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Recent Developments in the Income Taxation of Individuals, Trusts, Estates and Partnerships

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**RECENT DEVELOPMENTS IN THE INCOME TAXATION OF INDIVIDUALS,
TRUSTS, ESTATES AND PARTNERSHIPS**

WILLIAM AND MARY TAX INSTITUTE -- 1993

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I. Accounting

A. Accounting Methods

1. **Rev. Procs. 92-74 and 92-75**, 1992-38 I.R.B. 16 and 22, modifying and superseding Rev. Procs. 85-36 and 85-37, 1985-2 C.B. 434 and 438. Exclusive procedures for taxpayers to obtain expeditious consent to change method of accounting to an accrual method for: (1) taxpayers required to use inventories in order to clearly reflect income, and (2) other taxpayers, respectively.
2. **Multi-year warranty contracts**
 - a. Announcement 92-93, 1992-27 I.R.B. 13 (6/17/92). The IRS plans to issue a revenue procedure to allow taxpayers to change their method of accounting for multi-year insurance policies purchased in connection with the sale of multi-year motor vehicle service warranties, to allow amortizing the cost of the policies over the term of the policies.
 - b. Announcement 92-127, 1992-38 I.R.B. 41. IRS settlement offer to automobile dealers on the method of accounting for extended service warranties issued in connection with motor vehicle sales.

- c. Rev. Proc. 92-98, 1992-48 I.R.B. 10 (11/13/92). Procedures by which accrual method automobile (and other consumer durable good) manufacturers, wholesalers and retailers may, in certain specified and limited circumstances, include a portion of an advance payment related to the sale of a multi-year service warranty contract in gross income over the life of the service warranty obligation. See Rev. Proc. 92-97, 1992-48 I.R.B. 7 (11/13/92) (procedures for changing method of accounting for costs of multi-year insurance policies purchased in conjunction with the sale of such warranties to customers).
- 3. **Rev. Rul. 92-65**, 1992-35 I.R.B. 6 (8/12/92), modifying Rev. Rul. 91-30, 1991-1 C.B. 61. The portion of Rev. Rul. 91-30 that holds a personal service corporation that performs veterinary services to be performing § 448 "health" services and requires it (a) under § 11(b)(2) to use the 34 % tax rate and (b) under § 441(i) to use the calendar year, will not be applied to taxable years beginning prior to 5/13/91 (with additional time for meeting the calendar year requirement).

B. Inventories

- 1. **Rev. Proc. 92-79**, 1992-39 I.R.B. 13; "Alternative LIFO Method" for automobile dealers, which is a comprehensive dollar-value, link-chain LIFO method that encompasses several LIFO sub-methods. The revenue procedure contains a 14-step simplified computational methodology.

C. Installment Method

- 1. **Applegate v. Commissioner**, 980 F.2d 1125, 92-2 U.S.T.C. ¶ 50, 623 (7th Cir. 12/7/92). Taxpayer (landlord farmer) was entitled to report the sale of grain crop share rentals to a grain elevator pursuant to "price later" contracts under the installment method. These contracts did not specify a purchase price, but the sellers (taxpayers) could "demand" at any time within one year that the buyer pay its "regular bid price" in effect on the demand date. The court held these contracts not to be § 453(f)(4)(A) evidences of indebtedness "payable on demand" because the "demand" had the function not only of triggering the buyer's obligation to pay, but also of establishing the price. The seller's "valuable right" to wait until he believes the price is best before making demand differentiates these "price later" contracts from the "payable on demand" options of an obligee to require immediate payment of an amount specified in (or computable from) the terms of the instrument.

2. **Frane v. Commissioner**, 93-2 U.S.T.C. ¶50,386 (8th Cir. 7/6/93, aff'g and rev'g 98 T.C. 341 (1992)). The automatic cancellation of an installment obligation between related parties at the death of the obligee [the "self-canceling installment note or the "death-terminating installment note"] results in gain recognition under §453B equal to the difference between the basis of the obligation and its face value. The cancellation is treated as a "transmission of installment obligations at death" under §453B(c), not as a §453B(f) "disposition," so the gain is treated as §691 income in respect of a decedent and taxed to the estate, under §§691(a)(5)(iii) and 691(a)(2). (The Tax Court had held the gain to be includible in the decedent's last tax return.)

D. Year of Receipt or Deduction

1. **T.D. 8459**, final regulations under §468B, relating to the tax treatment of transfers to settlement funds, as well as income earned, and distributions made, by such funds (12/18/92). A qualified settlement fund is (1) established or approved by a governmental authority (including an agency or court), (2) established to resolve claims under CERCLA, tort, contract breach, law violation or otherwise designated by Commissioner, and (3) a trust under state law or segregated from other assets of the transferor. Note that both designated and qualified settlement funds are currently taxed on income at the maximum §1(e) rate in effect for the year, now 39.6%.
2. **Rev. Proc. 93-34**, 1993-28 I.R.B. (8/10/93). Provides rules under which a §468B(d)(2) designated settlement fund or a Reg. §1.468B-1 qualified settlement fund will be considered "a party to the suit or agreement" for purposes of the §130 exclusion by an assignee from gross income of amount it receives (for assuming the liability of a party to the suit or agreement to make described periodic payments of damages to a claimant).
3. **Rev. Rul. 92-51**, 1992-27 I.R.B. 9 (6/12/92), rendering obsolete Rev. Ruls. 71-119 [1971-1 C.B. 163], 70-567 [1970-2 C.B. 133], and 64-131 (third fact situation) [1964-1 C.B. 485]. This ruling applies § 468B(g), which provides that nothing in any provision of law shall be construed as providing that an escrow account, settlement fund, or similar fund is not subject to current income tax.

4. **Roanoke Gas Co. v. United States**, 977 F.2d 131, 92-2 U.S.T.C. ¶ 50,496 (4th Cir. 10/1/92). Utility company's obligation to reduce its rates through a future rate adjustment, even if imposed to account for past overcharges, relates merely to future income, and was not a liability giving rise to an immediately deductible expense. The court rejected taxpayer's argument that an immediate tax deduction was proper because it was based upon the regulator's order requiring refunds, which refunds were (for financial accounting purposes) immediately deductible from income.
5. **Southwestern Energy Co. v. Commissioner**, 100 T.C. No. 32 (6/1/93). Follows **Roanoke Gas Co. v. United States**, 977 F.2d 131, 92-2 U.S.T.C. ¶ 50,496 (4th Cir. 1992), in holding that utility's obligation to reduce rates through a future rate reduction was not a liability that gives rise to an immediately deductible expense.

II. Business Income and Deductions

A. Depreciation, Depletion and Credits

1. Intangibles

- a. **Newark Morning Ledger Co. v. United States**, 945 F.2d 555, 91-2 U.S.T.C. ¶ 50,451 (3d Cir. 9/12/91), cert. granted, 112 S. Ct. 1583 (4/6/92), rev'g and remanding 734 F. Supp. 176, 90-1 U.S.T.C. ¶ 50,193 (D. N.J. 1990). Depreciation taken on the intangible asset "paid subscribers," which arose from existing subscriber relationships with 460,000 at-will subscribers, to which \$67 million of the \$328 million adjusted tax basis was allocated (in a former §§ 332-334(b)(2) liquidation in 1977) was denied because the taxpayer could not demonstrate that the value of the paid subscribers was "separate and distinct from goodwill" on the ground that at-will subscribers (as distinct from contractually-bound subscribers) give rise to a mere "expectation of continued patronage," which is the essence of goodwill. The court refused to follow **Colorado National Bankshares, Inc. v. Commissioner**, T.C. Memo. 1990 - 495, because it and other cases "represent no more than a minority strand amid the phalanx of cases . . . which support the Service's position." The Third Circuit also rejected valuation of customer lists based on the stream of income to be generated in future years; the cost basis value of the customer lists was roughly \$3 million as opposed to the \$67 million value of the income stream.

- b. Newark Morning Ledger Co. v. United States, 93-1 U.S.T.C. ¶ 50,228 (U.S. 4/20/93) (5-4), rev'g and remanding 945 F.2d 555, 91-2 U.S.T.C. ¶ 50,451 (3d Cir. 1991). Justice Blackmun held that "paid subscribers" [going beyond a mere list of customers] was an intangible asset having an ascertainable value and a limited useful life (the duration of which can be ascertained with reasonable accuracy) and, therefore, was depreciable. The Court rejected the IRS argument that the asset "paid subscribers" was part of goodwill as a matter of law. The Court found the issue of separability from goodwill to be a question of fact, i.e., whether the asset is capable of being valued and whether that value diminishes over time, and on this issue the Government presented no evidence to refute taxpayer's methodology. The Court rejected the Government's suggestion that the \$67.8 million allocated to this asset was overstated (and that a \$3 million subscription drive could generate the same number of subscribers). Justice Souter in dissent held the asset to be one of "the expectancy of continued patronage" from existing customers, which is part of the definition of goodwill.
- c. 1993 Act §13261 provides 15-year amortization under new Code §197 for intangibles acquired after 8/10/93 and held in connection with a trade or business or income producing activity ("section 197 intangibles"). Statute contains election to apply to property acquired after 7/25/91. Section 197 intangibles include goodwill and franchises, as well as covenants not to compete entered into in connection with the acquisition of a trade or business; however, the current §162 deduction treatment under §1253(d)(1) of contingent amounts paid for franchises is not affected.
- d. Canterbury v. Commissioner, 99 T.C. No. 12 (8/17/92). Taxpayers acquired a number of McDonald's franchises, each by purchase of an existing McDonald's restaurant operation for a purchase price in excess of the value of tangible assets. The Tax Court rejected Commissioner's determination that the portion of each such excess allocable to § 1253 amortizable franchise fees should be limited to the amount charged by the franchisor to the original franchisee [\$950 until 1960, \$12,500 between 1960 and 1987, and \$22,500 since 1987]. All intangible assets acquired, including goodwill (except for a relatively small allocation to going-concern value), were found to inhere in the franchise.

- e. Colorado National Bankshares, Inc. v. Commissioner, 93-1 U.S.T.C. ¶ 50,077 (10th Cir. 1/25/93) aff'g T.C. Memo. 1990-495. Taxpayer was permitted to amortize "core deposits" of acquired banks because they were separable from good will and taxpayer demonstrated that they had value and a limited useful life.
 - f. Jefferson-Pilot Corp. v. Commissioner, 93-1 U.S.T.C. ¶ 50,348 (4th Cir. 6/14/93), aff'g 98 T.C. 435 (1992). FCC licenses are within the § 1253 definition of "franchise" which, in § 1253(b)(1), includes both commercial franchises and government grants of licenses.
 - g. Stokely USA, Inc. v. Commissioner, 100 T.C. No.29 (5/24/93). Taxpayer allowed §1253 amortization on the "Stokely" trademark it purchased for a lump-sum payment because the transferor retained the significant right to prevent taxpayer's use of the trademark in connection with pork and beans for 20 years.
2. AMT Preference for Excess Percentage Depletion
- a. United States v. Hill, 113 S. Ct. 941, 93-1 U.S.T.C. ¶ 50,037 (U.S. 1/25/93) (9-0), rev'g 945 F.2d 1529, 91-2 U.S.T.C. ¶ 50,475 (Fed. Cir. 1991). In computing the § 57(a)(8) item of AMT tax preference for the excess of percentage depletion over the adjusted basis of the property, the adjusted basis does not include the unrecovered costs of depreciable tangible items used to exploit the mineral deposits. Judge Souter, speaking for the Court, used the analogy of an apartment building and the land it sits on to show that the mineral property and the depreciable tangible property are separate assets for § 1016 purposes.
 - b. The Comprehensive National Energy Policy Act of 1992 (Pub. L. No. 102-486) repeals the excess percentage depletion AMT preference for oil and gas and limits the excess intangible drilling costs AMT preference. Act § 1915, Code § 57(a)(1) and (2).
3. Rev. Rul. 92-72, 1992-37 I.R.B. 5. Circumstances under which a taxpayer is not considered to be selling oil or natural gas through a related retailer, and therefore would not be considered a retailer itself for § 613A(d)(2) percentage depletion purposes.
4. T.D. 8437, final regulations under § 613A, clarifying the circumstances under which percentage depletion is available in the case of oil and gas wells (9/22/92).

5. **Rev. Rul. 93-26**, 1993-15 I.R.B. 5. An integrated oil company that has begun under § 291(b) to amortize 30% of its IDC over a 60-month period must continue to amortize any undeducted IDC even though it ceases to be an integrated oil company. Should the integrated oil company dispose of such property during the 60-month amortization period, the unamortized portion of the IDC amount is included in basis for determining gain or loss upon the disposition and is not subject to continued amortization.
6. **Nalle v. Commissioner**, 99 T.C. No. 9 (8/5/92), *rev'd*, 93-2 U.S.T.C. ¶50,468 (5th Cir. 8/16/93). **Tax Court**: ITC claimed on rehabilitated buildings was disallowed because, prior to the start of the rehabilitation process, the eight buildings were relocated from various cities in Texas to a business park in Austin -- even though 75% or more of the existing exterior walls were "retained"-- because § 48(g)(1)(A)(iii) requires the walls be "retained in place" and subsequently-proposed (and later adopted as final) Reg. § 1.48-12(b)(5) provides that a relocated building does not qualify. **Fifth Circuit**: Rehab. credit under §48(g) [later transferred to §47(c), and amended] allowed to "qualified rehabilitated [40-year old] buildings" that had been relocated (by being moved up to 80 miles) to an office park in Austin, TX. Reg. §1.48-12(b)(5) (disallowing the credit for relocated buildings) was held to be invalid in that it was not a reasonable interpretation of the statutory "external wall test" ("75% or more of the external walls of [the building] are retained in place as external walls in the rehabilitative process"). The court also found the retroactive application of the regulation to be "troubling," and refused to require taxpayers "to examine the legislative history before relying on the plain-spoken word of Congress..."
7. **Pacific Enterprises v. Commissioner**, 101 T.C. (7/12/93). Taxpayer's reclassification of an amount of "working gas" (inventory) as "cushion gas" constituted an impermissible change of accounting method (which would have resulted in deferring \$26 million of income until abandonment of the reservoir), which Commissioner disallowed under §446(e) because approval was not requested. "Cushion gas" (for reservoirs) and "line pack gas" (for pipelines) are capital assets, not FIFO inventory as IRS contended. The volume of nonreversible cushion gas was determined, based upon "economic recoverability" (as opposed to "physical recoverability"), and this nonrecoverable volume is subject to depreciation.
8. **Proposed regulations** (PS-55-89) under § 168(i)(4), relating to MACRS election to group assets in one or more general asset accounts (F.R. 8/31/92).

