2017 NEW DEVELOPMENTS

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INTRODUCTION

This publication is produced by the Land Grant University Tax Education Foundation. The Land Grant University Tax Education Foundation is pleased to provide the *National Income Tax Workbook* to approximately 29,000 tax practitioners in tax schools taught in 32 states. This publication supplements the *2017 National Income Tax Workbook*. It includes new cases and legislation that was adopted in late 2017, and is important for filing 2017 tax returns.

The Tax Cuts and Jobs Act substantially changes how tax practitioners will advise taxpayers and file 2018 tax returns. The *2018 National Income Tax Workbook* and supplemental publications and courses will provide a comprehensive discussion of these changes. Please visit our website at `taxworkbook.com` for more information about online courses and tax workshops near you.

Partnerships

REG-116256-17

I.R.C. § 754

This document contains proposed amendments to the regulation relating to the requirements for making an I.R.C. § 754 election to adjust the basis of partnership property. Section 754 provides that if a partnership files an election, the basis of partnership property shall be adjusted, in the case of a distribution of property, in the manner provided in I.R.C. § 734 and, in the case of a transfer of a partnership interest, in the manner provided in I.R.C. § 743. The election applies with respect to all distributions of property by the partnership and to all transfers of interests in the partnership during the tax year with respect to which such election was filed and all subsequent tax years.

The current regulation states that a section 754 election must be made in a written statement filed with the partnership return for the tax year during which the distribution or transfer occurs. For the section 754 election to be valid, the return must be filed not later than the time prescribed for filing the return for such tax year, including extensions. The section 754 election statement must (i) set forth the name and address of the partnership making the election, (ii) be signed by any one of the partners, and (iii) contain a declaration that the partnership elects under section 754 to apply the provisions of section 734(b) and section 743(b).

Accordingly, under the current regulation, a partnership that files an unsigned section 754 election statement with its partnership return (whether filed electronically or in paper) has not made a valid section 754 election. These proposed amendments would remove the signature requirement contained in Treas. Reg. § 1.754-1(b) [REG-116256-17].

Ltr. Rul. 2017-45-005

I.R.C. § 708

Conversion of an LLC taxed as partnership to a limited partnership will not cause termination of the partnership. The partnership and its members do not recognize taxable income, gain, or loss on the conversion. The IRS further concluded that the conversion will not cause the partnership to be treated as an association taxable as a corporation [Ltr. Rul. 2017-45-005 (August 4, 2017)].

REG-119337-17

I.R.C. §§ 6221, 6225, 6226, 6227

These proposed regulations provide guidance on certain international issues related to the centralized partnership audit regime. They address provisions related to chapters 3 and 4 of subtitle A of the Internal Revenue Code, provisions related to creditable foreign tax expenditures and foreign tax credits, issues related to treaties and reductions to the rate of tax on foreign persons, and issues related to certain foreign corporations [REG-119337-17].

S Corporations

Messina v. Commissioner

I.R.C. § 1366

Two taxpayers together owned 80% of an S corporation. The S corporation owned a qualified subchapter S subsidiary (QSub). The QSub was the borrower under a loan from an unrelated entity. The taxpayers formed a second wholly-owned S corporation to acquire the loan. They made shareholder loans to the second S corporation to pay off the loan. The taxpayers contended that the second S corporation should be disregarded for I.R.C. § 1366(d)(1)(B) purposes and the loans deemed indebtedness of the first S corporation to them, allowing them to increase their bases in the first corporation's indebtedness and benefit from its pass-through losses. The IRS argued that the separate corporate existence of the second S corporation should be respected, and the loan should not be treated as indebtedness of the first S corporation to the taxpayers.

The court held that the second S corporation was not the incorporated pocketbook of the taxpayers. It was not their agent and not a conduit. The court further held that the taxpayers had made an actual economic outlay to the second S corporation, which in turn made an actual economic outlay to the first S corporation and its QSub. The step transaction doctrine did not apply, and the taxpayers were bound by the form of their transaction [*Messina v. Commissioner*, T.C. Memo. 2017-213].

Tax Exempt Entities

Ltr. Rul. 2017-31-015

I.R.C. §501

The taxpayer was a group whose membership was limited to organizations licensed to use software of a specific software company. The IRS determined that the taxpayer was not a business league under I.R.C. § 501(c)(6) because the taxpayer was not organized to improve business conditions of one or more lines of business and it was formed to provide particular services to its members [Ltr. Rul. 2017-31-015 (August 4, 2017)].

Creditguard of America, Inc. v. Commissioner

I.R.C. §§ 6151, 6601

The IRS revoked the taxpayer's tax-exempt status retroactively to January 1, 2002. In a subsequent deficiency proceeding, the taxpayer agreed to assessment of a deficiency for its 2002 tax year and of underpayment interest on that deficiency "as provided by law." The IRS accrued and assessed interest on the deficiency from the date that the taxpayer's 2002 corporate tax return would have been due. The taxpayer did not pay, and the IRS began a collection action.

The taxpayer argued that interest began accruing no earlier than the date that the IRS issued the final determination revoking the taxpayer's tax-exempt status, even though the revocation was retroactive. The court held that retroactive revocation of the taxpayer's tax-exempt status requires restoring the taxpayer to the position it would have occupied if it had never enjoyed tax-exempt status during its 2002 tax year. The taxpayer was liable for interest beginning on the date its 2002 corporate tax return would have been due [*Creditguard of America, Inc. v. Commissioner*, 149 T.C. No. 17 (2017)].

