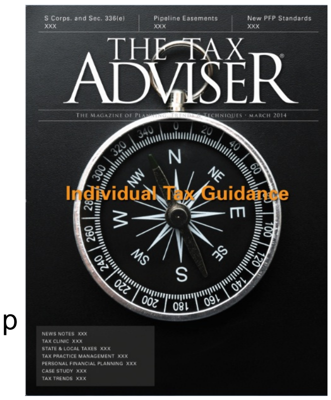
THE TAX ADVISER

Individual Taxation: Digest of Recent Developments: Part I

INDIVIDUALS

by David R. Baldwin, CPA; Lawrence H. Carlton, CPA; Karl L. Fava, CPA, Donna Haim, CPA; Jonathan Horn, CPA; Susanne Morrow, CPA; S. Miguel Reyna, CPA; Kenneth L. Rubin, CPA; Kaye F. Sheridan, DBA, CPA; Amy M. Vega, CPA; and Donald J. Zidik Jr., CPA
Published March 01, 2014

EXECUTIVE SUMMARY



- In the wake of the *Windsor* decision, the IRS explained that same-sex and opposite-sex individuals who are in registered domestic partnerships, civil unions, or other similar formal relationships that are not marriages under state law are not considered married for federal tax purposes.
- A Wisconsin district court judge held that the Sec. 107(2) exclusion for rental allowances paid to ministers as part of their compensation violates the Establishment Clause of the First Amendment to the U.S. Constitution.
- Sec. 108(a)(1)(E), which expired at the end of 2013, excluded up to $2 million of discharge of qualified principal residence indebtedness from gross income.
- The Tax Court in a number of decisions reiterated the rule that a noncustodial parent may not claim a dependency exemption for a child unless the parent attaches to his or her return a Form 8332, *Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent*, signed by his or her ex-spouse.

This article is Part I of a two-part article covering recent developments affecting taxation of individuals, including regulations, cases, and IRS guidance. The items are arranged in Code section order. This part covers Sec. 1, *Tax Imposed*, through Sec. 170, *Charitable, etc., Contributions and Gifts*. Part II, which will appear in the April issue, will cover developments from Sec. 183, *Activities Not Engaged in for Profit*, through Sec. 7703, *Determination of Marital Status*.

Sec. 1: Tax Imposed (Filing Status)

In a district court case, the taxpayer testified in a deposition that his daughter stayed with him a couple of months during the year, mostly over holidays, and that he did not have primary physical custody of his daughter.[1] The taxpayer could not prove he provided more than half of his daughter's support or other facts to support that she was his dependent. Therefore, the court denied the taxpayer head-of-household filing status and the dependency exemption for his daughter.

Sec. 24: Child Tax Credit

When a taxpayer filed a Chapter 7 bankruptcy petition on Oct. 30, 2012, the bankruptcy trustee asked to see her 2012 tax return when it was filed. The taxpayer was due a refund of $2,762, of which $2,000 was from a child tax credit she had claimed on her Form 1040, *U.S. Individual Income Tax Return*. The trustee told the taxpayer that the full amount of the refund was part of the bankruptcy estate, but the taxpayer claimed the $2,000 child tax credit was exempt because it was a public assistance benefit designed to assist families with dependent children in meeting their obligations, which was exempt from the bankruptcy estate under Maine law. The bankruptcy court distinguished the child tax credit, which is not a refundable credit, from the additional child tax credit, which is, and concluded that the child tax credit was not exempt for bankruptcy purposes.[2] The taxpayer was required to pay the 2012 tax refund to the bankruptcy estate.

In a district court case, the taxpayer was denied the child tax credit for a disabled daughter over the statutory age limit of 16.[3] The child tax credit makes no exceptions for disability.

Sec. 36: First-Time Homebuyer Tax Credit

Although the first-time homebuyer tax credit has expired, cases involving it continue to be litigated. In a case decided by the Court of Federal Claims, a divorced taxpayer was denied the first-time homebuyer tax credit because his new home was purchased before his divorce decree was final.[4] The taxpayer was considered to have a beneficial ownership interest in his ex-wife's home because he was still considered married when his new home was purchased. Therefore, he was not considered a first-time homebuyer.

