# Recent Developments in Federal Income Taxation

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## 20% Deduction for Qualified Business Income
## 2017 TCJA § 11011
## *Outline: item D.1, page 2*

- 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: issued August 16, 2018.
- Final regulations: issued January 18, 2019 [Outline page 4, item a]
- Proposed regulations: issued January 18, 2019
  - Provide guidance on treatment of previously suspended losses that constitute qualified business income.
- Rev. Proc. 2019-38 (9/24/2019) [Outline page 7, item c]
  - Safe harbor under which rental real estate enterprises are treated as a trade or business for purposes of § 199A

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## § 199A, Final Regulations on Suspended Losses
## T.D. 9899, 85 Fed. Reg. 38060 (6/25/20).
## *Outline: item D.2.d, page 8*

- Final regulations provide guidance on:
  - Treatment of previously suspended losses included in qualified business income, and
  - Determining the § 199A deduction for taxpayers that hold interests in regulated investment companies, split-interest trusts, and charitable remainder trusts.
- Previously suspended losses:
  - If a loss or deduction that would otherwise be included in QBI is disallowed or suspended under any provision of the Code, the loss or deduction is generally taken into account for purposes of computing QBI in the year it is taken into account in determining taxable income.
  - The determination of whether a suspended or disallowed loss or deduction attributable to a specified service trade or business is QBI:
    - Determination is made in the year the loss or deduction is incurred.
    - In the later year when the loss or deduction is taken into account, it will be fully allowed, partially allowed, or disallowed, depending on the taxpayer's taxable income in the year the loss or deduction was incurred.

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## Costs of Entertainment
## 2017 TCJA § 13304
## *Outline: item D.2, page 9*

- TCJA § 13304 amends Code § 274(a) to disallow business deductions for:
  1. Costs "[w]ith respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation."
  2. Membership dues with respect to any club organized for business, pleasure, recreation or other social purposes.
- Applies to taxable years beginning after 2017.
- Notice 2018-76, 2018-42 I.R.B. 599 (10/3/18).
  - Treasury and IRS will issue proposed regulations.
  - Meals are still deductible (subject to 50% limit) if, among other requirements, taxpayer (or employee) is present and meal is provided to current or potential business customer, client, consultant, or similar business contact.

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## Final Regulations
## 85 F.R. _____ (10/9/20)
## *Outline: item D.2.b, page 10*

- Provide guidance on:
  - Entertainment expenses
  - Business meal expenses (consistent with Notice 2018-76)
  - Other matters, such as travel meal expenses, meals provided at employer-operated eating facilities, and exceptions to the normal 50 percent limitation, such as food or beverages treated as employee compensation.

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## Reg. § 1.274-11(b)(1)(ii)
## 85 F.R. _____ (10/9/20)
## *Outline: item D.2.b, page 10*

- "Entertainment" does not include food or beverages unless the food or beverages are provided during or at an entertainment activity.
- If food or beverages are provided during or at an entertainment activity, the food or beverages are not considered entertainment if:
  - the food or beverages are purchased separately from the entertainment, or
  - the cost of the food or beverages is stated separately from the cost of the entertainment on one or more bills, invoices, or receipts.

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## Reg. § 1.274-12(a)(1)
## 85 F.R. _____ (10/9/20)
## *Outline: item D.2.b, page 11*

- Taxpayers may deduct 50 percent of an otherwise allowable business meal expense if:
  1. The expense is not lavish or extravagant under the circumstances;
  2. The taxpayer, or an employee of the taxpayer, is present at the furnishing of the food or beverages; and
  3. The food and beverages are provided to a "business associate."
     - "Business associate" means "a person with whom the taxpayer could reasonably expect to engage or deal in the active conduct of the taxpayer's trade or business."
     - Includes "a customer, client, supplier, employee, agent, partner, or professional adviser, whether established or prospective."

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## Reg. § 1.274-11(d)
## 85 F.R. _____ (10/9/20)
## *Outline: item D.2.b, page 11*

- Examples 1 and 2.
  1. Taxpayer A invites B, a business contact, to a baseball game. A purchases tickets for A and B to attend the game. While at the game, A buys hot dogs and drinks for A and B.
  2. The baseball game is entertainment as defined in Prop. Reg. § 1.274-11(b)(1)) and, thus, the cost of the game tickets is an entertainment expense and is not deductible by A. The cost of the hot dogs and drinks, which are purchased separately from the game tickets, is not an entertainment expense and is not subject to the § 274(a)(1) disallowance. Therefore, A may deduct 50 percent of the expenses associated with the hot dogs and drinks purchased at the game.

