CURRENT DEVELOPMENTS

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Moderator:
Tracy Watkins, RSM US LLP, Washington, DC

Panelists

Charles Gorham, Special Counsel, Office of Chief Counsel – Income Tax & Accounting, Internal Revenue Service, Washington, D.C.


Kathy Reed, Branch Chief, Branch 7, Income Tax & Accounting, Internal Revenue Service, Washington, D.C.

Scott Dinwiddie, Associated Chief Counsel, Office of Chief Counsel – Income Tax & Accounting, Internal Revenue Service, Washington, D.C.

Selvan Boominathan, CohnReznick, Washington, D.C.

The information contained herein is of general nature and based on authorities that are subject to change. Applicability to specific situations is to be determined through consultation with your tax advisor. The government panelists did not participate in the preparation of this handout.
Cases


In *Brokertech Holdings*, the tax court concluded that cash grants provided by the State of New Jersey to Brokertec Holdings, Inc. f.k.a. ICAP US Investment Partnership (Brokertec) as an incentive to move its offices to New Jersey qualify as a nontaxable contribution to capital under section 118.

Brokertec is a financial services company and parent of a consolidated group that includes ICAP, North America, Inc., f.k.a. Garban Intercapital North America, Inc. (Garban), and First Brokers Holdings Inc., f.k.a. First Brokers Securities, Inc. (First Brokers).

The September 11, 2001, terrorist attacks destroyed Garban’s office space in New York City and rendered the nearby office space of First Brokers almost useless for conducting business. Therefore, the company sought a new location to continue operations. The New Jersey Business Employment Incentive program (BEIP) offers financial incentives and technical assistance to attract businesses to move to the state to help develop the economy and revitalize cities. Garban and First Brokers opted to apply for the program and move their offices to New Jersey to take advantage of this opportunity. Garban and First Brokers received grants and used the grants to acquire the stock of ICAP Holdings (USA), Inc. (ICAP). This acquisition expanded Brokertec’s business into other trading markets.

From 2010 through 2013, Brokertec excluded the grants from income, asserting that the grants qualified as nonshareholder contributions to capital under section 118. The IRS assessed a deficiency of over $40 million on Brokertec. The IRS argued that the grants did not meet the requirements of section 118 because they did not require Brokertec to construct or enhance capital assets.

Section 118(a) states that, for a corporation, gross income does not include any contribution to the capital of the taxpayer. Section 118 also provides that the exclusion applies to contributions of capital by persons other than shareholders, including the value of land or other property contributed to a corporation by a governmental unit or by a civic group for the purpose of inducing the corporation to locate its business in a particular community, or for the purpose of enabling the corporation to expand its operating facilities.

The court determined that the evidence presented by Brokertec established that the intent of New Jersey in providing the BEIP grants was to induce Brokertec to establish their offices in a targeted area to bring new jobs and revitalize the area. The program requires Garban to establish facilities in New Jersey and operate them for a minimum period with an agreed upon number of employees. The court noted that the Supreme Court adopted a common-sensed definition of working capital. The court explained that as a financial services company, Brokertec relies primarily on human capital and the investment in the stock of ICAP enhanced efficiency. The court concluded that the circumstances and motive of the donor are substantially similar to that of *Brown Shoe Co. v. Commissioner*, 339 U.S. 583 (1950) and *Commissioner v. McKay Prods. Corp.*, 178 F.2d 639 (3d Cir. 1949) having the purpose of enlarging the working capital of the business. Accordingly, the court concluded based on the evidence presented and case law that the BEIP grant disbursements qualified as contributions to capital pursuant to section 118(a).


In *Quebe*, the district court granted the motion of the IRS for summary judgment, concluding that the taxpayers, owners of an S corporation, were not entitled to certain refunds of tax based on claimed deductions under section 179D of the Code. Section 179D permits a taxpayer to deduct the cost of energy efficient commercial building property placed in service during the taxable year. In the case of building property owned by a tax-exempt government entity, section 179D(d)(4) permits that government entity to allocate the section 179D deduction to the person “primarily responsible” for designing the property.

