as property in satisfaction of or securing of a present or antecedent debt of the debtor.

The debtor first argued that the debtor had received a direct benefit for the rent payment because the debtor received the right to farm the rented land. However, the court found that the lessee was the initial family partnership; therefore, the debtor did not receive a direct benefit from payment of the rent.

The debtor next argued that the debtor received reasonably equivalent value through the indirect benefit of the $22,500 rent reimbursement payment from the new partnership which sublet the farmland. The trustee responded that any benefit received by the debtor for the rent payment must be a contemporaneous exchange at the time of the rent payment. The trustee noted that the new partnership did not even exist at the time of the debtor's rent payment.

Contemporaneous Exchange

The trustee argued that the determination of whether the debtor received reasonably equivalent value had to be made at the time of the debtor's transfer of the funds in issue. The trustee cited *BFP v. Resolution Trust Corp.*,[5] and following cases which held that the determination of reasonably equivalent value received from a foreclosure sale had to be made at the time of the sale. However, the court found that the U.S. Supreme Court did not require that a reasonably equivalent benefit be received by a debtor at the time of the transfer. In addition, the court noted that the *BFP*-following cases allowed post-transfer repayments where the debtor received an indirect benefit at the time of the transfer.

The court noted that in this case there was no dispute that the debtor actually received from the reimbursement more than the debtor paid for the rent. The question was whether the debtor received an indirect benefit from payment of the rent. The court found that as part of the series of transactions, it was clear that the debtor's payment of the rent for the first partnership gave rise to the debtor's right to receive reimbursement from the new partnership. The court noted that much of the delay in making the reimbursement was caused by the time needed to form the second partnership and that the payment of the rent was made at the same time as the debtor expressed to the landlord the desire to sublease the farmland to the new partnership. Thus, the court held that the debtor's payment of the 2017 rent for the first partnership was not an avoidable fraudulent transfer.

In Conclusion

In many ways, this was an easy case in that (1) the debtor paid money and received money in reimbursement, relieving the court of any need to value the property received by the debtor for the payment; (2) the debtor was involved with all the parties, as a member of both partnerships; and (3) the reimbursement left the debtor, and the debtor's bankruptcy estate, in the same position as to the ability to pay creditors. Since the purpose of the reasonably equivalent value requirement is the protection of creditors, the court might have simply ruled against the trustee on that last fact. Indeed, where a debtor's estate is not reduced by the pre-petition transfer and later reimbursement, the case opens up some pre-bankruptcy planning for the debtor, so long as the debtor receives a reasonably equivalent value that will be available to pay creditors.

ENDNOTES

[1] *In re* McMartin, 2019 Bankr. LEXIS 908 (Bankr. D. N.D. 2019).

[2] 11 U.S.C. § 548(a)(1). See Harl and Achenbach, *Agricultural Law*, § 120.04[2][e] (2019).

[3] *See, e.g.*, *In re* Janz, 140 B.R. 256 (Bankr. D. N.D. 1991) (debtors' conveyance of most of farm to son for cash, promissory note, and lifetime interest in one-third of crops avoidable as fraudulent conveyance because consideration received for land substantially less than fair market value of land and debtors made insolvent by transaction); *In re* Stevens, 112 B.R. 175 (Bankr. S.D. Tex. 1989) (debtor's disclaimer and renunciation of inheritance within three months before filing bankruptcy when debtor insolvent was avoidable fraudulent transfer).

[4] *In re* McMartin, 2019 Bankr. LEXIS 908 (Bankr. D. N.D. 2019).

[5] 511 U.S. 531 (1994).

CASES, REGULATIONS AND STATUTES

FEDERAL ESTATE AND GIFT TAXATION

IRA. The decedent owned an IRA and had received the required minimum distributions for the year of death. The decedent's estate was the sole beneficiary of the IRA and the decedent's will bequeathed the decedent's interest in the IRA to beneficiaries. The executor divided the IRA into separate IRAs for each beneficiary by making trustee-to-trustee transfers. The IRS ruled that (1) The division of the IRA as of the decedent's date of death by means of trustee-to-trustee transfers into inherited IRAs for the benefit of the beneficiaries will not result in taxable distributions or payments under I.R.C. § 408(d)(1) to the estate. (2) Because the estate was listed as the designated beneficiary of the IRA, the IRA is treated as having no designated beneficiary. Because the IRA had no designated beneficiary and the decedent died after the required distribution beginning date, the beneficiaries can take required minimum distributions from each of their inherited IRAs for the remaining life expectancy of the decedent. The amount required to be distributed each year is determined using the decedent's age in the calendar year of death and the applicable actuarial table. The life expectancy factor is reduced by one each subsequent calendar