BUSINESS ISSUES

Deductions

Barrett v. Commissioner

I.R.C. § 162

The taxpayer deducted transportation and travel expenses incurred during trips to Washington D.C. The IRS disputed whether the taxpayer was away from home in pursuit of a trade or business when he performed services in D.C. They argued that the taxpayer's tax home was in D.C. because his work there was permanent rather than temporary, and it produced the bulk of his total income for the years in issue. The taxpayer contended that his tax home was in Las Vegas, where he maintained a residence, managed rental properties, and where he performed some of the services related to his business.

Deciding whether transportation and travel expenses are deductible requires the determination of a taxpayer's tax home [I.R.C. § 162(a)]. The word *home* for purposes of section 162(a)(2) generally refers to the area of a taxpayer's principal (if there is more than one regular) place of employment and not where his or her personal residence is located. When taxpayers have multiple jobs in different locations during the year, are married, and incur duplicate living expenses, identifying the location of the tax home requires a review of multiple factors, including: (1) whether employment is permanent, temporary, or indefinite; (2) whether there is a business justification for incurring duplicate living expenses; (3) whether the spouses have separate tax homes; and (4) whether the taxpayers actually have multiple tax homes during one year because their principal places of business have changed.

The court found that the taxpayer performed substantial services in Las Vegas, traveled to D.C. only to complete those services, was required to be in D.C. only a few weeks at a time, and had other income-producing activities in the Las Vegas area. Las Vegas was the taxpayer's tax home and he could deduct transportation and travel expenses for trips to D.C. [*Barrett v. Commissioner*, T.C. Memo 2017-195].

Owens v. Commissioner

I.R.C. § 166

The taxpayer spent his career lending money for a profit. He loaned money through business entities and out of his personal funds. One of his personal loans to a commercial laundry resulted in a total loss. The taxpayer claimed a bad debt deduction, and the IRS argued that the taxpayer's private lending was not a trade or business. For the lending activity to be considered a trade or business, the taxpayer must have been involved in the activity with continuity and regularity, and with the primary purpose of earning income or making a profit. Facts and circumstances to consider in deciding whether a taxpayer is in the business of lending money include the following:

- The total number of loans made
- The period over which the loans were made
- The adequacy and nature of the taxpayer's records
- Whether the loan activities were kept separate and apart from the taxpayer's other activities
- Whether the taxpayer sought out the lending business
- The amount of time and effort expended in the lending activity
- The relationship between the taxpayer and his or her debtors

The court found that the taxpayer was involved in the trade or business of lending money during the years at issue and his advances to the commercial laundry were a bona fide debt that became worthless. He was entitled to claim the bad debt deduction [*Owens v. Commissioner*, T.C. Memo 2017-157].

Rutter v. Commissioner

I.R.C. § 166

The taxpayer acquired a company that developed technology systems to enable remote monitoring of patients' health. He was the "driving force" of the company but owned no common stock. He made numerous cash advances to the company, which the company recorded as loans. The company incurred substantial losses and the taxpayer ultimately claimed a bad debt deduction under I.R.C. § 166. The taxpayer asserted that all his advances to the company constituted bona fide debt and the IRS contended that the taxpayer's cash advances were capital investments made in his capacity as an investor.

In determining whether an advance of funds constitutes bona fide debt, "economic reality provides the touchstone." If an outside lender would not have lent funds to the corporation on the same terms as did the insider, an inference arises that the advance is not a bona fide loan. To give rise to a deduction under section 166(a)(1), a debt must have become wholly worthless during the tax year. Section 166(a)(2) provides that when a debt is partially worthless, the taxpayer can deduct the amount charged off within the tax year. Before a taxpayer may deduct a debt in part, he or she must be able to demonstrate the amount that is worthless and the part that has been charged off [Treas. Reg. § 1.166-3(a)(2)(iii)].

The court found that the IRS did not abuse its discretion in determining that the taxpayer was not entitled to a deduction for a partially worthless debt. Even if the taxpayer established that his advances were debt and that this debt was a business debt, he did not establish the amount of the partially worthless debt [*Rutter v. Commissioner*, T.C. Memo. 2017-174].

Self-Employment Tax

Martin v. Commissioner

I.R.C. § 1402

The taxpayers owned a farm, and rented a portion of the land to a wholly owned S corporation. The S corporation contracted with an unrelated entity to raise chickens according to the entity's exacting specifications. The taxpayers followed the entity's specific instructions to build structures designed only to raise the entity's chickens. The S corporation paid the taxpayers wages for their labor and rent for the use of the farm and structures. The IRS asserted that the rent was subject to self-employment tax pursuant to I.R.C. § 1402(a)(1).

The Tax Court, reversing its holding in previous similar cases, held that the IRS failed to show a sufficient nexus between the rental income and the taxpayers' obligations to participate in the production or management of the production of agricultural commodities. Therefore, the rent the taxpayers received pursuant to the lease was not includible in their net self-employment income [*Martin v. Commissioner*, 149 T.C. No. 12 (2017)].

Trade or Business

Welch. v. Commissioner

I.R.C. § 183

The taxpayer was engaged in cattle, hay, and horse operations. The taxpayer reported losses for every year at issue. Generally, I.R.C. § 183 disallows any net loss from an activity conducted without a bona fide profit motive. For purposes of determining whether there is a profit motive, multiple activities may be treated as one activity.

The court considered the degree of organizational and economic interrelationship of the taxpayer's activities, the business purpose served by carrying on the activities separately or together, and the similarity of the activities. The court concluded that the cattle, hay, and horse activities were one activity.