9. **T.D. 8455**, final regulations under § 179, relating to the election to expense depreciable business assets (12/23/92).
10. **PS-19-92**, proposed regulations under § 42, concerning the low-income housing credit (F.R. 12/29/92).
11. **The Comprehensive National Energy Policy Act of 1992** (Pub. IL. No. 102-486) makes permanent the 10% tax credit for business investment in solar and geothermal energy, but does not extend the § 29 tax credit for non-conventional fuels. Act §§ 1916, 1918.
12. **1993 Act §13131** expands and simplifies Code §32 earned income tax credit, effective 1/1/94.
13. **1993 Act §13151** increases the Code §168 recovery period for nonresidential real property from 31.5 years to 39 years, effective for property placed in service after 5/13/93.
14. **1993 Act §13443** adds new Code §45B which gives restaurant owners a tax credit to offset the cost of paying the 7.65% FICA tax on tips received by servers, effective for taxes paid after 1993.
15. **1993 Act §13111** extends the §41 credit R&E credit, retroactively effective for expenditures made between 7/1/92 and 6/30/95.
16. **1993 Act §13012** extends the §51 target jobs credit, effective for targeted employees who began work after 6/30/92 and on or before 12/31/94.
17. **1993 Act §13142** permanently extends the §42 low-income housing credit, retroactively to 7/30/92.
18. **1993 Act §13301-4** add new Code §§1391-1397D, which provides tax incentives for "empowerment zones" and "enterprise communities," effective 8/10/93.

B. Expenses

1. Home Office

- a. **Soliman v. Commissioner**, 935 F.2d 52,91-1 U.S.T.C. ¶ 50,291 (4th Cir. 6/5/91) (2-1), cert. granted 3/23/92, aff'g 94 T.C. 20 (1990) (reviewed). Anesthesiologist's home office expenses were deductible under § 280A(c)(1) because the home office was his "principal place of business" under the Tax Court's new "facts and circumstances" test which replaced the "focal point" test. The

taxpayer spent a substantial amount of time in that office performing essential managerial/administrative functions and there was no other location available for performance of such functions. Dissent on the ground taxpayer did not do his most important work at his home office nor did he spend the majority of his time there, following Pomarantz v. Commissioner, 867 F.2d 495, 88-2 U.S.T.C. ¶ 9588(9th Cir. 1988).

b. Commissioner v. Soliman, 113 S. Ct. 701, 93-1 U.S.T.C. ¶ 50,014 (U.S. 1/12/93) (8-1), rev'g 91-1 U.S.T.C. ¶ 50,291 (4th Cir. 1991). The principal place of business for purposes of the § 280A(c)(1)(A) exception to the nondeductibility of home office expenses is to be determined by "the relative importance of the activities performed at each business location and the time spent at each place." An anesthesiologist whose actual treatments were performed in hospitals, and who spent 30-35 hours per week in hospitals -- as opposed to 10-15 hours per week at home -- did not qualify for the exception.

- (1) The Court (Kennedy) noted that "the statute does not allow for a deduction whenever a home office may be characterized as legitimate." It held that "the point where goods and services are delivered [i.e., the focal point] must be given great weight," but that "no one test is determinative in every case." The Court further held that the "essentiality" of the functions performed in the home office should not have "much weight," nor should "the availability of alternative space" have any bearing whatsoever on the "principal place of business" inquiry.
- (2) Justice Blackmun, concurring, noted that "principal" compels a comparison, and the bulk of taxpayer's time was spent in hospitals and the greater part of his remuneration was earned there.
- (3) Justice Thomas, concurring in the judgment, proposed a brighter line test, i.e., the "focal point" test, or (as he would call it) the "place of sale or service" test, with reversion to a "totality-of-the-circumstances analysis" only where the home office is one of several locations where goods or services are delivered."

(4) Justice Stevens dissented on the ground that Congress intended to allow the deduction to "self-employed taxpayers who manage their business from a home office," but do not meet or deal there with patients, clients or customers. Justice Stevens stated that "the principal office of a self-employed person's business would seem to me to be the most typical example" and cited an example contained in Prop. Reg. § 1.280A-2(b)(3), allowing the deduction to "the outside salesperson who has no office space except at home and spends a substantial amount of time on paperwork at home."

c. Notice 93-12, 1993-8 I.R.B. 46 (2/8/93). IRS guidance for home office deductions in light of the Soliman decision: (1) Proposed Reg. § 1.280A-2(b)(3) will be conformed to that decision, i.e., outside salesperson who spends 30 hours per week visiting customers and 12 hours per week working at his home office *cannot* deduct expenses for the business use of his home; (2) the IRS will not challenge 1991 or earlier home office deductions if they reasonably fell within the pre-Soliman Publication 587 (Business Use of Your Home) discussion or the example at the end of pre-Soliman proposed regulations; and (3) the IRS will waive 1992 estimated tax penalties to the extent they were attributable to the loss of home office deductions for which taxpayers would have qualified under pre-Soliman authority.

2. Capitalization and INDOPCO

a. Rev. Rul. 92-80, 1992-39 I.R.B. 7. The INDOPCO, Inc. v. Commissioner, 112 S. Ct. 1039, 92-1 U.S.T.C. ¶ 50,113 (U.S. 2/26/92), decision does not affect the treatment of advertising costs under § 162(a). "These costs are generally deductible . . . even though advertising may have some future effect on business activities, as in the case of institutional or goodwill advertising."

b. TAM 9240004 under §§ 263 and 263A (6/29/92). Taxpayer must capitalize the costs incurred for the removal and replacement of asbestos insulation on machines because the removal and replacement made the machines more readily marketable. The TAM cited the INDOPCO, Inc. case.

- c. TAM 9315004 (12/17/92). The costs of an environmental cleanup of PCB soil contamination were capital expenditures -- rather than currently deductible business expenses -- because the costs were significant relative to taxpayer's overall investment and were incurred under a long-term systematic plan of rehabilitation and restoration. Capitalized costs may be added to the cost of depreciable facilities.
- d. Victory Markets, Inc. v. Commissioner, 99 T.C. No. 34 (12/23/92). Deduction of taxpayer target's expenses under § 162 in a successful takeover was denied and those expenses required to be capitalized because the takeover was not hostile and it resulted in long-term benefits to taxpayer. The court followed INDOPCO because the facts of the two cases are "strikingly similar"; the court did not address taxpayer's argument that INDOPCO should be narrowly construed to apply to "friendly" acquisitions only.
- e. T.D. 8482, final regulations under §263A, relating to accounting for costs incurred in producing property and acquiring property for resale (8/6/93). See, also, IA-64-91, proposed amendments to §263A regulations, relating to exceptions to the capitalization of "handling costs" (F.R. 8/9/93).

3. Captive Insurance

- a. Sears, Roebuck & Co. v. Commissioner, 972 F.2d 858, 92-2 U.S.T.C. ¶ 50,426(7th Cir. 8/18/92), aff'g on this issue 96 T.C. 61 (1991). A trier of fact could have properly concluded that the transactions between Sears and Allstate, its wholly-owned subsidiary -- characterized by the parties as "insurance" -- had substance as "insurance" independent of tax consequences. The court rejected the Helvering v. Le Gierse, 312 U.S. 531 (1941), definition of insurance ["risk-shifting" and "risk distribution"] in favor of the test as to whether the transaction "has some substance independent of tax effects," Judge Easterbrook going on to note that "it is a blunder to treat a phrase in an opinion as if it were statutory language." The court noted that corporations do not insure primarily to shift risks, but "to spread the costs of casualties over time," particularly in light of the fact that much of the insurance sold to corporations is experience-rated.

- b. AMERCO, Inc. v. Commissioner, 979 F.2d 162, 92-2 U.S.T.C. ¶ 50,571 (9th Cir. 11/5/92). Parent and subsidiaries can shift risk to a captive insurer where that insurer has significant unrelated business (related taxpayers' share of insurer's business was 26%-48%; unrelated business was 52%-74%). Harper Group v. Commissioner, 979 F.2d 1341, 92-2 U.S.T.C. ¶ 50,572 (9th Cir. 11/5/92), follows the AMERCO case despite unrelated business of only 29% -33% because it cannot be said Tax Court "committed clear error."
 - c. Ocean Drilling & Exploration Co. v. United States, 24 Cl. Ct. 714, 92-1 U.S.T.C. ¶ 50,018 (Cl. Ct. 12/18/91), aff'd per curiam, 93-1 U.S.T.C. ¶ 50,160 (Fed. Cir. 3/9/93). Unrelated business (44% and 66% during the years in issue) written by a Bermuda captive insurance company was sufficient to reduce significantly the risk to which the insured parent was exposed, and thus transferred the bulk of the risk to the captive insurance company. Aff'd per curiam, 93-1 U.S.T.C. ¶ 50,160 (Fed. Cir. 3/9/93).
 - d. Rev. Rul. 92-93, 1992-45 I.R.B. 6, distinguishing Rev. Rul. 77-316, 1977-2 C.B. 53. Parent corporation may deduct premiums paid to its insurance company subsidiary for group-term life insurance on parent's employees under § 162, and the employees may exclude from gross income under § 79 an amount equal to the cost of \$50,000 of life insurance coverage, because the arrangement does not involve self-insurance. These holdings also apply to accident and health insurance.
- 4. Rev. Proc. 92-56, 1992-28 I.R.B. 7. Administratively continues for another 18 months (through 1993 for calendar year taxpayers) the temporary modification of Reg. § 1.861-8(e)(3), which allocates R & D expenditures between U.S. and foreign source income based on sales. The rules had been modified by legislative enactments between 1981 and mid-1992.
 - 5. Kliethermes v. United States, 27 Fed. Cl. 111, 92-2 U.S.T.C. ¶ 50,584 (Fed. Cl. 11/13/92). Uncompensated officer/50% shareholder could not deduct unreimbursed expenses incurred on behalf of the corporation under § 162 because (being unpaid) he was not engaged in a trade or business and the Deputy v. du Pont, 308 U.S. 488, 40-1 U.S.T.C. ¶ 9161 (1939), line of cases holds that a shareholder is not entitled to deduct payments of corporate expenses.

6. **Excess-Parachute Payments**

- a. **Powell v. Commissioner**, 100 T.C. No. 6 (2/2/93). Employee severance payment of \$3,475,000 made in May 1985 by corporate employer to its president/taxpayer (subsequent to a merger agreement in which corporate employer was acquired) was not an excess parachute payment (nondeductible under § 280G and subject to excise tax under § 4999) because the payment was made pursuant to an employment agreement that was not "entered into, renewed, or amended in any significant aspect after June 14, 1984." One-half of a stock option cancellation payment of \$1,525,000 was potentially subject to tax as a parachute payment, but it did not equal or exceed three times taxpayer's base amount of \$309,949.
 - b. **Balch v. Commissioner**, 100 T.C. No. 21 (4/12/93). Consulting contract payments to former senior executives of acquired corporation constituted § 280G "excess parachute payments" and are both nondeductible and subject to the § 4999 excise tax. (The acquisition took place on 6/14/84 and the original severance pay agreements were entered into on the next day under the mistaken belief that the effective date for the 1984 Act golden parachute provision was for agreements entered into after 6/15/84. The effective date, in reality, was for agreements entered into after 6/14/84, so the severance pay agreements were subject to the golden parachute provisions. The consulting contracts replaced the severance pay agreements after the parties learned of their mistake.)
7. **Proposed amendments** of regulations (PS-2-89) under § 174, relating to the definition of "research or experimental expenditures" and the interpretation of the § 174(e) reasonableness requirement, added in 1989 (F.R. 3/24/93). Withdraws 1989 proposed regulation position that excludes from the definition of "research or experimental expenditures" any costs paid or incurred after the "basic design specification" of the product or property was met (unless for significant design changes) because the Service responded favorably to arguments that progress is often achieved in small, incremental steps.
8. **Placid Oil Co. v. IRS**, 93-1 U.S.T.C. ¶ 50,234 (5th Cir. 4/15/93) rev'g and remanding 92-1 U.S.T.C. ¶ 50,051 (N.D. Tex. 1991). Professional fees and expenses paid in bankruptcy proceedings should be analyzed individually to segregate among currently deductible, amortizable and nonamortizable categories.

9. **Rugby Productions Ltd. v. Commissioner**, 100 T.C. No. 35 (6/14/93). Personal service corporation owned by Joan Rivers and her late spouse was denied deductions for the premiums on a disability income insurance policy on Joan Rivers (but payable to the corporation) because any proceeds would be tax-exempt under §104(a)(3), and §265(a)(1) denies deductibility of expenditures paid to recover tax-exempt income.
10. **1993 Act §13209** reduces from 80% to 50% the Code §274(n) allowance for deduction of meals and entertainment, effective for years beginning after 1993.
12. **1993 Act §13209** denies deduction of club dues by amending §274(a), effective for years beginning after 1993.
13. **1993 Act §13272** denies under Code §274(m) any business travel deduction for spouses and dependents on their nonbusiness travel, for tax years beginning after 1993.
14. **1993 Act §13222** denies deduction for lobbying expenses by adding new Code §§170(f)(9) and 6033(e) and amending §162(e), effective for expenses incurred after 1993. See, Sheppard, "The New Etiquette of Lobbying," Tax Notes, Aug. 30, 1993, p. 1176; Alexander, "The New Rules Limiting Deductibility of Lobbying Expenses," Tax Notes, Sept. 30, 1993, p. 1509.
15. **1993 Act §13116** allows elections under Code §179 to deduct \$17,500 of business investment, effective for property placed in service in tax years beginning after 1992.

C. Losses and At Risk

1. **In re Antonelli**, 92-2 U.S.T.C. ¶ 50,619 (Bankr. D. Md. 11/6/92). Section 469 passive activity losses of an individual debtor in a Chapter 11 proceeding were not among the tax attributes to which the bankruptcy estate succeeds under § 1398(g), in the absence of regulations that so provide. But see, IA-5-92, proposed regulations under § 1398 that would so provide (F.R. 11/9/92).

2. **Proposed regulations** (IA-5-92) under § 1398, relating to the application of §§ 469 and 465 to the bankruptcy estates of individuals (F.R. 11/9/92). These proposed regulations would add § 469 PALs and § 465 at risk losses to those listed in § 1398(g), under which the estate succeeds to certain enumerated attributes of the individual bankrupt (which, in turn, revert to the debtor upon termination of the bankruptcy estate). Anti-avoidance provisions in Prop. Reg. § 1.469-4(h) permit the IRS to regroup activities to prevent tax avoidance.
3. **Woodall v. Commissioner**, 964 F.2d 361, 92-2 U.S.T.C. ¶ 50,363 (5th Cir. 6/12/92). Claimed § 165 partnership loss deduction of \$78,441 on nightclub fire was reduced to \$8,541 because schedule L balance sheet attached to nightclub's partnership tax return stated that \$8,451 was the adjusted basis of all depreciable partnership assets at the beginning of the year. **Portillo v. Commissioner**, 932 F.2d 1128, 91-2 U.S.T.C. ¶ 50,304 (5th Cir. 1991), distinguished on the ground that the IRS here relied upon 'taxpayer's statement, not another's statement.
4. **Black Gold Energy Corp. v. Commissioner**, 99 T.C. No. 24(10/15/92). Accrual basis taxpayer may not claim a § 166 bad debt loss as a guarantor, based upon its delivery of its own promissory note to the creditor in settlement of its guarantee obligation. The court follows **Putnam v. Commissioner**, 352 U.S. 82, 57-1 U.S.T.C. ¶ 9200 (1956), which held the guarantor's loss to arise from the inability of the debtor to reimburse the guarantor -- so that the loss cannot arise any earlier than when the guarantor makes payment to the creditor, Reg. § 1.166-9(a).
5. **Litwin v. United States**, 93-1 U.S.T.C. ¶ 50,041 (10th Cir. 1/9/93). Taxpayer permitted § 166(a) bad debt deductions for loans and guarantees of third-party loans to his start-up corporation because his dominant motivation was not to protect his investment [the loans guaranteed far exceeded his investment], but to earn a salaried income from the company [although he deferred his salary for the three years before the corporation became bankrupt]. **United States v. Generes**, 72-1 U.S.T.C. ¶ 9259 (U.S. 1972), distinguished.
6. **Garner v. Commissioner**, 93-1 U.S.T.C. ¶ 50,167 (5th Cir. 3/23/93). Corporate officer/sole shareholder failed to prove that his personal guaranty of more than \$1 million of corporate obligations was made for the dominant motive of protecting his \$30,000 to \$50,000 salary, as opposed to protecting his investment in the corporation, so § 166 business bad debt deductions were disallowed because the bad debt was a nonbusiness obligation.

