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Individual Taxation: Digest of Recent Developments

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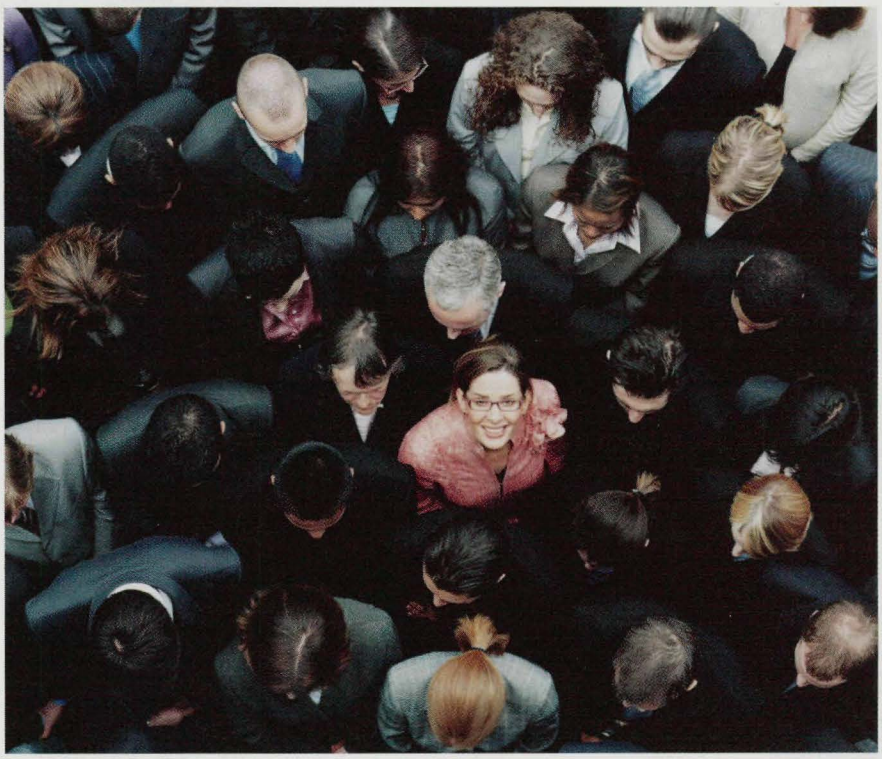
This article covers recent developments affecting taxation of individuals, including last year's tax relief and small business legislation, regulations, cases, and IRS guidance. The items are arranged in Code section order.



Sec. 1: Tax Imposed

In mid-December 2010, Congress passed and President Barack Obama signed into law the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (Tax Relief Act).[1] This act extended the 2001 and 2003 tax cuts for two more years through the end of 2012. Thus, the highest statutory tax rate for individuals continues to be 35%. The higher child credit and the lower tax rate for qualified dividends and capital gains continue through 2012. For 2011 and 2012, as in 2010, there is no phaseout of itemized deductions or personal exemptions. Various other changes were included in the act. For further information, see Tax Trends, "EGTRRA and JGTRRA Tax Rates Extended for Two Years in Lame Duck Session," 42 *The Tax Adviser* 133 (February 2011).

Sec. 25A: Hope and Lifetime Learning Credits

The American opportunity tax credit was extended through 2012 by the Tax Relief Act. A report titled "The American Opportunity Tax Credit," issued by the Treasury Department on October 12, 2010, explains how the American opportunity tax credit works, estimates what benefits typical families can expect to receive compared with prior law, and shows how families have already benefited from

1 Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, P.L. 111-312.

the new credit. Among the findings in the report:

- The American opportunity tax credit increased tax incentives for higher education by over 90%, or $8.7 billion, in 2009.
- 12.5 million students and their families received a tax incentive for higher education in 2009, an increase of 400,000 from 2008.
- American opportunity tax credit recipients in 2009 received an average tax credit of over $1,700, about 75% more than the average Hope scholarship or the lifetime learning credit recipient in 2008.
- 4.5 million students and families received a tax refund from the American opportunity tax credit in 2009 with an average value of $800, which they would not have been eligible for in 2008.

Sec. 35: Overpayments of Tax

The Sixth Circuit held that the Tax Court properly upheld the IRS's application of an individual's tax overpayment to his tax liability for a discharged tax year, rather than the year requested by the individual.[2] Although the IRS generally will honor a taxpayer's request to apply voluntary payments, the individual's overpayment was not a voluntary payment; therefore, his desire to have the funds allocated to his tax liabilities for a particular tax year was inconsequential. The IRS possessed statutory discretion to credit the overpayment to any tax year.

