

ONPOINT PUBLICATIONS – TALKING POINTS GUIDE

TAX WEEK IN REVIEW – NOVEMBER 25, 2016

U.S. Tax Court Cases in Review:

BARNES V. COMMISSIONER – T.C. Memo 2016-212

PLR's\CCA's\TAM's in Review:

PLR 201648001 – Alimony Defined

PLR 201648013 – Like Kind Exchange Not Solely in Kind

PLR 201648019 – Exempt Purpose Defined

IR News Releases:

IRS Warns of Refund Delays

Form 4255, Recapture of Investment Credit, Released in Draft

Conservation Easement Audit Technique Guide Released

TALKING POINTS FOR TAX WEEK IN  
REVIEW NOVEMBER 25, 2016

**Slide 1. Title Page – Tax Week in Review for Week Ending 11/25/2016**

**Opinions, Decisions and Rulings Released This Week**

**Slide 2.**

BARNES V. COMMISSIONER – T.C. Memo 2016-212

*Issue: Upon audit, taxpayer was found to have unreported income and unsubstantiated deductions for tax years 2008 and 2009. The taxpayer contested the determination in Tax Court.*

Taxpayer (T) has several sources of income and deductions:

- Wages for employment with Robert Half, a temporary help service
- Barnes & Barnes Financial Services – a sole proprietorship providing tax preparation services and a second sole proprietorship, providing financial consulting to churches
- One residential rental property, reported on Schedule E, for a 50% interest in a house inherited from her father and rented to her cousin.
- Charitable contribution deduction for unreimbursed expenses, including overseas travel.

**Slide 3.**

**Unreported Income and Bank Deposits Method**

- IRS determined income to be understated for years under audit, as determined by the bank deposits method, which included examination of ten bank accounts maintained by T.
- The Tax Court found the bank deposits method to be reasonable as T's businesses were cash basis and T maintained no formal or informal records for her businesses.
- At trial, T presented a listing of deposits (spreadsheet) and testified that all funds identified by the IRS were received from nontaxable sources.
- IRS presented evidence to include additional deposits as income. This evidence is considered a "new matter" presented after the original deficiency notice was issued.

TALKING POINTS FOR TAX WEEK IN  
REVIEW NOVEMBER 25, 2016

**Slide 4.**

Unreported Income and Bank Deposits Method

The Tax Court Opinion:

- Allowed for the reduction of income for selected deposits presented by T as expense reimbursements, merchant refunds or loan repayments.
- Disallowed the characterization of 4 deposits as income, as presented by the IRS at trial.
- After adjustments, unreported income of \$25,755 for 2008 and \$25,902 for 2009 were determined to be the amounts to be included in income.

**Slide 5.**

The Preponderance of Evidence and Burden of Proof

- For Bank-Deposit method of reconstructing income:
  - Taxpayer has burden of proof to show reconstruction is in error and
  - IRS is not required to show a likely source of the income for each deposit.
- The taxpayer generally bears the burden of proving that the determinations in the notice of deficiency are erroneous.
- IRS bears burden of proof regarding any new matter introduced after the notice of deficiency was issued.

---

*The Preponderance of Evidence and Burden of Proof - Overview*

*At trial, T presented a spreadsheet with a list of deposits and descriptions indicating the listed deposits were from nontaxable sources. In its bank deposit analysis, the IRS had already made its determinations as to which deposits (such as interbank transfers) were nontaxable. At the time of trial, the IRS had also modified its position and reduced its determination of the amount of taxable deposits for both years.*

*T claimed that the IRS's determination was incorrect and that the deposits presented on her spreadsheet should be deducted from the income analysis. She did not contest that she had already reported the deposits as income, but rather the deposits were from nontaxable sources. The IRS argued that T failed to prove that the deposits determined to be unreported income were from nontaxable sources.*

TALKING POINTS FOR TAX WEEK IN  
REVIEW NOVEMBER 25, 2016

*For T to prevail in this argument, the following conditions must be true:*

- 1. T received an amount;*
- 2. The amount was nontaxable;*
- 3. She deposited the amount into her bank account;*
- 4. The IRS treated this deposit as income in its bank-deposits analysis.*

*This is a resolution of factual matters. Therefore, there must be a preponderance of evidence from the party who bears the burden of proof. In this case:*

