Current Events on Income, Gain, Exclusions and Deferrals 2017
PART II

2-1 Income, Capital Gains, Exclusions and Deferrals

Items Included in or Excluded from Gross Income, and Related Matters.

"Cash for Keys" Program:

- In Bobo v. Comm'r, T.C. Summ. Op. 2016-74, the Tax Court held that a lender's payment to make foreclosure easier did not result in ordinary income.

2-1 Income, Capital Gains, Exclusions and Deferrals

- The taxpayers participated in the program and received $20,500. GTS issued a Form 1099- MISC showing $20,500 in nonemployee compensation and a Form 1099-A reporting its acquisition of the home when the principal loan balance was $716,426 and the fair market value was $607,500.

- The IRS claimed that the $20,500 payment resulted in ordinary income, as evidenced by the fact that GTS issued a Form1099-MISC showing $20,500 in nonemployee compensation.

2-1 Income, Capital Gains, Exclusions and Deferrals

The Court first noted that it is well settled that a transfer of property by a deed in lieu of foreclosure is a “sale or exchange.”

- The Court found that the transfer of the deed in lieu of foreclosure and the cash-for-keys payment were the results of a single transaction.
- Therefore the payment should be treated as a part of the deed in lieu of foreclosure transaction.

2-1 Income, Capital Gains, Exclusions and Deferrals

"Love Offerings" from Church Were Income.

- In Jackson v. Comm'r, T.C. Summ. Op. 2016-69.
- Jackson was a pastor of a small church. At some time prior to 2012, he informed the board of directors of the church that he did not want to be paid a salary for his services, but that he would not be opposed to receiving "love offerings."

2-2 Income, Capital Gains, Exclusions and Deferrals

- The church's bookkeeper, however, sent Jackson a Form 1099-MISC for 2012 reporting nonemployee compensation of $4,815.
- The Tax Court took little time to conclude that the payments, regardless of notations on the checks, were a substitute for a salary, and therefore gross income. Gross income is broadly defined under Commissioner v. Duberstein, 363 U.S. 278 (1960).

2-2 Income, Capital Gains, Exclusions and Deferrals

Child Tax Credit Age Limit for a Disabled Child.

In Polsky v. U.S., 844 F.3d 170 (3d Cir. 2016):

- The parents argued that under § 152(c)(3)(B) there are no age limits for the dependency exemption deduction for a person who is permanently disabled. By incorporating the provisions of § 152(c) into § 24, Congress incorporated the age exception for a permanently disabled person.
- The Court rejected the parents' argument, age exception is not incorporated into § 24, as that section specifically imposes the age 17 limit.

2-3 Income, Capital Gains, Exclusions and Deferrals

Gift Cards for Both Goods and Services.

- In TAM 201610017, IRS has concluded that a company can defer the recognition of advance payment income received from the sale of unredeemed gift cards that are redeemable for goods or services for up to two years, to the extent it can make an appropriate estimate of the amounts that are deferrable under Reg. § 1.451-5 using an allocation similar to that found in under Reg. § 1.451-5(a)(3).

2-4 Income, Capital Gains, Exclusions and Deferrals

- In TAM 201610017, the IRS concluded that a company could defer for up to two years the recognition of advance payment income received from the sale of unredeemed gift cards that were redeemable for goods or services.
- It was eligible to defer amounts received for its gift cards to the extent that it could make an appropriate estimate of the amounts that were deferrable.

2-5 Income, Capital Gains, Exclusions and Deferrals

Discounts to Non-Employees.

- In FAA 20171202F, the IRS determined that discounts provided by a company to non-employee individuals designated by its employees do not qualify for nontaxable fringe benefit treatment and are thus taxable to the designating employees.
- FAA= Field Attorney Advice

2-5 Income, Capital Gains, Exclusions and Deferrals

- Section 132(a)(2) excludes from gross income the fringe benefit of qualified employee discounts. An employee for purposes of § 132(a) is defined as an individual currently employed by the employer, an individual who retired from the employer, or became disabled while working for the employer, or a widow or widower of any one of these (§ 132(h)). And, spouses and dependent children of the above mentioned groups are treated as employees for purposes of § 132(a)(2) (§ 132(h)(2)).

