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TAX SECTION
STATE BAR OF TEXAS

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Dear Fellow Tax Section Members:

We are nearing the end of our fiscal year, and as Chair, I can truly say that the Tax Section is one of the most active sections of the State Bar. The Tax Section continues to offer a wide variety of programs, events, committees and publications for the benefit of its members. There is a lot happening at the Tax Section. Here is a recap of a few recent and pending developments.

Tax Section Annual Meeting

The Tax Section Annual Meeting is around the corner. It will be held at the Houston Marriott Marquis in Houston, Texas on Friday, June 22, 2018. If you have not already registered, you may do so on our website at https://www.texasbar.com/AM/Template.cfm?Section=Annual_Meeting_Home&Template=/CM/HTMLDisplay.cfm&ContentID=30096. The Annual Meeting is a great opportunity to network with other tax lawyers throughout the state of Texas and get caught up on the most recent developments in tax law. We will once again host a networking happy hour on Thursday, June 21, 2018, also at the Houston Marriott Marquis, from 5:00 p.m.–6:00 p.m. The happy hour is open to all Tax Section members, and I look forward to seeing many of you there. On Friday, June 22, 2018, we will have our annual Tax Legends lunch which provides an interview with a tax legend. This year the tables are turned and **Dan Baucum** will interview Tax Legend **Bill Elliott**. Thank you to Annual Meeting Chair **John Strohmeyer** for his work to make this a huge success. We hope to see you all at our Annual Meeting!

Committee on Governmental Submissions

The Committee on Governmental Submissions is on track to set yet another record this year with its governmental submissions. To date, the Committee has issued 17 comment projects with additional ones on the way. The State and Local Tax Committee has filed six of these with Tax Controversy and Estate and Gift Tax with four each. Also issuing comments are Energy and Natural Resources, International Tax, and Partnership and Real Estate. Thank you to COGS Chairs **Henry Talavera**, **Jeff Blair**, **Ira Lipstet** and **Jason Freeman**.

New This Year

Back in October 2017, the Tax Section announced a new free webcast series "**First Wednesday Tax Update**". These webcasts have been wildly popular. The webcasts are offered the first Wednesday of each month (barring a holiday) and always focus on Recent Developments in Federal Income Taxation, and are presented by **Bruce McGovern**, Professor of Law and Director, Tax Clinic, South Texas College of Law Houston (and may occasionally include other guest speakers). If you miss it, after a few weeks it will be in the Tax Section's 24/7 online library. Special thanks to **Sara Giddings**, Co-Chair of the Solo and Small Firm Committee, for coming up with this idea for providing convenient and relevant continuing legal education for our members, and to **Bruce McGovern**, Chair of the General Tax Committee for bringing Sara's idea to life.

Also new this year, the Tax Section introduced an important new CLE offering, the Federal Tax Workshop Program, an un-taped, in depth, interactive seminar focusing on one topic with the Department of Treasury and Internal Revenue Service and prominent private practice speakers. The inaugural seminar was "New Partnership Audit Rules in Depth", held at the Belo Mansion in Dallas on March 21, 2018. The inaugural seminar was a one-day program designed to familiarize tax professionals with the new partnership audit rules that will affect the audits of most partnerships and LLCs beginning January 1, 2018. This seminar featured Treasury Department and IRS attorneys from Washington, D.C. who are involved in writing the new tax rules. In addition, non-government panelists shared their tips for drafting partnership and LLC agreements in light of these new rules. Many thanks to **Dan Baucum** for his leadership in putting this important CLE together. The program was nationally recognized in the press and received top ratings by attendees. We anticipate that next year the seminar will draw an audience from around the nation.

Outstanding Texas Tax Lawyer

Each year the Tax Section issues the Outstanding Texas Tax Lawyer Award to a tax attorney whose achievements demonstrate satisfaction of the rigorous substantive standards specified in our by-laws. **Cynthia Ohlenforst** of K&L Gates, who was nominated by Sam Megally, was selected by the Council this year. We will present her this Award at the Annual Meeting Speakers' Dinner on June 21, 2018 in Houston, Texas. Please congratulate Cynthia Ohlenforst on this honor if you see her.

Scholarship Recipients

Each year the Tax Section issues several scholarships to deserving law students who are selected from among qualifying candidates. The deadline for submitting scholarships was April 6, 2018. The Law School Liaison Task Force received 19 applications from students at 10 law schools. Recipients of the scholarships will be recognized at the Awards Dinner on June 21, 2018 in Houston, Texas. Many thanks to **Stephen Long** for his hard work and dedication to this program.

Special Thanks

As my tenure as Chair of the Tax Section comes to an end, I would like to recognize and give special thanks to the many outstanding tax lawyers who make the Tax Section great. This list includes **Elizabeth Copeland**, **Alyson Outenreath,** the Officers, Council Members, Committee Chairs and Vice Chairs, project leaders, and everyone else involved with the Tax Section who tirelessly give their time, energy and resources to the various activities of the Tax Section. I look forward to recognizing many of the Tax Section's outstanding leaders at the Tax Section Annual Meeting on June 22, 2018. I would also like to thank **Kelly Rorschach**, the Tax Section Administrator, and **Tracy Nuckols** from the Big Bar for their endless help this year.

Join a Committee

We have an active set of committees, both substantive and procedural. Our substantive committees are: Corporate Tax, Employee Benefits, Energy and Natural Resources, Estate and Gift Tax, General Tax Issues, International Tax, Partnership and Real Estate, Property Tax, Solo and Small Firm, State and Local Tax, Tax Controversy, Tax- Exempt Finance, and Tax-Exempt Organizations. In addition, our procedural committees include: the Committee on Governmental Submissions, Annual Meeting Planning Committee, Continuing Legal Education Committee, Newsletter Committee, and Tax Law in a Day Committee.

Any members interested in joining a committee may do so by visiting our website at www.texastaxsection.org.

Contact Information

Below is my contact information as well as the contact information for our Tax Section Administrator, Kelly Rorschach, if you would like additional information:

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Congratulations!!

The following students will receive the Law Students Pursuing Tax Law Scholarship



- Lindsay Thomason, South Texas College of Law Houston
- Dominick Constantino, University of Texas School of Law
- Alexandra Romeo, Southern Methodist University, Dedman School of Law
- Adam Bateman, South Texas College of Law Houston

TAX SECTION
STATE BAR OF TEXAS

Annual Meeting
CLE: 6.25 hrs/1.00 hr Ethics
CPE: 7.5 hrs/1.00 hr Ethics
Thursday, June 21, 2018
Friday, June 22, 2018

Location:
Marriott Marquis Hotel
1777 Walker Street
Houston, Texas 77010

Thursday, June 21
5:00 pm - 6:00 pm
Complimentary Networking Reception
Marriott Marquis Hotel
ALL TAX SECTION MEMBERS WELCOME!

Friday, June 22
8:30 am - 9:15 am
Section Membership Meeting and Awards

Stephanie Schroepfer, Chair
Norton Rose Fulbright US LLP, Houston
Catherine Scheid, Chair-Elect
The Law Offices of Catherine Scheid, Houston

9:15 am - 10:15 am
Tax Reform: Now What?
1.00 hr CLE/0.00 hr Ethics

Eric Solomon
Ernst & Young, Washington, D.C.

10:15 am - 10:30 am - Break

10:30 am - 11:15 am
Tax Issues in Divorce, including International Tax Issues
0.75 hr CLE/0.00 hr Ethics

Matt Beard
Meadows, Collier, Reed, Cousins, Crouch & Ungerman, LLP, Dallas
Joan Crain
BNY Mellon, Miami, FL
Randall Wilhite
Fullenweider Wilhite, Houston

11:15 am - 12:00 pm
International Tax Updates
0.75 hr CLE/0.00 hr Ethics

Daniel Price
Office of Chief Counsel of the Internal Revenue Service, Austin
Jason Freeman
Freeman Law PLLC, Frisco

12:00 pm - 12:30 pm - Break to pick up lunch
(Ticket Required)

12:30 pm - 1:30 pm
Lunch Session: Texas Tax Legends Interview
1.00 hr CLE/0.00 hr Ethics

Daniel Baucum, ***Munsch,*** *Hardt, Kopf & Harr, PC, Dallas*, **interviews Tax Section Former Chair and 2017 Outstanding Texas Tax Lawyer Recipient William "Bill" Elliott,** *Elliott, Thomason & Gibson, LLP, Dallas*

1:30 pm - 1:45 pm - Break

1:45 pm - 2:30 pm
State and Local Tax Issues
0.75 hr CLE/0.00 hr Ethics

Ira Lipstet
DuBois Bryant & Campbell LLP, Austin
Amanda Traphagan
Seay & Traphagan PLLC, Austin

2:30 pm - 3:30 pm
Ethical Issues in New Client Acquisition
1.00 hr CLE/1.00 hr Ethics

John Strohmeyer
Strohmeyer Law PLLC, Houston
Kris Coleman
Red Five Security LLC, Washington, D.C.
Warren Fisher
Ytterberg Deery Knull LLP, Houston
Heather Hatfield
Porter Hedges LLP, Houston

3:30 pm - 3:45 pm - Break

3:45 pm - 4:45 pm
Property Tax Update
1.00 hr CLE/0.00 hr Ethics

Amy Stowe
Law Offices of Amy Stowe, Dallas
Roland Altinger
Harris County Appraisal District, Houston

RECENT DEVELOPMENTS IN FEDERAL INCOME TAXATION

"Recent developments are just like ancient history, except they happened less long ago."

By

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State Bar of Texas Tax Section
First Wednesday Tax Update
February 7, 2018

Note: This outline was prepared jointly with Professor Cassady V. ("Cass") Brewer of the Georgia State University College of Law, Atlanta, GA.

On December 22, 2017, the President signed legislation that makes significant amendments to the Internal Revenue Code of 1986. This legislation, which became Pub. L. No. 115-97, is colloquially referred to as the Tax Cuts and Jobs Act ("TCJA"). This outline refers to the legislation in this manner and summarizes changes that, in our judgment, are the most important. The outline does not attempt to list the legislation's provisions comprehensively or to explain them in detail. For further explanation and details, the complete Conference Report accompanying TCJA may be found here. Finally, readers should note that many of the TCJA changes affecting individual taxpayers are temporary and sunset for taxable years beginning after December 31, 2025.

I. ACCOUNTING

A. Accounting Methods

1. Many more taxpayers now can use the cash method of accounting. The 2017 Tax Cuts and Jobs Act, § 13102, made several amendments to expand the universe of C corporations, partnerships, and businesses with inventory that can use the cash method of accounting. These amendments apply to taxable years beginning after 2017.

General Rules for C Corporations. Code § 448(a) provides as a general rule that a C corporation, or a partnership with a C corporation as a partner, cannot use the cash method of accounting. Prior to amendment by the 2017 Tax Cuts and Jobs Act, an exception in § 448(b)(3) provided that this prohibition did not apply to an entity that met a gross receipts test for *all* prior tax years, and § 448(c)(1) provided that an entity met the gross receipts test for a year if its average annual gross receipts (measured over the three preceding tax years) did not exceed $5 million. The legislation made two significant changes. *First*, the legislation removed the requirement that an entity must meet the gross receipts test for all prior tax years in order to use the cash method. Instead, under amended § 448(b)(3), the inquiry is simply whether the entity's average annual gross receipts, measured over the three preceding tax years, were below a specified limit. *Second*, the legislation increased the $5 million limit to $25 million. Accordingly, a C corporation, or a partnership with a C corporation as a partner, can use the cash method of accounting for a year if its average annual gross receipts, measured over the three prior years, do not exceed $25 million.

Farming C Corporations. Under Code § 447(a), taxable income from farming of a C corporation (or a partnership with a C corporation as a partner) engaged in the trade or business of farming must be determined using the accrual method of accounting. Prior to amendment by the 2017 Tax Cuts and Jobs Act, § 447(c)(2) provided that that this requirement did not apply if the C corporation met the gross receipts test specified in § 447(d). This gross receipts test required that, for all prior tax years, the C corporation's gross receipts must not have exceeded $1 million ($25 million in the case of family corporations). The legislation amended § 447(c)(2) to apply the same gross receipts test (in § 448(c)) that applies to C corporations generally. Pursuant to this amendment, a C corporation (or a partnership with a C corporation as a partner) engaged in the trade or business of farming can use the cash method of accounting for a year if its average annual gross receipts, measured over the three prior years, do not exceed $25 million.

Businesses with Inventory. Under § 471(c)(1)(A) as amended by the 2017 Tax Cuts and Jobs Act, a business that meets the gross receipts test of § 448(c) (average annual gross receipts, measured over the three prior years, do not exceed $25 million) can use the cash method of accounting *even if inventories are a material income-producing factor*. Thus, even if a C corporation has inventory, as long as it meets the gross receipts test, it can use the cash method of accounting.

Inflation Adjustment. According to § 448(c)(4), as amended by the 2017 Tax Cuts and Jobs Act, the $25 million figure used for purposes of the average gross receipts test will be adjusted for inflation (rounded to the nearest million) for taxable years beginning after 2018.

Change in Method of Accounting. A business that changes from the accrual method to the cash method to take advantage of the new rules will have a change in method of accounting. According to §§ 447(d) and 448(d)(7), these changes in method of accounting are treated as made with the consent of the IRS. Presumably, the IRS will issue automatic change procedures to facilitate such changes.

2. Congress has expanded the small construction contract exception to the percentage-of-completion method of accounting. Generally, § 460(a) requires taxpayers to account for long-term contracts using the percentage-of-completion method of accounting. An exception exists, commonly known as the "small construction contract" exception, pursuant to which a taxpayer need not use the percentage-of-completion method for construction contracts if (1) at the time the contract is entered into, the taxpayer expects the contract to be completed within the two-year period beginning on the contract commencement date, and (2) the taxpayer's average annual gross receipts (measured over the three taxable years preceding the taxable year in which such contract is entered into) do not exceed a specified limit. Prior to amendment by the 2017 Tax Cuts and Jobs Act, § 460(e)(1)(B)(ii) provided that that this limit was $10 million. Section 13102 of the legislation amended Code § 460(e)(1)(B)(ii) to provide that the test used for purposes of the second part of the small construction contract exception is the gross receipts test of § 448(c) (average annual gross receipts, measured over the three prior years, do not exceed $25 million). This change applies to contracts entered into after December 31, 2017, in taxable years ending after that date. Any change in method of accounting that a taxpayer makes pursuant to this new rule is treated, according to § 460(e)(2)(B), as made with the consent of the IRS and must be effected on a cut-off basis for all similarly classified contracts entered into on or after the year of change.

B. Inventories

1. **Simplified inventory accounting for small businesses.** Under § 471(a) and Reg. § 1.471-1, taxpayers for whom the production, purchase, or sale of merchandise is an income-producing factor must account for inventories. Generally, under Reg. § 1.446-1(c)(2), when the use of inventories is necessary to clearly reflect income, a taxpayer must use the accrual method for purchases and sales. The 2017 Tax Cuts and Jobs Act, § 13102, redesignated § 471(c) as § 471(d) and added new § 471(c). New § 471(c) provides that taxpayers meeting the gross receipts test of § 448(c) (average annual gross receipts, measured over the three prior years, do not exceed $25 million) are not required to account for inventories under § 471. Instead, such taxpayers can use a method of accounting for inventories that either (1) treats inventories as non-incidental materials and supplies, or (2) conforms to the taxpayer's financial accounting treatment of inventories (either in an "applicable financial statement" as defined in § 451(b)(3) or in the taxpayer's books and records). This rule applies to taxable years beginning after 2017. Any change in method of accounting that a taxpayer makes pursuant to this new rule is treated, according to § 471(c)(4), as made with the consent of the IRS. Presumably, the IRS will issue automatic change procedures to facilitate such changes.

C. Installment Method

D. Year of Income or Deduction

1. **An expanded exception to the uniform capitalization rules for small businesses.** The 2017 Tax Cuts and Jobs Act, § 13102, redesignated Code § 263A(i) as § 263A(j) and added new § 263A(i). New § 263A(i) excludes from the uniform capitalization rules of § 263A any taxpayers meeting the gross receipts test of § 448(c) (average annual gross receipts, measured over the three prior years, do not exceed $25 million). In the case of a taxpayer other than a corporation or a partnership, the gross receipts test is applied as if each trade or business of the taxpayer were a corporation or partnership. This exclusion is broader than one that existed before this change. Prior to this amendment, taxpayers that produced property and those that acquired property for resale generally were subject to § 263A, but an exception existed for taxpayers acquiring property for resale with average annual gross receipts that did not exceed $10 million. Under new § 263A(i), all taxpayers (other than tax shelters), including those that produce property, with average annual gross receipts that do not exceed $25 million, are not subject to the uniform capitalization rules. This provision applies to taxable years beginning after 2017. Any change in method of accounting that a taxpayer makes pursuant to this new rule is treated, according to § 263A(i)(3), as made with the consent of the IRS. Presumably, the IRS will issue automatic change procedures to facilitate such changes.

2. **Accrual-method taxpayers may have to recognize income sooner as a result of legislative changes.** The 2017 Tax Cuts and Jobs Act, § 13221, amended Code § 451 to make two changes that affect the recognition of income and the treatment of advance payments by accrual method taxpayers. Both changes apply to taxable years beginning after 2017. Any change in method of accounting required by these amendments for taxable years beginning after 2017 is treated as initiated by the taxpayer and made with the consent of the IRS.

All events test linked to revenue recognition on certain financial statements. The legislation amended Code § 451 by redesignating § 451(b) through (i) as § 451(d) through (k) and adding a new § 451(b). New § 451(b) provides that, for accrual-method taxpayers, "the all events test with respect to any item of gross income (or portion thereof) shall not be treated as met any later than when such item (or portion thereof) is taken into account as revenue in" either (1) an applicable financial statement, or (2) another financial statement specified by the IRS. Thus, taxpayers subject to this rule must include an item in income for tax purposes upon the earlier of satisfaction of the all events test or recognition of the revenue in an applicable financial statement (or other specified financial statement). According to the Conference Report that accompanied the legislation, this means, for example, that any unbilled receivables for partially performed services must be recognized to the extent the amounts are taken into income for financial statement purposes. Income from mortgage servicing contracts is not subject to the new rule. The new rule also does not apply to a taxpayer that does not have either an applicable financial statement or another specified financial statement. An "*applicable financial statement*" is defined as **(1)** a financial statement that is certified as being prepared in accordance with generally accepted accounting principles that is **(a)** a 10-K or annual statement to shareholders required to be filed with the Securities and Exchange Commission, **(b)** an audited financial statement used for credit purposes, reporting to shareholders, partners, other proprietors, or beneficiaries, or for any other substantial nontax purpose, or **(c)** filed with any other federal agency for purposes other than federal tax purposes; **(2)** certain financial statements made on the basis of international financial reporting standards and filed with certain agencies of a foreign government; or **(3)** a financial statement filed with any other regulatory or governmental body specified by IRS.

Advance payments for goods or services. The legislation amended Code § 451 by redesignating § 451(b) through (i) as § 451(d) through (k) and adding a new § 451(c). This provision essentially codifies the deferral method of accounting for advance payments reflected in Rev. Proc. 2004-34, 2004-22 I.R.B. 991. New § 451(c) provides that an accrual-method taxpayer who receives an advance payment can either (1) include the payment in gross income in the year of receipt, or (2) elect to defer the category of advance payments to which such advance payment belongs. If a taxpayer makes the deferral election, then the taxpayer must include in gross income any portion of the advance payment required to be included by the applicable financial statement rule described above, and include the balance of the payment in gross income in the taxable year following the year of receipt. An advance payment is any payment: (1) the full inclusion of which in gross income for the taxable year of receipt is a permissible method of accounting (determined without regard to this new rule), (2) any portion of which is included in revenue by the taxpayer for a subsequent taxable year in an applicable financial statement (as previously defined) or other financial statement specified by the IRS, and (3) which is for goods, services, or such other items as the IRS may identify. The term "advance payment" does *not* include several categories of items, including rent, insurance premiums, and payments with respect to financial instruments.

II. BUSINESS INCOME AND DEDUCTIONS

A. Income

1. When we said tangible personal property, we really meant tangible personal property, says Congress. Under § 74(c), an employee can exclude from gross income the value of an "employee achievement award," and the employer's deduction for such an award is limited by § 274(j)(1). An employee achievement award is defined in § 274(j)(3)(A)(i) as an item of tangible personal property transferred by an employer to an employee that is awarded as part of a meaningful presentation and under conditions and circumstances that do not create a significant likelihood of the payment of disguised compensation. The 2017 Tax Cuts and Jobs Act, § 13310, amended Code § 274(j) to add a definition of "tangible personal property" in new § 274(j)(3)(A)(ii). Under this definition, the term "tangible personal property" does not include either (1) cash, cash equivalents, gift cards, gift coupons, or gift certificates, or (2) vacations, meals, lodging, tickets to theater or sporting events, stocks, bonds, other securities, and other similar items. Despite this definition, arrangements can qualify as an employee achievement award if they "confer only the right to select and receive tangible personal property from a limited array of such items pre-selected or pre-approved by the employer." This provision applies to amounts paid or incurred after 2017.

B. Deductible Expenses versus Capitalization

1. Required amortization of specified research or experimental expenditures incurred after 2021. The 2017 Tax Cuts and Jobs Act, § 13206, amended Code § 174 to require the capitalization and amortization of specified research or experimental expenditures. The amortization period is 5 years (15 years for expenditures attributable to foreign research), beginning at the midpoint of the year in which the expenditures are paid or incurred. The term "specified research or experimental expenditures" is defined as research or experimental expenditures paid or incurred by the taxpayer during a taxable year in connection with the taxpayer's trade or business. The term includes expenditures for software development. This rule applies to amounts paid or incurred in taxable years beginning after 2021.

C. Reasonable Compensation

1. Could we see compensation levels of top corporate officers actually decline? Code § 162(m) limits to $1 million the deduction of publicly traded corporations for compensation to covered employees (generally, certain top corporate officers). Certain types of compensation are not subject to this limit and are not taken into account in determining whether compensation exceeds $1 million, including remuneration payable (1) on a commission basis, or (2) solely on account of attainment of one or more performance-based goals if certain approval requirements are met ("performance-based compensation"). The 2017 Tax Cuts and Jobs Act, § 13601, amended Code § 162(m) to eliminate the exceptions for commissions and performance-based compensation. Accordingly, such compensation must be taken into account in determining the amount of compensation with respect to a covered employee for a taxable year that exceeds $1 million and therefore is not deductible. The legislation also amended the definition of "covered employee" in four ways: (1) the statutory definition now includes the principal executive officer and principal financial officer (whereas formerly the statutory definition referred only to the chief executive officer), (2) the definition includes persons who served as principal executive officer or principal financial officer *at any time during the taxable year* (rather than at the end of the year), (3) the definition includes officers whose compensation must be reported to shareholders under the Securities Exchange Act of 1934 by reason of their being among the *three* highest compensated officers (rather than four highest compensated officers), and (4) the definition now includes a person who was a covered employee for any preceding taxable year beginning after 2016 (which means the limit applies to compensation paid after termination of employment or after the employee's death). Finally, the legislation expands the category of corporations subject to the § 162(m) limit by defining "publicly traded corporation" to include foreign corporations publicly traded through American depositary receipts (ADRs) and certain large private corporations and S corporations. These changes apply to taxable years beginning after 2017. A transition rule provides that the changes do not apply to remuneration provided pursuant to a written binding contract that was in effect on November 2, 2017 as long as the contract is not materially modified after that date. Compensation provided pursuant to a renewal of a grandfathered contract is subject to the new rules.

D. Miscellaneous Deductions

1. Standard mileage rates for 2018. Notice 2018-3, 2018-2 I.R.B. 285 (12/14/17). The standard mileage rate for business miles in 2018 goes up to 54.5 cents per mile (from 53.5 cents in 2017) and the medical/moving rate goes up to 18 cents per mile (from 17 cents in 2017). The charitable mileage rate remains fixed by § 170(i) at 14 cents. The portion of the business standard mileage rate treated as depreciation is 25 cents per mile for 2018 (unchanged from 2017).

2. Oh, come on! No more deductions for taking a client to a professional sports game? The 2017 Tax Cuts and Jobs Act, § 13304, amended Code § 274(a) to disallow deductions for costs "[w]ith respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation." Similarly, no deduction is allowed for membership dues with respect to any club organized for business, pleasure, recreation or other social purposes. This rule applies to taxable years beginning after 2017.

3. And no more deductions for employers for most qualified transportation fringe benefits such as employer-paid parking. The 2017 Tax Cuts and Jobs Act, § 13304(c), amended Code § 274(a) by adding § 274(a)(4), which provides that, for amounts paid or incurred after 2017, no deduction is allowed for any "qualified transportation fringe" (as defined in § 132(f)) provided to an employee of the taxpayer. A qualified transportation fringe is any of the following provided by an employer to an employee: (1) transportation in a commuter highway vehicle in connection with travel between the employee's residence and place of employment, (2) any transit pass, (3) qualified parking, and (4) any qualified bicycle commuting reimbursement. Further, the legislation added new § 274(*l*), which provides:

1. **General Rule.** No deduction shall be allowed under this chapter for any expense incurred for providing any transportation, or any payment or reimbursement, to an employee of the taxpayer in connection with travel between the employee's residence and place of employment, except as necessary for ensuring the safety of the employee.

2. **Exception.** In the case of any qualified bicycle commuting reimbursement (as described in section 132(f)(5)(F)), this subsection shall not apply for any amounts paid or incurred after December 31, 2017, and before January 1, 2026.

Effect on Employers. Under § 274 as amended, an employer *cannot* deduct the cost of transportation in a commuter highway vehicle, a transit pass, or qualified parking paid or incurred after 2017. However, the employer *can* deduct the cost of a qualified bicycle commuting reimbursement paid or incurred after 2017 and before 2026.

Effect on Employees. With one exception, the legislation did not change the tax treatment of employees with respect to qualified transportation fringes. Employees can still (as under prior law) exclude from gross income (subject to applicable limitations) any of the following provided by an employer: (1) transportation in a commuter highway vehicle in connection with travel between the employee's residence and place of employment, (2) any transit pass, or (3) qualified parking. The exception is a qualified bicycle commuting reimbursement, which, under new § 132(f)(8), must be included in an employee's gross income for taxable years beginning after 2017 and before 2026.

4. Rats! We knew that we should have been architects or engineers instead of tax advisors. The 2017 Tax Cuts and Jobs Act, § 11011, added § 199A, thereby creating an unprecedented, new deduction for trade or business (and certain other) income earned by sole proprietors, partners of partnerships (including members of LLCs taxed as partnerships or as sole proprietorships), and shareholders of S corporations. New § 199A is intended to put owners of flow-through entities (but also including sole proprietorships) on par with C corporations that will benefit from the new reduced 21% corporate tax rate; however, in our view, the new provision actually makes many flow-through businesses even more tax-favored than they were under pre-TCJA law.

Big Picture. Oversimplifying a bit to preserve our readers' (and the authors') sanity, new § 199A essentially grants a special 20 percent deduction for "qualified business income" (principally, trade or business income, but not wages) of certain taxpayers (but not most personal service providers except those falling below an income threshold). In effect, then, new § 199A reduces the top marginal rate of certain taxpayers with respect to their trade or business income (but not wages) by 20 percent (i.e., the maximum 37 percent rate becomes 29.6 percent on qualifying business income assuming the taxpayer is not excluded from the benefits of the new statute). Most high-earning (over $415,000 taxable income if married filing jointly) professional service providers (including lawyers, accountants, investment advisors, physicians, etc., but *not* architects or engineers) are excluded from the benefits of new § 199A. Of course, the actual operation of new § 199A is considerably more complicated, but the highlights (lowlights?) are as summarized above.

Effective dates. Section 199A applies to taxable years beginning after 2017 and before 2026.

Initial Observations. Our initial, high-level observations of new § 199A are set forth below:

1. *How § 199A applies.* New § 199A is applied at the individual level of any qualifying taxpayer by first requiring a calculation of taxable income excluding the deduction allowed by § 199A and then allowing a special deduction of 20 percent of qualified business income against taxable income to determine a taxpayer's ultimate federal income tax liability. Thus, the deduction is *not* an above-the-line deduction allowed in determining adjusted gross income; it is a deduction that reduces taxable income. The deduction is available both to those who itemize deductions and those who take the standard deduction. The deduction cannot exceed the amount of the taxpayer's taxable income reduced by net capital gain. The § 199A deduction applies for income tax purposes; it does *not* reduce self-employment taxes. Query what states that piggyback off federal taxable income will do with respect to new § 199A. Presumably, the deduction will be disallowed for state income tax purposes.

2. *Eligible taxpayers.* Section 199A(a) provides that the deduction is available to "a taxpayer other than a corporation." The deduction of § 199A is available to individuals, estates, and trusts. For S corporation shareholders and partners, the deduction applies at the shareholder or partner level. Section 199A(f)(4) directs Treasury to issue regulations that address the application of § 199A to tiered entities.

3. *Qualified trades or businesses (or, what's so special about architect and engineers?)—§ 199A(d).* One component of the § 199A deduction is 20 percent of the taxpayer's qualified business income. To have qualified business income, the taxpayer must be engaged in a qualified trade or business, which is defined as any trade or business *other than* (1) the trade or business of performing services as an employee, or (2) a specified service trade or business. A specified service trade or business is defined (by reference to Code § 1202(e)(3)(A)) as "any trade or business involving the performance of services in the fields of health, … law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees." Architects and engineers must be special, because they are excluded from the definition of a specified service trade or business. There is no reasoned explanation for this exclusion in the 2017 TCJA Conference Report. *Note:* taxpayers whose taxable income, determined without regard to the § 199A deduction, is below a specified threshold are not subject to the exclusion for specified service trades or businesses, i.e., these taxpayers can take the § 199A deduction even if they are doctors, lawyers, accountants etc. The thresholds are $315,000 for married taxpayers filing jointly and $157,500 for all other taxpayers. (These figures will be adjusted for inflation in years beginning after 2018.) Taxpayers whose taxable income exceeds these thresholds are subject to a phased reduction of the benefit of the § 199A deduction until taxable income reaches $415,000 for joint filers and $207,500 for all other taxpayers, at which point the service business cannot be treated as a qualified trade or business.

4. *Qualified business income—§ 199A(c).* One component of the § 199A deduction is 20 percent of the taxpayer's qualified business income, which is generally defined as the net amount from a qualified trade or business of items of income, gain, deduction, and loss included or allowed in determining taxable income. Excluded from the definition are: (1) income not effectively connected with the conduct of a trade or business in the United States, (2) specified investment-related items of income, gain, deduction, or loss, (3) amounts paid to an S corporation shareholder that are reasonable compensation, (4) guaranteed payments to a partner for services, (5) to the extent provided in regulations, payments to a partner for services rendered other than in the partner's capacity as a partner, and (6) qualified REIT dividends, qualified cooperative dividends, or qualified publicly traded partnership income (because these three categories are separate components of the § 199A deduction).

5. *Determination of the amount of the § 199A deduction—§ 199A(a)-(b).* Given the much-touted simplification thrust of the 2017 Tax Cuts and Jobs Act, determining the amount of a taxpayer's § 199A deduction is surprisingly complex. One way to approach the calculation is to think of the § 199A deduction as the sum of three buckets, subject to two limitations. *Bucket 1* is the sum of the following from all of the taxpayer's qualified trades or businesses, determined separately for each qualified trade or business: the lesser of (1) 20 percent of the qualified trade or business income with respect to the trade or business, or (2) the greater of (a) 50 percent of the W–2 wages with respect to the qualified trade or business, or (b) the sum of 25 percent of the W–2 wages with respect to the qualified trade or business, plus 2.5

percent of the unadjusted basis immediately after acquisition of all qualified property. (*Note:* this W-2 wages and capital limitation *does not apply* to taxpayers whose taxable income is below the $157,500/$315,000 thresholds mentioned earlier in connection with the definition of a qualified trade or business. For taxpayers below the thresholds, Bucket 1 is simply 20 percent of the qualified trade or business income. For taxpayers above the thresholds, the wage and capital limitation phases in and fully applies once taxable income reaches $207,500/$415,000.) *Bucket 2* is 20 percent of the sum of the taxpayer's qualified REIT dividends and qualified publicly traded partnership income. *Bucket 3* is the lesser of (1) 20 percent of the taxpayer's qualified cooperative dividends, or (2) the taxpayer's taxable income reduced by net capital gain. *Limitation 1* is that the sum of Bucket 1 and Bucket 2 cannot exceed 20 percent of the amount by which the taxpayer's taxable income exceeds the sum of the taxpayer's net capital gain and qualified cooperative dividends. *Limitation 2* is an overall limitation and provides that the sum of Buckets 1, 2 and 3 (after application of Limitation 1) cannot exceed the amount of the taxpayer's taxable income reduced by the taxpayer's net capital gain. Thus, a taxpayer's § 199A deduction is determined by adding together Buckets 1 and 2, applying Limitation 1, adding Bucket 3, and then applying Limitation 2.

6. *An incentive for business profits rather than wages.* Given a choice, most taxpayers who qualify for the § 199A deduction would prefer to be compensated as an independent contractor (i.e., 1099 contractor) rather than as an employee (i.e., W-2 wages), unless employer-provided benefits dictate otherwise because, to the extent such compensation is "qualified business income," a taxpayer may benefit from the 20 percent deduction authorized by § 199A.

7. *The "Edwards/Gingrich loophole" for S corporations becomes more attractive.* New § 199A exacerbates the games currently played by S corporation shareholders regarding minimizing compensation income (salaries and bonuses) and maximizing residual income from the operations of the S corporation. For qualifying S corporation shareholders, minimizing compensation income not only will save on the Medicare portion of payroll taxes, but also will maximize any deduction available under new § 199A.

5. Unless you fit in one of the exceptions, Congress just increased the interest rate on all your business loans. The 2017 Tax Cuts and Jobs Act, § 13301, amended § 163(j) to limit the deduction for business interest expense. Consequently, if your business is impacted by amended § 163(j), you will pay more for the use of borrowed funds, which is a de facto interest increase. Basically, the deduction for business interest expense under amended § 163(j) will be limited to 30 percent of "adjusted taxable income" (essentially earnings before interest, tax, depreciation and amortization (EBITDA) for the first 4 years, and then earnings before interest and taxes (EBIT) thereafter). Businesses with average annual gross receipts (computed over 3 years) of $25 million or less and businesses in certain industries (notably real estate if a proper election is made, but also floor plan financing of auto dealers and regulated utilities) are exempted from the limitations of amended §163(j). Real estate businesses must accept slightly longer recovery periods by using the alternative depreciation system for certain depreciable property if they elect out of the § 163(j) limitation. Because real estate businesses making the election out must use the alternative depreciation system for so-called qualified improvement property (among other categories), electing out of the § 163(j) limitation would seem to have the effect of making qualified improvement property ineligible for bonus depreciation under § 168(k).

6. To make room for § 199A, Congress repealed the § 199 domestic production activities deduction. We will remember fondly some of the issues it generated, such as whether assembling items into gift baskets constituted "manufacturing." The 2017 Tax Cuts and Jobs Act, § 13305, repealed Code § 199, which granted a special deduction to taxpayers with domestic production activities. The repeal is effective for taxable years beginning after 2017.

7. Violations of law just became a little more expensive. The 2017 Tax Cuts and Jobs Act, § 13306, amended Code § 162(f) to disallow deductions:

> for any amount paid or incurred (whether by suit, agreement, or otherwise) to, or at the direction of, a government or governmental entity in relation to the violation of any law or the investigation or inquiry by such government or entity into the potential violation of any law.

Prior to amendment, § 162(f) stated simply that "[n]o deduction shall be allowed … for any fine or similar penalty paid to a government for the violation of any law." The intent of this provision appears to be to broaden the category of nondeductible items beyond those that might technically constitute a fine or penalty. The amended statute contains exceptions for (1) certain amounts for restitution or remediation (including remediation of property) or to come into compliance with law that are identified as such in a court order or settlement agreement, (2) amounts paid or incurred pursuant to a court order in a suit in which no government or governmental entity is a party, and (3) any amount paid or incurred as taxes due. Payments of restitution for failure to pay taxes that are assessed as restitution in the same manner as a tax qualify for the first exception just listed only if the amounts "would have been allowed as a deduction under this chapter if it had been timely paid." This rule appears to mean that a payment of restitution in a tax case qualifies for the exception only if the taxes would have been deductible if timely paid. The legislation also adds to the Code § 6050X, which requires government agencies to report to the IRS and the taxpayer the amount of each settlement agreement or order entered into where the aggregate amount required to be paid or incurred to or at the direction of the government is at least $600 (or such other amount as may be specified by Treasury). These reports will separately identify any amounts that are for restitution or remediation of property, or correction of noncompliance. The disallowance of deductions and the new reporting requirement apply to amounts paid or incurred on or after December 22, 2017, the date of enactment, but do not apply to amounts paid or incurred under any binding order or agreement entered into before that date.

8. Professional gamblers have a new incentive to fly coach when traveling to a casino: otherwise deductible expenses of a professional gambler are now deductible only to the extent of gains from wagering transactions. Under Code § 165(d), losses from wagering transactions are deductible only to the extent of gains from wagering transactions. Thus, the cost of wagers incurred by an individual are deductible (on Schedule A as an itemized deduction) only to the extent of gambling winnings (reported on the "other income" line of Form 1040). The 2017 Tax Cuts and Jobs Act, § 11050, amended Code § 165(d) by adding a new sentence that reads: "the term 'losses from wagering transactions' includes any deduction otherwise allowable under this chapter incurred in carrying on any wagering transaction." The effect of this amendment is to change the result in *Mayo v. Commissioner*, 136 T.C. 81 (2001), in which the Tax Court held that expenses other than the cost of wagers incurred by a taxpayer engaged in the trade or business of gambling are not subject to the limitation of § 165(d) and instead are deductible as business expenses under § 162(a). Under § 165(d) as amended, costs of a professional gambler, including both the cost of wagers and other costs such as the cost of traveling to a casino, are deductible only to the extent of gambling winnings. This change applies to taxable years beginning after 2017 and before 2026.

- The legislation did not change the deductibility of losses from wagering transactions for non-professional gamblers. Code § 67(g), as amended by the Tax Cuts and Jobs Act, disallowed the deduction of all miscellaneous itemized deductions for taxable years beginning after 2017 and before 2026. Under Code § 67(b)(3), however, the deduction for losses from wagering transactions described in § 165(d) is not a miscellaneous itemized deduction.

9. Businesses will have to allow survivors of sexual harassment and sexual abuse to dish the dirt or else forgo a deduction. The 2017 Tax Cuts and Jobs Act, § 13307, amended Code § 162 by redesignating § 162(q) as § 162(r) and adding new § 162(q), which provides that no deduction is allowed for any settlement, payment, or attorney fees related to sexual harassment or sexual abuse if such payments are subject to a nondisclosure agreement. The provision applies to amounts paid or incurred after the date of enactment, December 22, 2017.

10. Glad-handing local officials is now more expensive: deductions for local lobbying expenses are disallowed. The 2017 Tax Cuts and Jobs Act, § 13308, amended Code § 162(e) by striking § 162(e)(2) and (7) and redesignating the remaining paragraphs accordingly.

Prior to their repeal, § 162(e)(2) and (7) allowed as a deduction costs incurred in carrying on a trade or business to lobby local councils or similar governing bodies, including Indian tribal governments. This change applies to amounts paid or incurred after the date of enactment, December 22, 2017.

11. Standard mileage rates for 2018. Notice 2018-3, 2018-2 I.R.B. 285 (12/14/17). The standard mileage rate for business miles in 2018 goes up to 54.5 cents per mile (from 53.5 cents in 2017) and the medical/moving rate goes up to 18 cents per mile (from 17 cents in 2017). The charitable mileage rate remains fixed by § 170(i) at 14 cents. The portion of the business standard mileage rate treated as depreciation is 25 cents per mile for 2018 (unchanged from 2017).

E. Depreciation & Amortization

1. Certain depreciation and amortization provisions of the 2017 Tax Cuts and Jobs Act:

a. Increased limits and expansion of eligible property under § 179.

Increased § 179 Limits. The 2017 Tax Cuts and Jobs Act, § 13101, increased the maximum amount a taxpayer can deduct under § 179 to $1 million (increased from $520,000). This limit is reduced dollar-for-dollar to the extent the taxpayer puts an amount of § 179 property in service that exceeds a specified threshold. The legislation increased this threshold to $2.5 million (increased from $2,070,000). These changes apply to property placed in service in taxable years beginning after 2017. The legislation did not change the limit on a taxpayer's § 179 deduction for a sport utility vehicle, which remains at $25,000. The basic limit of $1 million, the phase-out threshold of $2.5 million, and the sport utility vehicle limitation of $25,000 all will be adjusted for inflation for taxable years beginning after 2018.

Revised and expanded definition of qualified real property. The 2017 Tax Cuts and Jobs Act, § 13101, also simplified and expanded the definition of "qualified real property," the cost of which can be deducted under § 179 (subject to the applicable limits just discussed). Prior to amendment by the 2017 Tax Cuts and Jobs Act, § 179(f) defined qualified real property as including "qualified leasehold improvement property," "qualified restaurant property," and "qualified retail improvement property." The legislation revised the definition of qualified real property by replacing these three specific categories with a single category, "qualified improvement property" as defined in § 168(e)(6). Section 168(e)(6) defines qualified improvement property (subject to certain exceptions) as "any improvement to an interior portion of a building which is nonresidential real property if such improvement is placed in service after the date such building was first placed in service." In addition, the legislation expands the category of qualified real property by defining it to include the following improvements to nonresidential real property placed in service after the date the property was first placed in service: (1) roofs, (2) heating, ventilation, and air-conditioning property, (3) fire protection and alarm systems, and (4) security systems. These changes apply to property placed in service in taxable years beginning after 2017.

Section 179 property expanded to include certain personal property used to furnish lodging. The 2017 Tax Cuts and Jobs Act, § 13101, also amended Code § 179(d)(1). The effect of this amendment is to include within the definition of § 179 property certain depreciable tangible personal property used predominantly to furnish lodging or in connection with furnishing lodging (such as beds or other furniture, refrigerators, ranges, and other equipment).

b. Goodbye, basis; hello 100 percent § 168(k) bonus first-year depreciation!

100 percent bonus depreciation for certain property. The 2017 Tax Cuts and Jobs Act, § 13201, amended Code § 168(k)(1) and 168(k)(6) to permit taxpayers to deduct 100 percent of the cost of qualified property for the year in which the property is placed in service. This change applies to property *acquired and placed in service* after September 27, 2017, and before 2023. The percentage of the property's adjusted basis that can be deducted is reduced from 100 percent to 80 percent in 2023, 60 percent in 2024, 40 percent in 2025, and 20 percent in 2026. (These periods are extended by one year for certain aircraft and certain property with longer production periods). Property *acquired on or before September 27, 2017* and placed in service after that date is eligible for bonus depreciation of 50 percent if placed in service before 2018, 40 percent if placed in service in 2018, 30 percent if placed in service in 2019, and is ineligible for bonus depreciation if placed in service after 2019.

Used property eligible for bonus depreciation. The legislation also amended Code § 168(k)(2)(A) and (E) to make used property eligible for bonus depreciation under § 168(k). Prior to this change, property was eligible for bonus depreciation only if the original use of the property commenced with the taxpayer. This rule applies to property *acquired and placed in service* after September 27, 2017. Note, however, that used property is eligible for bonus depreciation only if it is acquired "by purchase" as defined in § 179(d)(2). This means that used property is *not* eligible for bonus depreciation if the property (1) is acquired from certain related parties (within the meaning of §§ 267 or 707(b)), (2) is acquired by one component member of a controlled group from another component member of the same controlled group, (3) is property the basis of which is determined by reference to the basis of the same property in the hands of the person from whom it was acquired (such as a gift), or (4) is determined under § 1014 (relating to property acquired from a decedent). In addition, property acquired in a like-kind exchange is not eligible for bonus depreciation.

Qualified property. The definition of "qualified property" eligible for bonus depreciation continues to include certain trees, vines, and plants that bear fruits or nuts (deductible at a 100 percent level for items planted or grafted after September 27, 2017, and before 2023, and at reduced percentages for items planted or grafted after 2022 and before 2027). The definition also includes a qualified film or television production. Excluded from the definition is any property used in a trade or business that has had floor plan financing indebtedness (unless the business is exempted from the § 163(j) interest limitation because its average annual gross receipts over a three-year period do not exceed $25 million).

Section 280F $8,000 increase in first-year depreciation. For passenger automobiles that qualify, § 168(k)(2)(F) increases by $8,000 in the first year the § 280F limitation on the amount of depreciation deductions allowed. The legislation continues this $8,000 increase for passenger automobiles *acquired and placed in service* after 2017 and before 2023. For passenger automobiles acquired *on or before* September 27, 2017, and placed in service after that date, the previously scheduled phase-down of the $8,000 increase applies as follows: $6,400 if placed in service in 2018, $4,800 if placed in service in 2019, and $0 after 2019.

c. Changes to the 280F depreciation limits on passenger automobiles and removal of computer and peripheral equipment from the definition of listed property. The 2017 Tax Cuts and Jobs Act, § 13202, amended Code § 280F(a)(1)(A) to increase the maximum amount of allowable depreciation for passenger automobiles and for which bonus depreciation under § 168(k) is not claimed. The maximum amount of allowable depreciation is $10,000 for the year in which the vehicle is placed in service, $16,000 for the second year, $9,600 for the third year, and $5,760 for the fourth and later years in the recovery period. The legislation also amended § 280F(d)(4) to remove computer or peripheral equipment from the definition of listed property. Both changes apply to property placed in service after 2017 in taxable years ending after 2017.

d. Changes to the depreciation of certain property used in a farming business.

Modifications to the depreciation of farm machinery and equipment. The 2017 Tax Cuts and Jobs Act, § 13203, made two changes with respect to the depreciation of any machinery or equipment (other than any grain bin, cotton ginning asset, fence, or other land improvement) that is used in a farming business. (For this purpose, the term "farming business" is defined in Code § 263A(e)(4).) The legislation amended Code § 168(b)(2) and (e)(3)(B) to repeal the required use of the 150 percent declining balance method and to reduce the recovery period from 7 years to 5 years. Accordingly, such machinery and equipment should be depreciable over 5 years using the double declining balance method and the half-year convention. This change applies to property placed in service after 2017 in taxable years ending after 2017.

Mandatory use of ADS for farming businesses that elect out of the new interest limitation. The 2017 Tax Cuts and Jobs Act, § 13205, amended Code § 168 to add new § 168(g)(1)(G), which requires a farming business that elects out of the newly-enacted interest limitation of § 163(j) to use the alternative depreciation system for any property with a recovery period of 10 years or more. This change applies to taxable years beginning after 2017. **Note:** aside from longer recovery periods, the requirement to use the alternative depreciation system for property with a recovery period of 10 years or more would seem to have the effect of making such property ineligible for bonus depreciation under § 168(k) even if it normally would be eligible for bonus depreciation.

e. Revised definitions and minor adjustments to recovery periods for real property. With respect to real property, the 2017 Tax Cuts and Jobs Act, § 13204, amended Code § 168 to simplify certain definitions and make minor adjustments for purposes of the alternative depreciation system.

Three categories consolidated into one. The legislation replaced the categories of "qualified leasehold improvement property," "qualified restaurant property," and "qualified retail improvement property" with a single category, "qualified improvement property." Code § 168(e)(6) defines qualified improvement property (subject to certain exceptions) as "any improvement to an interior portion of a building which is nonresidential real property if such improvement is placed in service after the date such building was first placed in service." Qualified improvement property is depreciable over 15 years using the straight-line method and is subject to the half-year convention. This change applies to property placed in service after 2017. **Note:** the Conference Agreement indicates that the normal recovery period for qualified improvement property is 15 years, but § 168 as amended does not reflect this change. This should be addressed in technical corrections.

Residential rental property has a 30-year ADS recovery period. The legislation reduced the recovery period for residential rental property for purposes of the alternative depreciation system from 40 years to 30 years. The general recovery period for such property remains at 27.5 years. This change applies to property placed in service after 2017.

Mandatory use of ADS for real property trades or businesses electing out of the new interest limitation. The legislation amended Code § 168 to add new § 168(g)(1)(F) and (g)(8), which require a real property trade or business that elects out of the newly-enacted interest limitation of § 163(j) to use the alternative depreciation system for nonresidential real property, residential rental property, and qualified improvement property. This change applies to taxable years beginning after 2017. **Note:** aside from longer recovery periods, the requirement to use the alternative depreciation system for qualified improvement property would seem to have the effect of making qualified improvement property ineligible for bonus depreciation under § 168(k).

F. Credits

1. A new credit for employers that pay wages to certain employees during periods of family and medical leave. The 2017 Tax Cuts and Jobs Act, § 13403, adds to the Code new § 45S, which provides that an "eligible employer" can include the "paid family and medical leave credit" among the credits that are components of the general business credit under § 38(b). The credit is equal to a percentage of the amount of wages paid to "qualifying employees" during periods in which the employees are on family and medical leave. The credit is available against both the regular tax and the alternative minimum tax.

Amount of the credit. To be eligible for the credit, the employer must pay during the period of leave at a rate that is at least 50 percent of the wages normally paid to the employee. The credit is 12.5 percent of the wages paid, increased by 0.25 percentage points for each percentage point by which the rate of payment exceeds 50 percent. The maximum credit is 25 percent of wages. Thus, if an employer pays an employee at a rate that is 60 percent of the employee's normal wages, the credit is 15 percent of wages paid (12.5 percent plus 2.5 percentage points). The credit reaches 25 percent when the employer pays at a rate that is 100 percent of employee's normal wages. The credit cannot exceed the amount derived from multiplying the employee's normal hourly rate by the number of hours for which the employee takes leave. The compensation of salaried employees is to be prorated to an hourly wage under regulations to be issued by the Treasury Department. The maximum amount of leave for any employee that can be taken into account for purposes of the credit is twelve weeks per taxable year.

Eligible employer. An eligible employer is defined as one who has in place a written policy that (1) allows all full-time "qualifying employees" not less than two weeks of annual paid family and medical leave, and that allows all part-time qualifying employees a commensurate amount of leave on a pro rata basis, and (2) requires that the rate of payment under the program is not less than 50 percent of the wages normally paid to the employee.

Eligible employee. An eligible employee is defined as any employee as defined in section 3(e) of the Fair Labor Standards Act of 1938 who has been employed by the employer for one year or more and who, for the preceding year, had compensation not in excess of 60 percent of the compensation threshold for highly compensated employees. For 2017, the threshold for highly compensated employees (see § 414(q)(1)(B)) was $120,000. Thus, for purposes of determining the credit in 2018, an employee is an eligible employee only if his or her compensation for 2017 did not exceed $72,000 ($120,000 * 60 percent).

Family and medical leave. The term "family and medical leave" is defined as leave described under sections 102(a)(1)(a)-(e) or 102(a)(3) of the Family and Medical Leave Act of 1993. (Generally, these provisions describe leave provided because of the birth or adoption of a child, because of a serious health condition of the employee or certain family members, or because of the need to care for a service member with a serious injury or illness.) If an employer provides paid leave as vacation leave, personal leave, or other medical or sick leave, this paid leave is not considered to be family and medical leave.

No double benefit. The legislation amends Code § 280C(a) to provide that no deduction is allowed for the portion of wages paid to an employee for which this new credit is taken. Thus, if an employer pays $10,000 to an employee and takes a credit for 25 percent, or $2,500, the employer could deduct as a business expense only $7,500 of the wages.

Effective date. The credit is available for wages paid in taxable years beginning after 2017.

G. Natural Resources Deductions & Credits

H. Loss Transactions, Bad Debts, and NOLs

1. Those NOLs are not worth what they used to be (at least until 2026). The 2017 Tax Cuts and Jobs Act, § 11012, amended § 461 by adding § 461(l), which disallows "excess business losses" for noncorporate taxpayers for taxable years beginning in 2018. Such "excess business losses" are determined after application of the passive loss rules of § 469. Essentially, as the authors read the statute, losses disallowed for a taxable year under § 461(l) are carried over to the next taxable year and become NOL carryforwards subject to revised § 172(a) (discussed below). Thus, the practical effect of § 461(l) appears to be a one-year deferral of "excess business losses." An "excess business loss" is defined as the amount by which a noncorporate taxpayer's aggregate trade or business deductions exceed aggregate gross income from those trades or businesses, plus $250,000 ($500,000 for joint filers). The term "aggregate trade or business deductions" apparently does not include § 172 carryforwards, so NOLs carried forward from 2017 and prior taxable years are not limited by new § 461(l). Such carryforwards are, however, limited by the changes made to § 172(a) (as discussed below). For partnerships and S corporations, new § 461(l) applies at the partner or shareholder level, and for farmers, the prior limitation on "excess farm losses" under § 461(j) is suspended so that only § 461(l) applies to limit such losses. After 2018, the cap on "excess business losses" is adjusted annually for inflation. Mercifully, new § 461(l) sunsets for taxable years beginning on or after January 1, 2026.

a. Surely you jest . . . there's even more bad news for NOLs? The **2017 Tax Cuts and Jobs Act**, § 13302(a), amended § 172(a) such that, for taxable years beginning in 2018, NOLs (except "farming losses" and NOLs of non-life insurance companies) no longer may be carried back two years, and any carried forward NOLs are capped at 80 percent of taxable income (computed without regard to NOLs). This change to § 172(a) is permanent.

b. The good news: NOLs now are like BFFs; they stick with you until you die! The **2017 Tax Cuts and Jobs Act**, § 13302(b), amended § 172(b)(1)(A)(ii) so that NOLs may be carried forward indefinitely (except by non-life insurance companies) rather than being limited to 20 years as under pre-TCJA law. This change to § 172(b) is permanent.

I. At-Risk and Passive Activity Losses

III. INVESTMENT GAIN

A. Gains and Losses

B. Interest, Dividends, and Other Current Income

C. Profit-Seeking Individual Deductions

1. **Say it isn't so! Miscellaneous itemized deductions are no longer deductible beginning in 2018.** The 2017 Tax Cuts and Jobs Act, § 11045, amended Code § 67 by adding § 67(g), which disallows as deductions all miscellaneous itemized deductions for taxable years beginning after 2017 and before 2026. Miscellaneous itemized deductions are defined in § 67(b) and, prior to the Tax Cuts and Jobs Act, were deductible to the extent that, in the aggregate, they exceeded 2 percent of the taxpayer's adjusted gross income. The largest categories of miscellaneous itemized deductions are: (1) investment-related expenses such as fees paid for investment advice or for a safe deposit box used to store investment-related items, (2) unreimbursed employee business expenses, and (3) tax preparation fees.

D. Section 121

E. Section 1031

1. **When it comes to like-kind exchanges, President Trump, qualified exchange intermediaries, and non-dealers in real estate are winners, but those exchanging airplanes, earth movers, and other large equipment are "losers."** The 2017 Tax Cuts and Jobs Act, § 13303, amended § 1031(a)(1) so that the term "real property" is substituted for "property" for taxable years beginning after 2017. Pre-TCJA § 1031(e) (livestock of different sexes), (i) (mutual ditch, reservoir, or irrigation company stock), and (h)(2) (U.S. and non-U.S. personal property) are repealed. In effect, then, like-kind exchanges under § 1031 for 2018 and future years are limited to real property. New § 1031(e) provides that if under § 761(a) a partnership elects out of subchapter K, then an interest in such a partnership is treated for purposes of § 1031 as "an interest in each of the assets of such partnership and not as an interest in a partnership." The changes to § 1031 are permanent. Nevertheless, a transition rule (TCJA § 13303(c)) allows any forward or reverse exchange that began under § 1031 before 2018 to qualify for nonrecognition if completed after December 31, 2017 (assuming, of course, that all other requirements of § 1031 are met).

F. Section 1033

G. Section 1035

H. Miscellaneous

1. **A self-created patent, invention, model or design, secret formula or process is excluded from the definition of a capital asset.** The 2017 Tax Cuts and Jobs Act, § 13314, amended Code § 1221(a)(3) to expand the types of self-created property that are excluded from the definition of a capital asset. Prior to amendment by the Tax Cuts and Jobs Act, Code § 1221(a)(3) excluded from the definition of a capital asset "a copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property, held by" a taxpayer whose personal efforts created the property or (in the case of a letter, memorandum, or similar property) a taxpayer for whom the property was produced. This same property is excluded from the capital asset category if it is held by a taxpayer whose basis in the property is determined by reference to the basis of the person who created it or for whom it was created (e.g., a taxpayer who acquired the property from the creator as a gift). The legislation adds to the list of property subject to this rule "a patent, invention, model or design (whether or not patented), a secret formula or process." A conforming amendment to Code § 1231(b)(1)(C) excludes this same property from the definition of "property used in a trade or business" for purposes of § 1231. Thus, a self-created patent, model or design, secret formula or process is not a capital asset and is not subject to § 1231. The effect of this provision is to treat gain

or loss from the sale or disposition of these assets as ordinary. This rule applies to dispositions after 2017.

- The legislation creates an unresolved conflict between amended § 1221(a)(3), on the one hand, and § 1235, on the other. Section 1235(a) provides that a transfer (other than by gift, inheritance, or devise) by a "holder" of property consisting of all substantial rights to a patent or an undivided interest in a patent is treated as the sale or exchange of a capital asset held for more than one year. This is true regardless of whether payments received by the transferor are payable periodically as the transferee uses the patent or are contingent on the productivity, use, or disposition of the property transferred. The term "holder" includes an individual whose efforts created the property. Thus, if an individual whose personal efforts created a patent sells the patent, § 1235 dictates that the gain is long-term capital gain and § 1221(a)(3) dictates that the patent is not a capital asset. In our view, § 1235 should take priority because it essentially says that gain from the sale of a self-created patent is long-term capital gain and does not make this result contingent on the patent's status as a capital asset. This conflict is likely the result of a legislative oversight. The House version of the legislation would have amended § 1221(a)(3) and would have repealed § 1235. The final version of the legislation amended § 1221(a)(3) but left § 1235 in place.

IV. COMPENSATION ISSUES

A. Fringe Benefits

1. Meals provided for the convenience of the employer will not be deductible beginning in 2026. The 2017 Tax Cuts and Jobs Act, § 13304, amended Code § 274 by adding § 274(o), which disallows as deductions meals provided for the convenience of the employer (within the meaning of § 119), which otherwise would be deductible by the employer. This rule applies to amounts paid or incurred after 2025.

2. The Tax Court ices the IRS by allowing the Boston Bruins' 100% deduction for away-game meals as a *de minimis* fringe, while the winning slap shot may be that hotel and banquet facilities can be "leased." Jacobs v. Commissioner, 148 T.C. No. 24 (6/26/17). The taxpayers, a married couple, own the S corporation that operates the Boston Bruins professional hockey team. When the Bruins travel to away games, the team provides the coaches, players, and other team personnel with hotel lodging as well as pre-game meals in private banquet rooms. Game preparation (e.g., strategy meetings, viewing films, discussions among coaches and players) also takes place during these team meals. The Bruins enter into extensive contracts with away-game hotels, including terms specifying the food to be served and how the banquet rooms should be set up. The taxpayers' S corporation spent approximately $540,000 on away-game meals at hotels over the years 2009 and 2010, deducting the full amount thereof pursuant to §§ 162, 274(n)(2)(B), and 132(e). Section 274(n) generally disallows 50 percent of meal and entertainment expenses, but § 274(n)(2)(B) provides an exception if the expense qualifies as a *de minimis* fringe benefit under § 132(e). Under Reg. § 1.132–7, employee meals provided on a nondiscriminatory basis qualify under § 132(e) if (1) the eating facility is owned or leased by the employer; (2) the facility is operated by the employer; (3) the facility is located on or near the business premises of the employer; (4) the meals furnished at the facility are provided during, or immediately before or after, the employee's workday; and (5) the annual revenue derived from the facility normally equals or exceeds the direct operating costs of the facility. The IRS argued that the Bruins' expenses do not qualify under § 132(e) and thus should be limited to 50 percent under § 274(n) because meals at away-game hotels are neither at facilities "operated by the employer," nor "owned or leased by the employer," nor "on or near the business premises of the employer." After easily determining that the other requirements for *de minimus* fringe benefit treatment were met, the Tax Court (Judge Ruwe) focused upon whether, for purposes of § 132(e) and Reg. § 1.132-7, the Bruins' away-game hotels can be considered facilities that are "operated by the employer," "leased by the employer," and "on or near the business premises of the employer." Judge Ruwe held that because away-game travel and lodging are indispensable to professional hockey and because the Bruins' contracts with the hotels specify many of the details regarding lodging, meals, and banquet rooms, the meal expenses are 100 percent deductible as a *de minimis* fringe. The hotel facilities are "operated by the employer" because the regulations expressly construe that term to include being operated under contract with the employer.

The hotel facilities also should be considered "leased" by the employer, the court concluded, due to the extensive contracts and the team's exclusive use and occupancy of designated hotel space. Further, the court concluded that, because away-game travel and lodging is an indispensable part of professional hockey, the hotel facilities should be considered the business premises of the employer.

- **The slap shot to the IRS:** The Tax Court's holding that the Bruins' "lease" the hotel facilities is somewhat at odds with regulations under § 512. Reg. § 1.512(b)-1(c)(5) provides that amounts received for the use or occupancy of space where personal services are rendered to the occupant (e.g., hotel services) does not constitute rent for purposes of the § 512 exclusion from unrelated business taxable income. *See also* Rev. Rul. 80-298, 1980-2 C.B.197 (amounts received by tax-exempt university for professional football team's use of playing field and dressing room along with maintenance, linen, and security services is not rental income for purposes of § 512 exclusion from UBTI). Judge Ruwe's decision may embolden tax-exempt organizations seeking to exclude so-called "facility use fees" (e.g., payments made to an aquarium for exclusive use of its space for corporate events) from UBTI.

a. **But wait, upon further consultation with the replay center, the call is reversed!** The 2017 Tax Cuts and Jobs Act, § 13304, amends Code § 274(n) to remove the exception to the 50 percent limitation for meal expenses that qualify as a *de minimis* fringe benefit. Accordingly, employers can deduct only 50 percent of the cost of employee meals provided at an employer-operated eating facility. This rule applies to amounts paid or incurred after 2017 and before 2026. Beginning in 2026, such costs are *entirely disallowed* as deductions pursuant to new Code § 274(o).

3. **Are we really so strapped for cash that we have to tax people who ride their bicycles to work?** The 2017 Tax Cuts and Jobs Act, § 11047, amends Code § 132(f) by adding § 132(f)(8), which provides that the exclusion from gross income provided by § 132(f)(1)(D) for qualified bicycle commuting reimbursements provided by employers shall not apply to any taxable year beginning after 2017 and before 2026.

