1992

Recent Developments - Taxation of Individuals, Partnerships, Estates and Trusts and Exempt Organizations

Meade Emory
I. ACCOUNTING

A. Accounting Methods

1. **Fidelity Associates, Inc. v. Commissioner**, 63 T.C.M. (CCH) 2327 (1992). Taxpayer sold schoolbooks and bereavement books pursuant to 2-year sponsorship contracts, on which it paid commissions to its sales representatives promptly after its approval of a sponsorship contract. Taxpayer deducted these commissions as they were earned and paid, but recorded these commissions for financial accounting purposes ratably with the inclusion of the book sale income [which was accrued as the books were shipped]. The § 446(a) conformity requirement does not preclude taxpayer's accrual of commissions paid because § 446(a) does not require absolute conformity; a § 446(b) change is impermissible because taxpayer's method of accounting is an acceptable method which clearly reflects income.


3. **Rev. Rul. 92-28**, 1992-15 I.R.B. 41. Contractors are permitted under § 460(e)(1) to use different methods for reporting income on long-term contracts, some of which are subject to mandatory use of the percentage of completion method and some of which are exempt from that requirement.

4. **RLC Industries Co. v. Commissioner**, 98 T.C. 457 (1992). Commissioner abused her discretion under 446(b) and Reg. 1.61-1-3(d)(5) in determining that taxpayer was not entitled to include its California fee timberland together with its Oregon fee timberlands in a single pool for purposes of computing depletion.
5. **Resale Mobile Homes, Inc. v. Commissioner**, 965 F.2d 818 (10th Cir 1992). Accrual method mobile home seller was required to report anticipated participation interest [i.e., a portion of the interest rate charged to purchasers] from consumer installment sales contracts it sold to finance companies in the tax year those contracts were sold, and not only at the time checks were received from the finance companies, because under the all events" test taxpayer had the right to receive participation interest.

6. **I.R.S. Announcement 92-93**, 1992-27 I.R.B. 43. 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.

7. **Rev. Rul. 92-65**, 1992-35 I.R.B. 6, 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**


2. **Hagen v. Commissioner**, 951 F.2d 1259 (10th Cir. 1991), remanding 57 T.C.M. (CCH) 1487 (1989). Commissioner's method of reconstruction of securities dealer's cost of goods sold was held arguably to lack rational basis," so the issue was remanded to Tax Court for further consideration.


C. **Installment Method**

1. **Estate of Silverman v. Commissioner**, 98 T.C. 54 (1992). Exchange (1982) of stock in state-chartered stock S&L for passbook saving accounts and CDs in acquiring federally-chartered mutual S&L was taxable, and (inasmuch as term account and CD principal could not be withdrawn for 6 years) could be reported on an amended 1982 return (filed in
1987) as an installment sale. The accounts and CDs did not secure" the indebtedness, but represented the purchaser's obligation.

2. **Estate of Frane v. Commissioner**, 98 T.C. 341 (1992) (reviewed, 5 judges dissenting). Self-canceling installment notes held by decedent for amounts due from his children on the sale to them of stock give rise to income under § 453B(a) and (f) at decedent's death because the cancellation is to be treated as a disposition of the note. (The 20-year term of the notes was less than decedent's life expectancy.) **Estate of Moss v. Commissioner**, 74 T.C. 1239 (1980) (treating SCIN as contingent), not followed.

3. **Baker v. Comm.**, unpub. op. (7th Cir. 1992), aff'g., 60 T.C.M. (CCH) 1443. Although there should be no doubt on this subject, when a taxpayer reports income per the installment method, it is the law in effect at the time of the receipt that governs its taxation (and not the law in effect when the election is made).

**D. Year of Receipt or Deduction**


2. **Truck & Equipment Corp. of Harrisonburg v. Commissioner**, 98 T.C. 141 (1992). Temp. Treas. Reg. § 1.404(b)-1T, relating to the timing of deductions for employee compensation (here, bonuses) received more than 2½ months after the employer's year in which the related services are rendered, is valid. Taxpayer failed to show it was unforeseeable either administratively or economically impracticable to avoid the deferral of receipt because the deferral was, in fact, foreseen.


4. **Ball, Ball & Brosamer, Inc. v. Commissioner**, 964 F.2d 890 (9th Cir. 1992). Contract between taxpayer/construction company and U.S. Army to extend space shuttle runway was not "substantially completed" under Treas. Reg. § 1.45-3(b)(2) until 1984 when the entire project was finished and accepted by the Army. The fact that only $146,409 on a $22 million contract was paid in 1984 was irrelevant because progress payments before the end of 1983 had to be viewed in the context of required completion and payment bonds.

5. **Rev. Rul. 92-51**, 1992-27 I.R.B. 9, 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.
I. BUSINESS INCOME AND DEDUCTIONS

A. Depreciation, Depletion, and Credits


2. Rev. Rul. 92-25, 1992-14 I.R.B. 5. Rules for determining the portion of total production attributable to a net profits interest, for purposes of determining § 613A(c)(2) "average daily production."

3. Apple Computer, Inc. v. Commissioner, 98 T.C. 232 (1992). Income generated upon the exercise of nonstatutory employee stock options may constitute wages paid or incurred for qualified services in calculating the § 41 [formerly § 44F] increasing research credit.

4. Kansas City Southern Industries, Inc. v. Commissioner, 98 T.C. 242 (1992). Commissioner abused her discretion in denying taxpayer's application to revoke its § 185(c) election [to amortize railroad grading], which taxpayer sought in order to obtain the benefits of depreciation and investment tax credit. The court found that the denial was motivated by the IRS desire to compel adherence to its administrative position that grading was nondepreciable -- a position that had been rejected by the courts -- and to preclude taxpayer from relying on the favorable judicial decisions.


6. Rev. Rul. 92-37, 1992-21 I.R.B. 5. Surviving spouse's basis for calculating cost depletion on property representing her 1/2 share of community oil and gas property for the taxable year of decedent's death is her adjusted basis as of the end of her taxable year, i.e., a fair market value basis under § 1014(b)(6).

7. Rev. Rul. 92-38, 1992-21 I.R.B. 6. A production payment, the consideration for which is used to purchase depreciable mining equipment to be used in developing a mineral property, qualifies as a production payment carved out for development under § 636(a), i.e., it is not a mortgage loan, and it does qualify as an economic interest in the mineral property.

8. Nalle v. Commissioner, 99 T.C. No. 9 (Aug. 5, 1992). 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) Treas. Reg. § 1.48-12(b)(5) provides that a relocated building does not qualify.

9. **Canterbury v. Commissioner**, 99 T.C. No. 12 (1992). 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 other intangible assets acquired, including goodwill (except for a relatively small allocation to going-concern value), were found to inhere in the franchise. See, Green, "Section 1253 Revisited: A Case Study Of Modern Reform," 56 Tax Notes 1329 (Sept. 7, 1992).


B. Expenses

1. **Employee Business Expenses.**


   b. **Proposed amendments of regulations** (EE-46-91) under § 132, relating to working condition fringe benefits (1) for transportation provided to government employees for security concerns and (2) to bona fide volunteers who perform services for exempt organizations or governmental units (56 Fed. Reg. 48,465 (1991) (to be codified at 26 C.F.R. § 1.132)).

2. **Soliman v. Commissioner**, 935 F.2d 52 (4th Cir. 1991) (2-1), cert. granted, 112 S. Ct. 1472 (1992), 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 Pomerantz.

3. **INDOPCO Inc. v. Commissioner**, 112 S. Ct. 1039 (1992), aff’g, National Starch & Chem. Corp. v. Commissioner, 918 F.2d 426 (3rd Cir. 1990). Professional expenses incurred by a target corporation in the course of a friendly takeover are not deductible under § 162(a) as ordinary and necessary business expenses because they were capital in nature, having been "incurred for the purpose of changing the corporate structure for the benefit of future operations." The fact that the expenditures do not create or enhance a separate and distinct additional asset is not controlling. The Court noted that "[t]he notion that deductions are exceptions to the norm of capitalization finds support in various aspects of the Code." See, Raby, "Expenses That Benefit The Future: INDOPCO & The ‘White Knights," 54 Tax Notes 1648 (March 30, 1992); Adams & Hinderliter, "INDOPCO, Inc. v. Commissioner: Impact Beyond Friendly Takeovers," 55 Tax Notes 93 (April 6, 1992); Javaras and Maynes, "Business Expansion And Protection In The Post-INDOPCO World," 55 Tax Notes 971 (May 18, 1992); Sheppard, "Is The IRS Abusing INDOPCO?" 56 Tax Notes 1110 (Aug. 31, 1992).


5. **LTR 9240004**. Relying on INDOPCO the IRS has ruled that costs for the removal and replacement of asbestos insulation must be capitalized.

6. **In re Federated Dep’t Stores, Inc.**, 135 B.R. 950 (S.D. Ohio 1992). Break-up fees paid to "white knights" [DeBartolo and Macy's] in connection with failed mergers were deductible either as § 162(a) business expenses or as 165(a) abandonment losses. National Starch & Chem. Corp. v. Commissioner, 918 F.2d 426 (3rd Cir. 1990), distinguished because the mergers here never materialized. See, also, In re Federated Dep’t Stores, Inc., 135 B.R. 962 (S.D. Ohio 1992) (neither § 269 nor § 382 limited the use of NOLs).

7. **Frederick Wiseman Co. v. Commissioner**, 97 T.C. 563 (1991) (reviewed). Amount paid in redemption of corporation’s outstanding shares from all but one shareholder and the incidental expenses incurred in connection with the redemption, which was brought about by an outside force and necessary to the survival of the corporation’s automobile distributorship business, are not deductible under § 162(a). They are nondeductible capital expenditures [nonamortizable because of the § 311(a) prohibition against gain or loss recognition on stock redemptions]. See also § 162(k). Five Star Mfg. Co. v. Commissioner, 355 F.2d 724 (5th Cir. 1966), rev’g 40 T.C. 379 (1963), not followed because it has been sapped of any remaining vitality" by the Supreme Court’s Gilmore [372 U.S. 39 (1963)]/Hilton Hotels [397 U.S. 580 (1970)]/Woodward [397 U.S. 572 (1970)]/Arkansas Best [485 U.S. 212 (1988)] line of cases.

8. **Ocean Drilling & Exploration Co. v. United States**, 92-1 U.S.T.C. ¶ 50,018 (Cls. Ct. 1991). 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. The Tax Court trilogy of Sears Roebuck & Co., 96 T.C. 61, modified, id. at 671
1991; The Harper Group, 96 T.C. 45 (1991); and AMERCO, 96 T.C. 18 (1991) involved unrelated business of 99%, 30% and 52% to 74%, respectively.

9. Chicago Stadium Corp. v. United States, 91-2 U.S. T.C. ¶ 50,352 (N.D. Ill. 1991), cert. granted, 112 S. Ct. 1472 (1992). Payments in 1977 to majority (50.1%) shareholder-employee of sporting arena corporation of $30,000 plus 50% of corporation’s gross receipts from Chicago Bulls’ 1973 lease was unreasonable compensation; only the amount allowed by the IRS ($138,000 of $335,700 total payments) was deductible. Corporation lost $340,000 in 1977. Court rejected the contention that shareholder acquired a share of the Chicago Bulls in order for the Bulls to remain as a tenant.

10. Noyce v. Commissioner, 97 T.C. 670 (1991). Expenses and depreciation of private airplane were deductible by vice chairman of Intel Corporation. Deductions for depreciation under § 168 are not subject to the § 162 requirements that they be "ordinary and necessary" or reasonable in amount; the only requirement is that the depreciable property be used in the taxpayer’s trade or business.


12. Rev. Rul. 92-3, 1992-3 I.R.B. 4. Day care provider should compute the 280A deduction by multiplying total costs by two fractions: (1) total square footage used in the business over total square footage of the home, and (2) total hours the business is operated (including preparation and cleanup) over total number of hours in a year (i.e., 8760 or, for 1992, 8784).


14. King’s Court Mobile Home Park, Inc. v. Commissioner, 98 T.C. 511 (1992). Taxpayer’s original return omitted $58,000 of rental income which was diverted by its controlling shareholder. The amended return included the amount in income and increased its deduction for wages in the same amount. Held, the $58,000 was not paid to the controlling shareholder with the intent to compensate, so taxpayer was not entitled to deduct that amount.