2-5 Income, Capital Gains, Exclusions and Deferrals

- A qualified employee discount is any employee discount with respect to qualified property or services to the extent that the discount does not exceed certain limits– for services, 20% of the price at which the services are offered to its customers. If a discount exceeds 20%, then the excess is includable in the employee's income.
- Company stated that employees may find bigger discounts on the open market, and that the discount offered under Program is, in most cases, less than that offered to Company's large customers.

2-6 Income, Capital Gains, Exclusions and Deferrals

Accordingly, the FAA held that Company must collect and pay to IRS under § 3501(b) employment taxes based on both:

- The value of discounts given to non-employee individuals through Program on behalf of the employees who designated them; and
- The value of the excess discount.

2-6 Income, Capital Gains, Exclusions and Deferrals

On August 24, 2016, the IRS issued Rev. Proc. 2016-47 to provide a self-certification procedure that taxpayers may use to claim that they are eligible for a waiver of the 60-day rollover requirement for a distribution from a retirement plan or IRA.

Rev. Proc. 2016-47 provides that a taxpayer may make a written certification to a plan administrator or IRA trustee that a contribution satisfies the conditions set forth below.

2-6 Income, Capital Gains, Exclusions and Deferrals

The first condition for self-certification is that the IRS must not have previously denied a waiver.

The second condition is that the taxpayer must have missed the 60-day deadline for the following reasons:

- An error was committed by the financial institution receiving the contribution or making the distribution;
- The distribution, having been made in the form of a check, was misplaced and never cashed;

2-7 Income, Capital Gains, Exclusions and Deferrals

- The distribution was deposited into and remained in an account that the taxpayer mistakenly thought was an eligible retirement plan;
- The taxpayer's principal residence was severely damaged;
- A member of the taxpayer's family died;
- The taxpayer or a member of the taxpayer's family was seriously ill;
- The taxpayer was incarcerated;

2-7 Income, Capital Gains, Exclusions and Deferrals

- Restrictions were imposed by a foreign country;
- A postal error occurred;
- The distribution was made on account of a levy under § 6631 and the proceeds of the levy have been returned to the taxpayer; or
- The party making the distribution to which the rollover relates delayed providing information.

2-7 Income, Capital Gains, Exclusions and Deferrals

The third condition for self-certification is that the contribution must be made to the plan or IRA as soon as practicable after the reason or reasons listed above no longer prevent the taxpayer from making the contribution. This requirement is deemed to be satisfied if the contribution is made within 30 days after the reason or reasons no longer prevent the taxpayer from making the contribution.

2-7 Income, Capital Gains, Exclusions and Deferrals

The IRS intends to modify the instructions to Form 5498 to require that an IRA trustee that accepts a rollover contribution after the 60-day deadline report that the contribution was accepted after the 60-day deadline.

A self-certification is not a waiver by the IRS of the 60-day rollover requirement. A taxpayer, however, may report the contribution as a valid rollover unless later informed otherwise by the IRS.

Rev. Proc. 2016-47 is effective August 24, 2016.

2-13 Income, Capital Gains, Exclusions and Deferrals

In Gowen v. Comm’r, T.C. Summ. Op. 2017-57.

Gowen, a CPA who holds a master’s degree in taxation, borrowed $50,000 from his KPMG retirement plan in 2012. The loan complied with § 72(p) requirements and therefore was not treated as a taxable distribution from the plan when issued.

2-13 Income, Capital Gains, Exclusions and Deferrals

- Gowen was required to make 120 semimonthly payments of $451 beginning on March 30, 2012, and ending on March 15, 2017. He, however, soon lost his job at KPMG and stopped making payments beginning with the payment due on August 30, 2012.
- The plan administrator immediately notified Gowen that his “cure period” for default expired.

