Current Federal Tax Developments

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October 23, 2017

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Section: 1
Inflation Adjusted Numbers Issued by IRS for 2018 Including New Indexed Maximum Small Employer HRA Amounts

Citation: Revenue Procedure 2017-58, 10/19/17

The IRS released inflation adjusted amounts for a number of tax related items for 2017 in Revenue Procedure 2017-58.

The tax tables for 2018 will be:

Married Couples Filing a Joint Return

If Taxable Income Is:	The Tax Is:
Not over $19,050	10% of the taxable income
Over $19,050 but not over $77,400	$1,905 plus 15% of the excess over $19,050
Over $77,400 but not over $156,150	$10,657.50 plus 25% of the excess over $77,400
Over $156,150 but not over $237,950	$30,345 plus 28% of the excess over $156,150
Over $237,950 but not over $424,950	$53,249 plus 33% of the excess over $237,950
Over $424,950 but not over $480,050	$114,959 plus 35% of the excess over $424,950
Over $480,050	$134,244 plus 39.6% of the excess over $480.050

Heads of Household

If Taxable Income Is:	The Tax Is:
Not over $13,600	10% of the taxable income
Over $13,600 but not over $51,850	$1,360 plus 15% of the excess over $13,600
Over $51,850 but not over $133,850	$7,097.50 plus 25% of the excess over $51,850
Over $133,850 but not over $216,700	$27,052.50 plus 28% of the excess over $133,850
Over $216,700 but not over $424,950	$50,795.50 plus 33% of the excess over $216,700
Over $424,950 not over $453,350	$119,518 plus 35% of the excess over $424,950
Over $453,350	$129,458 plus 39.6% of the excess over $453,350

Single

If Taxable Income Is:	The Tax Is:
Not over $9,525	10% of the taxable income
Over $9,525 but not over $38,700	$952.50 plus 15% of the excess over $9,525

Over $38,700 but not over $93,700	$5,328.75 plus 25% of the excess over $38,700
Over $93,700 but not over $195,450	$19,078.75 plus 28% of the excess over $93,700
Over $195,450 but not over $424,950	$47,568.75 plus 33% of the excess over $195,.450
Over $424,950 not over $426,700	$123,303.75 plus 35% of the excess over $424,950
Over $426,700	$123,916.25 plus 39.6% of the excess over $426,700

Married Filing Separate Returns

If Taxable Income Is:	The Tax Is:
Not over $9,525	10% of the taxable income
Over $9,525 but not over $38,700	$952.50 plus 15% of the excess over $9,525
Over $38,700 but not over $78,075	$5,328.75 plus 25% of the excess over $38,700
Over $78,075 but not over $118,975	$15,175.50 plus 28% of the excess over $78,075
Over $118,975 but not over $212,475	$26,624.50 plus 33% of the excess over $118,975
Over $212,475 but not over $240,025	$57,479.50 plus 35% of the excess over $212,475
Over $240,025	$67,122 plus 39.6% of the excess over $240,025

Estates and Trusts

If Taxable Income Is:	The Tax Is:
Not over $2,600	15% of the taxable income
Over $2,600 but not over $6,100	$390 plus 25% of the excess over $2,600
Over $6,100 but not over $9,300	$1,265 plus 28% of the excess over $6,100
Over $9,300 but not over $12,700	$2,161 plus 33% of the excess over $9,300
Over $12,700	$3,283 plus 39.6% of the excess over $12,700

Other inflation-adjusted items in the notice are:

Unearned Income Taxed As if Parent's Income ("Kiddie Tax")	Unearned income in excess of $1,050
Adoption Credit	Maximum credit for both special needs adoptions and other adoptions is $13,840. The credit begins to phase out at adjusted gross income of $207,580 and is fully phased out at $247,580
Lifetime Learning Credit	Modified adjusted gross income in excess of $57,000 ($114,000 for a joint return) is used to determine the reduction in the credit

Earned Income Credit

The threshold phase-out amounts and completed phase-out amounts for 2016 for married couples filing a joint return:

	Number of Qualifying Children			
Item	**One**	**Two**	**Three or More**	**None**
Earned Income Amount	$10,200	$14,320	$14,320	$6,800
Maximum Amount of Credit	3,468	5,728	6,444	520
Threshold Phaseout Amount (Single, Surviving Spouse or Head of Household)	18,700	18,700	18,700	8,510
Completed Phaseout Amount(Single, Surviving Spouse or Head of Household)	40,402	45,898	49,298	15,310
Threshold Phaseout Amount (Married Filing Jointly)	24,400	24,400	24,400	14,200
Completed Phaseout (Married Filing Jointly)	46,102	51,598	54,998	21,000

Excess Investment Income for Earned Income Credit	EITC not allowed if investment income exceeds $3,500

Refundable Credit for Coverage Under a Qualified Health Plan. For taxable years beginning in 2018, the limitation on tax imposed under § 36B(f)(2)(B) for excess advance credit payments is determined using the following table:

If the household income (expressed as a percent of poverty line) is:	The limitation amount for unmarried individuals (other than surviving spouses and heads of household) is:	The limitation amount for all other taxpayers is:
Less than 200%	$300	$600
At least 200% but less than 300%	$775	$1,550
At least 300% but less than 400%	$1,300	$2,600