4. **Those who move for work-related reasons now have a higher tax bill. Is this really good for the economy?** Provided that certain requirements are met, Code § 217 allows a taxpayer to deduct moving expenses paid or incurred in connection with the taxpayer's commencement of work (either as an employee or as a self-employed individual) at a new principal place of work. Section 132(g) of the Code excludes from an employee's gross income a "qualified moving expense reimbursement," defined as an employer's reimbursement of moving expenses that, if paid by the employee, would be deductible under § 217. The 2017 Tax Cuts and Jobs Act amended both provisions. Section 11049 of the TCJA amended Code § 217 by adding § 217(k), which provides that the deduction for moving expenses shall not apply to any taxable year beginning after 2017 and before 2026. Section 11048 of the TCJA amended Code § 132(g) by adding § 132(g)(2), which provides that the exclusion from gross income for a qualified moving expense reimbursement shall not apply to any taxable year beginning after 2017 and before 2026. Both amendments contain an exception for members of the armed forces on active duty who move pursuant to a military order and incident to a permanent change of station, i.e., such individuals can still deduct moving expenses and exclude moving expense reimbursements.

B. Qualified Deferred Compensation Plans

C. Nonqualified Deferred Compensation, Section 83, and Stock Options

1. **Employees of privately owned corporations can elect to defer income from "qualified equity grants" for up to five years.** The 2017 Tax Cuts and Jobs Act, § 13603, amended Code § 83 by adding § 83(i), which allows a "qualified employee" to elect to defer income attributable to "qualified stock" transferred to the employee by the employer. The election must be made no later than 30 days after the first time the employee's right to the stock is substantially vested or is transferable, whichever occurs earlier. Generally, the effect of this provision is to allow the employee to defer including in income the amount that the employee normally would be required to include under the rules of § 83(a). Under the rules of § 83(h), the employer's deduction for the value of the stock should be deferred until the employee includes the value in gross income. If the

employee does *not* make the § 83(i) election, then the normal rules of § 83 apply. If the employee *does* make the § 83(i) election, then the employee must include in gross income the amount determined under § 83(a) (normally the fair market value of the stock less whatever the employee paid for it, *determined when the rights of the employee in the stock first become transferable or not subject to substantial risk of forfeiture*) upon the first to occur of the following: (1) the first date the qualified stock becomes transferable (including transferable to the employer); (2) the date the employee first becomes an "excluded employee;" (3) the first date on which any stock of the employer becomes readily tradable on an established securities market; (4) the date five years after the first date the employee's right to the stock becomes substantially vested; or (5) the date on which the employee revokes his or her election. The statute contains many definitions. A "qualified employee" generally is any employee other than an "excluded employee." Excluded employees are defined as a 1 percent owners (currently or during the ten preceding calendar years), those who have been at any prior time the Chief Executive Officer or the Chief Financial Officer, and those who are one of the four highest compensated officers (currently or during any of the ten preceding taxable years) determined on the basis of the shareholder disclosure rules for compensation under the Securities Exchange Act of 1934. "Qualified stock" is generally defined as stock transferred by an "eligible corporation" that is an employer of an employee in connection with the employee's performance of services if the employee receives the stock either in connection with the exercise of an option or in settlement of a restricted stock unit. A corporation is an "eligible corporation" if (1) no stock of the corporation (or any predecessor) is readily tradable on an established securities market during any preceding calendar year, and (2) the corporation has a written plan under which not less than 80 percent of all employees who provide services to the corporation in the United States (or any U.S. possession) are granted stock options, or are granted restricted stock units, with the same rights and privileges to receive qualified stock. A corporation that transfers qualified stock to an employee must provide notice to the employee that the stock is qualified stock and that the employee may be eligible to elect to defer income on such stock. This provision applies to options exercised, or restricted stock units settled, after 2017

D. Individual Retirement Accounts

1. We can no longer unwind Roth conversions if the market goes down. The 2017 Tax Cuts and Jobs Act, § 13611, amended Code § 408A(d)(6)(B) by adding § 408A(d)(6)(B)(iii), which prohibits recharacterizing conversion contributions to a Roth IRA as made to a traditional IRA. This change still permits conversions of a traditional IRA to a Roth IRA (and therefore still permits so-called back-door Roth IRAs), but prohibits recharacterizing the conversion by the October 15 extended due date for individual returns. This change therefore precludes an individual from deciding to unwind a Roth conversion by the extended due date of the individual's return based on market performance. The provision applies to taxable years beginning after 2017.

V. PERSONAL AND INDIVIDUAL INCOME AND DEDUCTIONS

A. Rates

1. Under the new, simplified rate structure of the 2017 Tax Cuts and Jobs Act, the number of individual rate brackets has been reduced from seven to seven. The 2017 Tax Cuts and Jobs Act, § 11001(a), added Code § 1(j), which replaces the existing rate structure for ordinary income of individuals with a new rate structure for taxable years beginning after 2017 and before 2026. Unless Congress takes further action, the existing rate structure, as adjusted for inflation, will apply once more for taxable years beginning after 2025. The following tables show the rate structure for individuals that had been scheduled to take effect for taxable years beginning in 2018 and the rate structure that will apply by virtue of the 2017 Tax Cuts and Jobs Act. The brackets established by the 2017 Tax Cuts and Jobs Act will be adjusted for inflation for tax years beginning after 2018.

2018 Rates for Single Individuals		If taxable income is:	Then income tax equals:
1	*Before TCJA*	Not over $9,525	10% of taxable income
	After TCJA	Not over $9,525	10% of taxable income
2	*Before TCJA*	Over $9,525 but not over $38,700	$952.50 plus 15% of the excess over $9,525
	After TCJA	Over $9,525 but not over $38,700	$952.50, plus 12% of the excess over $9,525
3	*Before TCJA*	Over $38,700 but not over $93,700	$5,328.75 plus 25% of the excess over $38,700
	After TCJA	Over $38,700 but not over $82,500	$4,453.50, plus 22% of the excess over $38,700
4	*Before TCJA*	Over $93,700 but not over $195,450	$19,078.75 plus 28% of the excess over $93,700
	After TCJA	Over $82,500 but not over $157,500	$14,089.50, plus 24% of the excess over $82,500
5	*Before TCJA*	Over $195,450 but not over $424,950	$47,568.75 plus 33% of the excess over $195,450
	After TCJA	Over $157,500 but not over $200,000	$32,089.50, plus 32% of the excess over $157,500
6	*Before TCJA*	Over $424,950 not over $426,700	$123,303.75 plus 35% of the excess over $424,950
	After TCJA	Over $200,000 but not over $500,000	$45,689.50, plus 35% of the excess over $200,000
7	*Before TCJA*	Over $426,700	$123,916.25 plus 39.6% of the excess over $426,700
	After TCJA	Over $500,000	$150,689.50, plus 37% of the excess over $500,000

2018 Rates for Married Individuals Filing Joint Returns and Surviving Spouses		If taxable income is:	Then income tax equals:
1	*Before TCJA*	Not over $19,050	10% of taxable income
	After TCJA	Not over $19,050	10% of taxable income
2	*Before TCJA*	Over $19,050 but not over $77,400	$1,905 plus 15% of the excess over $19,050
	After TCJA	Over $19,050 but not over $77,400	$1,905, plus 12% of the excess over $19,050
3	*Before TCJA*	Over $77,400 but not over $156,150	$10,657.50 plus 25% of the excess over $77,400
	After TCJA	Over $77,400 but not over $165,000	$8,907, plus 22% of the excess over $77,400
4	*Before TCJA*	Over $156,150 but not over $237,950	$30,345 plus 28% of the excess over $156,150
	After TCJA	Over $165,000 but not over $315,000	$28,179, plus 24% of the excess over $165,000
5	*Before TCJA*	Over $237,950 but not over $424,950	$53,249 plus 33% of the excess over $237,950
	After TCJA	Over $315,000 but not over $400,000	$64,179, plus 32% of the excess over $315,000
6	*Before TCJA*	Over $424,950 but not over $480,050	$114,959 plus 35% of the excess over $424,950

	After TCJA	Over $400,000 but not over $600,000	$91,379, plus 35% of the excess over $400,000
7	*Before TCJA*	Over $480,050	$134,244 plus 39.6% of the excess over $480,050
	After TCJA	Over $600,000	$161,379, plus 37% of the excess over $600,000

2. The rates of tax on net capital gains and qualified dividends remain essentially the same under the 2017 Tax Cuts and Jobs Act. The 2017 Tax Cuts and Jobs Act, § 11001(a), added Code § 1(j). For taxable years beginning after 2017, and before 2026, § 1(j)(5) retains the existing maximum rates of tax on net capital gains and qualified dividends. Thus, the maximum rates of tax on adjusted net capital gain remain at 0 percent, 15 percent, or 20 percent. The maximum rate of tax on unrecaptured section 1250 gain remains at 25 percent, and the maximum rate on 28-percent rate gain remains at 28 percent. Further, the 3.8 percent tax on net investment income remains in place. However, unlike current law, which determines the rate of tax on adjusted net capital gain by reference to the rate of tax that otherwise would be imposed on the taxpayer's taxable income (including the adjusted net capital gain), new § 1(j)(5) defines "breakpoints" that are used for this purpose. The breakpoints are those under the current rate structure (before amendment by the 2017 Tax Cuts and Jobs Act) but are adjusted for inflation for taxable years beginning after 2017. For taxable years beginning in 2018, the following table shows the breakpoints that establish the rate of tax on adjusted net capital gain.

2018 Rates of Tax on Adjusted Net Capital Gain

Tax Rate	Single	Head of Household	Married Filing Jointly	Married Filing Separately	Estates and Trusts
0% if taxable income does not exceed	$38,600	$51,700	$77,200	$38,600	$2,600
15% if taxable income does not exceed	$425,800	$452,400	$479,000	$239,500	$12,700
20% if taxable income exceeds	$425,800	$452,400	$479,000	$239,500	$12,700

3. An incentive for kids to be entrepreneurial? The Tax Cuts and Jobs Act modified the kiddie tax by applying the rates of tax applicable to trusts and estates to the unearned income of children. The 2017 Tax Cuts and Jobs Act, § 11001(a), added Code § 1(j). For taxable years beginning after 2017 and before 2026, § 1(j)(4) modifies the so-called "kiddie tax" by taxing the unearned income of children under the rate schedule that applies to trusts and estates. (The earned income of children continues to be taxed at the rates that normally apply to a single individual.) This changes the approach of current law, under which the tax on unearned income of children is determined by adding it to the income of the child's parents and calculating a hypothetical increase in tax for the parents. Under the new approach, the child's tax on unearned income is unaffected by the parents' tax situation. The 2017 Tax Cuts and Jobs Act does not change the categories of children subject to the kiddie tax.

B. Miscellaneous Income

1. Provisions of the 2017 Tax Cuts and Jobs Act that affect ABLE accounts.

a. Designated beneficiaries of ABLE accounts can contribute an additional amount and are eligible for the saver's credit. Code § 529A, enacted by the Stephen Beck, Jr., Achieving a Better Life Experience (ABLE) Act of 2014 (which became Division A of the

Tax Increase Prevention Act of 2014), provides a tax-favored savings account for certain individuals with disabilities—the ABLE account. ABLE accounts permit certain individuals who became disabled before reaching age 26 and their families to contribute amounts to meet expenses related to the designated beneficiary's disability without affecting the beneficiary's eligibility for Supplemental Security Income, Medicaid, and other public benefits. ABLE accounts are modeled on § 529 accounts that are used to save for college education. Like § 529 accounts, ABLE accounts must be established pursuant to a state program, contributions to ABLE accounts are not tax deductible, the earnings of the ABLE account are not subject to taxation, and distributions from ABLE accounts are not included in the designated beneficiary's income to the extent they are used for qualified expenses related to the disability. Aggregate contributions to an ABLE account from all contributors cannot exceed the annual per-donee gift tax exclusion ($15,000 in 2018). The 2017 Tax Cuts and Jobs Act, § 11024, amended Code § 529A to increase this contribution limit for contributions made before 2026. Under the increased limit, once the overall limitation on contributions is reached, an ABLE account's designated beneficiary who is an employee (as defined) can contribute an additional amount equal to the lesser of: (1) the compensation includible in the beneficiary's income for the year, or (2) the federal poverty line for a one-person household as determined for the immediately preceding year ($12,486 for a single individual under age 65 in 2016). A designated beneficiary is considered to be an employee for this purpose only if the person is an employee with respect to whom no contribution is made to a defined contribution plan, an annuity contract described in § 403(b), or an eligible deferred compensation plan described in § 527. The legislation also makes designated beneficiaries of ABLE accounts who contribute eligible for the saver's credit of § 25B for contributions made before 2026. Both amendments are effective for taxable years beginning after December 22, 2017, the date of enactment.

b. Tax-free rollovers are permitted from a § 529 college savings account to an ABLE account. The 2017 Tax Cuts and Jobs Act, § 11025, amends Code § 529 to permit amounts in a § 529 account to be rolled over without penalty to an ABLE account if the owner of the ABLE account is the designated beneficiary of the § 529 account or a member of the designated beneficiary's family. Amounts rolled over pursuant to this provision, together with any other contributions to the ABLE account, are taken into account for purposes of the limit on aggregate contributions to the ABLE account. Any amount rolled over that exceeds this limitation is included in the gross income of the distributee in the manner provided by § 72. This provision applies to distributions from a § 529 account after December 22, 2017 (the date of enactment) that are transferred within 60 days and before 2026 to an ABLE account.

2. A new exclusion for cancellation of student loans on account of the death or permanent disability of the student. The 2017 Tax Cuts and Jobs Act, § 11031, amended Code § 108(f) by adding § 108(f)(5), which excludes from a taxpayer's gross income any amount which would be included in gross income by reason of the discharge of a student loan if the loan is discharged on account of the death or total and permanent disability of the student. For this purpose, the term "student loan" has the meaning set forth in § 108(f)(2) (which describes loans made by the federal or a state government or any political subdivision as well as loans made by certain public benefit corporations and educational organizations), and also includes private educational loans as defined in Consumer Credit Protection Act § 140(7). This exclusion applies to discharges of indebtedness occurring after 2017 and before 2026.

C. Hobby Losses and § 280A Home Office and Vacation Homes

D. Deductions and Credits for Personal Expenses

1. Standard deduction for 2018. The 2017 Tax Cuts and Jobs Act, § 11021, added Code § 63(c)(7), which significantly increases the standard deduction for taxable years beginning after 2017 and before 2026. This change, combined with the legislation's limitation or elimination of many itemized deductions, is expected to cause a large number of taxpayers who have itemized deductions in prior years to take the standard deduction beginning in 2018. The standard deduction for 2018 will be $24,000 for joint returns and surviving spouses (increased from $13,000), $12,000 for unmarried individuals and married individuals filing separately (increased from $6,500), and

$18,000 for heads of households (increased from $9,550). These figures will be adjusted for inflation for tax years beginning after 2018.

2. Let's hope new withholding tables are issued soon. The deduction for personal exemptions has disappeared. The 2017 Tax Cuts and Jobs Act, § 11041, amended Code § 151(d) by adding § 151(d)(5), which reduces the exemption amount to zero for taxable years beginning after 2017 and before 2026. The effect of this amendment is to eliminate the deduction for personal exemptions. The reduction of the exemption amount to zero required conforming amendments to other Code provisions that make use of the exemption amount. For example, under § 6012, an individual taxpayer generally does not need to file a return if the taxpayer's gross income does not exceed the sum of the basic standard deduction plus the exemption amount under § 151(d). The legislation addresses this by amending § 6012 to provide that an individual need not file a return if the taxpayer's gross income does not exceed the standard deduction. Similarly, § 642(b)(2)(C) allows a qualified disability trust to deduct an amount equal to the exemption amount under § 151(d), and § 6334(d) exempts from levy an amount of weekly wages equal to 1/52 of the sum of the standard deduction and the aggregate amount of the taxpayer's deductions for personal exemptions under § 151. The legislation addresses this issue by amending those provisions to refer to $4,105 (to be adjusted for inflation), the exemption amount that had been scheduled to take effect in 2018 before the Tax Cuts and Jobs Act. The legislation also directs Treasury to develop rules to determine the amount of tax that employers are required to withhold from an employee's wages but gives Treasury the discretion to apply current wage withholding rules for 2018.

3. Has the federal deduction for your high property or state income taxes made them easier to bear? Brace yourself! The deduction for state and local taxes not paid or accrued in carrying on a trade or business or an income-producing activity is limited to $10,000. The 2017 Tax Cuts and Jobs Act, § 11042, amended Code § 164(b) by adding § 164(b)(6). For individual taxpayers, this provision generally (1) eliminates the deduction for foreign real property taxes, and (2) limits to $10,000 ($5,000 for married individuals filing separately) a taxpayer's itemized deductions on Schedule A for the aggregate of state or local property taxes, income taxes, and sales taxes deducted in lieu of income taxes. This provision applies to taxable years beginning after 2017 and before 2026. The provision does *not* affect the deduction of state or local property taxes or sales taxes that are paid or accrued in carrying on a trade or business or an income-producing activity (i.e., an activity described in § 212) that are properly deductible on Schedules C, E, or F. For example, property taxes imposed on residential rental property will continue to be deductible. With respect to income taxes, an individual can deduct only *foreign* income taxes paid or accrued in carrying on a trade or business or an income-producing activity. As under current law, an individual cannot deduct state or local income taxes as a business expense even if the individual is engaged in a trade or business as a sole proprietor. *See* Reg. § 1.62-1T(d).

4. Better be careful with that cash-out refinance. You could wind up with home equity indebtedness, the interest on which is no longer deductible. And there's more good news: the limit on acquisition indebtedness has dropped to $750,000. Prior to the 2017 Tax Cuts and Jobs Act, Code § 163(a) and (h)(3) allowed a taxpayer to deduct as an itemized deduction the interest on up to $1 million of acquisition indebtedness and up to $100,000 of home equity indebtedness. Acquisition indebtedness is defined as indebtedness secured by a qualified residence that is incurred to acquire, construct, or substantially improve the residence. Home equity indebtedness is defined as any indebtedness secured by a qualified residence that is not acquisition indebtedness. The Tax Cuts and Jobs Act, § 11043, amended § 163(h)(3) by adding § 163(h)(3)(F). For taxable years beginning after 2017 and before 2026, § 163(h)(3)(F) disallows the deduction of interest on home equity indebtedness and limits the amount of debt that can be treated as acquisition indebtedness to $750,000 ($375,000 for married taxpayers filing separately). There is no transition rule for home equity indebtedness. Therefore, the interest on any outstanding home equity indebtedness will become nondeductible beginning in 2018. The provision contains three transition rules that might affect acquisition indebtedness: (1) the new $750,000 limit on acquisition indebtedness does not apply to debt incurred on or before December 15, 2017; (2) any refinancing of indebtedness is treated for purposes of the December 15, 2017, transition date as incurred on the date that the original indebtedness was incurred to the extent the amount of the new indebtedness does not exceed the amount of the refinanced indebtedness (but this rule applies only for the term of the original indebtedness); and (3) a taxpayer who entered into a written, binding contract before December 15, 2017, to close on the purchase of a principal residence before January 1, 2018, and who purchases the residence before April 1, 2018 with indebtedness is considered to have incurred acquisition indebtedness prior to December 15, 2017.

- These rules could have an unanticipated effect on taxpayers who engage in a cash-out refinancing of existing acquisition indebtedness. If the amount of the new loan that exceeds the refinanced loan (i.e., the cash-out) is used for purposes unrelated to the home, that portion of the loan will be home equity indebtedness, the interest on which will not be deductible. For example, if a taxpayer refinances $100,000 of acquisition indebtedness by taking out a new loan of $110,000 and using the extra $10,000 to pay off high-interest credit card debt, the extra $10,000 will be home equity indebtedness and the interest on that portion of the loan will not be deductible.

5. Expansion of the 7.5 percent threshold for deduction of medical expenses. Prior to the 2017 Tax Cuts and Jobs Act, medical expenses generally were deductible only to the extent they exceeded 10 percent of a taxpayer's adjusted gross income. For taxable years beginning after 2012 and ending before 2017, this threshold was reduced to 7.5 percent if the taxpayer or the taxpayer's spouse had attained age 65 by the close of the year. The 2017 Tax Cuts and Jobs Act, § 11027, amended § 213(f) to provide that the 7.5 percent threshold applies to all taxpayers for taxable years beginning after 2016 and ending before 2019, i.e., to calendar years 2017 and 2018. Further, the legislation provides that this threshold applies for purposed of both the regular tax and the alternative minimum tax.

6. An increased incentive to purchase insurance: say goodbye to the deduction for personal casualty losses (except those in federally declared disaster areas). The 2017 Tax Cuts and Jobs Act, § 11044, amended Code § 165(h) by adding § 165(h)(5), which eliminates the deduction for personal casualty losses, other than those attributable to a federally declared disaster, for taxable years beginning after 2017 and before 2026. Despite this general disallowance, the legislation permits taxpayers to offset the amount of any personal casualty gains by the amount of otherwise-disallowed personal casualty losses.

7. ♪♫I keep on fallin' in and out of love with you.♫♪ Congress has repealed the § 68 overall limitation on overall deductions again. The 2017 Tax Cuts and Jobs Act, § 11046, amended Code § 68 by adding § 68(f), which provides that the overall limitation on itemized deductions does not apply to taxable years beginning after 2017 and before 2026. This limitation reduces the amount of most itemized deductions by the lesser of 3 percent of the amount by which the taxpayer's adjusted gross income exceeds a specified threshold, or 80 percent of the itemized deductions. Congress first enacted this limitation as part of the Omnibus Budget Reconciliation Act of 1990. In the Economic Growth and Tax Relief Reconciliation Act of 2001, Congress repealed § 68 prospectively on a phased reduction schedule beginning in 2006, with full repeal effective for taxable years beginning after 2009. The provision did not apply in taxable years 2010 through 2012. Congress reinstated § 68 in the American Taxpayer Relief Act of 2012 for taxable years beginning after 2012. The provision was in effect for taxable years 2013 through 2017, and now has been repealed once more.

8. An enhanced child tax credit. The 2017 Tax Cuts and Jobs Act, § 11022, added Code § 24(j), which significantly increases the child tax credit and establishes a new credit for dependents other than qualifying children for taxable years beginning after 2017 and before 2026.

Child Tax Credit. The legislation increases the child tax credit from $1,000 to $2,000 per qualifying child and increases the refundable portion of the credit from $1,000 to $1,400 per qualifying child. The $1,400 refundable portion of the credit will be adjusted for inflation for taxable years beginning after 2018. The legislation retains the current-law age limit for the credit, i.e., a person can be a qualifying child only if he or she has not attained age 17 by the end of the taxable year. The refundable portion of the credit is determined in the same manner as under current law, except that the earned income threshold for determining the refundable portion is reduced from $3,000 to $2,500. To claim the child tax credit (either the refundable or nonrefundable portion), a taxpayer must include on the return for each qualifying child with respect to whom the credit is claimed a Social Security Number that was issued before the due date for filing the return. If the child tax credit is not available with respect to a qualifying child because of the absence of a Social Security Number, the taxpayer can claim the new, nonrefundable credit described below with respect to that child.

New Nonrefundable Credit for Dependents Other Than a Qualifying Child. The legislation also makes available (as an increase to the basic child tax credit) a new, nonrefundable credit of $500 for each dependent other than a qualifying child. This new credit would apply, for example, with respect to a parent who is the taxpayer's dependent and therefore a qualifying relative. The new, nonrefundable credit is available only with respect to a dependent who is a citizen, national, or resident of the U.S., i.e., the credit is not available with respect to a dependent who is a resident of the contiguous countries of Canada and Mexico.

Increased Phase-out Thresholds. The legislation significantly increases the modified adjusted gross income thresholds at which the credits (both the child tax credit and the new nonrefundable credit) begin to phase out. Under current law, the child tax credit is phased out by $50 for each $1,000 by which the taxpayer's modified AGI exceeds $55,000 for married taxpayers filing separately, $75,000 for single taxpayers or heads of household, and $110,000 for married taxpayers filing a joint return. Thus, under current law, the credit is phased out entirely for married taxpayers filing a joint return once modified AGI reaches $130,000. The legislation increases the phase-out thresholds to $400,000 for married couples filing a joint return and $200,000 for all other taxpayers. These increased thresholds will increase the number of taxpayers who benefit from the credit.

E. Divorce Tax Issues

1. **♪♫Breaking up is hard to do.♫♪ But, if you have been thinking about it, split up in 2018 if you want to save taxes. Under the Tax Cuts and Jobs Act, alimony is not deductible by the payor and is not taxable for the recipient.** The 2017 Tax Cuts and Jobs Act, § 11051, repealed both Code § 215, which authorized an above-the-line deduction for alimony payments, and Code § 71, which included alimony payments in the recipient's gross income. For those subject to the new rules, the payor of alimony will not be able to deduct the payments, and the recipient will not include the alimony payments in gross income. This change applies to any divorce or separation instrument (as defined in former Code § 71(b)(2)) executed after 2018. It also applies to any divorce or separation instrument executed before 2018 that is modified after 2018 if the modification expressly provides that the amendments made by the Tax Cuts and Jobs Act will apply. The legislation also made various conforming amendments to other Code provisions.

F. Education

1. **Private elementary and secondary schools have a new incentive to raise tuition: up to $10,000 per year can be withdrawn tax-free from § 529 accounts to pay it.** The 2017 Tax Cuts and Jobs Act, § 11032, amended Code § 529(c) by adding § 529(c)(7), which permits tax-free distributions from § 529 accounts to pay "expenses for tuition in connection with enrollment or attendance at an elementary or secondary public, private, or religious school." The limit on distributions for this purpose is $10,000 during the taxable year, which applies per student, not per account. Thus, if a student is a designated beneficiary of more than one § 529 account, the student can receive only $10,000 free of tax for this purpose in a given year regardless of whether the funds are distributed from multiple accounts. This provision applies to distributions occurring after 2017.

G. Alternative Minimum Tax

1. **The AMT will apply to fewer individuals because of increased exemption amounts and phase-out thresholds.** The 2017 Tax Cuts and Jobs Act, § 12002, amended Code § 55(d) by adding § 55(d)(4), which increases the AMT exemption amount for non-corporate taxpayers as well as the thresholds for alternative minimum taxable income above which the exemption amount phases out. These changes apply to taxable years beginning after 2017 and before 2026; the figures will be adjusted for inflation for taxable years beginning after 2018. The legislation did not change the exemption amount or the phase-out threshold for trusts and estates. The figures for 2018 both before and after the changes made by the 2017 Tax Cuts and Jobs Act are shown in the following tables:

AMT Exemption Amounts for 2018		
Filing Status	**Before TCJA**	**After TCJA**
Married Filing Separately	$43,100	$54,700
Single and HOH	$55,400	$70,300
Married Filing Jointly and Surviving Spouses	$86,200	$109,400
Estates and Trusts	$24,600	$24,600

AMTI Phase-Out Thresholds for 2018		
Filing Status	**Before TCJA**	**After TCJA**
Married Filing Separately	$82,050	$500,000
Single and HOH	$123,100	$500,000
Married Filing Jointly and Surviving Spouses	$164,100	$1 million
Estates and Trusts	$82,050	$82,050

VI. CORPORATIONS

A. Entity and Formation

B. Distributions and Redemptions

C. Liquidations

D. S Corporations

1. **If you're a cash-method S corp pining to be a C corp, here's your chance!** The 2017 Tax Cuts and Jobs Act, § 13543, added new § 481(d) and new § 1371(f) to make it easier for cash-method S corporations to convert to C corporations (which typically, but not always, especially after TCJA's revisions to § 448, are accrual-method taxpayers). Specifically, new § 481(d) provides that any adjustment (such as changing from the cash to the accrual method) otherwise required under § 481(a)(2) with respect to an S to C conversion may be taken into account ratably over six years starting with the year of the change (instead of taking into account the adjustment entirely in the year of change) if three conditions are met: (i) the converting S corporation existed prior to December 22, 2017 (the date of TCJA's enactment); (ii) the conversion from S to C status takes place prior to December 22, 2019 (two years from the date of TCJA's enactment); and (iii) all of the shareholders of the S corporation on December 22, 2017, are "in identical proportions" the shareholders of the C corporation. New § 1371(f) further provides that "money" distributed by the above-described converted S corporations *after* the "post-termination transition period" (generally one year) is allocable to and chargeable against the former S corporation's accumulated adjustments account ("AAA") in the same ratio as AAA bears to accumulated earnings and profits ("E&P"). Thus, new § 1371(f) is more favorable to S corporations converting to C status than the normal rule of § 1371(e), which allows distributions of money *during* the "post-termination transition period," but not after, to be allocable to and chargeable against AAA. As a practical matter, then, S corporations converting to C corporations within the confines of new § 481(d) and § 1371(f) may make nontaxable, stock-basis reducing distributions of money out of their AAA during the one-year period following the conversion (pursuant to § 1371(e)) as well as wholly or partially (depending upon AAA as compared to E&P) nontaxable, basis-reducing distributions of money after the normal one-year, post-termination transition period. These changes to § 481 and § 1371 are permanent, but of course, will apply only to S to C conversions that meet the criteria of § 481(d) (i.e., pre-TCJA existing S corporations that convert to C status before December 22, 2019, and that have the same shareholders in the same proportions post-conversion).

2. **In line with the continuing expansion of eligible shareholders of subchapter S corporations, ESBTs now may have non-U.S. individuals as current beneficiaries.** The 2017 Tax Cuts and Jobs Act, § 13541, makes a technical change to § 1361(c)(2)(B)(v) such that for 2018 and

future years an "electing small business trust" (an "ESBT," as particularly defined in § 1361(e)) may have as a current beneficiary of the ESBT a "nonresident alien" individual. Under § 7701(b)(1)(B), a nonresident alien individual is someone who is neither a citizen nor a resident of the U.S. This change to § 1361 is permanent.

3. **Perhaps there's something special about ESBTs that Congress or the IRS hasn't told us?** The 2017 Tax Cuts and Jobs Act, § 13542, makes another technical change relating to ESBTs by adding new § 641(c)(2)(E) effective for taxable years beginning after 2017. New § 641(c)(2)(E) will allow the charitable contribution limitation and carryover rules of § 170 that apply to individuals to apply to ESBTs (rather than the rules applicable to trusts) when the subchapter S corporation in which the ESBT owns stock makes a charitable contribution deductible under § 170. Essentially, without getting into the details, the charitable contribution limitation and carryover rules of § 170 are more liberal for individuals than for trusts. This change to § 641 is permanent.

Planning note: Speaking of ESBTs, trusts generally are eligible for § 199A's new 20-percent deduction for "qualified business income." Thus, even absent estate and gift tax savings, some tax planners are advising principal shareholders of S corporations that they should consider setting up ESBTs for their children and grandchildren to own stock in their S corporations earning "qualified business income." In particular, if the ESBT's taxable income (before taking into account § 199A) is at or below $157,500, then "qualified business income" allocable to the ESBT shareholder would appear to be taxed at a maximum rate of 29.6% (i.e., top rate of 37% applied to taxable income reduced by the 20 deduction) regardless of § 199A's specified service business limitation or W-2 wage and capital cap.

E. Mergers, Acquisitions and Reorganizations

F. Corporate Divisions

G. Affiliated Corporations and Consolidated Returns

H. Miscellaneous Corporate Issues

1. **Back to the future: Remember the good ole days before 1986 when C corporations were tax shelters? By introducing a flat corporate tax rate of 21 percent, Congress has given new life to C corporations and will force us to relearn personal holding company, accumulated earnings tax, and other anti-abuse rules (e.g., § 269A) we've long ignored.** The centerpiece of the 2017 Tax Cuts and Jobs Act is a permanent reduction in corporate tax rates. Section 13001 of the legislation amended § 11(b) to impose tax on taxable income of corporations, including personal service corporations, at a flat rate of 21 percent. Prior to this amendment, § 11(b) provided graduated rates with a top rate of 35 percent (which top rate applied to the first dollar of personal service corporation income). For personal service corporations and companies with significant profit from U.S. operations, the reduction in the corporate rate is a huge benefit. In fact, this rate reduction is estimated to reduce corporate income taxes by roughly $1.3 trillion over the next ten years. Prior to this change, most businesses avoided C corporation status unless they were (or planned to be) publicly traded, were so-called "blocker" corporations, or, in some cases, were taken private by investment funds. Venture capital backed companies also tended to choose C corporation status to simplify their capital structure and tax compliance obligations. Now, however, C corporation status may be a sensible choice for some personal service and other closely-held corporations, especially if the business will be held for the life of the major shareholders (thereby benefiting from the step-up in basis at death) or the shareholders will exit via a stock sale at some indeterminate time in the future. One of the authors has heard anecdotally that many older, highly compensated law firm partners (drawing $1 million or more annually and thus excluded from new § 199A) who expect to retire soon are considering incorporating as old-fashioned personal service corporations, especially those in states with high income tax rates. No doubt, the accumulated earnings tax (§§ 535-537) and the IRS's power to reallocate income between a shareholder and his or her personal service corporation (§ 269) will come into play to deter such strategies, but a 21 percent rate as compared to a 37 percent rate is tempting. Nevertheless, despite the reduced rate, subchapter C is still a double-tax regime. In particular, asset sales (or deemed asset sales at liquidation) by C

corporations will continue to suffer a big tax bite notwithstanding the reduced corporate rate. Furthermore, new § 199A must be considered for any flow-through entities. *Bottom line:* Although the authors believe that flow-through status remains the best option in most situations, the choice-of-entity analysis just got more complicated and will require even more crystal-ball gazing.

2. **Although we will have to relearn some old C corporation anti-abuse provisions, here's something we can forget: the corporate AMT.** The 2017 Tax Cuts and Jobs Act, § 12001, repealed the corporate alternative minimum tax (by amending Code § 55) effective for taxable years beginning after 2017. Corporations that incurred AMT in past years will want to be sure to claim that amount as a credit against regular tax going forward. A special rule regarding the refundable portion of the AMT credit is designed to allow a corporation to use fully in 2018 through 2021 any AMT credits carried forward. Also, corporations that have had other credits (e.g, the R&D credit) limited in past years by the AMT may be able to claim those credits going forward.

3. **A reduced corporate dividends received deduction.** The 2017 Tax Cuts and Jobs Act, § 13002, amended Code § 243 and certain other provisions to reduce the corporate dividends received deduction. Prior to this amendment, a corporation could deduct 100 percent of dividends received from a corporation in its affiliated group, 80 percent of dividends received from a corporation of which the recipient owns 20 percent or more of the stock (measured by vote and value), and 70 percent of dividends received from all other corporations. The legislation reduced the 80 percent and 70 percent figures to 65 percent and 50 percent, respectively. The legislation did not change the 100 percent dividends received deduction. These changes apply to taxable years beginning after 2017.

VII. PARTNERSHIPS

A. Formation and Taxable Years

B. Allocations of Distributive Share, Debt, and Outside Basis

1. **♫♪You got to know when to hold'em, know when to fold'em, know when to walk away, and know when to run….♫♪ Carried interests still qualify for preferential long-term capital gain rates, but the holding period just increased to 3 years for specified interests in hedge funds and other investment partnerships.** For years there has been a big brouhaha over managers of real estate, hedge fund, and other investment partnerships being taxed at preferential long-term capital gain rates (e.g., 20%) on their distributive shares of partnership income notwithstanding the fact that they received their interests in these partnerships as part of their compensation for services rendered (which compensation otherwise would be taxed at ordinary income rates). Congress and eventually President Trump have threatened for several years to take action against this "loophole." Well, at long last, Congress still has done NOTHING about it, but can claim that it did!

New § 1061. Specifically, the 2017 Tax Cuts and Jobs Act, § 13309, created new § 1061 and redesignated pre-TCJA § 1061 as § 1062. New § 1061 requires a three-year holding period for allocations of income with respect to "applicable partnership interests" to qualify for preferential long-term capital gain rates. Specifically, net long-term capital gain allocated to a partner who holds an applicable partnership interest is characterized as short-term capital gain to the extent the gain is attributable to the disposition of partnership property held by the partnership for three years or fewer. An applicable partnership interest is one that is transferred to (or is held by) a taxpayer in connection with the performance of substantial services by the taxpayer, or any other related person, in any "applicable trade or business." An applicable trade or business means any activity conducted on a regular, continuous, and substantial basis which, regardless of whether the activity is conducted in one or more entities, consists, in whole or in part, of ''raising or returning capital," and either "investing in (or disposing of) specified assets (or identifying specified assets for such investing or disposition)," or ''developing specified assets." Specified assets for this purpose generally are defined as securities, commodities, real estate held for rental or investment, cash or cash equivalents, options or derivative contracts with respect to any of the foregoing, and (*big furrowed brow here*) "an interest in a partnership to the extent of the partnership's proportionate interest in any of the foregoing" (e.g., tiered partnerships). There are significant exceptions, though, for (i) employees of another entity holding interests in a partnership that only performs services for that other entity; and (ii) partnership interests acquired for invested capital (including via a § 83(b) for a capital interest in a partnership).

What about § 1231 assets? It is unclear (at least to the authors) whether § 1061's three-year holding period rule applies to trump (*no pun intended*) quasi-capital gain treatment under § 1231. Basically, new § 1061 works by transmuting (i) otherwise net long-term capital gain (as defined in § 1222) attributable to an "applicable partnership interest" (i.e., all of a taxpayer's net long-term capital gain as normally calculated) into short-term capital gain, but (ii) only to the extent such gain exceeds net long-term capital gain (as defined in § 1222) attributable to the disposition of partnership property held by the partnership for three years or more (i.e., net long-term gain that is excluded from transmutation under § 1061). Short- and long-term capital gain (or loss) is defined under § 1222 by reference to a "capital asset" as defined in § 1221 and is determined at the partnership level. Code § 1221 excludes § 1231 assets from the definition of "capital assets." To wit, in the recent case of *CRI-Leslie, LLC v. Commissioner*, 147 T.C. No. 8 (9/7/16), the IRS was successful in arguing, over the strenuous objection of the taxpayer, that a § 1231 asset is not a "capital asset" within the meaning of § 1234A (which treats gains and losses realized upon termination of rights with respect to a "capital asset" as capital gain or loss). The taxpayer in *CRI-Leslie* had entered into a contract to sell a hotel that it owned and had received a deposit of $9.7 million. Ultimately, the buyer under the contract defaulted and forfeited the $9.7 million deposit, which was retained by the taxpayer. The hotel property was a § 1231 asset, not a capital asset. Relying upon § 1234A, the taxpayer reported the $9.7 million as net long-term capital gain. The IRS, however, asserted a deficiency based upon treating the forfeited $9.7 million deposit as ordinary income. The taxpayer argued that its characterization of the forfeited deposit as long-term capital gain was supported by the legislative history of § 1234A because, according to the taxpayer, Congress enacted § 1234A to "ensure that taxpayers received the same tax characterization of gain or loss whether the property is sold or the contract to which the property is subject is terminated." Nonetheless, the Tax Court (Judge Laro) rejected the taxpayer's argument that the legislative history of § 1234A supported the taxpayer's position. Instead, Judge Laro agreed with the IRS that "[s]ince section 1234A expressly refers to property that is 'a capital asset in the hands of the taxpayer' and no other type of property, and since property described in section 1231 is excluded explicitly from the definition of 'capital asset' in section 1221, we must conclude that the plain meaning of 'capital asset' as used in section 1234A does not extend to section 1231 property." The court was "unable find anything in the legislative history of section 1234A to support [the taxpayer's] assertion that Congress intended to include section 1231 property within its ambit." The legislative history accompanying new § 1061 likewise is bereft of any reference to § 1231 property.

What about partnership interests held by S corporations? Under § 1061(c)(4)(A), an interest in a partnership is not subject to the carried interest rule if it is held "directly or indirectly … by a corporation." Absent any limitation in the statute, the term "corporation" should include a subchapter S corporation. Has Congress left a glaring loophole?

Who cares? Isn't § 1061 just a paper tiger? New § 1061 is deserving of much more study, but we suspect that the provision will catch only those very rare taxpayers who either (i) fail to hold their carried interests for more than three years, or (ii) lack the sophisticated advice to plan around the statute. One commentator characterizes the new statute as "joke" given that most managers of real estate, hedge funds, and investment partnerships hold their carried interests for well over three years. *See* Sloan, *Carried Interest Reform is a Sham*, Washington Post, December 1, 2017. On the other hand, maybe this comment is just "fake news." New § 1061 is permanent and applies to taxable years beginning after 2017.

2. **Congress has made a technical correction to § 704(d) that makes partnership outside basis calculations with respect to charitable contributions and foreign taxes the same as for S corporations.** If you wish to avoid brain damage, stop reading and trust us that the foregoing statement is accurate. Otherwise, continue reading.

A recap of some basic rules for determining the basis of a partner's partnership interest. In general, the basis that a partner has in a partnership interest is adjusted upward by the partner's capital contributions and distributive share of income (including tax-exempt income) and downward (but not below zero) by distributions received by the partner and the partner's distributive share of losses and nondeductible expenditures. *See* § 705(a). Under § 704(d), a partner can take into account the partner's distributive share of losses for any taxable year only to the extent of the basis of the partner's partnership interest, determined after adjusting the basis for distributions and nondeductible expenditures of the partnership. *See* Reg. § 1.704-1(d)(2). To the extent such losses are limited in this manner, the excess is carried over to subsequent years and may be used when the partner has sufficient outside basis. *See* § 704(d); Reg. § 1.704-1(d)(1). But, in the case of charitable contributions and foreign taxes paid or incurred by a partnership, these items are not taken into account in computing partnership taxable income and, consequently, a partner's distributive share of income or loss of the partnership. *See* § 703(a)(2)(B) and (C). Instead, a partner separately takes into account his/her/its distributive share of these items under § 702(a)(4) and (6); however, due to a technical glitch in the regulations (*see* Reg. § 1.704-1(d)(2)), the outside basis limitation of § 704(d) did not apply properly to take into account a partner's separately-determined share of partnership charitable contributions. Specifically, if a partner had a positive outside basis, then (prior to the TCJA) the partner claimed the charitable contribution on the partner's return and reduced outside basis by the partner's separately-determined share of the adjusted basis of contributed property. If a partner had a zero outside basis, though, such partner still could claim the charitable contribution on the partner's return, but was not required to reduce outside basis. Further, those same technically-deficient regulations did not address the application of § 704(d) with respect to foreign taxes paid or accrued by a partnership, but even if they did apply to tie a partner's foreign tax deduction to the partner's basis in the partnership interest, § 901 allows a partner to take a credit in lieu of a deduction for foreign taxes paid or accrued by the partnership. Hence, in certain circumstances a partner with a zero outside basis could benefit from the partner's separately-stated share of charitable contributions or foreign taxes paid or incurred by the partnership, while another partner with a positive outside basis had to reduce outside basis for such items.

TCJA's technical correction to § 704(d). The 2017 Tax Cuts and Jobs Act, § 13503, amended § 704(d) permanently by adding new § 704(d)(3)(A) so that for taxable years beginning after 2017, a partner's outside basis is reduced by the partner's separately-stated share of charitable contributions and foreign taxes paid or incurred by the partnership before determining the partner's allowable share of distributive losses under § 704(d). In the case of a partnership's charitable contribution of appreciated property, the reduction in a partner's outside basis is determined by reference to the partner's share of the partnership's adjusted basis in the contributed property. In addition, TCJA § 13503 adds new § 704(d)(3)(B) so that, in the case of a partnership's charitable contribution of property with a fair market value in excess of its adjusted basis, the reduction in outside basis otherwise required by § 704(d)(3)(A) does not apply to the extent of the partner's separately-determined share of such excess. These changes to § 704(d) make the determination of a partner's outside basis with respect to charitable contributions and foreign taxes paid the same as the determination of subchapter S shareholder's outside basis with respect to such items. *See* § 1366(d)(4); Reg. § 1367-1(f).

C. Distributions and Transactions Between the Partnership and Partners

D. Sales of Partnership Interests, Liquidations and Mergers

1. No more technical terminations of partnerships. How will we get out of § 754 elections? The 2017 Tax Cuts and Jobs Act, § 13504, amended Code § 708(b) to repeal the § 708(b)(1)(B) rule regarding technical terminations of partnerships. Prior to amendment, § 708(b)(1)(B) treated a partnership as terminated if, within any 12-month period, there was a sale or exchange of 50 percent or more of the total interest in partnership capital and profits. This change applies to taxable years beginning after 2017. One effect of a technical termination of a partnership was that it terminated elections that had been made by the partnership. An example of this is the election under § 754 to adjust the basis of partnership assets upon certain distributions of property or upon the transfer of a partnership interest. The § 754 election formerly ended when a technical termination of a partnership occurred. Because technical terminations no longer occur, a § 754 election now can be revoked during the life of a partnership only with the consent of the IRS.

2. The Tax Court gives the IRS a lesson on the intersection of partnership and international taxation: subject to the exception in § 897(g), a foreign partner's gain from the redemption of its interest in a U.S. partnership was not income effectively connected with the conduct of a U.S. trade or business. Grecian Magnesite Mining, Industrial & Shipping Co., S.A. v. Commissioner, 149 T.C. No. 3 (7/13/17). The taxpayer, a corporation organized under the laws of Greece, held a 15 percent interest (later reduced to 12.6 percent) in Premier Chemicals, LLC, an LLC organized under Delaware law and classified for federal tax purposes as a partnership. The taxpayer accepted Premier's offer to redeem its partnership interest and received a total of $10.6 million, half of which was paid in 2008 and half in January 2009. The taxpayer and Premier agreed that the payment in January 2009 was deemed to have been paid on December 31, 2008, and that the taxpayer would not share in any profits or losses in 2009. The taxpayer realized $1 million of gain from the 2008 redemption payment and $5.2 million from the 2009 redemption payment. The taxpayer filed a return on Form 1120-F for 2008 on which it reported its distributive share of partnership items, but did not report any of the $1 million realized gain from the 2008 redemption payment. The taxpayer did not file a U.S. tax return for 2009 and thus did not report any of the $5.2 million realized gain from the 2009 redemption payment. The IRS issued a notice of deficiency in which it asserted that all of the $6.2 million of realized gain was subject to U.S. tax because it was U.S.-source income effectively connected with the conduct of a U.S. trade or business. The taxpayer conceded that $2.2 million of the gain was subject to U.S. taxation pursuant to § 897(g), which treats amounts received by a foreign person from the sale or exchange of a partnership interest as amounts received from the sale or exchange of U.S. real property to the extent the amounts received are attributable to U.S. real property interests. The taxpayer's concession left $4 million of realized gain in dispute. The Tax Court (Judge Gustafson) held that the $4 million of disputed gain was not income effectively connected with the conduct of a U.S. trade or business and therefore was not subject to U.S. taxation. (The court found it unnecessary to interpret the tax treaty in effect between the U.S. and Greece because U.S. domestic law did not impose tax on the gain and the IRS did not contend that the treaty imposed tax beyond U.S. domestic law.) In reaching this conclusion, the court addressed several issues.

The court first analyzed the nature of the gain realized by the taxpayer. Under § 736(b)(1), payments made in liquidation of the interest of a retiring partner that are made in exchange for the partner's interest in partnership property are treated as a distribution to the partner. Treatment as a distribution triggers § 731(a)(1), which provides that a partner recognizes gain from a distribution to the extent the amount of money received exceeds the partner's basis in the partnership interest and directs that the gain recognized "shall be considered as gain or loss from the sale or exchange of the partnership interest of the distributee partner." Pursuant to § 741, gain recognized from the sale or exchange of a partnership interest is "considered as gain or loss from the sale or exchange of a capital asset" except to the extent provided by § 751. (The IRS did not contend that § 751 applied.) The taxpayer asserted that these provisions lead to the conclusion that the taxpayer's gain must be treated as arising from the sale of a single asset, its partnership interest, which is a capital asset. The government argued that the taxpayer's gain must be treated as arising from the sale of separate interests in each asset owned by the partnership. Otherwise, the government argued, the rule in § 897(g), which imposes U.S. tax to the extent amounts received from the sale of a partnership interest are attributable to U.S. real property interests, would be rendered inoperable. The court agreed with the taxpayer. Section 897(g), the court explained,

> actually reinforces our conclusion that the entity theory is the general rule for the sale or exchange of an interest in a partnership. Without such a general rule, there would be no need to carve out an exception to prevent U.S. real property interests from being swept into the indivisible capital asset treatment that section 741 otherwise prescribes.

The court noted that this conclusion is consistent with the court's prior decision in *Pollack v. Commissioner*, 69 T.C. 142 (1977).

The court next addressed whether the $4 million of disputed gain was effectively connected with the taxpayer's conduct of a U.S. trade or business. Pursuant to § 875(1), the taxpayer was considered to be engaged in a U.S. trade or business because the partnership of which it was a partner, Premier, was engaged in a U.S. trade or business. Accordingly, the issue was narrowed to whether the disputed gain was effectively connected with that trade or business. Because foreign-source income is considered effectively connected with a U.S. trade or business only in narrow circumstances, which the IRS acknowledged were not present, the taxpayer's disputed gain could be considered effectively connected income only if it was U.S.-source income. Pursuant to the general rule of § 865(a), income from the sale of personal property by a nonresident is foreign-source income. The IRS asserted that an exception in § 865(e)(2) applied. Under this exception, if a nonresident maintains an office or other fixed place of business in the United States, income from a sale of personal property is U.S.-source if the sale is attributable to that office or fixed place of business. The court assumed without deciding that Premier's U.S. office would be attributed to the taxpayer under § 864(c)(5). Accordingly, the issue was whether the gain was attributable to Premier's U.S. office. Under § 864(c)(5)(B), income is attributable to a U.S. office only if the U.S. office is a material factor in the production of the income and the U.S. office "regularly carries on activities of the type from which such income, gain, or loss is derived." The court concluded that neither of these requirements was satisfied. The court examined Reg. § 1.864-6(b)(2)(i) and concluded that, although Premier's business activities might have had the effect of increasing the value of the taxpayer's partnership interest, those business activities did not make Premier's U.S. office a material factor in the production of the taxpayer's gain. Further, the court concluded, even if the U.S. office was a material factor, Premier did not regularly carry on activities of the type from which the gain was derived because "Premier was not engaged in the business of buying or selling interests in itself and did not do so in the ordinary course of business." Because the disputed gain was not U.S.-source income, it was not effectively connected with the conduct of a U.S. trade or business and therefore not subject to U.S. taxation.

- In reaching its conclusion that the taxpayer's gain was not effectively connected with the conduct of a U.S. trade or business, the court rejected the IRS's contrary conclusion in Rev. Rul. 91-32, 1991-1 C.B. 107. In that ruling, according to the court, the IRS concluded

> that gain realized by a foreign partner from the disposition of an interest in a U.S. partnership should be analyzed asset by asset, and that, to the extent the assets of the partnership would give rise to effectively connected income if sold by the entity, the departing partner's pro rata share of such gain should be treated as effectively connected income.

The court characterized the analysis in the ruling as "cursory" and declined to follow it.

- The taxpayer should have reported some of its gain in 2008, should have filed a 2009 U.S. tax return reporting gain in 2009, and should have paid tax with respect to both years because all of the gain realized from the 2008 distribution and some of the gain realized from the 2009 distribution was attributable to U.S. real property interests held by the U.S. partnership, Premier. Nevertheless, the court declined to impose either the failure-to-file penalty of § 6651(a)(1) or the failure-to-pay penalty of § 6651(a)(2) because the taxpayer had relied on the advice of a CPA and therefore, in the court's view, established a reasonable cause, good faith defense.

a. Grecian Magnesite may have won the battle, but the IRS has won the war with respect to a non-U.S. partner's sale of an interest in a partnership doing business in the U.S. (thereby codifying the IRS's position in Rev. Rul. 91-32). The 2017 Tax Cuts and Jobs Act, § 13501, amended § 864(c) by adding § 864(c)(8). New § 864(c)(8) 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). TCJA § 13501 makes corresponding changes to the withholding rules for effectively connected income under § 1446. These changes to § 864(c) and § 1446 statutorily reverse the Tax Court's recent decision in *Grecian Magnesite Mining, Industrial & Shipping Co., S.A. v. Commissioner*, 149 T.C. No. 3 (7/13/17) and effectively adopt the IRS's position in Rev. Rul. 91-32, 1991-1 C.B. 107.

E. Inside Basis Adjustments

1. Fun's over! Automatic § 754 elections (and corresponding downward inside basis adjustments) are now triggered more easily under § 743(d). Under pre-TCJA law, § 743(d) applied to transfers of interests in partnerships with a "substantial built-in loss." A substantial built-in loss exists for this purpose if the partnership's aggregate adjusted basis in its assets exceeds their aggregate fair market value by more than $250,000 immediately after the transfer. The 2017 Tax Cuts and Jobs Act, § 13502, amended § 743(d) to add that, notwithstanding the absence of a substantial built-in loss of more than $250,000 in the partnership's assets, a substantial built-in loss also exists if the transferee of a partnership interest would be allocated (based upon a hypothetical liquidation of the partnership's assets at fair market value) a loss of more than $250,000 immediately after the transfer. Generally, the consequence of § 743(d) is an automatic election under § 754 resulting in a downward adjustment to a partnership's basis in its built-in loss assets. Essentially, then, § 743(d) is designed to hinder sales of partnership interests when a substantial built-in loss exists by preventing the transferee from benefitting from the absence of a § 754 election upon the partnership's subsequent sale of assets. This TCJA change is permanent. The Conference Report illustrates the application of expanded § 743(d) as follows:

> For example, a partnership of three taxable partners (partners A, B, and C) has not made an election pursuant to section 754. The partnership has two assets, one of which, Asset X, has a built-in gain of $1 million, while the other asset, Asset Y, has a built-in loss of $900,000. Pursuant to the partnership agreement, any gain on sale or exchange of Asset X is specially allocated to partner A. The three partners share equally in all other partnership items, including in the built-in loss in Asset Y. In this case, each of partner B and partner C has a net built-in loss of $300,000 (one third of the loss attributable to asset Y) allocable to his partnership interest. Nevertheless, the partnership does not have an overall built-in loss, but a net built-in gain of $100,000 ($1 million minus $900,000). Partner C sells his partnership interest to another person, D, for $33,333. Under the provision, the test for a substantial built-in loss applies both at the partnership level and at the transferee partner level. If the partnership were to sell all its assets for cash at their fair market value immediately after the transfer to D, D would be allocated a loss of $300,000 (one third of the built-in loss of $900,000 in Asset Y). A substantial built-in loss exists under the partner-level test added by the provision, and the partnership adjusts the basis of its assets accordingly with respect to D.

This change applies to transfers of partnership interests after 2017.

F. Partnership Audit Rules

G. Miscellaneous

VIII. TAX SHELTERS

IX. EXEMPT ORGANIZATIONS AND CHARITABLE GIVING

A. Exempt Organizations

1. Congress shoots a probable NCAA "airball": After TCJA, it will cost 21 percent more to pay big-time, private school coaches like Coach K (Duke-$7.2M); but Wildcat fans celebrate as Coach Calipari (Kentucky-$6.5M) gets an "assist" from the IRS. Presumably believing that $1 million salaries at tax-exempt organizations are per se unreasonable, Congress decided to take a "shot" (*pun intended*) at curtailing them under TCJA. Specifically, the 2017 Tax Cuts and Jobs Act, § 13602, adds Code § 4960 to impose a 21 percent excise tax on "applicable tax-exempt organizations" ("ATEOs") and broadly-defined "related organizations" paying over $1 million annually to "covered employees." In addition to § 527 political organizations and § 521 farmers cooperatives, ATEOs include the following two additional types of organizations: (i) those exempt from tax under § 501(a) (most nonprofits, including churches, hospitals, and private schools); and (ii) those "with income excluded from taxation under § 115(l)" (income of certain public utilities and income derived from "any essential governmental function and accruing to a State or any political subdivision thereof"). A "covered employee" is defined as any one of the five highest compensated employees of an ATEO either (i) for the current taxable year or (ii) for any year beginning after December 31, 2016. Licensed medical or veterinarian professionals, however, are excluded from the definition of "covered employee." New § 4960 is permanent and effective for taxable years beginning after 2017. Given that many tax-exempt organizations have taxable years ending June 30 or October 31, many potentially affected organizations will have time to either comply or attempt to avoid new § 4960.

The probable NCAA "airball." Congress apparently thought that new § 4960 defined an ATEO so that both public and private colleges and universities would have to pay the 21 percent excise tax on compensation exceeding $1 million. The legislative history accompanying § 4960 states: "An [ATEO] is an organization exempt from tax under section 501(a), an exempt farmers' cooperative, *a Federal, State or local governmental entity with excludable income*, or a political organization." *See* H.R. Conf. Rep. No. 115-466, at 492 (Dec. 15, 2017) (emphasis added). At least one well-respected exempt organization scholar, however, has pointed out that, at least according to the IRS, "[i]ncome earned by a state, a political subdivision of a state, or an integral part of a state or political subdivision of a state" is not taxable regardless of § 115, citing Rev. Rul. 87-2, 1987-1 C.B. 18. Instead, it is the IRS's position that public colleges and universities are not taxable under our federalist system unless and until Congress enacts a specific statutory provision subjecting such state-affiliated organizations to tax like § 511(a)(2)(B) (state colleges and universities are subject to unrelated business income tax). *See* the blog post by Professor Ellen P. Aprill here, and her full law review article on the subject: Ellen P. Aprill, *The Integral, the Essential, and the Instrumental: Federal Income Tax Treatment of Government Affiliates*, 23 J. Corp. Law 803 (1997).

And another thing … Churches are exempt from taxation under § 501(a) along with hospitals and private schools. But we wouldn't bet money that any church paying its pastor more than $1 million annually is going to pay an excise tax under new §4960 without a fight based on the First Amendment. Ultimately, the church may lose such a fight because it is clear that churches are subject to the unrelated business income tax of § 511, but if a church can pay its pastor $1 million a year, it can pay a tax lawyer to litigate too.

2. Successful private colleges and universities really must be in the dog house because, in addition to taxing them for highly-paid coaches, Congress has decided to tax their endowments too! And, just to keep us on our toes, the legislative history says the statute turns on the number of an institution's "tuition paying" students, but § 4968 simply reads "students." The 2017 Tax Cuts and Jobs Act, § 13701, adds § 4968 which imposes a new 1.4 percent annual excise tax upon the net investment income of certain private colleges and universities and affiliated organizations with endowments worth $500,000 or more per full-time student. The excise tax imposed by new § 4968 is similar in many respects to the annual excise tax imposed upon private foundations under § 4940. In particular, new § 4968 applies to an "applicable educational institution" which is defined as institution: (i) that is an "eligible educational institution" as described in § 25A(f)(2) (which in turn refers to 20 U.S.C. § 1088); (ii) that has at least 500 students during the preceding taxable year more than 50 percent of which are in the U.S.; (iii) that is not described in the first section of § 511(a)(2)(B) (state colleges and universities); and (iv) that has assets (other than assets used directly in carrying out the institution's exempt purpose) with an aggregate fair market value as of end of the preceding taxable year of at least $500,000 per student. For this latter purpose, the number of students of an institution is based on the daily average number of full-time students attending the institution, with part-time students taken into account on a full-time student equivalent basis. Moreover, the legislative history of new § 4968 states that the $500,000 per student figure should be calculated based upon "tuition paying" students; however, the Senate Parliamentarian struck that language from § 4968 immediately before it was passed by the House and Senate. Whether regulations can fill in the gap is anybody's guess. New § 4968 is permanent and effective for taxable years beginning after 2017, again giving fiscal-year private colleges and universities time to cope.

3. Oh goody! Changes to the UBIT rules too! The 2017 Tax Cuts and Jobs Act, §§ 13702 and 13703, also made certain changes to the determination of unrelated business income with respect to tax-exempt organizations. Most tax-exempt organizations are subject to federal income tax at regular rates (corporate rates for exempt corporations and trust rates for exempt trusts) on net income (i.e., after permissible deductions) from a trade or business, regularly carried on, that is unrelated to the organization's exempt purpose (other than its need for revenue). Exceptions exist for most types of passive, investment income as well as for narrow categories of other types of income (e.g., thrift store sales). *See* §§ 511-514.

Stop using good UBI money to chase bad UBI money! Under pre-TCJA law, if an exempt organization had unrelated business income from one activity, but unrelated losses from another activity, then the income and losses could offset, meaning that the organization would report zero or even negative UBI. Congress apparently doesn't like this result, so under new § 512(a)(6) income and losses from separate unrelated businesses no longer may be aggregated. This new UBI provision is effective for taxable years beginning after 2017, thus giving fiscal year nonprofits some time to plan. Moreover, under a special transition rule, unrelated business income net operating losses arising in a taxable year beginning before January 1, 2018, that are carried forward to a taxable year beginning on or after such date, are not subject to § 512(a)(6).

Congress doesn't like using UBI to help fund fringe benefits, so when your organization's employees are pumping iron at the charity's free gym, you can pump up your UBI too. Under new § 512(a)(7), an organization's unrelated business taxable income is increased by the amount of any expenses paid or incurred by the organization that are not deductible because of the limitations of § 274 for (i) qualified transportation fringe benefits (as defined in § 132(f)); (ii) a parking facility used in connection with qualified parking (as defined in § 132(f)(5)(C)); or (iii) any on-premises athletic facility (as defined in § 132(j)(4)(B)). New § 512(a)(7) is effective for amounts paid or incurred after 2017, so affected tax-exempt organizations need to deal with this change immediately.

Perhaps worth noting here: Because the TCJA reduced the top federal income tax rate on C corporations to 21 percent, it likewise reduced to 21 percent the top rate on UBI of tax-exempt organizations formed as nonprofit corporations, which are the vast majority. So, the news for tax exempts is not all bad.

