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Highlights

IRS Issues FAQ Guidance on Negative Tax Basis Capital Account Reporting: The IRS has issued guidance in the form of an FAQ on the new negative tax basis capital account reporting requirement added to the 2018 Form 1065 instructions. The instructions require partnerships to report partners' tax basis capital accounts on Line 20 of Schedule K-1 if those amounts are negative at either the beginning or ending of the year. Notice 2019-20 provides penalty relief for some partnerships that fail to report the amounts. The FAQ defines a partner's tax basis capital account, explains how it is calculated with examples, and provides a safe harbor that allows partnerships to calculate a partner's tax basis capital account by subtracting the partner's share of partnership liabilities under IRC Sec. 752 from the partner's outside basis. The FAQ can be accessed at www.irs.gov/businesses/partnerships/form-1065-frequently-asked-questions .

IRS Issues Proposed Regulations on Electing Small Business Trusts: Thanks to the Tax Cuts and Jobs Act (TCJA), a Nonresident Alien (NRA) is now permitted to be a potential current beneficiary of an Electing Small Business Trust (ESBT) [IRC Sec. 1361(c)(2)(B)(v)]. To provide clarity on this new provision, the IRS has issued proposed regulations (REG-117062-18) that would ensure S corporation income will continue to be subject to U.S. federal income tax when an NRA is a deemed owner of an ESBT. Specifically, the proposed regulations would modify the allocation rules under Reg. 1.641(c)-1 to require that the S corporation income of the ESBT be included in the S portion of the ESBT if that income otherwise would have been allocated to an NRA deemed

owner under the grantor trust rules. The regulations are proposed to apply to all ESBTs after 12/31/17. Prop. Regs. 1.641(c)-1 and 1.1361-1 .

IRS Makes Corrections to Final QBI Regulations: The IRS has made corrections to final regulations on the new Qualified Business Income (QBI) deduction under IRC Sec. 199A. (The regulations were originally published in the *Federal Register* on 2/8/19.) The corrections are minor, mostly addressing grammatical errors. In addition, the IRS has determined there is good cause to bypass the 60-day delay in the effective date of the corrected regulations. Given that IRC Sec. 199A is currently effective, a 60-day delay would be unnecessary and contrary to the public interest. The corrections are effective on 4/17/19 and are applicable on or after 2/8/19. TD 9847.

IRS Releases Proposed Reliance Regulations on Qualified Opportunity Funds: The IRS has released proposed regulations on the taxability of investments in Qualified Opportunity Funds (QOFs). The regulations, which update portions of rules proposed by the IRS in October 2018, address the following issues: (1) the meaning of the term *substantially all* for use and holding period requirements; (2) transactions that may trigger gain; (3) the timing and amount of the included gain; (4) the treatment of leased property; (5) the use of qualified opportunity zone business property; and (6) when a QOF can reinvest proceeds from the sale of qualifying assets without paying a penalty. The proposed rules generally apply to tax years ending after the date the regulations are published in the *Federal Register*. However, taxpayers may generally rely on the rules [except for Prop. Reg. 1.1400Z2(c)-1, which doesn't apply until 1/1/28] if they apply them consistently and in their entirety. REG-120186-18 and News Release IR 2019-75 .

Other Current Releases

Applicable Federal Rates for May: The Section 7520 rate for May 2019 is 2.8%, while the Applicable Federal Rates (AFRs) are as follows (Rev. Rul. 2019-12):

	Annual	Semiannual	Quarterly	Monthly
Short-term (≤ 3 years)	2.39%	2.38%	2.37%	2.37%
Mid-term (> 3 years but ≤ 9 years)	2.37%	2.36%	2.35%	2.35%
Long-term (> 9 years)	2.74%	2.72%	2.71%	2.70%

Employee Benefits—IRS Comments on Unused Transportation Fringe Benefits: In a recent Information Letter, the taxpayer was participating in her employer's qualified transportation fringe benefit plan when she was fired. At that time, she had approximately $380 of unused commuter benefits. (The benefits were obtained through compensation reduction contributions.) According to the IRS, employees who stop participating in a qualified transportation benefit plan without cancelling their compensation reduction election can't receive a refund of any amount (even if contributions exceed actual benefits). This is the case whether the employee is fired or quits voluntarily. The IRS also concluded that the terminated employee can't use the funds for continued transportation expenses. Information Letter 2019-0002.

