

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
First Wednesday Tax Update
October 4, 2017

Vest v. Commissioner, 119 A.F.T.R.2d 2017-2043 (5th Cir. 6/2/17) *Outline: item C.1.a, page 2*

- The taxpayers owned an interest in Truebeginnings, LLC, an accrual basis partnership, which owned interests in two other partnerships, referred to as VAS and Metric.
- Truebeginnings:
 - Sold computer equipment and zero-basis intangibles to VAS and Metric in exchange for 10-year promissory notes
 - Used the installment method to report > \$3 million of gain
- Issue: did § 453(g)(1)-(2) disallow the installment method? Disallowance occurs for sales of depreciable property between related persons unless it is established that the disposition did not have tax avoidance as one of its principal purposes.
- Held: Yes. The substance of the transaction revealed a tax avoidance purpose.

**Estate of Bartell v. Commissioner,
147 T.C. No. 5 (8/10/16)
*Outline: item E.1, page 4***

- Bartell Drug, an S corporation, wished to acquire Property 2 and sell Property 1.
 - Ultimately engaged in a reverse § 1031 exchange.
 - Prior to the § 1031 exchange:
 - Arranged for another party to acquire Property 2.
 - Guaranteed financing of renovations to Property 2 and occupied Property 2 as a tenant.
- Issue: Did the exchange of Property 1 for Property 2 qualify as a § 1031 like-kind exchange?
- Held: Yes. Court rejected IRS's argument that Bartell Drug was the owner of Property 2 before the exchange.
- Note: IRS has non-acquiesced. A.O.D. 2017-06, 2017-33 I.R.B. 194 (8/23/17).

3

**Jacobs v. Commissioner,
148 T.C. No. 24 (6/27/17)
*Outline: item A.1, page 5***

- The taxpayers were shareholders of the S corporation that operates the Boston Bruins.
- When the Bruins travel to away games, the team provides the coaches, players, and other team personnel with pre-game meals in private banquet rooms (as well as hotel lodging).
 - The meals are provided pursuant to detailed contracts between the Bruins and the hotel.
- Issue: can the S corporation deduct 100% of the cost of the meals?
- Held: Yes. The meals qualify as a de minimis fringe benefit within the meaning of § 132(e). Therefore, the meals fall within an exception (in § 274(n)(2)(B)) to the normal rule of § 274(n) that only 50% of the cost of meals is deductible.

4

Notice 2017-48, 2017-39 I.R.B. 254 (9/5/17)
Notice 2017-52, 2017-40 I.R.B. 262 (9/14/17)

Outline: item A.2, page 6

- 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, 2019, to charitable organizations for the relief of victims of Hurricanes Harvey or Irma, the IRS will not 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; or
 3. The payments are deductible by the employer only as a charitable contribution (§ 170) rather than as a business deduction (§ 162).
- Employees who make the election cannot deduct the forgone leave as a charitable contribution.

5

Ann. 2017-11, 2017-39 I.R.B. 255 (8/30/17)
Ann. 2017-13, 2017-40 I.R.B. 271 (9/12/17)

Outline: item B.1, page 6

- Qualified employer-sponsored retirement plans can make loans or hardship distributions, and IRAs can make hardship distributions, to participants who live or work in areas identified by FEMA for individual assistance on account of Hurricanes Harvey or Irma.
 - Also permitted to certain family members to assist such participants.
 - Hardship distributions must be made by January 31, 2018.
- IRS will not challenge a plan's disregard of procedural requirements imposed by the plan if the plan administrator (or financial institution for IRAs) makes a good faith, diligent effort to comply.
- To make a loan or hardship distribution, a plan that does not provide for them must be amended by first plan year beginning after 2017.
- Unless attributable to post-tax contributions, hardship distributions are includible in an employee's gross income and possibly subject to 10% penalty for early withdrawal.