2-13 Income, Capital Gains, Exclusions and Deferrals

- The plan administrator issued a Form 1099-R for 2012, reporting that Gowen had received a $46,000 distribution in 2012.
- Gowen did not report the distribution on his 2012 return. He claimed that the notices and statement he received were confusing and led him to believe that his cure period did not end until 2013.

2-14 Income, Capital Gains, Exclusions and Deferrals

Loans from a qualified retirement plan generally are treated as distributions unless the specific requirements of § 72(p) are met.

- Gowen argued that under the regulation his first non-payment date, August 30, 2012, started a quarter running from August through October of 2012, and therefore his cure period did not end until the end of January 2013.
- The Court found that argument clearly wrong If the first non-payment date is in the third calendar quarter, the maximum cure period ends at the end of the fourth calendar.

2-14 Income, Capital Gains, Exclusions and Deferrals

IRS Provides Guidance on the Cure Period for Plan Loans.

- In ILM 201736022, the IRS provided two situations illustrating the maximum cure period for missed installment payments due under a retirement plan loan.
- To meet the exception that a plan loan not result in a deemed distribution.
    - A repayment period of five years or less;
    - Level amortization over the loan term;
    - Payments at least quarterly.

2-15 Income, Capital Gains, Exclusions and Deferrals

In Ozimkoski v. Comm'r, T.C. Memo 2016-228, the Tax Court held that a surviving wife received a taxable distribution when her deceased husband's Individual Retirement Account (IRA) was improperly transferred to her IRA and then she took a distribution from her IRA to make a settlement payment concerning her husband's estate.

2-15 Income, Capital Gains, Exclusions and Deferrals

Taxpayer's husband died in 2006 shortly after he executed a new will that left all his property to the wife. The husband had a traditional IRA with Wachovia. Wachovia could not find any beneficiary designation and there was no proof that the surviving wife was the designated beneficiary.

- The husband's son from a prior marriage challenged the will.
- In 2008 the son and the wife reached a settlement agreement under which she was to pay the son $110,000 "free of any tax."

2-15 Income, Capital Gains, Exclusions and Deferrals

- The husband's IRA was to be the source of the settlement payment, and Wachovia realized that someone was going to have to pay tax on any distribution from the husband's IRA.
- The wife then took a distribution of $142,000 from her IRA and wrote a $110,000 check to the son to satisfy the settlement agreement.
- Wachovia issued a Form 1099-R to the wife showing the $142,000 distribution from her IRA. The wife was not yet age 59.5 in 2008.

2-16 Income, Capital Gains, Exclusions and Deferrals

- The wife did not report any of the distributions on her 2008 return. The IRS asserted a deficiency, an early withdrawal penalty, and an accuracy-related penalty for 2008.

The Court first noted that Wachovia incorrectly rolled over all of the husband's IRA to the wife's IRA. That was improper because the wife was not the named beneficiary of the husband's IRA. Wachovia should have distributed the IRA assets to the husband's estate.

2-16 Income, Capital Gains, Exclusions and Deferrals

There was no dispute that the wife withdrew the amount in question from her IRA, and that no exception applied to the early withdrawal penalty. The Court had some sympathy for the wife and did not uphold an accuracy-related penalty.

2-34 Income, Capital Gains, Exclusions and Deferrals

Income and Penalties from Retirement Plan Distributions.

No Modification of Substantially Equal Periodic Payments Causing Recapture, If Additional Distribution Covered by Another Exception.

You Cannot Rely on Your Financial Advisers.

2-37 Income, Capital Gains, Exclusions and Deferrals

Watson v. Comm'r, T.C. Summ. Op. 2011-113, where the taxpayer left her employment position when she was age 53. When she was age 55 she received distributions from her former employer's pension plan. She did not pay the 10% penalty on the distributions, relying on the exception in § 72(t)(1)(A)(v), which applies to distributions made to an employee "after separation from service after attainment of age 55." The Court followed precedent and legislative history in holding that the exception only applies if the plan participant has attained age 55 on or before separation from service. The exception does not apply if the participant is less than age 55 before separation from service. Therefore the exception did not apply to the taxpayer.