7. **1993 Act §13143** provides relief from the Code §469 passive activity loss rules for real estate professionals, effective for tax years beginning after 1993.

D. Business Income

1. **T.D. 8454**, final regulations under § 56(g), relating to adjusted current earnings for AMT purposes (12/18/92).
2. **Rev. Rul. 93-16**, 1993-8 I.R.B. 5. An FAA project grant to a corporate public-use airport owner is a § 118 nonshareholder contribution to capital, and the corporation must reduce the basis of its property under § 362(c)(2) rules.
3. **1993 Act §13150** provides an election for business debtors to exclude from gross income under §108(a) any discharge of "qualified real property business indebtedness," effective 1/1/93.
4. **Worden v. Commissioner**, (10th Cir. 9/93). An insurance agent is not taxable on commissions he contractually waived with his client (having them remit to him, when the policy is first taken out, that amount of the premium net of his commission). He reported his override commissions attributable to the policy's renewal. See, Simmons, "Tenth Circuit Allows Waiver of Life Insurance Commission," Tax Notes, Oct. 11, 1993, p. 237.
5. **Mark D. Collins**, 93-2 U.S.T.C. ¶50,486 (2nd Cir. 8/30/93). Ticket vendor at off-track parlor had gross income when he punched up tickets to gamble in his own name. Although gambling losses were incurred they could not offset embezzlement income.

III. Capital Gain and Loss

- A. **Dial v. Commissioner**, 968 F.2d 898, 92-2 U.S.T.C. ¶ 50,364 (9th Cir. 6/30/92). Affirms summary judgment holding treasury bill futures contracts to be capital assets, even though former 1221(5) [repealed by 1981 ERTA, but in effect during tax years in question] excepted any "obligation of the United States" from capital-asset treatment, because the futures contracts are not "hedges." **Arkansas Best Corp. v. Commissioner**, 485 U.S. 212, 88-1 U.S.T.C. ¶ 9210 (U.S. 1988), followed.

- B. Eck v. Commissioner, 99 T.C. 1 (7/6/92). Christmas tree farmer who sold individual trees to retail customers [by use of a "Tree Cutting Permit" arrangement before payment] did not retain an economic interest in the trees within the meaning of § 631(b) in order to be entitled to capital gains treatment on the sales; no binding contract was entered into prior to the cutting.
- C. Aizawa v. Commissioner, 99 T.C. No. 10 (8/6/92). Taxpayers owned rental property with an original cost in 1981 of \$120,000 and an adjusted basis of \$100,091.38. The property was subject to a recourse purchase money (seller-financed) mortgage of \$90,000. In 1987, the property was sold by the sellers at a foreclosure sale for \$72,700, and the sellers obtained a deficiency judgment of \$60,800 [\$133,500 minus \$72,700] against the cash-basis taxpayers. [The \$133,500 consists of \$90,000 mortgage principal; \$18,000 accrued and unpaid interest; \$25,000 attorney's fees; and \$500 court costs.] In view of the clear separation between the foreclosure sale and the unpaid recourse liability, the amount realized was equal to the \$72,700 proceeds of the foreclosure sale, resulting in a loss on the sale of \$27,391.38, with future payments of principal nondeductible and any subsequent discharge of the indebtedness treated as income (to the extent of borrowed funds that have not been repaid). The Commissioner argued for a loss of \$10,091.38, contending that the amount realized was the \$90,000 unpaid mortgage principal; the opinion indicated that this might be proper where "the unpaid recourse liability for mortgage principal [does not] survive as part of a deficiency judgment." Taxpayer contended that the \$60,800 deficiency judgment should be deducted from the \$90,000 mortgage principal to arrive at an amount realized of \$29,200, for a loss of \$70,891.38; this has the defect of not having added the unpaid accrued interest, attorneys fees, and court costs to unpaid mortgage principal, or (alternatively) of omitting them from the calculated deficiency judgment.
- D. Williford v. Commissioner, T.C. Memo 1992-450 (8/10/92). Collector/part-time art dealer who sold eight paintings for a profit of \$1,757,875 from his private collection in two years was entitled to capital gains treatment because he did not advertise, held the art for several years and devoted minimal time and effort to the sales. Negligence penalty applied for deducting expenses relating to taxpayer's investment paintings on his Schedule C.
- E. Standley v. Commissioner, 99 T.C. No. 13 (8/18/92). Amounts received through a "dairy termination program" (in part to compensate farmers who, under the program, sold dairy herd cows for slaughter) in excess of the fair market value of cows for dairy purposes are ordinary income, and not § 1231 capital gains income, because the excess was intended to replace receipts from the milk production operation. Goodwill with respect to the operation of a dairy farm was not sold because taxpayer only agreed not to be a dairy farmer for five years.

- F. **FI-31-92**, proposed Regulation § 1.1001-3, relating to the treatment of modifications of debt instruments as 1001 realization events (F.R. 12/2/92), subsequent to Cottage Savings Ass'n v. Commissioner, 111 S. Ct. 1503(1991). Defines "modification" [¶(c)] and provides rules for determination of whether common types of modifications are significant [¶(e)]; only a significant modification of a debt will be a taxable event, and these include changes in annual interest rate of more than .25% and extensions of maturity by five years or more (or 1/2 of original term, if shorter).

- G. **TAM 9302001** (8/31/92). Insolvent owners of apartment complex [transferred to the lender in exchange for cancellation of a nonrecourse debt to which the property was subject] realized gain in an amount equal to the excess of the balance of the debt over their adjusted basis in the property. The § 108(a)(1)(B) insolvency exclusion does not apply to gains from property dispositions.

- H. **In re Mehr**, 93-1 U.S.T.C. ¶ 50,091 (Bankr. D. N.J. 1/28/93). The bankruptcy estate of individual debtors at least 55 years old could not (under § 121) exclude \$125,000 of gain from the sale of their personal residence owned by the estate. The estate's succession under § 1398(g) to the tax attributes of the debtor, including basis, holding period and character of assets (§ 1398(g)(6)), was not meant to entitle the estate to take the § 121 election on behalf of the debtor.

- I. **Murphy v. United States**, 93-1 U.S.T.C. ¶ 50,270 (9th Cir. 5/4/93). Section 1256 mark-to-market provision was held to be constitutional when gains inherent in commodity futures contract were taxed as if they were sold on the last business day of the year. The inherent gains were receivable by taxpayer daily, as a matter of right, under the Reg. § 1.451-2 constructive receipt doctrine.

- J. **Federal National Mortgage Assn. v. Commissioner**, 100 T.C. No. 36(6/17/93) (reviewed, unanimous). Taxpayer's sale and exchange of (1) regulated fixtures contracts on debt securities, (2) options on such regulated fixtures contracts, and (3) Treasury securities give rise to ordinary gains and losses because the transactions constituted hedges [or "microhedges" (which offset the risk that interest rates would increase -- an event which would reduce taxpayer's anticipated profit on particular transactions)]. These hedging transactions were held to be "an integral part of the system by which FNMA purchased and held mortgages," and were excluded from the definition of "capital asset" by § 1221(4); mortgage notes were held by FNMA in the ordinary course of banking, and the hedging transactions simply dealt with other types of notes receivable (which acted as surrogates for the mortgage notes and did not have to be the asset taxpayer intended to acquire). The court held that Corn Product Refining Co. v. Commissioner, 350 U.S. 46, 55-2 U.S.T.C. ¶ 9746 (1955), as interpreted by Arkansas Best Corp. v. Commissioner, 485 U.S. 212, 88-1 U.S.T.C. ¶ 9210 (1988), allows for broad interpretations of the five exceptions

under § 1221. See, Sheppard, "Tax Court's Fannie Mae Decision Makes the World Safe for Hedging," Tax Notes, June 28, 1993, p. 1736.

- K. 1993 Act prevents conversion of ordinary income to capital gains by adding new Code §1258, effective for transactions entered into after 4/30/93.
- L. 1993 Act §13113 adds new Code §1202 permitting taxpayers (other than C corporations) to exclude 50% of any gain on "qualified small-business stock" held for more than 5 years, effective for stock issued after 8/10/93.
- M. Stoller v. Commissioner, 93-1 U.S.T.C. ¶50,349 (D.C. Cir. 6/11/93), aff'g and rev'g T.C. Memo. 1990-659. Commodities trader's losses resulting from the "cancellation" of pre-1981 Act forward contracts and their replacement with new contracts having different delivery dates were ordinary losses, and not capital losses (as the Tax Court had found where a futures contract was closed by offsetting an opposite (buy/sell) contract because then the contract had been "sold or exchanged").

VI. Exempt Organizations and Charitable Giving

- A. Proposed amendments to regulations (EE-70-91) under § 512(b)(1), relating to the exclusion from unrelated business taxable income of income from interest rate swaps and currency swaps because it is "substantially similar [to] income from ordinary and routine investments in connection with a securities portfolio" (9/4/91). T.D. 8423, final regulations (F.R. 7/29/92).
- B. EE-74-92, proposed regulations under §§ 512 and 513, relating to whether sponsorship payments received by exempt organizations are unrelated business taxable income (F.R. 1/22/93).
- C. Thorne v. Commissioner, 99 T.C. 67(7/20/92). Trustee of charitable foundation was held liable for §§ 4944(a)(2) and 4945(a)(2) first-tier taxes, for knowingly making investments which jeopardized charitable purposes [depositing foundation corpus in unlicensed Bahamian bank] and making taxable expenditures [failing to exercise expenditure responsibility on grants], respectively, as well as the additional § 6684 penalty for willful and flagrant conduct.
- D. Rev. Proc. 92-59, 1992-29 I.R.B. 11. Guidelines for public interest law firms exempt under § 501(c)(3), including procedures under which a public interest law firm may accept fees for its services. Guidelines attempt to distinguish between "representation of a broad public interest" and "representation of . . . a private interest."

- E. State of Michigan v. United States, 802 F. Supp. 120, 92-2 U.S.T.C. ¶ 50,424 (W.D. Mich. 7/28/92). Trust guaranteeing payment of college tuition to children of parents who invested in the trust was not exempt from tax.
- F. Airlie Foundation, Inc. v. United States, 93-1 U.S.T.C. ¶ 50,355 (D.D.C. 5/19/93). Corporation's exempt status was revoked because its activities served the private interests of its executive director and part of its earning inured to the benefit of the executive director.
- G. Rev. Rul. 92-107 and 92-108, 1992-51 I.R.B. 4 and 5. A fund established and maintained by (1) a national organization and its local affiliates or (2) a community trust qualifies as a pooled income fund under § 642(c)(5) under certain circumstances. But see Notice 93-9, 1993-5 I.R.B. 13 (1/13/93) (announces revocation of Rev. Rul. 92-108, 1992-51 I.R.B. 5 (relating to pooled income funds), by Rev. Rul. 93-8, 1993-5 I.R.B. 6(1/13/93)).
- H. Announcement 93-2, 1993-2 I.R.B. (12/21/92). Proposed examination guidelines for colleges and universities for comment before publication in the Internal Revenue Manual.
- I. Greene v. United States, 806 F. Supp. 1165, 93-1 U.S.T.C. ¶ 50,033 (S.D. N.Y. 11/24/92). Charitable contribution to private operating foundation of only the long-term capital gains portion of commodities futures contracts [characterized by § 1256 as 60% long-term and 40% short-term capital gain], which were immediately sold by the private foundation, did not result in the taxation of the long-term capital gain to the donor on either the "anticipatory assignment of income" or the "step transaction" theory. The donors had received a 1974 private letter ruling that they were entitled to a full FMV charitable contribution deduction and no gain was to be recognized when the charity sold the futures contracts.
- J. PS-56-90, proposed regulations under § 514(c)(9)(E), relating to the application of the unrelated business income tax to partnerships in which one or more (but not all) of the partners are qualified tax-exempt organizations (including educational organizations and § 401 qualified trusts) (F.R. 12/30/92). See also EE-27-91, proposed regulations under § 514(c)(9) -- publication held up under OMB memorandum dated 1/25/93.

- K. Atlanta Athletic Club v. Commissioner, 93-1 U.S.T.C. ¶ 50,051 (11th Cir. 1/11/93), rev'g T.C. Memo. 1991-83. Tax-exempt social club was not subject to unrelated business income tax on its \$2.3 million gain from a land sale by reason of the § 512(a)(3)(D) nonrecognition exception where the land was used for club members' recreation and the sale proceeds were reinvested in recreational facilities. Direct, albeit desultory, use by occasional member joggers, kite-flyers, and partiers sufficed, inasmuch as there is no requirement that the members' recreational use be the "dominant use."
- L. Bond v. Commissioner, 100 T.C. No. 4 (1/19/93). Taxpayers were allowed a \$60,000 charitable contribution deduction for donating two blimps to a 170(c)(2) organization despite their failure to attach to the Form 8283 (completed and signed by a qualified appraiser) accompanying their tax return, the written appraisal report required by Reg. § 1.170A-13. The court held the reporting requirements to be "directory," and not "mandatory" despite the § 170(a) requirement that a deduction be allowed "only if verified under regulations prescribed by the Secretary."
- M. Moore Charitable Trust v. United States, 93-1 U.S.T.C. ¶ 50,090 (C.D. Ill. 1/19/93). Crop share rents received by tax-exempt charitable trust were excludable from UBIT as rent under § 512(b)(3)(A) because there was neither a joint venture with the tenant nor § 512(b)(3)(B)(ii) nonpassive rent that was dependent upon tenant's income "(other than an amount based on a fixed percentage . . . of receipts or sales)." Accord, Trust U/W Oblinger v. Commissioner, 100 T.C. No. 9 (2/23/93).
- N. Geisinger Health Plan v. Commissioner, 93-1 U.S.T.C. ¶ 50,123 (3d Cir. 2/8/93), rev'g and remanding T.C. Memo. 1991-649. HMO, standing alone, does not qualify for § 501(c)(3) status because it does not sufficiently benefit the community in addition to its subscribers. Remanded for determination of whether it was an integral part of a larger system of nonprofit entities. Geisinger Health Plan v. Commissioner, 100 T.C. No. 26 (5/3/93), on remand. HMO is not entitled to § 501(c)(3) exempt status as an integral part of a larger system of exempt affiliates (under Reg. § 1.502-1(b)) because its activities served the private purposes of its members (subscribers), and the court was unable to conclude that the HMO's "operations were so substantively and closely related to the exempt purposes of its affiliates that those private interests may be disregarded."
- O. United Cancer Council, Inc. v. Commissioner, 100 T.C. No. 11 (3/11/93). The Due Process Clause of the Fifth Amendment does not require the Commissioner to initiate judicial review before revoking in 1990, retroactively to 1984, her predecessor's 1969 favorable ruling letter that determined petitioner to be exempt under § 501(c)(3).

