductible Expenses versus Capitalization

C. Reasonable Compensation

D. Miscellaneous Deductions

1. The CEO and sole shareholder of a janitorial corporation used cocaine as a chick magnet, but can the corporation deduct the cleanup costs? Held, the price paid for the cocaine overdose death of the boss's girlfriend is not a deductible corporate business expense. Cavanaugh v. Commissioner, T.C. Memo. 2012-324 (11/26/12). James Cavanaugh the CEO and sole shareholder of Jani-King International took a holiday trip to the Cavanaugh's villa in St. Maarten with his 27 year-old girlfriend, a body guard and another female Jani-King employee. Unfortunately the girlfriend died from an overdose of cocaine. The girlfriend's mother sued the individuals and the corporation for wrongful death. The taxpayer's S corporation paid the full amount of the settlement, including a $250,000 reimbursement to Cavanaugh and claimed a business expense deduction. The Tax Court (Judge Holmes) began its opinion in this case as follows:

> Twenty-seven-year-old Colony Anne (Claire) Robinson left Texas in November 2002 for a Thanksgiving vacation in the Caribbean with her boyfriend, his bodyguard, and another employee of the company that he had spent decades building.

> She did not return home alive.
>
> The coroner's report showed a massive amount of illegal drugs in her body and concluded that they were the likely cause of her death. Her mother sued the boyfriend and his company for wrongful death. The parties settled. The company paid most of the $2.3 million settlement directly; the boyfriend contributed $250,000, which the company then reimbursed.

Siding with the IRS, Judge Holmes looked to the origin of the claim, which the court held to be applicable to the corporation's payment in settlement of the wrongful death claim. The court concluded that although the claim related to the conduct of the three corporate employees, the conduct was not related to the corporate business, i.e., its profit-seeking activities. The court also rejected the taxpayer's theory that the bodyguard supplied cocaine in the course of his employment as a bodyguard and enabler for the CEO. Further, the court rejected the taxpayer's argument that reimbursement of the taxpayer's contribution to the settlement was contractually required under a corporate indemnity agreement. In addition, the court found that the payment was not deductible under the theory that it was made to protect the corporation's business reputation because there was no evidence that underlay that theory.

- Judge Holmes distinguished and refused to follow *Kopp's Co. v. United States*, 636 F.2d 59 (4th Cir. 1980), in which the court upheld a corporation's deduction for a payment made to settle pending litigation against the corporation brought by an individual injured by the CEO's son who, while home on military leave and making "personal and permissive use of" a corporate-owned car, had an accident that severely injured the individual.

a. The corporation's deductions are vaporized like freebase on appeal. Cavanaugh v. Commissioner, 766 Fed. Appx. 98 (5th Cir. 3/29/19), *aff'g* T.C. Memo. 2012-324 (11/26/12). In a per curiam opinion, the U.S. Court of Appeals for the Fifth Circuit affirmed the Tax Court's decision. The court agreed with the Tax Court that, under *United States v. Gilmore*, 372 U.S. 39 (1963), the deductibility of the corporation's litigation expenses is determined by the origin and character of the claim against it, and not by the claim's potential consequences. The court rejected the taxpayer's argument that the *Gilmore* analysis does not apply when the corporation itself is named as a defendant in the litigation that is settled. Decisions holding otherwise, the court stated, such as *Kopp's Co. v. United States*, 636 F.2d 59 (4th Cir. 1980), "directly conflict with *Gilmore*, which is binding on this court." In this case, the court reasoned, although the board of directors of Jani-King International approved the settlement on the advice of counsel, the claim arose from the provision of cocaine by employees of Jani-King, a non-business activity, and not from their employment by Jani-King. Accordingly, the court held, the Tax Court properly disallowed the corporation's deduction of the settlement payment. The court also held that the Tax Court properly had disallowed the corporation's deduction of its reimbursement of James Cavanaugh for the $250,000 he had contributed. According to the court, Cavanaugh had waived the argument that the reimbursement was required by the corporation's by-laws, and the payment was a nondeductible voluntary payment by the corporation of another's legal expenses.

2. No, you can't plead the Fifth Amendment to avoid a deficiency assessment under § 280E and, duh, when your company's name is "THC, LLC," the IRS probably is going to figure out that you sell marijuana. Feinberg v. Commissioner, 916 F.3d 1330 (10th Cir. 2/26/19). This case had some weird facts: an LLC aptly but perhaps stupidly named Total Health Concepts, LLC ("THC, LLC") that had elected subchapter S status. And it had some procedural quirks: the Service agreed that the Tax Court's reasoning (failure to substantiate expenses) for upholding the asserted deficiency should be overturned, but the Tenth Circuit (Judge McHugh) nevertheless upheld the Tax Court's ultimate conclusion on the basis of § 280E. Section 280E disallows any deduction or credit otherwise allowable if such amount is paid or incurred in connection with a trade or business "if such trade or business (or the activities which comprise such trade or business) consists of trafficking in controlled substances …." The Tax Court had upheld the deficiency based upon the taxpayer's failure to substantiate expenses; however, the Tenth Circuit ruled that this was improper because the notice of deficiency itself did not raise the issue of substantiation. The Tenth Circuit nonetheless upheld the deficiency based upon the Service's argument that § 280E disallowed the taxpayer's deductions because the taxpayers had not met their burden of proving that the Service's determination that THC was unlawfully trafficking in a controlled substance was erroneous. The court rejected the taxpayers' argument that placing the burden of proof on them violated their Fifth Amendment privilege against self-incrimination. The court held that, although the Fifth Amendment provides protection against self-incrimination in criminal proceedings, it does not shift the burden of proof to the IRS in a civil tax matter. As a result, because the deficiency was based upon the Service's disallowance of deductions under § 280E, and because the taxpayer had failed to provide any evidence that it was not in the marijuana business, the Service's position was upheld. Although not mentioned by either court, the authors wonder, "What was the taxpayer thinking? The company's name was 'THC, LLC.' Didn't the taxpayer realize that might attract the Service's attention?"

3. Rats! We knew that we should have been architects or engineers instead of tax advisors. The 2017 Tax Cuts and Jobs Act, § 11011, added § 199A, thereby creating an unprecedented, new deduction for trade or business (and certain other) income earned by sole proprietors, partners of partnerships (including members of LLCs taxed as partnerships or as sole proprietorships), and shareholders of S corporations. The Consolidated Appropriations Act, 2018, Pub. L. No. 115-141, Division T, § 101 ("CAA 2018"), signed by the President on March 23, 2018, amended § 199A principally to address issues related to agricultural or horticultural cooperatives. New § 199A is intended to put owners of flow-through entities (but also including sole proprietorships) on par with C corporations that will benefit from the new reduced 21% corporate tax rate; however, in our view, the new provision actually makes many flow-through businesses even more tax-favored than they were under pre-TCJA law.

Big Picture. Oversimplifying a bit to preserve our readers' (and the authors') sanity, new § 199A essentially grants a special 20 percent deduction for "qualified business income" (principally, trade or business income, but not wages) of certain taxpayers (but not most personal service providers except those falling below an income threshold). In effect, then, new § 199A reduces the top marginal rate of certain taxpayers with respect to their trade or business income (but not wages) by 20 percent (i.e., the maximum 37 percent rate becomes 29.6 percent on qualifying business income assuming the taxpayer is not excluded from the benefits of the new statute). Most high-earning (over $415,000 taxable income if married filing jointly) professional service providers (including lawyers, accountants, investment advisors, physicians, etc., but *not* architects or engineers) are excluded from the benefits of new § 199A. Of course, the actual operation of new § 199A is considerably more complicated, but the highlights (lowlights?) are as summarized above.

Effective dates. Section 199A applies to taxable years beginning after 2017 and before 2026.

Initial Observations. Our initial, high-level observations of new § 199A are set forth below:

1. *How § 199A applies.* New § 199A is applied at the individual level of any qualifying taxpayer by first requiring a calculation of taxable income excluding the deduction allowed by § 199A and then allowing a special deduction of 20 percent of qualified business income against taxable income to determine a taxpayer's ultimate federal income tax liability. Thus, the deduction is *not* an above-the-line deduction allowed in determining adjusted gross income; it is a deduction that reduces taxable income. The deduction is available both to those who itemize deductions and those who take the standard deduction. The deduction cannot exceed the amount of the taxpayer's taxable income reduced by net capital gain. The § 199A deduction applies for income tax purposes; it does *not* reduce self-employment taxes. Query what states that piggyback off federal taxable income will do with respect to new § 199A. Presumably, the deduction will be disallowed for state income tax purposes.

2. *Eligible taxpayers.* Section 199A(a) provides that the deduction is available to "a taxpayer other than a corporation." The deduction of § 199A is available to individuals, estates, and trusts. For S corporation shareholders and partners, the deduction applies at the shareholder or partner level. Section 199A(f)(4) directs Treasury to issue regulations that address the application of § 199A to tiered entities.

3. *Qualified trades or businesses (or, what's so special about architect and engineers?)—§ 199A(d).* One component of the § 199A deduction is 20 percent of the taxpayer's qualified business income. To have qualified business income, the taxpayer must be engaged in a

qualified trade or business, which is defined as any trade or business *other than* (1) the trade or business of performing services as an employee, or (2) a specified service trade or business. A specified service trade or business is defined (by reference to Code § 1202(e)(3)(A)) as "any trade or business involving the performance of services in the fields of health, … law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees." Architects and engineers must be special, because they are excluded from the definition of a specified service trade or business. There is no reasoned explanation for this exclusion in the 2017 TCJA Conference Report. *Note:* taxpayers whose taxable income, determined without regard to the § 199A deduction, is below a specified threshold are not subject to the exclusion for specified service trades or businesses, i.e., these taxpayers can take the § 199A deduction even if they are doctors, lawyers, accountants etc. The thresholds are $315,000 for married taxpayers filing jointly and $157,500 for all other taxpayers. (These figures will be adjusted for inflation in years beginning after 2018.) Taxpayers whose taxable income exceeds these thresholds are subject to a phased reduction of the benefit of the § 199A deduction until taxable income reaches $415,000 for joint filers and $207,500 for all other taxpayers, at which point the service business cannot be treated as a qualified trade or business.

4. *Qualified business income—§ 199A(c).* One component of the § 199A deduction is 20 percent of the taxpayer's qualified business income, which is generally defined as the net amount from a qualified trade or business of items of income, gain, deduction, and loss included or allowed in determining taxable income. Excluded from the definition are: (1) income not effectively connected with the conduct of a trade or business in the United States, (2) specified investment-related items of income, gain, deduction, or loss, (3) amounts paid to an S corporation shareholder that are reasonable compensation, (4) guaranteed payments to a partner for services, (5) to the extent provided in regulations, payments to a partner for services rendered other than in the partner's capacity as a partner, and (6) qualified REIT dividends or qualified publicly traded partnership income (because these two categories are separate components of the § 199A deduction).

5. *Determination of the amount of the § 199A deduction—§ 199A(a)-(b).* Given the much-touted simplification thrust of the 2017 Tax Cuts and Jobs Act, determining the amount of a taxpayer's § 199A deduction is surprisingly complex. One way to approach the calculation is to think of the § 199A deduction as the sum of two buckets, subject to one limitation. *Bucket 1* is the sum of the following from all of the taxpayer's qualified trades or businesses, determined separately for each qualified trade or business: the lesser of (1) 20 percent of the qualified trade or business income with respect to the trade or business, or (2) the greater of (a) 50 percent of the W–2 wages with respect to the qualified trade or business, or (b) the sum of 25 percent of the W–2 wages with respect to the qualified trade or business, plus 2.5 percent of the unadjusted basis immediately after acquisition of all qualified property. (*Note:* this W-2 wages and capital limitation *does not apply* to taxpayers whose taxable income is below the $157,500/$315,000 thresholds mentioned earlier in connection with the definition of a qualified trade or business. For taxpayers below the thresholds, Bucket 1 is simply 20 percent of the qualified trade or business income. For taxpayers above the thresholds, the wage and capital limitation phases in and fully applies once taxable income reaches $207,500/$415,000.) *Bucket 2* is 20 percent of the sum of the taxpayer's qualified REIT dividends and qualified publicly traded partnership income. The *limitation* is that the sum of Buckets 1 and 2 cannot exceed the amount of the taxpayer's taxable income reduced by the taxpayer's net capital gain. Thus, a taxpayer's § 199A deduction is determined by adding together Buckets 1 and 2 and applying the limitation.

6. *Revised rules for cooperatives and their patrons.* The Consolidated Appropriations Act, 2018, Pub. L. No. 115-141, Division T, § 101, signed by the President on March 23, 2018, amended § 199A to fix what was commonly referred to as the "grain glitch." Under 199A as originally enacted, farmers selling goods to agricultural cooperatives were permitted to claim a deduction effectively equal to 20 percent of gross sales, while farmers selling goods to independent

buyers effectively could claim a deduction equal to 20 percent of net income. Some independent buyers argued that this difference created an unintended market preference for producers to sell to agricultural cooperatives. Under the amended version of § 199A, agricultural cooperatives would determine their deduction under rules set forth in § 199A(g) that are similar to those in old (and now repealed) section § 199. The § 199A deduction of an agricultural cooperative is equal to 9 percent of the lesser of (1) the cooperative's qualified production activities income, or (2) taxable income calculated without regard to specified items. The cooperative's § 199A deduction cannot exceed 50 percent of the W-2 wages paid of the cooperative. A cooperative can pass its § 199A deduction through to their farmer patrons. In addition, the legislation modified the original version of § 199A to eliminate the 20-percent deduction for qualified cooperative dividends received by a taxpayer other than a corporation. Instead, under the amended statute, taxpayers are entitled to a deduction equal to the lesser of 20 percent of net income recognized from agricultural and horticultural commodity sales or their overall taxable income, subject to a wage and capital limitation.

7. *An incentive for business profits rather than wages.* Given a choice, most taxpayers who qualify for the § 199A deduction would prefer to be compensated as an independent contractor (i.e., 1099 contractor) rather than as an employee (i.e., W-2 wages), unless employer-provided benefits dictate otherwise because, to the extent such compensation is "qualified business income," a taxpayer may benefit from the 20 percent deduction authorized by § 199A.

8. *The "Edwards/Gingrich loophole" for S corporations becomes more attractive.* New § 199A exacerbates the games currently played by S corporation shareholders regarding minimizing compensation income (salaries and bonuses) and maximizing residual income from the operations of the S corporation. For qualifying S corporation shareholders, minimizing compensation income not only will save on the Medicare portion of payroll taxes, but also will maximize any deduction available under new § 199A.

a. Let the games begin! Treasury and the Service have issued final regulations under § 199A. T.D. 9847, Qualified Business Income Deduction, 84 F.R. 2952 (2/8/19). The Treasury Department and the Service have finalized proposed regulations under § 199A (see REG-107892-18, Qualified Business Income, 83 F.R. 40884 (8/16/18)). The regulations address the following six general areas. In addition, Reg. § 1.643(f)-1 provides anti-avoidance rules for multiple trusts.

Operational rules. Reg. § 1.199A-1 provides guidance on the determination of the § 199A deduction. The operational rules define certain key terms, including qualified business income, qualified REIT dividends, qualified publicly traded partnership income, specified service trade or business, and W-2 wages. According to Reg. § 1.199A-1(b)(14), a "trade or business" is "a trade or business that is a trade or business under section 162 (a section 162 trade or business) other than performing services as an employee." In addition, if tangible or intangible property is rented or licensed to a trade or business conducted by the individual or a "relevant passthrough entity" (a partnership or S corporation owned directly or indirectly by at least one individual, estate, or trust) that is commonly controlled (within the meaning of Reg. § 1.199A-1(b)(1)(i)), then the rental or licensing activity is treated as a trade or business for purposes of § 199A even if the rental or licensing activity would not, on its own, rise to the level of a trade or business. The operational rules also provide guidance on computation of the § 199A deduction for those with taxable income below and above the \$157,500/\$315,000 thresholds mentioned earlier as well as rules for determining the carryover of negative amounts of qualified business income and negative amounts of combined qualified REIT dividends and qualified publicly traded partnership income. The regulations clarify that, if a taxpayer has an overall loss from combined qualified REIT dividends and qualified publicly traded partnership income, the overall loss does not affect the amount of the taxpayer's qualified business income and instead is carried forward separately to offset qualified REIT dividends and qualified publicly traded partnership income in the succeeding year. Reg. § 1.199A-1(c)(2)(i). The operational rules also provide rules that apply in certain special situations, such as Reg. § 1.199A-1(e)(1), which clarifies that the § 199A deduction has no effect on the adjusted basis of a partner's partnership interest or the adjusted basis of an S corporation shareholder's stock basis.

