

Recent Developments in Federal Income Taxation

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To obtain today's outline and slides:

<https://tinyurl.com/outline0419>

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Gaylor v. Mnuchin,
___ F.3d ___ (7th Cir. 3/15/19)
Outline: item A.1, page 2

- Holds the parsonage allowance exclusion of 107(2) to be constitutional.

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Deduction of State and Local Taxes
Outline: item D.1, page 3

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

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Deduction of State and Local Taxes

Outline: item D.1.b, page 4

- Proposed regulations: 83 Fed. Reg. 43,563 (8/27/18).
 - Apply to contributions *after* 8/27/18.
- The proposed regulations:
 - Generally require taxpayers to reduce the amount of any federal income tax *charitable contribution deduction* by the amount of any corresponding state or local tax *credit*.
 - Provide an exception: a taxpayer's federal charitable contribution deduction is *not* reduced if the corresponding state or local credit does not exceed 15 percent of the taxpayer's federal deduction.
 - Example: T contributes \$1,000 to state charity and gets 10% state tax credit.
 - Provide that a *state or local tax deduction* normally will *not* reduce a taxpayer's federal *deduction* (provided the state and local deduction does not exceed the taxpayer's federal deduction).

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Deduction of State and Local Taxes

IRS News Release IR-2018-178 (9/5/18)

Rev. Proc. 2019-12, 2019-04 I.R.B. 401 (12/29/18)

Outline: item D.1.c-d, page 5

- This News Release provides:
 - 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 regardless of whether the taxpayer is doing business as a sole proprietor, partnership or corporation.
- Rev. Proc. 2019-12:
 - Sets forth safe harbors for C corporations and "specified passthrough entities."
 - General principle: the taxpayer's federal charitable contribution deduction is reduced by any state tax credit, but the balance of the payment can be a business expense deduction under § 162 if the payment is made with a business purpose.

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Deduction of State and Local Taxes
Rev. Rul. 2019-11, 2019-__ I.R.B. __ (3/29/19)
Outline: item D.1.e, page 6

- Addresses application of the tax benefit rule to those whose deductions for state and local taxes have been limited to \$10,000.
- The tax benefit rule has long required taxpayers to include in gross income amounts deducted in a prior tax year that are recovered in the current tax year.
- However, under § 111(a), the amount so includible in gross income is limited to the amount deducted that resulted in a reduction of the taxpayer's tax liability for the prior year.
- In other words, the inclusion in gross income of the amount recovered is limited to the "tax benefit" of the amount previously deducted.

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Deduction of State and Local Taxes
Rev. Rul. 2019-11, 2019-__ I.R.B. __ (3/29/19)
Outline: item D.1.e, page 6

- *Situation 1 (State income tax refund fully includable).*
- *Facts:* Taxpayer A paid local real property taxes of \$4,000 and state income taxes of \$5,000 in 2018. A's state and local tax deduction was not limited by section 164(b)(6) because it was below \$10,000. Including other allowable itemized deductions, A claimed a total of \$14,000 in itemized deductions on A's 2018 federal income tax return. In 2019, A received a \$1,500 state income tax refund due to A's overpayment of state income taxes in 2018.
- *Held:* In 2019, A received a \$1,500 refund of state income taxes paid in 2018. Had A paid only the proper amount of state income tax in 2018, A's state and local tax deduction would have been reduced from \$9,000 to \$7,500 and as a result, A's itemized deductions would have been reduced from \$14,000 to \$12,500, a difference of \$1,500. A received a tax benefit from the overpayment of \$1,500 in state income tax in 2018. Thus, A is required to include the entire \$1,500 state income tax refund in A's gross income in 2019.

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Deduction of State and Local Taxes
Rev. Rul. 2019-11, 2019-__ I.R.B. __ (3/29/19)
Outline: item D.1.e, page 6

- *Situation 2 (State income tax refund not includable)*
- *Facts:* Taxpayer B paid local real property taxes of \$5,000 and state income taxes of \$7,000 in 2018. Section 164(b)(6) limited B's state and local tax deduction on B's 2018 federal income tax return to \$10,000, so B could not deduct \$2,000 of the \$12,000 state and local taxes paid. Including other allowable itemized deductions, B claimed a total of \$15,000 in itemized deductions on B's 2018 federal income tax return. In 2019, B received a \$750 state income tax refund due to B's overpayment of state income taxes in 2018.
- *Held:* In 2019, B received a \$750 refund of state income taxes paid in 2018. Had B paid only the proper amount of state income tax in 2018, B's state and local tax deduction would have remained the same (\$10,000) and B's itemized deductions would have remained the same (\$15,000). B received no tax benefit from the overpayment of \$750 in state income tax in 2018. Thus, B is not required to include the \$750 state income tax refund in B's gross income in 2019.