Sec. 61: Gross Income Defined

Guidance directed at virtual currency users was issued by the Treasury Department's Financial Crimes Enforcement Network.[5] Individuals use these virtual currencies (the most well-known one is Bitcoin) to purchase real or virtual goods or services or as payment for goods and services, or they sell them for use as real currency. Bitcoin use has been unregulated and untraceable. There is the beginning of an attempt to regulate the use of this virtual currency by requiring money transmitter licensing. Some have speculated that the IRS might have to issue guidance on the use of this currency, but it appears that bitcoins would be included in income under Sec. 61, which defines gross income as "all income from whatever source derived."

Sec. 62: Adjusted Gross Income Defined

In an Office of Chief Counsel Internal Revenue Service Memorandum, the IRS discusses the tax treatment of attorneys' fees paid under a settlement of employee lawsuits.[6] In general, attorneys' fees recovered must be included in gross income when the underlying recovery is taxable. Sec. 62(a)(20) allows for an above-the-line deduction for attorneys' fees and court costs paid in connection with any action involving a claim of unlawful discrimination. Sec. 62(e) defines unlawful discrimination and lists various federal, state, and local laws that fall under this definition. Attorneys' fees and costs incurred in an action involving an employment relationship are deductible as an above-the-line deduction under Sec. 62(e)(18). If attorneys' fees are not deductible above the line because they are not received in connection with an action involving a claim of unlawful discrimination, they may still be deducted as miscellaneous itemized deductions subject to the 2% floor. For taxpayers subject to the alternative minimum tax, this deduction is not permitted.

Sec. 63: Taxable Income Defined

After the Supreme Court struck down Section 3 of the Defense of Marriage Act (DOMA)[7] in *Windsor*,[8] the IRS ruled that same-sex couples who are legally married under state or foreign laws are considered married for federal tax purposes, regardless of where they live. However, according to an FAQ section on the IRS website, same-sex and opposite-sex individuals who are in registered domestic partnerships, civil unions, or other similar formal relationships that are not *marriages* under state law are not considered married for federal tax purposes.

The IRS position seems clear that registered domestic partners are not married for federal tax purposes and thus are not able (or required) to file federal tax returns with a filing status of married filing jointly or separately. One example of a tax provision that applies to married individuals but not domestic partners is Sec. 63(c)(6)(A), which generally prohibits a taxpayer from itemizing deductions if the taxpayer's spouse claims the standard deduction. This rule does not apply to registered domestic partners since they are not considered spouses for federal tax purposes. A registered domestic partner can itemize deductions or claim the standard deduction regardless of whether his or her partner itemizes or claims the standard deduction.

Sec. 66: Treatment of Community Income

Another provision that does not apply to registered domestic partners is Sec. 66, which deals with treatment of community income. Sec. 66 applies only to married taxpayers and does not apply to registered domestic partners since they are not married for federal tax purposes, according to the IRS's FAQs for registered domestic partners and individuals in civil unions.[9]

The IRS has issued temporary regulations that incorporate changes made in Notice 2011-70[10] in the deadline for requesting equitable innocent spouse relief, which also applies to relief from joint liability for community property income under Sec. 66(c).[11] Instead of a two-year deadline, a request for relief must be filed with the IRS within the period of limitation for collection of tax.

Under Sec. 66(c), married taxpayers who do not file a joint federal income tax return but are nonetheless liable for community income because they live in a community property state can request relief from joint liability in two ways. In a community property state, each spouse is responsible for the tax on one-half of all the community property income for the year. Traditional relief from joint liability has been allowed under Sec. 66(c) to a requesting spouse on income that the requesting spouse did not know existed and had no reason to know existed. If a requesting spouse fails to satisfy those requirements, the IRS has discretion to grant equitable relief. The eligibility requirements used for granting equitable relief are the same for Sec. 66(c) and for Sec. 6015(f). As a result, the IRS has applied the same two-year deadline for spouses to file for equitable relief in community property states and will now apply the new longer deadline to Sec. 66(c) equitable relief cases.

Sec. 67: 2% Floor on Miscellaneous Itemized Deductions

The Tax Court allowed a taxpayer to deduct her tax preparation fees, based on her verbal testimony of the amount paid, even though there were many inconsistencies at trial.[12] The amount deductible, however, was subject to the 2%-of-adjusted-gross-income floor limitation under Sec. 67(a).