Rehabilitation Expenditures Treated as Separate New Building	For calendar year 2018, the per low-income unit qualified basis amount under § 42(e)(3)(A)(ii)(II) is $6,800.
Low-Income Housing Credit	The amount used to calculate the State housing ceiling is the greater of (1) $2.40 multiplied by the State population or (2) $2,765,000
Employee Health Insurance Credit under §45R	The average wage phase-out begins at $26,700
Exemption Amounts for Alternative Minimum Tax	Joint Returns or Surviving Spouses $86,200
	Single and Head of Household $55,400
	Married Individuals Filing a Separate Return $43,100
	Estates and Trusts $24,600
AMTI Level at Which the 28% Rate Applies	Married Individuals Filing Separate Returns $95,750
	Other Taxpayers $191,500
AMT Phaseout of Exemption Amounts Begin at	Joint Returns or Surviving Spouses $164,100
	Single and Head of Household $123,100
	Married Individuals Filing Separate Returns $82,050
AMT Exemption for Child Subject to the "Kiddie Tax"	The child's earned income plus $7,650
Certain expenses of elementary and secondary school teachers	$250
Transportation Mainline Pipeline Construction Industry Optional Expense Substantiation Rules for Payments to Employees under Accountable Plans	Up to $18 an hour for rig related expenses if the employer does not reimburse fuel. Up to $11 an hour if the employer does reimburse fuel [Rev Proc 2002–41]
Standard Deduction	Married Individuals Filing a Joint Return and Surviving Spouses $13,000
	Heads of Household $9,550
	Single $6,500
	Married Individuals Filing Separate Returns $6,500
Standard Deduction for Person Who May be Claimed as a Dependent	Greater of $1,050 or the sum of $350 and the individual's earned income
Aged or Blind Additional Standard Deduction	The additional standard deduction is $1,300. The amount is increased to $1,600 if the individual is unmarried and not a surviving spouse
Overall Limit on Itemized Deductions ("Pease" Limitation) Begins to Apply	Joint return or Surviving Spouse $320,000
	Head of Household $293,500
	Single $266,700

	Married Individual Filing a Separate Return $160,000
Cafeteria Plan Medical FSA Deferrals	Maximum of $2,650
Qualified Transportation Fringe Benefit	Monthly limitation for transportation in a commuter highway vehicle and any transit pass is $260. Monthly maximum exclusion for qualified parking is $260
United State Savings Bonds Higher Education Expenses	Exclusion begins to phase out for modified gross income above $119,550 for joint returns and $79,700 for other returns. The exclusion completely phases out for modified adjusted gross income of $149,550 or more for joint returns and $94,700 or more for other returns
Adoption Assistance Programs	The limits and phase outs are the same as for the adoption credit
Personal Exemption	$4,150
Personal Exemption Phase-Out	Married filing joint and surviving spouse begins at $320,00 and is completely phased out at $442,500
	Heads of household begins at $293,350 and is completely phased out at $415,850
	Single begins at $266,700 and is completely phased out at $389,200
	Married individuals filing separate returns begins at $160,000 and is completely phased out at $221,250
Section 179 Expensing	For 2018 the maximum amount that can be expensed is $520,000 and the amount begins to be reduced when property placed in service exceeds $2,070,000
Eligible Long-Term Care Premiums Limit Based on Age Attained at Close of Taxable Year	40 or less $420
	More than 40 but not more than 50 $780
	More than 50 but not more than 60 $1,560
	More than 60 but not more than 70 $4,160
	More than 70 $5,200
Medical Savings Account High Deductible Health Plan	Self-only coverage: annual deductible not less than $2,300 and not more than $3,450, with a maximum out of pocket of no more than $4,600
	Family coverage: annual deductible not less than $4,600 and not more than $6,850, with a maximum out of pocket of no more than $8,400
Interest on Education Loans	Begins to phase out at modified adjusted gross income of $65,000 ($135,000 for joint returns) and is completely phased out at

	MAGI of $80,000 or more ($165,000 or more for joint returns)
Insubstantial Benefit Limitations for Contributions Associated with Charitable Fund Raising Campaigns	For purposes of defining the term "unrelated trade or business" for certain exempt organizations under § 513(h)(2), "low cost articles" are articles costing $10.90 or less.
	Under § 170, the $5, $25, and $50 guidelines in section 3 of Rev. Proc. 90-12, 1990-1 C.B. 471 (as amplified by Rev. Proc. 92-49, 1992-1 C.B. 987, and modified by Rev. Proc. 92-102, 1992-2 C.B. 579), for the value of insubstantial benefits that may be received by a donor in return for a contribution, without causing the contribution to fail to be fully deductible, are $10.90, $54.50, and $109, respectively.
Covered Expatriate	An individual generally is a covered expatriate if the individual's "average annual net income tax" under §877(a)(2)(A) for the five taxable years ending before the expatriation date is more than $165,000.
Tax Responsibilities for Expatriation	The amount that would be includible in the gross income of a covered expatriate by reason of § 877A(a)(1) is reduced (but not below zero) by $713,000.
Foreign Earned Income Exclusion	$104,100
Unified Credit Against Estate Tax	Basic exclusion amount for 2017 is $5,600,000
Valuation of Qualified Real Property in Decedent's Gross Estate	If the executor elects to use the special use valuation method under § 2032A for qualified real property, the aggregate decrease in the value of qualified real property resulting from electing to use § 2032A for purposes of the estate tax cannot exceed $1,140,000.
Annual Exclusion for Gifts	Present interest gifts $15,000
	Gifts to spouse who is not a citizen of the United States $152,000
Requirement to Maintain Minimum Essential Coverage	The amount used to determine the penalty under §5000A(c) is $695
Notice of Large Gifts Received from Foreign Persons	$16,111
Interest on a Certain Portion of an Estate Tax Payable in Installments	The dollar amount used to determine the "2-percent portion" (for purposes of calculating interest under § 6601(j)) of the estate tax extended as provided in § 6166 is $1,520,000.
Minimum penalty for failing to file a tax return	For tax years beginning in 2018, the amount of the additional tax under § 6651(a) for