Determination of W-2 Wages and the Unadjusted Basis of Property. Reg. § 1.199A-2 provides rules for determining the amount of W-2 wages and the unadjusted basis immediately after acquisition (UBIA) of qualified property. The amount of W-2 wages and the UBIA of qualified property are relevant to taxpayers whose taxable incomes exceed the $157,500/$315,000 thresholds mentioned earlier. For taxpayers with taxable income in excess of these limits, one component of their § 199A deduction (*Bucket 1* described earlier) is the lesser of (1) 20 percent of the qualified trade or business income with respect to the trade or business, or (2) the greater of (a) 50 percent of the W-2 wages with respect to the qualified trade or business, or (b) the sum of 25 percent of the W-2 wages with respect to the qualified trade or business, plus 2.5 percent of the UBIA of all qualified property. The rules of Reg. § 1.199A-2 regarding W-2 wages generally follow the rules under former § 199 (the now-repealed domestic production activities deduction) but, unlike the rules under former § 199, the W-2 wage limitation in § 199A applies separately for each trade or business. The amount of W-2 wages allocable to each trade or business generally is determined according to the amount of deductions for those wages allocated to each trade or business. Wages must be "properly allocable" to qualified business income to be taken into account for purposes of § 199A, which means that the associated wage expense must be taken into account in determining qualified business income. In the case of partnerships and S corporations, a partner or S corporation shareholder's allocable share of wages must be determined in the same manner as that person's share of wage expenses. The regulations provide special rules for application of the W-2 wage limitation to situations in which a taxpayer acquires or disposes of a trade or business. Simultaneously with the issuance of these regulations, the Service issued Rev. Proc. 2019-11, 2019-9 I.R.B. 742 (1/18/19), which provides guidance on methods for calculating W–2 wages for purposes of § 199A. The regulations also provide guidance on determining the UBIA of qualified property. Reg. § 1.199A-2(c)(1) restates the statutory definition of qualified property, which is depreciable tangible property that is (1) held by, and available for use in, a trade or business at the close of the taxable year, (2) used in the production of qualified business income, and (3) for which the depreciable period has not ended before the close of the taxable year. The regulations clarify that UBIA is determined without regard to both depreciation and amounts that a taxpayer elects to treat as an expense (e.g., pursuant to § 179, 179B, or 179C) and that UBIA is determined as of the date the property is placed in service. Special rules address property transferred with a principal purpose of increasing the § 199A deduction, like-kind exchanges under § 1031, involuntary conversions under § 1033, subsequent improvements to qualified property, and allocation of UBIA among partners and S corporation shareholders.

Qualified Business Income, Qualified REIT Dividends, and Qualified Publicly Traded Partnership Income. Reg. § 1.199A-3 provides guidance on the determination of the components of the § 199A deduction: qualified business income (QBI), qualified REIT dividends, and qualified publicly traded partnership (PTP) income. The proposed regulations generally restate the statutory definitions of these terms. Among other significant rules, the regulations clarify that **(1)** gain or loss treated as ordinary income under § 751 is considered attributable to the trade or business conducted by the partnership and therefore can be QBI if the other requirements of § 199A are satisfied, **(2)** §1231 gain or loss is *not* QBI if the § 1231 "hotchpot" analysis results in these items becoming long-term capital gains and losses, and that §1231 gain or loss *is* QBI if the § 1231 analysis results in these items becoming ordinary (assuming all other requirements of § 199A are met), **(3)** losses previously suspended under §§ 465, 469, 704(d), or 1366(d) that are allowed in the current year are treated as items attributable to the trade or business in the current year, except that such losses carried over from taxable years ending before January 1, 2018, are not taken into account in a later year for purposes of computing QBI, and **(4)** net operating losses carried over from prior years are *not* taken into account in determining QBI for the current year, except that losses disallowed in a prior year by § 461(*l*) (the provision enacted by the 2017 TCJA that denies excess business losses for noncorporate taxpayers) *are* taken into account in determining QBI for the current year.

Aggregation Rules. Reg. § 1.199A-4 permits, but does not require, taxpayers to aggregate trades or businesses for purposes of determining the § 199A deduction if the requirements in Reg. § 1.199A-4(b)(1) are satisfied. Treasury and the Service declined to adopt the existing aggregation rules in Reg. § 1.469-4 that apply for purposes of the passive activity loss rules on the basis that those rules, which apply to "activities" rather than trades or businesses and which serve purposes somewhat different from those of § 199A, are inappropriate. Instead, the regulations permit aggregation if the following five requirements are met: (1) the same person, or group of persons, directly or indirectly owns 50 percent or more of each of the businesses to be aggregated, (2) the required level of ownership exists for the majority of the taxable year in which the items attributable to the trade or business are included in income, (3) all of the items attributable to each trade or business to be aggregated are reported on returns with the same taxable year (not taking into account short taxable years), (4) none of the aggregated businesses is a specified service trade or business, and (5) the trades or businesses to be aggregated meet at least two of three factors designed to demonstrate that the businesses really are part of a larger, integrated trade or business. The regulations also impose a consistency rule under which an individual who aggregates trades or businesses must consistently report the aggregated trades or businesses in subsequent taxable years. In addition, the regulations require that taxpayers attach to the relevant return a disclosure statement that identifies the trades or businesses that are aggregated.

Specified Service Trade or Business. Reg. § 1.199A-5 provides extensive guidance on the meaning of the term "specified service trade or business." For purposes of § 199A, a qualified trade or business is any trade or business *other than* (1) the trade or business of performing services as an employee, or (2) a specified service trade or business. Code § 199A(d)(2) defines a specified service trade or business (by reference to Code § 1202(e)(3)(A)) as "any trade or business involving the performance of services in the fields of health, … law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees." Architects and engineers are excluded. For taxpayers whose taxable incomes are below the $157,500/$315,000 thresholds mentioned earlier, a business is a qualified trade or business even if it is a specified service trade or business. The regulations provide guidance on what it means to be considered providing services in each of these categories. Regarding the last category, the regulations state that a trade or business in which the principal asset is the reputation or skill of one or more employees means any trade or business that consists of one or more of the following: (1) a trade or business in which a person receives fees, compensation, or other income for endorsing products or services, (2) a trade or business in which a person licenses or receives fees (or other income) for use of an individual's image, likeness, name, signature, voice, trademark, or symbols associated with that person's identity, or (3) receiving fees or other income for appearing at an event or on radio, television, or another media format. The regulations set forth several examples. The regulations also create a de minimis rule under which a trade or business (determined before application of the aggregation rules) is not a specified service trade or business if it has gross receipts of $25 million or less and less than 10 percent of its gross receipts is attributable the performance of services in a specified service trade or business, or if it has more than $25 million in gross receipts and less than 5 percent of its gross receipts is attributable the performance of services in a specified service trade or business.

Special Rules for Passthrough Entities, Publicly Traded Partnerships, Trusts, and Estates. Reg. § 1.199-6 provides guidance necessary for passthrough entities, publicly traded partnerships trusts, and estates to determine the § 199A deduction of the entity or its owners. The regulations provide computational steps for passthrough entities and publicly traded partnerships, and special rules for applying § 199A to trusts and decedents' estates.

Effective Dates. The regulations generally apply to taxable years ending after February 8, 2019, the date on which the final regulations were published in the Federal Register. Nevertheless, taxpayers can rely on the final regulations in their entirety, or on the proposed regulations published in the Federal Register on August 16, 2018 (see REG-107892-18, Qualified Business Income, 83 F.R. 40884 (8/16/18)) in their entirety, for taxable years ending in 2018. However, to prevent abuse, certain provisions of the regulations apply to taxable years ending after December 22, 2017, the date of enactment of the 2017 TCJA. In addition, Reg. § 1.643(f)-1, which provides anti-avoidance rules for multiple trusts, applies to taxable years ending after August 16, 2018.

a. The Service has issued a revenue procedure that provides guidance on methods for calculating W-2 wages for purposes of § 199A. Rev. Proc. 2019-11, 2019-9 I.R.B. 742 (1/18/19). This revenue procedure provides three methods for calculating "W-2 wages" as that term is defined in § 199A(b)(4) and Reg. § 1.199A-2. The first method (the unmodified Box method) allows for a simplified calculation while the second and third methods (the modified Box 1 method and the tracking wages method) provide greater accuracy. The methods are substantially similar to the methods provided in Rev. Proc. 2006-47, 2006-2 C.B. 869, which applied for purposes of former Code § 199. The revenue applies to taxable years ending after December 31, 2017.

b. The Service has provided a safe harbor under which a rental real estate enterprise will be treated as a trade or business solely for purposes of § 199A. Rev. Proc. 2019-38, 2019-42 I.R.B. ___ (9/24/19). Whether a rental real estate activity constitutes a trade or business for federal tax purposes has long been an area of uncertainty, and the significance of this uncertainty has been heightened by Congress's enactment of § 199A. To help mitigate this uncertainty, the Service has issued this revenue procedure to provide a safe harbor under which a rental real estate enterprise will be treated as a trade or business solely for purposes of § 199A and the regulations issued under that provision. (The revenue procedure is the final version of a proposed revenue procedure set forth in Notice 2019-7, 2019-9 I.R.B. 740 (1/18/19).) If a rental real estate enterprise does not fall within the safe harbor, it can still be treated as a trade or business if it otherwise meets the definition of trade or business in Reg. § 1.199A-1(b)(14). The proposed revenue procedure defines a "rental real estate enterprise" as "an interest in real property held for the production of rents [that] may consist of an interest in a single property or interests in multiple properties." Those relying on the revenue procedure must hold the interest directly or through a diregarded entity and must either treat each property held for the production of rents as a separate enterprise or treat all similar properties held for the production of rents (with certain exceptions) as a single enterprise. Commercial and residential real estate cannot be part of the same enterprise. Taxpayers that choose to treat similar properties as a single enterprise must continue to do so (including with respect to newly acquired similar properties) when the taxpayer continues to rely on the safe harbor, but a taxpayer that treats similar properties as separate enterprises can choose to treat similar properties as a single enterprise in future years. For a rental real estate enterprise to fall within the safe harbor, the following three requirements must be met:

1. Separate books and records are maintained to reflect income and expenses for each rental real estate enterprise;

2. For rental real estate enterprises that have been in existence fewer than four years, 250 or more hours of rental services are performed (as described in this revenue procedure) per year with respect to the rental enterprise. For rental real estate enterprises that have been in existence for at least four years, in any three of the five consecutive taxable years that end with the taxable year, 250 or more hours of rental services are performed (as described in this revenue procedure) per year with respect to the rental real estate enterprise; and

3. The taxpayer maintains contemporaneous records, including time reports, logs, or similar documents, regarding the following: (i) hours of all services performed; (ii) description of all services performed; (iii) dates on which such services were performed; and (iv) who performed the services. If services with respect to the rental real estate enterprise are performed by employees or independent contractors, the taxpayer may provide a description of the rental services performed by such employee or independent contractor, the amount of time such employee or independent contractor generally spends performing such services for the enterprise, and time, wage, or payment records for such employee or independent contractor. Such records are to be made available for inspection at the request of the IRS. The contemporaneous records requirement does not apply to taxable years beginning prior to January 1, 2020.

4. The taxpayer attaches to a timely filed original return (or an amended return in the case of 2018 only) a statement that describes the properties included in each enterprise, describes rental real estate properties acquired and disposed of during the taxable year, and represents that the requirements of the revenue procedure are satisfied.

The revenue procedure provides a definition of "rental services." The revenue procedure applies to taxable years ending after December 31, 2017. For 2018, taxpayers can rely on the safe harbor in this revenue procedure or the one in the proposed revenue procedure that was set forth in Notice 2019-7, 2019-9 I.R.B. 740 (1/18/19).

E. Depreciation & Amortization

F. Credits

G. Natural Resources Deductions & Credits

H. Loss Transactions, Bad Debts, and NOLs

I. At-Risk and Passive Activity Losses

III. INVESTMENT GAIN AND INCOME

A. Gains and Losses

B. Interest, Dividends, and Other Current Income

C. Profit-Seeking Individual Deductions

1. The IRS gets hoisted by its own petard, and in the process, we get an unusual lesson in "following the money" for purposes of the interest expense deduction limits under IRC § 163. Lipnick v. Commissioner, 153 T.C. No. 1 (8/28/19). Although the facts are a bit convoluted, this Tax Court opinion by Judge Lauber reaffirms the "follow the money" principles for determining deductible interest expense under IRC § 163, including for debt-financed partnership distributions and the aftermath thereof. The taxpayer's father held membership interests in several limited liability companies ("LLCs") classified as partnerships for federal income tax purposes. The LLCs owned and managed very profitable residential rental properties in the Washington, D.C., area. In 2009—*really??? . . . during the great recession??? . . . wow!*—the LLCs made nonrecourse debt-financed distributions to the taxpayer's father totaling approximately $80 million. The taxpayer's father used the proceeds of these debt-financed distributions to purchase investment assets that he held personally. Similarly, in 2012, the taxpayer's father received, directly and indirectly, yet another debt-financed distribution of approximately $1.7 million from a residential rental property limited partnership ("LP") in which he and his family limited partnership ("FLP") were partners. The taxpayer's father also used the proceeds of this debt-financed distribution to purchase investment assets that he held personally. For the years 2009-2012, pursuant to Notice 89-35, 1989-1 C.B. 675, and Temp. Reg. § 1.163-8T(a)(4)(i)(C), the taxpayer's father reported his allocable share of the LLCs' and the LP's interest expense (including the LP's interest expense passed through his FLP) as investment interest for purposes of the IRC § 163(d)(1) limitation on the deductibility of investment interest. (Incidentally, it appears that the taxpayer's father was able to deduct his entire allocable share of the LLCs' and LP's interest expense during the years 2009-2012 because the taxpayer's father had ample investment income during those years.) Midway through 2011, the taxpayer's father gave a portion of his membership interests in the LLCs to his taxpayer-son. Then, in October of 2012, the taxpayer's father died bequeathing his partnership interests in the LP and FLP to his taxpayer-son. The foregoing transfers from the father to the taxpayer-son were treated as part-gift/part-sale transactions because the father's allocable share of the LLCs' and LP's debt (including debt allocated via the FLP) was treated as an amount realized by the father, and an amount paid by the taxpayer-son, under Reg. § 1.752-1(h) and § 1.1001-2(a)(4)(v). In fact, the taxpayer's father had reported taxable capital gains of approximately $23 million from his "gift" of the LLC interests to his taxpayer-son in 2011. (Presumably, no capital gains were realized or recognized upon the taxpayer father's bequest of the LP and FLP interests to his taxpayer-son in 2012 due to the estate's stepped-up basis.) After receiving the foregoing LLC, LP, and FLP interests, the taxpayer-son did not continue to report his allocable share of the LLCs' and LP's interest expense as investment interest. Rather, the taxpayer-son reported his allocable share of the LLCs' and LP's interest expense for the years 2012 and 2013 as properly allocable to the underlying real estate assets and rental income of the LLCs and the LP. Accordingly, the taxpayer-son deducted his allocable shares of the interest expense against his allocable shares of the rental income. The IRS, noticing the change in treatment of the interest, audited the taxpayer-son (because the LLCs and the LP were not subject to TEFRA-partnership audit rules), disallowed the deduction of the interest expense against the rental income of the LLCs and the LP, and proposed deficiencies for 2012 and 2013 totaling approximately $500,000. (Presumably, unlike his father, the taxpayer-son did not have sufficient investment income to be able to fully deduct his allocable share of the interest expense from the LLCs and LP.)

- In support of his position that the interest expense was properly allocable to and deductible against the rental income of the LLCs and the LP (including debt allocated via the FLP), the taxpayer-son relied upon Reg. § 1.752-1(h) and § 1.1001-2(a)(4)(v) cited above as well as the regulations under IRC § 163. Specifically, Temp. Reg. § 1.163-8T(c)(3)(ii)(C) provides that if a taxpayer "takes property subject to debt," and no debt proceeds are disbursed to the taxpayer, the debt is treated as being used to acquire the property. Accordingly, the associated interest expense is allocated to the acquired property for purpose of the deduction limitations of IRC § 163. The taxpayer-son contended that even though his LLC interests were received via "gift," and the LP interest was received via a bequest, the taxpayer-son was allocated a share of LLCs' and the LP's debt, and he thus acquired his interests "subject to debt." Further, the taxpayer-son relied upon Notice 89-35, 1989-1 C.B. 675, which provides in relevant part that "in the case of debt proceeds allocated under [Reg. 1.163-8T] to the purchase of an interest in a passthrough entity (other than by way of a contribution to the capital of the entity), the debt proceeds and the associated interest expense shall be allocated among all of the assets of the entity using any reasonable method." The IRS argued that taxpayer-son was bound by the father's treatment of the interest as an investment expense because a "once investment interest, always investment interest" rule should apply. Moreover, the IRS argued that Temp. Reg. § 1.163-8T(c)(3)(ii)(C) was not relevant because the taxpayer-son did not actually "take [his LLC and LP interests] subject to a debt" as contemplated by the regulations and Notice 89-35; but rather, the rules of Reg. § 1.752-1(h) and § 1.1001-2(a)(4)(v) use such an approach for purposes of subchapter K, not IRC § 163. The Tax Court (Judge Lauber) disagreed with the IRS, however, citing Temp. Reg. § 1.163-8T(c)(3)(ii)(C) and Notice 89-35, 1989-1 C.B. 675, as noted above. Judge Lauber determined that the IRS's position had no authoritative support and that the taxpayer-son's position was correct. Judge Lauber wrote, "In short, whereas [the taxpayer's father] received a debt-financed distribution, the [taxpayer-son] is treated as having made a debt-financed acquisition of the partnership interests he acquired from [his father]." Therefore, reasoned Judge Lauber, the IRS's own Notice 89-35, 1989-1 C.B. 675, expressly allows the interest expense to be allocated to the real estate assets and income generated by the LLCs and LP (as was done by the taxpayer-son).

