unsuccessfully, that it violated the "tax benefit" rule and later argued, unsuccessfully, that Mrs. Backemeyer was not entitled to a "step up in basis" (which would be contrary to the statutory provision cited above).[4] IRS then conceded that Mrs. Backemeyer's Schedule F farming business should be treated as separate from Mr. Backemeyer's Schedule F farming business. Finally, the Tax Court held that the "tax benefit" rule does not apply where the inputs are transferred by reason of death. The outcome was that the post-death handling of the matter was consistent with longstanding practice. Most (but not all) assets are entitled to a new basis at death up (or down) from the pre-death basis. Related party handling of the matter is carried out in a matter parallel to the way it is done with unrelated parties.

The Tax Court decision provides helpful guidance in handling issues arising with new basis at death and is believed to be correctly decided.

It was very clear that the Internal Revenue Service staff working on the case was not well acquainted with how modern day farming is carried on. Moreover, it was also clear that they were also not well acquainted with the Internal Revenue Code.

ENDNOTES

[1] 147 T.C. No. 17 (2016).
[2] See I.R.C. § 1014(a)(1).
[3] I.R.C. § 1014(a)(1).
[4] I.R.C. § 1014(a)(1).

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

BANKRUPTCY

FEDERAL TAX

DISCHARGE. The debtors, husband and wife, filed a return for 1998 which did not report an employment severance payment, a distribution from an IRA and a distribution from a pension annuity. The former employer sent the debtors a Form W-2 showing the severance payment as compensation and the IRA and pension fund custodians sent Forms 1099-R showing the distributions from the IRA and pension. The debtors made their own attempt to determine the taxability of the amounts by personal legal research and did not consult with an attorney or other tax professional. The debtors explained to the IRS that they believed the reporting forms to be incorrect and that all the amounts were not taxable. The IRS initiated court action against the debtors to reduce tax assessments to judgment and to foreclose a tax lien on the debtors' property. The debtors filed for Chapter 7 bankruptcy, causing a stay of the IRS case, and received a discharge. The IRS case was reinstated and the IRS filed a motion to exclude the taxes from discharge under Section 523(a)(1)(C) for filing a fraudulent return or willfully attempting to evade or defeat the taxes. The court held that the taxes were dischargeable because the IRS failed to prove that the debtors did not have a good faith belief that the taxes were not owed and that the debtors intended to evade payment of the taxes. The court also found that the debtors did not commit any of the "badges of fraud," which include "understatement of income, inadequate or falsified records, failure to file tax returns, implausible or inconsistent explanations of behavior, concealing assets, failure to cooperate with tax authorities, lack of credibility of taxpayer's testimony, sophistication in tax matters, engaging in or attempting to conceal illegal activities, failing to make estimated tax payments, backdating documents, filing false documents with the IRS, and other conduct, the likely effect of which would be to mislead or conceal." **United States v. Schmidt, 2016-2 U.S. Tax Cas. (CCH) ¶ 50,507 (E.D. Wash. 2016)**.

FEDERAL FARM PROGRAMS

PACKERS AND STOCKYARDS ACT. The GIPSA has issued interim final regulations amending the regulations issued under the Packers and Stockyards Act, 1921, as amended and supplemented (P&S Act). The new regulations add a paragraph addressing the scope of sections 202(a) and (b) of the P&S Act. This rule clarifies that conduct or action may violate sections 202(a) and (b) of the P&S Act without adversely affecting, or having a likelihood of adversely affecting, competition. The new rule reiterates USDA's longstanding interpretation that not all violations of the P&S Act require a showing of harm or likely harm to competition. The regulations would specifically provide that the scope of section 202(a) and (b) encompasses conduct or action that, depending on their nature and the circumstances, can be found to violate the P&S Act without a finding of harm or likely harm to competition. **81 Fed. Reg. 92566 (Dec. 20, 2016)**.

