CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

BANKRUPTCY

GENERAL

EXEMPTIONS

PENSION PLANS. The debtor claimed a profit-sharing plan and two IRAs as exempt retirement funds under Section 522(b)(4)(A) of the Bankruptcy Code. The court held that the profit-sharing plan was not eligible for the exemption because the debtor failed to get a favorable determination letter from the IRS for the plan. Because the IRAs received rollover funding from the plan, the IRA funds were also not qualified for the exemption. In addition, the court found that the plan was disqualified because the debtor had control of the fund and engaged in prohibited transactions. ***In re* Daniels, 2013-2 U.S. Tax Cas. (CCH) ¶ 50,602 (1st Cir. 2013), *aff'g*, 2012-2 U.S. Tax Ca. (CCH) ¶ 50,607 (D. Mass. 2012), *aff'g*, 2011-2 U.S. Tax Cas. (CCH) ¶ 50,477 (Bankr. D. Mass. 2011)**.

FEDERAL TAX

DISCHARGE. The debtor failed to file the 2004 income tax return until after the IRS assessed and attempted to collect taxes for that year based on a substitute return created by the IRS. The IRS abated a portion of the assessed taxes after the filing of the return and the debtor entered into an agreement to pay the back taxes in installments. The debtor made nine payments and then filed for Chapter 7 and received a discharge. After the discharge, the IRS resumed efforts to collect the 2004 unpaid taxes and the debtor filed an action for violation of the discharge injunction by the IRS. The court held that, because the debtor did not file a return before the IRS assessment, the debtor's return filed after the assessment was not a "return" for purposes of Section 523(a) and the 2004 taxes were not discharged in the Chapter 7 case. **In re Wendt, 2013-2 U.S. Tax Cas. (CCH) ¶ 50,607 (Bankr. S.D. Fla. 2013)**.

FEDERAL FARM PROGRAMS

CROP INSURANCE. The FCIC has adopted as final regulations amending the Common Crop Insurance Regulations, Extra Long Staple (ELS) Cotton Crop Insurance Provisions to make the ELS Cotton Crop Insurance Provisions consistent with the Upland Cotton Crop Insurance Provisions and to allow a late planting period. **78 Fed. Reg. 70485 (Nov. 26, 2013)**.

FEDERAL ESTATE AND GIFT TAXATION

NO ITEMS.

FEDERAL INCOME TAXATION

CASUALTY LOSSES. The taxpayers, husband and wife, built a home on a rural tract of land without obtaining the necessary building permits. The home was destroyed in a forest fire and the taxpayers claimed a casualty loss deduction based on the cost of construction of similar properties. In a Chief Counsel Advice letter, the IRS ruled that the deduction could not be disallowed on public policy grounds as supporting the violation of local building codes. However, the deduction could be disallowed because the taxpayers failed to provide sufficient evidence of the taxpayers' basis in the property since the taxpayers did not provide evidence of the cost of building the home. **CCA 201346009, Aug. 1, 2013**.

CHARITABLE ORGANIZATIONS. The IRS has issued proposed regulations regarding the definition of "candidate-related political activity" for purposes of qualification of a charitable organization for I.R.C. § 501(c)(4) status. Under the proposed guidelines, candidate-related political activity includes: (1) communications that (a) expressly advocate for a clearly identified political candidate or candidates of a political party, (b) are made within 60 days of a general election (or within 30 days of a primary election) and clearly identify a candidate or political party, and (c) must be reported to the Federal Election Commission; (2) any contribution that is recognized under campaign finance law as a reportable contribution and grants to section 527 political organizations and other tax-exempt organizations that conduct candidate-related political activities; (3) voter registration drives and "get-out-the-vote" drives; (4) distribution of any material prepared by or on behalf of a candidate or by a section 527 political organization; (5) preparation or distribution of voter guides that refer to candidates (or, in a general election, to political parties); and (6) holding an event within 60 days of a general election (or within 30 days of a primary election) at which a candidate appears as part of the program. 78 Fed. Reg. 71535 (Nov. 29, 2013).

COURT AWARDS AND SETTLEMENTS. In a short Chief Counsel Advice letter, the IRS stated: "Once it has been determined (as in your case) that the damages were received on account of personal physical injury or physical sickness, all compensatory

damages, including lost wages, are excludable from gross income under section 104(a)(2). See *Rev. Rul. 85-97* and *Schleier, 515 U.S. 323, 330 (1996)*." **CCA 201346010, July 29, 2013**.