The taxpayer had been involved with agriculture since his middle school days and with agricultural economics since college. He was only at the ranch on the weekends, but his daily communication with his ranch managers were sufficient to show a profit motive. The court held that the taxpayer's ranch activity was a for-profit activity [*Welch. v. Commissioner*, T.C. Memo. 2017-229].

ESTATES AND TRUSTS

Estate Tax

Estate of Sower v. Commissioner

I.R.C. § 2010

The taxpayer's husband died in 2012. The husband's estate reported a deceased spousal unused exclusion (DSUE) and elected portability of the DSUE. The taxpayer died in 2013. Her estate claimed the DSUE reported by her husband's estate. As a part of an examination of the estate tax return filed by the taxpayer's estate, the IRS also examined the estate tax return filed by the husband's estate. The IRS reduced the amount of the DSUE by the amount of taxable gifts given by the husband. The IRS did not determine or assess a deficiency against the husband's estate, but the IRS determined an estate tax deficiency against the taxpayer's estate. The court found that the IRS acted within the authority granted by I.R.C. § 2010(c)(5)(B) when it examined the estate tax return of a predeceased spouse to determine the correct DSUE amount [*Estate of Sower v. Commissioner*, 149 T.C. No. 11 (2017)].

Estate of Sommers v. Commissioner

I.R.C. § 2053

The decedent had made gifts to his nieces. In accordance with the agreements governing those gifts, the decedent's nieces were required to pay the gift tax due. The decedent died before the nieces paid the gift tax. The decedent's estate claimed a deduction for the gift tax owed.

I.R.C. § 2053(a) allows a deduction from the gross estate for funeral and administration expenses, claims against the estate, and indebtedness in respect of property included in the decedent's gross estate. Gift taxes owed by a decedent's estate at his or her death are generally deductible [Treas. Reg. § 20.2053-6(d)]. However, a claim against an estate is deductible in computing estate tax liability only to the extent that it exceeds any right to reimbursement to which its payment would give rise. The court found that because the estate's payment of the decedent's gift tax liability would give rise to a claim for reimbursement from the nieces under the agreements governing the gifts, the gift tax owed on those gifts at decedent's death is not deductible under section 2053(a). [*Estate of Sommers v. Commissioner*, 149 T.C. No. 8 (2017)].

Special Use Valuation

Ltr. Rul. 2017-43-013

I.R.C. § 2032A

The taxpayer requested a determination that the transfer of the decedent's grandson's interest in property to the decedent's daughter will not trigger the tax consequences of I.R.C. § 2032A(c). Section 2032A generally provides that if certain conditions are met, the executor may elect to value qualified real property based on its current use as a farm, rather than at its FMV based on its highest and best use. Section 2032A(c)(1)(A) provides that if, within 10 years after the decedent's death and before the death of the qualified heir, the qualified heir disposes of any interest in qualified real property (other than by a disposition to a member of the qualified heir's family), then an additional estate tax is imposed. In this situation, under section 2032A(e)(1) and (e)(2), both the grandson and the daughter are qualified heirs of the decedent because they are lineal descendants of the decedent, and the transfer of the property to the decedent's daughter will not trigger the additional estate tax [Ltr. Rul. 2017-43-013 (July 26, 2017)].

FOREIGN TAX ISSUES

Earned Income Exclusion

Acone v. Commissioner

I.R.C. § 911

The taxpayer flew airplanes for a South Korean airline company in 2011 and 2012, but he spent only about a third of each year in South Korea and more than 40% of each year in the United States. He returned to his home in the United States frequently during those years and spent most of his days off in the United States, where his wife and house remained. When the taxpayer stayed in South Korea, he always stayed in the same hotel, provided to him at no cost by the airline. He retained his US citizenship, voting registration, driver's license, bank accounts, and church membership.

The taxpayer claimed an exclusion for foreign earned income under I.R.C. § 911(a)(1). The court found that the taxpayer was not a *qualified individual* for purposes of the foreign earned income exclusion because his abode was "within the United States" for purposes of section 911(d)(3) and because he was not a bona fide resident of South Korea for purposes of section 911(d)(1)(A) [*Acone v. Commissioner*, T.C. Memo. 2017-162].

Linde v. Commissioner

I.R.C. § 911

The taxpayer was a helicopter pilot in Iraq. The court found that he had stronger ties to Iraq than he did to the United States. At all relevant times his economic and social life was centered in Iraq. He credibly testified that, while it was becoming nearly impossible for him to work as a helicopter pilot in the United States, he could do so in Iraq for the near future. He did not work in any other country besides Iraq, and he spent two-thirds of each year at issue there. The taxpayer qualified for the foreign earned income exclusion [*Linde v. Commissioner*, T.C. Memo. 2017-180].

Reporting

United States v. Bussell

I.R.C. §§ 6011, 7403

In June 2013, the IRS assessed an approximately $1,200,000 penalty against the taxpayer for failing to disclose her financial interests in an overseas account on her 2006 tax return, which she was required to report in 2007. The taxpayer did not pay the penalty, and the government filed suit. The taxpayer previously had been criminally charged for concealing financial assets in 2002. On appeal, she admitted that she willfully failed to disclose her financial interests in her overseas account on her 2006 tax return, but she raised several arguments seeking reversal of the district court's summary judgment ruling. The taxpayer contended that the penalty against her violated the Eighth Amendment Excessive Fines Clause, violated the statute of limitations, and violated the Due Process and Ex Post Facto Clauses. The court upheld the penalty [*United States v. Bussell*, 120 A.F.T.R. 2d (RIA) 2017-6379, (9th Cir. 2017)].