B. Charitable Giving

1. Provisions of the 2017 Tax Cuts and Jobs Act that affect charitable contributions.

a. If the legislation does not cause you to take the standard deduction, you can deduct even more of your cash contributions to public charities. The 2017 Tax Cuts and Jobs Act, § 11023, added new Code § 170(b)(1)(G) and redesignated existing § 170(b)(1)(G) as § 170(b)(1)(H). New § 170(b)(1)(G) increases the limit that applies to the deduction of certain charitable contributions by individuals. Prior to the Tax Cuts and Jobs Act, the limit on the deduction for charitable contributions that an individual made to a public charity or certain other organizations was 50 percent of the individual's contribution base, which, generally speaking, is adjusted gross income. The legislation increased this percentage to 60 percent for *cash contributions* that an individual makes to public charities and certain other organizations specified in § 170(b)(1)(A). Any contribution that exceeds this limit can be carried forward to each of the succeeding five years. This increased limit applies to taxable years beginning after 2017 and before 2026.

b. If you don't get a contemporaneous written acknowledgment for your charitable contribution over $250, the donee charity no longer can bail you out with an amended Form 990. Plus, Treasury and the IRS can check at least one regulatory project off the "to do" list. Under Code § 170(f)(8), a taxpayer's charitable contribution of $250 or more is disallowed unless the taxpayer obtains a "contemporaneous written acknowledgement" ("CWA") of the contribution from the charity indicating whether the charity provided any good or service (and an estimate of the value of any such good or service) to the taxpayer in consideration for the contribution. On the other hand, § 170(f)(8)(D) provides an exception to the CWA requirement if the donee charity files a return, on such form and in accordance with such regulations as the Secretary may prescribe, that includes the same content. Yet, the IRS's position (which has been upheld 8-3-6 by the Tax Court in a reviewed opinion by Judge Lauber) has been that the § 170(f)(8)(D) exception is not available unless and until the Treasury Department and the IRS issue final regulations implementing the exception, which to date they have not done. *See, e.g.*, 15 West 17th Street LLC v. Commissioner, 147 T.C. No. 19 (12/22/16). The 2017 Tax Cuts and Jobs Act, § 13705, permanently repealed § 170(f)(8)(D) effective for taxable years beginning after December 31, 2016.

c. No more charitable contribution deduction for 50-yard line seats! Normally, a taxpayer who receives a substantial return benefit for a payment to a charity (e.g., admission to the museum) cannot claim a charitable contribution deduction for the payment. Under pre-TCJA law, though, special rules applied to certain payments to colleges and universities in exchange for rights to purchase preferred tickets or seating at athletic events. These special rules (§ 170(l)) generally permitted the taxpayer to treat 80 percent of a payment to a college or university as a charitable contribution even when preferred seating or ticket rights were granted in exchange if (i) the amount was paid to or for the benefit of a school with a regular faculty and curriculum and meeting certain other requirements; and (ii) such amount would have been allowable as a charitable contribution deduction but for the fact that the taxpayer received (directly or indirectly) as a result of the payment the right to purchase tickets for seating at the school's athletic events. The 2017 Tax Cuts and Jobs Act, § 13704, permanently amended § 170(l) so that no charitable contribution deduction is allowed with respect to payments for the right to purchase tickets or seating at a school's athletic events. The amendment to § 170(l) is effective for contributions made in taxable years beginning after 2017.

X. TAX PROCEDURE

A. Interest, Penalties and Prosecutions

1. Return preparers need to be extra careful with not only the earned income tax credit, but also with the child tax credit, additional child tax credit, and the American Opportunity Tax Credit. T.D. 9799, Tax Return Preparer Due Diligence Penalty Under Section 6695(g), 81 F.R. 87444 (12/5/16). The Treasury Department and the IRS have issued proposed and temporary regulations that amend Reg. § 1.6695-2 to implement changes made by the Protecting Americans from Tax Hikes Act of 2015. These changes extend the § 6695(g) preparer due diligence requirements to returns or claims for refund including claims of the child tax credit (CTC), additional child tax credit (ACTC), and American Opportunity Tax Credit (AOTC), in addition to the earned income credit (EIC). As a result of these changes, one return or claim for refund may contain claims for more than one credit subject to the due diligence requirements. Each failure to comply with the due diligence requirements set forth in the regulations results in a penalty, and therefore more than one penalty could apply to a single return or claim for refund. Examples in the temporary regulations illustrate how multiple penalties could apply when one return or claim for refund is filed. Revisions to Form 8867 have been made for 2016 so that it is a single checklist to be used for all applicable credits. The temporary regulations are effective on December 5, 2016.

a. Congress has directed Treasury to issue preparer due diligence requirements with respect to head-of-household filing status. The 2017 Tax Cuts and Jobs Act, § 11001(b), amended Code § 6695(g) to extend the preparer due diligence requirements to returns or claims for refund that claim eligibility for head-of-household filing status. This change is effective for taxable years beginning after 2017.

2. Congress has reduced to zero the Affordable Care Act's penalty for failure to maintain minimum essential coverage for months beginning after 2018. The 2017 Tax Cuts and Jobs Act, § 11081, amended Code § 5000A(c) to reduce to zero the penalty enacted as part of the Affordable Care Act for failing to maintain minimum essential coverage. This change applies to months beginning after 2018. Accordingly, for 2017 and 2018, individual taxpayers still must answer the question on the return concerning whether they and other household members had minimum essential coverage and will be subject to the penalty of § 5000A(c) (referred to as the shared responsibility payment) for failure to maintain such coverage. Under § 5000A(c)(1) and Reg. § 1.5000A-4(a), the individual shared responsibility payment for months during which an individual fails to maintain minimum essential coverage is the lesser of: (1) the sum of the monthly penalty amounts (generally 1/12 of the greater of a fixed dollar amount—$695 per adult with a family maximum of $2,085 for 2017—or a percentage—2.5 percent for 2017—of the amount by which household income exceeds the filing threshold), or (2) the sum of the monthly national average bronze plan premiums for the shared responsibility family—$272 per month per individual for 2017.

B. Discovery: Summons and FOIA

C. Litigation Costs

D. StatutoryNotice of Deficiency

E. Statute of Limitations

1. The time period for the IRS to return wrongfully levied funds, and for taxpayers to bringing suit for wrongful levy, is now two years. The 2017 Tax Cuts and Jobs Act, § 11071, amended Code § 6343(b) to increase from nine months to two years the period of time within which the IRS can return to a taxpayer money (or monetary proceeds from the sale of property) upon which the IRS has wrongfully levied. The legislation also amended Code § 6532(c) to increase from nine months to two years the period of time within which a taxpayer can bring an action for wrongful levy. Under both Code provisions, the two-year period runs from the date of levy. These amendments are effective with respect to (1) levies made after the date of enactment, which is December 22, 2017, and (2) levies made on or before December 22, 2017 provided that the nine-month period had not expired as of the date of enactment.

F. Liens and Collections

G. Innocent Spouse

H. Miscellaneous

XI. WITHHOLDING AND EXCISE TAXES

XII. TAX LEGISLATION

A. Enacted

1. Congress couldn't even get the name right in this legislation. Nevertheless, this is significant legislation that affects virtually all areas of federal taxation. An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018, Pub. L. No. 115-97, was signed by the President on December 22, 2017. This legislation is colloquially referred to as the Tax Cuts and Jobs Act ("TCJA"). (The legislation included the short title "Tax Cuts and Jobs Act," but the name was stricken by the Senate Parliamentarian immediately prior to the Senate's passage of the final bill.) The TCJA makes significant amendments to the Internal Revenue Code of 1986 that are too numerous to list. The Conference Report accompanying the TCJA may be found here. The legislation generally applies to tax years beginning after 2017. Many of the TCJA changes affecting individual taxpayers are temporary and sunset for taxable years beginning after 2025. Some provisions, such as certain amendments of the rules for depreciation, apply prior to 2018.

XIII. TRUSTS, ESTATES & GIFTS

A. Gross Estate

B. Deductions

1. "The difference between death and taxes is death doesn't get worse every time Congress meets." Well, estate and gift taxes actually just got a little better. Congress has doubled the basic exclusion amount. The 2017 Tax Cuts and Jobs Act, § 11061, amended Code § 2010(c)(3) by adding § 2010(c)(3)(C), which increases the basic exclusion amount from $5 million to $10 million for decedents dying after 2017 and before 2026. Pursuant to § 2010(c)(3)(B), the $10 million amount is adjusted for inflation for calendar years after 2011. Accordingly, for 2018, the basic exclusion amount is $11.2 million. The legislation also directs the Treasury Department to issue regulations to carry out the new rule with respect to any difference between the exclusion amount in effect at the time of the decedent's death and the amount in effect at the time of any gifts the decedent made.

C. Gifts

D. Trusts

RECENT DEVELOPMENTS IN FEDERAL INCOME TAXATION

"Recent developments are just like ancient history, except they happened less long ago."

By

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State Bar of Texas Tax Section
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Note: This outline was prepared jointly with Professor Cassady V. ("Cass") Brewer of the Georgia State University College of Law, Atlanta, GA.

On February 9, 2018, the President signed the Bipartisan Budget Act of 2018, Pub. L. No. 115-123. This outline summarizes the changes made by this legislation that, in our judgment, are the most important. The outline does not attempt to list the provisions of the legislation comprehensively or to explain them in detail. Readers should note that many provisions of the Bipartisan Budget Act of 2018 apply retroactively to 2017.

I. ACCOUNTING

II. BUSINESS INCOME AND DEDUCTIONS

A. Income

B. Deductible Expenses versus Capitalization

C. Reasonable Compensation

D. Miscellaneous Deductions

E. Depreciation & Amortization

1. Certain depreciation and amortization provisions of the Bipartisan Budget Act of 2018:

a. We suppose it makes sense that racehorses have a swift recovery period. The Bipartisan Budget Act of 2018, § 40304, retroactively extended the classification of racehorses as 3-year MACRS property so that the classification applies to racehorses placed in service before 2018. A racehorse placed in service after 2017 qualifies for the 3-year recovery period only if it is more than two years old when placed in service.

b. Good news for those who placed motorsports entertainment complexes in service during 2017. The Bipartisan Budget Act of 2018, § 40305, retroactively extended the § 168(e)(3)(C)(ii) classification of motorsports entertainment complexes as 7-year property to include property placed in service through December 31, 2017. *See* § 168(i)(15)(D). Such property is depreciable over a 7-year recovery period using the straight-line method.

c. A portion of the cost of certain mine safety equipment can be treated as a current deduction through 2017. The Bipartisan Budget Act of 2018, § 40307, retroactively extended the election under § 179E to treat 50 percent of the cost of any qualified advanced mine safety equipment property as an expense in the tax year in which the equipment is placed in service. The election is available for qualifying property placed in service before January 1, 2018.

F. Credits

1. Employers who retained employees despite becoming inoperable in areas affected by Hurricanes Harvey, Irma, or Maria are eligible for a 40 percent employee retention credit. The Disaster Relief and Airport and Airway Extension Act of 2017 ("2017 Disaster Relief Act"), Pub. L. No. 115-63, was signed by the President on September 29, 2017. Section 503 of the 2017 Disaster Relief Act provides that an "eligible employer" can include the "Hurricane Harvey employee retention credit" among the credits that are components of the general business credit under § 38(b). The credit is equal to 40 percent of "qualified wages" for each "eligible employee." The cap on the amount of qualified wages that can be taken into account is $6,000. Thus, the maximum credit per employee is $2,400. An *eligible employer* is an employer that conducted an active trade or business on a specified date in the Hurricane Harvey disaster zone, Hurricane Irma disaster zone, or Hurricane Maria disaster zone, if the trade or business became inoperable on any day after the specified date and before January 1, 2018, as a result of damage sustained by the relevant hurricane. The specified dates are August 23, 2017 (Harvey), September 4, 2017 (Irma), and September 16, 2017 (Maria). The term *eligible employee* is defined as an employee whose principal place of employment with an eligible employer was in the relevant disaster zone on the relevant specified date. The term *qualified wages* means wages (as defined in § 51(c)(1), but without regard to § 3306(b)(2)(B)) paid or incurred by an eligible employer with respect to an eligible employee on any day after the relevant specified date and before January 1, 2018, during the period beginning on the date the trade or business first became inoperable at the employee's principal place of employment and ending on the date on which the trade or business resumed significant operations at the principal place of employment. Wages can be qualified wages regardless of whether the employee performed no services, performed services at a different location, or performed services at the employee's principal place of employment before significant operations resumed. An employee is not considered an eligible employee if the employer is allowed a credit with respect to the employee under § 51(a), i.e., an eligible employer cannot claim the 40 percent credit with respect to an employee for any period if the employer is allowed a Work Opportunity Tax Credit with respect to the employee under § 51 for that period.

- Section 501 of the 2017 Disaster Relief Act defines the terms Hurricane Harvey disaster area, Hurricane Irma disaster area, and Hurricane Maria disaster area as an area with respect to which the President has declared a major disaster by reason of the relevant hurricane before October 17, 2017. (*Note:* the date originally in the 2017 Disaster Relief Act was September 21, 2017. This date was changed to October 17, 2017, by the Bipartisan Budget Act of 2018, Division B, § 20201, Pub. L. No. 115-123, which was signed by the President on February 9, 2018.) The terms Hurricane Harvey disaster zone, Hurricane Irma disaster zone, and Hurricane Maria disaster zone are defined as the portion of the relevant disaster area determined by the President to warrant individual or individual and public assistance from the federal government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act by reason of the relevant hurricane.

a. Congress has provided a similar credit to employers who retained employees despite becoming inoperable in areas affected by California wildfires. The Bipartisan Budget Act of 2018, Pub. L. No. 115-123, § 20103 of Division B, provides that an "eligible employer" can include the "California wildfire employee retention credit" among the credits that are components of the general business credit under § 38(b). This credit is essentially the same as the "Hurricane Harvey employee retention credit" enacted as part of the 2017 Disaster Relief Act, except that it applies to a different category of employers. For purposes of the California wildfire employee retention credit, an *eligible employer* is one that conducted an active trade or business on October 8, 2017, in the California wildfire disaster zone whose trade or business was inoperable on any day after October 8, 2017, and before January 1, 2018, as a result of damage sustained by reason of wildfires with respect to which the President declared a major disaster under the Robert T. Stafford Disaster Relief and Emergency Assistance Act. Like the Hurricane Harvey employee retention credit, the California wildfire employee retention credit is a credit equal to 40 percent of "qualified wages" (up to $6,000) for each "eligible employee," so that the maximum credit per employee is $2,400.

- The Bipartisan Budget Act of 2018 defines the term "California wildfire disaster zone" as the portion of the California wildfire disaster area determined by the President to warrant individual or individual and public assistance from the Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act by reason of wildfires in California. The term "California wildfire disaster area" is defined as an area with respect to which the President declared a major disaster from January 1, 2017, through January 18, 2018, under section 401 of the Stafford Act by reason of wildfires in California.

III. INVESTMENT GAIN

IV. COMPENSATION ISSUES

A. Fringe Benefits

B. Qualified Deferred Compensation Plans

1. **Retirement plans can make loans and hardship distributions to victims of Hurricanes Harvey and Irma.** Announcement 2017-11, 2017-39 I.R.B. 255 (8/30/17) and Announcement 2017-13, 2017-40 I.R.B. 271 (9/12/17). Section 401(k) plans and similar employer-sponsored retirement plans can make loans and hardship distributions to victims of Hurricanes Harvey and Irma. Participants in § 401(k) plans, employees of public schools and tax-exempt organizations with § 403(b) tax-sheltered annuities, as well as state and local government employees with § 457(b) deferred-compensation plans, may be eligible to take advantage of these streamlined loan procedures and liberalized hardship distribution rules. IRA participants are barred from taking out loans, but may be eligible to receive distributions under liberalized procedures. Pursuant to this relief, an eligible plan will not be treated as failing to satisfy any requirement under the Code or regulations merely because the plan makes a loan, or a hardship distribution for a need arising from Hurricanes Harvey or Irma, to an employee, former employee, or certain family members of employees whose principal residence or place of employment was in one of the Texas counties (as of August 23, 2017) or Florida counties (as of September 4, 2017) identified for individual assistance by the Federal Emergency Management Agency (FEMA) because of the devastation caused by Hurricanes Harvey or Irma. Similar relief applies with respect to additional areas identified by FEMA for individual assistance after August 23, 2017 (in the case of Harvey) or September 4, 2017 (in the case of Irma). To qualify for this relief, hardship withdrawals must be made by January 31, 2018. To facilitate access to plan loans and distributions, the IRS will not treat a plan as failing to follow procedural requirements imposed by the terms of the plan for plan loans or distributions merely because those requirements are disregarded for any period beginning on or after August 23, 2017 (in the case of Harvey) or September 4, 2017 (in the case of Irma) and continuing through January 31, 2018, provided the plan administrator (or financial institution in the case of IRAs) makes a good-faith diligent effort under the circumstances to comply with those requirements. As soon as practicable, the plan administrator (or financial institution in the case of IRAs) must make a reasonable attempt to assemble any forgone documentation.

- This relief means that a retirement plan can allow a victim of Hurricanes Harvey or Irma to take a hardship distribution or borrow up to the specified statutory limits from the victim's retirement plan. It also means that a person who lives outside the disaster area can take out a retirement plan loan or hardship distribution and use it to assist a son, daughter, parent, grandparent or other dependent who lived or worked in the disaster area.

- A plan is allowed to make loans or hardship distributions before the plan is formally amended to provide for such features. Plan amendments to provide for loans or hardship distributions must be made no later than the end of the first plan year beginning after December 31, 2017. In addition, the plan can ignore the reasons that normally apply to hardship distributions, thus allowing them, for example, to be used for food and shelter.

- Except to the extent the distribution consists of already-taxed amounts, a hardship distribution made pursuant to this relief will be includible in gross income and generally subject to the 10-percent additional tax of § 72(t).

a. Congress makes access to retirement plan funds even easier for victims of Hurricanes Harvey, Irma, and Maria. The Disaster Relief and Airport and Airway Extension Act of 2017 ("2017 Disaster Relief Act"), Pub. L. No. 115-63, was signed by the President on September 29, 2017. Section 502 of the 2017 Disaster Relief Act provides special rules that apply to distributions from qualified employer plans and IRAs and to loans from qualified employer plans for victims of Hurricanes Harvey, Irma, and Maria. To a large extent, these rules supersede those in Announcement 2017-11, 2017-39 I.R.B. 255 (8/30/17), and Announcement 2017-13, 2017-40 I.R.B. 271 (9/12/17).

Qualified Hurricane Distributions. Section 502(a) of the 2017 Disaster Relief Act provides four special rules for "qualified hurricane distributions." **First**, the legislation provides that qualified hurricane distributions up to an aggregate amount of $100,000 are not subject to the normal 10-percent additional tax of § 72(t) that applies to distributions to a taxpayer who has not reached age 59-1/2. **Second**, the legislation provides that, unless the taxpayer elects otherwise, any income resulting from a qualified hurricane distribution is reported ratably over the three-year period beginning with the year of the distribution. **Third**, the legislation permits the recipient of a qualified hurricane distribution to contribute up to the amount of the distribution to a qualified employer plan or IRA that would be eligible to receive a rollover contribution of the distribution. The contribution need not be made to the same plan from which the distribution was received, and must be made during the three-year period beginning on the date of the distribution. If contributed within the required three-year period, the distribution and contribution are treated as made in a direct trustee-to-trustee transfer within 60 days of the distribution. The apparent intent of this rule is to permit the taxpayer to exclude the distribution from gross income to the extent it is recontributed within the required period. Because the recontribution might take place in a later tax year than the distribution, presumably a taxpayer would include the distribution in gross income in the year received and then file an amended return for the distribution year upon making the recontribution. **Fourth**, qualified hurricane distributions are not treated as eligible rollover distributions for purposes of the withholding rules, and therefore are not subject to the normal 20 percent withholding that applies to eligible rollover distributions under § 3405(c). A *qualified hurricane distribution* is defined as any distribution from an eligible retirement plan as defined in § 402(c)(8)(B) (which includes qualified employer plans and IRAs) made before January 1, 2019, and (1) on or after August 23, 2017, to an individual whose principal place of abode on that date was located in the Hurricane Harvey disaster area and who sustained an economic loss by reason of Hurricane Harvey, (2) on or after September 4, 2017, to an individual whose principal place of abode on that date was located in the Hurricane Irma disaster area and who sustained an economic loss by reason of Hurricane Irma, or (3) on or after September 16, 2017, to an individual whose principal place of abode on that date was located in the Hurricane Maria disaster area and who sustained an economic loss by reason of Hurricane Maria.

Recontributions of Withdrawals Made for Home Purchases. Section 502(b) of the 2017 Disaster Relief Act permits an individual who received a "qualified distribution" to contribute up to the amount of the distribution to a qualified employer plan or IRA that would be eligible to receive a rollover contribution of the distribution. A qualified distribution is a hardship distribution that an individual received from a qualified employer plan or IRA after February 28, 2017, and before September 21, 2017, that was to be used to purchase or construct a principal residence in the Hurricane Harvey, Irma, or Maria disaster areas that was not purchased or constructed on account of the hurricanes. The contribution need not be made to the same plan from which the distribution was received, and must be made during the period beginning on August 23, 2017, and ending on February 28, 2018. The distribution and contribution are treated as made in a direct trustee-to-trustee transfer within 60 days of the distribution. The apparent intent of this rule is to permit the taxpayer to exclude the distribution from gross income to the extent it is recontributed within the required period.

Loans. For victims of Hurricanes Harvey, Irma, or Maria, section 502(c) of the 2017 Disaster Relief Act increases the limit on loans from qualified employer plans and permits repayment over a longer period of time. Normally, under § 72(p), a loan from a qualified employer plan is treated as a distribution unless it meets certain requirements. One requirement is that the loan must not exceed the lesser of (1) $50,000 or (2) the greater of one-half of the present value of the employee's nonforfeitable accrued benefit or $10,000. A second requirement is that the loan must be repaid within five years. In the case of a loan made to a "qualified individual" during the period from September 29, 2017 (the date of enactment) through December 31, 2018, the legislation increases the limit on loans to the lesser of (1) $100,000 or (2) the greater of *all* of the present value of the employee's nonforfeitable accrued benefit or $10,000. The legislation also provides that, if a qualified individual has an outstanding plan loan on August 23, 2017 (for Harvey victims), September 4, 2017 (for Irma victims), or September 16, 2017 (for Maria victims) with a due date for any repayment on or before December 31, 2018, the due date is delayed for one year. If an individual takes advantage of this delay, then any subsequent repayments are adjusted to reflect the delay in payment and interest accruing during the delay. This appears to require reamortization of the loan. A *qualified individual* is defined as an individual whose principal place of abode (1) was located in the Hurricane Harvey disaster area on August 23, 2017, and who sustained an economic loss by reason of Hurricane Harvey, (2) was located in the Hurricane Irma disaster area on September 4, 2017, and who sustained an economic loss by reason of Hurricane Irma, or (3) was located in the Hurricane Maria disaster area on September 16, 2017, and who sustained an economic loss by reason of Hurricane Maria.

Hurricane Harvey, Irma, and Maria Disaster Areas. Section 501 of the 2017 Disaster Relief Act defines the Hurricane Harvey disaster area, Hurricane Irma disaster area, and Hurricane Maria disaster area as an area with respect to which the President has declared a major disaster by reason of the relevant hurricane before October 17, 2017. (*Note:* the date originally in the 2017 Disaster Relief Act was September 21, 2017. This date was changed to October 17, 2017, by the Bipartisan Budget Act of 2018, Division B, § 20201, Pub. L. No. 115-123, which was signed by the President on February 9, 2018.)

b. Congress has enacted similar rules to allow easier access to retirement funds for those affected by California wildfires. The Bipartisan Budget Act of 2018, Pub. L. No. 115-123, § 20102 of Division B, provides those affected by California wildfires with the same special rules for distributions from qualified employer plans and IRAs and for loans from qualified employer plans that Congress previously enacted as part of the 2017 Disaster Relief Act for those affected by Hurricanes Harvey, Irma, and Maria.

Qualified Wildfire Distributions. The legislation provides that "qualified wildfire distributions" up to an aggregate limit of $100,000 are not subject to the normal 10-percent additional tax of § 72(t), are to be included in gross income over a three-year period unless the recipient elects otherwise, can be recontributed to an eligible plan within three years and thereby treated as tax-free rollovers, and are not subject to the normal 20 percent withholding that applies to eligible rollover distributions under § 3405(c). A *qualified wildfire distribution* is defined as any distribution from an eligible retirement plan as defined in § 402(c)(8)(B) (which includes qualified employer plans and IRAs) made on or after October 8, 2017, and before January 1, 2019, to an individual whose principal place of abode during any portion of the period from October 8, 2017, to December 31, 2017, was located in the California wildfire disaster area and who sustained an economic loss by reason of the wildfires.

Recontributions of Withdrawals Made for Home Purchases. The legislation permits an individual who received a "qualified distribution" to contribute up to the amount of the distribution to a qualified employer plan or IRA that would be eligible to receive a rollover contribution of the distribution. A qualified distribution is a hardship distribution that an individual received from a qualified employer plan or IRA after March 31, 2017, and before January 15, 2018, that was to be used to purchase or construct a principal residence in the California wildfire disaster area that was not purchased or constructed on account of the wildfires. The contribution need not be made to the same plan from which the distribution was received, and must be made during the period beginning on October 8, 2017, and ending on June 30, 2018. The distribution and contribution are treated as made in a direct trustee-to-trustee transfer within 60 days of the distribution. This special rule permits the taxpayer to exclude the distribution from gross income to the extent it is recontributed within the required period.

Loans. The legislation provides those affected by California wildfires the same increased loan limit and extended repayment period that Congress previously provided in the 2017 Disaster Relief Act to those affected by Hurricanes Harvey, Irma, and Maria. In the case of a loan made to a "qualified individual" during the period from February 9, 2018 (the date of enactment) through December 31, 2018, the legislation increases the limit on loans to the lesser of (1) $100,000 or (2) the greater of *all* of the present value of the employee's nonforfeitable accrued benefit or $10,000. The legislation also provides that, if a qualified individual has an outstanding plan loan on or after October 8, 2017, with a due date for any repayment on or before December 31, 2018, the due date is delayed for one year. A *qualified individual* is any individual whose principal place of abode during any portion of the period from October 8, 2017, to December 31, 2017, was located in the California wildfire disaster area and who sustained an economic loss by reason of the wildfires.

California Wildfire Disaster Area. The Bipartisan Budget Act of 2018 defines the term "California wildfire disaster area" as an area with respect to which the President declared a major disaster from January 1, 2017, through January 18, 2018, under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act by reason of wildfires in California.

C. Nonqualified Deferred Compensation, Section 83, and Stock Options

D. Individual Retirement Accounts

V. PERSONAL AND INDIVIDUAL INCOME AND DEDUCTIONS

A. Rates

B. Miscellaneous Income

1. An exclusion from gross income for wrongfully incarcerated individuals. The 2015 PATH Act, § 304, added to the Code § 139F, which excludes from the gross income of an individual who is convicted of a criminal offense under federal or state law and wrongfully incarcerated any civil damages, restitution, or other monetary award relating to the individual's incarceration. An individual was wrongfully incarcerated if the individual is pardoned, granted clemency, or granted amnesty for the offense because the individual was innocent, or if the conviction is reversed or vacated and the charging instrument is then dismissed or the individual is found not guilty at a new trial. The new provision applies to taxable years beginning before, on, or after December 18, 2015, the date of enactment. A special rule allows individuals to make a claim for credit or refund of any overpayment of tax resulting from the exclusion, even if the claim would normally be barred by operation of any law or rule of law (including res judicata), if the claim for credit or refund is filed before the close of the one-year period beginning on December 18, 2015.

a. Congress has extended to December 18, 2018, the time within which individuals can file claims for refund based on the § 139F exclusion. The Bipartisan Budget Act of 2018, § 41103, extends the time within which individuals who are eligible for the Code § 139F exclusion can file a claim for credit or refund of any overpayment of tax resulting from the exclusion. Pursuant to this amendment, even if an individual's claim was barred as of December 18, 2015, by operation of any law or rule of law (including res judicata), the individual can make a claim for credit or refund based on the § 139F exclusion if the claim is filed before the close of the three-year period beginning on December 18, 2015. Thus, individuals have until December 18, 2018, to file such claims.

2. Congress has extended through 2017 the exclusion for discharge of qualified principal residence indebtedness. The Bipartisan Budget Act of 2018, § 40201, retroactively extended through December 31, 2017 the § 108(a)(1)(E) exclusion for up to $2 million ($1 million for married individuals filing separately) of income from the cancellation of qualified principal residence indebtedness.

C. Hobby Losses and § 280A Home Office and Vacation Homes

D. Deductions and Credits for Personal Expenses

1. Deducting casualty losses in areas affected by Hurricanes Harvey, Irma, and Maria just got easier. The Disaster Relief and Airport and Airway Extension Act of 2017 ("2017 Disaster Relief Act"), Pub. L. No. 115-63, was signed by the President on September 29, 2017. Section 504(b) of the 2017 Disaster Relief Act provides special rules for disaster losses in specified areas that are attributable to Hurricanes Harvey, Irma, or Maria. Normally, a personal casualty loss is deductible only to the extent that it exceeds $100 and only to the extent the sum of all personal casualty losses exceeds 10 percent of adjusted gross income. The 2017 Disaster Relief Act provides that a "net disaster loss" is deductible only to the extent it exceeds $500 (rather than $100) and is deductible without regard to the normal 10-percent-of-AGI threshold. An individual with a net disaster loss can deduct the sum of any non-disaster personal casualty losses, which remain subject to the $100 and 10 percent thresholds, and the net disaster loss. For example, if an individual has AGI of $90,000, a non-disaster-related casualty loss of $10,000 from the theft of a personal car, and a net disaster loss from Hurricane Harvey of $50,000, then the individual can deduct $900 of the theft loss ($10,000 reduced by $100 reduced by 10 percent of AGI) and can deduct $49,500 of the net disaster loss ($10,000 reduced by $500). The deduction for the net disaster loss is available both to those who itemize their deductions and those who do not. For those who do not itemize, the standard deduction is increased by the amount of the net disaster loss. The disallowance of the standard deduction for purposes of determining alternative minimum taxable income does not apply to this increased portion of the standard deduction.

A net disaster loss is defined as the amount by which "qualified disaster-related personal casualty losses" exceed personal casualty gains. A qualified disaster-related personal casualty loss is a loss described in § 165(c)(3) (which generally defines casualty losses) that is attributable to Hurricanes Harvey, Irma, or Maria and that arises: (1) in the Hurricane Harvey disaster area on or after August 23, 2017, (2) in the Hurricane Irma disaster area on or after September 4, 2017, or (3) in the Hurricane Maria disaster area on or after September 16, 2017. Section 501 of the 2017 Disaster Relief Act defines each of these areas as an area with respect to which the President has declared a major disaster by reason of the relevant hurricane before October 17, 2017. (*Note:* the date originally in the 2017 Disaster Relief Act was September 21, 2017. This date was changed to October 17, 2017, by the Bipartisan Budget Act of 2018, Division B, § 20201, Pub. L. No. 115-123, which was signed by the President on February 9, 2018.)

a. The IRS has provided safe harbor methods for determining casualty and theft losses for personal-use residential real property and personal belongings. Rev. Proc. 2018-8, 2018-2 I.R.B. 286 (12/13/17). This revenue procedure provides safe harbor methods that individual taxpayers can use in determining the amount of their casualty and theft losses for their personal-use residential real property and personal belongings. Additional safe harbor methods are available in the case of casualty and theft losses occurring as a result of any federally declared disaster. The IRS will not challenge an individual's determination of the decrease in fair market value of personal-use residential real property or personal belongings if the individual qualifies for and uses one of the safe harbor methods described in the revenue procedure. The revenue procedure is effective December 13, 2017.

b. An additional safe harbor for personal-use residential real property affected by Hurricanes Harvey, Irma, or Maria. Rev. Proc. 2018-9, 2018-2 I.R.B. 290 (12/13/17). This revenue procedure provides the Cost Indexes Safe Harbor Method that individual taxpayers may use in determining the amount of their casualty losses pursuant to Code § 165 for their personal-use residential real property damaged or destroyed as a result of Hurricane and Tropical Storm Harvey, Hurricane Irma, and Hurricane Maria (the "2017 Hurricanes"). Specifically, this revenue procedure provides a safe harbor method that individuals may use to determine the decrease in fair market value of their personal-use residential real property on their U.S. income tax returns filed with the IRS. The IRS will not challenge an individual's determination of the decrease in fair market value of personal-use residential real property attributable to one of the 2017 Hurricanes if the individual qualifies for and uses the safe harbor method described in the revenue procedure. The revenue procedure is effective for losses that are attributable to the 2017 Hurricanes and that arose after August 22, 2017 in specified areas.

c. Congress has enacted legislation to make deducting casualty losses easier in areas affected by California wildfires. The Bipartisan Budget Act of 2018, § 20104(b) of Division B, provides the same special rules for disaster losses that are attributable to California wildfires as it previously provided for disaster losses attributable to Hurricanes Harvey, Irma, and Maria. Specifically, the legislation provides that a "net disaster loss" is deductible only to the extent it exceeds $500 (rather than $100) and is deductible without regard to the normal 10-percent-of-AGI threshold. The deduction for the net disaster loss is available both to those who itemize their deductions and those who do not. For those who do not itemize, the standard deduction is increased by the amount of the net disaster loss. The disallowance of the standard deduction for purposes of determining alternative minimum taxable income does not apply to this increased portion of the standard deduction. A *net disaster loss* is defined as the amount by which "qualified disaster-related personal casualty losses" exceed personal casualty gains. A qualified disaster-related personal casualty loss is a loss described in § 165(c)(3) (which generally defines casualty losses) that arises in the California wildfire disaster area on or after October 8, 2017, that is attributable to the wildfires.

2. Those affected by Hurricanes Harvey, Irma, or Maria can use prior-year earned income to determine their earned income tax credit and child tax credit. The Disaster Relief and Airport and Airway Extension Act of 2017 ("2017 Disaster Relief Act"), Pub. L. No. 115-63, was signed by the President on September 29, 2017. Section 504(c) of the 2017 Disaster Relief Act provides that a "qualified individual" can elect to use prior-year earned income for purposes of determining the individual's earned income tax credit under § 32 and child tax credit under § 24. The election is available for qualified individuals whose earned income for the tax year that includes the "applicable date" is lower than their earned income for the preceding tax year. The applicable date is August 23, 2017, for Hurricane Harvey, September 4, 2017, for Hurricane Irma, and September 16 for Hurricane Maria. If a qualified individual makes this election, it applies for purpose of both the earned income tax credit and the child tax credit. For married couples filing a joint return, the election is available if either spouse is a qualified individual, and the earned income for the preceding year is the sum of the earned income in the preceding year of both spouses. A *qualified individual* is defined as a "qualified Hurricane Harvey individual," a "qualified Hurricane Irma individual," or a "qualified Hurricane Maria individual." A qualified Hurricane Harvey individual is defined as an individual whose principal place of abode on August 23, 2017 was located (1) in the Hurricane Harvey disaster zone, or (2) outside the Hurricane Harvey disaster zone, but within the Hurricane Harvey disaster area if the individual was displaced from his or her principal place of abode by reason of Hurricane Harvey. The terms "qualified Hurricane Irma individual" and "qualified Hurricane Maria individual" are defined in a similar manner but with dates of September 4, 2017, and September 16, 2017, respectively.

- Section 501 of the 2017 Disaster Relief Act defines the terms Hurricane Harvey disaster area, Hurricane Irma disaster area, and Hurricane Maria disaster area as an area with respect to which the President has declared a major disaster by reason of the relevant hurricane before October 17, 2017. (*Note:* the date originally in the 2017 Disaster Relief Act was September 21, 2017. This date was changed to October 17, 2017, by the Bipartisan Budget Act of 2018, Division B, § 20201, Pub. L. No. 115-123, which was signed by the President on February 9, 2018.) The terms Hurricane Harvey disaster zone, Hurricane Irma disaster zone, and Hurricane Maria disaster zone are defined as the portion of the relevant disaster area to warrant individual or individual and public assistance from the federal government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act by reason of the relevant hurricane.

a. Those affected by California wildfires also can use prior year earned income to determine their earned income tax credit and child tax credit. The Bipartisan Budget Act of 2018, § 20104(c) of Division B, provides that a "qualified individual" can elect to use prior-year earned income for purposes of determining the individual's earned income tax credit under § 32 and child tax credit under § 24. The election is available for qualified individuals whose earned income for the tax year that includes any portion of the period from October 8, 2017, to December 31, 2017, is lower than their earned income for the preceding tax year. A *qualified individual* is defined as an individual whose principal place of abode during any portion of the period from October 8, 2017, to December 31, 2017, was located (1) in the California wildfire disaster zone, or

(2) outside the California wildfire disaster zone, but within the California wildfire disaster area if the individual was displaced from his or her principal place of abode by reason of the wildfires.

- The Bipartisan Budget Act of 2018 defines the term "California wildfire disaster zone" as the portion of the California wildfire disaster area determined by the President to warrant individual or individual and public assistance from the Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act by reason of wildfires in California. The term "California wildfire disaster area" is defined as an area with respect to which the President declared a major disaster from January 1, 2017, through January 18, 2018, under section 401 of the Stafford Act by reason of wildfires in California.

3. Mortgage insurance premiums paid through 2017 remain deductible The Bipartisan Budget Act of 2018, § 40202, retroactively extended through December 31, 2017, the § 163(h)(3)(E) deduction (subject to the pre-existing limitations) for mortgage insurance premiums paid or accrued in connection with acquisition indebtedness with respect to a qualified residence of the taxpayer.

4. You might be glad you paid your child's college tuition in December 2017 rather than January 2018. The Bipartisan Budget Act of 2018, § 40203, retroactively extended through December 31, 2017, the § 222 above-the-line deduction for individuals of a limited amount ($0, $2,000, or $4,000, depending on the taxpayer's adjusted gross income) of qualified tuition and related expenses for higher education of the taxpayer, the taxpayer's spouse, or dependents.

5. Retroactive extension of certain deductions and credits for energy efficiency by the Bipartisan Budget Act of 2018:

a. A retroactive incentive for homeowners to make energy-efficient home improvements. Does this make sense? Section 40401 of the Bipartisan Budget Act of 2018 retroactively extended the § 25C credit for 10 percent of the amount paid or incurred by a taxpayer for qualified energy efficiency improvements (such as exterior windows, exterior doors, and energy-saving roofs) and 100 percent of the amount paid or incurred by a taxpayer for residential energy property expenditures (such as high-efficiency furnaces, water heaters, and air conditioning systems). The credit is available for qualifying improvements made to a taxpayer's principal residence and is subject to a lifetime cap of $500. As extended, the credit is available for property placed in service before January 1, 2018.

b. Congress has retroactively extended the credit for residential energy efficient property. Section 40402 of the Bipartisan Budget Act of 2018 retroactively extended the § 25D 30 percent credit for qualified fuel cell property, qualified small wind energy property, and qualified geothermal heat pump property. The 30 percent credit is now available for property in these categories placed in service before January 1, 2020, which matches Congress's previous extension of the credit (in 2015) for solar property. The credit for all categories of eligible property (including solar) phases down to 26 percent for property placed in service after 2019 and before 2021, and to 22 percent for property placed in service after 2020 and before 2022.

c. Congress gives a "thumbs up" to new energy efficient homes. Section 40410 of the Bipartisan Budget Act of 2018 retroactively extended the § 45L credit of $2,000 or $1,000 (depending on the projected level of fuel consumption) an eligible contractor can claim for each qualified new energy efficient home constructed by the contractor and acquired by a person from the contractor for use as a residence during the tax year. As extended, the credit is available for homes acquired before January 1, 2018.

d. A retroactive incentive to make commercial buildings energy efficient. Section 40413 of the Bipartisan Budget Act of 2018 retroactively extended the § 179D deduction for the cost of energy efficient commercial building property. Generally, these are improvements deigned to reduce energy and power costs with respect to the interior lighting systems, heating, cooling, ventilation, and hot water systems of a commercial building by 50 percent or more in comparison to certain standards. The lifetime limit on deductions under § 179D is $1.80 per square foot. As extended, the deduction is available for property placed in service before January 1, 2018.

E. **Divorce Tax Issues**

F. **Education**

G. **Alternative Minimum Tax**

VI. CORPORATIONS

VII. PARTNERSHIPS

A. **Formation and Taxable Years**

B. **Allocations of Distributive Share, Debt, and Outside Basis**

1. **♫♪You got to know when to hold'em, know when to fold'em, know when to walk away, and know when to run….♫♪ Carried interests still qualify for preferential long-term capital gain rates, but the holding period just increased to 3 years for specified interests in hedge funds and other investment partnerships.** For years there has been a big brouhaha over managers of real estate, hedge fund, and other investment partnerships being taxed at preferential long-term capital gain rates (e.g., 20%) on their distributive shares of partnership income notwithstanding the fact that they received their interests in these partnerships as part of their compensation for services rendered (which compensation otherwise would be taxed at ordinary income rates). Congress and eventually President Trump have threatened for several years to take action against this "loophole." Well, at long last, Congress still has done NOTHING about it, but can claim that it did!

New § 1061. Specifically, the 2017 Tax Cuts and Jobs Act, § 13309, created new § 1061 and redesignated pre-TCJA § 1061 as § 1062. New § 1061 requires a three-year holding period for allocations of income with respect to "applicable partnership interests" to qualify for preferential long-term capital gain rates. Specifically, net long-term capital gain allocated to a partner who holds an applicable partnership interest is characterized as short-term capital gain to the extent the gain is attributable to the disposition of partnership property held by the partnership for three years or fewer. An applicable partnership interest is one that is transferred to (or is held by) a taxpayer in connection with the performance of substantial services by the taxpayer, or any other related person, in any "applicable trade or business." An applicable trade or business means any activity conducted on a regular, continuous, and substantial basis which, regardless of whether the activity is conducted in one or more entities, consists, in whole or in part, of ''raising or returning capital," and either "investing in (or disposing of) specified assets (or identifying specified assets for such investing or disposition)," or ''developing specified assets." Specified assets for this purpose generally are defined as securities, commodities, real estate held for rental or investment, cash or cash equivalents, options or derivative contracts with respect to any of the foregoing, and (*big furrowed brow here*) "an interest in a partnership to the extent of the partnership's proportionate interest in any of the foregoing" (e.g., tiered partnerships). There are significant exceptions, though, for (i) employees of another entity holding interests in a partnership that only performs services for that other entity; and (ii) partnership interests acquired for invested capital (including via a § 83(b) for a capital interest in a partnership).

What about § 1231 assets? It is unclear (at least to the authors) whether § 1061's three-year holding period rule applies to trump (*no pun intended*) quasi-capital gain treatment under § 1231. Basically, new § 1061 works by transmuting (i) otherwise net long-term capital gain (as defined in § 1222) attributable to an "applicable partnership interest" (i.e., all of a taxpayer's net long-term capital gain as normally calculated) into short-term capital gain, but (ii) only to the extent such gain exceeds net long-term capital gain (as defined in § 1222) attributable to the disposition of partnership property held by the partnership for three years or more (i.e., net long-term gain that is excluded from transmutation under § 1061). Short- and long-term capital gain (or loss) is defined under § 1222 by reference to a "capital asset" as defined in § 1221 and is determined at the partnership level. Code § 1221 excludes § 1231 assets from the definition of "capital assets." To wit, in the recent case of *CRI-Leslie, LLC v. Commissioner*, 147 T.C. No. 8 (9/7/16), the IRS was successful in arguing, over the strenuous objection of the taxpayer, that a § 1231 asset is not a "capital asset" within the meaning of § 1234A (which treats gains and losses realized upon termination of rights with respect to a "capital asset" as capital gain or loss). The taxpayer in *CRI-Leslie* had entered into a contract to sell a hotel that it owned and had received a deposit of $9.7 million. Ultimately, the buyer under the contract defaulted and forfeited the $9.7 million deposit, which was retained by the taxpayer. The hotel property was a § 1231 asset, not a capital asset. Relying upon § 1234A, the taxpayer reported the $9.7 million as net long-term capital gain. The IRS, however, asserted a deficiency based upon treating the forfeited $9.7 million deposit as ordinary income. The taxpayer argued that its characterization of the forfeited deposit as long-term capital gain was supported by the legislative history of § 1234A because, according to the taxpayer, Congress enacted § 1234A to "ensure that taxpayers received the same tax characterization of gain or loss whether the property is sold or the contract to which the property is subject is terminated." Nonetheless, the Tax Court (Judge Laro) rejected the taxpayer's argument that the legislative history of § 1234A supported the taxpayer's position. Instead, Judge Laro agreed with the IRS that "[s]ince section 1234A expressly refers to property that is 'a capital asset in the hands of the taxpayer' and no other type of property, and since property described in section 1231 is excluded explicitly from the definition of 'capital asset' in section 1221, we must conclude that the plain meaning of 'capital asset' as used in section 1234A does not extend to section 1231 property." The court was "unable find anything in the legislative history of section 1234A to support [the taxpayer's] assertion that Congress intended to include section 1231 property within its ambit." The legislative history accompanying new § 1061 likewise is bereft of any reference to § 1231 property.

What about partnership interests held by S corporations? Under § 1061(c)(4)(A), an interest in a partnership is not subject to the carried interest rule if it is held "directly or indirectly … by a corporation." Absent any limitation in the statute, the term "corporation" should include a subchapter S corporation. Has Congress left a glaring loophole?

Who cares? Isn't § 1061 just a paper tiger? New § 1061 is deserving of much more study, but we suspect that the provision will catch only those very rare taxpayers who either (i) fail to hold their carried interests for more than three years, or (ii) lack the sophisticated advice to plan around the statute. One commentator characterizes the new statute as "joke" given that most managers of real estate, hedge funds, and investment partnerships hold their carried interests for well over three years. *See* Sloan, *Carried Interest Reform is a Sham*, Washington Post, December 1, 2017. On the other hand, maybe this comment is just "fake news." New § 1061 is permanent and applies to taxable years beginning after 2017.

a. **Does the word "corporation" in the Code include an S corporation? The Treasury Department and the IRS don't think so.** Notice 2018-38, 2018-12 I.R.B. ___ (3/1/18). Under § 1061(c)(4)(A) as enacted by the 2017 Tax Cuts and Jobs Act, an interest in a partnership is not subject to the carried interest rule if it is held "directly or indirectly … by a corporation." In this notice, the Treasury Department and the IRS have announced that they intend to issue regulations providing guidance on § 1061 and that "those regulations will provide that the term 'corporation' for purposes of section 1061(c)(4)(A) does not include an S corporation." Other than reciting the statutory definitions of "S corporation" and "C corporation," the notice does not provide any explanation of how the regulations will arrive at that result. According to the notice, the regulations will be effective for taxable years beginning after December 31, 2017.

C. Distributions and Transactions Between the Partnership and Partners

D. Sales of Partnership Interests, Liquidations and Mergers

E. Inside Basis Adjustments

F. Partnership Audit Rules

1. **Bye bye TEFRA!** The Bipartisan Budget Act of 2015 § 1101, Pub. L. No. 114-74, signed by the President on 11/2/15, made sweeping changes to the partnership audit rules. The TEFRA rules (in §§ 6221-6231) and Electing Large Partnership rules (in §§ 6240-6242, 6245-6248, 6251-6252, and 6255) have been repealed and replaced in new §§ 6221-6223, 6225-6227, 6231-6235, and 6241, with an entity-level audit process that allows the IRS to assess and collect the taxes against the partnership unless the partnership properly elects out. The new rules will simplify the current complex procedures on determining who is authorized to settle on behalf of the partnership

and also avoid the IRS's need to send various notices to all of the partners. Under the new provisions the IRS may reduce the potential tax rate assessed against the partnership to take into account factors such as tax-exempt partners and potential favorable capital gains tax rates. The new rules should significantly simplify partnership audits. As a result, the audit rate of partnerships might increase. Although partnerships with 100 or fewer partners can elect out of the new rules, § 6221(b), such election is not available if there is another partnership as a partner. Implementation of the new rules is deferred; the new rules apply to partnership taxable years beginning after 12/31/17. Partnership agreements should be amended to take into account these changes.

a. **The early bird catches the worm (or is that eats the worm at the bottom of the tequila bottle?).** T.D. 9780, Election into the Partnership Audit Regime Under the Bipartisan Budget Act of 2015, 81 F.R. 51795 (8/5/16). The Treasury and IRS have promulgated Temp. Reg. § 301.9100-22T dealing with the time, form, and manner for making an election to have the new partnership audit regime, §§ 6221-6223, 6225-6227, 6231-6235, and 6241, enacted in the Bipartisan Budget Act of 2015, apply to returns filed for tax years beginning after 11/2/15 and before 1/1/18. Under Temp Reg. § 301.9100-22T(b) an election to have the new partnership audit regime apply must be made within 30 days of the date of the written notice from the IRS that the partnership return has been selected for examination. The election must be in writing, signed by the tax matters partner, and must include the name, taxpayer identification number, address, and telephone number of the individual who signs the statement, as well as the partnership's name, taxpayer identification number, and tax year to which the statement applies. The statement must include representations that the partnership is not insolvent and does not reasonably anticipate becoming insolvent, the partnership is not currently and does not reasonably anticipate becoming subject to a title 11 bankruptcy petition, and the partnership has sufficient assets, and reasonably anticipates having sufficient assets, to pay the potential imputed underpayment that may be determined during the partnership examination. The election must designate the partnership representative (§ 6223). An election may not be revoked without the IRS's consent. Temp. Reg. § 301.9100-22T(c) allows a partnership that has not been issued a notice of selection for examination to make an election with respect to a partnership return for the purpose of filing an administrative adjustment request under § 6227 (as amended); this election may only be made after 12/31/17. The temporary regulation is effective on 8/5/16.

b. **The "thawed" version of the centralized partnership audit rules is here, and all 277 pages of the new rules still stink for partnerships and partners (but at least the regs didn't change much, and the Federal Register version is only 69 pages)!** REG-136118-15, Centralized Partnership Audit Regime, 82 F.R. 27334-01 (6/14/17). As we all know by now, effective for tax years beginning after December 31, 2017, the old TEFRA partnership audit rules (in §§ 6221-6231) and Electing Large Partnership rules (in §§ 6240-6242, 6245-6248, 6251-6252, and 6255) have been repealed and replaced by a new "Centralized Partnership Audit Regime" contained in §§ 6221-6223, 6225-6227, 6231-6235, and 6241. The IRS originally released proposed regulations under the new regime in January 2017, but the Trump administration's regulatory freeze forced those regulations to be withdrawn just two days after they were released. The Treasury Department has now reissued the proposed regulations in substantially the same form as the version released in January. Only two minor changes were made from the original version of the proposed regulations issued in January: (i) an example with respect to netting ordinary income and depreciation was deleted (see the January version of Prop. Reg. § 301.6225-1(f) Ex. 3), and (ii) the portion of the regulations seeking comments concerning tiered partnership "push-out" adjustments (discussed below) was expanded. The scope and complexity of the new "Centralized Partnership Audit Regime" preclude in-depth coverage here, but the highpoints are summarized below.

The Practical Effect. Virtually all partnership agreements (including, of course, most LLC operating agreements) should be amended to reflect the new Centralized Partnership Audit Regime. The new regime cannot be ignored because it fundamentally alters the obligations of the partnership and the partners to each other and to the IRS.

Overview. The new rules implement an entity-level audit process that allows the IRS to assess and collect the taxes from the partnership unless the partnership properly elects out of the regime or properly "pushes out" the tax liability to its partners. Under the new centralized process, the IRS audits the partnership's items of income, gain, loss, deduction, and credit, and the partners' distributive shares thereof, for a partnership's taxable year (the "reviewed year"). Then, the IRS sends the partnership a "notice of proposed partnership adjustment" ("NOPPA"). *See* § 6221; Prop. Reg. § 301.6221(a)-1. Thereafter, the partnership has a 330-day period (subject to agreed-upon extensions) to respond to the IRS's proposed adjustments, including the ability to request modifications (discussed below) to any proposed tax liability imposed upon the partnership. Next, at the conclusion of the audit process the IRS sends a "final notice of partnership adjustment" ("FPA") to the partnership (the "adjustment year"). Absent filing a petition in the Tax Court, the tax liability (including penalties) of the partners relating to the reviewed year must be satisfied by the partnership in the adjustment year. *See* § 6231; Prop. Reg. § 301.6231-1. The partnership, not the partners, is liable for any finally determined underpayment of tax (an "imputed underpayment" as defined by the regulations) by the partners from the reviewed year even if those partners are not the same as the partners in the adjustment year. *See* § 6225(a)-(b); Prop. Reg. 301.6225-1.

Modifications to Partnership Level Adjustment. Modifications to a proposed partnership-level adjustment can be asserted by the partnership based upon mitigating factors (e.g., tax-exempt partners, amended returns filed by partners from the reviewed year, lower tax rates applied to some partners, etc.). To assert such modifications, the partnership must submit a "request for modification with respect to a partnership adjustment" to the IRS within 270 days (subject to consensual extension) of the date of the NOPPA. *See* § 6225(c); Prop. Reg. § 301.6225-2. The purpose of allowing partnership-asserted modifications is to determine as accurately as possible the amount of tax owed by the partners as a result of the partnership-level adjustment without requiring the IRS to assess and collect the tax separately from each partner (as was the case under TEFRA). Accordingly, as compared to TEFRA, the new regime substantially eases the IRS's administrative burden with respect to partnership audits and collection of taxes, but correspondingly increases the administrative burden imposed upon partnerships and their partners. Expect the audit rate of partnerships to increase under the new regime.

"Push-Out" Election. As an alternative to assessment and collection of tax from the partnership, the partnership may elect to "push out" the imputed underpayment to the appropriate partners from the reviewed year. The affected partners then become liable for the tax attributable to the imputed underpayment rather than the partnership itself. The push-out election must be made by the partnership representative within 45 days (not subject to extension) of the mailing of the final partnership adjustment ("FPA") under § 6231. *See* § 6226; Prop. Reg. § 301.6226-1.

Some Finer Points. Special rules govern the treatment of adjustments from a reviewed year that do not result in an imputed underpayment and are therefore otherwise taken into account by the partnership and the partners in the adjustment year. *See* Prop. Reg. § 301.6225-3. Moreover, the impact of the adjustments on capital accounts and outside basis across reviewed years and adjustment years is reserved under the proposed regulations. See Prop. Reg. § 301.6225-4. The new regime also imposes tougher rules on partners who treat items inconsistently with the partnership's treatment of such items. *See* § 6222; Reg. § 301.6222-1.

Partnership Representatives. Unlike the familiar "tax matters partner" designation under TEFRA, the new regime permits any person (even a non-partner) with a substantial presence in the U.S. to be designated the "partnership representative" in the audit, assessment, and collection process. The partnership representative is designated by the partnership for each tax year on its annual information return (Form 1065). Moreover, any action taken by the partnership representative vis-à-vis the IRS is binding upon the partnership regardless of the partnership agreement or state law to the contrary. See § 6223; Prop. Reg. §§ 301.6223-1, 301.6223-2.

Election Out of the New Regime for Small Partnerships. Partnerships with 100 or fewer partners may elect out of the new regime, but not if the partnership has another partnership or certain other flow-through entities as a partner, possibly including single-member LLCs (the effect of which currently is unknown under the proposed regulations). Depending upon certain special rules, S corporations may or may not disqualify a partnership from electing out of the new regime. *See* § 6621(b); Prop. Reg. § 301.6621(b)-1. Eligible partnerships that elect out of the new regime will subject their partners to pre-TEFRA audit procedures (i.e., partners will be audited and assessed separately and possibly inconsistently).

Pre-2018 Election Into the New Regime. The reissued proposed regulations do not affect the ability of partnerships to elect into the new regime for tax years beginning before January 1, 2018, but after November 2, 2015. See T.D. 9780, Election into the Partnership Audit Regime Under the Bipartisan Budget Act of 2015, 81 F.R. 51795 (8/5/16).

c. **Treasury has issued final regulations on electing out of the new partnership audit regime.** T.D. 9829, Election Out of the Centralized Partnership Audit Regime, 83 F.R. 4 (1/2/18). The Treasury Department and the IRS have finalized, with some changes, the portion of the proposed regulations that address electing out of the new Centralized Partnership Audit Regime (REG-136118-15, Centralized Partnership Audit Regime, 82 F.R. 27334-01 (6/14/17).) Like the proposed regulations, final Reg. § 301.6221(b)-1 provides that a partnership with 100 or fewer partners that does not have certain kinds of partners can make an election not to be subject to the new regime on the partnership's timely filed return, including extensions, for the taxable year to which the election applies. To constitute a valid election, the elction must include all information required by the IRS in forms, instructions, or other guidance. This final regulation applies to partnership taxable years beginning after December 31, 2017.

G. Miscellaneous

VIII. TAX SHELTERS

IX. EXEMPT ORGANIZATIONS AND CHARITABLE GIVING

A. Exempt Organizations

B. Charitable Giving

1. **Taxpayers have a greater ability to deduct charitable contributions for relief efforts in areas affected by Hurricanes Harvey, Irma, or Maria.** The Disaster Relief and Airport and Airway Extension Act of 2017 ("2017 Disaster Relief Act"), Pub. L. No. 115-63, was signed by the President on September 29, 2017. Section 504(a) of the 2017 Disaster Relief Act provides special rules for charitable contributions for the benefit of victims of Hurricanes Harvey, Irma, or Maria. Normally, the limit that applies to the deduction for most charitable contributions by individuals is 50 percent of the taxpayer's contribution base, which, generally speaking, is adjusted gross income. Lower limits can apply depending on the type of recipient and the type of property contributed. The limit that applies to the deduction for most charitable contributions by corporations generally is 10 percent of taxable income. Contributions that exceed these limits generally can be carried forward five years. The legislation provides that "qualified contributions" by an individual are not subject to the normal limits, and instead are allowed up to the amount by which the taxpayer's contribution base (AGI) exceeds the other charitable contributions the taxpayer makes, i.e., those subject to the normal limit. In effect, this permits individual taxpayers to deduct qualified contributions up to 100 percent of the taxpayer's contribution base (AGI) after taking into account other charitable contributions. Further, qualified contributions are not subject to the normal overall limit on itemized deductions of § 68. For corporations, the limit on qualified contributions is the amount by which the corporation's taxable income exceeds the corporation's other charitable contributions, i.e., the corporation can deduct qualified contributions up to 100 percent of taxable income after taking into account other charitable contributions. Qualified contributions by an individual or a corporation that that exceed the relevant limit can be carried forward five years. A *qualified contribution* is defined as a charitable contribution (as defined in § 170(c)) that meets three requirements: (1) the contribution must be paid in cash to an organization described in § 170(b)(1)(A) during the period from August 23 through December 31, 2017, for relief efforts in the Hurricane Harvey disaster area, Hurricane Irma disaster area, or Hurricane Maria disaster area, (2) the taxpayer must obtain from the organization a contemporaneous written acknowledgment that the contribution was used (or will be used) for such relief efforts, and (3) the taxpayer must elect the application of this special rule. For partnerships or S corporations, the election is made separately by each partner or shareholder. The legislation does not specify the manner of making the election. Presumably, taking the deduction on the return will constitute an election.

a. **Congress has enacted a similar increase in the limit on deductions for charitable contributions towards relief efforts in areas affected by California wildfires.** The

Bipartisan Budget Act of 2018, § 20104(a) of Division B, provides that "qualified contributions" by an individual are not subject to (1) the normal limits on charitable contributions, and instead are allowed up to 100 percent of the taxpayer's contribution base (AGI) after taking into account other charitable contributions, and (2) are not subject to the normal overall limit on itemized deductions of § 68. For corporations, the limit on qualified contributions is 100 percent of taxable income after taking into account other charitable contributions. Qualified contributions by an individual or a corporation that that exceed the relevant limit can be carried forward five years. A *qualified contribution* is defined as a charitable contribution (as defined in § 170(c)) that meets three requirements: (1) the contribution must be paid *in cash* to an organization described in § 170(b)(1)(A) during the period from October 8, 2017, through December 31, 2018, for relief efforts in the California wildfire disaster area, (2) the taxpayer must obtain from the organization a contemporaneous written acknowledgment that the contribution was used (or will be used) for such relief efforts, and (3) the taxpayer must elect the application of this special rule. For partnerships or S corporations, the election is made separately by each partner or shareholder.

- This provision may have little effect for most individuals for two reasons. First, beginning in 2018, many more individuals will take the increased standard deduction enacted as part of the 2017 Tax Cuts and Jobs Act and will not itemize their deductions on Schedule A of Form 1040. Second, pursuant to the 2017 Tax Cuts and Jobs Act, the § 68 overall limit on itemized deductions does not apply to taxable years beginning after 2017 and before 2026.

X. TAX PROCEDURE

A. Interest, Penalties and Prosecutions

B. Discovery: Summons and FOIA

C. Litigation Costs

D. StatutoryNotice of Deficiency

E. Statute of Limitations

F. Liens and Collections

1. If the IRS wrongfully levies on assets in a retirement account, the taxpayer can recontribute the assets pus interest in a tax-free rollover. The Bipartisan Budget Act of 2018, § 41104, amended Code § 6343 by adding § 6343(f). Section 6343(f) provides that, if the IRS determines that an individual's account or benefit under an eligible retirement plan (as defined in § 402(c)(8)(B)) was levied upon wrongfully or otherwise not in accordance with administrative procedures and property or an amount of money is to be returned to the individual, then the individual can contribute the money (plus any interest paid by the IRS) or property into the same retirement plan (if permitted by the plan) or another eligible plan or IRA without regard to the normal limits on contributions or rollovers. When this provision applies, the distribution resulting from the levy and the subsequent contribution are treated as a tax-free rollover. The contribution is treated as having been made for the same taxable year in which the distribution resulting from the levy occurred. Any interest paid by the IRS is treated as earnings within the plan after the contribution and is not included in the taxpayer's gross income. The rollover does not count towards the one-rollover-per- twelve- months limitation of § 408(d)(3)(B). A taxpayer who already included the amount of the distribution in gross income in an earlier year and has had tax assessed is entitled to have the assessment abated and to obtain a refund of any tax paid. The provision applies to amounts paid by the IRS in taxable years beginning after 2017.