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## Reg. § 1.274-11(d)
## 85 F.R. _____ (10/9/20)
## *Outline: item D.2.b, page 11*

- Example 3.
  1. Taxpayer C invites D, a business contact, to a basketball game. C purchases tickets for C and D to attend the game in a suite, where they have access to food and beverages. The cost of the basketball game tickets, as stated on the invoice, includes the food and beverages.
  2. The basketball game is entertainment as defined in § 1.274-11(b)(1) and, thus, the cost of the game tickets is an entertainment expense and is not deductible by C. The cost of the food and beverages, which are not purchased separately from the game tickets, is not stated separately on the invoice. Thus, the cost of the food and beverages also is an entertainment expense that is subject to the § 274(a)(1) disallowance. Therefore, C may not deduct any of the expenses associated with the basketball game.

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## Reg. § 1.274-11(d)
## 85 F.R. _____ (10/9/20)
## *Outline: item D.2.b, page 11*

- Example 4.
  1. Assume the same facts as in Example 3, except that the invoice for the basketball game tickets separately states the cost of the food and beverages.
  2. As in Example 3, the basketball game is entertainment as defined in § 1.274-11(b)(1) and, thus, the cost of the game tickets, other than the cost of the food and beverages, is an entertainment expense and is not deductible by C. However, the cost of the food and beverages, which is stated separately on the invoice for the game tickets, is not an entertainment expense and is not subject to the § 274(a)(1) disallowance. Therefore, C may deduct 50 percent of the expenses associated with the food and beverages provided at the game.

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## Duffy v. Commissioner
## T.C. Memo. 2020-108 (7/13/20)
## *Outline: item A.1, page 12*

- The taxpayers, a married couple, purchased a second residence in Oregon that they occasionally rented (the Gearhart property).
- They borrowed $1.4 million from J.P. Morgan Chase to purchase the property.
  - They later sold the property for $800,000 and paid approximately $750,000 in partial satisfaction of the JPMC loan.
  - JPMC cancelled the remaining $650,000 of the loan.
- Issue: what is the taxpayers' amount realized in the sale? Is it the $1.4 million, or the $800,000 sale price?
- Held: The $1.4 million loan balance. The loan was nonrecourse debt under Oregon's anti-deficiency statute.
  - 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.
  - 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. 12

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## CARES Act Suspension of RMDs
## *Outline: item B.1, page 14*

- If a taxpayer turned 70-½ in 2019, he or she was required take their 2019 minimum distribution by April 1, 2020.
- Such taxpayers, and others who previously had turned 70-½, also must take their 2020 RMD by December 31, 2020.
- The CARES Act:
  - Suspends all RMDs for 2020.
  - These include both RMDs that should have been taken by April 1, 2020, and those that normally would be taken by December 31, 2020.
- Issue:
  - How to treat RMDs already taken in 2020? Rollover to IRA? Treat as coronavirus-related distribution and repay over three years?
  - See Notice 2020-51, 2020-29 I.R.B. 73 (6/23/20) (can treat as rollovers RMDs already taken if recontributed by August 31, 2020).

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## Cost Basis of Life Insurance Contract
## Rev. Rul. 2020-5, 2020-9 I.R.B. 454 (2/24/20)
## *Outline: item B.1, page 14*

- Rev. Rul. 2020-5 reflects modifications made by the TCJA (2017) in the determination of a taxpayer's cost basis in a life insurance contract.
  - The TCJA added a new subsection "(B)" to § 1016(a)(1).
    - Clarifies that the basis of an annuity or life insurance contract includes premiums and other costs paid without reduction for mortality expenses or other reasonable charges incurred under the contract (also known as ''cost of insurance'').
  - In other words, basis is not reduced by the cost of the insurance.
  - Reverses position taken in Rev. Rul. 2009-13.
- The Ruling gives examples and reiterates this treatment is effective for transactions entered into on or after 8/26/2009.

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## Champions Retreat Golf Founders, LLC v. Comm'r, 959 F.3d 1033 (11th Cir. 5/13/20)

***Outline: item B.1.a, page 15***

- The taxpayer, an LLC classified as a partnership, granted a conservation easement on 348 acres of land, including a golf course, alongside the Little and Savannah Rivers.
- Under § 170(h)(4)(A), to give rise to a deduction, the easement must serve "conservation purpose" defined in part as "the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem" or "the preservation of open space . . . where such preservation is for the scenic enjoyment of the general public."
- Issue: did the easement meet the conservation purpose requirement?
- Held: Yes.
  - Although the course was not open to the public, it was inhabited by birds and wildlife and the denseflower knotweed, a rare plant species grew on one portion of the land.
  - Canoers and kayakers could enjoy the scenic views.

