Current Federal Tax Developments

Week of March 11, 2019

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Table of Contents

Section: Policy
Treasury Announces Revision to Use of Temporary Regulations and Notices

Citation: Policy Statement on the Tax Regulatory Process, 3/5/19

The Treasury Department released a policy statement (Policy Statement on the Tax Regulatory Process) that indicated the agency will rely less on temporary regulations and subregulatory guidance (such as Notices) than it has in the past.

The statement begins by noting the IRS will continue to use the notice-and-comment process for both interpretative and legislative regulations even though the Administrative Procedures Act (APA) exempts interpretive regulations from that requirement. The policy explains:

> *This process allows the public to participate before any final rule becomes effective and ensures that all views are adequately considered. It also enables the public to apprise the government of relevant information that the government may not possess or to alert the government to consequences that it may not foresee.*

With regard to temporary regulations, the agency will now begin issuing a "good cause" statement when a temporary regulation is issued. Previously the IRS had taken the position that such a statement was not required for tax temporary regulations. The policy statement provides:

> *As a matter of sound regulatory policy, the Treasury Department and the IRS commit to include a statement of good cause when issuing any future temporary regulations under the Internal Revenue Code. In certain exceptional circumstances, sound tax administration may require temporary regulations to be issued without notice and comment. For example, such regulations may be necessary and appropriate to stop abusive practices or to immediately resolve an injurious inconsistency between existing regulations and a new statute or judicial decision. When sound tax administration does warrant temporary regulations, the Treasury Department and the IRS will make their reasons for issuing such immediately-effective regulations clear by including a statement of good cause in the preamble.*

Presumably this will set a higher bar for the IRS to clear in order to issue temporary regulations, resulting in few such regulations.

The IRS has not used temporary regulations generally in dealing with the Tax Cuts and Jobs Act changes. Rather the agency has favored issuing proposed regulations with a statement in the preamble to the proposed regulations that "taxpayers may rely" on those proposed regulations until final regulations are issued. So, as a practical matter, this is simply formally announcing what the IRS has already been doing.

The policy statement outlines limits on subregulatory guidance. The statement provides:

> *Subregulatory guidance is not intended to affect taxpayer rights or obligations independent from underlying statutes or regulations. Unlike statutes and regulations, subregulatory guidance does not have the force and effect of law. Taxpayers can have confidence, however, that the IRS will not take positions inconsistent with its subregulatory guidance when such guidance is in effect. In applying subregulatory guidance, the effect of subsequent legislation, court decisions, rulings, and procedures must be considered.*

The IRS states they will not claim in litigation that subregulatory guidance has the force of law. The statement continues:

> *When proper limits are observed, subregulatory guidance can provide taxpayers the certainty required to make informed decisions about their tax obligations. Such guidance cannot and should not, however, be used to modify existing legislative rules or create new legislative rules. The Treasury Department and the IRS will adhere to these limits and will not argue that subregulatory guidance has the force and effect of law. In litigation before the U.S. Tax Court, as a matter of policy, the IRS will not seek judicial deference under Auer v. Robbins, 519 U.S. 452 (1997) or Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984), to interpretations set forth only in subregulatory guidance.*

The policy outlines how the IRS will decide whether to issue regulatory or subregulatory guidance:

> *In deciding whether to issue regulations or subregulatory guidance, the Treasury Department and the IRS must consider the content and nature of the interpretation or position being announced. Factors to be considered include the intended effect on taxpayers' rights or duties, the need for public comments, the form and content of prior positions, the significance of the issues, the statutory framework, and whether the interpretation or position is of short-term or long-term value.*

Regulatory guidance rather than subregulatory guidance will be issued in the following situations:

> *After weighing relevant factors, if the intended interpretation or position would have the effect of modifying existing legislative rules or creating new legislative rules on matters not addressed in existing regulations, the interpretation or position will generally be issued through notice-and-comment rulemaking, absent exceptional circumstances.*

Similarly, the IRS will issue subregulatory guidance in the following situations:

> *Where the Treasury Department and the IRS intend to provide only an interpretation of existing law applied to a limited set of facts, a statutorily prescribed form of relief, a statement of agency procedure or practice, a public announcement of intent to issue proposed legislative rules, or an announcement that has only immediate or short-term value, the intended interpretation or position will generally be issued as subregulatory guidance rather than through notice-and-comment rulemaking.*

Finally, the policy statement outlines limits on cases where the IRS issues a notice that explains what the IRS plans to issue as regulatory guidance at some point in the future. The key problem is when such a notice is issued and then the promised regulations do not appear timely.

