

# Current Federal Tax Developments

Week of July 27, 2020

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ACCOUNTING  
CONTINUING EDUCATION

CURRENT FEDERAL TAX DEVELOPMENTS  
WEEK OF JULY 27, 2020  
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# Current Federal Tax Developments

Kaplan Financial Education

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## **SECTION: PPP LOAN SBA ANNOUNCES TENTATIVE PLAN TO BEGIN ACCEPTING FORGIVENESS INFORMATION FROM LENDERS ON AUGUST 10**

### **Citation: SBA Procedural Notice, “Procedures for Lender Submission of Paycheck Protection Program Loan Forgiveness Decisions to SBA and SBA Forgiveness Loan Reviews,” 7/24/20**

The Small Business Administration announced that it has tentative plans to begin accepting lender forgiveness decision information on August 10 using a new “PPP Forgiveness Platform.”<sup>1</sup> Note that this platform is intended solely for lenders—borrowers will submit their forgiveness application to their lender. Once the lender has made a determination on forgiveness, the lender then transmits data to the SBA.

The date is tentative because, as of the July 23 release date of the notice, Congress was considering legislation that could make various changes to the PPP loan program yet again.

The SBA Procedural Notice provides the following information about this new platform:

SBA has partnered with a financial services technology provider – Goldschmitt-CRI – to make available a secure SaaS platform (the PPP Forgiveness Platform) to accept loan forgiveness decisions, supporting documentation, and requests for forgiveness payments. The PPP Forgiveness Platform is available only to PPP Lenders, not PPP borrowers.

This platform makes available a user interface for Lenders to upload required data and documentation, monitor the status of the forgiveness request, and respond to SBA in case of an inquiry or if SBA selects the loan for review. SBA will post a link to the PPP Forgiveness Platform on its website. The PPP Forgiveness Platform will go live and begin accepting Lender submissions on **August 10**,

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<sup>1</sup> SBA Procedural Notice, “Procedures for Lender Submission of Paycheck Protection Program Loan Forgiveness Decisions to SBA and SBA Forgiveness Loan Reviews,” July 23, 2020, <https://www.sba.gov/sites/default/files/2020-07/5000-20038.pdf> (retrieved July 24, 2020), p. 4

2020, subject to extension if any new legislative amendments to the forgiveness process necessitate changes to the system.<sup>2</sup>

While borrowers will not be using this system, final approval of forgiveness cannot take place until lenders are able to send the data to the SBA and the SBA approves the lender's determination to grant forgiveness. So borrowers will not get a final determination of the status of any forgiveness application until after both the lender begins accepting such applications and the SBA begins accepting the data from the lenders.

The following morning the AICPA published an article online in the *Journal of Accountancy* that made the case that borrowers likely shouldn't be rushing to apply for forgiveness in any event. The article outlines points made in the AICPA Town Hall presented on the same day the SBA notice was published.<sup>3</sup>

The article quotes Kari Hipsak, CPA, CGMA, an AICPA manager, as noting that the real deadline for applications will not come until 10 weeks after the covered period ends:

“There's no need to rush through the forgiveness,” she said. “A lot of businesses, I think, want to put the forgiveness behind them, but there are still a lot of unanswered questions. And so as long as there's not a deadline to have this application submitted, other than 10 months after the end of the covered period, it's really a business decision.”<sup>4</sup>

The article goes on to note other items related to PPP loan forgiveness that indicate not rushing to apply for forgiveness may be the most prudent approach:

- There is a lack of clarity about how broad the utilities class of expenses is.
- We expect additional guidance regarding the many exceptions a borrower may qualify for to mitigate or eliminate the FTE reduction of forgiveness, including the new one added by the Paycheck Protection Program Flexibility Act.
- We need clarification regarding how self-employed borrowers document paying their income replacement payroll cost for 2020.