	failure to file a tax return within 60 days of the due date of such return (determined with regard to any extensions of time for filing) shall not be less than the lesser of $215 or 100 percent of the amount required to shown as tax on such returns.
Penalty for failure to file certain information returns	Organization (§ 6652(c)(1)(A)) – per return daily penalty $20, maximum penalty: lesser of $10,000 or 5% of gross receipts of the organization for the year
	Organization with gross receipts exceeding $1,049,000 (§ 6652(c)(1)(A)) – per day penalty of $100, maximum penalty of $52,000
	Managers (§ 6652(c)(1)(B)) – per day penalty of $10, maximum penalty of $5,000
	Public inspection of annual returns and reports (§ 6652(c)(1)(C)) – per day penalty $20, maximum penalty $10,000
	Public inspection of applications for exemption and notice of status (§ 6652(c)(1)(D)), per day penalty of $20, no maximum limits
Failure to file a return required under § 6034 (relating to returns by certain trust) or § 6043(b) (relating to terminations, etc., of exempt organizations)	Organization or trust (§ 6652(c)(2)(A)) – per day penalty $10, maximum penalty $5,000
	Managers (§ 6652(c)(2)(B)) – per day penalty $10, maximum penalty $5,000
	Split-Interest Trust (§6652(c)(2)(C)(ii)) – per day penalty $20, maximum penalty $10,000
	Any trust with gross receipts exceeding $262,000 (§ 6652(c)(2)(C)(ii)) – per day penalty $100, maximum penalty $52,000
Failure to file a disclosure required under § 6033(a)(2):	Tax-exempt entity (§ 6652(c)(3)(A)) – per day penalty $100, maximum penalty $52,000
	Failure to comply with written demand (§ 6652(c)(3)(B)(ii)) – per day penalty $100, maximum penalty $10,000
Failure to furnish a copy of the return to the taxpayer (§ 6695(a))	$50 per return, maximum penalty $26,000
Failure to sign the return (§ 6695(b))	$50 per return, maximum penalty $26,000
Failure to furnish identifying number (§ 6695(c))	$50 per return, maximum penalty $26,000
Failure to retain copy or list of returns (§ 6695(d))	$50 per return, maximum penalty $26,000
Failure to file correct information returns (§ 6695(e))	$50 per return and item in return, maximum penalty $26,000
Negotiation of check by preparer (§ 6695(f))	$520 per check with no limit

Failure to be diligent in determining eligibility for child tax credit, American opportunity tax credit, and earned income credit (§ 6695(g))	$520 per return with no limits
Failure to file partnership return (§ 6698(b)(1))	$200
Failure to file S corporation return (§ 6699(b)(1))	$200
Failure to file correct information return and/or payee statements – average gross receipts for last three years of more than $5,000,000	General rule - $270 per return, maximum $3,282,500
	Corrected on or before 30 days after required filing date - $50 per return, maximum $547,000
	Corrected after 30th day but on or before August 1st - $100 per return, maximum penalty $1,641,000
Failure to file correct information return and/or payee statements – average gross receipts for last three years of $5,000,000 or less	General rule - $260 per return, maximum penalty $1,094,000
	Corrected on or before 30 days after required filing date - $50 per return, maximum $191,000
	Corrected after 30th day but on or before August 1st - $100 per return, maximum penalty $547,000
Failure to file correct information returns and/or payee statements due to an intentional disregard of the filing requirement (or correct information reporting requirement	Return other than a return required to be filed under §§ 6045(a), 6041A(b), 6050H, 6050I, 6050J, 6050K, or 6050L (§ 6721(e)(2)(A)) - Greater of (i) $540 or (ii) 10% of aggregate amount of items required to be reported correctly
	Return required to be filed under §§ 6045(a), 6050K, or 6050L (§ 6721(e)(2)(B)) - Greater of (i) $540 or (ii) 5% of aggregate amount of items required to be reported correctly
	Return required to be filed under § 6050I(a) (§ 6721(e)(2)(C)) - Greater of (i) $27,350 or (ii) amount of cash received up to $107,000
	Return required to be filed under § 6050V (§ 6721(e)(2)(D)) - Greater of (i) $540 or (ii) 10% of the value of the benefit of any contract with respect to which information is required to be included on the return
Revocation or denial of passport in case of certain tax delinquencies	Amount of a delinquent tax debt for 2017 is $51,000
Periodic Payments Received under Qualified Long-Term Care Insurance Contracts or under Certain Life Insurance Contracts	The stated dollar amount of the per diem limitation under § 7702B(d)(4), regarding periodic payments received under a qualified

	long-term care insurance contract or periodic payments received under a life insurance contract that are treated as paid by reason of the death of a chronically ill individual, is $360.
Qualified small employer health reimbursement arrangement (IRC §9831(d))	Maximum reimbursements for year cannot exceed $5,050 ($10,250 for family coverage)

Section: 263
LB&I Division Issues Memorandum on Units of Property and Major Components for Mining Industry

Citation: LB&I Memorandum LB&I-04-0917-004, 9/11/17

The IRS Large Business & International Division has issued a memorandum (LB&I-04-0917-004) dealing with the classification of various types of mining equipment to determine units of property and major components under Reg. §1.263(a)-3(e).