Sec. 36: First-Time Homebuyer Credit

The first-time homebuyer credit expired in 2010 (eligible home purchases must have closed on or before September 30, 2010). The GAO issued a report, "Tax Administration: Usage and Selected Analyses of the First-Time Homebuyer Credit," to Congress in response to a request for updated information on the use of the first-time homebuyer credit. The report identifies the number of first-time homebuyer credits and dollar amounts claimed for each credit version by state and provides state rankings, using selected statistics, such as the total dollar amount of the credit claimed in each state.

A June 2010 report issued by the Treasury Inspector General for Tax Administration (TIGTA) reported that 4,608 prisoners claimed the first-time homebuyer tax credit while incarcerated at the time they reported a home purchase.[3] TIGTA estimated that approximately 1,295 of the claims were processed, resulting in $9.1 million in tax credits.

Sec. 36C: Adoption Expenses

The IRS issued guidance[4] on the expanded adoption credit under Sec. 36C[5] and released Form 8839, Qualified Adoption Expenses, for claiming the refundable credit on 2010 tax returns.

The IRS provided safe harbors for determining the finality of foreign adoptions for purposes of the adoption credit under Sec. 36C and the exclusion for employer reimbursements under Sec. 137.[6] The safe harbors apply to adoptions governed by the Hague Convention on Protection of Children and Cooperation in Respect of Intercountry Adoption (convention) and subject to the Intercountry Adoption Act of 2000 (convention adoptions). Rev. Proc. 2005-31[7] continues to apply to nonconvention adoptions. Finally, the revenue procedure provides guidance on filing amended returns to claim the credit or exclusion for convention adoptions that became final in 2008 or 2009. A taxpayer within the scope of this revenue procedure who meets the requirements of a safe harbor may rely on that safe harbor to determine when a foreign adoption of an eligible child is final.

Rev. Proc. 2010-35 modifies and supersedes portions of Rev. Proc. 2009-50.[8] For tax years beginning in 2010, it provides:

EXECUTIVE SUMMARY

- The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 extended the current individual income tax rates on ordinary income and the rates on qualified dividend and capital gains income for two years through 2012.
- The IRS, changing its longstanding position, ruled that debt on a mortgage loan used to acquire, construct, or substantially improve a qualified residence, to the extent it exceeds $1 million, qualifies as home equity indebtedness, and thus the interest on up to $100,000 of that debt is deductible as an itemized deduction.
- The Tax Court held that the Sec. 121 exclusion of gain from the sale of a principal residence applied only to the home that the taxpayer used as a principal residence and not to a replacement home built on the site of the home that was used as a principal residence.
- In two cases, the Tax Court held that a taxpayer was not entitled to a charitable deduction for the donation of a home to a fire department for use in live fire-training exercises.

2 *Bryant*, No. 09-1957 (6th Cir. 10/21/10).

3 TIGTA, *Additional Steps Are Needed to Prevent and Recover Erroneous Claims for the First-Time Homebuyer Credit* (2010-41-069) (June 17, 2010).

4 Notice 2010-66, 2010-42 I.R.B. 437; Rev. Proc. 2010-31, 2010-40 I.R.B. 413; Rev. Proc. 2010-35, 2010-42 I.R.B. 438.

5 Enacted by the Patient Protection and Affordable Care Act, P.L. 111-148.

6 Rev. Proc. 2010-31.

7 Rev. Proc. 2005-31, 2005-1 C.B. 1374.

8 Rev. Proc. 2009-50, 2009-45 I.R.B. 617.

Adoption credit under Sec. 36C: The maximum credit is increased to $13,170 from $12,170. The available adoption credit begins to phase out for taxpayers with modified adjusted gross income in excess of $182,520 and is completely phased out for taxpayers with modified adjusted gross income of $222,520 or more.

Exclusion from income under Sec. 137: The amount that an employee can exclude from gross income for the adoption of a child with special needs is increased to $13,170. The maximum amount that an employee can exclude from gross income for the amounts paid or expenses incurred by an employer for qualified adoption expenses furnished under an adoption assistance program for other adoptions by the employee is $13,170, and the amount excludible from an employee's gross income is phased out as under the adoption credit.

The IRS has provided interim guidance for computing and substantiating claims for the adoption credit beginning with the 2010 tax year, including but not limited to the following provisions: [9]

- An adoption credit amount claimed in an earlier tax year that an individual carries forward to a tax year beginning in 2010 is allowed as a refundable tax credit. Amounts carried forward to a tax year beginning in 2010 are not subject to an income limitation in that tax year.
- For both domestic and foreign adoptions, if an individual pays or incurs qualified adoption expenses (QAEs; these include reasonable and necessary adoption fees, court costs, attorneys' fees, and other expenses directly related to, and for the principal purpose of, adopting an eligible child) during or after the tax year in which the adoption becomes final, the credit is allowed in the tax year in which the individual pays or incurs the QAEs.
- For domestic adoptions, the credit is allowed for QAEs that an individual pays or incurs in a tax year before the adoption becomes final. However, an individual may not claim the credit for those QAEs until the next tax year.
- For foreign adoptions, the credit is allowed only in the tax year in which the adoption becomes final.
- Expenses for an unsuccessful domestic adoption are aggregated with the expenses of a successful adoption of another child for purposes of applying the dollar limitation.