DEPENDENTS. The taxpayer was divorced and the divorce decree awarded physical custody of the couple's two children to the former spouse. The divorce decree provided that each parent could claim the federal tax dependency exemption for one of the children and that either parent could purchase the dependency exemption for the other child. For 2009 the taxpayer did exercise the purchase option and paid the former spouse for the exemption for the other child. The children lived with the former spouse during 2009. The taxpayer claimed deductions for both children but did not file a signed Form 8332, *Release/Revocation Of Release Of Claim To Exemption For Child By Custodial Parent*, or similar document with the return. The former spouse also claimed the deduction for both children. In 2013, just before trial in the present case, the former spouse provided a signed Form 8332 for one of the children for 2009. The court held that the late-filed Form 8332 was ineffective because it was not submitted until after the period of limitations to assess tax against the former spouse for 2009. The court also held that the divorce decree was insufficient to shift eligibility for the dependency deduction to the taxpayer for federal tax purposes. **Katz v. Comm'r, T.C. Summary Op. 2013-98**.

DEPRECIATION. The taxpayer purchased a jet aircraft for use in the taxpayer's insurance business and took possession on December 30, 2003. The taxpayer had wanted a few modifications of the interior to add larger projection screens and a conference table, but the modifications could not be performed before delivery and were scheduled for January 2004. After taking possession on December 30, the taxpayer made two flights to meet business clients and business associates for meals. The court discounted the business purpose of the trips which appeared to be staged solely to provide evidence of business use of the aircraft in 2003 for purposes of claiming a bonus depreciation deduction for the aircraft. However, the court held that the aircraft was not placed in service in 2003 because the aircraft did not have the modifications completed until January 2004. The court noted the taxpayer's own testimony that the modifications were essential for the business purposes of the aircraft, which included the making of presentations to clients while in the air. **Brown v. Comm'r, T.C. Memo. 2013-275**.

FIRST TIME HOMEBUYER CREDIT. In February 2009 the taxpayer's cousin acquired the title to a home. In May 2009, the cousin transferred title to the property to a family limited partnership in which the taxpayer owned a 47 percent interest. The taxpayer claimed the first time homebuyer credit for the property on the taxpayer's 2008 tax return. The court upheld the IRS disallowance of the credit because (1) the taxpayer did not purchase the house, (2) the family limited partnership was not eligible for the credit because the LLP was not an individual and the LLP, as an entity, could not use the house as a personal residence. **Li v. Comm'r, T.C. Summary Op. 2013-97**.

INVESTMENT INTEREST. The taxpayer had a tax return prepared by a CPA firm. The taxpayer's return was selected for audit by the IRS, initially as to whether or not the taxpayer had properly limited the taxpayer's deduction for mortgage interest expense. In a review of the tax return, the CPA firm discovered that through its inadvertence a portion of the mortgage interest expense listed on the return was actually investment interest expense. Given that through its own inadvertence the CPA firm was unaware of the increased investment interest expense, the return that it prepared for the taxpayer (which the taxpayer later filed) did not make an election on Form 4952, *Investment Interest Expense Deduction* to treat capital gain as investment income in order to fully deduct the increased investment interest expense. The examining agent denied the election as not timely made. The taxpayer filed an appeal in the Tax Court which allowed the taxpayer to seek an extension of time from the IRS to file the election. The IRS granted the extension. **Ltr. Rul. 201347004, Aug. 30, 2013**.

LIFE INSURANCE. The taxpayer purchased a life insurance policy on the taxpayer's life. The policy provided that the taxpayer was entitled to receive dividends from the policy which could be used to (1) pay dividends directly to the taxpayer in cash, (2) allow dividends to accumulate interest at not less than 2 percent per annum, (3) apply dividends to the payment of any premium due, or (4) apply dividends to purchase paid-up additional insurance. The taxpayer chose to receive the dividends as cash or to pay a portion of the annual premium. The taxpayer did not include the annual dividends in taxable income. When the taxpayer surrendered the policy, the insurance company sent the taxpayer a check for the cash value of the policy plus the unpaid dividend for that year. The taxpayer argued that the dividends should not be counted against the premiums paid because the three year statute of limitations had passed on the prior tax years. The court disagreed, noting that at the time of the dividends in past years, the taxpayer's premiums paid exceeded the dividends received; therefore, the limitations period did not apply. However, when the insurance policy was surrendered, the dividends paid had exceeded the premiums paid by the taxpayer. Therefore, the taxpayer's investment in the policy had been reduced to zero and the payment of the cash value of the policy was taxable income to the taxpayer. **Brogan v. Comm'r, T.C. Summary Op. 2013-95**.

The taxpayer had purchased a life insurance policy on the life of the taxpayer. The policy provided for dividend payments and the right to borrow against the cash value of the policy. The taxpayer borrowed from the policy and the interest was allowed to accrue against the policy cash value. The taxpayer terminated the policy when the taxpayer could no longer afford the premiums. The taxpayer received a cash distribution of the value of the policy less the amount owed on the loan. The insurance company issued a Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc*., listing a gross distribution of $65,903 and taxable income of $33,125, representing the difference of the distribution over the taxpayer's investment in the policy.

