CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

FEDERAL FARM PROGRAMS

COTTON. The CCC has adopted as final regulations that specify the requirements for the CCC-approved warehouses storing cotton, which are administered by the FSA. The regulations also change the definition of Bales Made Available for Shipment (BMAS). CCC-approved cotton warehouses are currently required to report BMAS, among other data, to FSA every week. The regulations clarify that bales made available, but not picked up by the shipper, can only be reported by the warehouse operator as BMAS for no longer than the first two weeks that such bales have been made available for delivery but have not yet been picked up. This rule change includes whether bales not picked up are reported by the warehouse operator to FSA in the weekly report; it does not change any warehouse tariffs, late fees, or restocking fees. **79 Fed. Reg. 70995 (Dec. 1, 2014)**.

MEAT AND POULTRY LABELING. The FSIS has adopted final regulations establishing January 1, 2018, as the uniform compliance date for new meat and poultry product labeling regulations that are to be issued between January 1, 2015, and December 31, 2016. FSIS periodically announces uniform compliance dates for new meat and poultry product labeling regulations to minimize the economic impact of label changes. **79 Fed. Reg. 71007 (Dec. 1, 2014)**.

FEDERAL ESTATE AND GIFT TAXATION

ALLOCATION OF BASIS FOR DEATHS IN 2010. The decedent died in 2010 and the executor became ill, was hospitalized, and required an extended recovery. Because of the illness, the executor failed to file a timely Form 8939, *Allocation of Increase in Basis for Property Acquired from a Decedent*. The estate requested an extension of time pursuant to Treas. Reg. § 301.9100-3 to file the Form 8939 to make the I.R.C. § 1022 election and to allocate basis provided by I.R.C. § 1022 to eligible property transferred as a result of the decedent's death. *Notice 2011-66, 2011-2 C.B. 184 section I.D.1*, provides that the IRS will not grant extensions of time to file a Form 8939 and will not accept a Form 8939 filed after the due date except in four limited circumstances provided in section I.D.2: "Fourth, an executor may apply for relief under § 301.9100-3 in the form of an extension of the time in which to file the Form 8939 (thus, making the Section 1022 election and the allocation of basis increase), which relief may be granted if the requirements of § 301.9100-3 are satisfied. Treas. Reg. § 301.9100-3(b)(1)(ii) provides that a taxpayer is deemed to have acted reasonably and in good faith if the taxpayer failed to make the election because of intervening events beyond the taxpayer's control. The IRS granted an extension of time to file the election. **Ltr. Rul. 201447012, Aug. 12, 2014.**

GENERATION SKIPPING TRANSFERS. The decedents, husband and wife, each created trusts by will for their grandchildren, including grandchildren born after the execution of testator's will and after testator's death, providing for distributions of trust income in such amounts as the trustee, in the trustee's sole and absolute discretion, shall deem advisable. Both trusts were irrevocable prior to September 26, 1985. The trustee sought a state court order to merge the trusts with the same beneficiaries and terms as the original trusts. The IRS ruled that the merger would not subject the trusts to GSTT because (1) the proposed merger will not shift a beneficial interest to a beneficiary who occupies a lower generation (as defined in I.R.C. § 2651) than the person or persons who held the beneficial interest prior to the merger, and (2) the proposed merger will not extend the time for vesting of any beneficial interest in the trusts beyond the period provided for in the original trusts. **Ltr. Rul. 201448018, Sept. 2, 2014**.