Sec. 59: Alternative Minimum Tax Definitions and Special Rules

The IRS granted a taxpayer an extension of time to make an election under Sec. 59(e) as permitted by Regs. Sec. 301.9100-3 in a number of situations where the taxpayer acted reasonably and in good faith and where granting an extension of time to make an election would not prejudice the interests of the government.[10] Although some of these rulings involved corporations, the same principles would apply if the taxpayer were an individual.

Sec. 61: Gross Income Defined

Credit card rebates: Use of credit cards may entitle cardholders to rebates, which can be received in the form of cash or donations to charity. Two questions were involved in a recent letter ruling:[11] (1) Is the rebate considered income? The IRS says no. The rebate is really an adjustment to the purchase price of the goods or services purchased by the cardholder. This is not considered an "accession to wealth" and thus is not includible in income.[12] (2) Is the cardholder entitled to a charitable contribution deduction if it opts to have its rebate donated to a qualified charitable organization? The IRS says yes. Because the cardholder chooses whether to have the rebate go to charity, this is a voluntary contribution and qualifies as a Sec. 170 charitable contribution.

Whether the cardholder is allowed to deduct the donation depends on whether the recordkeeping requirements of Secs. 170(f)(8) and (f)(17) are satisfied. Under Sec. 170(f)(8), for contributions of $250 or more, the donor must receive written, contemporaneous acknowledgment from the charity noting the amount of the contribution and stating that no goods or services were provided in exchange for the donation. Under Sec. 170(f)(17), the donor must have records showing the name of the charity, the amount of the donation, and the date the contribution was made. Because the written acknowledgment used in the facts of this letter ruling did not note the date the credit card company remitted the donation to the charity, the cardholder's acknowledgment did not satisfy the requirements of Sec. 170(f)(17).

Registered domestic partners: In May 2010, the IRS issued Letter Ruling 201021048, Chief Counsel Advice (CCA) 201021049, and CCA 201021050.[13] These rulings note that due to a state law change in California, registered domestic partners should treat income that is community property income for state purposes as such when they file their federal return. CCA 201021050 notes that for 2007–2009, amended returns can be filed to reflect this treatment.

Additional informal guidance was issued as the 2011 filing season approached. This information was included in IRS Publications 17, *Your Federal Income Tax* (2010), and 555, *Community Property* (2010), as well as the instructions to the 2010 Form 1040, U.S. Individual Income Tax Return. The information pertains to registered domestic partners in California, Nevada, and Washington.[14]

Foreign accounts: In early 2011, the IRS announced a new voluntary disclosure program for taxpayers with unreported income from offshore accounts. This new initiative, the 2011 Offshore Voluntary Disclosure Initiative, has some features

9 Notice 2010-66.

10 IRS Letter Rulings 201024034 (6/18/10), 201033032 (8/20/10), and 201027004 (7/9/10).

11 IRS Letter Ruling 201027015 (7/9/10).

12 See Rev. Rul. 76-96, 1976-1 C.B. 23, as modified by Rev. Rul. 2005-28, 2005-1 C.B. 997.

13 IRS Letter Ruling 201021048 (5/28/10); CCA 201021049 (5/28/10); and CCA 201021050 (5/28/10).

14 For additional information, see Nellen, "Filing Reminders: Domestic Partners and Same-Sex Couples" (March 1, 2011), www.aicpa.org/InterestAreas/Tax/Resources/Individual/Pages/DomesticPartners.aspx.

that are different from the 2009 voluntary disclosure program, such as a different penalty structure. The new disclosure program is available through August 31, 2011. For more on this, see Gervie, "Offshore Voluntary Disclosure Initiative," 42 *The Tax Adviser* 271 (April 2011).

Sec. 104: Compensation for Injuries or Sickness

In a Tax Court case, the petitioner allegedly suffered a second heart attack due to harassment by co-workers; he also alleged invasion of privacy.[15] A settlement resulted in a payment of $350,000 from the employer as noneconomic sickness damages and not as wages or other income. The taxpayer did not report this as taxable income. The Tax Court held that the taxpayer had the burden of proof under Sec. 6201(d) because he did not fully cooperate with the IRS in providing the requested documents.