The taxpayers claimed section 179D deductions in 2009 and 2010 in connection with lighting systems in nine government-owned buildings. With respect to five of the buildings, which were located on a U.S. Air
Force Base (USAFB), the IRS claimed that the deduction was improper because the energy improvements at issue were not placed in service in the years for which the taxpayers claimed the deductions. The court found that the taxpayers’ own records showed it did not install any lighting in the USAFB buildings until several years later, and therefore that the lighting could not have been placed in service in the years the taxpayers claimed. The taxpayers attempted to rely on a letter they had received from the USAF, dated in December, 2012 and signed by an Air Force base maintenance officer, stating that the in-service date for the buildings was April, 2009. The court, however, held that the letter created no genuine issue of material fact, as it did not identify any of the buildings at issue, and in any event the facts contradicted any such assertion. The court also rejected the taxpayer’s argument that the court should rule that the deductions were allowable in later years when the lighting fixtures were installed, under the “mitigation” provisions of sections 1311-1314. The court held that the mitigation provisions were not at play in the case, and that the proper course was for the taxpayer to file refund claims for those later years. The court similarly held for the IRS as to the remaining four buildings, which were owned by a city school district. As to those buildings, the issue was not whether the lighting was placed in service in the tax years at issue. Rather, the court noted that section 179D requires that in the case of deductions allocated by a governmental entity, the taxpayer must be “primarily responsible” for the design of the lighting system. The court found that there was no evidence that the taxpayers did anything more than install lighting fixtures in the four school buildings according to lighting designs produced by other parties. Accordingly, the court granted summary judgment for the IRS as to the full amount of the refunds at issue.

c. Siemer Milling Company v. Commissioner, T.C. Memo 2019-37

In *Siemer Milling Company* the U.S. Tax Court held that the taxpayer at issue had not properly supported the R&D credit claimed under section 41, and disallowed the taxpayer’s R&D credit claim for the tax years ended May 31, 2011 and 2012. The R&D credit study that resulted in the claim was prepared by the taxpayer’s accounting firm, and the disallowance amounted to $122,424 for 2011 and $116,246 for 2012.

*Facts of the case*

The taxpayer is an Illinois-based company engaged in the business of milling and selling wheat flour. The taxpayer claimed the research credit for research activities for seven projects, some spanning both tax years at issue. The taxpayer’s credit claim included employee activities from employees with titles including miller, maintenance personnel, lab technicians, lab supervisors, a research and development manager and research and development staff.

*Grounds for the Tax Court’s decision*

The court applied the section 41 research credit rules to each project independently. To qualify for the R&D credit each project must pass a four-part test. Generally, this requires:

- A permitted purpose (which includes a new or improved function, performance, reliability or quality) related to a product or process.
- An intent to discover information that is technological in nature by relying on principles of a hard science: engineering, computer science, biological or physical science.
- Technical uncertainty at the project’s outset regarding capability, method or appropriate design.
- A systematic, trial and error process of experimentation to attempt to resolve technical uncertainties.

*Successful taxpayer arguments*

While the court ultimately determined that the taxpayer failed to support its R&D credit claim, the taxpayer was successful on several important issues. The tax court agreed with the taxpayer’s position regarding whether its projects were business components in accordance with section 41. In doing so, the court found that the development or improvement of a single business component can span multiple years.
Relatedly, the court agreed that a project could face the same uncertainty in more than one year because, “not all uncertainties are neatly resolved within the confines of a single taxable year.” Additionally, the court also determined that the taxpayer was not required to “employ or contract with someone with a specialized degree to prove that research relied on the physical or biological sciences, engineering, or computer science.”

**Successful IRS arguments**

However, the Tax Court sided with the IRS on issues that ultimately doomed the taxpayer’s entire R&D credit claim. The court applied the 4-part test to each project, and the taxpayer failed to provide evidence to show that each project met each part of the 4-part test. The ruling established that the taxpayer failed to provide adequate documentation as evidence to support its credit claim.

