1990

Recent Developments in Federal Income Taxation

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RECENT FEDERAL TAX DEVELOPMENTS

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I. Accounting

A. Accounting Methods

1. Wayne Bolt & Nut Co. v. Commissioner, 93 T.C. 500 (10/23/89). Change from "a seriously flawed and disorganized method of determining inventory" to a method based on a complete physical inventory constituted a change in method of accounting. The corrected opening physical inventory was about ten times the $268,000 book opening inventory under the prior method, the bulk of the understatements of inventory having occurred in years barred by the statute of limitations. Section 481 was held to be applicable.

2. Diebold, Inc. v. United States, 90-1 U.S.T.C. para. 50,003 (Fed. Cir. 12/19/89). The change in treatment by an automated teller machine manufacturer of repairable ATM replacement modules from "inventory" to "depreciable property" was a change in accounting method that could be effected only by filing Form 3115, and not by filing amended returns.

3. Rev. Rul. 90-38, 1990-18 I.R.B. 7, revoking Rev. Rul 70-539, 1970-2 C.B. 70, and modifying Rev. Rul. 75-56, 1975-1 C.B. 98. A taxpayer that has for two or more years capitalized interest under §266, without making a valid election to do so, has nonetheless adopted a method of accounting and may not file amended returns for those prior years. It may only change the method of accounting with the Commissioner's consent pursuant to Reg. §1.446-1(e) by filing Form 3115.

B. Installment Method

1. Tecumseh Corrugated Box Co. v. Commissioner, 94 T.C. No. 22 (3/21/90). The sale of unimproved real property to the Federal government following a related party installment sale constituted a §453(e)(1) "second disposition" to which neither the §453(e)(6) involuntary conversion exception nor the §453(e)(7) non-tax avoidance exception applied.

2. Notice 90-27, 1990-15 I.R.B. 21. Guidance relating to the application of the (§§384, 382 and new [but not old] 1374) built-in gains rules to installment sales, which would have the effect of extending these provisions to income recognized under the installment method during a taxable year following the expiration of the applicable recognition period.

change of mind nor a subsequent change in circumstances will suffice, but permission will be granted where the taxpayer's intention to timely elect out is thwarted by a mistake which the taxpayer makes a timely effort to correct.

4. Notice 90-56, 1990-38 I.R.B. 28. The IRS plans to amend Reg. §15A.453-1(c)(7) to clarify that it may require an alternative method of basis recovery with respect to installment obligations where basis is inappropriately deferred, the improper deferral permitting the creation of artificial gain and a corresponding artificial loss.

C. Year of Receipt or Deduction

1. Proposed regulations (IA-258-84) under §461(h), relating to the economic performance requirement of the "all events test" for an amount to be "incurred" by an accrual method taxpayer (F.R. 6/7/90).

2. Proposed regulations (IA-130-86) under §460(b) relating to the "look-back method" for long-term contract income reported under the percentage of completion method of accounting (F.R. 6/12/90).

II. Business Income and Deductions

A. Depreciation, Depletion and Credits

1. Browning v. Commissioner, 89-2 U.S.T.C. para. 9666 (9th Cir. 12/5/89). Depreciation deductions disallowed on three 200-year old violins purchased before 1982 because taxpayer failed to present any reliable evidence of claimed 12-year useful life or of salvage value.

2. Clinger v. Commissioner, T.C. Memo. 1990-459 (8/27/90). Professional portrait painter was disallowed ACRS deductions for a $9,000 oil painting hung in her studio because the enactment of ACRS under ERTA did not eliminate the requirement that taxpayer establish that an asset has a determinable useful life in order for it to be depreciable. Rev. Rul. 68-232, 1968-1 C.B. 79, followed ("[a] valuable and treasured art piece does not have a determinable useful life.")

3. United States v. Goodyear Tire & Rubber Co., 89-2 U.S.T.C. para. 9658 (U.S. 12/11/89), reversing Federal Circuit. The §902 indirect credit is calculated by using U.S. tax concepts of "accumulated profits." The §902 credit with respect to any particular year is calculated by multiplying the total foreign tax paid by that portion of the foreign subsidiary's after-tax "accumulated profits" actually paid to the domestic parent in the form of a taxable dividend (i.e., a fraction, the numerator of which is the taxable dividend and the denominator of which is "accumulated profits minus foreign taxes" each with respect to that year). Post-1986 indirect credits are calculated based upon "post-1986 undistributed earnings" and not on accumulated profits for a particular year, so the controversy no longer exists.

4. Wiggins v. Commissioner, 90-2 U.S.T.C. para. 50,362 (5th Cir. 6/26/90). Retroactive application to 1983 tax year of 1984 Act amendment to §55(f)(2) alternative minimum tax provision added by 1982 TEFRA, excluding ITC recapture from the computation of regular tax, was constitutional because
it was a technical correction designed to close an unintended loophole [that allowed taxpayers to avoid paying ITC recapture in a year they were subject to the alternative minimum tax].

5. Rev. Rul. 90-62, 1990-31 I.R.B. 4. If gas is sold after it is "removed from the premises," for a price that is lower than the representative market or field price (RMFP), gross income from the property for purposes of the §613A percentage depletion allowance is determined without regard to the RMFP (which is a ceiling price for this purpose).

6. Rev. Rul. 90-70, 1990-35 I.R.B. 4. If a well is "spudded in" before 1/1/91 and there is continual dwelling until the productive horizon is reached, then the well is considered to have been "drilled" before 1/1/91 for purpose of the §29 credit for producing fuel from a nonconventional source.

7. Rev. Rul. 90-65, 1990-33 I.R.B. 5. Economically recoverable precious metals that are fabricated into, and represent more than half the cost of, an item used in taxpayer's trade or business are nevertheless not depreciable; the costs of such metals must be capitalized under §263A and accounted for separately from the remainder of the costs in order to clearly reflect income.

8. Oglethorpe Power Corr. v. Commissioner, T.C. Memo. 1990-505 (9/24/90). Electrical generating plant was placed in service not at the time its initial synchronization tests were conducted in November 1981, but at the time it was declared available for commercial operation and began producing income in March 1982; therefore, safe harbor leases executed in April 1982 were valid because the leases were executed within three months of the plant being placed in service.


B. Expenses

1. American Business Service v Commissioner, 93 T.C. 449 (10/3/89). Expenses for 49 charter boat cruises which were made available to taxpayer's approximately 100 permanent employees, but which excluded its 13,000 temporary employees, were not nondeductible under §274(a) because of the §274(e)(5) exception for recreational activities "primarily for the benefit of employees [generally]." There was no discrimination in favor of the "restricted class" of employees and taxpayer was legitimately concerned about lack of social interaction among its permanent employees.


rate found in Appendix A of 41 C.F.R., Chapter 301, etc., or $122 for high-cost localities and $85 for other continental U.S. localities). See also Notice 90-14, 1990-7 I.R.B. 20 (how an employee may claim an above-line deduction for reimbursed business expenses that were permitted, but not required, to be reported on Form W-2). See also Rev. Proc. 90-15, 1990-10 I.R.B. 23, modifying Rev. Proc. 89-67 (optional method for deducting meals while away from home); Rev. Proc. 90-34, 1990-26 I.R.B. 13 (automobile expense methods).

4. Soliman v. Commissioner, 94 T.C. 20 (1/18/90) (reviewed, 10-6). Self-employed anesthesiologist entitled to a §280A home office deduction where he lacked any other office even though his home was not the "focal point" of his business. Pomarentz v. Commissioner, 88-2 U.S.T.C. para. 9588 (9th Cir. 1988), distinguished because there the emergency room physician spent (allegedly) insubstantial amount of time working in his home office, and taxpayer here spent over 30%. The Tax Court will no longer follow its opinion in Drucker v. Commissioner, 79 T.C. 605 (1982), reversed, 83-2 U.S.T.C. para. 9550 (2d Cir. 1983). See IR-90-55 (Commissioner will move for reconsideration in, will appeal from, and will not follow Soliman.)

5. Hamacher v. Commissioner, 94 T.C. No. 21 (3/12/90). The exclusive use requirement for a §280A(c)(1) home office deduction is not satisfied where the office is used for both an independent contractor business and an employee business (where the employee business use was not for the employer's convenience).

6. Rev. Rul. 90-23, 1990-11 I.R.B. 4. For a taxpayer with a regular place of business, daily transportation expenses between taxpayer's residence and temporary work locations are §162(a) deductible business expenses regardless of the distance involved. Temporary work locations are locations at which the taxpayer performs services on an irregular or short-term basis (generally a matter of days or weeks) and do not include locations at which taxpayer works on a regular basis.

7. True v. United States, 90-1 U.S.T.C. para. 50,062 (10th Cir. 1/29/90), reversing District Court. A civil penalty assessed against a pipeline (Subchapter S) company under §311(b)(3) of the Federal Water Pollution Control Act for pipeline leakage was nondeductible under §162(f) (and the applicable example in Reg. §1.162-21(c)(2)) because it was not essentially compensatory. The penalty was to be imposed in addition to cleanup costs.

8. Rev. Rul. 90-20, 1990-9 I.R.B. 8. Deduction by the carrying party of 100% of the §617 exploration expenses and §616 development expenditures in connection with a mineral property carried interest arrangement is permitted under reasoning similar to that of Rev. Rul. 71-207, 1971-1 C.B. 160, for oil and gas properties.

9. Danville Plywood Corp. v. United States, 90-1 U.S.T.C. para. 50,161 (Fed. Cir. 3/21/90). Taxpayer not entitled to deduct a Super Bowl weekend trip for customers, employees, spouses, friends and children as a sales seminar business expense because the expenses were not ordinary and necessary expenses under §162(a).

10. Drake v. Commissioner, T.C. Memo. 1990-176 (4/4/90). Cost of daily travel to Forty Plus organization was not for the primary purpose of seeking
employment where taxpayer admitted that a substantial amount of the time he spent there was for purposes other than his own job-seeking endeavors.

C. Losses and At Risk

1. T.D. 8290, and PS-065-89, temporary and proposed regulations under §469 (2T) permitting §165(c)(3) deductions of nonrecurrent casualty and theft losses sustained in connection with a passive activity without regard to §469 limitations (2/23/90). See also Notice 90-21, 1990-12 I.R.B. 9 (also explains how the §280B capitalization requirement applies to demolition of damaged structures).

2. Rev. Rul. 89-96, 1989-2 C.B. 114. A casualty insurance company that enters into a retroactive agreement of insurance following a catastrophe may not include that loss in the §832(b)(5) category of "losses incurred during the taxable year on insurance contracts" because the requisite element of risk shifting is not involved; only investment risks were assumed.