The court found that one-half of the payment was for physical injury and thus was excluded from income. The other half was for emotional distress. The taxpayer could exclude any part of this that was for medical care, but he provided no evidence to support his exclusion, so that half of the payment was deemed taxable. The court waived an accuracy-related penalty because it found the taxpayer's belief that the settlement was to compensate him for his heart attack and disability was not unreasonable.

Sec. 107: Rental Value of Parsonages

The Tax Court held that a minister who received a parsonage allowance for two homes used personally could exclude the allowance under Sec. 107.[16] The IRS had interpreted the statute as allowing an exclusion for only one home. The court noted that nothing in Sec. 107 and its related regulations and legislative history indicates just one home. The court also referred to Sec. 7701(m) (now Sec. 7701(p)), which incorporates the rule that unless indicated otherwise, "words importing the singular include and apply to several persons, parties, or things."[17] Dissenting judges argued that exclusions should be interpreted narrowly and that there was no legislative purpose served by allowing an exclusion on more than one residence.

Sec. 108: Cancellation of Debt Income

The IRS has issued temporary and proposed regulations that provide guidance on the elective deferral of cancellation of debt (COD) income by a partnership or an S corporation for the reacquisition of applicable debt instruments under Sec. 108(i).[18] The temporary regulations apply to reacquisitions of applicable debt instruments in tax years ending after December 31, 2008.

In a news release, the IRS reminded health care professionals that they may be due a refund on their 2009 returns if they received student loan relief under state programs rewarding those who work in underserved communities.[19] The Patient Protection and Affordable Care Act expanded the exclusion for amounts received by health professionals under loan repayment and forgiveness programs to include any state loan repayment or loan forgiveness programs intended to increase the availability of health care services in underserved areas or health professional shortage areas.[20] The act also made the exclusion retroactive to 2009.

Sec. 117: Qualified Scholarships

Under Sec. 117, a qualified tuition reduction is excludible from the gross income of a highly compensated employee only if the reduction is made on a nondiscriminatory basis. For purposes of the qualified plan minimum coverage rules, a two-part test is applied to determine whether the classification is reasonable and nondiscriminatory. The IRS has privately ruled that a university's two tuition reduction plans, taken together, did not discriminate in favor of highly compensated employees.[21] As a result, tuition benefits to the university's employees for education below the graduate level at the university or at another educational institution were excludible from the employees' gross income under Sec. 117(d)(1). The letter ruling noted that the standard applied to qualified retirement plans when determining if a plan discriminates in favor of highly compensated employees is not the same for a tuition reduction plan. The determination should be made based on an analysis of all relevant facts and circumstances.

The IRS also ruled that awards made by exempt organizations or private foundations for scholarships for underprivileged students to obtain secondary, technical, associate, undergraduate, or graduate degrees are excludible from the recipient's gross income subject to Sec. 117 limitations.[22]

Sec. 121: Exclusion of Gain from Sale of Principal Residence

A married couple voluntarily demolished their principal residence and reconstructed a new home on the same property on the site of the original residence. The Tax Court ruled that they were not entitled to a Sec. 121 income exclusion of $500,000 on the gain they realized on the sale of the reconstructed home.[23] The taxpayers never lived in the home, thus failing Sec. 121(a)'s requirement that the property be used as a principal residence. The Tax Court reviewed the legislative history, regulations, and case law and determined that Sec. 121(a) had to be construed narrowly and that it was not enough that the land or property on which the taxpayers' reconstructed home was situated had been the site of their original residence or that the original residence would have qualified for the exclusions. The exclusion could apply only where the home that is sold was the actual principal residence.

15 *Parkinson*, T.C. Memo. 2010-142.
16 *Driscoll*, 135 T.C. No. 27 (2010).
17 1 U.S.C. §1.
18 T.D. 9498.
19 IR-2010-74 (June 16, 2010).
20 Sec. 108(f)(4).
21 IRS Letter Ruling 201029003 (7/23/10).
22 IRS Letter Ruling 201021028 (5/28/10).
23 *Gates*, 135 T.C. No. 1 (2010).

Sec. 151: Allowance of Deductions for Personal Expenses

In a Tax Court case, the taxpayer claimed dependency exemption deductions for family members (two parents, two nieces, and a nephew).[24] The family members lived in Mexico, and the taxpayer sent money to the family frequently (approximately $1,900 total). The taxpayer used a professional preparer. The IRS disallowed the deduction.

Observation: This case raises, but does not answer, some interesting questions. Where did the taxpayer get the Social Security numbers? Did the IRS assess preparer penalties?