C. **Losses and At-Risk**


2. **American Offshore, Inc. v. Commissioner,** 97 T.C. 579 (1991) (reviewed). Taxpayers were not barred from claiming a § 166 bad debt deduction for worthlessness of an installment obligation by the § 453 rules which [under § 453B(a) and (f) limit the deferral available if an installment obligation is disposed of or cancelled; i.e., the § 166 deduction is not precluded by § 453B(a) or (f).

3. **Holden v. Commissioner,** 98 T.C. 160 (1992). Taxpayers were required to recalculate their alternative minimum tax for 1980 to take into account a net operating loss carryback from 1983.

4. **Callahan v. Commissioner,** 98 T.C. 276 (1992). Taxpayers/limited partners were subject to overcalls of three times their cash contributions, but could by written notice elect out of the overcall provision so long as the partnership was solvent. Held, the overcall obligation is contingent and illusory, so taxpayers' 465 amounts at risk are limited to their cash contributions. Pritchett v. Commissioner, 827 F.2d 644 (9th Cir. 1987), rev'g and remanding 85 T.C. 580 (1985), distinguished.


6. **Woodall v. Commissioner,** 964 F.2d 361 (5th Cir. 1992). 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 (5th Cir. 1991), distinguished on the ground that the IRS here relied upon taxpayer's statement, not another's statement.


D. **Business Income**

1. **Breakell v. Commissioner,** 97 T.C. 282 (1991). In computing alternative minimum tax, the 58(h) adjustment for items that do not result in the reduction of regular tax will follow the principles of **First Chicago Corp. v. Commissioner,** 88 T.C. 663 (1987), aff'd 842 F.2d 180 (7th Cir. 1988). The court held that only that portion of the non-utilized § 1202 preference deduction (a total of $163,354 out of the total § 1202 deduction of $427,646) that did not contribute to the negative adjusted gross income ($4,527) was eligible for § 58(h) treatment; the remaining $158,895 (equal to negative AGI) had already been taken into account in computing AMT.


II. **CAPITAL GAIN AND LOSS**

1. **Guardian Industries Corp. v. Commissioner,** 97 T.C. 308 (1991). Silver-bearing waste material generated in the course of taxpayers' photofinishing business is § 1221(1) property held primarily for sale to customers in the ordinary course of business; therefore, income from 228 such sales of silver waste to refiners during a 2-year period (giving rise to 37%-39% of taxpayer's net income) is ordinary income, and not short-term capital gain. The environmental, etc. reasons for extracting the silver waste from discharged waste waters are not conclusive of the purpose for which the silver waste was held.

2. **Bramblett v. Commissioner,** 960 F.2d 526 (5th Cir. 1992), rev'g 59 T.C.M. (CCH) 876 (1990). Partnership sales of investment real estate to a related corporation [identically owned by partnership's four partners], which developed the real estate and sold it to various third parties, produced capital gains because the partnership was not directly in the business of selling land [neither frequency nor substantiality of sales]. The corporation was not the agent of the partnership and its activities cannot be attributed to the partnership; it had as a major independent business reason for its existence the insulation of the individuals from unlimited liability during the development process.

3. **Dial v. Commissioner,** 968 F.2d 898 (9th Cir. 1992). Affirms summary judgment holding treasury bill futures contracts to be capital assets, even though former § 122(5)

4. *Eck v. Commissioner*, 99 T.C. No. 1 (1992). 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.

5. *Aizawa v. Commissioner*, 99 T.C. No. 10 (1992). 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 $18,391.38, 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.

6. *Williford v. Commissioner*, 64 T.C.M. (CCH) 422 (1992). 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.

7. *Standley v. Commissioner*, 99 T.C. No. 13 (1992). 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.
III. EXEMPT ORGANIZATIONS AND CHARITABLE GIVING

1. McLennan v. United States, 91-2 U.S.T.C. ¶ 49,893 (Cls. Ct. 1991). Charitable deduction allowed for transfer of scenic easement to conservancy over government objections that taxpayers lacked donative intent and conservation objectives, but made the transfer to maintain their property values and to receive a tax deduction.

2. Estate of Miller v. Commissioner, 62 T.C.M. (CCH) 997 (1991). "Official Big Game Hunter of Louisiana" was allowed to deduct as a charitable contribution the value of his animal hunting trophies donated to the State of Louisiana.

3. Chronicle Publishing Co. v. Commissioner, 97 T.C. 415 (1991). Newspaper publisher's donation of its clippings library to a charitable organization does not give rise to any deduction because (a) it falls within the § 1221(3) category of letter or memorandum, or similar property" as an archive" under Treas. Reg. § 1.1221-1(c)(2), which is ordinary income property on which contributions would be disallowed under § 170(e)(1)(A), and (b) the § 1221(3)(B) provision covering a taxpayer for whom such property was prepared or produced" applies to corporations.

4. Powell v. United States, 945 F.2d 374 (11th Cir. 1991), vacating and remanding 91-1 U.S.T.C. ¶ 50,117 (S.D. Fla. 1990). On issue of deductibility of payments to Church of Scientology of Florida, dismissal of taxpayer's complaint reversed and taxpayer given the opportunity to show the IRS's administrative inconsistency in allowing deductions to members of other religions who make quid pro quo payments. Hernandez v. Commissioner, 490 U.S. 680 (U.S. 1989), distinguished because there wasn't a proper factual record to establish the IRS's discordant treatment of religious contributions."

5. Ann Jackson Family Foundation v. Commissioner, 97 T.C. 534 (1991) (reviewed). Private nonoperating foundation was not required to include in § 4942(d) "distributable amount" for the § 4942(a) excise tax on undistributed income of private foundations, distributions received from § 4947(a)(2) split-interest trust. Interpretative Foundation Excise Tax Reg. § 53.4942(a)-2(b)(2) was invalidated because the 1981 ERTA amendment to § 4942 limited the required distribution to a minimum investment return" of 5% of the foundations assets," not to adjusted net income.""

6. Guide Int'l Corp. v. United States, 948 F.2d 360 (7th Cir. 1991). Nonprofit organization whose membership was restricted to owners of IBM mainframes did not quality as a § 501 (c)(6) exempt business league because it primarily promoted one segment of the mainframe computer business and not a line of business.

7. I.R.S. News Release IR-92-4 (Jan. 17, 1992) and I.R.S. Announcement 92-15, 1992-5 I.R.B. 51. Payments to tax-exempt organizations for extensive promotions of payors constitute advertising income subject to the § 511 et seq. unrelated business income tax, and not nontaxable contributions, under examination guidelines proposed. As a matter of audit tolerance, the IRS will not apply the guidelines to purely local organizations that receive relatively insignificant gross revenue from corporate sponsors and generally operate with significant amounts of volunteer labor.
8. **Hodgdon v. Commissioner**, 98 T.C. 424 (1992). The § 1011(b) "bargain sale" rule is applicable for gain recognition purposes to an otherwise valid charitable contribution that must be carried over to a future taxable year, as is provided by Treas. Reg. § 1.1011-2(a)(2).

9. **Texas Learning Technology Group v. Commissioner**, 958 F.2d 122 (5th Cir. 1992). Section 501(c)(3) organization created by an interlocal agreement among 11 school districts does not qualify for the § 509(a)(1) "political subdivision" exception from private foundation status because it has not been delegated any authority to exercise sovereign power.


12. **Thorne v. Commissioner**, 99 T.C. No. 4 (1992). 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.


IV. INTEREST


2. Rev. Proc. 92-12, 1992-3 I.R.B. 27. Points paid by cash basis taxpayers for the acquisition of a principal residence are deductible if: (1) so designated on Uniform Settlement Statement; (2) computed as a percentage of amount borrowed; (3) charged under established business practice; (4) paid for acquisition of principal residence; and (5) paid directly by taxpayer. See Rev. Proc. 92-11, 1992-3 I.R.B. 26 (guidance provided for filing information returns for points received in connection with the financing of the purchase of a principal residence); see also Rev. Rul. 92-2, 1992-3 I.R.B. 5.


V. NONTAXABLE EXCHANGES


3. LTR 9227002. 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. See, "IRS Refusal To Apply Economic Unit Test In Denial Of Section 1033 Appears Questionable," Letter Ruling Review, Aug. 1992.


VI. PARTNERSHIPS

A. Partnership Audit Rules


2. **Affiliated Equipment Leasing II v. Commissioner,** 97 T.C. 575 (1991). Tax Court lacks jurisdiction over former § 6612(c) interest on tax-motivated transactions in a partnership level proceeding because it is an "affected item" that can only be determined at the individual partner level.

3. **Carmel v. Commissioner,** 98 T.C. 265 (1992). In a proceeding determining adjustments to nonpartnership items, husband sought § 6013(e) innocent spouse relief with respect to possible adjustments of partnership items attributable to wife’s interest in a TEFRA partnership. Held, the Tax Court lacks jurisdiction to order Commissioner to issue an affected item” notice of deficiency at the end of the partnership proceeding; the existing statutory scheme does not provide a prepayment forum to raise the issue of innocent spouse relief with respect to a liability attributable to an investment in a TEFRA partnership.

4. **Harris v. Commissioner,** 99 T.C. No. 6 (1992). 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.

5. **Treaty Pines Investment Partnership v. Commissioner,** 967 F.2d 206 (5th Cir. 1992). 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.

6. **McKnight v. Commissioner,** 99 T.C. No. 8 (1992). Small partnership exception in TEFRA applies to "simple" partnerships where the same-share rule is satisfied, as
it was according to Treas. 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.

7. **Hambrose Leasing 1984-5 Limited Partnership v. Comm.,** 99 T.C. No. 15 (1992). The determination of a partner's amount "at-risk" with respect to partnership liabilities personally assumed is not a partnership item, but is an "affected item" with respect to which the Tax Court lacks jurisdiction in a partnership level proceeding.


9. **Aufleger v. Comm.,** 99 T.C. No. 5 (1992). Held that unexpired portion of 3-year limitations period is "tacked" on to period during which running of period is suspended under §6229(d).

10. **Rev. Proc. 92-33,** 1992-17 I.R.B. 28. IRS clarifies "free transferability of interests" standard indicating that the partnership will fail that standard if the transferability of more than 20% of all interests is restricted.

**B. Miscellaneous**

1. **Echols v. Commissioner,** 950 F.2d 209 (5th Cir. 1991) (per curiam), denying petition for reh'g of 935 F.2d 703 (5th Cir. 1991). Taxpayer entitled to take a § 165(a) loss deduction for a worthless interest in a partnership, whether or not title had been divested or the partnership interest had been abandoned. The test for worthlessness is a combination of a subjective determination by the taxpayer of the fact and year of worthlessness to him, and the existence of objective factors reflecting completed transaction(s) and identifiable event(s) in the year in question." The alternative holding of the original decision is reaffirmed.

2. **Schneer v. Commissioner,** 97 T.C. 643 (1991) (reviewed, 2 judges dissenting). Assignment of income by partner to partnership respected for tax purposes because the court concluded that taxpayer partner "earned" the income while a partner of the partnership to which he had agreed to pay such income. Generally, income of a type normally earned by the partnership may be freely assigned by the partner where the venture was not formed merely to avoid the effect of **Lucas v. Earl,** 281 U.S. 111 (1930). Concurring (Beghe and another judge) say income to individual, with § 162(a) deduction. Dissents say partner was the true earner because (Wells) the fees were for past services" and (Halpern) because the fees were earned by the taxpayer and § 721 precludes any deduction. See, Sheppard, "Partnership Mysticism and the Assignment-of-Income Doctrine," 54 **Tax Notes** 8 (Jan. 6, 1992); Asimow, Applying the Assignment of Income Principle Correctly," 54 **Tax Notes** 607 (Feb. 3, 1992); Cowan, "Tax Court Leaves Confusion In Wake Of Decision On Assignment Of Income To Partnership," 55 **Tax Notes** 1535 (June 15, 1992); Kamin, "Analyzing Partnerships' Assignment Of Income In **Schneer,**" 57 **Tax Notes** 129 (Oct. 5, 1992).