FEDERAL INCOME TAXATION

BUSINESS EXPENSES. The taxpayer was employed full-time as an engineer for a corporation and also operated a sole proprietorship engaged in the business of vehicle reconditioning and auto leasing and sales. The taxpayer operated the auto company with the primary purpose of providing reliable transportation for the employees of the employer corporation. The taxpayer provided automobiles to the employees at or below cost, and the corporation paid the taxpayer a fee for these services. During the tax years in issue the taxpayer paid rent for an auto lot and for a small office. The taxpayer traveled to various locations to perform his duties for the employer and to conduct the business of the taxpayer's auto company. The taxpayer reported income and expenses for the taxpayer's auto business, including expenses for travel, legal and professional fees, rent or lease, and car and truck. The taxpayer argued that the income from the auto company was less than reported on the tax returns but failed to identify deposits in the taxpayer's checking account as non-income items; therefore, the court upheld the IRS determination of income from the auto company. The IRS disallowed most of the business expense deductions. The court held that the legal fees were not deductible because they were not

related to the taxpayer's business activities. Although some travel expenses were shown to be related to the taxpayer's engineer employment, those expenses were reimbursed by the employer. The taxpayer failed to provide substantial evidence that other travel expenses were related to the auto company activities and the court upheld the IRS disallowance of those travel deductions. The deductions for rent expenses were allowed only to the extent the taxpayer provided cancelled checks made out to the landlord. **Safakish v. Comm'r, T.C. Memo. 2014-242**.

CAPITAL GAIN. The taxpayer solely owned a corporation which planned to build a luxury condominium tower on land owned by another corporation. The two corporations entered into a contract to sell the land to the taxpayer's corporation. The taxpayer began development of the construction and pre-sold several units but the landowner terminated the land sales contract. The taxpayer filed suit for specific performance of the contract and won a judgment in state court. During the appeal process, the taxpayer sold the taxpayer's right to purchase the property under the judgment. The taxpayer claimed the proceeds of the sale as capital gains but the IRS allowed the income only as ordinary income. The Tax Court agreed with the IRS and ruled that the land was the property sold by the taxpayer and the land was inventory to the taxpayer who was in the business of buying and selling property. The appellate court reversed, holding that the taxpayer did not sell the land but only the right to purchase the land under the judgment; therefore, the taxpayer realized long-term capital gain on an asset, the right to purchase the property, which arose under the contract entered into more than two years before the judgment and subsequent sale. **Long v. Comm'r, 2014-2 U.S. Tax Cas. (CCH) ¶ 50,510 (11th Cir. 2014), *rev'g*, T.C. Memo. 2013-233**.

CORPORATIONS.

CHECK-THE-BOX ELECTION. The taxpayer was a foreign entity eligible to be treated as a disregarded entity for U.S. income tax purposes. However, the taxpayer failed to timely file Form 8832, *Entity Classification Election* electing to treat the taxpayer as a disregarded entity for federal tax purposes. The IRS granted an extension of time to file the election. **Ltr. Rul. 201447017, July 25, 2014; Ltr. Rul. 201448006, Aug. 19, 2014**.

The taxpayer argued that payments made to LLCs were not reportable payments under I.R.C. § 6041 because the LLCs were exempt payees. Therefore, the taxpayer claimed that no backup withholding was required with respect to the LLC-payees under I.R.C. § 3406. The taxpayer did not produce any documentation that the LLCs have elected to be classified as corporations for federal tax purposes. All persons engaged in a trade or business who, in the course of that trade or business, make payments of $600 or more to another person are required to report the payments to the IRS. I.R.C. § 6041(a), unless an exemption under Treas. Reg. § 1.6041-3 applies. Returns of information are not required under I.R.C. § 6041 for payments made to a "corporation described in § 1.6049-4(c)(1)(ii)(A)." Treas. Reg. § 1.6041-3(p)(1). In a Chief Counsel Advice letter, the IRS ruled that, because there was no evidence that the LLC payees filed Form 8832 to be taxed as corporations, the taxpayer was required to report payments to the LLCs. **CCA 201447025, June 19, 2014**.

DEPRECIATION. The taxpayer was a corporation which timely filed consolidated federal income tax returns for two years. Taxpayer did not claim the additional first year depreciation deduction under I.R.C. §§ 168(k)(1) or (k)(5) for all classes of qualified property placed in service during the two tax years. However, the taxpayer inadvertently failed to attach the election statement not to deduct the additional first year depreciation for such property to the consolidated federal income tax returns for either year. The IRS granted the taxpayer an extension of time to file an amended return with the statement making the election out of the additional first-year depreciation. **Ltr. Rul. 201447010, Aug. 13, 2014**.