PERISHABLE AGRICULTURAL COMMODITIES ACT. The AMS has issued proposed regulations which amend the regulations under the Perishable Agricultural Commodities Act (PACA) to enhance clarity and improve the administration and enforcement of the PACA. The proposed revisions to the regulations would provide greater direction to the industry of how growers and other principals that employ selling agents may preserve their PACA trust rights. The proposed revisions would further provide greater direction to the industry on the definition of "written notification" and the jurisdiction of USDA to investigate alleged PACA violations. **81 Fed. Reg. 90255 (Dec. 14, 2016)**.

The GIPSA has issued proposed regulations which amend the regulations issued under the Packers and Stockyards Act, 1921, as amended and supplemented (P&S Act). The proposed amendments would identify criteria that the Secretary may consider when determining whether a live poultry dealer's use of a poultry grower ranking system for ranking poultry growers for settlement purposes is unfair, unjustly discriminatory, or deceptive or gives an undue or unreasonable preference, advantage, prejudice, or disadvantage. The proposed amendments would also clarify that absent demonstration of a legitimate business justification, failing to use a poultry grower ranking system in a fair manner after applying the identified criteria is unfair, unjustly discriminatory, or deceptive and a violation of section 202(a) of the P&S Act regardless of whether it harms or is likely to harm competition. **81 Fed. Reg. 92723 (Dec. 20, 2016)**.

FEDERAL ESTATE AND GIFT TAXATION

PORTABILITY. The decedent died, survived by a spouse, on a date after the effective date of the amendment of I.R.C. § 2010(c), which provides for portability of a "deceased spousal unused exclusion" (DSUE) amount to a surviving spouse. The decedent's estate did not file a timely Form 706 to make the portability election. The estate discovered its failure to elect portability after the due date for making the election. The estate represented that the value of the decedent's gross estate was less than the basic exclusion amount in the year of the decedent's death including any taxable gifts made by the decedent. The IRS granted the estate an extension of time to file Form 706 with the election. **Ltr. Rul. 201651006, Sept. 7, 2016; Ltr. Rul. 201651007, Sept. 7, 2016; Ltr. Rul. 201650004, Aug. 12, 2016, Ltr. Rul. 201650009, Aug. 11, 2016.**

In a Chief Counsel Advice letter, the IRS stated: "If the taxpayer had a GROSS ESTATE of more than $5 million – no relief is available to him at all, even if the estate is nontaxable due to the marital deduction. The taxpayer had an absolute obligation to file a Form 706 within 9 months of date of death and having failed to do so, the election for portability is missed. If the taxpayer had a GROSS ESTATE of less than $5 million, having missed the ability of timely filing a Form 706, the taxpayer's only recourse for obtaining the portability election is to seek relief through the private letter ruling process. The relief will likely be granted. Merely filing a late Form 706 would be ineffective in making this election and the election will not be respected." **CCA 201650017, Oct. 14, 2016**.

SPECIAL USE VALUATION. The decedent's estate executor filed the Form 706 late and included a request for a 12-month extension of time to make the special use valuation election. However, the executor failed to comply with all the requirements of Treas. Reg. § 301.9100-2. Treas. Reg. § 301.9100-2(a)(2)(vii) provides an automatic 12-month extension of time to make the estate tax election to specially value qualified real property (where the IRS has not yet begun an examination of the filed return) under I.R.C.§ 2032A(d)(1) provided the taxpayer takes corrective action as defined in Treas. Reg. § 301.9100-2(c). Under Treas. Reg. § 301.9100-2(c), corrective action means, for those elections required to be filed with a return, filing an original or an amended return for the year the regulatory or statutory election should have been made with attachment of the appropriate form or statement for making the election. The IRS ruled that, because the intended to make the election prior to the IRS examination of the Form 706 and immediately sought an extension of time after the IRS ruled the election invalid, the estate would be granted an extension of time to file the special use valuation election. **Ltr. Rul. 201652017, Sept. 19, 2016**.