2. The fees for installment agreements are going up! T.D. 9798, User Fees for Installment Agreements, 81 F.R. 86955 (12/2/16). The Treasury Department and the IRS have finalized without change proposed regulations (REG-108792-16, User Fees for Installment Agreements, 81 F.R. 56543 (8/22/16)) that significantly increase the user fees for entering into an installment agreement. Prior to the effective date of these regulations: (1) the general user fee for an installment agreement is $120, which is reduced to $52 for a direct debit installment agreement that permits the IRS to withdraw the installment payments from the taxpayer's bank account; (2) the user fee is $43 for a low income taxpayer, defined as a taxpayer who has income at or below 250 percent of the federal poverty guidelines; and (3) the fee for restructuring or reinstating an installment agreement is $50. Under the final regulations, the fee for low income taxpayers remains the same, but the general fee increases to $225, the direct debit fee increases to $107, and the fee for restructuring or reinstating an installment agreement increases to $89. In addition, the regulations establish two new user fees for online payment agreements. The general user fee for a taxpayer who sets up an installment agreement online is $149, and the fee for a direct debit online payment agreement is $31. These regulations apply to installment agreements entered into, restructured, or reinstated on or after January 1, 2017.

a. Low-income taxpayers can pay no fee for installment agreements, and the user fees for installment agreements for other taxpayers will never go up again. Wait, really? The Bipartisan Budget Act of 2018, § 41105, amended Code § 6159 by redesignating subsection (f) as subsection (g) and adding new subsection (f). New § 6159(f) provides that any fee imposed by the IRS for entering into an installment agreement cannot exceed the fee in effect on February 9, 2018, the date of enactment of the legislation. Section 6159(f) as amended also provides that a taxpayer whose adjusted gross income does not exceed 250 percent of the federal poverty guidelines will either (1) pay no fee for a direct debit installment agreement that permits the IRS to withdraw the installment payments from the taxpayer's bank account, or (2) pay the applicable fee up front if the agreement does not provide for direct debit and then obtain a refund of the fee upon completion of the installment agreement. This provision applies to installment agreements entered into on or after the date which is 60 days after the date of the enactment. Because the date of enactment is February 9, 2018, the provision should apply to agreements entered into on or after April 10, 2018.

G. Innocent Spouse

H. Miscellaneous

1. What does "separate return" mean? Ibrahim v. Commissioner, 788 F.3d 834 (8th Cir. 6/10/15), *rev'g* T.C. Memo. 2014-8. The taxpayer and his wife originally filed separate tax returns. He claimed head of household filing status on his return, and his wife claimed single filing status on her return. The IRS sent a timely notice of deficiency to the taxpayer; he filed a Tax Court petition to challenge the deficiency. The taxpayer and his wife did not elect to file an amended joint return before receipt of the notice of deficiency. The taxpayer argued that he was entitled to amend his return to elect married filing jointly filing status. Section 6013(b)(2)(B) specifically bars taxpayers from electing to file a joint return after filing separate returns "after there has been mailed to either spouse, with respect to such taxable year, a notice of deficiency under section 6212, if the spouse, as to such notice, files a petition with the Tax Court within the time prescribed in section 6213." The Tax Court (Judge Nega) held that § 6013(b)(2) applies to married taxpayers who file returns with an incorrect status, such as head of household or single filing status. Thus, according to the Tax Court, the taxpayer was ineligible to elect to amend his return to file jointly with his spouse, and the deficiency was upheld. The Tax Court rejected the taxpayer's argument that it should follow *Glaze v. United States*, 641 F.2d 339 (5th Cir.1981), which held that "separate return" as used in § 6013(b) refers only to married filing separately status and not to any other filing status, including head of household. Prior Tax Court precedent was cited as controlling because the case was appealable to the Eighth Circuit, which had not addressed the issue.

- The U.S. Court of Appeals for the Eighth Circuit saw it differently and reversed (2-1) in an opinion by Judge Benton. After analyzing the context in which the term "separate return" appears in numerous Code sections, the court concluded that the term applies only to a "married filing separately" return. A head of household return, the court held, is not a "separate return" for purposes of § 6013(b). The majority rejected the IRS's reliance on Rev. Rul. 83-183, 1983-2 C.B. 220, which ruled that taxpayers may not file joint returns more than three years after the due date of the return if one of the spouses has filed a return claiming any of the following filing statuses: unmarried, head of household, or married filing separately. Thus, according to the court, the taxpayer could file an amended joint return, even after receipt of the notice of deficiency, when he had erroneously filed with head of household filing status and his wife had erroneously filed with single filing status.

- Judge Bye dissented and would have held that for purposes of

§ 6013 any non-joint returns, including head-of-household returns, should be treated as separate returns.

a. The Tax Court now agrees with the Eighth Circuit. Camara v. Commissioner, 149 T.C. No. 13 (9/28/17). The taxpayer and his wife were married at all relevant times. The taxpayer filed a return for 2012 and erroneously indicated on the return that his filing status was single. His wife did not file a return for 2012. The IRS issued to the taxpayer a notice of deficiency that changed his filing status to married filing separately. The taxpayer and his wife challenged the notice of deficiency by filing a petition in the Tax Court. On May 27, 2016, approximately one year after filing the petition, the taxpayer and his wife filed a joint return for 2012. The IRS asserted that the taxpayers were precluded from filing a joint return by § 6013(b). Section 6013(b)(1) provides that "if an individual has filed a separate return for a taxable year for which a joint return could have been made by him and his spouse," the individual and his or her spouse can nevertheless file a joint return. However, § 6013(b)(2) provides that "the election" authorized by § 6013(b)(1) cannot be made in certain circumstances. According to § 6013(b)(2)(A), the election to file a joint return cannot be made if more than three years have elapsed from the due date of the return (determined without regard to extensions). Section § 6013(b)(2)(B) provides that the election to file jointly cannot be made after the IRS has mailed a notice of deficiency to either spouse if the spouse files with respect to the notice a timely petition with the Tax Court. The IRS asserted that both of these exceptions precluded the taxpayer from filing a joint return. In a unanimous, reviewed opinion by Judge Thornton, the Tax Court reassessed its holding in *Ibrahim v. Commissioner*, T.C. Memo. 2014-8, and other prior decisions and held that the term "separate return" in § 6013(b)(1) "means a return on which a married taxpayer has claimed the permissible filing status of married filing separately, rather than a return on which a married taxpayer has claimed a filing status not properly available to him or her." Because a taxpayer is precluded by § 6013(b)(2) from filing a joint return only if the taxpayer has previously filed a "separate return," and the taxpayer in this case had not filed a separate return, the taxpayer was not barred from electing to file a joint return. In reaching this conclusion, the court relied on the statutory language of § 6013(b)(2), which bars a taxpayer from filing jointly only if the taxpayer has previously made an "election" to file a separate return. The court reasoned that filing a return with an erroneous filing status is not an election for this purpose. The court also relied on its analysis of (1) the historical development of joint filing status and rate structures for those filing jointly, and (2) the legislative history of § 6013(b). The Tax Court thus has aligned itself with the holdings in *Glaze v. United States*, 641 F.2d 339 (5th Cir.1981), and *Ibrahim v. Commissioner*, 788 F.3d 834 (8th Cir. 2015).

2. The IRS has provided extensions of filing and payment due dates for those in areas affected by Hurricanes Harvey, Irma, and Maria. In news release IR-2017-160 (9/26/17), the IRS has summarized the relief announced in a series of prior news releases for those in areas affected by Hurricanes Harvey, Irma, and Maria. The relief is available to individuals and businesses anywhere in Florida, Georgia, Puerto Rico, and the Virgin Islands, as well as parts of Texas. (Parts of Puerto Rico qualify for the Hurricane Irma relief, and all of Puerto Rico qualifies for the Hurricane Maria relief. Hurricane Maria struck Puerto Rico just after September 15, 2017, so in theory there are parts of Puerto Rico that do not qualify for relief from September 15 due dates.) The prior news releases are IR-2017-135 (8/28/17) (relief in Texas for Harvey), VI-2017-01 (9/8/17) (relief in Virgin Islands for Irma), PR-2017-01 (9/12/17) (relief in Puerto Rico for Irma), IR-2017-150 (9/12/17) (relief in Florida for Irma), IR-2017-155 (9/15/17), (expanded relief in Florida for Irma), IR-2017-156 (9/19/17) (expanding Irma relief to all of Georgia).

Deadlines extended to January 31, 2018. For those in affected areas, the following due dates have been extended to January 31, 2018: (1) the September 15, 2017, and January 16, 2018, due dates for quarterly estimated tax payments; (2) the September 15, 2017, due date for certain returns, such as those for calendar-year partnerships that filed timely extension requests for 2016; (3) the October 16, 2017, due date for 2016 individual returns for individuals who filed timely extension requests; (4) the October 31, 2017, due date for quarterly payroll and excise tax returns; and (5) the November 15, 2017, due date for 2016 returns of calendar-year tax-exempt organizations that filed timely extension requests. Note: individuals who filed a timely request for an extension of time to file their 2016 returns do not obtain any relief for tax payments related to the 2016 return because those payments were due on April 18, 2017.

Waiver of late-deposit penalties for federal payroll and excise taxes. For those in affected areas, the IRS has waived late-deposit penalties for federal payroll and excise taxes due during the first fifteen days of the disaster period. The specific dates vary according to the location.

Relief provided automatically. The IRS will automatically provide filing and penalty relief to any taxpayer with an address of record in one of these disaster areas. Taxpayers in one of these areas who receive a notice from the IRS regarding a late-filing or late-payment penalty should contact the IRS at the number listed on the notice to have the penalty abated.

a. The IRS has provided similar extensions of filing and payment due dates for those affected by California wildfires. In news release IR-2017-172 (10/31/17), the IRS has extended to January 31, 2018, several filing and payment due dates that occurred beginning on October 8, 2017, for those in areas affected by California wildfires. The relief is available to individuals and businesses in the counties of Butte, Lake, Mendocino, Napa, Nevada, Sonoma and Yuba, as well as firefighters and relief workers who live elsewhere. The due dates extended include the October 16, 2017, due date for 2016 individual returns for individuals who filed timely extension requests, the October 31, 2017, due date for quarterly payroll and excise tax returns, and the January 16, 2018, due date for quarterly estimated tax payments. The IRS will automatically provide filing and penalty relief to any taxpayer with an address of record in one of these disaster areas. Taxpayers in one of these areas who receive a notice from the IRS regarding a late-filing or late-payment penalty should contact the IRS at the number listed on the notice to have the penalty abated.

b. The IRS has provided extensions of filing and payment due dates for those affected by California wildfires, flooding, mudflows and debris flows. In news release CA-2018-1 (1/17/18), the IRS has extended to April 30, 2018, several filing and payment due dates for those affected by the wildfires, flooding, mudflows and debris flows that took place beginning on Dececember 4, 2017, in parts of California. The relief is available to individuals and businesses in the counties of Los Angeles, San Diego, Santa Barbara, and Ventura. The due dates extended include the January 16, 2018, due date for quarterly estimated tax payments and the April 17, 2018, due date for 2017 individual returns. More generally, taxpayers have until April 30, 2018, to file most tax returns (including individual, corporate, and estate and trust income tax returns; partnership returns, S corporation returns, and trust returns; estate, gift, and generation-skipping transfer tax returns; and employment and certain excise tax returns; annual information returns of tax-exempt organizations; and employment and certain excise tax returns), that have either an original or extended due date occurring on or after December 4, 2017, and before April 30, 2018. The IRS will automatically provide filing and penalty relief to any taxpayer with an address of record in one of these disaster areas. Taxpayers in one of these areas who receive a notice from the IRS regarding a late-filing or late-payment penalty should contact the IRS at the number listed on the notice to have the penalty abated. Affected taxpayers who reside or have a business located outside the covered disaster area must call the IRS disaster hotline at 866-562-5227 to request this tax relief.

3. Trust but verify—taxpayers need to check the amount of taxes being withheld from their paychecks. The IRS has issued revised withholding tables that take into account changes made by the 2017 Tax Cuts and Jobs Act. Notice 1036 (1/11/18) and IRS News Release IR-2018-05 (1/11/18). Among other changes, the 2017 Tax Cuts and Jobs Act reduced tax rates, significantly increased the standard deduction, and eliminated personal exemption deductions. The overall effect of the legislation is to reduce the amount of tax owed by most taxpayers. In light of these changes, the IRS has issued new withholding tables for use by employers. The new withholding tables generally direct employers to withhold less in taxes from the paychecks of employees compared to the former tables. The IRS has directed employers to begin using the new tables as soon as possible, but no later than February 15, 2018. The new withholding tables are designed not to require employees to file a new Form W-4 with their employers.

a. The IRS has updated its online withholding calculator and issued a revised Form W-4. IRS News Release IR-2018-36 (2/28/18). The IRS has released an updated withholding calculator on its website to help taxpayers check their 2018 withholding in light of the changes made by the 2017 Tax Cuts and Jobs Act. Simultaneously, the IRS issued a revised Form W-

4 that eliminates references to dependents and reflects certain other changes enacted by the legislation.

4. Seniors now will benefit not only from the early-bird special, but also from a simplified return on Form 1040SR. The Bipartisan Budget Act of 2018, § 41106, directs the Secretary of the Treasury to make available an individual federal income tax return, to be known as "Form 1040SR," for use by individuals who have attained age 65 by the close of the taxable year. Form 1040SR is to be as similar as practicable to Form 1040EZ, except that it will be available regardless of the taxpayer's level of income and regardless of whether the taxpayer's income includes social security benefits, distributions from qualified retirement plans or annuities, interest and dividends, or capital gains and losses taken into account in determining adjusted net capital gain. Congress has directed that Form 1040SR be available for taxable years beginning after February 9, 2018, the date of enactment.

XI. WITHHOLDING AND EXCISE TAXES

A. Employment Taxes

B. Self-employment Taxes

1. ♪♫Ain't no closing time, ain't no cover charge. Just country boys and girls getting down on the farm.♫♪ And now there ain't no self-employment tax from renting agricultural land to your wholly owned S corporation (at least if it's a fair market rent). Martin v. Commissioner, 149 T.C. No. 12 (9/27/17). The taxpayers, a married couple, owned a farm in Texas consisting of more than 300 acres. They entered into an agreement with Sanderson Farms, Inc., a large poultry producer, to raise and deliver young chickens designated as broilers. The contract, known as the Broiler Production Agreement (BPA), contained extensive requirements with which the taxpayers had to comply. To enable their performance under the BPA, the taxpayers constructed facilities on the farm at a cost of $1.2 million. Subsequently, the taxpayers formed a wholly-owned S corporation and entered into oral employment agreements with it. They set their salaries at amounts consistent with those of other growers based on information they had gathered. They assigned the BPA to their S corporation. They also entered into a five-year lease with the S corporation pursuant to which the S corporation paid them a total of $1.3 million to rent their farm (excluding their residence and ten acres). The rent was a fair market rent and was consistent with amounts that Sanderson Farms paid other growers for the use of similar premises. During 2008 and 2009, the S corporation paid rent to the taxpayers of $259,000 and $271,000, respectively. The IRS asserted that these amounts were net earnings from self-employment and therefore subject to self-employment tax. In a reviewed opinion (12-0-4) by Judge Paris, the Tax Court held that the rental payments were not subject to self-employment tax. In reaching this conclusion, the court reconsidered and declined to follow its analysis of this issue in *McNamara v. Comissioner*, T.C. Memo. 1999-333, and instead adopted the approach of the U.S. Court of Appeals for the Eighth Circuit, which reversed the Tax Court's decision in *McNamara*. *See McNamara v. Commissioner*, 236 F.3d 410 (8th Cir. 2000). Under § 1402(a)(1), rentals from real estate are excluded from net earnings from self-employment, but this exclusion does not apply to income derived by an owner or tenant of land if

> (A) such income is derived under an arrangement, between the owner or tenant and another individual, which provides that such other individual shall produce agricultural or horticultural commodities … on such land and that there shall be material participation by the owner or tenant … in the production or management of the production of such … commodities, and
>
> (B) there is material participation by the owner or tenant … with respect to such agricultural or horticultural commodity.

The court rejected the IRS's argument that the rental payments received by the taxpayers fell into this exception. The IRS argued that there existed an arrangement between the taxpayers and both their S corporation and Sanderson Farms that required the taxpayers to materially participate in the production of agricultural commodities (the broilers). The court reasoned, however, that in its prior opinion in *McNamara*, it had not given sufficient consideration to the statute's requirement that the rent be "*derived under*" an arrangement requiring the owner's material participation, i.e., that there be a nexus between the rent received and the owner's material participation. If the rental agreement stands on its own, then the required nexus necessarily does not exist. Consistent with the Eighth Circuit's analysis, the court reasoned that market-rate rents strongly suggest that the rental agreement stands on its own and is not part of an arrangement requiring material participation. Accordingly, the court held as follows:

> Irrespective of a taxpayer's material participation—actual, required, or otherwise—the taxpayer may establish that the rental agreement stands on its own, unrelated to the taxpayer's farming activity. … If the rental income received was at or below market value, the burden of production then shifts to the Commissioner to show a nexus between the rent and the agricultural arrangement requiring the taxpayer to materially participate.

In this case, the court found, the rental income received by the taxpayers was at or below fair market value. Therefore, the burden of production shifted to the IRS to demonstrate a nexus between the rent and the arrangement requiring the taxpayers' material participation. The IRS, however, did not brief this issue and instead relied upon the Tax Court's prior analysis in *McNamara*, which interpreted the term "arrangement" broadly.

- Judge Gustafson, in a dissent joined by Judge Ashford, reasoned that, although a fair market rent may be evidence that a rental agreement stands on its own and is not part of an arrangement requiring material participation, there is no basis for the evidentiary regime set forth in the majority opinion. "There is no reason to select the reasonableness of the rent as a special fact that somehow gives rise to a presumption and shifts the burden of production.

- Judge Nega's dissent, in which Judges Ashford, Gustafson, and Lauber joined, concluded that the approach of the U.S. Court of Appeals for the Eighth Circuit in *McNamara*, which the majority opinion adopted, is inconsistent with the plain language of § 1402(a)(1). The statute, he stated, does not provide a special rule for rents that are at or below a fair market rent. "A better reading of section 1402(a)(1), including the words 'derived under', is that the arrangement as a whole must be the focus instead of what the parties define as falling within two or more income streams (in this case payments for personal services and for the use of real estate and personal property)." Judge Nega expressed concern that the majority's approach will give rise to situations in which "the existence of a tax-indifferent party leads to an agreement between two parties to mischaracterize a transaction to provide an unjustified tax result for the non-tax-indifferent party."

C. Excise Taxes

XII. TAX LEGISLATION

A. Enacted

1. Congress has retroactively extended a number of provisions designed to act as taxpayer incentives and made other changes. Wait, retroactive incentives? The Bipartisan Budget Act of 2018, Pub. L. No. 115-123, was signed by the President on February 9, 2018. This legislation retroactively extends a number of provisions through 2017, such as § 163(h)(3)(E)'s treatment of mortgage insurance premiums as deductible mortgage interest, the § 222 above-the-line deduction for qualified tuition and related expenses, the § 108(a)(1)(E) exclusion for cancellation of qualified principal residence indebtedness, favorable recovery periods for certain depreciable property, and various credits related to energy efficiency. The legislation also makes certain other changes to the Internal Revenue Code, such as a provision that precludes any increase in the current user fees for installment agreements.

XIII. TRUSTS, ESTATES & GIFTS

RECENT DEVELOPMENTS IN FEDERAL INCOME TAXATION

"Recent developments are just like ancient history, except they happened less long ago."

By

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I. ACCOUNTING

II. BUSINESS INCOME AND DEDUCTIONS

A. Income

B. Deductible Expenses versus Capitalization

C. Reasonable Compensation

D. Miscellaneous Deductions

1. **Unless you fit in one of the exceptions, Congress just increased the interest rate on all your business loans.** The 2017 Tax Cuts and Jobs Act, § 13301, amended § 163(j) to limit the deduction for business interest expense. Consequently, if your business is impacted by amended § 163(j), you will pay more for the use of borrowed funds, which is a de facto interest increase. Basically, the deduction for business interest expense under amended § 163(j) will be limited to the sum of: (1) business interest income, (2) 30 percent of "adjusted taxable income," and (3) floor plan financing interest. The term "adjusted taxable income" is defined essentially as earnings before interest, tax, depreciation and amortization (EBITDA) for 2018 through 2022, and then earnings before interest and taxes (EBIT) for subsequent years. Businesses with average annual gross receipts (computed over 3 years) of $25 million or less and businesses in certain industries (notably real estate if a proper election is made, but also floor plan financing of auto dealers and regulated utilities) are exempted from the limitations of amended §163(j). Real estate businesses must accept slightly longer recovery periods by using the alternative depreciation system for certain depreciable property if they elect out of the § 163(j) limitation. Because real estate businesses making the election out must use the alternative depreciation system for so-called qualified improvement property (among other categories), electing out of the § 163(j) limitation would seem to have the effect of making qualified improvement property ineligible for bonus depreciation under § 168(k).

a. **Treasury and the IRS have provided interim guidance by giving insight on forthcoming proposed regulations regarding the § 163(j) limitation on deduction of business interest.** Notice 2018-28, 2018-16 I.R.B. 492 (4/2/18). In this notice, the Treasury Department and the IRS have announced that they intend to issue proposed regulations providing guidance on several issues related to the limitation of § 163(j) on the deduction of business interest. The notice describes some of the rules that will be included in the proposed regulations in order to provide taxpayers with interim guidance. These rules fall into the following five broad categories.

Treatment of Interest Disallowed by Former § 163(j) in Tax Years Beginning Before 2018. The version of § 163(j) in effect before the amendments made by the Tax Cuts and Jobs Act applied only to corporations. Under the pre-TCJA version of § 163(j), interest disallowed as a deduction was treated as interest paid or accrued in the succeeding taxable year and could be carried forward indefinitely. In addition, under the prior version of § 163(j), a corporation could carry forward for three years any “excess limitation” (the amount by which 50 percent of the corporation’s adjusted taxable income exceeded its net interest expense), which made it less likely that the corporation would be subject to § 163(j) in those subsequent years. The notice provides that the proposed regulations will (1) clarify that taxpayers with interest disallowed under the prior version of § 163(j) for the last taxable year beginning before January 1, 2018, may carry such interest forward as business interest to the taxpayer’s first taxable year beginning after December 31, 2017, and that the rules of new § 163(j) then will apply to the interest carried forward, and (2) provide that, because new § 163(j) does not have a mechanism for carrying forward any excess limitation, no amount previously treated as an excess limitation carryforward may be carried to taxable years beginning after December 31, 2017. The proposed regulations also will address the interaction of § 163(j) (including the rules for amounts carried forward from taxable years beginning before 2018) with new § 59A, commonly referred to as the base erosion and anti-abuse tax (BEAT) provision, which imposes a minimum tax on certain large corporations that make deductible payments to related foreign parties.

Business Interest Expense and Income of C Corporations. The notice provides that the proposed regulations will take the position that (1) all interest paid or accrued by a C corporation on indebtedness of the C corporation will be business interest within the meaning of § 163(j)(5), and (2) with respect to indebtedness held by a C corporation, all interest that is includible in the C corporation’s gross income will be business interest income within the meaning of § 163(j)(6). In other words, a C corporation is not treated as having investment interest or investment income; instead, all interest paid or accrued by a C corporation and all interest included in income of a C corporation is treated as business interest and business interest income. The notice provides that this rule will not apply to subchapter S corporations. According to the notice, the proposed regulations also will address whether and to what extent interest is properly characterized as business interest or business interest income when it is paid or accrued by, or includible in the gross income of, a non-corporate entity such as a partnership in which a C corporation holds an interest.

Application of § 163(j) to Consolidated Groups. With respect to a corporate consolidated group, the notice provides that the proposed regulations will apply the § 163(j) limitation at the consolidated group level. Accordingly, the limitation of 30 percent of adjusted taxable income will be determined with reference to consolidated taxable income, which necessarily means that intercompany obligations will be disregarded for purposes of the § 163(j) limitation. The proposed regulations also will address other issues, such as the allocation of the § 163(j) limitation among consolidated group members. The notice indicates, however, that Treasury and the IRS anticipate that the proposed regulations will *not* treat as a single taxpayer for purposes of § 163(j) an affiliated group of corporations that does not file a consolidated return.

Impact of § 163(j) on Earnings and Profits. According to the notice, the proposed regulations will clarify that the limitation of § 163(j) does not affect whether or when business interest expense of a C corporation reduces the corporation’s earnings and profits.

Application of § 163(j) to Partnerships and S Corporations. With respect to partnerships, § 163(j)(4) provides that the limitation on business interest applies at the partnership level. Partners, however, also are subject to § 163(j) in determining their taxable income. The notice indicates that the proposed regulations will provide that, in determining a partner’s annual limitation under § 163(j), a partner can include the partner’s share of the partnership’s business interest income for the taxable year only to the extent of the partner’s share of the excess of (1) the partnership’s business interest income over (2) the partnership’s business interest expense (not including floor plan financing). In addition, the proposed regulations will provide that a partner cannot include the partner’s share of the partnership’s floor plan financing interest in determining the partner’s annual limitation under § 163(j). Similar rules will apply to an S corporation and its shareholders.

E. **Depreciation & Amortization**

F. **Credits**

G. **Natural Resources Deductions & Credits**

H. **Loss Transactions, Bad Debts, and NOLs**

I. **At-Risk and Passive Activity Losses**

III. INVESTMENT GAIN

A. Gains and Losses

1. **The Tax Court emphasizes that the alchemy of transforming § 1231 gain into capital gain does not render § 1231 assets to be capital assets.** CRI-Leslie, LLC v. Commissioner, 147 T.C. 217 (9/7/16). The taxpayer, an LLC treated as a TEFRA partnership, entered into a contract to sell a hotel property that it owned and received a deposit of $9.7 million. The buyer under the contract defaulted and forfeited the $9.7 million deposit, which was retained by the taxpayer. The hotel property was a § 1231 asset, not a capital asset. The taxpayer reported the $9.7 million forfeited deposit as net long-term capital gain, and the IRS asserted a deficiency based on treating the forfeited deposit as ordinary income. The taxpayer argued that its characterization of the forfeited deposit as long-term capital gain was supported by § 1234A, which provides that:

> Gain or loss attributable to the cancellation, lapse, expiration, or other termination of—
>
> > (1) a right or obligation (other than a securities futures contract, as defined in section 1234B) with respect to property which is (or on acquisition would be) a capital asset in the hands of the taxpayer, or
> >
> > (2) a section 1256 contract (as defined in section 1256) not described in paragraph (1) which is a capital asset in the hands of the taxpayer,
>
> shall be treated as gain or loss from the sale of a capital asset. The preceding sentence shall not apply to the retirement of any debt instrument (whether or not through a trust or other participation arrangement).

The taxpayer's position was that "Congress clearly intended for section 1234A to apply not only to payments received from contract terminations relating to capital assets but also to payments from terminations relating to section 1231 property." The IRS argued that the "plain and unambiguous wording" of § 1234A requires a narrow interpretation limited to a "capital asset in the hands of the taxpayer." The Tax Court (Judge Laro) agreed with the IRS's position. The court rejected the taxpayer's argument that the legislative history of § 1234A, *see* S. Rept. No. 105-33, at 134 (1997), 1997-4 C.B. (Vol. 2) 1067, 1214, warranted extending § 1234A to § 1231 assets because it demonstrated that Congress enacted § 1234A to "ensure that taxpayers received the same tax characterization of gain or loss whether the property is sold or the contract to which the property is subject is terminated." The court reasoned that "[s]ince section 1234A expressly refers to property that is 'a capital asset in the hands of the taxpayer' and no other type of property, and since property described in section 1231 is excluded explicitly from the definition of 'capital asset' in section 1221, we must conclude that the plain meaning of 'capital asset' as used in section 1234A does not extend to section 1231 property." The court was "unable find anything in the legislative history of section 1234A to support [the taxpayer's] assertion that Congress intended to include section 1231 property within its ambit."

a. **"The problem with the view that Section 1234A should be understood to reach Section 1231 property is that *the Code's plain language flatly forecloses it*," says the Eleventh Circuit.** CRI-Leslie, LLC v. Commissioner, 882 F.3d 1026 (11th Cir. 2/15/18), *aff'g* 147 T.C. 217 (9/7/16). In a relatively brief but well written and even entertaining opinion by Judge Newsom, the U.S. Court of Appeals for the Eleventh Circuit affirmed the Tax Court's decision. The court recognized that, had the sale of the hotel gone through as planned, the taxpayer's gain from the sale would have been a § 1231 gain and therefore eligible to be classified as long-term capital gain.

Because the sale did not go through, however, the characterization of the taxpayer's gain was goverened by § 1234A. Pursuant to § 1221(a)(2), the court reasoned, assets that are "property used in the trade or business" and therefore subject to § 1231 are expressly excluded from the category of capital assets. The plain langauage of § 1234A, the court emphasized, makes clear that it applies only to termination of rights with respect to a capital asset. "If, as CRI-Leslie acknowledges, the hotel isn't a 'capital asset' within the meaning of Section 1221, then Section 1234A's special rule … simply doesn't apply. That's it. End of case." The court rejected the taxpayer's argument that, although the language of § 1234A refers only to capital assets, Congress intended that § 1234A provide taxpayers with the same tax treatment whether the underlying property is sold or the contract to which the property is subject is terminated. The taxpayer emphasized portions of the legislative history of § 1234A in which Congress cited cases the result of which would be changed by § 1234A. These cases involved property subject to § 1231. The court acknowledged that the taxpayer's argument was "not without foundation" and seemed "to have attracted some scholarly supporters. *See*, *e.g.*, Boris I. Bittker, Martin J. McMahon & Lawrence Zelenak, *Federal Income Taxation of Individuals* ¶ 32.01[4][b] … ." But the court ultimately declined to adopt this view. "In a contest such as we have here, between clear statutory text and (even compelling) evidence of sub- or extra-textual 'intent,' the former must prevail."

2. Unlike most taxpayers in similar situations, these taxpayers were able to show that their initial purpose of developing the property for sale to customers changed to holding the property as an investment. Sugar Land Ranch Development, LLC v. Commissioner, T.C. Memo. 2018-21 (2/22/18). The petitioner in this case, Sugar Land Ranch Development, LLC (SLRD), a TEFRA partnership, was organized under Texas law in 1998 "principally to acquire contiguous tracts of land in Sugar Land, Texas, just southwest of Houston, and to develop that land into single-family residential building lots and commercial tracts." Between 1998 and 2008, SLRD took certain actions with respect to the land, which formerly had been an oil field. These actions included capping oil wells and some environmental cleanup. Because of the effects of the subprime mortgage crisis, in 2008, SLRD's managers decided that SLRD would not subdivide or otherwise develop the property and instead would hold it as an investment and sell it once the market had recovered. Their decision was memorialized in a contemporaneous unanimous written consent document as well as in a resolution adopted by SLRD's members in November 2009. In 2011, a major homebuilder, Taylor Morrison of Texas, Inc., approached SLRD about buying two parcels of land and later decided to acquire a third parcel as well. In total, these three parcels were approximately 580 acres in size. Taylor Morrison acquired two of the parcels by paying SLRD a lump sum in 2012, the year in issue. (Taylor Morrison also was obligated to pay SLRD a percentage of the final sale price of each future home developed and sold on one of the properties, as well as a fixed amount for each plat recorded on both parcels, but none of these amounts were paid in 2012). On its partnership return on Form 1065 for 2012, SLRD reported an $11 million capital gain with respect to the sale of one parcel and a $1.6 million capital loss with respect to the other. The IRS issued a notice of final partnership administrative adjustment in which it asserted that the aggregate net income from the two sales was ordinary income. The Tax Court (Judge Thornton) held that SLRD properly characterized the gain and loss from the sales of the two properties as capital gain and loss. To determine whether the parcels were held for investment and therefore capital assets or instead property held primarily for sale to customers in the ordinary course of business, the court applied a multi-factor test derived from the decision of the U.S. Court of Appeals for the Fifth Circuit (to which this case is appealable) in *Suburban Realty Co. v. United States*, 615 F.2d 171 (5th Cir. 1980). These factors include:

> the frequency and substantiality of sales of property; the taxpayer's purposes in acquiring the property and the duration of ownership; the purpose for which the property was subsequently held; the extent of developing and improving the property to increase sales revenue; the use of a business office for the sale of property; the extent to which the taxpayer used advertising, promotion, or other activities to increase sales; and the time and effort the taxpayer habitually devoted to the sales. … Frequency and substantiality of sales is the most important factor.

In this case, the court explained, SLRD never subdivided the property and never developed or sold lots from the parcels in question. It also did not undertake marketing or promotional activities. Instead, SLRD received an unsolicited offer from Taylor Morrison to purchase the parcels. For at least three years before SLRD sold the parcels, there was no development activity on them. The court also rejected the IRS's arguments that SLRD's sales of these parcels should be viewed as part of development activity undertaken by related parties on adjacent land. The court concluded that the evidence, including "the highly credible testimony" of SLRD's managers, showed "that in 2008 SLRD ceased to hold its property primarily for sale in that business [of selling residential and commercial lots to customers] and began to hold it only for investment."

3. **Warning: This case hot out of La La Land involving the short sale of a personal residence converted to rental property may short circuit your brain!** Simonsen v. Commissioner, 150 T.C. No. 8 (03/14/18). In a one-of-a-kind case of first impression interpreting an *almost* one-of-a-kind regulation, the Tax Court (Judge Holmes) ruled that both the IRS and the taxpayer got it wrong, so neither won. The case involved (1) a short sale of a principal residence converted to rental property, (2) satisfaction of a recourse mortgage that is treated as nonrecourse debt for federal income tax purposes due to a unique provision of California law, and (3) arcane tax regulations that result in neither gain nor loss being recognized upon a disposition of property. In other words, this is the kind of case that only pointed-headed tax professors like us can love!

The facts. The taxpayers in this case, husband and wife, purchased their principal residence in California in 2005 for $695,000. Their five-year, interest-only mortgage on the home was approximately $566,000. In 2008, when the great recession hit, the value of the taxpayers' home plummeted, wiping out their equity. In September of 2010, the taxpayers converted their principal residence to a rental property, and the taxpayers moved elsewhere in California. After renting the property for about one year, and with home values still being depressed, the taxpayers grew tired of using good money to chase bad, and they entered into a short sale transaction with an unrelated buyer and their lender, Wells Fargo. The closing occurred in November 2011. (In a typical short sale, a buyer purchases property for a price that is below the amount of debt encumbering the property, so the sales proceeds (net of expenses of sale) are paid entirely to the lender in exchange for the lender releasing the mortgage and releasing the seller from any deficiency.) The taxpayers' short sale resulted in approximately $363,000 of gross sales proceeds and approximately $346,000 of net sales proceeds after expenses. All $346,000 of net sales proceeds was paid at the closing to Wells Fargo, and Wells Fargo released its mortgage on the property and discharged the taxpayers from the remaining $220,000 (approximately) principal balance of their loan. For their tax year 2011, the taxpayers received a Form 1099-S (Proceeds from Real Estate Transactions) for $363,000 from the title company, and a Form 1099-C (Cancellation of Debt) for approximately $220,000 from Wells Fargo. For reasons explained below, these Forms 1099 were misleading as to the actual tax treatment of the taxpayers' short sale, so the title company and Wells Fargo bear some responsibility for the taxpayers' (and the IRS's) confusion in this case, as detailed below.

The taxpayers' mistakes. For reasons that do not require elaboration, but in part due to the Forms 1099 received, the taxpayers mistakenly, but honestly, reported the short sale and the discharge of indebtedness on their 2011 federal income tax return as two separate transactions. This in turn led to the taxpayers erroneously reporting a $216,000 (approximately) loss deduction under § 165 and $219,000 (approximately) of excludible cancellation of indebtedness income under § 108(a)(1)(E) (qualified principal residence indebtedness). The taxpayers also made another mistake concerning the tax treatment of the short sale. California has an anti-deficiency statute applicable to certain owner-occupied residential real property. Thus, a lender may be able to foreclose on protected residential real property, but the lender cannot pursue a deficiency judgment if the value of the property is less than the principal amount of the debt. Therefore, due to California law, certain home mortgage indebtedness is treated as nonrecourse debt for federal income tax purposes even though it is treated as recourse debt for all other purposes.

The IRS's mistake. After auditing the taxpayers' 2011 federal income tax return, the IRS combined the short sale and discharge of indebtedness into one transaction, which is the correct approach under *2925 Briarpark, Ltd. v. Commissioner*, 163 F.3d 313 (5th Cir. 1999), *aff'g* T.C. Memo 1997-298. Accordingly, the IRS treated the taxpayers as having an amount realized on the short sale of approximately $566,000, but no discharge of indebtedness income. If the mortgage was nonrecourse indebtedness for federal income tax purposes, treating the entire principal amount of the debt as the amount realized is the correct approach under *Crane v. Commissioner*, 331 U.S. 1 (1947). At this point, though, the IRS's analysis went awry. The IRS, citing Reg. § 1.165-9(b)(2) (adjusted basis for loss purposes with respect to personal use property converted to rental property), treated the taxpayers' adjusted basis in the property at the time of sale as being only $495,000, the property's fair market at the time it was converted to rental property less allowable depreciation. Hence, the IRS's view was that the taxpayers actually had gain from the short sale (amount realized of $566,000 less adjusted basis of $495,000). This analysis (after denying the § 165 loss and taking into account the gain) led to a deficiency assessment against the taxpayers of $70,000 for 2011, which prompted the taxpayers to file a petition in Tax Court. The IRS's mistake was that it failed to consider the difference between the taxpayers' adjusted basis for determining gain and their adjusted basis for determining loss under Reg. § 165-9(b)(2), as Judge Holmes explained in his opinion.

Judge Holmes's opinion. After recounting the facts as wells the taxpayers' and the IRS's mutual mistakes in their approaches as summarized above, Judge Holmes focused upon Reg. § 1.165-9(b)(2). Judge Holmes determined that neither the taxpayer nor the IRS had properly applied the regulation. As the IRS asserted, the regulation does indeed require a taxpayer converting personal use property to determine the basis of a personal residence converted to rental property by subtracting appropriate depreciation from the lower of adjusted basis or fair market, but the regulation expressly states that the result is the taxpayer's *adjusted basis for determining loss*.Thus, a proper application of the regulation results in one adjusted basis (after taking into account depreciation) for *gain purposes*, and another adjusted basis (after taking into account depreciation) for *loss purposes*. *See, e.g.*, Reg. § 1.1015-1(a)(1) (which does the same thing in the context of a gift of property when the fair market value of the property at the time of the gift is lower than its adjusted basis). Therefore, although the taxpayers' amount realized was approximately $566,000 as the IRS determined, the taxpayers' adjusted basis in the property differed depending upon whether gain or loss was being determined. The amount realized of $566,000 did not exceed their adjusted basis for determining gain and was not less than their adjusted basis for determining loss. Because the amount realized of $566,000 was between the taxpayers' loss basis of $495,000 and the taxpayers' gain basis of $695,000 (or thereabouts, as the exact amount was unnecessary to determine), the taxpayers realized neither a gain nor a loss upon the sale. The taxpayers' still had a tax deficiency for 2011 unrelated to the short sale, so technically the IRS "won" the case, but it was a Pyrrhic victory for the IRS, and Judge Holmes declined to impose penalties.

B. Interest, Dividends, and Other Current Income

C. Profit-Seeking Individual Deductions

D. Section 121

E. Section 1031

F. Section 1033

G. Section 1035

H. Miscellaneous

IV. COMPENSATION ISSUES

V. PERSONAL AND INDIVIDUAL INCOME AND DEDUCTIONS

A. Rates

B. Miscellaneous Income

C. Hobby Losses and § 280A Home Office and Vacation Homes

1. A taxpayer with four years of significant losses from a ranch in Texas prevailed in establishing that the activity was engaged in for profit. Welch v. Commisioner, T.C. Memo. 2017-229 (11/20/17). The taxpayer had a B.S. degree in agricultural economics, a Ph.D from the University of Chicago in economics, and served as an economics professor for forty years at several institutions, including the University of Chicago, Southern Methodist University, and UCLA. He had a number of business ventures. In 1987 he began purchasing land near Centerville Texas, and eventually developed it into an 8,700-acre ranch with 25 full-time employees. The activities at the ranch were extensive and consisted primarily of a cattle operation, a hay operation, and a horse operation. The taxpayer invested $9.6 million of his own funds as capital for the horse operation. He devoted about two-thirds of his assets and 80 percent of his annual income to the ranch, where he spent Thursday to Sunday of each week. The ranch incurred losses ranging from $2 million to $4 million in the years 2007 through 2010. The IRS disallowed the losses under § 183 on the basis that the taxpayer had not engaged in the ranch activity for profit. The Tax Court (Judge Paris) examined the factors set forth in Reg. § 1.183-2 as well as those developed in judicial decisions and concluded that the taxpayer had engaged in the ranching activity as a for-profit activity during the years in issue. Judge Paris concluded, among other things, that the taxpayer had operated the ranch in a business-like manner, had expertise and had surrounded himself with competent advisors and employees, and expended significant time and effort on the activity. She cautioned, however, that "the Court is not declaring Center Ranch a for-profit activity ad infinitum. If Center Ranch's future losses cannot be reined in, petitioner may again find his profit motives before this Court."

D. Deductions and Credits for Personal Expenses

E. Divorce Tax Issues

F. Education

VI. CORPORATIONS

A. Entity and Formation

B. Distributions and Redemptions

C. Liquidations

D. S Corporations

E. Mergers, Acquisitions and Reorganizations

F. Corporate Divisions

G. Affiliated Corporations and Consolidated Returns

H. Miscellaneous Corporate Issues

1. **After reading a combined 140+ pages, how about next time we just flip a coin? Surely the answer cannot be as simple as the outcome: Owning related-party DISC stock via a Roth IRA is OK, but owning related-party FSC stock via a Roth IRA is not OK?** The following recent cases dramatically illustrate the uncertainties faced by advisors, the IRS, and the courts when deciding between transactions that constitute creative but legitimate tax planning and those that are considered "abusive." Both cases centered on taxpayers using statutorily-sanctioned tax-planning devices in tandem (Roth IRAs coupled with a DISC or a FSC). Nonetheless, a Sixth Circuit panel unanimously held for the taxpayer while a majority of the Tax Court held for the IRS (even after considering the Sixth Circuit's decision). Moreover, the Sixth Circuit and the Tax Court reached conflicting conclusions notwithstanding the fact that the taxpayers and the IRS agreed there was *no significant difference* between the cases in either the relevant facts or the controlling law. If this is no surprise to you, you can stop here. If you are intrigued, read further.

a. **Form is substance, says the Sixth Circuit. The IRS is precluded from recharacterizing a corporation's payments to a DISC held by a Roth IRA.** Summa Holdings, Inc. v. Commissioner, 848 F.3d 779 (6th Cir. 2/16/17), *rev'g* T.C. Memo 2015-119 (6/29/15). Two members of the Benenson family each established a Roth IRA by contributing $3,500. Each Roth IRA paid $1,500 for shares of a Domestic International Sales Corporation (DISC). These members of the Benenson family were the beneficial owners of 76.05 percent of the shares of Summa Holdings, Inc., the taxpayer in this case and a subchapter C corporation. Summa Holdings paid (and deducted) commissions to the DISC, which paid no tax on the commissions. The DISC distributed dividends to each of the Roth IRAs, which paid unrelated business income tax on the dividends (at roughly a 33 percent rate according to the court) pursuant to § 995(g). (The structure involved a holding company between the Roth IRA and the DISC, but the presence of the holding company appears not to have affected the tax consequences.) This arrangement allowed the balance of each Roth IRA to grow rapidly. From 2002 to 2008, the Benensons transferred approximately $5.2 million from Summa Holdings to the Roth IRAs through this arrangement, including $1.5 million in 2008, the year in issue. By 2008, each Roth IRA had accumulated over $3 million. The IRS took the position that the arrangement was an impermissible way to avoid the contribution limits that apply to Roth IRAs. The IRS disallowed the deductions of Summa Holdings for the commissions paid to the DISC and asserted that, under the substance-over-form doctrine, the arrangement should be recharacterized as the payment of dividends by Summa Holdings to its shareholders, followed by contributions to the Roth IRAs by the two members of the Benenson family who established them. The IRS determined that each Roth IRA had received a deemed contribution of $1.1. By virtue of their level of income, the two Benenson family members were ineligible to make any Roth IRA contributions. Pursuant to § 4973, the IRS imposed a 6 percent excise tax on the excess contributions.

The Tax Court's decision (Summa I). The Tax Court (Judge Kerrigan) upheld the IRS's recharacterization. Judge Kerrigan relied upon *Repetto v. Commissioner*, T.C. Memo 2012-168 and Notice 2004-8, 2004-1 C.B. 333, both of which addressed using related-party businesses and Roth IRAs in tandem to circumvent excess contribution limits. Foreshadowing its argument in *Repetto*, the IRS had announced in Notice 2004-8 that these arrangements were listed transactions and that it would attack the arrangements on several grounds, including "that the substance of the transaction is that the amount of the value shifted from the Business to the Roth IRA Corporation is a payment to the Taxpayer, followed by a contribution by the Taxpayer to the Roth IRA and a contribution by the Roth IRA to the Roth IRA Corporation." Importantly, subsequent Tax Court decisions, *Polowniak v. Commissioner*, T.C. Memo 2016-31 and *Block Developers, LLC v. Commissioner*, T.C. Memo 2017-142, adopted the IRS's position in Notice 2004-8 and struck down tandem Roth IRA/related-party business arrangements like the one under scrutiny in *Summa I*.

The Sixth Circuit's decision (Summa (II)). In an opinion by Judge Sutton, the U.S. Court of Appeals for the Sixth Circuit reversed.[1] The court emphasized that "[t]he Internal Revenue Code allowed Summa Holdings and the Benensons to do what they did." The issue was whether the IRS's application of the substance-over-form doctrine was appropriate. The court first expressed a great deal of skepticism about the doctrine:

> Each word of the "substance-over-form doctrine," at least as the Commissioner has used it here, should give pause. If the government can undo transactions that the terms of the Code expressly authorize, it's fair to ask what the point of making these terms accessible to the taxpayer and binding on the tax collector is. "Form" is "substance" when it comes to law. The words of law (its form) determine content (its substance). How odd, then, to permit the tax collector to reverse the sequence—to allow him to determine the substance of a law and to make it govern "over" the written form of the law—and to call it a "doctrine" no less.

Although the court expressed the view that application of the substance-over-form doctrine makes sense when a "taxpayer's formal characterization of a transaction fails to capture economic reality and would distort the meaning of the Code in the process," this was not such a case. The substance-over-form doctrine as applied by the IRS in this case, the court stated, was a "distinct version" under which the IRS claims the power to recharacterize a transaction when there are two possible options for structuring a transaction that lead to the same result and the taxpayer chooses the lower-tax

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[1] Although the Tax Court had both disallowed Summa Holdings' deductions for the commissions paid to the DISC and upheld imposition of the 6 percent excise tax of § 4973 on the deemed excess Roth IRA contributions made by Summa Holdings' shareholders, Summa Holdings appealed to the Sixth Circuit only the disallowance of its deductions. The shareholders have appealed to the First and Second Circuits the issue whether they made excess Roth IRA contributions. Those appeals are currently pending.

option. The court concluded that the IRS's recharacterization of Summa Holding's transactions as dividends followed by Roth IRA contributions did not capture economic reality any better than the taxpayer's chosen structure of DISC commissions followed by dividends to the DISC's shareholders.

b. Not so fast, says the Tax Court. The IRS can still win a Roth IRA case if a tax-saving corporation's stock is in substance owned by individual shareholders instead of their Roth IRAs. Mazzei v. Commissioner, 150 T.C. No. 7 (03/05/18). The taxpayers in this case were members of the Mazzei family (husband, wife, and adult daughter). They owned 100 percent of the stock of Mazzei Injector Corp., an S corporation. The taxpayers established separate Roth IRAs that each invested $500 in a Foreign Sales Corporation ("FSC"). Under prior law and somewhat like DISCs, FSCs provided a Code-sanctioned tax benefit because they were taxed at much lower rates than regular corporations pursuant to an express statutory regime. After the taxpayers' Roth IRAs invested in the FSC, Mazzei Injector Corp. paid the FSC a little over $500,000 in deductible commissions from 1998 to 2002. These deductible payments exceeded the amounts the taxpayers could have contributed to their Roth IRAs over these years, and just as in *Summa Holdings*, the IRS argued that substance over form principles applied to recharacterize the entire arrangement as distributions by the S corporation to its shareholders, followed by excess Roth IRA contributions subject to the § 4973 excise tax and related penalties. Because the case is appealable to the Ninth Circuit, the Tax Court was not bound by the Sixth Circuit's decision in *Summa Holdings*. Thus, the Tax Court could have followed its own decision in *Summa Holdings* to agree with the IRS that in substance the entire arrangement amounted to an end-run around Roth IRA contribution limits; however, the Tax Court did not adopt this *Summa Holdings*-inspired approach. Instead, in a reviewed opinion (12-0-4) by Judge Thornton, relying upon Ninth Circuit precedent as well as the U.S. Supreme Court's decision in *Frank Lyon Co. v. United States*, 435 U.S. 561 (1978), the Tax Court reasoned that the Roth IRAs had no real downside risk or exposure with respect to holding the FSC stock and thus were not the true owners of the stock. Judge Thornton determined that, for federal income tax purposes, the taxpayers should be considered the owners of the stock, stating:

> [B]ecause petitioners (through various passthrough entities) controlled every aspect of the transactions in question, we conclude that they, and not their Roth IRAs, were the owners of the FSC stock for Federal tax purposes at all relevant times. The dividends from the FSC are therefore properly recharacterized as dividends from the FSC to petitioners, followed by petitioners' contributions of these amounts to their respective Roth IRAs. All of these payments exceeded the applicable contribution limits and were therefore excess contributions. We therefore uphold respondent's determination of excise taxes under section 4973.

Notably, though, the Tax Court declined to impose penalties on the taxpayers because they relied on independent professional advice in connection with setting up the FSC and their Roth IRAs.

- *Dissenting opinion.* Four Judges (Holmes, Foley, Buch, and Morrison) dissented, with some joining only parts of the dissenting opinion written by Judge Holmes. Judge Holmes reasoned that the majority should have followed the Sixth Circuit's decision in *Summa Holdings* instead of engaging in "judge-made doctrine." In our view, Judge Holmes's dissenting opinion is both entertaining and insightful, summing up the conflicting opinions in *Summa I*, *Summa II*, and *Mazzei* as follows: "What's really going on here is that the Commissioner doesn't like that the Mazzeis took two types of tax-advantaged entities and made them work together." Judge Holmes also aptly observed:

> After the Sixth Circuit released Summa II we told the parties here to submit supplemental briefs. The Mazzeis and the Commissioner agreed that the only difference between these cases and Summa II was that the Mazzeis used a FSC instead of a DISC. The Commissioner said this difference shouldn't affect our analysis, and he admitted that the Mazzeis followed all of the necessary formalities. He nevertheless said we should ignore Summa II because it's from a different circuit and only the commission payments' deductibility was properly before the court there. He said we should instead follow Court Holding, look at the transaction as a whole,

and decide the cases based on his views of the statute's intent, not the Code's plain language.

The Mazzeis urged us to follow Summa II's reasoning. They said they should get the FSC and Roth IRA tax benefits the Code explicitly provides and that the Commissioner shouldn't get to rewrite statutes based on his musings about congressional intent. And they said that their use of an FSC instead of a C corporation was enough to distinguish these cases from Repetto.

- *Our conclusion? Flip a coin.* Tax advisors setting up these tandem Roth IRA/related-party business arrangements, at least where the structure involves a corporation that enjoys statutorily-sanctioned tax benefits--*such as a very low 21 percent rate, perhaps?*--may prefer to flip a coin than to predict the ultimate outcome, at least outside the Sixth Circuit. One thing is almost certain, though: We will be reading and writing more about tandem Roth IRA/related-party business arrangements in the near future.

VII. PARTNERSHIPS

A. Formation and Taxable Years

B. Allocations of Distributive Share, Debt, and Outside Basis

C. Distributions and Transactions Between the Partnership and Partners

D. Sales of Partnership Interests, Liquidations and Mergers

E. Inside Basis Adjustments

1. **The IRS has finally recognized that partnership returns are filed electronically. Section 754 elections no longer require a partner's signature.** REG-116256-17, Streamlining the Section 754 Election Statement, 82 F.R. 47408 (10/12/17). If a partnership wishes to make a § 754 election, the current regulations (Reg. § 1.754-1(b)) require the partnership to attach to its return a written statement that (i) sets forth the name and address of the partnership making the election, (ii) is signed by one of the partners, and (iii) contains a declaration that the partnership elects under § 754 to apply the provisions of §§ 734(b) and 743(b). Many partnership returns are filed electronically with § 754 elections that, in the IRS's view, do not comply with the requirement that the election be signed by one of the partners. As a result, the IRS has received many requests for so-called "9100 relief" to make a late § 754 election. In these proposed regulations, the IRS proposes to eliminate the requirement that a partnership's § 754 election be signed by one of the partners. Pursuant to these amendments, a § 754 election must comply only with the other two requirements to be a valid election. This change will be effective upon the publication of final regulations in the Federal Register, but the preamble to the proposed regulations states that taxpayers can rely on these proposed amendments now. Therefore, partnerships filing their returns electronically with an otherwise valid § 754 election need not request 9100 relief.

F. Partnership Audit Rules

G. Miscellaneous

VIII. TAX SHELTERS

IX. EXEMPT ORGANIZATIONS AND CHARITABLE GIVING

A. Exempt Organizations

1. **Successful private colleges and universities really must be in the dog house because, in addition to taxing them for highly-paid coaches, Congress has decided to tax their endowments too! And, just to keep us on our toes, the legislative history says the statute turns on the number of an institution's "tuition paying" students, but § 4968 simply reads "students."** The 2017 Tax Cuts and Jobs Act, § 13701, adds § 4968 which imposes a new 1.4 percent annual excise tax upon the net investment income of certain private colleges and universities and affiliated organizations with endowments worth $500,000 or more per full-time student. The excise tax imposed by new § 4968 is similar in many respects to the annual excise tax imposed upon

private foundations under § 4940. In particular, new § 4968 applies to an "applicable educational institution" which is defined as institution: (i) that is an "eligible educational institution" as described in § 25A(f)(2) (which in turn refers to 20 U.S.C. § 1088); (ii) that has at least 500 students during the preceding taxable year more than 50 percent of which are in the U.S.; (iii) that is not described in the first section of § 511(a)(2)(B) (state colleges and universities); and (iv) that has assets (other than assets used directly in carrying out the institution's exempt purpose) with an aggregate fair market value as of end of the preceding taxable year of at least $500,000 per student. For this latter purpose, the number of students of an institution is based on the daily average number of full-time students attending the institution, with part-time students taken into account on a full-time student equivalent basis. Moreover, the legislative history of new § 4968 states that the $500,000 per student figure should be calculated based upon "tuition paying" students; however, the Senate Parliamentarian struck that language from § 4968 immediately before it was passed by the House and Senate. Whether regulations can fill in the gap is anybody's guess. New § 4968 is permanent and effective for taxable years beginning after 2017, again giving fiscal-year private colleges and universities time to cope.

a. Students negotiating for scholarships at private colleges and universities now have a little more leverage. The 2017 Tax Cuts and Jobs Act, § 13701, added § 4968 which imposes a new 1.4 percent annual excise tax upon the net investment income of certain private colleges and universities and affiliated organizations. As originally passed late in 2017, new § 4968 taxed private colleges and universities (and affiliates) with endowments worth $500,000 or more per "student" (as defined in the statute to account for full and part-time students); however, the legislative history of new § 4968 stated that the $500,000 per student figure should be calculated based upon "tuition-paying" students. The discrepancy between the statute and the legislative history was created because the Senate Parliamentarian struck the "tuition-paying" language from § 4968 immediately before the 2017 Tax Cuts and Jobs Act ultimately was passed by Congress. Thanks to the Bipartisan Budget Act of 2018, § 41109, though, § 4968 is amended to include the "tuition-paying" modifying language. Thus, only those private colleges and universities (and affiliates) with endowments worth $500,000 or more per tuition-paying student will be subject to the new 1.4 percent annual excise tax. In other respects, the excise tax imposed by new § 4968 is similar to the annual excise tax imposed upon private foundations under § 4940. In particular, new § 4968 applies to an "applicable educational institution" which is defined as an institution: (i) that is an "eligible educational institution" as described in § 25A(f)(2) (which in turn refers to 20 U.S.C. § 1088); (ii) that has at least 500 tuition-paying students during the preceding taxable year more than 50 percent of which are in the U.S.; (iii) that is not described in the first section of § 511(a)(2)(B) (state colleges and universities); and (iv) that has assets (other than assets used directly in carrying out the institution's exempt purpose) with an aggregate fair market value as of end of the preceding taxable year of at least $500,000 per student. For this latter purpose, the number of students of an institution is based on the daily average number of full-time students attending the institution, with part-time students taken into account on a full-time student equivalent basis. New § 4968 is permanent and effective for taxable years beginning after 2017, again giving fiscal-year private colleges and universities time to cope.

2. Newman's Own just got its "own" tax exemption so that we can continue to enjoy delicious salad dressings, pizzas, and other food that makes both our tummies and our hearts feel good. Newman's Own is popularly known for donating 100 percent of its profits to charity. What many may not have known, however, is that the ownership structure of Newman's Own potentially subjected it to an excise tax under the private foundation excess business holdings rules of § 4943. The Bipartisan Budget Act of 2018, § 41110, remedies this problem by creating a new exception in § 4943(g) for "independently-operated philanthropic business holdings" of private foundations. Although the new exception is complicated and requires careful study by those potentially benefitting, it essentially allows private foundations that have been *bequeathed* 100% of the voting interests in a business enterprise to avoid the general rule of § 4943, which requires such business enterprises to be sold by the private foundation within a 5- to 10-year period. To qualify, in addition to having been donated to (not purchased by) the private foundation, the business enterprise generally must distribute 100 percent of its annual profits to the owning foundation and must have an independent board of directors separate from the board of the owning foundation. New § 4943(g) is effective for taxable years beginning after December 31, 2017.

3. **Well, the IRS doesn't call it an "F" reorg, but that's what tax-exempts can do after this ruling.** Rev. Proc. 2018-15 , 2018-9 I.R.B. 379 (02/08/18). Obsoleting Rev. Rul. 67-390 and Rev. Rul. 77-469, the IRS has ruled in Rev. Proc. 2018-15 that reincorporations, redomestications, and certain other corporate restructurings involving exempt organizations do not require a new application for exemption (Form 1023) by the surviving entity. Under Rev. Proc. 2018-15, a "corporate restructuring" of a § 501(c) organization means "incorporation under the laws of a state, reincorporation of a corporation incorporated under the laws of one state under the laws of a different state, filing articles of domestication for a corporation incorporated under the laws of one state under the laws of a different state, or a statutory merger of one corporation with and into another corporation." If a § 501(c) organization engages in such a corporate restructuring after January 1, 2017, and the surviving organization is (1) a domestic business entity; (2) classified as a corporation under § 301.7701-2(b)(1) or (2); and (3) carries out the same purposes as the exempt organization that engaged in the corporate restructuring, then it does not need to file a new exemption application (Form 1023) with the IRS. Further, for § 501(c)(3) organizations (the most common type of tax-exempts under § 501(c)), the articles of organization of the surviving organization must continue to meet the organizational test of Reg. § 1.501(c)(3)-1(b), including § 1.501(c)(3)-1(b)(4) (regarding dedication of assets to exempt purposes). Thus, qualifying incorporations, reincorporations, redomestications, and mergers of most § 501(c) entities effectively are treated as "F" reorganizations, allowing the organization to continue its exempt status merely by notifying the IRS on the organization's annual Form 990. The organization's tax identification number also remains the same. Finally, Rev. Proc. 2018-15 does not apply to any corporate restructuring in which (1) the restructuring organization or the surviving organization is a disregarded entity, limited liability company, partnership, or foreign business entity; or (2) the surviving organization obtains a new EIN.

- The IRS's prior published position along with limited case law had held that any type of change in form (even mere reincorporation from one state to another) required a § 501(c)(3) organization to reapply to the IRS (Form 1023) for recognition of the organization's tax-exempt status. *See American New Covenant Church v. Commissioner*, 74 T.C. 293 (1980) (unincorporated association becomes a nonprofit corporation); Rev. Rul. 77-469, 1977-2 C.B. 196 (same); Rev. Rul. 67-390 (describing four distinct transactions—incorporation of an exempt trust, incorporation of an exempt association, reincorporation by Act of Congress, and reincorporation from one state to another—all requiring new applications for exempt status). Recent private letter rulings indicated that the IRS was reconsidering its position. *See* PLR 201426028 (06/27/14) (legislatively mandated, intrastate conversion from "public nonprofit corporation" status to "nonprofit corporation" does not require reapplication for exemption); PLR 201446025 (08/20/14) (a reincorporation or "redomestication" of an exempt, nonprofit corporation from one state to another does not require reapplication for exemption).

4. **The Tax Court has held that referral fees paid to an exempt organization by a debt collection firm are subject to UBIT because the fees were neither "royalties" nor for services "primarily for the convenience" of the organization's hospital-members.** New Jersey Council of Teaching Hospitals v. Commissioner, 149 T.C. No. 22 (12/20/17). The taxpayer was a § 501(c)(3) tax-exempt supporting organization that facilitated the common charitable activities of its members. The taxpayer's members were tax-exempt teaching hospitals in New Jersey. The taxpayer's revenue consisted of annual dues paid by its hospital-members for educational programs and other healthcare-related activities, as well as certain payments received from third parties that contracted with the taxpayer and the taxpayer's hospital-members. Essentially, the taxpayer would endorse certain third parties providing services to hospitals, and if a hospital-member contracted with the third party, then the taxpayer would receive specified payments from the third party. These third-party payments derived from credit card programs, internet providers, research and polling services, equipment maintenance firms, transportation providers, debt collection agencies, and group purchasing arrangements. The Service audited the taxpayer for the years 2004 through 2007, and determined that certain of the third-party payments received by the taxpayer constituted unrelated

business income. Specifically, the Service contended that payments received by the taxpayer from a debt-collection agency and a group purchasing program during the years at issue were taxable as unrelated business income. Accordingly, the Service determined that the taxpayer had a total UBIT deficiency of approximately $820,000 attributable to the years 2004 through 2007. The taxpayer contended, alternatively, that the payments from the debt collection agency were either "royalties" (excluded from UBIT by § 512(b)(2)), or from an activity conducted "primarily for the convenience" of the taxpayer's hospital-members (excludable because under § 513(a)(2) such an activity is not considered an unrelated trade or business). With respect to the payments received from the group purchasing arrangement, the taxpayer did not argue the "royalty" exception applied, but the taxpayer did argue that the "primarily for convenience" exception applied. The Tax Court (Judge Lauber) held for the IRS with respect to both types of payments. Regarding the taxpayer's contention that the payments from the debt collection agency were "royalties," Judge Lauber pointed to the taxpayer's agreement with the agency. The agreement did not purport to license any part of the taxpayer's intellectual property and, in fact, was labeled a "Service Agreement." Regarding the taxpayer's contention that even if the "royalty" exception did not apply, both the debt collection agency and group purchasing payments should be excluded from UBIT as revenue from an activity conducted "primarily for the convenience" of its hospital-members, Judge Lauber also agreed with the Service. Judge Lauber determined, based upon examples in the regulations as well as prior judicial decisions, that the "convenience" exception is targeted toward minor revenue-producing activities conducted by tax exempt organization for the benefit of individual members, employees, students, patients, etc. of the organization (e.g., on-campus bookstore, hospital pharmacy). Judge Lauber determined that the "convenience" exception should not apply to a revenue-generating service that addresses needs of institutional members of an exempt organization outside the core mission (in this case facilitating undergraduate and graduate education in teaching hospitals and innovative, efficient healthcare delivery) of the exempt organization. (In this latter regard, Judge Lauber cited several cases upholding the Service's position that payments made by insurance companies to trade associations whereby members purchase insurance are UBIT.) Finally, Judge Lauber reasoned that even if the taxpayer was correct that the payments from the debt collection agency and from the group purchasing arrangement made such third-party services more affordable and thereby "convenient" for its hospital-members, the taxpayer's dominant motive for obtaining the payments (over $2.2 million from 2004 to 2007) was revenue, not "primarily" for the convenience of its hospital-members.