2-37 Income, Capital Gains, Exclusions and Deferrals

Distributions for Health Insurance Premiums.

Applies for distributions from an "individual retirement plan."

The requirement that the individual had received unemployment compensation for 12 consecutive weeks is strictly applied by the courts.

2-38 Income, Capital Gains, Exclusions and Deferrals

Distributions for Medical Expenses.

This exception applies only to distributions which are used for deductible medical expenses paid in the same taxable year that the distribution was made.

Qualified Higher Education Expenses. Under § 72(t)(2)(E), an exception to the 10% penalty exists for distributions from an individual retirement plan to the extent they do not exceed the qualified higher education expenses of the taxpayer for the taxable year. Defined in § 529(e)(3).

2-38 Income, Capital Gains, Exclusions and Deferrals

This exception applies only to distributions from an individual retirement plan, and does not apply to § 401(k) plans or thrifts savings plans under § 401(a).

Only postsecondary schools are eligible educational institutions, and elementary schools and secondary schools do not qualify.

2-39 Income, Capital Gains, Exclusions and Deferrals

The Disability Exception.

Considered to be disabled if he is "unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or to be of long-continued and indefinite duration."

2-39 Income, Capital Gains, Exclusions and Deferrals

The taxpayer must produce sufficient evidence to show that the disability exception applies, and the mere fact that the taxpayer had qualified for disability insurance benefits under an insurance policy is not sufficient to trigger the exception.

2-40 Income, Capital Gains, Exclusions and Deferrals

QDRO Exception.

This exception, however, does not apply to distributions from an IRA under the applicable definitions.

No General Hardship Exception.

2-40 Income, Capital Gains, Exclusions and Deferrals

Other Issues Concerning Distributions from Qualified Plans or IRAs.

Distributions After the Death of a Spouse.

This exception does not apply if a surviving spouse, here the wife, rolls funds from her deceased husband's IRA into her own IRA.

2-41 Income, Capital Gains, Exclusions and Deferrals

The Levy Rule.

Taxpayers, therefore, should make the IRS actually levy against the IRA so that the distribution is actually caused by the levy.

Loans from an IRA. In Colegrove v. Comm'r, T.C. Summ. Op. 2010-44, the taxpayer argued pro se that he was not subject to the 10% penalty because distributions were actually "loans."

2-41 Income, Capital Gains, Exclusions and Deferrals

You Need a QDRO. In Hartley v. Comm'r, T.C. Memo. 2012-311 because a family court judge ordered him to withdraw funds to pay alimony. The judge did not issue a (QDRO), and therefore no exception to the penalty applied.

In Beech v. Comm'r, T.C. Summ. Op. 2012-74, the Court held that a distribution a taxpayer received from her deceased mother's IRA was taxable because she did not effect a trustee-to-trustee transfer.

- Although § 408(d) provides that a distribution from an IRA is not taxable if rolled over in 60 days, that rollover provision does not apply to an inherited IRA.

2-19 Income, Capital Gains, Exclusions and Deferrals

Issues Related to Cancellation of Indebtedness Income.

In General. Generally income from a discharge of indebtedness, commonly referred to as cancellation of debt (COD) income, must be included in gross income under § 61(a)(12). Section 108(a) provides that gross income does not include COD income if the discharge occurs in a Title 11 bankruptcy case or occurs when the taxpayer is insolvent (up to the amount the taxpayer is insolvent), or if the debt discharged is qualified farm indebtedness or qualified real property business indebtedness. Special rules apply for qualified principal residence debt that is discharged before January 1, 2015.

2-20 Income, Capital Gains, Exclusions and Deferrals

Guidance for Real Estate Developers. In Rev. Rul. 2016-15, the IRS ruled that real property developed and held by a taxpayer for lease in a leasing business is "real property used in a trade or business" for purposes of § 108(a)(1)(D), but real property developed and held by a taxpayer primarily for sale to customers in the ordinary course of business is not.