6

**Petersen v. Commissioner,
148 T.C. No. 22 (6/13/17)**

Outline: item D.1, page 10

- The taxpayers were shareholders of an S corporation that had established an Employee Stock Ownership Plan (ESOP).
 - The ESOP owned shares for the benefit of employees.
- The S corporation used the accrual method of accounting and accrued deductions for > \$1 million in wages and vacation pay.
- Issue: were the S corporation's deductions disallowed by the forced matching rule of § 267(a)(2)?
 - This rule defers deductions of an accrual method taxpayer for items payable to a related cash-method taxpayer until the cash-method taxpayer includes the item in gross income.
- Held: Yes. The shares held by the ESOP trust are attributed to the employees who, as shareholders, are related to the S corp. pursuant to § 267(e).

7

**T.D. 9821 – Due Dates of Corporate Returns
82 F.R. 33441 (7/20/17)**

Outline: item H.1, page 13

- The Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, § 2006(a) (7/31/15), changed the due date of C corporation returns.
- Final regulations implement the statutory changes and:
 - Defer the due date of C corporation returns to the 15th day of the fourth month following the close of the taxable year.
 - Do not change the due date for S corporation returns (still 15th day of third month following close of the year).
 - Generally apply to tax years beginning after 2015.
 - Note: For C corporations using a June 30 tax year, the new rule applies to tax years beginning after 2025!
- Automatic extension is 6 months, except for June 30 taxpayers, who have a 7-month automatic extension prior to 2026.

8

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

Outline: item D.1, page 14

- 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 \$4.4 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.

9

Repeal of TEFRA Audit Rules

Outline: item F.1.b, page 17

- The Bipartisan Budget Act of 2015, § 1101 (11/2/15):
 - Repeals the TEFRA audit rules for years beginning after 2017.
 - Replaces with a new regime under which tax will be collected from the partnership (not the partners), unless the partnership elects to pass the liability to the partners.
- All partnerships are subject to the new regime unless they can and do elect out.
 - Partnerships with 100 or fewer partners can elect out of the new regime, provided they don't have certain kinds of partners.
- Need to look at partnership agreements now.
- Partnerships can opt in for tax years beginning after 11/2/15. T.D. 9780, 81 F.R. 51795 (8/5/16).
- Proposed Regulations (REG-136118-15) issued 6/14/17. 82 F.R. 27334 (6/14/17).

10

**Seaview Trading, LLC v. Commissioner,
858 F.3d 1281 (9th Cir. 6/7/17)**

Outline: item G.2, page 18

- Seaview Trading, LLC, a tax partnership, had two members, AGK and KMC, each of which was a single-member, disregarded LLC.
 - AGK's sole member was Robert Kotick, and KMC's sole member was Mr. Kotick's father.
- The IRS audited Robert Kotick's 2001 return and disallowed certain deductions in connection with his investment in Seaview, but did not disallow his share of a large loss passed through from Seaview.
 - After the limitations period for assessment of Mr. Kotick's 2001 return had expired, the IRS audited Seaview and issued a Final Partnership Administrative Adjustment disallowing the loss.
- Issue: was Seaview subject to the TEFRA audit rules?
- Held: Yes. Seaview was not eligible for the small partnership exception to the TEFRA audit rules because its members, although disregarded, were pass-thru partners. See § 6231(a)(9). 11

**T.D. 9821 – Due Dates of Partnership Returns
82 F.R. 33441 (7/20/17)**

Outline: item G.1, page 19

- The Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, § 2006(a) (7/31/15), changed the due date of partnership returns.
- Final regulations implement the statutory changes and:
 - Accelerate the due date of partnership returns to the 15th day of the third month following the close of the taxable year (March 15 for calendar-year partnerships).
 - Generally apply to tax years beginning after 2015.
- Automatic extension is 6 months.
- The IRS has waived late-filing penalties for partnerships that filed returns or extension requests by the old due date (15th day of the fourth month following year end) for the first tax year beginning after 2015. Notice 2017-47, 2017-38 I.R.B. 232 (9/1/17). 12