D. Section 121

E. Section 1031

F. Section 1033

G. Section 1035

H. Miscellaneous

IV. COMPENSATION ISSUES

A. Fringe Benefits

B. Qualified Deferred Compensation Plans

C. Nonqualified Deferred Compensation, Section 83, and Stock Options

D. Individual Retirement Accounts

1. A rollover that was deposited 62 days after withdrawal from an IRA was not taxable because it constituted a bookkeeping error and qualified for a hardship waiver. Burack v. Commissioner, T.C. Memo. 2019-83 (7/9/19). The taxpayer withdrew $524,981 from her IRA to purchase a home while waiting for her former home to sell. She planned to redeposit the funds in her IRA within the 60-day period permitted by § 408(d)(3)(A) for making a tax-free rollover of IRA funds. Pershing, LLC served as custodian of the IRA. The taxpayer's financial adviser was a representative of Capital Guardian, LLC. The relationship between Pershing and Capital Guardian was not entirely clear. Capital Guardian generated statements for the taxpayers IRA and the statements listed both Pershing and Capital Guardian. Pursuant to instructions from Capital Guardian, on Thursday, August 21, 2014, 57 days after the taxpayer's withdrawal, the taxpayer sent a check for $524,981 by overnight delivery to Capital Guardian, which received the check the next day. For reasons that are not clear, the check was not deposited at Pershing in the taxpayer's IRA until Tuesday, August 26, 2014, which was 62 days after the taxpayer's withdrawal. The IRS issued a notice of deficiency in which the IRS asserted that the taxpayer had to include the withdrawn funds in gross income because the taxpayer had not rolled them over within the required 60-day period. The Tax Court (Judge Ruwe) held that the taxpayer was entitled to treat the transaction as a tax-free rollover for two reasons. *First*, the court concluded that the withdrawn funds were not redeposited in a timely manner because of a bookkeeping error by Capital Guardian. "Because the check was received by Capital Guardian during the rollover period but not book-entered by Capital Guardian until after, we find that the late recording is due to a bookkeeping error." The court reasoned that the situation was analogous to that in *Wood v. Commissioner*, 93 T.C. 114 (1989), in which the court reached a similar conclusion when the taxpayer had transferred stock to Merrill Lynch within the 60-day period with instructions that it be deposited in the taxpayer's IRA, but Merrill Lynch deposited the stock in a nonqualified account before transferring it to the IRA after the 60-day period. *Second*, the court held that the taxpayer was eligible for a hardship waiver under § 408(d)(3)(I). As interpreted by Rev. Proc. 2003-16, 2003-1 C.B. 359, an automatic waiver under § 408(d)(3)(I) is granted if, prior to the expiration of the 60-day period, a financial institution receives funds on behalf of a taxpayer, the taxpayer follows all procedures required by the financial institution for depositing the funds into an eligible retirement plan (including giving instructions for deposit of the funds) and, "solely due to an error on the part of the financial institution, the funds are not deposited into an eligible retirement plan within the 60-day rollover period," if two conditions are satisfied: (1) the funds are deposited into an eligible retirement plan within 1 year from the beginning of the 60-day rollover period; and (2) if the financial institution had deposited the funds as instructed, it would have been a valid rollover. The court concluded that all requirements for an automatic hardship waiver were satisfied and that this served as an alternative basis for treating the taxpayer's withdrawal and contribution as a tax-free rollover.

V. PERSONAL INCOME AND DEDUCTIONS

VI. CORPORATIONS

A. Entity and Formation

B. Distributions and Redemptions

1. Thirty years after the Technical and Miscellaneous Revenue Act of 1988, the regulations under § 301 are proposed to be updated to make conforming changes. REG-21694-16, Updating Section 301 Regulations to Reflect Statutory Changes, 84 F.R. 11263 (3/26/19). The Technical and Miscellaneous Revenue Act of 1988 amended § 301(b)(1) and § 301(d), effective as if the amendments had been included in the Tax Reform Act of 1986, to eliminate certain distinctions that previously existed between corporate and non-corporate distributees and certain special rules for distributions to or from foreign corporations. As amended, these statutory provisions state that the amount of a corporate distribution is the amount of money received plus the fair market value of property received (§ 301(b)(1)), and that the basis of property received from a corporation is the fair market value of that property (§ 301(d)). These proposed amendments update Reg. § 1.301-1 to reflect these changes and make certain non-substantive changes including modifying cross-references and reorganizing some provisions. Although the proposed regulations would be effective when published as final regulations, the statutory changes that they reflect are already effective.

2. Treasury and the IRS have withdrawn the 2009 proposed regulations on allocation of consideration and allocation and recovery of basis in transactions involving corporate stock. REG-143686-07, The Allocation of Consideration and Allocation and Recovery of Basis in Transactions Involving Corporate Stock or Securities; Withdrawal, 84 F.R. 11686 (3/28/19). In 2009, Treasury and the IRS published proposed regulations under §§ 301, 302, 304, 351, 354, 356, 358, 368, 861, 1001, and 1016 regarding the recovery of stock basis in (1) § 301 distributions and transactions that are treated as § 301 distributions, and (2) sale and exchange transactions to which § 302(a) applies (including certain aspects of reorganization exchanges). The proposed regulations also provided the method for determining gain realized under § 356 and made a number of clarifying, but nonsubstantive, modifications to the rules for determining stock basis under § 358 resulting from a reorganization. The core principal underlying the rules was that each share of stock is a separate unit of property that can be sold or exchanged and the results of a transaction should be determined with respect to the consideration received in regard to each share. After considering comments submitted on the proposed regulations, Treasury and the IRS "determined that it is unlikely that approach of the 2009 Proposed Regulations can be implemented in comprehensive final regulations without significant modifications." Accordingly, Treasury and the IRS have withdrawn the 2009 proposed regulations and will continue to study the issues addressed in them "with a particular focus on issues surrounding sections 301(c)(2) and 304, and [Reg.] § 1.302-2(c)." The notice of withdrawal published in the Federal Register reiterates the belief of Treasury and the IRS in the core principle underlying the 2009 proposed regulations:

> The Treasury Department and the IRS continue to believe that under current law, the results of a section 301 distribution should derive from the consideration received by a shareholder in respect of each share of stock, notwithstanding designations otherwise. See *Johnson v. United States*, 435 F.2d 1257 (4th Cir. 1971). The Treasury Department and the IRS also continue to believe that, under current law, with respect to redemptions governed by section 302(d), any unrecovered basis in the redeemed stock of a shareholder may be shifted to other stock only if such an adjustment is a proper adjustment within the meaning of [Reg.] § 1.302-2(c). Not all shifts of a redeemed shareholder's unrecovered basis result in proper adjustments, and certain basis adjustments can lead to inappropriate results. See, e.g., Notice 2001-45, 2001-33 I.R.B. 129.

C. Liquidations

D. S Corporations

1. In line with the continuing expansion of eligible shareholders of subchapter S corporations, ESBTs now may have non-U.S. individuals as current beneficiaries. The 2017 Tax Cuts and Jobs Act, § 13541, makes a technical change to § 1361(c)(2)(B)(v) such that for 2018 and future years an "electing small business trust" (an "ESBT," as particularly defined in § 1361(e)) may have as a current beneficiary of the ESBT a "nonresident alien" individual. Under § 7701(b)(1)(B), a nonresident alien individual is someone who is neither a citizen nor a resident of the U.S. This change to § 1361 is permanent.

a. Final regulations address the treatment of ESBTs that are S corporation shareholders and have nonresident aliens as beneficiaries. T.D. 9868, Electing Small Business Trusts With Nonresident Aliens as Potential Current Beneficiaries, 84 F.R. 28214 (6/18/19). The Treasury Department and the IRS have finalized without change proposed regulations (REG-117062-18, Electing Small Business Trusts With Nonresident Aliens as Potential Current Beneficiaries, 84 F.R. 16415 (4/19/19)) addressing the treatment of electing small business trusts that are S corporation shareholders and have nonresident aliens as beneficiaries. The preamble to the proposed regulations noted the apparent assumption in the legislative history of the 2017 Tax Cuts and Jobs Act that an ESBT is subject to tax and therefore would be subject to tax on the ESBT's share of the S corporation's income. That preamble notes, however, that ESBTs can be grantor trusts for federal tax purposes with the result that the beneficiaries of the ESBT, not the ESBT itself, are subject to tax on the S corporation's income. If a nonresident alien is a beneficiary of an ESBT, this could lead to the S corporation's income not being subject to U.S. taxation (e.g., if the income is foreign-source). Therefore, according to the premable to the proposed regulations, the regulations generally

> would modify the allocation rules under § 1.641(c)-1 to require that the S corporation income of the ESBT be included in the S portion of the ESBT if that income otherwise would have been allocated to an NRA deemed owner under the grantor trust rules. Accordingly, such income would be taxed to the domestic ESBT by providing that, if the deemed owner is an NRA, the grantor portion of net income must be reallocated from the grantor portion of the ESBT to the ESBT's S portion.

The final regulations apply to all ESBTs after December 31, 2017.

E. Mergers, Acquisitions and Reorganizations

1. Maybe Chubby Checker said it best: ♫♪Jack be nimble; Jack be quick. Jack go under [COI] limbo stick.♪♫ Rev. Proc. 2018-12, 2018-6 I.R.B. 349 (1/24/18). Among other requirements, shareholders of a target corporation must maintain a "substantial" proprietary interest (i.e., stock) in an acquiring corporation to qualify a transaction for tax-deferred reorganization treatment under § 368. The regulations under § 368 set forth this shareholder continuity of interest ("COI") test. *See* Reg. § 1.368-1(e). The COI requirement is designed to prevent transactions that resemble sales from qualifying for tax-deferred reorganization treatment. Determining whether adequate COI exists for any particular transaction requires a comparison of the aggregate value of the target shareholders' stock before the reorganization with the aggregate value of their stock held in the acquiring corporation after the reorganization. The required level of COI—jokingly, the "limbo stick"—varies in height depending upon the type of reorganization attempted (e.g., 50 percent safe harbor for straight and forward triangular mergers; 80 percent statutory requirement for reverse triangular mergers). Put differently, if boot in a reorganization is too high, the COI limbo stick is tripped, and the shareholders of the target corporation will not qualify for nonrecognition treatment. Thus, regardless of the type of reorganization attempted, valuation of the target shareholders' pre- and post-reorganization stockholdings is critical for obtaining nonrecognition treatment.

Average trading price valuations allowed. Subject to other requirements and limitations, since 2011 Treasury and the IRS have permitted applicable COI tests to be met based upon <u>actual trading values</u> of publicly-traded acquiror stock on either the closing date (as defined) or the signing date (as defined). *See* Reg. § 1.368-(e)(2). Proposed regulations promulgated in 2011 for publicly-traded acquirors provide that, under specified circumstances, certain *average* trading price determinations of value are allowed for COI purposes. *See* Prop. Reg. § 1.368-1(e)(2)(vi)(A). Commentators noted that average trading price methods often are used to determine the actual consideration paid by an acquiring corporation to target shareholders under acquisition agreements, so those same commentators argued that such average trading price methods should be acceptable for COI purposes in lieu of actual trading prices on either the closing date or signing date. Rev. Proc. 2018-12 reflects Treasury's and the IRS's general agreement with the commentators that average trading price valuation methods are acceptable for COI purposes. The revenue procedure describes in detail the average trading price valuation methods that may be used for certain reorganization transactions. In particular, Rev. Proc. 2018-12 specifies that it applies to § 368(a)(1)(A) [mergers], (B) [stock for stock], (C) [stock for assets], and (G) [bankruptcy] reorganizations where the acquiring corporation is publicly traded. The safe harbor valuation methods outlined in the revenue procedure are (i) the average of the daily volume weighted average prices; (ii) the average of the average high-low daily prices; and (iii) the average of the daily closing prices. Of course, the specific requirements and limitations of Rev. Proc. 2018-12 are quite technical and must be carefully considered in connection with any potential reorganization transaction relying upon the revenue procedure for COI purposes. Nonetheless, the takeaway is that if one of the foregoing valuation methods is used to determine the stock consideration paid to target shareholders by a publicly-traded acquiring corporation in one of the specified reorganizations, then such method generally may be used for COI purposes as well. Rev. Proc. 2018-12 states that it applies only for COI purposes (not other valuation purposes) and that if the safe harbors of the revenue procedure are not met, the reorganization nevertheless may qualify for nonrecognition treatment under general federal tax principles. Finally, Rev. Proc. 2018-12 provides that the IRS will entertain requests for rulings and determination letters that fall outside the scope of the revenue procedure.

a. Taxpayers have sufficient guidance on continuity of interest and the proposed regulations issued in 2011 are withdrawn. REG-124627-11, Corporate Reorganizations; Guidance on the Measurement of Continuity of Interest, 84 F.R. 12169 (4/1/19). As indicated earlier, since 2011, final regulations under § 368 generally have permitted the determination of whether the continutity of interest (COI) requirement is satisfied to be based on the actual trading value of a publicly traded acquiring corporation's stock on either the closing date (as defined) or the signing date (as defined). *See* Reg. § 1.368-(e)(2). Proposed regulations promulgated in 2011 under § 368 provide in part that, under specified circumstances, certain average trading price determinations of value (rather than actual trading value on a specific date) are allowed for determining whether the COI requirement is satisfied. See Prop. Reg. § 1.368-1(e)(2)(vi)(A). Treasury and the IRS have concluded that current law generally provides sufficient guidance to taxpayers with respect to the COI requirement. Accordingly, the proposed regulations issued in 2011 have been withdrawn. However, because the IRS also has concluded that taxpayers in certain cirtcumstances should be able to rely on average stock valuation methods for purposes of measuring COI, the IRS issued Rev. Proc. 2018-12, discussed above, which specifies the circumstances in which the IRS will not challenge the use of certain average stock valuation methods in determining whether the COI requirement is satisfied.

2. Proposed regulations address the items of income and deduction that are included in the calculation of built-in gains and built-in losses under § 382(h). REG-125710-18, Regulations Under Section 382(h) Related to Built-In Gain and Loss, 84 F.R. 47455 (9/10/19). In an effort to minimize tax-motivated tax-free acquisitions, Congress has enacted various provisions that limit an acquiring corporation's ability to make use of an acquired corporation's tax attributes, such as its net operating losses and tax credits. One such provision, § 382, in very simplified terms, limits an acquiring corporation's ability to use an acquired corporation's pre-acquisition net operating losses. Somewhat more accurately, § 382 limits the ability of a ''loss corporation'' to offset its taxable income in periods subsequent to an ''ownership change'' with losses attributable to periods prior to that ownership change. The § 382 limitation imposed on a loss corporation's use of pre-change losses for each year subsequent to an ownership change generally is equal to the fair market value of the loss corporation immediately before the ownership change, multiplied by the applicable long-term tax-exempt rate as defined in § 382(f). A loss corporation's built-in gains and built-in losses affect its § 382 limitation. Section 382(h) provides rules relating to the determination of a loss corporation's built-in gains and losses as of the date of the ownership change. Generally, built-in gains recognized during the five-year period beginning on the date of the ownership change allow a loss corporation to increase its § 382 limitation, and built-in losses recognized during this same period are subject to the loss corporation's § 382 limitation. These proposed regulations address the items of income and deduction that are included in the calculation of built-in gains and losses under § 382 and reflect numerous changes made by the 2017 Tax Cuts and Jobs Act, which generated significant uncertainty regarding the application of § 382. The preamble to the proposed regulations indicates that Treasury and the IRS propose to withdraw the following IRS notices and incorporate their subject matter into the proposed regulations: Notice 87-79, Notice 90-27, Notice 2003-65, and Notice 2018-30. The proposed withdrawal of the prior IRS notices would be effective on the day after the proposed regulations are published as final regulations in the Federal Register. The proposed regulations generally would be effective for ownership changes occurring after the date on which they are published as final regulations in the Federal Register. However, taxpayers and their related parties (within the meaning of §§ 267(b) and 707(b)(1)) may apply the proposed regulations to any ownership change occurring during a taxable year with respect to which the period described in § 6511(a) (the limitations period on refund claims) has not expired, as long as the taxpayers and all of their related parties consistently apply the rules of these proposed regulations to such ownership change and all subsequent ownership changes that occur before the effective date of final regulations.