2-21 Income, Capital Gains, Exclusions and Deferrals

Final Regulations on COD Income and Grantor Trusts and Disregarded Entities. On June 10, 2016, the IRS issued final regulations (T.D. 9771) relating to the exclusion from gross income of discharge of indebtedness income of a grantor trust or a disregarded entity.

The final regulations provide that for purposes of applying § 108(a)(1)(A) and (B) to the discharge of indebtedness income of a grantor trust or a disregarded entity, neither the grantor trust nor the disregarded entity shall be considered to be the "taxpayer." Instead, the owner of the grantor trust or the owner of the disregarded entity is the "taxpayer."

2-22 Income, Capital Gains, Exclusions and Deferrals

The insolvency exclusion applies to the discharged indebtedness of a grantor trust or a disregarded entity only to the extent the owner of the trust or entity is insolvent. If the trust or entity is insolvent but the owner is solvent, § 108(a)(1)(B) does not apply to the discharge of indebtedness income.

In the case of a partnership, the bankruptcy and insolvency exclusions apply at the partner level.

- The final regulations apply to discharge of indebtedness income occurring on or after June 10, 2016.

2-22 Income, Capital Gains, Exclusions and Deferrals

State Pension Plan Not an Asset to Include in Insolvency Test. In Schieber v. Comm'r, T.C. Memo. 2017-32, the Tax Court held that a taxpayer that received cancellation of indebtedness (COD) income did not have to include.

In 2009, a lender canceled $418,596. He received about $5,000 per month from the plan at that time.

2-22 Income, Capital Gains, Exclusions and Deferrals

Excluding the pension plan, the Schiebers' assets were stipulated to be worth $924,919 and their total liabilities were $1,218,227. Therefore the Schiebers were insolvent by $293,308.

The IRS claimed that the pension should be included in the couple's assets to determine insolvency because it was an "income-producing asset." The couple claimed it should not be so included because they could not convert their interest in the plan into cash or the equivalent.

2-22 Income, Capital Gains, Exclusions and Deferrals

Section 108(d)(3) simply states that the term "insolvent" means "the excess of liabilities over the fair market value of assets."

in Carlson v. Comm'r, 116 T.C. 87 (2001). There the Court held that an asset exempt from creditors is included in the insolvency determination because it can give the taxpayer "the ability to pay an immediate tax on" COD income. The test is whether the asset gives the taxpayer the ability to pay an "immediate tax."

Here the Schiebers could not use the pension plan to immediately pay the income tax.

2-25 Income, Capital Gains, Exclusions and Deferrals

Remember the Burden-Shifting Rule for Information Return Disputes. In Martin v. Comm'r, T.C. Summ. Op. 2009-121, the Tax Court held that a couple was not liable for COD income because the IRS failed to prove the amount of such income as was its burden under § 6201(d).

In 1999 the Martins bought a used car for $12,360, borrowing $8,872 from a lender. They stopped making payments to the lender in 2001. The lender repossessed the vehicle and issued a Form 1099-C to the Martins showing $6,704 of COD income.

2-25 Income, Capital Gains, Exclusions and Deferrals

Ruling.

"if a taxpayer asserts a reasonable dispute" with respect to any item of income reported on an information return, and the taxpayer has fully cooperated with the IRS, the IRS shall have the burden of producing "reasonable and probative information" concerning the alleged deficiency." Here Mr. Martin had credibly testified that the vehicle had a fair market value at least equal to the debt at the time it was repossessed.

2-25 Income, Capital Gains, Exclusions and Deferrals

See also Linkugel v. Comm'r, T.C. Summ. Op. 2009-180, where the burden-shifting rule was also applied in a case where a couple defaulted on their mortgage in 2000.

- The Court first found that § 6201(d) applied because the husband had cooperated with the IRS, and therefore the IRS could not rely solely on the Form 1099-C

2-25 Income, Capital Gains, Exclusions and Deferrals

- The Court then noted that a debt is discharged at the moment it become clear that it will never be repaid. Any identifiable event that fixes the loss with certainty may be considered.
- The issuance of a Form 1099-C is one such identifiable event, but is not dispositive. a mere bookkeeping entry by a creditor does not result in COD income.