year. The amount required to be taken from each inherited IRA will be determined independently of any required minimum distributions required to be taken by the other beneficiaries. (3) The division of the IRA by means of trustee-to-trustee transfer into several inherited IRAs will not constitute a transfer within the meaning of I.R.C. § 691(a)(2). The beneficiaries will each include, in their gross income, the amounts of income in respect of decedent from their respective inherited IRA when the distribution or distributions from the inherited IRAs are received. (4) The beneficiaries of each respective inherited IRA are separately responsible for any tax liabilities relating to required minimum distributions from their inherited IRAs for the tax year subsequent to the year the inherited IRAs are established or the year of death if later (and all subsequent tax years). No income taxes or penalties for failure of the beneficiaries to take their required minimum distributions for the tax year subsequent to the year the inherited IRAs are established or the year of death if later (or any subsequent tax years) will be passed to the estate or the executor. **Ltr. Rul. 201909003, Nov. 28, 2018**.

MARITAL DEDUCTION. The decedent's will bequeathed an usufruct (civil law life estate) in the remainder of the decedent's estate. The executor hired an attorney to prepare the estate's Form 706, *United States Estate (and Generation-Skipping Transfer) Tax* return which was timely filed but did not include any QTIP election for the property passing to the surviving spouse because the value of the estate property did not exceed the applicable exclusion amount. After the return was filed, an addition piece of estate property was discovered which caused the estate to exceed the applicable exclusion amount and make the QTIP election worthwhile. The estate sought an extension of time to file an amended Form 706 with the QTIP election. I.R.C. § 2056(b)(7)(B)(v) provides that an election under I.R.C. § 2056(b)(7) with respect to any property shall be made by the executor on the return of tax imposed by I.R.C. § 2001. Such an election, once made, shall be irrevocable. Treas. Reg. § 20.2056(b)-7(b)(4)(i) provides that, in general, the election referred to in I.R.C. § 2056(b)(7)(B)(i)(III) and (v) is made on the last estate tax return filed by the executor on or before the due date of the return, including extensions or, if a timely return is not filed, the first estate tax return filed by the executor after the due date. Treas. Reg. § 301.9100-3 provides the standards used to determine whether to grant an extension of time to make an election whose date is prescribed by a regulation (and not expressly provided by statute). Requests for relief under Treas. Reg. § 301.9100-3 will be granted when the taxpayer provides the evidence to establish to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith, and that granting relief will not prejudice the interests of the government. Treas. Reg. § 301.9100-3(b)(1)(v) provides that a taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional, including a tax professional employed by the taxpayer, and the tax professional failed to make, or advise the taxpayer to make, the election. The IRS granted the estate an extension of time to file an amended Form 706 with the QTIP election because the estate relied on a professional to file the return. **Ltr. Rul. 201903014, Oct. 9, 2018**.

FEDERAL FARM PROGRAMS

MEAT AND MEAT PRODUCTS. The AMS has issued proposed regulations amending the regulations governing the voluntary grading and certification relating to meats, prepared meats, meat products, shell eggs, poultry products, and rabbit products. The proposed amendments include: changing terminology to scheduled and nonscheduled, billing of holidays, billing excessive hours over and above agreement hours, and removing the administrative volume charge. **84 Fed. Reg. 10998 (March 25, 2019)**.

FEDERAL INCOME TAXATION

DEPENDENTS. The IRS has published information about claiming dependents on 2018 tax returns. taxpayers should remember that personal exemptions are suspended for 2018. Taxpayers cannot claim a personal exemption for anyone on their tax return. This means that an exemption can no longer be claimed for a tax filer, spouse or dependents. *Claiming dependents*. A dependent is either a child or a qualifying relative who meets a set of tests. Taxpayers should remember to list the name and Social Security number for each dependent on their tax return. *Dependents cannot claim dependents*. Taxpayers cannot claim any dependents if someone can claim the taxpayer or their spouse, if filing jointly , as a dependent. *Dependents may have to file a tax return*. The requirement to file a return depends on certain factors such as total income, whether the dependents are married and if they owe certain taxes. *Child Tax Credit*. Taxpayers may be able to claim this credit for each qualifying child under age 17 at the end of the year, if the taxpayer claimed that child as a dependent. *Credit for Other Dependents*. Taxpayers may be able to claim this credit for qualifying relatives and children who do not qualify for the Child Tax Credit. **Tax Reform Tax Tip 2019-35**.