Sec. 152: Dependent Defined

In a Tax Court case, the taxpayer claimed a deduction for children as stipulated by a divorce decree.[25] However, the stipulation and judgment the taxpayer presented did not conform to the form and substance of Form 8332, Release of Claim to Exemption for Child of Divorced or Separated Parents, as required by Sec. 152(e)(2)(A), so the deduction was denied.

Sec. 163: Interest

In Rev. Rul. 2010-25,[26] the IRS considered the case of an unmarried taxpayer who had purchased a principal residence for its fair market value of $1,500,000. The taxpayer paid $300,000 and financed the remainder by borrowing $1,200,000 through a loan secured by the residence. In 2009, the taxpayer paid interest that accrued on the indebtedness during that year and had no other debt secured by the residence. The IRS ruled that debt incurred to acquire, construct, or substantially improve a qualified residence can constitute home equity indebtedness (within the meaning of Sec. 163(h)(3)(C)) to the extent it exceeds $1 million.

Specifically, the taxpayer may deduct as interest on acquisition indebtedness under Sec. 163(h)(3)(B) interest paid in 2009 on $1 million of the $1,200,000 indebtedness used to acquire the principal residence. The taxpayer may also deduct, as interest on home equity indebtedness under Sec. 163(h)(3)(C), interest paid in 2009 on $100,000 of the remaining indebtedness of $200,000. The $200,000 is secured by the qualified residence, is not acquisition indebtedness under Sec. 163(h)(3)(B), and does not exceed the fair market value of the residence reduced by the acquisition indebtedness secured by the residence. Thus, $100,000 of the $200,000 is treated as home equity indebtedness under Sec. 163(h)(3)(C). Further, the IRS will not follow the decisions in *Pau*[27] and *Catalano*.[28] The holding in *Pau* was based on the assertion that taxpayers must demonstrate that debt treated as home equity indebtedness "was not incurred in acquiring, constructing or substantially improving their residence." The definition of home equity indebtedness in Sec. 163(h)(3)(C) contains no such restrictions, so the IRS will determine home equity indebtedness consistent with the provisions of this revenue ruling, notwithstanding the decisions in *Pau* and *Catalano*.

Sec. 165: Losses

To assist individuals in computing a casualty loss deduction for costs to repair personal residences or appliances for damage stemming from corrosive drywall materials, the IRS provided a safe-harbor method.[29] The safe harbor allows a deduction for damages that might not otherwise qualify as a casualty under Sec. 165, which requires that the damage result from an event "of a sudden, unexpected, and unusual nature."[30] However, taxpayers must pay for repairs in order to be able to take a deduction under the safe harbor.

Sec. 170: Charitable Contributions

Conservation easement: The Fifth Circuit reversed a Tax Court ruling on the value of a facade donation and remanded the case for redetermination of the allowed deduction.[31] Whitehouse owned two adjacent buildings, known as Maison Blanche and the Kress building. They planned to combine the two into a Ritz-Carlton hotel. Whitehouse had claimed a deduction of $7.5 million for the donation of an historic preservation facade easement of Maison Blanche. The Tax Court valued the donation at $1.8 million, based on the fact that the easement did not burden the adjacent Kress building. However, the appeals court found that the easement was still relevant for easement valuation purposes since the two buildings were to be combined and the easement would have an effect on the future fair market value of the combined buildings.

Fire department donation: In *Hendrix*, taxpayers decided to demolish their home and construct a new house.[32] After obtaining two estimates for the demolition that they felt were too expensive, they contacted the local fire department to discuss letting the city use their home for

24 *Silverio*, T.C. Summ. 2010-60.
25 *Konrad*, T.C. Memo. 2010-179.
26 Rev. Rul. 2010-25, 2010-44 I.R.B. 571.
27 *Pau*, T.C. Memo. 1997-43.
28 *Catalano*, T.C. Memo. 2000-82.
29 Rev. Proc. 2010-36, 2010-42 I.R.B. 439. See also Fava, Weiss, and Huber, "Tax Relief for Homeowners with Corrosive Drywall," 211 *Journal of Accountancy* 45 (April 2011).
30 Rev. Rul. 72-592, 1972-2 C.B. 101.
31 *Whitehouse Hotel L.P.*, 615 F.3d 321 (5th Cir. 2010).
32 *Hendrix*, No. 2:09-cv-132 (S.D. Ohio 7/21/10).

training and then destroy it and return the empty lot to the taxpayer. The taxpayers retained an accounting firm to analyze the proposed transaction; the firm concluded that the donation was "aggressive and not explicitly sanctioned by the IRC." The taxpayers obtained an appraisal of the property and proceeded with the transaction. They claimed a deduction on their return, and the IRS disallowed it. The court granted the IRS's motion for summary judgment on two grounds. First, the appraisal fell far short of the requirements of a qualified appraisal. The taxpayers conceded that certain content was missing, but the court ruled that it was not even close to substantial compliance. Second, the donee obtained no contemporaneous written acknowledgment. Thus, the court declined to review whether a transaction of this type would qualify for a charitable deduction.