TRUSTS. The taxpayer established an irrevocable trust for the benefit of the taxpayer, the taxpayer's spouse, mother, and two minor children. The trust provided that a distribution committee be formed which consisted of the taxpayer, the mother, spouse and the guardians for the children. The distribution committee has authority to make distributions as follows: "(1) At any time, Trustee, pursuant to the direction of a majority of the Distribution Committee, with the written consent of Grantor, shall distribute to any beneficiary such amounts of the income or principal as directed by the Distribution Committee (Grantor's Consent Power); (2) At any time, Trustee, pursuant to the direction of all of the Distribution Committee members, other than Grantor, shall distribute to any beneficiary such amounts of the net income or principal as directed by the Distribution Committee (Unanimous Member Power); and (3) At any time, Grantor, in a nonfiduciary capacity, may direct the Trustee to distribute to any one or more beneficiary other than Grantor, such amounts of the principal (including the whole thereof) as Grantor deems advisable to provide for the health, maintenance, support and education of the beneficiaries (Grantor's Sole Power)." The IRS ruled that, during the existence of the distribution committee, no trust income, deductions or credits were included in the taxpayer income, deductions or credits. The IRS also ruled that contributions to the trust by the taxpayer were not completed gifts since the taxpayer retained power over trust distributions. However, distributions made under the grantor consent power and the unanimous member consent power were taxed to the taxpayer as completed gifts. **Ltr. Rul. 201650005, Aug. 26, 2016**.

FEDERAL INCOME TAXATION

ALIMONY. The taxpayer was divorced and the divorce decree provided for payments by the taxpayer to the former spouse. Under I.R.C. § 71(b)(1) periodic payments are alimony for federal tax purposes if (1) such payment is received by (or on behalf of) a spouse under a divorce or separation instrument, (2) the divorce or separation instrument does not designate such payment as a payment which is not includible in gross income under section 71 and not allowable as a deduction under section 215, (3) in the case of an individual legally separated from his spouse under a decree of divorce or of separate maintenance, the payee spouse and the payor spouse are not members of the same household at the time such payment is made, and (4) there is no liability to make such payment for any period after the death of the payee spouse and there is no liability to make any payment (in cash or property) as a substitute for such payment after the death of the payee spouse. The divorce decree provided that the divorce court would not have jurisdiction to consider modification of the award; therefore, the IRS ruled that the payments could continue after the death of the former spouse and were not alimony for federal tax purposes. **Ltr. Rul. 201648001, July 26, 2016**.

BUSINESS EXPENSES. The taxpayer operated a network marketing business. The taxpayer claimed deductions for various business expenses, including a home office deduction, deduction for travel expenses, wages paid to the taxpayer's child, vehicle expenses, and meals and entertainment. To substantiate the home office expenses, the taxpayer provided only pictures of the rooms in the taxpayer's residence which the taxpayer claimed as used for the business. The taxpayer provided no evidence of the size of the house or the size of the rooms involved in the business. The court held that the photos did not establish that the rooms were used regularly and exclusively for the business activity, nor what percentage of the house was alleged to have been used for the business. The taxpayer provided a handwritten list of tasks performed by the taxpayer's son for the business. The court did not find the list credible and noted that the taxpayer did not issue a Form 1099 MISC to the son to report the payment of miscellaneous income; therefore, no deduction was allowed for the claimed wages. The taxpayer provided a written list of truck use in the business and some bank statements and receipts. However, the court held that such records did not meet the substantiation requirements of I.R.C. § 274(d) and were properly disallowed as deductions because the information did not include the business purpose of the travel, the miles involved, or the clients involved in each trip. Similarly, the deductions for meals and entertainments were disallowed because the handwritten list of activities did not include details of the business purpose or business relationship with the person involved in the meals. **Alexander v. Comm'r, T.C. Memo. 2016-214**.

CAPITAL EXPENSES. The taxpayer was an attorney in private practice who purchased a condominium leased to a third party. The lease required the taxpayer to make improvements to the property and the taxpayer hired a construction company to construct walls and modify the ceilings. The taxpayer filed returns for two years, claiming deductions for the cost of the improvements and the real estate agent fees. The IRS disallowed the deductions for the improvements and agent fee as capital expenses. The court agreed and held that the construction was more than a repair because it was a permanent improvement which increased the useful life of the unit. **Ekeh v. Comm'r, T.C. Summary Op. 2016-80**.