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<sup>2</sup> SBA Procedural Notice, “Procedures for Lender Submission of Paycheck Protection Program Loan Forgiveness Decisions to SBA and SBA Forgiveness Loan Reviews,” p. 4

<sup>3</sup> Jeff Drew and Ken Tysiac, “PPP forgiveness: No need to rush, and other tips,” *Journal of Accountancy* website, July 24, 2020, <https://www.journalofaccountancy.com/news/2020/jul/ppp-loan-forgiveness-tips.html> (retrieved July 24, 2020)

<sup>4</sup> Jeff Drew and Ken Tysiac, “PPP forgiveness: No need to rush, and other tips,” *Journal of Accountancy* website, July 24, 2020

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- It will be important to take time and clearly document the necessary items prior to the application, instead of having to rush to assemble significant amounts of additional documentation a lender may request.<sup>5</sup>

### **SECTION: 36B** **IRS RELEASES 2021 ACA PREMIUM TAX CREDIT** **PERCENTAGES**

#### **Citation: Revenue Procedure 2020-36, 7/21/2020**

The IRS has updated items related to the premium tax credit under IRC §36B that was enacted as part of the Affordable Care Act to take into account indexing required under the law.<sup>6</sup> The updated items are:

- The applicable percentage table under IRC §36B(b)(3)(A)(i) and
- The employee's required contribution under IRC §36B(c)(2)(C)(i)(II) used to determine if an employer's offer of coverage is affordable.

Under IRC §36B, if an individual is not offered an affordable health plan providing minimum value by his/her employer, a credit is available up to the difference between the cost of the second lowest cost Silver Plan available to the employee and the applicable percentage for the year of the individual's household income.

A plan is deemed not affordable if the employee's required contribution to the employer's plan exceeds the required contribution percentage.

Both the applicable percentage and the employer's required contribution percentage are adjusted each year based on indexing calculations.

The applicable percentage table for 2021 will be:

In the case of household income (expressed as a percent of poverty line) within the following income tier:	The initial premium percentage is	The final premium percentage is
Up to 133%	2.07%	2.07%

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<sup>5</sup> Jeff Drew and Ken Tysiac, "PPP forgiveness: No need to rush, and other tips," *Journal of Accountancy* website, July 24, 2020

<sup>6</sup> Revenue Procedure 2020-36, July 21, 2020, <https://www.irs.gov/pub/irs-drop/rp-20-36.pdf> (retrieved July 21, 2020)

In the case of household income (expressed as a percent of poverty line) within the following income tier:	The initial premium percentage is	The final premium percentage is
133% up to 150%	3.10%	4.14%
150% up to 200%	4.14%	6.52%
200% up to 250%	6.52%	8.33%
250% up to 300%	8.33%	9.83%
300% up to 400%	9.83%	9.83%

For 2021, the required contribution percentage for purposes of IRC §36B(c)(2)(C)(i)(II) and Reg. §1.36B-2(c)(3)(v)(C) is 9.83%.

## **SECTION: 170**

### **IRS POSITION TAKEN IN CASE OF UNRELATED TAXPAYER DOES NOT BIND AGENCY IN OTHER CASES**

#### **Citation: Belair Woods, LLC v. Commissioner, TC Memo 2020-112, 7/22/20**

It's been a rough summer for taxpayers attempting to dispute IRS disallowances of charitable contribution deductions for conservation easements under IRC §170(h). In the most recent case, the plaintiff was coming before the Court for the third time and, as with the last two, the IRS prevailed on the issue in front of the Tax Court.

In this case, the taxpayer in *Belair Woods, LLC v. Commissioner*, TC Memo 2020-112<sup>7</sup> was disputing the IRS's position that the easement in question failed the "protected in perpetuity" requirement under IRC §170(h)(5)(A). That provision and regulations<sup>8</sup> implementing the provision, require that the grant of the easement must, in the event

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<sup>7</sup> *Belair Woods, LLC v. Commissioner*, TC Memo 2020-112, July 22, 2020, <https://www.ustaxcourt.gov/UstcInOp2/OpinionViewer.aspx?ID=12291> (retrieved July 24, 2020)

<sup>8</sup> Reg. §1.170A-14(g)(6)

the easement is extinguished, provide the charity with a proportionate share of the proceeds upon a later sale of the property.