3. San Antonio Savings Ass'n v. Commissioner, 89-2 U.S.T.C. para. 9614 (5th Cir. 11/2/89); Centennial Savings Bank F.S.B. v. United States, id. at para. 9612, cert. granted 10/1/90; First Federal Savings and Loans Ass'n of Temple v. United States, id. at para. 9613. Regulated S&Ls realized recognizable losses on their concurrent exchanges of fixed-rate, long-term residential first-mortgage loans with other S&Ls pursuant to FHLBB Memorandum R-49.

4. Cottage Savings Ass'n v. Commissioner, 89-2 U.S.T.C. para. 9662 (6th Cir. 12/4/89), reversing Tax Court, cert. granted 10/1/90. Regulated S&L may not deduct losses on its exchanges of fixed-rate, long-term residential first-mortgage loans with other S&Ls pursuant to FHLBB Memorandum R-49 (which held that such losses would not be recognized for financial accounting purposes) because §165 and Reg. §1.165-1(b) limit deductibility to losses actually sustained and these transactions did not change taxpayer's economic position. The Fifth Circuit held to the contrary in San Antonio Savings Ass'n. (11/2/89) (apparently not available to 6th Circuit at time of preparation of this opinion).

5. FNMA v. Commissioner, 90-1 U.S.T.C. para. 50,105 (D.C. Cir. 2/20/90). On FHLBB Memorandum R-49 mortgage exchanges, losses on mortgages swapped in concurrent mortgage sales program were recognized because the mortgages were "materially different." Follows Fifth Circuit and disagrees with Sixth Circuit. However, losses on mortgages replaced under a Resale/Refinance program were not entitled to be recognized because they were not the result of genuine exchanges.

6. Halliburton Co. v. Commissioner, 93 T.C. 758 (12/26/89). Loss deductions (about $8 million) were allowed for 1979 on property (stock and debt of subsidiary) expropriated by the government of Iran in that year because taxpayer had no reasonable prospect of recovery as of 12/31/79. The court so held despite taxpayer's expending time and money through its attorneys to follow the course of events after 1979 and the settlement of its claim for about $3 million in 1984.

7. Continental Illinois Corp. v. Commissioner, 94 T.C. No. 12 (2/28/90). Follows Halliburton Co. v. Commissioner in finding Iranian expropriation loss deductible in 1979. The result was not affected by taxpayer's holding
of Iranian deposit accounts because taxpayer had no right of setoff and, therefore, no reasonable prospect of recovery.


9. Rod Warren Ink v. Commissioner, 90-2 U.S.T.C. para. 50,465 (9th Cir. 8/20/90), reversing 92 T.C. 995 (1989). For purposes of calculating the amount of undistributed personal holding company income, embezzlement losses are deductible in the years in which they occurred because a departure from the literal meaning of §165(e) (deductibility in the year of discovery) is necessary in order to avoid an absurd result (arising from §545(b)(4)'s prevention of loss carrybacks for PHC purposes).

D. Business Income

1. 1989 Act §7611 amended §59(g) to change the calculation of the adjusted current earnings (ACE) preference for AMT purposes.


3. Commissioner v. Indianapolis Power & Light Co., 90-1 U.S.T.C. para. 50,007 (U.S. 1/9/90) (9-0). The Court rejected the Commissioner's contention that a deposit which serves to secure the payment of future income is an advance payment and held that customer deposits did not constitute taxable income. (The Court noted that an advance payment not only protects the seller against the risk of inability to collect money owed it but also protects against the risk that the purchaser will back out of the deal before the seller performs.) The Court noted the consistency of this decision with the Tax Court's longstanding treatment of lease deposits, e.g., J&E Enterprises, Inc. v. Commissioner, 26 CCH T.C.M. 944 (1967).

III. Capital Gain and Loss

A. Rev. Rul. 90-16, 1990-8 I.R.B. 5. Property transfer to creditor by insolvent taxpayer in satisfaction of recourse debt (secured by the property) where property has a fair market value in excess of taxpayer's basis is a sale or disposition resulting in realization and recognition of gain under §1001 to the extent value exceeds basis. The excess of the debt over the fair market value is income from the discharge of indebtedness (subject to the §108 rules). See also GCM 39814 (bifurcated transaction theory).

B. Azar Nut Co. v. Commissioner, 94 T.C. No. 26 (3/20/90). Corporation's $111,000 loss on terminated executive's house purchased for its $285,000 fair market value pursuant to employment contract and sold at a loss after two years of sales effort was not deductible as §162(a) compensation but was a §165(f) capital loss under the Arkansas Best Corp. (88-1 U.S.T.C. para. 9210 (U.S. 1988)), doctrine.

C. ITT Corp. v. United States, 90-1 U.S.T.C. para. 50,214 (S.D.N.Y. 4/6/90). ITT did not have recognizable loss on the acquisition of its subsidiaries' convertible debentures upon their conversion into ITT stock of value greater than the debentures' face value, which debentures were then returned to the subsidiaries for repayment of the face value.
D. **Cook v. United States**, 90-1 U.S.T.C. para. 50,288 (1st Cir. 5/22/90). Transfer of Procter & Gamble stock from husband to wife was made in discharge of a marital obligation, so wife's basis was the fair market value of the stock at the time of the transfer -- §1041 not then being applicable. Wife was not considered to be the owner of property given to her husband by herself and members of her family. A prior Tax Court holding, affirmed by the Second Circuit, that the transfer was not a taxable event to the husband, was not binding on wife.

E. **Nestle Holdings, Inc. v. Commissioner**, 94 T.C. No. 50 (6/6/90). Redeemable preferred stock received by accrual method taxpayer on a sale of inventory is §1001(b) "property," not "money received," and, in computing gain or loss on the sale, is to be included in "amount realized" at fair market value and not at its redemption price. Taxpayer conceded that a long-term note had to be valued at face and could not be discounted to its fair market value. (The stock and the note were sold back to purchaser in the following year for the fair market values originally reported by taxpayer.)

IV. Corporations

A. Entity and Formation

1. 1989 Act §7203 amended §351 by changing "stock or securities" to "stock"; securities are, therefore, no longer nonrecognition property for §351 purposes. Effective for transfers after 10/2/89.

2. 1989 Act §7208(a) amended §385 to authorize regulations to treat an interest in a corporation "as in part stock and in part indebtedness."

B. Distributions and Redemptions

1. **Caamano v. Commissioner**, 89-2 U.S.T.C. para. 9464 (5th Cir. 8/8/89), affirming Tax Court. In this structural change, making the former parent, McDermott, Inc. (Delaware), into a subsidiary of its former subsidiary, McDermott International (Panama), International gave one share of its common stock plus 35 cents in exchange for each share of Inc Stock. Taxpayers were former shareholders of Inc. The issue is whether the International common stock was "property" for purposes of §304(a)(2)(A) (the parties agreed that the cash was property); if §304 is not applicable to the exchange, §1001 would be. The court relied on language in §304(b)(3)(B) in finding that when [International] "distributed its own stock to taxpayers... the stock [was] not... 'property' for the purposes of... section 304." The court noted the lack of bail-out of corporate assets.

2. **Bhada v. Commissioner**, 90-1 U.S.T.C. para. 50,001 (6th Cir. 12/19/89), affirming Tax Court. Defers to the Tax Court and the Fifth Circuit's affirmance in **Caamano v. Commissioner** in this "close" case in which the interplay of Code sections is "both complex and confusing."

4. **Anchor National Life Insurance Co. v. Commissioner**, 93 T.C. 382 (10/28/89). Debt-equity case determined under Ninth Circuit law, with additional attention paid to the unique financing requirements of insurance companies. Held to be debt because advances were made for certificates of contribution issued for emergency financing to meet requirements imposed by the State of California.

5. Rev. Rul. 90-11, 1990-6 I.R.B. 6. Guidance provided regarding the Federal income tax consequences, if any, of a corporation's adoption of a "poison pill" plan. The adoption of the plan is not an income-realization event in the absence of either a redemption or a post-triggering event transaction. The rights will be exempted from the §382 option attribution rules so long as they can be redeemed for a nominal amount without shareholder approval.

6. Rev. Rul. 90-27, 1990-14 I.R.B. 7. Dutch-auction rate preferred stock is equity, so dividends received on it qualify for the §243(a) 70% deduction. There is no arrangement that effectively guarantees that a holder of the stock can sell its shares.

7. **Gunther v. Commissioner**, 90-2 U.S.T.C. para. 50,434 (7th Cir. 8/6/90). The (pre-TEFRA) 1981 transfer of all the stock of one family-owned corporation in exchange for stock and debentures of the second corporation fell within the terms of both to a second family-owned corporation §§304 and 351. The Seventh Circuit chose to follow the Tax Court (1964, 1966) - Sixth Circuit (1968) Haserot-Stickney case in finding §351 to prevail, Judge Tannenwald's dissent in Haserot II notwithstanding. Section 304 was amended by TEFRA (1982) to provide that §304 will now govern transfers which fall under both §§304 and 351.

C. Liquidations

1. **Rojas v. Commissioner**, 90-1 U.S.T.C. para. 50,237 (9th Cir. 4/26/90). The Bliss Dairy (83-1 U.S.T.C. para. 9229 (U.S. 1983)) tax benefit rule will not be extended to require a corporation to recognize as income $900,000 of §162(a) deductions taken for producing unharvested crops that were eventually distributed to its shareholders during a (pre-1986 Act) corporate liquidation.

D. S Corporations

1. **Gold-N-Travel, Inc. v. Commissioner**, 93 T.C. No. 618 (11/21/89). The tax matters person of an S corporation must be a shareholder (by §6244 analogy to the tax matters partner); therefore a petition filed by the non-shareholder S corporation president in response to an FSAA addressed to the corporation was imperfect. The remedy, however, was not dismissal of the petition; the court allowed 60 days to cure the defect subject to evidence that the president was authorized to file the original petition.

2. **Radtke v. United States**, 90-1 U.S.T.C. para. 50,113 (7th Cir. 2/23/90). Dividends paid by a Subchapter S legal services corporation to its sole shareholder-employee constituted wages subject to FICA and FUTA taxes where the employee's stated annual salary was zero.

4. Dial USA, Inc. v. Commissioner, 95 T.C. No. 1 (7/2/90). The amount of a shareholder's basis in an S corporation is not a "subchapter S item" that can be determined under the §§6241 et seq. S corporation audit and litigation procedures. The court denied sua sponte the Commissioner's motion for entry of a decision that included findings regarding the amount of each individual shareholder's basis in the S corporation.

5. Hang v. Commissioner, 95 T.C. No. 6 (7/18/90). Reallocation of (orthodontic lab) S corporation income from shareholder-children to orthodontist father, who was not a shareholder of record, was not within the subchapter S audit and litigation procedures.