B. Charitable Giving

X. TAX PROCEDURE

A. Interest, Penalties and Prosecutions

1. A majority of the Tax Court refuses to call a procedural foot-fault on the IRS, but not all the judges see it that way. Graev v. Commissioner, 147 T.C. No. 16 (11/30/16), *opinion vacated*, No. 30638-08 (U.S. Tax Court 3/30/17). The taxpayers had claimed a charitable contribution deduction for the donation of a facade conservation easement that ultimately was disallowed by the Tax Court (140 T.C. 377 (2013)). The IRS examining agent determined that the taxpayers were liable for the § 6662(h) 40 percent gross valuation misstatement penalty, and he prepared a penalty approval form for which he obtained written approval from his immediate supervisor. On that form only the § 6662(h) 40 percent penalty was asserted. The agent prepared a notice of deficiency that included the 40 percent penalty. However, before the notice of deficiency was issued, a Chief Counsel attorney reviewed a draft and, through a memorandum approved by his supervisor, the attorney advised that an alternative § 6662(a) 20 percent accuracy-related penalty should be added to the notice. The notice of deficiency was revised to include the 20 percent § 6662(a) accuracy-related penalty, the calculation of which in the notice of deficiency yielded a zero 20 percent penalty to avoid stacking with the 40 percent penalty. The notice of deficiency was issued as revised, but the revised notice with the alternative 20 percent penalty was not reviewed or approved by the examining agent's supervisor. After the IRS conceded that the 40 percent gross valuation misstatement penalty did not apply, it asserted the alternative 20 percent accuracy-related penalty as a non-zero amount, since the stacking issue no longer existed. The taxpayers argued that, because the notice of deficiency showed a zero amount for the § 6662(a) 20 percent penalty, the IRS failed to comply with the requirements of § 6751(a), which requires that a computation of the penalty be included in the notice of deficiency, and § 6751(b), which requires that the "initial determination of ... [the] assessment" of the penalty be "personally approved (in writing) by the immediate supervisor ... or such higher level official as the Secretary may designate," and that these failures barred assessment of the 20 percent penalty. In a reviewed opinion by Judge Thornton, the Tax Court (9-3-5) held that: (1) the notice of deficiency complied with the requirements of § 6751(a); (2) because the penalty had not yet been assessed, the taxpayers' argument that the IRS failed to comply with § 6751(b)(1) was premature; and (3) the 20 percent accuracy-related penalty for a substantial understatement applied. With respect to the first holding, regarding compliance with § 6751(a), the court reasoned as follows:

> The notice of deficiency clearly informed petitioners of the determination of the 20% penalty (as an alternative) and clearly set out the computation (albeit reduced to zero, as it had to be then, to account for the greater 40% penalty). The notice of deficiency thus complied with section 6751(a).
>
> Moreover, even if petitioners were correct that the IRS failed to include a computation of a penalty as required by section 6751(a), such a failure would not invalidate a notice of deficiency. In similar contexts this Court has held that procedural errors or omissions are not a basis to invalidate an administrative act or proceeding unless there was prejudice to the complaining party.

With respect to the third holding regarding application of the 20 percent accuracy-related penalty, the court rejected the taxpayers' defenses and concluded that: (1) the taxpayers had not established that they had reasonable cause for claiming the charitable contribution deductions and acted in good faith; (2) "the authorities that support [the taxpayers'] deductions for the cash and conservation easement contributions are not substantial when weighed against the contrary authorities;" and (3) the taxpayers had no reasonable basis for their return position and had not adequately disclosed on their return the relevant facts concerning their deductions because they had not disclosed a side letter from the National Architectural Trust (NAT) (the easement holder) obligating the NAT to refund the taxpayers' cash contribution and work to remove the easement if the IRS disallowed entirely their charitable contribution deductions for the easement.

- A concurring opinion by Judge Nega (with whom Judges Goeke and Pugh joined) would have reached the same result as the majority on the ground that the taxpayers were not prejudiced, and would have left "to another case the more detailed statutory analysis performed by both the majority and the dissent."

- A dissent by Judge Gustafson (joined by Judges Colvin, Vasquez, Morrison and Buch) would not have sustained the penalty on the ground that the IRS failed to comply with § 6751(b)(1) because "the responsible revenue agent included a 20% accuracy-related penalty on the notice of deficiency without first obtaining the 'approv[al] (in writing)' of his 'immediate supervisor'."

a. But the Second Circuit serves the Tax Court some *Chai*. Chai v. Commissioner, 851 F.3d 190 (2d Cir. 3/20/17), *aff'g in part, vacat'g in part, and rev'g in part* T.C. Memo. 2015-42 (3/11/15). The taxpayer in this case received in 2003 a $2 million payment for serving as an accommodation party in connection with tax shelters. The taxpayer did not report the payment as income and took the position that the $2 million was a nontaxable return of capital. The IRS issued a notice of deficiency for 2003 increasing the taxpayer's income by the $2 million payment and asserting both a deficiency in self-employment tax and a 20 percent accuracy-related penalty. (The notice of deficiency did not assert a deficiency in income tax because the taxpayer had offsetting losses from a partnership subject to the TEFRA audit rules. Those losses ultimately were disallowed at the partnership level and the IRS amended its answer in this Tax Court proceeding to assert a deficiency in income tax. This sequence of events led to several interesting procedural issues with respect to the deficiency in income tax.) In his post-trial briefing in the Tax Court, the taxpayer raised for the first time the same argument regarding the penalty as the taxpayer had raised in *Graev v. Commissioner*, 147 T.C. No. 16 (11/30/16), i.e., that the IRS was barred from assessing the 20 percent accuracy-related penalty because it had failed to comply with the requirement of § 6751(b) that the "initial determination of ... [the] assessment" of the penalty must be "personally approved (in writing) by the immediate supervisor ... or such higher level official as the Secretary may designate." The Tax Court (Judge Cohen) refused to address this argument on the basis that it was untimely because the taxpayer had raised it for the first time post-trial. In an opinion by Judge Wesley, the Second reversed the Tax Court's ruling on the penalty issue. (The Second Circuit affirmed the Tax Court's ruling that the $2 million payment was subject to self-employment tax and vacated its ruling that it had no jurisdiction to consider the increased deficiency in income tax asserted by the IRS. In light of the taxpayer's concession that the $2 million was includible in gross income, the Second Circuit remanded with instructions to uphold the additional income tax deficiency.) The Second Circuit found the view of the majority in *Graev* on the penalty issue unpersuasive and sided with the dissenting judges in *Graev*. The court focused on the language of § 6751(b) and concluded that it is ambiguous regarding the timing of the required supervisory approval of a penalty. Because of this ambiguity, the court examined the statute's legislative history and concluded that Congress's purpose in enacting the provision was "to prevent IRS agents from threatening unjustified penalties to encourage taxpayers to settle." That purpose, the court reasoned, undercuts the *Graev* majority's conclusion that approval of the penalty can take place at any time, even just prior to assessment. The court held "that § 6751(b)(1) requires written approval of the initial penalty determination no later than the date the IRS issues the notice of deficiency (or files an answer or amended answer) asserting such penalty." Further, the court held "that compliance with § 6751(b) is part of the Commissioner's burden of production and proof in a deficiency case in which a penalty is asserted. … Read in conjunction with § 7491(c), the written approval requirement of § 6751(b)(1) is appropriately viewed as an element of a penalty claim, and therefore part of the IRS's *prima facie* case."

b. The Tax Court has adopted the Second Circuit's approach to the required supervisory approval of penalties, but nevertheless upheld the imposition of penalties on these taxpayers. Graev v. Commissioner, 149 T.C. No. 23 (12/20/17). In a reviewed, supplemental opinion by Judge Thornton, the Tax Court (9-1-6) has reversed the portions of its opinion in *Graev v. Commissioner*, 147 T.C. No. 16 (11/30/16) that held it was premature to consider whether § 6751(b) barred assessment of the § 6662(a) accuracy-related penalties asserted by the IRS. In *Chai v. Commissioner*, 851 F.3d 190 (2d Cir. 3/20/17), the U.S. Court of Appeals for the Second Circuit held "that § 6751(b)(1) requires written approval of the initial penalty determination no later than the date the IRS issues the notice of deficiency (or files an answer or amended answer) asserting such penalty." Further, the Second Circuit held "that compliance with § 6751(b) is part of the Commissioner's burden of production and proof in a deficiency case in which a penalty is asserted." Because this case is appealable to the Second Circuit, and in the interest of promoting uniformity on an issue that affects many cases, the Tax Court accepted the Second Circuit's holding. Accordingly, the question in this case was whether the IRS had obtained the required written approval of the accuracy-related penalties by the date the notice of deficiency was issued or by the date the IRS filed an answer or amended answer asserting the penalty. The IRS asserted the 20 percent accuracy-related penalty with respect to both the taxpayers' non-cash charitable contribution (the façade conservation easement) and their cash charitable contribution. The penalty with respect to the cash contribution was asserted for the first time in an amended answer by the IRS Chief Counsel attorney handling the litigation, and the taxpayers conceded that this penalty received the requisite approval by the Associate Area Counsel. The taxpayers contended that § 6751(b)(1) barred assessment of the 20 percent penalty with respect to the their noncash charitable contribution. The IRS had prepared a proposed notice of deficiency that asserted a 40 percent accuracy-related penalty under § 6662(h), which was the penalty proposed by the Revenue Agent who had conducted the audit and approved by the Revenue Agent's immediate supervisor. An attorney in the IRS Chief Counsel's Office reviewed the proposed notice of deficiency and recommended that the IRS assert an alternative position with respect to the penalty, i.e., that the § 6662(a) 20 percent penalty applied. The recommendation was approved by the attorney's immediate supervisor (the Associate Area Counsel) and included in the final notice of deficiency, which was signed by an IRS Technical Services Territory Manager. The taxpayers made the following three-part argument: (1) the Office of IRS Chief Counsel serves in only an advisory capacity until proceedings begin in the Tax Court, (2) the IRS Chief Counsel attorney who recommended the alternative penalty in this case accordingly had no authority to make an initial determination of a penalty that appeared in the notice of deficiency, and therefore (3) the IRS had not complied with the requirement of § 6751(b)(1) that there be an "initial determination of [the] assessment" of the penalty that is approved by the immediate supervisor of the person making the initial determination. In essence, the taxpayers attempted to distinguish between advice, as had been provided by the IRS Chief Counsel attorney who recommended the penalty, and an "initial determination," which is required by the statute. The court rejected the taxpayers' arguments and held that § 6751(b)(1) did not bar assessment of the alternative 20 percent penalty because the IRS Chief Counsel attorney who first recommended the penalty made the requisite "initial determination," which was approved by the attorney's immediate supervisor, the Associate Area Counsel.

- In a concurring opinion, Judge Lauber, joined by Judges Marvel, Thornton, Pugh, and Ashford, emphasized that § 6751(b)(1) should be interpreted in light of its purpose, which, as discussed by the Second Circuit in *Chai v. Commissioner*, 851 F.3d 190 (2d Cir. 3/20/17), was to prevent IRS employees from threatening unjustified penalties in an effort to encourage taxpayers to settle. This purpose, Judge Lauber wrote, supports the Tax Court majority's approach of treating the action of the IRS official who first proposes that a penalty be asserted as the "initial determination" of the assessment of the penalty. In contrast, Judge Lauber argued, the position expressed in Judge Buch's dissenting opinion (that an initial determination can be made only by an IRS officer with the technical authority to make a penalty determination or issue a notice of deficiency) would mean that "an IRS official would be free to use penalties as a battering ram against taxpayers, without obtaining supervisory approval under section 6751(b), so long as he lacked authority to do what he was doing."

- In a lengthy opinion, Judge Holmes concurred in the result only. Judge Holmes advocated deciding this case under the rule of *Golsen v. Commissioner*, 54 T.C. 742 (1970), *aff'd*, 445 F.2d 985 (10th Cir. 1971), pursuant to which the court applies the precedent of the U.S. Court of Appeals to which its decision can be appealed. Judge Holmes predicted that, by adopting the holding and reasoning of the Second Circuit in *Chai v. Commissioner*, 851 F.3d 190 (2d Cir. 3/20/17), the majority decision will give rise to difficult issues of interpretation and "will even end up harming taxpayers unintentionally."

- In a dissenting opinion, Judge Buch, joined by Judges Foley, Vasquez, Goeke, Gustafson, and Morrison, agreed with the majority that the court should adopt the holding of the Second Circuit in *Chai v. Commissioner*, 851 F.3d 190 (2d Cir. 3/20/17), but disagreed "on the issue of whether a recommendation from an attorney within the IRS Office of Chief Counsel can constitute 'the initial determination' to impose a penalty for purposes of section 6751(b)(1)." Judge Buch emphasized that the IRS Office of Chief Counsel serves in an advisory capacity. "Because the [IRS Chief Counsel] attorney has the authority only to advise or recommend, we would hold that the attorney's recommendation to assert a penalty is not the initial determination that must be approved in writing."

2. **♫♪Don't do the crime if you can't do the time."♫♪ Well, at least you won't have to pay interest or late-payment penalties on the restitution you pay.** Klein v. Commissioner, 149 T.C. No. 15 (10/3/17). The taxpayers, a married couple, pleaded guilty to filing a false tax return in violation of § 7206(1). They were sentenced to time in prison (27 months and 63 months) and ordered to pay to the IRS restitution with respect to the years 2003 to 2006 of more than $562,000. The U.S. District Court that sentenced the taxpayers rejected their arguments that the tax loss calculation on which the restitution was based did not take into account all allowable deductions and that the actual tax loss to the government was approximately $22,000. Pursuant to § 6201(4), the IRS assessed the full amount of restitution that had been ordered (more than $562,000) and the taxpayers ultimately paid it. The IRS also assessed interest and late-payment penalties on the restitution, both calculated beginning on the original due dates of the taxpayers' returns for 2003 through 2006. The IRS subsequently filed against each of them a notice of federal tax lien based on the interest and late-payment penalties, in response to which the taxpayers requested a collection due process hearing. In the CDP hearing, the taxpayers did not request a collection alternative and instead argued that they had paid the full amount of restitution that had been ordered. The IRS issued a notice of determination upholding the notices of federal tax lien, and the taxpayers sought review of the notice of determination in the Tax Court. The Tax Court (Judge Lauber), ruling on cross-motions for summary judgment, first held that, because the taxpayers had not received a notice of deficiency or otherwise had the opportunity to dispute the underlying tax liability (the interest and late-payment

penalties), § 6330(c)(2)(B) did not bar the taxpayers from disputing the underlying tax liability in the CDP hearing. Because the taxpayers were contesting the underlying tax liability, the court's standard of review was not abuse of discretion, but rather de novo. The court went on to hold that the relevant statutes did not permit the IRS to assess interest or additions to tax for late payment with respect to restitution ordered in a criminal proceeding. Section 6601(a) provides that interest shall be paid "[i]f any amount of tax imposed by this title … is not paid on or before the last date prescribed for payment" Section 6651(a)(3) imposes an addition to tax of .5 percent per month when there is a failure "to pay any amount in respect of any tax required to be shown on a return" within a specified time period. The provision that authorizes the IRS to assess restitution (§ 6201(4)), the court explained, permits the IRS to

> assess and collect the amount of restitution under an order pursuant to section 3556 of title 18, United States Code, for failure to pay any tax imposed under this title *in the same manner as if such amount were such tax* (emphasis added).

The language of (§ 6201(4)), the court concluded, makes clear that "[t]he amount of restitution is not a 'tax imposed by' title 26." Therefore, an assessment of restitution does not trigger interest under § 6601(a) or an addition to tax for late payment under § 6651(a)(3). The court rejected the IRS's argument that the legislative history of § 6201(4) supports a contrary conclusion. According to the court, the legislative history suggests that Congress's purpose in enacting § 6201(4) in 2010 was to allow the IRS to assess restitution simply as a mechanism to create an account receivable against which a taxpayer's payment of restitution could be credited. The court pointed out that the IRS can collect interest and late-payment penalties if it undertakes an audit to determine the taxpayers' civil tax liabilities for the years in question, which might be either lower or higher than the amount of restitution paid. As of the date of the court's opinion, the IRS had not begun audit procedures.

- In Muncy v. Commissioner, T.C. Memo. 2017-83 (5/17/17), the Tax Court similarly examined the language in § 6201(4) and concluded that the amount of any deficiency (as defined in § 6211(a)) for a tax year is not reduced by any criminal restitution paid. In that decision, the court noted that "[a]ny amount paid to the IRS as restitution for taxes owed must be deducted from any civil judgment the IRS obtains to collect the same tax deficiency."

B. Discovery: Summons and FOIA

C. Litigation Costs

D. StatutoryNotice of Deficiency

E. Statute of Limitations

1. Maybe the IRS thought that "Island Time" applied to determine the limitations period on assessment? Coffey v. Commissioner, 150 T.C. No. 4 (1/29/18).Even though the taxpayer may not have been a bona fide resident of the U.S. Virgin Islands and therefore improperly failed to file a U.S. tax return herself, the IRS duly received copies of the taxpayer's USVI returns for 2003 and 2004 from the U.S. Virgin Islands Bureau of Internal Revenue ("BIR") and entered the taxpayer's return information into the taxpayer's IRS transcript no later than March 2006. According to the Tax Court, because that process and the provided information equated to receipt by the IRS of an adequate "return" to calculate U.S. federal income tax liability under the test of *Beard v. Commissioner*, 82 T.C. 766 (1984), *aff'd*, 793 F.2d 139 (6th Cir. 1986), the IRS was barred by the three-year limitations period of § 6501(a) from assessing tax when it issued a notice of deficiency to the taxpayer in September 2009.

Background: As a possession of the United States, the U.S. Virgin Islands has a so-called "mirror tax system." Essentially, under this system, U.S. Virgin Island residents are taxed similar to U.S. residents by virtue of a fiction treating the U.S. Internal Revenue Code as if it referred to the USVI everywhere it actually refers to the United States. Thus, *bona fide residents* of the U.S. Virgin Islands with only USVI-source income generally complete and file IRS forms solely with the USVI BIR (not the IRS) to report and pay income taxes pursuant to § 932(d). Then, pursuant to § 7654(a), in the case of a taxpayer that has had income taxes withheld and remitted to the U.S. Treasury for a particular tax year, a Tax Implementation Agreement ("TIA") between the IRS and the BIR requires return information to be transmitted to the IRS (and vice versa from the IRS to the BIR) allowing any taxes so withheld and paid to the U.S. Treasury to be "covered over" to the USVI Treasury. (Nonresidents of the USVI with both US- and VI-sourced income must file with both the IRS and the USVI Bureau of Internal Revenue and pay taxes accordingly.)

The Taxpayer: Claiming to be a bona fide resident of the USVI (a fact which the IRS vigorously disputed), the taxpayer filed her income tax returns for 2003 and 2004 solely with the BIR. A copy of the taxpayer's returns then were duly transmitted by the BIR to the IRS pursuant to the TIA and entered into the taxpayer's IRS transcript no later than March of 2006. The taxpayer was claiming to be a bona fide resident of the USVI to obtain the benefits of reduced income tax rates under a USVI economic development program. The IRS commenced audits of the taxpayer's 2003 USVI return in August of 2005 and the taxpayer's 2004 USVI return in May of 2006; however, the IRS never requested that the taxpayer sign a waiver extending the three-year limitations period on assessment under § 6501(a). Accordingly, upon a motion for summary judgment, the taxpayer argued that, regardless of whether she was a bona fide resident of the USVI for tax years 2003 and 2004, and regardless of whether she herself filed a return with the IRS for those years, because the IRS received sufficient information via the TIA to calculate her U.S. tax liability by March of 2006, the IRS was precluded from issuing a notice of deficiency in September of 2009 because the three-year limitations period on assessment of § 6501(a) already had expired. This limitations period generally is three years from the time the taxpayer files a return. The IRS argued that the limitations period of § 6501(a) had not begun to run at all because the taxpayer had not filed a return with the IRS showing $0 income.

The Tax Court: In a reviewed opinion (5-7-4) by Judge Holmes, the Tax Court agreed with the taxpayer's position that the three-year limitations period of § 6501(a) barred the IRS from assessing the tax. According to Judge Holmes's opinion, the *Beard* test requires that an adequate return for purposes of § 6501(a) must (1) contain sufficient data to permit calculation of tax liability, (2) purport to be a return, (3) be an honest and reasonable attempt to satisfy the requirements of tax law, and (4) be executed under penalties of perjury. Judge Holmes and four other judges (Foley, Vasquez, Gustafson, and Buch) reasoned that transmittal from the BIR to the IRS under the TIA of copies of the first two pages of taxpayer's 2003 and 2004 income tax returns as well as related W-2 wage statements met that test. Seven judges (Thornton, Gale, Goeke, Paris, Kerrigan, Pugh, and Ashford) concurred only in the result, reasoning more broadly that the taxpayer's filing of a return with the BIR pursuant to § 932(d) should be sufficient in and of itself to start the statute of limitations under § 6501 regardless of the *Beard* test. The four dissenting judges (Marvel, Morrison, Lauber, and Nega) would have held in favor of the IRS, reasoning that because the taxpayer's return information was transmitted to the IRS by the BIR, but neither the taxpayer nor someone authorized to act for them had filed a return with the IRS, the statute of limitations never began to run and therefore the assessment was not be time-barred.

F. Liens and Collections

G. Innocent Spouse

H. Miscellaneous

1. The Tax Court has concluded that "the excess of A over B" can be a negative number when B is larger than A. Galloway v. Commissioner, 149 T.C. No. 19 (10/17/17). The taxpayers, a married couple, claimed in 2011 the American Opportunity Credit provided by § 25A for postsecondary educational expenses with respect to each of three children. They claimed a credit of $2,500 with respect to each child, or a total of $7,500. They determined the amount of their credit on Form 8863, which was attached to their return. However, they mistakenly included on Form 1040 only the $3,000 refundable portion of the credit and omitted the $4,500 nonrefundable portion. Their return showed tax liability of $6,984 reduced by the $3,000 credit, or $3,984. The taxpayers also had $8,287 withheld from their wages, which meant that they claimed a refund of $4,303. In the course of processing the return, the IRS adjusted their tax liability to take into account the $4,500 nonrefundable portion of the credit. The IRS calculated their tax liability as $6,984 - $4,500 nonrefundable credit, or $2,484, reduced by both the $3,000 refundable portion of the educational credit and their withholding of $8,287, which resulted in the IRS issuing a refund to the taxpayers of

$8,803. The IRS later disallowed the educational credits, determined a deficiency of $7,500, and imposed an accuracy-related penalty of $1,500. The taxpayers ultimately conceded that they were not entitled to any educational credits. The issue was the amount of the taxpayers' deficiency for 2011. The Tax Court (Judge Halpern) held that their deficiency was $7,500. The term "deficiency" is defined in § 6211(a) as "the amount by which the tax imposed … exceeds the excess of (1) the amount shown as the tax by the taxpayer upon his return … plus the amounts previously assessed (or collected without assessment) as a deficiency, over (2) the amount of rebates … made." Section 6211(b)(4) directs that, in determining the amount of a deficiency, the amount by which certain credits (including the refundable portion of the credit at issue here) exceed the amount of tax shown on the return must be treated as negative amounts of tax. The IRS calculated the taxpayers' deficiency as the amount by which the $6,984 tax imposed exceeded the excess of (1) the $3,984 shown as the tax due on the return over (2) the $4,500 rebate made by the IRS (the nonrefundable portion of the education credits). The IRS's position was that the excess of $3,984 over $4,500 is a negative number (-$516), and therefore the taxpayers' deficiency was the amount by which the $6,984 tax imposed exceeded -$516, which is $7,500. After reviewing its prior decisions in analogous situations and the relevant statutory provisions, the court agreed with the IRS's position. The court rejected the taxpayers' argument that the excess of tax shown due on the return over rebates can be a negative number only when no rebate exists. The court also upheld the IRS's imposition of an accuracy–related penalty under § 6662(a) and (b)(2) for a substantial understatement of income tax. The definition of "understatement" in § 6662(d)(2)(A) is similar to (but not the same as) the definition of "deficiency." The court concluded that the taxpayers had an understatement of $7,500, which was a "substantial" understatement because it exceeded the greater of 10 percent of the $6,984 tax required to be shown on the return or $5,000. Finally, the court rejected the taxpayers' reasonable, cause, good faith defense to the penalty because, according to the court, the taxpayers had already claimed the American Opportunity Credit for each of their children for the first four years of post-secondary education, and the forms and instructions on which they relied clearly provided that the credit is not available for a fifth year.

XI. WITHHOLDING AND EXCISE TAXES

A. Employment Taxes

B. Self-employment Taxes

C. Excise Taxes

XII. TAX LEGISLATION

A. Enacted

XIII. TRUSTS, ESTATES & GIFTS

RECENT DEVELOPMENTS IN FEDERAL INCOME TAXATION

"Recent developments are just like ancient history, except they happened less long ago."

By

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Note: This outline was prepared jointly with Professor Cassady V. ("Cass") Brewer of the Georgia State University College of Law, Atlanta, GA.

I. ACCOUNTING

II. BUSINESS INCOME AND DEDUCTIONS

III. INVESTMENT GAIN

IV. COMPENSATION ISSUES

V. PERSONAL AND INDIVIDUAL INCOME AND DEDUCTIONS

A. Rates

B. Miscellaneous Income

1. **Who would have thought that selling your life insurance policy to a complete stranger was a good idea anyway?** Notice 2018-41, 2018-20 I.R.B. 584 (04/26/18) The 2017 Tax Cuts and Jobs Act, §§ 13520-13522, modified the rules concerning the exclusion of life insurance proceeds upon the death of the insured as well as the determination of basis in a life insurance contract. The modified rules primarily impact the tax treatment of so-called life settlements (where a stranger purchases a life insurance policy on a healthy insured) and viatical settlements (where a stranger purchases a life insurance policy on a terminally-ill insured). Particularly, as explained in detail below, amended § 101 now contains a special carve-out to the normal life insurance policy transfer-for-value rules. *See* § 101(a)(3). This special carve-out applies to "reportable policy sales," which generally will include life settlement and viatical settlement transactions. Furthermore, § 13520 of the TCJA adds new Code § 6050Y to impose unique reporting requirements on the transferor and the insurer with respect to "reportable policy sales." In part, new § 6050Y will require disclosure of "reportable death benefits," as defined, but essentially meaning death benefits paid on an insurance policy that has been transferred in a "reportable policy sale." Finally, § 13521 of the TCJA adds a new subsection "(B)" to Code § 1016(a)(1) to clarify (and reverse the IRS's position in Rev. Rul. 2009-13, 2009-1 C.B. 1029 (05/01/09)) that basis in 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''). Notice 2018-41 states that the IRS will issue proposed regulations providing guidance concerning the new rules and that otherwise required reporting under § 6050Y will be delayed until after final regulations are published. We commend Notice 2018-41 for careful study by those readers advising clients on life settlement and viatical settlement transactions. The changes made by TCJA to Code § 101 and the addition of § 6050Y (which are the focus of the Notice) apply to taxable years beginning after 2017. The amendment adding new § 1016(a)(1)(B) applies retroactively to transactions entered into after August 25, 2009. For additional background, see below.

Some background. Section 101 generally excludes from gross income the proceeds of a life insurance policy payable by reason of the death of the insured. If, however, a life insurance policy is transferred for valuable consideration prior to the death of the insured (i.e., "a transfer for value"), then death benefit proceeds (to the extent they exceed the transferee-owner's basis in the policy) are includable in gross income by the transferee-owner of the policy upon the insured's death *unless an* *exception applies*. These exceptions provide that, notwithstanding a transfer for value, death benefit proceeds remain excludable if (i) the transferee-owner's basis in the policy is determined in whole or in part by reference to the transferor's basis (e.g., a carryover basis transaction) or (ii) the transferee-owner is the insured, a partner of the insured, a partnership in which the insured is a partner, or a corporation of which the insured is a shareholder or officer. If a transfer-for-value exception does not apply, then Rev. Rul. 2009-14, 2009-1 C.B. 1031 (05/02/09) sets out the IRS's position that any death benefit payable to the transferee-owner is ordinary income (to the extent it exceeds the transferee-owner's basis in the policy) while a subsequent sale of the policy by the transferee-owner before the death of the insured can produce capital gain.

Why new rules? Life settlement and viatical settlement transactions have increased over the last several years. The increase in the estate and gift tax exemption has contributed in part to this market because some previously purchased life insurance policies are no longer required to pay anticipated estate taxes. Changes to restrictive state laws concerning so-called "stranger-owned" life insurance also have contributed to an increase in these transactions. In a typical *life settlement* transaction, the policyholder, often the individual insured under the life insurance contract, sells his or her life insurance contract to an unrelated person. The consideration paid generally is a lump-sum cash payment that is less than the death benefit on the policy, but more than the amount that would be received by the policyholder upon surrender of the life insurance contract. The IRS previously announced its position regarding the tax treatment of life settlement transactions in Rev. Rul. 2009-13, 2009-1 C.B. 1029. Oversimplifying somewhat, Revenue Ruling 2009-13 provides that the seller of a policy in a life settlement transaction recognizes capital gain except with respect to the "inside buildup" in the policy (e.g., growth in cash surrender value of cash value life insurance) over prior premium payments. This latter amount attributable to the inside buildup in the policy is characterized as ordinary income. The IRS also took the position in Rev. Rul. 2009-13 that the seller's basis in a transferred policy must be adjusted downward by the cost of insurance separate from the investment in the contract. As discussed above, TCJA's addition of new Code § 1016(a)(1)(B) reverses the IRS's position in this regard. A *viatical settlement*, a special type of life settlement transaction, may involve the sale of a life insurance contract by the owner, but under § 101(g) may not necessarily be taxed like a life settlement transaction. Under a viatical settlement, a policyholder may sell or assign a life insurance contract after the insured has become terminally ill or chronically ill. If any portion of the death benefit under a life insurance contract on the life of an insured who is terminally ill or chronically ill (within the meaning of § 101(g)) is sold (through the sale of the life insurance contract) or assigned in a viatical settlement to a "viatical settlement provider" (as defined), the amount paid for the sale or assignment of that portion is treated as an amount paid under the life insurance contract by reason of the death of the insured (which may be excludable under § 101), rather than gain from the sale or assignment (which generally would not be excludable under § 101 unless a transfer-for-value exception applied). A viatical settlement provider for purposes of these rules is a person regularly engaged in the trade or business of purchasing, or taking assignments of, life insurance contracts insuring the lives of terminally ill or chronically ill individuals (provided certain requirements are met). *See* Rev. Rul. 2002-82, 2002-2 C.B. 978 (12.23/02).

So, what's in the new rules? Under new § 101(a)(3), the longstanding transfer-for-value exceptions described above do not apply if the transfer of the life insurance policy is a "reportable policy sale." A reportable policy sale is defined as "the acquisition of an interest in a life insurance contract, directly or indirectly, if the acquirer has no substantial family, business, or financial relationship with the insured apart from the acquirer's interest in such life insurance contract." Pursuant to § 101(a)(3)(B), the term "indirectly" as used in this context applies to the acquisition of an interest in a life insurance contract via a partnership, trust, or other entity. Beyond the above statutory language, however, new § 101(a)(3) provides no further guidance as to specifics, such as the "substantial family, business, or financial relationships" (including ownership via partnerships, trusts, or other entities) that exempt an otherwise reportable policy sale from the special inclusion rule of new §103(a)(3). In effect, then, Notice 2018-41 is the IRS's means of telling insurers and those engaged in life settlement and viatical settlement transactions that the IRS knows the statutes are unclear and that the necessary guidance to comply with the new rules is forthcoming.

C. Hobby Losses and § 280A Home Office and Vacation Homes

D. Deductions and Credits for Personal Expenses

1. Has the federal deduction for your high property or state income taxes made them easier to bear? Brace yourself! The deduction for state and local taxes not paid or accrued in carrying on a trade or business or an income-producing activity is limited to $10,000. The 2017 Tax Cuts and Jobs Act, § 11042, amended Code § 164(b) by adding § 164(b)(6). For individual taxpayers, this provision generally (1) eliminates the deduction for foreign real property taxes, and (2) limits to $10,000 ($5,000 for married individuals filing separately) a taxpayer's itemized deductions on Schedule A for the aggregate of state or local property taxes, income taxes, and sales taxes deducted in lieu of income taxes. This provision applies to taxable years beginning after 2017 and before 2026. The provision does *not* affect the deduction of state or local property taxes or sales taxes that are paid or accrued in carrying on a trade or business or an income-producing activity (i.e., an activity described in § 212) that are properly deductible on Schedules C, E, or F. For example, property taxes imposed on residential rental property will continue to be deductible. With respect to income taxes, an individual can deduct only *foreign* income taxes paid or accrued in carrying on a trade or business or an income-producing activity. As under current law, an individual cannot deduct state or local income taxes as a business expense even if the individual is engaged in a trade or business as a sole proprietor. *See* Reg. § 1.62-1T(d).

a. The IRS is not going to give blue states a pass on creative workarounds to the new $10,000 limitation on the personal deduction for state and local taxes. Notice 2018-54, 2018-24 I.R.B. ___ (05/23/18). In response to new § 164(b)(6), many states—including Connecticut, New Jersey, and New York—have enacted workarounds to the $10,000 limitation. For instance, New Jersey reportedly has enacted legislation giving property owners a special tax credit against otherwise assessable property taxes if the owner makes a contribution to charitable funds designated by local governments. Connecticut reportedly has enacted a new provision that taxes the income of pass-through entities such as S corporations and partnerships, but allows the shareholders or members a corresponding tax credit against certain state and local taxes assessed against them individually. Notice 2018-54 announces that the IRS and Treasury are aware of these workarounds and that proposed regulations will be issued to "make clear that the requirements of the Internal Revenue Code, informed by substance-over-form principles, govern the federal income tax treatment of such transfers." In other words, blue states, don't bank on a charitable contribution or a flow-through income tax substituting for otherwise assessable state and local taxes to avoid new § 164(b)(6). The authors predict that this will be an interesting subject to watch over the coming months.

E. Divorce Tax Issues

1. ♪♫Breaking up is hard to do.♫♪ But, if you have been thinking about it, split up in 2018 if you want to save taxes. Under the Tax Cuts and Jobs Act, alimony is not deductible by the payor and is not taxable for the recipient. The 2017 Tax Cuts and Jobs Act, § 11051, repealed both Code § 215, which authorized an above-the-line deduction for alimony payments, and Code § 71, which included alimony payments in the recipient's gross income. For those subject to the new rules, the payor of alimony will not be able to deduct the payments, and the recipient will not include the alimony payments in gross income. This change applies to any divorce or separation instrument (as defined in former Code § 71(b)(2)) executed after 2018. It also applies to any divorce or separation instrument executed before 2018 that is modified after 2018 if the modification expressly provides that the amendments made by the Tax Cuts and Jobs Act will apply. The legislation also made various conforming amendments to other Code provisions.

a. Speaking of other Code provisions, perhaps an "alimony trust" is the solution? Notice 2018-37, 2018-18 I.R.B. 521 (04/12/18). Along with repeal of Code §§ 71 and 215, the 2017 Tax Cuts and Jobs Act, § 11051(b)(1)(C), repealed Code § 682 with the same effective date provision as described above for the repeal of Code §§ 71 and 215. Section 682 governs so-called "alimony trusts" whereby one spouse benefits from the income of a trust established by the other spouse if the trust is part of the decree of divorce or separate maintenance. Generally, if a trust qualifies under Code § 682, then even if the trust would be a grantor trust as to the spouse establishing the trust (e.g., the husband), the other spouse (e.g., the wife) is taxable on the trust's income in accordance with the normal rules of subchapter J. In Notice 2018-37, the IRS has announced that Treasury regulations will be issued to clarify that § 682 as in effect prior to the enactment of the 2017 Tax Cuts and Jobs Act, § 11051(b)(1)(C), will continue to apply to alimony trusts set up this year (presumably even if modified after 2018 unless the modification expressly states that post-TCJA law should apply). *Query* (again!) if an alimony trust may be set up and minimally funded this year between "friendly" divorcing couples to allow trust income to be taxed to a former spouse based upon subsequent contributions to the corpus of the trust by the other spouse after 2018. Notice 2018-37 also solicits comments regarding whether guidance is needed under §§ 672(e)(1)(A) (grantor treated as holding any trust power or interest in favor of grantor's spouse or former spouse); 674(d) (grantor power over beneficial enjoyment of trust limited by a reasonably definite external standard); or 677 (trust income for benefit of grantor).

F. Education

VI. CORPORATIONS

A. Entity and Formation

B. Distributions and Redemptions

C. Liquidations

D. S Corporations

E. Mergers, Acquisitions and Reorganizations

F. Corporate Divisions

G. Affiliated Corporations and Consolidated Returns

H. Miscellaneous Corporate Issues

1. After reading a combined 140+ pages, how about next time we just flip a coin? Surely the answer cannot be as simple as the outcome: Owning related-party DISC stock via a Roth IRA is OK, but owning related-party FSC stock via a Roth IRA is not OK? The following recent cases dramatically illustrate the uncertainties faced by advisors, the IRS, and the courts when deciding between transactions that constitute creative but legitimate tax planning and those that are considered "abusive." Both cases centered on taxpayers using statutorily-sanctioned tax-planning devices in tandem (Roth IRAs coupled with a DISC or a FSC). Nonetheless, a Sixth Circuit panel unanimously held for the taxpayer while a majority of the Tax Court held for the IRS (even after considering the Sixth Circuit's decision). Moreover, the Sixth Circuit and the Tax Court reached conflicting conclusions notwithstanding the fact that the taxpayers and the IRS agreed there was *no significant difference* between the cases in either the relevant facts or the controlling law. If this is no surprise to you, you can stop here. If you are intrigued, read further.

a. Form is substance, says the Sixth Circuit. The IRS is precluded from recharacterizing a corporation's payments to a DISC held by a Roth IRA. Summa Holdings, Inc. v. Commissioner, 848 F.3d 779 (6th Cir. 2/16/17), *rev'g* T.C. Memo 2015-119 (6/29/15). Two members of the Benenson family each established a Roth IRA by contributing $3,500. Each Roth IRA paid $1,500 for shares of a Domestic International Sales Corporation (DISC). These members of the Benenson family were the beneficial owners of 76.05 percent of the shares of Summa Holdings, Inc., the taxpayer in this case and a subchapter C corporation. Summa Holdings paid (and deducted) commissions to the DISC, which paid no tax on the commissions. The DISC distributed dividends to each of the Roth IRAs, which paid unrelated business income tax on the dividends (at roughly a 33 percent rate according to the court) pursuant to § 995(g). (The structure involved a holding company between the Roth IRA and the DISC, but the presence of the holding company appears not to have affected the tax consequences.) This arrangement allowed the balance of each Roth IRA to grow rapidly. From 2002 to 2008, the Benensons transferred approximately $5.2 million from Summa Holdings to the Roth IRAs through this arrangement, including $1.5 million in 2008, the year in issue. By 2008, each Roth IRA had accumulated over $3 million. The IRS took the position that the arrangement was an impermissible way to avoid the contribution limits that apply to Roth IRAs. The

IRS disallowed the deductions of Summa Holdings for the commissions paid to the DISC and asserted that, under the substance-over-form doctrine, the arrangement should be recharacterized as the payment of dividends by Summa Holdings to its shareholders, followed by contributions to the Roth IRAs by the two members of the Benenson family who established them. The IRS determined that each Roth IRA had received a deemed contribution of $1.1. By virtue of their level of income, the two Benenson family members were ineligible to make any Roth IRA contributions. Pursuant to § 4973, the IRS imposed a 6 percent excise tax on the excess contributions.

The Tax Court's decision (Summa I). The Tax Court (Judge Kerrigan) upheld the IRS's recharacterization. Judge Kerrigan relied upon *Repetto v. Commissioner*, T.C. Memo 2012-168 and Notice 2004-8, 2004-1 C.B. 333, both of which addressed using related-party businesses and Roth IRAs in tandem to circumvent excess contribution limits. Foreshadowing its argument in *Repetto*, the IRS had announced in Notice 2004-8 that these arrangements were listed transactions and that it would attack the arrangements on several grounds, including "that the substance of the transaction is that the amount of the value shifted from the Business to the Roth IRA Corporation is a payment to the Taxpayer, followed by a contribution by the Taxpayer to the Roth IRA and a contribution by the Roth IRA to the Roth IRA Corporation." Importantly, subsequent Tax Court decisions, *Polowniak v. Commissioner*, T.C. Memo 2016-31 and *Block Developers, LLC v. Commissioner*, T.C. Memo 2017-142, adopted the IRS's position in Notice 2004-8 and struck down tandem Roth IRA/related-party business arrangements like the one under scrutiny in *Summa I*.

The Sixth Circuit's decision (Summa (II)). In an opinion by Judge Sutton, the U.S. Court of Appeals for the Sixth Circuit reversed.[1] The court emphasized that "[t]he Internal Revenue Code allowed Summa Holdings and the Benensons to do what they did." The issue was whether the IRS's application of the substance-over-form doctrine was appropriate. The court first expressed a great deal of skepticism about the doctrine:

> Each word of the "substance-over-form doctrine," at least as the Commissioner has used it here, should give pause. If the government can undo transactions that the terms of the Code expressly authorize, it's fair to ask what the point of making these terms accessible to the taxpayer and binding on the tax collector is. "Form" is "substance" when it comes to law. The words of law (its form) determine content (its substance). How odd, then, to permit the tax collector to reverse the sequence—to allow him to determine the substance of a law and to make it govern "over" the written form of the law—and to call it a "doctrine" no less.

Although the court expressed the view that application of the substance-over-form doctrine makes sense when a "taxpayer's formal characterization of a transaction fails to capture economic reality and would distort the meaning of the Code in the process," this was not such a case. The substance-over-form doctrine as applied by the IRS in this case, the court stated, was a "distinct version" under which the IRS claims the power to recharacterize a transaction when there are two possible options for structuring a transaction that lead to the same result and the taxpayer chooses the lower-tax option. The court concluded that the IRS's recharacterization of Summa Holding's transactions as dividends followed by Roth IRA contributions did not capture economic reality any better than the taxpayer's chosen structure of DISC commissions followed by dividends to the DISC's shareholders.

b. Not so fast, says the Tax Court. The IRS can still win a Roth IRA case if a tax-saving corporation's stock is in substance owned by individual shareholders instead of their Roth IRAs. Mazzei v. Commissioner, 150 T.C. No. 7 (03/05/18). The taxpayers in this case were members of the Mazzei family (husband, wife, and adult daughter). They owned 100 percent of the stock of Mazzei Injector Corp., an S corporation. The taxpayers established separate

[1] Although the Tax Court had both disallowed Summa Holdings' deductions for the commissions paid to the DISC and upheld imposition of the 6 percent excise tax of § 4973 on the deemed excess Roth IRA contributions made by Summa Holdings' shareholders, Summa Holdings appealed to the Sixth Circuit only the disallowance of its deductions. The shareholders have appealed to the First and Second Circuits the issue whether they made excess Roth IRA contributions. Those appeals are currently pending.

Roth IRAs that each invested $500 in a Foreign Sales Corporation ("FSC"). Under prior law and somewhat like DISCs, FSCs provided a Code-sanctioned tax benefit because they were taxed at much lower rates than regular corporations pursuant to an express statutory regime. After the taxpayers' Roth IRAs invested in the FSC, Mazzei Injector Corp. paid the FSC a little over $500,000 in deductible commissions from 1998 to 2002. These deductible payments exceeded the amounts the taxpayers could have contributed to their Roth IRAs over these years, and just as in *Summa Holdings*, the IRS argued that substance over form principles applied to recharacterize the entire arrangement as distributions by the S corporation to its shareholders, followed by excess Roth IRA contributions subject to the § 4973 excise tax and related penalties. Because the case is appealable to the Ninth Circuit, the Tax Court was not bound by the Sixth Circuit's decision in *Summa Holdings*. Thus, the Tax Court could have followed its own decision in *Summa Holdings* to agree with the IRS that in substance the entire arrangement amounted to an end-run around Roth IRA contribution limits; however, the Tax Court did not adopt this *Summa Holdings*-inspired approach. Instead, in a reviewed opinion (12-0-4) by Judge Thornton, relying upon Ninth Circuit precedent as well as the U.S. Supreme Court's decision in *Frank Lyon Co. v. United States*, 435 U.S. 561 (1978), the Tax Court reasoned that the Roth IRAs had no real downside risk or exposure with respect to holding the FSC stock and thus were not the true owners of the stock. Judge Thornton determined that, for federal income tax purposes, the taxpayers should be considered the owners of the stock, stating:

> [B]ecause petitioners (through various passthrough entities) controlled every aspect of the transactions in question, we conclude that they, and not their Roth IRAs, were the owners of the FSC stock for Federal tax purposes at all relevant times. The dividends from the FSC are therefore properly recharacterized as dividends from the FSC to petitioners, followed by petitioners' contributions of these amounts to their respective Roth IRAs. All of these payments exceeded the applicable contribution limits and were therefore excess contributions. We therefore uphold respondent's determination of excise taxes under section 4973.

Notably, though, the Tax Court declined to impose penalties on the taxpayers because they relied on independent professional advice in connection with setting up the FSC and their Roth IRAs.

- *Dissenting opinion.* Four Judges (Holmes, Foley, Buch, and Morrison) dissented, with some joining only parts of the dissenting opinion written by Judge Holmes. Judge Holmes reasoned that the majority should have followed the Sixth Circuit's decision in *Summa Holdings* instead of engaging in "judge-made doctrine." In our view, Judge Holmes's dissenting opinion is both entertaining and insightful, summing up the conflicting opinions in *Summa I*, *Summa II*, and *Mazzei* as follows: "What's really going on here is that the Commissioner doesn't like that the Mazzeis took two types of tax-advantaged entities and made them work together." Judge Holmes also aptly observed:

> After the Sixth Circuit released <u>Summa II</u> we told the parties here to submit supplemental briefs. The Mazzeis and the Commissioner agreed that the only difference between these cases and <u>Summa II</u> was that the Mazzeis used a FSC instead of a DISC. The Commissioner said this difference shouldn't affect our analysis, and he admitted that the Mazzeis followed all of the necessary formalities. He nevertheless said we should ignore <u>Summa II</u> because it's from a different circuit and only the commission payments' deductibility was properly before the court there. He said we should instead follow <u>Court Holding</u>, look at the transaction as a whole, and decide the cases based on his views of the statute's intent, not the Code's plain language.
>
> The Mazzeis urged us to follow <u>Summa II</u>'s reasoning. They said they should get the FSC and Roth IRA tax benefits the Code explicitly provides and that the Commissioner shouldn't get to rewrite statutes based on his musings about congressional intent. And they said that their use of an FSC instead of a C corporation was enough to distinguish these cases from <u>Repetto</u>.

- *Our conclusion? Flip a coin.* Tax advisors setting up these tandem Roth IRA/related-party business arrangements, at least where the structure involves a corporation that enjoys statutorily-sanctioned tax benefits--*such as a very low 21 percent rate, perhaps?*--may prefer to flip a coin than to predict the ultimate outcome, at least outside the Sixth Circuit. One thing is almost certain, though: We will be reading and writing more about tandem Roth IRA/related-party business arrangements in the near future.

c. The First Circuit has agreed with the Sixth Circuit and declined to recharacterize a corporation's payments to a DISC held by a Roth IRA. Benenson v. Commissioner, 887 F.3d 511 (1st Cir. 4/6/18), *rev'g* T.C. Memo 2015-119 (6/29/15). In an opinion by Judge Stahl, the U.S. Court of Appeals for the First Circuit has upheld the same Roth IRA-DISC transaction considered by the Sixth Circuit in *Summa Holdings, Inc. v. Commissioner*, 848 F.3d 779 (6th Cir. 2/16/17). In that transaction, members of the Benenson family established Roth IRAs that acquired shares of a Domestic International Sales Corporation (DISC), to which a subchapter C corporation (Summa Holdings) paid (and deducted) commissions to the DISC. The Tax Court upheld the IRS's recharacterization of the transaction under the substance over form doctrine. Under the IRS's view of the transaction, the C corporation's payments of commissions to the DISC should be recharacterized as nondeductible distributions by the C corporation to its shareholders, followed by the shareholders' contributions of those amounts to their Roth IRAs in excess of applicable limits, which triggered the 6 percent excise tax of § 4973 The Sixth Circuit addressed the C corporation's deductions and rejected the IRS's argument that the C corporation's deductions should be disallowed under the substance over form doctrine. In this case, the First Circuit considered the appeal of the Tax Court's decision by shareholders who were residents of Massachusetts, who appealed the Tax Court's decision that they should be treated as having made excess Roth IRA contributions. Like the Sixth Circuit, the First Circuit declined to apply the substance over form doctrine, which the court characterized as "not a smell test," but rather a tool of statutory interpretation. The court reasoned that Congress appeared to contemplate ownership of DISCS by IRAs when it enacted relevant statutory provisions such as § 995(g), which imposes unrelated business income tax on distributions that a DISC makes to tax-exempt organizations that own shares of the DISC. The court concluded:

> The Benensons used DISCs, a unique, congressionally designed corporate form their family's business was authorized to employ, and Roth IRAs, a congressionally designed retirement account all agree they were qualified to establish, to engage in long-term saving with eventual tax-free distribution. Such use violates neither the letter nor the spirit of the relevant statutory provisions.
>
> …

- In a dissenting opinion, Judge Lynch argued that the IRS's application of the substance over form doctrine should be upheld. In Judge Lynch's view, the parties had not used the DISC for the purpose intended by Congress, but rather to evade the Roth IRA contribution limits. Judge Lynch also disagreed with the majority that the relevant statutory provisions contemplated a Roth IRA holding stock in a DISC. At most, Judge Lynch noted, Congress might have intended to allow traditional IRAs to own DISC stock, but taxpayers have not used DISCs as a way to circumvent the contribution limits on traditional IRAs because, in contrast to Roth IRAs, distributions from a traditional IRA are not tax-free.

VII. PARTNERSHIPS

VIII. TAX SHELTERS

A. Tax Shelter Cases and Rulings

B. Identified "tax avoidance transactions"

C. Disclosure and Settlement

D. Tax Shelter Penalties

1. Jurisdiction is not arithmetic—you can't divide $24.9 million by 193. Diversified Group, Inc. v. United States, 123 Fed. Cl. 442 (9/29/15). The Court of Federal Claims (Judge Sweeny), in a case of first impression, held that it lacked jurisdiction in a suit seeking a refund of a partial payment of a § 6707 penalty assessed for failure to register a tax shelter as required

§ 6111. The plaintiff argued that the penalty was divisible, that it was not necessary to pay the full amount of the penalty prior to bringing suit but only to pay the penalty with respect to one of the 193 individual transactions involving the tax shelter. The court rejected this argument, holding that the $24.9 million penalty for failure to register the tax shelter related to a single act.

> Although it is true that the IRS calculated the amount of the penalty based upon each client's aggregate investment in the tax shelter, neither the number of clients that participated in the tax shelter nor the number of commercial steps necessary to accomplish that participation in the tax shelter triggers liability under § 6707. Consequently, the penalty is not divisible for any reason, including the number of clients who participated in the tax shelter.

Thus, the full payment rule for seeking a refund established by *Flora v. United States*, 357 U.S. 63 (1958), had not been met because the penalty was not divisible and "'[e]xceptions to the full payment rule have been recognized by the courts only where an assessment covers divisible taxes.' *Rocovich v. United States*, 933 F.2d 991, 995 (Fed. Cir. 1991). A tax or penalty is divisible when 'it represents the aggregate of taxes due on multiple transactions.'"

a. The Federal Circuit sees it the same way. Diversified Group, Inc. v. United States, 841 F.3d 975 (Fed. Cir. 11/10/16). In an opinion by Chief Judge Prost, the U.S. Court of Appeals for the Federal Circuit affirmed the Claims Court's decision. The plaintiff argued that the $24.9 million § 6707 penalty was divisible because it was calculated based upon each client's aggregate investment in the tax shelter. The plaintiff emphasized that a separate Form 8264 (the form by which a tax shelter is registered) necessarily would be required for each client's investment because it would be impossible to fill out a Form 8264 for the entire tax shelter on the first day it was offered for sale because, at that time, many of the details that the form requires are unknown. Accordingly, the plaintiff argued, each filing should be considered a separate instance of tax shelter registration under § 6111. The court concluded, however, that § 6707 penalties are not divisible into the individual transactions or investors that may comprise a single tax shelter:

> Section 6707(a) provides that "if a person ... fails to register such tax shelter ... such person shall pay a penalty with respect to such registration." This language makes clear that liability for a § 6707 penalty arises from the single act of failing to register the tax shelter (which, under Temp. Treas. Reg. § 301.611-1T, A-1, A-47, is failing to file the necessary Form(s) 8264). This omission creates a single source of liability, regardless of how many individuals or transactions are involved in the tax shelter. Liability cannot be sub-divided beyond this.

b. A District Court in New York reaches the same conclusion. Larson v. United States, 118 A.F.T.R.2d 2016-7004 (S.D.N.Y 12/28/16). The IRS assessed more than $160 million in penalties against the taxpayer under § 6707 for failure to register two tax shelters as required by § 6111. The tax shelters involved were the Foreign Leveraged Investment Program ("FLIP"), also known as the Offshore Portfolio Investment Strategy ("OPIS"), and the Bond Linked Issue Premium Structure ("BLIPS"). The penalties were later reduced to $67.6 million to reflect payments made by other persons who were jointly and severally liable. The taxpayer paid $1.4 million and brought this action seeking a refund of the $1.4 million and abatement of all assessed penalties. The District Court (Judge Caproni), relying on the holdings in *Diversified Group, Inc. v. United States*, 841 F.3d 975 (Fed. Cir. 11/10/16) and *Pfaff v. United States*, 117 A.F.T.R.2d 2016-981 (D. Colo. 3/10/16), held that the § 6707 penalties imposed on the taxpayer were not divisible. Because the taxpayer had not paid the full amount of the tax for which he sought a refund, as required by the full payment rule of *Flora v. United States*, 357 U.S. 63 (1958), the court granted the government's motion to dismiss for lack of subject matter jurisdiction. In reaching this conclusion, the court rejected the taxpayer's argument that application of the full payment rule to his situation violated the due process clause of the Fifth Amendment. He argued that, taking into account his inability to challenge the penalty in the Tax Court because of the absence of a notice of deficiency, application of the full payment rule violated his right to due process because he could not pay the penalty and could not seek review of his claim without paying the penalty. The court similarly rejected the taxpayer's claim for judicial review under the Administrative Procedure Act, in which the taxpayer asserted that the IRS's penalty assessment and denial of his refund claim were arbitrary, capricious, and an abuse of discretion, and his argument that the § 6707 penalty was an excessive fine that violates the Eighth Amendment. Finally, the court dismissed for failure to state a claim the taxpayer's claim to compel the IRS to give him information relating to payments from others who are jointly and severally liable.

c. The Second Circuit agrees. Larson v. United States, 888 F.3d 578 (2d Cir. 4/25/18). In an opinion by Judge Wesley, the U.S. Court of Appeals for the Second Circuit has affirmed the District Court's decision. The court rejected the taxpayer's argument that the full payment rule of *Flora v. United States*, 357 U.S. 63 (1958) (*Flora I*) and *Flora v. United States*, 362 U.S. 145 (1960) (*Flora II*) applies only to cases involving tax deficiencies. The taxpayer's argument was that (1) taxpayers are required to make full payment of the tax allegedly due before bringing suit for a refund in a U.S. District Court or the U.S. Court of Federal Claims only when the taxpayer has had the opportunity to seek judicial review in the Tax Court, and (2) the full payment rule does not apply in cases such as this one, which involved an assessable penalty for which no review is available in the Tax Court. The court recognized that "*Flora I* and *Flora II* acknowledge the existence and availability of Tax Court review," but concluded that "Tax Court availability was not essential to the Supreme Court's conclusion in either opinion." The court also rejected the taxpayer's argument that application of the full payment rule violated his Fifth Amendment right to due process. The taxpayer's prepayment opportunity for a conference with the IRS Appeals Division, the court held, satisfied the requirement of due process. The court similarly rejected the taxpayer's claim for judicial review under the Administrative Procedure Act. The court suggested that Congress had implicitly precluded prepayment judicial review through "the ful payment rule of § 1346(a)(1)," and even if it had not, Congress had provided special and adequate review procedures (post-payment review in refund litigation) that make APA review inappropriate. The court also concluded that the District Court lacked subject matter jurisdiction over the taxpayer's claim that the § 6707 penalty was an excessive fine that violates the Eighth Amendment. The court ended its opinion with the following:

> We close with a final thought. The notion that a taxpayer can be assessed a penalty of $61 million or more without any judicial review unless he first pays the penalty in full seems troubling, particularly where, as Larson alleges here, the taxpayer is unable to do so. But, "[w]hile the *Flora* rule may result in economic hardship in some cases, it is Congress' responsibility to amend the law." *Rocovich v. United States*, 933 F.2d 991, 995 (Fed. Cir. 1991).

IX. EXEMPT ORGANIZATIONS AND CHARITABLE GIVING

A. Exempt Organizations

1. The IRS finalizes Form 1024-A for social welfare organizations to use to apply for recognition of (c)(4) status and receive an IRS determination letter. Rev. Proc. 2018-10, 2018-7 I.R.B. 355 (01/24/18). The IRS has released a final version of Form 1024-A, Application for Recognition of Exemption Under Section 501(c)(4) of the Internal Revenue Code. The new Form 1024-A may be used by (c)(4) "social welfare organizations" to apply for a determination letter from the Service recognizing their exempt status. The new form is a byproduct of the controversy that arose several years ago regarding § 501(c)(4) social welfare organizations. The Protecting Americans from Tax Hikes Act of 2015 (Pub. L. No. 114-113, div. Q) (the PATH Act), addressed the controversy by adding § 506 to the Code. Section 506 accomplished two objectives. Sections 506(a)-(d) require purported § 501(c)(4) organizations to notify the Secretary of the Treasury (the Secretary) no later than 60 days after the organization is established. The Treasury and the IRS subsequently promulgated Form 8976 for this purpose; however, Form 8976 is merely a notification form. It is not a formal application to the IRS for recognition of exempt status under § 501(c)(4). In fact, unlike a § 501(c)(3) charitable organization (which uses Form 1023 to apply for recognition of exempt status), a § 501(c)(4) social welfare organization is not required to apply to the IRS for a determination letter recognizing its exempt status, and many § 501(c)(4) organizations do not so apply. For those § 501(c)(4) organizations that do wish to apply, however, the PATH Act also added new § 506(f). Section 506(f) permits (but does not require) § 501(c)(4) social welfare organizations to apply to the IRS for a determination letter recognizing the organization's exempt status in a manner similar to the mandatory process used for § 501(c)(3) charitable organizations. The final version of the Form 1024-A recently published by the IRS was designed for this purpose, fulfilling the statutory mandate of § 506(f). Note that additional requirements may apply to credit counseling organizations seeking recognition of exempt status under § 501(c)(4). See § 501(q). Now that Form 1024-A is finalized, § 501(c)(4) organizations no longer will use Form 1024 (which is used by other types of § 501(c) organizations *except* § 501(c)(3) organizations to apply for a determination letter recognizing their exempt status.

B. Charitable Giving

X. TAX PROCEDURE

A. Interest, Penalties and Prosecutions

B. Discovery: Summons and FOIA

C. Litigation Costs

1. After the monks lose their patience, a good deed by the IRS gets punished; however, the monks and their blood-sucking attorneys get no award of administrative or litigation costs under § 7430 due to the IRS's concession. Friends of the Benedictines in the Holy Land, Inc. v. Commissioner, 150 T.C. No. 5 (02/21/18). As required by § 508, the taxpayer applied for tax-exempt status under § 501(c)(3) by filing a Form 1023 (Application for Recognition of Exemption) on July 2, 2012. After receiving no response from the IRS (other than a perfunctory acknowledgment letter) for over a year, the taxpayer filed a declaratory judgment action in Tax Court on September 20, 2013, as allowed by § 7428. Generally, § 7428 allows such declaratory judgment actions if the IRS does not issue a determination letter within 270 days from the date the organization files a properly-completed Form 1023. On September 22, 2013, two days after the taxpayer filed the § 7428 declaratory judgment action, the IRS issued a determination letter granting § 501(c)(3) status to the taxpayer retroactive to March 14, 2012. Next, on October 1, 2013, IRS counsel contacted the taxpayer's counsel about filing a motion to dismiss the pending declaratory judgment action in Tax Court; however, the taxpayer's counsel preferred to resolve the litigation by preparing a joint decision and stipulation to which the IRS would agree and the Tax Court would adopt. *(Perhaps taxpayer's counsel was laying a trap?)* Over the next month and one-half, IRS counsel and the taxpayer's counsel crafted a joint decision and stipulation stating that the taxpayer was indeed tax-exempt under § 501(c)(3). The Tax Court adopted and entered the joint decision and stipulation on December 31, 2013. Then *(perhaps closing the trap?)* on January 30, 2014, the taxpayer filed a motion for an award of reasonable administrative and litigation costs under § 7430. Generally, § 7430 permits taxpayers to recover reasonable administrative and litigation costs incurred in any administrative or court proceeding brought by or against the United States with respect to the "determination, collection, or refund of any tax, interest, or penalty" under the Code, including declaratory judgment actions filed under § 7428. To recover under § 7430, the taxpayer must establish that (1) it is the prevailing party, (2) it did not unreasonably protract the proceedings, (3) the amount of the costs requested is reasonable, and (4) it exhausted the administrative remedies available. Regardless, if the position of the United States in the administrative or court proceeding is "substantially justified," the taxpayer is not entitled to an award of costs under § 7430.