DISASTER LOSSES. On February 25, 2019, the President determined that certain areas in Texas were eligible for assistance from the government under the Disaster Relief and Emergency Assistance Act (42 U.S.C. § 5121) as a result of severe storms and flooding which began on September 10, 2018. **FEMA-4416-DR**. On February 25, 2019, the President determined that certain areas in Mississippi were eligible for assistance from the government under the Act as a result of severe storms and flooding which began on December 28, 2018. **FEMA-4415-DR**. On February 25, 2019, the President determined that certain areas in Kansas were eligible for assistance from the government under the Act as a result of severe storms and flooding which began on October 8, 2018. **FEMA-4417-DR**. On March 4, 2019, the President determined

that certain areas in Washington were eligible for assistance from the government under the Act as a result of severe storms and tornadoes which began on December 10, 2018. **FEMA-4418-DR**. On February 25, 2019, the President determined that certain areas in Alabama were eligible for assistance from the government under the Act as a result of severe storms and tornadoes which began on March 3, 2019. **FEMA-4419-DR**. Accordingly, taxpayers in these areas may deduct the losses on their 2018 or 2017 federal income tax returns. See I.R.C. § 165(i).

INNOCENT SPOUSE RELIEF. The taxpayer and spouse filed joint returns for 2003 and 2006 but did not immediately pay the taxes listed on the returns. The taxes for these years were attributable 17 percent to the non-requesting spouse and 83 percent to the taxpayer. The spouse filed for bankruptcy and the spouse's liability for the remaining 2003 and 2006 taxes was discharged. After several attempts at offers in compromise and installment payment of the taxes, the taxpayer requested innocent spouse relief for one-half of the 2003 and 2006 remaining taxes. The court first denied any relief for the 2003 taxes because those taxes were paid from IRS assessments against refunds from later tax years and the taxpayer failed to provide any evidence that the taxpayer was responsible for those refund payments. Under I.R.C. § 6015(b) and (c), relief is available only from an understatement of tax, that is, a proposed or assessed deficiency. I.R.C. § 6015(b) and (c) does not authorize relief from an underpayment of tax reported on a joint return; thus the court held that the taxpayer was not entitled to relief under those sections because the taxpayer was seeking relief as to underpaid taxes. I.R.C. § 6015(f) provides a requesting spouse may be relieved of joint liability if, taking into account all the facts and circumstances, it would be inequitable to hold the requesting spouse liable for any unpaid tax or deficiency or any portion thereof. Under *Rev. Proc. 2013-34, I.R.B. 2013-43, 397*, a taxpayer must satisfy seven threshold conditions before the IRS will consider a request for equitable relief: (1) the requesting spouse filed a joint return for the taxable year for which relief is sought; (2) relief is not available to the requesting spouse under I.R.C. § 6015(b) or (c); (3) the claim for relief is timely filed; (4) no assets were transferred between the spouses as part of a fraudulent scheme; (5) the non-requesting spouse did not transfer disqualified assets to the requesting spouse; (6) the requesting spouse did not knowingly participate in the filing of a fraudulent joint return; and (7) absent certain enumerated exceptions, the tax liability from which the requesting spouse seeks relief is attributable to an item of the non-requesting spouse's income. The IRS agreed that the taxpayer met the first six requirements and the court found that the 2006 tax liability was 83 percent attributable to the taxpayer; thus, the only taxes for which innocent spouse relief could be granted were the 17 percent attributable to the spouse, found to be $1,455. *Rev. Proc. 2013-34* provides a non-exhaustive list of seven factors that are considered when determining whether to grant equitable relief: (1) marital status; (2) economic hardship if relief is not granted; (3) in the case of an underpayment, knowledge or reason to know the tax liability would not be paid; (4) legal obligation to pay the outstanding tax liability; (5) significant benefit derived from the unpaid tax liability; (6) compliance with the income tax laws; and (7) mental or physical health. The court found the first, second, fourth, and sixth factors to be neutral, found that the fifth factor favored granting of relief because the taxpayer did not significantly benefit from the failure to pay the taxes, and found the seventh factor favored relief because the taxpayer was in poor physical health which affected the taxpayer's earning ability. The court also found that the small amount of tax relief available would not significantly affect the economic burden on the taxpayer. Thus, after weighing the factors of *Rev. Proc. 2013-34*, the court held that the IRS properly denied equitable innocent spouse relief for the taxpayer. **Brooks v. Comm'r, T.C. Summary Op. 2019-5**.