E. Affiliated Corporations

1. Long v. Commissioner, 93 T.C. 5 (7/11/89), reconsidered, 93 T.C. 352 (9/13/89). Taxpayer was required to make actual payment -- not merely a constructive payment -- within 90 days (as specified in the closing agreement) of an account payable set up pursuant to Rev. Proc. 65-17, 1965-1 C.B. 833 (which account payable was equal to a §482 allocation made between two corporations entirely owned by taxpayer).

2. Rev. Rul. 89-98, 1989-2 C.B. 219. An excess loss account in a subsidiary's stock is eliminated following the acquisition of that subsidiary's stock by a third corporation in a qualified purchase for which a §338(h)(10) election is made, by reason of the deemed §332 election (and asset sale) resulting from the election.


4. T.D. 8294 and CO-78-87, temporary and proposed regulations under §§337(d) and 1502 to implement General Utilities repeal (3/9/90). This is done by disallowing all losses on the disposition of stock of a member of the group filing consolidated returns (the "loss disallowance rule" of -20T) which would (1) eliminate duplication of loss deductions, (2) prevent "son of mirrors" transactions as outlined in Notice 87-14, 1987-1 C.B. 445, and (3) do much more.

5. T.D. 8295 and CO-008-90, temporary, proposed and final regulations on deferred intercompany transactions and property distributions among members of an affiliated group (3/9/90). These consolidated returns regulations (-13T and -14T) set forth rules concerning the creation and restoration of deferred gain or loss in order to preserve the neutrality principle underlying the deferral rules.

6. Procacci v. Commissioner, 94 T.C. No. 24 (3/13/90). No §482 allocation of rent income to taxpayers' partnership from their related corporation for use of a golf course operated by the corporation at a loss. Factually, the golf course had been bankrupt and was in poor physical condition, so the partnership would have been unable to receive any rent for it from an unrelated party.
7. **Procter and Gamble Co. v. Commissioner,** 95 T.C. No. 23 (9/18/90). No §482 adjustments for royalties from P&G's Spanish subsidiary to its Swiss subsidiary where Spanish law (i.e., Spanish administrative policy) prohibits the payment of royalties. **Commissioner v. First Security Bank of Utah,** 405 U.S. 394 (1972), followed. The court rejected Commissioner's argument that Reg. §1.482-1(d)(6) (taxpayer election to defer income where payment prevented because of "currency or other restrictions") would be rendered meaningless by the court's decision.

8. **Idaho First National Bank v. Commissioner,** 95 T.C. No. 14 (8/23/90). Losses incurred in disposing of assets (i.e., investment assets, mortgages and real estate loans) acquired from an insolvent bank which were incurred in rehabilitating the acquired bank are "rehabilitation losses" which not built-in deductions under Reg. §1.1502-15(a)(2)(i).

F. **Reorganizations and Corporate Divisions**

1. **Baicker v. Commissioner,** 93 T.C. 316 (9/6/89). The transferee corporation in a divisive D reorganization did not succeed to any investment credit rights of the transferor corporation with respect to the transferred assets because (a) section 381 does not apply to a divisive D reorganization and (b) there is no applicable non-statutory principle requiring a carryover.

G. **Personal Service Corporations**

1. **Sargent v. Commissioner,** 93 T.C. 572 (11/13/89) (reviewed, 6 judges dissenting). Professional hockey players were treated as employees of the hockey team (partnership) with which each of their own PSCs (of which the player was sole shareholder, president and sole director) had contracted -- and not employees of their own PSCs -- because the nature of the team sport of hockey involves a high level of control over player activity by coaches and managers. Income was therefore allocated to players under both §61 (Lucas v. Earl (U.S. 1930)) and §482. **Professional & Executive Leasing, Inc.** (89 T.C. 225 (1988)) followed; **Keller** (77 T.C. 1014 (1981)) distinguished because there taxpayer was the employee of his PSC.

H. **Loss Corporations**

1. T.D. 8277, Temporary Reg. §1.382-2T amended with respect to ownership changes under the option attribution rules (12/23/89).

2. Proposed regulations (CO-77-89) under §269, relating to acquisitions made to evade or avoid tax in ownership changes resulting from bankruptcy reorganizations under §382(1)(5) where an active trade or business is not carried on (F.R. 8/14/90).

3. Proposed regulations (CO-62-87) under §382, providing (prospectively) option attribution rules that apply in determining whether the §382(1)(5) stock ownership requirement are satisfied, which options would be deemed exercised if the exercise would cause pre-change shareholders and qualified creditors to own less than the requisite amount of stock (F.R. 9/6/90).
V. Employee Compensation and Plans

A. **Mirza & Associates, Ltd. v. United States**, 89-2 U.S.T.C. para. 9492 (7th Cir. 8/10/89). Actuarial assumption of 5% interest in a defined benefit plan was unreasonable under §412(c)(3) (for 1980), so the allowable deduction was initially reduced from $625,000 to $442,000 for that year; the deduction was further reduced to $115,000 by requiring taxpayer under §404(a)(1)(A)(iii) to amortize participant's past service over a 10-year period.


C. Announcement 90-1, 1990-2 I.R.B. 31. The IRS announced that (pending contrary action by the Department of Labor) it will not raise "prohibited transaction" issues with respect to certain incidental services offered by banks to individuals who maintain IRA or Keogh investments, provided that these investments are treated in the same manner as other accounts.

D. Rev. Proc. 89-65, 1989-2 C.B. 786, superseding Notice 89-8. The §401(b) remedial amendment period is extended until the end of the first plan year beginning after 12/31/90, etc.


F. Rev. Rul. 90-24, 1990-11 I.R.B. 6. The transfer of funds from one §403(b) investment to another §403(b) investment is not a §403(b)(1) distribution provided that the transferred funds continue to be subject to any distribution restrictions required for nonelective contributions.

G. Proposed regulations (EE-61-88, EE-22-90, EE-129-86, and EE-44-87) under §401(a)(4), relating to retirement plan nondiscrimination requirements and other matters including provisions on coverage, §401(a)(26) participation, compensation ceilings, compensation definition, §401(l) social security integration, cash or deferred arrangements, and employee and matching contributions (F.R. 5/14/90). Proposed regulations and amendments of proposed regulations (EE-49-90) relating to §401(a)(4) nondiscrimination requirements and application of the §410(b) average benefit percentage test to ESOPs (F.R. 9/14/90).

H. **Lima Surgical Associates, Inc. v. United States**, 90-1 U.S.T.C. para. 50,329 (Cl. Ct. 6/15/90). Plan and trust set up to pay "severance pay" to employees of a medical corporation fails to qualify as a §501(c)(9) VEBA because it actually pays non-qualifying deferred compensation in the form of pension-type benefits on retirement.

I. **Thoburn v. Commissioner**, 95 T.C. No. 11 (8/9/90). Participants in a profit-sharing plan who were disqualified persons nevertheless borrowed money from the plan, which loans were prohibited transactions under §4975. The IRS is not precluded from determining §4975 excise tax deficiencies by a settlement agreement entered into with the DOL with respect to the same violations.
VI. Exempt Organizations and Charitable Giving

A. Abortion Rights Mobilization, Inc. v. Baker, 89-2 U.S.T.C. para. 9576 (2d Cir. 9/6/89) (2-1), reversing District Court. Various "competitive advocate" individuals and organizations lacked standing to challenge the Roman Catholic Church's tax-exempt status on the ground that the Church's anti-abortion activities violated the §501(c)(3) prohibition on lobbying and campaigning.

B. American Medical Ass'n v. United States, 89-2 U.S.T.C. para. 9585 (7th Cir. 10/12/89), reversing District Court. Regulation on the allocation of membership dues to circulation income found valid even though the final rule differed from the rule originally proposed because the notice and comment requirements of the Administrative Procedure Act are satisfied where an agency changes its course [which indicates the agency took the process seriously] so long as the final rule is generally consistent with the tenor of the original proposal. The crucial issue is whether parties affected by a final rule were put on notice that "their interests [were] 'at stake'"; interested parties are notified even by a favorable proposal and can intervene to support it.

C. Phi Delta Theta Fraternity v. Commissioner, 89-2 U.S.T.C. para. 9600 (6th Cir. 10/24/89 (2-1). Income derived from special endowment and used to pay for publication of fraternity's quarterly periodical is not §512(a)(3)(B) "exempt function income" but is taxable as UBIT.

D. Manning Ass'n v. Commissioner, 93 T.C. 596 (11/15/89). On declaratory judgment, held that association formed to preserve the ancient Manning household, etc., did not qualify for exemption under §501(c)(3) as an educational organization because its family-focused purposes -- social, recreational and genealogical -- are substantial nonexempt objectives which "destroy the exemption."

E. American Postal Workers Union, AFL-CIO v. United States, 90-1 U.S.T.C. para. 50,013 (D. D.C. 12/19/89). Union dues and service fees paid by union members to receive health plan benefits were not unrelated business income because a union-sponsored health plan is substantially related to the purposes for which tax exemption is granted to labor organizations.

F. Rev. Proc. 90-12, 1990-8 I.R.B. 20. Guidelines on the deductibility of contributions to charities that provide token benefits (value of 2% of payment [limited to $50] or [for $27.76 payment] logo-bearing item costing up to $5.45, plus non-commercial quality publications) to contributors.

G. Disabled American Veterans v. Commissioner, 94 T.C. No. 6 (2/26/90) (reviewed, 12-4). Amounts received by §501(c)(4) organization for the (one-time) use of its donor list were from a business activity unrelated to its exempt purpose but were excluded from unrelated business taxable income under §512(b)(2) as royalties because a royalty is a payment for the right to use an intangible asset. Dissent on the ground that §512(b)(2) encompasses only royalties earned from traditional sources of passive investment income and what was received here were rents.

H. GCM 39827 (8/20/90). Payments from an insurance company for the use of an exempt organization's name and logo in return for what are characterized as "royalty payments" are in reality consideration for the performance of services and constitute UBTI. Even if the payments are royalties, they are also payments for the use of the organization's membership list and the entire transaction is "governed by §513(h)(1)(B)" and the payments constitute UBTI.
I. Calhoun Academy v. Commissioner, 94 T.C. No. 17 (3/1/90). On declaratory judgment for exemption under §501(c)(3), private school failed to carry its burden of showing that it operates in accordance with a nondiscriminatory policy towards black students because it failed to take affirmative steps of some sort in light of the absence of either a single black student or a plausible explanation of inability to attract black students.

J. Woodbury v. Commissioner, 90-1 U.S.T.C. para. 50,199 (10th Cir. 4/4/90). Taxpayers made a valid election under §170(b)(1)(C)(ii) to utilize the 50% method for deducting their charitable donation of appreciated property when they attached a supplemental worksheet of calculations to their tax return. They were bound by that election and could not revoke it in favor of the 30% method when that later became advantageous.