The taxpayer was the sole shareholder of a corporation which elected to be taxed as a disregarded entity. The taxpayer hired a professional tax return preparer to prepare and file the taxpayer's individual tax return. The preparer advised the taxpayer to claim the additional first year depreciation deduction under I.R.C. §§ 168(k)(1) or (k)(5) for all classes of qualified property placed in service during the tax year. However, the taxpayer decided later that it would have been better not to deduct the additional first year depreciation. The taxpayer claimed that the tax return preparer did not fully discuss all the federal and state tax ramifications of the failure to elect out of the additional first year depreciation. The IRS granted the taxpayer an extension of time to file an amended return with the election out of the additional first-year depreciation. **Ltr. Rul. 201448003, Aug. 28, 2014**.

DOMESTIC PRODUCTION DEDUCTION. The taxpayer was a corporation which computes its taxable income on the basis of a 52-53 week taxable year ending on the last Saturday in Dec. The taxpayer's taxable year for 2014 began on December 29, 2013, and ends on December 27, 2014. The taxpayer's taxable year for 2015 will begin December 28, 2014, and end on December 26, 2015. The taxpayer's taxable year for 2016 will begin on December 27, 2015, and end on December 31, 2016. The taxpayer's taxable year for 2017 will begin on January 1, 2017, and end on December 30, 2017. Thus, the taxpayer's 2017 taxable year literally does not include December 31, and thus, absent a special rule, there is potentially no calendar year that ends during the 2017 taxable year. I.R.C. § 199(b)(2) provides that the amount of the deduction allowable under section 199(a) for any taxable year shall not exceed 50 percent of the W-2 wages of the taxpayer for the taxable year. I.R.C. § 199(b)(2)(A) provides that the term "W-2 wages" means, with respect to any person for any taxable year of such person, the sum of the amounts described in I.R.C. § 6051(a)(3) and (8) paid by such person with respect to employment of employees by such person during the calendar year ending during such taxable year. I.R.C. § 441(f)(2)(A) provides that in any case in which the effective date or the applicability of any provision of the Code is expressed in terms of taxable years beginning, including, or ending with reference to a specified date which is the first or last day of a month, a taxable year described in I.R.C. § 441(f)(1) shall be treated as beginning with the first day of the calendar month beginning nearest to the first day of such taxable year, or as ending with the last day of the calendar month ending nearest to the last day of such taxable year. The IRS ruled that

the taxpayer's 2017 tax year would be deemed to have ended on December 31, 2017 for purposes of I.R.C. § 199. **Ltr. Rul. 201447027, Aug. 19, 2014**.

FOREIGN ACCOUNTS. The IRS has issued guidance with respect to jurisdictions that are treated as if they had a FATCA intergovernmental agreement (IGA) in effect pursuant to *Announcement 2014-17, 2014-18 I.R.B. 1001*, but that do not sign the IGA before December 31, 2014. *Announcement 2014-38* provides that a jurisdiction that is treated as if it had an IGA in effect, but that has not yet signed an IGA, retains such status beyond December 31, 2014, provided that the jurisdiction demonstrates firm resolve to sign the IGA as soon as possible. After December 31, 2014, Treasury will review the list of jurisdictions having an agreement in substance on a monthly basis to assess whether it continues to be appropriate to treat such a jurisdiction as if it had an IGA in effect or whether a jurisdiction should be removed from the list. **Ann. 2014-38, I.R.B. 2014-51**.

HEALTH INSURANCE. The IRS has adopted as final regulations relating to the requirement to maintain minimum essential coverage enacted by the Affordable Care Act. These final regulations provide individual taxpayers with guidance under I.R.C. § 5000A on the requirement to maintain minimum essential coverage and rules governing certain types of exemptions from that requirement. **79 Fed. Reg. 70464 (Nov. 26, 2014)**.