INDIVIDUAL ISSUES

Affordable Care Act

McGuire v. Commissioner

I.R.C. § 36B

The taxpayers received an advance premium tax credit (APTC) under the Affordable Care Act. The APTC was paid directly to a health insurance provider to reduce the amount of the premium to be paid by the taxpayers. Due to a change in financial circumstances, the taxpayers ultimately were not entitled to the APTC. The taxpayers made repeated efforts to get Covered California to take into account the change in their household income, but it never did. After the close of the tax year, the taxpayers did not receive a Form 1095-A, Health Insurance Marketplace Statement. They did not report the excess tax credit as an increase to tax on their return. The court held that it does not have the equitable power to override the clear and unambiguous language of the Internal Revenue Code and excess premium assistance credits are an increase in tax under I.R.C. § 36B(f)(2) [*McGuire v. Commissioner*, 149 T.C. No. 9 (2017)].

Notice 2017-67

I.R.C. § 9831

This notice provides guidance on the requirements for providing a qualified small employer health reimbursement arrangement (QSEHRA) under I.R.C. § 9831(d), the tax consequences of the arrangement, and the requirements for providing written notice of the arrangement to eligible employees. This guidance includes sections on the following topics:

a. Eligible employer
b. Eligible employee
c. Same terms requirement
d. Statutory dollar limits
e. Written notice requirement
f. Minimum essential coverage (MEC) requirement
g. Proof of MEC requirement
h. Substantiation requirement
i. Reimbursement of medical expenses
j. Reporting requirement
k. Coordination with premium tax credit
l. Failure to satisfy the requirements to be a QSEHRA

m. Interaction with health savings account (HSA) requirements

[Notice 2017-67, 2017-47 I.R.B. 517]

Charitable Deduction

310 Retail, LLC v. Commissioner

I.R.C. § 170

The taxpayer claimed a charitable contribution deduction for a conservation easement. The IRS claimed that the taxpayer failed to satisfy the I.R.C. § 170(f)(8) substantiation requirement because the taxpayer did not receive a contemporaneous written acknowledgment (CWA) from the donee organization.

Section 170(f)(8)(B) provides that a CWA must specify whether the donee organization provided any goods or services in consideration, in whole or in part, for the gift. The deed of easement did not include an explicit statement that the donee had provided no goods or services to the donor in exchange for the easement. However, it included a merger clause stating that it represented the parties' "entire agreement" and that any prior or simultaneous correspondence, understandings, agreements, and representations were void. The deed thus negated the provision or receipt of any consideration not stated in the deed.

The court found that the deed of easement included the required affirmative indication that the donee supplied the taxpayer with no goods or services in exchange for the gift [*310 Retail, LLC v. Commissioner*, T.C. Memo. 2017-164].

See also *Big River Development, L.P. v. Commissioner*, T.C. Memo. 2017-166, in which a deed of easement qualified as a CWA.

BC Ranch II, L.P. v. Commissioner

I.R.C. § 170

The taxpayer granted conservation easements and reserved the right to adjust the boundaries of the property covered by the easements. The adjustments required approval from the North American Land Trust. The court concluded that the adjustment provision did not prevent the grants of the conservation easements from satisfying the perpetuity requirement of I.R.C. §170(h)(2)(C), and thus did not prevent the taxpayers from taking the applicable charitable deductions [*BC Ranch II, L.P. v. Commissioner*, 867 F.3d 547 (2017)].

Gardner v. Commissioner

I.R.C. § 170

The taxpayer donated hunting specimens to an ecological foundation. Relying on an appraisal, he claimed an I.R.C. § 170 charitable contribution deduction. The IRS argued that FMV should be determined by considering market prices for comparable items. The taxpayer insisted that the donated items were museum-quality hunting specimens endowed with special value for study and research, that they had no true comparables in the open market, and that the court must accordingly determine their value by estimating what it would cost to replace them.

The regulations define FMV as "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts" [Treas. Reg. §1.170A-1(c)(2)]. The court considered whether the donated items were commodities or collectibles. If a hunting trophy is properly considered a collectible, it will matter who shot the animal, precisely where it was shot, and which collectors owned it previously. If instead it is valued as a commodity, it must be valued by consulting the prices for comparable items in the marketplace. The court concluded that the specimens were commodities and that the market price approach was the proper methodology to ascertain FMV [*Gardner v. Commissioner*, T.C. Memo. 2017-165].

Disaster Tax Relief

Disaster Tax Relief and Airport and Airway Extension Act of 2017

The Disaster Tax Relief and Airport and Airway Extension Act of 2017 (the "Act") provides tax relief for victims of hurricanes Harvey, Irma, and Maria.

Section 501 of the Act provides the following definitions:

1. Disaster zones are that portion of the 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.
2. Disaster areas are areas with respect to which a major disaster has been declared by the president before September 21, 2017, under section 401 of such Act.

Section 502 of the Act provides special rules for retirement distributions. I.R.C. § 72t (the additional tax on early retirement withdrawals) does not apply to a qualified hurricane distribution from an eligible retirement plan. The following rules apply:

1. Up to $100,000 total distributions are eligible (including prior tax years).
2. The taxpayer can repay amounts to the plan within 3 years.
3. Unless the taxpayer elects out, any amount required to be included in gross income is included ratably over a 3-year period.
4. The taxpayer can re-contribute withdrawals for home purchases cancelled due to eligible disasters.