K. Davis v. United States, 90-1 U.S.T.C. para. 50,270 (U.S. 5/21/90) (9-0). Funds transferred to taxpayers' Mormon missionary sons were neither contributions "for the use of" [meaning "in trust for"] the Mormon Church nor were they contributions "to" [which includes expenses in connection with only taxpayers' own rendition of services to a qualified organization] the Church, so deductibility under §170 was denied.

L. Portland Golf Club v. Commissioner, 90-1 U.S.T.C. para. 50,332 (U.S. 6/21/90). Tax-exempt social club could not use losses from the sale of food and drink to nonmembers to offset its earnings from investments in determining unrelated business taxable income where the nonmember sales were not motivated by an intent to make a profit, for which determination the case was remanded. In making the "intent" demonstration, taxpayer must employ the same (gross to gross) method of allocating fixed expenses as it uses in calculating its actual loss.


N. 885 Investment Company v. Commissioner, 95 T.C. No. 12 (8/16/90). Tax benefit rule applied to require taxpayer to recognize income in 1983 on its 1983 recovery of property donated in 1979 even though the 1979 §170 charitable contribution deduction was erroneous. (The 1979 deduction was not challenged by the Commissioner.) Unvert v. Commissioner, 81-2 U.S.T.C. para. 9667 (9th Cir. 1981), followed. The tax benefit concept did not require a complete reversal of the $115,695 deduction, but the amount of 1983 income was limited to the $21,040 fair market value of the returned property.

O. T.D. 8308, final regulations relating to lobbying expenditures by certain tax-exempt public charities and by private foundations. (8/30/90).

VII. Interest

A. T.D. 8281, temporary and proposed regulations relating to the treatment of price level adjusted mortgages (PLAMs) under the OID and qualified residence provisions (1/8/90). A PLAM is a debt instrument with a fixed (3% to 5%) rate of interest and a principal balance that is adjusted monthly for the percentage change in an inflation index, designed to be a mortgage with payments constant in purchasing power instead of dollars.

B. Section 7202 of the 1989 Act amended §163 to provide special rules to limit corporate deductions (1) of interest on "high yield discount obligations" and (2) of interest paid to tax-exempt related persons.
Williams v. Commissioner, 94 T.C. No. 27 (3/21/90). On the purchase of a condominium for a $10,000 down payment and a fully recourse, non-interest bearing note, neither §446(b) nor §461(g) limits the interest deduction of a cash method taxpayer to the amount of interest that economically accrued rather than to the amount of interest determined under (pre-1984 Act) §483. The $1,504,000 note required payments of $477,000 in the year of sale and $1,027,000 thirty years after sale, with the unstated interest being 66% of the total payments.

Weis v. Commissioner, 94 T.C. No. 28 (3/21/90). On the purchase of farmland for payments of $11,500 per year and a $607,000 balloon payment six years later, accrual basis partnership's annual interest deductions were limited by the amounts determined under (pre-1984 Act) §483 (about $4,000) and not the ($49,000) amounts economically accrued under the §461 accrual-of-interest rules.

Rev. Rul. 90-40, 1990-18 I.R.B. 5. Interest expense required to be capitalized under §263A(f) may not be reduced by interest income earned from temporarily investing unexpended debt proceeds.

Huntsman v. Commissioner, 90-2 U.S.T.C. para. 50,340 (8th Cir. 6/14/90), reversing Tax Court. Points paid on the refinancing of taxpayers' principal residence were deductible in the year paid under §461(g)(2) because, under the facts of the case and under the statute's "broad [construction]," the refinancing merely had to be "in connection with" the purchase or improvement of the residence.

VIII. Nontaxable Exchanges

Rev. Rul. 89-121, 1989-2 C.B. 203. Whether an exchange of assets of one business (i.e., a television station) for the assets of a similar business qualifies under §1031 requires an analysis of the underlying assets exchanged because the business assets cannot be treated as a single property. See also Rev. Proc. 89-63, id. at 12 (no rulings on exchanges of assets of similar businesses (other than real property) until the IRS resolves this issue). See proposed regulations (IA-12-89) under §1031 relating to exchanges of personal property and multiple properties (F.R. 4/26/90).

Section 7601(a) of the 1989 Act amended §1031 to have gain on exchanges between related persons triggered by the disposition of property received within two years of the exchange.

P.L. 101-194, §502(a) (Ethics Reform Act of 1989), adding new Code §1043. Elective nonrecognition of gain on the sale of property by a Federal executive branch officer or employee pursuant to a divestiture reasonably necessary to comply with Federal conflict-of-interest requirements.

Estate of Bowers v. Commissioner, 94 T.C. No. 34 (4/16/90). Descendent's transfer of an oil and gas lease and his acquisition of a farm did not constitute a §1031 exchange where the farm purchase had been substantially implemented in the preceding tax year, prior to the attempt to recast the non-interdependent sale and purchase as an "exchange."

Rev. Rul. 90-34, 1990-16 I.R.B. 6. X's transfer of property (Blackacre) to Y, in exchange for property of a like kind (Whiteacre) purchased from Z by Y and transferred directly from Z to X, qualified as to X for nonrecognition as a §1031 exchange even though legal title to Whiteacre is never held by Y.
F. Proposed regulations (IA-237-84) under §1031 relating to deferred exchanges (F.R. 5/16/90).

IX. Partnerships

A. T.D. 8274 and PS-19-89, amendments to temporary and proposed regulations (nonrecourse liabilities) under §§752 and 704 (11/20/89).

B. Saso v. Commissioner, 93 T.C. 730 (12/18/89). Partnership audit procedures with respect to mining venture. No petition was filed with respect to FPAA. Section 6653(a) and 6661 penalties, as well as §6621(c) additional interest, were determined with respect to taxpayer-partners in a subsequent notice of deficiency. Held that these are §6231(a)(5) "affected items" that require partner-level factual determinations, but the Tax Court lacks jurisdiction over the 1982 partnership items.

C. Wind Energy Technology Associates III v. Commissioner, 94 T.C. No. 48 (5/30/90). A notice of final partnership administrative adjustment mailed to the tax matters partner seven days after the mailing of the commencement notice to the partners which does not satisfy the §6223(d) requirement that the commencement notice be mailed at least 120 days before the FPAA is mailed, nevertheless is valid. The FPAA suspends the running of the statute of limitations for making assessments. See also Tempest Associates, Ltd. v. Commissioner, 94 T.C. No. 49 (6/4/90) (mailing of FPAA triggers time limits whether or not a tax matters partner is in place).

D. Roberts v. Commissioner, 94 T.C. No. 53 (6/11/90). Determination of partner's amounts at risk under §465 in three partnerships which were based upon alleged stop-loss agreements with third persons are not partnership items and need not be resolved in a TEFRA partnership proceeding. A partner-level notice of deficiency was appropriate.

E. 1983 Western Reserve Oil & Gas Company v. Commissioner, 95 T.C. No. 4 (7/12/90). FPAA notices issued to tax matters partners of bankrupt partnerships and the resulting Tax Court proceedings do not violate the Bankruptcy Code §362(a) automatic stay provisions.

F. Woody v. Commissioner, 95 T.C. No. 15 (8/23/90). The Tax Court, in a partner-level proceeding, did not have jurisdiction to reallocate guaranteed payments, which are partnership items that were required to be determined in the partnership administrative proceeding. However, since there was an issue of §6661 additions in this partner-level proceeding, partner's claimed overpayment attributable to amounts of guaranteed payments he and others previously reported as income for the years in issue was within the Tax Court's jurisdiction.

G. Melvin v. Commissioner, 90-1 U.S.T.C. para. 50,052 (9th Cir. 1/23/90). The California tort law-created right of contribution from other limited partners for payments beyond taxpayer's pro-rata share of loan was a §465(b)(4) loss-limiting arrangement for at-risk purposes.

H. Thornock v. Commissioner, 94 T.C. No. 25 (3/19/90). Limited partners were not at risk under §465(b)(2) and were protected from loss under §465(b)(4) in a computer leasing partnership whose ultimate unrelated creditor provided funds on a nonrecourse basis and had no right to require any of the entities related to the partnership to enforce the limited partners' guarantees.
Rev. Rul. 90-17, 1990-8 I.R.B. 13. In a partnership merger, if the resulting partnership is a continuation of one of the merged partnerships under §708(b)(2)(A), liquidating distributions by the other merging partnerships of 50% or more of the capital and profits interest in the resulting partnership do not cause the resulting partnership to terminate under §708(b)(1)(B).

J. Campbell v. Commissioner, T.C. Memo. 1990-162 (3/27/90) (Scott, J.). Taxpayer, an employee of a hotel limited partnership syndicator, was required to include in income the value of partnership profits interests he received in exchange for his services because the interests received by taxpayer in exchange for services were "property" and §721(a) applies only to transferors of property. Reg. §1.721-1(b)(1) does not, by negative implication, exclude from taxation recipients of partnership profits interests. Diamond (56 T.C. 530 (1971), aff'd, (7th Cir. 1974)), followed. Valuation of partnership profits interests based upon present value of projected tax benefits and cash distributions. Negligence penalties applied with respect to other issues so question as to whether taxpayer negligent on this issue was not reached.

K. Hunt v. Commissioner, T.C. Memo. 1990-248 (5/22/90). Limited partnership formed by three Hunt brothers to hold silver-related assets and obligations, with Placid Oil Company subsidiary as general partner, was a bona fide partnership valid for federal income tax purposes, and not merely a financing arrangement for loans from Placid to the Hunt brothers. Therefore, the dissolution of the partnership and release of the limited partners from guarantee obligations to Placid did not give rise to cancellation of indebtedness income.

L. Notice 90-41, 1990-26 I.R.B. 7. Guidance provided regarding the application of the exemption to the §514 debt-financed property unrelated business income provisions contained in §514(c)(9)(E) to certain partnerships in which one or more (but not all) of the partners are §514(c)(9)(C) qualified tax-exempt organizations.

M. Ware v. Commissioner, 90-2 U.S.T.C. para. 50,342 (2d Cir. 6/21/90). Portion of payments received by attorney upon withdrawing from his law partnership was a §751 unrealized receivable (ordinary income) and not §741 capital gain because the fee he received directly from a client, not previously includible in partnership income, was itself an unrealized receivable.

N. Estate of Carberry v. Commissioner, 95 T.C. No. 5 (7/16/90). Special allocation of partnership 1970 intangible drilling costs did not have "substantial economic effect" because it did not provide for distribution of partnership assets on liquidation according to capital accounts adjusted for the special allocation. Additional interest was imposed under former §6621(c) because the lack of "substantial economic effect" found is the equivalent of "without economic substance," which constitutes a "sham" under that provision.