This case involved partnership-level proceedings subject to the unified audit and litigation procedures of the Tax Equity and Fiscal Responsibility Act of 1982. Three partnerships were involved in the growing of almonds and had each purchased the farm land used in their operations. Two of the partnerships borrowed money which was then loaned to the third partnership for the purchase of additional farm land. The partnerships incurred interest expense on the loans used to purchase the farm land and incurred property taxes on the same land. The partnerships attempted to take current deductions for the interest and taxes paid on the farm land but the IRS assessed deficiencies, arguing that the interest and taxes had to be capitalized into the cost of the land. The court held that the interest on the loans used to purchase farm land for the growing of almonds and the property taxes on the same land had to be capitalized because the land was necessary and indispensable to the growing of the almond trees. However, the interest allocable to farm land used to grow row crops was currently deductible because the crops produced current income. **Wasco Real Properties I, LLC v. Comm'r, T.C. Memo. 2016-224**.

CHILD TAX CREDIT. The taxpayers, husband and wife, were the parents of a disabled child who was 20 and 21 years of age for the two tax years involved. The taxpayers claimed a child tax credit based on the child's disability but the IRS denied the credit because the child was over age 17 in the tax years involved. The court acknowledged that, while the definition of qualifying child under I.R.C. § 24 used the definition under I.R.C. § 152 for purposes of the dependent deduction, the court held that I.R.C. § 24(c)(1) added the requirement that the child must be less than 17 years old in order to be a qualifying child for purposes of the child tax credit. Therefore, the court held that the taxpayers were not entitled to the child tax credit for the tax years in which the child was 20 and 21 years old. The appellate court affirmed. **Polsky v. Werfel, 2016-2 U.S. Tax Cas. (CCH) ¶ 50,506 (3d Cir. 2016),** ***aff'g per curiam*****, 2015-1 U.S. Tax Cas. (CCH) ¶ 50,229 (E.D. Penn. 2015)**.

CORPORATIONS

DISTRIBUTIONS. The IRS has issued proposed regulations that provide guidance regarding the distribution by a distributing corporation of stock or securities of a controlled corporation without the recognition of income, gain, or loss. The proposed regulations provide guidance in determining whether a corporation is a predecessor or successor of a distributing or controlled corporation for purposes of the exception under I.R.C. § 355(e) to the nonrecognition treatment afforded qualifying distributions, and they provide certain limitations on the recognition of gain in certain cases involving a predecessor of a distributing corporation. The proposed regulations also provide rules regarding the extent to which I.R.C. § 355(f) causes a distributing corporation (and in certain cases its shareholders) to recognize income or gain on the distribution of stock or securities of a controlled corporation. The proposed regulations affect corporations that distribute the stock or securities of controlled corporations and the shareholders or security holders of those distributing corporations. **81 Fed. Reg. 91738 (Dec. 19, 2016)**.

DEPRECIATION. The taxpayer was a corporation on the accrual method of accounting. In the tax years involved, the taxpayer placed in service qualified property, under I.R.C. § 168(k)(2), and made the election under I.R.C. § 168(k)(2)(D)(iii) not to claim the 50 percent or 100 percent additional first year depreciation deduction, as applicable, for all classes of qualified property placed in service during those taxable years except

5-year and 7-year property. However, the taxpayer failed to file the election statement identifying the classes of property subject to the election. The IRS granted the request for an extension of time to file the statements with amended returns within 60 days. **Ltr. Rul. 201649001, Aug. 25, 2016**.

DISASTER LOSSES. On December 2, 2016, the President determined that certain areas in Pennsylvania are eligible for assistance from the government under the Disaster Relief and Emergency Assistance Act (42 U.S.C. § 5121) as a result of severe storms and flooding which began on October 20, 2016. **FEMA-4292-DR.** Accordingly, taxpayers in the areas may deduct the losses on their 2016 or 2015 federal income tax returns. See I.R.C. § 165(i).

EARNED INCOME TAX CREDIT. During the tax year, the taxpayer did not earn any wages or business profits but sold some tools. The taxpayer reported the proceeds of the sale as taxable income under "wages, salaries, and tips" and claimed an earned income tax credit and a recovery rebate credit. The IRS denied the two credits, arguing that the taxpayer had no income subject to self-employment taxes. The court found that the taxpayer was not engaged in a trade or business of selling tools; therefore, the proceeds were not self-employment income. Because the taxpayer had no earned income, the court held that the taxpayer was not eligible for the earned income tax credit or the recovery rebate credit. **Berry v. Comm'r, T.C. Summary Op. 2016-81**.