5. **Rev. Rul. 92-15**, 1992-12 I.R.B. 6. Provides for adjustment in basis of lower-tier partnership property where the upper tier partnership distributes property to a partner and, both partnerships having made § 754 elections, under § 734(b) adjusts the basis of its interest in the lower tier partnership. Similar rules for the distribution of a lower-tier partnership interest to a partner of the upper-tier partnership where § 732(a)(2) applies to limit the distributee partner's basis in the partnership interest.

6. **Weiss v. Commissioner**, 956 F.2d 242 (11th Cir. 1992). Partner did not realize § 752(b) capital gain upon the forfeiture of his partnership interest [for failure to meet a capital call] on the dissolution of a Florida motel operation partnership because he continued to be liable on his share of partnership liabilities, i.e., his personal guarantee of a bank loan to the partnership.

7. **Rev. Proc. 92-33**, 1992-17 I.R.B. 28, supplementing Rev. Proc. 89-12, 1989-1 C.B. 798. The IRS will rule that a partnership lacks free transferability of interests if the partnership agreement restricts transferability of partnership interests representing more than 20% of all interests in partnership capital, income, gain, loss, deduction, and credit. (Treas. Reg. § 301.7701-2(e)(1) provides that free transferability exists if members owning "substantially all" of the interests of an entity can freely substitute a non-member.)

8. **Rev. Proc. 92-35**, 1992-18 I.R.B. 21. The IRS will not take the position that a limited partnership has "continuity of life" if local law or the partnership agreement provides that the remaining general partners (or at least a majority in interest of all remaining partners) may agree to continue the partnership upon the bankruptcy or removal of a general partner. (Compare Rev. Proc. 89-12, 1989-1 C.B. 798, where the IRS would not rule if less than a majority in interest could continue the partnership.)

9. **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.

10. **Mark IV Pictures, Inc. v. Commissioner**, 969 F.2d 669 (8th Cir. 1992), aff'g 60 T.C.M. (CCH) 1171. 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]. See, Raby, "Receiving An Equity Interest For Services: Wherein Ordinary Income Can Be Offset By Capital Loss," 56 Tax Notes 911 (Aug. 17, 1992).
VII. INDIVIDUAL INCOME AND DEDUCTIONS

A. Miscellaneous Deductions and Credits

1. Cloud v. Commissioner, 97 T.C. 613 (1991). Payments to the Democratic Party made by deputy registrar of State Bureau of Motor Vehicles were nondeductible political contributions. Negligence penalty inappropriate on this issue because payments were apparently required; the Commissioner abused his discretion in not waiving the § 6661 penalty under § 6661(c).

2. Ianniello v. Commissioner, 98 T.C. 165 (1992). Taxpayers were forced to forfeit the amount they skimmed from their restaurants and bars as a result of their RICO convictions. The skimmed amounts are § 61 income in the 1981 and 1982 years of receipt even though they were acquired unlawfully; fraud penalties were added. Taxpayers were not entitled to § 165(a) loss deductions in those years because the skimmed amounts were not forfeited until 1989 and 1990. Neither the Fifth Amendment Double Jeopardy Clause nor the Eighth Amendment Excessive Fines Clause was violated.

3. O'Neill Irrevocable Trust v. Commissioner, 98 T.C. 227 (1992). Deduction for fees paid by trust for investment advice is subject to the § 67(a) 2%-of-AGI floor because they are not § 67(e) costs which are unique to the administration of an estate or a trust [such as trustee fees or trust accounting fees mandated by law or the trust agreement]. See, Kasner, "Tax Court Decision Is Bad News For Trustees," 55 Tax Notes 369 (April 20, 1992).

4. Induni v. Commissioner, 98 T.C. No. 42 (1992). A portion of taxpayer's § 163(a) mortgage interest and § 164(a)(1) real property tax deductions must be disallowed under § 265(a) by reason of the deductions' partial allocability to a tax-exempt living quarters allowance received by taxpayer as an INS employee stationed at Montreal and living in Canada. The double benefit allowed military officers and ministers under § 265(a)(6) does not inure to others.


B. Damages

1. **Sparrow v. Commissioner**, 949 F.2d 434 (D.C. Cir. 1991), aff'g 57 T.C.M. 9(CCH) 816 (1989). Damages for the settlement of a racial discrimination complaint under Title VII of the Civil Rights Act of 1964 were taxable, and were not § 104(a)(2) personal injury payments because that section is limited to an award of money recoverable in an action at law and Title VII provides only for equitable relief [back pay being an equitable remedy akin to restitution]. The court rejects Burke [929 F.2d 1119 (6th Cir. 1991)] and Rickel 900 F.2d 655 (3rd Cir. 1990)].

2. **Stocks v. Commissioner**, 98 T.C. 1 (1992). Portion of settlement payment (1/6) received by college professor on account of a potential racial discrimination claim by tenured faculty member was excludable under § 104(a)(2), but remaining portion (5/6) received on account of a contract claim for failure to notify of termination before February 1st was taxable.

3. **Redfield v. Insurance Co. of North America**, 940 F.2d 542 (9th Cir. 1991). Damages for age discrimination were excludable from gross income under § 104(a)(2), so tax withholding by defendant was improper.

4. **Ray v. United States**, 92-1 U.S.T.C. ¶ 50,210 (Cls. Ct. 1992). 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. **Miscellaneous Income**

1. *Montelepre Systemed, Inc. v. Commissioner*, 956 F.2d 496 (5th Cir. 1992). Payment of $1.5 million to taxpayer-hospital operator for giving up a contractual right of first refusal was properly characterized as § 83 compensation in the year received because that was the first year that taxpayer's contractual right ceased being subject to a substantial risk of forfeiture.


3. *Rev. Rul. 92-53*, 1992-27 I.R.B. 7. The amount by which a nonrecourse debt exceeds the fair market value of the property securing the debt is taken into account in determining whether, and to what extent, a taxpayer is insolvent within the meaning of 108(d)(3) [excess of liabilities over FMV of assets], but only to the extent that the excess nonrecourse debt is discharged.

4. *Bannon v. Commissioner*, 99 T.C. No. 3 (1992). 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.


10. *Rev. Rul. 92-69*, 1992-36 I.R.B. 5. IRS provides that employer-provided outplacement services are excludable as a working condition fringe (§132(d)) unless they are offered in lieu of higher severance payments.

11. *Bannon v. Comm.*, 99 T.C. No. 3 (1992). State payments for woman’s care of daughter were not excludable welfare benefits but were taxable compensation.
VIII. PROCEDURE, PENALTIES AND PROSECUTIONS

A. Penalties and Prosecutions

1. Barton v. Commissioner, 97 T.C. 548 (1991) (reviewed). Tax Court has jurisdiction, in determining whether an overpayment exists, to determine taxpayers' liability for increased interest under form § 6621(c) on tax attributable to a tax-motivated transaction. White v. Commissioner, 95 T.C. 209 (1990), holding that increased interest under former § 6621(c) was not part of a "deficiency" for Tax Court jurisdiction purposes, was distinguished.

2. Mullikin v. United States, 952 F.2d 920 (6th Cir. 1991) (2-1), rev'g and remanding 90-2 U.S.T.C. ¶ 50,414 (E.D. Ky. 1990). Refund suit for $99,000 in penalties imposed on accountant who prepared Form 941 quarterly employment tax returns that omitted cash wages paid to his client's employees. The district court erred in applying the 28 U.S.C. § 2462 five-year statute of limitations to assessment of § 6701 penalties because no statute of limitations is applicable. It further erred in limiting the $10,000 penalties to one per year because there were four quarterly taxable period[s] in each of the two years involved.

2. Spitz v. Commissioner, 954 F.2d 1382 (7th Cir. 1992) (Posner, J.), rev'g 60 T.C.M. (CCH) 920 (1990). Government failed to prove civil fraud by clear and convincing evidence against a [former IRS agent and] CPA and his wife who misreported fees that the CPA earned from a tax shelter venture, received by wife under an erroneous social security number, because taxpayers were believable, albeit "thoroughly disorganized," and the evidence of fraud was weak and equivocal."

3. Emergency Unemployment Compensation Act, Pub. L. No. 102-164, 105 Stat. 1049 (1991). The cost of extended jobless benefits will be offset by modifying the § 6654 estimated tax rules for noncorporate taxpayers for years after 1991. Those taxpayers whose modified AGI exceeds $75,000 and is more than $40,000 over prior year's AGI (and who made an estimated tax payment, or were penalized for failure to do so, in any of the three preceding tax years) will no longer be able to use the 100% of prior year's tax alternative to avoid § 6654 penalties. Modified AGI does not include gains from involuntary conversions or from principal residence sales, or increases in qualified pass-through items from less-than-10% interests in S corporations or limited partnerships (except for general partners).

4. United States v. Security Pacific Business Credit, Inc., 956 F.2d 703 (7th Cir. 1992). A net payroll lender under § 3505 who was also a § 6672 responsible person was liable for interest on the unpaid withholding taxes up to the 25% [of the loan amount] limit of § 3505 despite the absence of any preassessment interest requirement in § 6672. The court was "reluctant to truncate § 3505 in order to protect a nonexistent policy."

5. Goulding v. United States, 957 F.2d 1420 (7th Cir. 1992). Attorney subjected to § 6694 preparer penalties under the Treas. Reg. § 301.7701-15(b) "substantial preparation" rule with respect to limited partners' tax returns by reason of his negligent preparation of three tax shelter partnership returns and Schedules K-1.
6. **Rev. Rul. 92-54, 1992-27 I.R.B. 20.** A corporation may avoid the § 6655(a) penalty for underpayment of estimated tax installments by relying on the preceding year's tax liability under § 6655(d)(1)(B)(ii) only when the preceding year's tax return showed a positive tax liability, as opposed to a zero tax liability.


8. **Knudsen v. United States,** 966 F.2d 733 (2d Cir. 1992). 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.

9. **Adler & Drobny Ltd. v. United States,** 792 F. Supp. 579 (N.D. Ill. 1992). Accountant who prepared Schedule K-1 was not the preparer of partners' individual returns where the returns were complicated and the K-1s were not under §7701(a)(36) a "substantial portion" of any of the returns. **Goulding v. United States,** 717 F. Supp. 545 (N.D. Ill. 1989), aff'd, 957 F.2d 1420 (7th Cir. 1992), not followed.

10. **Turpin v. United States,** 970 F.2d 1344 (4th Cir. 1992), rev'g and remanding 91-2 U.S.T.C. ¶ 50,403 (D. Md. 1991). 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.

11. **Niedringhaus v. Commissioner,** 99 T.C. No. 11 (1992). 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,** 489 U.S. 192 (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."

12. **Rev. Proc. 92-23, 1992-13 I.R.B. 21.** IRS identifies circumstances under which disclosure on a taxpayer's return is adequate for purposes of reducing the understatement of tax under §6662(d) and for purposes of the preparer penalty (§6694(a)). See, also, **Notice 92-41, 1992-39 I.R.B. 1,** providing that old Form 8275 may be used to disclose a position for §6662 purposes.

B. **Summons**

1. **Mimick v. United States**, 952 F.2d 230 (8th Cir. 1991), rev’g and remanding 91-1 U.S.T.C. ¶50,070 (D. Neb. 1991). Third-party recordkeeper summons and taxpayer summonses were enforceable even though the IRS failed to deliver attested copies [as required by § 7603] because the IRS acted in good faith and taxpayer was not harmed.

2. **PAA Management, Ltd. v. United States**, 962 F.2d 212 (2nd Cir. 1992). Reversing district court order quashing 7602 summonses that were issued to third-party recordkeepers alter final partnership administrative adjustments. The § 6223(f) provision that only one FPAA may be sent to each partner for each year does not mean that the IRS’s determination is not subject to subsequent revision. Section 6230(h) provides that the summons power is not to be circumscribed by § 6223(l).

3. **DiAndre v. United States**, 968 F.2d 1049 (10th Cir. 1992). 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.