Sec. 71: Alimony and Separate Maintenance Payments

An above-the-line deduction may be claimed for alimony or separate maintenance payments during the tax year if those payments meet the following requirements:

- The payments must be made under a divorce or separation agreement (Sec. 71(b)(1)(A));
- The agreement must not specifically designate the payment as not includible in the recipient spouse's gross income under Sec. 71 and not deductible by the payer spouse under Sec. 215 (Sec. 71(b)(1)(B));
- Legally separated spouses under a decree of divorce or separate maintenance must not be members of the same household when payments are made (Sec. 71(b)(1)(C)); and
- The payer's obligation to make the payment must end at the death of the payee spouse (Sec. 71(b)(1)(D)).

After examining the facts in a case before it and Florida case law, the Tax Court determined that the taxpayers did not satisfy the Sec. 71(b)(1)(D) requirement that the payer's obligation end at the death of the payee spouse and therefore were not entitled to deduct the payment as alimony.[13]

In another case, voluntary monthly payments made to a joint checking account under a predivorce draft separation agreement did not constitute deductible alimony payments under Sec. 71. The Tax Court held that letters between the taxpayer and his former spouse did not satisfy the written separation agreement requirement and did not create a "meeting of the minds."[14] Prior case law has established that a written separation agreement requires a clear statement in written form memorializing the terms of support between the parties. Letters that do not show a meeting of the minds between the parties cannot collectively constitute a written separation agreement.

Sec. 72: Annuities; Certain Proceeds of Endowment and Life Insurance Contracts

The Tax Court upheld an additional 10% tax imposed on an early IRA distribution.[15] The taxpayer claimed she met the exception for distributions to first-time homebuyers; however, the court found that she failed to prove that she owned the property. Only the taxpayer's brother was listed on the deed, and there was no other executed written agreement with the brother showing her ownership interest.

In a private letter ruling, the IRS ruled that the taxpayer modified his previous election to receive a series of substantially equal periodic payments by rolling over some of his IRA funds into a different IRA at another bank.16 As a result of this transfer, the taxpayer was assessed an early withdrawal recapture penalty that could not be corrected by rolling the funds back into the original IRA.

In a case decided by the Fifth Circuit, the taxpayer filed a timely but unsigned tax return that reported an early retirement plan distribution.17 The taxpayer was assessed a 10% additional tax on the early retirement distribution and a late filing penalty for filing an unsigned return (which he subsequently signed after the filing deadline had passed). The taxpayer was unable to offer any substantial proof that he did not receive this early distribution. Because the Tax Court determined that positions taken in a signed tax return may be treated as admissions, the court upheld the 10% additional tax.

In a Tax Court case, the taxpayer claimed that an early distribution from a retirement plan should not be subject to the additional 10% tax because it met the exception for deductible medical expenses.18 The taxpayer did not itemize the alleged medical expenses on his tax returns and was unable to offer any proof to substantiate the expenses. The Tax Court upheld the 10% additional tax.

In another private letter ruling, the IRS determined that disability benefits paid by a public employer retirement system under a statute would not constitute gross income to the recipient to the extent the benefits did not exceed two-thirds of the employee's average final compensation.19 However, to the extent the payments did exceed the two-thirds amount, it was considered gross income to the recipient under Sec. 72.

Sec. 83: Property Transferred in Connection With Performance of Services

In a private letter ruling, the IRS determined that the taxpayer's request to revoke a Sec. 83(b) election should be allowed since the request was properly made within the 30-day time period following the initial election.20

The Eleventh Circuit affirmed the Tax Court's ruling in the *Davis* case that stock the father/shareholder received upon the exercise of a nontransferable stock option granted to him by the family-held S corporation was a transfer in connection with the performance of services under Sec. 83(b).21 The Tax Court's findings that the options were granted to the father to secure his continued involvement in the management of the family business and to preserve his ownership interest and that the grant was not part of a plan to resolve the father's divorce dispute were upheld. The Tax Court's method of valuing the exercised shares was also upheld. As a result of the finding that the income was properly taxed to the father, the company's deduction for this amount was proper.