Another 2010 case involved a home donated to a fire department, but the claimed charitable contribution deduction was disallowed for reasons different from those in *Hendrix*.[33] In the 2010 Tax Court decision, the taxpayer donated to the fire department a house intended to be demolished as part of a remodeling project. The IRS and the court questioned the valuation the taxpayer had assigned to the home. The court noted that since the taxpayer had not donated the land, there was a "constructive severance." In addition, because the fire department was required to demolish the home, any value as residential property would not apply. The court held that the value of the removal services provided by the fire department was substantial but the value of the home, severed from the land and usable only for destruction, did not exceed the value of the services received, so no charitable contribution deduction resulted.

Sec. 213: Medical Expenses

When a person pays another person's expenses, both income tax and gift tax issues can arise. A 2010 Tax Court case involved a mother who directly paid her adult daughter's medical expenses ($24,559) and real estate taxes ($5,508).[34] The daughter claimed the deductions on her return, and the IRS disallowed them. The daughter argued that, in substance, the mother had given her the funds and she had paid the expenses, while the IRS argued that the form controlled. Following the form of the transaction, the daughter had no deductions because she had not paid anything. The mother had no legal obligation to pay the daughter's expenses.

The court held for the daughter. With respect to the medical expenses, it found that a donative intent existed and that the treatment for gift tax purposes did not control the income tax treatment. Per Sec. 2503(e)(1), a transfer made directly to another person's medical care provider is not considered a gift for gift tax purposes. However, for income tax purposes, substance over form indicated that the daughter really made the payment to the doctors and thus was entitled to a deduction. Similarly, for the real estate taxes, the substance controlled and the daughter was considered to have made the payment. The court noted that there was "no danger of a 'double deduction'" from the decision because taxes are deductible only by the person upon whom they are legally imposed (Regs. Sec. 1.164-1(a)), and that legal obligation was upon the daughter, not the mother.

Sec. 263: Capital Expenditures

In a situation addressed in CCA 201036009, the taxpayer negotiated a purchase agreement with a seller seeking relief under chapter 11 bankruptcy.[35] After negotiating with the bankruptcy court, the taxpayer assumed assets and certain liabilities in the transaction (the liabilities would have been discharged in bankruptcy). The taxpayer requested clarification about whether the assumed liabilities should be capitalized as part of the purchase price of the assets or currently expensed. The taxpayer did not provide sufficient evidence to preclude capitalization under Sec. 263. The CCA did state that more detail might have supported the taxpayer's position to not capitalize the liabilities.

Sec. 280F: Listed Property

The Small Business Jobs Act[36] includes a provision removing cell phones from the definition of listed property in Sec. 280F(d)(4)(A). The amendment is retroactive to tax years beginning after December 31, 2009.

Sec. 469: Passive Activity Losses and Credits Limited

In attempting to reach the requisite 750-hour threshold to meet the definition of a real estate professional for purposes of Sec. 469(c)(7) (exempting real estate professionals from the passive rule for rental real estate activities), the taxpayer, owner of four residential rental properties, argued that he was on call at all times.[37] The owner had a full-time job outside real estate. He handled maintenance, tenant relations, and rent collection for the rental properties. He kept records of his visits to the properties but not how much time he spent. The IRS disallowed the taxpayer's claimed loss as a real estate professional but allowed a portion of the loss under the rental real estate with active participation rule.[38]

The court held that on-call time is not actual time spent and thus cannot count toward the time requirements of Sec. 469(c)(7). The court also upheld the IRS assessment of an accuracy-related penalty. The taxpayer was unable to show reasonable cause. The court noted that the taxpayer had not relied upon his CPA because he had not provided all relevant information to the CPA.

Sec. 1001: Determination of Amount and Recognition of Gain or Loss

In a Tax Court case, the taxpayer failed to provide evidence of the cost basis of real property sold.[39] Selling expenses per the

33 *Rolfs*, 135 T.C. No. 24 (2010).
34 *Lang*, T.C. Memo. 2010-286.
35 CCA 201036009 (9/10/10).
36 Small Business Jobs Act of 2010, P.L. 111-240.
37 *Moss*, 135 T.C. No. 18 (2010).
38 Sec. 469(i), allowing a $25,000 offset for rental real estate activities.
39 *Whitaker*, T.C. Memo. 2010-209.

closing statement did not match the statement attached to her 2003 Form 4797, Sales of Business Property, and did not support her recognition of gain.

