

Federal Income Tax Update 2017

By:
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General Topics

1. Wasco Real Properties T.C. Memo 2016-224

- A. Family owns 3 partnerships
- B. Partnerships purchased land
 - 1. Almond trees planted on land
- C. Partnerships deducted interest for loan to buy the land and property tax
- D. Under Section 263A you must capitalize direct and indirect costs of producing real property
 - 1. Planting trees meets production requirement
 - 2. Must capitalize interest and taxes

2. Estate of Steve Backemeyer 147 T.C. No. 17

- A. Steve was a cash method farmer
- B. Purchased inputs in 2010 and deducted cost
 - 1. Did not use the inputs
- C. Steve died in 2011
 - 1. Wife inherited business and inputs
 - 2. Deducted cost of inputs
- D. IRS attempted to use tax benefit rule to require Steve's 2011 return to report income equal to cost of inputs
 - 1. Section 111 codifies part of tax benefit rule
 - 2. Death is not inconsistent with tax deduction
 - a) Tax benefit does not apply

3. Jeremy Jacobs 148 T.C. No. 24

- A. Boston Bruins owner claims cost of meals when team is out of town
- B. Meets the Section 132 requirements
 - 1. Not discriminatory
 - a) Includes non-players
 - 2. Hotel rental and payment for food meets leasing and employer operation rules

4. Boris Putanec T.C. Memo 2016-221

- A. Taxpayer acquired a CARDS loan
- B. Deducted \$100 million loss based on face value of loan
- C. Since not likely loan would be paid, loss not face value
- D. Taxpayer allowed related payment deductions

5. Charitable Contributions

A. RERI Holdings 1 LLC - 149 T.C. No. 1

1. Taxpayer purchased property and contributed it to University of Michigan 17 months later
 - a) Claimed value and deduction of \$33 million
2. Did not include cost of property on its return
 - a) Need to comply with requirement substantially
 - b) Omission of cost violated requirement
 - 1) Zero contribution deduction

B. ILM 201651013

1. Grantor created a trust
 - a) Following his death trust divided into 2 trusts based on conflict
2. Beneficiary of trust 2 modifies agreement to contribute assets to Foundation
3. Distribution under Sec. 642 (c) must be pursuant to governing instrument
 - a) No charitable deduction
 1. Not based on instrument
4. IRS rules that charitable contribution deductible under Sec. 642 not 661 or 662

5. Charitable Contributions

C. Ten Twenty Six Investors T.C. Memo 2017-115

1. Partnership made conservation easement contribution in 2004
2. NAT recorded it in 2005
3. No deduction
 - a) Did not meet the perpetuity requirement

D. PLR 201702002

1. Charity runs hospital
 - a) Has significant losses
2. Leases hospital to University Medical Center
 - a) Lease covers expenses
3. Rev. Rul. 73-313 allowed lease of medical facility to private doctor without violating tax exemption
4. Lease does not violate tax exemption or generate unrelated business income

6. TAM 201650014

A. Taxpayer does land clearing, grading and compacting soil for home construction

1. Taxpayer also does common improvements

B. Section 460 (a) requires percent of completion

1. Section 460 (e) allows completed contract for home construction

C. Howard Hughes Co., 805 F. 3d (175) ruled that common improvements do not meet exception

D. Current taxpayer does sufficient home construction items to use completed contract

7. Estate of Andrew McKelvey 148 T.C. No. 13

A. Taxpayer created Monster

B. In 2007 he sold stock using a variable prepaid forward contract (VPFC)

C. In 2008 he paid to extend contract

D. Is the extension a taxable transaction?

1. Rev. Rul. 2003-7 VPFC not a sale or exchange until settled
2. Is extension an exchange of property for other property?
 - a) Court ruled that this is an obligation not a right (property)
 - b) Treat as open transaction

8. Deferred Compensation - Section 409A

A. CCA 201645012

1. Employee agrees to defer compensation normally paid in 2015
2. Has to work in 2015, 2016, and 2017
3. Received defined compensation increased by 25%
 - a) Qualifies as a substantial risk of forfeiture under Section 409A

B. ILM 201725027

1. Taxpayer deferred compensation
2. Employee of taxpayer deferred compensation
3. Taxpayer would receive deferred compensation if employee forfeited his compensation
 - a) Violates Section 409A
4. Additional plan had deferred compensation with varying payment
 - a) Also violates Section 409A