The memo is meant to provide some consistently and eliminate confusion over what are units of property and major components of units of property for mining organizations. However, since making use of definitions will likely change how an organization has been classifying items as units of property or major components, an entity wishing to make use of this provision will need to go through the procedures for a change of accounting method.

The memorandum has guidance that would apply to taxpayers under examination, guidance that changes depending on whether the taxpayer wishes to adopt this method and whether the taxpayer had properly filed a request for a change of method to deal with the current regulations in this area.

However, for taxpayers not currently under examination, the memo provides the following guidance:

> *A taxpayer that chooses to change the definition of its UOP and major components as described in this directive must follow the automatic change in method of accounting provisions contained in section 11.08 of Rev. Proc. 2017-30, 2017-18 I.R.B. 1131. Such a change constitutes a change in method of accounting to which the provisions of I.R.C. §§ 446 and 481, and the associated regulations thereunder, apply.*

Taxpayers in the mining industry and those advising them should consult this memorandum to decide if the taxpayer should move to adopt the classifications in the memorandum or use other classifications that the taxpayer believes are defensible under the regulations.

The memorandum provides a list of items that will be treated as constituting a unit of property as well as major components of those units of property. These definitions would be used to determine what is to be capitalized or expensed pursuant to the rules under Reg. §1.263(a)-3.

Section: 415
IRS Announces 2018 Retirement Plan Inflation Adjusted Limits

Citation: Notice 2017-64, 10/20/17

The IRS announced in Notice 2017-64 the inflation adjusted limitations imposed on qualified plans for 2018.

Type	2018 Amounts	2017 Amounts
Maximum annual benefit-DB Plan (§415)	$ 215,000	$ 215,000
Contribution limit DC Plan (§415)	55,000	54,000
Annual Compensation Limit (§404(l))	275,000	270,000
Catch up Contributions to Employer Plan	6,000	6,000
Elective Deferrals (§402(g))	18,500	18,000
Highly Compensated Employee (§414(q))	120,000	120,000
Key Employee Compensation (§416(i))	175,000	175,000
SIMPLE Deferral Limitation (§408(p))	12,500	12,500
SIMPLE Catch Up Contribution (414(v)(2)(B))	3,000	3,000
SEP Compensation Limit (§408(k))	600	600
IRA Limitations		
Maximum IRA Contribution (before catch-up) (§219(b)(5)(A))	5,500	5,500
Deduction phases out for individuals that are an active participant in an employer plan for adjusted gross income between	Single and Head of Household - $63,000 to $73,000	Single and Head of Household - $62,000 to $72,000
	Married Filing Joint - $101,000 - $121,000	Married Filing Joint - $99,000 - $119,000
	Married Filing Separate - $0 - $10,000	Married Filing Separate - $0 - $10,000
Deduction phases out for individuals whose spouse is an active participant in a an employer plan phases out between	$189,000 - $199,000	$186,000 - $196,000
Roth IRA Maximum Contribution Phaseout Begins:		
Married filing joint	189,000	186,000

Other except married filing separate	120,000	117,000

Section: 469
Restricted Stock Interest Still Found to Constitute Ownership Interest for Qualifying as Real Estate Professional But IRS Announces Nonacquiesence With Decision

Citation: Stanley v. United States, 116 AFTR2d ¶2015-5419, Case No. 5:14-CV-05236, U.S.D.C. Western District of Arkansas, nonacqu, AOD 2017-07, 10/16/17

An Arkansas U.S. District Court case involved the court resolving a number of not often raised in court questions regarding the interaction of the passive activity rules, the real estate professional classification, S corporations and stock provided to an employee that was subject to restrictions triggering treatment under IRC §83(b). The case in question is the case of *Stanley v. United States*, 116 AFTR2d ¶2015-5419, Case No. 5:14-CV-05236, U.S.D.C. Western District of Arkansas.

The issues arose regarding Mr. and Mrs. Stanley's claimed deductions for losses on Schedule E that arose from real estate related activities. Mr. Stanley took the position that he qualified as a real estate professional and that all of the various items reported on Schedule E were properly classified as a single activity under the passive activity rules.

One key issue that the court had to deal with initially involved the interaction of restricted stock and an S corporation. Mr. Stanley worked for Lindsey Management Co., Inc. (LMC), initially full time as its President, later going to half-time after 15 years and finally retiring from the company. He was also President of Lindsay Communications, Inc., a company that provided telecommunications services to the property management company.