In another case, an E&Y IT consulting business partner received shares of Cap Gemini in exchange for his partnership interest.[40] Merrill Lynch held 75% of the shares in individual accounts for each partner, and the partner could not sell the shares for up to five years. The partner reported gain on all the shares in 2000. The shares later lost substantial value, and the partner filed an amended return claiming that the shares were subject to substantial restrictions and should not have been included in income in 2000. He received a refund, and the IRS brought suit to recover the refund. Because the partner received the benefits of ownership and the stock was only held in escrow to enforce his obligations under the contract, a district court held he had to include the income in 2000.

The Tax Court held in another case that a transfer of stock under a 90% stock loan was really a sale.[41] The taxpayer transferred the legal title to the stock to a promoter, who sold the stock immediately after the transfer. The only interest the taxpayer retained was the option to purchase the shares' equivalent at the end of the three-year loan period.

Tax protesters lost arguments that gains from sale of property and capital gain distributions were not income.[42] The court did not accept the taxpayers' self-prepared Forms 1099-B, Proceeds from Broker and Barter Exchange Transactions, and 1099-S, Proceeds from Real Estate Transactions, supporting the taxpayers' contention that amounts received from sales of property and securities are not taxable income under the Internal Revenue Code. Having no evidence of the taxpayers' basis in the securities sold, the court concluded that the basis was zero; it also accepted the IRS's determination of the other sold property's basis.

The Tax Court held that a minister who received a parsonage allowance for two homes used personally could exclude the allowance under Sec. 107.

In another case, the Tax Court did not uphold the IRS's determination of gain on the foreclosure of a mortgaged condominium of a longtime nonfiler.[43] The Tax Court relied on a closing statement and loan documents to determine the condominium's basis for purposes of the gain calculation. However, the Tax Court upheld the reconstructed (zero) basis of the taxpayer's interest in the sale of a real estate partnership interest.

Sec. 1012: Basis of Property

The double category method for determining basis of mutual fund shares has been abolished.[44] Single category averaging is still available by election. FIFO is the default method.

In Notice 2010-67, the IRS provided broker penalty relief for reporting certain transfers of stock in 2011.[45] The notice provides that, solely for 2011 stock transfers described in the notice, the IRS will not assert penalties for failure to furnish a transfer statement under Sec. 6045A and that the transferred stock may be treated as a noncovered security upon its subsequent sale or transfer.

Sec. 1031: Like-Kind Exchange

The Eleventh Circuit upheld a Tax Court decision disallowing nonrecognition of gain from a multiparty like-kind exchange between related parties.[46] The parties' convoluted transaction was determined to be a tax avoidance scheme without other valid business reasons.

Sec. 1035: Certain Exchanges of Insurance Policies

The IRS ruled that the transfer of cash surrender value in exchange for a new annuity contract after attaining age 59½ qualified as a nontaxable Sec. 1035 exchange.[47]

Sec. 1042: Sales of Stock to Employee Stock Ownership Plans

The IRS ruled that the transfer of qualified replacement property to a spouse during divorce proceedings should be treated as a gift and would not cause recapture of deferred gain.[48]

Sec. 6015: Innocent Spouse

There has been a great deal of activity by the IRS, the Tax Court, and the circuit courts regarding the two-year rule in Sec. 6015(f). In *Lantz*,[49] the Seventh Circuit reversed the Tax Court, holding that the two-year deadline for filing a request for relief under Regs. Sec. 1.6015-5(b)(1) is a valid interpretation of Sec. 6015(f). Writing for the unanimous circuit panel, the judge reversed the Tax Court and remanded the case, holding that the circuit "would not accept 'audible silence' as a reliable guide to congressional meaning." The panel criticized the Tax Court's rationale of inferring no limitation period if it was not made explicit in the statute, saying, "[t]hat is not how statutes that omit a statute of limitations are usually interpreted."

In another case, *Mannella*, the Third Circuit also overruled the Tax Court

40 *Fort*, 1:08-CV-3885-TWT (N.D. Ga. 5/20/10).
41 *Calloway*, 135 T.C. No. 3 (2010).
42 *O'Boyle*, T.C. Memo. 2010-149.
43 *MacGregor*, T.C. Memo. 2010-187.
44 Regs. Sec. 1.1012-1.
45 Notice 2010-67, 2010-43 I.R.B. 529.
46 *Ocmulgee Fields, Inc.*, 613 F.3d 1360 (11th Cir. 2010), aff'g 132 T.C. No. 6 (2009).
47 IRS Letter Ruling 201038012 (9/24/10).
48 IRS Letter Ruling 201024005 (6/18/10).
49 *Lantz*, No. 09-3345 (7th Cir. 6/8/10), rev'g 132 T.C. No. 131 (2009).