The taxpayer's and the IRS's arguments. Taxpayer's counsel originally had agreed to assist the taxpayer with the filing of the Form 1023 on a pro bono basis. Nevertheless, citing the determination letter as well as the joint decision and stipulation, the taxpayer's counsel argued (1) that it was the "prevailing party" in both the administrative proceedings and the § 7428 declaratory judgment action and (2) that it thus should be awarded administrative and litigation costs totaling $69,000. *(Assuming the best, perhaps taxpayer's counsel was going to donate the $69,000 to the taxpayer?)* The IRS countered that, although the taxpayer did not unreasonably protract the proceedings or fail to exhaust administrative remedies, the taxpayer was not the "prevailing party" and the asserted costs were unreasonable.

The Tax Court's analysis. The Tax Court (Judge Wells) initially noted with respect to the taxpayer's arguments and the IRS's response that § 7430 requires a bifurcated analysis whereby an award of administrative costs is determined separately from an award of litigation costs. The taxpayer had asserted that its administrative costs were roughly $8,500 and that its litigation costs were roughly $60,500. The IRS first argued that no administrative costs should be awarded under § 7430 because a request for a § 501(c)(3) determination letter is tantamount to a request for a private letter ruling, and the regulations under § 7430 provide an exception to the recovery of administrative costs in connection with a request for a private letter ruling or "similar determination." *See* Reg. § 301.7430-3(a). Judge Wells ruled with respect to this initial argument by the IRS that because an organization is required by § 508 to seek a determination letter in order to be classified as exempt under § 501(c)(3), the exception in the regulations for private letter rulings or "similar determinations" did not apply. Next, with respect to the IRS's argument that the taxpayer was not the "prevailing party" for administrative purposes under § 7430, the IRS asserted that its issuance of the determination letter on September 22, 2013, granting the taxpayer's exempt status under § 501(c)(3) meant the taxpayer did not "prevail" over any contrary position asserted by the IRS. Judge Wells ruled that the Tax Court did not need to decide whether the issuance of a determination letter meant the taxpayer "prevailed" administratively because the taxpayer had not adequately proven its administrative costs, but rather only litigation costs. Finally, with respect to litigation costs, the IRS argued that no award should be granted under § 7430 because the IRS's position in the declaratory judgment action, albeit a complete concession, was substantially justified. With respect to this argument by the IRS, Judge Wells determined that a complete concession by the IRS was reasonable under the circumstances and therefore the IRS's position was substantially justified. Accordingly, Judge Wells held that the taxpayer was not a prevailing party within the meaning of § 7430 and was not entitled to an award of litigation costs either.

- Although Judge Wells awarded neither administrative nor litigation costs, his opinion notes that the Tax Court was sympathetic to the taxpayer's plight, stating:

> Petitioner waited well over 14 months after it applied, and even then the IRS declined to give petitioner any assurance that a ruling would be forthcoming. We cannot criticize petitioner for then filing a petition; and the IRS' almost immediate issuance of a determination and concession indicates that petitioner should not have been put to the trouble and expense of doing so.

D. StatutoryNotice of Deficiency

E. Statute of Limitations

1. "'When *I* use a word,' Humpty Dumpty said in rather a scornful tone, 'it means just what I choose it to mean—neither more nor less.'" And when Congress says that a six-year limitations period on assessment applies when a taxpayer omits income from specified foreign financial assets "with respect to which information is required to be reported under section 6038D," it means just that. Rafizadeh v. Commissioner, 150 T.C. No. 1 (1/2/18). The taxpayer did not report income earned on a foreign financial account with respect to the years 2006 through 2009. The IRS issued a notice of deficiency with respect to these years on December 8, 2014, after the expiration of the normal three-year limitations period on assessment specified by § 6501(a). The IRS argued that the six-year limitations period on assessment set forth in § 6501(e)(1)(A)(ii) applied. Section 6501(e)(1)(A)(ii) provides that the limitations period is six years from the date the return is filed if two conditions are met: (1) the taxpayer omits an amount properly includible in gross income that "is attributable to one or more assets with respect to which information is required to be reported under section 6038D … ," and (2) the amount omitted exceeds $5,000. Section 6038D requires an individual who holds an interest in a "specified foreign financial asset" to report on the individual's income tax return certain information if the aggregate value of all the individual's specified foreign financial assets exceeds $50,000. (This $50,000 threshold does not apply in determining whether the six-year limitations period of § 6501(e)(1)(A)(ii) applies.) The reporting requirement of § 6038D, which was added to the Code by the Hiring Incentives to Restore Employment Act of 2010 (HIRE Act), Pub. L. No. 111-147, applies to taxable years beginning after March 18, 2010. Because all of the taxable years involved began before March 18, 2010, the taxpayer was not required by § 6038D to report the foreign accounts in question. The Tax Court (Judge Pugh) held in favor of the taxpayer. The court focused on the language of § 6501(e)(1)(A)(ii), which refers to omitted income that "is attributable to one or more assets with respect to which information is required to be reported under section 6038D." This statutory language, the court noted, refers not just to assets specified in § 6038D, but to assets with respect to which § 6038D requires reporting. The court concluded that "the most natural reading of this phrase is that the six-year statute of limitations applies only when there is a section 6038D reporting requirement (or would be barring an exception that is to be disregarded)." In reaching this conclusion, the court rejected the IRS's arguments to the contrary, which appear to be based on the effective date of § 6501(e)(1)(A)(ii). Section 6501(e)(1)(A)(ii), also added to the Code by the HIRE Act, applies to returns filed after March 18, 2010, and also to returns filed before that date if the limitations period on assessment was open on March 18, 2010, which the taxpayer conceded (for purposes of his motion for summary judgment) was true. Because the normal three-year limitations period on assessment had expired before the IRS issued the notice of deficiency, and because the six-year limitations period of § 6501(e)(1)(A)(ii) did not apply, the court granted summary judgment in favor of the taxpayer.

F. <u>Liens and Collections</u>

1. Does the date on the notice or the date on the envelope control when the period for responding begins to run? Weiss v. Commissioner, 147 T.C. 179 (8/17/16). In this collection due process case the taxpayer sought review of the IRS's determination to uphold a notice of intent to levy. Before the IRS may levy against a taxpayer's property, it must provide written notice of the proposed levy and inform the taxpayer of his right to a CDP hearing. Section 6330(a)(2) requires that a levy notice must be sent or delivered to the taxpayer "not less than 30 days before the day of the first levy," and § 6330(a)(3)(B) requires the notice to inform the taxpayer in simple and nontechnical terms of his right "to request a hearing during the 30-day period" specified in § 6330(a)(2). An IRS Revenue Officer attempted to deliver to the taxpayer in person a Final Notice of Intent to Levy, but was deterred by a dog blocking the driveway. The Revenue Officer chose instead to mail the notice by certified mail two days later without generating a new notice. The taxpayer argued that the period of limitations on collection of these liabilities expired in July 2009 based on the contention that he intentionally filed his request for a CDP hearing one day late, and thus was entitled only to an "equivalent hearing" rather than to the CDP hearing that the IRS afforded him. If the taxpayer's contentions were correct, the period of limitations on collection would not have been suspended during the CDP process, and his tax liabilities would appear to have been uncollectible. The Tax Court (Judge Lauber) held that when the date appearing on a levy notice is earlier than the date of mailing, the 30-day period prescribed by § 6330(a)(2) and (3)(B) is calculated by reference to the date of mailing. The statutory directive that levy and lien notices should be drafted "in simple and nontechnical terms" does not require invalidation of a levy notice when there is a mismatch between the letter date and the mailing date. On the facts of the case, the taxpayer's request for a CDP hearing was timely because he mailed his Form 12153 to the IRS, and under §§ 7502 and 7503 it was deemed received by the IRS, within 30 days of the IRS's mailing of the levy notice, even though it was mailed more than 30 days after the date on the notice itself. Accordingly, the period of limitations on collection was suspended pursuant to § 6330(e)(1) when the taxpayer timely requested a CDP hearing.

a. The D.C. Circuit agrees. The take-away: keep the envelope in which the final notice of intent to levy is mailed! Weiss v. Commissioner, 121 A.F.T.R.2d ¶ 2018-783 (D.C. Cir. 5/22/18). In a per curiam, unpublished opinion, the U.S. Court of Appeals for the D.C. Circuit has affirmed the Tax Court's decision. According to the court, when the date appearing on a levy notice is earlier than the date of mailing, the 30-day period prescribed by § 6330(a)(2) and (3)(B) for requesting a collection due process hearing is calculated by reference to the date of mailing. Although the taxpayer mailed his request for a CDP hearing more than 30 days after the date of the notice of levy, he mailed it within 30 days of the date on which the IRS mailed the notice. (The court's opinion notes that the taxpayer's wife opened the IRS notice and discarded the envelope, so that the taxpayer apparently was not aware of the later date of mailing.) Because his request for a CDP hearing was timely, it had the effect of suspending the running of the ten-year limitations period on collection, and therefore the IRS could exercise its collection powers. The court expressed its dissatisfaction with its ruling as follows:

> Nonetheless, in spite of the unappealing proposition that we must side either with a taxpayer deliberately attempting to manipulate the Code to prevent paying his own

> taxes or a government agency that seems not to care whether it provides the citizenry with notice of their rights and liabilities, we must decide whether the date on the notice or the date of mailing governs. The taxpayer's position has the advantage of common sense. But the government's position has the insurmountable advantage of compliance with the language of the statute.

2. Economic hardship relief from a levy is not available to a corporate taxpayer. Lindsay Manor Nursing Home, Inc. v. Commissioner, 148 T.C. No. 9 (3/23/17). The taxpayer, a corporation that operated a nursing home in rural Oklahoma, failed to pay its federal withholding and employment taxes for the fourth quarter of 2013. In response to the IRS's final notice of intent to levy, the taxpayer requested a CDP hearing and submitted a letter to the IRS settlement officer challenging the appropriateness of the levy on the grounds of economic hardship. The taxpayer argued that it was operating at a loss and could not "survive or provide essential care services to its patients if the IRS is able to file a levy against every available source of income." The IRS settlement officer declined to consider the economic hardship argument because, under the relevant regulation, Reg. § 301.6343-1(b)(4)(i), relief is available only on account of economic hardship of an individual taxpayer. The regulation provides that the IRS must release a levy if one of several conditions is satisfied, including the following:

> The levy is creating an economic hardship due to the financial condition of an individual taxpayer. This condition applies if satisfaction of the levy in whole or in part will cause an individual taxpayer to be unable to pay his or her reasonable basic living expenses.

The IRS settlement officer issued a notice of determination upholding the collection action. The taxpayer filed a petition in the Tax Court and moved for summary judgment on the grounds that the regulation's limitation of economic hardship relief to individuals is contrary to the statute (§ 6343(a)(1)(D)) and therefore invalid and that the settlement officer had abused her discretion by failing to consider its request for economic hardship relief. The Tax Court (Judge Paris) upheld the validity of the regulation and concluded that the settlement officer had not abused her discretion. The court assessed the validity of the regulation by applying the two-step analysis of *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). The court concluded in *Chevron* step one that the statute, § 6343(a)(1)(D), is ambiguous, and in step two that Reg. § 301.6343-1(b)(4)(i) is a permissible construction of the statute. In its analysis of *Chevron* step one, the court examined not only the plain language of the statute but also its legislative history. (The U.S. Supreme Court's decision in *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120 (2000), suggests that courts should consider legislative history in connection with *Chevron* step one rather than step two, but there is some uncertainty on this point. The Tax Court previously has noted this ambiguity. *Square D Co. v. Commissioner*, 118 T.C. 299, 310 & n.6 (2002), *aff'd*, 438 F.3d 739 (7th Cir. 2006).) Accordingly, the court denied the taxpayer's motion for summary judgment.

- Although the court concluded that economic hardship relief from a levy is not available to a corporate taxpayer, it noted that taxpayers other than individuals are entitled to the protection of § 6330(c)(3)(C), which requires an appeals officer conducting a CDP hearing to consider "whether any proposed collection action balances the need for the efficient collection of taxes with the legitimate concern of the person that any collection action be no more intrusive than necessary." The court stated:

> This conclusion [regarding the lack of economic hardship relief under § 6343(a)(1)(D)], however, does not foreclose nonindividual taxpayers from relief in circumstances where the proposed collection action, if sustained, could result in some form of economic difficulty. These economic realities and consequences of the Commissioner's proposed collection action are properly considered for all taxpayers as part of the intrusiveness analysis within the section 6330(c)(3)(C) balancing test—namely whether the intrusiveness caused by sustaining the proposed collection action outweighs the Government's need for the efficient collection of taxes.

a. With economic hardship relief out of the way, the government succeeds in its quest to levy. Lindsay Manor Nursing Home, Inc. v. Commissioner, T.C. Memo. 2017-50 (3/23/17). In a separate, memorandum opinion, Judge Paris addressed the taxpayer's remaining grounds for its motion for summary judgment and the government's motion for summary judgment. The court rejected the taxpayer's arguments that the IRS settlement officer (1) abused her discretion in rejecting the taxpayer's request for an installment agreement, (2) failed adequately to consider whether the proposed collection action balances the need for the efficient collection of taxes with the taxpayer's legitimate concern that the collection action be no more intrusive than necessary, as required by § 6330(c)(3)(C), and (3) was not impartial. The court denied the taxpayer's motion for summary judgment and granted the government's motion.

b. Vacated as moot. Well, at least we know what the Tax Court thinks about the issue. Linday Manor Nursing Home, Inc. v. Commissioner, 121 A.F.T.R.2d 2018-1164 (10th Cir. 3/27/18). The taxpayer in this case requested economic hardship relief from a levy on the ground that the levy would leave it unable to care for its patients. During the course of this litigation, however, the taxpayer ceased operating nursing homes. Accordingly, the U.S. Court of Appeals for the Tenth Circuit dismissed the taxpayers' appeal as moot and vacated the Tax Court's decision.

3. Assuming without deciding that the 30-day period for requesting a CDP hearing is subject to equitable tolling, this taxpayer failed to establish circumstances that would justify doing so, says the Fourth Circuit. Cunningham v. Commissioner, 716 Fed. Appx. 182 (4th Cir. 1/18/18), *aff'g* Cunningham v. Commissioner, No. 14090-16 L (U.S. Tax Court (12/7/16)). The IRS issued a final notice of intent to levy, in response to which the taxpayer requested a collection due process hearing. Following the CDP hearing, the IRS issued a notice of determination upholding the proposed collection action. The notice of determination advised the taxpayer that, if she wished to contest the determination in the Tax Court, she must do so within the 30-day period (prescribed by § 6330(d)(1)), and that the 30-day period began to run on the day after the date of the letter. The letter was dated May 16, 2016. The taxpayer mailed her petition to the Tax Court on June 16, 2016, which was 31 days after the date of the letter. The Tax Court granted the IRS's motion to dismiss for lack of subject matter jurisdiction. On appeal, the taxpayer argued that the 30-day period for seeking review in the Tax Court was subject equitable tolling. In an unpublished opinion by Judge Diaz, the U.S. Court of Appeals for the Fourth Circuit affirmed the Tax Court's decision. According to the Fourth Circuit, the taxpayer had to clear three hurdles in order for equitable tolling to apply: (1) the 30-day period specified by § 6330(d)(1) must be a mandatory claim-processing rule rather than a jurisdictional rule, (2) equitable tolling must be available for untimely actions under the statute, and (3) the circumstances must warrant equitable tolling. In connection with the second "hurdle," the court noted that "it is uncertain whether the presumption [established by *Irwin v. Department of Veterans Affairs*, 498 U.S. 89 (1990), that equitable tolling is available to litigants] applies at all outside the context of Article III courts." But the court rested its decision on the third condition. In the court's view, circumstances warranting equitable tolling were "wholly absent here." The taxpayer argued that she had been misled by the notice of determination, which caused her to believe that the day after the letter's date was day zero, the following day was day one etc. The court rejected this interpretation as contrary not only to Tax Court Rule 25(a), but also to the plain language of the letter and common sense. Equitable tolling, the court emphasized, is available only in rare instances in which it would be unconscionable to enforce a limitations period due to circumstances other than the party's own conduct. In this case, the court stated, the error resulted from the taxpayer's own mistake.

- In *Guralnik v. Commissioner*, 146 T.C. 230 (6/2/16), the Tax Court previously had held that the 30-day period specified in § 6330(d)(1) for seeking review in the Tax Court of an IRS notice of determination following a CDP hearing is jurisdictional and not subject to equitable tolling.

G. Innocent Spouse

H. Miscellaneous

1. Planning to travel overseas? You might need to cancel that vacation if you are seriously delinquent on your taxes. The Fixing America's Surface Transportation (FAST) Act, § 32101, Pub. L. No. 114-94, signed by the President on 12/4/15, adds new Code § 7345, which provides that having a "seriously delinquent tax debt" is grounds for denial, revocation, or limitation of a passport. A "seriously delinquent tax debt" is generally defined as an unpaid, legally enforceable federal tax liability of an individual that has been assessed and exceeds $50,000 (to be adjusted in future years for inflation) for which a notice of lien has been filed in public records pursuant to § 6323 or a notice of levy has been filed pursuant to § 6331. Debts that are being paid on a timely basis pursuant to an installment agreement or an offer in compromise are excluded from the category of seriously delinquent tax debts, as are debts with respect to which collection is suspended because a collection due process hearing or innocent spouse relief has been requested or is pending. The IRS will certify to the Secretary of the Treasury that an individual has a seriously delinquent tax debt, and Treasury will transmit the certifications to the Secretary of State for action. The IRS must contemporaneously notify the taxpayer of the certification. The taxpayer is permitted to challenge the certification as erroneous by bringing an action in a United States District Court or the Tax Court. The new provision is effective on the date of enactment, December 4, 2015.

a. The IRS prepares to implement passport denial and revocation procedures. On June 2, 2017 the IRS updated its website with information about upcoming implementation procedures for Code § 7345, added by the FAST Act, which provides that having a "seriously delinquent tax debt" is grounds for denial, revocation, or limitation of a passport: https://perma.cc/YBB2-H73Y. The IRS also added a generic paragraph about passport revocation to its Notice of Intent to Levy, both CP 90 and CP 504 (the CDP and non-CDP notices, respectively). On June 7 and June 14, the National Taxpayer Advocate (NTA) published blog posts in which she criticized the IRS's approach. See https://perma.cc/6GSE-GSHQ and https://perma.cc/3DFP-HCRQ. More formal guidance should be forthcoming, but practitioners should review the IRS website and the NTA's blog posts so affected clients can be alerted. Under the IRS's planned approach, the IRS will certify taxpayers with a "seriously delinquent debt" to the State Department automatically when certain criteria are met and the total amount owed passes $50,000. Taxpayers will not receive a warning letter immediately prior to certification. For many taxpayers the Notice of Intent to Levy will arrive long before a passport certification, perhaps years before. Once certification has happened, the taxpayer cannot get it reversed by simply paying down the balance to under the threshold.[2]

b. The IRS has explained what you need to do to take that overseas trip if you have a seriously delinquent tax debt. Notice 2018-1, 2018-3 I.R.B. 299 (1/12/18). This notice provides information about the implementation of Code § 7345. The notice provides detailed background information on § 7345 and provides guidance to taxpayers on when the IRS will notify the State Department of a seriously delinquent tax debt and steps that can be taken to have a certification reversed. The notice provides that the State Department will not be notified that a taxpayer has a seriously delinquent tax debt if one of the exceptions listed in § 7345(b)(2) applies. Therefore, the State Department will not be notified if the debt (1) is being timely paid pursuant to an installment agreement, (2) is being timely paid under an offer in compromise accepted by the IRS, (3) is being timely paid under the terms of a settlement agreement with the Department of Justice, (4) has collection action suspended because of a request for a due process hearing (or because such a request is pending), or (5) has collection action suspended because the individual made an innocent spouse election (§ 6015(b) or (c)) or the individual requested innocent spouse relief (§ 6015(f)). If the IRS has notified the State Department that an individual has a seriously delinquent tax debt, the IRS will notify the State Department (in accordance with § 7345(c)) that the certification has been reversed if the IRS determines that the tax debt should not have been certified (for example, because one of the exceptions just listed applies or a circumstance set forth in the Internal Revenue Manual applies). Once the State Department receives notification that the certification has been reversed, it is required to remove the certification from the individual's record. Therefore, the notice suggests,

> taxpayers notified that certification of their seriously delinquent tax debt has been transmitted to the State Department should consider paying the tax owed in full, or entering into an installment agreement under section 6159 or an offer in compromise under section 7122 with respect to the debt.

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[2] We thank Christine Speidel, Director of the Federal Tax Clinic at Villanova University School of Law, for alerting us to this development and for writing the summary of it.

The notice provides that, when a taxpayer who has been certified as having a seriously delinquent tax debt applies for a passport, the State Department will provide the applicant with 90 days to resolve their tax delinquency before denying the application. The notice advises that, if a taxpayer needs a passport to travel within those 90 days, the taxpayer must contact the IRS and resolve the matter within 45 days from the date of the passport application so that the IRS has adequate time to notify the State Department. Ways of resolving the matter include making full payment, entering into an installment agreement, or having the IRS accept an offer in compromise. Finally, the notice reminds taxpayers that the sole remedy for a taxpayer who believes that a certification is erroneous (or that the IRS has incorrectly failed to reverse a certification) is to bring an action in a United States District Court or in the Tax Court. Nevertheless, the notice suggests, "the taxpayer may contact the phone number in the Notice CP508C to request reversal of the certification if the taxpayer believes that the certification is erroneous."

- The IRS began sending certifications of unpaid tax debt to the State Department in February 2018.

2. Whistleblowers benefit under the Bipartisan Budget Act of 2018, including those whistling to the SEC, CFTC, and SSA. The Bipartisan Budget Act of 2018, §§ 41107 and 41108, make changes that benefit IRS whistleblowers as well as whistleblowers to the Securities and Exchange Commission ("SEC"), the Commodity Futures Trading Commission ("CFTC"), and to the Social Security Administration ("SSA") pursuant to qualifying state false claims acts. Section 41107 amends § 62(a)(21) to permit not only IRS whistleblowers, but also SEC, CFTC, and SSA whistleblowers who receive an award, to deduct their attorneys' fees in determining adjusted gross income. Previously, § 62(a)(21) allowed an above-the-line deduction for attorneys' fees paid or incurred in connection with only an IRS (not other government agencies) whistleblower award. Further, § 41108 of the Bipartisan Budget Act amends Code § 7623 (governing IRS whistleblower awards) to expand the definition of the "proceeds" that count toward the $2 million threshold to be eligible for an IRS whistleblower award. Previously, eligible proceeds to determine qualification for an IRS whistleblower award under § 7623 included only "penalties, interest, additions to tax, and additional amounts provided under the internal revenue laws." As amended, however, revised § 7623 expands the definition of eligible proceeds to include the foregoing as well as "any proceeds arising from laws for which the Internal Revenue Service is authorized to administer, enforce, or investigate, including criminal fines and civil forfeitures, and violations of reporting requirements." The amendment made to § 62(a)(21) is effective for taxable years beginning after December 31, 2017. The amendment made to § 7623 applies to "information provided before, on, or after the date of enactment [February 9, 2018] with respect to which a final determination for an award has not been made before such date of enactment [February 9, 2018]."

- The expanded § 7623 definition of eligible proceeds presumably is meant to avoid controversies like the one that arose in *Whistleblower 21276-13W v. Commissioner*, 147 T.C. No. 4 (8/3/16). Following the Tax Court's prior order that the parties attempt to resolve their differences (144 T.C. 290 (6/2/15)), the IRS and the petitioners, a married couple, agreed that the petitioners were eligible for a whistleblower award of 24 percent of the collected proceeds (i.e., the proceeds eligible for an award), but disagreed as to the amount of the collected proceeds. The targeted taxpayer paid to the government approximately $74 million, which consisted of tax restitution ($20 million), a criminal fine ($22 million), and civil forfeitures representing fees received from U.S. clients ($32 million). The parties agreed that the tax restitution payment constituted collected proceeds, but disagreed as to whether payments of the criminal fine and civil forfeitures constituted collected proceeds. Section 7623(b)(1) provides that a whistleblower award is:

> at least 15 percent but not more than 30 percent of the collected proceeds (including penalties, interest, additions to tax, and additional amounts) resulting from the action (including any related actions) or from any settlement in response to such action.

The IRS argued that the plain language of § 7623 dictates that only proceeds assessed and collected under a provision of title 26 may be used to determine the amount of a whistleblower award because § 7623 relates solely to violations of federal tax laws, and therefore criminal fines and civil forfeitures (which are not assessed under title 26) are not "collected proceeds" within the meaning of

§ 7623(b)(1). The IRS also argued that, if forfeitures could be used for payment of the whistleblower award, an irreconcilable conflict would be created between the whistleblower statute in title 26 and the provisions of title 42 regarding criminal fines and those of title 31 regarding civil forfeitures that specify the purposes for which moneys collected in this case under title 18 may be used. In a very thorough opinion, the Tax Court (Judge Jacobs) held that § 7623(b)(1), which "is straightforward and written in expansive terms," does not limit "collected proceeds" to amounts assessed and collected under title 26. The court similarly rejected the IRS's second argument, which the court characterized as arising "from a fundamental misinterpretation of the plain language of the statute." According to the court, § 7623(b)(1) "does not refer to, or require, the availability of funds to be used in making an award."

XI. WITHHOLDING AND EXCISE TAXES

XII. TAX LEGISLATION

XIII. TRUSTS, ESTATES & GIFTS

RETHINKING "PUBLIC USE": RECENT CASES AND EMERGING TRENDS CONCERNING EXCLUSIVITY FOR PUBLIC PROPERTY TAX EXEMPTIONS

***By Daniel R. Smith, Esq. and Andrew Albright, Esq*.**[1]

It is commonly understood that public property is not taxable. Generally, property owned by a public entity and used for public purposes will be exempt from ad valorem taxation. That is why public schools, universities, parks, and roads, for example, can be operated and managed without the tax burden shouldered by private property owners. Whether certain property qualifies for a public property exemption may seem obvious. Property owners, appraisal districts, and courts, however, have struggled for decades when applying Texas law, especially as to whether the property must be *exclusively* used for public purposes. Published opinions have yielded mixed and inconsistent results, though recent cases are clarifying governing standards.

A. Origin of Public Property Exemption

The Texas Constitution makes clear that all property in the state, "unless exempt as required by or permitted by this Constitution," shall be taxed in proportion to its value.[2] In other words, property tax exemptions must originate in the constitution. The constitution provides two separate and distinct sources for public property exemptions.

The first source, Article 11, Section 9, states:

> The property of counties, cities and towns, owned and held only for public purposes, such as public buildings and the sites therefor, fire engines and the furniture thereof, and all property used, or intended for extinguishing fires, public grounds and all other property devoted exclusively to the use and benefit of the public shall be exempt from forced sale and from taxation, provided, nothing herein shall prevent the enforcement of the vendors lien, the mechanics or builders lien, or other liens now existing. [3]

There is no doubt that this provision requires exclusive public use in order for its public property exemption to apply. The drafters removed any uncertainty by expressly including the terms "exclusively" and "only for public purposes" in its language.

The second source, Article 8, Section 2(a), provides, in pertinent part, that "the legislature may, by general laws, exempt from taxation public property used for public purposes."[4] Unlike its counterpart, the language of this provision does not expressly require use only and exclusively for public purposes. Moreover, this language does not create a property exemption. It simply allows the legislature to create

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[2] TEX. CONST. art. 8, §1(b).
[3] *Id.* art. 11, §9.
[4] *Id.* art. 8, §2(a).

an exemption by statute. This statutory exemption, found in Section 11.11(a) of the Texas Tax Code, is the exemption that has puzzled courts.[5]

B. Confusing the Exemptions

Keeping these two exemptions straight has been a challenge. Opinions from Texas courts of appeals demonstrate the confusion set upon the judiciary when interpreting the concept of public use. This has resulted in misapplication of controlling standards and misinterpreting the reach of certain decisions.

For instance, in the 1980s, the Grand Prairie Hospital Authority was denied a public property exemption on medical office space in two separate cases, commonly referred to as the *Grand Prairie Hospital Authority* decisions.[6] The Hospital Authority, a public entity, had leased this space to private physicians for their own commercial purposes. Both the Fort Worth Court of Appeals and the Dallas Court of Appeals affirmed the denial of the Hospital Authority's exemption because the office was not being "exclusively used" for a public purpose.

These courts were analyzing statutory exemptions, particularly the one found in Section 11.11(a) of the Texas Tax Code. They confused their analysis, however, by looking to the self-executing constitutional exemption found in Article 11, Section 9 of the Texas Constitution for guidance, which expressly requires exclusive public use. They further relied upon opinions interpreting this constitutional exemption, particularly the Supreme Court of Texas's decision in *Satterlee v. Gulf Coast Waste Disposal Authority*.[7] The particular holding in *Satterlee*, however, does not concern the public use requirement for the *statutory* exemption. *Satterlee*, moreover, does not establish a broad-sweeping exclusivity requirement for all public property tax exemption cases, nor does it intend to.

In 2013, the Amarillo Court of Appeals in *Texas Student Housing Authority v. Brazos County Appraisal District* chose to follow the precedent set by its *Grand Prairie Housing Authority* "sister courts."[8] The court of appeals refused to apply the public property exemption found in Section 11.11(a) of the Texas Tax Code to student housing facilities associated with Texas A&M University. This is because these facilities provided room and board to teenagers attending hockey and cheerleading camps during the summer months, which the court believed did not qualify as exclusive public use. Interestingly, the court of appeals acknowledged the distinction between the two exemptions. Nevertheless, it chose to follow the *Grand Prairie Hospital Authority* decisions because the Supreme Court of Texas has yet to overturn them. It explained that "both cases rely on *Satterlee*" and that the effect of doing so "is to imprint upon section 11.11(a) an exclusivity element."[9]

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[5] *See* Tex. Tax Code §11.11(a).
[6] *Grand Prairie Hosp. Auth. v. Tarrant Appraisal Dist.*, 707 S.W.2d 281 (Tex. App.—Fort Worth 1986, writ ref'd n.r.e.); *Grand Prairie Hosp. Auth. v. Dallas County Appraisal Dist.*, 730 S.W.2d 849 (Tex. App.—Dallas 1987, writ ref'd n.r.e.).
[7] 576 S.W.2d 773 (Tex. 1978).
[8] 440 S.W.3d 779 (Tex. App.—Amarillo 2013), *rev'd on other grounds*, 460 S.W.3d 137 (Tex. 2015).
[9] 440 S.W.3d at 794-95.

C. A Path to Clarifying Standards

Recent opinions show that courts are beginning to recognize, or at least hint that they might recognize, that the public use component of the two exemptions are different and are to be interpreted differently. They clarify that merely leasing public property to a private entity will not necessarily destroy the property's exempt status. Importantly, these decisions reflect a trend toward liberally interpreting the concept of public use to encourage private involvement in managing and promoting public recreation areas.

In *Lower Colorado River Authority v. Burnet Central Appraisal District*, the appraisal district revoked the public property exemption claimed by the Lower Colorado River Authority (LCRA) on its Sunset Point RV Park property.[10] LCRA, a special water control district, had historically operated and managed the park itself. It later contracted with a private company to operate and manage the park through a lease agreement. The private company profited from the lease, but was restricted to operating the premises as a public commercial recreation facility and public park.

Citing the *Grand Prairie Hospital Authority* decisions, the appraisal district contended that the park was not tax exempt because it was being leased to a private party for private commercial purposes. The Austin Court of Appeals rejected this argument. Even though the private company might enjoy a profit, the company was operating the property for a public purpose, namely the operation of a public park. This is the same underlying purpose for which the LCRA itself was operating the park. Accordingly, there was public use sufficient for a public property exemption, which use just happened to be exclusive. Passing on the *Grand Prairie Hospital Authority* decisions, the court noted, "We leave for another day whether we agree with the construction and interpretation of the constitutional provisions outlined in these opinions."[11]

In 2018, the Fort Worth Court of Appeals issued *Tarrant Appraisal District v. Tarrant Regional Waiter District*.[12] Tarrant Regional Water District (TRWD) owned land along the Trinity River that it planned to develop into a public recreation area. TRWD leased part of the land to a private company that would operate a restaurant on the premises for profit. The lease limited the permitted uses of the property to "restaurant (eat-in and take-out) with alcohol sales, recreational activities and entertainment, including live music to the extent permitted by applicable municipal ordinances."[13]

Citing the *Grand Prairie Hospital Authority* decisions, the appraisal district argued that the property was no longer tax-exempt because it was leased to a private company for private commercial purposes. The court of appeals rejected this position. It emphasized that neither Section 11.11(a) of the Texas Tax Code nor Article 8, Section 2(a) of the Texas Constitution makes any mention of "exclusive" public use, unlike the language in Article 11, Section 9 of the Texas Constitution. Furthermore, the court of appeals expressly overruled its holding in its *Grand Prairie Housing Authority* decision. "TRWD has no obligation to prove that the Property was devoted exclusively to the use and benefit of the public," the court of appeals wrote.

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[10] *Lower Colorado River Auth. v. Burnet Cent. Appraisal Dist.*, 497 S.W.3d 117 (Tex.App.—Austin 2016, pet. denied).
[11] *Id.* at 121 n. 2.
[12] 2018 WL 1865918 (Tex. App.—Fort Worth, Apr. 19, 2018)(on reh'g)
[13] *Id.* at *2.

"So long as the Property is 'used for public purposes,' TRWD is entitled to an exemption under tax code section 11.11(a)."[14]

Recognizing that whether property is used for public purposes is a highly fact-specific question, the court of appeals agreed that the requirement had been met. The evidence showed that the property was leased to the restaurant in connection with TRWD's optimistic plan to develop the property for economic and recreational purposes. It further showed that the property is used primarily for the comfort and welfare of the public, and that the restaurant's lease payments would go into a public fund where they would be used for public purposes. Accordingly, the property is used for public purposes as a matter of law.[15]

D. Conclusion

Although the confusion over whether Section 11.11(a) of the Texas Tax Code requires exclusive public use may not be completely resolved, *LCRA* and *Tarrant Regional Water District* go a long way in clearing up misconceptions about governing standards. These cases have severely weakened any precedential value of the *Grand Prairie Hospital Authority* decisions and *Satterlee* in interpreting the statutory public property exemption. The Supreme Court of Texas, though, has not weighed in on the issue. We will see if it will follow the trend set by these recent cases in clarifying and liberalizing governing standards.

[14] *Id.* at *7.

[15] *City of San Antonio v. Bastrop Central Appraisal District* provides a good counter-example of public property not being used for a public purpose, and thus not tax-exempt. The City of San Antonio acquired lands in Bastrop County for the purpose of extracting lignite to use in electricity generation for the benefit of San Antonio residents, but the city later leased the land to Alcoa, Inc., a privately-owned company, "for the exclusive use and benefit of Alcoa." The Austin Court of Appeals held that the city was not entitled to an exemption as the property was no longer used for public purposes. 275 S.W.3d 919 (Tex. App.-Austin 2009, pet. dism'd).

Would it be Wayfair to Kill Quill? The U.S. Supreme Court Reconsiders State Sales Tax Nexus Law in Summer 2018

By Jimmy Martens & Claire Galley with Martens, Todd, Leonard & Ahlrich

This summer, it's anticipated that the U.S. Supreme Court may uphold a South Dakota statute requiring out-of-state companies to comply with the state's sales tax collection and remitting laws when certain economic thresholds are met. In doing so, the Court may overrule, distinguish, or substantially limit its 1992 decision holding that only sellers with a physical presence within a state are within reach of that state's sales taxing authority. If the Court does depart from its longstanding, bright-line physical presence rule, it will spell major changes both for national online sellers and state economies, as billions of revenue dollars become accessible to state tax collectors and lawmakers scramble to implement a workable scheme for tax regulation in this context.

Quill Corp. v. North Dakota

In 1992, the U.S. Supreme Court decided *Quill Corp. v. North Dakota*, which struck down the North Dakota Supreme Court's decision holding that the mail-order office supplier was required to collect and remit North Dakota use tax on its sales to roughly 3,000 customers within North Dakota. The Court held that a state may only impose tax obligations on a seller that is physically present within its borders. This physical presence includes employees, agents, or independent contractors working in the state, tangible personal property within the state (inventory, vehicles, or rented personal property), or a physical location there (an office, salesroom, distribution center, warehouse, or other place of business). The Court imposed the physical presence requirement to prevent state legislatures from creating unfair burdens on interstate commerce.

The landscape has changed since *Quill*: remote sales have exploded in volume due to the internet. Many argue that now brick-and-mortar, in-state sellers and state coffers are the ones that need protection. In the internet era, and in light of Congress' failed efforts to address the issue, state legislators have chipped away at *Quill* by enacting so-called "Amazon laws," named for the e-commerce giant they first sought to target. These include click-through, notice, affiliate, and economic nexus laws.

Click-Through Nexus

A "click-through nexus" law, like that of New York, requires an out-of-state seller to collect sales tax when the out-of-state seller pays a commission to an in-state company whose website allows customers to "click through" to the out-of-state-seller's website and make purchases there. At least twenty states have enacted this type of statute.

Notice Laws

Notice laws are another type of Amazon law rolled out by states eager to reach and tax online sales dollars. Louisiana, for example, requires out-of-state sellers that do not collect and pay Louisiana use tax to notify their Louisiana customers that their purchases are subject to Louisiana use tax and provide each one with an annual notice containing the total amount the purchaser has paid that seller for property or taxable services in the preceding year. Similarly, the remote seller must file an annual statement for each Louisiana purchaser with the Louisiana Department of Revenue that includes the total amount paid by the purchaser to that seller for property or taxable services in the preceding year.

Affiliate Nexus Laws

Affiliate nexus laws treat the in-state physical presence of a related company as the physical presence of the seller when certain conditions are met. For example, Texas' affiliate nexus applies when:

- The out-of-state seller sells the same or similar product as the related company under the same or similar business name;
- The out-of-state seller uses the related company's Texas facilities or employees to advertise, promote, or facilitate the out-of-state seller's sales;
- The out-of-state seller uses the related company's Texas facilities, or employees are used to perform any activity on the out-of-state seller's behalf intended to establish or maintain a marketplace for the out-of-state seller in Texas, including receiving or exchanging returned merchandise; or
- The related company maintains a distribution center or warehouse and delivers property sold by the out-of-state seller to customers.

Economic Nexus Laws

In 2005, Ohio enacted an "economic nexus statute" in order to gain taxing jurisdiction over out-of-state companies for its commercial activity tax, or "CAT." Ohio's economic nexus statute provides that any seller who makes over $500,000 in sales to Ohio purchasers is subject to Ohio's CAT. Other states have followed suit, drafting similar statutes for their sales tax laws with sales thresholds ranging from $500,000 to no threshold at all. The Ohio Supreme Court upheld Ohio's economic nexus statute in *Crutchfield v. Testa*. Notably, the U.S. Supreme Court refused to review the Ohio high court's decision, thus leaving it intact.

These and other Amazon laws are intended to bolster state use tax law enforcement, and some even provide for expedited and streamlined legal procedures for tax collection.

South Dakota v. Wayfair

Perhaps the most deliberate challenge to *Quill* is that of the South Dakota state legislature, which is now pending before the U.S. Supreme Court in *South Dakota v. Wayfair*. South Dakota's law requires sellers with no physical presence in South Dakota to collect and remit sales tax to the state when the seller either has $100,000 or more in gross revenue from sales to South Dakota residents or has over 200 transactions with South Dakota residents in a given year.

Before the law came into force in May 2017, South Dakota sent compliance notices to the four largest out-of-state sellers that it believed would exceed the threshold and who were not collecting sales taxes. Of those, Wayfair Inc., Overstock.com, Inc., and Newegg Inc. refused to comply. South Dakota filed suit, and the case made its way to the South Dakota Supreme Court, which ruled for the sellers and against the state, citing *Quill*. The state filed a petition for a writ of certiorari, which the U.S. Supreme Court granted. The U.S. Supreme Court announced in January of 2018 that it would hear the case.

On April 17, 2018, the Court heard oral argument in a bristling hearing in which the justices peppered both sides with pointed questions, focusing on practical implications of the impending decision. Specifically, the Court expressed concerns over the accuracy and availability of fact information used to predict the economic repercussions of a decision to limit or overturn *Quill*. The parties' advocates and the justices discussed how the decision may affect small businesses' barriers to market entry, potential double taxation from conflicting state sales tax schemes, the cost to businesses, not just of software upgrades, but of audits as well. The line of questioning also addressed the potential for a chaotic and litigation-filled gap period between the issuance of the Court's opinion and Congressional action in response.

Many express doubt that the Supreme Court will overturn *Quill* in light of the political nature of the questions posed in *South Dakota v. Wayfair*, emphasizing that it is Congress's job to police states' infringement on interstate commerce and to develop a taxing scheme that brings the currently insurmountable task of nation-wide state and local sales tax compliance within reach for online sellers. However, it is also doubtful that the High Court would grant certiorari only to simply punt to Congress without further input or development of the issue.

In the absence of a final decision, online sellers face a dilemma: comply with state laws that are, on their face, unconstitutional at present, or defy those laws and risk the repercussions from state governments. If the Court were to overturn *Quill*, online sellers' exposure from failing to comply with state laws could be nominal or overwhelming, depending on whether states are allowed to, and do in fact apply their laws retrospectively.

The Court's decision in *South Dakota v. Wayfair* is certain to cause ripple effects throughout the tax world. For example, doing away with the physical presence standard may raise issues regarding the calculation of Texas franchise tax obligations for combined entities with out-of-state members. Even if the Court declines to overturn *Quill*, state legislatures that have ignored the physical presence standard may have to enact laws to make up for the potential tax revenue lost. At the very least, the pressure on Congress to resolve this issue should reach its pinnacle. The High Court's decision is expected by the end of the current term, in June.

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About Martens, Todd, Leonard & Ahlrich

Martens, Todd, Leonard & Ahlrich is a trial and appellate law firm headquartered in Austin, Texas, handling only tax cases. The firm specializes in Texas sales tax and Texas franchise tax controversies. The firm's attorneys have handled cases all the way through the Texas Supreme Court and U.S. Supreme Court. The firm's attorneys speak and write frequently on a variety of Texas sales tax and franchise tax topics and have published articles in publications such as the Journal of State Taxation, the Texas Bar Journal, the Texas Lawyer, the Texas Tech Administrative Law Journal, as well as on the firm blog and through LAT Seminars ACPEN webcast offerings. Look for in-depth courses and presentations on the *South Dakota v. Wayfair* case and its implications, available this summer.

For more information, please visit https://texastaxlaw.com/.

BACKDATING, RESCISSION AND REFORMATION

By: William D. Elliott[1]

May 18, 2018

BACKDATING

1. Introduction

A. Backdating is commonly encountered.[2]

(1) Contracts frequently begin and end with the following language:

> THIS STOCK PURCHASE AGREEMENT ("Agreement"), dated effective as of _______, 2018, is made and entered into between _____________, ("Seller"), __________________, ("Buyer"), and _______________., a Texas corporation ("Corporation").
>
> . . . .
>
> IN WITNESS WHEREOF, the Seller, Buyer and Corporation have each signed this Agreement all as of the date first above written.

(a) This language simply illustrates backdating, but backdating is not simple.

(b) The opening paragraph uses "as of" language suggesting an effective date of the agreement. The ending language states that the parties signed the agreement on the effective date – the "as of" date. Is this what happened?

(c) Did all three parties sign the agreement at the same time?

(d) Is the effective "as of" date intended to be the global effective for all purposes or are there contractual provisions that commence in effect on the "as of" date but other provisions start on the date of the agreement?

(e) What is the date of the agreement?

[1] Attorney at law, Elliott, Thomason & Gibson, LLP, Dallas, Texas.
[2] The leading literature on backdating is limited, but those most helpful to this author for this article are the following. The seminal article on backdating is Kwall & Duhl, *Backdating*, 63 Bus. Law. 1143 (2008). Also helpful is Cummings, *Backdating Documents: Wrong or Just Dumb?*, 145 Tax Notes 333 (Oct. 20, 2014).

(f) The agreement is ambiguous on the issue of the date of the agreement.

(g) Also, the language is stilted. "In Witness Whereof"

(2) Backdating issues can arise in a variety of settings:

(a) Date of a conveyance of property.

(b) Shareholder withdrawals – loan or dividend.

(c) Compensation issues

(i) Effective date for measuring compensation.[3]

(ii) Effective date for other contractual provisions.

(iii) Carried interest awarded after the commence of the employment period.

(d) Entity formation

(i) The LLC operating agreement or the limited partnership agreements are signed "as of" the date of the certificate of formation of the entity, even though much later.

(ii) Partners or shareholders agreeing to become partners or shareholders and contributing capital, but a different time from formation date.

(e) Board decisions. Unanimous consent resolutions evidencing a corporate decision are a form of backdating.

(3) The two ideas of backdating:

(a) Acceptable Backdating: That which memorializes an understanding reached earlier.

(b) Wrong: Backdating that fabricates.

2. Memorializing a Prior Understanding

A. Practical Reality

(1) Obtaining original signatures for a document simultaneously with its effective

[3] For a discussion of backdating of stock options from a decade ago, See generally Victor Fleischer, *Options Backdating, Tax Shelters, and Corporate Culture*, 26 Va. Tax Rev. 1031, 1037 (2007), cited in Kwall & Duhl, *Backdating*, 63 Bus. Law. 1155 n.2 (2008).

date is difficult.

(2) Signature pages are circulated via e-mail apart from the agreement to which the signatures are to be affixed. Contracting signing today is accomplished by e-mailing the signature page, signing it, scanning it, and then e-mail the PDF of the signature page.

(3) Electronic or digital signatures are emerging as well.[4]

B. The word "backdating" is an inherently ambiguous word.

(1) Contracting parties can and do sign a document at times separate from the effective date of the agreement.

(2) Many legal agreements have date lines left blank.

(3) The informality of decision making in business organizations invites informality in documenting when a decision was made.

(a) Texas Business Organizations Code permits decision making by unanimous consent resolutions in lieu of an actual meeting.

(b) TBOC §6.201 permits any corporate action and permits to take action without a meeting if everyone entitled to vote on the action signs a written consent stating the action taken. The unanimous consent has the same legal effect as a unanimous vote at a meeting.

(c) There is no requirement in TBOC for partner voting or consents and may be formal or informal at option of the partners. The deference is to the partnership agreement. A general or limited partnership would have to elect to have TBOC Chapter 6 provisions apply.[5]

C. Definition of Backdating

(1) The Oxford English Dictionary, 1961 edition, did not define the word "backdate." "Predate" was defined as: "To ascertain or fix the date or time of (an event); to refer or assign to a certain date."

(2) The more modern The New Oxford American Dictionary defines backdate as "to

[4] See Electronic Signatures in Global and National Commerce Act, Pub. L. 106-229, 114 Stat. 464 (June 30, 2000), which provides that:

> *a signature, contract, or other record relating to such transaction may not be denied legal effect, validity, or enforceability solely because it is in electronic form; and (2) a contract relating to such transaction may not be denied legal effect, validity, or enforceability solely because an electronic signature or electronic record was used in its formation.*

[5] TBOC §6.301.

put an earlier date (on a document or agreement) than the actual one."[6]

D. Who Argues for Backdating?

(1) First impression - is that taxpayers are more likely to argue that the earlier date was the effective date of the agreement.

(2) For example, in *Baird v. Comm'r*,[7] there were three dates:

(a) "Preliminary Agreement" (so called), August 29, 1970

(b) Signing of deed, October 28, 1970

(c) Recording of deed, November 17, 1970

(d) Taxpayer argued the date of the transaction is August 29.

(e) IRS argued for November 17, 1970, when the deed was signed.

(f) At issue in the case was when taxpayer was entitled to depreciation deductions and whether taxpayer could deduct as interest certain mortgage fees and points. The Tax Court framed the issue as a factual issue trying to determine when the benefits and burdens of property ownership passed to taxpayer.

(i) Transaction involved a precarious financing situation. Cash was required to be put up at the last minute before expiration of permanent financing.

(ii) An interim construction loan had been in place. Construction was ongoing. To enable permanent financing to be arranged, Taxpayer needed to act quickly to purchase the property and then lease it back to Seller with an accompanying deposit of the necessary $57,000, with documents to follow.

(iii) The cash payment represented prepared interest to induce completion of permanent financing.

(g) Tax Court concluded that August 29 was the date when taxpayer acquired the property

(a) The later dating of the deed merely memorialized a prior agreement.

(b) The parties intended for August 29 to be when ownership passed to taxpayer.

[6] The New Oxford American Dictionary (Oxford Univ. Press, 2001), p. 117.
[7] Baird v. Comm'r, 68 T.C. 115 (1977).

(c) The case illustrates how the complete set of facts explains away any suggestion of falseness or tax-avoidance motives to the earlier dating of documents. The financial distress and the need for quick action and payment of monies explained the case, even though the court observed the presence of a tax motivation on the taxpayer's part.[8]

E. Roles Reversed: IRS Arguing for the Earlier Date of a Transaction

(1) On occasion, the earlier dating of transaction paperwork can reverse the conventional roles of the taxpayers and the IRS and witness the IRS arguing for the effective date of a transaction to be earlier dating. Such was the case in *Moore v. Commissioner*,[9] a case involving a re-alignment of LLC interests but accomplished in such a manner to call into question the effective date of the change of ownership.

(2) Three members of a LLC, organized in April 1995, and were planning on selling the LLC to a third party on July 28, 2000. But before the final sale, in July 2000, the three members re-aligned their interests pursuant to a written agreement "effective as of Jan. 1, 1997), but without any clear indication of the actual execution date. LLC distributions for the years 1998, 1999 and 2000 were made according to the re-aligned percentages.

(3) The role reversal led to the taxpayer arguing for a July 2000 effective date of the re-aligned interests, while the IRS argued for the January 1, 2000 effective date. If taxpayer prevailed, she was entitled to installment sale on the sale to third parties, while the IRS position denied installment treatment.

(4) The Tax Court concluded that it did not find any motive by the taxpayer's backdating to obtain an unwarranted tax benefit. In the words of the court:

> *We do not view the effective date provision as an attempt to backdate the assignment and assumption agreement in order to retroactively obtain an unwarranted tax benefit. Rather, we consider its purpose to have been to reduce to writing a prior oral understanding among the parties. As the cases . . . make clear, "backdating" generally involves an effort to make it appear that the document in question was executed on a date prior to its actual execution date; i.e., there is an effort to mislead the reader. That is not true of the assignment and assumption agreement, where the "effective as of" phrase makes clear that the intended effective date differs from the execution date.*[10]

[8] On the issue of mortgage points paid, the Tax Court felt prevented there from being a clear reflection of income, thus preventing a deduction in the year of payment of the entire amount paid as points in 1970.
[9] Moore v. Comm'r, 93 T.C.M. 1275 (2007).
[10] Moore v. Comm'r, 93 T.C.M. 1275 (2007).

(5) Taxpayers threw up several arguments, more of a defensive nature considering the confused evidential record, all of which the court batted away. The heart of the court's conclusion was the absence of a sought-after tax benefit dependent upon timely action of the taxpayer, which time had passed. The re-alignment of the LLC interests was mostly tax neutral, thought the court. The parties were dealing at arm's length, the Tax Court concluded.

F. Undocumented Shareholder Withdrawals

(1) A commonly encountered area fraught with tax risk is the undocumented shareholder withdrawal and the preparation of paperwork to support the withdrawals after the facts. Most tax advisors have encountered one (or more likely a series) of corporate distributions to shareholders without any manifest evidence of intent to treat the withdrawal as a loan or a dividend or compensation.

(2) The primary fact question is intent of the shareholder of the corporation when the distribution is made. Burden of proof is on shareholder.[11]

(3) Backdating is a temptation. The intention of the controlling or sole shareholder and the corporation are evidenced by shareholder resolutions, promissory notes, or other papers prepared long after the facts.

(4) Documentation will not be controlling in all instances. See, e.g. *Regensburg v. Commissioner*[12] when the court held for a dividend despite book entries reflecting loans and other documentation, relying on failure to evidence the distributions with a promissory and failure to repay any of the supposed loans.

G. Indicia of Acceptable Backdating

(1) A point made in decisions accepting backdating is that the intended effective date (the "as of" phrase) clearly establishes in the agreement that the intended effective date is separate from the execution date of the agreement.[13]

> THIS STOCK PURCHASE AGREEMENT ("Agreement") is signed at the dates adjacent to the signatures of the parties, but dated effective as of ________, 2018, and is made and entered into between _____________, ("Seller"), __________________, ("Buyer"), and

[11] There is abundant precedent for this point, but *Wiese v. Comm'r*, 93 F.2d 921 (8th Cir. 1938), cert. denied, 304 U.S. 589 (1938). is representative; the Court of Appeals phrased the issues as whether withdrawals:

> *. . . by the sole owner of the stock of a corporation . . . are to be considered income to the stockholder for the years in which the withdrawals were made, or . . . when the charges against the stockholder were canceled on the books of the corporation. [93 F.2d at 921.]*

[12] 144 F.2d 41 (2nd. Cir. 1944), cert. denied, 323 U.S. 783 (1944).
[13] E.g. Moore v. Comm'r, 93 T.C.M. 1275 (2007).

_______________., a Texas corporation ("Corporation").

. . . .

The parties have signed this Agreement at the dates indicated below their signatures.

____
Name: ____________________________
Date of Signing: ______________,. 2018

(2) The courts will find this clarity a positive factor.

3. Errant Backdating – Fabricating the Past

A. Backdating is disregarded by a court upon a finding that the taxpayer attempted to have documents achieve a tax result dependent upon a timely action by the taxpayer when time had passed.[14]

B. The court may even find the backdating fraudulent.

C. For example, in *Whistler v. Commissioner*,[15] a CPA was convicted of preparation of fraudulent income tax returns and who established trusts to reduce clients' tax liability, and in establishing the trusts, backdated documents to allow clients to claim deductions for years prior to the establishment of the trusts, deducted for expenses that never occurred, and misstated ownership of assets. Whistler then prepared and filed tax returns containing these misrepresentations.

D. Also illustrative of inappropriate backdating is *Dobrich v. Commissioner*,[16] documents were backdated to enable taxpayer to fall within the timetables required for naming replacement properties within Section 1031 like kind exchange transactions. The taxpayer had imposed on him the civil fraud penalties of IRC § 6663.

E. It easy enough to select egregious cases to make the point that backdating is bad, or even ugly, but what is particularly challenging is discern when backdating cross the line.

(1) Where is the demarcation line?

(2) How is backdating that memorializes a past fact to be separated from backdating

[14] Moore v. Comm'r, 93 T.C.M. 1275 (2007).
[15] Whistler v. Comm'r, 2005-2 USTC ¶ 50,569, 139 Fed. Appx. 1 (9th Cir. 2005).
[16] Dobrich v. Comm'r, 74 T.C.M. 985 (1997), supplemented 75 T.C.M. 1687 (1998), aff'd. without published opinion 188 F.3d 512, 99-2 USTC ¶ 50,826 (9th Cir. 1999).

that fabricates?

(3) In their seminal article on backdating, Kwall and Duhl probe deeply to discover the location of the line.[17] They summarize the essential problem as follows:

> *In many cases, it will be unclear whether backdating fabricates or memorializes because complex law and ambiguous facts can cloud the time that the event actually occurred. Moreover, when backdating in fact fabricates the date of an event, the backdating might be innocuous if it neither adversely affects the rights of any third party nor violates any law. By contrast, backdating that in fact memorializes an event can be problematic if it supports the inference that the document was executed on the earlier date of the event.* [18]

4. Separating the Good from the Bad and Ugly

A. State Contact Law and Property Law Principles Complicate Analysis

(1) The decided cases involving backdating issues contain substantial discussions of state law contract of law and property law issues[19] among the issues commonly discussed are:

(a) Effective date of an agreement subject to conditions precedent and conditions subsequent, and contingencies.

(b) Effect of parol evidence on determining when a agreement was reached.

(c) Implications under state law of preliminary agreements versus final agreements.

(d) Choice of law issues when multi-state agreements are entered into.

(2) State property law issues of when ownership exists in property can be outwardly simple, or not.

B. Seeking Clarity

(1) Lawyers in the middle of the action, under deadline, do not have that clean of a record in front of them such as found in a court of appeals decision.

(2) The CPA under deadline to prepare a tax return, face similar challenges.

[17] Kwall & Duhl, *Backdating*, 63 Bus. Law. 1143 (2008).
[18] Kwall & Duhl, *Backdating*, 63 Bus. Law. 1143, 1173 (2008).
[19] Both of the cases discussed in detail above would be examples of containing discussions of state law contract and property law concepts: Moore v. Comm'r, 93 T.C.M. 1275 (2007); Baird v. Comm'r, 68 T.C. 115 (1977).

(3) Best practices would seem to suggest that the lawyer or CPA understand and have work product supporting the facts allowing for backdating an agreement or conveyancing to an earlier time.

C. What Did the Client Intend?

(1) Backdating issue often turns on the issue of intension.

(2) In *Baird v. Comm'r*, above, the August 29 dating of the preliminary agreement and unsigned deed was supported by expressions of client intention. In *Moore v. Commissioner*, above, the parties expressed themselves somewhat variously on the effective date issue and the lack of clear expression of intent proved fatal to their argument.

(a) Further, in *Moore*, there were inconsistencies between the stated intentions of the parties and the collateral paperwork and tax returns.

(b) But the Tax Court in both cases, and in trial courts in most cases, studied the evidentiary record with care, probably much more extensively than did the drafting attorney or the CPA preparing the tax return.

(c) It is not a question of the professionals not doing their duty, but rather the practical reality of time and money and not having the luxury of a full factual development.

D. Who Is Disadvantaged by the Backdating?

(1) The question posed by backdating is whether the backdating is innocuous or does the backdating harm someone. Parties to an agreement are free to select whatever date they wish to be the effective date of the agreement.

(2) Kwall and Duhl present two circumstances to illustrate this point.

(a) Landlord and tenant agree that a lease is effective January 1 but the actual signing is on March 1. The business agreement is to pay the landlord rent for January and February even though occupancy did not occur until March 1.

(b) An employment arrangement is agreed to on March 1. but provides that compensation is paid since January 1.

(3) Who is to object, provided no law is broken and no third parties are harmed.?

5. Ethical and Circular 230 Issues

A. Ethical Considerations

(1) Model Rule 8.4(c) and its corollary DR 1-102(A)(4) prohibit attorneys from engaging in "conduct involving dishonesty, fraud, deceit or misrepresentation." See Texas Rules of Prof. Conduct, §1.02(c)("A lawyer shall not assist or counsel a client to engage in conduct that the lawyer knows is criminal or fraudulent."); .

(2) Model Rule 3.3(a)(1) and its corollary DR 7-102(A)(5) prohibit attorneys from "knowingly mak[ing] a false statement of fact or law [to a tribunal]." See Texas Rules of Prof. Conduct, §3.01, comment 3, §4.01 ("lawyer shall not knowingly (a) make a false statement of material fact or law to a third person. . . . "

(3) Model Rule 8.4(d) and its corollary DR 1-102(A)(5) prohibit attorneys from engaging in "conduct that is prejudicial to the administration of justice."[20]

(a) Model Rule 8.4(c) has been adopted by each of the forty-seven states that have adopted the Model Rules of Professional Conduct.

(b) A similar rule is employed by the minority of states that have adopted the Model Code of Professional Responsibility.[21]

(4) The Model Rules of Professional Conduct define "fraud" as "conduct that is fraudulent under the substantive or procedural law of the applicable jurisdiction and has a purpose to deceive."[22] States that have adopted the Model Rules similarly require that the attorney have a "purpose to deceive" to sustain a fraud charge. [23]

(5) Model Rules shed no light on the requisite mental state for dishonesty, deceit, or misrepresentation, and the law varies from state to state.[24] Texas Rules of Professional Conduct define fraud as having a purpose to deceive, and not mere negligent misrepresentation.[25]

(6) Falsification of documents is prohibited under Model Rule 8.4(c).[26]

B. Circular 230

(1) Circular 230 does not speak to backdating directly, but indirectly.

(2) Section 10.22 generally requires the tax practitioner to exercise due diligence in preparing documents, in determining the correctness of representations made to

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[20] See, e.g., Model Rules of Prof'l Conduct R. 8.4(c) (2006). See Tex. Rules Prof. Conduct, Preamble 5.
[21] See ABA & Bureau of Nat'l Affairs, supra note 108, §§ 1:3, 101:401.
[22] Model Rules of Prof'l Conduct R. 1.0(d) (2006).
[23] See, e.g., Ariz. Rules of Prof'l Conduct 1.0(d); Ill. Rules of Prof'l Conduct, Terminology; Pa. Rules of Prof'l Conduct 1.0(d).
[24] Compare Florida Bar v. Fredericks, 731 So. 2d 1249, 1252 (Fla. 1999) (Intent required to be proved for a fraud charge), with Parese v. Statewide Grievance Comm., No. CV88-0348079, 1993 WL 137568, at *3 (Conn. Super. Ct. 1993) (legal liability for misrepresentations rests on false statements made either intentionally or negligently).
[25] Tex. Rules Prof. Conduct, Terminology.
[26] See, e.g., In re Sealed Appellant, 194 F.3d 666 (5th Cir. 1999) (backdating of endorsement on stock certificate).

the IRS (Treasury), or to clients with reference to any matter administered by the IRS.

6. Best Practices

A. The following suggestions of best practices comes from the author's experience and from considerations coming to mind after of reading backdating cases.

B. Disclosure: The Universal Cure

(1) When drafting a contract after the fact clearly state when the agreement is effective and when the signatures are affixed to the agreement. The opening paragraph of the agreement states the parties to the agreement and then states that the agreement is being entered into by the parties to be effective "as of" a date certain. Then, on the signature blocks, the date for each signature is provided for.[27]

(2) This clarity of intention puts everyone on notice that a contract date is selected different from signature dating. In *Barry E. Moore*, the Tax Court said as much in stating:

> *[B]ackdating" generally involves an effort to make it appear that the document in question was executed on a date prior to its actual execution date; i.e., there is an effort to mislead the reader. That is not true of the ... agreement [at issue], where the "effective as of" phrase makes clear that the intended effective date differs from the execution date.*[28]

C. Professional Due Diligence

(1) The slippery slope of facts and memory invite the professional into building something of a evidence record in the professional's files.

D. Care on Client Selection

(1) Best guard against risk of professional malpractice is care in the selection of clients.