- 1. The taxpayer generally bears the burden of proving that the determinations in the notice of deficiency are erroneous. Welch v. Helvering, 290 U.S. 111, 115 (1993).*
  - a. T would need to prove that the deposits presented on her spreadsheet were from nontaxable sources AND had been included in the taxable amounts determined by the IRS.*
- 2. IRS bears burden of proof regarding any new matter. Rule 142(a)(1). New matter includes a new theory that requires the presentation of different evidence. This also includes items resulting in increases of deficiencies that are presented after the original notice of deficiency has been issued. Wayne Bolt & Nut Co. v. Comm. 93 T.C. 500, 507 (1989).*
  - a. For the IRS to prevail for the inclusion of the additional deposits, it would need to present new evidence previously not used in the determination of the notice of deficiency. The preponderance of evidence favored the taxpayer's argument that these came from nontaxable sources and the 4 deposits introduced at trial were excluded from income by the Court.*
- 3. The IRS bears the burden of proof for issues for which the taxpayer shows that the requirements of section 7491(a)(1) and (2) are satisfied. Higbee v. Commissioner, 116 T.C. 438, 442 (2001);*
  - a. Section 7491(a)(1) requires the taxpayer to present credible evidence with respect to factual issues relevant to ascertaining the taxpayer's tax liability. Credible evidence is evidence that, after critical analysis, would constitute a sufficient basis for deciding the issue in favor of the taxpayer if no contrary evidence were submitted.*
  - b. Section 7491(a)(2) requires the taxpayer to comply with substantiation and record-keeping requirements and cooperate with the IRS's reasonable requests for witnesses, information, documents, meetings, and interviews.*

TALKING POINTS FOR TAX WEEK IN  
REVIEW NOVEMBER 25, 2016

**Slide 6:**

Charitable Contributions Disallowed

- T deducted \$16,727 in charitable contributions for 2008, which included \$5,112 for travel to Africa on a trip sponsored by Williams Temple Church.
- The IRS limited the 2008 deduction to \$12,576, including an allowance of \$961 for the trip to Africa. (The IRS later claimed this allowance was in error, but did not contest it at trial.)
- Due to a lack of contemporaneous records and documentation required under IRC Section 170, T was not able to support claims that deductions were in excess of those allowed by the IRS.

---

IRC Section 170

*IRC Section 170 allows for charitable contributions to be deductible, whether it be money or property. While unreimbursed expenses which are incidental to performing services for a charitable organization are considered deductible, contributions of services are not.*

*Per IRC Section 170(f)(8)(A), provides that “no deduction shall be allowed under for any contribution of \$250 or more unless the taxpayer substantiates the contribution by a contemporaneous written acknowledgement of the contribution by the donee organization that meets the requirements of subparagraph (B).” [section 170(f)(8)(B)].”*

*Per the court record, to be contemporaneous, records should be “obtained by the taxpayer on or before the earlier of (1) the date the taxpayer filed the original return for the taxable year of the contribution or (2) the due date (including extensions) for the filing of the original return for the year.”*

*A letter from the church indicated that she paid \$5,112 for the trip, but did not meet the requirements of IRC Section 170(f)(8)(B), which states:*

*(B) Content of acknowledgement - An acknowledgement meets the requirements of this subparagraph if it includes the following information:*

*(i) The amount of cash and a description (but not value) of any property other than cash contributed.*

## TALKING POINTS FOR TAX WEEK IN REVIEW NOVEMBER 25, 2016

(ii) *Whether the donee organization provided any goods or services in consideration, in whole or in part, for any property described in clause (i).*

(iii) *A description and good faith estimate of the value of any goods or services referred to in clause (ii) or, if such goods or services consist solely of intangible religious benefits, a statement to that effect.*

*The Court recognized that T could have performed services for Williams Temple Church, incidental to her participation in the trip. Therefore, a portion of the expenses could be deemed a charitable contribution. However, T failed to substantiate her payment with a contemporaneous written acknowledgement from Williams Temple Church, as required by IRC Section 170(f)(8)(A).*

---

### **Slide 7:**

#### Rental Property Expenses Disallowed

- T inherited a 50% interest in her father's home and rented it to her cousin for \$200 per month. Despite lack of routine payments, T never evicted the cousin.
- T collected and reported rents of \$800 and \$1,000 for years 2008 and 2009, respectively.
- The IRS argued that, with the home's fair market value estimated at \$275,000, the rents were below fair rental value of the property. As such, Section 280A(a) prevents T from deducting any related expenses.

