# Recent Developments in Federal Income Taxation

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## Hoops, LP v. Commissioner, T.C. Memo. 2022-9 (2/23/22)

### *Outline: item C.1, page 2*

- In 2012, an accrual method partnership, Hoops, LP, which owned the NBA's Memphis Grizzlies, sold substantially all the assets to a buyer.
  - The buyer assumed substantially all the liabilities of Hoops, including the obligation to pay approximately $10.7 million in nonqualified deferred compensation to two players (Zach Randolph and Michael Conley).
- Hoops included the assumed liabilities in its amount realized from the sale.
- Hoops filed an amended partnership return for 2012 claiming a deduction for the deferred compensation.
- Issues:
  1. Could the partnership deduct the deferred compensation in 2012?
  2. Did Hoops have to include the assumed liabilities in its amount realized?
- Held:
  1. No. Section 404(a)(5) defers Hoops' deduction until the year in which the players include the compensation in gross income.
  2. Yes, under the definition of amount realized in § 1001(b) and Reg. § 1.1001-2(a)(1).

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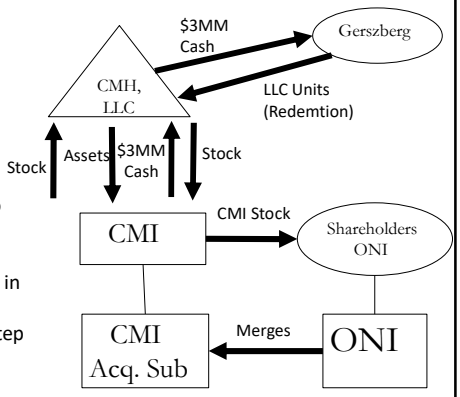
## Complex Media, Inc. v. Comm'r, T.C. Memo. 2021-14 (3/31/21).

### *Outline: item E.1, page 4*

- ❑ CMI forms Acquisition Sub.
- ❑ ONI merges into Acq. Sub. with ONI S/Hs receiving CMI stock
- ❑ ONI ceases to exist and ONI shareholders become shareholders of CMI.
- ❑ CMI distributes stock to CMH, LLC in exchange for $7.6 MM of assets in purported §351 contrib.
  - CMI/CMH, LLC transaction documents agree to treat this step as a §351 nonrecognition transaction
- ❑ CMI simultaneously distributes $3MM to CMH, LLC in redemption of some CMI stock just received.
  - CMI/CMH, LLC documents agree to treat this step as a redemption separate from the §351 transaction.
  - However, on its tax return, CMH, LLC reports this step as taxable boot as part of the §351 transaction.
- ❑ CMH, LLC distributes $3MM to Gerszberg in redemption of all of his partnership units.

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## Complex Media, Inc. v. Comm'r, T.C. Memo. 2021-14 (3/31/21).

***Outline: item E.1, page 4***

- A.O.D. 2023-11 I.R.B. ___ (3/13/23):
  - The IRS has announced that it will not follow *Complex Media* regarding a taxpayer's ability to disavow the chosen form of a transaction for tax purposes, especially if the taxpayer "does not fully, properly, and consistently report the transaction." Furthermore, the IRS will not follow Complex Media in determining the fair market value of debt (i.e., the deferred payment obligation) for purposes of § 351(b)(1).

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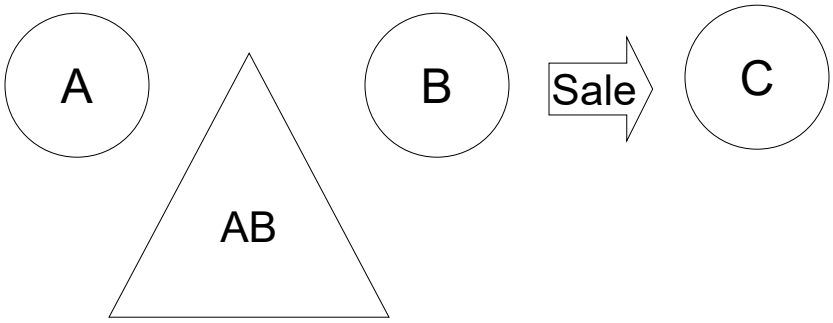
## Sale of a Partnership Interest




Assets of Partnership
- Inventory
- Land

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# Sale of a Partnership Interest

- Section 741: "In the case of a sale or exchange of an interest in a partnership, gain or loss shall be recognized to the transferor partner. Such gain or loss shall be considered as gain or loss from the sale or exchange of a capital asset, except as otherwise provided in section 751 (relating to unrealized receivables and inventory items)."
- Section 751(a): "The amount of any money, or the fair market value of any property, received by a transferor partner in exchange for all or a part of his interest in the partnership attributable to—
  1. unrealized receivables of the partnership, or
  2. inventory items of the partnership,

  shall be considered as an amount realized from the sale or exchange of property other than a capital asset."