Sec. 104: Compensation for Injuries or Sickness

Several recently issued private letter rulings deal with Sec. 104, which provides that gross income does not include amounts received under workers' compensation acts as compensation for personal injuries or sickness; the amount of any damages received (whether by suit or agreement) on account of personal physical injuries or physical sickness, except for amounts attributable to (and not in excess of) deductions allowed under Sec. 213 for medical expenses for any prior tax year; and amounts received through accident or health insurance (or through an arrangement having the effect of accident or health insurance) for personal injuries or sickness (other than amounts received by an employee, to the extent such amounts are attributable to contributions by the employer that were not includible in the gross income of the employee, or are paid by the employer).22 Each of these rulings confirmed that the damages or other compensation the taxpayer received that were related to physical injury were properly excluded from the taxpayer's gross income.

Sec. 107: Rental Value of Parsonages

Sec. 107 provides that gross income does not include the rental allowance paid to a minister as part of his or her compensation, to the extent the allowance is used to rent or provide a home. For a minister to be eligible for this exclusion, several other requirements must be met. In one case, the Tax Court found that the minister was not entitled to an exclusion under Sec. 107 because he was unable to show that the allowance was designated in an official action between the minister and the church as required under Regs. Secs. 1.107-1(a) and (b).[23]

In November, a district court judge in Wisconsin held that the Sec. 107(2) exclusion for rental allowances paid to ministers as part of their compensation violates the Establishment Clause of the First Amendment to the U.S. Constitution "because the exemption provides a benefit to religious persons and no one else, even though doing so is not necessary to alleviate a special burden on religious exercise."[24]

Sec. 108: Income From Discharge of Indebtedness

A roofing supply company employee took a series of loans that were to be repaid from future bonuses from the company. After experiencing financial difficulties, the company was sold. Since the taxpayer was no longer an employee of the company, he was issued a Form 1099-MISC, *Miscellaneous Income*, by his former employer, the new company, showing the amount of the loans as nonemployee compensation paid in the current year. The taxpayer did not report the income on his tax return, claiming it was a discharge of indebtedness that was not taxable because he was insolvent. The Tax Court agreed with the taxpayer, finding that the Form 1099-MISC memorialized the new company's decision to forgive the debt, and that the new company made a bookkeeping error when it classified the forgiven debt as nonemployee compensation.[25]

Married taxpayers were required to recognize ordinary income from cancellation of a portion of a note secured by residential property because the income realized on the discharge of debt was clearly ordinary income taxed at ordinary rates.[26] The Tax Court also disagreed with the taxpayers' alternative argument that the discharge of indebtedness qualified to be excluded from income as principal residence indebtedness because the taxpayers did not use any of the note proceeds to finance the construction or substantial improvement of the property or to refinance a debt that was incurred to construct or improve the residence.

In October 2013, the IRS released Publication 4681, *Canceled Debts*, *Foreclosures*, *Repossessions, and Abandonments (for Individuals)*. The publication explains the federal tax treatment of canceled debts resulting from foreclosures, repossessions, and abandonments.

At the end of 2013, Sec. 108(a)(1)(E), which excludes up to $2 million of discharge of qualified principal residence indebtedness from gross income, expired. Under the provision, the debt must have been used to acquire, construct, or substantially improve the taxpayer's principal residence or to refinance the debt and must have been secured by the residence. This provision applied to discharges after Dec. 31, 2006, and before Jan. 1, 2014.

In Letter Ruling 201328023,[27] the IRS found that a taxpayer qualified for the exclusion from income of discharged qualified principal residence indebtedness under Sec. 108(a)(1)(E). The taxpayer used the loan proceeds to purchase an apartment unit in a cooperative apartment complex next to the one she owned and to finance structural renovations and improvements to combine the two units into a single apartment. The taxpayer refinanced the loan and then settled the debt for an amount less than the principal amount. The IRS determined that the amount equal to the outstanding principal balance on the first loan before refinancing constituted acquisition indebtedness under Sec. 163(h)(3)(B).

In Letter Ruling 201338007,[28] the IRS granted the taxpayers a 45-day extension from the date of the letter to file an amended return to make the election under Sec. 108(c)(3)(C) (qualified real property indebtedness) and Regs. Sec. 1.108-5(b) (time and manner for making election).