- P. TAM 9302002 (9/24/92). Corporation that provides fund-raising services to nonprofit organizations was not allowed to exclude from gross income a reserve for the anticipated amount of uncollectible pledges.
- Q. Hearst Corp. v. United States, 93-1 U.S.T.C. ¶ 50,303 (Fed. Cl. 5/4/93). Taxpayer failed to show the value of its Hearst Metrotome News File Library contributed to UCLA exceeded the \$1.8 million allowed by the IRS. Although the donation took place in four deliveries over the years 1981-1985, the step transaction doctrine was applied to make sales occurring after the first (1981) delivery irrelevant for comparison purposes because "the substance of the transaction [revealed] that the ultimate result was intended from the outset," following King Enterprises, Inc. v. United States, 418 F.2d 511, 69-2 U.S.T.C. ¶ 9720 (Ct. Cl. 1969) (which did not restrict the step transaction doctrine to situations where the parties have a binding commitment to take steps remaining after the first step).
- R. 1993 Act §13171 makes permanent the relief from AMT of gifts of appreciated property to charities by repealing Code §57(a)(6), effective for contributions made after 6/30/92 (tangible personal property) and for other property after 1993.
- S. 1993 Act §§13172-3 amend Code §170 and add new Code §§ 6115 and 6714 to require substantiation of all contributions of more than \$250 and written disclosure of all quid pro quo contributions in excess of \$75, effective 1/1/94.

VII. Interest

- A. Proposed regulations (IA-55-90) under § 6611, clarifying the period during which interest is allowed on overpayments that are credited against a taxpayer's liability for interest (F.R. 8/25/92).
- B. Rev. Rul. 92-91, 1992-44 I.R.B. 4. Homeowner's interest overcharges and recoveries by reason of financial institution's miscalculation of interest on adjustable rate mortgage are (1) deductible under § 163(h)(3) in the year of payment, and (2) includable in gross income in the year of recovery to the extent that the deduction of the overcharge reduced the homeowner's federal income tax in a prior tax year.
- C. Sharp v. United States, 27 Cl. Ct. 52, 92-2 U.S.T.C. ¶ 50,561 (Cl. Ct. 10/30/92). Investment interest that was disallowed under § 163(d) may be carried over from loss years, and the amount of investment interest that may be carried over is not limited by any taxable income cap. The court followed the "plain language of § 163(d)(2)" and disregarded contrary legislative history. Beyer v. Commissioner, 916 F.2d 153, 90-2 U.S.T.C. ¶ 50,536 (4th Cir. 1990), followed.

- D. T.D. 8447, final regulations under § 6621(c), regarding an increase in the rate of interest payable on large corporate underpayments (11/10/92).
- E. FI-189-84, proposed regulations on debt instruments with OID (F.R. 12/22/92).
- F. Consolidated Edison Co. of N.Y. v. United States, 93-1 U.S.T.C. ¶ 50,034 (S.D. N.Y. 11/19/92) (Wood, J.). Discounts (at 8% annual rates) given by New York City to induce taxpayer to prepay its real property tax installments constituted § 103 interest payments from N.Y.C. to taxpayer. The prepayments are to be treated as loans, with the entire undiscounted amounts of its tax liabilities deductible under § 164(a)(1) as property taxes paid or accrued.
- G. T.D. 8463, final regulations under § 1286, relating to OID treatment by taxpayers holding stripped bonds and stripped coupons (12/28/92).
- H. TAM 9307005 (10/27/92). The interest income received by an individual on a federal tax refund is includable in computing 163(d) net investment income, even though an overpayment of tax is not an investment in the usual sense.
- I. Security Bank Minnesota v. Commissioner, 93-1 U.S.T.C. ¶ 50,301 (8th Cir. 5/21/93)(2-1), aff'g 98 T.C. No. 4(1992). The § 1281(a)(2) mandatory accrual rules do not apply to bank loans bearing only stated interest, made in the ordinary course of business by a cash basis bank. The court found the general statutory scheme in which §§ 1281 through 1283 fit to be concerned with the treatment of discounted obligations, as was the legislative history to the Tax Reform Act of 1984.
- J. T.D. 8476, final regulations under §§ 147-150 and 103A, relating to arbitrage restrictions applicable to tax-exempt bonds issued by state and local governments (6/14/93).
- K. 1993 Act §13206(d) amends Code §163(d) by restricting net investment income treatment of capital gains, for purposes of deducting interest, unless taxpayer elects to reduce the amount of net capital gain eligible for the 28% maximum capital gains rate, effective for tax years beginning after 1992.
- L. Williams v. Commissioner, 93-2 U.S.T.C. ¶50,423 (7th Cir. 7/23/93). Interest and expense deduction arising from a payment made more than 6 months after a condominium sales contract was executed--where the second equal payment was to be made 30 years after--was disallowed because the condominium sale took place when the installment payment was made (on the contract settlement date), and not the earlier contract date.

- M. **Gatto v. Commissioner**, 93-2 U.S.T.C. ¶50,423 (9th Cir. 7/26/93). Interest deductions under §163 disallowed on loans made back to grantor/taxpayer by trusts he created and funded. Each fund transfer from grantor was soon followed by a return of the cash to the grantor in exchange for a promissory note bearing 20% interest.
- N. **Lenz v. Commissioner**, 101 T.C. No. 17 (9/30/93). The carryover of excess investment interest under §163(d) is not limited by the amount of the taxpayer's taxable income in the year the expense was incurred. Tax Court will no longer follow its decision in **Beyer v. Commissioner**, 92 T.C. 1304 (1989), but agrees with the Court of Appeals decision in that case (916 F.2d 153 (4th Cir. 1990)).
- O. **Ratliff v. Commissioner**, 101 T.C. No. 18 (9/30/93). Allocation of payments in interest bearing notes to principal until fully paid, and thereafter to interest, does not, as a matter of law, control the allocation of payments for income tax purposes.

VIII. Nontaxable Exchanges

- A. **TAM 9227002** (2/27/92). S corporation's sale of professional sports franchise not eligible for § 1033 involuntary conversion relief where it was the sports stadium (owned by a related, but separate, partnership consisting of the S corporation shareholders and family members), and not the team, that was threatened with condemnation by the city, even though the league required common family ownership of the team and its home stadium.
- B. Proposed regulations (IA-107-91) under §§ 453 and 1031, relating to the coordination of the § 1031 (a)(3) deferred like-kind exchange provisions with the § 453 installment sale provisions (F.R. 11/2/92).
- C. **Suffness v. United States**, 974 F.2d 608, 92-2 U.S.T.C. ¶ 50,513 (5th Cir. 10/8/92). Taxpayers owed interest on the amount of additional tax they remitted after they failed timely to reinvest, in like-kind property under § 1071 and § 1033, the proceeds of the involuntary conversion of FCC broadcast property.
- D. **Rev. Rul. 92-95**, 1992-45 I.R.B. 5. A (new) annuity contract acquired in exchange for another (old) annuity contract in a 1035 transaction has as its date of purchase for purposes of § 72(u)(4) (defining "immediate annuity") and § 72(q)(2)(I) (exempting distributions under an immediate annuity from the § 72(q)(1) premature withdrawal penalty) the date of purchase of the old annuity contract.

- E. Rev. Rul. 92-105, 1992-49 I.R.B. (11/19/92). Taxpayer's interest in an Illinois land trust constitutes real property which may be exchanged for other real property under § 1031. The holding is not applicable if the arrangement creates an entity (such as a partnership). (Several states, including California, Florida and Virginia, have laws that permit similar arrangements under which the trustee holds title and the beneficiary has the exclusive right to direct the trustee on title matters and the exclusive control of property management (together with the benefits and obligations of property ownership).)
- F. Arnes v. United States, 981 F.2d 456, 93-1 U.S.T.C. ¶ 50,016 (9th Cir. 12/11/92). Affirms district court's grant of summary judgment to taxpayer, holding that the divorce-settlement redemption of taxpayer's stock (in a corporation she owned equally with her former husband) qualified for exemption under § 1041. The former husband was held to have been relieved of an obligation by the corporate redemption, so A-9 of Temp. Reg. § 1.10401-IT would treat taxpayer's stock as having been transferred to her former husband, and then retransferred to the corporation (the "third party") in a non-§ 1041 transaction. The \$450,000 cash is to be treated as paid to taxpayer by the corporation on behalf of her former husband (and presumably constituted a taxable distribution to her former husband). See, Temp. Reg. §1.1041-1T, A-2, Ex. (3).
- G. TAM 9252001 (2/12/92). Receipt of like-kind real property by a surviving corporation following a merger in exchange for property transferred by a predecessor corporation prior to the merger qualified for § 1031 nonrecognition treatment.
- H. 1993 Act §13114 adds new Code §1044 permitting deferral of up to \$50,000 (individuals) or \$250,000 (C corporations) of capital gain on the sale of publicly traded securities, the proceeds of which are reinvested in a "specialized small business investment company" (SBIC), effective for sales on or after 8/10/93.

IX. Partnerships

A. Partnership Audit Rules

1. Harris v. Commissioner, 99 T.C. 121 (7/28/92). NOL carrybacks attributable to settlement of partnership items of a TEFRA partnership may be taken into account in a Rule 155 computation in partners' personal tax (non-TEFRA) proceeding.

2. **Treaty Pines Investment Partnership v. Commissioner**, 967 F.2d 206, 92-2 U.S.T.C. ¶ 50,418 (5th Cir. 8/5/92). Tax Court improperly refused to exercise jurisdiction to rule on the validity of a settlement with IRS concerning taxpayers' partnership items, and (inasmuch as the settlement was valid despite its not being on Form 906) the Tax Court lacked subject matter jurisdiction to order taxpayers to comply with the terms of the Notice of Final Partnership Administrative Adjustment.
3. **McKnight v. Commissioner**, 99 T.C. No. 8 (8/5/92). Small partnership exception in TEFRA applies to "simple" partnerships where the same-share rule is satisfied, as it was according to Reg. § 301.6231(a)-1T(a)(3) where only items "available for distribution" during the year were considered, and certain other items (i.e., those consistently exclusive to a partner) were excluded from the rules.
4. **Hambrose Leasing 1984-5 Limited Partnership v. Commissioner**, 99 T.C. No. 15 (9/1/92). Determination of individual partners' amounts at risk with respect to partnership liabilities personally assumed by individual partners is not a partnership item, but is an affected item, which can be dealt with only in a partner-level proceeding.
5. **Dubin v. Commissioner**, 99 T.C. No. 17 (10/14/92). Commissioner failed to comply with the TEFRA procedures with respect to the taxpayer wife of a bankrupt husband who held their partnership interests as community property. All the items in the statutory notice sent to her were partnership items or affected items, and the statutory notice was invalid because Temp. Reg. § 301.6231(c)-7T(a) bankruptcy rule could not be applied to taxpayer-wife, who, herself, was not bankrupt -- even though, for other purposes, husband and wife are treated as one.

B. Miscellaneous

1. **Mark IV Pictures, Inc. v. Commissioner**, 969 F.2d 669, 92-2 U.S.T.C. ¶ 50,365 (8th Cir. 7/13/92), aff'd T.C. Memo. 1990-571. Affirms Tax Court findings that general partners in religious film production limited partnership: (1) received their general partnership interests in exchange for services rather than property [because lack of written contracts and arm's length negotiations precluded partners from showing that film rights were exchanged for partnership interests], and (2) received capital interests rather than profits interests [because of shift in capital occurring at formation giving them the right to receive 50% of liquidation proceeds].

2. **Rev. Rul. 92-97**, 1992-46 I.R.B. (10/29/92). The allocation to a partner of his share of the partnership's cancellation of indebtedness (COD) income that differs from his share of the canceled debt under § 752(b) has substantial economic effect under § 704(b) if (1) deficit restoration obligations covering the resulting negative capital account balances can be invoked to satisfy other partners' positive capital account balances, (2) the requirements of the economic test are otherwise met, and (3) substantiality is independently established. But if there is no deficit restoration offset, taxpayer cannot achieve substantial economic effect by using a "qualified income offset" -- even though this is a safe harbor in the § 704(b) regulations.
3. **Classification**
 - a. **Proposed amendments** of regulations (PS-7-92), which amends Reg. § 301.7701-2(b)(1), regarding the characteristic of continuity of life, to permit a majority of interest of the remaining general and limited partners combined to agree to continue a partnership upon an event of withdrawal of a general partner without the partnership having "continuity of life" (F.R. 7/22/92). T.D. 8475, final regulations amending Reg. § 301.7701-2, regarding the characteristic of continuity of life of a limited partnership (5/13/93).
 - b. **Rev. Proc. 92-88**, 1992-42 I.R.B. 39. Guidance regarding classification of limited partnerships formed under a state limited partnership act that IRS has determined (in a published ruling) corresponds to the ULPA. Generally follows Rev. Proc. 89-12, 1989-1 C.B. 798, except for net worth rules for individual general partners (the lesser of 10% of total contributions or \$1 million, excluding any interest in the partnership). See also, Rev. Proc. 92-87, 1992-42 I.R.B. 38 (IRS will not rule whether partnerships that satisfy the Rev. Proc. 92-88 guidelines are classified as partnerships).
 - c. **Rev. Rul. 93-5**, 1993-3 I.R.B. 6(12/28/92). A Virginia limited liability company is classified for federal tax purposes as a partnership because it lacks the corporate characteristics of continuity of life and free transferability of interests. See also, Rev. Rul. 93-6, 1993-3 I.R.B. 8 (12/28/92) (same ruling for Colorado LLCs). Both states have "bulletproof" LLC statutes.

- d. **Rev. Rul. 93-30**, 1993-16 I.R.B. 4. Nevada limited-liability company is classified as a partnership because it lacks a preponderance of the four corporate characteristics, in that it possesses centralized management and limited liability but does not possess continuity of life and free transferability of interests.
 - e. **Rev. Rul. 93-38**, 1993-21 I.R.B. 4. Depending upon the provisions of its LLC agreement, a Delaware LLC can assume for federal tax purposes the characteristics of a partnership (Situation 1: lacking continuity of life, centralized management and free transferability of interests, and possessing limited liability), or it can assume the characteristics of an association (Situation 2: possessing the four characteristics).
 - f. **Rev. Rul. 92-49**, 1992-26 I.R.B. 8, amplifying Rev. Rul. 57-7, 1957-1 C.B. 435. IRS will continue to take the position that the arrangement between the owner of coin-operated amusements and the occupant of premises is a lease from the occupant (as lessor) to the owner (as lessee). It will, however, not challenge a taxpayer's good faith position that such an arrangement is a joint venture.
 - g. **Rev. Rul. 93-50**, 1993-25 I.R.B. 13. West Virginia LLC is classified as a partnership under a "bulletproof" statute.
 - h. **Rev. Rul. 93-53**, 1993-26 I.R.B. 7. Florida LLC may be classified as a partnership or an association, depending upon its articles of organization. The LLC considered is classified as a partnership because it lacks continuity of life and free transferability of interest.
4. **Proposed regulations** (PS-103-90) under § 761, relating to requirements to be met by natural gas producers subject to a gas balancing agreement in order to elect under § 761(a) to be excluded from the application of subchapter K (F.R. 9/16/92). Provides additional rules (i.e., must use "cumulative gas balancing method" unless all the producers in the same GBA agree in writing to use the "annual gas balancing method") to eliminate the potential for prolonged deferral of income where producers under a single GBA (co-owners) use different methods (i.e., the entitlement method and the sales method) to account for gas sales.