and held that the two-year limitation is valid.[50] A third case involving the validity of Regs. Sec. 1.6015-5(b)(1) is on appeal in the Second Circuit.[51]

Despite the decisions in the Third and Seventh Circuits, the Tax Court, in a divided opinion, maintained its position that Regs. Sec. 1.6015-5(b)(1) is an invalid interpretation of Sec. 6015(f).[52] In a case appealable to the Sixth Circuit, Audrey Marie Hall filed joint income tax returns with her former husband for the 1998 and 2001 tax years. The taxpayers failed to pay the full tax liabilities for those years. They divorced in 2003, and Hall's husband was held liable for the outstanding tax liabilities as directed by their divorce decree. In 2004, the IRS commenced collection actions against them by issuing a notice of intent to levy. In 2008, Audrey Hall requested innocent spouse relief, which the IRS denied because she did not file the request within the two-year limitation period. Hall appealed the denial to the Tax Court.

The Tax Court revisited its position following the Seventh Circuit ruling in *Lantz* but found that the application to Sec. 6015(f) of the two-year period in Secs. 6015(b) and (c) renders subsection (f) ineffective. The court also found that the limitation period is not simply a procedural rule in the case of this equitable statute because it makes the time of the claim the only relevant factor. The court explained, "[t]he statute requires consideration of all facts and circumstances to decide whether there is inequity," and found the limitation period inconsistent with the purpose of the statute. The court distinguished subsection (f) from subsections (b) and (c), explaining that subsection (f) requires the consideration of current circumstances as well as the circumstances that existed during the tax year when the liability was incurred. Both sets of circumstance are to be considered in determining whether holding an individual liable for a joint liability will yield an inequitable result, the court explained, noting that subsections (b) and (c) only require a tax year factual analysis. The court concluded that the harsh and inequitable results of the limitation period are not allowable in a reasonable interpretation of the statute, thus holding Regs. Sec. 1.6015-5(b)(1) invalid.

Addressing Sec. 6343(a)(1)(D), which provides for the release of a levy where the IRS determines the levy is creating an economic hardship due to the financial condition of the taxpayer, the court rejected the Seventh Circuit's reference to that provision as a form of relief for an individual whose equitable spousal relief claim is rejected based on the limitation period. Noting that Sec. 6015(f) was enacted after Sec. 6343, the court said, "if Congress had found it sufficient, presumably section 6015(f) would not have been enacted." Five judges joined in a dissenting opinion.

Chief Counsel Notice CC-2010-011 updates IRS policies and procedures announced in CC-2010-005 regarding the validity of the two-year deadline described in Sec. 6015(f). The IRS will move to remove the "small tax case" designation (based on the election under Tax Court Rule 171) for any cases where the two-year deadline is an issue because that designation does not give the IRS an opportunity to appeal. In a case appealable to a circuit in which an appeal of the issue is pending, the IRS may move, in the alternative, to hold the case in abeyance pending resolution of that appeal. Further, Notice CC-2010-011 provides that the IRS will not settle or concede the two-year deadline issue in any docketed case. If it is determined that a petitioner would be entitled to relief on the merits except for the fact that the request for relief under Sec. 6015(f) was filed late, the IRS will determine how to preserve the two-year deadline issue while conceding the merits of the Sec. 6015(f) claim. If an appeal regarding the two-year deadline issue has been filed in the circuit within which the petitioner resides, the IRS may request that the Tax Court hold the case in abeyance pending the resolution of the issue on appeal, or the parties may stipulate to be bound by the case on appeal in that circuit.

Sec. 6041: Information at Source

The Small Business Jobs Act created a new information reporting requirement (Form 1099-MISC, Miscellaneous Income) starting in 2011 for landlords, even if they were not previously considered as being in a trade or business. This requirement was subsequently repealed on April 14, 2011, as part of the Comprehensive 1099 Taxpayer Protection and Repayment of Exchange Subsidy Overpayments Act of 2011.[53] However, for payers required to file 1099s, the act did not repeal the increase in the information reporting penalties that were mandated by the Small Business Jobs Act (see News Notes, p. 364).

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50 *Mannella*, 631 F.3d 115 (3d Cir. 2011), rev'g 132 T.C. No. 10 (2009).

51 *Coulter*, No. 10-680 (2d Cir.), appeal from Heather L. Coulter, No. 1003-09, an unreported stipulated decision.

52 *Hall*, 135 T.C. No. 19 (2010).

53 Comprehensive 1099 Taxpayer Protection and Repayment of Exchange Subsidy Overpayments Act of 2011, P.L. 112-9.