The retirement distribution rules apply to distributions made due to Hurricane Harvey on or after August 23, 2017 and before January 1, 2019. Distributions due to Hurricane Irma must be made or after September 4, 2017, and before January 1, 2019. Distributions due to Hurricane Maria must be made on or after September 16, 2017, and before January 1, 2019.

Section 503 of the Act provides for employer credits. It grants an employee retention credit for employers affected by the hurricanes (businesses that were inoperable at the employee's principal place of employment in the designated hurricane disaster zone). The credit is for 40% of qualified wages up to $6,000.

Section 504a of the Act temporarily suspends the limit on charitable contributions under I.R.C. §170 for contributions

- paid between August 23, 2017 and December 31, 2017;
- in cash; and
- to an organization described in I.R.C. §170(b)(1)(A) for relief efforts in the Hurricane Harvey disaster area, the Hurricane Irma disaster area, or the Hurricane Maria disaster area.

The taxpayer must obtain contemporaneous written acknowledgment that such contribution was used (or is to be used) for relief efforts, and the taxpayer must elect the application of this subsection.

Section 504b of the Act provides the following rules for personal casualty losses:

- For uncompensated losses arising in the disaster areas, there is no requirement that losses exceed 10% of AGI.
- The net disaster loss can increase an individual taxpayer's standard deduction and the taxpayer does not have to itemize deductions.

Section 504c of the Act provides that for 2017, taxpayers can use earned income from the prior year to determine the earned income tax credit and child tax credit [Disaster Tax Relief and Airport and Airway Extension Act of 2017, Pub. L. No. 115-63].

Income

Bon Viso v. Commissioner

I.R.C. § 61

The taxpayers claimed that the gross gambling winnings reflected on their Forms W-2G, Certain Gambling Winnings, should be reduced by the amounts of bets they placed to produce their winnings. Although the taxpayers introduced evidence of losses at another casino (in addition to lottery tickets and sporting bets), the record contained no evidence specifying how much they bet to produce the winnings reflected on the Forms W-2G.

The court acknowledged that in certain situations the court may estimate the amount of a reduction in income even if the taxpayer fails to keep records, but only if the taxpayer presents sufficient evidence to establish a rational basis for making the estimate. Because the court had no basis for estimating the amounts of the bets, the court held that the taxpayers must include the full gambling winnings in their gross income. The court noted, however, that for taxpayers not engaged in the trade or business of gambling, gambling losses are allowable as an itemized deduction, but only to the extent of gambling winnings [*Bon Viso v. Commissioner*, T.C. Memo. 2017-154].

Gaylor v. Mnuchin

I.R.C. § 107

The court considered the constitutionality of I.R.C § 107(2), which excludes from the gross income of a "minister of the gospel" a "rental allowance paid to him as part of his compensation." Although the phrase *minister of the gospel* appears on its face to be limited to Christian ministers, the IRS has interpreted the phrase liberally to include certain religious leaders of other faiths.

The Freedom from Religion Foundation brought this lawsuit to challenge section 107(2) because it discriminates against secular employees and violates both the Establishment Clause of the First Amendment and the Equal Protection Clause of the Fifth Amendment.

The court held that section 107(2) violates the Establishment Clause because it provides financial assistance to one group of religious employees without any consideration to the secular employees who are similarly situated to ministers. The court has not yet determined the appropriate remedy [*Gaylor v. Mnuchin*, 120 A.F.T.R. 2d (RIA) 2017-6128 (W.D. Wisconsin 2017)].

Fiscalini v. Commissioner

I.R.C. §§ 1001, 1015

The taxpayer and his parents jointly owned real property. In 2003, the taxpayer's parents gifted him their interest in the property. Pursuant to I.R.C. § 1015(a), the taxpayer's basis in the interest in the property that his parents gave him was the same as the parents' cost basis in that interest. Thus, the taxpayer's basis in the property was the sum of his cost basis in the interest in that property that he purchased and his basis in his parents' interest in that property.

The taxpayer's parents then acquired the property from taxpayer. The taxpayer received no cash and no other property from his parents, although they discharged the taxpayer's mortgage loans on the property.

I.R.C. § 1001(b) provides that the amount realized from the sale of property is the sum of any money received plus the FMV of property other than money that the transferor received. Treas. Reg. §1.1001-2(a)(1) provides that generally the amount realized from the sale of property includes the amount of liabilities from which the transferor is discharged because of the sale.

The court found that the taxpayer's sale of the property to his parents was a transfer of property that was in part a sale and in part a gift. With some adjustments, the taxpayer's capital gain on the property was the discharged liabilities less the taxpayer's adjusted basis [*Fiscalini v. Commissioner*, T.C. Memo. 2017-163].

LOSS LIMITATIONS

Passive Activity Losses

Hickam v. Commissioner

I.R.C. § 469

The taxpayer brokered real estate mortgages and other loans as an independent contractor for a mortgage brokerage company. He also managed and maintained three rental real estate properties. He did not keep contemporaneous records of the hours he spent or the services he performed for the rental properties. In response to an IRS audit, the taxpayer prepared a log of his hours and his services with respect to the three properties.

Under I.R.C. § 469(c)(1), rental activity is generally treated as per se passive regardless of whether the taxpayer materially participates unless the taxpayer qualifies as a real estate professional under the exception provided by section 469(c)(7)(B). If a taxpayer qualifies as a real estate professional, the section 469(c)(2) disallowance does not apply. The taxpayer's rental real estate activity, if conducted as a trade or business or for the production of income, is not treated as a passive activity if the taxpayer materially participates in the activity.