5. **Rev. Proc. 92-92**, 1992-46 I.R.B. 34. The IRS will not challenge a bankrupt or insolvent partnership's treatment of a reduction of an indebtedness as a 108(e)(5) purchase price adjustment, provided the transaction otherwise qualifies but for the partnership's bankruptcy or insolvency.
6. **T.D. 8450**, final regulations under § 7704, relating to a publicly traded partnership's adding a "substantial new line of business" (12/10/92). See also, **Rev. Proc. 92-101**, 1992-52 I.R.B. 19 (12/11/92) (safe harbor provisions).
7. **T.D. 8439**, final regulations under § 707(a)(2), relating to the treatment of transactions between partners and partnerships, and between partners themselves, i.e., the partnership disguised sales rules, etc. (9/25/92). See also, **Notice 92-46**, 1992-42 I.R.B. 29 (9/25/92) (proposed regulations may be elected for certain post-4/24/91 transfers if at least one of the transfers considered part of a sale occurs before 11/30/92).
8. **The Comprehensive National Energy Policy Act of 1992** (Pub. L. No. 102-486) requires precontribution gain on property contributed to a partnership to be recognized on the subsequent distribution of other property to the contributing partner. Act § 1937, new Code 737, to apply to distributions on or after 6/25/92.
9. **PS-164-84**, proposed regulations under § 704(c), relating to allocations with respect to appreciated property contributed by a partner to a partnership (F.R. 12/24/92). See also PS-50-92 (F.R. 1/4/93).
10. **Rev. Rul. 93-7**, 1993-4 I.R.B. 5 (12/31/92). If a partnership acquires indebtedness issued by a partner, and subsequently distributes it to the partner so that the debt is extinguished, then the § 731(b) distribution of property rules [nonrecognition of gain or loss, and (if there is a § 754 election in effect) § 734(b) provides for basis adjustment of partnership property to take into account § 731(a) gain or loss recognition by the distributee partner or change in the basis of the distributed property under § 732] determine the consequences for the partnership, and the partner will recognize capital gain or loss to the extent the indebtedness' FMV differs from its § 732 basis [under § 732(a) for nonliquidating distributions, adjusted basis to the partnership; under § 732(b) for liquidating distributions, adjusted basis of the partner's interest reduced by money distributed in the same transaction]. The partner will also have § 61(a)(12) cancellation of indebtedness income in the amount by which the issue price exceeds the FMV of the indebtedness. Reg. § 1.731-1(c)(2) applies to direct loans from a partnership to a partner, and is inapplicable here.

11. **Rev. Rul. 93-13**, 1993-7 I.R.B. 12. If a partnership with a § 754 election in effect makes a series of liquidating cash payments to a partner that are treated as distributions under § 736(b)(1) (i.e., as made in exchange for the interest of that partner in partnership property), then the § 734(b) basis adjustments to partnership property will correspond in timing and amount with the recognition of gain or loss by the retiring partner with respect to those payments.
12. **Rev. Proc. 93-27**, 1993-24 I.R.B. (6/9/93). Guidance on the treatment of the receipt of a partnership profits interest for services. The IRS will not treat the receipt as a taxable event in the absence of any of the following: (1) the profits interest relates to a substantially certain and predictable stream of income from partnership assets; (2) the partner disposes of the profits interest within 2 years of receipt; or (3) the profits interest is a limited partnership interest in a § 7704(b) publicly traded partnership.
13. **1993 Act §13262** amends Code §736(b) to limit deductible treatment of payments made to retired or deceased partners for goodwill and unrealized receivables, effective for partners retiring or dying on or after 1/5/93.

X. Personal and Individual Income and Deductions

A. Miscellaneous Deductions and Credits

1. **Rev. Proc. 92-71**, 1992-35 I.R.B. 17 (8/10/92). Describes account statements that will be accepted as proof of payment for purposes of substantiating deductions in lieu of producing canceled checks, such as bank account statements and credit card charge statements that show the amount, the date and the name of the payee. (The date shown, however, is not necessarily the date of the deduction.)
2. **Grigg v. Commissioner**, 979 F.2d 383, 93-1 U.S.T.C. ¶ 50,020 (5th Cir. 12/21/92). Taxpayers' vacation condominium, used by them "more than 14 days and more than 10 percent of the days which the unit was rented" does not fall within the § 280A(f)(1)(B) hotel exception because taxpayers' personal use of their condominium as a "dwelling" meant they did not use their condominium "exclusively" as a "hotel, motel, inn or similar establishment." Taxpayers' condominium losses were made subject to § 280A limitations.

3. **The Comprehensive National Energy Policy Act of 1992** (Pub. L. No. 102-486) disallows any deduction for travel expenses while temporarily away from home in connection with any period of employment exceeding one year, effective for costs paid or incurred after 12/31/92. Act 1938, Code § 162(a). See Notice 93-29, 1993-18 I.R.B. 14 (for "away-from-home" periods of more than one year straddling the end of 1992, travel expenses incurred before the end of 1992 are deductible, and travel expenses incurred thereafter are not).
4. **Speck v. United States**, 93-1 U.S.T.C. ¶ 50,202 (Fed. Cl. 3/30/93). The first trial opinion by this court, which denies "away from home" deductions to a Canadian hockey player, with criticism of the conduct of taxpayers' counsel in this and 230 other related hockey player tax refund cases. See **Stemkowski v. Commissioner**, 690 F.2d 40, 82-2 U.S.T.C. ¶ 9589 (2d Cir. 1982), for the appeal of one of the 43 cases in the Tax Court.
5. **Rev. Rul. 93-27**, 1993-15 I.R.B. 4. Taxpayer is not entitled to a § 166(a)(1) bad debt deduction for the amount of her own expenditures for supporting her children caused by an arrearage in court-ordered child support payments owed by a former spouse because her expenditures did not create any basis in the child support obligation (which was not contingent upon those expenditures).
6. **Induni v. Commissioner**, 93-1 U.S.T.C. ¶ 50,200 (2d Cir. 4/1/93). Deductions for mortgage interest and real estate taxes, attributable to tax exempt living quarters allowance received by INS employee, were disallowed under § 265(a)(1). The exception to § 265 denial contained in § 265(a)(6) applies only to people in the military and the clergy.
7. **Kraft v. United States**, 93-1 U.S.T.C. ¶ 50,278 (6th Cir. 4/7/93). Restitution to Blue Cross/Blue Shield of Michigan paid by a doctor under a criminal plea bargain agreement is not eligible for § 1341 treatment because the funds were not obtained under a "claim of right."
8. **O'Neill Trust v. Commissioner**, 93-1 U.S.T.C. ¶ 50,332 (6th Cir. 6/2/93), **rev'g** 98 T.C. 227 (1992). Investment advisor fees paid by trust where trustees lacked investment experience met the § 67(e) exception to the § 67(a) two-percent floor, and are deductible in full because they would not have been incurred if the property had not been held in trust.

B. Miscellaneous Income

1. Damages

- a. **Ray v. United States**, 25 Cl. Ct. 535, 92-1 U.S.T.C. ¶ 50,187 (Cl. Ct. 3/27/92), aff'd without published opinion, (Fed. Cir. 2/22/93). Damages received in the settlement of a labor dispute arising from employer's breach of a collective bargaining agreement were not excludable under § 104(a)(2) because they were not payments for personal injury.
- b. **Horton v. Commissioner**, 100 T.C. No. 8 (2/9/93) (reviewed, 15-3). Taxpayers injured in a fire resulting from a gas explosion caused by utility's negligence could exclude \$500,000 punitive damages under § 104(a)(2) because the punitive damages were awarded by reason of a tort-type personal injury suit. **Miller v. Commissioner**, 93 T.C. 330 (1989), rev'd, 90-2 U.S.T.C. ¶ 50,515 (4th Cir. 1990), adhered to; the court tentatively distinguished the Fourth Circuit holding on the ground that Maryland punitive damages (in Miller) were "purely punitive," while Kentucky punitive damages (this case) serve both to compensate the injured party and to punish the wrongdoer.
- c. **Kovacs v. Commissioner**, 100 T.C. No. 10 (2/24/93) (reviewed, 14-5). Statutorily imposed interest on wrongful death damages is not excludable from income under § 104(a)(2). (Michigan state law allows compound interest at 6% [12% from 6/1/80] calculated from the date of filing the complaint to the date of satisfaction of the judgment.) The portion of attorney's fees allocable to taxable interest is not deductible above the line and is subject to the 2% floor of 67. Dissents based on the amendment to § 104(a)(2) by the Periodic Payment Settlement Act of 1982, Pub. L. 97-473, which added to the parenthetical "and whether as lump sums or as periodic payments."
- d. **Glatthorn v. United States**, 93-1 U.S.T.C. ¶ 50,338 (S.D. Fla. 4/13/93). Law firm associate's action against his former firm for contractual damages also contained tort claims (i.e., fraud, conversion and civil theft), so 1/2 of the settlement was allocated to tort recovery and was non-taxable under § 104(a)(2).

- e. **Downey v. Commissioner**, 100 T.C. No. 40 (6/29/93) (reviewed), supplementing 97 T.C. 150 (1991). The entire amount of damages received by airline pilot under ADEA was excludible under §104(a)(2). *Contra*, **Maleszewski v. U.S.**, 93-1 U.S.T.C. ¶50,358 (N.D. Fla. 6/4/93).
 - f. **Reese v. United States**, 93-2 U.S.T.C. ¶50,447 (Fed. Cl. 7/29/93). Punitive damages received in 1987 by taxpayer in settlement (after trial) of her suit for sex discrimination, sexual harassment and intentional infliction of emotional distress were includible in gross income. The court based this conclusion on three grounds: (i) exceptions to §61 should be construed narrowly; (ii) the title and subject matter of §104 focus on payments received as compensation for injuries or sickness; and (iii) the historical context of the 1918 enactment of the predecessor to §104(a)(2) suggests an intention to exclude only c o m p e n s a t o r y payments.
- 2. **Rev. Rul. 92-99**, 1992-46 I.R.B. 5 (10/30/92). If the principal amount of an undersecured nonrecourse debt that arose out of the purchase of property is reduced by the holder of the debt (who was not the seller of the property), the debt reduction may not be treated as a § 108(e)(5) purchase price adjustment (in the absence of an infirmity that clearly relates back to the original sale), but results in § 61(a)(12) discharge of indebtedness income.
 - 3. **Bannon v. Commissioner**, 99 T.C. 60 (7/20/92). Payments received by taxpayer from the state of California, under its In-Home Supportive Services Program, for providing nonmedical care to her totally disabled adult daughter were includable in taxpayer's gross income.
 - 4. **Rev. Rul. 92-69**, 1992-36 I.R.B. 5(8/20/92). Situations where the value of employer-provided outplacement services qualifies as a § 132(d) working condition fringe, and does not constitute gross income (or wages for FICA, FUTA or withholding purposes), because the employer derives a substantial business benefit (beyond what it would get from "the mere payment of additional compensation") and the employee's hypothetical payment would be deductible under § 162.
 - 5. **Proposed regulations** (EE-101-91) under § 61, relating to the valuation of an employee's use of employer-provided fuel when an employer-provided automobile is valued pursuant to the automobile lease valuation rule (F.R. 10/9/92). Valuation at FMV or, alternatively, 5.5 cents per mile of personal use, with additional methods for automobile fleets.

6. **Rev. Rul. 92-109**, 1992-52 I.R.B. 5 (12/8/92). United States citizens who lost their U.S. citizenship and subsequently had it restored are not liable for federal income and gift taxes in the interim.
7. **FI-25-92**, proposed regulations under §§ 101,7702 and 7702A, relating to the federal income tax treatments of amounts received as "qualified accelerated death benefits" by terminally ill individuals (F.R. 12/15/92). See Notice 93-37 for delay in effective date to date of publication of final regulations.
8. **Cato v. Commissioner**, 99 T.C. No. 33 (12/22/92). Amounts received by taxpayers from a § 501(c)(3) placement agency for operating a foster family home for developmentally disabled children are excludable under § 131 (added by the Tax Reform Act of 1986). With respect to the 1985 tax year to which § 131 was inapplicable, the excess of foster care payments over expenses is both includable in gross income and subject to self-employment tax.
9. **Dodge v. Commissioner**, 981 F.2d 350, 93-1 U.S.T.C. ¶ 50,021 (8th Cir. 12/9/92). Affirms finding that taxpayer, an "insurance speculator" who carried 30 to 60 hospital indemnification policies (paying a fixed amount per hospitalized day) and had a "friendly" doctor admit him into a hospital, could not exclude policy benefits under § 104(a)(3) for six hospitalizations for back and neck pain after alleged falls because taxpayer did not suffer any legitimate illness or injury. However, § 104(a)(3) exclusion treatment was available for the seventh hospitalization for a perforated colon [a side effect of a biopsy performed in anticipation of a hemorrhoidectomy] where he did undergo surgery.
10. **T.D. 8460**, final regulations under § 108(e)(4), relating to the acquisition of indebtedness by a person related to the debtor (12/28/92).
11. **T.D. 8457**, final amendments of regulations under §§ 61 and 132, relating to the valuation of fringe benefits under § 61 [eliminates requirement that employers notify employees of use of a special valuation rule and clarifies requirements for using such rules] and the exclusion of certain benefits as working condition fringes under § 132(a)(3) [sets forth rules for transportation provided to government employees because of security concerns and provides for exclusion of the value of directors' and officers' liability insurance protection provided by an § 501(a) exempt organization to its bona fide volunteers from their income under § 132(d)] (12/29/92).

12. **The Comprehensive National Energy Policy Act of 1992** (Pub. L. No. 102-486) limits employer-provided transit subsidies to be excluded from taxable income would be raised from \$21 to \$60 per month. Amount of employer-provided parking assistance which may be excluded would be capped at \$155. ("Employee" is defined for this purpose as not to include the self-employed. New Code § 132(f)(5)(E).) Act § 1911, Code § 132.
13. **Rev. Rul. 93-43**, 1993-24 I.R.B. 54. Under §123, if total insurance proceeds received for increased living expenses incurred due to a casualty exceeds the individual's increased living expenses during the loss period, the excess portion is includable in gross income for the year in which the loss period ends (or, if later, the year in which the excess portion of the insurance proceeds is received).
14. **1993 Act §§ 13201-5** increase top individual rate to 36%; impose 39.6 rate on income over \$250,000; leave capital gain unaffected; increase individual AMT rate to 26-28%; and make permanent the §68 itemized deduction phase-out (Pease) and §151(d) personal exemption phase-out (PEP). There is a 3-year installment election for payment of any 1993 regular tax increases. Regarding the application of this same rate structure to estates see, Barnett, "Further Tax Discrimination Against the Dead," Tax Notes, Sept., 13, 1993.
15. **1993 Act §13215** increases the taxable portion of Social Security retirement benefits under Code §86 for more affluent [married over \$44,000] to 85 %, effective, 1/1/94.
16. **1993 Act §13213** imposes substantial new restrictions on the Code §217 deduction for moving expenses, effective 1/1/94.
17. **1993 Act §13101** extends the §127 employer-provided educational assistance exclusion, retroactively from 7/1/92 through 12/31/94.