The taxpayer was divorced in 2013 and in 2012, during the proceedings, the taxpayer challenged the former spouse's statement of income because it did not include wages earned from performing as a musician for a church. The couple filed joint returns in 2011 and 2012 but the former spouse included the church income only on the 2011 return. The IRS assessed a deficiency on the 2012 return and collected the taxes owed by withholding that amount from a refund due to the taxpayer on the taxpayer's 2014 return. The taxpayer filed for a refund of the levied amount under the equitable innocent spouse relief provisions. Although the IRS agreed that the taxpayer was entitled to equitable innocent spouse relief, the former non-requesting spouse filed a challenge as intervenor to granting the relief. If the requesting spouse meets the threshold requirements under *Rev. Proc. 2013-34, I.R.B. 2013-43, Rev. Proc. 2013-34* provides a non-exhaustive list of seven factors that are considered when determining whether to grant equitable relief: (1) marital status; (2) economic hardship if relief is not granted; (3) in the case of an underpayment, knowledge or reason to know the tax liability would not be paid; (4) legal obligation to pay the outstanding tax liability; (5) significant benefit derived from the unpaid tax liability; (6) compliance with the income tax laws; and (7) mental or physical health. The court found that the taxpayer met the threshold requirements of Rev. Proc. 2013-34 but was not eligible for the streamlined determination. The court held that the taxpayer was eligible for equitable innocent spouse relief because (1) the taxpayer was divorced, (2) the taxpayer would suffer economic hardship because the taxpayer suffered from a medical disability and did not have sufficient income to cover living expenses, (3) the taxpayer did not receive a significant benefit from the understatement of income, (4) the taxpayer had complied with the income tax laws since 2013, and the taxpayer suffered from poor physical health. The court did find that the taxpayer had reason to know that the church income was not listed on the 2012 return but held that this one factor was not sufficient to offset the five factors in favor of granting relief. **Henry v. Comm'r, T.C. Memo. 2019-24**.

IRA. The IRS has published information about early withdrawals from individual retirement account or retirement plan. *Early Withdrawals*. An early withdrawal normally is taking cash out of a retirement plan before the taxpayer is 59½ years old. *Additional Tax*. The IRS charges a 10 percent penalty on early withdrawals from most qualified retirement plans, with some exceptions to this rule. *Nontaxable Withdrawals*.

The additional tax does not apply to nontaxable withdrawals, including withdrawals of contributions that taxpayers paid tax on before they put them into the retirement plan. *Rollovers are a nontaxable withdrawal*. A rollover happens when taxpayers take cash or other assets from one retirement plan and put the money in another plan within 60 days. A rollover can also happen when they direct their plan administrator to make the payment directly to another retirement plan or to an IRA. *Form 5329*. Taxpayers who took an early withdrawal in 2018 may have to file Form 5329 with their federal tax return. See also Pub. 590-B, *Distributions from Individual Retirement Arrangements*, and Pub. 575, *Pension and Annuity Income*. **IRS Tax Tip 2019-36**.

LEGAL EXPENSES. The taxpayer was the sole shareholder of an S corporation operating as a commercial cleaning franchisor. The taxpayer went on a vacation with a girl friend and two employees. The girl friend died from a cocaine overdose during the vacation and the taxpayer and S corporation were sued by the girl friend's family. The corporation's board agreed to settle the lawsuit with the taxpayer contributing to the settlement fund. The corporation claimed a deduction for the settlement payment, the taxpayer's contribution and related legal expenses. The taxpayer claimed the passed-through deductions on the taxpayer's personal return. The taxpayer argued that, because the corporation was named a party to the suit, the legal expenses and settlement were reasonable and necessary business expenses of the corporation. I.R.C. § 162 permits an individual or corporate taxpayer to deduct all ordinary and necessary expenses paid or incurred in carrying on a trade or business. The Tax Court cited *United States v. Gilmore, 372 U.S. 39 (1963)*for holding that when determining the deductibility of litigation expenses as business expenses, "the origin and character of the claim with respect to which an expense was incurred, rather than its potential consequences upon the fortunes of the taxpayer, is the controlling basic test." In this case, the Tax Court found that the origin of the litigation was the alleged supplying of cocaine to the deceased girl friend, which was not connected to the profit motive of the business or the taxpayer. The Tax Court held that the legal expenses were not deductible business expenses. On appeal the appellate court affirmed. **Cavanaugh v. Comm'r, 2019 U.S. App. LEXIS 9390 (5th Cir. 2019), *aff'g*, T.C. Memo. 2012-324**.