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# Grecian Magnesite Mining Co., S.A. v. Comm'r, 149 T.C. No. 3 (7/13/17) *[Not in outline]*

- The taxpayer, a corporation organized under the laws of Greece, held an interest in a U.S. LLC taxed as a partnership.
- The partnership redeemed the taxpayer's partnership interest and the taxpayer realized $4 million of gain not associated with U.S. real property.
- Issue: was the taxpayer's gain effectively connected with the conduct of a U.S. trade or business and therefore subject to U.S. tax?
- Held: No. The court:
  1. Held that the taxpayer was treated as selling its partnership interest, rather than an interest in each partnership asset.
  2. Held that the gain was not effectively connected income.
  3. Rejected the contrary conclusion in Rev. Rul. 91-32.

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## Grecian Magnesite Mining Co., S.A. v. Comm'r, 149 T.C. No. 3 (7/13/17)
## *[Not in outline]*

- Section 864(c)(8), added by the 2017 Tax Cuts and Jobs Act, provides that, effective for dispositions after November 27, 2017:
  - gain or loss on the sale or exchange of all (or any portion of) a partnership interest owned by a nonresident alien individual or a foreign corporation in a partnership engaged in any trade or business within the U.S. is treated as effectively connected with a U.S. trade or business (and therefore taxable by the U.S. unless provided otherwise by treaty) to the extent that the transferor would have had effectively connected gain or loss had the partnership sold all of its assets at fair market value as of the date of the sale or exchange.
  - The amount of gain or loss treated as effectively connected under this rule is reduced by the amount of such gain or loss that is already taxable under § 897 (relating to U.S. real property interests).
- These changes to § 864(c) statutorily reverse the Tax Court's decision in *Grecian Magnesite Mining, Industrial & Shipping Co., S.A. v. Commissioner*, 149 T.C. No. 3 (7/13/17).

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## Rawatt v. Commissioner, T.C. Memo. 2023-14
## *Outline: item D.1, page 5*

- The taxpayer, a Canadian citizen and nonresident of the U.S., held an interest in a U.S. LLC taxed as a partnership.
- Taxpayer sold her interest in the partnership in 2008 and realized a gain of $22.4 million, of which $6.5 million was attributable to inventory of the partnership held in the U.S.
- Taxpayer moved for summary judgment based on the *Grecian Magnesite* decision.
- Issue: was the taxpayer's gain effectively connected with the conduct of a U.S. trade or business and therefore subject to U.S. tax?
- Held: Perhaps. Taxpayer's motion for summary judgment denied:
  - Taxpayer is treated as selling the inventory to the extent § 751 applies.
  - Under § 865(b), the source of the gain on the inventory is determined by the place of sale.
  - If taxpayer ultimately shows the gain is foreign-source income, she might not be subject to U.S. tax on the gain.

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## Tice v. Commissioner, 160 T.C. No. 8 (4/10/23)

***Outline: item E.1, page 6***

- The taxpayer claimed to be a bona fide resident of the U.S. Virgin Islands (USVI) for tax years 2002 and 2003.
  - Pursuant to § 932(c) (coordination of U.S. and USVI income taxes), the taxpayer filed Form 1040 only with the Virgin Islands Bureau of Internal Revenue.
  - The IRS determined that taxpayer was not a bona fide resident of the USVI.
- The IRS issued a notice of deficiency for these years in 2015.
- Taxpayer moved for summary judgment on the basis that assessment of tax was barred by the limitations period of § 6501(a).
- Issue: did the filing of a return only with the VIBIR start the running of the § 6501(a) three-year limitations period on assessment of tax?
- Held: No.
  - The court assumed for purposes of the motion that taxpayer was not a bona fide resident of the USVI.
  - To file a return with the IRS requires an intentional act by the taxpayer.
  - Follows decisions of the 8th and 11th Circuit. This case is appealable to 5th Circuit.
  - Note: for returns filed for 2006 and later tax years, Reg. § 1.932-1(c)(2)(ii) provides that § 6501 limitations period begins running upon filing a return with the VIBIR. [11]

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## Estate of Tanner v. Commissioner, T.C. Memo. 2023-54 (5/1/23)

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

- The taxpayer claimed to be a bona fide resident of the U.S. Virgin Islands (USVI) for tax years 2003 and 2004.
  - Pursuant to § 932(c) (coordination of U.S. and USVI income taxes), the taxpayer filed Form 1040 only with the Virgin Islands Bureau of Internal Revenue.
  - The IRS determined that taxpayer was not a bona fide resident of the USVI.
- The VBIR requested that taxes the taxpayer had paid to the US be "covered over" to the USVI Treasury through "cover-over requests" sent to IRS in 2005 and 2006.
  - A cover-over request typically includes a partial or complete copy of a taxpayer's USVI return.
- About a decade later, the IRS issued a notice of deficiency to the taxpayer.
- Taxpayer moved for summary judgment on the basis that assessment of tax was barred by the limitations period of § 6501(a).
- Issue: did the VIBIR's cover-over request to the IRS start the running of the § 6501(a) three-year limitations period on assessment of tax?
- Held: Taxpayer's motion for summary judgment denied. Genuine issues of material fact exist regarding whether taxpayer intended to file a return with IRS. [12]

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## Kriss v. United States, 53 F.4th 726 (1st Cir. 11/22/22)