The election is to be made on Form 982, *Reduction of Tax Attributes Due to Discharge of Indebtedness (and Sec. 1082 Basis Adjustment)*. The taxpayers, husband and wife, each received a Schedule K-1 from an LLC in which each owned an interest. The K-1s showed cancellation-of-debt (COD) income and a note stating that the partners might be able to exclude some or all of it, but the firm that prepared the taxpayers' income tax return failed to make the Sec. 108(c)(3)(C) election. While preparing the taxpayers' next tax return, the firm discovered that the current-year Schedules K-1 from the LLC reduced the taxpayers' tax basis capital accounts and reduced the taxpayers' proportionate interest in the adjusted basis of the LLC's depreciable property as though the Sec. 108(c)(3)(C) election had been made. After this was discovered, the taxpayers submitted a request for an extension of time to make the election.

In Letter Ruling 201325004,[29] the IRS granted the taxpayer an extension of 45 days from the date of the letter to file an amended return to make the election under Sec. 108(c)(3)(C). The taxpayer owned an interest in an LLC treated as a partnership for tax purposes and was the sole owner of an S corporation that owned the remaining interest in the LLC. The LLC realized COD income but did not report the COD income on its Form 1065, *U.S. Return of Partnership Income*. The taxpayer also did not include the COD income on his tax return. After discovering the error, the taxpayer requested an extension of time to make the election. The IRS concluded that the taxpayer acted reasonably and in good faith and granted the extension. (The IRS granted an extension to taxpayers in a similar situation in two additional letter rulings, 201316009 and 201316010.[30])

Secs. 151–153: Personal Exemptions

In a Tax Court case, a noncustodial father claimed a dependency exemption for two of his three children, as well as a child tax credit and head-of-household filing status on his 2009 tax return.[31] Under the divorced couple's 2003 "Judgment of Absolute Divorce," the mother had primary residential custody of their three children, but the dependency exemption deductions for the three children would be divided between the two parents. Specifically, in odd-numbered years the mother was entitled to claim the two younger children as dependency exemptions, and the father was entitled to claim the remaining child; in even-numbered years, the exemptions were reversed. The mother's entitlement to any dependency exemption, however, was contingent on her being employed and earning income, while the father's entitlement to any dependency exemption was contingent on his staying current with his child support payments. Although the mother's entitlement to any dependency exemption was contingent on her being employed, she was not required to sign Form 8332, *Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent*.

The father stayed current on his child support payments, and he contended that he was entitled to claim dependency exemptions for all three children (although he mistakenly claimed only two children) for the 2009 tax year because the mother had been unemployed that year. However, the mother also claimed dependency exemptions for two of the children, and the IRS issued a notice to the father disallowing the exemption deduction for the child both had claimed, the child tax credit, and head-of-household filing status.

The father could not claim his children as dependents based on the general "qualifying child" requirements because the children primarily lived with their mother. However, in the case of divorced parents, special rules determine which parent may claim a dependency exemption deduction for a child.[32] Under these rules, the father may claim a "qualifying child" if:

1. The child receives more than one-half of the child's support during the calendar year from the child's parents who are divorced under a decree of divorce;

2. The child was in the custody of one or both parents for more than one-half of the calendar year;

3. The custodial parent signs a written declaration that she will not claim the child as a dependent for any tax year beginning in that calendar year; and

4.The noncustodial parent attaches the written declaration to his return for the appropriate tax year.

The father's claim failed because there was never any written declaration that the mother would not claim a dependency exemption for the disputed child. The court agreed that under the conditions set out in the divorce judgment, the father was entitled to claim dependency exemptions for all three children. However, the father cannot claim any of his children as dependents qualifying for exemptions without Form 8332 or an equivalent document signed by the mother and attached to the father's tax return. Therefore, the father was denied dependency exemptions for all three of his children on his 2009 tax return, as well as the child tax credit and head-of-household status.

In another Tax Court case, the taxpayer supported a minor child in 2010 and subsequently claimed a dependency exemption for the child on his 2010 federal income tax return.[33] Based on this dependency exemption, the taxpayer also claimed head-of-household status, the child tax credit, and the earned income tax credit (EITC). The IRS allowed his claim for a dependency exemption along with his head-of-household status. However, the child tax credit and the EITC were disallowed.