PAYMENT OF TAXES. The IRS has published information for taxpayers who may not be able to fully pay their taxes by the tax payment deadline. Everyone should file their 2018 tax return by the tax filing deadline regardless of whether they can pay in full. Taxpayers who can't pay all their taxes have options including: *Online Payment Agreement*. Individuals who owe $50,000 or less in combined income tax, penalties and interest and businesses that owe $25,000 or less in payroll tax and have filed all tax returns may qualify for an Online Payment Agreement. Most taxpayers qualify for this option and an agreement can usually be set up on IRS.gov in a matter of minutes. *Installment Agreement*. Installment agreements are paid by direct deposit from a bank account or a payroll deduction. *Delaying Collection*. If the IRS determines a taxpayer is unable to pay, it may delay collection until the taxpayer's financial condition improves. *Offer in Compromise (OIC)*. Taxpayers who qualify enter into an agreement with the IRS that settles their tax liability for less than the full amount owed. **IR-2019-60**.

PLUG-IN ELECTRIC VEHICLE CREDIT. The IRS has announced that the plug-in electric vehicle credit provided by I.R.C. § 30D will begin to phase-out for General Motors brand electric vehicles sold or leased after April 1, 2019. If a new qualified plug-in electric drive motor vehicle sold by General Motors is purchased for use or lease on or after April 1, 2019, the allowable credit is as follows: (1) for vehicles purchased for use or lease on or after April 1, 2019, and on or before September 30, 2019, the credit is 50 percent of the otherwise allowable amount determined under I.R.C. § 30D(b); (2) for vehicles purchased for use or lease on or after October 1, 2019, and on or before March 31, 2020, the credit is 25 percent of the otherwise allowable amount determined under I.R.C. § 30D(b); (3) for vehicles purchased for use or lease on or after March 31, 2020, no credit is allowable. **Notice 2019-22, I.R.B. 2019-14**.

MOVING EXPENSES. The IRS has issued guidance for reporting moving expenses on Form W-2. Some employers reported nontaxable reimbursements for moves that occurred in 2017 and other reimbursements under Form W-2, box 12, code P for the 2018 tax year. Code P on the 2018 Form W-2 should only be used to report moving expenses that qualify for the military exclusion. Employers should not report any other amounts under code P for 2018. The IRS stated that any employers who used code P in Box 12 erroneously should inform employees to disregard the amount but that corrected W-2s do not need to be filed with the SSA or IRS. Additionally, employers are not required to furnish employees with a corrected statement. Instead, employers may inform employees to omit the Box 12, code P amount when entering W-2 information in tax return preparation software. See also *Notice 2018-75, I.R.B. 2018-41*, *556* which states that employer payments or reimbursements in 2018 for employee moving expenses incurred in 2017 are excluded from wages for employment tax purposes. **https://www.irs.gov/forms-pubs/clarification-on-code-p-reporting-in-box-12-of-the-2018-form-w-2-19-mar-2019**

OFFERS IN COMPROMISE. The IRS has issued an updated version of Form 656-B, *Form 656 Booklet, Offer in Compromise*. The booklet includes updated versions of the various forms required when a taxpayer wishes to have IRS accept his offer in compromise (OIC). An accepted OIC is an agreement between the taxpayer and IRS that often settles a tax debt for less than the full amount owed. The taxpayer's OIC must make an appropriate offer based on what the IRS considers the taxpayer's true ability to pay. The booklet sets out the rules, in laymen's terms, for making an offer in compromise and having it accepted. For example: "Eligibility. Submitting an application does not ensure that IRS will accept the OIC. To be eligible, the following conditions must be met: (1) file all tax returns legally required to file; (2) have received a bill for at least one tax debt included on the offer; (3) make all required estimated tax payments for the current year, and (4) make all required federal tax deposits for the current quarter,