9. AM 2017-002

A. Taxpayer issues hybrid coupons

1. Reduces sale price
2. Sufficient coupons make price zero

B. Reg. Sec. 1.451-4 allows taxpayer to reduce revenue for premium coupons

C. These do not qualify as premium coupons

1. Attempting to limit Giant Eagle v Comm.

10. Michael H. Wu CA-7

- A. Taxpayer made an excess contribution to IRA in 2007
- B. Withdrew excess before April 15, 2010
- C. Tax imposed on excess until withdrawn
 - 1. Tax for 2007-2009
 - 2. Exception does not apply
 - a) Withdraw before tax return of year of excess contributions

11. Summa Holdings Inc CA-6

- A. Taxpayer created a DISC
- B. The children of the owner of taxpayer created Roth IRAs
- C. The Roth IRA's owned a corporation that owned the DISC
- D. Over \$3 million was contributed to the Roth IRA
- E. IRS imposed the substance over form doctrine
 - 1. Court rejected
 - 2. Taxpayer followed the exact wording of the code

12. Like-Kind Exchange - Section 1031

- A. The Malulani Group T.C. Memo 2016-209
 - 1. Taxpayer had qualified intermediary sell land
 - 2. Intermediary purchased replacement from related party
 - 3. Section 1031 (f) denies tax-free exchange
 - a) Fact that taxpayer tried to acquire unrelated property immaterial
 - b) Comparable basis disregarded since related party had NOL deduction
- B. PLR 201648013
 - 1. Taxpayer uses a QI
 - 2. The property sold secures debt
 - a) QI pays debt with cash of sale
 - 3. QI borrows money to buy replacement property
 - 4. Taxpayer not treated as receiving boot

12. Like-Kind Exchange Section 1031

- C. PLR 201706009
 - 1. Taxpayer exchanging Towers for Cable Distribution Systems
 - 2. State law classifications of these items do not control the decision
 - 3. Exchange will be treated as like-kind
- D. AOD 2017-06
 - 1. IRS will not acquiesce to Bartell
 - 2. Taxpayer had leased property before the exchange
 - a) Court allowed like-kind exchange

13. PLR 201702034

- A. Taxpayer required to dispose of its broadcast rights and obtain lower ones
- B. This transaction qualifies as a Section 1033 involuntary conversion

14. Greenteam Material Recovery Facility T.C. Memo 2017-122

- A. Taxpayer had contracts with cities and counties to collect and dispose waste
- B. Sold contract
- C. Qualifies as capital gain under Section 1253, franchise sales

15. Wells Fargo & Co DC – Memo

- A. Taxpayer engaged in “STARS” a sham transaction
 - 1. Divided into two – a trust and a loan
- B. Since loan has some potential economic substance lack of business purpose ignored
- C. Interest expense deductible

Individual Taxation

1. AOD 2017-05

- A. In Tsehay, T.C. Memo 2016-200, taxpayer filed as married filing separately
 - 1. Claimed dependency exemption and earned income credit
 - 2. Court approved
- B. IRS will not acquiesce

2. Ryan Fleischer T.C. Memo 2016-238

- A. Taxpayer is an investment advisor
- B. Taxpayer created an S corporation
 - 1. Had employment contract
 - 2. Received a reported salary
- C. Taxpayer not S corporation had agreements with businesses that paid the income
 - 1. Taxpayer not the S corporation has earned the income

3. Michael Yoklic T.C. Memo 2017-143

- A. Taxpayer filed for and received unemployment benefits in 2012
- B. Received letter in 2012 that he did not receive the payments correctly
- C. Repaid the money in 2013
 - 1. Under claim of right taxable in 2012 even though not legally earned

4. Tony Pedregon Lopez T.C. Memo 2017-171

- A. Taxpayer’s child won pageant award money
- B. Included income and expenses on his return
 - 1. Rejected
 - 2. Income and expenses must be reported on daughter’s tax return

5. Robert Polsky CA-3

- A. Taxpayer claimed child tax credit for permanently disabled daughter over age 17
 - 1. District court denied
- B. District court correct, qualified dependent definition different for dependency deduction and credit