E. Second Opinion: Useful for Small Firms

(1) Another strategy especially for small firms would be to hire an outside lawyer to provide a second opinion on a backdating issue.

7. Hypothetical for Discussion

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[27] Also recommended by Kwall & Duhl, *Backdating*, 63 Bus. Law. 1175 (2008).
[28] Moore v. Comm'r, T.C. Memo 2007-134.

Company maintaining an investment fund (in the form of a limited partnership) decides to liquidate the fund as of May 1. On April 1, the Chief Financial Officer asks company counsel to prepare agreements evidencing carried interests for several company employees and providing for payment for the carried interest payments incident to fund liquidation. The CFO presents the attorney with a payment schedule reflecting the carried intertest payments to be made and the recipients.

The agreement is to specify the beginning holding period for the carried interests for all recipients being the later of date of employment of the recipient or the formation of the fund.

There is no paperwork supporting the awarding of the carried interests.

RESCISSION[29]

1. Introduction to Rescission

A. The topic of rescission presented here concerns when, for federal tax purposes, should taxpayers be permitted to rescind a previously completed transaction. Stated differently, when will the Service respect a rescission or reversal of a transaction or action so that the transaction or action will be respected for federal tax purposes.

B. The principal rule is that a transaction may be disregarded for federal tax purposes if the parties to the transaction, in the same tax year as the original transaction, rescind the transaction and restore themselves to the same position they would have occupied had they not undertaken the original transaction ("status quo ante").[30] Some bedrock principles pervade the federal tax law, though:

(1) The fundamental principle of the annual accounting period requires that income be determined by the close of the tax year.

(2) The claim of right doctrine provides that amounts received under a claim of right are income even if the right is challenged and at risk of being returned.

C. Rescissions appear to be increasing in frequency. Yet, there is no central or general framework for analyzing the taxation of rescissions. Consider this:

(1) The controlling case, *Penn v. Robertson*, was decided in 1940.

(a) *Penn v. Robertson*[31] held that rescission of a stock purchase plan in December 1931 (in response to shareholder challenges to the plan) had the consequence of disregarding dividend income paid in 1931 on stock purchased under the plan.[32]

(2) The controlling ruling today was issued in 1984.

(a) Rev. Rul. 80-58[33] is the guiding ruling describing rescissions in the same tax year as the rescinded transaction. The key passage in the ruling:

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[29] As stated many times, no one working in this area of rescission can do so without tracking closely Sheldon Banoff's writings. His seminal papers dominate the field of rescission. This paper is no different. Constant citation to his writings is dispensed with for convenience. We just attached his 1984 paper, with his permission, to ease the discussion. The same result follows from New York State Bar Association Tax Section, Report on The Rescission Doctrine (August 11, 2010), 2010 TNT 156-10. See also, Lee Sheppard, Oh, Never Mind, IRS Rescissions Ruling Practice, Tax Notes (Aug. 30, 2010)(commenting on the NY State Bar report).

[30] Rev. Rul. 80-58, 1980-1 C.B. 181.

[31] 115 F.2d 167 (4th Cir. 1940).

[32] Under the stock purchase plan in *Penn*, the taxpayer (employee) purchased employer stock with employer loans. Dividend income would be the source of the loan repayment. Shareholder lawsuits challenging the plan led to rescission of the plan in December 1931. Dividends were paid in 1930 and 1931, of which only the 1931 dividends were disregarded because of the rescission.

[33] Rev. Rul. 80-58, 1980-1 C.B. 181.

The legal concept of rescission refers to the abrogation, canceling, or voiding of a contract that has the effect of releasing the contracting parties from further obligations to each other and restoring the parties to the relative positions that they would have occupied had no contract been made. A rescission may be effected by mutual agreement of the parties, by one of the parties declaring a rescission of the contract without the consent of the other if sufficient grounds exist, or by applying to the court for a decree of rescission.[34]

(b) The ruling involved the following transaction:

Situation 1:[35]: In February 1978, A sold land to B under a condition that obligated A, at the request of B, to accept reconveyance of the land from B if B was unable to have the land rezoned within nine months. If there were a reconveyance under the contract, A and B would be placed in the same positions they were prior to the sale.

In October 1978, B determined that rezoning was not possible and conveyed the land back to A. B received back all amounts he had paid.

Answer: Rescission of the sale during 1978 placed A and B at the end of the taxable year in the same positions as they were prior to the sale. Thus, rescission respected.

Situation 2: Same as Situation 1, except B conveyed land to A in February 1979.

Answer: Rescission not respected. Gain recognized in year of sale.

(c) Issues arising from Rev. Rul. 80-58 discussed below.

(3) Today, the Service has a "no ruling" policy in place on rescissions.[36]

D. There is little academic discussion of taxation of rescission. There are not more than a handful of academic articles or papers on taxation of rescission. The Bibliography lists the most useful articles and papers, two of which are attached to this paper.

[34] Id.
[35] Taken from Rev. Rul. 80-58, supra, Situation 1.
[36] Rev. Proc. 2018-3, 2018-1 I.R.B. 130 (Jan. 2, 2018), §3.02(8).

2. Uncertainties with the Rescission Doctrine of Rev. Rul. 80-58[37]

A. **Status Quo Ante.** The ruling uses the phrase "*restoring the parties to the relative positions that they would have occupied had no contract been made*" to express the *status quo ante* requirement.

(1) **Uncertainties.** Of concern to practitioners, the *status quo ante* requirement has not been developed in published guidance or case law. Therefore, legal advice on the certainty of a rescission transaction will prove difficult.

(2) **Some Principles.** Private letter rulings have spoken to the *status quo ante* requirement to some degree with the result that some principles have emerged. The feeling has been expressed among commentators that the private ruling policy, now suspended, has been more liberal than Rev. Rul. 80-58.

(a) The rescission does not result in material change in the legal or financial arrangement of the parties.[38]

(b) Interim events are ignored as long as parties are placed in position that they would have had had no contract been made, such as events that would have occurred anyway. E.g. Rescission of preferred stock redemption respected when stockholder receives dividend he would have received anyway during interim period.[39]

(c) Identical parties and property subject to rescission and underlying transaction.[40]

(d) No consideration paid for rescission. Some PLRs permitting mutual release and indemnity in rescission agreement.[41] What if one party bears disproportionate share of expenses? Is this a form of paying consideration?

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[37] This portion of the paper is principally drawn from New York State Bar Association Section of Taxation, *Report on The Rescission Doctrine* (August 11, 2010).

[38] P.L.R. 200701019 (Jan. 5, 2007); P.L.R. 200716024 (Apr. 20, 2007).

[39] P.L.R. 200716024 (Apr. 20, 2007). See Fleischman v. Comm'r, 1936 WL 7217 (B.T.A.) (1936)(taxpayer sold pictures and busts to Evans for $75,000 cash; shortly after sale, parties agreed on rescission with taxpayer paying $22,500 cash and issuing promissory note to purchaser for balance; Held: valid rescission even though taxpayer retained $52,500 cash).

[40] Hope v. Comm'r, 55 T.C. 1020 (1971), acq. 1971 WL 29314 (July 29, 1971), aff'd 471 F.2d 738 (3rd Cir. 1973), cert. denied, 414 U.S. 824 (1973)(taxpayer sold his stock for $20 a share, but later discovered that the stock at that time was trading for over $50 a share on the market. In the year of the sale, he filed a complaint for rescission against the agent and the purchasers of the optioned stock. The following year, the parties settled the dispute. Held: No same year rescission since parties to rescission different from sale; settlement in following year is not rescission); Hutcheson v. Comm'r. 71 T.C.M. 2425 (1996)(Merrill Lynch mistakenly sold 100,000 Walmart shares in January 1989 for around $30/share; later in year, ML purchased 96,600 shares to replace mistakenly sold shares for $44/share, with taxpayer contributing funds. Held: No rescission. Purchasers of 100,000 shares were not same parties who sold 96,600 shares. ML was agent).

[41] P.L.R. 200716024 (Apr. 20, 2007); P.L.R. 200533002 (Aug. 19, 2005).

(3) **Non-Reversible Items.** Uncertain exists with respect to non-reversible items or events, such as transaction expenses incurred on the original and rescinded transactions, or shareholder votes that occurred in between the original transaction and rescission.

(4) **Partial Rescission**. When rescission is only partial, then there is uncertainty. Some transactions might be more easily separated into distinct parts than others.[42]

(5) **Close Enough Rescission**. Complete restoration of the parties to the original status be impossible. Regulatory constraints may prevent *status quo ante* from being achieved. Query: How close must the parties come to *status quo ante*? IRS indicates in private rulings some flexibility.[43]

B. **Same Taxable Year**. The accepted rule is that if the rescission occurs in the same taxable year as the original transaction, then the rescission validly abrogates and nullifies the original transaction.[44] The rescission must completely restore the parties as if the transaction did not happen.

(1) **Different Tax Years.** If the parties to the transaction have different tax years, then the issue arises when the rescission is in the same tax year for one party, but a subsequent tax year for another party.

(a) In compensation context, the limited authority focuses on employee's, not the employer's, tax year.[45] Not much guidance outside of compensation situations.

(b) Drafters of the original agreement would be well advised to have disparate tax years in mind when drafting to avoid this problem.

C. Related Taxpayers. Whether and to what extent rescission can occur between related parties remains unclear.

(1) P.L.R. 201016048 (Dec. 22, 2009) involves cancellation of debt between related parties as part of a cross-border rescission agreement may be disregarded.

(2) Rev. Rul. 80-58 involved unrelated parties.

D. **Taxpayer's Intent**. A difficult issue is ascertaining taxpayer's intent in rescinding the transaction.

(1) The various kinds of reasons to pursue a rescission are numerous. Mistakes of fact or law, adverse or unintended or undesirable tax consequences, or event

[42] P.L.R. 200908016 (Feb. 20, 2009) would illustrate a respected partial redemption.
[43] P.L.R. 200701019 (Jan. 5, 2007).
[44] Rev. Rul. 80-58, 1980-1 C.B. 181; Penn v. Robertson, 115 F.2d 167 (4th Cir. 1940) is the seminal case and was accepted by Rev. Rul. 80-58. Banoff at 960, et seq. delves into the Penn decision.
[45] Fender Sales, Inc. v. Comm'r, 22 T.C.M. 550 (1963), rev'd on other grounds, 338 F.2d 924 (9th Cir. 1964).

retroactive legislation may motivate a rescission.

(2) Mistakes in fact or law commonly appear in rescission authorities as satisfactory motivations.[46]

(3) Taxpayer's intent is usually a deciding factor in rescission cases.[47]

(4) Query: Is tax motivation to pursue a rescission prohibited or permitted?

> **Example**: Shareholders of S Corporation transferred their shares. After the transaction, but within the same taxable year, they realized the share transfers limit their use of tax losses per IRC §1366(d).[48] They want to rescind the transfer.
>
> **Example**: Taxpayers converted LLC into a corporation in anticipation of an IPO. The IPO was cancelled because of deteriorating market conditions. For tax reasons, the taxpayers want to rescind the conversion (within the same taxable year) and have the corporation converted back to a LLC.[49]

E. Unilateral Actions: Dividends, Gifts and Tax Elections

(1) Rev. Rul. 80-58 spoke to a contract being rescinded – the "legal concept of rescission refers to the abrogation, canceling, or voiding of a contract." Despite this language, rescission can be extended to unilateral actions, or at least there are private rulings so indicating..

(2) Dividends.

(a) Rescissions of dividends pursuant to clerical or scrivener's errors have enjoyed success.

(i) E.g. (Scrivener error) *Hanco Distributing, Inc. v. United States*[50] involved an attempted pro-rata dividend from a personal holding company, but because of a math error by the company's clerk, one shareholder was paid more than his proportionate part. In December of the same year, the company realized it's error and returned the excess. Held: Rescission respected.

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[46] E.g. Van Fleet v. Comm'r, 2 B.T.A. 825 (1925).
[47] Exception: Davis v. United States, 378 F.Supp. 579 (N.D. Tex. 1974)(parents intent was to gift stock to children, but accountant mistakenly arranged sale; rescission changed transaction to gift; in same taxable year).
[48] P.L.R. 9829044 (July 17, 1998).
[49] P.L.R. 200613027 (Mar. 31, 2006).
[50] 73-2 USTC ¶9632, 32 AFTR2d 73-5485 (D.C. Utah 1973).

(b) Otherwise, rescissions of dividends have been unsuccessful.

(i) In *Crelin's Estate v. Commissioner*[51] a rescission of a dividend by a personal holding company in the same year was not respected. The corporation rescinded the dividend after learning that the tax advice triggering the dividend payment was incorrect. The court held the dividend was "in fact no more than a voluntary payment by stockholders."[52]

(ii) FSA 200124008 (June 15, 2001)(dividend rescinded and repaid pursuant to rescission agreement between corporation and shareholder is income to recipient in year of receipt and contribution of capital when returned; no legal obligation to return dividend established).[53]

(c) The risk of failing to rescind a dividend can be harsh. The unsuccessful rescission of a dividend is (i) receipt of a taxable dividend, (ii) a contribution to capital, and possibly (iii) a subsequent cash distribution to enable the tax to be paid on the rescinded dividend.[54]

(3) Gifts

(a) Donors of gifts may wish to rescind a gift for various reasons, including scrivener's error, nontax motivations, and even tax reasons.[55]

(b) Mistake of fact has allowed rescission of a gift.[56]

(c) Misunderstanding the tax law has been held to be insufficient to support a rescission.[57]

(4) Tax Elections

(a) Tax elections are unilateral and tax motivated. Thus, rescinding tax elections may be limited.

(b) S Corporation elections have been inconsistent treated. Request to rescind

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[51] 203 F.2d 812 (9th Cir. 1953), cert. denied 346 U.S. 873 (1953). Similarly, Blanco v. United States, 602 F.2d 324 (Ct. Cl. 1979)(attempt to rescind dividend was not respected; parties were not restored to *status quo ante*).
[52] Id. at 815. See also, Rev. Rul. 75-375, 1975-2 C.B. 266 (a voluntary repayment by a stock life insurance company's shareholders of the previous year's dividend, to the extent the dividend invaded the policyholders' surplus account as described in IRC § 815(c), was held not to alter the tax consequences of the dividend paid).
[53] Similar, Rev. Rul. 75-275, 1975-2 C.B. 166.
[54] Banoff, supra. at 982.
[55] Dodge v. United States, 413 F.2d 1239 (5th Cir. 1969)(permitting gift to be reformed retroactively).
[56] Davis v. United States, 378 F.Supp. 579 (N.D. Tex. 1974)(parents intent was to gift stock to children, but accountant mistakenly arranged sale; rescission changed transaction to gift; in same taxable year). See P.L.R. 8205019 (Nov. 3, 1981)(IRS also refused to bless as free from gift tax the return of a gift which had been made under a mistake of the application of the gift tax laws)
[57] Board v. Comm'r, 14 T.C. 322 (1950).

voluntary S Corporation election (in same year) have been denied.[58] But rescission transactions have allowed restoration of revoked S Corporation elections.[59]

(c) Limited circumstances for revocation of Section 83(b) election found in Reg. 1.83-2(f) ("mistake of fact"; revocation made within 60 days of first awareness of mistake).[60] Is rescission a way around mistake of fact?

(d) Section 9100 relief is possible for a botched transaction or election.[61]

F. Form and Timing of Rescission

(1) Form of Rescission

(a) A leading commentary on rescission has recommended that a rescission transaction be explicitly identified as a rescission drawing form the private rulings on the subject.[62] This is a meritorious recommendation.

(b) There is an absence of guidance on the form of the rescission. Including a mutual release and indemnity in a rescission would be a logical thought, but as mentioned earlier, these additional provisions create uncertainty.[63]

3. Stages of a Transaction

A. Rescinding a Transaction During Negotiations

(1) **General Rule.** Taxpayers who rescind during negotiations have the greatest chance of success, when there are no firm agreements. Rescission at this stage should have no tax consequences.

(a) Parties are free to arrange their affairs as they wish.[64]

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[58] P.L.R. 8336029 (June 6, 1983).

[59] P.L.R. 200533002 (April 28, 2005)(corporation will be treated as an S corporation during the period between a sale of its newly issued convertible preferred stock and the later rescission of the sale); P.L.R. 200752035 (Sept. 26, 2007)(a company will be treated as continuing to be an S corporation from the date on which its subchapter S election would have been terminated by the transfer of stock to an ineligible shareholder).

[60] Rev. Proc. 2006-31, 2006-2 C.B. 32(IRS standards for reversing IRC §83(b) elections; rescission of election requires mistake of fact).

[61] Treas. Reg. 301.9100-3(b)(1)(v).

[62] New York State Bar Association Tax Section, Report on The Rescission Doctrine (August 11, 2010), p. 29. The mention of Branum v. Campbell, 211 F.2d 147 (5th Cir. 1954) to support this point seems a bit stretched, but the basic recommendation is sound.

[63] P.L.R. 200716024 (Apr. 20, 2007)(permitting mutual release); P.L.R. 20053 3002 (Aug. 19, 2005) (permitting the inclusion of indemnity).

[64] Appeal of Lang, 3 B.T.A. 417 (1926)(" The parties were free to make such arrangement and provide such terms as they saw fit . . ."); Dunlap v. Comm'r, 74 T.C. 1377, 1425 (1980)(complicated facts in which parties has agreed to sell stock, conditioned upon approval of Federal Reserve; Condition not satisfied two years later and so parties reached new agreement with somewhat different transaction terms; Tax Court treated cancellation of first contract

(2) Circumstances may cloud the tax consequences

(a) **Substance over Form.** When a transaction is abandoned, but ultimately completed in another form, with the same purchaser shortly thereafter, then the substance over form argument arises as a risk. In *Court Holding Co.*[65] negotiations occurred for a corporation to sell corporate property. Negotiations were abandoned. Then, the corporate property was distributed in liquidation to shareholders, who then sold the property to the same purchaser. Supreme Court held transaction, in substance, to be a corporate sale of property and ignore the form as a sale by shareholders.

(b) **Partial Agreement.** Tax certainty diminishes when an agreement is attempted to be rescinded or changed after an agreement as to one or more terms of an agreement.

(i) E.g. Agreement reached about principal and interests payment amounts.

(ii) **Agreement on Price.** What about tentative or partial agreement on purchase price? Consider the typical situation when clients reach agreement on price before consulting with tax advisors and discover that the tax consequences make the tentative purchase price untenable? What if the parties then to negotiate a new transaction structure and a new price?

(c) Banoff, supra. at 949 cites cases in which an agreement reached on terms of purchase price and interest payments, followed by the parties attempting to agree on a different principal/interest allocation is not respected.

B. Rescinding a Transaction After Contract Signing

(1) **General Rule.** Generally, the parties can rescind a transaction after contract signing and before closing, though with less certainty than rescinding before contract signing stage. When form of transaction respect, then changes up to closing respected.

(a) When substance controls over form, then changing an agreement after the contract has been signed is less certain.

(b) Conditions precedent, which are common in transactions, introduce certainty into a rescission even after contract signing.

(2) **Form Respected**. In *Alderson v. Comm'r*,[66] the Court held that it was acceptable

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and negotiation of new contract as a single, modifying transaction; "The parties may arrive at a purchase price in any manner they please. . . ."), rev'd. on other grounds 670 F.2d 785 (8th Cir.1982).

[65] Comm'r v. Court Holding Co., 324 U.S. 331 (1945), rev'g 143 F.2d 823 (5th Cir. 1944).

[66] 317 F.2d 790 (9th Cir. 1963). But see Estate of Bowers v. Comm'r, 94 T.C. 582 (1990), when substantial implementation of the sale before restructuring as an exchange cast the transaction as a sale.

to allow the taxpayers to amend an executed sales contract to convert the transaction into an exchange for purposes of IRC § 1031.

(a) A written, signed, agreement can be amended or modified to provide for deferred payments of an amount not yet due, and has been respected. This outcome has come about even though 1) the purchaser was initially willing to contract for immediate payment; and 2) the taxpayer's primary objective in entering into the deferred payment agreement was to minimize taxes.[67]

(b) In *Reed v. Comm'r*,[68] shortly before closing (scheduled for 12/27/73), an escrow arrangement was introduced into the agreement to defer closing until 1/3/74 to change the tax year of gain recognition. Held: arm's length agreement, bona-fide modification to purchase agreement, prior to constructive receipt, was valid.

(c) The Fifth Circuit in *Busby v. United States*[69] held similarly when a cotton farm used an escrow device to defer income from the sale of cotton until a later year, based on the finding of a bona-fide, arm's length, agreement.

(3) **Sale or Exchange of Contracts.** IRS has argued that substitution of one written agreement for another written agreement represents a sale or exchange of the contracts, resulting in a gain recognition.

(a) IRS unsuccessful: *Comm'r v. Olmstead Life Agency*,[70]

(b) See Treas. Reg. §1.1001-1(a): a taxable exchange only occurs on the receipt of property "differing materially either in kind or in extent."

C. Rescinding a Transaction After Closing

(1) Once closed, the rescission of a transaction will involve questions of timing, as the following discussion makes clear.

(2) In corporate reorganizations, express contract terms may introduce adjustments to the original transaction that might include contingent consideration, escrows or other security arrangements, rescission rights, warranty or indemnity clauses, or conditional agreements, or reformation of the transaction. All of these types of post-closing mechanisms, introduce issues common to corporation reorganization transactions, as discussed in detail in Bittker & Eustice, namely:

(a) Continuity of interest,

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[67] Reed v. Comm'r, 723 F.2d 138, 142-43 (1st Cir. 1983), citing Oates v. Comm'r, 18 T.C. 570, 584-85 (1952); aff'd 207 F.2d 711 (7th Cir.1953); Goldsmith v. United States, 586 F.2d 810, 817, 218 Ct. Cl. 387 (1978); Comm'r v. Olmstead, Inc., 304 F.2d 16, 21-2 (8th Cir.1962); Cowden v. Comm'r, 289 F.2d 20, 23, 23 n. 1 (5th Cir.1959).
[68] 723 F.2d 138, 142-43 (1st Cir. 1983).
[69] 679 F.2d 48 (5th Cir.1982).
[70] 304 F.2d 16 (9th Cir. 1962).

(b) Definition of stock or securities,

(c) Definition of voting stock,

(d) When is the transaction closed, and

(e) Even if closed, what happens upon subsequent adjustments.[71]

(3) Contract mechanisms might be introduced to allow for the parties to modify a transaction. Banoff, supra at 951 discusses these contract provisions that have the effect of changing the transaction.

(a) **Options**. Instead of purchasing property, buyer could negotiate for an option at a set price. Buyer could evaluate the property financial performance before deciding to purchase property.[72]

(b) **Conditional Sales**. Strategic use of conditions precedent and subsequent can be introduced in a contract to affect when a contract is completed.

(i) Conditions precedent have been more respected, especially when the conditions are thought substantial, e.g. shareholder approval; important that shareholder approval more than a mere formality.[73]

(ii) Conditions subsequent have proven less successful in defining when a contract has been completed.

(iii) In sum, facts and circumstances will influence outcome. Conditions that have a manipulative odor are unlikely to succeed.[74]

(c) **Escrows**.

(i) Escrows can be used to modify or rescind a transaction.

(ii) Terms of escrow usually determine taxation. Taxation is imposed on the party to the escrow who benefits from it.

(iii) Purchase price can be adjusted through escrow, especially if earnings targets are met or not.

(iv) Rev. Proc. 84-42[75] sets for conditions necessary for favorable rulings

[71] B. Bittker & J. Eustice, Federal Income Taxation of Corporations and Shareholders ¶12.38[1] (Thomson Reuters 2017), citing among others, Banoff, "Tax Planning for the Unexpected," 68 Taxes 1033 (Dec. 1990).
[72] Koch v. Comm'r, 67 T.C. 71, 82 (1976), acq. 1979-1 C.B. 1.
[73] Terry v. Comm'r, 35 T.C.M. 1718 1976)(shareholder approval held to be important conditions precedent). Contrast Baird v. Comm'r, 68 T.C. 115, 127 (1977), when sale held completed despite shareholder approval condition.
[74] Banoff, at 952.
[75] 1984-1 C.B. 521. See generally, B. Bittker & J. Eustice, Federal Income Taxation of Corporations and Shareholders ¶12.38 (Thomson Reuters 2017).

in contingent stock transactions. Bittker & Eustice describe the surprising uncertainty related to the taxation of escrow arrangements, whether escrowed shares are returned to issuer or if recaptured shares are transferred to satisfy a specific obligation. The issue framed by Bittker & Eustice is whether shares in escrow are part of a purchase price adjustment or a separate transaction with separate gain or loss realization and recognition.[76]

(d) **Representations and Warranties**.

(i) The traditional representations and warranties found in virtually corporate transactions can be viewed in their usual role as allocating risk incident to the transaction, but also in causing payment of damages for violation of representations and warranties.

(ii) Taxation of the damages resulting from violation representations and warranties present issues some afield of the principal topic of this paper, but Bittker & Eustice provides a healthy discussion.[77]

(iii) The B& E authors discuss the tax uncertainties flowing from damage payments but wonder whether the damages are a form of purchase price adjustment, or whether the damages are a separate taxable exchange under Treas. Reg. §1.1001-1(a) ("differing materially in kind or extent")

(e) **Express Right of Rescission**.

(i) Banoff distinguishes termination rights from rescission rights. A termination does not involve restoration of rights, while rescission involves restoration. A contract can define rescission in any form the parties wish.

(ii) Among the litigated issues is whether a contract with rescission right was a completed contact, or a conditional contract. Absolute and unconditional rescission rights have been held to be complete sales.[78]

(iii) The agreement could provide for a rescission following the occurrence of one or more conditions. In corporate merger and acquisition transactions, the rescission right can take many forms, such as

[76] B. Bittker & J. Eustice, Federal Income Taxation of Corporations and Shareholders ¶12.38[3] (Thomson Reuters 2017).

[77] Id.

[78] Metropolitan Commercial Corp. and Subs. v. Comm'r, 22 T.C.M. 533 (1963)(sale of stock subject to put right); Robinson v. Comm'r, 32 T.C.M. 1130 (1973)(sale of stock subject to buyer's option right to require seller to repurchase stock). Major Realty Corp. and Subs v. Comm'r, 42 T.C.M. 373 (1981)(rescission right did not convert contract into an option or conditional contrac; treated as a condition subsequent not affecting finality of salet).

i. an option to put back acquiring corporation's stock, or

ii. call or redemption rights, or

iii. right of acquiring corporation to rescind all or part of the acquisition.

(iv) Bittker & Eustice at ¶12.38[4] discuss the tax uncertainty when target, its shareholders, or acquiring corporation retain right to rescind transaction. After reviewing the principal rulings in the area, which generally dispense with concerns over boot, continuity of interest in reorganizations, Bittker & Eustice state:

> *From these various authorities, it would seem that rescission rights in either the transferor or the transferee should not ordinarily constitute boot to the transferors (or affect continuity of interest of the reorganization) if the proprietary interest of the acquired corporation's shareholders in the acquiring corporation lasts, or could be expected to last, for a reasonable duration (five years seems to be the IRS's rule of thumb).*[79]

(v) The substantially-all requirement under IRC §§368(a)(1)(C), 368(a)(2)(D), and 368(a)(2)(E), however, presents uncertainty arising from transferee's right to return acquired assets from transferor (or its shareholders) pursuant to an express rescission right.[80]

[79] Id. at ¶12.38[4][b].
[80] Id.

TAX EFFECTS OF REFORMATION

1. Introduction to Reformation

A. Reforming concerns a court order reforming a transaction or document retroactive to the original date of the transaction or document.[81] The IRS is rarely a party to a reformation proceeding, which is commonly a state court action.

B. Reformation distinguished from amendment.

(1) A reformation is distinguished from amendment or modification. An amendment or modification intends to change an instrument.

(2) A reformation does not change the agreement; it orders a change in the drafted instrument so that the instrument will correctly express what has been the real agreement from inception.

2. State Law Principles Governing Reformation[82]

A. Overview of State Law Reformation Proceedings

(1) State law allows contracts, trusts, other legal documents to be rescinded, reformed or even terminated. Judicial action is often required.

(2) Settlement of disputes may also lead to a change to a contract, trust, or document.[83]

(3) Reformation can happen other than be judicial action; agreement of parties can reform a transaction or agreement.

B. Fraud, Duress

(1) Fraud, duress are traditional grounds for rescinding or reforming a contract or document.[84]

C. Mistake of Fact or Law

(1) A mutual mistake made in preparing a written instrument would allow a reformation to correct the mistake so that the instrument truly reflects the original agreement of the parties. Reformation would require:

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[81] Bannof, supra at 974-975.

[82] S. Akers, *Reformation Proceedings*, Sophisticated Estate Planning Techniques, ALI-ABA, C766 ALI-ABA 35 (1992). This paper directly relied upon the Akers paper, without any further citation to it.

[83] Brinker v. Wobaco Trust Limited, 610 S.W.2d 160, 166 (Tex. App. – Texarkana, 1980), writ ref. n.r.e. (1981) and authorities cited.

[84] Restatement (Second) of Trusts §333, Comment e (1959); Brinker v. Wobaco Trust Limited, 610 S.W.2d 160 (Tex. App. – Texarkana, 1980), writ ref. n.r.e. (1981).

(a) An original agreement, and

(b) A mutual mistake, made after the original agreement, in reducing the original agreement in writing.[85]

(2) Scrivener's error are grounds for reformation of an instrument. A unilateral mistake is generally not sufficient grounds for rescission of a contract. In *Brinker v. Wobaco Trust, Ltd.*[86] reformation of a trust was allowed to correctly express that trust remaindermen ("issue of settlor") should be issue of settlor by first marriage. It did not matter that mistake was fact or of law, or that parties were negligent in failing to discover the mistake before signing document.

(3) Change of intentions is insufficient to allow reformation.[87]

D. Mistake as to Tax Consequences

(1) Mistake as to tax consequences of an instrument have permitted reformation (or revocation) of an instrument. A requirement is that the tax effects of the transfer is a sole or major purpose of transfer.[88]

(2) In *Davis v. United States*[89] the district court upheld a court-ordered reformation of an original transaction structured as sales of stock to children into net gifts, all in the same tax year. Taxpayer has intended to make net gifts but taxpayer's agent erred in structuring transaction as sale.

(a) Banoff questions scope of *Davis*. Must reformation be based on initial mistake? Is intent relevant as long as reformation occurs in same tax year? Are mistakes of a broader nature subject to being reformed in a similar manner?

(b) At the very least, Davis supports reformation occurring in the same tax year.

3. General Tax Doctrines

A. Effect of State Court Judgments on Tax Effects

(1) ***Bosch***

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[85] Cherokee Water Co. v. Forderhause, 741 S.W.2d 377 (Tex. 1988); B. Smith, Correcting Mistakes of Law in Texas, 9 Texas L. Rev. 309 (1931).
[86] 610 S.W.2d 160, 166 (Tex. App. – Texarkana, 1980), writ ref. n.r.e. (1981).
[87] DuPont v. Southern National Bank of Houston, 771 F.2d 74 (5th Cir. 1985).
[88] Stone v. Stone, 319 Mich. 194 29, N.W.2d 271 (1947) (husband and wife allowed to rescind gift to children, which was made for the sole purpose of tax minimization, where the U.S. Supreme Court subsequently held that the donor was still subject to income tax even after such a transfer); Irish v. Irish, 361 Pa. 410, 65 A.2d 345 (1945) (court allowed modification to eliminate reversion to grantor where United States Supreme Court case subsequently held that such a reversion would cause trust assets to be included in a settlor's estate for estate tax purposes).
[89] 378 F.Supp. 579 (N.D. Tex. 1974).

(a) The 1967 Supreme Court opinion in *Commissioner v. Estate of Bosch*,[90] is one of the seminal cases and establishes the proposition that where federal estate tax liability turns on character of a property interest held and transferred by decedent under state law, federal authorities are not conclusively bound by determination made of such property interest by a state trial court in proceeding in which the united States is not a party.

(b) The case is pertinent if not important for reformation issue. A state court decision permitting a document to be reformed could control tax consequences flowing from the document, if the state court proceeding was binding upon the IRS.

(c) In *Bosch*, the issue was qualification of a transfer in trust qualified for the marital deduction. The trust was for the spouse, provided her with an income interest for life, and granted her a general power of appointment. During life, the wife attempted to convert the general power of appointment to a non-general power of appointment. Trustee brought a state court lawsuit to construe the wife's release of the general power of appointment under state law, asking whether the release of the power was effective under state law. The state trial court held the release was a nullity.

(d) The Supreme Court concluded that the federal courts in tax cases would be bound only by the state's highest court in the matter before it. The Court stated:

> *We hold that where the federal estate tax liability turns upon the character of a property interest held and transferred by the decedent under state law, federal authorities are not bound by the determination made of such property interest by a state trial court.*[91]

(e) When the case was remanded, the Second Circuit that the highest court in New York would uphold the partial release of the general power of appointment, and therefore invalidated the availability of the marital deduction.[92]

(2) IRS Gloss to *Bosch*

(a) Rev. Rul. 69-286[93] is the IRS interpretation of *Bosch*, invoking a two-part test:

(i) The state court opinion must be issued by the highest court of the

[90] 387 U.S. 456 (1967).
[91] 387 U.S. at 457.
[92] 382 F.2d 295 (2nd Cir. 1967).
[93] 1969-1 C.B. 222.

state, and

(ii) The decree must have determined state property rights.

(b) The IRS also feels unbound by state court proceedings in a non-adversarial proceeding.[94]

B. Compromise and Settlements

(1) A reformation can occur because of a compromise or settlement.

(2) The 1938 Supreme Court decision in *Lyeth v. Hoey*[95] addressed the question whether property received by an heir from the estate of his ancestor is acquired by inheritance, when it is distributed under an agreement settling a contest by the heir of the validity of the decedent's will and concluded that the answer to the issue is a federal question and determined by federal courts.

(a) The taxpayer was a grandson and heir of a decedent who had left the bulk of his estate in trust for the benefit of others. The grandson opposed the probate of the will because of lack of testamentary capacity and undue influence. In compromise and settlement, the grandson received $140,000.

(b) The IRS felt that the settlement proceeds should be taxed as ordinary income. The Court interpreted the predecessor to IRC §102(a) broadly and rejected the IRS position.

(3) *Lyeth* Progeny

(a) The subsequent cases to *Lyeth* have placed further gloss.

(b) The legitimacy of the claims in a family settlement agreement will be determinative whether the settlement is bona fide.[96]

(c) The principal appears in subsequent cases that an amount received is "is taxable or nontaxable according to what it represents."[97]

(d) If amounts received in settlement relate to the recipient's right to income, such settlement proceeds will generally be taxable or will be taxable as ordinary income.[98]

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[94] G.C.M. 39183, 1984 WL 264963 (March 6, 1984). See also, PLR 200144018 (Nov. 2, 2001)(court order modifying the trust to correct a scrivner's error was consistent with applicable state law, as it would be applied by the highest court of the state, and that the taxpayer should be deemed not to hold or to have released a general power of appointment over the trust).
[95] 305 U.S. 188 (1938).
[96] Ahmanson Foundation v. United States, 674 F.2d 761 (9th Cir. 1981).
[97] Bath v. United States, 480 F.2d 289, 292 (5th Cir. 1973).
[98] Getty v. Comm'r, 91 T.C. 160 (1988), rev'd 913 F.2d 1486 (9th Cir. 1990).

(4) **Sales & Exchanges**

(a) A settlement and compromise may take on attributes of a sale & exchange, in which event, the IRS could argue that a capital gain realization event has taken place in the settlement.

(b) The Fifth Circuit has held thusly: ("Thus, ... where the rationale of *Lyeth* is implicated but where, in addition, the transaction resembles a sale of exchange of property, we think that *Lyeth* governs unless it may be said that the circumstances surrounding the transaction fairly exclude the possibility that the exchange is in reality a compromise of an underlying and controverted claim such as one of gift, bequest, or inheritance"[99]

(5) **Gift Tax Effects**

(a) There is mixed authority on whether reformations will be effective in reversing taxable gifts.[100]

(b) In *Dodge v. United States*[101] a scivener's error led to an overly large transfer, reformation was obtained. The Fifth Circuit concluded that the excess gifts were incomplete gifts, defective from inception, and were subject to recall by the donor.

(c) A reformation can have gift tax effects. The IRS has stated:

> *An intrafamily settlement of litigation will not be regarded as a bona fide compromise agreement unless the parties' claims were bona fide and are satisfied, to the extent feasible, on an economically fair basis.*[102]

4. Reformation in Practice

A. Estate Planning Reformations

(1) Reforming estate planning instruments, such as will and trusts, is fairly frequent.

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[99] Early v. Comm'r, 445 F.2d 166, 169-170 (5th Cir. 1971)

[100] Van Den Wymelenberg v. United States, 397 F.2d 443 (7th Cir. 1968), cert. denied 393 U.S. 953 (1968)(reformation proceeding to revise trust to comply with IRC § 2503(c) cannot change federal gift tax consequences of a completed transaction); Dodge v. United States, 413 F.2d 1239 (5th Cir. 1969)(permitting gift to be reformed).

[101] 413 F.2d 1239 (5th Cir. 1969).

[102] P.L.R. 8902045 (Jan. 13, 1989).

(2) Reformation of trusts intending to hold S Corporation stock is also common.[103]

B. Charitable Gifts

(1) **Statutory Reformations.** Congress has permitted reformation of effective split interest trusts since beginning in 1974. The reformation provisions have been extended various times, and the 1984 Tax Reform Act established a permanent reformation procedure in IRC § 2055(e)(3).

(2) **Judicial Proceedings.** If a charity is paid in settlement of a will contest or other proceeding (apart from statutory reformation under IRC §2055(e)(2)(A)), then there has developed case law and IRS rulings concerning when the charitable deduction will be allowed.

(a) Rev. Rul. 89-31[104] explains under what circumstances the IRS will permit a charitable deduction for payments paid to a charity in settlement of a will context. The IRS requires a "bona fide" will contest.

(b) The case law is substantial. E.g. Northern Trust Company, Executors of Estate of William W. Seide v. United States, 78-1 U.S.T.C. ¶ 13,229 (N.D. Ill. 1977); Estate of Edgar v. Comm'r, 74 T.C. 983 (1981), aff'd, 676 F.2d 685 (3d Cir. 1982); Estate of Johnson v. United States, 941 F.2d 1318, 91-2 U.S.T.C. ¶60,084 (5th Cir. 1991).[105]

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[103] See Rev. Rul. 93-79, 1993-2 C.B. 269 (reformation lacked retroactive effect regarding government; trust not a qualified Subchapter S trust from date of formation)..

[104] 1989-1 C.B. 277.

[105] Representative literature on the subject would be: Gerzog, *The Times They Are Not A-Changin': Reforming The Charitable Split-Interest Rules (Again)*, 85 Chicago-Kent L. Rev. 849 (2010); and although a student note, nevertheless helpful, Note, *Galloway, Split-Interest Trusts, And Undivided Portions: Does Disallowing The Charitable Contribution Deduction Overstep Legislative Intent?*, 20 Regent U. L. Rev. 125 (2007);

RECOMMENDED ARTICLES

The following list contains the best articles on these subjects, at least in the opinion of the authors. The 1984 Banoff and 1990 Cashion papers have been attached to this paper. These are older articles from 1984 and 1990 and have proven a little difficult to locate and thus have been attached with permission.

Sheldon I. Banoff, *Unwinding or Rescinding a Transaction: Good Tax Planning or Tax Fraud?* 62 CCH Taxes 942 (1984) (attached with permission).

Sheldon I. Banoff, *Tax Planning for the Unexpected*, 68 CCH Taxes No. 12 (Dec. 1990).

Shelley Cashion, *If I Had It to Do Over Again: The Federal Income Tax Consequences of Unwinding or Rescinding a Transaction and Remedial Techniques for Mistakes by the Tax Practitioner*, 38th Annual Taxation Conference, University of Texas School of Law (1990) (attached with permission).

New York State Bar Association Tax Section, Report on The Rescission Doctrine (August 11, 2010), 2010 TNT 156-10.

David H. Schnabel, Revisionist History: Retroactive Federal Tax Planning, 60 Tax Law. 685 (2007).

David Hansen, *Unwinding Unwinding*, 57 Emory L.J. 871 (2008).

Hugh C. Montgomery, *Remedial Tax Planning: How to Fix It When It's Broke*, 25th Annual Southern Federal Tax Institute (Oct. 1990).[106]

Jeffrey L. Kwall and Stuart Duhl, *Backdating*, 63 Bus. Law. 1153 (August 2008).

Jasper L. Cummings, Jr., *Backdating Documents: Wrong or Just Dumb?*, Tax Notes (Oct. 20, 2014), p. 333.

[106] As an aside, the Montgomery paper is not publicly available. Remarkably, the Southern Federal Tax Institute does not have any of their proceedings prior to 1998. This author located a CPA in the southeast U.S. who has attended every Southern Federal Tax Institute and has maintained a copy of all of the proceedings. The gentleman kindly shared the Montgomery paper with me. If you want a copy, send me a request.

Handling a Tax Controversy: Audits, Appeals, Litigation, and Collections

Administrative Collection Procedures: Collection Due Process, Offers in Compromise, Installment Agreements, and Trust Fund Recovery Penalties

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Publications
"Addressing the Corporate Inversion Loophole: A Proposal to Redefine Domestic Corporation Status," *Texas Tax Lawyer*, Volume 43, Issue 2 (Winter 2016).
"Should a Mailbox Be Enough? A Proposal to Redefine Domestic Corporation Status," *ABA Section of Taxation News Quarterly*, Winter 2009.

Navigating the world of IRS collection actions can be a bit daunting. This paper provides an overview of the collections process. Section One discusses what options are available when a Taxpayer cannot pay his or her tax obligations in full, Section Two discusses IRS collection methods, and Section Three provides a brief discussion of the Appeals process.

Section One: Options if Taxes Cannot be Paid in Full

I. INSTALLMENT AGREEMENTS

Installment agreements are agreements in which the IRS allows taxpayers to pay their liabilities over a period of time. During the period of the installment agreement, penalties and interest continue to accrue. A taxpayer will not qualify for an installment agreement if he or she is not current on all tax filings.

A. User Fees for Installment Agreements.

a. Regular Installment Agreement – $225
b. Regular Installment Agreement with direct debit – $107
c. Low Income Installment Agreement – $43
d. Online Payment Agreement (non-direct debit) – $149
e. Online Payment Agreement with direct debit – $31
f. Restructured/Reinstatement of Installment Agreement – $89
g. Low Income Restructured/Reinstatement of Installment Agreement – $43

B. Guaranteed Installment Agreements. An installment is legally guaranteed if a Taxpayer owns $10,000 or less and the following requirements are met: (1) during the past 5 years, the Taxpayer (and spouse, if it is a joint return) has filed all income tax returns and paid any taxes due, (2) has not entered into an installment agreement for payment of tax, (3) agrees to pay the entire amount within three years, (4) agrees to comply with all tax laws during the agreement, and (5) the Taxpayer is not financially able to pay the liability in full when due and upon request has submitted proof of this fact. The $10,000 threshold is for taxes only and is determined without regard to interest, penalties, additions to tax, and additional amounts due.

C. Streamlined Installment Agreements. Streamlined installment agreements are available for taxpayers who owe $50,000 or less. Streamlined installment agreements were increased from $25,000 or less to $50,000 or less under the "Fresh Start"

Initiative. However, the requirements are slightly different for amounts of $25,000 or less versus amounts between $25,001 and $50,000.

1. *Streamlined Agreements for $25,000 or less*.
    a. Type of Taxpayers Eligible: Individual taxpayers who owe any type of tax, defunct business, including any type of entity and any type of tax, and operating business for income tax liabilities only.
    b. Payment Terms: Up to 72 months or the number of months necessary to satisfy the liability in full by the collection expiration date, whichever is less.
    c. Federal Tax Lien: No federal tax lien assessment determination is required.
2. *Streamlined Agreements for $25,001 to $50,000.*
    a. Type of Taxpayer Eligible: Individual taxpayers who owe any type of tax debt and all out of business sole proprietor tax debts.
    b. Payment Terms: Up to 72 months or the number of months necessary to satisfy the liability in full by the collection expiration date, whichever is less.
    c. Verification of Payment: Taxpayer will have to verify that he or she can pay the outstanding debt.
    d. Payment Method: Payment must be made by direct debit or payroll deduction.
    e. Federal Tax Lien: No federal tax lien assessment determination is required.
3. *Expanded Streamlined Processing*. The IRS is testing expanded streamlined processing through September 30, 2018 to include amounts up to $100,000. The test criteria change the streamlined requirements for amounts of $25,001 to $50,000 and allows for streamlined agreements for $50,001 to $100,000.
    a. $25,001-$50,000 Streamlined Agreement Test Criteria.
        i. Payment Terms: Up to 72 months or the number of months necessary to satisfy the liability in full by the collection expiration date, whichever is less.
        ii. No verification of payment is required.
        iii. Payment Method: Direct debt or payroll deduction is preferred but not required.

iv. Federal Tax Lien: No federal tax lien assessment is required if payment is made by direct debit or payroll deduction. If payment is not made by direct debit or payroll deduction, a lien determination will be made.

b. $50,001- $100,000 Streamline Agreement Test Criteria.

i. Type of Taxpayer Eligible: Individual taxpayers who owe any type of tax debt and all out of business sole proprietor tax debts.

ii. Payment Terms: Up to 84 months or the number of months necessary to satisfy the liability in full by the collection statute expiration date, whichever is less.

iii. Payment Method: Direct debit or payroll deduction is preferred but not required.

iv. A collection statement is required if direct debit or payroll deduction are not used for payment.

v. Federal Tax Lien: a determination of federal tax lien is required.

D. **In Business Express Trust Fund Installment Agreement**. Small businesses with employees can qualify for an In-Business Trust Fund Express Installment Agreement. In order to qualify, an aggregate of $25,000 or less must be owed, and the business must be currently compliant with all filing and payment requirements. The balance owed must be paid within the earlier of 24 months or prior to the Collection Statute Expiration Date. A business must be enrolled in a direct debit installment agreement if the amount owed is $10,000 or greater. A lien filing determination is not required.

E. **Partial Payment Installment Plans**. If full payment cannot be achieved by the Collection Expiration Date and taxpayer has some ability to pay, the Taxpayer can enter into a partial payment installment agreement. Partial payment installment agreements were allowed by the American Jobs Creation Act of 2004. In order to qualify, a Taxpayer must be in compliance with filing, withholding, federal tax deposits, and estimated tax payment requirements. The Taxpayer must agree to pay the maximum monthly payment amount based on the Taxpayer's ability to pay. The Taxpayer will be required to provide either a Form 443-A, collection information statement of wage earners and self-employed individuals, and/or a Form 433-B, collection information statement for businesses, to determine what the amount that the Taxpayer is able to pay. In most cases the Taxpayer will be required to use equity in assets to pay liabilities. A Taxpayer must make a good faith attempt to sell assets in order to pay the liability. Additionally, a partial pay installment agreement will be granted if the Taxpayer has no assets or equity in assets or has already liquidated all available assets. Further, a partial payment installment agreement may be granted if a Taxpayer does not sell or cannot borrow against his or her assets if assets have minimal equity or equity insufficient to allow creditor to loan funds, Taxpayer is unable to utilize equity, asset has some value but Taxpayer is unable to sell the asset because it is currently unmarketable, asset is necessary to generate income for the partial payment installment agreement and the government will receive more from future income generated by the asset than from the sale of the asset, the sale of the asset would impose an economic hardship on the Taxpayer to sell the property, borrow on the equity of the property, or use the liquid asset to pay taxes, or the Taxpayer's loan payment would exceed the Taxpayer's disposable income and Taxpayer wouldn't qualify for a loan. Under a partial payment installment plan, the collection statute expiration date can be extended pursuant to Internal Revenue Code §6502(a)(2)(A) and Internal Revenue Manual 5.14.2.1.3.

F. **Appeal**. Internal Revenue Code §7122(e) provides the right to appeal any rejection of an installment agreement. If a Taxpayer disagrees with the IRS' rejection of an installment agreement, a Taxpayer should appeal by completing Form 9423, Collection Appeal Request, within 30 days to the office or revenue officer who took the action regarding the rejection of the installment agreement.

II. OFFER IN COMPROMISE

An offer in compromise is an agreement between the Taxpayer and the Government that settles tax liability for payment of less than the full amount owed. Section 7122 of the Internal Revenue Code gives the Secretary of Treasury broad authority to compromise tax liabilities. The IRS' policy statement in regards to offer in compromises is set in Internal Revenue Manual 5.8.1.1.3: "the Service will accept offer in compromises when it is unlikely that the tax liability can be collected in full and the amount offered reasonably reflects collection potential. An offer in compromise is a legitimate alternative to declaring a case currently not collectible or a protracted installment agreement." An offer in compromise will not be accepted if it is believed that the liability can be paid in full as a lump sum, or by installment agreements that extend through the remaining statutory period for collection or other means of collection. An offer in compromise is effective for the entire assessed tax liability including penalties and interest for the periods covered by the offer. For the periods covered in the offer in compromise, all questions of tax liability are conclusively settled. Both the Government and the Taxpayer are prohibited from reopening a tax period covered by the offer in compromise except in cases where there was a falsification of information or documents, concealment of the ability to pay and/or assets, or a mutual mistake of material fact that is of enough significance to cause the agreement to be set aside or reformed.

Treasury Regulation §301.7122-1 provides that the grounds for compromise are (1) doubt as to collectability, (2) doubt as to liability, and (3) to promote effective tax administration. A doubt to collectability exists when genuine doubts exists that the IRS will be able to collect the full liability amount within the collection period. A doubt to liability exists when there is a genuine dispute to the existence or amount of the correct debt under law. A doubt to liability compromise cannot be sustained if the merits of the liability have been adjudicated by a court decision. In order to enter a compromise under promotion of effective tax administration, there is no doubt that the assessed tax is correct and no doubt that the amount could be collected, but the Taxpayer has economic hardship or other special circumstance which would allow the IRS to accept an offer in compromise. Under Treasury Regulation §301.6343-1, the IRS is allowed to compromise a tax liability based on effective tax administration if a financial hardship exists, public policy dictates it, or sufficient equitable considerations exists. Financial hardship as it applies to effective tax administration exists when the IRS determines the existence of a financial hardship by reducing a taxpayer's gross income by the national and local expense standards. An effective tax administration offer analysis can take into consideration more than just national and local expense standards including a Taxpayer's age, employment status, dependents, education expenses, and any extraordinary circumstances. Financial hardship effective tax administration compromises are only available to individuals and not corporations, partnerships, or other entities. Under effective tax administration, the IRS can compromise a liability based on public policy and equitable considerations if the Taxpayer can show that forcing payment in full would undermine the public's confidence that the tax laws are being administered in a fair and equitable matter. An example of public policy and equitable considerations under effective tax administration is found in Treasury Regulation §301.7122-1(c)(3)(iv), Example 1. This example provides that a compromise under effective tax administration would be granted in the case of an individual that suffered from a serious illness that required continuous hospitalization for several years and left him or her unable to manage financial affairs; however, once he or she recovered, the individual immediately filed his or her delinquent taxes and his or her compliance history was not so egregious as to outweigh the justifications for settlement.

In order to be eligible for an offer in compromise, a Taxpayer must file all tax returns that are legally required to be filed, received a bill for at least one tax debt included in the offer, make all required estimated tax payments for the current year, and make all required federal tax deposits for the current quarter if a business owner with employees. An individual that is currently in an open bankruptcy proceeding is not eligible to apply for an offer in compromise nor is a taxpayer whose case has been referred to the Department of Justice. Additionally, generally if a Taxpayer is able to pay his or her tax debt in full or through an installment agreement, the Taxpayer will not be eligible for an offer in compromise. When determining whether or not the Taxpayer can pay the tax debt in full or through an installment agreement, the IRS will look at the taxpayer's income and assets to make a determination of the taxpayer's reasonable collection potential. Under the "Fresh Start" Initiative, the IRS, when calculating collection potential will only look at one year of future income for offers paid with 6 months and 2 years of future income for offers paid in 6 –24 months. The IRS has an offer in compromise pre-qualifier on its website located at https://irs.treasury.gov/oic_pre_qualifier/.

The Taxpayer must initiate the first proposal for an offer in compromise. A proposal for an offer in compromise must include the basis on which he or she proposes to compromise: doubt as to collectability, doubt as to liability, or for effective tax administration. A Taxpayer should file an offer in compromise by Form 656. A completed offer must include, in addition to Form 656, either a completed and signed Form 433-A for individuals or Form 433-B for businesses, the application fee of $186, and the initial payment. The requirement for the application fee and initial payment can be waived if a low income certification is met.

The low income certification is set out on Section 1 of Form 656 and is only available to individuals and sole proprietors. The amount of initial fee submitted with the application depends on whether the Taxpayer is seeking a lump sum offer or periodic payment. A lump sum cash offer is any offer of payment made in five or fewer installments within five months of acceptance of the offer. There are limited exceptions where more favorable payment terms may be warranted, yet the payment terms cannot exceed 24 months. Internal Revenue Manual 5.8.1.9.4 sets out examples of some limited exceptions to payment within 5 months. A lump sum cash offer must include payments equal to 20% of the offer amount. A periodic payment is any offer in 6 or more installments. The total installments cannot exceed 24 months. A periodic payment offer must include the first proposed installment payment. Additionally, the Taxpayer is required to pay additional installments while the offer is being evaluated by the IRS. All payments made with the offer and during the consideration of the offer will be applied to the tax debt and are non-refundable.

If a Taxpayer has a genuine doubt that he or she owes part or all of the tax debt, he or she should complete and submit a Form 656-L, Offer in Compromise (Doubt to Liability). A Taxpayer will complete Form 656-L with an explanation as to why the tax is incorrect. The Taxpayer must indicate the amount he or she offers to pay in regards to the tax debt. The offer must be $1 or more and payable within 90 days of the notice of acceptance, unless an alternative payment term is approved at the time of acceptance. A Taxpayer does not send any payment with Form 656-L.

During the period that an offer in compromise is pending, the statute of limitations for assessment and collection is suspended. The IRS will keep any refunds due to the taxpayer for any tax period while the offer is pending. While the offer is pending, collection by levy on property owned by the offer Taxpayer is prohibited unless collection is in jeopardy and for 30 days after the offer is rejected. However, the prohibition on levy does not require release of a levy that was served prior to the offer submission. While an offer is pending, there is no prohibition of the filing of Notices of Federal Tax liens. By submitting an offer, the Taxpayer agrees that he or she will comply with all provisions of the internal revenue law, including the requirement to file timely tax returns and timely pay taxes for the 5 year period beginning with the date of acceptance of this offer and ending through the fifth year, including any extensions to file and pay. Additionally, the Taxpayer must promptly pay any tax liabilities assessed after the offer. The IRS must notify the Taxpayer within 24 months if the offer has been accepted or rejected. If a determination is not made within 24 months, the offer in compromise is deemed to be accepted.

Internal Revenue Code §7122(e) provides the right to appeal any rejection of an offer in compromise. If a Taxpayer disagrees with the IRS' rejection of an offer in compromise, a Taxpayer should appeal within 30 days of the rejection by either completing Form 13711, Request for Appeal of Offer in Compromise or by a separate letter with the following information: (1) name, address, social security number, and daytime phone number, (2) statement that he or she wants to appeal the IRS findings to the Appeals office, (3) copy of the rejected offer letter, (4) a list of specific items the Taxpayer doesn't agree with and a statement of why he or she disagrees with each item, (5) any additional information the Taxpayer wants Appeals to consider, (6) the facts supporting the position on any issue with which the Taxpayer disagrees, (7) the law or authority, if any, on which the Taxpayer relies, and he or she signs the letter statement that it is true under the penalties of perjury.

III. CURRENTLY NOT COLLECTIBLE

The IRS will designate a current Taxpayer's account as currently not collectible under certain circumstances, removing the account from the inventory. Internal Revenue Service policy statement 5-71 provides the authority for reporting accounts currently not collectible. Generally, an account will be reported as currently not collectible when after taking all the steps in the collection process it is determined that the Taxpayer has no assets or income which are, by law, subject to levy. Additionally, if there are limited assets or income but it is determined that a levy would create a hardship, the liability may be reported as currently not collectible. A hardship exists if the levy would prevent the Taxpayer from meeting necessary living expenses; a determination must be made on a case-by-case basis to determine if the levy would result in an actual hardship, rather than a mere inconvenience. In addition, accounts can be placed in currently not collectible status for a variety of other reasons, including but not limited to, the inability to locate the taxpayer or assets, partial or complete expiration of the statute of limitation for collection of the tax, death of an individual with no collection potential from the estate, a business cannot pay back taxes but can remain current, and inability to contact a taxpayer although the address is known and there is no means to enforce collection.

Generally, a collection information statement will be secured prior to determining that an account is currently not collectible. The Internal Revenue Manual 5.16.1.2.9(6) provides exceptions for when a collection information statement is required; the amount must be under a certain amount set by the Internal Revenue Service and at least one of the following must exist: (1) Taxpayer has a terminal illness or excessive medical bills, (2) the Taxpayer is incarcerated, (3) the Taxpayer's only source of income is Social Security, welfare, or unemployment, or (4) the Taxpayer is unemployed with no source of income. Upon agreement with a Taxpayer that the tax is currently not collectible, the IRS must release, as soon as practical, a levy on salary or wages (IRC §643(e)). During the period that the Taxpayer is determined currently not collectible, the statute of limitations continues to run and penalties and interest continue to accrue. In general, the IRS will file a Notice of Federal Tax Lien on accounts being reported as currently not collectible when the aggregate unpaid balance equals or exceeds $10,000. An account that is determined to be currently not collectible will generally be monitored and the IRS will follow up with Taxpayers to determine an ability to pay.

Section Two: IRS Collection Methods

I. FEDERAL TAX LIEN

A federal tax lien is a legal claim against all current and future property. The lien protects the government's interest in a Taxpayer's property, including real estate, personal property and financial assets. The IRS will file a Notice of Federal Tax Lien that identifies all tax liabilities owned by a Taxpayer. The Notice of Federal Tax Lien is necessary to establish the priority rights against other credits and the Notice of Federal Tax Lien alerts other creditors that that the government has an interest in the property. Internal Revenue Code §6320 states that a Taxpayer must be notified in writing not more than 5 business days after the filing of the notice of lien. This notice is sent as Letter 3172, and this letter should reflect (1) the amount of unpaid tax, (2) the right of the person to request a hearing during the 30 day period beginning after five business days of the filing of the lien (this date should be stated in the letter), (3) administrative appeals available to the taxpayer with respect to such lien and the procedures relating to such appeals, provisions relating to the release of liens on property, and (4) the provision of

Internal Revenue Code §7345 relating to the certification of serious delinquent tax debts and the denial, revocation, or limitation of passports of individuals with such debts.

A. Appealing a Federal Tax Lien. A federal tax lien can be appealed by the date set forth in the notice. This date should be thirty days following five business days from the date the lien was filed. The federal tax lien should be appealed on Form 12153 where the Taxpayer will indicate why he or she disagrees with the filing of the tax lien.

B. Release, Discharge, or Subordination of Lien. A lien can either be released by the IRS issuing a Certificate of Release of Federal Tax Lien or by the lien being self-released. The IRS will issue a Certificate of Release of Federal Tax Lien no later than 30 days after the Taxpayer satisfies the tax liability or the liability becomes legally unenforceable or the IRS accepts a bond guaranteeing payment of the debt. A lien is self-released if the date of refiling has passed, and the IRS has not refilled the Notice of Federal Tax Lien. A Federal Tax Lien must be renewed every 10 years. The Notice of Federal Tax Lien will typically state the date when a tax lien must be renewed.

A specific property may be discharged from a lien pursuant to Internal Revenue Code §6325(b). Section 6325(b)(1) allows for a discharge if the value of the Taxpayer's remaining property encumbered by the federal tax lien is equal to at least twice the amount of the federal tax liability secured by the lien and any encumbrance entered into before the IRS filed its public notice of lien. Section 6325(b)(2)(A) allows a discharge if the tax liability is partially satisfied with an amount paid that is not less than the value of the United States' interest in the property being discharged. A discharge can occur if the government's interest in the property has no value (IRC §6325(b)(2)(B) or an agreement with the IRS is reached allowing the property to be sold. Finally, pursuant to Section 6325(b)(4) a discharge can be issued to a third party who owns the property if a deposit is made or an acceptable bond is provided equal to the Government's interest in the property.

Internal Revenue Code §6325(d) allows a named creditor to move its junior creditor position ahead of the United States' in a particular property. Section 6325(d)(1) provides that a subordination can be issued if the Taxpayer pays an amount equal to the lien or interest to which the certificate subordinates the lien of the United States. Pursuant to Section 6325(d)(2) a subordination can be issued if the IRS determines that the issuance of the certificate of subordination will increase the amount the government realizes and makes the collection of the tax liability easier.

II. IRS LEVY

A levy is a legal seizure that actually takes a Taxpayer's property or rights to property to satisfy a Taxpayer's debt. The IRS cannot seize a Taxpayer's property if the Taxpayer has a current or pending Installment Agreement, Offer in Compromise, or a determination that the amount is currently not collectible. The IRS will typically only seize property after the IRS has assessed the tax and sent a bill, the Taxpayer neglected or refused to pay the tax, and the IRS sent a Final Notice of Intent to Levy and Notice of a Right to a Hearing 30 days before the actual seizure. However, in certain circumstances the IRS can seize a Taxpayer's property without a hearing; such situations include, the collection of tax being in jeopardy, levy is served to collection tax from a state refund, levy served to collect the tax debt of a federal contractor, or a disqualified employment tax levy is served. A disqualified employment tax levy is the seizure of unpaid employment taxes and can be served when a Taxpayer previously requested a Collection Due Process Appeal on employment taxes for other periods within the past 2 years. Typically, if property is levied without the 30 day right to hearing, a Taxpayer is given a 10 day period after the levy to appeal. Certain property is exempt from seizure; for example, unemployment benefits, certain annuity and pension benefits, certain service-connected disability payments, worker's compensation, certain public assistance payments, minimum weekly exempt income, assistance under the Job Training Partnership Act, and income for court-ordered child support payments.

The Final Notice of Intent to Levy must be sent by certified mail with a return receipt requested to Taxpayer's last known address. The Notice of Intent to Levy must include the amount of unpaid tax, right to request a hearing during the 30 day period, and the proposed action to be taken. A Taxpayer has 30 days to appeal the Notice of Intent to Levy and the appeal should be made on Form 121533.