XI. Procedure. Penalties and Prosecutions

A. Penalties and Prosecutions

1. **Leuhsler v. Commissioner**, 963 F.2d 907, 92-2 U.S.T.C. ¶ 50,374 (6th Cir. 5/11/92). Negligence penalty imposed on CPA who invested in tax shelter master recording leases that lacked economic substance. **Heasley v. Commissioner**, 902 F.2d 380, 90-1 U.S.T.C. ¶ 50,314 (5th Cir. 1990), distinguished.

2. **Mitchell v. United States**, 977 F.2d 1318, 92-2 U.S.T.C. ¶ 50,512 (9th Cir. 10/9/92), **rev'g and remanding** 90-2 U.S.T.C. ¶ 50,495 (W.D. Wash 1990). Taxpayer was subject to a separate § 6701(a) penalty for aiding in the preparation of each of 34 Forms K-1 containing information that investors incorporated into their tax returns that resulted in understatements.
3. **Knudsen v. United States**, 966 F.2d 733, 92-2 U.S.T.C. ¶ 50,332 (2d Cir. 6/10/92). Payment of FICA taxes into federal depository account by corporation shortly before bankruptcy constitutes a defense by responsible officer to § 6672 penalty for unpaid taxes, even though the bank subsequently reversed its credit to the depository account and applied the monies towards repayment of a commercial bank loan owed by the corporation.
4. **Turpin v. United States**, 970 F.2d 1344, 92-2 U.S.T.C. ¶ 50,383 (4th Cir. 7/17/92), **rev'g and remanding** 91-2 U.S.T.C. ¶ 50,403 (D. Md. 7/25/91). President and sole shareholder of coal operating company did not willfully fail to collect and pay over withholding taxes because he reasonably believed that the company that owned the facility at which the mining took place had paid the taxes.
5. **Barnett v. IRS**, 93-1 U.S.T.C. ¶ 50,269 (5th Cir. 4/28/93). A 20% shareholder/corporate officer of a bankrupt oil and gas drilling company whose other 20% shareholder/corporate officer failed to pay over withheld taxes is a responsible person under § 6672 because he signed checks to pay other creditors after he became aware of the withholding tax liability.
6. **Niedringhaus v. Commissioner**, 99 T.C. No. 11 (8/11/92). Fraud penalties applied on tax protester's underpayments as a result of his failure to file returns or pay taxes, or to file delinquent returns [which themselves omitted the lion's share of his income] until after being notified of IRS's investigation. **Cheek v. United States**, 498 U.S. 192, 91-1 U.S.T.C. ¶ 50,012 (1991), followed as it differentiates between "a good-faith misunderstanding of the law" and "a good-faith belief that the law is invalid or a good-faith disagreement with the law," the latter entailing the obligation of "[taking] the risk of being wrong."
7. **Conti v. Commissioner**, 99 T.C. No. 20 (9/29/92). Taxpayers were not entitled to offer into evidence the results of polygraph tests administered to them unilaterally, without notice to Commissioner, to corroborate a cash hoard claim (to avoid deficiencies, fraud penalties and substantial understatement penalties).

8. **Lamb v. United States**, 977 F.2d 1296, 92-2 U.S.T.C. ¶ 50,538 (8th Cir. 10/30/92). There is no statute of limitations for the government to assess penalties under § 6700 [for promoting an abusive tax shelter] and § 6701 [for aiding and abetting understatement of tax liabilities] because the 5-year "catch-all" statute of limitations, 28 U.S.C. § 2462, does not apply to the Internal Revenue Code. The court followed **Mullikin v. United States**, 92-1 U.S.T.C. ¶ 50,020 (6th Cir. 1991).
9. **United States v. Sanford**, 93-1 U.S.T.C. ¶ 50,055 (11th Cir. 12/29/92). Bankruptcy court lacked the equitable power to reduce, in part, penalties under § 6651(a)(1) (failure to file), § 6651(a)(2) (failure to pay) and § 6654(a) (underpayment of estimated tax). These penalties may either be waived in full for each tax year or be applied in full, but may not be reduced.
10. **Reiss v. United States**, 93-1 U.S.T.C. ¶ 50,086 (8th Cir. 1/14/93). The failure of a notice of assessment of § 6694 preparer penalties to comply with § 7522 by including the particularities of each assessed penalty did not invalidate the notice of assessment where there was sufficient information "to identify the returns involved, the nature of the error charged, and the amounts of the assessment."
11. **McMurray v. Commissioner**, 93-1 U.S.T.C. ¶ 50,107 (1st Cir. 2/9/93). Taxpayers avoided former § 6653 negligence and former § 6659 charitable valuation overstatement penalties with respect to their claimed deductions of \$1,360,000 on their donation of a \$29,450 peat bog to a charity for conservation purposes because they reasonably, and in good faith, relied on a professional real estate appraiser's valuations based upon the commercial value of the peat contained in the bog even though permits for harvesting were highly unlikely to be granted.
12. **Notice 93-22**, 1993-17 I.R.B. 11 (4/7/93). Notice providing relief from the requirement -- contained in both the § 6081 regulations and the instructions to Form § 4868 -- that the automatic 4-month filing extension may be obtained only upon full payment of the tax properly estimated to be due, and no late filing penalty will be assessed. However, the (1/2% per month) late payment penalty and interest on the underpayment, as applicable, will be imposed. Effective through 8/15/93.

13. **Mando v. United States**, 93-1 U.S.T.C. ¶ 50,340 (Bankr. E.D. Ky. 5/12/93). IRS held to be estopped to pursue president of optical company for § 6672 "responsible person" penalties because of revenue officers' course of conduct in determining that he was not a "responsible person" [a determination later reversed without further factual development] while encouraging him to continue operating the business. (The president's culpable brother [the secretary-treasurer] took full responsibility for the failures to pay.) The court found estoppel by reason of the government's failure to meet its "minimum standard of decency, honor and reliability."
14. **Kinnie v. United States**, 93-1 U.S.T.C. ¶ 50,311 (6th Cir. 5/24/93). IRS not required to follow the oral designation of corporate accountant with respect to monies tendered to pay trust fund taxes, but was free to apply the payment to non-trust fund taxes. Rev. Rul. 79-284, 1979-2 C.B. 283, and Rev. Rul. 73-305, 1973-2 C.B. 43, followed.
15. **Bassett v. Commissioner**, 100 T.C. No. 41 (6/30/93). The parents of a child actress who failed to file income tax returns were obligated under §6012(b)(2), as her guardians, to file tax returns on her behalf. The §6651(a) failure to file penalty was properly applied to the child actress because her parents had a duty to file and their failure was not due to reasonable cause.
16. **1993 Act §13214** modifies the Code §6654 individual estimated tax safe harbor based on the preceding year's tax where AGI exceeds \$150,000, by: (i) eliminating the 1990 Act removal of the safe harbor where income increases sharply and (ii) substituting a new 110% [of last year's income] safe harbor, effective for taxable years beginning after 1993.
17. **1993 Act §13251** imposes a stricter standard for the Code §6662 accuracy-related penalty, effective 1/1/94. "Reasonable basis" replaces "not frivolous" as the floor for avoiding the penalty where adequate disclosure is made on tax returns. No corresponding change was made to the §6694 preparer penalty.

B. Summons

1. **DiAndre v. United States**, 968 F.2d 1049, 92-2 U.S.T.C. ¶ 50,373 (10th Cir. 7/7/92). No violation of § 6103 occurred when the IRS disclosed certain tax return information in a circular letter sent to the corporation's customers in the course of a criminal investigation where the disclosure met the § 6103(k)(6) safe harbor, i.e., as relating to tax liability determination, that the information sought not otherwise reasonably available and that the disclosures were necessary to obtain the information sought.
2. **United States v. Church of Scientology Western United States**, 973 F.2d 715, 92-2 U.S.T.C. ¶ 50,441 (8/19/92), aff'g, unreported District Court decisions. Partial enforcement of IRS Church summonses affirmed where IRS inquiries had "appropriate purpose and [were] not the product of bad faith"; however, § 7611 imposes upon IRS the special duty of showing "actual necessity" for the church documents sought, which goes beyond the "relevance" standard for other types of summonses. (The Church Tax Inquiry Letter set out as concerns (1) substantial nonexempt commercial purpose and (2) private inurement.)
3. **United States v. Moore**, 970 F.2d 48, 92-2 U.S.T.C. ¶ 50,454 (5th Cir. 8/28/92) (per curiam). Psychotherapist's accounts receivable records were not protected by privilege against IRS summons because, even if there were a privilege, the identity of a patient or the fact and time of treatment would not be within it.
4. **Wooden Horse Investments, Inc. v. United States**, 806 F. Supp. 1487, 92-2 U.S.T.C. ¶ 50,482 (E.D. Wash. 8/12/92). Summonses ordered enforced over taxpayer's claim that they were issued in retaliation for its refusal to extend the statute of limitations because they were not issued in bad faith but merely sought information relating to taxpayer's deduction of \$25 million interest on \$100,000 worth of debt.
5. **Church of Scientology of California v. United States**, 113 S. Ct. 447, 92- 2 U.S.T.C. ¶ 50,562 (U.S. 11/16/92). Compliance with District Court summons enforcement order, by delivery of tapes by state court to the IRS, did not moot the Church's appeal because of the existence of power in the Court of Appeals to effectuate a partial remedy by ordering the return or destruction of the tapes.

6. **Grandbouche v. Commissioner**, 99 T.C. No. 31 (11/30/92). Protective order was granted on behalf of a tax-protestor type of barter organization to limit a subpoena duces tecum to the organization's bank to those documents relating to the petitioner in the case at hand, in order to protect the First Amendment rights of freedom of association of the organization's other members.
7. **United States v. Merrill Lynch & Co.**, 93-1 U.S.T.C. ¶ 50,067 (S.D. N.Y. 1/25/93). IRS summons under § 7602(a) for names of seven client "§ 453 partnerships" [partnerships engaging in transactions using the § 453 installment sales provisions] was enforced under **Tiffany Fine Arts, Inc. v. United States**, 85-1 U.S.T.C. ¶ 9117 (U.S. 1985), because the information was relevant for the dual purpose of both a legitimate investigation of the tax liabilities of Merrill Lynch itself and an investigation of the tax liabilities of the § 453 partnerships. The § 7609(f) third-party summons requirements did not have to be followed.

C. Litigation Costs

1. **IA-003-89**, proposed regulations under § 7430, relating to the recovery of administrative costs incurred by taxpayers in IRS administrative proceedings (F.R. 12/23/92).
2. **Heasley v. Commissioner**, 967 F.2d 116, 92-2 U.S.T.C. ¶ 50,412 (5th Cir. 7/20/92), aff'g and remanding T.C. Memo 1991-189. Attorney's fees awarded with respect to negligence and substantial understatement penalties, but not valuation overstatement and additional interest penalties on which the IRS was not "not substantially justified," because taxpayers "substantially prevailed." The \$100 to \$200 per hour actually charged by attorneys was reduced to the \$75 statutory rate, with COLA from 1/1/86 § 7430 date -- not from the 1/1/81 EAJA date.
3. **Estate of Hubberd v. Commissioner**, 99 T.C. No. 18 (9/16/92). The 28 U.S.C. § 2412(d)(2)(B) net worth requirement [\$2 million or less for individuals and \$7 million or less for business owners, partnerships, corporations, associations, etc.] applies to the award of § 7430 litigation costs to an estate, and it is the net worth of the estate that is to be considered. (Taxpayer argued that the net worth of the estate beneficiaries should have been considered.)

4. **Hong v. Commissioner**, 100 T.C. No. 8 (2/9/93). The § 7430(c)(4)(A)(iii) net worth limitation of \$2 million on recovery of litigation costs is to be applied on an individual basis to spouses, each of whose individual net worth was below \$2 million, but whose combined net worth exceeded \$2 million. The vetoed Revenue Bill of 1992, H.R. 11, 102d Cong., 2d Sess. § 4914, provided that spouses filing a joint return were to have been treated as one individual for purposes of the net worth requirement.
5. **Hanson v. Commissioner**, 975 F.2d 1150, 92-2 U.S.T.C. ¶ 50,554 (5th Cir. 10/26/92), *rev'g* an unreported Tax Court decision. Litigation expenses awarded to *pro se* taxpayers because notice of deficiency issued in 1988 was barred by the statute of limitations, as conceded after one year of litigation, and the IRS position was not "substantially justified" with respect to taxpayers who in 1980 filed a genuine return for the 1977 year (following the failure of tax protester litigation, and one taxpayer's criminal conviction for willful failure to file a return for the 1977 year). The Fifth Circuit emphasized that taxpayer's brief motions, albeit accompanied by legal memoranda and numerous exhibits relating to taxpayers' earlier attempts to invalidate the tax system, were themselves not improper and the Tax Court abused its discretion in denying litigation expenses.
6. **Kreidle v. Department of Treasury**, 92-2 U.S.T.C. ¶ 50,449 (Bankr. D. Colo. 6/23/92). Section 7430 attorney's fees awarded based upon parties' stipulations -- despite IRS counsel's attempt to withdraw them one day later, on the argument that debtor's counsel was a "litigation-crazed fiend." The court did not acquiesce in that characterization.
7. **Barton v. United States**, 93-1 U.S.T.C. ¶ 50,144 (8th Cir. 3/11/93). District court abused its discretion in denying § 7430 attorneys' fees because government could not reasonably have concluded that the executive vice president [second in command], with authority to sign checks and knowledge of the corporation's unpaid withholding taxes, was a responsible person under § 6672 in light of his lack of responsibility for paying withholding taxes.
8. **Portillo v. Commissioner**, 93-1 U.S.T.C. ¶ 50,222 (5th Cir. 4/13/93), *rev'g* and remanding T.C. Memo. 1992-99. Government position [that an unsubstantiated and unreliable Form 1099 submitted to the IRS by a contractor who dealt with taxpayer was sufficient support for a notice of deficiency] was not "substantially justified," so remanded for determination of taxpayer's attorney's fees and costs.