FOREIGN INCOME. The taxpayers, husband and wife, had operated a camera store which sold foreign-made cameras. The taxpayers also provided sales consulting which produced commissions. The taxpayers owned bank accounts in Switzerland, Austria and Mexico. The taxpayer had the commissions and some of the proceeds of camera sales deposited in the Swiss bank account and transferred funds from that account to the bank accounts in Austria and Mexico. The taxpayer did not file income tax returns for 1999 through 2011 until 2011 but only for a few of the tax years. The taxpayers also did not file any foreign bank and financial account reports (FBAR) from 1999 through 2011 and filed the FBARs for a few years in 2011. In 2010, the taxpayers applied for participation in the Voluntary Disclosure Program and falsely listed all of the funds in the Swiss account as after-tax funds. They did not include a report on the Austrian or Mexican bank accounts. Taxpayers with interests in foreign bank accounts are required to report details about those accounts annually under 31 U.S.C. § 5314. Willful failure to file a report results in the maximum penalty of the greater of $100,000 or 50 percent of the balance in the account at the time of violation. See 31 U.S.C. §§ 5321(a)(5)(C), 5321(a)(5)(D)(ii). The issue in this case was whether the taxpayers willfully failed to file the reports and were subject to the higher penalty. The court held that "willful" failure to report includes reckless disregard of a statutory duty and that the standard of proof is proof by a preponderance of the evidence. The court held that the taxpayers willfully failed to file several years of FBARs because (1) the taxpayers were reasonably sophisticated business people with experience in international sales, (2) the taxpayers kept the Swiss account secret and did not seek advice about disclosure requirements, (3) the taxpayers had actual knowledge of the FBAR requirements which were mentioned in the income tax returns they filed, and (4) the taxpayers filed a false application for the Voluntary Disclosure Program. **United States v. Bohanec, 2016-2 U.S. Tax Cas. (CCH) ¶ 50,498 (C.D. Calif. 2016)**.

HOBBY LOSSES. The taxpayer was employed full time as a marketing and sales representative. The taxpayer also operated a racehorse activity which purchased, trained and raced horses in Washington and Oregon. From 2004 through 2014, the taxpayer had mixed success racing horses, with some horses not performing at all and some horses winning large numbers of races and prizes. However, each year produced a tax loss for the activity and the taxpayer was required to invest money from the marketing job in the horse racing activity. The court held that the activity was not operated with the intent to make a profit because (1) although the taxpayer kept separate and accurate records for each horse, the records were not used to adjust the activity to make it profitable and taxpayer had no business plan; (2) there were no profits over 20 years of activity; (3) although the taxpayer claimed that one horse could make the activity profitable in the future, the court held such evidence insufficient to show a profit motive over the prior years; (4) the annual losses offset income from other sources; and (5) although the taxpayer employed expert horse trainers, the taxpayer had no expertise and did not consult with experts on how to operate a profitable horse racing activity. **Carmody v. Comm'r, T.C. Memo. 2016-225**.

Although the taxpayer was otherwise fully employed, the taxpayer obtained a real estate broker's license and in 2010 and 2011 signed a total of four buyer-broker agreements to represent four buyers seeking real estate. However, no sales were made in 2010 or 2011 or any years before or after those tax years. The court held that the taxpayer did not operate the real estate activity with an intent to make a profit because (1) the taxpayer did not keep complete and accurate records and did not prepare a business plan; (2) the taxpayer did not spend a substantial amount of time on the activity; (3) the activity had no gross receipts or profits; (4) the losses from the activity offset income from the taxpayer's employment; and (5) the taxpayer received personal pleasure from the activity, particularly in trips made to Las Vegas which were charged to the activity. **Long v. Comm'r, T.C. Summary Op. 2016-88**.