### ***Issues Previously Decided by the Court***

The deed that was the item being examined in this case provided for the following, as described in the opinion:

The deed recognizes the possibility that the easement might be extinguished at some future date. In the event the property were sold following judicial extinguishment of the easement, paragraph 17 provided that “[t]he amount of the proceeds to which Grantee shall be entitled, after the satisfaction of any and all prior claims, shall be determined, unless otherwise provided by Georgia law at the time, in accordance with the Proceeds paragraph.” Paragraph 19, captioned “Proceeds,” specified that the deed granted the Conservancy “a real property interest, immediately vested in Grantee,” and that this vested property interest entitled the Conservancy to receive, in the event of an extinguishment, a share of any future proceeds determined

by multiplying the fair market value of the Property unencumbered by this Conservation Easement (minus any increase in value after the date of this Conservation Easement attributable to improvements) by the ratio of the value of the Conservation Easement at the time of this conveyance to the value of the Property at the time of this conveyance without deduction for the value of the Conservation Easement. (emphasis was in the original document)<sup>9</sup>

The Court notes that this deed presents issues very similar to ones the Court had decided in the IRS’s favor in prior cases, specifically citing *BBM-Rose Hill, Ltd. v. Commissioner*, 900 F.3d 193 (5th Cir. 2018); *Oakbrook Land Holdings, LLC v. Commissioner*, 154 T.C. \_\_ (May 12, 2020); *Coal Prop. Holdings, LLC v. Commissioner*, 153 T.C. 126 (2019); and *Carroll v. Commissioner*, 146 T.C. 196 (2016).<sup>10</sup>

Two particular issues are noted by the Court. First, the Court notes that the deed does not give the charity a proportionate share of the gross sales proceeds, but rather only the proceeds reduced by any increase in value related to improvements:

First, the regulatory fraction used in the deed to determine the grantee’s proportionate share of post-extinguishment proceeds is applied, not to the full sale proceeds — an amount presumably equivalent to the FMV of the property at the time of sale — but to the proceeds “minus any increase in value after the date of this Conservation Easement attributable to improvements.” Thus, the grantee’s share is improperly reduced on account of (i) appreciation in the value of improvements existing when the easement was granted

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<sup>9</sup> *Belair Woods, LLC v. Commissioner*, TC Memo 2020-112, p. 5

<sup>10</sup> *Belair Woods, LLC v. Commissioner*, TC Memo 2020-112, pp. 2-3



plus (ii) the FMV of any improvements that the donor or its successors subsequently make to the property. By reducing the grantee's share in this way, the deed violates the regulatory requirement that the donee receive, in the event the property is sold following extinguishment of the easement, a share of proceeds that is "at least equal to the proportionate value that the perpetual conservation restriction at the time of the gift, bears to the value of the property as a whole at that time." See sec. 1.170A-14(g)(6)(ii), Income Tax Regs.

As we have noted previously, the requirements of this regulation "are strictly construed." *Carroll*, 146 T.C. at 212. Because the grantee in this case "is not absolutely entitled to a proportionate share of \* \* \* [the] proceeds" upon a post-extinguishment sale of the Property, the conservation purpose underlying the contribution is not "protected in perpetuity." *Coal Prop. Holdings, LLC*, 153 T.C. at 127, 139; accord, *Plateau Holdings, LLC v. Commissioner*, T.C. Memo. 2020-93, at \*23; *Oakbrook Land Holdings, LLC v. Commissioner*, T.C. Memo. 2020-54. The U.S. Court of Appeals for the Fifth Circuit has likewise sustained the disallowance of a charitable contribution deduction where the judicial extinguishment provision of an easement deed included a carve-out for donor improvements similar to that here. See *PBBM-Rose Hill*, 900 F.3d at 208.<sup>11</sup>

As well, the Court found the reduction for satisfaction of any and all prior claims also ran afoul of the regulations:

The easement deed here has a second problem, which was also present in *Coal Prop. Holdings*. The grantee's tentative share of the proceeds, as determined under paragraph 19 of the deed, is adjusted further by paragraph 17. It provides that the grantee's share will be determined under the Proceeds paragraph, but only "after the satisfaction of any and all prior claims." Prior claims against the sale proceeds might be held by various creditors of Belair or its successors.