if a business owner with employees." OIC of trust fund taxes: "If the business owes trust fund taxes, responsible individuals may be held liable for the trust fund portion of the tax. Trust fund taxes are the money withheld from an employee's wages, such as income tax, Social Security, and Medicare taxes. A business is not eligible for consideration of an OIC unless the trust fund portion of the tax is paid or the trust fund penalty determination(s) has/have been made on all potentially responsible individual(s). However, if submitting the OIC as a victim of payroll service provider fraud or failure, the trust fund assessment is not required prior to submitting the offer." If a taxpayer has individual and business tax debts that a taxpayer wishes to compromise, the taxpayer must send in two Forms 656. Taxpayers should complete one Form 656 for their individual tax debts and one Form 656 for their business tax debts. Each Form 656 will require the $186 application fee and initial payment. A business is defined as a corporation, partnership, or any business that is operated as other than a sole-proprietorship. An individual's share of a partnership debt will not be compromised. The partnership must submit its own offer based on the partnership's and partners' ability to pay. The booklet contains the following updated forms and instructions for submitting an OIC: Form 433-A (OIC), *Collection Information Statement for Wage Earners and Self-employed Individuals*; Form 433-B (OIC), *Collection Information Statement for Businesses*; Form 656, *Offer in Compromise*. The IRS has announced that using previous versions of the forms may result in delayed processing of OIC applications. The booklet instructs taxpayers to use IRS's OIC Pre-Qualifier Tool to confirm that they are eligible for an OIC and to calculate a preliminary offer amount. **See Forms and Publications on www.IRS.gov**.

REFUND. The taxpayer obtained the automatic six-month extension for filing the taxpayer's 2012 return. The taxpayer had made estimated tax payments and included an additional payment with the extension request, all of which were deemed paid on April 15, 2013. The taxpayer failed to timely file the 2012 return and the return was not filed until August 29, 2015, claiming a refund. However, on June 15, 2015, the IRS sent the taxpayer a notice of deficiency which included unpaid taxes and penalties. The taxpayer filed a petition with the Tax Court on September 16, 2015. The court found two limitation periods for filing for a refund. I.R.C. § 6511(b)(2)(A) allows a refund claim if the claim is filed "within 3 years from the time the return was filed." Where a notice of deficiency is filed prior to the return, the refund claim is deemed made on the date of the notice of deficiency. In this case, the court held that, because the refund claim was deemed made before the actual filing of the return, the three year limitation period of I.R.C. § 6511(b)(2)(A) did not apply. Under I.R.C. § 6511(b)(2)(B): "If the claim was not filed within such 3-year period, the amount of the credit or refund shall not exceed the portion of the tax paid during the 2 years immediately preceding the filing of the claim." The Tax Court held that, because the refund claim was deemed to be made on June 15, 2015 and the taxpayer made the tax payments on April 15, 2013, the refund claim was not made within the two years after payment of the taxes. Thus, the Tax Court held that the taxpayer claim for refund was made after the two year statute of limitation had expired and no refund was allowed. On appeal, the appellate court reversed. The appellate court focused on the provision in I.R.C. § 6512(b)(3) which provides that, if the notice of deficiency is filed in the third year after the due date for filing the applicable return "(with extensions)," the limitation period for a refund claim was three years after payment of the taxes. After examining the legislative history of I.R.C. § 6512(b)(3) the appellate court held that the phrase "(with extensions)" modified the phrase "third year after the due date" of the return; therefore, because the notice of deficiency was filed in the third year after the due date of the taxpayer's return, the taxpayer had three years after the payment of the taxes to file a refund claim. **Borenstein v. Comm'r, 2019 U.S. App. LEXIS 9650 (2d Cir. 2019), *rev'g and rem'g*, 149 T.C. No. 10 (2017)**.

S CORPORATIONS

SHAREHOLDER. The taxpayer was divorced in May 2009 and the divorce decree provided that the former spouse's interest in an S corporation be transferred to the taxpayer within 30 days, although no shares were ever actually transferred to the taxpayer. The corporation had been wholly owned by the spouse but was administratively terminated in 1995; however, the corporation continued to earn income from an investment in another company owned by the former spouse. The company issued Forms K-1 to the S corporation showing income in 2010 and 2011 but the taxpayer did not include the amounts in taxable income for those years. The taxpayer argued that, because no shares were transfer to the taxpayer, the taxpayer was not liable for taxes on the income from the S corporation. The court held that the divorce decree was sufficient to transfer the beneficial interest in the shares to the taxpayer under state law, in this case Connecticut law governing the divorce and Florida law governing corporations. Under Treas. Reg. § 1.1366-1(a), the beneficial owner of shares in an S corporation is liable for the taxes owed on the *pro rata* share of the corporation's income, regardless of whether distributions are made. Thus, the court held that, because the taxpayer received the beneficial interest in the S corporation's stock under the 2009 divorce decree, the taxpayer had to include the taxpayer's share of the corporation income in the taxpayer's taxable income in 2010 and 2011. **Bonilla v. United States, 2019 U.S. Dist. LEXIS 47853 (D. Conn. 2019)**.