T.D. 9821 – Filing Extension for Form 990

82 F.R. 33441 (7/20/17)

Outline: item A.1, page 20

- Final regulations provide an automatic six-month extension of time for filing certain returns, including those in the Form 990 series filed by tax-exempt organizations.
 - For calendar-year filers, the extended due date is November 15.
 - Organizations must file a timely request for an extension (normally Form 8868).
 - Generally applies to tax years beginning after 2015.
- Previously, the automatic extension was three months for most forms in the 990 series.
- The Form 990 returns eligible for the automatic extension are Form 990, Form 99-EZ, Form 99-PF, Form 990-T, and Form 990-BL.

13

**RP Golf, LLC v. Commissioner,
860 F.3d 1096 (8th Cir. 6/26/17)**

Outline: item B.2, page 21

- The taxpayer donated to a land trust a conservation easement on a golf course on December 29, 2003.
 - At the time of the donation, the property was encumbered by two mortgage loans.
- The taxpayer and the mortgage holders entered into a subordination agreement in April 2004, effective as of December 31, 2003.
- Issue: was the taxpayer's \$16.4 million deduction disallowed by Reg. § 1.170A-14(g)(2), which requires that a mortgage encumbering the property be subordinated at the time the easement is granted?
- Held: Yes. The taxpayer's attempt to give retroactive effect to the subordination agreement did not meet the "protected in perpetuity" requirement of the regulation.
 - *Accord Minnick v. Commissioner*, 796 F.3d 1156 (9th Cir. 2015); *Mitchell v. Commissioner*, 775 F.3d 1243 (10th Cir. 2015).

14

**Rubel v. Commissioner,
856 F.3d 301 (3d Cir. 5/9/17)**

Outline: item G.1, page 24

- The IRS issued a notice of determination denying the taxpayer innocent spouse relief.
 - This triggered a 90-day period in which the taxpayer could file a petition in the Tax Court. This period expired on April 12.
- In subsequent correspondence, the taxpayer submitted additional evidence.
 - The IRS responded with a letter adhering to its position. The letter erroneously reminded the taxpayer that her petition was due in the Tax Court on April 19.
- Issue: did the Tax Court have jurisdiction to consider the taxpayer's petition, filed on April 19?
- Held: No. The 90-day limitations period is jurisdictional.
- *See also Matuszak v. Commissioner*, 862 F.3d 192 (2d Cir. 7/5/17)

**Steele v. United States,
119 A.F.T.R.2d 2017-2065 (D.D.C. 6/1/17)**

Outline: item H.1.c, page 27

- Held: although the IRS has statutory authority to require the use of PTINs by those who prepare tax returns for compensation, it cannot charge fees for issuing PTINs.
- In a subsequent order (120 A.F.T.R.2d 2017-5145 (D.D.C. 7/7/17), the court:
 - Declared all fees charged by the IRS for issuing PTINs unlawful.
 - Permanently enjoined the United States from charging such fees.
 - Ordered the United States to refund all PTIN fees paid from September 1, 2010, to the present.

**IR-2017-160 (9/26/17) - Extended Filing and
Payment Dates for Harvey, Irma, and Maria**

Outline: item H.4, page 28

- This news release summarizes relief announced in a series of prior news releases for those in areas affected by Hurricanes Harvey, Irma, and Maria.
- Relief available to individuals and businesses anywhere in Florida, Georgia, Puerto Rico, and Virgin Islands, as well as parts of Texas.
- The following due dates are extended to January 31, 2018:
 - 9/15/17 and 1/16/18 dates for quarterly estimated tax payments.
 - 9/15/17 due date for certain returns, including those for calendar-year partnerships that filed 2016 extension requests.
 - 10/16/17 extended due date for 2016 individual returns.
 - 10/31/17 due date for quarterly payroll and excise tax returns.
 - 11/15/17 extended date for returns of calendar-year tax-exempts.
- Relief is provided automatically; request abatement if not.

17