It is not necessarily unreasonable for a deed to provide that prior claims may be paid from sale proceeds. What is unreasonable is the requirement that all prior claims be paid out of the grantee's share of the proceeds, even if those claims represent liabilities of Belair or its successors. See *Coal Prop. Holdings, LLC*, 153 T.C. at 145 n.5. Because the grantee's share of the proceeds is improperly reduced by carve-outs both for donor improvements and for claims against the donor, the deed's judicial extinguishment provisions do not satisfy the regulatory requirements.<sup>12</sup>

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<sup>11</sup> *Belair Woods, LLC v. Commissioner*, TC Memo 2020-112, pp. 9-10

<sup>12</sup> *Belair Woods, LLC v. Commissioner*, TC Memo 2020-112, pp. 10-11

But, the Court noted, the taxpayer raised other arguments that had not been dealt with before in this situation.<sup>13</sup>

***The IRS Was Taking a Position Inconsistent with One Taken in Prior Cases***

On June 27 we had looked at a taxpayer's unsuccessful attempt to hold the IRS to a position the IRS had previously conceded in earlier years in the case of *Audio Technica U.S., Inc. v. United States*, CA6, Case No. 19-3469.<sup>14</sup> The Court there held that the IRS's concessions in prior years as part of a settlement of those earlier year cases did not bar the IRS from asserting a different position in an examination of a later year that did proceed to trial.

In this case the taxpayer was not asserting the IRS had previously taken an inconsistent position with this taxpayer, but rather had accepted that such deed terms were acceptable via a stipulation in another unrelated taxpayer's case.

The decision describes the facts as follows:

Petitioner contends that judicial estoppel should prevent the IRS from disallowing Belair's deduction because, in an unrelated case, the Government stipulated that a deed with an analogous extinguishment clause satisfied the regulations. Petitioner directs our attention to *DMB Realco LLC v. United States*, Civil No. 16-1585-NVW (D. Ariz. filed May 23, 2016), where the IRS had disallowed a \$26.44 million charitable contribution deduction for a conservation easement. The parties filed a "joint stipulation of facts for purposes of summary judgment" in which they stipulated that the easement deed, originally conveyed in 2006, satisfied the "judicial extinguishment" regulation after the deed was amended in 2012. The Government concurrently filed a motion for summary judgment contending that the original, unamended deed controlled as to whether the taxpayer was entitled to a deduction. Before the court could hear argument on that motion, the parties reached a settlement that allowed the taxpayer a deduction of \$6.61 million.<sup>15</sup>

The Court notes that the concept of judicial estoppel is applicable in Tax Court cases, but only if particular conditions are met. Those conditions are stricter under the

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<sup>13</sup> *Belair Woods, LLC v. Commissioner*, TC Memo 2020-112, p. 2

<sup>14</sup> Ed Zollars, CPA, "IRS Not Barred From Challenging Item Agreed to in Prior Settlements," *Current Federal Tax Developments* website, June 27, 2020, <https://www.currentfederaltaxdevelopments.com/blog/2020/6/27/irs-not-barred-from-challenging-item-agreed-to-in-prior-settlements> (retrieved July 24, 2020)

<sup>15</sup> *Belair Woods, LLC v. Commissioner*, TC Memo 2020-112, p. 12

holdings of the Eleventh Circuit Court of Appeals if the matter involves a case to which the taxpayer was not a party, such as in this situation:

Judicial estoppel applies in the Tax Court. See *Huddleston v. Commissioner*, 100 T.C. 17, 28 (1993). Generally, three non-exhaustive factors guide our analysis when asked to invoke this doctrine. We consider whether: (1) “a party’s later position \* \* \* [is] ‘clearly inconsistent’ with its earlier position,” (2) “the party has succeeded in persuading a court to accept that party’s earlier position,” and (3) “the party seeking to assert an inconsistent position would derive an unfair advantage.” *New Hampshire v. Maine*, 532 U.S. 742, 750-751 (2001). Where (as here) a party seeks to invoke judicial estoppel on the basis of a prior proceeding to which it was not a party, the Court of Appeals for the Eleventh Circuit — to which an appeal of this case would appear to lie — instructs trial courts to apply a stricter, two-factor test. That test asks whether: “(1) the party took an inconsistent position under oath in a separate proceeding, and (2) the inconsistent positions were ‘calculated to make a mockery of the judicial system.’” *Slater v. U.S. Steel Corp.*, 871 F.3d 1174, 1181 (11<sup>th</sup> Cir. 2017) (quoting *Burnes v. Pemco Aeroplex, Inc.*, 291 F.3d 1282, 1285 (11<sup>th</sup> Cir. 2002)).<sup>16</sup>

The Tax Court found the taxpayers failed to meet this rather hefty burden:

None of these conditions is met here. The Government’s “earlier position” was simply a concession, and it evidently made that concession for the purpose of facilitating summary judgment on another theory that it deemed meritorious. Parties to litigation make concessions for all sorts of reasons unrelated to the underlying merits, and the Government’s action in the Arizona case was not “clearly inconsistent” with respondent’s current position. *Ibid.* (quoting *New Hampshire*, 532 U.S. at 750-751). Nor did the Government “persuad[e] a court to accept \* \* \* [its] earlier position.” *Ibid.* Because the Government made a tactical stipulation and ultimately settled the case, the District Court had no occasion either to accept or to reject the Government’s position. See *Kaplan v. Commissioner*, 795 F.3d 808, 813 (8<sup>th</sup> Cir. 2015), *aff’g* T.C. Memo. 2014-43. Finally, petitioner has not shown how the Government’s concession in the earlier case would allow it to derive “an unfair advantage,” see *New Hampshire*, 532 U.S. at 751, much less that it was “calculated to make a mockery of the judicial system,” see *Slater*, 871 F.3d at 1181; *Smith Lake, LLC v. Commissioner*, T.C. Memo. 2020-107.<sup>17</sup>

### ***Improvements Weren’t Part of the Donation***

The taxpayer next argued that the clause in the deed related to the improvements should be ignored as the “‘property that is the subject of [the] donation’ is simply ‘the

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<sup>16</sup> *Belair Woods, LLC v. Commissioner*, TC Memo 2020-112, pp. 12-13

<sup>17</sup> *Belair Woods, LLC v. Commissioner*, TC Memo 2020-112, pp. 13-14

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underlying land” and thus the value of the improvements can be ignored if a later sale took place.

The Court rejected this view of the donation:

We disagree. The donation of a conservation easement gives rise to a deduction only if it imposes “a restriction (granted in perpetuity) on the use which may be made of the real property.” Sec. 170(h)(2)(c). The “donation under this paragraph” thus consists of the use restrictions that are imposed in perpetuity by the easement deed. See sec. 1.170A-14(g)(6)(i), Income Tax Regs. The restrictions imposed by the easement deed necessarily apply, not only to the land, but also to any improvements made by the grantor pursuant to its reserved rights.

Here, the deed reserves to Belair the right to conduct forestry and agricultural activities, but it restricts the scale of those activities and the manner in which they may be performed. Para. 4(a) and (b). The deed reserves to Belair the right to “construct a limited number of new improvements,” but restricts that right in various ways. The deed specifies the permissible location of residential driveways and utility lines, including water, septic, and power lines. Para. 4(e)(i). Utility lines must be buried if possible “so as to minimize interference with the scenic nature” of the conserved area. *Ibid.* The installation of any irrigation system must not “interfere with the Conservation Values protected herein.” Para. 4(e)(ii).