X. Personal and Individual Income and Deductions

A. Miscellaneous Deductions and Credits

1. Hardy v. Commissioner, 93 T.C. 684 (12/13/89) (reviewed). The Tax Court overruled its opinion in Hoopengarner (80 T.C. 538 (1983); aff'd by unpublished 9th Cir. opinion) and will no longer allow the deduction of start-up or pre-opening expenses not deductible under §162 under §212 (here, loan fees) because: (1) the pre-opening expense doctrine is grounded on the requirement that expenses and related income be matched in a
particular year and such expenditures must be classified as capital where appropriate; (2) Congress intended parity in treatment of expenses under §§162 and 212; and (3) §195 would otherwise be made meaningless.

2. Antonides v. Commissioner, 90-1 U.S.T.C. para. 50,029 (4th Cir. 1/11/90). Yacht chartering venture was not engaged in for profit (§183) because taxpayers could not have anticipated making a profit in the foreseeable future based on taxpayers' cash flow analysis; §6661 penalty imposed.

3. Accardo v. Commissioner, 94 T.C. No. 8 (2/27/90). Taxpayer could not deduct under §212(2) the legal expenses incurred for his successful defense of a RICO criminal prosecution because the claim arose in connection with his alleged racketeering activities and not in connection with his ownership of income-producing CDs. United States v. Gilmore, 63-1 U.S.T.C. para. 9285 (U.S. 1963), followed. Negligence and substantial understatement penalties imposed.

4. Polyak v. Commissioner, 94 T.C. No. 20 (3/12/90). Lodging expenses while in Florida to alleviate chronic ailments, and not to obtain treatment from a physician in a licensed hospital or equivalent outpatient facility, are not §213(d)(2) medical expenses.

5. Stephens v. Commissioner, 90-2 U.S.T.C. para. 50,336 (2d Cir. 6/11/90), reversing Tax Court. Neither the public policy exception to §165 nor the codification of the public policy exception to the deductibility of §162 expenses bars deduction of $530,000 paid as restitution by taxpayer to the corporation from which he was convicted of embezzling because the payment was not made to a government but to a private person.

6. Perry v. Commissioner, 90 TNT 183-13 (5th Cir. 8/15/90) (unpublished), affirming 92 T.C. 472 (1989). Taxpayer not entitled to §166 bad debt deduction by reason of her ex-husband's failure to make court ordered child support and alimony payments because she lacked a basis in the debt.

B. Miscellaneous Income


2. Pistillo v. Commissioner, 90-2 U.S.T.C. para. 50,469 (6th Cir. 8/24/90), reversing Tax Court. Entire settlement award received in an age discrimination lawsuit is excludable under §104(a)(2) because taxpayer suffered a dignitary tort and was personally injured.

3. Byrne v. Commissioner, 89-2 U.S.T.C. para. 9500 (3d Cir. 8/22/89), reversing Tax Court. Entire amount of settlement received on Fair Labor Standards Act and state wrongful discharge claims was excludable as a §104(a)(2) personal injury payment.

4. Miller v. Commissioner, 93 T.C. 330 (9/13/89) (reviewed, 2 judges dissenting). Entire amount received in settlement of defamation action was excludable from gross income under §104(a)(2). It was immaterial that the defamation action was for damage to professional reputation (focus on the nature of the injury and not its consequences) and the settlement included
punitive damages (the statutory language encompasses punitive damages and Rev. Rul. 84-108, 1984-2 C.B. 32, represents only the Commissioner's position on a specific factual situation and does not constitute substantive authority).

5. **Rickel v. Commissioner**, 90-1 U.S.T.C. para. 50,200 (3d Cir. 4/3/90). Entire amount received in settlement of Age Discrimination in Employment Act suit against former employer is excludable from gross income under §104(a)(2) because the suit was analogous to the assertion of a tort-type right. But see **Burke v. United States**, 90-1 U.S.T.C. para. 50,203 (E.D. Tenn. 3/20/90) (amounts receivable in settlement of sex discrimination suit were considered back pay and were not excludable from gross income under §104(a)(2)).

6. **Brooks v. Commissioner**, 94 T.C. 189 (2/28/90). Taxpayer recovered damages which included statutory interest from his attorney for malpractice on the negligent handling of a personal injury action. The interest portion of the recovery was not excludable from gross income under §104(a)(2).

7. **Adkins v. United States**, 89-2 U.S.T.C. para. 9489 (6th Cir. 8/15/89). Lump-sum payments received in settlement of lawsuit against former employer for wrongful termination of retiree health benefit program were not excludable as §106 "contributions" to "accident or health plans."

8. **MacNaughton v. United States**, 89-2 U.S.T.C. para. 9599 (6th Cir. 10/23/89 (2-1). Upholds jury finding that restricted stock was received in connection with the performance of services and, therefore, governed by §83 even if the stock was not received as "compensation." Income was triggered in the year that the stock was exchanged for (transferable) publicly traded stock even though the written legend on the stock was removed in an earlier year. But see **Centel Communications Co. v. Commissioner**, 92 T.C. 612 (3/23/89).

10. **Schulman v. Commissioner**, 93 T.C. 623 (11/29/89). Taxpayer purchased for $40 partnership units of his employer on 3/31/79 pursuant to a non-traded option earlier granted to him; the units were subject to resale restrictions which were not waived in writing until after 6/8/79 but the waiver was backdated to 3/31/79 and contained a reference to an event taxpayer did not learn of until April 1979. Taxpayer valued his units under §83 in 1979 at about $40 although the other partners sold their units for $275 in early August 1979 pursuant to a 7/31/79 agreement between all the partners and the purchaser. Taxpayer sold his units to the purchaser for $286 on 4/1/80. Held: 1979 compensation of $235 and 1980 short term capital gain of $11. Negligence penalty imposed.

11. **Pagel, Inc. v. Commissioner**, 90-2 U.S.T.C. para. 50,347 (8th Cir. 6/15/90). Section 83 will apply to a restricted nonqualified stock option which was not publicly traded, received by an underwriter, at the time the option is exercised or disposed of as provided in Reg. §1.83-7(b)(2) because the option has no "readily ascertainable fair market value."
12. Maxwell v. Commissioner, 95 T.C. No. 9 (7/31/90). Payment of $122,500 by corporation to principal shareholder under a settlement agreement for employment-related injuries was excludable from gross income under §104(a)(2) as personal injury damages (and deductible by the corporation under §162) because the corporation and shareholders reasonably relied on their attorneys to conclude that the settlement payment was necessary under California law -- even though tax considerations also played a part.

13. Notice 90-7, 1990-3 I.R.B. 5. Guidance for the §135 exclusion from gross income of interest on series EE U.S. savings bonds where the proceeds are used to pay qualified higher education expenses of the taxpayer or the taxpayer’s spouse or dependent.

14. Rev. Rul. 90-79, 1990-38 I.R.B. 26. An individual U.S. citizen residing abroad may not offset the gain realized from the sale of a personal residence with the loss realized on the repayment of the nonfunctional (i.e., §988 is inapplicable because the transaction is not business or profit-seeking related) currency denominated mortgage loan used to finance the purchase of the residence. Ditto where there is loss on the residence and gain on the mortgage loan.

XI. Procedure, Penalties and Prosecutions

A. Penalties and Prosecutions

1. Smith v. Commissioner, 93 T.C. 378 (9/28/89). Taxes withheld do not reduce the amount of underpayment subject to the §6661 penalty, to the extent the withheld taxes were refunded pursuant to tax returns timely filed. Woods (91 T.C. 88 (1988)) distinguished.

2. Rowell v. Commissioner, 89-2 U.S.T.C. para. 9519 (8th Cir. 9/5/89). Attorney tax practitioner’s income from tax return preparation reconstructed by multiplying the average charge for preparing a return by the number of tax returns bearing his preparer’s number, obtained from the IRS service center. Taxpayer’s regular and substantial understatements of income over several years constituted fraud.

3. Denenburp v. United States, 89-2 U.S.T.C. para. 9606 (S.D. Tex. 10/5/89). Summary judgment granted to impose late filing penalties despite accountant’s reluctance to file an incorrect return and taxpayer needed corrected documents to show the true nature of a corporate stock acquisition from his brothers, which required the cooperation of taxpayer’s estranged brothers.

4. Laurins v. Commissioner, 89-2 U.S.T.C. para. 9636 (9th Cir. 11/17/89). Fraud penalty upheld for 1973-75 years against an attorney who was a former IRS employee. The IRS cashing in 1977 of taxpayer’s check -- on the back of which taxpayer wrote that it was in "full accord and satisfaction of 1977 and all prior years" -- was not an "accord and satisfaction" so the 1973-75 liability was not discharged. The §7122 compromise regulations and procedures are the exclusive method of settling claims.

5. The Improved Penalty Administration and Compliance Tax Act, 1989 Act §§7701 et seq., substantially revamped the civil tax penalty provisions of the Code.
6. Notice 90-20, 1990-10 I.R.B. 17. Guidance on adequate disclosure (of non-frivolous positions) with respect to the §6662(b)(1) & (2) accuracy-related penalty imposed on underpayments of tax attributable to negligence (20% of negligent portion) and substantial understatements of income tax (20% unless authority or disclosure). Also, substantial authority with respect to §6662(b)(2) expanded. The Notice also provides guidance on the revised preparer penalties. See also Rev. Proc. 90-16, 1990-10 I.R.B. 24.

7. Smith v. United States, 90-1 U.S.T.C. para. 50,134 (11th Cir. 3/1/90). IRS entitled to directed verdict on §6672 responsible officer and willfulness issues despite contentions that (1) officer was advised that any payment to the IRS would be a Bankruptcy Code voidable transfer and (2) the IRS approved the employer-corporation's bankruptcy reorganization plan in which it agreed to collect from the bankruptcy estate an amount which was less than the total withholding tax owed. See also Hochstein v. United States, 90-1 U.S.T.C. para. 50,205 (2d Cir. 4/3/90)(2-1)(controller liable even though financing firm furnished only net payroll).

8. Estate of Wilbanks v. Commissioner, 94 T.C. No. 18 (3/6/90). Partial summary judgment granted to the effect that Commissioner did not abuse his discretion by refusing to grant an extension of time to file an estate tax return which was requested three months after the due date of the return.

9. United States v. Energy Resources Co., 90-1 U.S.T.C. para. 50,281 (U.S. 5/29/90) (8-1). A bankruptcy court has the authority to order the IRS to treat payments made by Chapter 11 bankruptcy debtors as trust fund payments, where the bankruptcy court determines this is necessary for the success of a reorganization plan.

10. Begier v. IRS, 90-1 U.S.T.C. para. 50,294 (U.S. 6/4/90)(9-0). Payments of §7501 trust fund taxes from a bankrupt's general accounts cannot be avoided by the trustee as preferences because they were not transfers of "property of the debtor" but were transfers of property held in trust.