2-26 Income, Capital Gains, Exclusions and Deferrals

Qualified Principal Residence Debt Exclusion and Government Programs.

- In the PATH Act, Congress extended the § 108(a)(1)(E)(ii) exclusion from COD income of qualified principal residence debt forgiveness to arrangements entered into and evidenced in writing before January 1, 2017.

2-26 Income, Capital Gains, Exclusions and Deferrals

- The Notice outlines exactly when debt is considered discharged subject to an arrangement entered into and evidenced in writing before January 1, 2017.
- Practitioners should consult the Notice for details if clients are participating in those programs in late 2016 but have not concluded modifications prior to 2017.

2-26 Income, Capital Gains, Exclusions and Deferrals

Guidance on the Foreign Earned Income Exclusion;

- Overview. Section 911 allows a qualified individual to elect to exclude from U.S. gross income the foreign earned income and housing cost amount of such individual, up to limits.

2-27 Income, Capital Gains, Exclusions and Deferrals

Qualified Individual. Under § 199(d)(1), a "qualified individual" means an individual whose tax home is in a foreign country, and who either is (a) a citizen of the U.S. and has been a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year.

2-28 Income, Capital Gains, Exclusions and Deferrals

Qualified Individual Case; A Taxpayer Loses. In Acone v. Comm'r, T.C. Memo. 2017-162, the Tax Court held that a commercial airline pilot was not a "qualified Individual" under § 911 because his "abode" was in the U.S. rather than in South Korea, and he was not a bona fide resident of that country.

- Acone is a pilot who worked for Korean Air Lines ("KAL") from 2006 to 2013.
- Acone received at least nine days off per month, and usually spent that time at his New Hampshire home. When in South Korea, Acone stayed in a hotel owned by KAL.

2-28 Income, Capital Gains, Exclusions and Deferrals

In 2011 and 2012 the Acones claimed the maximum allowable foreign earned income exclusion under § 911.

- The taxpayer's "tax home" for the relevant period must be in a foreign country.
- The taxpayer must be a bona fide resident of a foreign country for the entire taxable year.

2-28 Income, Capital Gains, Exclusions and Deferrals

One's "abode" is one's "home, habitation, residence, domicile, or place of dwelling." It does not mean one's principal place of business, has a "domestic rather than vocational" meaning, and stands in contrast to "tax home." The word connotes stability, not transience.

2-29 Income, Capital Gains, Exclusions and Deferrals

Qualified Individual Case: Taxpayer Is a Winner. In Linde v. Comm'r, 2017 T.C. Memo. 2017-180, the Tax Court held that an employee of a government contractor who worked as a helicopter pilot in Iraq during three taxable years had a tax home in Iraq and was a bona fide resident of that country, entitling him to the foreign earned income exclusion under § 911.

2-30 Income, Capital Gains, Exclusions and Deferrals

As it usually does in such cases, the IRS claimed that Linde's tax home was not in Iraq because his "abode" was in the U.S. The Tax Court disagreed under all the facts and circumstances, noting that temporary presence in the U.S. and maintenance of a dwelling in the U.S., in and of themselves, do not necessarily mean that a person's abode is in the U.S.

Here the Court concluded that Linde had stronger ties to Iraq than to the U.S. in 2010-2012.

2-32 Income, Capital Gains, Exclusions and Deferrals

Guidance on Virtual Currency Transactions; Bitcoin

For Federal tax purposes virtual currency is treated as "property." General tax principles applicable to property transactions apply to transactions using virtual currency.

2-46 Income, Capital Gains, Exclusions and Deferrals

Egg Donor Cannot Exclude Payments From Gross Income Under § 104(a)(2).

Overview. In Perez v. Comm'r, 144 T.C. No. 4 (2015), the Tax Court held that an egg donor could not exclude from gross income under § 104(a)(2) the amounts she received under an egg donation contract that were designated to compensate her for pain and suffering, finding that the payments received were taxable compensation for services.

