

# **Recent Developments in Federal Income Taxation**

---

Bruce A. McGovern

Professor of Law and Director, Tax Clinic  
South Texas College of Law Houston  
Houston, Texas

---

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

1

To obtain today's outline and slides:

<https://tinyurl.com/outline0919>

<https://tinyurl.com/slides0919>

2

**Pugh v. Commissioner**  
**T.C. Summ. Op. 2019-2 (2/28/19)**  
***Outline: item D.1, page 2***

- The taxpayer financed the purchase of two vacant lots and paid interest on the acquisition loans.
- He planned to construct the headquarters of his software development business on the lots, but these plans never took place.
  - 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.
- Issue: is the interest paid by the taxpayer deductible because the indebtedness was allocable to his trade or business, or was it either (1) investment interest subject to the limit of § 163(d), or (2) personal interest that is not deductible?
- Held: deductible business interest. Although the properties were not actually used in the taxpayer's trade or business, the court was "satisfied that the properties were certainly 'allocable' to that business."

3

3

**Barbara v. Commissioner**  
**T.C. Memo. 2019-50 (5/13/19)**  
***Outline: item I.1, page 3***

- The taxpayers, a married couple, resided in Florida.
- The husband used the proceeds from the sale of his Chicago-area garbage-collection business to start a lending business.
  - The lending business had its office in Chicago with two full-time employees.
  - He 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, 460 hours per year in Chicago and 240 in Florida.
- Issue: did the husband materially participate in the lending business?
- Held: Yes. The seventh material participation test in Reg. § 1.469-5T(a) 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." This test was satisfied. All hours the taxpayer worked, including those worked remotely in Florida, counted for purposes of determining material participation.

4

4

**Breland v. Commissioner**  
**T.C. Memo. 2019-59 (5/29/19)**  
***Outline: item A.1, page 3***

- The taxpayers, a married couple, purchased real property on Dauphin Island, Alabama.
- The property was subject to a recourse mortgage loan from Whitney Bank in the amount of \$11.2 million.
  - Whitney Bank foreclosed and was the high bidder at the foreclosure sale with a bid of \$7.2 million.
  - The taxpayers later filed for chapter 11 bankruptcy protection in federal court. Whitney Bank filed a proof of claim for \$6.3 million.
- Issue: what is the taxpayers' amount realized in the foreclosure sale? Is it the \$11.2 million loan balance, or the \$7.2 million sale price?
- Held: The \$7.2 million sale price. The taxpayers realized a \$4.3 million loss.
  - Reg. § 1.1001-2(a)(1): a taxpayer's AR includes the amount of any liabilities from which the taxpayer is discharged as a result of transferring property.
  - But this rule applies to nonrecourse debt. In the case of recourse debt, the portion of the loan included in AR is limited to the property's FMV. <sup>5</sup>

5

**Bui v. Commissioner**  
**T.C. Memo. 2019-54 (5/21/19)**  
***Outline: item B.1, page 5***

- The taxpayer owned and used property in San Jose, California (Red River property) as her principal residence and owned other property in San Jose that was a rental property (Cedar Grove property).
- In 2007, she obtained three home equity lines of credit from Wells Fargo, one secured by the Red River property and two by the Cedar Grove property.
  - The taxpayer had evidence of \$10,000 spent for custom drapes and \$12,000 for driveway expansion at the Cedar Grove property
  - In 2011, she sold the Red River property in a short sale and began using the Cedar Grove property as her principal residence.
  - Also in 2011, Wells Fargo cancelled all lines of credit, which had a balance of \$355,488, and issued Form 1099-C.
- Issue: were the loans "qualified principal residence indebtedness," discharge of which was excluded from income under expired § 108(a)(1)(E) ?
- Held: only \$12,000 (loan proceeds secured by Red River property and spent on driveway expansion) was qualified principal residence indebtedness. <sup>6</sup>