11. Notice 90-45, 1990-28 I.R.B. 11. Information return penalties under §§6721-6724, revised in the 1989 Act, which increase after 30 days and after August 1, will be applied in 1990 subject to a prior administrative policy providing for waiver where the filer furnishes corrected information by October 1, except that under the prior administrative policy the waiver for failure to file was based on a showing of reasonable cause.

12. Estate of McClanahan v. Commissioner, 95 T.C. No. 8 (7/24/90). Declining health of CPA does not excuse imposition of negligence penalties for failure to file his own tax returns on a timely basis for seven consecutive years. Substantial understatement penalties under §6661 at the 25% rate were properly imposed in addition to the negligence penalties.

13. Sage v. United States, 90-2 U.S.T.C. para. 50,453 (5th Cir. 8/13/90). The §6501(a) three-year statute of limitations does not bar the assessment of §6700 penalties for abusive tax shelter promotion; "laches alone provides preclusive effect on the IRS's penalty power." Planned Investments, Inc. v. United States, 89-2 U.S.T.C. para. 9470 (6th Cir. 1989), followed.

14. Cannata v. Commissioner, T.C. Memo. 1990-502 (9/24/90). Extensions of time to file, reporting zero estimated tax liability, were valid because taxpayers did not fail to "properly estimate" their tax liability even though
their accountant overlooked a Form 1099-MISC reflecting a $195,825.90 income item when he calculated taxpayers' estimated tax liability, so taxpayers were not liable for the §6651(a)(1) failure to file penalty. Crocker v. Commissioner, 92 T.C. 899 (1989), distinguished.

B. Litigation Costs

1. Cassuto v. Commissioner, 93 T.C. 256 (8/28/89). Attorney's fees under §7430 (effective 1986-88) awarded where Commissioner's position for two out of three years was not substantially justified. Fees were limited to $75 per hour, adjusted for inflation, despite far higher prevailing market rates.

2. Powell v. Commissioner, 90-1 U.S.T.C. para. 50,036 (5th Cir. 1/16/90), reversing Tax Court. In this §7430 (effective 1983-85) case, the Tax Court erred in denying the requested $200 hourly rate by limiting fees to a $75 hourly rate.

3. Buchanan v. United States, No. 89-35704, 90 TNT 146-22 (9th Cir. 6/27/90) (unpublished). The district court did not abuse its discretion in awarding attorney's fees under §7430 by reason of the Service's attempt to enforce a levy on homeowner's house which IRS thought belonged to a church owing more than $300,000 in delinquent taxes. The court felt the IRS had "jumped to a conclusion" and should have investigated further as to ownership where its only evidence of ownership by the church was homeowner's testimony under oath and the house deed to the church given by the homeowner.

C. Statutory Notice

1. McKay v. Commissioner, 89-2 U.S.T.C. para. 9574 (9th Cir. 10/6/89) (2-1). Statutory notice was valid where taxpayer timely received it, even though it was not sent to his "last known address." (Taxpayer timely received the copy of the notice of deficiency sent to his attorney.)

2. Borgman v. Commissioner, 89-2 U.S.T.C. para. 9635 (1st Cir. 11/17/89). A notice of deficiency mailed to taxpayer at two of his former Illinois addresses, despite his having informed the revenue agent auditing his return of a new Massachusetts address four months earlier, sufficed to toll the statute of limitations as of the day of mailing when the postal service forwarded one of the notices to the new address and taxpayer received it five days after it was mailed -- two days after the statute of limitations would have run out. Neither §6212(a) or §6212(b)(1) prescribe the address to which the notice must be mailed, but the latter subsection sets up a "safe harbor" for Commissioner [mailing to last known address] where taxpayer does not actually receive the notice.

3. Coleman v. Commissioner, 94 T.C. 82 (2/26/90). Taxpayer unsuccessfully asserted a statute of limitations defense; IRS "habit evidence" plus an incomplete Postal Service Form 3877 sufficed for the IRS to prove timely mailing of the notice of deficiency.

4. Miller v. Commissioner, 94 T.C. No. 19 (3/8/90). Joint notice of deficiency was valid as to divorced wife where it was timely sent to husband's address and husband forwarded a copy of it to wife who filed a timely Tax Court petition even though she did not actually receive her copy until more than
3 years after two of the tax returns were filed because it was the mailing that tolled the period of limitations.


6. Ward v. Commissioner, 90-2 U.S.T.C. para. 50,430 (5th Cir. 8/1/90), reversing Tax Court. Deficiency notice mailed to prior address while IRS was still processing taxpayer's change of address notification was not valid because IRS did not use reasonable diligence where the IRS agent was ignorant of the meaning of the computer code indicating that a change of address was pending. The IRS was deemed to have notice of the address change at the time the computer code was posted and could have delayed sending the deficiency notice until the new address was entered into the computer. A different result might apply if taxpayer sent a change of address notification at a time when the limitations period had nearly run.

7. Pearce v. Commissioner, 95 T.C. No. 20 (9/12/90). Notice of deficiency (or transferee liability) was held valid where it was based, in part, on a "determination" that taxpayer had not filed a tax return -- even though this determination was wrong -- because the notice on its face did not reveal that the Commissioner failed to make a determination. Scar v. Commissioner, (9th Cir. 1987), distinguished. But see Kong v. Commissioner, T.C. Memo. 1990-480 (9/6/90) (notice of deficiency assessing tax at 70% rate because of the unavailability of taxpayer's return held invalid, following Scar: the fact that the amount disallowed was the same as the amount disallowed on the return for the correct partnership was not relevant).

D. Statute of Limitations

1. Estate of Taft v. Commissioner, T.C. Memo. 1989-427 (8/15/89). A tax attorney was not estopped from raising the statute of limitations when he inserted a specific 7-1/2 month time limit, readily visible, on each of the Form 872-A consents he signed, which the IRS review staff employee did not notice. There was lack of equitable estoppel because taxpayer did not make a false representation or a wrongful misleading silence.

2. Huene v. Commissioner, T.C. Memo. 1989-570 (10/24/89). A restricted "Form 872M" created by a taxpayer with the intent to mislead IRS employees that the form was a Form 872A was not valid to extend the statute of limitations and to limit taxpayers' liability on a deficiency to $50. Taxpayers were estopped from asserting the statute of limitations.

3. Masraff v. Commissioner, T.C. Memo. 1989-638 (11/30/89). A Form 872-A (revised 9/80) consent to extend the 1980 statute of limitations is not terminated by an overassessment on Form 870 for that year. The court held that I.R.M. §4541.81(5) (6/12/84) to the contrary did not change the plain meaning of the words on the Form 872-A.

5. **Kernan v. Commissioner**, 90-1 U.S.T.C. para. 50,252 (9th Cir. 5/3/90). Execution of a Form 872 for a particular tax year does not terminate a prior Form 872-A indefinite extension of the statute of limitations.

6. **Stenclik v. Commissioner**, 90-2 U.S.T.C. para. 50,374 (2d Cir. 6/26/90). Form 872-A agreement to extend the statute of limitations is indefinite and is not terminated after the passage of a "reasonable time" nor does laches apply; notice of deficiency issued more than three years later was timely.

7. **Illinois Masonic Home v. Commissioner**, 93 T.C. 145 (8/2/89). The expiration of the period of limitations on assessment of additional estate tax before the distribution of estate assets to petitioners not only bars the remedy of collecting additional estate tax from the petitioners as transferees, but also extinguishes the estate’s liability as well. **Diamond Gardner Corporation**, 38 T.C. 875 (1962), followed. A transferee cannot be held liable for the transferor’s tax if the expiration of the period of limitations has extinguished the transferor’s liability before the assets were transferred because §6901 merely provides for a secondary method of enforcing the liability of the transferor.

8. **Fehlhaber v. Commissioner**, 94 T.C. No. 54 (6/13/90) (reviewed, unanimous). A notice of deficiency sent after the expiration of the limitations period for an S corporation, but prior to limitations expiration for its sole shareholder, was timely for an assessment to be made against the shareholder. The court refused to follow **Kelley v. Commissioner**, 89-1 U.S.T.C. para. 9360 (9th Cir. 1989), because the appeal lies to another circuit.

9. **Fendell v. Commissioner**, 90-2 U.S.T.C. para. 50,345 (8th Cir. 6/22/90). Expiration of the three-year limitation period for the trust at the time deficiency notices were issued against the trust beneficiaries bars deficiencies against the beneficiaries resulting from the disallowance of losses claimed by the trust.

10. **Calumet Industries, Inc. v. Commissioner**, 95 T.C. No. 21 (9/13/90). Commissioner is not barred from assessing a deficiency for an open year (1979) attributable to an NOL carryback adjustment from an otherwise closed year (1981) because §6501(h) (permitting a deficiency to be assessed in an otherwise closed year based upon the adjustment of an NOL carryback from an open year) is inapplicable and does not nullify the agreed-upon §6501(c)(4) extension for 1979.

E. **Miscellaneous**

1. **Belk v. Commissioner**, 93 T.C. 434 (10/2/89). Taxpayer-wife was allowed "innocent spouse" relief under §6013(e) with respect to "grossly erroneous items" for which there was "no basis in fact or law" (i.e., capital loss carryovers, clerical mistakes, but not losses sustained in a year and claimed in that year as a protective measure). Late filing penalty imposed on wife even though husband assumed the duty to file and failed to do so.

2. **Bokum v. Commissioner**, 94 T.C. 126 (2/28/90) (reviewed, 5 judges dissenting). Wife not entitled to innocent spouse status under §6013(e) because she had knowledge of the transaction which gave rise to the error on the tax return. Majority declines to follow **Price v. Commissioner**, 89-
2 U.S.T.C. para. 9598 (9th Cir. 10/18/89), reversing Tax Court. Dissent on the ground that knowledge means she "had reason to know that the deductions were phony."

3. **Ness v. Commissioner**, 94 T.C. No. 47 (5/29/90). The fact that a portion of a claimed deduction had been disallowed did not thereby make it a "grossly erroneous item" for purposes of the §6013(e) innocent spouse provisions; the deduction did have "a basis in law."

4. **Zackim v. Commissioner**, 89-2 U.S.T.C. para. 9582 (3d Cir. 10/13/89), reversing Tax Court. Res judicata based upon a Tax Court decision (entered pursuant to a stipulation of settlement) does not apply to tax fraud in the same year, whether the fraud was discovered before or after the Tax Court decision, because §6212(c) excludes claims for tax fraud from claim preclusion.

5. **Koranga v. Commissioner**, 90-1 U.S.T.C. para. 50,030 (4th Cir. 1/2/90). The Tax Court properly denied taxpayers' motion to modify a settlement stipulation on the ground of unilateral mistake because there was no evidentiary record to support their claim of mistake. The $270,000 settlement of a claim based on $638,000 of unexplained deposits allegedly included the double-counting of a $228,000 item.