To address this issue, the policy provides:

> *To limit the uncertainty that these situations may create, the Treasury Department and the IRS will include a statement in each future notice of intent to issue proposed regulations stating that if no proposed regulations or other guidance is released within 18 months after the date the notice is published, taxpayers may continue to rely on the notice but, until additional guidance is issued, the Treasury Department and the IRS will not assert a position adverse to the taxpayer based in whole or in part on the notice.*

Section: 162
Recipients of Sexual Harassment Settlements Will Be Allowed to Deduct Legal Fees Even if Confidentiality Clause is in the Agreement

Citation: IRS Website, "Section 162(q) FAQ", 2/28/19

The IRS has published on their website a frequently asked question page dealing with a deduction for legal fees under IRC §162(q) (Section 162(q) FAQ).

For those who may not have memorized the Internal Revenue Code, IRC §162(q) is a provision added by the Tax Cuts and Jobs Act. This provision provides:

> *(q)* ***Payments related to sexual harassment and sexual abuse*** *No deduction shall be allowed under this chapter for—*
>
> > *(1) any settlement or payment related to sexual harassment or sexual abuse if such settlement or payment is subject to a nondisclosure agreement, or*
> >
> > *(2) attorney's fees related to such a settlement or payment.*

A concern raised after the passage of the Tax Cuts and Jobs Act was that the provision appeared to prevent a deduction for legal fees regardless of whether the party was the one paying a settlement or the party receiving the settlement.

The IRS has posted a notice on the website clarifying that the agency believes the rules are different for the party that is receiving the payment. The FAQ on the website states:

> ***Question:***
>
> *Does section 162(q) preclude me from deducting my attorney's fees related to the settlement of my sexual harassment claim if the settlement is subject to a nondisclosure agreement?*
>
> ***Answer:***
>
> *No, recipients of settlements or payments related to sexual harassment or sexual abuse, whose settlement or payment is subject to a nondisclosure agreement, are not precluded by section 162(q) from deducting attorney's fees related to the settlement or payment, if otherwise deductible. See Publication 525, Taxable and Nontaxable Income, for additional information on when all or a portion of attorney's fees may be deductible.*

Section: 165
Gambling Losses Linked to Prescribed Drug Were Not a Casualty Loss

Citation: Mancini v. Commissioner, T.C. Memo. 2019-16, 3/4/19

The Tax Court took a look at what it takes to create a casualty loss in the case of *Mancini v. Commissioner*, T.C. Memo. 2019-16. In this case the taxpayer argues that his gambling losses were a casualty loss since a drug he had been prescribed caused him to compulsively gamble. While the court agreed he had proven the causal link between the drug and his gambling, it also found that his loss did not meet the requirements under the IRC to be a treated as a casualty loss.

The drug in question had been prescribed to Mr. Mancini to help control his Parkinson's disease. While it did so, over time it was discovered that a significant number of patients prescribed the drug developed. As the Court described the situation:

> *Pramipexole is a dopamine agonist, meaning it activates dopamine receptors in the brain. That helps Parkinson's patients control their movements, but can also affect the brain's executive function in a way that distorts risk/reward assessments. Pramipexole was approved by the FDA in 1997, and by the early 2000s there were reports of users' developing impulse control disorders (ICDs), which make sufferers unable to control their behavior despite negative consequences. The most common ICDs observed among Parkinson's patients taking Pramipexole were compulsive eating (Mancini gained about 40 pounds while on the drug), shopping, or gambling; and hypersexuality. By around 2008 the correlation between Pramipexole and these ICDs was widely accepted. Today physicians prescribing the drug closely monitor patients for signs that they're developing an ICD.*

Mr. Mancini did develop ICD related to the use of the drug in the Court view, relying on the testimony of the taxpayer's expert. In Mr. Mancini's case the result was compulsive gambling. The gambling habit caused Mr. Mancini to liquidate assets well below market value to obtain funds to gamble after exhausting his more liquid assets. By the time his wife and daughter took action and notified his doctor of his situation he had drained all of bank accounts and virtually all of his retirement funds.

On his tax returns he claimed net losses generated by the drug's effect at nearly $3.5 million. Normally gambling losses are limited in deduction to the amount of gambling winnings.[1] If these transactions are governed by that rule then the $3.5 million of losses in excess of his winnings would not lead to a tax deduction.

But Mr. Mancini argued that his losses should fall under the personal casualty loss rule of IRC §165(c)(3) which allows a deduction for "losses of property not connected with a trade or business or a transaction entered into for profit, if such losses arise from fire, storm, shipwreck, or other casualty, or from theft."