STATE AND LOCAL TAXES. The IRS has issued a Revenue Ruling providing guidance to taxpayers regarding the inclusion in income of recovered state and local taxes in the current year when the taxpayer deducted state and local taxes paid in a prior year, subject to the I.R.C. § 164(b)(6) limitation. The ruling provides four examples to illustrate the rules for 2018 filers. In each example, the taxpayers are unmarried individuals whose filing status is "single" and who itemized deductions on their federal income tax returns for 2018 in lieu of using their standard deduction of $12,000. The taxpayers did not pay or accrue the taxes in carrying on a trade or business or an activity described in I.R.C. § 212. For 2018, the taxpayers were not subject to alternative minimum tax under I.R.C. § 55 and were not entitled to any credit against income tax. The taxpayers use the cash receipts and disbursements method of accounting. *Situation 1*: The taxpayer paid local real property taxes of $4,000 and state

income taxes of $5,000 in 2018. The taxpayer's state and local tax deduction was not limited by I.R.C. § 164(b)(6) because it was below $10,000. Including other allowable itemized deductions, the taxpayer claimed a total of $14,000 in itemized deductions on the taxpayer's 2018 federal income tax return. In 2019, the taxpayer received a $1,500 state income tax refund due to the taxpayer's overpayment of state income taxes in 2018. *Situation 2*: The taxpayer paid local real property taxes of $5,000 and state income taxes of $7,000 in 2018. I.R.C. § 164(b)(6) limited the taxpayer's state and local tax deduction on the 2018 federal income tax return to $10,000, so the taxpayer could not deduct $2,000 of the $12,000 state and local taxes paid. Including other allowable itemized deductions, the taxpayer claimed a total of $15,000 in itemized deductions on the 2018 federal income tax return. In 2019, the taxpayer received a $750 state income tax refund due to the taxpayer's overpayment of state income taxes in 2018. *Situation 3*: The taxpayer paid local real property taxes of $5,000 and state income taxes of $6,000 in 2018. I.R.C. § 164(b)(6) limited the taxpayer's state and local tax deduction on C's 2018 federal income tax return to $10,000, so the taxpayer could not deduct $1,000 of the $11,000 state and local taxes paid. Including other allowable itemized deductions, the taxpayer claimed a total of $15,000 in itemized deductions on the 2018 federal income tax return. In 2019, the taxpayer received a $1,500 state income tax refund due to the taxpayer's overpayment of state income taxes in 2018. *Situation 4*: The taxpayer paid local real property taxes of $4,250 and state income taxes of $6,000 in 2018. I.R.C. § 164(b)(6) limited the taxpayer's state and local tax deduction on the taxpayer's 2018 federal income tax return to $10,000, so the taxpayer could not deduct $250 of the 10,250 state and local taxes paid. Including other allowable itemized deductions, the taxpayer claimed a total of $12,500 in itemized deductions on the 2018 federal income tax return. In 2019, the taxpayer received a $1,000 state income tax refund due to the taxpayer's overpayment of state income taxes in 2018. Section 164 generally provides an itemized deduction for certain taxes paid or accrued during the taxable year. I.R.C. § 164(a) provides a deduction for (1) state and local, and foreign, real property taxes; (2) state and local personal property taxes; (3) state and local, and foreign, income, war profits and excess profits taxes; and (4) the generation-skipping transfer tax imposed on income distributions. I.R.C. § 164(a) also provides a deduction for state and local, and foreign, taxes not previously described that were paid or accrued within the taxable year in carrying on any trade or business or an activity described in I.R.C. § 212 (relating to expenses for production of income). I.R.C. § 164(b)(6), as added by the Tax Cuts and Jobs Act, Pub. L. 115-97, limits an individual's deduction for the aggregate amount of state and local taxes paid during the calendar year to $10,000 ($5,000 in the case of a married individual filing a separate return). The dollar limitations apply to taxable years beginning after December 31, 2017, and before January 1, 2026, but they do not apply to any taxes described