F. Corporate Divisions

2. The IRS has suspended two old revenue rulings on the active trade or business requirement of §§ 355(a)(1)(C) and (b). Rev. Rul. 2019-9, 2019-14 I.R.B. 925 (3/21/19). If certain requirements are met, § 355(a)(1) permits a corporation to distribute stock and securities of a controlled corporation to its shareholders and security holders without recognizing gain or loss and without income to the recipients. One of those requirements is that the distributing corporation and the controlled corporation must be engaged in an active trade or business immediately after the distribution. I.R.C. §§ 355(a)(1)(C), 355(b); Reg. § 1.355-3(a)(1)(i). To qualify, each trade or business must have been actively conducted throughout the five-year period ending on the date of the distribution. I.R.C. § 355(b)(2)(B); Reg. § 1.355-3(b)(3). Under Reg. § 1.355-3(b)(2)(ii), a "trade or business" is "a specific group of activities … being carried on by the corporation for the purpose of earning income or profit, and the activities included in such group include every operation that forms a part of, or a step in, the process of earning income or profit." The same regulation further provides that "[s]uch group of activities ordinarily must include the collection of income and the payment of expenses." In Rev. Rul. 57-464, 1957-2 C.B. 244, and Rev. Rul. 57-492, 1957-2 C.B. 247, the IRS concluded that certain activities conducted by a corporation did not meet the active trade or business requirement largely because the activities had failed to generate income. The IRS has suspended these rulings pending the completion of a study by the Treasury Department and the IRS. The study, which was previously announced in a statement on the IRS website dated September 25, 2018, concerns

> [possible] guidance to address whether a business can qualify as an [active trade or business] if entrepreneurial activities, as opposed to investment or other non-business

> activities, take place with the purpose of earning income in the future, but no income has yet been collected.

Pending completion of this study, the IRS will entertain requests for private letter rulings regarding the qualification as an active trade or business of corporations that have not collected income.

- A subsequent statement on the IRS website dated May 6, 2019, requests information in a number of categories to assist the IRS in identifying entrepreneurial activities that do not generate income but nevertheless should qualify as an active trade or business and explains the rationale for the study as follows:

> In recent years, the IRS has observed a significant increase in entrepreneurial ventures that collect little or no income during lengthy and expensive R&D phases, particularly pharmaceutical and technology ventures. However, these types of ventures often use the R&D phase to develop new products that will generate income in the future but do not collect income during that phase. If a corporation wishes to achieve a corporate-level business purpose by separating one R&D segment from an established business or from another R&D segment, the IRS's historical application of the income collection requirement likely would present a challenge for section 355 qualification.

G. Affiliated Corporations and Consolidated Returns

H. Miscellaneous Corporate Issues

VII. PARTNERSHIPS

A. Formation and Taxable Years

B. Allocations of Distributive Share, Partnership Debt, and Outside Basis

C. Distributions and Transactions Between the Partnership and Partners

1. No, you "May" not. T.D. 9833, Partnership Transactions Involving Equity Interests of a Partner, 83 F.R. 26580 (6/8/18). The Treasury Department and the Service have finalized, with only minor, nonsubstantive changes, Temp. Reg. § 1.337(d)-3T, Temp. Reg. § 1.732-1T(c), and corresponding proposed regulations issued in 2015. *See* T.D. 9722, Partnership Transactions Involving Equity Interests of a Partner, 80 F.R. 33402 (6/12/15). These regulations are intended to prevent a corporate partner from avoiding recognition under § 311(b) of corporate-level gain through transactions with a partnership involving equity interests of the corporate partner. An example of the type of transaction—commonly called a "May Company" transaction—is as follows: A corporation enters into a partnership and contributes appreciated property. The partnership then acquires stock of that corporate partner, and later makes a liquidating distribution of this stock to the corporate partner. Under § 731(a), the corporate partner does not recognize gain on the partnership's distribution of its stock. By means of this transaction, the corporation has disposed of the appreciated property it formerly held and acquired its own stock, permanently avoiding its gain in the appreciated property. If the corporation had directly exchanged the appreciated property for its own stock, § 311(b) would have required the corporation to recognize gain upon the exchange. Under the regulations, if a transaction has the effect of an exchange by a corporate partner of its interest in appreciated property for an interest in stock of the corporate partner owned, acquired, or distributed by a partnership (a "Section 337(d) Transaction"), the corporate partner must recognize gain under a "deemed redemption" rule.

Deemed Redemption Rule. Under the deemed redemption rule, a corporate partner in a partnership that engages in a Section 337(d) Transaction must recognize gain at the time, and to the extent, that the corporate partner's interest in appreciated property (other than stock of the corporate partner) is reduced in exchange for an increased interest in stock of the corporate partner. The complicated deemed redemption rule is triggered by the partnership's purchase of stock of a corporate partner (or stock or other equity interests of any corporation that controls the corporate partner within the meaning of § 304(c), except that § 318(a)(1) and (3) do not apply for that purpose); gain recognition can be triggered without a subsequent distribution. The regulations provide general principles that apply in determining the amount of appreciated property effectively exchanged for stock of the corporate partner. The corporate partner's economic interest with respect to both the stock of the corporate partner and all other appreciated property of the partnership must be determined based on all facts and circumstances, including the allocation and distribution rights set forth in the partnership agreement. The gain from the hypothetical sale used to compute gain under the deemed redemption rule is determined by applying the principles of § 704(c). The corporate partner's recognition of gain from a Section 337(d) Transaction triggers two basis adjustments. First, the partnership increases its adjusted basis in the appreciated property that is treated as the subject of a Section 337(d) Transaction by the amount of gain that the corporate partner recognizes with respect to that property as a result of the Section 337(d) Transaction regardless of whether the partnership has a § 754 election in effect. Second, the basis of the corporate partner's interest in the partnership is increased by the amount of gain the corporate partner recognizes. In limited circumstances, a partnership's acquisition of stock of the corporate partner does not have the effect of an exchange of appreciated property for that stock. For example, if a partnership with an operating business uses the cash generated in that business to purchase stock of the corporate partner, the deemed redemption rule does not apply because the corporate partner's share in appreciated property has not been reduced, and thus no exchange has occurred. The rules also do not apply if all interests in the partnership's capital and profits are held by members of an affiliated group (defined in § 1504(a)) that includes the corporate partner.

Distribution of Corporate Partner's Stock. A distribution of the corporate partner's stock to the corporate partner by the partnership also can trigger gain recognition. In addition to any gain previously recognized under the deemed redemption rule, if stock of a corporate partner is distributed to the corporate partner, the corporate partner must recognize gain to the extent that the partnership's basis in the distributed stock exceeds the corporate partner's basis in its partnership interest (as reduced by any cash distributed in the transaction) immediately before the distribution.

De Minimis Exception. The rules described above do not apply if a de minimis exception is satisfied. The de minimis exception applies if three conditions are met: (1) the corporate partner and any related persons own less than 5 percent of the partnership, (2) the partnership holds stock of the corporate partner worth less than 2 percent of the value of the partnership's gross assets, including stock of the corporate partner, and (3) the partnership has never, at any time, held more than $1 million in stock of the corporate partner or more than 2 percent of any particular class of stock of the corporate partner.

Effective Date. The final regulations apply to transactions that occur on or after June 12, 2015.

a. We thought the final regulations on partnership transactions involving equity interests of partners were already sufficiently complex. Proposed regulations modify certain key definitions. REG-135671-17, Partnership Transactions Involving Equity Interests of a Partner, 84 F.R. 11005 (3/25/19). These proposed regulations modify certain definitions in the final regulations that were issued in June 2018 to address so-called "May Company" transactions. See T.D. 9833, Partnership Transactions Involving Equity Interests of a Partner, 83 F.R. 26580 (6/8/18). The deemed redemption rule in the final regulations is triggered when a corporate partner exchanges an interest in appreciated property for an interest in "Stock of the Corporate Partner" owned, acquired, or distributed by the partnership. The final regulations generally define Stock of a Corporate Partner as stock, or other equity interests, including options, warrants, and similar interests, in the Corporate Partner or a corporation that controls the Corporate Partner within the meaning of § 304(c) (except that § 318(a)(1) and (3) do not apply). The propsod regulations would make four amendments to the final regulations. *First*, the final regulations excluded the attribution rules of § 318(a)(1) and (3) to limit for this purpose the meaning of control as defined in § 304(c) (generally stock possessing 50 percent or more of total combined votong power or value) to entities that own a direct or indirect interest in the corporate partner. Out of concern that excluding the attribution rules of § 318(a)(1) and (3) in determining control would allow taxpayers to structure transactions to eliminate gain on appreciated assets the proporsed regulations eliminate the exclusion of the attribution rules of § 318(a)(1) and (3) in determining control. Instead, according to the preamble, the proposed regulations implement the rationale for the prior exclusion of the attribution rules more directly:

> For the purpose of testing direct or indirect ownership of an interest in the Corporate Partner, ownership of Stock of the Corporate Partner would be attributed to an entity under section 318(a)(2) (except that the 50-percent ownership limitation in section

318(a)(2)(C) would not apply) and under Section 318(a)(4), but otherwise without regard to section 318. Thus, sections 318(a)(1), 318(a)(3), and 318(a)(5) would not apply for determining whether an entity directly or indirectly owns an interest in Stock of the Corporate Partner, but once an entity is found to directly or indirectly own an interest in such stock, then the section 304(c) control definition would apply in its entirety to determine whether the tested entity is a Controlling Corporation.

Second, the proposed regulations would modify the rule in the 2018 final regulations that Stock of a Corporate Partner does not include any stock or equity interest held or acquired by a partnership if all interests in the partnership's capital and profits are held by members of an affiliated group within the meaning of § 1504(a) (the "Affiliated Group Exception")." Out of concern that the Affiliated Group Exception may result in abuse, Treasury and the IRS propose to remove the Affiliated Group Exception from the regulations and have requested comments describing situations in which a more tailored version of it might be appropriate. *Third*, the proposed regulations would make certain modifications to the rule in the 2018 final regulations that Stock of the Corporate Partner includes interests in any entity to the extent that the value of the interest is attributable to Stock of the Corporate Partner (the so-called value rule). *Finally*, the proposed regulations would make certain conforming changes to the exception for certain dispositions of stock in Reg. § 1.337(d)–3(f)(2). The proposed regulations would be effective on the date they are published as final regulations in the Federal Register, but taxpayers may rely on them for transactions occurring on or after June 12, 2015, provided that the taxpayer consistently applies all of the proposed regulations to such transactions.

D. <u>Sales of Partnership Interests, Liquidations and Mergers</u>

1. The Tax Court gives the Service a lesson on the intersection of partnership and international taxation: subject to the exception in § 897(g), a foreign partner's gain from the redemption of its interest in a U.S. partnership was not income effectively connected with the conduct of a U.S. trade or business. <u>Grecian Magnesite Mining, Industrial & Shipping Co., S.A. v. Commissioner</u>, 149 T.C. 63 (7/13/17). The taxpayer, a corporation organized under the laws of Greece, held a 15 percent interest (later reduced to 12.6 percent) in Premier Chemicals, LLC, an LLC organized under Delaware law and classified for federal tax purposes as a partnership. The taxpayer accepted Premier's offer to redeem its partnership interest and received a total of $10.6 million, half of which was paid in 2008 and half in January 2009. The taxpayer and Premier agreed that the payment in January 2009 was deemed to have been paid on December 31, 2008, and that the taxpayer would not share in any profits or losses in 2009. The taxpayer realized $1 million of gain from the 2008 redemption payment and $5.2 million from the 2009 redemption payment. The taxpayer filed a return on Form 1120-F for 2008 on which it reported its distributive share of partnership items, but did not report any of the $1 million realized gain from the 2008 redemption payment. The taxpayer did not file a U.S. tax return for 2009 and thus did not report any of the $5.2 million realized gain from the 2009 redemption payment. The Service issued a notice of deficiency in which it asserted that all of the $6.2 million of realized gain was subject to U.S. tax because it was U.S.-source income effectively connected with the conduct of a U.S. trade or business. The taxpayer conceded that $2.2 million of the gain was subject to U.S. taxation pursuant to § 897(g), which treats amounts received by a foreign person from the sale or exchange of a partnership interest as amounts received from the sale or exchange of U.S. real property to the extent the amounts received are attributable to U.S. real property interests. The taxpayer's concession left $4 million of realized gain in dispute. The Tax Court (Judge Gustafson) held that the $4 million of disputed gain was not income effectively connected with the conduct of a U.S. trade or business and therefore was not subject to U.S. taxation. (The court found it unnecessary to interpret the tax treaty in effect between the U.S. and Greece because U.S. domestic law did not impose tax on the gain and the Service did not contend that the treaty imposed tax beyond U.S. domestic law.) In reaching this conclusion, the court addressed several issues.

The court first analyzed the nature of the gain realized by the taxpayer. Under § 736(b)(1), payments made in liquidation of the interest of a retiring partner that are made in exchange for the partner's interest in partnership property are treated as a distribution to the partner. Treatment as a distribution triggers § 731(a)(1), which provides that a partner recognizes gain from a distribution to the extent the amount of money received exceeds the partner's basis in the partnership interest and directs that the gain recognized "shall be considered as gain or loss from the sale or exchange of the partnership interest of the distributee partner." Pursuant to § 741, gain recognized from the sale or exchange of a partnership interest is "considered as gain or loss from the sale or exchange of a capital asset" except to the extent provided by § 751. (The Service did not contend that § 751 applied.) The taxpayer asserted that these provisions lead to the conclusion that the taxpayer's gain must be treated as arising from the sale of a single asset, its partnership interest, which is a capital asset. The government argued that the taxpayer's gain must be treated as arising from the sale of separate interests in each asset owned by the partnership. Otherwise, the government argued, the rule in § 897(g), which imposes U.S. tax to the extent amounts received from the sale of a partnership interest are attributable to U.S. real property interests, would be rendered inoperable. The court agreed with the taxpayer. Section 897(g), the court explained,

> actually reinforces our conclusion that the entity theory is the general rule for the sale or exchange of an interest in a partnership. Without such a general rule, there would be no need to carve out an exception to prevent U.S. real property interests from being swept into the indivisible capital asset treatment that section 741 otherwise prescribes.

The court noted that this conclusion is consistent with the court's prior decision in *Pollack v. Commissioner*, 69 T.C. 142 (1977).

The court next addressed whether the $4 million of disputed gain was effectively connected with the taxpayer's conduct of a U.S. trade or business. Pursuant to § 875(1), the taxpayer was considered to be engaged in a U.S. trade or business because the partnership of which it was a partner, Premier, was engaged in a U.S. trade or business. Accordingly, the issue was narrowed to whether the disputed gain was effectively connected with that trade or business. Because foreign-source income is considered effectively connected with a U.S. trade or business only in narrow circumstances, which the Service acknowledged were not present, the taxpayer's disputed gain could be considered effectively connected income only if it was U.S.-source income. Pursuant to the general rule of § 865(a), income from the sale of personal property by a nonresident is foreign-source income. Nonetheless, the Service asserted that an exception in § 865(e)(2)(A) applied (the "U.S. office rule"). Under the U.S. office rule, if a nonresident maintains an office or other fixed place of business in the United States, income from a sale of personal property is U.S.-source if the sale is attributable to that office or fixed place of business. The court assumed without deciding that Premier's U.S. office would be attributed to the taxpayer under § 864(c)(5). Accordingly, the issue was whether the gain was attributable to Premier's U.S. office. Under § 864(c)(5)(B), income is attributable to a U.S. office only if the U.S. office is a material factor in the production of the income and the U.S. office "regularly carries on activities of the type from which such income, gain, or loss is derived." The court concluded that neither of these requirements was satisfied. The court examined Reg. § 1.864-6(b)(2)(i) and concluded that, although Premier's business activities might have had the effect of increasing the value of the taxpayer's partnership interest, those business activities did not make Premier's U.S. office a material factor in the production of the taxpayer's gain. Further, the court concluded, even if the U.S. office was a material factor, Premier did not regularly carry on activities of the type from which the gain was derived because "Premier was not engaged in the business of buying or selling interests in itself and did not do so in the ordinary course of business." Because the disputed gain was not U.S.-source income, it was not effectively connected with the conduct of a U.S. trade or business and therefore not subject to U.S. taxation.