INNOCENT SPOUSE RELIEF. The taxpayer filed for innocent spouse relief from unpaid taxes due for three tax years in which the taxpayer and former spouse had filed joint tax returns. Almost all of the taxable income came from the taxpayer's former spouse's business. Although the IRS agreed to grant equitable relief, the former spouse filed as an intervenor in the case and challenged the grant of relief. The court upheld the IRS grant of relief because (1) the taxpayer was divorced, (2) the taxpayer was currently experiencing financial hardship from lack of employment and failure of the former spouse to provide court-ordered child support, (3) the support payments were not excessive, (4) the taxpayer had complied with all tax laws since the divorce, and (5) the former spouse had agreed in the divorce agreement to pay all back taxes. **Demeter v. Comm'r, T.C. Memo. 2014-238**.

The taxpayer was a dentist and had sold the dental practice in 2007. The taxpayer and former spouse filed a joint return for 2007 which included income from wages of the spouse, business income from the dental practice and capital gain from the sale of the dental practice. The only taxes paid were those withheld from the wages of the spouse. The couple separated in 2008 and each made some payments on the unpaid taxes. The divorce agreement provided that each spouse agreed to pay one-half of the unpaid 2007 taxes. The IRS denied the taxpayer statutory and equitable innocent spouse relief. The court held that the equitable relief was properly denied because (1) the taxpayer had sufficient assets to pay the taxes, (2) the payment of the taxes would not cause any financial hardship, (3) the taxpayer had actual knowledge of the failure to pay the taxes, (4) the taxpayer was obligated by the divorce agreement to pay at least one-half of the taxes, and (5) there was no evidence that the former spouse controlled the household finances or denied the taxpayer access to financial records. The court also noted that the sale of the taxpayer's dental practice gave rise to most of the taxes due for 2007 and the spouse had paid one-half of the taxes owed. **Johnson v. Comm'r, T.C. Memo. 2014-240**.

PARTNERSHIPS

DISCHARGE OF INDEBTEDNESS. The taxpayer was a partner in an LLC taxed as a partnership. The LLC was in the real estate business and owned commercial property. The LLC renegotiated a loan, which resulted in discharge of indebtedness which was reported on the Form 1065 and on Schedule K-1 filed with the taxpayer. The taxpayer had the federal tax return prepared and filed by a qualified tax return preparer; however, the return preparer did not realize that the discharge of indebtedness income was qualified real property business indebtedness eligible to be excluded from income under an I.R.C. § 108(c)(3)(C) election. The taxpayer filed a personal income tax return without making the election. The IRS granted an extension of time to file an a personal income tax return with the election. **Ltr. Rul. 201447011, Aug. 18, 2014**.

ELECTION TO ADJUST BASIS. The taxpayer was a limited liability company which elected to be taxed as a partnership . A partner died during the tax year but the partnership's accountant failed to include an election under I.R.C. § 754 to adjust the basis of partnership assets. The IRS granted an extension of time to file the election. **Ltr. Rul. 201448002, Aug. 11, 2014**.

QUALIFIED DEBT INSTRUMENTS. The IRS has announced the 2015 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
2015	$5,647,300	$4,033,800

The $5,647,300 figure is the dividing line for 2015 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 $5,647,300 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 $4,033,800 or less (for 2015), both parties may elect to account for the interest under the cash method of accounting. **Rev. Rul. 2014-30, 2014-2 C.B. 910**.

QUARTERLY INTEREST RATE. The IRS has announced that, for the period January 1, 2015 through March 31, 2015, the interest rate paid on tax overpayments remains at 3 percent (2 percent in the case of a corporation) and for underpayments remains at 3 percent. The interest rate for underpayments by large corporations remains at 5 percent. The overpayment rate for the portion of a corporate overpayment exceeding $10,000 remains at 0.5 percent. **Rev. Rul. 2014-29, I.R.B. 2014-52.**

S CORPORATIONS

ELECTION. The taxpayer was a corporation eligible to make the S corporation election but failed to timely file Form 2553, *Election by a Small Business Corporation*. The IRS granted an extension of time to file the election. **Ltr. Rul. 201470009, June 9, 2014**.