6

**Finnegan v. Commissioner**  
**962 F.3d 1261 (11th Cir. 6/11/19)**

***Outline: item E.1, page 7***

- 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 IRS generally must issue a notice of deficiency, which provides taxpayer with 90 days to petition the Tax Court.
  - The IRS issued a notice of deficiency for the years 1994 through 2001 more than three years after the returns were filed.
  - The IRS argued the notice of deficiency was timely under the § 6501(c)(1) fraud exception, 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.”
  - IRS relied on *Allen v. Commissioner*, 128 T.C. 37 (2007), and argued that the **return preparer**, not the taxpayers, had the required fraudulent intent.
- **Issue:** could the taxpayers challenge application of the fraud exception and ask the Tax Court to reconsider its decision in *Allen*?
- **Held:** no, because the taxpayers raised this argument for the first time in a motion for reconsideration. They waived the argument.

7

7

**IRS Expands Voluntary Identity Protection PIN Program**

***Outline: item H.1, page 8***

- The 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 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.
- Possible eventual expansion to all states, which is supported by AICPA.

8

8

**Truncated TINs: T.D. 9861**  
**84 Fed. Reg. 31717 (7/3/19)**  
***Outline: item H.2, page 8***

- Final regulations permit employers voluntarily to truncate employees' social security numbers (SSNs) on copies of Forms W-2 that are furnished to employees 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.
  - 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 documents filed or furnished after December 31, 2020 (July 3, 2019, for information returns filed with SSA).

9

9

**Helmert v. Cenlar FSB**  
**123 A.F.T.R.2d 2019-2287 (D. Miss. 6/18/19)**  
***Outline: item H.3, page 8***

- The lender foreclosed on Mr. Helmert's home mortgage loan.
  - He 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.
  - He asserted that Form 1099-A is issued to reflect loan forgiveness.
- Issue: had Mr. Helmert stated a claim against the lender based on the Form 1099-A?
- Held: no. Form 1099-C, not Form 1099-A, is issued to reflect cancellation of debt. Form 1099-A "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."

10

10

**Moya v. Commissioner**  
**152 T.C. No. 11 (4/17/19)**  
***Outline: item H.4, page 9***

- The taxpayer moved from Nevada to Santa Cruz, California.
- An IRS audit of her returns was conducted by the IRS office in Las Vegas.
  - Through written correspondence, the taxpayer requested that the examination of her returns be transferred to an IRS office near Santa Cruz and that a hearing scheduled in Las Vegas take place instead in Santa Cruz.
  - 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, in examining her returns, the IRS had violated the Taxpayer Bill of Rights (TBOR), including her rights to be informed, to challenge the IRS position and be heard, and to a fair and just tax system.
- Issue: do alleged violations of the TBOR provide a basis for invalidating a notice of deficiency?
- Held: No. The Tax Court generally does not look behind a notice of deficiency. Taxpayer had a full opportunity to challenge in the Tax Court.<sup>11</sup>

11

**Slaughter v. Commissioner**  
**T.C. Memo. 2019-65 (6/4/19)**  
***Outline: item B.2, page 10***

- The taxpayer, an author of crime fiction, had publishing contracts that:
  - Gave the publishers not only the right to print, publish, distribute, sell, and license the works 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.
  - Required the taxpayer to provide photographs and appear at promotional events and contained various forms of noncompete clauses.
  - Did not allocate the taxpayer's compensation in any way.
- On her tax returns, prepared by CPAs, the taxpayer allocated:
  - Some of the royalties and advances to her trade or business of writing (Schedule C, subject to self-employment tax), and
  - Most to payment for an intangible asset (Schedule E, not subject to SE tax).
- Issue: were the royalties and advances received by the taxpayer subject to self-employment tax?
- Held: Yes. Her trade or business included writing and developing her brand.

12

**Partner SE Tax: T.D. 9869**  
**84 Fed. Reg. 3178 (7/2/19)**  
***Outline: item B.3, page 11***

- Final regulations 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.

13