INNOCENT SPOUSE RELIEF. The taxpayer and former spouse jointly owned several rental real estate properties and the former spouse owned several properties alone. The former spouse, however, solely ran the real estate activity with minimal participation by the taxpayer. The taxpayer had no access to the financial records of the real estate activity. After an audit, the IRS disallowed all the deductions of losses from the real estate activity claimed on three joint returns filed before the couple separated and the IRS assessed additional taxes and penalties. The taxpayer sought innocent spouse relief solely under I.R.C. § 6015(c). Although the IRS granted the relief, the former spouse challenged the IRS decision in the Tax Court. Under I.R.C. § 6015(c), the requesting spouse must: (1) have joined in the filing of a joint return for the year at issue; (2) be divorced or legally separated from the non-requesting spouse at the time relief is sought; and (3) seek relief no later than two years after the date on which the IRS first commences collection activity for the year at issue. However, I.R.C. § 6015(c)(3)(C) denies relief if "the requesting spouse had actual knowledge of an erroneous item that is allocable to the non-requesting spouse." The court noted that the exception required the requesting spouse have "actual knowledge" and not merely reason to know about the erroneous item. In this case, the assessed taxes resulted from the IRS disallowance of most of the losses from the former spouse's real estate activity because the spouse did not qualify as a real estate professional. Thus, the issue was whether the taxpayer had any knowledge that the former spouse would not qualify as a real estate professional. The court held that the taxpayer did not have actual knowledge that the former spouse would not qualify as a real estate professional. The court noted that the taxpayer did not have any knowledge of federal tax law and had been told by a CPA that the former spouse qualified as a real estate professional. **McDonald v. Comm'r, T.C. Summary Op. 2016-79**.

MILEAGE DEDUCTION. The IRS has announced that the standard mileage rate for 2017 is 53.5 cents (reduced from 54 cents in 2016) per mile for business use, 14 cents per mile for charitable use and 17 cents (reduced from 19 cents in 2016) per mile for medical and moving expense purposes. Under *Rev. Proc. 2010-51, 2010-2 C.B. 883*, a taxpayer must reduce the basis of an automobile used in business by the amount of depreciation the taxpayer claims for the automobile. If a taxpayer uses the business standard mileage rate to compute the expense of operating an automobile for any year, a per-mile amount (25 cents per mile for 2017) is treated as depreciation for those years in which the taxpayer used the business standard mileage rate. If the taxpayer deducted the actual costs of operating an automobile for one or more of those years, the taxpayer may not use the business standard mileage rate to determine the amount treated as depreciation for those years. The 2010 revenue procedure also provides rules under which the amount of ordinary and necessary expenses of local travel or transportation away from home that are paid or incurred by an employee will be deemed substantiated under Treas. Reg. § 1.274-5 when a payor (the employer, its agent, or a third party) provides a mileage allowance under a reimbursement or other expense allowance arrangement to pay for such expenses. Use of a method of substantiation described in this revenue procedure is not mandatory and a taxpayer may use actual allowable expenses if the taxpayer maintains adequate records or other sufficient evidence for proper substantiation. **Notice 2016-79, 2016-2 C.B. 918**.

NET OPERATING LOSSES. The taxpayer was an attorney who filed returns for three years that reported net operating losses (NOLs). The taxpayer did not include with those returns an election to carry those NOLs forward instead of back to prior years. The taxpayer filed returns for a subsequent year which carried forward the NOLs to offset income in that year. I.R.C. § 172(b) requires NOLs to be first carried back to the prior two tax years before being carried forward to subsequent years, unless the taxpayer makes an election on a timely filed return to forego the carryback of NOLs. The taxpayer provided no evidence to support the existence of any NOLs and no evidence that the alleged NOLs were used up in prior tax years. The court found that the taxpayer failed to provide adequate evidence to support the claimed business expenses as actually paid or as a reasonable business expense. In addition, the lack of an election to carry forward the NOLs prohibited the use of the NOLs to reduce taxable income in subsequent years. Thus, the court disallowed the NOLs in the subsequent tax year. **Chaganti v. Comm'r, T.C. Memo. 2016-222**.