- In reaching its conclusion that the taxpayer's gain was not effectively connected with the conduct of a U.S. trade or business, the court rejected the Service's contrary conclusion in Rev. Rul. 91-32, 1991-1 C.B. 107. In that ruling, according to the court, the Service concluded

> that gain realized by a foreign partner from the disposition of an interest in a U.S. partnership should be analyzed asset by asset, and that, to the extent the assets of the partnership would give rise to effectively connected income if sold by the entity, the departing partner's pro rata share of such gain should be treated as effectively connected income.

The court characterized the analysis in the ruling as "cursory" and declined to follow it.

- The taxpayer should have reported some of its gain in 2008, should have filed a 2009 U.S. tax return reporting gain in 2009, and should have paid tax with respect to both years because all of the gain realized from the 2008 distribution and some of the gain realized from the 2009 distribution was attributable to U.S. real property interests held by the U.S. partnership, Premier. Nevertheless, the court declined to impose either the failure-to-file penalty of § 6651(a)(1) or the failure-to-pay penalty of § 6651(a)(2) because the taxpayer had relied on the advice of a CPA and therefore, in the court's view, established a reasonable cause, good faith defense.

b. Grecian Magnesite may have won the battle, but the Service has won the war with respect to a non-U.S. partner's sale of an interest in a partnership doing business in the U.S. (thereby codifying the Service's position in Rev. Rul. 91-32). The 2017 Tax Cuts and Jobs Act, § 13501, amended § 864(c) by adding § 864(c)(8). New § 864(c)(8) provides that, effective for dispositions after November 27, 2017, gain or loss on the sale or exchange of all (or any portion of) a partnership interest owned by a nonresident alien individual or a foreign corporation in a partnership engaged in any trade or business within the U.S. is treated as effectively connected with a U.S. trade or business (and therefore taxable by the U.S. unless provided otherwise by treaty) to the extent that the transferor would have had effectively connected gain or loss had the partnership sold all of its assets at fair market value as of the date of the sale or exchange. The amount of gain or loss treated as effectively connected under this rule is reduced by the amount of such gain or loss that is already taxable under § 897 (relating to U.S. real property interests). TCJA § 13501 makes corresponding changes to the withholding rules for effectively connected income under § 1446. These changes to § 864(c) and § 1446 statutorily reverse the Tax Court's and the D.C. Circuit's decisions and effectively adopt the Service's position in Rev. Rul. 91-32, 1991-1 C.B. 107. New § 864(c)(8) thus essentially renders the application of the U.S. office rule meaningless with respect to a partnership interest owned by a nonresident alien individual or a foreign corporation in a partnership engaged in a U.S. trade or business.

c. A victory in the DC Circuit for the taxpayer, but merely a pyrrhic victory for future, similarly-situated taxpayers. Grecian Magnesite Mining, Industrial & Shipping Co., S.A. v. Commissioner, 926 F.3d 819 (D.C. Cir. 6/11/19), *aff'g* 149 T.C. 63 (7/13/17). The U.S. Court of Appeals for the District of Columbia Ciruit, in an opinion by Judge Srinivasan, has upheld the Tax Court's decision that the $4 million of disputed gain was not effectively connected income by virtue of the U.S. office rule in § 865(e)(2)(A). (The Service did not appeal the Tax Court's first holding that, pursuant to the general rule of § 865(a), subject to a narrow exception in § 897(g) for U.S. real property interests, income from the sale of a partnership interest by a nonresident is a sale of personal property and therefore foreign-source income.) In reaching its decision affirming the Tax Court, the D.C. Circuit assumed without deciding, as did the Tax Court, that Permier's U.S. office would be attributed to the taxpayer under § 864(c)(5). Further, the D.C. Circuit agreed with the Tax Court that little deference should be given to the Service's position espoused in Rev. Rul. 91-32, 1991-1 C.B. 107, that gain realized by a foreign partner from the disposition of an interest in a U.S. partnership should be analyzed asset by asset. The Service made a technical argument that the Tax Court's decision was incorrect under canons of statutory interpretation, but the D.C. relied upon competing canons of statutory intepretation to side with the taxpayer.

E. Inside Basis Adjustments

F. Partnership Audit Rules

G. Miscellaneous

VIII. TAX SHELTERS

IX. EXEMPT ORGANIZATIONS AND CHARITABLE GIVING

X. TAX PROCEDURE

A. Interest, Penalties, and Prosecutions

1. Wait a minute, I thought we had a deal?! The IRS can assess and collect the full amount of restitution ordered in a criminal proceeding if the restitution is due immediately, even if the U.S. District Court that ordered it set a schedule of payments. Carpenter v.

Commissioner, 152 T.C. No. 12 (4/18/19). The taxpayer agreed to plead guilty in U.S. District Court to two counts of willfully making and subscribing to a false federal income tax return in violation of § 7206(1) and was sentenced to 27 months in prison and ordered to pay to the IRS restitution of $507,995. According to the District Court's order, "the restitution was 'due and payable immediately' and … 'if … [petitioner] can't pay' the entire amount of restitution, he must pay $100 per month beginning 60 days after his release from imprisonment … [and] 'continue making payments until the monies are repaid.'" Following his release from prison in May 2016, the taxpayer complied with this payment schedule. Pursuant to § 6201(4), the IRS assessed the full amount of restitution that had been ordered. The assessment occurred in January 2016, apparently while the taxpayer was still in prison. The IRS subsequently sent a final notice of intent to levy, which indicated that he owed approximately $760,000. This represented the restitution assessed plus interest and penalties. The IRS also filed a notice of federal tax lien. In response, the taxpayer requested a collection due process hearing. He initially indicated that Social Security disability benefits were his only source of income and requested collection alternatives. When the IRS informed him that he was ineligible for collection alternatives because he had failed to file returns for 2011 through 2015, he responded that he had mistakenly requested collection alternatives and that the IRS had no authority to collect because it had not issued a notice of deficiency. Following the CDP hearing, the IRS Appeals Division issued notices of determination upholding the collection action and the taxpayer sought review of the notices of determination in the Tax Court. The Tax Court (Judge Cohen) held that IRS Appeals did not abuse its discretion in sustaining the collection action. In reaching this conclusion, the court considered two issues. *First,* the court rejected the taxpayer's argument that § 6201(4) does not authorize the IRS to exercise administrative collection powers without obtaining a further order from the sentencing court. Section 6201(4) provides in part:

> A. The Secretary shall assess and collect the amount of restitution under an order pursuant to section 3556 of title 18, United States Code, for failure to pay any tax imposed under this title in the same manner as if such amount were such tax.
>
> B. An assessment of an amount of restitution under an order described in subparagraph (A) shall not be made before all appeals of such order are concluded and the right to make all such appeals has expired.

These provisions, the court reasoned, "indicate[] that Congress intended to grant the Secretary collection authority that is independent from title 18 and the underlying criminal procedures." *Second,* the court rejected the taxpayer's argument that the payment schedule set forth by the sentencing court limited the amount that the IRS could collect. The court distinguished between restitution due immediately with a schedule of payments, such as in the taxpayer's case, and restitution that the sentencing court expressly declines to order as due immediately. Only in the latter situation, the court reasoned, would the IRS be precluded from collecting more than the amounts due under the payment schedule. The court concluded that, unless the sentencing court expressly declines to order restitution payable immediately, the court's judgment imposes an immediate obligation on the defendant to pay the restitution. In this case, the court explained, the sentencing court did not decline to order the restitution as payable immediately, and therefore the IRS could assess and collect the entire amount owed despite the schedule of payments established by the sentencing court.

- The IRS conceded and abated the assessed interest and the additions to tax for late payment based on the Tax Court's decision in *Klein v. Commissioner*, 149 T.C. 341 (2017), in which the court held that the language of § 6201(4)(A) makes clear that "[t]he amount of restitution is not a 'tax imposed by' title 26"and that an assessment of restitution therefore does not trigger interest under § 6601(a) or an addition to tax for late payment under § 6651(a)(3).

- In *Muncy v. Commissioner*, T.C. Memo. 2017-83 (5/17/17), the Tax Court similarly examined the language in § 6201(4) and concluded that the amount of any deficiency (as defined in § 6211(a)) for a tax year is not reduced by any criminal restitution paid. In that decision, the court noted that "[a]ny amount paid to the IRS as restitution for taxes owed must be deducted from any civil judgment the IRS obtains to collect the same tax deficiency."

B. Discovery: Summonses and FOIA

60 Day IRA Rollovers--The Bookkeeping Exception

- Published on October 5, 2019

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I suppose that most people who are either in retirement or planning for retirement are familiar with the 60 day IRA rollover rule. This is the rule that says that when you take money out of your IRA, you don't have to pay tax on the distribution if you put the money back into your IRA (or another IRA) by the 60th day after you receive the distribution. The 60 day IRA rollover rule has been a friend to many taxpayers and a thorn to others. The rule tends to be applied very strictly by the Internal Revenue Service but sometimes with a little taste of grace by the Tax Court.

Burack v. Commissioner is a Tax Court Memorandum decision from this past summer in which the court found that the 60 day IRA rollover rule includes a brief bookkeeping exception or extension. Burack, T.C. Memo 2019-83 (July 8, 2019)

Here are the facts. Nancy sold her home in New York City, and before she received the proceeds, she bought a new home in Philadelphia. Knowing about the 60 day IRA rollover rule, she withdrew $500,000 from her IRA to help pay for the new house, and she planned to restore those funds to her IRA when she received the proceeds from the sale of her home in New York.

Nancy's IRA was with Capital Guardian, LLC/Pershing, LLC. The court was unsure about the relationship between Capital Guardian and Pershing but described Capital Guardian as Nancy's financial adviser and Pershing as the custodian of her IRA assets.

When Nancy sold her place in New York City, she wisely had a cashiers check issued on closing payable to "Pershing FBO Nancy J. Burack". The question was what to do with the check. Should she deposit it back to the account at Pershing directly or send it through to Capital Guardian so that they could deposit it back to the account at Pershing. Based on assurances given by Capital Guardian, Nancy decided to send the check to Capital Guardian where it arrived on the 58th day of the 60 day IRA rollover period.

Four days later Capital Guardian deposited the check into Nancy's IRA account at Pershing.

No mention was made by the court about what happened next, but I think it is reasonable to assume that Pershing's computer system issued a 1099 to Nancy because the 60 day IRA rollover rule was not satisfied and Pershing's computer system thought that it had no choice but to declare the rollover defective and the original distribution taxable. Then, I suspect that Nancy and her advisers excluded the income that was reported on the 1099 from Nancy's income tax return but perhaps included a helpful explanatory statement to the IRS's computer system when Nancy filed her income tax return, hoping that the explanatory statement might allay any concerns that the IRS computer system might have when it couldn't match the 1099 from Pershing's computer system with Nancy's income tax return. That is the way we do that sort of thing, isn't it?

Two and a half years later, the IRS issued notice of deficiency to Nancy saying that Nancy had not satisfied the 60 day IRA rollover rule and that she owed income tax on the entire amount of the $500,000 distribution.

The Tax Court found that Nancy was justified in sending the rollover check to Capital Guardian even though Pershing was custodian of her IRA. Nancy had no contact with Pershing; her IRA statements were from Capital Guardian, not Pershing; Capital Guardian and Pershing used the same account number for Nancy's IRA; and Nancy's IRA statements listed both Capital Guardian and Pershing. Importantly, Nancy dealt exclusively with Capital Guardian about the rollover. Based on these facts, the Tax Court concluded that Nancy did all that she needed to do to satisfy the 60 day IRA rollover rule and that she was excused for the extra two days which amounted to a harmless bookkeeping error by Capital Guardian and not Nancy.

It is tempting to say that this is a "so what" case that is limited to its facts and is unlikely to come up again. I am not so sure that is right. I think this is an important case for tax advisers to remember when nothing else seems to work and your client is staring a bad tax result straight in the face. So remember Nancy's case and hope that you never need it but that it may work if you do. No doubt that Nancy, her lawyer, Capital Guardian and Pershing were all very pleased with their outcome in the Tax Court and breathed a collective sigh of relief.

Jim Griffin

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U.S. Supreme Court finds in-state beneficiary inadequate for trust tax

TAX ALERT | June 21, 2019

On June 21, 2019, the U.S. Supreme Court issued a unanimous decision in *North Carolina Department of Revenue v. The Kimberly Rice Kaestner 1992 Family Trust*, affirming the North Carolina Supreme Court in holding that the presence of in-state beneficiaries alone did not authorize a state to tax trust income that has not been distributed to the beneficiaries and where the beneficiaries had: 1) no right to the income, and 2) were uncertain to ever receive a distribution from the trust.

Background

Recall that in 1992, Joseph Lee Rice, III, a New York resident, established a trust as the settlor (creator) under New York law for the benefit of his descendants. The trustee was also a New York resident at the time the trust was created, and a Connecticut resident during the tax periods at issue. The trust was subsequently divided into three separate share trusts, one of which was the Kimberley Rice Kaestner 1992 Family Trust (the Trust). The Trust's beneficiary, Kimberley Rice Kaestner (daughter to the settlor), had no connection to North Carolina until she moved to the state in 1997.

Throughout the periods at issue, Ms. Kaestner received no distributions from the Trust and was not aware of its existence until after moving to the state. Additionally, no funds were distributed during the periods, and she had no right to withdraw assets because distributions were at the sole discretion of the trustee. All the Trust's assets were located outside North Carolina, while the custodian of those assets resided in Boston, Massachusetts. All of the business of the Trust took place in New York, where the tax returns and accountings were prepared. The beneficiaries had no role in the management or investment decisions of the Trust. The only connection between the Trust and North Carolina was that Ms. Kaestner resided in the state for the periods in question

During tax years 2005 through 2008, North Carolina taxed all the worldwide income of the Trust on the basis that Ms. Kaestner, the sole beneficiary of the Trust, was a resident of the state. The Trust later challenged the North Carolina assessment, seeking a refund of prior-year taxes paid. The North Carolina Supreme Court found that a beneficiary living in the state did not create the necessary minimum contacts required under due process solely based on a beneficiary availing themselves of the benefits and protections of North Carolina law to subject the Trust to tax.

The petition for a writ of certiorari was granted by the U.S. Supreme Court on Jan. 11, 2019, and oral arguments were heard in mid-April.

For more information on the factual background of the case and the oral arguments in front of the U.S. Supreme Court, please read our alert, U.S. Supreme Court hears arguments in *Kaestner* trust tax nexus case.

The decision

Justice Sotomayor, writing for the Court, focused the issue on whether the Due Process Clause of the U.S. Constitution prohibited a state from taxing trusts based solely on the in-state residency of a trust beneficiary. Explaining that the Court uses a two-prong analysis in examining a tax law under the Due Process Clause, the Justice cited to the Due Process analysis in 1992's *Quill v. North Dakota* decision that requires: 1) "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax," and 2) "the income attributed to the state for tax purposes must be rationally related to values connected with the taxing state."

After reviewing various trust taxation case law, the Court further explained that the Due Process Clause demanded attention to the relationship between the trust party and the trust assets that a state seeks to tax. In the case of an in-state beneficiary, the Court noted that the Constitution required the beneficiary to have "some degree of possession, control, or enjoyment of the trust property, or a right to receive that property" before a tax could be sustained.

In applying this analysis, the Court noted that the Trust made no distributions to the beneficiary located in North Carolina in the years at issue. The other parties to the Trust, including the trustee and settlor, resided outside of North Carolina. The Trust administration was conducted in New York and Massachusetts and the trustee had no direct investments in North Carolina. The only connection the Trust had with the state was the presence of an in-state beneficiary.

Accordingly, the Court found that North Carolina's law (N.C. Gen. Stat. section 105-160.2) imposing a tax on a trust with only an in-state beneficiary as the sole connection to the state was unsustainable under the first prong of the Due Process Clause's minimum connection requirement. First, the beneficiaries did not receive any income from the Trust in the years at issue. Second, the beneficiaries had no right to demand trust income or otherwise control, possess or enjoy the trust assets — the distribution of trust assets was entirely in control of the trustee. Finally, the Court noted that there was no guarantee that trust assets would ever be distributed to any beneficiary of the Trust.

The Court did not need to continue the due process analysis under the second prong because the minimum connection was not found.

Importantly, the Court specifically noted that the opinion was limited to the specific facts presented, and that the decision was not intended to "imply approval or disapproval" of trust taxes based on the residence of beneficiaries that may have different access or control of trust assets not present in the *Kaestner* fact pattern.

Takeaways

The *Kaestner* decision marks the one-year anniversary of another state tax nexus decision, *South Dakota v. Wayfair*, a landmark case that addressed state tax nexus under the Commerce Clause of the U.S. Constitution. Though *Wayfair* overruled the physical presence standard mandated by *Quill v. North Dakota*, it did not address whether non-resident taxpayers had sufficient contact with the state to satisfy the minimum contact requirements under the Due Process Clause of the U.S. Constitution.

Considering the far-reaching implications of the Court's decision, *Kaestner* is one of the most important trust taxation cases considered by the Court in decades.