6. David Schieber T.C. Memo 2017-32

- A. Taxpayer is a retired California public employee
 - 1. Receives state retirement benefits
- B. A liability is cancelled
 - 1. Taxpayer omits part based on insolvency
- C. Court approves omission of pension from assets since cannot claim anything but monthly payment

7. Charles Adkins Ct. Fed. Cl.

- A. Taxpayer had theft from “pump and dump” investment group
- B. Claimed loss even though recovery lawsuit still existed
- C. Claim valid
 - 1. Able to prove that recovery not realistic

8. Megan Zhao Creigh T.C. Summ 2017-26

- A. Taxpayer has undergraduate and master degree in computer science
- B. Worked for several corporations dealing with computer systems
- C. Created a personal service business
 - 1. Could not recruit clients
- D. Got an EMBA
 - 1. Cost non-deductible
 - 2. Qualified her for new business

9. Deductible Expenses

- A. Legal fees
 - 1. Ellen Sas T.C. Summ 2017-2
 - a) In 2010 taxpayer received and reported \$612,000 bonus
 - b) Taxpayer fired and sued to return bonus
 - c) Paid attorney who arranged settlement
 - 1) No income returned
 - d) Sec. 62 allows deduction for legal fees up to amount of income reported
 - 1) Since no additional income, does not qualify
 - 2) Below the line deduction
 - 3) Origin of claim prevents deduction as business
 - 2. Arthur Dulik T.C. Summ 2017-51
 - a) Taxpayer fired, offered severance agreement
 - 1) Hired attorney to remove or modify agreement
 - b) Created an S corporation to perform services
 - c) Attorney told him to sign agreement
 - 1) Deducted as business expense
 - d) Origin of claim makes expense for employment
 - 1) Itemized deduction

9. Deductible Expenses

- B. Medical expenses
 - 1. Victoria Maley Tax Court Bench Opinion
 - a) Had spinal problems
 - b) Went through “healing” services
 - c) Fact not conventional treatment does not prevent deduction
 - 2. Joseph Morrissey DC
 - a) Homosexual male paid in vitro fertilization expenses
 - b) Deduction denied – not personal
- C. Conservation easement donation
 - 1. Mark Rutkoske 149 T.C. No. 6
 - a) Normally donation deductible up to 50% of taxable income
 - 1) Exception – 100% for farmers and ranchers
 - b) Sale of land not treated as farming income
 - 1) Deduction limited

10. Devine v Comm T.C. Memo 2017-111

- A. Taxpayer sued for sexual harassment, pregnancy discrimination and hostile working situation
 - 1. Suffered some medical problems
 - 2. Claimed she was hit
- B. Settlement simply says harassment and pregnancy discrimination
 - 1. Since does not mention physical injury, receipt taxable

11. Christopher Cooke T.C. Memo 2017-074

- A. Taxpayer created partnership that purchased Larry Bird's former home
- B. Converted it into bed and breakfast
 - 1. Discontinued rental
 - 2. Placed for sale
- C. Stayed in house more than 14 days during year
 - 1. Treated as residence
 - 2. Losses denied
 - 3. Repair and maintenance arguments rejected

12. Retirement Payments

- A. PLR 201706004
 - 1. Taxpayer failed to arrange the trust entitled to his IRA
 - 2. Surviving spouse had court remove trust requirement
 - 3. Spouse can roll over IRA without recognizing income
- B. Raymond McGaugh CA-7
 - 1. Taxpayer asked Merrill Lynch to buy stock as part of his IRA
 - a) Merrill Lynch refused
 - 2. Taxpayer ordered Merrill Lynch to send \$50,000 to corporation to purchase stock
 - a) Stock sent to Merrill Lynch and it tried unsuccessfully to send to taxpayer
 - 3. No constructive receipt
 - a) Stock purchase non-taxable

12. Retirement Payments

- C. Louelia Salomon T.C. Memo 2017-139
 - 1. Taxpayer took leave of absence from work
 - a) Birth of 3rd child
 - b) Out 3 months
 - 2. Borrowed \$40,000 from 401k retirement plan
 - a) Arranged for employer to withdraw money from pay to repay loan
 - b) Employer agreed but failed to pay
 - 3. Since not repaid by employer, taxpayer repaid when informed
 - 4. Repayment after cure period
 - a) Loan is a taxable distribution