Estate Tax—Ten-year Statute of Limitation Applies to Estate Tax Collection from Transferees: Upon timely filing the estate tax return, a decedent's trustees elected to defer a portion of the tax under IRC Sec. 6166(a). Later that year, the trust distributed the remaining assets, primarily stock in a hotel, to the heirs. A decade later, the hotel went bankrupt, and the estate defaulted. Transferees of an estate's property are personally liable if the estate tax is not paid when due [IRC Sec. 6324(a)(2)]. The statute of limitations for collection of estate tax is ten years from the first assessment, which must be made within three years after the return filing [IRC Secs. 6501(a) and 6502(a)]. The statute is suspended while the Section 6166(a) election is in effect [IRC Sec. 6503(d)]. The District Court in Utah ruled that the IRS could not bring a transferee liability claim under IRC Sec. 6324(a) because the liability was governed by IRC Sec. 6901(a) as a breach of contract subject to the state statute of limitations, which was time-barred. The Tenth Circuit reversed and remanded the case. Because the IRS brought the case under IRC Sec. 6324(a)(2) within the ten-year statute of limitations, as extended by the Section 6166(a) election, the government's claim was timely and valid. *Mary Carol S. Johnson*, 123 AFTR 2d 2019-1272 (CA 10).

Income Tax—IRS Explains Effect of Elected Farm Income on QBI Deduction: Farmers and fishermen can elect (by completing Schedule J of Form 1040 to compute their current tax liability by averaging, over the prior three-year period, some or all of their taxable income from a farming or fishing business (IRC Sec. 1301). Recently, the IRS clarified that the Qualified Business Income (QBI) deduction should take into account income, gains, losses, and deductions from farming or fishing, but only to the extent the deduction is attributable to a farming or fishing business and included in elected farm income on line 2a of Form 1040, Schedule J . Therefore, once the election is made, the taxpayer must be consistent and use elected farm income to calculate the QBI deduction. More information is available at www.irs.gov/forms-pubs/elected-farm-income-may-be-used-to-figure-qualified-business-income-deduction-19-apr-2019 .

Income Tax—IRS Explains Interplay between SALT and Home Expense Deductions: IRC Sec. 280A(a) generally disallows a deduction for the business use of a home. However, under IRC Sec. 280A(b) , amounts are deductible if they would have otherwise been allowable as individual expenses. In a recent Program Manager Technical Advice (PMTA), the IRS explained the interplay between this exception and the new $10,000 ($5,000 if married filing separately) limit on state and local taxes. If an individual's total state and local taxes meet or exceed the limit, or the standard deduction is claimed, none of the taxes relating to the business use of the home qualify for the Section 280A(b) exception. If taxes don't meet or exceed the limit (and the standard deduction isn't claimed), the individual can expense the business portion of the taxes up to the difference between the $10,000 ($5,000) limit and the amount actually deducted under IRC Sec. 164 . PMTA 2019-001.

Income Tax—IRS Issues Safe Harbor for Professional Sports Teams: The IRS has issued a safe harbor for professional sports teams that treats certain personnel contracts and rights to draft players as having a zero value for determining gain or loss. For the safe harbor to apply, (1) all

parties to the trade must use the safe harbor; (2) no team may transfer property other than a personnel contract, draft pick, or cash; (3) the contract or draft pick can't be an amortizable Section 197 intangible; and (4) the teams' financial statements can't reflect assets or liabilities resulting from the trade (other than cash). Under the safe harbor, no gain or loss is recognized on the trade unless cash is received. The safe harbor applies to trade agreements entered into by a professional sports team after 4/10/19. However, a team may choose to apply the safe harbor in any open tax year. Rev. Proc. 2019-18.

Income Tax—Milling Company Didn't Qualify for Research Credit: The taxpayer was engaged in the business of milling and selling wheat flour. During the years at issue, it employed millers, maintenance personnel, lab technicians, lab supervisors, a Research and Development (R&D) manager, and R&D staff. After hiring a public accounting firm to perform an R&D tax credit study, the company claimed Section 41 credits of $122,424 and $116,246 for the tax years ended 5/31/11 and 5/31/12, respectively. The IRS disallowed the credits for both years, claiming that the taxpayer failed to prove that its expenses were qualified research expenditures. The Tax Court agreed, holding that the company failed to prove that it engaged in a process of experimentation for any of its projects. However, the company wasn't liable for Section 6662 penalties because it acted with reasonable cause and good faith when it relied on the accounting firm's R&D study. *Siemer Milling Company*, TC Memo 2019-37 (Tax Ct.).

Income Tax—Personal Residence Wasn't Converted to Rental Property: In 2005, the taxpayers moved into an apartment so their personal residence could be renovated. Due to the apartment's size, many of their belongings were stored at the residence. In 2008, the couple moved to another home. After renovations to the first home were completed, the taxpayers were informed that their homeowners insurance coverage would terminate if the home remained vacant. So, they rented the property to a friend for $500 a month (below market value). In 2013, the taxpayers sold the home and claimed a substantial loss on their tax return. The IRS disallowed the loss, claiming that the home was the taxpayers' primary residence. The Tax Court agreed, holding that (1) the taxpayers' move to the apartment wasn't motivated by a desire to renovate and sell the home as an income-producing asset and (2) the only reason for leasing the home was to satisfy the insurance company. *Carlos and Pamela Langston* , TC Memo 2019-19 (Tax Ct.).