C. **Litigation Costs**

1. **Bayer v. Commissioner**, 98 T.C. 19 (1992) (reviewed), on reconsideration of 61 T.C.M. (CCH) 2890 (1991). Cost of living adjustments for the § 7430(c)(1)(B)(iii) $75 hourly rate for attorney’s fees should be computed from the 10/1/81 effective date of the Equal Access to Justice Act [28 U.S.C. § 2414, 5 U.S.C. § 504], as opposed to the 1/1/86 effective date of § 7430(c)(1)(B)(iii) because the circumstances surrounding enactment of the I.R.C. provision show Congress intended to conform § 7430 to the EAJA as far as possible. Tax Court adheres to its earlier decision and refuses to follow **Cassuto v. Commissioner**, 936 F.2d 736 (2d Cir. 1991), which held that the 1/1/86 date for COLA calculation applies.

2. **Proposed regulations** (IA-3-89) under § 7430, relating to the circumstances which exhaustion of remedies has taken place for attorney’s fee recoveries (57 Fed. Reg. 19,828 (1992)) (to be codified at 26 C.F.R. § 301.7430). Following **Minahan v. Commissioner**, 88 T.C. 492 (1987), in not requiring taxpayers to agree to extend the time for assessment and collection.

3. **Heasley v. Commissioner**, 967 F.2d 116 (5th Cir. 1992), aff’g, rev’g and remanding 61 T.C.M. (CCH) 2503 (1991). 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 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.

D. **Statutory Notice**

1. **Inverworld, Ltd. v. Commissioner**, 98 T.C. 70 (1992). Tax Court petition addressed to statutory notice for taxpayer’s liability for § 1441-1464 withholding tax could not be amended to contest taxpayer’s deficiencies in corporate income tax for the same years that were determined by a separate statutory notice. The petition did not (1) indicate the amount of deficiencies determined, (2) refer to or dispute what taxpayer is contesting, (3) refer to or attach the separate statutory notice, which was not cured by a general statement in the prayer for relief.

2. **Powell v. Commissioner**, 958 F.2d 53 (4th Cir. 1992). Tax Court erred in dismissing taxpayers’ petition for lack of jurisdiction where it was filed within 90 days of taxpayers receipt of actual notice of the deficiency by means of an IRS notice of levy. The 2/29/88 notice of deficiency was insufficient because it was not mailed to taxpayers’ last known address where taxpayers had filed a tax return with a new address on 2/11/88.

3. **Cross v. Commissioner**, 98 T.C. No. 41 (1992). An Indian reservation geographically bounded on all sides by the State of Washington is not "outside the United States" within the meaning of § 6213(a), so a notice of deficiency sent to taxpayer residing there does not allow him 150 days within which to file his Tax Court petition.

E. **Statute of Limitations**

1. **Bufferd v. Commissioner**, 952 F.2d 675 (2d Cir. 1992), cert. granted, 112 S. Ct. 2990 (1992). Follows Siben v. Commissioner, 930 F.2d 1034 (2d Cir. 1991) and refuses to follow Kelley v. Commissioner, 877 F.2d 756 (9th Cir. 1989), in finding pass-through income from an S corporation on which the limitations period had run could be assessed against individual shareholder whose limitations period was still open.

2. **Felhaber v. Commissioner**, 954 F.2d 653 (11th Cir. 1992), aff'g 94 T.C. 863 (1990). The limitations period for assessing a tax liability against an S corporation shareholder begins to run from the date that the individual, not the S corporation, files his return. Kelley v. Commissioner, 877 F.2d 756 (9th Cir. 1989), not followed. Section 6037(a) (last sentence) applies only to the S corporation's own corporate-level taxes.

3. **Crawford v. Commissioner**, 97 T.C. 302 (1991). The § 183(e)(4) special statutory period for the assessment of a deficiency can be extended on a Form 872 agreement under § 6501(c)(4), entered into after the normal § 6501(a) three-year period of limitations had expired.
4. **Berry v. Commissioner**, 97 T.C. 339 (1991). A Form 872-A extension of the statute of limitations for 1982, entered into more than 2 years after the overpayment (through withholding) of taxpayers' 1982 tax [no return having been filed], does not revive the expired time period for filing a claim for § 6512(b)(3) credit or refund of the overpayment of tax because the Form 872-A was regarded as a legal nullity.

5. **St. John v. United States**, 951 F.2d 232 (9th Cir. 1991) (per curiam). Judgment for government notwithstanding the verdict because Form 872-A extends the statute of limitations for an indefinite period, and does not require the government to assess deficiencies within a reasonable period of time.

6. **DeSantis v. United States**, 783 F. Supp. 165 (S.D.N.Y. 1992). A Form 906 closing agreement does not terminate a Form 872-A indefinite extension. The closing agreement provided that the taxes in question may be assessed "on or before the expiration of one year following the 5/1/85 date on which the decision of the controlling case became final; the statutory notice was mailed on 12/13/89 and the assessment was made on 5/11/90. Held, the means of termination specified in the Form 872-A consents are exclusive.

7. **L & H Co. v. United States**, 963 F.2d 949 (7th Cir. 1992). Taxpayers presented no evidence other than their own testimony that they mailed their late 1981 tax return on 9/4/82, so no claim for refund of taxes allegedly overpaid for 1981 was timely filed; alleged telephone contacts with 20 different IRS employees in 1984 and 1985 did not turn up a single employee who remembered speaking with taxpayers.

8. **Anderson v. United States**, 966 F.2d 487 (9th Cir. 1992). Taxpayer's testimony that she mailed and saw the postal clerk postmark her return (together with an affidavit from the friend who drove with her to the post office and waited in the car) was sufficient evidence for the common law presumption that her timely mailed federal income tax return was delivered to the IRS; the presumptions in § 7502 do not replace the common law rule. **Wood v. Commissioner**, 909 F.2d 1155 (8th Cir. 1990), followed.

9. **Galuska v. Commissioner**, 98 T.C. No. 45 (1992). 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.

10. **Green v. Commissioner**, 963 F.2d 783 (5th Cir. 1992). 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 (11th Cir. 1992), and **Bufferd v. Commissioner**, 952 F.2d 675 (2d Cir.), cert. granted, 112 S. Ct. 2990 (1992), followed.

11. **Scheidt v. Commissioner**, 967 F.2d 1448 (10th Cir. 1992). 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.
F. Miscellaneous

1. Russo v. Commissioner, 98 T.C. 28 (1992). Taxpayer wife’s motion to amend the petition to add an innocent spouse claim was denied because it was untimely raised and because London Option loss deduction was not "grossly erroneous" under § 6013(e)(2) [in that it was sanctioned initially by private letter rulings, although finally found to be not intended" by the relevant Code sections].

2. Ness v. Commissioner, 954 F.2d 1495 (9th Cir. 1992), rev’g 94 T.C. 784 (1990). Innocent spouse relief awarded for that part of a $103,000 deduction that exceeded the $35,000 amount that was at risk. The court found that the impermissible $68,000 excess amount could be and was grossly erroneous" (i.e., lacked a basis in law) even though the $35,000 part of the deduction was allowable.

3. Diamond v. United States, 944 F.2d 431 (8th Cir. 1991). In affirming summary judgment for defendant in § 7431 damage action by physician, held that IRS agent did not unlawfully disclose return information in violation of § 6103 when he identified himself in a circular letter to patients as a member of the Criminal Investigation Division because the IRS’s interpretation of § 6103 [so directing special agents to identify themselves] was made in good faith, albeit erroneously.

4. Vahlco Corp. v. Commissioner, 97 T.C. 428 (1991). Texas corporation, whose charter was forfeited for failure to file franchise tax report and pay taxes, and which, therefore, lacked capacity to sue in Texas courts, lacked capacity to bring an action in Tax Court.

5. Levitt v. Commissioner, 97 T.C. 437 (1991). Tax Court lacked jurisdiction over wife where she did not sign, nor authorize her husband to sign on her behalf, the joint Tax Court petition in the instant case. The court refused to rule on the effect of her not signing the spouses’ joint tax returns and the powers of attorney, or on the validity of the notice of deficiency. Husband took no formal position on his wife’s motions, and testified that "I took it for granted that my job was to do the financing and her job was to take care of my home."

6. Stauffacher v. Commissioner, 97 T.C. 453 (1991). The Tax Court has jurisdiction to redetermine the interest assessed on deficiencies it has found, but taxpayers failed to show that the Commissioner’s calculation was incorrect.

7. Allison v. Commissioner, 97 T.C. 541 (1991). The automatic stay on a Tax Court case is terminated when the bankruptcy case is closed, dismissed, or a discharge is granted or denied; it is not reimposed on the reopening of the bankruptcy case (absent an order from the bankruptcy court).

8. Meyer v. Commissioner, 97 T.C. 555 (1991). Tax Court lacks jurisdiction on § 6651 and § 6654 penalties based on taxes computed and shown due (but not
paid) on delinquent filed returns because such additions are not subject to the deficiency procedures.

9. **Friedman v. Commissioner**, 97 T.C. 606 (1991). Innocent spouse relief is available where the "grossly erroneous items" are attributable to a jointly filed Form 1045 (Application for Tentative Refund).

10. **Plumb v. Commissioner**, 97 T.C. 632 (1991). Taxpayers attempted to elect to relinquish the NOL carryback period under § 172(b)(3) for regular tax purposes, but not for alternative minimum tax purposes. The election was invalid because this option is not available by reason of the existence of only one NOL carryback period that applies for both regular and AMT purposes.

11. **Baldwin v. Commissioner**, 97 T.C. 704 (1991). Tax Court has jurisdiction [for the 1985 year] over a disallowed Form 1045 NOL carryback application because the amount credited against taxpayers' unpaid 1985 taxes as a result of a tentative carryback adjustment for a 1987 NOL constituted a "rebate" for deficiency purposes. (Commissioner issued statutory notices for 1985 and 1987, and taxpayers petitioned only for 1985; the 1985 deficiency was the result of disallowance of a 1987 bad debt deduction that gave rise to the NOL.)

12. **Magee v. United States**, 92-1 U.S.T.C. ¶50,063 (1991). Flora "full payment" rule is satisfied and court has jurisdiction where taxes and penalties were paid even though $23,000 in interest for which government had counterclaimed had not been paid.


14. **Proposed regulations** (IA-54-90) under § 468B, relating to (a) the tax treatment of transfers to certain escrow accounts, settlement funds, etc., (b) the taxation of income earned by these funds, and (c) the tax treatment of distributions made by these funds (F.R 2/14/92).

15. **Holywell Corp. v. Smith**, 112 S. Ct. 1021 (1992), rev'd 911 F.2d 1539 (11th Cir. 1990). Trustee appointed to liquidate substantially all of corporate debtors' property (which had been transferred into the trust pursuant to a bankruptcy chapter 11 plan) and to distribute the proceeds to creditors was required to file income tax returns and pay taxes because he was an "assignee" under § 6012(b)(3). He was similarly required to file returns and pay taxes with respect to income attributable to the trust property originally owned by an individual bankrupt under § 6012(b)(4) because he was the fiduciary" of a trust." The United States, as creditor, was not precluded by the failure of the chapter 11 plan to require the trustee to pay taxes because creditors are not bound by such plans with respect to post confirmation claims.

bankruptcy of solvent corporation from recovering from the United States funds withdrawn by a corporate officer and used to discharge his own individual federal tax liability.


20. **United States v. Bailey**, 789 F. Supp. 788 (N.D. Tex. 1992). Husband and wife were permanently enjoined under § 7407 from acting as income tax preparers because they repeatedly and willfully understated their clients’ tax liabilities, the court’s opinion setting forth 39 fact situations.

21. **Devore v. Commissioner**, 963 F.2d 280 (9th Cir. 1992), rev’g and remanding 58 T.C.M. (CCH) 715 (1989). Remanded for evidentiary hearing to determine if taxpayer was prejudiced by his former counsel’s conflict of interest in the dual representation of taxpayer and his exwife that prevented the former counsel from raising [§ 6013(e)] innocent spouse and agency defenses on his behalf.