6. **Conklin v. Commissioner**, 90-1 U.S.T.C. para. 50,131 (10th Cir. 3/1/90), reversing Tax Court. **Tavery v. Commissioner**, 90-1 U.S.T.C. para. 50,121 (10th Cir. 3/1/90), reversing District Court. On separate deficiency notices issued against husband and wife, Tax Court lacked jurisdiction where wife paid the four asserted contested deficiencies before the IRS issued husband's notice of deficiency. (Commissioner also asserted four additional items against husband which Commissioner conceded before trial, but once the concession was accepted by the Tax Court the case became nonjusticiable.) Wife was not precluded by the doctrine of collateral estoppel.


8. **Doolin v. United States**, 90-1 U.S.T.C. para. 60,022 (N.D.N.Y. 4/20/90). Estate not entitled to recover interest on estate tax overpayment accruing after the March 1986 date the IRS sent by ordinary mail a refund check - - even though the check was not received and was not replaced until March 1990, because U.S. district courts lack authority beyond §6611(b)(2) to award interest (which can be awarded only until tender of the refund check).

9. **United States v. Dalm**, 90-1 U.S.T.C. para. 50,154 (3/20/90) (6-3), reversing Sixth Circuit. The doctrine of equitable recoupment may not be used as the sale basis for jurisdiction in an otherwise time-barred refund suit (Kennedy). Taxpayer's litigation of her income tax liability in the Tax Court (without raising an equitable recoupment claim based on gift tax paid) forecloses her from litigating that claim now in a separate action for refund of gift tax. **Bull v. United States**, 295 U.S. 247 (U.S. 1935), distinguished. Dissent (Stevens) on the ground that the Tax Court lacked jurisdiction to consider a plea of equitable recoupment, so Bull should apply. See also **Fairley v. United States**, 90-1 U.S.T.C. para. 60,018 (8th Cir. 4/26/90).

11. **Emmons v. Commissioner**, 90-1 U.S.T.C. para. 50,217 (5th Cir. 4/11/90). Late returns are considered filed as of the date of delivery, and not as of the postmark date (§7502(a)(2)).


14. T.D. 8297, temporary regulations under §7605, relating to the time and place for conducting tax examinations (4/2/90). The regulations provide that Service generally will not adjust the place of examination based on the location of the office of taxpayer's representative; if less than 13 months remains on the statute of limitations, an extension will be required to accommodate a taxpayer's request for transfer.

15. Proposed regulations (IA-130-87) under §6045(e), to expand the information reporting requirements for real estate transactions occurring on and after 1/1/91 (F.R. 4/18/90).

16. **Sergv v. Commissioner**, T.C. Memo. 1990-442 (8/15/90). Taxpayers could not hold IRS to the terms of a settlement agreement they had signed because it was clear at the time of signing that the agreement might be altered at a later date, so there was no meeting of the minds.

17. T.D. 8312, final regulations relating to §6081(a) extension of time to file federal income tax returns and to pay any taxes owing by citizens and U.S. residents whose tax homes, in a real and substantial sense, are outside of the United States and Puerto Rico and who are not merely travelling abroad on the due date of the return (9/7/90).

**XII. Tax Shelters**

A. **Hayden v. Commissioner**, 89-2 U.S.T.C. para. 9642 (6th Cir. 11/22/89) (2-1), affirming Tax Court. The disallowance of amortization deductions for a 7-year partnership licensing agreement was affirmed on the ground that the transactions were not entered into with a bona fide profit objective. Dissent on the ground that the transaction had economic substance if analyzed over the 17-year life of the patent, as opposed to the 7-year term of the partnership's license.

B. **Autrey v. United States**, 89-2 U.S.T.C. para. 9659 (11th Cir. 12/6/89)(2-1). Jury verdict in favor of cattle breeding tax shelter promoters on assessments under §§6700, 6701 and 6694 was vacated and the case remanded for retrial because it was improper for the jury, in determining whether the tax shelters lacked economic substance, to have considered the values for the bull semen, the warranty of
fertility and the management services provided to investors by cattle breedings enterprises because these items had no value as a matter of law.

C. **Burrill v. Commissioner**, 93 T.C. 643 (12/11/89). Loss and interest deductions claimed on metals futures transactions were disallowed because the transactions did not occur. Negligence penalty applied.

D. **A. Ross Winans Grantor Trust v. Commissioner**, T.C. Memo 1989-653 (12/12/89). In these test cases for thoroughbred breeding programs, the court found the transactions were motivated by business purpose and had economic substance, but prices paid for horses and breeding rights far exceeded their fair market values (to which depreciation deductions were limited). Overvaluation (§6659) and substantial understatement (§6661) penalties, as well as the interest penalty (§6662(c)), were imposed -- but not the negligence penalty (§6653(a)).

E. **Shuman v. United States**, 90-1 U.S.T.C. para. 50,045 (5th Cir. 1/5/90), reversing District Court. Reverses summary judgment for "art masters" promoters in §6700 penalty case because government expert's opinion that "master plates" lacked value was sufficient to raise factual issues.

F. **Lockwood v. Commissioner**, 94 T.C. 252 (2/28/90). Master recordings were retired by "actual physical abandonment" (under Reg. §1.167(a)-8(a)(4)) when taxpayer stored them in a non-temperature controlled closet in his home and the abandonment was an exchange, permitting the deduction of a loss equal to his adjusted basis, but also requiring his benefit on the extinguishing of the nonrecourse debt on abandonment to offset his loss. The recordings were not "permanently retired ... but not disposed of ... or physically abandoned" (under Reg. §1.167(a)-8(a)(3)) which would have permitted recognition of loss measured by the excess of adjusted basis over estimated salvage or fair market value. The court noted that exchange treatment would not necessarily arise had the debt been recourse.

G. **James v. Commissioner**, 90-1 U.S.T.C. para. 50,185 (10th Cir. 3/26/90), and **Shriver v. Commissioner**, 90-1 U.S.T.C. para. 50,190 (8th Cir. 3/28/90). Computer sale-leaseback tax shelters were shams lacking economic substance.

H. **Sheldon v. Commissioner**, 94 T.C. No. 46 (5/29/90) (reviewed, 9-7). Treasury bill straddle transactions (involving purchases and repos) were "real" but "lacked tax-independent" purpose (or, "economic substance") so taxpayer's large interest deduction in the current year (with corresponding interest income deferred to a later year) was denied, following **Goldstein v. Commissioner**, 66-2 U.S.T.C. para. 9561 (2d Cir. 1966). Dissent on the ground that some of the transactions involved "purposive" borrowings because they initially had profit potential.

I. **Heasley v. Commissioner**, 90-1 U.S.T.C. para. 50,314 (5th Cir. 6/5/90). Penalties against blue-collar taxpayers based on O.E.C. Leasing Corporation tax shelter were disallowed. Valuation penalty (§6659) improper where the IRS completely disallowed the deductions and credits containing the valuation overstatement, following **Todd** (89-1 U.S.T.C. para. 9116 (5th Cir. 1988)). Negligence penalty (§6653(a)) improper because too stringently applied; moderate-income investors need not independently investigate their investments but may rely on their financial advisors and accountants. Substantial understatement penalty (§6661) should have been waived because of the same reliance. Additional interest penalty (§6621(c)) should also have been waived.
J. Freytag v. Commissioner, 90-2 U.S.T.C. para. 50,381 (5th Cir. 7/6/90). Loss deductions for First Western Government Securities commodities straddle program investments were disallowed because they were sham transactions or (alternatively) were not entered into primarily for economic profit. Special trial judge's report was properly issued by the Tax Court in the name of the chief judge (Sterrett) even though the chief judge's adoption was done on the same day as the special trial judge's report.

K. Evans v. Commissioner, 90-2 U.S.T.C. para. 50,387 (8th Cir. 7/13/90), reversing Tax Court. Motion picture limited partnership had the requisite "$183" profit objective when it purchased a major Hollywood firm ["Heartbeat"] and executed an exclusive distribution agreement with the movie's seller. The court reviewed the evidence was "left with a definite and firm conviction that a mistake has been made by the tax court" because the partnership operated in a business-like manner, the purchase price did not exceed the cost of production and the lack of hobby aspects. While a $28.5 million gross was necessary for a profit, a 60% bracket limited partner could recoup his cash investment at an $8 million gross.

L. Casebeer v. Commissioner, 90-2 U.S.T.C. para. 50,435 (9th Cir. 8/6/90). Affirms Tax Court decision holding Finalco computer leasing shelters to be shams, lacking business purpose and economic substance.

M. Datamatic Services, Inc. v. United States, 90-2 U.S.T.C. para. 50,437 (7th 8/9/90). Affirms abusive tax shelter penalty on a company that sold medical equipment to investors for leasing to physicians.

N. Bailey v. Commissioner, 90-2 U.S.T.C. para. 50,474 (2d Cir. 8/21/90) (2-1), affirming, vacating and remanding 90 T.C. 558 (1988). In movie tax shelter, the findings of the Tax Court (1) that notes were not bona fide debt representing a depreciable investment in the stream of payments generated by the movies and (2) the interest payments on the notes were not deductible were vacated to see whether the amount of the notes was closely related to the value of the assets purchased.


XIII. Trusts, Estates & Gifts

A. Gross Estate

1. Smoot v. United States, 90-1 U.S.T.C. para. 60,002 (7th Cir. 12/27/89). Reg. §20.2032A-8(a)(2), which provides that remainder interests of qualified heirs which are subject to divestment in favor of non-qualified heirs disqualify the property for special use valuation, could not be relied upon by the IRS where there was a possibility that a testamentary power of appointment could be exercised in favor of nonqualified heirs. Instead, the "wait and see" approach adopted by Congress elsewhere in §2032A applied here (to §2032A(c)(1)).

2. Estate of Fletcher v. Commissioner, 94 T.C. No. 5 (1/31/90). Certificate of deposit (payable on death) and Series E bonds (husband "or" decedent) includable in decedent's estate because she died three hours after her husband in an automobile accident by reason (respectively) of Oklahoma law and Federal law.
3. **Prussner v. United States**, 90-1 U.S.T.C. para. 60,007 (7th Cir. 2/15/90). Section 2032A special use valuation election held valid despite executor’s failure to attach a recapture agreement as required by the regulations.

4. **Estate of Newhouse v. Commissioner**, 94 T.C. No. 14 (2/28/90). Value of closely held stock with different stock classes having confused rights is subject to discounts for the possibility of litigation costs and also (35%) for lack of control and lack of marketability.