***Outline: item H.1.g, page 11***

- Issue: if an individual taxpayer files his or her federal tax return late, can the tax debt ever be discharged in bankruptcy?
- One-day late approach: interprets section 523(a) of the Bankruptcy Code to mean that, if a return is filed even a day late, the tax debt can never be discharged in bankruptcy.
  - *In re McCoy*, 666 F.3d 924 (5th Cir. 2012) (late-filed Mississippi state tax return); *In re Mallo*, 774 F.3d 1313 (10th Cir. 12/29/14) (late-filed federal income tax return); *In re Fahey*, 779 F.3d 1 (1st Cir. 2/18/15) (late-filed Massachusetts state tax return).
- Multi-factor "*Beard*" test: applied to determine whether taxpayer's late return qualifies as a "return" w/o addressing merits of one-day late rule:
  - *Justice v. United States*, 817 F.3d 738 (11th Cir. 3/30/16); *In re Smith*, 828 F.3d 1094 (9th Cir. 7/13/16); *Giacchi v. United States*, 856 F.3d 244 (3d Cir. 5/5/17).
- Application of *Beard* test: in *Kriss*, the First Circuit held that, under the *Beard* test, the taxpayer had not made an honest and reasonable attempt to comply with the tax law. His only excuse for not filing is that his wife allegedly informed him that the returns had been filed.

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## Mann Construction, Inc. v. United States, 27 F.4th 1138 (6th Cir. 3/3/22)

***Outline: item H.2, page 12***

- In Notice 2007-83, the IRS concluded that certain trust arrangements involving cash value life insurance policies are listed transactions.
- The IRS imposed penalties on a corporation and its two shareholders under § 6707A for failing to disclose a transaction that, according to the IRS, was a transaction described in Notice 2007-83.
- Held: the IRS failed to comply with the Administrative Procedure Act in issuing Notice 2007-83 and the notice therefore is invalid.

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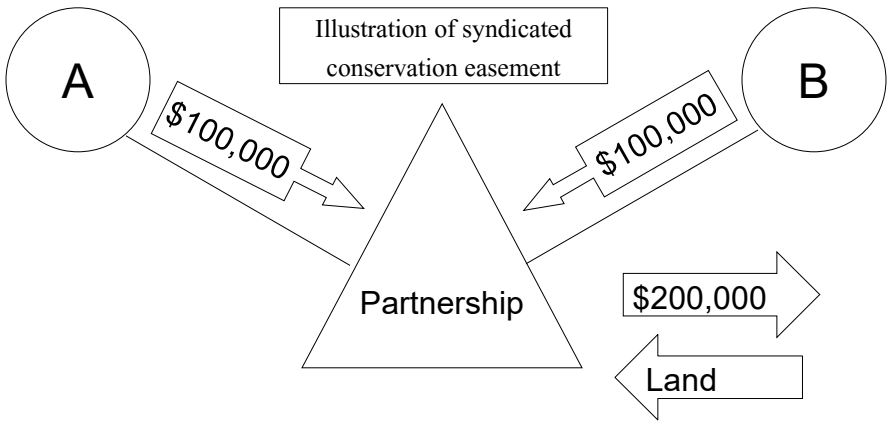
## Conservation Easements
## *Outline: item H.2.a, page 13*




- Land is appraised at its "highest and best use" at $2 million
- Partnership grants conservation easement to charitable organization
- Appraised value of land restricted by easement is $1 million
- Difference of $1 million is charitable contribution deduction ($500k/partner)

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## Green Valley Investors, LLC. v. Commissioner, 159 T.C. No. 5 (11/9/22)
## *Outline: item H.2.a, page 13*

- Holds that Notice 2017-10, which identifies syndicated conservation easements as listed transactions, is a legislative rule, improperly issued by the IRS without notice and comment as required under the APA.
- Notice 2017-10 therefore is invalid.
- IRS was prohibited from imposing penalties for failing to disclose listed transactions
- Note: on December 8, 2022, the IRS issued proposed regulations identifying syndicated conservation easements as listed transactions. [See outline page 14, item b]

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## Franklin v. United States, 49 F.4th 429 (5th Cir. 9/15/22)

***Outline: item H.3, page 15***

- The IRS assessed $421,766 in penalties for the plaintiff's failure to file accurate tax returns and failure to report a foreign trust of which he was the beneficial owner.
- Pursuant to § 7345, the IRS issued a notice of certification of a "seriously delinquent tax debt" and notified the Secretary of State.
- The State Department revoked the plaintiff's passport.
- The plaintiff challenged the revocation in a U.S. District Court.
- Issues: (1) is the IRS's assessment invalid because the IRS failed to comply with the supervisory approval requirement of § 6751(b)? (2) is § 7345 unconstitutional because it violates the Due Process Clause of the Fifth Amendment?
- Held: (1) Taxpayer's claims under § 6751(b) are barred by the Anti-Injunction Act because each of the claims under § 6751(b) implicitly challenges the validity of the penalties; (2) No. International travel is not a "fundamental right," and therefore either a rational basis standard of review or intermediate scrutiny applies, which § 7345 meets.

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