Recent Developments in Federal Income Taxation

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To obtain today's outline and slides:
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CLE Number for Today's Webcast:
174092504

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Keefe v. Commissioner, 2020 WL 4032469 (2d Cir. 7/17/20)

Outline: item A.1.a., page 3

- The taxpayers, a married couple, acquired and restored Wrentham House, a historic mansion in Newport, Rhode Island.
  - From 2000 to 2008 they spent $10 million repairing and restoring the mansion with the goal of turning it into a luxury vacation rental property.
  - The taxpayers contacted a real estate agent, who orally informed clients of the property
  - When the work was completed in 2008, the taxpayers never rented the property.
  - They sold it in a short sale for $6 million and realized a large loss.
- Issue: is the taxpayer's loss a capital loss, or instead a § 1231 loss that was converted by § 1231 to an ordinary loss?
- Held: a capital loss. The property was not "used in a trade or business" within the meaning of § 1231, and therefore was a capital asset.

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Miscellaneous Itemized Deductions 2017 TCJA § 11045

Outline: item C.1, page 3

- For taxable years beginning after 2017 and before 2026, miscellaneous itemized deductions are not deductible.
- Includes:
  - Investment-related expenses
  - Unreimbursed employee business expenses
  - Tax preparation fees
- Notice 2018-61 (7/13/18): proposed regs. will clarify that estates and non-grantor trusts are not affected.

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Miscellaneous Itemized Deductions
2017 TCJA § 11045
Outline: item C.1.a, page 3

- Proposed regulations issued May 2020
  - REG-113295-18, Effect of Section 67(g) on Trusts and Estates, 85 F.R. 27693 (5/11/20)
- Proposed amendments to Reg. § 1.67-4 would:
  - Clarify that § 67(g) does not deny deductions described under § 67(e)(1) and (2) for estates and nongrantor trusts.
  - Do not address whether such deductions will continue to be deductible for purposes of the AMT
- Proposed amendments to Reg. § 1.642(h)-2 would:
  - Provide guidance under § 642(h) regarding net operating loss and capital loss carryovers under § 642(h)(1) and the excess deduction under § 642(h)(2).

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Notice 2020-46, 2020-27 I.R.B. 7 (6/11/20)
Outline: item A.1, page 5

- Under leave-based donation programs, employees can elect to forgo vacation, sick, or personal leave in exchange for cash payments the employer makes to charitable organizations.
- If an employer makes cash payments pursuant to such a program before January 1, 2021, to charitable organizations for the relief of victims of the COVID-19 pandemic, the IRS will <u>not</u> assert that:
  1. The payments constitute gross income or wages of the employees;
  2. The employees, by making the election, have constructively received gross income or wages.

  The payments are deductible by the employer either as a charitable contribution (§ 170) or as a business deduction (§ 162).
- Employees who make the election cannot deduct the forgone leave as a charitable contribution.

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Coronavirus-Related Retirement Plan Distributions
Outline: item B.1, page 5

- Coronavirus related distributions from retirement plans:
  - Penalty-free withdrawals of up to $100,000
  - Income from withdrawals can be reported ratably over three years
  - Amounts withdrawn can be recontributed within three years and treated as tax-free rollovers
- Definition:
  - any distribution from an eligible retirement plan made: (1) on or after January 1, 2020, and before December 31, 2020, (2) to an individual who is diagnosed (or whose spouse or dependent is diagnosed) with the virus under an approved test or:
    - who experiences adverse financial consequences as a result of being quarantined, being furloughed or laid off or having work hours reduced due to such virus or disease, being unable to work due to lack of child care due to such virus or disease, closing or reducing hours of a business owned or operated by the individual due to such virus or disease, or other factors as determined by [the IRS].

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Notice 2020-50
2020-28 I.R.B. 35 (6/22/20)
Outline: item B.1.a, page 6

- Provides guidance on:
  - Distributions qualifying as coronavirus-related distributions.
    - Qualified individuals
    - Distributions that qualify
    - Distributions that can be recontributed and treated as a tax-free rollover
  - Tax treatment of receiving and recontributing coronavirus-related distributions.
    - Report income from ratably over 3 years or elect to report entirely in year of receipt
    - Mechanism for reporting receipt and recontributions (new Form 8915-E).
  - Plan loans
  - Issues for employer plans and IRAs

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Feigh v. Commissioner, 152 T.C. 267 (5/15/19)

Outline: item D.1, page 8

- Holds that "Medicaid waiver payments" that individuals received and excluded from gross income under Notice 2014-7 are "earned income" for purposes of the earned income credit and the additional child tax credit.
- A.O.D. 2020-2, 2020-14 I.R.B. 558 (3/30/20).
  - IRS acquiesces in the result in *Feigh*
  - "in cases in which the Service permits taxpayers, pursuant to [Notice 2014-7], to treat qualified Medicaid waiver payments as difficulty of care payments excludable under § 131, the Service will not argue that payments that otherwise fall within the definition of earned income under § 32(c)(3) are not earned income for determining eligibility for the EIC and the ACTC merely because they are excludable under the Notice."