5. **Gradow v. United States**, 90-1 U.S.T.C. para. 60,010 (Fed Cir. 3/1/90). Full value of community property transferred by decedent to a trust in exchange for a life estate was includable under §2036 because the transfer was not for full and adequate consideration. The transferred property was considered to be one-half of the fee, and not the value of decedent’s remainder interest in half of the community property. A consideration credit under §2043 was allowed.

6. Rev. Rul. 90-21, 1990-9 I.R.B. 13. Life insurance proceeds (payable to a third party for a non-business purpose) are includible in a decreased stockholder’s gross estate under §2035 where the stockholder disposed of control of the corporation owning the policy for less than adequate consideration within 3 years of death.

7. **Estate of Wood v. Commissioner**, 90-2 U.S.T.C. para. 60,031 (8th Cir. 7/26/90)(2-1). Section 2032A special use valuation election on a never-received estate tax return was made timely (because of the common law doctrine that mailing created a presumption of delivery) based upon the testimony of the estate’s attorney and the Easton, MN postmistress, who remembered the timely mailing and post-marking of the estate tax return, which testimony was credited by the Tax Court. The Commissioner argued that the §7502 scheme envisions that only mailing by registered or certified mail creates a presumption of delivery.

8. **Estate of Pattison v. Commissioner**, T.C. Memo. 1990-428 (8/8/90). Court agrees with government expert’s valuation of Waller County property based upon its highest and best use as rural residential property, and not with taxpayer’s expert who valued the property as agricultural property.

9. **Estate of Murphy v. Commissioner**, T.C. Memo. 1990-472 (8/30/90). Minority discounts not allowed for estate tax purposes on the testamentary exercise of a power of appointment for 49.65% of a newspaper corporation’s stock, where three weeks earlier decedent made transfers of .88% of the stock to each her two children because taxpayer briefly fragmented her 51.41% control block for tax avoidance purposes. **Estate of Bright** (5th Cir. 1981), distinguished, *inter alia*, on the ground that it preceded the unification of estate and gift taxes.

B. **Estate Tax Credits and Deductions**

1. **Estate of Clopton v. Commissioner**, 93 T.C. 275 (8/29/89). Section 2055 estate tax charitable deduction denied for bequest to racially discriminatory private school which had previously been exempt under §501(c)(3) but which was not listed in the 10/31/77 Publication No. 78 (Cumulative List). The revocation of exemption was not publicized, the executor knew nothing of the revocation and the organization certified it was exempt (i.e., an organization described in §170(c)).
2. **Estate of Warren v. Commissioner,** 93 T.C. No. 57 (12/14/89). Decedent's will and applicable Texas law required that administrative expenses be deducted from residuary corpus in determining the §2055 charitable estate tax deduction. A settlement agreement adopted as an agreed final judgment by the Texas Probate Court, allocating a portion of administrative expenses to estate income, was not followed under the **Commissioner v. Estate of Bosch** (U.S. 1967) doctrine because it incorrectly applied Texas law.

3. **Estate of Hall v. Commissioner,** 93 T.C. No. 60 (12/26/89). Charitable deductions for a split-interest trust were disallowed under §2055(e)(2) and there was no §2055(e)(3) qualified reformation because the Ohio judicial proceeding to change the major defect in the trust was not timely commenced.

4. **Trent v. United States,** 90-1 U.S.T.C. para. 60,009 (6th Cir. 1/11/90). Section 2053 deduction disallowed for probate-court-ordered modified (increased) alimony in excess of the actuarial value of the alimony payments set forth in the original separation agreement, because the Ohio probate court's order was void in that it had no jurisdiction to modify the original alimony provision.

5. **Estate of Carter v. United States,** 90-1 U.S.T.C. para. 60,003 (E.D. La. 12/14/89). Simultaneous death of spouses, with presumption under Louisiana law that the younger survived. Held, that where the younger husband had a usufruct life estate in wife's estate, the value of that usufruct should be determined under the valuation tables based upon his life expectancy at the time of wife's death, resulting in a §2013 tax on prior transfer credit to his estate of $292,000. Contra: **Estate of Marks v. Commissioner,** 94 T.C. No. 44 (5/3/90) (reviewed, 15-1).

6. Rev. Rul. 90-8, 1990-5 I.R.B. Selling expenses and late payment interest on additional taxes arising from the disposition of qualified real property (under §2032A) to a nonqualified individual are not deductible as necessary administrative expenses.

7. Rev. Rul. 90-3, 1990-3 I.R.B. 13. If a pecuniary bequest is required to be paid with assets valued at the time of payment, the possibility that post-death fluctuations (declines) in estate asset values may diminish the residuary bequest to the surviving spouse does not cause the residuary bequest to be a nondeductible terminable interest for purposes of §2056(b).

8. **Estate of Higgins v. Commissioner,** 90-1 U.S.T.C. para. 60,011 (6th Cir. 3/12/90). Marital deduction reduced because estate did not make a valid QTIP election. The question concerning the election was answered "no" and no property for the election was identified on Schedule M.

9. **Estate of Chagra v. Commissioner,** T.C. Memo. 1990-352 (7/11/90). Unenforceable (and unpaid) gambling debts were not deductible under §2053; Texas probate court's approval of inventory that included these debts filed one week before trial did not shift burden of proof to Commissioner. Reasonable cause for failure to file timely estate tax return found in executrix's reliance on specific legal advice given by the estate's attorney, distinguishing **United States v. Boyle,** 469 U.S. 241 (1985).

10. **Estate of Howard v. Commissioner,** 90-2 U.S.T.C. para. 60,033 (9th Cir. 8/7/90), (2-1), reversing Tax Court. On challenge by estate of wife, QTIP
election made by husband's estate was held to valid even though "the stub" (income accumulated between the last distribution date and spouse's death) went to trust corpus and not to spouse's estate. Prop. Reg. §20.2056(b)-7(c)(ii), while not having the force of law, was not a nullity and converged with court's reading of the law.

C. Gift Tax

1. Estate of Dillingham v. Commissioner, 90-1 U.S.T.C. para. 60,021 (10th Cir. 5/14/90). Value of checks delivered to donors in December 1980 but not cashed until late January 1981 were not 1980 gifts because donor-decedent did not part with "dominion and control" over the property represented by the checks under state (Oklahoma) law -- even though the checks were cashed four months prior to decedent's death. The court refused to adopt the "relation back" doctrine to make these checks gifts in 1980.

2. Rev. Rul. 90-45, 1990-21 I.R.B. 4. The surviving spouse's election of a statutory share in decedent's estate is not an acceptance of "the [property] interest or any of its benefits"; the subsequent timely disclaimer of a portion of the property interest -- not later than 9 months after decedent's death -- is a qualified disclaimer under §2518.

3. Estate of Smith v. Commissioner, 94 T.C. No. 55 (6/13/90) (reviewed, 10-8). Section 2504(c) does not bar the Commissioner from revaluing prior taxable gifts (made more than 3 years earlier) when calculating "adjusted taxable gifts" under §2001(b)(1)(B) for estate tax purposes, but the taxpayer should adjust the §2001(b)(2) subtraction for "gift taxes payable" in conformity with any increase in value. The majority refuses to follow Boatmen's First National Bank of Kansas City v. United States, 89-1 U.S.T.C. para. 13,795 (W.D. Mo. 1988).

4. Krabbenhoft v. Commissioner, 94 T.C. No. 56 (6/19/90) (reviewed, 14-2). Section 483 does not apply to gift tax valuation, so the transfer of $404,000 of farmland to taxpayers' sons under a $400,000 thirty-year installment sale agreement, with 6% interest included in the annual payments, resulted in a $151,000 taxable gift when the obligation was revalued using 11% interest -- even though the §483 safe harbor interest rate for purposes of the entire Internal Revenue Code was 6%. The court refused to follow Ballard v. Commissioner (7th Cir. 1988) where this case would be appealed to the Eighth Circuit.

5. Ordway v. United States, 90-2 U.S.T.C. para. 60,035 (11th Cir. 8/10/90) (2-1). Disclaimers constituted taxable gifts because they were held untimely under Jewitt v. Commissioner, 455 U.S. 305 (1982), because they were not filed within a reasonable time after obtaining knowledge of the transfer creating taxpayer's interest; the disclaimers were not filed until 1979, 38 years after taxpayer learned of his contingent remainder interest in a 1917 trust.

D. Miscellaneous

1. Rocovich v. United States, 89-2 U.S.T.C. 13,819 (Cl. Ct. 10/16/89). Estate's refund suit dismissed for lack of jurisdiction under the Flora (U.S. 1958) full payment rule despite its contention that it was entitled to defer a portion of estate taxes under §6166 because (1) the taxpayer must pay all taxes the IRS has determined are due, and (2) §6166 is not an exception to
the full payment rule (despite the IRS concession to the contrary in GCM 35,696 (2/27/74)).

2. Estate of Hallas v. Commissioner, 94 T.C. No. 33 (4/11/90). There was no conflict of interest in the Commissioner's calling as an expert witness an appraiser who had previously valued the same property when employed by taxpayer because no confidential information had been acquired in that relationship. Further, held that there is no federal testimonial privilege for appraisers of property; they have a public duty and are not advocates for their clients.

3. Rev. Rul. 90-55, 1990-27 I.R.B. 7. A grantor trust is not required under §645 to adopt the calendar year as its taxable year because its income is reportable by the grantor as if the trust did not exist, so deferral cannot occur.

4. Getty v. Commissioner, 90-2 U.S.T.C. para. xx,xxx (9th Cir. 9/14/90), reversing 91 T.C. 160 (1988). Ten million dollars received from the settlement of a suit brought by J. Paul Getty's son Ronald against the Getty Museum is excludable from Ronald's income under §102(a) even though it was in lieu of (as Ronald's lawsuit alleged) an equalizing income interest (which would have been includable under §102(b)) promised to Ronald by his father because his father would have "probably" remedied the claimed inequality with a bequest of property.

XIV. Withholding and Excise Taxes


B. Hopper v. Commissioner, 94 T.C. No. 31 (3/27/90). Losses from real estate rentals (self-storage facilities) were not available to offset attorney's law practice profit in determining "net earnings from self-employment" for the §1402(a) self-employment tax because services provided to tenants were not substantial.

XV. Legislation

A. P. L. 101-234, the Medicare Catastrophic Coverage Act of 1988, which enacted §59B, was repealed retroactively.

B. P.L. 101-239, Revenue Reconciliation Act of 1989 (Title VII of OBRA), signed by President Bush on 12/19/89.

C. Notice 90-6, 1990-3 I.R.B. 1. (1/16/90). Guidance provided on the interpretation of "binding contract" for purposes of the RRA of 1989 transitional rules. A contract is binding even if: (1) it is subject to a condition outside the parties' control; (2) insubstantial terms remain to be negotiated; or (3) it is subject to formal board approval.