Mr. Stanley began to acquire activities related to his work with Lindsey. The Court noted:

> From the beginning of Roy's employment with LMC, the Stanleys acquired minority ownership interests in business entities that owned or operated the rental properties and adjoining golf courses managed by LMC. By 2009 and 2010, the Stanleys had an ownership interest in more than 100 entities. The Stanleys also directly owned two rental properties, two percent of a third rental property, and interests in 88 (in 2010) and 90 (in 2009) additional entities through the Roy E. Stanley Family Limited Partnership.

Mr. Stanley claimed he qualified as real estate professional under §469(c)(7) and, having grouped all of these activities together, could claim losses available to him from the operations he had acquired ownership interests in.

Generally to be a real estate professional a taxpayer must meet two criteria. They are:

- The taxpayers spent more than 750 hours performing services in real estate activities *and*
- More time was spent by the taxpayer in participation in those activities than in other activities in which the taxpayer materially participated.

The taxpayer cannot count as real estate activities time spent in an enterprise in which the taxpayer did not have at least a 5% ownership interest.

The initial issue the IRS raised was their claim that Mr. Stanley was not a more than five percent owner of LMC, Inc. Should the IRS carry this point Mr. Stanley could not be a real estate professional since his hours for LMC, Inc. would no longer count as real estate hours—and they would be greater than his other hours.

His ownership of the stock was, via his employment agreement, subject to certain restrictions. The court summarized the situation as follows:

> Roy testified that, from the time he began working at LMC in 1994, he owned ten percent of the company. Roy admitted into evidence a stock certificate evidencing his ownership of 10 shares out of 100 shares of LMC stock issued. (Pl. Hearing Exh. 6). Scott Rogerson, Chief Financial Officer and President of Corporate Operations for LMC, testified that the certificate was in fact a stock certificate from LMC to Roy for ten shares of stock in LMC. (Doc. 59, p. 9). Mr. Rogerson testified that the stock certificate issued to Roy was restricted only by the terms of the Roy's employment agreement with LMC. (Doc. 59, p. 9). Roy testified under oath that his stock in LMC was voting stock, but that meetings of the 2 or 3 shareholders at LMC were informal and that, with only ten percent of the stock, his role was to give advice as opposed to making decisions. *Id.* at 27, 55. *Roy's ownership of the stock was acknowledged in his February 1, 2004 employment agreement and a subsequent employment agreement, which memorialized the understanding between the parties to those agreements that Roy would relinquish his stock upon full retirement from LMC.* (Doc. 57, pp. 7 and 10). Roy's salary from LMC was reported as W-2 income from wages or salaries on line 7 of the Stanleys' tax returns for 2009 and 2010. (Doc. 50-4, p. 3 and Doc. 50-5, p. 3). Income received as a result of Roy's 10-percent ownership interest in LMC was reported on a Form K-1 from LMC each year and reported on Schedule E of the returns as distributions from an S corporation. (Doc. 50-4, p. 59 and Doc. 50-5, p. 61*). Upon his resignation from LMC, and pursuant to his employment agreement with LMC, Roy transferred the stock certificate back to James Edgar Lindsey. (Pl. Hearing Exh. 7). [Emphasis added]*

The IRS argued that despite the fact that he held shares that purported to be 10% of the company's stock, his ownership should not count for purposes of the passive activity rules.

The IRS first argued that, due to the terms of the arrangement, Roy did bear any risk of loss during the period in question. The Court did not accept this view, noting:

> The parties dispute whether Roy bore any risk of loss were LMC to experience a loss during Roy's tenure. This argument, however, does not factor into the Court's analysis, as it is rooted in speculation. LMC never experienced a loss during Roy's tenure. Rather, the issue here is whether Roy has adequately and reasonably substantiated his ownership for purposes of the tax code. The Court finds that he has. Furthermore, the fact that Roy did not make a capital contribution for his shares is not determinative of whether he nevertheless owned 10 percent of the stock of LMC. A capital contribution is merely one avenue of acquiring ownership of stock or other property.

The IRS's next argument was more interesting—the IRS, pointing out that Mr. Stanley's stock was restricted, argued that, pursuant to §83, the stock was not outstanding for tax purposes. Thus, the IRS claimed, he failed to hold at least 5% of the "tax stock" in this case.

Although the opinion does not reference it, it seems likely the IRS was arguing by reference to Reg. 1.1361-1(b)(3) which provides:

> *(3) Treatment of restricted stock*. For purposes of subchapter S, stock that is issued in connection with the performance of services (within the meaning of §1.83-3(f)) and that is substantially nonvested (within the meaning of § 1.83-3(b)) is not treated as outstanding stock of the corporation, and the holder of that stock is not treated as a shareholder solely by reason of holding the stock, unless the holder makes an election with respect to the stock under section 83(b). In the event of such an election, the stock is treated as outstanding stock of the corporation, and the holder of the stock is treated as a shareholder for purposes of subchapter S. See paragraphs (l)(1) and (3) of this section for rules for determining whether substantially nonvested stock with respect to which an election under section 83(b) has been made is treated as a second class of stock.

That provision is important in the S context because is such stock is treated as "outstanding" in most cases the corporation would have two classes of stock outstanding, a fact that would put the S election at risk under the second class of stock rules.

