

Federal Tax Update

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INDIVIDUALS

Final Regulations under Code Section 108 require that the ultimate owners rather than the disregarded entities themselves – grantor trusts and single owner limited liability companies – must be in bankruptcy or otherwise insolvent to fall within either of these exceptions to the general rule that relief from indebtedness is taxable.

In Belot v. Commissioner, TC Memo 2016-113, the Tax Court determined that a “sale, assignment and transfer” of shares of stock and membership interests between spouses per a second agreement 13 months after the original marital settlement which contemplated the parties owning and operating a business together was a tax free transfer incident to a divorce notwithstanding the existence of a prior agreement and the transactional-type language in the second agreement.

In Slavin v. Commissioner, TC Summary Opinion 2016-28, the Tax Court reiterated that converting delinquent back interest into principal of a refinanced loan (at least with the same lender) does not give rise to an immediate interest deduction.

In Nacchio v. United States, 117 AFTR2d 2016-2070, the Federal Circuit Court of Appeals reversed in the US Court of Claims and denied a former telecommunications executive a deduction on disgorged profits from insider trading, holding that a forfeiture is not restitution even though repaid funds may be distributed among claimants in civil securities litigation.

In Letter Ruling 201622008, IRS confirmed that the disposition of a tenancy in common interest in real property permits the fractional owner to seek a like-kind exchange.

In Letter Ruling 201625001, IRS denied tax-free exchange treatment to an heir who inherited an annuity and negotiated a payout check prior to purchasing another annuity several days later.

RETIREMENT PLANS

In Nemlowill v. United States, 117 AFTR2d 2016-_____, a California Federal District Court refused to enjoin the Internal Revenue Service from levying against a retirement trust as injunctive relief is not available in a collection action.

In Letter Ruling 201623001, IRS determined, where a widow asserted her community property right to one-half of an IRA left to the son of the couple, that the transfer of funds from the son to his mother was a taxable distribution to him and the deemed contribution by the mother to the IRA was subject to the annual statutory limit; the Court rejected an assertion that the inherited IRA rules applied as Code Section 408 by statute is to be applied without regard to community property laws.

In Letter Ruling 201625022, IRS declined to waive the 60-day rollover period on IRAs where its funds were utilized to purchase their daughter's home and prevent its foreclosure, and their vacation property sale intended to replace the IRA monies closed eight days beyond the rollover period.

ESTATES

In Duckett v. Enomoto, 117 AFTR2d 2016-750, an Arizona Federal District Court refused to order a trustee to distribute trust funds to IRS as the result of a lien when the trust language gave him sole discretion to distribute funds.

BUSINESS

Proposed Regulations under Code Section 409A attempt to clarify numerous unanswered issues under prior 2007 Regulations including allowing teachers who work ten months but spread their pay over 12 months to avoid coming under the deferred compensation restrictions.

In Squeri v. Commissioner, TC Memo 2016-116, the Tax Court determined that the "duty of consistency" applied and a taxpayer could not assert that amounts reported as income in an open year should have been reported in a closed tax year.

In Powell v. Commissioner, TC Memo 2016-111, the Tax Court disallowed most automobile mileage claimed by the taxpayer, citing the strict substantiation requirements for vehicle expenses but stating that it can be supported by reconstruction if done to the level of credibility of a contemporaneous record.

In O'Connor v. Commissioner, 117 AFTR2d 2016-_____, the Tenth Circuit Court of Appeals agreed with the Tax Court that a US Citizen licensed to practice law in Germany could not deduct the cost of a US legal education as it qualified him for a new business (stating that the result would be the same regarding educational and other costs to be admitted in another state).

In Estate of Marshall v. Commissioner, TC Memo 2016-119, the Tax Court determined that shareholders of a construction business which had received a \$41 million litigation award were liable as transferees for unpaid corporate taxes when they sold their stock to a third party and corporate funds were knowingly depleted to accomplish the buy-out.

In Hess v. Commissioner, TC Summary Opinion 2016-27, the Tax Court held that a couple whose Amway revenue never exceeded \$2,200 in any year and whose losses averaged \$20,000 per year were not engaged in an activity for profit.

In Peterson v. Commissioner, 117 AFTR2d 2016-714, the Eleventh Circuit Court of Appeals agreed with the Tax Court that payments under the Mary Kay post-retirement deferred compensation plans which were tied to customer base at retirement were subject to self employment tax and could not be considered as exempt proceeds from the sale of a business.

In Revenue Ruling 2016-15, IRS clarified that indebtedness of a developer must relate to property used in its business as opposed to property held for sale to customers in order to qualify for the qualified real property business indebtedness exclusion in the case of discharged liabilities.

In Chief Counsel Advice 201623006, IRS declared that fines paid to the Financial Industry Regulatory Authority (FINRA) are nondeductible as FINRA is considered an instrumentality of the US Government as it performs a governmental function.

PROCEDURE

In Solers, Inc. v. United States, 117 AFTR2d 2016-_____, the Fourth Circuit Court of Appeals agreed with a Virginia Federal District Court that IRS could withhold certain documents sought under the Freedom of Information Act (FOIA) and redact others based on various grounds including the “deliberative process privilege” which protects written notations of Revenue Agents which are “predecisional and deliberative.”

In Guralnik v. Commissioner, 146 TC No. 15, the Tax Court found a Petition to have been filed timely one day after the last date for filing shown on the Notice of Deficiency when the Tax Court was closed on the last day due to a snow storm.

In Ericson v. Commissioner, TC Memo 2016-107, the Tax Court disagreed with IRS and rejected imposition of a civil fraud penalty on a preparer’s own returns despite substantial adjustments; although he prepared up to 1,000 tax returns a year, the Court found that the taxpayer was not a “sophisticated tax preparer”, had minimal education in tax preparation and was misguided in his understanding of many areas of the tax law.

In Finnegan v. Commissioner, TC Memo 2016-118, the Tax Court allowed the statute of limitations to remain open indefinitely in the case of an individual who used a problem

preparer but should easily have known of the fraudulent nature of the returns and the other steps taken by the preparer to minimize taxes.

In an Unnumbered Memorandum from Deputy Commissioner John Dalrumple, IRS directed that all initial contacts with taxpayers to commence an examination be by letter rather than telephone in light of the abundance of phone scams.

In Chief Counsel Advice 201623010, IRS stated that it does not have discretion to abate a frivolous return penalty due to mental incompetence, stating that intent is not an element in the requirements for the frivolous return penalty.