12. Retirement Payments

- D. ILM 201736022
 - 1. If money borrowed from 401(k), must be repaid within 5 years
 - a) Payment due monthly
 - 2. Failure to pay may fall under cure period
 - a) Payment within calendar quarter after quarter of missed payment
 - b) Memo has 2 examples of valid cure period payments
- E. Jack Taylor T.C. Memo 2017-132
 - 1. Fire fighter retired because of disability
 - 2. At 60, payment based on age, work, etc.
 - 3. Payment treated as retirement subject to tax

13. Passive Activities

- A. Stephen Hardy T.C. Memo 2017-16
 - 1. Taxpayer is a plastic surgeon
 - 2. He becomes a partner of partnership that runs a surgical center
 - 3. Taxpayer reports partnership as passive income
 - 4. Court ruled that taxpayer and partnership are not a combined unit
 - a) Treat as passive
- B. Kurt Hickam T.C. Summ 2017-66
 - 1. Taxpayer brokered real estate mortgages and other loans
 - 2. Own and managed some real estate
 - 3. Brokerage not real estate professional
 - 4. Real estate owned and managed did not meet hour requirement
 - 5. Losses passive

14. Estate Tax

A. Hurford Investments No. 2 (Non-published T.C.)

1. Individual received phantom stock
2. At death, spouse inherited it
3. She transferred it to a partnership
4. Section 691
 - a) Income in respect of a decedent
 - 1) Estate tax paid deducted when income received
 - b) Disposition causes recognition of income

B. Estate of Nancy Powell 148 T.C. No 18

1. Shortly before her death, son transfers cash and securities she owns to partnership and partnership interest to charitable trust
2. Full amount included in estate
 - a) Decedent had right to reclaim items
 - b) Transfer within 3 years of death

14. Estate Tax

C. Estate of Sheldon Sommers 149 T.C. No. 8

1. Decedent made a net gift within 3 years of death
2. Gift tax paid within 3 years included in estate
 - a) Payment is a credit
 - b) Since payment made after death, no credit

15. ILM 201711009

- A. Taxpayer denied charitable contribution since used non-qualified appraiser
- B. Gross value penalty of 40% must be determined on each property separately

16. Mae Asad and Sam Akel T.C. Memo 2017-80

- A. Taxpayers filed joint returns for 2008 and 2009
 1. Claimed losses for rental property
 2. IRS denied losses
- B. Taxpayers divorced
 1. Divorce decree includes 50/50 tax liability
- C. IRS approved different innocent spouse relief
 1. Divorce does not control
 2. IRS allocation approved

Corporate Taxation

1. ILM 201651014

- A. Taxpayer issued convertible debt
 1. Converted into a warrant
- B. Paid expenses to issue debt
 1. Capitalized under Sec. 263
 2. Amortized it over life of debt
- C. Creditor converted debt
 1. Warrant treated as stock because of minimal price
 2. Unamortized expenditure not deductible
 - a) Part of stock cost

2. ILM 201716045

- A. Parent transfers assets to subsidiary for Class A and Class B stock
- B. Parent sells Class A stock to its shareholder
 - 1. Claims a capital loss
- C. IRS rules the Class A stock a Sec. 351(g) non-qualified preferred stock
 - 1. Denies the loss since shareholder is an accommodation party

3. J. Michael Bell CA-9

- A. Taxpayer transferred assets to a new corporation for "debt"
- B. IRS argued that it was stock not debt
 - 1. Wanted Sec. 351 to apply
- C. Based on Section 385, item received is stock not debt

4. Gregory Hann Ct. of Fed. Cl.

- A. Taxpayer received employee stock options
- B. Corporation decides to have IPO
 - 1. Allows employee to join
- C. Taxpayer agrees
 - 1. Sale reduced by the underwriter's fees
- D. Full value compensation and fees capital loss

5. Michael Tseytin CA-3

- A. Taxpayer majority shareholder of corporation
 - 1. Wants to merge into unrelated corporation
- B. Taxpayer buys minority shareholder stock
 - 1. Transfers 100% of stock for cash and stock
- C. Taxpayer argues he did not own stock of minority
 - 1. Court rejects
 - 2. Danielson applies
- D. Argues his loss on more stock
 - 1. Each block treated separately
 - 2. Section 356 has gain but no loss

