

# **Recent Developments in Federal Income Taxation**

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Bruce A. McGovern

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

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To obtain today's outline and slides:

<https://tinyurl.com/outline1019>

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**Rev. Proc. 2019-18**  
**2019-18 I.R.B. 1077**  
***Outline: item A.1, page 2***

- Provides a safe harbor for professional sports teams
  - Teams can 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 from the trade of a personnel contract or a draft pick.
- Four requirements must be satisfied for the safe harbor to apply.
- If the safe harbor applies:
  1. A team recognizes gain or loss only to the extent it receives cash.
  2. Only cash is included in the team's amount realized.
  3. A team's basis in contracts/draft picks received includes only cash provided.
  4. Cash provided is allocated equally to contracts or draft picks received.
  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.

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**Rev. Proc. 2019-18**  
**2019-18 I.R.B. 1077**  
***Outline: item A.1, page 2***

- *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 the 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.

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**Rev. Proc. 2019-18**  
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***Outline: item A.1, page 2***

■ ***Example 2—One team provides cash in the trade.***

1. In 2018, Team A trades Player Contract 1 and \$10x to Team B for Player Contract 2. The teams apply the safe harbor in the revenue procedure.
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.

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**Rev. Proc. 2019-18**  
**2019-18 I.R.B. 1077**  
***Outline: item A.1, page 2***

■ ***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. § 1.167(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.

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**Rev. Proc. 2019-18**  
**2019-18 I.R.B. 1077**  
***Outline: item A.1, page 2***

- **Example 4**—One team provides cash and one team has an 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 \$20x, and the teams apply the safe harbor in this revenue procedure.
  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. Team D has a \$20x basis in Player Contract 3, the amount of cash Team D provided to Team C. Team D's \$20x basis is recovered through depreciation under Reg. § 1.167(a)-3(a) over the life of Player Contract 3.<sup>7</sup>

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**Cavanaugh v. Commissioner**  
**766 Fed. Appx. 98 (5th Cir. 3/29/19)**  
***Outline: item D.1.a, page 5***

- Cavanaugh, the CEO and sole shareholder of Jani-King, International, an S corporation, took a trip to his villa in the Caribbean with his girlfriend, his bodyguard, and another Jan-King employee.
  - While there, his girlfriend died of a cocaine overdose.
  - The board of directors of Jani-King, International authorized a settlement of a wrongful death claim brought by the girlfriend's mother in the amount of \$2.3 million and reimbursement of Cavanaugh's payment of \$250,000 towards the settlement.
- **Issue:** can the S corporation deduct the payments as a business expense?
- **Held:** No. The deductibility of the payments is governed by the "origin of the claim" doctrine (*U.S. v. Gilmore*, (U.S. 1963)). Although the board of directors 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. The Tax Court properly disallowed the deduction of the settlement payment.

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**20% Deduction for Qualified Business Income**  
**2017 TCJA § 11011**

***Outline: item D.3, page 63***

- TCJA § 11011 adds Code § 199A, which generally allows a 20% deduction for “qualified business income.”
  - Available to individuals, estates, and trusts for taxable years beginning after 2017 and before 2026
- Proposed regulations: 83 Fed. Reg. 40884 (8/16/18).
- Final regulations: issued January 18, 2019 [Outline page 8, item a]
- Proposed regulations: issued January 18, 2019
  - Provide guidance on treatment of previously suspended losses that constitute qualified business income.

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**Rev. Proc. 2019-38**

**2019-42 I.R.B. \_\_\_\_\_**

***Outline: item D.3.b, page 11***

- Provides a safe harbor under which rental real estate enterprises are treated as a trade or business for purposes of § 199A.
- Requirements:
  1. Separate books and records for each rental real estate enterprise.
  2. For RRE in existence fewer than 4 years, 250 or more hours of rental service are performed.
  3. Taxpayer maintains contemporaneous records (does not apply to tax years beginning before 2020)
  4. Statement attached to timely filed original return (or amended return for 2018 only).

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**Lipnick v. Commissioner**  
**153 T.C. No. 1 (8/28/19)**  
***Outline: item C.1, page 12***

- Father was a partner in an LLC classified as a partnership.
- The partnership borrowed funds and distributed the proceeds to Father.
- Father used the proceeds to purchase investment assets.
- Father treated his share of partnership's interest expenses as investment interest subject to the limits of section 163(d).
- Father:
  - Gave some of his LLC interest to Son.
  - Died and bequeathed the remaining LLC interest to Son.
- Issue: is Son's share of the partnership's interest expense investment interest?
- Held: No. The debt is treated as debt incurred to acquire the LLC interest.

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**Burack v. Commissioner**  
**T.C. Memo. 2019-83 (7/19/19)**  
***Outline: item D.1, page 13***

- Held: an IRA distribution that was re-deposited on the 62<sup>nd</sup> day after the distribution qualified as a tax-free rollover under section 408(d)(3)(A) because the delay resulted from a bookkeeping error and the taxpayer qualified for a hardship waiver.

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## Other Recent Developments

- T.D. 9868 (final regulations on nonresident aliens as beneficiaries of electing small business trusts) [page 15, item 1.a]
- Withdrawal of proposed regulations on continuity of interest [page 16, item a]
- Rev. Rul. 2019-9 [page 17, item 1]
- Proposed regulations on “May Company” transactions [page 19, item a]
- Grecian Magnesite [item c, page 22]
- Carpenter v. Commissioner [item 1, page 22]

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