22. **H Graphics/Access. Ltd. Partnership v. Commissioner**, 63 T.C.M. (CCH) 3148 (1992). Limited partner who executed Form 870-P (“Settlement Agreement for Partnership Adjustments”) but who changed the adjustment figures on the form (by deleting them with correction fluid and typing in new numbers with adjustments equal to 10% of original adjustments) and sent the form to the Service Center did not improperly induce the IRS to enter into the agreement. The IRS argued that the form submitted by taxpayer was deceptive because the changed adjustment figures were not highlighted or noted in the letter attached to the form. However, the form referred to itself as an offer by the taxpayer, and the taxpayer’s lawyer testified he believed the form could be changed to make a settlement offer. **Huene v. Commissioner**, 58 T.C.M. (CCH) 456, and **Herschler v. Commissioner**, 48 T.C.M. (CCH) 1475 distinguished.


**IX. TAX SHELTERS**

1. **Corra Resources, Ltd. v. Commissioner**, 945 F.2d 224 (7th Cir. 1991). Taxpayer who invested in a sham coal mining venture [the Pikeville Quadrangle lease] was not entitled to a § 165(a) abandonment deduction for the $77,500 cost of the mining lease by reason
of its not taking any step that irrevocably cut its ties to the asset because mentally walk[ing] away from the investment" was not enough and taxpayer should not be permitted to hedge its bets by reaping the benefits should mining commence. (Taxpayer’s accountant concluded that something was fishy when the IRS notice was the first product to emerge from the Pikeville Quadrangle."


3. **Cannon v. Commissioner**, 949 F.2d 345 (10th Cir. 1991), aff’d 59 T.C.M. (CCH) 164 (1990). Affirmed Tax Court’s disallowance of losses on Mexican gold and silver mining venture under § 183 despite neither party’s having explicitly raised that Code section because § 183 is interrelated with §§ 162 and 212, which were raised.

4. **Emershaw v. Commissioner**, 949 F.2d 841 (6th Cir. 1991) (2–1), aff’d 59 T.C.M. (CCH) 621. Taxpayers were at risk for their pro rata share of a partially recourse note issued in connection with a computer sale-leaseback transaction despite the transaction having involved a circle of offsetting obligations recorded only on bookkeeping entries because (1) the transaction is not a § 465(b)(4) loss-limiting arrangement and (2) the taxpayers were ultimately at risk. The dissent in **Baldwin v. Commissioner**, 904 F.2d 447 (9th Cir. 1990), was followed by the majority.

5. **HGA Cinema Trust v. Commissioner**, 950 F.2d 1357 (7th Cir. 1991). In O.P.M. equipment leasing transactions, partnership long-term promissory notes were not valid indebtedness.

6. **Gard v. United States**, 92-1 U.S.T.C. (CCH) ¶ 50,159 (N.D. Ga. 1992). Attorney who wrote an opinion used without his knowledge in connection with an abusive computer software tax shelter, but lacked actual knowledge that the software was overvalued, was not subject to the § 6701 aiding and abetting understatement penalty. However, there is a fact issue with respect to the § 6701 penalty for promoting abusive tax shelters because that section requires only that he knew or should have known that false or fraudulent statements were made in connection with his participation in the tax shelter.

7. **Nickerson v. Commissioner**, 962 F.2d 973 (10th Cir. 1992), aff’d 58 T.C.M. (CCH) 826 (1989). Research and development tax shelter § 174 deductions were disallowed under the two-step "generic tax shelter" and "economic substance" test from **Rose v. Commissioner**, 88 T.C. 386 (1987), aff’d, 868 F.2d 851 (6th Cir. 1989), because of lack of non-tax profit motive. Penalties under §§ 6661 and 6653(a), as well as § 6621(c) increased interest, affirmed.

were "economic shams," i.e., devoid of any economic substance and designed only to produce tax benefits, because the amended statute created an irrebuttable presumption that the trades were made while engaged in a trade or business. (These were the same type of "London options" transactions as described in Glass v. Commissioner, 87 T.C. 1087 (1986).) This creates a conflict with the Second and Third Circuits.

9. **Hildebrand v. Commissioner**, 967 F.2d 350 (9th Cir. 1992). 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 (5th Cir. 1991), followed.

10. **Estate of Wallace v. Commissioner**, 965 F.2d 1038 (11th Cir. 1992). 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.

11. **Krause v. Commissioner**, 99 T.C. No. 7 (1992). Enhanced oil recovery limited partnership activities were not engaged in with actual and honest profit objectives.

X. **WITHHOLDING AND EXCISE TAXES**


3. **Proposed regulations** (IA-28-91) under § 6302, relating to the simplification of employment tax deposit system (57 Fed. Reg. 21,043 (1992) (to be codified at 26 I.F.R. § 31.6302). Provides for semi-weekly (over $12,000) or monthly ($12,000 or less) deposits, where the "one-day" rule ($100,000 or more) is inapplicable.

XI. **TRUSTS, ESTATES & GIFTS**

1. **Connecticut Nat'l Bank v. United States**, 937 F.2d 90 (2d Cir. 1991), on remand 92-1 U.S.T.C. ¶ 60,102 (D. Conn. 1992). Decedent's estate was entitled to use a stepped-up basis (determined as of the later death of decedent's wife) for purposes of computing the estate's capital gain on the sale of stock held by the estate as marital trust property for decedent's wife (but not yet distributed to the marital trust at the time of wife's death) because the uniform basis rule of Treas. Reg. 1. § 1014(a)(1) requires this result. On remand, the district court granted government's summary judgment motion with "duty-bound distaste."

Meade Emory, Esq., Lane Powell Spears Lubersky, Seattle

MEADE EMORY was formerly Assistant to the Commissioner of Internal Revenue and Legislative Counsel, Joint Committee on Taxation, U.S. Congress. He currently divides his time between his Seattle law practice and law teaching. Beginning in 1993 he will be a visiting professor of law at Northwestern University School of Law.

LETTER RULING REVIEW: Copyright 1992 by Tax Analysts, 6830 North Fairfax Drive, Arlington, Virginia 22213. All rights reserved. No part of this newsletter may be reproduced in any form, by microfilm, xerography, or otherwise, or incorporated into any information retrieval system, without the written permission of the copyright holder. ISSN 1047-1596

For subscription information call (800) 955-2444, or (703) 533-4600.
Hog Farmer’s Transfer Of Hogs To Wife As Compensation For Work Makes Her Eligible For IRA Deduction

While it is true that income from the operation of a farm may be eligible for an IRA deduction (§ 219), on the ground that it is compensatory in nature (see § 401(c)(2)), the ability to make a deductible IRA contribution will be available only to the individual taxpayer that works the farm. Assume, for example that husband and wife own farm property but that a hog farm operation on that property is operated by the husband alone. In LTR 9202003 the wife performed services in connection with the hog farm operation and, in order to provide her with “compensation” eligible for making an IRA contribution the husband “paid” her, in kind, by giving her hogs with a value of $2,000 which she soon sold on the market for at or about that amount (all of which was duly reported to the IRS on a Form W-2 issued to the wife). The husband took a deduction on the Schedule F for the value of the hogs (“farm labor”) but did not include any amount in income attributable to the sale of the hogs. Although the wife reported the income from the sale of the hogs as “other income” that inclusion was shielded by a corresponding IRA deduction. In opining on these events the IRS approved all of the above except it noted that the husband’s transfer of the hogs (zero basis in his hands since their cost had been expensed) would have been a gain realizing event to the husband (properly includible on Sch. F). Although not specifically observed this would have given the hogs an FMV basis in the wife’s hands with the result that their sale by her on the market would generate no gain. The receipt of the hogs would still be “compensation” to the wife, the IRS confirmed, permitting her to take an IRA deduction. Thus when the dust settles on the entire transaction there is no net inclusion in the couple’s tax base—the Sch. F inclusion is offset by the deduction for compensation and the compensatory income received by the wife can be offset by a deduction for an IRA contribution. This result was reached without any IRS consideration of 1041 which excludes from income transfers between husband and wife (including income arising from the sale or exchange of property by one to the other).
Transactions between husband and wife in a farm context have been the subject of recent scrutiny by the IRS. See, "Hog Farmer’s Transfer Of Hogs To Wife As Compensation For Work Makes Her Eligible For IRA Deduction," Letter Ruling Review, Feb. 1992, p. 1. In LTR 9206008 the burden of self-employment taxes prompted the husband to seek to deduct rent (in determining net income from self-employment) paid to his spouse for the use of her interest in jointly held farm property. Since rental payments between spouses for the use of property are otherwise deductible (including for purposes of determining net income from self-employment under §1402(a)), all of this should have passed muster except for the taxpayers’ failure to honor the niceties. For example, the husband deducted on the Schedule F the full amount of the interest on the mortgage on the farm property and in one of the years the full amount of the property taxes (whereas consistency would have required the husband’s spouse to claim, probably on her Schedule E, those deductions attributable her one-half interest in the property). Therefore, for purposes of computing deductions attributable to interest and taxes, the husband treated the entire farm property as used in the farming business whereas for purposes of claiming rental deductions one-half of the property was treated as belonging to the wife. While it is possible, therefore, to reduce self-employment income, when jointly held property is involved, by a rental arrangement between spouses, the “price” for such a tactic would be giving up that portion of the “other” deductions attributable to the lessor spouse’s one-half interest (which may not make the effort worth the candle).
Passive Loss Disallowed For AMT May Not Be Carried Back To Pre-Enactment Year

While there was a phase-in following the 1986 Act for the limitation on the deductibility of passive losses (§33 469) such was not the case as respects the alternative minimum tax (AMT). Thus, in 1987, the first year in which the passive loss rules would be applicable, no amount of passive loss would be deductible in determining the taxpayer’s AMT liability (although 65 percent of the loss would have been deductible in determining regular tax liability). In LTR 9152004 the taxpayer (who had a 1987 passive loss) took the position that since § 469 is prospective only (applying only to post-1986 years) that such loss could be carried back to 1986 and used in calculating the NOL for AMT purposes in that year. In nipping this effort in the bud the IRS relied upon the principle that it is the law in effect in the year in which the loss is incurred (1987 in this case) that determines its deductibility (not the law applying to the year in which the loss is to be carried back). Thus, since none of the loss was useable in 1987 (because of § 58(b)(2)) none could be carried back to a pre-1987 year. However, if the regular income tax were involved, instead of the AMT, 65 percent of the taxpayer’s 1987 loss could be carried back for regular income tax purposes since that amount of the loss would have been allowed in 1987 pursuant to the phase-in rules. § 469(m).
Physical Abandonment Of Nuclear Plant Not Necessary To Secure Abandonment Loss

The IRS’ regulations regarding abandonment losses seem to convey the meaning that there must be an actual physical giving up of the property before a tax loss will be justified. A “mere intention to abandon” without a “relinquishment of possession and control” will not be sufficient. Reg. §1.167(a)-8(a)(4). In LTR 9220003 it appears, however, that these words, in some instances, might not apply with full force. Although the taxpayer had previously received letter rulings from the IRS approving the taking of an abandonment loss regarding a nuclear-powered electric generating plant it had constructed, this plan had been postponed until 1989 when the loss was actually claimed. While the taxpayer had, at that time, applied for a “possession only license” from the regulatory commission, the property nonetheless remained in the taxpayer’s possession and under a “full power license” from that body. Backtracking from a hard and fast “bright-line,” and upholding the 1989 deduction, the IRS concluded that the “act necessary to evidence the intent to abandon property need only be appropriate to the particular circumstances.” In this instance, recognizing just how hard nuclear plants are to abandon ("...the taxpayer can not simply walk away from the property"), the IRS was satisfied that the taxpayer “has consistently acted in such a manner to manifest its intent to abandon...”. Thus, it was sufficient that the taxpayer had prepared a plan for decommissioning and that it was in fact preparing for decommissioning. Actual physical abandonment was not necessary in this case.
The burdensome nature of the self-employment tax has placed a premium on ingenuity in this area. Of late taxpayers in farming activity seem to have been seeking ways in which to lessen the impact of this tax which now sits at a 15.3 percent level. For example, in LTR 9206008 the IRS concluded that a farmer could not deduct, in determining self-employment income, rent paid to his wife for the use of farm property. More recently, in LTR 9210004, the taxpayer husband transferred grain to his spouse under circumstances where it was sold by local grain elevator and the proceeds remitted to her. While she reported the income from the grain (as capital gain on Sch. D because it was not inventory to her) the income therefrom was omitted from the Sch. F filed with the taxpayers' joint return thereby reducing the amount subject to the SE tax. In view of the fact that the IRS could not really attack the transfer of zero basis crops on anticipatory assignment of income principles (having long since conceded that issue, e.g., Rev. Rul. 55-138, 1955-1 C.B. 223) it had to approach the issue from another tact. Left without much law on its side, and plainly not liking the taxpayer's objective, the IRS was forced to rely upon factual deficiencies, and several missteps were made, in its adverse ruling. First, there was a hint that the transfer was compensatory in nature (there being some indication that the transfer was made to “reward” the donee for her services on the farm). (If this were the case, although LTR 9210004 does not so state, the transfer of the grain would have been a gain realizing event to the donor and hence SE income.) Second, there was an indication that the husband never really departed with the grain (he having been listed as the “patron” on the elevator deposit document). Thirdly, the IRS noted that the transferee spouse may have never received the grain itself but rather the deposit document which, it was observed, may have been the equivalent of cash (a notion which appears to be a stretch since the deposit document itself would not result in income to the donor). In sum, though, the IRS relied upon its conclusion (which seems based on the facts of this particular case and does not announce what should be a general rule) that the entire transaction appeared to be premised on tax avoidance grounds. To be sure interspousal transfers are likely to be more rigorously examined but it would seem plain that even if the SE tax cannot be avoided in that context that more careful taxpayers should be able to do so when the crop is transferred to a family member other than a spouse. See, e.g., Harris, “When is Grain a Capital Asset?,” 30 South Dakota L. Rev. 275 (1985).
Crop Transfer Again Fails To Reduce SE Tax Burden