in I.R.C. § 164(a)(1) and (2) that are paid or accrued in carrying on a trade or business or an activity described in I.R.C. § 212. I.R.C. § 111(a) excludes from gross income amounts attributable to the recovery during the taxable year of any amount deducted in any prior year to the extent the amount did not reduce the amount of tax imposed by Chapter 1 of the Code. I.R.C. § 111 partially codifies the tax benefit rule, which generally requires a taxpayer to include in gross income recovered amounts that the taxpayer deducted in a prior taxable year to the extent those amounts reduced the taxpayer's tax liability in the prior year. If the taxpayers in Situations 1 through 4 had paid only the exact amount of state and local tax in the prior taxable year, their itemized deductions may have been lower or they may have opted for the standard deduction. Thus, the taxpayer in each situation must determine the amount of itemized deductions that the taxpayer would have deducted in the prior year had the taxpayer paid only the exact amount of tax. The taxpayer must then compare this amount to the total itemized deductions actually taken on the return, or the standard deduction that could have been taken on the return, and include the difference as income on the current year return if the taxpayer received a tax benefit in the prior taxable year from that itemized deduction. *Situation 1: State income tax refund fully includable*. In 2019, the taxpayer received a $1,500 refund of state income taxes paid in 2018. Had the taxpayer paid only the exact amount of state income tax due in 2018, the taxpayer's state and local tax deduction would have been reduced from $9,000 to $7,500 and as a result, the taxpayer's itemized deductions would have been reduced from $14,000 to $12,500, a difference of $1,500. Thus, the taxpayer received a tax benefit from the overpayment of $1,500 in state income tax in 2018 and the taxpayer is required to include the entire $1,500 state income tax refund in the taxpayer's gross income in 2019. *Situation 2: State income tax refund not includable*. In 2019, the taxpayer received a $750 refund of state income taxes paid in 2018. Had the taxpayer paid only the exact amount of state income tax due in 2018, the taxpayer's state and local tax deduction would have remained the same ($10,000) and the taxpayer's itemized deductions would have remained the same ($15,000). Thus, the taxpayer received no tax benefit from the overpayment of $750 in state income tax in 2018, and the taxpayer is not required to include the $750 state income tax refund in the taxpayer's gross income in 2019. *Situation 3: State income tax refund partially includable*. In 2019, the taxpayer received a $1,500 refund of state income taxes paid in 2018. Had the taxpayer paid only the exact amount of state income tax due in 2018, the taxpayer's state and local tax deduction would have been reduced from $10,000 to $9,500 and as a result, the taxpayer's itemized deductions would have been reduced from $15,000 to $14,500, a difference of $500. Thus, the taxpayer received a tax benefit from $500 of the overpayment of state income tax in 2018 and the taxpayer is required to include $500 of the taxpayer's state income tax refund in the taxpayer's gross income in 2019. *Situation 4: Standard deduction*. In 2019, the taxpayer received a $1,000 refund of state income taxes paid in 2018. Had the taxpayer paid only the exact amount of state income tax due in 2018, the taxpayer's state and local tax deduction would have been reduced from $10,000 to $9,250, and, as a result, the taxpayer's itemized deductions would have been reduced from $12,500 to $11,750, which is less than the standard deduction of $12,000 that the taxpayer would have taken in 2018. The difference between the taxpayer's claimed itemized deductions ($12,500) and the standard deduction the taxpayer could have taken ($12,000) is $500. Thus, the taxpayer received a tax benefit from $500 of the overpayment of state income tax in 2018 and the taxpayer is required to include $500 of the taxpayer's state income tax refund in the taxpayer's gross income in 2019. **Rev. Rul. 2019-11, I.R.B. 2019-17**.

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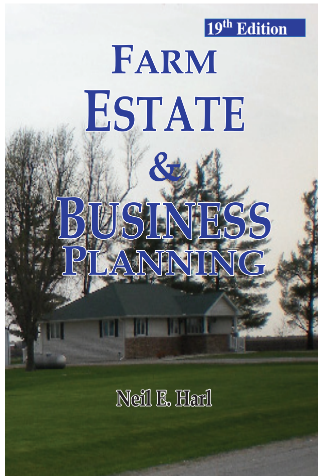

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