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Deduction of State and Local Taxes
Rev. Rul. 2019-11, 2019-__ I.R.B. __ (3/29/19)
Outline: item D.1.e, page 6

- *Situation 3 (State income tax refund partially includable)*
- *Facts:* Taxpayer C paid local real property taxes of \$5,000 and state income taxes of \$6,000 in 2018. Section 164(b)(6) limited C's state and local tax deduction on C's 2018 federal income tax return to \$10,000, so C could not deduct \$1,000 of the \$11,000 state and local taxes paid. Including other allowable itemized deductions, C claimed a total of \$15,000 in itemized deductions on C's 2018 federal income tax return. In 2019, C received a \$1,500 state income tax refund due to C's overpayment of state income taxes in 2018.
- *Held:* In 2019, C received a \$1,500 refund of state income taxes paid in 2018. Had C paid only the proper amount of state income tax in 2018, C's state and local tax deduction would have been reduced from \$10,000 to \$9,500 and as a result, C's itemized deductions would have been reduced from \$15,000 to \$14,500, a difference of \$500. C received a tax benefit from \$500 of the overpayment of state income tax in 2018. Thus, C is required to include \$500 of C's state income tax refund in C's gross income in 2019.

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Deduction of State and Local Taxes
Rev. Rul. 2019-11, 2019-__ I.R.B. __ (3/29/19)
Outline: item D.1.e, page 6

- *Situation 4 (Standard deduction)*
- *Facts:* Taxpayer D paid local real property taxes of \$4,250 and state income taxes of \$6,000 in 2018. Section 164(b)(6) limited D's state and local tax deduction on D's 2018 federal income tax return to \$10,000, so D could not deduct \$250 of the \$10,250 state and local taxes paid. Including other allowable itemized deductions, D claimed a total of \$12,500 in itemized deductions on D's 2018 federal income tax return. In 2019, D received a \$1,000 state income tax refund due to D's overpayment of state income taxes in 2018.
- *Held:* In 2019, D received a \$1,000 refund of state income taxes paid in 2018. Had D paid only the proper amount of state income tax in 2018, D's state and local tax deduction would have been reduced from \$10,000 to \$9,250, and, as a result, D's itemized deductions would have been reduced from \$12,500 to \$11,750, which is less than the standard deduction of \$12,000 that D would have taken in 2018. The difference between D's claimed itemized deductions (\$12,500) and the standard deduction D could have taken (\$12,000) is \$500. D received a tax benefit from \$500 of the overpayment of state income tax in 2018. Thus, D is required to include \$500 of D's state income tax refund in D's gross income in 2019.

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Johnson v. Commissioner,
152 T.C. No. 6 (3/11/19)
Outline: item D.2, page 8

- Addresses receipt of lump sum Social Security benefits and the determination of modified adjusted gross income for purposes of eligibility for the § 36B premium tax credit

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Notice 2019-20
2019-14 I.R.B. 927 (3/7/19)
Outline: item G.1, page 9

- Provides penalty relief for failure of partnerships to report negative tax capital account information on Schedule K-1

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Walquist v. Commissioner,
152 T.C. No. 3 (2/25/19)
Outline: item A.1, page 10

- Holds that accuracy-related penalties determined by the IRS's Automated Correspondence Exam System are "automatically calculated through electronic means."
- Therefore, they are exempt from the section 6751(b) supervisory approval requirement.

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Palmolive Building Investors, LLC v. Commissioner,
152 T.C. No. 4 (2/28/19)
Outline: item A.2, page 10

- Holds section 6751(b) supervisory approval requirement does not require that all penalties be determined at the same time.

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ATL & Sons Holdings, Inc. v. Commissioner,
152 T.C. No. 8 (3/13/19)
Outline: item A.3, page 11

- Holds that filing an extension request for an individual S corporation shareholder's return does not extend the time to file the S corporation's return.

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**Gregory v. Commissioner,
152 T.C. No. 7 (3/13/19)
*Outline: item D.1, page 12***

- Holds that filing a power of attorney on Form 2848 does not provide the IRS with clear and concise notification of the taxpayer's new address.

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**Campbell v. Commissioner,
T.C. Memo. 2019-4 (2/4/19)
*Outline: item F.1, page 13***

- Holds that IRS abused its discretion in the context of a CDP hearing.

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