“Utility and driveway placement and any construction performed shall be done in such a manner as to minimize damage to the environment and the Conservation Values.” Para. 4(e)(iii). “Roads, the driveway and utilities shall not be placed in locations which significantly interfere with the Conservation Values.” *Ibid.* Any ponds constructed may not exceed four acres in toto, may not “impact the ecological integrity of any wetlands [or] creek,” and are conditioned on the Conservancy’s approval as to location. Para. 4(f).

In short, the deed’s restrictions are imposed on the entirety of the conserved area — both the land and any improvements Belair makes to it. The “property that is the subject of \* \* \* [the] donation” thus includes both the land and its improvements. Sec. 1.170A-14(g)(6)(i), Income Tax Regs.; see *Hewitt v. Commissioner*, T.C. Memo. 2020-89, at \*18 (“The subject property refers to the property that is sold that generates the proceeds after the easement is extinguished.”). The proceeds that the Conservancy must receive upon a post-extinguishment sale of the subject property thus include the Conservancy’s proportionate share of proceeds attributable to improvements.<sup>18</sup>

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<sup>18</sup> *Belair Woods, LLC v. Commissioner*, TC Memo 2020-112, pp. 15-16

### ***Improvements Are Worthless***

The final argument we'll look at posits that any future improvements would not materially increase the value of the property, so this is a case of, as the Court puts it, "no harm, no foul."<sup>19</sup>

The Court doesn't accept this argument. One problem with such an argument is understanding why, if this would never matter, such a clause was put into the deed in the first place:

To start, petitioner's contention rests uneasily with the terms of the deed. Paragraph 4(a) reserves to Belair the right to "construct a limited number of new improvements" and enumerates the types of improvements that Belair may make. Paragraph 19 explicitly subtracts from the sale proceeds, and reserves to Belair, "any increase in value after the date of this Conservation Easement attributable to improvements." It is hard to understand why the draftsman would have included this language if Belair had believed that its anticipated improvements would not enhance the property's value. And it seems entirely plausible that they would do so: Roads, driveways, irrigation systems, water pipes, electric cables, and septic systems have value intrinsically and as furnishing essential services to Belair's adjoining residential parcels.<sup>20</sup>

Also, the language simply is at odds with the requirements of the regulations:

Deductions are a matter of legislative grace, and a taxpayer must prove its entitlement to the deductions it claims. *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79, 84 (1992). To be entitled to a deduction for the donation of a conservation easement, the donor must ensure that the donation "gives rise to a property right, immediately vested in the donee organization," to receive a proportionate share of the proceeds of any post-extinguishment sale. Sec. 1.170A-14(g)(6)(ii), Income Tax Regs. The deed here does not meet this test because it reserves to Belair the right to make "improvements" of obvious value and to retain all proceeds attributable to those improvements.<sup>21</sup>

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<sup>19</sup> *Belair Woods, LLC v. Commissioner*, TC Memo 2020-112, p. 16

<sup>20</sup> *Belair Woods, LLC v. Commissioner*, TC Memo 2020-112, p. 17

<sup>21</sup> *Belair Woods, LLC v. Commissioner*, TC Memo 2020-112, pp.17-18

## **SECTION: 1221**

### **SECOND CIRCUIT AGREES WITH TAX COURT, TAXPAYER'S PROPERTY WAS NOT USED IN A TRADE OR BUSINESS, LOSS ON SALE WAS CAPITAL**

**Citation: Keefe v. Commissioner, CA2, Case Nos. 18-2357, 18-2594, 7/17/20**

The question of whether real estate was or was not a capital asset in the hands of the taxpayer was the key issue in the case of *Keefe v. Commissioner*,<sup>22</sup> CA2, Case Nos. 18-2357, 18-2594, *affirming* TC Memo 2018-28. This issue comes up often with real estate, with taxpayers having a particular interest when they are unable to recover what they had invested in the property upon disposing of it.

#### ***The Tax Court Case***

In this case, the taxpayer was looking at a seven-figure loss on the sale of a historic waterfront mansion they had acquired to restore and attempt to rent in Newport, Rhode Island. The restoration ended up taking much longer than anticipated and was far costlier. Although they talked with a real estate agent about renting out the property to wealthy individuals who were expected to pay \$75,000 a month for the property during peak season, it was never actually rented out.