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## Hoffman Properties II, LP v. Commissioner, 956 F.3d 832 (6th Cir. 4/14/20)

***Outline: item B.2.a, page 17***

- Part of a series of IRS attacks on charitable contribution deductions for conservation easements
- Most successful IRS strategy: easement does not protect the property in perpetuity, as required by § 170(h)(2)(C) and (h)(5)(A).
- This case disallows donor's $15 million charitable contribution deduction for a façade conservation easement on the historic the historic Tremaine Building in Cleveland, Ohio.
- The easement deed gave the donor the ability to alter the building's façade or airspace with the approval of the holder of the easement.
  - The holder's consent would be deemed given if the holder failed to approve or reject the proposed change within 45 days.
- Held: this provision violates the "protected in perpetuit"y requirement.

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## Oakbrook Land Holdings LLC v. Commissioner, 154 T.C. No. 10 (5/12/20) T.C. Memo. 2020-54 (5/12/20)

***Outline: item B.2.b, page 18***

- Part of a series of IRS attacks on charitable contribution deductions for conservation easements
- Most successful IRS strategy: easement does not protect the property in perpetuity, as required by § 170(h)(2)(C) and (h)(5)(A).
- This case disallows donor's $9.7 million charitable contribution deduction because extinguishment language in the deed dictating what would happen if the easement were extinguished:
  - Failed to preserve donee's proportionate benefit, as required by Reg. § 1.170A-14(g)(6)(ii) .
  - Required that the charitable-donee's benefit upon destruction or condemnation of the property be reduced by the value of improvements to the property made by the taxpayer-donor after the contribution, contrary to Reg. § 1.170A-14(g)(6)(ii).

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## Kroner v. Commissioner T.C. Memo. 2020-73 (6/1/2020)

***Outline Item A.1, page 20***

- Issue: Whether the IRS complied with the requirement of § 6751(b)(1) that the initial determination of the assessment of a penalty be "personally approved (in writing) by the immediate supervisor of the individual making such determination."
- Held: In determining when penalties are approved, the content of the document sent to the taxpayer is the relevant inquiry and not the IRS's subjective intent in mailing the document.
  - The court concluded that the IRS made its initial determination of the assessment of penalties no later than August 6, 2012, when Letter 915 was delivered to the taxpayer.
  - Because the initial determination to assert penalties occurred before the supervisor signed the Civil Penalty Approval Form on October 31, 2012, the IRS had failed to satisfy its burden of production under § 6751(b) and the taxpayer, therefore, was not liable for the § 6662(a) accuracy related penalties.

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## Amanda Iris Gluck Irrevocable Trust v. Comm'r, 154 T.C. No. 11 (5/6/20)

***Outline: item F.1, page 20***

- The IRS made a computational adjustment and increased the gross income of the taxpayer, a partner in a TEFRA partnership, by $48.6 million of partnership income omitted from the partner's return.
  - The IRS was not required to issue a notice of deficiency
- After the IRS issued a final notice of intent to levy, the taxpayer requested a CDP hearing.
  - In the CDP hearing, the taxpayer contested its underlying tax liabilities for the years involved.
  - The IRS Settlement Officer concluded the taxpayer was barred from contesting the liabilities by § 6330(c)(2)(B) because the taxpayer had a prior opportunity to contest them.
    - The prior opportunity was to pay the tax and sue for a refund.
    - IRS conceded in Tax Court this was incorrect.
- Held: the Tax Court has jurisdiction to review the underlying tax liabilities even though it would not have jurisdiction to review computational adjustments in a deficiency proceeding.

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## Audio Technica U.S., Inc. v. United States, 963 F.3d 569 (6th Cir. 6/26/20)

***Outline: item H.1, page 22***

- The taxpayer and the IRS settled litigation in the Tax Court in which the issue was the amount of the § 41 R&D tax credit to which the taxpayer was entitled.
  - The stipulated decision entered in the Tax Court reflected calculations based on a "fixed-base percentage" of 0.92%.
  - The lower the fixed-base percentage, the higher the R&D credit.
- For later years, the taxpayer again used a fixed-base percentage of 0.92% and the government again disallowed the taxpayer's R&D credits. The taxpayer paid the tax due and sued for a refund in U.S. District Court.
- Issue: does the doctrine of judicial estoppel bar the government from challenging the fixed-base percentage used by the taxpayer?
- Held: No. Judicial estoppel applies when the party's position was asserted under oath and accepted by the court in the prior proceeding. Here, there was no judicial acceptance by the Tax Court of the parties' position.

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## E-Filing of Amended Individual Returns
## IR-2020-182 (8/17/20)
## *Outline: item H.2, page 23*

- Individuals who wish to amend a federal income tax return by filing Form 1040-X historically have had to mail the form to the IRS.
- IRS announcement: individuals now can e-file Form 1040-X using available software products to amend Forms 1040 or 1040-SR.
  - Taxpayers still will have the option to mail a paper version of Form 1040-X.
  - Only 2019 returns can be amended through e-filing.
  - Whether the ability to e-file amended returns will be expanded to other years is not entirely clear.
    - The announcement states that "[a]dditional improvements are planned for the future."

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