### **Slide 8:**

#### Rental Property Expenses Disallowed

- The Court disallowed all but real estate taxes to be deducted.
  - T failed to prove that rent was reduced because of the property's condition or prevailing market conditions.
  - As rent was below fair rental value, the property was deemed to have been used for personal purposes and expenses were disallowed under Section 280A.
  - Section 280A(a) does not limit deductions for property taxes.

The full text can be read here: [T.C. Memo 2016-212](#)

---

TALKING POINTS FOR TAX WEEK IN  
REVIEW NOVEMBER 25, 2016

---

Applying IRC Section 280A

*The Tax Court applied the rules of IRC Section 280A(a), (b), and (d) in determining whether the rental property was a rental or personal residence.*

- 1. T claimed that the condition of the house warranted a reduced rent. Pictures of the house did not provide conclusive evidence of damages that would reduce the rental value of the property.*
- 2. The Court agreed with the IRS that rents were below fair market value.*
- 3. To determine if the property was a residence for each tax year, the Court applied the rules of Section 280A(d)(1) and (2).*
  - a. Her personal use of the property was 365 days, as her cousin did not pay fair rental value.*
  - b. Since 14 days is greater than 10% of the days rented at FRV, the Court compared 14 to the 365 days of personal use. As 365 is greater than the 14 day allowance, the property is considered to be a personal use property for the entire year.*

*The Court decision allowed for the property tax deductions citing Section 164(a)(1):*

*“Section 164(a)(1) allows a deduction for certain taxes, including state and local property taxes regardless of whether they are paid or incurred in connection with a trade or business or income-producing activity.”*

---

TALKING POINTS FOR TAX WEEK IN  
REVIEW NOVEMBER 25, 2016

**Slide 9.**

PLR 201648001 – ALIMONY DEFINED

*Issue: Are premiums paid for maintaining a life insurance policy intended to provide continued spousal support considered to be alimony?*

- As part of their divorce agreement, Taxpayer (T) and ex-spouse included the following under the Section “Spousal Support:”
  - “Ex-spouse was further ordered to maintain a life insurance policy in an amount sufficient to cover his maintenance and child support obligations.”
- IRC Section 71(a) provides that gross income includes payments for alimony or separate maintenance payments.
- Per the ruling, the payments for the life insurance were found not to be alimony, despite having met three of the four requirements defining alimony.

The full text can be read here: [PLR 201648001](#)

---

*Alimony and Separate Maintenance Payments*

*Section 71(b)(1) defines the term “alimony or separate maintenance payment” as any payment in cash if—*

- (A) such payment is received by (or on behalf of) a spouse under a divorce or separation instrument,*
- (B) the divorce or separation instrument does not designate such payment as a payment which is not includible in gross income under section 71 and not allowable as a deduction under section 215,*
- (C) in the case of an individual legally separated from his spouse under a decree of divorce or of separate maintenance, the payee spouse and the payor spouse are not members of the same household at the time such payment is made, **and***
- (D) there is no liability to make such payment for any period after the death of the payee spouse and there is no liability to make any payment (in cash or property) as a substitute for such payment after the death of the payee spouse.*

TALKING POINTS FOR TAX WEEK IN  
REVIEW NOVEMBER 25, 2016

*If a payment satisfies all of the factors set forth in section 71(b) then it is alimony, but if it fails to satisfy any one of the above factors, it is not alimony.*

*In the case presented, the agreement met only requirements of (A), (B) and (C). As the agreement does not stipulate that payments cease upon the death of T (the payee spouse), the requirement of Section 71(b)(1)(D) has not been met.*

---

**Slide 10.**

PLR 201648013 – LIKE KIND EXCHANGE NOT SOLELY IN KIND

*Issue: Will sale proceeds paid to the qualified intermediary and used to repay outstanding debt secured by the relinquished property be 1) Treated as having met the requirements of having no actual or constructive receipt of monies, and 2) Be treated as liability relief for purposes of the boot netting rules?*

- Taxpayer (T) is engaged in the business of providing loans and leases to consumers of property. Properties are purchased with 3<sup>rd</sup> party debt and debt is collateralized by properties held by T, who is the owner for federal income tax purposes.
- T implements a Like Kind Exchange Program to engage in like kind exchanges for its leased properties. T enters into a Master Exchange Agreement (MEA) with a qualified intermediary (QI).