III. TRUST FUND RECOVERY PENALTY

To encourage prompt payment of withheld income and employment taxes, including social security taxes, railroad retirement taxes, or collected excise taxes, Congress passed a law that provides for the Trust Fund Recovery Penalty in Internal Revenue Code §7501. A Trust Fund Penalty can be assessed against any person required to collect, truthfully account for, and pay over any tax who willfully fails to collect, account for or pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or payment thereof and such person shall be liable for a penalty equal to the amount of the tax evaded, or not collected, or not accounted for and paid over (IRC §6672). A responsible person is a person or group of people that have the duty to perform and the power to direct the collecting, accounting, and paying of trust fund taxes. The determination of responsible person is based upon a fact and circumstances test. A responsible person may be an officer or employee of a corporation, a member or employee of a partnership, a corporate director or shareholder, a member of a board of trustees of a nonprofit organization, another person with authority and control over funds to direct their disbursement, another corporation or third party payer, payroll service providers or responsible parties within a payroll service provider, professional employer organizations or responsible parties within a professional employer organization, responsible parties within the common law employer, or business entities that are determined to be the collection agency in the case of certain collected excise taxes. Willfulness does not require fraudulent intent or evil purpose; it only requires knowingly, or intentionally, disregarding the statutory provisions. Willfulness occurs when there is knowledge of the nonpayment or reckless disregard as to whether payments are made (*Turpin v. United States*, 970 F. 2d 1344 (4th Cir. 1992)). Willfulness can be established if a responsible person failed to investigate or correct mismanagement after being notified that withholding taxes have not been satisfied (I.R.M. 5.7.3.3.2). Intentional preference of other creditors over the United States is sufficient to establish the element of willfulness if the responsible person knew or recklessly disregarded the existence of an unpaid deficiency (*Turpin v. United States).* Internal Revenue Manual 8.25.1.4.2 lists the following factors in determining willfulness: (1) whether the responsible person had knowledge of a pattern of noncompliance as delinquencies accrued, (2) whether the responsible person received prior IRS notices that returns were not filed, or were inaccurate, or that employment taxes had not been paid, (3) actions taken by the responsible person to ensure its Federal employment tax obligations have been met after becoming aware of the tax delinquencies; and (4) whether fraud or deception was used to conceal the nonpayment of tax from the responsible person.

A trust fund recovery penalty case must be brought within three years from the later of April 15th of the year following the year the liabilities accrued, or the date the return for the period at issue was actually filed (IRC §6501). The filing of a substitute return by the IRS does not begin the statute of limitations (IRC §6501(b)(3)). Additionally, the tax may be assessed at any time in the case of a false or fraudulent return with the intent to evade tax, in the case of a willful attempt in any matter to defeat or evade tax, or when no return is filed (IRC §6501(c)). If a notice of proposed assessment is issued before the expiration of the period of limitations, the period of limitations shall not expire before the later of 90 days after the notice is mailed or delivered in person, or if there is a timely protest, 30 days after the Secretary makes a final determination with respect to the protest (IRC §6672(b)(3)).

The process of assessing a Trust Fund Recovery Penalty begins with a revenue agent conducting an investigation to determine which individuals are responsible and willful and whether there is collectability potential. The IRS will attempt to conduct interviews with potentially responsible persons. The revenue officer will use Form 4180, Interview with Individual Relative to Trust Fund Recovery Penalty, to record the interview; this form will be used as evidence when assessing the penalty. Typically, the IRS will request corporate records, bank documents, and other related documents. If these documents are not provided, the IRS can issue a summons to obtain the documents. After determining who the responsible party or parties may be, the IRS must make a collectability determination. A collectability determination must be made in order to determine if the Tax Fund Recovery Penalty should be assessed. In order to make this determination, the IRS will request that a Form 433-A (Collection Information Sheet for Wage Earners and Self-Employed Individuals) be completed. The IRS will consider the following factors when making a collectability determination: (1) current financial condition, (2) involvement in a bankruptcy proceeding, (3) income history and future income potential, and (4) asset potential, the likelihood of increase of equity in assets and Taxpayer's potential to acquire assets in the future (IRM 5.7.5.3). The IRS utilizes this information to make a determination regarding collectability, and a trust fund recovery penalty will normally not be assessed if there is no present or future collection potential or neither the responsible person nor their assets/income source can be located (I.R.M. 5.7.5.1.1).

When the revenue officer identifies the responsible person or persons and determines that there is collection potential, Letter 1153, Notice of Proposed Assessment, must be issued to each responsible person. The notice must advise the person or persons against whom the penalty is asserted of the proposed assessment, the amounts at issue, and the right to appeal the proposed assessment by filing a protest within 60 days from the date on the letter or 75 days if the letter is addressed outside of the United States (IRC §6672(b)(2). Once the Notice of Proposed Assessment is received, the Taxpayer has a couple of options: (1) agree to the assessment, (2) request a conference with revenue office group manager, (3) request a fast track mediation, (4) file a timely appeal, or (5) do nothing and have the penalty assessed. If the Taxpayer agrees to the assessment, he or she will sign Form 2751, Proposed Assessment of the Trust Fund Recovery Penalty. Fast Track Mediation is designed to promote resolution 30-40 days after the initial meeting with the Appeals officer; the request for Fast Track Mediation must be made before a protest is submitted but does not extend the time to request pre-assessment appeal. An appeal must be filed within 60 days from the date on Letter 1153 or 75 days if the letter is addressed outside of the United States. If the total proposed assessment for each tax period is $25,000, a small case request can be filed. For a small case request, the Taxpayer sends a letter stating that he or she wants to appeal the proposed assessments to the attention of the IRS officer whose name and address is on Letter 1153. The letter will include a copy of Taxpayer's Letter 1153, explanation of why the Taxpayer does not believe they are responsible for the unpaid taxes, and/or reason he or she disagrees with the amount, and a clear explanation of the Taxpayer's duties and responsibilities during the tax periods listed in the letter. If the total amount of the proposed assessment for any one period is greater than $25,000, the Taxpayer must file a formal written protest for all periods. The written protest must be sent to the IRS officer whose name and address was in Letter 1153 and must include a statement that the Taxpayer wants to appeal the proposed assessment(s), include the Taxpayer's name, address, social security number, and daytime telephone number, a copy of Letter 1153, list of tax periods involved, explanation of why the Taxpayer does not believe that he or she is responsible for the unpaid taxes or the reason he or she disagrees with the amount of proposed assessment(s), include a clear explanation of the Taxpayer's duties and responsibilities, cite the authority or law on which the Taxpayer is relying, and sign the written protest under the penalties of perjury, by making the following statement: "Under the penalties of perjury, I declare that I examined the facts stated in this protest, including any accompanying documents, and, to the best of my knowledge and belief, they are true, correct, and complete."

As an alternative to appealing the trust fund recovery penalty assessment, the Taxpayer may pay a portion of the penalty and then file a refund and request for abatement. The Taxpayer must pay the portion of a trust fund recovery penalty that equals the amount due for a single employee for the period at issue or for one transaction if the claim relates to excise tax (IRM 5.7.7.4). Once the payment is made, the Taxpayer must file a separate Form 843, Claim for Refund and Request for Abatement, for each tax period and type of tax or penalty (IRC §7422(a); Treas. Reg. §301.6402-2(d). The claim for refund must include each ground upon which a refund is claimed and facts sufficient to establish the grounds for allowance (Treas. Reg. §301.6402-2(b)(1) and only payments within the two years prior to the claim will be considered for a refund (IRC §6511(a)). A Taxpayer must wait the later of 6 months or rejection of a refund claim to initiate refund litigation. (IRC §6532(a)(1)). If a refund claim is disallowed, the Service will issue a certified letter to indicate the disallowance of the claim and to notify the Taxpayer of the two year period to file a suit. Taxpayer may file an administrative appeal within 30 days of the date of the Notice of Claim Disallowance but this appeal does not extend the two year period to file suit in Federal District Court or Federal Claims Court.

Section Three: Appeals

I. COLLECTION DUE PROCESS

Collection due process was created by the IRS Restructuring and Reform Act 1998. The purpose of collection due process is to give Taxpayers an opportunity for a meaningful hearing before the IRS issues its first levy or immediately after it files its first Notice of Federal Tax Lien. The collection due process hearing affords the Taxpayer a hearing before an appeals officer. At the hearing, the Taxpayer may raise the following issues: (1) collection alternatives such as installment agreement or offer in compromise, (2) subordination or discharge of lien, (3) withdrawal of Notice of Federal Tax Lien, (4) appropriate spouse defenses, (5) the existence or amount of tax, but only if the Taxpayer did not receive a Notice of Deficiency or did not otherwise have an opportunity to dispute the tax liability. However, a Taxpayer cannot raise an issue that was raised and considered at a prior administrative hearing or judicial hearing if the Taxpayer participated meaningfully in that hearing or proceeding. A Taxpayer is entitled to only one hearing per type of tax and tax period for the liability listed on the Notice of Federal Tax Lien or Final Notice of Intent to Levy.

After the hearing, the appeals officer will issue a Notice of Determination. The Notice of Determination will verify that the Internal Revenue Code requirements are satisfied, outline the issues and defenses raised by the Taxpayer, a discussion of whether proposed collection alternative balances the need for efficient collection while ensuring that collection is no more intrusive than necessary, and that an appeal of the decision must be made within 30 days. If the Taxpayer is dissatisfied with the conference, the Taxpayer may seek judicial review in the US Tax Court, if the Tax Court has jurisdiction over the underlying tax liability, or if not, to a United States District Court or Court of Federal Claims. The Taxpayer must file the notice of appeal within 30 days of the hearing.

II. COLLECTION APPEALS PROGRAM

The Collection Appeals Program was implemented in 1996. The Collection Appeals Program offers the Taxpayer the opportunity to obtain appellate relief on a wide variety of actions taken during collection, including the issuance of a federal tax lien, a levy or garnishment of wages, seizure of property, rejection of offer in compromise or installment agreement, denial by the IRS to withdraw a notice of tax lien, or denial of a discharge, subordination, or subrogation of a lien. Collection Appeals Program does allow for a wider variety of actions, but the existence of or amount of liability cannot be considered nor are alternatives considered under appeal. The determination from the Collection Appeals Program is final and cannot be appealed. An appeal under this program can be requested by using IRS Form 9423.

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How the IRS is Adapting to Cryptocurrency and the Sharing Economy

By: Joshua Wu

The idea of sharing assets is not a new idea. People have been sharing buses, cars, houses, and tools for decades. But the connectivity that the digital revolution has created allows people to share assets on a massive scale. New technology allows economic arrangements that, due to transaction costs, were previously inefficient. Over 162 million people participate in the sharing economy, with more than 70 million people relying on it as their primary income source.[1] Adding fuel to the new economy is cryptocurrency, which allows people from across the globe to transact business without the barriers and risks of traditional currency exchange. Cryptocurrency also adds a layer of anonymity on a much larger scale than was possible in the past using cash, diamonds, and the like.

Back in 2009, Satoshi Nakamoto started a cryptocurrency called Bitcoin. The currency remained largely outside the realm of daily life and received little attention from the Internal Revenue Service ("IRS"). Over time the technology underlying Bitcoin evolved into other cryptocurrencies and applications. Slowly, the idea of cryptocurrency moved into mainstream commerce as businesses began accepting cryptocurrency. Eventually, cryptocurrency caught the attention of investors and a historic increase in cryptocurrency value ensued. As of June 2, 2017, the total value of the Bitcoin supply and circulation was $41 billion.[2] The price of a Bitcoin in September 2017 hit $3,320, rising to $19,211 by December of 2017. Investors have seen massive returns over the last two years which may lead to significant taxable gain.

At first, the IRS was relatively slow to respond to the digital revolution. The National Taxpayer Advocate advised the IRS to develop guidance for taxpayers who participate in the new digital economy. The U.S. House of Representatives also held hearings in May of 2016 where academics and practitioners shared concerns regarding the tax compliance issues for participants in the digital economy.[3] The IRS took the suggestions of Congress and the Taxpayer Advocate to heart and, in August 2016, released the IRS Sharing Economy Tax Center (IR-2016-110). The website provided information to taxpayers involved in the sharing economy and linked to relevant IRS Publications. The site was designed to provide a simple question and answer format for entrepreneurs that wanted to comply with the tax law.

In a similar vein to the sharing economy guidance, the IRS issued frequently asked questions addressing cryptocurrency in 2014. (Notice 2014-21.) The IRS decided to treat cryptocurrency as property, not currency. In the Notice, the IRS defined cryptocurrency as a "digital representation of value that functions as a medium of

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[1] See McKinsey Global Institute (2016), available at https://www.mckinsey.com/global-themes/employment-and-growth/independent-work-choice-necessity-and-the-gig-economy

[2] 2017 TNT 108-17, Lawmakers Ask IRS to Clarify Tax Treatment of Virtual Currency (June 2, 2017).

[3] See "The Sharing Economy: A Taxing Experience for New Entrepreneurs" – Hearing Before Committee on Small Business (May 2016).

exchange, a unit of account, and/or a store of value." The IRS stated that in some environments it operates like "real" currency, but it does not have legal tender status in any jurisdiction. Despite the resemblance of cryptocurrency to legal tender, buying and selling cryptocurrency as an investment is treated the same as buying and selling stock. For taxpayers spending cryptocurrency online or in stores, each purchase may result in taxable gain or loss on the cryptocurrency.

As with other types of property, the holding period for cryptocurrency is important because it determines whether the gain or loss is long-term or short-term. Long-term capital gains, for assets held longer than one year, are taxed at favorable rates (0% to 20%). Short-term capital gains, for assets held for one year or less, are taxed at ordinary income rates. Determining the holding period creates numerous compliance issues for taxpayers.

Imagine a taxpayer who purchased one Bitcoin for $1,000. In the most simplistic scenario, the taxpayer holds the Bitcoin and then sells it for $1,500 one month later. That would create $500 of short-term gain on the date of sale. However, the scenario gets much more complex if instead of buying, holding, and selling, the taxpayer purchases one Bitcoin for $1,000, uses a portion of the Bitcoin to buy a cellphone, to pay a utility bill, to purchase another cryptocurrency like Ethereum, and then sells the remaining amount. Now there are four taxable events all occurring at different times, and the IRS guidance provides that the taxpayer must determine the fair market value of the Bitcoin in U.S. dollars as of the date of each taxable event.

Adding to this complexity is the Tax Cuts and Jobs Act ("TCJA"). For 2018 and forward the TCJA made significant changes to Section 1031 (like-kind exchange). Before 2018, certain exchanges of property (real and certain personal) could be made without triggering a taxable event. Since the IRS classified cryptocurrency as property, it was possible that taxpayers exchanging (or trading) one type of cryptocurrency for another could defer tax until a later date. With over 100 types of cryptocurrency, this was a significant benefit. The TCJA closed any possibility of this deferral by changing Section 1031 so that it is limited to real property. One proposed (but not adopted) amendment to the original House version of the TCJA would have created a *de minimis* exemption for cryptocurrency transactions for goods and services below $600. The exemption would have made such small transactions exempt so that taxpayers would not have to track and pay taxes on small gains for purchases.[4]

The numerous tax compliance issues with cryptocurrency, combined with securities law and money laundering concerns, result in a complex legal framework for taxpayers attempting to invest and use cryptocurrency in their daily lives. Further, for individuals using cryptocurrency to participate in the sharing economy the compliance costs may exceed the income. As noted in the hearings before Congress, average monthly income from the sharing economy ranges from $314 to $533. Hours spent in the sharing economy average 12 per week. This means that many taxpayers earn under $25,000 per year from the sharing economy. At those levels, many taxpayers may be unwilling to

[4] Cryptocurrency Tax Fairness Act, H.R. 3708 (115th).

incur the expense of engaging tax advisors to help them comply with the complex requirements for reporting cryptocurrency gain and accounting for income and expenses incurred in the sharing economy activity.

Regardless of compliance costs, taxpayers need to realize that the IRS and Department of Justice have a strong interest in cryptocurrency enforcement. In the last year, the DOJ issued a summons to Coinbase and the IRS set up an internal virtual currency team. The IRS also hired a cryptocurrency software vendor called Chianalysis to track the movement of money through the bitcoin economy. Even some IRS forms have changed to adapt to cryptocurrency. The Form 433-A (OIC) that is used for offers in compromise was recently modified to include a checkbox for “Virtual Currency” under the normal section where personal assets are reported. Taxpayers and tax advisors need to be careful to include cryptocurrency and sharing economy activity on tax returns and other IRS forms. The penalties for failing to do so can be severe.

About the Author: Josh is a Member of Clark Hill Strasburger and works out of the firm’s San Antonio and Washington, DC offices. Josh advises large corporations, mid-size businesses, startup companies, and high-net-worth individuals on all aspects of federal tax law. He has particular experience with resolving complex IRS audits, administrative appeals, civil tax litigation, offshore trusts and assets, multijurisdictional investigations, and IRS collection matters.

Prior to joining Clark Hill Strasburger, Josh worked for several international law firms and has been quoted in major news outlets such as The Street, Federal Tax Weekly, and Business News Daily.

Lender Management Case
By Jim Roberts[1]

In December 2017, the US Tax Court handed down its decision in *Lender Management, LLC, et al v. Commissioner*, T. C. Memo 2017-246 (this decision came after consolidating cases involving the Marvin K. Lender Revocable Trust and the Keith F. Lender Revocable Trust). In this case, Lender Management, LLC ("Lender Management") reported net losses on its income tax returns for 2010 and 2011 of $462,505 and $307,760, respectively. The next year, 2012, saw a net profit of $376,238 and 2013 was even better at $808,302 in profit. During each of those years, Lender Management was treated as a partnership for federal income tax purposes. Those gains and losses were reported on the tax returns for those trusts.

Lender Management reported the losses and deducted them under Section 162. The IRS disagreed, claiming they were deductible under Section 212, making them subject to the limitation in Section 67 (2% floor) on the returns of the partners. On July 9, 2015, the IRS issued notices of final partnership administrative adjustments (FPAAs), disallowing deductions claimed pursuant to Section 162.

The sole issue before the Tax Court was whether Lender Management carried on a trade or business within the meaning of Section 162 during tax years 2010-2012, and thus whether the deductions were appropriate under Section 162 or, alternatively, if Lender Management did not carry on a trade or business, whether the deductions should be under Section 212 and subject to the Section 67 limitation.

Harry Lender made his fortune in bagels (Lender's Bagels). Harry's two sons, Marvin and Murray, were active in the business. After Harry's death, they continued to manage Lender's Bagels for many years. Marvin and his wife, Helaine, had three children, Keith, Sondra and Heidi, and 4 grandchildren. Murray had three children, Carl, Jay and Haris, and 6 grandchildren. At the time of the tax litigation, the family was scattered, living in various states and countries. Marvin's grandchildren and Murray's grandchildren were rarely in contact with one another. Divorces had occurred over the years. In 2000, Murray divorced his wife who took her share of financial assets, leaving Murray's family far fewer assets under management than Marvin's family. Those facts suggest that there was no single, cohesive family which unanimously supported any particular path or decision. In fact, the facts suggest that some family members may not have even known the others.

Over the years, the Lender fortune was managed through certain entities. Lender Management, which provided the investment management expertise for the entities, was initially owned by two revocable trusts, the Marvin Lender Trust and the Helaine Lender Trust. Marvin did most of the management work. In December 2010, their son, Keith, acquired 99% of Lender Management, leaving 1% in the Marvin Lender Trust, at least through December 2012.

Lender Management provided direct management services to 3 LLCs, Murray & Marvin

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Lender Investments ("M&M"), LLC, Lenco Investments, LLC ("Lenco") and Lotis Equity, LLC ("Lotis"), which, like Lender Management, were treated as partnerships for federal income tax purposes. The owners were in each case all of the children, grandchildren and great-grandchildren of Harry although the ownership percentages varied widely.

Looking at the structure, the IRS concluded that this was merely a family managing its own assets and normally that would not be considered a trade or business.

The Tax Court first pointed out that the Internal Revenue Code does not define "trade or business." The Court cited *Higgins v. Commissioner*, 312 U.S. 212, 217 (1941) in which the Supreme Court held that the courts need to decide whether a trade or business exists based on an examination of the facts in each case. To be engaged in a trade or business, "the taxpayer must be involved in the activity with continuity and regularity and … the taxpayer's primary purpose for engaging in the activity must be for income or profit." *Commissioner V. Groetzinger*, 480 U.S. 23, 35 (1987). The Tax Court contrasted a business activity with a "sporadic activity, a hobby, or an amusement diversion" saying those would not qualify. And the Tax Court pointed out that the activity does not need to generate an immediate profit or produce a profit in the tax year at issue but a good faith effort must exist to conduct the business for the pursuit of profit. By implication, this was not simply a home-brewed management operation.

On the issue of continuity, the Court said that Lender Management had been in operation for 25 years. It went on to say that the investment LLCs (M&M, Lenco and Lotis) were created in 2005 as part of a reorganization of Lender Management to accommodate greater diversification of the managed investments and more flexible asset allocation at the individual investor level. As part of that effort, Lender Management engaged a hedge fund specialist to help it restructure its affairs and its managed portfolio using a hedge fund, or "fund of funds," manager model. After the restructuring, M&M invested in private equities, Lenco in hedge funds and Lotis in public equities (Lotis merged into Lenco in 2010).

Lender Management employed five people, including Keith as CIO and President in 2012. The Court pointed out that Keith was a Cornell undergrad and held a Kellogg MBA, and the record showed that Keith worked more than full time at the job.

In this context, where an organization such as Lender Management is managing assets, the Court said a common factor in distinguishing the conduct of a trade or business from mere investment is the receipt of compensation other than the normal return that an investor receives. *Whipple v. Commissioner*, 373 US 193 (1963) at 202-203. Lender Management was paid for its services through a profits interest, entitling it a percentage of income and net increases in asset value. Unlike any of the partners which would have seen their income and value rise and fall merely as a function of return on investment, Lender Management operated more like an outside manager in that it was paid when net income was produced and it was entitled to a percentage of the growth. The Court believed that the profits interest was different from a normal investor's return and, thus, satisfied that factor, pointing out that the trade or business designation may apply even though the taxpayer invests his, her or its own funds alongside those that are managed for others, provided the facts otherwise support the conclusion that the taxpayer was not just a passive investor.

The court pointed out that each of the members of the LLCs understood they could withdraw their investments at any time if they became unsatisfied. And, further, Lender Management was not guaranteed a position as manager of the investments. It could be fired at any time. Another factor was that Lender Management, through some of its downstream entities, was managing investments for people who were not a part of the family. And Lender Management was being paid to do that in the same way that it was paid for the investment LLCs owned by the family. The Court went on to point out that Lender Management provided to "its clients" services that were comparable to that which a hedge fund manager might provide.

The Court acknowledged that the presence of family relationships indicated that heightened scrutiny would be appropriate in this context. Yet, in spite of that, the Tax Court concluded that Lender Management met the tests for characterization as a trade or business and, as a result, could deduct its losses in 2010 and 2011, and its owners could likewise deduct those losses without reduction under Section 67.

Practice Suggestions. In many families, family-owned LLCs and limited partnerships hold investment-grade assets and are managed by a general partner corporation or LLC. Many of the investment costs are subject to the 2% floor in Section 67. Practitioners might be well advised to note the different factors in the Lender Management case and consider restructuring family-owned LLCs and limited partnerships in a way so that management fees are paid to a management company (LLC, limited partnership, corporation, etc.) in a way that is not equivalent to a normal return on investment. In addition, consideration should be given to involving non-family members, operating continuously and regularly, perhaps at an established place of business. And, in addtion, not permanently tying the management entity to the family-owned LLCs and limited partnerships.

In many cases, these sorts of management entities will be owned by senior generations. Because the entities will hold profits interests, extraordinary care should be exercised whenever a senior generation wishes to transfer those profits interest to a lower, younger generation. Section 2701 may come into play and, if care is not exercised, the transfer of the profits interest could be treated as a transfer of every interest held by the senior generation transferor, even if interests are withheld, resulting in a much larger deemed gift for federal gift tax purposes than the senior generation might intend. Note the instant case offers no description of the transaction transferring 99% of Lender Management from the senior generation, Marvin and Elaine, to their son, Keith. For others attempting to structure management companies that might fit under the Lender Management decision, care should be taken to plan for the ownership of such management entities now and in the future, with an eye to the potential pitfalls when later attempting to transfer profits interest to younger generations.

What's The Fuss From the DOL About Missing Participants

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HOW DO MISSING PARTICIPANTS IMPACT MY PLAN?

- DOL civil penalties for failure to provide notices
- Fiduciary penalties
- Prohibited transactions
- Higher per participant administrative fees
- Difficult to terminate a plan
- Disqualification for missed RMDs
- Uncashed checks are not held in trust as required by ERISA
  - Float
  - Need to reverse 1099-R

WHO IS A MISSING PARTICIPANT?

- A participant is generally considered missing when use of the address supplied by the participant and reflected in the plan records as the most recent mailing address results in returned mail.

WHAT IF THE PLAN REQUIRES THE PARTICIPANT TO KEEP HER ADDRESS CURRENT WITH THE PLAN?

- PLAN LANGUAGE: "Participants are responsible for notifying the plan of a change of address and providing current contact information."
  - Plan provision
  - SPD provision

HOW DOES THIS PROBLEM COME UP IN THE FIRST PLACE?

- Bad addresses to start with
- Participants move and do not update their information
- Incorrect social security numbers
- Name changes
- Common names
- Change of recordkeepers
- Corporate changes
- Turnover of internal staff

HOW DO I KNOW IF MY PLAN HAS A MISSING PARTICIPANT PROBLEM?

- Returned mail that includes participant statements and notices
- Returned distribution checks
- Processing a correction under EPCRS that involves corrective additions to participant accounts.

WHY WOULDN'T A PARTICIPANT CASH A DISTRIBUTION CHECK?

- Incorrect mailing address
- Lost or misplaced physical check
- Mandatory cashout check that was not anticipated
- Just didn't get it done.

WHAT KINDS OF PLANS ARE IMPACTED?

- Defined benefit plans
- 401(K) plans
  - Especially plans with automatic enrollment
  - Plans with younger workers
- 403(b) plans
- Not:
  - IRAs
  - Governmental 457(b)

WHAT ARE MY LEGAL RESPONSIBILITIES?

- ERISA Fiduciary Duties
  - Duty of prudence
  - Duty of loyalty
- DOL says that plan fiduciaries must make reasonable efforts to locate missing participants and beneficiaries.
- A plan fiduciary may charge missing participants’ accounts reasonable expenses for efforts to find them.

WON'T THE IRS HELP ME FIND MY MISSING PARTICIPANTS?

- No. The IRS discontinued its letter forwarding program in 2012.
- The IRS does not believe that its addresses for missing participants are of any greater value than addresses available through other alternatives, such as commercial locator services.

WILL THE SOCIAL SECURITY ADMINISTRATION HELP ME FIND MY MISSING PARTICIPANTS?

- No.
- The Social Security Administration discontinued its letter forwarding program in 2014.

ARE THE CURRENT REGULATIONS SUFFICIENT?

- IRS, DOL and PBGC have not issued any official guidance on search processes.
- Current enforcement actions are unnecessarily and unfairly adversarial
- Enforcement positions:
  - Inconsistent across agents
  - Reflect legal positions never announced
  - Reflect legal positions contrary to announced positions
  - Creates confusion
  - Undermines industry efforts to improve voluntary compliance
- IRS and DOL demand “scorch the earth” search methods for missing participants that lack realistic cost/benefit balance

WHAT IS THE FOCUS OF THE DOL MISSING PARTICIPANT INVESTIGATIONS?

- DOL’s regional and national investigation focus
- Working to ensure that workers are connected to their pension checks
- Started in Philadelphia office in 2016
- Response to a surge in calls to DOL regarding Social Security Administration letters sent to individuals nearing retirement age
- Focused on large defined benefit plans with a high number of terminated vested participants who are not receiving monthly payments or lump sums
- In 2017 DOL recovered more than $274 million owed to 4,018 people.

WHO ELSE IS DEALING WITH MISSING PARTICIPANT PROBLEMS?

- MetLife—Made SEC 8-K filing disclosing that it had lost track of 13,500 participants who were owed pension benefits.
  - 2% of its pension risk transfer population
  - Increased reserves by $525 million and charge to earnings
- Self audit
- Missing participant practices established 25 years ago and management controls were ineffective.

HOW CAN THE IRS HELP?

- Favorable enforcement guidance issued to examiners in 2017 and 2018
- IRS Priority Guidance Plan includes development of guidance aimed at finding missing participants
- Forfeiture of benefit; permitted by IRS regulations
  - Plan provision required
  - Advance notice to affected participants of plan's forfeiture procedure
  - Benefit must be reinstated if the participant makes a claim
    - What about investment earnings?
  - How are forfeitures used?

WILL IRS PROVIDE RELIEF FROM DISQUALIFICATION DUE TO RMD FAILURES?

- In October 2017, the IRS National Office issued audit guidelines for required minimum distribution failures from qualified plans due to missing participants and beneficiaries
- Expanded to 403(b) plans in February, 2018
- Added to Internal Revenue Manual

WILL IRS PROVIDE RELIEF FROM DISQUALIFICATION DUE TO RMD FAILURES?

- IRS agents are instructed not to challenge the tax status of a plan as long as the plan has:
  - Searched plan, plan sponsor and publicly available records or directories for alternative contact information
  - Used any of the search methods below:
    - A commercial locator service
    - A credit reporting agency
    - A proprietary Internet search tool for locating individuals; and

WILL IRS PROVIDE RELIEF FROM DISQUALIFICATION DUE TO RMD FAILURES?

- Attempted contacts by certified mail to the last known mailing address and through appropriate means for any address or contact information (including email address and telephone numbers).

HOW CAN THE DOL HELP?

- Field Assistance Bulletin (FAB) 2014-01
  - Applies to terminating defined contribution plans
  - Reasonable efforts to locate all missing participants
- Search steps:
  - Required
    - Certified mail
    - Check records for other plans
    - Check with the designated beneficiary
    - Use free electronic search tools

HOW CAN THE DOL HELP?

- Search steps:
  - Additional—Facts & circumstances
    - Commercial locator services
    - Credit reporting agencies
    - Fee-based databases
  - Even More
    - Contact former co-workers
    - Try cell phones, public records, obituaries, social media, etc.
    - Continue to search indefinitely

HOW CAN THE DOL HELP?

- Safe Harbor Distribution Options
  - Participant notice
  - Transfer to IRA
  - Bank account
- Transfer to state unclaimed property fund/escheat
  - DOL Advisory Opinion 94-41A
- NOT: 100% INCOME TAX WITHHOLDING

HOW CAN THE DOL HELP?

- DOL Opposition to Forfeiture
  - DOL interprets ERISA as including a fiduciary duty to convey material information that plan participants need in order to protect their interests
    - Globe Woolen Co. v. Utica Gas & Electric Co, 224 N.Y. 483, 489 (N.Y. 1918)

HOW CAN THE PBGC HELP?

- Final regulations that apply to plan terminations on or after January 1, 2018 for:
  - DB plans that are covered by PBGC
  - DC plans
  - Small professional services DB plans
  - Multiemployer plans insured by PBGC that close out after 2017.

HOW CAN THE PBGC HELP?

- Two programs sponsored by PBGC
  - Transferring Plan
    - One time $35 administrative fee per participant account of more than $250
  - Notifying Plan
    - No fee
- Form MP-200

HOW CAN THE PBGC HELP?

- PBGC Program does not apply to:
  - Governmental plans
  - Non-ERISA church plans
  - Non-ERISA 403(b) plans

ARE THERE PRIVACY CONCERNS WITH ANY OF THE SEARCH METHODS?

- Social media
- Inquiring through other plans
- Asking beneficiaries
- Asking co-workers
- Asking family members

IS CONGRESS GOING TO DO ANYTHING?

- GAO Report issued on March 5, 2018 called on DOL to issue guidance to help ongoing plan sponsors search for separated participants.
- Additional recommendations:
  - DOL should address the obligations under ERISA of sponsors of ongoing plans to prevent, search for and pay costs associated with locating missing participants
  - IRS should review tax issues relating to distributions involving incorrect participant addresses and uncashed benefit checks, and clarify the IRC's requirements in these circumstances.

IS CONGRESS GOING TO DO ANYTHING?

- Additional recommendations:
  - IRS should consider revising its letter forwarding program in a cost-effective manner to again provide information on behalf of plan sponsors on unclaimed retirement accounts to participants.

IS CONGRESS GOING TO DO ANYTHING?

- Retirement Savings Lost and Found Act of 2018
  - Introduced by Sen. Elizabeth Warren (D-MA) and Sen. Steve Daines (R-MT)
  - Would create the Office of Retirement Savings Lost and Found to:
    - Assist participants and beneficiaries in finding and obtaining unclaimed retirement benefits
    - Provide plan administrators with a new option for balances of missing or lost participants.
  - Centralized database to allow retirees to view the location of their retirement funds.
  - Avoid plan disqualification by clarifying that minimum distribution requirements do not apply when a participant is missing

WHAT ARE BEST PRACTICES TO AVOID MISSING PARTICIPANTS?

- Follow the terms of your plan document
- Develop and apply a missing participant policy for identifying, searching and handling missing participant accounts
- Designate a person to be in charge of making regular efforts to keep participant information current
- Use search methods
- Keep records
- Alert the plan committee when a government audit/investgation starts

WHAT ARE BEST PRACTICES TO AVOID MISSING PARTICIPANTS?

- Review uncashed checks
- Review returned mail
- Add reminders to statements and plan communications about keeping addresses up to date
- Require beneficiary contact information
- Request personal email addresses and cell phone numbers during the exit process
- Promptly process mandatory cashouts and rollovers upon termination of employment

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QUESTIONS AT THE INTERSECTION OF CHOICE ENTITY AND ESTATE PLANNING

Look down field before converting pass-throughs to C corporations

March 16, 2018

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RSM

The Tax Cuts and Jobs act (TCJA) reduced the income tax rate for C corporations from 35 percent to 21 percent in 2018. No sooner was the ink dry on the new law before owners of pass-through entities began to work with their advisors to determine if it made sense to convert their entities to C corporations. As is often the case with sophisticated tax planning, conversion of a pass-though, whether an S corporation, limited liability company (LLC) or partnership, to a C corporation, is a multi-faceted prospect. That's because, for among other reasons, the owners of these entities are often wealthy individuals who have done or are considering doing wealth transfer planning with their entities. And some of the most popular planning techniques they use, including those for providing liquidity for estate taxes, can be far more gift, and sometime income, tax efficient if the entity is a pass-through rather than a C corporation. Let's take a look.

Three planning techniques

Assume for the moment that as part of their estate and business succession planning, Larry, Moe and Curly, respectively, used these three planning techniques. They each own stock or an interest in an entity taxed as a pass-through entity.

1) Transfer to IDGT

Larry transferred a 49 percent interest in the entity to an irrevocable trust that is an intentionally defective grantor trust (IDGT). The objective of this gift to the trust is to remove any subsequent appreciation in the value of the entity from Larry's taxable estate. This type of transfer is commonly made to an IDGT because while the transfer will be "effective" to remove the asset from the transferor's estate, it will be purposefully "defective" from an income tax standpoint because the trust will be disregarded as a separate taxpayer, and the transferor (Larry) will still be taxable on the trust's net income and net capital gains (or benefit by the net losses). Under current law, Larry's payment of the income tax on the income and gains recognized by the trust is not a gift for transfer tax purposes. Therefore, the trust is able to grow that much faster because it doesn't have to pay its income own taxes. Incidentally, if Larry's company is an S corporation, the IDGT's status as a grantor trust assures that it is an eligible S shareholder.

The entity generally limits distributions to whatever is necessary to cover the income taxes attributable to the shares. Although the distributions from the entity to cover income taxes are paid to the trust, the grantor status of the trust causes the income to be taxed to Larry. Therefore, these funds are retained by the trust as Larry himself pays the taxes. Larry's payment of the taxes are not gifts under current law. He likes the IDGT because, in addition to transferring appreciation above the gift tax value of the interest, he is reducing his estate by the gift-tax free payment of the income tax on the distributions made to the trust. And, with that excess cash flow, the IDGT is investing in a diversified portfolio, which addresses one of Larry's long-term objectives.

2) GRAT established

Moe established a five-year grantor retained annuity trust (GRAT) just last year and funded it with an interest in his entity. The GRAT will owe Moe an annual annuity for the five year term equal to the initial value of the transfer to the GRAT plus an interest rate factor prescribed by the Internal Revenue Service at inception. The GRAT is an IDGT so, similar to Larry, Moe personally pays the taxes attributable to any distributions made to the GRAT (as well as any other net income recognized by the GRAT). Therefore, the entity's tax distributions go a long way to funding the GRAT's annuity payments. To the extent that the GRAT can't cover an annuity payment with cash from the entity, it pays Moe back in (discounted) interests.

3) Interest sold in exchange for note

Curly seeded an IDGT a couple of years ago with a relatively small gift of cash and then sold a minority interest in his entity to the IDGT in exchange for a nine-year note that pays interest only with a balloon principal payment due in the final year. The IDGT is easily able to handle the interest payments from the entity's distributions.

Loss of cash flow from tax distributions

Larry, Moe and Curly attend a presentation on choice of entity after TCJA. They are intrigued by the fact that, on conversion of their pass-through entities to C corporations, the company's annual income tax bill would drop significantly. They are, however, troubled by the loss of the cash flow from the tax distributions. In Larry's case, the IDGT will no longer have the funds to diversify the family's portfolio as well as its net worth. In Moe's case, loss of the distributions would be very problematic because now the GRAT will have to pay the annual annuity almost entirely with interests in the entity, which is expensive because of the required annual valuations and administratively cumbersome. In Curly's case, the loss of the cash flow from distributions would be less problematic than for Moe, but it's pretty clear that when the time for the final payment arrives, the IDGT will be paying the principal with discounted interests in the entity, not cash as he had hoped.

How to alleviate concerns

So, the three individuals ask you what they might consider doing to alleviate their concerns. Here are some ideas:

- Prior to conversion to a C corporation, the entity distributes a promissory note to each of its owners (meaning the individual and his IDGT) on a pro-rata basis in the amount of the distribution that the entity would have otherwise made in cash. The notes bear interest at the applicable federal rate. The interest payments will be deductible by the entity and taxable to the individual, both as an individual obligee and as grantor of the IDGT. This tax treatment compares favorably to the tax treatment of the dividends that the entity would have to pay to replicate the distributions from its days as a pass-through entity. Still, this is not a perfect solution, largely because it requires the entity to pay out cash rather than be able to retain and reinvest it, a principal benefit of the conversion to C status.
- The implications of this technique on Larry's situation are fairly straightforward. The implications to Moe (who did the GRAT) are less so. If Moe were to pass away before the end of the GRAT term, the value of the GRAT's assets would be included in his estate for estate tax purposes. Not only would the value of the interest be included, but so would the value of the note the GRAT holds from the entity. While one could argue that the value represented by the note would have been effectively included in the value of the interest anyway, the existence of the note does complicate matters. Curly, who did the sale to the IDGT, is likely to be the least concerned about the estate tax-side effects of the conversion because the IDGT's ability to service the note should be enhanced by the cash flow to (and its reinvestment by) the IDGT. And, he points out, that if he passes away before the note is repaid, only the unpaid principal balance of the note is included in his estate (not like that Moe guy). Anyway, in either Moe or Curly's cases, the IDGT could eventually use the note as legal tender to pay the annuity or to service the debt.
- These situations can get complicated if the IDGTs lose their grantor trust status before the entity has fully repaid the note. In Larry's case, the trust would become its own taxpayer, so it would have to pick up the tab for the tax on the interest payments it collects. In Moe's case, the implications would depend on whether he dies before the end of the GRAT term or after it. If before, then the note would go back to this estate. If after, then it would pass to the GRAT beneficiaries, which might be trusts. In Curly' s case, the trust may cease to be a grantor trust long after the original installment note and the entity's note were repaid, as the case may be.

Other considerations

The questions and issues posed here can by no means anticipate all of those that could arise if a pass-through entity owned by an IDGT is converted to a C corporation. For example, the IDGT could very well be doing double duty as an irrevocable life insurance trust (ILIT) or be pressed into service in that capacity in the future. The notion of an ILIT as a grantor trust can make a lot of sense if the grantor/insured will transfer (or sell) income producing assets to it. After all, every dollar of premium that the ILIT can pay with its own cash is a dollar of taxable gift the grantor doesn't have to make. This approach to planning with an IDGT/ILIT gets a certain multiplier effect if that income-producing asset is a pass-through entity, with robust distributions giving the trust what is essentially tax-free cash flow to pay those premiums or service a loan under a split-dollar arrangement.

Another consideration with regard to an entity owner's life insurance planning is that, with increasing frequency these days, individual are migrating policies to trusts or from one trust to another. In many cases, the principal tax issue is not gift or estate, it's income tax. That's because much of that policy migration is made by way of sales (to the trusts) rather than gifts. And if a sale is involved, so is the transfer for value rule under Internal Revenue Code section 101(a)(2). Absent an exception to the rule, a portion of the policy's death benefit will be taxable. Fortunately, a transfer to a trust that is grantor trust as to the insured is an exception and the proceeds will remain tax-free. But if or when the trust is not a grantor trust, perhaps because that status was toggled off after a GRAT term or after a note was repaid in a sale to IDGT transaction, an insurance transaction with that trust will invoke the rule. The most commonly used exception to the transfer for value rule is the partnership exception, which involves the trust being a partner of the insured. If the trust owns an interest in a partnership or LLC in which the grantor/insured is also a partner or member, then the exception is satisfied. That's why we so often see individuals scrambling to make their ILITs partners in a partnership before they reposition policies.

Although the discussion above contemplates a full conversion (which may be the only option for many S corporations) it should be noted that entities taxed as partnerships may have the opportunity to partially convert. This is primarily because unlike S corporations, a partnership may be owned by a corporate entity. In this scenario, instead of the entity itself converting, certain individual owners place their interests into a C corporation holding entity, with the IDGT or GRAT owners retaining a direct interest in the partnership. The structure may allow the trust to continue to receive the some or all of the benefits of pass-through ownership.

The point is that any individual who is considering converting from pass-through to C corporation status has much more to consider and over a much longer timeline than any initial cash flow analysis is likely to address. This conversion analysis should not ignore estate and transfer tax planning possibilities and ramifications, including life insurance issues.

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TAX SECTION OF
THE STATE BAR OF TEXAS

2017 – 2018 CALENDAR

July 2017	
Tuesday 07/04/17	**July 4th Holiday**
Monday 07/10/17	**Officer's Retreat** Norton Rose Fulbright US LLP 1301 McKinney, Suite 5100 Houston, Texas 77010
Thur - Sat 07/13/17 – 07/15/17	**Texas Bar College** Summer School Moody Gardens Hotel Galveston, TX
Saturday 07/15/17	**Tax Section Budget Deadline** (Budget must be submitted to State Bar of Texas)
Tuesday 07/18/17	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 800-525-8970; Conference Code: 2143975538# Henry Talavera 9:00 a.m.
Monday 07/24/17	**SBOT Chair and Treasurer Training** Texas Law Center 1414 Colorado St. Austin, TX 78701 10:30 a.m. – 2:30 p.m.
August 2017	
Friday 08/04/17	**Meeting of Council, Committee Chairs, and Committee Vice Chairs** Norton Rose Fulbright US LLP 1301 McKinney, Suite 5100 Houston, Texas 77010 (48th Floor) 10:30 a.m. – 12:30 p.m. w/lunch Dial In: 866-203-7023 Conference Code: 713-651-5591# Security Passcode: None – at the prompt press *
Thursday, 08/10/17	**Officer's Meeting** 4:00 p.m.

Thur – Tues 08/10/17 – 08/15/17	**American Bar Association Annual Meeting** New York Hilton Midtown, New York City, New York
Tuesday 08/15/17	**Government Submissions (COGS) Call with Committee Chairs** Dial –in: 800-525-8970; Conference Code 2143975538# Henry Talavera 9:00-9:30 a.m.
Thur – Fri 08/17/17 – 08/18/17	**Advanced Tax Law Course** Hilton Houston Post Oak, Houston, Texas
Sept 2017	
Friday 09/01/17	**Deadline for Submissions to State Bar of Texas Board of Directors Meeting Agenda**
Monday 09/04/17	**Labor Day Holiday**
Friday 09/15/2017	**Deadline for Appointment of Tax Section Nominating Committee**
Monday 09/15/17	**Submission Deadline – Texas Tax Lawyer (Fall Edition)** Submit to TTL Editor: Michelle Spiegel michelle.spiegel@nortonrosefulbright.com
Thur - Sat 09/14/17 – 0916/17	**American Bar Association Section of Taxation Joint Fall CLE Meeting** Hilton Austin, Austin Texas
Monday 09/18/17	**Tax Court Pro Bono Calendar Call-Houston**
Tuesday 09/19/17	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 800-525-8970; Conference Code: 2143975538# Henry Talavera 9:00-9:30 a.m.
Wed - Fri 09/20/17 – 09/22/17	**Rosh Hashanah (Religious Holiday)**
Thursday 09/21/17	**Comptroller Annual Meeting Briefing** Either Travis building or Stephen F. Austin office building (venue to be established)
Wednesday 09/27/17	**Officer's Meeting** 4:00 p.m.
Fri - Sat 09/29/17 – 09/30/17	**Yom Kippur (Religious Holiday)**

Oct 2017	
Monday 10/02/17	**Tax Court Pro Bono Calendar Call-Dallas**
Thur - Fri 10/05/17 – 10/06/17	**Sukkot (Religious Holiday)**
Monday 10/09/17	**Columbus Day Holiday**
Thursday 10/12/17	**Officer's Meeting** 4:00 p.m.
Monday 10/16/17	**Tax Court Pro Bono Calendar Call-El Paso**
Tuesday 10/17/17	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 800-525-8970; Conference Code: 2143975538# Henry Talavera 9:00-9:30 a.m.
Wednesday 10/18/17	**Outreach to Law Schools/SMU Dedman School of Law**
Thursday 10/19/17	**Tax Court Pro Bono Calendar Call-Lubbock**
Thursday 10/19/17	**Outreach to Law Schools/Texas Tech School of Law**
Sun - Wed 10/22/17 – 10/25/17	**Council on State Taxation (COST) 48th Annual Meeting** Orlando, Florida
Friday 10/27/17	**Council of Chairs Meeting** Texas Law Center 1414 Colorado St. Austin, TX 78701 10:30 a.m. – 2:30 p.m.
?	**National Association of State Bar Tax Sections ("NASBTS") Annual Meeting**
Monday 10/30/17	**Tax Court Pro Bono Calendar Call-Dallas**

Nov 2017	
Thursday 11/02/17	**20th Annual International Tax Symposium** Cityplace Events Dallas, TX 8:00 a.m.-5:00 p.m. followed by networking reception
Friday 11/03/17	**20th Annual International Tax Symposium Co-Sponsored with the University of Houston Law Center** University of Houston Student Center South, 4455 University Drive Houston, TX 77204 8:00 a.m.-5:00 p.m. followed by a networking reception
Wednesday 11/08/17	**Webinar "International Tax Law In A Day"** 8:30 a.m. – 2:00 p.m.
Thursday 11/09/17	**Webcast "International Tax Symposium"** 8:00 a.m. – 5:00 p.m.
Thursday 11/09/17	**Officer's Meeting** 4:00 p.m.
Friday 11/10/17	**Veterans Day Holiday**
Monday 11/13/17	**Tax Court Pro Bono Calendar Call-Houston**
Mon - Tues 11/13/17 – 11/14/17	**Austin Chapter CPA Annual Tax Conference**
Friday 11/17/17	**Meeting of Council** Norton Rose Fulbright US LLP 1301 McKinney, Suite 5100 Houston, Texas 77010 (Floor TBD) 10:30 a.m. – 12:30 p.m. w/lunch Dial In: 866-203-7023 Conference Code: 713-651-5591# Security Passcode: None – at the prompt press *
Friday 11/17/17	**Annual Meeting Deadline for submitting to SBOT date and time preferences for CLE programs, section meetings, council meetings, socials and special events**
Tuesday 11/21/17	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 800-525-8970; Conference Code: 2143975538# Henry Talavera 9:00-9:30 a.m.

Thursday 11/23/17	**Thanksgiving Day Holiday**
Monday 11/27/17	**Tax Court Pro Bono Calendar Call-Dallas**
Dec. 2017	
Tuesday 12/12/17	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 800-525-8970; Conference Code: 2143975538# Henry Talavera 9:00-9:30 a.m.
Tuesday 12/12/17	**COST Regional Meeting** Atlanta, Georgia
Wed - Fri 12/13/17 – 12/15/17	**UT Law Annual Taxation Conference**
Wed - Wed 12/13/17 – 12/20/17	**Chanuka (Other Holiday)**
Thursday 12/14/17	**Officer's Meeting** 4:00 p.m.
Monday 12/25/17	**Christmas (Other Holiday)**
Jan. 2018	
Monday 01/01/18	**New Year's Day Holiday**
Tuesday 01/02/18	**Nomination Period Opens for 2017 Outstanding Texas Tax Lawyer Award** • Nominations due April 1, 2018 • Nomination forms to be posted on website • Submit nomination forms to Tax Section Secretary: Charolette Noel
Monday 01/08/18	**Pro Bono Tax Court Calendar Calls-Houston and San Antonio**
Thursday 01/11/18	**Officer's Meeting** 4:00 p.m.
Friday 01/12/18	**Deadline for receipt of information for SBOT Board of Director's Meeting Agenda**
Friday 01/12/18	**Annual Meeting Deadline: Submit programming for the registration brochure, CLE topics, speakers, and speaker contact information and firms**

Monday 01/15/18	**Martin Luther King Jr. Day (Holiday)**
Friday 01/19/18	**Meeting of Council, Committee Chairs, and Committee Vice Chairs** Norton Rose Fulbright US LLP 1301 McKinney, Suite 5100 Houston, Texas 77010 51st Floor (Crooker) 10:30 a.m. – 12:30 p.m. w/lunch Dial In: 866-203-7023 Conference Code: 713-651-5591# Security Passcode: None – at the prompt press *
Tuesday 01/23/18	**Application Period Opens for Law Student Scholarship Program**
Tuesday 01/23/18	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 800-525-8970; Conference Code: 2143975538# Henry Talavera 9:00-9:30 a.m.
Friday 01/26/18	**Submission Deadline – Texas Tax Lawyer (Winter Edition)** Submit to TTL Editor: Michelle Spiegel michelle.spiegel@nortonrosefulbright.com
Feb. 2018	
Thursday 02/01/18	**Register and make guest room reservations for Annual Meeting (www.texasbar.com/annualmeeting)**
Monday 02/05/18	**Pro Bono Tax Court Calendar Call - Dallas**
Thursday 02/08/18	**Outreach to Law School/Texas A & M**
Friday, 02/09/18	**Tax Law in a Day CLE** Westin Oaks Galleria 5011 Westheimer Road Consulate Room – Third Floor of the Tower Houston, TX 77056
Thur - Sat 02/08/18 – 02/10/18	**American Bar Association Section of Taxation Midyear Meeting** Hilton San Diego, San Diego CA
Monday 2/12/18	**Pro Bono Tax Court Calendar Call - Houston**
Thursday 02/15/18	**Officer's Meeting** 4:00 p.m.

Monday 02/19/18	**George Washington's Birthday (Holiday)**
Tuesday 02/20/18	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 800-525-8970; Conference Code: 2143975538# Henry Talavera 9:00-9:30 a.m.
Wednesday 02/21/18	**International Fiscal Association Oil & Gas Meeting** Houston, Texas
Wednesday 02/21/18	**Outreach to Law School/Baylor Law School**
Thur - Fri 02/22/18 – 02/23/18	**International Fiscal Association Annual Conference** Houston, Texas
Friday 02/23/18	**Council of Chairs Meeting and Section Representative Election** Texas Law Center 1414 Colorado St. Austin, TX 78701 10:30 a.m. – 2:30 p.m.
Monday 02/26/18	**Pro Bono Tax Court Calendar Call – El Paso**
Wednesday 02/28/18	**Outreach to Law School / St. Mary's**
March 2018	
Thursday 03/01/18	**Nomination Deadline for Chair-Elect, Secretary, Treasurer, and 3 Elected Council Members**
Friday 03/02/18	**Annual Meeting Deadline: Order special awards, council and chair plaques, food and beverage and audio visuals**
Sun - Wed 03/04/18 – 03/07/18	**Annual Meeting of Unclaimed Property Professionals Organization (UPPO)** Tampa, Florida
Monday 03/05/18	**Pro Bono Tax Court Calendar Calls – Dallas and Houston**
Thursday 03/08/18	**Officer's Meeting** 4:00 p.m.
Monday 03/19/18	**Pro Bono Tax Court Calendar Call – San Antonio**
Tuesday 03/20/18	**Outreach to Law School/University of Texas**

Tuesday 03/20/18	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 800-525-8970; Conference Code: 2143975538# Henry Talavera 9:00-9:30 a.m.
Wednesday 03/21/18	**Federal Tax Workshop** Presented by the State Bar of Texas Tax Section / Texas Federal Tax Institute / Dallas Bar Association Tax Section Bolo Mansion, Pavilion West Ballroom 2101 Ross Avenue Dallas, TX 75201
Wednesday 03/21/18	**2018 State Bar of Texas Property Tax Committee Meeting & Legal Seminar** Thompson Conference Center University of Texas Austin, Texas
Wednesday, 03/28/18	**Outreach to Law Schools/University of Houston**
Thur 03/29/18	**Outreach to Law Schoosl/Texas Southern University**
Fri – Sun 03/30/18 – 04/01/18	**Good Friday, Passover, Easter Sunday (Religious Holiday)**
April 2018	
Monday 04/02/18	**Nominations for Outstanding Texas Tax Lawyer Due to Charolette Noel** Email**:** (cfnoel@jonesday.com)
Monday 04/02/18	**Law Student Scholarship Application Deadline**
Monday 04/2/18	**Nominating Committee Report Due to Council**
Tuesday, 04/3/18/	**Outreach to Law Schools/South Texas College of Law**
Wednesday, 04/4/18	**Outreach to Law School/University of North Texas, Dallas**
Wednesday, 04/4/18	**First Wednesday Tax Update presented by Professor Bruce McGovern** 12:00 p.m.-1:00 p.m.
Thursday 04/12/18	**Officer's Meeting** 4:00 p.m.
Friday 04/13/18	**Submission Deadline – Texas Tax Lawyer (Spring Edition)** Submit to TTL Editor: Michelle Spiegel michelle.spiegel@nortonrosefulbright.com

Monday 04/16/18	**Tax Court Pro Bono Calendar Call-Dallas**
Tuesday 04/17/18	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 800-525-8970; Conference Code: 2143975538# Henry Talavera 9:00-9:30 a.m.
Friday 04/20/18	**Meeting of Council** Norton Rose Fulbright US LLP 1301 McKinney, Suite 5100 Houston, Texas 77010 10:30 a.m. – 12:30 p.m. w/lunch Dial In: 866-203-7023 Conference code: 713-651-5591# Security passcode: None - at the prompt press * Note: Council Vote and Selection of Recipient of 2017 Outstanding Texas Tax Lawyer Award
Friday 04/20/18	**Council Vote and Selection of Recipient of 2017 Outstanding Texas Tax Lawyer Award**
Friday 04/27/18	**Annual Meeting Deadline: course materials for app; CLE articles, PowerPoints, speaker bios and photos**
May 2018	
Wednesday, 05/02/2018	**First Wednesday Tax Update presented by Professor Bruce McGovern** 12:00 p.m.-1:00 p.m.
Thur - Sat 05/10/18 – 05/12/18	**American Bar Association Section of Taxation May Meeting** Grand Hyatt, Washington, DC
Tuesday 05/15/18	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 800-525-8970; Conference Code: 2143975538# Henry Talavera 9:00-9:30 a.m.
Thursday 05/17/18	**Officer's Meeting** 4:00 p.m.
Monday 05/28/18	**Memorial Day Holiday**
June 2018	
Wednesday, 06/06/18	**First Wednesday Tax Update presented by Professor Bruce McGovern** 12:00 p.m.-1:00 p.m.

Wednesday-Friday 06/06/18-06/08/18	**Annual Texas Federal Tax Institute** La Cantera Resort San Antonio, TX
Thursday 06/14/18	**Officer's Meeting** 4:00 p.m.
Tuesday 06/19/18	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 800-525-8970 Conference Code: 2143975538# Henry Talavera 9:00-9:30 a.m.
Thur - Fri 06/21/18 – 06/22/18	**SBOT Annual Meeting** Marriott Marquis Hotel 1777 Walker Street Houston, TX 77010 (713) 654-1777
Thursday 06/21/18	**Tax Section Council Planning Retreat** Norton Rose Fulbright US LLP 1301 McKinney, Suite 5100 Houston, TX 77010 Crooker Conference Room 51st Floor 12:00 p.m. - 4:30 p.m.
Friday 06/22/18	**2018 Tax Section Annual Meeting Program** Marriott Marquis Hotel 1777 Walker Street Houston, TX 77010 (713) 654-1777
Friday 06/22/18	**Presentation of 2018 Tax Legend Award** Award Presentation During Tax Section Annual Meeting Program Marriott Marquis Hotel 1777 Walker Street Houston, TX 77010 (713) 654-1777

TAX SECTION

STATE BAR OF TEXAS

LEADERSHIP ROSTER

2017-2018

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TAX SECTION
THE STATE BAR OF TEXAS
COMMITTEE CHAIRS AND VICE CHAIRS
2017-2018

	COMMITTEE	CHAIR	VICE CHAIR
1.	**Annual Meeting**	**John R. Strohmeyer** *Term expires 2020* Strohmeyer Law PLLC 2925 Richmond Avenue 12th Floor Houston, Texas 77098 *713 714-1249* john@strohmeyerlaw.com	N/A (Planning Committee)
2.	**Continuing Legal Education**	**Dan Baucum** Munsch Hardt 500 N. Akard Street Suite 3800 Dallas, Texas 75201 *(214) 855-7509* dbaucum@munsch.com **Lora G. Davis** Davis Stephenson, PLLC 100 Crescent Court, Suite 440 Dallas, Texas 75201 *(214) 396-8802* lora@davisstephenson.com **Michael Threet** Haynes and Boone, LLP 2323 Victory Avenue, Suite 700 Dallas, TX 75219 *214-651-5091* michael.threet@ haynesboone.com **Amanda Traphagan** Seay & Traphagan 807 Brazos St., Suite 304 Austin, Texas 78701 *(512) 582-0120* atraphagan@seaytaxlaw.com	**Jim Roberts** Glast, Phillips & Murray, PC 14801 Quorum Dr., Suite 500 Dallas, Texas 75254 *(972) 419-7189* jvroberts@gpm-law.com

3.	**Corporate Tax**	**Jeffry M. Blair** Hunton Andrews Kurth, LLP 1445 Ross Ave., Suite 3700 Dallas, Texas 75202 *(214) 468-3306* jblair@huntonak.com	**Kelly Rubin** Jones Day 2727 North Harwood Street Dallas, Texas 75201-1515 *(241) 969-3768* krubin@jonesday.com
4.	**Employee Benefits**	**Mark L. Mathis** Conner & Winters, LLP Attorneys & Counselors at Law 1700 Pacific Ave., Suite 2250 Dallas, TX 75201 *(214) 217-8050* mmathis@cwlaw.com **James R. Griffin** Scheef & Stone LLP 500 N. Akard, Suite 2700 Dallas, TX 75201 *(214) 706-4209* jim.griffin@solidcounsel.com	**Paige Brewin** Norton Rose Fulbright US LLP 1301 McKinney, Suite 5100 Houston, Texas 77010 *(713) 651-5370* paige.brewin@ nortonrosefulbright.com **Justin Coddington** Norton Rose Fulbright US LLP 1301 McKinney, Suite 5100 Houston, Texas 77010 *(713) 651-8204* justin.coddington@ nortonrosefulbright.com **(Joe) Robert Fowler** Baker Botts, LLP 910 Louisiana St. Houston, Texas 77002-4995 *(713) 229-1229* rob.fowler@bakerbotts.com **Sarah Fry** Associate General Counsel and Assistant Secretary The North American Coal Corporation 5340 Legacy Drive Building 1, Suite 300 Plano, Texas 75024-3141 *(972) 448-5475* sarah.fry@nacoal.com
5.	**Energy and Natural Resources Tax**	**Crawford Moorefield** Clark Hill Strasburger 909 Fannin St., Suite 2300 Houston, Texas 77010 *(713) 951-5629* crawford.moorefield@ clarkhillstrasburger.com	**Todd Lowther** Shearman & Sterling, LLP 1100 Louisiana St., Suite 3300 Houston, Texas 77002 *(713) 354-4898* todd.lowther@shearman.com

			Hersh Verma Norton Rose Fulbright US LLP 1301 McKinney, Suite 5100 Houston, Texas 77010 *(713) 651-5186* hersh.verma@ nortonrosefulbright.com
6.	**Estate and Gift Tax**	**Celeste C. Lawton** Norton Rose Fulbright US LLP 1301 McKinney, Suite 5100 Houston, Texas 77010 *(713) 651-5278* celeste.lawton@ nortonrosefulbright.com **Laurel Stephenson** Davis Stephenson, PLLC 100 Crescent Ct., Suite 440 Dallas, Texas 75201 *(214) 396-8800* laurel@davisstephenson.com	**Matthew S. Beard** Meadows, Collier, Reed, Cousins, Crouch & Ungerman, LLP 901 Main St., Suite 3700 Dallas, Texas 75202 *(214) 749-2450* mbeard@meadowscollier.com **Carol Warley** RSM US LLP 1400 Post Oak Blvd, Suite 900 Houston, Texas 77056 *(713) 625-3500 or (713) 625-3585* carol.warley@rsmus.com
7.	**General Tax Issues**	**Prof. Bruce McGovern** South Texas College of Law 1303 San Jacinto Houston, Texas 77002 *(713) 646-2920* bmcgovern@stcl.edu	**[Pending]**
8.	**International Tax**	**John R. Strohmeyer** Strohmeyer Law PLLC 2925 Richmond Avenue 12th Floor Houston, Texas 77098 *713 714-1249* john@strohmeyerlaw.com **Benjamin Vesely** BDO USA, LLP 700 N. Pearl St., Suite 2000 Dallas, Texas 75201 *(214) 665-0763* bvesely@bdo.com	**Vu Le** Deloitte 2200 Ross Avenue, Ste. 1600 Dallas, TX 75201 *(469) 417-2698* vkle@smu.edu

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