In LTR 9229002 another farming couple tried to avoid the self-employment tax burden by transferring crops raised on the jointly held farm from the farmer husband to the non-farming spouse. The stratagem was to have the transferee spouse then sell the crops and report the gain thereon off Sch. F (thereby removing it from the tax base subject to the SE tax). Just as in a prior holding (See, “Transfer Of Crops To Spouse Doesn’t Avoid SE Income But This May Not Always Be So,” Letter Ruling Review, April, 1992, p. 1) the IRS held in LTR 9229002 that the crop transfer from the husband to his spouse lacked “economic substance” and was not, therefore, a valid gift. Here, however, just as in the prior situation, the underlying facts militated against a finding that an effective gift was made. Instead of making it a clear transfer in which the donee spouse had full dominion over the transferred property, the proceeds from the crop sale were deposited to a joint account (thereby allowing the IRS to conclude that the donor received a substantial economic benefit from the transfer). Further, the grain elevator deposits were not handled in a way in which it was possible to say that the donee spouse has “unfettered control” of the crop. Also, there was indication that a motivation for the transfer was the lowering of the couple’s state income tax burden (i.e., to increase the donee’s income so that she could file a separate state income tax return and lower their aggregate income tax liability). Although all of these circumstances came together to compel the conclusion that no effective gift had been made, it would seem that a properly handled transfer (without factual deficiencies of the type noted above) could carry the day and result in obtaining the donor’s SE tax objective. Cf., Elsie SoRelle, 22 T.C. 459 (1954); Estate of W.G. Farrier, 15 T.C. 277 (1950).
Universities Can Avoid UBI From Athletic Program Advertising

Whether program advertising for university athletic events generates UBI is a difficult issue for the IRS. True, it is still fighting the "regularly carried on" issue. For advertising income to be UBI it must be from a trade or business activity regularly carried on by the organization. Reg. §1.513-1(a). See, e.g., "Real Difficulty Exists In Avoiding UBI Tax On Program Advertising," Letter Ruling Review, Oct. 1989, p. 3. Even though the Commissioner lost NCAA v. Comm., 66 AFTR 2d 90-5602 (10th Cir. 1990), which held that "regularly carried on" requires an examination of the time span of the event to which the advertising relates rather than the time necessary to sell and place the ads, the IRS has shown no indication it will follow that thinking. In LTR 9137002 the ads involved were placed in the football program for a major university's three-month football season (admittedly a longer time span than the several day NCAA tournament). The program advertising was placed in two ways. The main center and cover places were sold by a national advertising agency. The bulk of the advertising was sold, however, by the publisher of the proceeds who, under its agreement with the university, was permitted to keep the proceeds of some 60 pages of ads as compensation for its preparation of the program which was sold to the university for x cents per copy. LTR 9137002 wrestles with whether the university had UBI as a result of both types of advertising. Conceding that the university had no actual income from the publisher itself, the IRS still saw the possibility that it had imputed income in that the finished programs were sold to the university at less than their fair market value. Despite this analysis the IRS couldn't get over the fact that the university paid, rather than received, amounts to the publisher. Thus, organizations such as that involved in LTR 9137002 can sidestep substantial amounts of UBI by receiving their "value" in the form of a reduced price for the publication of the program.

If, however, the university reserves some of the choice advertising for itself (as it did in LTR 9137002 the IRS will find UBI (although certainly the organization could contest that finding in court relying upon the holding in NCAA).
Exempt Org's Newsletter Doesn't Produce UBI, But Ads Do

When exempt organizations publish newsletters or similar items the UBI issues raised generally revolve around income generated by the publication itself and income from advertising. The first, as LTR 9137049 shows, is relatively easy to solve. There an exempt organization formed to educate inventors published a monthly newsletter containing articles on various inventors and the work they do as well as a listing of newly issued patents. Financial necessity compelled imposing a small charge ($10 per year) for the publication once distributed free and set the stage for a determination of whether this charge resulted in UBI. Considering the relationship between the publication and the organization’s exempt purpose it was not difficult for it to conclude that the publication contributed "importantly" to the accomplishment of the organization’s exempt purpose. Another part of the publication—a listing of business services to inventors—and the decision to impose a $50 per year charge upon those listed raised a more pesky issue. The Service’s front line position (reflected in Rev. Rul. 82-139, 1982-2 C.B. 108, involving ads in a bar association journal) is that income from commercial ads in a publication otherwise related to the org’s exempt purpose does produce UBI. There is, though, a willingness to treat such income as not productive of UBI if the ads are likely to produce only a negligible commercial benefit to the organization. In LTR 9137049 the IRS concluded that the advertisers in the inventor’s newsletter, under the heading “Business Services Offered,” do receive a commercial benefit and, therefore, UBI results. In LTR 9044071 (see, "Small Ads in Programs Book Don’t Generate UBI But Larger Ones Do," Letter Ruling Review, Jan. 1991, p. 4), on the other hand, the IRS showed a willingness, based solely on size (i.e., 48-per page or smaller) to conclude that no UBI resulted.
Ad Income Is UBI, As Usual, But Per American College, May Not Always Be

In the world after the Supreme Court's decision in *U.S. v. American College of Physicians*, 475 U.S. 834 (1986), the opening for advertising income to avoid classification as unrelated business income is narrow indeed. The Court's opinion in that case did, however, by refusing to accept the government's urging that advertising income is *per se* UBI, provide a clearly marked path for the classification of advertising income as other than UBI. Although the IRS did not follow that path in LTR 9211004 it, at least, admitted its existence. An organization (exempt pursuant to § 501(c)(3)), appearing to be much like a high school level NCAA, publishes a magazine for athletic administrators. Aside from articles of interest to its readership, the publication contained advertisements for services and goods related to the administration of high school athletics (e.g., materials to mark lines on the field). Although this situation was quite close to the medical products advertised in the journal which was involved in *American College* (found to result in UBI), and thus, was not within the opening which exists for avoidance of UBI. Although the IRS found that the ads did not meet the "stringent standards for relatedness" promulgated by the Supreme Court the IRS at least recognized the existence of such standards. For example, if there had been a "comprehensive or systematic presentation of any aspect of the goods or services publicized," such as would have been designed to present an encyclopedic listing, the way may have been open to avoidance of UBI. Suffice it say that while the IRS found that here the ads were not essentially different from "commercial advertising" the IRS at least recognizes that this may not always be the case.
Only Membership Dues Considered
In Determining UBI From
Advertising Income

The determination of unrelated business income from advertising ranks up there as one of the most difficult computations that may have to be made under the tax law. See, Reg. §1.512(a)-1(f). If the advertising income represents UBI (and it usually does) the organization is entitled (per Reg. §1.512(a)-1(d)(2)) to allocate an appropriate amount of the costs attributable to production and distribution to the advertising side (as distinct from the circulation side). If, after this allocation, the organization has excess advertising income (Reg. §1.512(a)-1(f)(2)(ii)) it has, of course, a clear exposure to a tax on UBI. If, however, expenses exceed circulation income (defined Reg. §1.512(a)-1(f)(3)(iii)) then the excess of such expenses over income is available to reduce UBI. Assume, for example, that an organization has, with respect to a publication related to its exempt purpose, circulation income of $60,000 and offsetting expenses of $70,000 (resulting in net circulation income of ($10,000)) and gross advertising income of $40,000 with offsetting allocable expenses of $20,000. The ability to use the ($10,000) loss in circulation income to further offset net income from advertising, reduces UBI to $10,000 rather than the $20,000 it would otherwise have been. This creates an incentive (and this was the issue in LTR 9204007) to reduce that portion of the income that would be considered circulation income with the result that it would be more likely that there would be a loss in circulation income that would be useable to reduce UBI. Where the right to the publication is included in the dues paid by the organization's membership, circulation income includes an allocable portion of membership receipts. In LTR 9204007 the organization had other sources of income (e.g., investment income, special program revenues, state convention fees, income from the sale of books and members' contributions to the organization's PAC) and sought a holding from the IRS that none of the income from these other sources would be considered in determining the portion of membership receipts allocable to the periodical. Thus, only membership dues (and even there only that portion allocable to the periodical) would be considered in the determination of circulation income making it more likely that the excess over income can be used to further reduce the income subject to the tax on UBI.
IRS Refusal To Apply Economic Unit Test In Denial Of Section 1033 Appears Questionable

The single-economic-unit rule, when applicable, permits a taxpayer to obtain section 1033 non-recognition treatment when a second asset has to be sold as result of the involuntary conversion of a first piece of property. Thus, in Harry G. Masser, 30 T.C. 741 (1958), when a group of parking lots were taken by condemnation, the taxpayer was allowed tax-free rollover on the sale of an adjacent terminal building to a third party. The notion was that the two pieces of property were acquired for, and were being used as, a single economic unit. The taxpayer was able to demonstrate that the continuation of the business using only the remaining asset would be impractical. In LTR 9227002 a stadium owned by Partnership 1 (P1) was declared "blighted" by the city as part of its plan to acquire the pro team which used that facility (the team being owned by Partnership 2 (P2)). When the team was acquired earlier the league required that the family buy both the team and the stadium in which the team played its home games. To meet this requirement the acquiring family had P1 (owned 60 percent by the parents and 40 percent by their children) acquire the stadium and P2 (owned 92 percent by an S corporation which itself was owned by the family in the same ratio) acquire the team. The stadium, as a result of the threatened condemnation, was sold to the city by P1. Since the stadium lease had another seven years to run, and since the lease terms gave the city no incentive to renegotiate the lease, the family concluded it had to dispose of the team as well (which P2 did by a sale to outside investors). The S corporation, being a 92 percent owner of P2, asserted section 1033 protection, upon reinvestment in property similar or related in service or use, with respect to the gain from the sale of the team. Citing two seemingly inapposite authorities (both involving situations where the taxpayer had no economic interest in the "related" property (i.e., Dorothy C. Thorpe Glass Mfg. Corp., 51 T.C. 300 (1968); Rev. Rul. 69-53, 1969-1 C.B. 199), the IRS concluded that the lack of an economic interest by P2 (or its partners) in the stadium meant that the sale of the team by P2 was ineligible for section 1033. This result seems subject to appropriate challenge since it appears clear that the individual owners of the S corp (the 92 percent partner in P2) were the same individuals who comprised the partnership which owned the stadium. Thus, the owners of P2 did have an economic interest in the stadium. Depending upon further development of the facts this case appears, indeed, to be a likely candidate for application of the single-economic-unit rule.
IRS Denies It Has Authority Under §1033 To Extend Time for Election