The IRS argued that this situation did not qualify as a casualty loss under prior case law, and the Tax Court agreed. The Court points out the IRS's objection that there was no physical damage to Mr. Mancini's property and the related case law that the agency cited:

> *A casualty loss is deductible only if the taxpayer's property suffered physical damage, and here there was none. See, e.g., Furer v. Commissioner, 33 F.3d 58 (9th Cir. 1994), 1994 WL 417425, at *1 ("loss must be the result of physical damage to property"), aff'g without published opinion T.C. Memo. 1993-165; Citizens Bank of Weston v. Commissioner, 28 T.C. 717, 720 (1957) (physical damage of property prerequisite), aff'd, 252 F.2d 425 (4th Cir. 1958); Dubin, 35 T.C.M. (CCH) at 1122 (same).*

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[1] IRC §165(d)

After describing other cases that demanded physical damage to property in order to obtain the casualty loss deduction[2] the Court concluded:

> *In each of these cases we had to decide whether a taxpayer was entitled to a casualty-loss deduction, which necessarily meant we had to decide what the prerequisites for that deduction were. And each decision unequivocally held that physical damage to the taxpayer's property was a prerequisite of a casualty loss deduction. We'll follow suit.*

The taxpayer objected that the IRS, in *Publication 547, Casualties, Disasters, and Thefts*, specially allowed a casualty loss in the case of a "loss on deposits [that occurs] when a bank, credit union, or other financial institution becomes insolvent or bankrupt." Interestingly enough, while Court eventually dismisses this as not relevant since publications aren't binding on the IRS, it did so after cautioning the IRS that the Court was tempted not to let the IRS off the hook, though it resisted that temptation:

> *Fortunately for the Commissioner, his own publications aren't the law. See, e.g., Stengel v. Commissioner, T.C. Memo. 1992-570, 1992 WL 235192, at *2, aff'd without published opinion, 996 F.2d 1227 (9th Cir. 1993). We have said, however, that we'll treat revenue rulings, which also aren't binding precedent, as concessions, and it's tempting to do the same with Publication 547 here. See Rauenhorst v. Commissioner, 119 T.C. 157, 171-73 (2002). But even if we did, that publication says only that taxpayers can claim as a casualty the "type of loss" that occurs when a bank becomes insolvent or goes bankrupt, see IRS Pub. 547, at 4 — it doesn't authorize casualty-loss deductions for decreases in bank accounts generally. We're therefore not inclined to let Publication 547 upset decades of caselaw from both our Court and the Ninth Circuit.*

Section: 401
IRS No Longer Has Immediate Plans to Issue Regulations on Defined Benefit Plan Post-Retirement Lump-Sum Distribution Windows

Citation: Notice 2019-18, 3/6/19

The IRS has announced it no longer intends to issue amended regulations under IRC §401(a)(9) in Notice 2019-18. The IRS has previously announced in Notice 2015-49 that it had intended to revise the minimum distribution regulations to address the practice of offering a temporary lump sum payment option to beneficiaries of a defined benefit pension plan who were currently receiving annuity payments.

The issue arises with regard to rules found in Reg. §1.401(a)(9)-6. The notice summarizes those rules as follows:

> *The regulations prohibit any change in the period or form of the distribution after it has commenced, except in accordance with §1.401(a)(9)-6, A-13. If certain conditions are met, § 1.401(a)(9)-6, A-13(a) permits changes to the payment period after payments have commenced in association with an annuity payment increase described in § 1.401(a)(9)-6, A-14.*

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[2] *Citizens Bank of Weston v. Commissioner*, 28 T.C. 717 (1957); *Pulvers v. Commissioner*, 407 F.2d 838, 839 (9th Cir. 1969), aff'g 48 T.C. 245 (1967); *Kamanski v. Commissioner*, 477 F.2d 452 (9th Cir. 1973), aff'g T.C. Memo. 1970-352; Dubin, 35 T.C.M. (CCH) at 1120; *Pang v. Commissioner*, T.C. Memo. 2011-55

> *Section 1.401(a)(9)-6, A-1(a) also provides that periodic annuity payments must be nonincreasing or may increase only as otherwise provided, such as permitted increases described in § 1.401(a)(9)-6, A-14. Section 1.401(a)(9)-6, A-14(a)(4) permits annuity payments to increase "[t]o pay increased benefits that result from a plan amendment." In addition, § 1.401(a)(9)-6, A-14(a)(5) permits annuity payments to increase "to allow a beneficiary to convert the survivor portion of a joint and survivor annuity into a lump sum upon the employee's death," but no similar rule is provided with respect to conversion of an employee's annuity benefit during an employee's life or conversion of a beneficiary's annuity other than upon the employee's death.*