Another due process-related trust taxation challenge from Minnesota, *Fielding v. Commissioner of Revenue*, rejected a rule that taxed the trust based on the location of the grantor. *Fielding* is currently on petition to the Court and action on that petition is now anticipated with the *Kaestner* decision delivered.

Resident / nonresident trust taxation jurisdiction provisions are not limited to the definitions used by North Carolina and Minnesota, as a number of states impose taxes on a trust based upon one or more of these factors:

- The residency of the grantor of the trust at the time the trust became irrevocable (like the Minnesota law)
- The residency of the beneficiary or beneficiaries of the trust (like the North Carolina law)
- The residency of the trustee(s) of the trust
- The location where the trust is being administered

In the wake of this decision, trustees, trust administrators and trust planners should consider broad-scope trust residency reconciliations to determine whether past residency decisions are still applicable going forward and whether refund claims are available. Reconciliations may include reviewing the historic and current residence of the all the parties to a trust, including the beneficiary, grantor and trustee. Due to the notoriety and importance of the issue, we anticipate providing further guidance in the coming days.

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U.S. Supreme Court denies Fielding petition after Kaestner

TAX ALERT | July 02, 2019

On June 28, 2019, the U.S. Supreme Court denied the Minnesota Department of Revenue's petition for writ of certiorari following the Minnesota Supreme Court's decision in *Fielding v. Commissioner of Revenue*. Recall that the Minnesota Supreme Court found that the state's grantor-domicile rule, as applied to trusts that had only "extremely tenuous" contacts with Minnesota, was unconstitutional under the Due Process Clauses of the Minnesota and U.S. Constitutions. The court had noted that the relevant Minnesota connections were to the trustee, not to the Minnesota grantor who established the trust at an earlier time.

In its Feb. 4, 2019 reply brief to the U.S. Supreme Court, the Minnesota Department of Revenue had argued that *Fielding* should be combined with *Kaestner*, a challenge to North Carolina's tax on the undistributed income of a trust earned for the benefit of an in-state resident, because both cases involved due process issues arising from trust taxation. The U.S. Supreme Court ultimately did not combine the cases and *Kaestner* was decided independently on June 21, 2019. For more information on the *Kaestner* decision, please read our alert, U.S. Supreme Court finds in-state beneficiary inadequate for trust tax.

Takeaways

Although *Kaestner* was a narrow decision limited to the specific facts in the case, trusts and trust parties should be cognizant of *Fielding* and *Kaestner*, two cases addressing due process concerns with state trust taxation provisions. Beneficiaries, trustees and grantors should consider performing a reconciliation of the residency of those parties in order to determine whether refunds or exposure exists. Trusts should consider speaking to their tax advisers about the holdings in these cases when considering a trust's nexus footprint.

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TAX SECTION
State Bar of Texas

July 1, 2019

Via Federal eRulemaking Portal
at www.regulations.gov

Internal Revenue Service
CC:PA:LPD:PR (REG-120186-18)

Room 5203
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

RE: *Comments on Proposed Regulations Concerning the Deferral of Gain Recognition on Amounts Reinvested in Qualified Opportunity Funds*

Dear Ladies and Gentlemen:

On behalf of the Tax Section of the State Bar of Texas, I am pleased to submit the enclosed response to the request of the Department of the Treasury ("Treasury") and Internal Revenue Service (the "IRS" or "Service") in the Notice of Proposed Rulemaking (REG-120186-18) issued on April 17, 2019 (the "Proposed Regulations"). The Proposed Regulations provide guidance regarding the application of Section 1400Z-2 of the Internal Revenue Code of 1986, as amended (the "Code") that was enacted on December 22, 2017 by Section 11011 of "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018," Public Law 115-117 commonly referred to as the Tax Cuts and Jobs Act of 2017 (the "TCJA").

On behalf of the Tax Section of the State Bar of Texas, I am pleased to submit the enclosed comments on the Proposed Regulations.

1414 Colorado Street, Austin, TX 78701
(512) 427-1463 or (800) 204-2222

July 1, 2019

THE COMMENTS ENCLOSED WITH THIS LETTER ARE BEING PRESENTED ONLY ON BEHALF OF THE TAX SECTION OF THE STATE BAR OF TEXAS. THE COMMENTS SHOULD NOT BE CONSTRUED AS REPRESENTING THE POSITION OF THE BOARD OF DIRECTORS, THE EXECUTIVE COMMITTEE OR THE GENERAL MEMBERSHIP OF THE STATE BAR OF TEXAS. THE TAX SECTION, WHICH HAS SUBMITTED THESE COMMENTS, IS A VOLUNTARY SECTION OF MEMBERS COMPOSED OF LAWYERS PRACTICING IN A SPECIFIED AREA OF LAW.

THE COMMENTS ARE SUBMITTED AS A RESULT OF THE APPROVAL OF THE COMMITTEE ON GOVERNMENT SUBMISSIONS OF THE TAX SECTION AND PURSUANT TO THE PROCEDURES ADOPTED BY THE COUNCIL OF THE TAX SECTION, WHICH IS THE GOVERNING BODY OF THAT SECTION. NO APPROVAL OR DISAPPROVAL OF THE GENERAL MEMBERSHIP OF THIS SECTION HAS BEEN OBTAINED AND THE COMMENTS REPRESENT THE VIEWS OF THE MEMBERS OF THE TAX SECTION WHO PREPARED THEM.

We commend Treasury and the Service for the time and thought that has been put into preparing the Proposed Regulations, and we appreciate being extended the opportunity to submit comments with respect to the Proposed Regulations.

Sincerely,

Christina A. Mondrik, Chair
State Bar of Texas, Tax Section

July 1, 2019

COMMENTS ON PROPOSED REGULATIONS CONCERNING THE DEFERRAL OF GAIN RECOGNITION ON AMOUNTS REINVESTED IN QUALIFIED OPPORTUNITY FUNDS

These comments on the Proposed Regulations (the "Comments") are submitted on behalf of the Tax Section of the State Bar of Texas. The principal drafters of these Comments were Chris M. Goodrich, Vice Chair of the General Tax Committee, and Nathan Smithson, Co-Chair of the Partnership and Real Estate Tax Committee. Argyrios Saccopoulos reviewed the Comments and made substantive suggestions. Jeffry M. Blair also reviewed the Comments and made suggestions on behalf of the Committee on Government Submissions ("COGS").

Although members of the Tax Section who participated in preparing these Comments have clients who would be affected by the principles addressed by these Comments or have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

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I. INTRODUCTION

These Comments are provided in response to Treasury's and the IRS's requests for comments on the Proposed Regulations concerning the deferral of gain recognition on amounts reinvested in qualified opportunity funds. Code Section 1400Z-2 was enacted on December 22, 2017 as part of the TCJA. Code Section 1400Z-2 permits the deferral of certain gains on the sale of property where such funds are invested in a qualified opportunity fund (a "QOF"). As a result of such deferral, taxpayers making permissible investments may be able to defer the taxation of capital gains until the earlier of the date that such investment is sold or exchanged or December 31, 2026. In order for such investment to be valid, substantially all of the fund's assets must be timely invested in appropriate property.

The Proposed Regulations were issued to provide taxpayers with guidance with respect to the types of gains that may be deferred, timing of investments and methods for determining qualification within the Code Section 1400Z-2 rules. We commend Treasury and the IRS for its efforts in issuing the Proposed Regulations. We also appreciate the opportunity to comment on the Proposed Regulations.

We respectfully offer the comments and suggestions described below.

II. PROPOSED REGULATION SECTION 1.1400Z2(d)-1(b)(4) (Six Month Rule)

Under the Proposed Regulations, an investment vehicle must hold at least 90% of its assets in qualified opportunity zone property to qualify as a QOF. A QOF must meet this 90% test every six months. In addition, the Proposed Regulations require that if a QOF acquires interests in an entity, at least 70% of the tangible property owned or leased by that entity must be qualified opportunity zone property for that entity to be treated as engaged in a qualified opportunity zone business (a "QOZB") and be treated as qualified opportunity zone property.

Under Proposed Regulations section 1.1400Z2(d)-1(b)(4), rollover cash received by a QOF in the immediately preceding 6 months (i.e., cash in respect to which a taxpayer makes the election contemplated in Section 1400Z-2(a)(1)) does not need to be considered for purposes of the 90% test, provided the cash is continuously held as cash or invested in cash equivalents or debt instruments having terms of 18 months or less. However, this rule does not apply to cash held by partnerships or corporations that have issued qualified opportunity zone partnership interests or qualified opportunity zone stock to the QOF, respectively (either, a "QOF Subsidiary"). There appears to be a trap for the unwary in a situation where a QOF receives cash and due to some business need immediately invests that cash into a QOF Subsidiary. The trap is that the cash may count against the QOF Subsidiary's satisfaction of the 70% test (e.g., if the 31-month working capital safe harbor can't be met as of a testing date due to construction costs and scheduling not yet being known to the QOF Subsidiary in the first few months). This failure of the QOF Subsidiary to satisfy the 70% test in turn could result in the 90% test not being satisfied for QOF.

Proposed Regulations section 1.1400Z2(d)-1(b)(4) appears to have the purpose of giving taxpayers additional time within which to deploy recently received capital contributions, but a QOF Subsidiary could also need leeway in deploying capital, where there is a business need for the QOF to immediately invest cash into the QOF Subsidiary. Moreover, even without a business need to hold cash in a QOF Subsidiary, taxpayers should not be penalized for simply choosing to hold cash in the bank account of an operating subsidiary instead of a parent. Accordingly, we respectfully recommend that the six-month period contemplated in Proposed Regulation section 1.1400Z2(d)-1(b)(4) apply regardless of whether the QOF or its QOF Subsidiary is holding the cash. We believe that this 6 months leeway will allow the QOF Subsidiary sufficient time to satisfy the "reasonable working capital" exception (e.g., the 31-month working capital safe harbor).

III. PROPOSED REGULATIONS SECTION 1.1400Z2(a)-1(b)(2)(iii) (Section 1231 Gains)

Section 1231 property (which generally consists of depreciable property used in a trade or business) is subject to special treatment under the Code. Gains and losses from Section 1231 property are netted. If the netted section 1231 gains and losses for a year result in a net section 1231 gain, then such gain is treated as a long-term capital gain for federal income tax purposes. If the netted section 1231 gains and losses produce a net loss, then such loss is treated as an ordinary loss. Net section 1231 gains that receive capital gain treatment qualify as capital gain eligible for rollover treatment under Section 1400Z-2. Whether section 1231 gains are capital gains is determined at the partner level rather than the partnership level, and therefore a partner must combine all of their section 1231 gains and losses to determine if there is capital gain treatment. Since the determination as to whether a taxpayer has a net section 1231 gain can't be made until the end of that taxpayer's taxable year, Proposed Regulations section 1.1400Z2(a)-1(b)(2)(iii) indicates that the 180-day investment period for 1231 gain doesn't start to run until the last day of the tax year in which the 1231 gain would otherwise have been recognized (i.e. if such gain was not deferred under 1400Z-2). We believe that this sets up a trap for the unwary because an investment in a QOF prior to the last day of a year in which a 1231 gain is realized would be disqualified from Section 1400Z-2(a) treatment since the investment occurred prior to the start of the 180-day rollover period. We respectfully request that the IRS adopt a rule similar to partners electing deferral of partnership capital gains permitting the 180-day period to run from the last day of the partnership's taxable year ***or*** the date of sale (pursuant to Proposed Regulations section 1.1400Z2(a)-1(c)(2)(iii)). In such an instance, the taxpayer making the investment could continue to bear the risk that the amount of gains invested would not qualify as section 1231 gain, but could still have a chance for deferral treatment if the gain does qualify a net section 1231 gain.

IV. PROPOSED REGULATIONS SECTION 1.1400Z2(d)-1(d)(5)(vii) (31-Month Working Capital Safe Harbor)

In respect to the 31-month working capital safe harbor under Proposed Regulation section 1.1400Z2(d)-1(d)(5)(iv), we respectfully believe that a clarification may be needed. We respectfully believe that the reference in Proposed Regulation section 1.1400Z2(d)-1(d)(5)(vii) to "section 1400Z-2(d)(2)(D)(1)" should be changed to either "section 1400Z-2(d)(2)(D)" or "section 1400Z-2(d)(2)(D)(i)."

V. PROPOSED REGULATIONS SECTION 1.1400Z2(d)-1(d)(5)(ii)(A) (Intangible Property)

Proposed Regulations section 1.1400Z2(d)-1(d)(5)(ii)(A) provides that a substantial portion of a QOZB's intangible property must be used in the active conduct of that business in the relevant qualified opportunity zone ("OZ"). Proposed Regulations section 1.1400Z2(d)-1(d)(5)(ii)(A) defines "substantial portion" as forty percent. However, this proposed regulation fails to provide any rules for determining when and to what extent intangible property is used in or outside of an OZ.

Under most state property laws, intangible property is generally treated as being located where the owner of that property is located. A significant issue can arise where a business has several business locations. For example, a business could have a main management and operations headquarters within an OZ and a technology research and development facility located outside of an OZ. As between these two sites, the Proposed Regulations do not provide sufficient rules on how to determine or measure where the technology is located. Further, the Proposed Regulations do not explain whether or to what extent the requisite use of the intangible property should be treated as being used by the intangible property owner located in the OZ or the extent that the intangible property should be treated as used by customers located outside of the OZ.

We respectfully request additional guidance with respect to how to determine when and to what extent intangible property will be treated as used in the active conduct of a trade or business. In addition, Proposed Regulations section 1.1400Z2(d)-1(d)(5)(i)(C) provides that, if the management and operations necessary to generate 50% or more of the OZ business' gross income are performed in the OZ, then that business is considered to be conducted within the OZ. We respectfully recommend that a similar rule be adopted in respect to intangible property.

VI. PROPOSED REGULATIONS SECTION 1.1400Z2(d)-1(d)(5)(ii)(B)(2) (Triple-Net-Lease Definition)

Proposed Regulations section 1.1400Z2(d)-1(d)(5)(ii)(B)(2) refers to the term "triple-net-lease" with respect to real property but does not define it. The Proposed Regulations simply indicate that merely entering into a triple-net-lease with respect to real property owned by a taxpayer is not active conduct of a trade or business by such taxpayer. For purposes of Code Section 199A, IRS Notice 2019-07 defines a triple-net-lease as a lease which "requires the *tenant or lessee to pay* taxes, fees, and insurance, and to be responsible for maintenance activities for a property in addition to rent and utilities." Notice 2019-07, 2019-9 IRB 740 (Emphasis added.) However, courts have determined that the appropriate test for determining which taxpayer is able to take ordinary and necessary deduction under Code Section 162 with respect to the property subject to a triple-net-lease is not based on who bears the costs for ad valorem taxes, insurance, maintenance and utilities, but rather who performs the services attendant to dealing with the ad valorem taxes, insurance, maintenance and utilities. Consequently, if a landlord (or its employees, agents or contractors) performs the services attendant to dealing with the ad valorem taxes, insurance, maintenance and utilities, but the landlord has the right to bill the tenant for all expenses associated with ad valorem taxes, insurance, maintenance and utilities, plus perhaps a small percentage service fee (e.g., 1-3%), such a "landlord-performance" triple-net-lease should not disqualify the relevant real estate subject to that lease from being an active trade or business. We respectfully recommend that the Proposed Regulations be supplemented to clarify the circumstances under which a triple-net-lease will be treated as an active conduct of a trade or business.

VII. PROPOSED REGULATIONS SECTION 1.1400Z2(d)-1(c)(7) (Placed in Service Rule)

We believe that Proposed Regulations Section 1.1400Z2(d)-1(c)(7) should be clarified to permit a QOF to elect to have the original use of real property improvements measured either from when such property is placed in service for depreciation purposes or when the first (temporary or permanent) certificate of occupancy is granted under local law in respect to such real property. This formulation of the rule would avoid uncertainty in determining the date of original use in cases where there is a delay between the date on which construction of improvements is sufficiently complete to enable the real property's intended use and the date on which a tenant or others actually begin using that improvement, e.g., the initial lease up period for a multi-family residential apartments. Compare Treasury Regulations sections 1.46-3(d)(2), 1.150-2(c) and 1.179-4(e). Accordingly, we respectfully request that Proposed Regulations Section 1.1400Z2(d)-1(c)(7) be clarified to permit QOFs to elect to have the original use of real property improvements measured either from such property is placed in service for depreciation purposes or when the first (temporary or permanent) certificate of occupancy is granted under local law in respect to such real property.

VIII. PROPOSED REGULATIONS SECTION 1.1400Z2(d)-1(c)(5)) (90% Holding Period Requirement)

Proposed Regulations section 1.1400Z2(d)-1(c)(5) provides guidance with respect to the requirements that (1) a corporation or partnership qualify as a QOZB during "substantially all" of a QOF's holding period for interests thereof, and (2) tangible property must meet certain usage requirements during "substantially all" of the QOF's holding period thereof. In each case, "substantially all" of a holding period is now defined as 90% of the holding period.