There are circumstances in which a taxpayer would conclude that it is best to pay the tax on the gain generated by the involuntary conversion of property. The regulations are clear that if the taxpayer elects in the year of the involuntary conversion to report the gain (caused, most often, by the receipt of insurance proceeds), that that taxpayer can change its mind and elect §1033 nonrecognition as long as that decision is made prior to the expiration of the period within which the converted property must be replaced (generally, two years after the close of the first taxable year in which any part of the gain is realized). See. Reg. § 1.1033(a)-2(c)(2). Even here, however, the regulations permit, upon the showing of "reasonable cause," some slippage in that provision is made to extend the time for acquiring replacement property as long as the application is made before the expiration of the two year period. Reg. §1.1033(a)-2(c)(3). In LTR 9138002 the taxpayer did not seek an expiration of the replacement period but, rather, an extension of the period during which an election could be made. Assume, for example, a 1985 involuntary conversion and a decision to report the gain in that year (prompted mainly by the fact that the property was underinsured, resulting in a less than anticipated gain). In 1987 some replacement property was acquired but nowhere nearly large enough to shield the entire gain. A suit against the insurance agent resulted in a subsequent settlement in 1988 and caused a reevaluation of the judgment not to utilize §1033. The question raised in LTR 9138002 was whether the taxpayer could apply to the IRS, based upon reasonable cause, for an extension of time in which to make the basic §1033 election (as distinct from seeking an extension of time in which to acquire replacement property). Although the IRS firmly concludes it will not extend the time for election under the §1033 regs, it does not opine on whether the taxpayer had potential recourse under Reg. §1.9100 which grants general authority (based upon a showing of "reasonable cause," which this taxpayer did not appear to be without) to the IRS to extend the time for making elections. See, e.g., “Extensions of Time to Make §911 Election Are Available But Not Always,” Letter Ruling Review, Nov. 1990, p. 6.
In other contexts the IRS has been more willing to apply § 1033 when timber is destroyed by a hurricane. See, e.g., Rev. Rul. 80-175, 1980-2 C.B. 230; “Timber Owner’s § 631 Gain Caused by ‘Hugo’ Eligible For § 1033,” Letter Ruling Review, Sept., 1991, p. 3. In LTR 9209007, however, the IRS seems to take a wrong turn in applying § 1033 to the destruction by Hurricane Hugo of timber on property that was held not for timber cutting purposes but in order to keep the property in a natural state for the flora and wildlife on the acreage. After the hurricane the taxpayer cut the damaged trees (in order to allow restoration of the acreage) and sold the resulting cut. The taxpayer intended to invest the income from that transaction in adjacent timber property to be held in the same manner. Since the taxpayer was not in the business of logging there was no § 631 election in effect which would have the effect of treating the cutting as a gain realizing event. See, e.g., LTR 9131034. Relying upon the notion that the taxpayer could have decided not to sell the damaged trees (but simply allowed the forest regeneration process to occur) the IRS concluded that § 1033 nonrecognition was not available. This holding harks back to less enlightened times it appeared to be the IRS position that § 1033 was not available if the taxpayer’s gain was generated by sale rather than the receipt of insurance proceeds or damages. See, e.g., Rev. Rul. 74-532, 1974-2 C.B. 270. It has been noted, though, that this stance “is hard to justify...if the property is damaged beyond repair and is sold for scrap as a prelude to the acquisition of replacement property....” Bittker & Lokken, Federal Taxation of Income Estate & Gifts, ¶44.3.2[1]. This clearly seems to have been a situation where the sale was the result of the partial destruction of the property and that therefore § 1033 should apply. The IRS seems on even weaker ground when it concludes that the taxpayer is further ineligible for § 1033 because it was not in the business of cutting timber but rather holding it in its natural state. The statute (§ 1033(a)) simply requires that the property of the taxpayer be destroyed in whole or in part. Unlike the unrepairable ship in C.G. Willis, 41 T.C. 468 (1964), which the IRS cites in support of its position, the trees in question were not repairable but destroyed. In other instances victims of Hugo received better treatment from the IRS and this taxpayer deserves the same.
Timber Owner's §631 Gain Caused By 'Hugo' Eligible For §1033

When property is involuntarily converted the realization of gain is most frequently attributable to the receipt of insurance proceeds. The gain so realized can avoid recognition if the taxpayer purchases property "similar or related in service and use" within the required time period. §§1033(a)(2)(A), (B). Timber destroyed by a casualty event (e.g., Hurricane Hugo) presents an unusual opportunity as LTR 9131034 demonstrates. Frequently, since large timber holdings will not be insured against such a calamity there will not be the conversion into cash as when insurance is present. There is, nevertheless, compelled gain recognition to the timberholder if an election has been made under §631 to treat the cutting of timber as the sale or exchange of that asset. Since most large timberholders will have made such an election (in order to obtain the capital gain treatment) the question arises whether §631 gain (measured by the excess of the FMV of the cut tree over its basis) can be sheltered by reinvestment in the requisite replacement property. LTR 9131034 answers this issue favorably to the taxpayer by concluding that §1033 provides nonrecognition "[r]egardless of whether the realization of gain or loss arises from...the cutting of timber under §631(a)...or actual sales..." The §1033 reinvestment period will begin to run in the year in which Hugo is deemed to have resulted in the taxable event. Thus, since there may not be an immediate conversion of the toppled trees into salable logs, other sources of funds may have to be used for the reinvestment. All that is fine and, as LTR 9131034 further announces, expenditures for reforestation, cleaning and clearing drainage systems, repairing fences, gates and roads, all qualify as reinvestment in property which is "similar or related in service and use."
Imposition of Restrictions Can Result in Involuntary Conversion

For property to be treated as involuntarily converted (for §1033 purposes) it is not necessary that it actually be taken by, or transferred to, the governmental entity. For example, in LTR 9148025 the city sought to impose restrictions upon property, which was being used as a mobile home park, under the flight path to the airport. The city's intent was to prohibit the use of the land (which was owned by the individual taxpayer and leased to a corporation, also owned by that person, for operation of the mobile home park) for residential purposes. The city chose the route of imposing restrictions rather than outright condemnation in order to minimize the compensation payable to the taxpayer. The court granted the city's application for possession and after the business tenants on the property had been moved out the underlying real property was returned to the individual taxpayer who then sold it a third party. The taxpayer sought to use the proceeds from the third party sale and the city's payment for the imposition of the restrictions to acquire replacement property. The IRS held that the city's restrictions constituted an involuntary conversion "notwithstanding the fact that the taxpayers retain ownership of the land." It further held that the "voluntary sale" of the land will be treated as part of the involuntary conversion for purposes of §1033.
Disclaimer, Causing Property To Pass Directly, Identifies Party To Make 1033 Election

It is only the owner of the property at the time of the involuntary conversion that may elect not to recognize gain under section 1033. If a condemnation proceeding occurs after the death of the decedent it becomes important to focus in on just who (e.g., the estate, a trust, or beneficiaries) is the proper party to make the section 1033 election. In LTR 9232004 property was left by the decedent in trust for life to his surviving spouse with remainder to their children. After death, but during estate administration, the spouse properly disclaimed (section 2518) her life interest. Subsequent to the disclaimer the property was sold (under threat of condemnation) to the county. Who would be the proper party to elect section 1033 nonrecognition? The IRS held that due to the disclaimer the property is treated as having never been transferred to the trust but, rather, as having passed directly to the children (the trust’s beneficiaries). Under local law, as real property, the property is treated as having passed directly, on the date of the decedent’s death, to the trust’s beneficiaries. Accordingly, the beneficiaries are the parties properly entitled to elect section 1033. Thus, when real property passes directly under local law, as is most often the case, it is the persons to whom the property so passes that are entitled to elect section 1033 nonrecognition. This is so even when that occurs as a result of a disclaimer.
Section 1033 Replacement Property
Can Be Acquired From Related Party

If property is taken by condemnation (or threat of condemnation) the qualifying replacement property can be like-kind rather than that falling within the more narrow group defined as "similar or related in service and use." In LTR 9224006 a first tier limited partnership (B), 99 percent owned by T, which also owned interests in two other limited partnerships (P, 80 percent and C, 99 percent), acquired a 5.5 acre property in an industrial area which it intended to use as a parking lot. The property, which was located in an industrial area abutting a newly completed jail, was sold to the county for $X within two years of its acquisition. It was assumed that the sale was under threat of condemnation (and the IRS did not deal with that issue). The qualifying replacement property was acquired by B from P and C ("sister related partnerships") thus raising the issue of whether such an acquisition can qualify for nonrecognition. Underlining that if the sale took place at the fair market value of the replacement property (in LTR 9224006 B represented that the sale took place at the FMV as determined by an independent appraiser) the IRS concluded that there was no obstacle to §1033 qualification. This holding is consistent with Rev. Rul. 73-120, 1973-1 C.B. 369, although in that holding the replacement property was acquired from the selling corporation's owners whereas here the property was acquired from another co-owned entity.
Grant Of Easement Qualifies As 'Like-Kind' For 1031 Swap

It seems clear that the real property interest received in a §1031 exchange (or for that matter purchased as a result of an involuntary conversion eligible under §1033(g)) need not be a fee interest in real property. For example, under certain circumstances a leasehold or a remainder interest in real property may qualify as "like-kind." See, e.g., "Exchange of Remainder Interest in Real Property for Fee Eligible for 1031," Letter Ruling Review, Dec. 1991, p. 4. It appears to be simply the next step to qualify an easement as well. In LTR 9215049 the taxpayer granted an agricultural conservation easement ("less than fee simple") which had the effect or removing the land from development for other than agricultural production. Although the statute under which this was accomplished provided for grants for 25 years or in perpetuity, this situation involved the latter and was approved by the IRS as being like-kind thereby permitting the county to transfer to the taxpayer a fee simple interest in improved or unimproved reality in a qualifying §1031 exchange. It should be observed that this would be the result even if the easement grant involved the retention by the grantor of recreational rights (or rights to maintain fences, roads, etc.). See, Rev. Rul. 72-549, 1972-2 C.B. 472.
Donor Gets Current Charitable Deduction Even Though Property Is Actually Transferred In Later Period

One can easily envision a situation where a donor seeks to make a charitable contribution of tangible property (typically artwork) but the donee is not yet ready to receive the property (e.g., the museum that is to house the property is not yet complete or is otherwise incapable of receiving the property). In such a situation must the donor's eligibility for an income tax charitable deduction wait upon the ability of the donee to actually take possession of the property? This was the situation in LTR 9218067 where the donor, although executing a deed to the contributed property, retained possession of the property (in fact, the property continued to be displayed in the donor's home) until a later year in which the museum was actually open. While such a situation raises the specter of the transfer of a future interest rather than a present interest, the IRS focused on the effectiveness of the deed to transfer a present interest at local law. Finding this to be the case, it was far easier for the IRS to conclude, as it did, that a present interest was conveyed and that the taxpayer was entitled to a full fair market value charitable deduction. Cf., Reg. §1.170A-5(a)(4). It was the ability of the donee museum to take possession of the property if it chose to do so that was significant. Although the IRS pointed out that the donee did have storage space that it could have used for the property pending completion of the museum, there is no real indication that this element was essential to the result. What was essential was the "understanding...of the parties [that there was not] a tacit reservation by the donor of a present right of possession."
Charitable Contribution of Nondepreciable Musical Instrument Results in Full Tax Benefit

The IRS's position on art works used in a business context is that they are nondepreciable property, because in the Service's view it is not possible to determine their useful life. Thus art works displayed in a doctor's office may not be depreciable for this reason. The same would be true of a very old musical instrument (e.g., a violin or cello); despite the fact that this asset constitutes the tool of the taxpayer's trade, his or her investment therein cannot be recovered through an allowance for depreciation. As LTR 9147049 demonstrates, though, the gift of the ancient musical instrument to charity works without a hitch. First, since the instrument is a capital asset (and it is, not by reason of §1231(b), but, rather, by reason of §1221), there would be no reduction, per §170(e)(1)(A), in the amount of the charitable deduction. Second, there is no further reduction in the FMV charitable deduction if the use of the contributed property is related to the organization's exempt function (as it was in LTR 9147049—an educational organization that maintained an instrument bank). While the capital gain nature of the contributed property would limit the deduction to 30% of AGI (§170(b)(1)(C)(i)) this potential disadvantage is outweighed by the eligibility of the property for the exclusion of tangible personal property from the AMT base—an exclusion which has been extended until June 30, 1992. Thus, even though the possessor of an invaluable musical instrument is unable to depreciate the property, its contribution to charity can result in full tax benefits.
**In Shift, IRS Holds On-Site Meals for Employees Ineligible for §119 Exclusion**