The court held that the taxpayer's mortgage brokerage services and his loan origination services were not included for purposes of the real estate professional test. The taxpayer did not meet the definition of a real estate professional and he failed to prove how much time he spent on his rental real estate activities [*Hickam v. Commissioner*, T.C. Summary Opinion 2017-66].

MISCELLANEOUS

Second Report to the President on Identifying and Reducing Tax Regulatory Burdens

This report recommends actions to eliminate, and in other cases mitigate, the burdens imposed on taxpayers by eight regulations that the Treasury has identified for review under Executive Order 13789. As stated in the order, it is the policy of the president that tax regulations provide clarity and useful guidance. Recent regulations, however, have increased tax burdens and impeded economic growth. The order therefore calls for immediate action to reduce tax regulatory burdens and provide useful and simplified tax guidance.

The order directed the Secretary of the Treasury to identify significant tax regulations issued on or after January 1, 2016, that (i) impose an undue financial burden on US taxpayers, (ii) add undue complexity to the federal tax laws, or (iii) exceed the statutory authority of the IRS.

Cross-Reference Executive Order 13789

See page 495 in the *2017 National Income Tax Workbook* for a discussion of the regulations identified in Executive Order 13789.

Executive Order 13789 further directs the Secretary to submit to the president a report recommending "specific actions to mitigate the burden imposed by regulations identified in the interim report."

The report recommends the following:

1. Proposed regulations under I.R.C. § 2704 on restrictions on liquidation of an interest for estate, gift, and generation-skipping transfer taxes are unworkable and should be withdrawn in their entirety. Note that these proposed regulations were withdrawn.
2. Proposed regulations under I.R.C. § 103 on the definition of a political subdivision should be withdrawn in their entirety. Treasury and the IRS may propose more targeted guidance in the future after further study of the relevant legal issues. Note that these proposed regulations were withdrawn.
3. Final regulations under I.R.C. § 7602 on the participation of a person described in I.R.C. § 6103(n) in a summons interview should continue to allow outside subject-matter experts to participate in summons proceedings. In certain highly complex examinations, effective tax administration may require the specialized knowledge of an economist, an engineer, a foreign attorney who is a specialist in foreign law, or other subject-matter experts. In some cases, there is a compelling need to look outside the IRS for expertise that the IRS's own employees lack. Outside experts should thus continue to be permitted to assist the IRS by reviewing summoned materials and, if necessary, by posing questions to witnesses under the guidance and in the presence of IRS employees. Such a role would be limited to the small subset of cases in which the IRS requires the assistance of a subject-matter expert to ensure effective tax administration.
4. Treasury and the IRS will continue to study the technical issues and consider comments

on regulations under I.R.C. §§ 707 and 752. Treasury and the IRS are reviewing and considering ways to rationalize and lessen the burden of partnership tax regulations governing liabilities and allocations more generally. In their review, Treasury and the IRS will consider the ways in which the rules under different sections of the Internal Revenue Code interact, and may propose further changes to the relevant liability or allocation regulation.

5. Final and temporary regulations under I.R.C. § 385 on the treatment of certain interests in corporations as stock or indebtedness address the classification of related-party debt as debt or equity for US federal income tax purposes. After further study of the documentation regulations, Treasury and the IRS are considering a proposal to revoke the documentation regulations as issued. Treasury and the IRS are actively considering the development of revised documentation rules that would be substantially simplified and streamlined in a manner that will lessen their burden on US corporations, while requiring sufficient legal documentation and other information for tax administration purposes.
6. The Office of Tax Policy and the IRS concluded that there should be an exception to I.R.C. § 367 regulations on the treatment of certain transfers of property to foreign corporations. To address taxpayers' concerns about the breadth of the regulations, they are actively working to develop a proposal that would expand the scope of the active trade or business exception and they expect to propose regulations providing such an exception.
7. The IRS and Treasury are considering substantially revising temporary regulations under I.R.C. § 337(d) on certain transfers of property to regulated investment companies (RICs) and real estate investment trusts (REITs).
8. The IRS and Treasury are considering substantially revising final regulations under I.R.C. § 987 on income and currency gain or loss with respect to a section 987 qualified business unit.

TAX PRACTICE

Filing Status

Fansu Camara v. Commissioner

I.R.C. § 6013

Although the taxpayers were married at all relevant times, the husband erroneously claimed single filing status on his 2012 individual income tax return. In the notice of deficiency, the IRS changed the husband's filing status to married filing separately. After petitioning the court, the taxpayers filed a joint 2012 income tax return. The IRS contended that the husband's original 2012 single return was a "separate return" and the limitations of I.R.C. § 6013(b)(2) applied to prevent the taxpayers from claiming the benefits available to married taxpayers who file a joint return.

Section 6013(b)(2) lists four limitations on the election to change to a joint return. Specifically, the IRS contended that section 6013(b)(2) barred the election to file a joint return because it was made more than 3 years from the filing deadline (without extensions) for filing, and it barred the election because the IRS had mailed a notice of deficiency.

The court held that the 2012 return that the husband originally filed, erroneously claiming "single" status, did not constitute a "separate return" within the meaning of section 6013(b). Because the section 6013(b) election applies only where an individual has filed a separate return, the section 6013(b)(2) limitations did not apply. The taxpayer was entitled to joint filing status and rates [*Fansu Camara v. Commissioner*, 149 T.C. No. 13 (2017)].

Knez v. Commissioner

I.R.C. § 6013

A head of household return is not a "separate return" for the joint return after separate return rules. The court held that where a married person files a return with a head of household filing status, the taxpayer has not filed a separate return for purposes of I.R.C. § 6013(b) [*Knez v. Commissioner*, T.C. Memo. 2017-205].