9. **Wilfong v. United States**, 93-1 U.S.T.C. ¶ 50,232 (7th Cir. 4/8/93). Attorney's fee award by district court to CPA who contested § 6694 preparer penalties was reversed because the government's position was substantially justified. Although the CPA prevailed in a jury trial, the evidence was such that the jury could have found the CPA negligent had it believed the government's evidence.
10. **Powers v. Commissioner**, 100 T.C. No. 30 (5/25/93). Litigation costs under § 7430 awarded where statutory notice lacked reasonable justification because IRS had no information about the underlying facts, and made no attempt to obtain information, before issuing the statutory notice in order to avoid expiration of the statute of limitations following receipt of taxpayer's Form 872-T.
11. **Lennox v. Commissioner**, 93-2 U.S.T.C. ¶50,444 (5th Cir. 8/4/93), **rev'g and remanding** T.C. Memo. 1992-382. Tax Court's refusal for purposes of amending §7430 litigation costs to consider events predating the notice of deficiency was improper and the Tax Court abused its discretion in finding the IRS position "substantially justified" on issuance of the notice where (i) taxpayers offered a limited extension of the statute of limitations (which was refused because 35 days was not long enough to get higher-level approval for its specific language) and (ii) the IRS surrendered more than a year after the Tax Court petition was filed without being given any additional information. The court found that the fact that "the IRS had a basis for suspicion" was not "a sufficient basis for issuance of the notice, in light of the opportunity for further, and much needed, investigation."

D. Statutory Notice

1. **Powerstein v. Commissioner**, 99 T.C. No. 22 (9/30/92). Assessments based upon the amounts shown as tax on amended returns filed during the pendency of a Tax Court proceeding violated the § 6213(a) restrictions on assessments.
2. **AOD No. 1993-4**, 1993-22 I.R.B. 4. Nonacquiesces in **Powell v. Commissioner**, 92-1 U.S.T.C. ¶ 50,147 (4th Cir. 1992), with respect to the issue relating to "whether a last known address may change subsequent to the mailing of a notice of deficiency."

3. **Balkissoon v. Commissioner**, 93-1 U.S.T.C. ¶ 50,347 (4th Cir. 6/11/93). Commissioner's failure to send notice of deficiency "by certified mail or registered mail" as authorized by § 6212(a) is inconsequential where taxpayers actually received the notice of deficiency sent by ordinary mail and were able to petition the Tax Court for redetermination. Section 6212(a) was held to be "a safe harbor to be relied upon only in those situations in which the taxpayer did not receive actual notice."

E. Statute of Limitations

1. Passthrough Entities

- a. **Bufferd v. United States**, 113 S. Ct. 927, 91-3 U.S.T.C. ¶ 50,038 (U.S. 1/25/93) (9-0), *aff'g*, 952 F.2d 675, 92-1 U.S.T.C. ¶ 50,031 (2d Cir. 1992). The 3-year period on which the IRS is permitted to assess an S corporation's shareholder's tax liability with respect to "pass-through" items runs from the filing date of the individual return, and not from the filing date of the corporate return.
- b. **Green v. Commissioner**, 963 F.2d 783, 92-2 U.S.T.C. ¶ 50,340 (5th Cir. 6/22/92). The expiration of the § 6501 period of limitations as to S corporations does not preclude the Commissioner from assessing deficiencies attributable to the disallowance of losses passed through from the S corporations to shareholders whose tax years were still open. **Fehlhaber v. Commissioner**, 954 F.2d 653, 92-1 U.S.T.C. ¶ 50,131 (11th Cir. 1992), followed.
- c. **Lardas v. Commissioner**, 99 T.C. 490 (10/22/92) (reviewed, 15-1). Deficiencies determined against the grantor of two grantor trusts (based upon disallowance of losses in the trusts) were timely even though issued more than three years after the trusts filed their information returns. The doctrine in **Golsen v. Commissioner**, 54 T.C. 742 (1970), *aff'd*, 445 F.2d 985, 71-2 U.S.T.C. ¶ 9497 (10th Cir. 1971), does not require the Tax Court to follow the Ninth Circuit's holding in **Kelley v. Commissioner**, 877 F.2d 756, 89-1 U.S.T.C. ¶ 9360 (1989), on the ground that it was not squarely in point because it concerned an S corporation. Dissent based upon **Fendell v. Commissioner**, 906 F.2d 362, 90-2 U.S.T.C. ¶ 50,345 (8th Cir. 1990) (concerning a complex trust).

2. **Galuska v. Commissioner**, 98 T.C. 661 (6/22/92). Forms 4868 and 2688 applications for extension do not constitute "returns" in order for taxpayer to receive an overpayment of his 1986 tax where no Form 1040 was filed for that year within the § 6511(b) [3-year or 2-year] period for filing a claim for refund.
3. **Allen v. Commissioner**, 99 T.C. No. 23 (10/6/92). Taxpayer not entitled to a refund of overpaid taxes based upon the § 6511(b)(2)(A) 3-year period, made applicable by § 6512(b)(3)(B), with respect to a return filed after the mailing of the deficiency notice.
4. **Scheidt v. Commissioner**, 967 F.2d 1448, 92-2 U.S.T.C. ¶ 50,326 (10th Cir. 6/18/92). Misaddressed notice of deficiency [P.O. Box 20711 vice 20748] tolled the statute of limitations even though it was not actually received by taxpayers until 21 days after the limitations period expired, but 63 days before taxpayers were required to file a Tax Court petition.
5. **Hall v. United States**, 975 F.2d 722, 92-2 U.S.T.C. ¶ 50,470 (10th Cir. 9/16/92) (2-1), rev'g 91-1 U.S.T.C. ¶ 50,104 (D. Utah 1991). The 1311-1314 mitigation of limitations provisions are limited to income taxes, and are not available to taxpayers seeking refunds of overpaid windfall profit taxes. The court relies on Reg. § 1.1311(a)-2(b), which so limits applicability and the omission of mention of windfall profit taxes in § 1312 ("Circumstances of Adjustment"). The dissent relies on **Chertkof v. United States**, 676 F.2d 984, 82-1 U.S.T.C. ¶ 9282 (4th Cir. 1982).
6. **Indiana National Corp. v. United States**, 980 F.2d 1098, 92-2 U.S.T.C. ¶ 50,610 (7th Cir. 11/30/92). A corporation's refund claim based on an NOL carryback is governed by the 38½-month limitations period of § 6511(d)(2)(A) [measured from the end of the loss year], and not by the 7-year limitation period of § 6511(d)(1) with respect to bad debt deductions that were included in the NOLs, except to the extent that these deductions resulted from recalculations which increased the NOL after the original filing. Taxpayer correctly determined, or overestimated, its bad debt deductions in the first place, so the special 7-year limitation period was applicable.
7. **Ginter v. United States**, 93-1 U.S.T.C. ¶ 50,079 (W.D. Mo. 1/6/93). The reporting of payments to workers as nonemployee compensation on Forms 1099 does not trigger the § 6501 three-year statute of limitations for assessment of employment taxes with respect to those same workers because the statute of limitations for assessment of employment taxes can be triggered only by filing Forms 940 and 941.

8. Aronson v. Commissioner, 93-1 U.S.T.C. ¶ 50,174 (2d Cir. 3/24/93) (per curiam). Taxpayer was not entitled to rely on a statement in IRS Publication 1035 that a Form 872-A consent keeps the statute of limitations open until the IRS or the taxpayer files "written notice ending the agreement" in light of the Form 872-A specifically mentioning Form 872-T as the proper method for taxpayer termination of consent. (There had been a fact issue as to whether taxpayer had enclosed cover letter with his Forms 872-A limiting the extensions, which fact issue the Tax Court had resolved against the taxpayer.)
9. Northern Indiana Public Service Co. v. Commissioner, 101 T.C. No. 20 (10/7/93). Special 6-year period of limitations contained in §6501(e) applies where there is an omission of gross income paid to nonresident aliens that exceeds 25 % of amount shown on Form 1042.

F. Miscellaneous

1. Innocent Spouse

- a. McGee v. Commissioner, 979 F.2d 66, 93-1 U.S.T.C. ¶ 50,015 (5th Cir. 12/15/92) (per curiam). Affirms (on clear error standard) Tax Court's denial of innocent spouse relief under § 66(c) to dentist's wife who knew of husband's irresponsible behavior in financial matters but made no effort to ascertain amount earned in the dental practice or whether tax returns were timely filed, so finding that taxpayer knew or should have known of the item of community income was not erroneous. Penalties for § 6651(a)(1) failure to file [under United States v. Boyle, 469 U.S. 24, 85-1 U.S.T.C. ¶ 13,602 (U.S. 1985)] and for former § 6653(a) negligence were affirmed under the clear error standard.
- b. Hayman v. Commissioner, 93-1 U.S.T.C. ¶ 50,272 (2d Cir. 5/4/93). Innocent spouse treatment denied to wife of tax shelter promoter who invested in various tax shelters with her husband. The wife failed to receive innocent spouse treatment because: (1) the deductions were attributable to both spouses, and not merely to the husband; (2) with respect to the "lack of knowledge requirement" of § 6013(e)(3), the court followed the Price v. Commissioner, 887 F.2d 959, 89-2 U.S.T.C. ¶ 9598 (9th Cir. 1989), standard of whether "a reasonably prudent taxpayer in her position at the time she signed the return could be expected to know that the return contained the substantial understatement," but found that she was aware of the large deductions (which sufficed to put her on notice) and "ignorance of the law" was not a

defense; (3) on balancing the equities, the wife was in no way misled or deceived by her husband or their accountant.

- c. **Bokum v. Commissioner**, 93-1 U.S.T.C. ¶ 50,342 (11th Cir. 6/4/93). Taxpayers failed to show they detrimentally relied upon an erroneous IRS statement that the statute of limitations had run on the Commissioner's right to challenge their 1971 tax return that took a tax shelter deduction, so (using its authority to entertain equitable estoppel claims) the Tax Court found the Commissioner not to be estopped. Innocent spouse treatment under § 6013(e) was denied because the deduction was not "grossly erroneous" in light of the Tax Court having found a similar deduction to be valid in **Brountas v. Commissioner**, 73 T.C. 491 (1979), rev'd, 692 F.2d 152, 82-2 U.S.T.C. ¶ 9626 (1st Cir. 1982).
 - d. **Pietromonaco v. Commissioner**, 93-2 U.S.T.C. ¶ 50,509 (9th Cir. 9/2/93). Innocent spouse relief granted despite spouse's knowledge of household expenses.
- 2. **Shore v. United States**, 26 Cl. Ct. 829, 92-2 U.S.T.C. ¶ 50,495 (Cl. Ct. 8/21/92). Claims Court lacked subject matter jurisdiction on a refund claim because of taxpayers' failure to pay assessed interest and penalties before filing their claim. The court refused to follow three of its recent cases to the contrary (**Katz v. United States**, 22 Cl. Ct. 714, 91-1 U.S.T.C. ¶ 50,289 (1991); **Mac v. United States**, 24 Cl. Ct. 511, 92-1 U.S.T.C. ¶ 50,063 (1991); and **Cohen v. United States**, 23 Cl. Ct. 717, 91-2 U.S.T.C. ¶ 50,384 (1991)) on the interpretation of the rule of **Flora v. United States**, 357 U.S. 63, 58-2 U.S.T.C. ¶ 9606 (1958).
 - 3. **Rink v. Commissioner**, 100 T.C. No. 20 (4/7/93). Closing agreement held to support IRS position where taxpayer was an experienced attorney who withheld important information from the IRS during the negotiation of that agreement.
 - 4. **Proposed regulations (IA-20-92)**, relating to Circular 230 rules of practice before the IRS (F.R. 10/8/92). Withdraws 1986 proposed amendments. Practitioner may not advise client to take a return position unless either (1) it is supported under the 1 in 3 "realistic possibility standard," or (2) it is a disclosed nonfrivolous position; support for the position must come from "approved" sources. No contingent fees unless litigation expected. Attorneys and CPAs may become enrolled agents. See also, final regulations relating to advertising and solicitation by practitioners before the IRS (9/8/92).

5. Apache Bend Apartments, Ltd. v. United States, 93-1 U.S.T.C. ¶ 50,279 (5th Cir. 4/9/93), (per curiam 11-3) on rehearing en banc of 964 F.2d 1556, 92-2 U.S.T.C. ¶ 50,443 (5th Cir. 6/25/92), aff'g. in part and rev'g in part 702 F. Supp. 1285 (N.D. Tex. 1988). Panel decision: Taxpayers had standing to challenge the "rifle shot" transition rules of the Tax Reform Act of 1986 which gave relief to others who were "similarly situated," but which did not give relief to taxpayers. The transition rules did not violate the Equal Protection Clause because there was a rational basis for Congress to have given relief to those taxpayers who petitioned Congress and most convincingly demonstrated that they relied on the old tax laws in making major investment decisions. (The court noted that taxpayers had not sought transitional relief from Congress.) En banc decision: Taxpayers did not have standing to challenge the constitutionality of transitional rules favoring other taxpayers.
6. Rev. Proc. 92-85, 1992-42 I.R.B. 32 (10/1/92). Revised standards that IRS will use to determine whether to grant an extension to make an election under Reg. § 301.9100-1. Provides (a) an automatic 12-month extension for certain elections, (b) an automatic 6-month extension for certain elections prescribed by the Code to be made by the due date of the return (or the due date of the return including extensions), and (c) for other extensions where taxpayer acted reasonably and in good faith, and the government would not be prejudiced.
7. Charter Co. v. United States, 971 F.2d 1576, 92-2 U.S.T.C. ¶ 50,500 (11th Cir. 9/15/92) (2-1). Taxpayer entitled to use a barred claim for the sole purpose of countering the IRS's offset against taxpayer's timely claim.
8. Day v. Commissioner, 975 F.2d 534, 92-2 U.S.T.C. ¶ 50,472 (8th Cir. 9/17/92). The Commissioner made more than a "naked assessment" in her determination that taxpayers omitted income from their massage parlor businesses. The statutory notice was accorded a presumption of correctness because it was based on a showing that records were kept on "door money," but not on "back room money" paid by the masseuses for the use of the back rooms, and the Commissioner showed a link between the taxpayers and the tax-generating income. Remanded for a determination of the innocent spouse issue.
9. Rev. Rul. 92-96, 1992-45 I.R.B. 22. Amounts of \$600 or more retained by licensed lottery ticket sales agents are treated as commissions paid by the state lottery for § 6041 information reporting purposes. However, no information return is required if the licensee is a corporation, Reg. § 1.6041-3(c).

10. **Rev. Proc. 92-90**, 1992-46 I.R.B. 30. Reduces IRS user fees for rulings in situations where taxpayer requests substantially identical rulings with respect to multiple entities.
11. **Harper v. Commissioner**, 99 T.C. No. 28 (10/29/92) (reviewed). Course of conduct of petitioner's attorney in failing to comply with discovery requests, court's orders compelling document production, court's pretrial standing order to stipulate facts and submit trial memorandum, and requirement of readiness to prosecute properly resulted in: (1) dismissal for failure to prosecute properly under Rule 123(b), and (2) attorney's personal liability under § 6673(a)(2) for \$7,400 (74 hours at \$100 per hour) of excessive costs.
12. **Real Property Tax Reporting**
 - a. **The Comprehensive National Energy Policy Act of 1992** (Pub. L. No. 102-486) requires information return reporting of the amount of real property taxes treated under § 164(d)(1)(B) as imposed on the purchaser of a residence. Act § 1939, Code § 6045(e)(4), effective for transactions after 12/31/92.
 - b. **The Comprehensive National Energy Policy Act of 1992** (Pub. L. No. 102-486) requires that both buyer and seller in seller-financed sales of residences report the other's name and taxpayer's identification number with respect to interest paid and received. Act § 1933, Code § 6109, applies to taxable years beginning after 12/31/91.
 - c. **Announcement 92-164**, 1992-47 I.R.B. 111. Provides for reporting on Form 1099-5 (pursuant to § 6045(e)), with respect to the seller of a residence, any real property tax treated as imposed on the purchaser. Notice 93-4, 1993-4 I.R.B. 7 (1/11/93). Reporting requirement under § 6045(e)(4) (as amended by the Energy Policy Act of 1992) for real estate brokers to reflect on revised Form 1099-5 portion of any real property tax that is allocable to a residential purchaser under § 164(d)(1)(B).
 - d. **IA-17-90**, proposed regulations, setting forth the § 6050H reporting requirements for recipients of points paid on residential mortgages (implementing 1989 Amendments to § 6050H) (F.R. 12/31/92).