**Slide 11.**

PLR 201648013 – LIKE KIND EXCHANGE NOT SOLELY IN KIND

- To purchase new properties, T deposits cash obtained from new loan borrowings with the QI to fund acquisitions.
- Any new properties purchased become security for the new loan proceeds and are subject to same disposition and loan repayment requirements, i.e. sales proceeds must be used to pay off debt that was secured by the relinquished property.
- T represents that it and the QI intend to treat exchange proceeds received by QI from “Relinquished Properties Subject to Liabilities” as relief from

TALKING POINTS FOR TAX WEEK IN  
REVIEW NOVEMBER 25, 2016

liabilities to be offset against consideration given by the Exchanger (T) in the form of cash or Replacement Property Debt, as provided in Treasury Regulation 1.1031(b)-1(c).

**Slide 12.**

PLR 201648013 – LIKE KIND EXCHANGE NOT SOLELY IN KIND

- The Tax Court held that since it was required that proceeds be received by the QI and used for loan repayments, the taxpayer does not have actual or constructive receipt of the sale proceeds, as required by Treas. Reg. 1.1031(k)-1.
- The Tax Court held that the “boot netting principle covers not just assumptions of debt, but also situations in which the proceeds of the relinquished property are used to pay off debt secured by the relinquished property.”

The full text can be read here: [PLR 201648013](#)

---

Like Kind Exchanges

*Whenever you sell business or investment property for a gain, you would generally be taxed on that gain. Section 1031 allows for a deferral of tax if you use the proceeds to purchase a similar property in a qualified like kind exchange. This is not the same as selling one property and buying another. A sale of a property that results in the exchange of cash would be taxable. A qualified like kind exchange is a sale of property and acquisition of another as a coordinated, interdependent transaction. This usually requires the use of an intermediary and needs to be in accordance with IRS regulations.*

*In the private letter ruling, the taxpayer was concerned about two specific requirements of Section 1031.*

1. *Recognition of Boot:*
  - a. *Any boot (money or other property not of a like kind) received will trigger a possible recognition of gain. The taxpayer has stated that the MEA prevents the taxpayer from having rights or benefits to sale proceeds.*
2. *Debt Relief as Boot:*
  - a. *If property relinquished is subject to a liability, the relief of such debt is considered to be a receipt of “other property or money.”*

TALKING POINTS FOR TAX WEEK IN  
REVIEW NOVEMBER 25, 2016

*When there are mortgages on both sides of the transaction, the taxpayer(s) may “net” the liabilities exchanged in a determination of the net benefits received. If the net is an overall decrease in debt assumed, this is considered to be a net cash benefit.*

- b. If there was only the sale of the taxpayer’s property and the cash received was used to pay-off an existing mortgage on the relinquished property, such a transaction would be a sale at full value with a recognition of the entire gain. In the case presented, the QI will be using funds to repay the loans, prior to the purchase of the replacement property.*
3. *For item (1), the Tax Court ruled that under the circumstances, the taxpayer had no constructive receipt of cash if the agreements were respected. Under the Master Exchange Agreement, T has no rights to receive, pledge, borrow or otherwise obtain the benefits of sale proceeds. The QI was to hold monies received and remit directly to the bank in payment of the loans collateralized by the relinquished property. Monies for purchases were drawn as loans from the bank and directed to the QI to make future purchases.*
4. *For item (2), the Tax Court followed the ruling found in Barker v. Commissioner, 74 T.C. 555 (1980), which allows for the use of sale proceeds to pay off debt on the relinquished property without triggering gain if the taxpayer incurs or assumes new debt on the purchase of the replacement property that equals or exceeds the original debt repaid.*