This guidance may be difficult to administer in the context of annual tax accounting periods that include only portions of multi-year holding periods. A holding period will be ongoing as a QOF files yearly tax returns and reports the results of its asset tests, however, whether a QOF meets the 90% holding period requirement can only be correctly assessed in light of a full and completed holding period.

For example, if a QOF invests all of its assets in a QOF Subsidiary that fails to meet all of the QOZB requirements for a period of six months in its first year, then the initial period of non-qualification would represent more than 10% of the holding period until the QOF reaches a five-year holding period in the QOF Subsidiary equity. Proposed Regulations section 1.1400Z2(d)-1(c)(5) appears to require a QOF to report a failed asset test and pay a penalty tax during this time, since the term "holding period" cannot, without explicit guidance, include assumed future periods. However, once a five-year holding period is actually achieved, the QOF will, retrospectively, turn out to have been compliance with the holding period requirement for the entire five-year period.

In light of these difficulties, we respectfully request that Proposed Regulations section 1.1400Z2(d)-1(c)(5) be revised to permit taxpayers to elect to apply the 90% holding period requirement either (1) to the taxpayer's actual holding period as of a testing date or (2) the taxpayer's "projected holding period," which must include a reasonable assessment of asset qualification in future periods. To limit this accommodation, proposed regulations could limit a "projected holding period" to an overall ten-year period (in order to align with the ten-year holding period requirement of Code Section 1400Z-2(c)); or, if less in the case of tangible property, the remaining useful life of the asset as determined for federal income tax purposes.

In the event that this request is not adopted, we respectfully suggest that taxpayers should be provided an alternative test for a QOF parent to treat interests in a QOF Subsidiary as qualified opportunity zone business property during an initial start-up period of noncompliance with the QOZB rules, as the statutory language in Code Section 1400Z-2(d)(2)(B)(i)(II) and -2(d)(2)(C)(ii) seem to relax the need for strict QOZB compliance in the case of "new" entities that are "organized for purposes of being a qualified opportunity zone business." Such "new" entities could be explicitly granted a 1-year grace period for start-up operations to achieve full QOZB compliance, which, in the context of an expected ten-year holding period, would align with the 90% holding period requirement of the current Proposed Regulations.

IX. PROPOSED REGULATIONS SECTION 1.1400Z2(b)-1(c)(6)(iv)(D)(1)) (Allocation Percentage for Profits Interests)

Proposed Regulations section 1.1400Z2(b)-1(c)(6)(iv)(D)(1) requires a holder of a profits interest in a QOF to consider all allocations and distributions to have been made in respect of the profits interest based on the "highest share of residual profits" a mixed-funds partner would receive with respect to that profits interest.

We recognize that it is inappropriate for a profits interest received for services to qualify for the fair market value basis election under Code Section 1400Z-2(c). However, the chosen method for distinguishing between allocations and distributions to the qualifying and non-qualifying investments has a significant negative impact on qualifying investments in that even though every dollar of profit is not "residual," every dollar of profit must be allocated as if it were.

To illustrate, suppose that a sponsor puts up 10% of the capital in a QOF (which capital is funded by a valid capital gain rollover under Code Section 1400Z-2(a)), and is, in consideration of its management services, also entitled to a 20% carried interest after achieving a 8% internal rate of return. Profits that are earned below this 8% "hurdle" rate are allocated in a 90:10 ratio in accordance with capital. Once the hurdle is achieved, profits are allocated in a 72:28 ratio (because the investor's 90% bears a 20% carried interest). Of the amount allocated to the sponsor in this residual tier, about 64% is attributable to the carried interest (assume a $100 residual allocation of which $28 is allocated to the sponsor; $18 out of the $28, or about 64%, is carried interest). Because this "allocation percentage" of about 64% governs "all" allocations and distributions – even, apparently, those allocated below the hurdle – most of the sponsor's 8% return on its own capital investment, earned on exactly the same terms as the 90% investor, is artificially converted into deemed profits interest allocations that build up the capital account in respect of the non-qualifying investment, for which there is no tax-free exit under Code Section 1400Z-2(c).

A well-advised taxpayer can easily avoid the harsh outcome of this rule simply by holding a carried interest through a separate regarded entity. Choosing a different, equally valid route for allocating profits up the chain through tiers of partnerships to the ultimate holders therefore has a huge difference in the ultimate holders' tax liability, without any corresponding substantive difference.

In order to avoid creating disparate outcomes for essentially identical investments, we respectfully suggest that the allocations and distributions in respect of a profits interest be segregated from and measured as the excess beyond the allocations and distributions that are made in respect of the mixed-funds taxpayer's qualifying investment.

X. PROPOSED REGULATIONS SECTIONS 1.1400Z2(c)-1(b)(2)(i) & 1.1400Z2(c)-1(b)(2)(ii)(1) (Rules for Section 1400Z-2(c) Gain)

Proposed Regulations section 1.1400Z2(c)-1(b)(2)(i) provides that if an investor in an QOF is taxed as a partnership and makes the election contemplated in Section 1400Z-2(c) (the "FMV Basis Election") upon its sale of QOF interests after 10 years:

- The investor's basis in its qualifying investment in the QOF is adjusted immediately before the investor sells or exchanges such interest so that its basis equals the fair market value of such interest plus the investor's share of the QOF's partnership liabilities under Section 752; and

- The basis of the QOF's partnership assets are also adjusted, solely with respect to the investor, in a manner similar to the adjustments which would have been made to those assets if (i) the investor had purchased the interest for cash equal to the fair market value of those assets as of the effectiveness of the FMV Basis Election and (ii) the QOF partnership had a valid Section 754 election in effect. Thus, this rule appears to mitigate the potential negative consequences of the Code Section 751 hot asset rules.

The effect of these rules is to eliminate any gain upon the investor's sale or exchange of qualifying investment after a 10-year holding period, regardless of whether the investor has used net losses allocated by the QOF partnership and whether the investor has received substantial leveraged distributions for the QOF. These rules also avoid the creation of offsetting capital losses and ordinary income items under any technical partnership tax rules.

In contrast, Proposed Regulations section 1.1400Z2(c)-1(b)(2)(ii)(1) states that, provided the 10-year holding period is met, when a taxpayer owns an interest in an QOF and that QOF owns an QOF Subsidiary, that taxpayer may elect to exclude from that taxpayer's gross income (for the pertinent year of sale) any capital gain (including unrecaptured items under Section 1250), but not Section 1245 recapture income, separately stated on the Schedule K-1 issued by the QOF that is derived from the sale of QOF's qualified opportunity zone property (which by definition could include a QOF Subsidiary or qualified opportunity zone business property directly owned by the QOF), but not qualified opportunity zone business property directly owned by a QOF Subsidiary.

While Proposed Regulations section 1.1400Z2(c)-1(b)(2)(ii)(1) allows multi-asset QOFs to sell separate assets on different occasions and still achieve capital gain savings without forcing an investor to sell his or her entire interest in the QOF, using this election may be less advantageous than the investor selling his or her interest in the QOF since selling interest in the QOF allows the investor to avoid being taxed on any depreciation recapture taxable as ordinary income.

This result incentivizes well advised taxpayers to form unduly complicated "parallel QOF" structures to hold any investments that might be sold separately, even if such investments could more naturally be held in a single QOF, so that each asset may be exited through sale of QOF interests. Further, this result may not be consistent with the statute because Proposed Regulations section 1.1400Z2(c)-1(b)(2)(ii)(1) does not exclude the full amount realized upon the sale of qualified opportunity zone business property by a QOF or QOF Subsidiary. Specifically, the exclusion does not apply to any portion of the amount realized, such as depreciation recapture, which is taxed as ordinary income. Given that the language of Code Section 1400Z-2(c) operates through an increase of the tax basis of an investment to fair market value, excluding this ordinary income portion of the amount realized from the election available under Proposed Regulations section 1.1400Z2(c)-1(b)(2)(ii)(1) appears to be unduly restrictive because it fails to provide, in practical effect, a "basis increase" that accounts for the full fair market value of the sold investment. We respectfully request that the language of Proposed Regulations section 1.1400Z2(c)-1(b)(2)(ii)(1) be revised to operate similarly to Proposed Regulations section 1.1400Z2(c)-1(b)(2)(i).

We appreciate the opportunity to provide these comments and suggestions on the Proposed Regulations. Thank you for your consideration.

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6.	**Estate and Gift Tax**	**Celeste C. Lawton** Norton Rose Fulbright US LLP 1301 McKinney, Suite 5100 Houston, Texas 77010 *(713) 651-5278* celeste.lawton@nortonrosefulbright.com **Laurel Stephenson** Davis Stephenson, PLLC 100 Crescent Ct., Suite 440 Dallas, Texas 75201 *(214) 396-8800* laurel@davisstephenson.com **Carol Warley** RSM US LLP 1330 Post Oak Blvd., Suite 2400 Houston, Texas 77056 *(713) 625-3583* carol.warley@rsmus.com	**Andrew Wagnon** RSM US LLP 1330 Post Oak Blvd., Suite 2400 Houston, Texas 77056 *(713) 625-3500 or (713) 335-8641* Andrew.Wagnon@rsmus.com **Matthew S. Beard** Meadows, Collier, Reed, Cousins, Crouch & Ungerman, LLP 901 Main St., Suite 3700 Dallas, Texas 75202 *(214) 749-2450* mbeard@meadowscollier.com

<table>
<tr><td>7.</td><td>General Tax Issues</td><td>Prof. Bruce McGovern
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bmcgovern@stcl.edu

Prof. Bret Wells
George Butler Research Professor and
Associate Professor of Law
University of Houston Law School
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713-743-2502
bwells@central.uh.edu</td><td>Dustin Whittenburg
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<tr><td>8.</td><td>International Tax</td><td>John R. Strohmeyer
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</table>

9.	**Partnership and Real Estate**	**Nathan ("Nate") Smithson** Jackson Walker LLP 2323 Ross Avenue, Suite 600 Dallas, Texas 75201 *(214) 953-5641* nsmithson@jw.com **Leonora ("Lee") S. Meyercord** Thompson & Knight LLP 1722 Routh Street, Suite 1500 Dallas, Texas 75201 *(214) 969-1315* Lee.Meyercord@tklaw.com	**Preston ("Trip") Dyer** Winstead PC 2728 N. Harwood St., Suite 500 Dallas, Texas 75201 *(214) 745-5297* pdyer@winstead.com **Argyrios ("Argy") C. Saccopoulous** Jackson Walker LLP 100 Congress Ave., Suite 1100 Austin, Texas 78701 *(512) 236-2062* asaccopoulos@jw.com
10.	**Property Tax**	**Daniel Richard Smith** Popp Hutcheson PLLC 1301 S Mo PAC Expy Sutie 430 Austin, Texas 78746 *(512) 664-7625* Daniel.smith@property-tax.com	**Tracy Turner** Brusniack Turner Fine, LLP 17480 Dallas Pkwy, Ste 210 Dallas, Texas 75370 *(214) 295-6095* tracy@texaspropertytaxattorneys.com **Ryan James** Low Swinney Evans & James, PLLC 3305 Northland, Ste. 500 Austin, Texas 78731 *(512) 379-5800* rjames@lsejlaw.com
11.	**Solo and Small Firm**	**Sara Giddings** P.O. Box 1825 San Angelo, TX 76903 *(903) 436-2536* sgiddings@giddingslawfirm.com **Irina Barahona** Attorney at Law 10420 Montwood Dr., Ste. N. 125 El Paso, TX 79935 *(915) 228-4905* ibarahona@izblaw.com	

12.	**State and Local Tax**	**Stephen Long** Baker & McKenzie LLP 2001 Ross Ave., Suite 2300 Dallas, Texas 75201 *(214) 978-3086* stephen.long@bakermckenzie.com	**Matt Hunsaker** Baker Botts, L.L.P. 2001 Ross Avenue Dallas, Texas 75201 *(214) 953-6828* matt.hunsaker@bakerbotts.com **Will LeDoux** K&L Gates, LLP 1717 Main Street, Suite 2800 Dallas, Texas 75201 *(214) 939-4908* william.ledoux@klgates.com **Robin Robinson** Deloitte Tax LLP 500 West 2nd St., Ste. 1600 Austin, TX 78701 *(512) 226-4628* rorobinson@deloitte.com **Kristie Iatrou** Texas Comptroller of Public Accounts 1700 N. Congress Avenue, Suite 320 Austin, Texas 78701 *512-463-4915* kristie.iatrou@cpa.texas.gov
13.	**Tax Controversy**	**Mike A. Villa** Meadows, Collier, Reed, Cousins, Crouch & Ungerman, LLP 901 Main Street, Suite 3700 Dallas, Texas 75202 *(214) 749-2405* mvilla@meadowscollier.com **Juan Vasquez** Chamberlain, Hrdlicka, White, Williams & Aughtry LLP Houston, Texas 77002 *713-658-1818* juan.vasquez@chamberlainlaw.com	**Bucky Brannen** Baker Botts LLP 2001 Ross Avenue Dallas, Texas 75201-2980 *(214) 953-6619* bucky.brannen@bakerbotts.com **Uzoma Alexander Eze** Eze Law Firm 440 Cobia Dr. Suite 602 Katy, Texas 77494 *(212) 847-0054* Uzoma@ezeenergytaxlaw.com **David C. Gair** Gray Reed & McGraw, P.C. 1601 Elm Street, Suite 4600 Dallas, Texas 75201 *(214) 954-4135* dgair@grayreed.com

14.	**Tax-Exempt Finance**	**Peter D. Smith** Norton Rose Fulbright 98 San Jacinto Blvd., Suite 1100 Austin, Texas 78701 *(512) 536-3090* peter.smith@nortonrosefulbright.com **Adam Harden** 300 Convent St, Suite 2100 San Antonio, Texas 78205 *(210) 270-7120* adam.harden@nortonrosefulbright.com	
15.	**Tax-Exempt Organizations**	**Katherine ('Katy") David** Clark Hill Strasburger , LLP 2301 Broadway Street San Antonio, TX 78215 *(210) 250-6122* katy.david@clarkhillstrasburger.com **Terri Lynn Helge** Associate Dean Texas A&M University School of Law 1515 Commerce Street Fort Worth, Texas 76102-6509 *(817) 429-8050* thelge@law.tamu.edu	**Kathleen ('Katie') Gerber** Thompson & Knight, LLP 333 Clay St., Suite 3300 Houston, Texas 77002 *(713) 951-5868* katie.gerber@tklaw.com
16.	**Government Submissions**	**Sam Megally** K&L Gates, LLP 1717 Main Street, Suite 2800 Dallas, Texas 75201 *(214) 939-5491* sam.megally@klgates.com	**Jason Freeman** Freeman Law, PLLC 2595 Dallas Parkway, Suite 420 Frisco, Texas 75034 *(214) 984-3410* Jason@freemanlaw-pllc.com **Jeffry M. Blair** Hunton Andrews Kurth, LLP 1445 Ross Avenue, Suite 3700 Dallas, Texas 75202 *(214) 468-3306* jblair@huntonak.com

17.	**Newsletter**	**Michelle Spiegel** Norton Rose Fulbright US LLP 1301 McKinney, Suite 5100 Houston, Texas 77010 *(713) 651-5164* michelle.spiegel@nortonrosefulbright.com	**Aaron Borden** Meadows, Collier, Reed, Cousins, Crouch & Ungerman, LLP 901 Main Street, Suite 3700 Dallas, Texas 75202 (214) 749-2402 aborden@meadowscollier.com
18.	**Tax Law in a Day**	**Renesha Fountain** Chamberlain, Hrdlicka, White, Williams & Aughtry 1200 Smith Street, Ste. 1400 Houston, Texas 77002 *(713) 658-2517* renesha.fountain@chamberlainlaw.com	**Harriet Wessel** Mondrik & Associates 11044 Research Blvd., Ste. B-400 Austin, Texas 78759 *(512) 542-9300* hwessel@mondriklaw.com
19.	**Pro Bono**	**Rachael Rubenstein** Clark Hill Strasburger, LLP 2301 Broadway Street San Antonio, TX 78215 *(210) 250-6006* rachael.rubenstein@clarkhillstrasburger.com **Robert D. Probasco** Texas A&M University School of Law 307 W. 7th Street, Suite LL50 Fort Worth, Texas 76102 *214-335-7549* probasco@law.tamu.edu	**Jaime Vasquez** Chamberlain, Hrdlicka, White, Williams & Aughtry, LLP 112 East Pecan Street, St 1450 San Antonio, Texas 78205 *(210) 507-6508* jaime.vasquez@chamberlainlaw.com **Tiffany Hamil** Law Office of Tiffany Hamil 6220 Campbell Rd., Suite 203 Dallas, Texas 75248 *(214) 369-0909* dfwtaxadvisor@gmail.com
20.	**Leadership Academy**	**Robert C. Morris** Norton Rose Fulbright US LLP 1301 McKinney, Suite 5100 Houston, Texas 77010 *(713) 651-8404* robert.morris@nortonrosefulbright.com	TBD
21.	**Section Representative to the State Bar Board**	**The Honorable Judge Elizabeth A. Copeland** United States Tax Court 400 Second Street, NW Room 223 Washington , DC 20217 jcopeland@ustaxcourt.gov	