The taxpayer hired an enrolled agent to prepare the income tax return and the $33,125 was not reported as income because the taxpayer was insolvent. Instead, the return included a Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment). The court held that the $33,125 was not discharge of indebtedness income because the policy loan was paid in full from the non-taxed portion of the distribution. **Brach v. Comm'r, T.C. Summary Op. 2013-96**.

MILEAGE DEDUCTION. The IRS has announced that the standard mileage rate for 2014 is 56 cents per mile for business use, 14 cents per mile for charitable use and 23.5 cents 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 (22 cents per mile for 2014) 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 2013-80, I.R.B. 2013-52**.

OIL AND GAS LEASE. The taxpayers purchased property in 1996 and 1998 which had expiring oil and gas leases. After the old leases expired, the taxpayers entered into new oil and gas leases and received a bonus payment for entering the leases. The leases entitled the taxpayers to 16 percent of the net profits from any oil and gas extracted under the leases. The taxpayers claimed the bonus payment as long-term capital gain. The court held that the bonus payment was ordinary income to the taxpayers because the taxpayers retained an interest in the oil and gas extracted. The court also held that the taxpayers could not claim any depletion deduction against the bonus payment because the taxpayers failed to provide any evidence of the amount of royalties they expected from the leases. **Dudek v. Comm'r, T.C. Memo. 2013-272**.

PARSONAGE ALLOWANCE DEDUCTION. The District Court for the Western District of Wisconsin has ruled that the I.R.C. § 107(2) exclusion from taxable income of the parsonage allowance was unconstitutional as a violation of the Establishment Clause of the First Amendment to the U.S. Constitution. **Freedom From Religion Foundation, Inc. v. Lew, 2013-2 U.S. Tax Cas. (CCH) ¶ 50,600 (W.D. Wis. 2013)**.

QUALIFIED DEBT INSTRUMENTS. The IRS has announced the 2014 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
2014	$5,557,200	$3,969,500

The $5,339,300 figure is the dividing line for 2014 below which (in terms of seller financing) the minimum interest rate is the lesser of 9 percent or the Applicable Federal Rate. Where the amount of seller financing exceeds the $5,557,200 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 $3,969,500 or less (for 2014), both parties may elect to account for the interest under the cash method of accounting. **Rev. Rul. 2013-23, 2013-2 C.B. 590**.

REPORTING. The IRS has adopted as final final regulations that require information reporting by persons who, in the course of a trade or business, receive mortgage insurance premiums, including prepaid premiums, aggregating $600 or more during any calendar year. The final regulations implement reporting requirements that result from the extension of the treatment of mortgage insurance premiums made by the American Taxpayer Relief Act of 2012. **78 Fed. Reg. 70856 (Nov. 27, 2013)**.

SAVER'S CREDIT. The IRS has published information on the saver's credit which helps offset part of the first $2,000 workers voluntarily contribute to IRAs and to 401(k) plans and similar workplace retirement programs. Also known as the retirement savings contributions credit, the saver's credit is available in addition to any other tax savings that apply. Taxpayers have until April 15, 2014, to set up a new individual retirement arrangement or add money to an existing IRA for 2013. However, elective deferrals (contributions) must be made by the end of the year to a 401(k) plan or similar workplace program, such as a 403(b) plan for employees of public schools and certain tax-exempt organizations, a governmental 457 plan for state or local government employees, and the Thrift Savings Plan for federal employees. The saver's credit can be claimed by:

• Married couples filing jointly with incomes up to $59,000 in 2013 or $60,000 in 2014;

• Heads of Household with incomes up to $44,250 in 2013 or $45,000 in 2014; and

• Married individuals filing separately and singles with incomes up to $29,500 in 2013 or $30,000 in 2014.

Like other tax credits, the saver's credit can increase a taxpayer's refund or reduce the tax owed. Though the maximum saver's credit is $1,000, $2,000 for married couples, the IRS cautioned that it is often much less and, due in part to the impact of other deductions and credits, may, in fact, be zero for some taxpayers. A taxpayer's credit amount is based on filing status, adjusted gross income, tax liability and amount contributed to qualifying retirement programs. Form 8880 is used to claim the saver's credit, and its instructions have details on figuring the credit correctly. Other special rules that apply to the saver's credit

include the following: (1) eligible taxpayers must be at least 18 years of age; (2) anyone claimed as a dependent on someone else's return cannot take the credit; and (3) a student cannot take the credit. A person enrolled as a full-time student during any part of 5 calendar months during the year is considered a student. Certain retirement plan distributions reduce the contribution amount used to figure the credit. For 2013, this rule applies to distributions received after 2010 and before the due date, including extensions, of the 2013 return. **IR-2013-93**.

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