However, the Court rejected any use of Section 83 to determine if stock was outstanding in the context of the passive income rules for a real estate professional, noting:

> Section 83 does not explicitly reference any provisions of the code or regulations at issue in this case. The Government has not cited to any authority that would require or allow application of Section 83 to 26 U.S.C. § 416(i)(1)(B)(i)(I), and the Court has not otherwise found any such authority. At the hearing, counsel for the Government argues that Section 83 was relevant to the issues in this case simply because it is entitled "Property Received in Connection with the Provision of Services." (Doc. 59, p. 95). The mere title of a section of the tax code does not act as a net that might ensnare any other provision falling within its broad subject-matter reach. The purpose of Section 83 appears to be to provide guidance on when a taxpayer should report certain property received in exchange for services (i.e. stock options) as gross income on a tax return, and further provides taxpayers with the option to elect to include such property in gross income in the year of transfer notwithstanding any restriction on its transferability or any substantial risk of forfeiture. 26 U.S.C. § 83(b). The Court finds that the section provides no authoritative, or even persuasive, guidance on the issue of whether Roy was a 5-percent owner of LMC.

Thus the Court found, being the owner of 10% of LMC, Mr. Stanley could count the hours he worked for LMC as real estate hours and, due to that, he was a real estate professional.

Another issue in this case arose because Mr. Stanley grouped rental real estate activities with other activities, a grouping the IRS argued was not allowed.

As the Court summarized:

> Subsection 1.469-9(e)(3)(i) is entitled "Grouping rental real estate activities with other activities—In general" and provides as follows:
>
> > *For purposes of this section,* a qualifying taxpayer may not group a rental real estate activity with any other activity of the taxpayer. For example, if a qualifying taxpayer develops real property, constructs buildings, and owns an interest in

> rental real estate, the taxpayer's interest in rental real estate may not be grouped with the taxpayer's development activity or construction activity. *Thus,* only the participation of the taxpayer with respect to the rental real estate may be used *to determine if the taxpayer materially participates in the rental real estate activity* under § 1.469-5T. (emphasis added by the court in the opinion)

However the Court read that provision in a very limited fashion. The Court held:

> The Court cannot agree with the Government's interpretation that this section categorically prohibits real estate professionals from grouping rental activity with other activity for all purposes. While this particular argument was not raised in the parties' original briefs, the Court requested briefing on the issue of whether subsection 1.469-9(e)(3)(i) "prohibit[s] grouping of rental real estate activities (whether singular or aggregated) with non-rental real estate activities for purposes of determining material participation in the rental real estate activity." (Doc. 56, p. 2). Implicit in that question was the Court's initial understanding that 1.469-9(e)(3)(i) likely limited grouping but only for purposes of determining material participation in a rental activity. The Government's arguments in its supplemental brief and at the hearing did not convince the Court that its initial understanding was wrong. Read in context, subsection 1.469-9(e)(3)(i) bars grouping only for purposes of determining material participation and does not categorically bar a real estate professional from grouping rental and non-rental activities for other purposes, including for purposes of determining passive activity loss and credit.

The opinion first holds that the language "for purposes of this section" limits the restriction only to the specific regulation (Reg. §1.469-9) and not for the general grouping regulation at Reg. §1.469-4.

The Court continues:

> 26 C.F.R. § 1.469-4(c)(1) explicitly allows for grouping of rental and non-rental activities in certain circumstances. This regulation on grouping does not include any provision indicating that real estate professionals are prohibited from availing themselves of the benefits of grouping their rental real estate activities with any other activity if they otherwise meet the requirements of the grouping regulation.

The Court then considered whether, in this case, it was appropriate to group the rental properties with other activities—and found that it was. The Court noted:

> The Stanleys grouped their aggregated Rental Activity with other trade or business activities, including LMC, LCI, and the activity of golf courses adjoining LMC-managed properties. Having considered the relevant facts and circumstances, the Court first finds that the Rental Activity, LMC, LCI, and the golf courses formed an appropriate economic unit. With few exceptions, the rental properties aggregated in the Stanleys' Rental Activity were all managed by LMC, with telecommunications services provided by LCI. LMC is a property-management company that manages rental apartment complexes, golf courses, and commercial properties in Arkansas and surrounding states. The parties stipulated that "[t]he vast majority of LMC's revenues came from property management fees." (Doc. 26-4, ¶ 31). LCI "provided telecommunications services . . . to some apartment complexes and golf courses managed by [LMC] or negotiated with third-party providers to provide telecommunications services to certain LMC-managed