Nominee

United States v. Balice

I.R.C. § 7403

The taxpayers attended a seminar that instructed attendees on how to create trusts to obtain tax benefits. After the seminar, the taxpayers executed a quitclaim deed purporting to transfer title of their primary residence to a trust. The taxpayers did not receive consideration for the transfer. The court found that the trust was the taxpayers' nominee, and that the IRS could foreclose on the property to satisfy the taxpayers' personal tax obligations [*United States v. Balice*, 120 A.F.T.R. 2d (RIA) 2017-5444 (D.C. New Jersey 2017)].

Powers of Attorney

C.C.A. 2017-36-021

I.R.C. §§ 6038, 6677

If line 3 of a Form 2848, Power of Attorney and Declaration of Representative, lists an income tax return to which an International Information Return (IIR) must be attached, such as Form 5471, Information Return of U.S. Persons With Respect To Certain Foreign Corporations, the Form 2848 does not cover the civil penalty associated with that IIR. If line 3 of a Form 2848 lists an income tax return to which an IIR is not required to be attached, such as Form 3520, Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts, Form 2848 does not cover the civil penalty associated with that IIR. If a representative designated on a Form 2848 prepared a Form 1120, U.S. Corporation Income Tax Return, and a Form 5471, and the taxpayer subsequently submits a Form 2848 designating a different representative and listing Form 5471 and not Form 1120, the IRS may discuss with the second representative only those penalties associated with Form 5471 [C.C.A. 2017-36-021 (August 1, 2017)].

Procedure

Borenstein v. Commissioner

I.R.C. § 6511, 6512

The taxpayer had an overpayment for the 2012 tax year. The IRS argued that the taxpayer was not entitled to a credit or refund under I.R.C. § 6511(a) and (b)(2)(B) because her tax payments were made more than 2 years after the date that the IRS mailed the notice of deficiency. The taxpayer claimed that she was eligible for the 3-year lookback period specified in the final sentence of I.R.C. § 6512(b)(3).

Section 6512(b)(1) grants the court jurisdiction to determine an overpayment for a year for which the court has also determined a deficiency (or has decided that there is no deficiency). Section 6512(b)(3) provides a special 3-year period for cases where the deficiency notice was mailed during the third year after the due date (with extensions) for filing the return.

The court found that the taxpayer was not eligible for the 3-year lookback period specified in the final sentence of section 6512(b)(3) because the notice of deficiency was not mailed to her during the third year after the due date (with extensions) for filing the return [*Borenstein v. Commissioner*, 149 T.C. No. 10 (2017)].

Returns

C.C.A. 2017-33-013

I.R.C. § 6031

The IRS considered whether Rev. Proc. 84-35, 1984-1 C.B. 509 provides partnerships with an automatic exemption from the requirement to file a Form 1065, U.S. Return of Partnership Income. Under Rev. Proc. 84-35, a domestic partnership with 10 or fewer partners that falls within the exceptions in I.R.C. § 6231(a)(1)(B) is deemed to have met the reasonable cause test, and, therefore, is not liable for the I.R.C. § 6698 penalty.

The IRS concluded that I.R.C. §§ 6031 and 6698 do not contain an automatic exception to the general filing requirement set forth in section 6031(a). Although the section 6698 penalty may be avoided if it is shown that the failure to file a complete or timely return was due to reasonable cause, such relief may be granted only if the partnership meets the requirements of the revenue procedure and examiners follow the procedures set forth in I.R.M. 20.1.2.3.3 [C.C.A. 2017-33-013 (July 12, 2017)].

Notice 2017-47

I.R.C. § 6072

This notice provides penalty relief to partnerships and real estate mortgage investment conduits (REMICs) that filed certain untimely returns or untimely requests for extension of time to file those returns for the first tax year that began after December 31, 2015. The IRS will grant relief from the penalties if either of the following conditions are satisfied:

- The partnership filed the Form 1065, 1065-B, 8804, 8805, 5471, or other return required to be filed with the IRS and furnished copies (or Schedules K-1) to the partners (as appropriate) by the date that would have been timely under I.R.C. § 6072 before amendment by the Surface Transportation Act (April 18, 2017 for calendar-year taxpayers, because April 15 was a Saturday and April 17 was a legal holiday in the District of Columbia).
- The partnership filed Form 7004, Application for Automatic Extension of Time To File Certain Business Income Tax, Information, and Other Returns, to request an extension of time to file by the date that would have been timely under section 6072 before amendment by the Surface Transportation Act and filed the return with the IRS and furnished copies (or Schedules K-1) to the partners (as appropriate) by the fifteenth day of the ninth month after the close of the partnership's tax year (September 15, 2017, for calendar-year taxpayers). If the partnership files Form 1065-B and was required to furnish Schedules K-1 to the partners by March 15, 2017, it must have done so to qualify for relief.

This relief will be granted automatically for penalties for failure to timely file Forms 1065, 1065-B, 8804, 8805, and any other returns, such as Form 5471, for which the due date is tied to the due date of Form 1065 or Form 1065-B. For reconsideration of a penalty covered by this notice that has not been abated by February 28, 2018, contact the number listed in the letter that notified the taxpayer of the penalty or call 800.829.0115 and state that the taxpayer is entitled to relief under Notice 2017-47. Taxpayers who qualify for relief under this notice will not be treated as having received a first-time abatement under the IRS's administrative penalty waiver program [Notice 2017-47, 2017-38 I.R.B. 232 (September 1, 2017)].