13. **InverWorld, Ltd. v. Commissioner**, 979 F.2d 868, 92-2 U.S.T.C. ¶ 50,594 (D.C. Cir. 11/24/92). Affirms Tax Court's denial of corporate taxpayer's motion to amend its original petition to redetermine withholding tax liabilities to permit Tax Court to consider almost \$800 million of income tax deficiencies because the original petition contained no objective indication of an intent to contest the income tax deficiencies, i.e., no mention of amount of deficiency assessed, amount contested and years in dispute.

14. **Levy**

- a. **GL-709-88**, proposed regulations under § 6331, relating to the collection of tax by means of levy (F.R. 12/11/92).
- b. **T.D. 8466**, final regulations under § 6332, relating to the 21-day period before a bank may surrender property subject to levy (12/31/92).
- c. **T.D. 8467**, final regulations under § 6332, regarding the consequences of honoring an IRS levy (1/11/93).

15. **Disclosure of Tax Return Information**

- a. **Barrett v. United States**, 93-1 U.S.T.C. ¶ 50,291 (S.D. Tex. 4/1/93), on remand from 5th Circuit, 795 F.2d 446, 86-2 U.S.T.C. ¶ 9571 (1986). Doctor not entitled to damages under § 7431 for § 6103 return information disclosures by the IRS because the disclosures to the doctor's patients were "necessary" to obtain information which was not "otherwise reasonably available."
- b. **Johnson v. Sawyer**, 93-1 U.S.T.C. ¶ 50,065 (5th Cir. 12/29/92) (2- 1), aff'g, modifying, rendering and remanding 91-2 U.S.T.C. ¶ 50,302 (S.D. Tex. 1991). IRS press release following Johnson's guilty plea to tax evasion violated § 6103 and constituted negligence per se under Texas law, so recovery of damages against the United States under Federal Tort Claims Act (FTCA) was proper. The action was not preempted by former § 7217, nor by the tax assessment and collection exception to the FTCA. The § 6103 violations resulted in the guilty plea becoming a matter of public knowledge by adding to the information in the court record such additional information as Johnson's middle initial, his age, his home address and his official job title. Remanded for recomputation of the \$10 million plus damages. Dissent on the ground that IRS violations of § 6103 did not give rise to a cause

of action under FTCA and did not in any event cause Johnson's damage. Neither majority nor dissent relied upon an agreement that the U.S. Attorney's office would not issue a press release on the conviction.

- c. Mallas v. United States, 93-1 U.S.T.C. ¶ 50,302 (4th Cir. 5/20/93). Damages under § 7431 awarded to "investment counselor" [tax shelter promoter] for disclosure of promoter's tax return information by sending 73 investors a revenue agent report setting forth the promoter's criminal conviction [without stating that the conviction was reversed] and disallowing the investors' deductions. The audits were held not to be "administrative proceedings," in which dissemination is allowed by § 6103(h)(4)(C); that the information disclosed was a matter of public record and was non-confidential was held irrelevant. Remanded for possible award of punitive damages in the event of a determination that IRS acted willfully or with gross negligence.
16. Weiner v. IRS, 93-1 U.S.T.C. ¶ 50,024 (2d Cir. 1/25/93) (per curiam), aff'g, 93-1 U.S.T.C. ¶ 50,075 (S.D.N.Y. 5/1/92). The court held that taxpayer has no remedy for three erroneous and improper levies due to IRS "computer error." The court found that computer error by IRS employees did not amount to knowing or negligent disclosure of confidential tax return information under § 7431. There is no legal remedy for IRS employees' failure to apologize, explain, or deal with her courteously.
17. Hearne v. United States, 93-1 U.S.T.C. ¶ 50,334 (W.D. Tex. 4/30/93). Taxpayers not entitled to deduct ranch expenses for lack of a profit motive, where their only income from the ranch was a nominal fee for grazing purposes. The IRS's reexamination of two years' tax returns was upheld -- even though the parties had already settled on an agreed tax liability for those years -- because the settlement did not qualify as a closing agreement. Taxpayers' action for § 7433 civil damages failed because they had not exhausted all administrative remedies. The court commented:

Notwithstanding the dismissal of the Hearn's causes of action under 26 U.S.C. § 7433, the Court is constrained to make some observations regarding the evidence in this case. The IRS' conduct was repugnant and is unacceptable behavior from a United States governmental agency. It is clear beyond doubt the IRS and its personnel acted unprofessionally toward the Hearn's who were, and are, American taxpayers -- good taxpayers too, who pay

substantial amounts each year. There is no excuse for the length of time taken to conduct the 1985 audit or the ones that followed. There is also no excuse for the IRS to offer, after 11 months of evaluation, a proposed settled -- a settlement approved by a supervisor -- and then repudiate the offer and reverse the past year's "ground rules" a month later. The dates of notification of each additional audit correspond to the Hearn's protests and the defensive actions taken by the Hearn's. The timing and conduct of the IRS at the very least suggests an abuse of authority as do the ex parte communications between Schampers (district) and the Appeals Division. The Hearn's, and all taxpayers, deserved better treatment than the Hearn's received.

In this case, the IRS picked on the wrong person who they incorrectly presumed to be a patsy. Douglass Hearne is a trained/experienced lawyer who knew his rights and refused to be run over by the unnamed IRS employees. The great majority of taxpayers simply have to take such abusive conduct without recourse, because they simply cannot afford or do not know how to protect themselves. Hearne sought and obtained the information he thought he needed and has succeeded in bringing the questionable conduct to public light. It is clear the IRS and its agents treated the Hearn's unfairly and acted unprofessionally, but the Court can only offer the Hearn's its condolences and sympathy. While the Hearn's do not benefit from their suit, the Court hopes the IRS employees will become knowledgeable of this case and conduct themselves according to their positions of trust as public servants representing our country and its taxpayers, both large and small.

A take nothing judgment will be entered consistent with this opinion.

18. Anthony v. United States, 93-1 U.S.T.C. ¶ 50,140 (10th Cir. 3/3/93). The "final civil settlement" of a \$32,000 deficiency for \$15,000 by compromise while suit was pending in Tax Court did not entitle IRS to recover an additional \$19,000 in interest in light of taxpayers' repeated receipt of assurances from the government that the settlement would cover their "entire civil liability." Attorney's fees awarded to taxpayers.

19. **Hagaman v. Commissioner**, 100 T.C. No. 12 (3/15/93). Transferee of furniture, jewelry, furs, a residence, cash and stock, valued at \$263,000, is subject to assessment under § 6901(a) based upon her liability under both Tennessee and Florida law (as recipient of voluntary transfers that hindered collection) despite Commissioner's failure to show that transferor was insolvent at the time of, or immediately after, the transfers. The court followed **Commissioner v. Stern**, 357 U.S. 39, 58-2 U.S.T.C. ¶ 9594 (1958), which held that § 6901(a) merely provides a procedure through which taxes may be collected if a basis exists under applicable state law or equity for holding the transferee liable.
20. **United States v. McDermott**, 93-1 U.S.T.C. ¶ 50,164 (U.S. 3/24/93) (6-3), **rev'g and remanding** 945 F.2d 1475, 91-2 U.S.T.C. ¶ 50,491 (10th Cir. 1991). Federal tax lien filed before delinquent taxpayer acquired real property is given priority with respect to that real property, over a private creditor's previously filed judgment lien. Section 6323(a) gives the tax lien priority from the time notice was filed, while the private creditor's lien did not attach until the property was acquired.
21. **Lewis v. United States**, 93-1 U.S.T.C. ¶ 50,218 (Bankr. W.D. Tenn. 12/28/92). Entertainer's federal income tax liabilities were not discharged in bankruptcy because his evasive conduct towards the collecting revenue officer over a period of years constituted a willful attempt to defeat the payment of taxes, which constitutes an exception to discharge under 11 U.S.C. § 523(a)(1)(C).
22. **Aronsohn v. Commissioner**, 93-1 U.S.T.C. ¶ 50,157 (3d Cir. 3/17/93), **aff'g**, 92-2 U.S.T.C. ¶ 50,452 (M.D. Pa. 1992). Taxpayers were equitably estopped by their CPA's execution (pursuant to a Form 2848 Power of Attorney) of a Form 870-AD containing an explicit preclusion of refund claims for years covered under the settlement.
23. **T.D. 8469**, final regulations under § 7605, describing the criteria to be utilized by IRS employees in setting a time and place of examination (4/2/93). No change was made to the proposed and temporary regulations provision that the business location of taxpayer's representative generally will not be considered in determining the place of examination because qualified local representatives are generally available to taxpayers.
24. **AOD No. 1993-1**, 1993-22 I.R.B. 4. Acquiesces in **McGraw-Hill, Inc. v. United States**, 90-1 U.S.T.C. ¶ 50,053 (S.D. N.Y. 1990), insofar as it held taxpayer not to be estopped from seeking a refund attributable to an item that was unrelated to the issues settled in a Form 870-A.D.

25. Ann. 93-82, 1993-22 I.R.B. 31. The Internal Revenue Bulletin will be published semimonthly from June through September 1993 because of budget constraints.
26. T.D. 8479, final amendments to regulations under § 6050I, relating to the reporting requirement for trades or businesses receiving multiple cash payments totalling more than \$10,000 within any 12-month period with respect to the same transaction or a related transaction (6/18/93).
27. Cohen v. United States, 93-1 U.S.T.C. ¶50,354 (Fed. Cir. 6/4/93). Taxpayer entitled to a refund of funds remitted to the IRS in response to a 90-day letter when the IRS failed to assess the deficiency before the expiration of the statute of limitations.
28. Hudson v. Commissioner, 100 T.C. No. 37 (6/23/93). There is no collateral estoppel where a trial court's judgment in an earlier proceeding was affirmed by an appellate court on grounds different from those relied upon by the trial court (and the appellate court did not pass on the trial court's conclusions of law or findings of fact).
29. 1993 Act §13252 requires information reporting by financial institutions under new Code §6050P, effective 1/1/94. See, Notice 93-52, 1993-34 I.R.B. 1, for rules for reporting such income.
30. Godfrey v. United States, 93-2 U.S.T.C. ¶50,384 (7th Cir. 6/28/93). IRS was required to pay interest when taxpayers did not receive their original income tax refund check and the replacement check was received four months late.
31. 1993 Act §13271 amends Code §6611(e) by expanding the category of tax returns for which the IRS does not have to pay interest if a refund is issued by the 45th day, effective for returns to be filed on or after 1/1/94.

XII. Tax Shelters

- A. Hildebrand v. Commissioner, 967 F.2d 350, 92-2 U.S.T.C. ¶ 50,350 (9th Cir. 6/26/92). Interest accrued on 30-year balloon nonrecourse debt incurred to purchase overvalued timeshare units was not deductible because the transaction was a sham. Lukens v. Commissioner, 945 F.2d 92, 91-2 U.S.T.C. ¶ 50,517 (5th Cir. 1991), followed.

- B. Estate of Wallace v. Commissioner, 965 F.2d 1038, 92-2 U.S.T.C. ¶ 50,387 (11th Cir. 7/13/92). Physician involved in cattle feeding business (in commercial feedlots) could not deduct the cost of prepaid cattle feed in the year purchased because under § 464 he was a "limited entrepreneur" who did not "actively participate" in the management of the cattle-feeding enterprise, i.e., he had no control over how the commercial feedlots were operated.
- C. Krause v. Commissioner, 99 T.C. 132 (7/29/92). Enhanced oil recovery limited partnership activities were not engaged in with actual and honest profit objectives.
- D. Lombardo v. Commissioner, 99 T.C. No. 19 (9/28/92). Taxpayers failed to show that Commissioner's determination was based upon a matter before the grand jury, and subject to the Rule 6(e) [Federal Rules of Criminal Procedure] secrecy requirement.
- E. Waters v. Commissioner, 978 F.2d 1310, 92-2 U.S.T.C. ¶ 50,547 (2d Cir. 10/21/92). Taxpayer was not at risk with respect to a nominally recourse note executed in connection with a non-sham computer leasing transaction because taxpayer was protected from loss under § 465(b)(4) and there was no realistic possibility he would suffer economic loss. The court held that a theoretical possibility of suffering economic loss is insufficient to avoid applicability of § 465(b)(4).
- F. Peat Oil & Gas Associates v. Commissioner, 100 T.C. No. 17 (3/31/93) (reviewed). Synthetic fuel tax shelters were generic tax shelters because any economic benefit to taxpayers/limited partners was precluded. The concurring opinions denied the deductions but, in view of the Sixth Circuit opinions in Rose v. Commissioner, 868 F.2d 851, 89-1 U.S.T.C. ¶ 9191 (1989), and Smith v. Commissioner, 937 F.2d 1089 (1991), would not follow the generic tax shelter analysis.
- G. Pasternak v. Commissioner, 93-1 U.S.T.C. ¶ 50,226 (6th Cir. 4/8/93). Investments in master sound recording leasing activities were shams, lacking in economic substance or profit motive. Negligence, valuation overstatement and (increased rate of interest for substantial underpayments attributable to) "tax-motivated transactions" penalties were upheld.
- H. Bailey v. Commissioner, 93-1 U.S.T.C. ¶ 50,237 (2nd Cir. 4/20/93). Partnership's nonrecourse notes used to purchase rights from a motion picture company for a share of the motion pictures' earnings were not genuine debt, so depreciation on interest deductions were disallowed. The Second Cir. affirmed the Tax Court finding that, because partnership's contract rights were "worth no more than 48-56% of the face value of the corresponding nonrecourse note," the nonrecourse noters should not be regarded as part of the purchase price of the contract rights.

- I. Kantor v. Commissioner, 93-2 U.S.T.C. ¶50,433 (9th Cir. 7/20/93), aff'g and rev'g T.C. Memo. 1990-380. Amounts paid by limited partnership to another firm to research and develop computer software, where that other firm had the opportunity to obtain for a nominal sum the exclusive right to market the technology, were not deductible under §174 because the limited partnership was not in a trade or business of its own. Snow v. Commissioner, 416 U.S. 500 (1974), distinguished because the partnership here did not demonstrate a "realistic prospect" of entering into its own business if the research was successful, because §174 does contain a "trade or business" requirement. Imposition of the new negligence penalty was reversed because taxpayers (limited partners) had "few, if any, warning signals that they would not have been entitled to the [§174] deduction" at the time they invested in the partnership.