While the property was not formally listed for rent, the agent did talk with some of her clients about the potential to rent this property and one expressed interest in doing so. But the fact that the restoration was not yet complete meant the property was not actually available for rent during the vast majority of time the agent talked to her clients about doing so. Eventually the taxpayer abandoned attempts to rent out the house due to simple economic issues.

The taxpayers ran into financial difficulties in continuing the project, with the bank increasing the taxpayer's required monthly payment on the financing provided from \$25,000 to \$39,000 per month. The taxpayers decided to simply attempt to sell off the property, eventually agreeing to a short sale of the mansion for \$6.5 million.

The preparer of the taxpayer's original 2009 return listed the loss on sale as a capital loss which limited the actual ability to offset income other than capital gains to \$3,000 per year—a pittance when there is a seven-figure loss.

An estate planner the taxpayers met with apparently caused the taxpayer to question the preparer's treatment of the loss as a capital loss. Following that meeting the taxpayers

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<sup>22</sup> *Keefe v. Commissioner*, CA2, July 17, 2020, [https://www.ca2.uscourts.gov/decisions/isysquery/52af8fdb-0613-403b-a2f2-38621bb35839/6/doc/18-2357\\_opn.pdf#xml=https://www.ca2.uscourts.gov/decisions/isysquery/52af8fdb-0613-403b-a2f2-38621bb35839/6/hilite/](https://www.ca2.uscourts.gov/decisions/isysquery/52af8fdb-0613-403b-a2f2-38621bb35839/6/doc/18-2357_opn.pdf#xml=https://www.ca2.uscourts.gov/decisions/isysquery/52af8fdb-0613-403b-a2f2-38621bb35839/6/hilite/) (retrieved July 20, 2020)

hired another firm to prepare amended income tax returns. On the amended return for the year of sale, the taxpayers now treated the transaction as sale of a §1231 asset, generating a large ordinary loss and a similarly large net operating loss, which was carried back to 2004 and forward to 2010.

Though the IRS initially issued the refunds, the IRS later examined the 2009 return and took the position that, in fact, the loss was not a §1231 loss, but rather this was the sale of a capital asset.

The Tax Court, citing Second Circuit precedent, noted that for the property to be treated as property used in a trade or business the taxpayers must be engaged in “continuous, regular, and substantial activity in relation to the management of the property” as part of the rental activity.

The Court found that, in fact, there never was a rental activity. The Court notes:

While we have no doubt that petitioners devoted a great deal of time, effort, and expense to the renovation of Wrentham House Mansion, the record overwhelmingly confirms that Wrentham House Mansion was never held out for rent or rented after the restoration was complete. Quite simply, the rental activity with respect to Wrentham House Mansion never commenced in any meaningful or substantive way. The cases on which petitioners rely are distinguishable because in each case where a rental trade or business was found to exist, the taxpayer had already started the rental activity and had provided substantial and continuous rental-related services. See *Alvary*, 302 F.2d at 796; *Gilford v. Commissioner*, 201 F.2d at 736; *Pinchot v. Commissioner*, 113 F.2d at 719. In contrast, petitioners never started a rental trade or business involving Wrentham House Mansion. *Richmond Television Corp. v. United States*, 345 F.2d 901, 907 (4th Cir. 1965), vacated and remanded on other grounds, 382 U.S. 68 (1965); *Glotov v. Commissioner*, T.C. Memo. 2007-147, slip op. at 5 (holding that a taxpayer is not carrying on a trade or business until the business is functioning as a going concern and performing the activities for which it was organized).

Because petitioners did not commence or operate a rental activity with respect to Wrentham House Mansion during the years at issue, we hold that Wrentham House Mansion was a capital asset at the time of its sale. It follows that any gain or loss was derived from the sale of a capital asset and respondent properly disallowed the NOL carryovers.