IRS Announces Six-year Plan to Modernize IT Systems: In a recent News Release, the IRS announced a six-year plan to modernize its information technology systems. The plan centers on the taxpayer experience, core taxpayer services and enforcement, modernized IRS operations, and cybersecurity and data protection. Among other things, the IRS hopes to (1) standardize customer workflows; (2) reduce wait times with customer callback technology, online notices, and live online customer support; and (3) make implementation of new tax provisions more straightforward. The plan, which will be executed in two three-year phases, is expected to cost between $2.3 billion and $2.7 billion. The IRS will provide regular reporting to Congress and oversight organizations as it works with partners in the tax community to carry out the plan. For

more information, visit www.irs.gov/pub/irs-utl/irs_2019_integrated_modernization_business_plan.pdf . News Release IR 2019-77 .

IRS Discontinues Form 2555-EZ for Foreign Earned Income Exclusion: Form 2555-EZ may be used to claim the Section 911(a) foreign earned income exclusion for 2018 if the taxpayer (1) is a U.S. citizen or resident alien; (2) earned wages in a foreign country; (3) had total foreign earned income of $103,900 or less; (4) is filing a calendar-year return that covers a 12-month period; (5) doesn't have self-employment income or business/moving expenses; and (6) doesn't claim the foreign housing exclusion or deduction. Recently, the IRS announced that Form 2555-EZ and its instructions will be discontinued for tax years beginning after 2018. Although no further revisions to the form will be available, existing revisions and the instructions will still be available on www.irs.gov . For tax years beginning after 2018, all taxpayers claiming the foreign earned income exclusion must use Form 2555. The IRS's announcement is available at www.irs.gov/forms-pubs/form-2555-ez-will-not-be-used-after-2018-17-apr-2019 .

IRS LB&I Division Adopts Three Additional Compliance Campaigns: The IRS's Large Business and International (LB&I) division employs an audit strategy that focuses on specific issues, or "campaigns." Since the beginning of the program, LB&I has identified 50 compliance campaigns. The division has now approved the following three additional campaigns: (1) transactions in which a foreign captive subsidiary performs services exclusively for a parent corporation or other members of a multinational group; (2) tax noncompliance and information reporting associated with offshore bank accounts; and (3) Form 5471 (Information Return of U.S. Persons With Respect to Certain Foreign Corporations) that are incorrectly sent to the IRS without being attached to a tax return. These campaigns were identified through LB&I data analysis and suggestions from IRS employees. More information can be found at www.irs.gov/businesses/corporations/irs-announces-the-identification-and-selection-of-three-large-business-and-international-compliance-campaigns .

Procedure—Final Regulations Authorize Return Information Disclosures to Census Bureau: Under IRC Sec. 6103(j)(1)(A), the IRS is authorized to furnish, upon written request by the Secretary of Commerce, returns (or information reflected thereon) to the Census Bureau for (1) the structuring of censuses and national economic accounts and (2) conducting related statistical activities authorized by law. In 2016, the IRS issued temporary and proposed regulations that allowed disclosure of certain items requested by the Commerce Secretary. Recently, the IRS released final regulations (TD 9856) that adopt the proposed regulations without change and remove the corresponding temporary regulations. Among other things, the final regulations permit disclosure of (1) certain components of total expenses or deductions for business tax returns; (2) purchases from Form 1125-A; (3) research tax credit carryforwards; and (4) whether a business has closed or stopped paying wages. The final regulations apply to disclosures to the Census Bureau made on or after 12/9/16. Reg. 301.6103(j)(1)-1.

Tax-exempt Organizations—Final Regulations Address Excise Taxes on Tax-exempt Organizations: The Pension Protection Act of 2006 added IRC Secs. 4966 and 4967, which impose excise taxes on certain distributions from donor-advised funds maintained by sponsoring organizations. In addition, the Tax Cuts and Jobs Act added IRC Secs. 4960 and 4968 , which impose excise taxes on excessive executive compensation and the investment income of private colleges and universities. In November 2018, the IRS released proposed regulations (REG-107163-18) that would require persons liable for these taxes to file Form 4720 by the 15th day of the fifth month after the end of the tax year in which the liability was incurred. Also, the proposed rules would add IRC Secs. 4966 and 4967 to the first-tier taxes subject to abatement under IRC Sec. 4962. Recently, the IRS issued final regulations (TD 9855) that adopt the proposed regulations without change. The final regulations are effective when published in the *Federal Register*. Regs. 53.4963-1, 53.6011-1, and 53.6071-1.

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