The court evaluated whether the taxpayer was allowed either tax credit based on the "qualifying child" requirements for both the child tax credit and the EITC. The child met all requirements to be his "qualifying child" except for one—the child was not related to the taxpayer. The court concluded that had the taxpayer adopted the child, the taxpayer would have been eligible for the child tax credit as well as the EITC. However, since the child did not meet all requirements to be considered the taxpayer's "qualifying child," the taxpayer could not claim either tax credit. Therefore, although he was allowed a dependency exemption for the minor child as well as head-of-household status, he was not allowed to claim the child tax credit or the EITC.

A number of issues were addressed in *Golit*,[34] including whether the taxpayer was entitled to a dependency exemption for a specific individual she identified on her return as her son and whether she was entitled to file using head-of-household status.

The taxpayer failed to prove that she was entitled to a dependency exemption for the unrelated person she claimed was her son. He was not her biological son and, in fact, was only two years younger than she was. The court did not find the taxpayer's claim that he was her adopted son credible, nor did she provide any documentation to support this claim. In addition, the taxpayer was not able to show that he was a member of her household during the year under audit, stating only that he lived with her "temporarily" and with friends the rest of the year. Therefore, the taxpayer did not prove that he satisfied the requirements for her to claim him as a dependent. Because the court found that the person was not her dependent, it also found she was also not entitled to claim head-of-household status.

In *White*,[35] the taxpayer was determined to be the custodial parent and entitled to claim her children as dependents, even though she did not file a Form 8332 and her husband was identified as the custodial parent in the separation agreement. During the years in question, the taxpayer and her ex-husband shared custody of their two children. During 2010, both children lived with the taxpayer for more than one-half of the year. During 2011, only one of the children lived with her more than one-half of the year. During both years, the taxpayer provided more than one-half of the support for the children who lived with her.

For both 2010 and 2011, the taxpayer filed as head of household and claimed dependency exemptions for the children who lived with her in the respective years. The IRS disallowed the filing status and dependency exemptions because the taxpayer did not file Form 8332 signed by her husband, and he was listed as the custodial parent. The Tax Court disagreed that the taxpayer was required to file Form 8332. Both the IRS and Tax Court were relying on Sec. 152(e), which provides circumstances where the noncustodial parent may claim a child as a dependent. The IRS's position was that Sec. 152(e) required Form 8332 to be filed. The court, however, indicated that Secs. 152(e)(4)(A) and (B) defined the custodial parent as the parent who had custody the greater portion of the year. The noncustodial parent is defined as the parent who is not the custodial parent. Regs. Sec. 1.152-4(d) defines custodial as the parent with whom the child spends the most nights during the year and the noncustodial parent as the parent who is not the custodial parent. Because the taxpayer met the requirements to be the custodial parent, the court held that the taxpayer was not required to file Form 8332 and was entitled to the dependency exemptions as claimed.

In *Haskett*,[36] the taxpayers contended they were entitled to a dependency exemption on their 2008 return for the support of the wife's mother. In late 2007, her mother moved from her own home to the petitioners' home due to failing health. The wife assisted her mother with daily activities and transportation to her medical appointments until May 2008. At this time, her mother moved to a nursing home. The taxpayers claimed they incurred $13,000 of expenses in support of the mother, including monthly payments for her stay at the nursing home and admission, daily living expenses, property taxes and insurance for her home, and funeral expenses. However, they were unable to substantiate these payments.

The mother received Social Security and Medicare benefits and payments from the state of Florida and the U.S. Department of Veterans Affairs, which were paid directly to the nursing home. The taxpayers indicated the Social Security benefits were used solely to maintain the mother's residence, but they offered no substantiation to prove it.

The IRS disallowed the dependency exemption, asserting that the taxpayers had not proved they provided more than half of the mother's support. The court upheld the IRS's determination because it agreed that the petitioners did not establish that she qualified as their dependent. For a parent to be a qualifying relative, Sec. 151(d) requires that the parent's gross income for the year be less than the exemption amount and that the taxpayer provide more than one-half of the parent's support. Any contribution by the parent toward her own support, including income excluded from gross income, must be taken into consideration in determining whether the support test is met.[37] The mother's total income for 2008 was approximately $11,000, and the taxpayers did not establish that they provided more than one-half of her support for that year. Therefore, she did not meet the qualifying relative requirement for the dependency exemption.