2-51 Income, Capital Gains, Exclusions and Deferrals

No Exclusion for Damages Received for Burned Bee Farm.

In Harris v. Comm'r, T.C. Memo. 2012- 333, the Court held that an individual could not exclude from income damages received as a result of a fire that destroyed his bee farm, finding that the settlement amount he received was intended to compensate him for extensive property damage and loss of income, and not to compensate him for personal physical injuries.

2-52 Income, Capital Gains, Exclusions and Deferrals

Taxpayers Repeatedly Lose Employment Related Cases.

Most cases under § 104(a)(2) are fact intensive and turn on the issue of whether damages the taxpayer received are in fact for physical injury or physical sickness.

2-66 Income, Capital Gains, Exclusions and Deferrals

There Is Still a FIFO Rule for Stock Basis.

In Turan v. Comm'r, T.C. Memo. 2017-141, the Tax Court held that the IRS properly calculated the taxpayer's basis in Fannie Mae stock using the first-in, first-out (FIFO) method when identical stock had been purchased at different times at different prices.

2-66 Income, Capital Gains, Exclusions and Deferrals

Scottrade used the FIFO method in reflecting monthly transactions and for its filing of Forms 1099-B with the IRS.

A taxpayer, however, may opt to identify the specific shares of stock they wish to sell. "Adequate identification" for shares held by a broker requires the taxpayer at the time of sale to designate a particular lot or lots of stock to be sold, and requires the broker to confirm such instructions in writing within a reasonable time.

2-67 Income, Capital Gains, Exclusions and Deferrals

Generally, adequate identification must be no later than the settlement date.

The Court had little sympathy for Turan. Turan offered no documentation or "objective evidence" to corroborate his claim of computer error or misfeasance by Scottrade. The Court upheld a $9,000 penalty.

2-67 Income, Capital Gains, Exclusions and Deferrals

Sale of Principal Residence.

Interaction of § 121 and § 1038. In DeBough v. Comm'r, 142 T.C. No. 17 (2014), aff'd, 116 A.F.T.R.2d (RIA) 5891 (8 Cir. 2015), the Tax Court held that an individual who excluded gain the under § 121 on property he sold under an installment agreement must recognize gain under § 1038 when he reacquired the property due to the buyer's default under the agreement.

2-69 Income, Capital Gains, Exclusions and Deferrals

Gain Previously Excluded Under § 121 Must Be Recognized.

- § 1038(e) expressly contemplates the sale and subsequent reacquisition of a principal residence;
- Other than § 1038(e), there is no provision in § 1038 that would allow a taxpayer to exclude § 121 gain.

2-69 Income, Capital Gains, Exclusions and Deferrals

Under § 1038(b), DeBough had to recognize gain in the amount of the $505,000 in payments he received prior to the reacquisition, minus $56,920.

- The basis calculation should result in a basis increase of $505,000 .

2-70 Income, Capital Gains, Exclusions and Deferrals

Reduced Exclusion When Unexpected Events; Birth of Second Child.

- In PLR 201628002, the IRS ruled that although a married couple had not owned and used their condo as their principle residence for two of the five years preceding its sale, they were eligible for a reduced maximum exclusion of income from the sale because the birth of the couple's second child was an unforeseen circumstance that necessitated the sale of the condo.

2-70 Income, Capital Gains, Exclusions and Deferrals

Reduced Exclusion When Unexpected Events; Birth of Second Child.

- In PLR 201628002, the IRS ruled that although a married couple had not owned and used their condo as their principle residence for two of the five years preceding its sale, they were eligible for a reduced maximum exclusion of income from the sale because the birth of the couple's second child was an unforeseen circumstance that necessitated the sale of the condo.

Reg. § 1.121-3(e)(2) provides a list of specific event safe harbors eligible for the "unforeseen circumstances" exception.

2-72 Income, Capital Gains, Exclusions and Deferrals

Survivor's Home Sale Exclusion.