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Rodriguez v. FDIC, 140 S. Ct. 713 (2/24/20)

Outline: item G.1, page 10

- Issue: what law governs ownership of a federal tax refund paid to a consolidated corporate group?
- Held: state law, not federal common law
  - The Tenth Circuit had applied the rule of *In re Bob Richards Chrysler-Plymouth Corp., Inc.*, 473 F.2d 262 (9th Cir. 1973).
  - Under this rule, as a matter of *federal common law*, in the absence of a contrary agreement, "a tax refund due from a joint return generally belongs to the company responsible for the losses that form the basis of the refund."
  - U.S. Supreme Court: federal common law is appropriate only in limited circumstances, and this is not one of them.
  - Remands to Tenth Circuit for application of state law.

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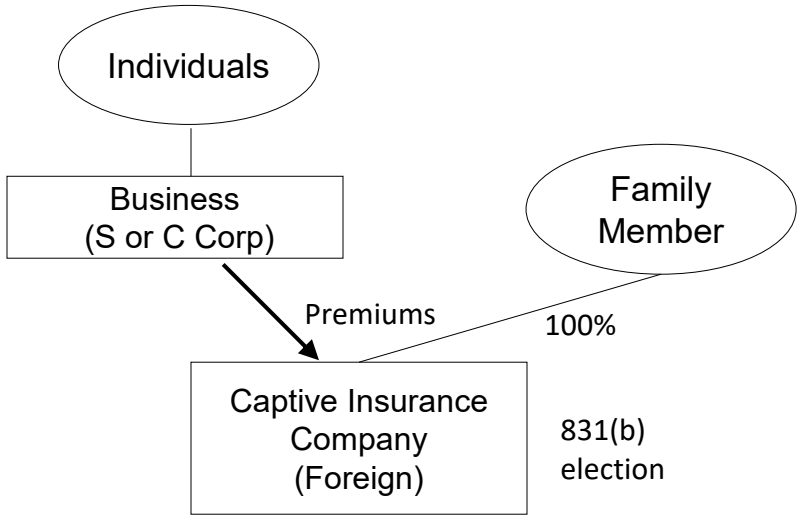
Captive Insurance Developments
Outline: item H.1, pages 11-14



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Captive Insurance Developments
Outline: item H.1, pages 11-14

- Notice 2016-66: micro-captive insurance transactions are "transactions of interest" that might be on their way to being listed. Persons entering into these transactions after November 1, 2006, must disclose the transaction as described in Reg. § 1.6011-4.
- CIC Services, LLC v. Internal Revenue Service, 925 F.3d 247 (6th Cir. 5/22/19) : rejects challenge to Notice 2016-66 as having been issued in violation of Administrative Procedure Act. Suit was barred by Anti-Injunction Act.
- IRS Victories in Tax Court: *Syzygy Ins. Co., Inc. v. Commissioner*, T.C. Memo. 2019-34 (4/10/19); *Reserve Mechanical Corp. v. Commissioner*, T.C. Memo. 2018-86 (6/18/18); *Avrahami v. Commissioner*, 149 T.C. No. 7 (8/21/2017).
- IR-2019-157 (9/16/19): IRS makes time-limited settlement offers to certain taxpayers with micro-captive insurance arrangements. Offers disallow 90% of deductions taken by the taxpayer.
- IR-2020-26 (1/31/20). IRS announces 80% of those receiving settlement offers accepted. IRS has established 12 new examination teams that are expected to open audits related to thousands of taxpayers.
- U.S. Supreme Court grants cert. *CIC Services*: Docket No. 19-930 (5/4/20). 12

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FBAR Penalties
Outline: item H.2, page 14

- Under 31 U.S.C. § 5321(a)(5)(A), the Secretary of the Treasury "may impose" a penalty for FBAR violations.
  - Pursuant to administrative orders, the authority to impose FBAR penalties has been delegated by the Secretary to the IRS.
- Maximum penalties:
  - Before the American Jobs Creation Act of 2004 ("AJCA"), 31 U.S.C. § 5321(a)(5) provided that the penalty for *willful* FBAR violations was the greater of $25,000 or the balance of the unreported account up to $100,000.
  - After the AJCA of 2004, the *normal* penalty for an FBAR violation is $10,000 per offending account, but the penalty for a *willful* FBAR violation "*shall be increased to the greater of*" $100,000 or 50 percent of the balance in the offending account at the time of the violation.
- The relevant regulation, 31 C.F.R. § 1010.820(g), reflects pre-ACJA law and caps the penalty for willful FBAR violations to $100,000 per account.
- Issue: can the government impose the higher, current statutory penalty?
  - No. *U.S. v. Colliot*, 121 A.F.T.R.2d 2018-1834 (W.D. Tex. 5/16/18); *U.S. v. Wadhan*, 325 F. Supp. 3d 1136 (D. Colo. 7/18/18).
  - Yes. *Norman v. United States*, 138 Fed. Cl. 189 (7/31/18); U.S. v. Schwarzbaum, ___ F. Supp.3d ___, 2020 WL 1316232 (S.D. Fl. 3/20/20) (8th Amendment issue) .

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