Although the nature of the company involved in LTR 9143003 is not identified it is not hard to imagine the type of business it is in. One could contemplate a suburban office complex too remote for its employees to obtain their lunches off-site. Most of the employees do their work on the telephone and a rush in such calls is experienced in the mornings and afternoons with some decrease in such traffic during the 11:00 a.m. to 1:00 p.m. period. Since, however, the office does business across the country it is important to maintain a high level of capability to respond to telephone inquiries at all times during the day. Because of this need the company has made a practice of limiting employee lunch periods to 30 or 35 minutes and to provide on-site free lunches. Although the IRS once issued a favorable ruling excluding such meals under §119, in LTR 9143003 it backs away from a carte blanche position of §119 qualification in such situations. The regs make clear that meals will be provided for the "convenience of the employer" if "furnished for a substantial noncompensatory business reason." Reg. §1.119-1(a)(2)(i). If meals periods have to be limited because of work load that will usually constitute a "substantial noncompensatory reason." Reg. §1.119-1(a)(2)(ii)(b). Further, there is no need that this need exists with respect to all of the company's employees; it is sufficient that it exist with respect to "substantially all" the employees. This company's failure to carry the day on the §119 exclusion came down to its inability to meet this standard. The information that it offered related to only 65 percent of its employees (not "substantially all"). Further, it was deficient in showing the need for a short lunch period; it was noted that for some employees the objective could have been met by working a longer day. What the company had to do was to demonstrate that the negative effect of a longer work day (since the IRS takes the position that the shorter lunch period can't be adopted just to let the employees off earlier in the day). Reg. §1.119-1(a)(2)(ii)(b). Perhaps the IRS has set an almost insurmountable standard to justify the 30 or 35 minute lunch period. Is the IRS requiring a showing that extension of the current work day is not feasible? If it is that may be a tough burden to carry.
Patent Infringement Proceeds
Received by Divorced Spouse
Tax-free to Her Per §1041

The transfer of property incident to a divorce is treated as a gift (that is, it is tax-free) to the transferee. §1041(b). Such transfers can take many forms other than the garden variety transfer of marital assets. In LTR 9143050 the husband, an inventor, was the plaintiff, during marriage, in several patent infringement suits with respect to patents in which only he had an interest. During the pendency of these proceedings the husband and his wife were divorced. The divorce settlement agreement granted the wife a stated percentage of any proceeds from these proceedings. When one of the cases eventually settled the proceeds available to the plaintiff were placed in a bank account with it disbursing to the wife the agreed upon percentage, thus raising the issue of whether §1041 shielded her from taxation of her receipt of these amounts. Naturally, the receipt of damage payments for patent infringement are generally taxable to the recipient. Thus, if the wife were considered to have received, pursuant to the divorce decree, an ownership stake in the pending proceeding, her receipt of a damage allocation would likely be considered as income to her. The IRS, however, viewed her as having been entitled, per the divorce decree, only to payment from her ex-husband equal to a certain percentage of the income produced by the property. This analysis saved the wife from income tax on the receipt (it being clear, also, that the receipt was not alimony since the obligation to make the payments would survive her death). State law, and to a great extent the manner in which the divorce decree was drawn, would play the largest role in determining the tax consequences in such a situation. Obviously, the lesson here is that when property is involved which is largely or wholly the potential right to receive income (i.e., a claim for taxable damages), tax-free treatment to the recipient is more likely to be achieved when the transferee receives only a right to a portion of the income rather than a part of the claim itself.
Incorporated Farm May Deduct Meals and Lodging Even Though Benefit Excluded by Incorporators

The threat of §269 application upon formation of a corporation, which denies deductions where the acquisition is made with a tax avoidance purpose, is one that is always present. What is its application where sole proprietors incorporate a family farm and subsequently enter into an employment contract with the corporation whereby the latter provides lodging and meals to the incorporators (so they may live on the premises to take care of the livestock)? Does the deductibility of the meals and lodging costs, under §162, associated with the exclusion of such benefit by the shareholder-employees, under §119, set the stage for denial of the §162 deduction to the corporation, as asserted by the agent in the matter involved in LTR 9134003? While it was the combination of corporate deduction and shareholder-employee excludability that whetted the Service’s interest, further analysis demonstrated that the combined benefit of a §162 deduction and a §119 exclusion could have been available absent incorporation. For example, the lease of property to a partnership composed of former sole proprietors would have permitted partnership deduction of the meals and lodging expenses and §119 exclusion to the partners. Thus, it can’t be said that the corporation would have been acquired for the purpose of obtaining a deduction not otherwise obtainable. The IRS went further, however, by stating that even if the motive were to obtain a §162 deduction with no offsetting income inclusion there would be no corporate deduction disallowance since the corporation’s deduction, otherwise permitted by statute, would not constitute avoidance. Thus, since there is no §269 application simply because corporate deduction is matched with income exclusion by the transferor, the way is open for family farm incorporation and §119 exclusion for the received benefits.
Cash Meal Allowances Not Excludable as a De Minimis Fringe and Subject to Withholding

A few weeks ago the IRS released a ruling holding that on-site meals for employees are ineligible for the §119 exclusion. See. LTR 9143003 discussed in Letter Ruling Review, Dec. 1991, p 2. More recently the IRS has opined on another aspect of this issue, i.e., whether cash allowances for meals are an excludable fringe benefit (§132) and whether, if taxable, they are subject to withholding. In LTR 9148001 a utility company had a longstanding policy (incorporated in the company’s collective bargaining agreement) of providing cash allowances for meals when work prevented employees from having meals at the regular time. For example, employees doing emergency work outside regular worktime were entitled to an allowance at four-hour intervals. Further, an allowance was also available if an employee worked more than one hour beyond regular work hours or preformed work more than two hours before work normally began. The end-of-day allowances were compensated for through payment of $11 whereas the pre-work or mid-day allowances resulted in a payment of $5.50. Although employees were entitled to the actual cost of the meal if they presented a receipt, in practice most elected to take the cash meal allowance. The allowances were paid regardless of whether the employee actually purchased a meal. The employer’s position was that the payments were within the exclusion (§132(e)) for de minimis fringe benefits, specifically the exclusion provided for in the regulations (Reg. §1.132-6T(d)(2)) for “occasional supper money.” The IRS, primarily for the reason that the payments were “routine” and not “occasional,” found them not to be a de minimis fringe. With respect to the employer’s assertion that it was administratively difficult to determine frequency since payments were made through its petty cash voucher system it was observed the procedures used by the employer were not determinative for this purpose. More important was whether “the costs associated with determining frequency...would exceed the nominal tax revenue generated by including the value of the benefits in income.” Next came the touchy issue of whether the allowances were “wages” imposing on the employer (in 1985) an obligation to withhold. The employer argued that the meal allowance should not have been subject to withholding because (citing §§3121(a)(20) and 3401(a)(19) and Central Illinois Public Service Co. v. U.S., 435 U.S. 21 (1978)) it was reasonable to believe that the employee would have been able to exclude the benefit under §132. The IRS, in reaching the opposite conclusion, and in denying §7805(b) relief, noted that whatever uncertainty existed on this issue when Central Illinois was decided, had been plainly resolved by the enactment of §132. (See, also, LTR 9146003, which held that truckers’ per diem allowances while away from home on the road were subject to income tax withholding and employment taxes.) Thus, it appears that if there is any kind of regularity to the payment of meal allowances (and a provision in a collective bargaining agreement would seem to provide the requisite regularity) the IRS is going to impose definite obligations on the employer to withhold and the employee to include.
Excess Sick Leave Transferred To Account For Payment Of Future Medical Expenses Is Taxable

It is clear, of course, that unused sick-leave credits that are received in cash are includible in income. Rev. Rul. 75-539, 1975-2 C.B. 45. As a variation the employer (the state government) in LTR 9227035 adopted a plan whereby the employee could elect, both with respect to past excess sick leave (i.e., the balance above 480 hours) and prospectively for the coming year, to convert excess sick leave hours (at a 25 percent of compensation rate) into cash which was to be deposited into a state account to pay the employee's medical expenses upon retirement or separation from service after age 55. Such an election prevented an employee from receiving cash outright for the excess leave. If the employee dies the amount on deposit will continue to be available for the benefit of the employee's spouse or for dependents. If the spouse dies (or the employee is unmarried) the amount on deposit will be transferred to an administrative account to pay costs of the plan. Using assignment of income concepts (i.e., Comm. v. P.G. Lake, 356 U.S. 260 (1958)), the IRS held that an election to participate in this plan, instead of receiving the cash, was the equivalent of the employee receiving the cash and paying it over to the plan. This conclusion was reached "notwithstanding that the income may be used to purchase a nontaxable benefit." See, sections 104(a)(3); 105(b). See, also, section 105(e). The IRS withheld ruling (see, Rev. Proc. 92-3, 1992-1 I.R.B. 63), however, on the issue of the treatment of reimbursements made from the plan (although it would seem that any such payments should be tax-free to the recipient).
Use Of Grantor Trust Avoids 1041 When Property With Debt In Excess Of Basis To Go To Spouse

Transfers incident to a divorce are not gain realizing events nor are they income to the recipient. Sec. 1041. However, this provision does not apply to the extent that liabilities are assumed (or the property is taken subject to) in excess of the basis of the property transferred. If, therefore, section 1041 applies to the transfer of partnership interests in a context in which the amount of liabilities to which the partnership interest is subject exceeds the basis of the transferor in such interests, the transaction will result in gain recognition to the transferor. See, section 1041(e). However, LTR 9230021 charts a way in which such property can be used to provide value to a transferee spouse without gain recognition. Therein the transferor (settlor) transferred the partnership interests to a trust for the benefit of his spouse. Although the trust had an independent trustee the grantor retained the power to remove the trustee and appoint a replacement (including himself). The trust's terms provided for payment to the grantor's spouse of so much income as the trustee deems appropriate (and, further, to make corpus distributions pursuant to the same standard). Because the distributions were not limited by a reasonably ascertainable standard (Reg. section 1.674(b)-1(b)(5)(i)) the exception for treatment as a trust taxable to the grantor did not apply. See, sections 674(a), (b)(5)(A), (d). Further, the grantor's right to replace the trustee prevented another exception (section 674(c)) from applying. Thus, since the trust was a grantor trust (all the income of which was taxed to the grantor/settlor) the IRS concluded that there was no "transfer of property," thereby rendering section 1041 inapplicable. It appears, therefore, that gain recognition can be sidestepped when property subject to debt in excess of basis is transferred in the context of a marital dissolution by making an irrevocable transfer (thereby satisfying the transferee spouse) to a trust taxable to the grantor.
Grantor Trust's Capital Losses Don't Pass Thru To Beneficiaries

In LTR 9220012 an irrevocable trust had been created for the benefit of a child of the settlors' pursuant to which the child (A) was the trustee and income beneficiary. Upon reaching the age of 40 the beneficiary was possessed the right to withdraw corpus amounts. In a prior year, A had resigned as trustee and an independent and unrelated trustee was named. After the trust sustained short term capital losses (which were carried forward since the trust did not have sufficient covering gains) an appropriate court order was obtained which eliminated the beneficiary's power to invade corpus. Presumably on the notion that he was the "owner" of the trust (per §678) A, the beneficiary, claimed the capital losses on his return. While this was justified for the years prior to the beneficiary's release of the power to withdraw corpus, the IRS held that this was not the case for the years subsequent to the release of the power. Pursuant to the Uniform Principal and Income Act (adopted by the relevant state in LTR 9220012) capital gains and losses are allocable to corpus. Thus, while the beneficiary possessed the power over corpus, after attaining the age of 40, it would be proper (per §§677 and 678(a)) to allocate the capital losses (a corpus item) to the beneficiary. After the release of the corpus power, the capital losses are properly chargeable to the trust itself (a result which one expects was not anticipated when the beneficiary sought and obtained the release of the power to withdraw corpus).