The IRS's original notice was issued in response to the following developments in employer sponsored defined benefit plans:

> *A number of sponsors of defined benefit plans have amended their plans to provide a limited period during which certain retirees who are currently receiving lifetime annuity payments from those plans may elect to convert their annuities into lump sums that are payable immediately. These arrangements are sometimes referred to as retiree lump-sum windows. Although the treatment under § 401(a)(9) of such a right to convert a current annuity into an immediate lump sum payment has not been addressed explicitly in regulations or other generally applicable published guidance, the addition of such a right to a plan has been treated in some instances as an increase in benefits that is described in § 1.401(a)(9)-6, A-14(a)(4) (with the result that the annuity payment period would be permitted to change under § 1.401(a)(9)-6, A-13(a)).*

Notice 2015-49, issued in July of 2015, provided that the IRS would issue regulations that would clarify that such temporary lump-sum options were not permitted increases in the annuity amount. The notice stated that the purpose of the minimum distribution rules of IRC §401(a)(9) were to ensure that amounts were not allowed to accumulate for excessive amounts of time in a tax deferred plan. Actuarily, the notice stated, a plan that allowed for a post-retirement window in which a lump sum could be taken would need to provide for reduced benefits in earlier years to take into account that later option.

However, such revised regulations were never issued by the IRS. The day before the new notice, Treasury had issued a revised policy statement in which the Department outlined what it perceived as issues with notices of intent to issue regulations when the related regulations were not issued for an extended period of time. Thus, it's not surprising that the IRS a day later announced a revision to the 2015 notice.

The new notice provides:

> *The Treasury Department and the IRS no longer intend to propose the amendments to the regulations under § 401(a)(9) that were described in Notice 2015-49. However, the Treasury Department and the IRS will continue to study the issue of retiree lump-sum windows. Until further guidance is issued, the IRS will not assert that a plan amendment providing for a retiree lump-sum window program causes the plan to violate § 401(a)(9), but will continue to evaluate whether the plan, as amended, satisfies the requirements of §§ 401(a)(4), 411, 415, 417, 436, and other sections of the Code. During this period, the IRS will not issue private letter rulings with regard to retiree lump-sum windows. However, if a taxpayer is eligible to apply for and receive a determination letter, the IRS will no longer include a caveat expressing no opinion regarding the tax consequences of such a window in the letter.*

Section: 6698
Partnerships Required to Add Tax Basis Capital Information to Partner K-1s Given Until March 15, 2020 to Provide the Information to the IRS

Citation: Notice 2019-20, 3/7/19

An earlier article on this site discussed the addition to the 2018 Form 1065 instructions that required partnerships to provide tax basis capital account information for partners whose tax basis capital would be negative and which are reporting partners' capital on the K-1 on basis other than the tax basis (IRS Adds Requirement for Tax Basis Partner Capital Information Reporting to Form 1065 Instructions, February 15, 2019).

Certain partnerships complained to the IRS that they will not be able to provide that information with this year's K-1s, at least not without delaying the issuance of K-1s to shareholders significantly. In response to these complaints, the IRS in Notice 2019-20 has provided a temporary reprieve to such partnerships.

The IRS has indicated the agency will not impose penalties under IRC §6722 (for failing to furnish the partner with a complete K-1 in accordance with the instructions) and IRC §6698 (for failing to provide a K-1 to the IRS with the tax return prepared in accordance with the instructions) if the requirements of the Notice are met. These penalties are the ones that apply to the failure to timely file other information returns, such as Forms 1099.

The Notice will apply if the partnership:

- Timely files the partner Schedule K-1s. The timely filing includes those provided to the partners and to the IRS on a return. That timely filing rule will apply to a partnership that obtained an extension of time to file its return and files the return before the end of the extension period; *and*
- By March 15, 2020 (or 180 days after what would have been the extended due date of the partnership return if it had filed for an extension) the partnership provides the IRS with a schedule that provides the following for each partner that the instructions require the partnership to provide negative tax basis information on:
    - The partner's name;
    - The partner's address;
    - The partner's taxpayer identification number;
    - The amount of the partner's tax basis capital account at both the beginning and the end of the taxable year.

The information is to be provided in accordance with the instructions found in Form 1065 and any additional guidance posted by the IRS on the IRS website at irs.gov. The schedule is to be mailed to:

> 1973 North Rulon White Blvd.
> Ogden, UT 84404-7843
> MS 4709
> Attn: Ogden PTE

The partnership does not need to provide the partners with amended K-1s, nor is the partnership required to file an administrative adjustment request.

The Notice warns that more instructions are going to be issued by the IRS on irs.gov regarding this relief, so advisers will need to watch for this additional information.