Sec. 162: Trade and Business Expenses

In a Tax Court decision, the taxpayer claimed vehicle expenses of $9,950, travel expenses of $16,975, and continuing medical education (CME) expenses of $3,000 on his Schedule C, *Profit or Loss From Business (Sole Proprietorship)*.[38] In the year in question, he worked as a doctor for a medical staffing service from which he received a Form W-2, *Wage and Tax Statement*, and worked for a different medical staffing service as an independent contractor. He lived and maintained his primary residence in Florida.

As an independent contractor, he provided medical services in Arizona on an Indian reservation. The group he contracted with asked that he stay at a given hotel; however, he would stay at a variety of locations. In the year in question, he made five trips to Arizona.

In his role as an employee, he worked at a number of hospitals and clinics in different locations. He would drive to the various locations. Although he used his automobile on a regular basis, he did not keep a daily mileage log.

Under examination, the IRS denied all of the travel and CME expenses for lack of substantiation. The vehicle expenses were for travel either between his home and various hospitals and clinics in his capacity as an employee or between the different clinics he worked at. Although he kept no daily mileage log, the taxpayer presented his daily diary, indicating the dates he attended patients at each of the locations. The IRS argued that the Sec. 274(d) substantiation requirements required him to keep a daily log and that the transportation between his home and the clinics and hospitals represented nondeductible commuting expenses. Although he did not keep a daily mileage log, the court found that the taxpayer was a credible witness and accepted his testimony about the miles he drove between various work sites. Therefore, it allowed him a deduction (on Schedule A, *Itemized Deductions*, as an unreimbursed employee business expense) for that travel. However, it disallowed the taxpayer's claimed deduction for his expenses for travel between home and his place of work because they were nondeductible commuting expenses.

In another case, the taxpayer was in the regular business of being a mortgage broker.[39] In the years 2005 and 2006, she claimed that she was also in the business of being a securities trader. As a result, she deducted as ordinary and necessary business expenses all of the expenses she incurred for her securities trading. Because her level of trading activity did not rise to the level of being a trader, the Tax Court disallowed all of those expenses.

In making the determination, the court looked at the number of trades the taxpayer executed, the amount of money involved in those trades, and the number of days out of the total available number of trading days that the taxpayer executed trades. Based on its review of these factors, the court found that her trading activities did not rise to the level of a trade or business.

The case highlights that for a taxpayer to be able to deduct the expenses of a trading activity as trade or business expenses, the activity must be significant, both in number of trades and money involved, and be conducted on a regular basis throughout the year. Otherwise, the expenses are limited to deductions for the production of income, which are Schedule A miscellaneous itemized deductions that generally have less tax benefit.

Sec. 170: Charitable Contributions

In 2004, a married couple donated $99,000 in cash and a conservation easement valued at $999,000 to a qualified charitable organization, the National Architectural Trust (NAT). The husband had learned from a neighbor who had made a similar contribution to the NAT and had received a "side letter" that promised to return the contributions if the IRS successfully challenged the deductibility of the contribution. At that time, the NAT had a policy of providing these side letters, and it assured the taxpayers before they made their gift that it believed this refund offer would not jeopardize their claim to a charitable deduction. The taxpayers made the contribution in late 2004 and received the side letter. The Tax Court concluded that the side letter constituted a condition on the gift that was not "so remote as to be negligible"[40] and that therefore the contribution was not deductible, as a conditional gift. The court found that the IRS was likely to challenge the contribution deduction due to the side letter and that although the letter was unenforceable under federal tax law because it was not recorded with the deed upon transfer, the organization could and would honor its refund offer.

Another issue in the *Golit*[41] case discussed above was the allowance of a charitable deduction. The taxpayer had her charitable contribution disallowed in full. The gift was to a Catholic church in Nigeria. Citing Sec. 170(c)(2)(A), the court held that a deduction for a charitable contribution was allowed only for donations to charities "created or organized in the United States . . . or under the law of the United States." That the church was affiliated ecumenically with U.S. churches was not sufficient to allow deductibility.

Footnotes

[1] *Hart*, No. 2:11-CV-00513-EJL (D. Idaho 6/6/13).