New Form 8809

The IRS issued a September 2017 version of Form 8809, Application for Extension of Time To File Information Returns. It contains a new line on which taxpayers must indicate that they qualify to use the form if they are using it for an extension of Form W-2, Wage and Tax Statement, or if they are seeking an additional extension. **Figure 1.1** shows the new line on Form 8809.

FIGURE 1.1 Form 8809 Line 7

7 If you are requesting an extension for Form W-2, or if you checked the box on line 5, you must meet one of the following criteria. Check the applicable box(es) that describes your need for an extension.

The business suffered a catastrophic event in a Presidentially Declared Disaster Area that made the business unable to resume operations or made necessary records unavailable . . . . ☐	Death, serious illness, or unavoidable absence of the individual responsible for filing the information returns affected the operation of the business . . . . ☐
Fire, casualty, or natural disaster affected the operation of the business . . . . ☐	The business was in its first year of establishment . . . . ☐

Pearson v. Commissioner

I.R.C. § 7502

Under I.R.C. § 6213(a), the last day for the taxpayers to petition the court was April 22, 2015 (90 days after mailing the notice of deficiency). The court received their petition via certified mail on April 29, 2015. The envelope containing the petition was properly addressed and had been deposited at a US post office with sufficient postage prepaid through Stamps.com, a US Postal Service (USPS) approved commercial vendor. The Stamps.com postage label showed April 21, 2015 as the date on which the postage was paid and the label was printed. The envelope did not bear a USPS postmark. The USPS entered the envelope into its tracking system for certified mail on April 23, 2015.

The court held that the date shown on the Stamps.com postage label was a postmark not made by the USPS within the meaning of I.R.C. § 7502(b), and the data retrieved from the USPS tracking system for certified mail is not a postmark made by the USPS within the meaning of Treas. Reg. § 301.7502-1(c)(1)(iii)(B)(3). However, the taxpayers' petition was timely mailed under section 301.7502-1(c)(1), and it was timely filed under section 7502(b) [*Pearson v. Commissioner*, 149 T.C. No. 20 (2017)].

Statute of Limitations

United States v. Estate of Chicorel

I.R.C. § 6502

The taxpayer argued that the government was barred by the statute of limitations from enforcing a 2002 assessment, which was assessed on September 12, 2005. The IRS filed a proof of claim with the probate court on January 28, 2009, and filed a collection action on March 11, 2016 (more than 10 years after the initial assessment). The relevant statute provides that where the assessment of tax is made within the period of limitation properly applicable thereto, such tax may be collected by levy or by a proceeding in court, but only if the levy is made or the proceeding begun within 10 years after the assessment of the tax [I.R.C. § 6502(a)].

The court found that the IRS initiated a timely proceeding in court within the meaning of section 6502(a) by submitting its proof of claim to the probate court, and that this tolled the statute of limitations with respect to the proceeding on the 2002 assessment. Section 6502(a) tolls the statute of limitations on collections and does not apply only to levies [*United States v. Estate of Chicorel*, 120 A.F.T.R. 2d (RIA) 2017-5506 (E.D. Michigan 2017)].

Taxpayer Identification Numbers

REG-105004-16

I.R.C. §§ 6051, 6052, 6109

This document contains proposed amendments to the regulations under I.R.C. §§ 6051 and 6052. To aid employers' efforts to protect employees from identity theft, these proposed regulations would amend existing regulations to permit employers to voluntarily truncate employees' social security numbers (SSNs) on copies of Forms W-2 that are furnished to employees so that the truncated SSNs appear in the form of IRS truncated taxpayer identification numbers (TTINs). These proposed regulations would also amend the regulations under I.R.C. § 6109 to clarify the application of the truncation rules to Forms W-2 and to add an example illustrating the application of these rules. Additionally, these proposed amendments would delete obsolete provisions and update cross references in the regulations under sections 6051 and 6052 [REG-105004-16].

CORRECTIONS AND CLARIFICATIONS

2

Like-Kind Exchanges	p. 54	The final citation to the *Estate of George H. Bartell, et al. v. Commissioner*, is **147 T.C. 140 (2016)**.
Business Issues	pp. 263–4	Figure 8.11 is **GDS Recovery Periods** Figure 8.12 is **ADS Recovery Periods**
Business Issues	p. 278	Clearwater's QPAI is **$157,755 ($1,319,000 – $870,000 – $291,245)**. Clearwater Construction's DPAD deduction is **$14,198**, which is the least of the following three amounts: 1. 9% of QPAI: **$157,755 × 9% = $14,198** 2. 9% of AGI before the DPAD: $213,114 × 9% = $19,180 3. 50% of W-2 wages: $325,000 × 50% = $162,500
Individual Issues	p. 348	If the organization sells the vehicle for **$500 or less**, the taxpayer can generally deduct $500.
Individual Issues	p. 352	Treas. Reg. § 1.170A-13(a) has not been updated for changes made by The Pension Protection Act of 2006 (P.L. 109-280). For contributions on or after 1/1/07, I.R.C. § 170(f)(1) requires a bank record or a written communication from the donee to substantiate a cash contribution.
Agricultural and Natural Resource Issues	p. 433	Long-term capital losses are reported in Part II of Form 8949, Sales and Other Dispositions of Capital Assets.
Foreign Tax Issues	p. 439	Starting in 2017, the automatic 6-month FBAR extension applies to all years.
New and Expiring Legislation	p. 481	Pursuant to Notice 2017-67, issued October 17, 2017, an employer sponsoring a QSEHRA is not required to issue a Form 1095-B, Health Coverage.