22.	**Law School Outreach and Scholarship**	**Audrey Morris** Internal Revenue Service MC 2000 NDAL 13th Floor 4050 Alpha Road Dallas, Texas 75244 *(469) 801-1112* audrey.m.morris@irscounsel.treas.gov	**Abbey B. Garber (Outreach)** Thompson & Knight 1722 Routh Street, Suite 1500 Dallas, Texas 75201 *(214) 969-1640* Abbey.Garber@tklaw.com **Prof. Alyson Outenreath (Scholarship)** Professor of Law Texas Tech University School of Law 1802 Hartford, Lubbock, Texas 79409 *806-834-8690* alyson.outenreath@ttu.edu

TAX SECTION OF
THE STATE BAR OF TEXAS

2019 – 2020 CALENDAR

June 2019	
Thurs - Fri 6/13-14/19	**SBOT Annual Meeting** JW Marriott Hotel 110 E 2nd St. Austin, Texas 78701 (512) 474-4777
Wed - Fri 6/12-14/19	**Leadership Academy Austin Session (with Annual Meeting)** Norton Rose Fulbright 98 San Jacinto Blvd, Ste 1100 Austin, Texas 78701 (512) 474-5201
Thursday 6/13/19	**Tax Section Council / Planning Retreat** JW Marriott Hotel Austin, Texas 78701 12:00 p.m. - 3:00 p.m.
Thursday 6/13/19	**2019 Tax Section Annual Meeting Speaker's Dinner** Second Bar + Kitchen 200 Congress Ave, Austin, TX 78701 (512) 827-2750
Thursday 6/13/19	**Presentation of Outstanding Texas Tax Lawyer** Award Presentation at State Bar Annual Meeting, Speakers' Dinner Second Bar + Kitchen 200 Congress Ave. Austin, TX 78701 (512) 827-2750
Friday 6/14/19	**2019 Tax Section Annual Meeting Program** JW Marriott Hotel 110 E 2nd St. Austin, Texas 78701 (512) 474-4777
Friday 6/14/19	**Interview of 2019 Tax Legend** **Presentation During Tax Section Annual Meeting Program** JW Marriott Hotel 110 E 2nd St. Austin, Texas 78701 (512) 474-4777

July 2019	
Thursday 7/4/19	**July 4th Holiday**
Thur - Sat 07/18-20/19	**Texas Bar College** Summer School Moody Gardens Hotel, Spa & Convention Center Seven Hope Boulevard Galveston, TX 77554
?	**Tax Section Budget Deadline** (Budget must be submitted to State Bar of Texas)
Monday 7/29/19	**SBOT Chair and Treasurer Training** Texas Law Center 1414 Colorado St. Austin, TX 78701 10:30 a.m. – 2:30 p.m.
August 2019	
Thurs – Fri 8/1-2/19	**Advanced Tax Law Course** Hilton Houston Westchase 9999 Westheimer Houston TX 77042 (713) 974-1000
Tuesday 8/6/19	**Officers' Call** 4:00 p.m.
Fri – Sat 8/8-9/19	**Officers' Retreat** Dallas, Texas
Thurs – Tues 8/8-13/19	**American Bar Association Annual Meeting** San Francisco Marriott Marquis, San Francisco, CA
Friday 8/16/19	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 1-800-270-2297 Conference Code: 15109392 11:00 a.m.
Friday 8/23/19	**Meeting of Council, Committee Chairs, and Committee Vice Chairs** Norton Rose Fulbright US LLP 1301 McKinney, Suite 5100 Houston, Texas 77010 (48th Floor) 10:30 a.m. – 12:30 p.m. w/lunch Dial In: 866-203-7023 Conference Code: 12777252# Security Passcode: None – at the prompt press *

Sept 2019	
?	**Deadline for Submissions to State Bar of Texas Board of Directors Meeting Agenda**
Monday 9/2/19	**Labor Day Holiday**
Wednesday 9/4/19	**Officers' Call** 2:00 p.m.
Monday 9/9/19	**Tax Court Pro Bono Calendar Call-El Paso**
Thurs – Sat 9/12-14/19	**ABA Business Law Section Annual Meeting** Washington DC
Thursday 9/12/19	**Deadline for Chair to Appoint Nominating Committee** (Bylaws 4.10029
Thursday 9/12/19	**Tax Court Pro Bono Calendar Call-Lubbock**
Thursday 09/12/19	**Law School Outreach – Texas Tech School of Law**
Thursday 9/12/19	**Deadline for Appointment of Tax Section Nominating Committee**
Friday 9/13/19	**Submission Deadline – Texas Tax Lawyer (Fall Edition)** Submit to TTL Editor: Michelle Spiegel michelle.spiegel@nortonrosefulbright.com
Thurs - Fri 9/19-20/19	**Leadership Academy Houston Session** **[cancelled due to flooding]**
Friday 9/20/19	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 1-800-270-2297 Conference Code: 15109392 11:00 a.m.
Thursday 9/26/19	**Law School Outreach – Texas A&M School of Law**
Sun - Tues 9/29 –10/1/19	**Rosh Hashanah (Religious Holiday)**

Oct 2019	
Thurs-Sat 10/3-5/19	**ABA Tax Section Joint Fall Meeting** San Francisco, CA
Tues - Weds 10/8-9/19	**Yom Kippur (Religious Holiday)**
Wednesday 10/9/19	**Law School Outreach – University of North Texas** 12:00 p.m.
Wednesday 10/9/19	**Officers' Call** 2:00 p.m.
Sun - Sun 10/13-20/19	**Sukkot (Religious Holiday)**
Monday 10/14/19	**Columbus Day Holiday**
Tuesday 10/15/19	**Tax Court Pro Bono Calendar Call –Dallas**
Friday 10/18/19	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 1-800-270-2297 Conference Code: 15109392 11:00 a.m.
Tues - Fri 10/22-25/19	**Council on State Taxation (COST) 50th Annual Meeting** JW Marriott, Washington DC
Friday 10/25/19	**Council of Chairs Meeting** Texas Law Center 1414 Colorado St. Austin, TX 78701 10:30 a.m. – 2:30 p.m.
Fri - Sat 10/25-26/19	**National Association of State Bar Tax Sections ("NASBTS") Annual Meeting** (members may attend at their own expense) Alston & Bird, LLP 950 F Street, NW Washington, DC 20004
Thursday 10/31/19	**Insurance Renewal is Due** **Note Premium Paid by Big Bar!**

Nov 2019	
Friday 11/1/19	**Meeting of Council** Norton Rose Fulbright US LLP 1301 McKinney, Suite 5100 Houston, Texas 77010 (48th Floor) 10:30 a.m. – 12:30 p.m. w/lunch Dial In: 866-203-7023 Conference Code: 12777252# Security Passcode: None – at the prompt press *
Monday 11/4/19	**Tax Court Pro Bono Calendar Call-Houston**
Wednesday 11/6/19	**Officers' Call** 2:00 p.m.
Thurs - Fri 11/7-8/19	**Austin Chapter CPA Annual Tax Conference** Norris Conference Center, Austin, Texas
Monday 11/11/19	**Veterans Day Holiday**
Tuesday 11/12/19	**Annual Meeting Deadline for submitting to SBOT date and time preferences for CLE programs, section meetings, council meetings, socials and special events**
Tuesday 11/14-15/19	**Texas Taxpayers and Research Association (TTARA) Annual Meeting** Austin, TX
Friday 11/15/19	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 1-800-270-2297 Conference Code: 15109392 11:00 a.m.
Monday 11/18/19	**Tax Court Pro Bono Calendar Call - Dallas**
Tuesday 11/20/19	**Comptroller Annual Briefing** 9 a.m. – 4:30 p.m. Robert E Johnson Legislative Office Building 1501 Congress Ave Austin, TX
Thurs-Fri 11/21-22/19	**International Tax Law Symposium** Houston, TX
Thursday 11/28-29/19	**Thanksgiving Day Holiday**

Dec. 2019	
Monday 12/2/19	**Tax Court Pro Bono Calendar Call-Dallas & San Antonio**
Wednesday 12/4/19	**Officers' Call** 2:00 p.m.
Wed - Thurs 12/4-6/19	**UT Law 66th Annual Taxation Conference** AT&T Conference Center, Austin, Texas
Monday 12/9/19	**Tax Court Pro Bono Calendar Call-Houston**
Friday 12/20/19	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 1-800-270-2297 Conference Code: 15109392 11:00 a.m.
Sun - Mon 12/22-30/19	**Hanukkah (Other Holiday)**
Wednesday 12/25/19	**Christmas (Other Holiday)**
Jan. 2020	**Tax Court Pro Bono Calendar Call-Dallas & San Antonio**
Wednesday 1/1/20	**New Year's Day Holiday**
?	**Nomination Period Opens for 2019 Outstanding Texas Tax Lawyer Award** • Nominations due April 1, 2020 • Nomination forms to be posted on website • Submit nomination forms to Tax Section Secretary: Dan Baucum
Wednesday 1/8/20	**Officers' Call** 2:00 p.m.
?	**Deadline for receipt of information for SBOT Board of Directors Meeting Agenda**
Monday 1/6/20	**Annual Meeting Deadline: Submit programming for the registration brochure, CLE topics, speakers, and speaker contact information and firms**
Monday 1/6/20	**Tax Court Pro Bono Calendar Call-Dallas**

Friday 1/10/20	**Meeting of Council, Committee Chairs, and Committee Vice Chairs** Polsinelli PC 2950 N. Harwood, Suite 2100 Dallas, Texas 75201
Friday 1/17/20	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 1-800-270-2297 Conference Code: 15109392 11:00 a.m.
Monday 1/20/20	**Martin Luther King Jr. Day (Holiday)**
Thurs - Fri 1/23-24/20	**Leadership Academy San Antonio Session (with Graduation Ceremony)** Chamberlain Hrdlicka 112 E Pecan St Ste 1450 San Antonio TX 78205 (210) 253-8383
Friday 1/24/20	**Submission Deadline – Texas Tax Lawyer (Winter Edition)** Submit to TTL Editor: Michelle Spiegel michelle.spiegel@nortonrosefulbright.com
Monday 1/27/20	**Tax Court Pro Bono Calendar Call-Houston**
Thurs - Sat 1/30-2/1/20	**American Bar Association Section of Taxation Midyear Meeting** Boca Raton, FL
Feb. 2020	
Saturday 2/1/20	**Register and make guest room reservations for Annual Meeting (www.texasbar.com/annualmeeting)**
Monday 2/3/20	**Tax Court Pro Bono Calendar Call-** **Dallas & San Antonio**
Wednesday 2/5/20	**Officers' Call** 2:00 p.m.
Friday 2/7/20	**SBOT Tax Section Tax Law in a Day CLE** Houston, Texas
Monday 2/17/20	**George Washington's Birthday (Holiday)**
Friday 2/21/20	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 1-800-270-2297 Conference Code: 15109392 11:00 a.m.
Monday 2/24/20	**Tax Court Pro Bono Calendar Houston**

Thurs - Fri 2/27-28/20	**International Fiscal Association Annual Congress** Boston MA
Friday 2/28/20	**Council of Chairs Meeting and Section Representative Election** Texas Law Center 1414 Colorado St. Austin, TX 78701 10:30 a.m. – 2:30 p.m.
March 2020	
Sunday 3/1/20	**Nomination Deadline for Chair-Elect, Secretary, Treasurer, and 3 Elected Council Members**
Monday 3/2/20	**Annual Meeting Deadline: Order special awards, council and chair plaques, food and beverage and audio visuals**
Wednesday 3/4/20	**Officers' Call** 2:00 p.m.
Friday 3/20/20	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 1-800-270-2297 Conference Code: 15109392 11:00 a.m.
Friday 3/??/2019	**2019 State Bar of Texas Property Tax Committee Meeting & Legal Seminar** Thompson Conference Center - UT Campus 2405 Robert Dedman Dr. Austin, Texas 78712
Tuesday 3/24/20	**Nominating Committee Report Due to Council** (Bylaws 4.1)
Sun - Wed 3/29-4/1/20	**Annual Meeting of Unclaimed Property Professionals Organization (UPPO)** JW Marriott Starr Pass Tucson, AZ
Monday 3/30/20	**Tax Court Pro Bono Calendar Call-Dallas**
April 2020	
Wednesday 4/1/20	**Nominations for Outstanding Texas Tax Lawyer Due to Dan Baucum** Email**:** (dbaucum@baucumlaw.com)
Wednesday 4/1/20	**Officers' Call** 2:00 p.m.

Friday 4/3/20	**Meeting of Council** Polsinelli PC 2950 N. Harwood, Suite 2100 Dallas, Texas 75201 **Note: Council Vote and Selection of Recipient of 2020 Outstanding Texas Tax Lawyer Award**
Monday 4/6/20	**Law Student Scholarship Application Deadline**
Wed-Thurs 4/8-16/20	**Passover (Religious Holiday)**
Friday 4/10/20	**Submission Deadline – Texas Tax Lawyer (Spring Edition)** Submit to TTL Editor: Michelle Spiegel michelle.spiegel@nortonrosefulbright.com
Fri – Sun 4/10-12/20	**Good Friday, Easter (Religious Holiday)**
?	**Tax Court Pro Bono Calendar Call**
Friday 4/17/20	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 1-800-270-2297 Conference Code: 15109392 11:00 a.m.
Monday 4/15/20	**Annual Meeting Deadline: course materials for app; CLE articles, PowerPoints, speaker bios and photos**
Monday 4/22/20	**Annual Meeting Deadline: submit any final programming changes for onsite event guide; CLE topic titles, speakers, speaker contact information and firm**
Thurs - Sat 4/29-5/2/20	**American Bar Association Section of Taxation May Meeting** Marriott Marquis, Washington, DC
May 2020	
Wednesday 5/6/20	**Officers' Call** 2:00 p.m.
Monday 5/11/20	**Last Day of Early Bird Registration for Annual Meeting**
Friday 5/15/20	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 1-800-270-2297 Conference Code: 15109392 11:00 a.m.
Monday 5/18/20	**Deadline to make guest room reservations for Annual Meeting at discounted rate (www.texasbar.com/annualmeeting)**

Monday 5/25/20	**Memorial Day Holiday**
June 2020	
Wednesday 6/3/20	**Officers' Call** 2:00 p.m.
Wed – Fri 6/3-5/20	**Annual Texas Federal Tax Institute** La Cantera Resort, San Antonio, Texas
Tuesday 6/5/20	**Deadline to Deliver to Members or Post on Tax Section Website Notice of Annual Meeting** (Bylaws 7.1) **Nominating Committee Report to be Posted on Tax Section Website** (Bylaws 4.1)
Friday 6/19/20	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 1-800-270-2297 Conference Code: 15109392 11:00 a.m.
Thurs – Fri 6/25-26/20	**SBOT Annual Meeting** Hilton Anatole, Dallas, Texas
TBD	**Tax Section Council Planning Retreat**
TBD	**Presentation of Outstanding Texas Tax Lawyer**
Thursday 6/25/20	**2020 Tax Section Annual Meeting Speaker's Dinner**
Friday 6/26/20	**2020 Tax Section Annual Meeting Program**
Friday 6/26/20	**Award Presentation to Council and Chairs During Tax Section Annual Meeting Program**
Other Events Not Yet Scheduled	
Spring 2020	**Tax Court Pro Bono Calendar Call**
TBD	**SBOT Tax Section Deep Dive Tax Workshop CLE**
TBD	**Law School Outreach**

Future Annual Meeting Dates and Locations	
Thurs-Fri 6/17-18/21	**State Bar of Texas Annual Meeting** Omni Hotel and Fort Worth Convention Center, Fort Worth,
Thurs-Fri 6/9-10/22	**State Bar of Texas Annual Meeting** Marriott Marquis, Houston
Thurs-Fri 6/22-23/23	**State Bar of Texas Annual Meeting** JW Marriott, Austin
Thurs-Fri 6/20-21/24	**State Bar of Texas Annual Meeting** Hilton Anatole, Dallas

Bylaws 7.4: Notice of regular meetings shall be delivered to the Council members by electronic mail, U.S. mail, overnight delivery service, or posting on the Section's website (or combination thereof) at least ten days prior to the date designated for such regular meeting.