> apartment complexes and golf courses." (Doc. 26-4, ¶ 25(a)). As for the golf courses, "[e]very LMC-managed golf course [is] located next to an LMC-managed apartment complex." (Doc. 26-4, ¶ 39). Some LMC apartment complexes have no adjoining golf course; some have 9-hole courses that are free for tenants to use; and some have 18-hole courses that tenants may be able to use at a reduced rate. All courses are also open to the public for a fee.
>
> While there are certainly significant differences in the types of services offered by the rental properties, LMC, LCI, and the golf courses, all four services worked in concert in connection with the same trade or business category—rental real estate. While the precise ownership of the various rental properties was technically diverse, it appears from the record that James E. Lindsey and/or his family exerted common control over the rental properties, LMC, LCI, and the golf courses. All the rental real estate properties as well as the golf courses were also under common control to the extent that they were all managed by LMC, which was an S corporation with a majority shareholder—Mr. Lindsey. As to the geographic location of the various activities, LMC is headquartered in Northwest Arkansas and the rental properties and golf courses it manages (and for which LCI provides services) are all concentrated in Arkansas and nearby states. Finally, the interdependencies of the rental properties with LMC and LCI and with the golf courses is apparent. As already stated, LMC and LCI were entities whose function was to perform services on behalf of LMC-managed rental properties. Those rental properties included certain complexes whose business model was to provide tenants with access—for free or at a reduced rate—to an adjoining golf course. While golf and apartment rentals are not inherently related, LMC created an apparently successful business model that linked the two, and the regulations allow for consideration of all relevant facts and circumstances—not just those factors that are specifically enumerated. Much as a fast food restaurant might attract customers via a playground area or a savings club might have an adjoining gas station or restaurant, LMC's model sought to attract tenants through golf. Roy testified that developing golf courses in conjunction with apartment rentals generally decreased neighborhood opposition that would otherwise be encountered in response to a proposed apartment rental development on its own. Grouping these two activities in this context represents a "reasonable method of applying the relevant facts and circumstances in grouping activities." 26 C.F.R. § 1.469-4(c)(2).
>
> The Court also finds that LMC, LCI, and the golf activities were insubstantial in relation to the Rental Activity. In making this determination, the Court has endeavored to consider all the "pertinent factors." TD 8565, 1994-43 I.R.B. 4 (rejecting a bright-line rule for determining insubstantiality "to avoid complex and mechanical rules," stating that "the regulations already adopt a facts-and-circumstances test that looks at all the pertinent factors"); *Candelaria v. United States,* 518 F. Supp. 2d 852, 859-60 (W.D. Tex. 2007); *Glick v. United States,* 96 F. Supp. 2d 850 (S.D. Ind. 2000). Because the test for insubstantiality is one that depends on the facts and circumstances of each individual case, the Court relies heavily on the evidence of record and finds that a lengthy legal analysis as to this point is unnecessary in this case.

The case is interesting because of the nature of the matters considered, especially the impact of restricted Section 83 stock held by an S shareholder in a real estate business. But advisers should note this represents a single U.S. District Court case and it’s very possible that a different

court (especially one that hears many more tax cases) might not react as favorably to the same arguments.

More to the point, the IRS has announced the agency will not follow the result in this case in Action on Decision 2017-07. In a footnote the agency described the specific issues the agency was disagreeing with.

> Nonacquiescence relating to the holdings that: 1) mere possession of a stock certificate, disregarding other conditions, restrictions or limitations on the possessor's rights regarding the stock, constitutes ownership for purposes of § 469(c)(7)(D)(ii); and 2) work performed by the taxpayer in a rental real estate activity for purposes of § 469(c)(7)(A) may also constitute work performed by the taxpayer in non-rental business activities of the taxpayer for other purposes of § 469.

Section: 2704
IRS Withdraws Anti-Kerr Section 2704 Proposed Regulations

Citation: FR Doc. 2017-22776, 10/20/17

The IRS in FR Doc 2017-22776 made official the withdrawal of proposed regulations issued in August of 2016 (REG-163113-02) under IRC §2704 that would have effectively reversed the *Kerr* decision with regard to family limited partnerships.

The proposed regulations would have significantly changed the regulations under IRC §2704 in ways that would have rendered it much more difficult to create family limited partnerships that could give rise to significant transfer tax discounts. The regulations specifically addressed issues that the Tax Court had noted in the *Kerr* decision when it decided for the taxpayer based on the IRS's regulations for that section.

Most advisers considered these regulations dead following the elections in November of 2016. The regulations were one of many studied by the IRS for possible withdrawal and, not surprisingly, were on the list of those the agency planned to withdraw when that study of regulations was completed. This notice simply makes that withdraw official.

Section: 5000A
IRS Will Require Taxpayers to Supply Health Care Coverage Information to Process 2017 Returns

Citation: IRS Will Require Taxpayers to Supply Health Care Coverage Information to Process 2017 Returns, 10/12/17

With "repeal and replace" of the ACA unsuccessful to date, the IRS has announced that the agency will reject 2017 income tax returns that do not address the ACA health care requirements (The Affordable Care Act: What's Trending, IRS Website).

The IRS had originally planned to reject 2016 returns that did not provide this information. However, early in 2017 when it appeared that "repeal and replace" was imminent and that the individual shared responsibility payment would be retroactively repealed the IRS decided not to begin requiring that information before processing a return. The IRS had not required that information in prior years, but the agency had gotten the systems ready to deal with this issue for 2016 returns.

The IRS has now apparently decided to stop anticipating what Congress will do and instead act as if the law will stay in place until Congress gets around to changing the law.

As the website notes:

> *The IRS will not accept the electronic tax return until the taxpayer indicates whether they had coverage, had an exemption or will make a shared responsibility payment. In addition, returns filed on paper that do not address the health coverage requirements may be suspended pending the receipt of additional information and any refunds may be delayed.*

The website goes on to explain:

> *Taxpayers remain obligated to follow the law and pay what they may owe at the point of filing. The 2018 filing season will be the first time the IRS will not accept tax returns that omit this information. After a review of our process and discussions with the National Taxpayer Advocate, the IRS has determined identifying omissions and requiring taxpayers to provide health coverage information at the point of filing makes it easier for the taxpayer to successfully file a tax return and minimizes related refund delays.*

The IRS had previously noted that even though the information was not required to process 2016 returns, taxpayers were still liable for the shared responsibility payment if they did not have coverage for 2016 and could face notices on the issue. While the IRS is limited in their ability to take certain actions to collect that fee under the ACA, the agency can still offset any refunds the taxpayer may be due until the collection statute would expire on any assessment related to this issue.