*Per the Court opinion:*

*“In Barker v. Commissioner, 74 T.C. 555 (1980), the Tax Court held that proceeds from the disposition of the relinquished property can be used to pay off debt on the relinquished property without triggering gain if the taxpayer incurs or assumes a liability on the purchase of the replacement property that equals or exceeds the debt on the relinquished property. The taxpayer in Barker received cash in the exchange but was contractually obligated by the transferee of the relinquished property to use the cash to pay off the relinquished property debt. **Thus, the Tax Court held that the boot netting principle in § 1.1031(b)-1(c) covers not just assumptions of debt but also situations in which the proceeds of the relinquished property are used to pay off the relinquished property debt.**”*

TALKING POINTS FOR TAX WEEK IN  
REVIEW NOVEMBER 25, 2016

**Slide 13.**

PLR 201648019 – EXEMPT PURPOSE DEFINED

*Issue: Does a 501(c)(3) organization meet the charitable purpose rule when donations are for the benefit of a specific individual?*

- Organization was formed for collecting donations that benefited Individual X, being treated for cancer.
- Funds were requested from family, friends and coworkers to be used for medical treatment and expenses of Individual X.
- Organization was chosen for examination and the 501(c)(3) status was revoked.
- Per the ruling, exemption from federal taxation is permitted for corporations, and any community chest, fund or foundation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes. No part of net earnings can inure to the benefit of any private shareholder or individual.

The full text can be read here: [PLR 201648019](#)

---

*Question: Would the result be different if the family had not created the entity and simply used a crowdfunding platform, such as GoFundMe or Indiegogo, to solicit funds from the general public? Would donations be gifts and not income?*

*As IRC Section 61(a) states gross income means all income from whatever source derived, unless statutorily excluded. One such exclusion is gifts - IRC Section 102(a). Generally speaking, crowdfunding donations will be considered to be personal gifts and therefore not taxable. One of the best known cases with regard to gifts is the Supreme Court decision of Commissioner v. Duberstein. (Commissioner v. Duberstein, 363 U.S. 278 (1960). In the Court's opinion, a gift was defined by the donor's intent and were proceeds from a detached and disinterested generosity, out of affection, respect, admiration, charity or like impulses.*

*Under the circumstances presented in PLR 201648019, solicited funds directly through a crowdfunding platform would have generated a better result. Keep in mind, that platforms such as GoFundMe, have filing requirements for any solicitation that generates \$20,000 or 200 plus donors. The pay processor will send out a Form 1099-K in either circumstance.*

TALKING POINTS FOR TAX WEEK IN  
REVIEW NOVEMBER 25, 2016

***In the News This Week***

**Slide 14:**

**IR 2016-152 – IRS reminds taxpayers that some refunds will be delayed**

Beginning in 2017, a new law approved by Congress requires the IRS to hold refunds on tax returns claiming the EITC or the ACTC until mid-February. The IRS must hold the entire refund, even the portion not associated with the EITC and ACTC, until at least Feb. 15. This change helps ensure that taxpayers get the refund they are owed by giving the agency more time to help detect and prevent fraud.

The full text can be read here: [IR 2016-152](#)

**Slide 15:**

**IRS releases new Audit Technique Guide for Conservation Easements**

Conservation easements are legal agreements that transfer use of a property in exchange for the promise that it will not be developed and will be preserved for purposes of outdoor recreation, protection of natural habitats or scenic enjoyment or similar conservation purposes. Since landowners may be able to take a charitable contribution for the value of the easement granted, the IRS is looking to review such deductions for aggressive valuations.

The IRS has identified areas of concern, including:

- Failure to meet charitable contributions rules, for example the easement was granted for a change in zoning by the county, or a quid pro quo.
- Noncompliance with substantiation requirements.
- Inadequate documentation or lack of conservation purpose.
- Lack of perpetuity evidenced by terms in the deeds.

The HTML version of the ATG can be read here: [Conservation Easements ATG](#)

TALKING POINTS FOR TAX WEEK IN  
REVIEW NOVEMBER 25, 2016

**Slide 15:**

**Draft form released for Investment Tax Credit**

Revised Form 4255, Recapture of Investment Credit, reflects the computational steps required under section 50(a)(1) and provides additional instructions on how to adjust the unused portion (i.e., carryover) of a recaptured credit.

The can find the Draft Form 4255 here: [Draft Form 4255](#)