The Court also sustained the imposition of the accuracy related penalty on the taxpayers in this case, finding they had not reasonably relied upon the advice of a professional:

Petitioners failed to prove that they had reasonable cause and acted in good faith within the meaning of section 6664(c)(1). Petitioners did not make a reasonable, good-faith effort to correctly assess their tax liabilities and their claimed reliance on a tax professional was both unreasonable and not credible. Petitioners’ attempt to recharacterize the tax treatment of their investment in Wrentham House Mansion



was opportunistic and appears to have been motivated by their financial problems and unpaid income tax liabilities. This attempted recharacterization had all the markings of being “too good to be true”, yet petitioners forged ahead, knowing that they had never actually commenced a rental activity involving Wrentham House Mansion and had not done all of the things the law required to be able to rent Wrentham House Mansion. Because petitioners failed to prove that they had reasonable cause for, and acted in good faith with respect to, the positions taken on their amended income tax returns and on their only return for 2010, we sustain respondent’s determination that they are liable for the section 6662 accuracy-related penalties.

While the Court doesn’t go into details regarding this matter, courts have often been less than sympathetic when a taxpayer gets conflicting advice on a position from professionals, then simply decides to believe the professional who comes up with most economically favorable answer.

The problem is that, to be able to rely on a professional, the taxpayer must make a reasonable attempt to determine which piece of advice is more credible. The burden is on the taxpayer to come up with a reason other than the tax savings for the reason they elected to believe the adviser for some reason other than getting a big refund when they followed that advice.

### ***Second Circuit Sustains Tax Court’s Decision***

The taxpayers appealed the Tax Court decision to the Second Circuit Court of Appeals, arguing the Tax Court had misapplied the case law interpreting the application of §§1221(a)(2) and 1231 when determining the house had not been used in a trade or business—specifically the trade or business of renting out real property.

The Second Circuit panel begins by looking at the standard for determining if there was a rental trade or business being undertaken:

Real estate rental is considered a “trade or business if the taxpayer- lessor engages in regular and continuous activity in relation to [renting] the property.” Although we have not identified an exhaustive list of factors to be used in this determination, we have considered the following: whether the taxpayer (or an agent) performs maintenance and repairs, whether the taxpayer employs labor to manage the property or provide tenant services, and whether the taxpayer purchases materials, collects rent, and pays expenses. The tax court also considered petitioners’ efforts to rent the property.

The panel concludes that, in fact, there was no trade or business conducted. The panel notes:

Applying this framework, we conclude that petitioners did not engage in “regular and continuous” rental activities because, as the tax court explained, they never commenced rental activity in a meaningful or substantive way. They did not advertise Wrentham House online, sign a lease with any potential tenant, furnish the property for rent after it was ready to occupy, comply with the notice and registration steps



required by the declaration of condominium to rent the property, or receive any rental payments or security deposits.

The panel notes that there were only limited attempts to rent the property, but continuous efforts to sell the property:

Petitioners did take some limited steps toward renting the property by engaging the rental agent, Burke. Burke first visited the house in 2006. Throughout 2007 and into 2008, she discussed prospective rentals with clients, including the one client who expressed interest but ultimately decided not to rent. But these rental efforts occurred only before the house was ready to occupy; Burke never listed the rental online, and the house was not held out for rent at any time after the restoration was complete.

Petitioners' insignificant efforts to rent Wrentham House stand in contrast to their significant efforts to sell it. Petitioners listed the house for sale continuously from 2004 to its ultimate sale in 2009, except for one week in 2008. Petitioners had the house appraised in 2005 and adjusted the list price at least five times, which suggests they were making real efforts to sell the property rather than creating a nominal listing simply because Bank of America required it for petitioners to take out a second mortgage.

The Court also took notice of the fact that although two tax credits were available for restoring the historic property, the taxpayers only pursued the one that was not contingent on renting the property:

In addition, petitioners' knowledge of the state and federal tax credits does not evince regular and continuous activity to rent the property. The state tax credit did not contain a rental requirement, so the fact that petitioners completed some steps toward obtaining that credit does not constitute any substantial step toward renting the property. Although petitioners were aware of the federal tax credit, which contained a rental requirement, they never sought it.