Section: 6013
Taxpayer Could Claim Earned Income Credit, But Apparently Not for Reason Tax Court Gave

Citation: Knez v. Commissioner, TC Memo 2017-205, 10/18/17

A married taxpayer generally can only claim an earned income credit if the taxpayer files a joint return per IRC §32(d). As well, a taxpayer is not allowed to elect to file a joint return if the taxpayer has filed a separate return, has received a notice of deficiency and files a petition with the Tax Court per IRC §6013(b)(2)(B).

But what happens if the taxpayer in question had filed a return using a filing status other than married filing separately, in this case head of household? Per the Tax Court in the case of Knez v. Commissioner, TC Memo 2017-205 that return did not constitute a "separate return" for these purposes and, thus, Ms. Knez could elect to file a joint return with her husband even after she had filed a Tax Court petition.

In the end it appears the Tax Court got to a "kind of" proper result (allowing the earned income tax credit) but likely via the wrong route, at least based on the facts given.

The Tax Court had considered a similar issue just a few weeks before in the case of *C*amara v. Commissioner, 149 TC No. 13 following the results in a case written up on our website at the time it was issued (*Ibrahim v. Commissioner,* Docket No. 14-2070, reversing and remanding TC Memo 2014-8, 6/10/15). However, in that case the taxpayer in question had claimed single filing status on his return, a status that was not available to him because he was married at all times during the year in question.

The Tax Court concludes that *Camara* applies in this case, but does so by concluding that Ms. Knez was not eligible to claim head of household status. The only problem with that statement is that it isn't true.

There is no question she was married at the end of the year and that IRC §2(b)(1) indicates that a taxpayer must be unmarried to claim that status. But IRC §2 goes on at IRC §2(c) to provide that "for purposes of this part, an individual shall be treated as not married at the close of the taxable year if such individual is so treated under the provisions of section 7703(b)."

IRC §7703(b) provides:

> *(b) Certain married individuals living apart*
>
> *For purposes of those provisions of this title which refer to this subsection, if—*
>
> > *(1) an individual who is married (within the meaning of subsection (a)) and who files a separate return maintains as his home a household which constitutes for more than one-half of the taxable year the principal place of abode of a child (within the meaning of section 152(f)(1)) with respect to whom such individual is entitled to a deduction for the taxable year under section 151 (or would be so entitled but for section 152(e)),*
> >
> > *(2) such individual furnishes over one-half of the cost of maintaining such household during the taxable year, and*
> >
> > *(3) during the last 6 months of the taxable year, such individual's spouse is not a member of such household,*
>
> *such individual shall not be considered as married.*

The Court's description of the facts of the case indicate that Ms. Knez met these requirements:

> Petitioner and her husband, George L. Knez, were married throughout 2014.
>
> They lived separately during that year, but they were not "legally separated * * * under a decree of divorce or of separate maintenance." See sec. 7703(a)(2). Petitioner and her husband continued to live separately at the time she filed her 2014 Federal income tax return, but they reunited in July 2015.

This is important because the Court concludes no separate return was filed because the court "we followed appellate court opinions ruling that single returns and head-of-household returns erroneously filed by married taxpayers do not constitute "separate returns" within the meaning of section 6013(b)(1)." But this particular head of household return, unlike the one in *Ibrahim* case, was not erroneously filed—it was a perfectly allowable filing status for Ms. Knez to have elected. In *Ibrahim* the taxpayer had lived with his spouse for the entire year—a very key distinction.

So, did electing to properly file head of household wipe out the earned income credit? While IRC §32(d) does talk about a taxpayer having to file a joint return if married, the provision specifically references IRC §7703 in determining if the taxpayer is married. And, as was noted above, IRC §7703 does not consider the individual married if the taxpayer lived apart from her spouse for last six months of the year and maintained a home for her child.

So where does that leave us with this case? Well, if a taxpayer who had lived with his/her spouse all year did file a head of household return, then they could change their status to married filing joint even after a Tax Court petition was filed under the holding of this case.

So how did this holding happen? Most likely because counsel did not represent the taxpayer, she never raised the defense that she was allowed to file head of household all along even though her husband had filed under a status he wasn't eligible for.

The IRS also went down the wrong path, though this is a bit tougher to understand. No doubt the agent quickly determined these spouses were married, but the agent failed to consider whether *one* of the two individual returns filed might have been using an allowed status. Alternatively, it's possible the agent was aware of information that the couple had lived together at some point during the last six months of the year (which would have invalidated her ability to claim head of household), but this data wasn't communicated at the trial for whatever reason.

The judge might have noticed this problem, but frankly he decided the issue put before him by the parties as it was put before him. That basically is the job judges are called upon to do.

So, in any event, this case is a good reminder that it's easy to overlook "simple" things because, frankly, the tax law is so complex it's easy to get "detoured" into working hard on one issue that isn't really the relevant one.