PARTNERSHIPS

ELECTION TO ADJUST BASIS. The taxpayer was an LLC which elected to be taxed as a partnership. One of the members died during the tax year and the taxpayer failed to make the I.R.C. § 754 election to adjust the basis of partnership property. The IRS granted an extension of time to file an election to adjust partnership basis. **Ltr. Rul. 201649003, Aug. 23, 2016**.

PARTNER'S DISTRIBUTIVE SHARE. The taxpayer participated in two businesses with a brother, a car export business and an entertainment business. The taxpayer filed Schedule C and claimed various deductions for the two activities but the IRS challenged only the deductions for travel, meals and "other" expenses. Some of the claimed deductions were based on payments made by the taxpayer to reimburse the brother for payments made for one or both activities. The IRS disallowed the deductions because the taxpayer failed to provide proof that any of the payments were made as part of the businesses. The taxpayer argued that the taxpayer and brother were partners in the two businesses. Although the IRS had not evaluated the claimed deductions under partnership tax law, the court decided to treat the taxpayer as a partner in both businesses and evaluated the deductibility of the taxpayer's payments under partnership law. Under partnership tax law, a partner's share of partnership deductions is based on the partner's basis in the partner's partnership interest. Payments made on behalf of the partnership would increase the basis and distributions from the partnership decrease the basis. Thus, the issue in this case was whether the taxpayer had sufficient basis in the partnership interest to allow for the deductions or the claimed payments. The court held that the taxpayer could not deduct the payments because the taxpayer failed to provide evidence to determine the taxpayer's contributions to and distributions from the partnership that support any basis of the taxpayer's partnership interest. **Nwabasili v. Comm'r, T.C. Memo. 2016-220**.

The taxpayer was a partner in two law firms. In 2011 the partnerships had income and filed a Form K-1 with the taxpayer showing the taxpayer's share of the partnerships' income. However, the firms were having financial difficulties and the taxpayer decided to forego payment of the taxpayer's distributive share so that it could be used to pay partnership expenses. The funds were used by the partnerships after 2011. The taxpayer had received professional tax advice which stated that the distributive share was still taxable to the taxpayer but the taxpayer decided to save the firms and "face the consequence." The taxpayer argued that, because the taxpayer did not receive any payments from the partnerships, the distributive share was not taxable. The court held that I.R.C. § 702 was clear that a partner's distributive share of partnership income was taxable to the partner whether or not the partner actually received any payments. **Mack v. Comm'r, T.C. Memo. 2016-229**.

PASSIVE ACTIVITY LOSSES. The taxpayer was an attorney in private practice who purchased a condominium leased to a third party. The lease required the taxpayer to make improvements to the property and the taxpayer hired a construction company to construct walls and modify the ceilings. Because the unit had not yet begun to rent during the two tax years involved, the real estate activity produced two years of losses and the taxpayer claimed loss deductions for both years. The IRS disallowed the operating losses as passive activity losses. The court found that the taxpayer produced insufficient evidence of the time spent on the real estate activity, either through written records or personal testimony. Thus, the court held that the taxpayer failed to prove that the taxpayer met the requirements of a real estate professional as provided in I.R.C. § 469(c)(7)(B). **Ekeh v. Comm'r, T.C. Summary Op. 2016-80**.

PENSION PLANS. For plans beginning in December 2016 for purposes of determining the full funding limitation under I.R.C. § 412(c)(7), the 30-year Treasury securities annual interest rate for this period is 2.86 percent. The 30-year Treasury weighted average is 2.91 percent, and the 90 percent to 105 percent permissible range is 2.61 percent to 3.05 percent. The 24-month average corporate bond segment rates for December 2016, without adjustment by the 25-year average segment rates are: 1.55 percent for the first segment; 3.76 percent for the second segment; and 4.73 percent for the third segment. The 24-month average corporate bond segment rates for December 2016, taking into account the 25-year average segment rates, are: 4.43 percent for the first segment; 5.91 percent for the second segment; and 6.65 percent for the third segment. **Notice 2016-78, 2016-2 C.B. 914**.