[2] *Tetrault*, No. 12-21373 (Bankr. Me. 7/9/13).

[3] *Rodriguez*, No. H-12-0049 (S.D. Tex. 6/4/13).

[4] *Triggiani*, 112 Fed. Cl. 349 (2013).

[5] FIN-2013-G001.

[6] Field Attorney Advice 20133501F (8/30/13).

[7] Defense of Marriage Act, P.L. 104-199.

[8] *Windsor*, 133 S. Ct. 2675 (2013).

[9] FAQs for registered domestic partners and individuals in civil unions, available here.

[10] Notice 2011-70, 2011-32 I.R.B. 135.

[11] Prop. Regs. Secs. 1.66-4 and 1.66-5, issued in REG-132251-11 (8/13/13).

[12] *Wright*, T.C. Memo. 2013-129.

[13] *Nye*, T.C. Memo. 2013-166.

[14] *Faylor*, T.C. Memo. 2013-143.

[15] *Ung*, T.C. Memo. 2013-126.

[16] IRS Letter Ruling 201323045 (6/7/13).

[17] *Fonteneaux*, No. 12-60418 (5th Cir. 8/23/13).

[18] *McGraw,* T.C. Memo. 2013-152. See also *Richards*, T.C. Memo. 2013-171.

[19] IRS Letter Ruling 201315001 (4/12/13).

[20] IRS Letter Ruling 201322007 (5/31/13).

[21] *Davis*, No. 12-10916 (11th Cir. 5/16/13), aff'g T.C. Memo. 2011-286.

[22] IRS Letter Rulings 201313018 (3/29/13), 201317007 (4/26/13), and 201318001 (5/3/13).

[23] *Rogers*, T.C. Memo. 2013-177.

[24] *Freedom From Religion Foundation, Inc. v. Lew*, No. 11-cv-626-bbc (W.D. Wis. 11/21/13).

[25] *McAllister*, T.C. Memo. 2013-96.

[26] *Callahan*, T.C. Memo. 2013-131.

[27] IRS Letter Ruling 201328023 (7/12/13).

[28] IRS Letter Ruling 201338007 (9/20/13).

[29] IRS Letter Ruling 201325004 (6/21/13).

[30] IRS Letter Rulings 201316009 and 201316010 (4/19/13).

[31] *Shenk*, 140 T.C. No. 10 (2013).

[32] Id., citing Sec. 152(e) and *Espinoza*, T.C. Memo. 2011-108.

[33] *Cooper*, T.C. Summ. 2013-59.

[34] *Golit*, T.C. Memo. 2013-191.

[35] *White*, T.C. Summ. 2013-77.

[36] *Haskett*, T.C. Summ. 2013-76.

[37] Regs. Sec. 1.152-1(a)(2)(ii).

[38] *Haskett*, T.C. Summ. 2013-76.

[39] *Nelson*, T.C. Memo. 2013-259.

40 *Graev*, 140 T.C. No. 17 (2013), quoting Regs. Sec. 1.170A-1(e).

41 *Golit*, T.C. Memo. 2013-191.

EditorNotes

David Baldwin is a partner with Cleveland Estes Avellone PLLC in Phoenix. Lawrence Carlton is director of taxes with Carlton & Duran CPAs PC in Bedford, Mass. Karl Fava is a principal with Business Financial Consultants Inc. in Dearborn, Mich. Donna Haim is a tax manager with Harper & Pearson Co. PC in Houston. Jonathan Horn is a sole practitioner specializing in taxation in New York City. Susanne Morrow is a tax partner with Ernst & Young LLP in San Francisco. Miguel Reyna is the sole owner of Reyna CPAs PLLC in Dallas. Kenneth Rubin is a partner with RubinBrown LLP in St. Louis. Kaye Sheridan is a professor and director of the Troy University School of Accountancy in Troy, Ala. Amy Vega is a senior tax manager with Grant Thornton LLP in New York City. Donald Zidik is a senior manager with Marcum LLP in Needham, Mass., and an adjunct professor of taxation at Suffolk University in Boston. Mr. Horn is chair and the other authors are members of the AICPA Individual and Self-Employed Tax Technical Resource Panel. For more information about this article, contact Mr. Horn at jmhcpa@verizon.net.