Starting January 1, 2008, a surviving spouse is entitled to a $500,000 gain exclusion provided the sale occurs no later than two years after the date of death of the individual's spouse.

The surviving spouse in the case of a jointly owned residence continues to be allowed a step up in basis in the residence for the deceased spouse's one-half share. The $500,000 exclusion is in addition to that benefit.

2-74 Income, Capital Gains, Exclusions and Deferrals

Court Has to Straighten Out a Family and the IRS on a Parent-Child Home Sale.

In Fiscaline v. Comm'r, T.C. Memo 2017-163, the Tax Court went back to basics to determine gain on a family transaction that was part gift and part sale.

2-74 Income, Capital Gains, Exclusions and Deferrals

Facts. In 1993, a son purchased a California home for $274,312, with his parents paying $40,000 of the purchase price for an interest in the home. The son borrowed $234,312 to complete the purchase. He and his wife used the home as their residence, and over the years improved the home.

In 2003 the parents transferred their interest in the home to the son for no consideration.

2-74 Income, Capital Gains, Exclusions and Deferrals

By 2007 the debt on the home was $664,048 due to refinancing that included increasing the mortgage amount.

To avoid foreclosure, the son sold the home to his parents, who borrowed $682,500, most of which they used to discharge the $664,048 debt the son had placed on the home.

2-75 Income, Capital Gains, Exclusions and Deferrals

Although the closing statement for the sale reflected a purchase price of $975,000. the son did not receive any cash or other property from the parents in addition to the debt relief the parents provided.

The son did not file his 2007 return until 2013. He did not report on that late return any gain from the sale of the home to the parents in 2007.

2-75 Income, Capital Gains, Exclusions and Deferrals

The IRS initially asserted that the son should have recognized a $975,000 long-term capital gain in 2007 due to the sale. The IRS also did not credit the son with any exclusion of gain under § 121, although it later agreed that the son was entitled to exclude $250,000 of gain on the sale under that section.

2-75 Income, Capital Gains, Exclusions and Deferrals

By the time of trial, the IRS position was that the son had to recognize $473,536 of gain.

The son claimed that he had to recognize only $70,487 of gain, which was the $664,048 of debt relief minus a basis of $329,687 (his original cost basis plus $40,000 for the parent's gift of their interest in 2003, plus more than $50,000 of improvements), and minus the $250,000 exclusion.

2-75 Income, Capital Gains, Exclusions and Deferrals

Court: This is not rocket science. The son' basis at the time of the 2007 sale was his original cost basis of $234,312, plus the carryover basis of $40,000 the son received due to the 2003 gift of the parent's interest. The son failed to prove that he had a basis increase of $50,000 due to capital improvements to the home.

by the Court's reckoning, after that exclusion had taxable gain of $122,985. The Court upheld the maximum late filing penalty since the son's return was five years late, as well as an accuracy-related penalty.

2-87 Income, Capital Gains, Exclusions and Deferrals

In Malulani Group, Limited v. Comm'r, T.C. Memo. 2016-209, the Tax Court ruled that an exchange of property between related parties did not qualify for deferred recognition of gain under the like-kind exchange rules of § 1031. The court determined the transaction was structured with a tax avoidance purpose, noting that the aggregate tax liability of the taxpayer and the related person that arose from their like-kind exchange and a sale transaction was significantly less than the hypothetical tax that would have arisen from the taxpayer's direct sale of the relinquished property.

2-90 Income, Capital Gains, Exclusions and Deferrals

Relinquished Property Proceeds Used to Retire Debt.

In PLR 201648013, the IRS concluded that under the § 1031 rules, a taxpayer will not be in actual or constructive receipt of relinquished property proceeds where the taxpayer's qualified intermediary (QI) must use the proceeds to repay loans secured by the relinquished property. The IRS also ruled that the QI's repayment of relinquished property debt with relinquished property proceeds will be treated as liability relief for purposes of the boot-netting rules of Reg. § 1.1031(b)-1(c).

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