QUALIFIED DEBT INSTRUMENTS. The IRS has announced the 2017 inflation adjusted amounts of debt instruments which qualify for the interest rate limitations under I.R.C. §§ 483 and 1274A:

Year of Sale or Exchange	1274A(b) Amount	1274A(c)(2)(A) Amount
2017	$5,717,400	$4,083,800

The $5,717,400 figure is the dividing line for 2017 below which (in terms of seller financing) the minimum interest rate is the lesser of 9 percent or the Applicable Federal Rate (AFR). Where the amount of seller financing exceeds the $5,717,400 figure, the imputed rate is 100 percent of the AFR except in cases of sale-leaseback transactions, where the imputed rate is 110 percent of AFR. If the amount of seller financing is $4,083,800 or less (for 2017), both parties may elect to account for the interest under the cash method of accounting. **Rev. Rul. 2016-30, 2016-2 C.B. 876**.

QUARTERLY INTEREST RATE. The IRS has announced that, for the period January 1, 2017 through March 31, 2017, the interest rate paid on tax overpayments remains at 4 percent (3 percent in the case of a corporation) and for underpayments remains at 4 percent. The interest rate for underpayments by large corporations remains at 6 percent. The overpayment rate for the portion of a corporate overpayment exceeding $10,000 remains at 1.5 percent. **Rev. Rul. 2016-28, 2016-2 C.B. 805.**

SELF-EMPLOYMENT TAX. The taxpayer performed computer consulting services for one client over several years. in 2013, the taxpayer also worked on the client's rural property performing odd jobs as well as computer tasks. The taxpayer reported the income on the 2013 tax return but did not pay self-employment taxes on the income. The court held that the taxpayer was not an employee of the client and the income was subject to self-employment taxes. **Stinson v. Comm'r, T.C. Summary Op. 2016-82**.

SAFE HARBOR INTEREST RATES
January 2017

	Annual	Semi-annual	Quarterly	Monthly
		Short-term		
AFR	0.96	0.96	0.96	0.96
110 percent AFR	1.06	1.06	1.06	1.06
120 percent AFR	1.15	1.15	1.15	1.15
		Mid-term		
AFR	1.97	1.96	1.96	1.95
110 percent AFR	2.17	2.16	2.15	2.15
120 percent AFR	2.36	2.35	2.34	2.34
		Long-term		
AFR	2.75	2.73	2.72	2.71
110 percent AFR	3.02	3.00	2.99	2.98
120 percent AFR	3.31	3.28	3.27	3.26

Rev. Rul. 2017-02, I.R.B. 2017-3.

TAX RETURN PREPARERS. The IRS has issued proposed regulations that modify existing regulations related to the penalty under I.R.C. § 6695(g) relating to tax return preparer due diligence. The regulations implement recent law changes that expand the tax return preparer due diligence penalty under I.R.C. § 6695(g) so that it applies to the child tax credit, additional child tax credit, and the American Opportunity Tax Credit, in addition to the earned income credit. **81 Fed. Reg. 87444 (Dec. 5, 2016)**.

TAX SHELTERS. The IRS has issued a notice concerning the tax treatment of syndicating conservation easement transactions that purport to give investors the opportunity to obtain charitable contribution deductions in amounts that significantly exceed the amount invested. The Notice provides an example of a transaction which is to be treated as a listed transaction for purposes of I.R.C. §§ 6111 and 6112 and Treas. Reg. § 1.6011-4(b)(2): "An investor receives promotional materials that offer prospective investors in a pass-through entity the possibility of a charitable contribution deduction that equals or exceeds an amount that is two and one-half times the amount of the investor's investment. The promotional materials may be oral or written. For purposes of this notice, promotional materials include, but are not limited to, documents described in § 301.6112-1(b)(3)(iii)(B) of the Regulations. The investor purchases an interest, directly or indirectly (through one or more tiers of pass-through entities), in the pass-through entity that holds real property. The pass-through entity that holds the real property contributes a conservation easement encumbering the property to a tax-exempt entity and allocates, directly or through one or more tiers of pass-through entities, a charitable contribution deduction to the investor. Following that contribution, the investor reports on his or her federal income tax return a charitable contribution deduction with respect to the conservation easement." Listed transactions are to be reported under Treas. Reg. § 6011-4 for each tax year in which the taxpayer participates in the transactions. **Notice 2017-10, I.R.B. 2017-4**.