6. Rev. Rul. 2017-9

- A. Taxpayer engages in a north-south transaction
 - 1. Can be treated as one or two transactions
 - 2. IRS will accept taxpayers preference unless actual transaction inconsistent with taxpayers position
- B. Section 356 not Section 301 applies to reorganization

7. ILM 201726012

- A. Parent corporation owns a subsidiary that owns an interest in a partnership
- B. The subsidiary either liquidates or merges into another subsidiary
- C. The transfer of the partnership interest treated as an exchange under Section 761(e)
 - 1. If partnership has a Section 754 election, make Section 743 adjustments
- D. The increase in depreciation treated as a non-deductible, non-capitalizable item

8. ILM 201653017

- A. Taxpayer formed corporation
 - 1. Contributed partnership interests
 - 2. Partnerships were investment funds
 - 3. Partnership did not distribute cash
- B. Corporation subject to Section 531 accumulated earnings tax
 - 1. Lack of cash immaterial

9. William Rutter T.C. Memo 2017-174

- A. Taxpayer is a biotechnology scientist
- B. He created a corporation that was attempting to work with other business as an adviser
 - 1. He received no stock
 - a) Stock issued to employees and family members
 - 2. Loaned \$43 million to corporation
 - 3. Claimed bad debt deduction
- C. Court reclassified loan as equity
 - 1. Even if debt, non-business bad debt
 - 2. Even if business debt, not worthless

10. PLR 201717010

- A. Taxpayer created corporation
 - 1. Provided lab reports to healthcare providers
 - a) No diagnosis or treatment
- B. Stock qualifies under Section 1202
 - 1. Gain excluded

Partnership Taxation

1. Vincent Castigliola T.C. Memo 2016-62

- A. Taxpayer, an attorney, joined others and formed a PLLC in Mississippi
- B. Reported guaranteed payment as self-employment income
 - 1. Did not include the rest
- C. Taxpayer not a limited partner
 - 1. All income is self-employment

2. Jeffrey W. Herrmann Ct. of Fed. Cl.

- A. Taxpayer worked as investment adviser in US business
- B. Was transferred to London to work in the business partnership
 - 1. Taxpayer required to become a partner
- C. Taxpayer received "salary" and "bonus"
 - 1. Reported when received
- D. IRS reclassified as share of partnership income in year earned
 - 1. Court rejected
 - 2. Treat as outside compensation under Sec. 707(a)(2)(A)

3. PLR 201714028

- A. Property and liability transferred for interest
- B. Liability valid
 - 1. Not disguised sale under Sec. 707(a)(2)(B)

4. Thomas Watts T.C. Memo 2017-114

- A. Taxpayer formed partnership
 - 1. Sold 80% to investor
- B. Investor decided to sell
 - 1. Taxpayer convinced investor to sell to preferred buyer
 - 2. Taxpayer gave up ownership
 - a) Claimed ordinary abandonment loss
- C. Court ruled not an abandonment

S Corporations

1. Steven Petersen 148 T.C. No. 22

- A. Taxpayer formed an S corporation
 - 1. Adopted the accrual method
- B. Taxpayer created an ESOP and contributed S corporation stock
 - 1. Employees are the beneficiaries
- C. IRS claimed that accrued compensation for employees that are part of ESOP subject to Section 267(a)(2)
 - 1. Deductible when paid
 - 2. ESOP ruled a trust by court
 - 3. Deduction when paid not accrued

2. Zane Penley T.C. Memo 2017-65

- A. Taxpayer created an S corporation
 - 1. Owned rental property
 - 2. Corporation reported loss
 - a) Deducted by taxpayer
- B. Taxpayer claimed real estate professional
 - 1. Court rejected reported hours
 - 2. Held not professional
- C. S corporation loss passive loss
 - 1. Non-deductible

3. PLR 201725022

- A. C corporation elects to be an S corporation
- B. Owns and rents property
 - 1. Provides related services
- C. Not passive income
 - 1. Therefore S election not terminated

4. Rupert Phillips T.C. Memo 2017-61

- A. Taxpayer owned S corporation stock
- B. Corporation borrowed money
 - 1. Taxpayer guaranteed
- C. Corporation failed to pay
 - 1. Creditor sued taxpayer
 - a) Got deficiency judgement
 - b) Taxpayer did not pay
 - 2. Increased stock basis by debt
 - a) Court rejected
 - b) No economic outlay