The Tax Court focused on the process of experimentation test of section 41, and repeatedly cited to *Union Carbide v. Commissioner* on this issue. The court found that the record did not establish the taxpayer had a, “methodical plan involving a series of trials to test a hypothesis, analyze the data, refine the hypothesis, and retest the hypothesis so that it constitutes experimentation in the scientific sense.” The Tax Court also disallowed the credit for several projects based on the technological in nature test because even though the taxpayer argued that they relied on principles of engineering and the physical and biological sciences, Seimer failed to establish the principles on which the research activities relied.

**Accuracy penalty**

The Tax Court also determined that the taxpayer was not subject to the section 6662 accuracy related penalties due to the credit disallowance. In doing so, the court continued its application of *Neonatology Assoc. v. Commissioner*. *Neonatology* provides that a taxpayer is not subject to accuracy related penalties where a taxpayer acted with reasonable cause and good faith by relying on a competent tax professional. Under the reasoning of *Neonatology*, reliance is reasonable where the advisor was a competent profession with sufficient expertise to justify reliance, the taxpayer provided all necessary and accurate information to the advisor, and the taxpayer actually relied in good faith on the advisor’s judgement. The court concluded that the taxpayer’s advisor was competent and sufficiently an expert, the taxpayer gave its advisor open access to all information, and the taxpayer actually relied in good faith on its advisor. Therefore, it met the reasonable cause standard of 6664(c) and therefore the accuracy related penalties should not apply.

**Revenue Procedures, Notices, and Private Letter Rulings**

**a. Revenue Procedure 2019-18**

Revenue Procedure 2019-18 provides a safe harbor method for sports teams to treat certain personnel contracts and rights to draft players as having a zero value for determining gain or loss recognized for federal income tax purposes if such contracts and rights are traded.

**Background**

Professional sports teams have historically struggled to assign a monetary value to contracts or draft picks due to the fluctuating nature of the performance of players and staff members, and market conditions. The IRS cites a dizzying list of factors that affect the value of a personnel contract in Rev. Proc. 2019-18, including: player performance, the changing needs of a team, the changing needs of other teams, a player’s effect on fan attendance, and the number of years until a player becomes a free agent, the size of a team’s market, the cost of player development, and the impact of injuries and slumps. The fact that teams trade personnel contracts on a small, private market also adds difficulty to assigning value.
The IRS notes that a team does not make these types of trades unless the team believes it will receive something of equal or greater value to what it is giving up under the team’s circumstances at the time. Accordingly, this valuation is highly subjective and virtually impossible to determine relative to a third-party.

How the safe harbor works

A trade qualifies for the safe harbor if:

- All parties to the trade use the safe harbor;
- Each party transfers and receives a personnel contract or draft pick;
- Transfers may only include personnel contracts, draft picks, or cash;
- No property transferred is treated as an amortizable section 197 intangible; and
- The teams’ financial statements do not reflect assets or liabilities resulting from the trade other than any cash.

If all of the above criteria are met, a team need not recognize any gain or loss on a trade other than any cash transferred in the trade because the contract value of each personnel contract or draft pick is treated as zero. If a team receives cash in the trade, the cash is treated separately and the team does not include the cash value in the basis of the assets. A team providing cash to another team receives basis in the personnel contract or draft pick acquired equal to the cash the team provides in the trade. For cash a team provides in a trade for two or more assets, the team must allocate its basis to each asset equally. The Rev. Proc. provides that a team may recognize gain or loss based on the amount received over the unrecovered basis of the personal contract, subject to the rules of sections 1231 and 1245. A team’s unrecovered basis in a personnel contract or draft pick is the team’s basis in such contract or draft pick as determined under section 167(c).

The IRS notes that teams must retain books and records to substantiate all the requirements of Rev. Proc. 2019-18, and, pursuant to section 6001, must furnish records of compliance to the IRS.

Effective date

The Rev. Proc. applies only to agreements involving trades of personnel contracts or draft picks entered into after April 10, 2019. The team, however, may choose to apply the Rev. Proc. to any open taxable year.


In Rev. Proc. 2019-13, the IRS released guidance to help taxpayers determine the proper treatment for depreciating passenger automobiles subject to 100 percent bonus depreciation. Specifically, Rev. Proc. 2019-13 provides a safe harbor method of accounting for determining depreciation deductions for passenger automobiles that qualify for the 100 percent additional first year depreciation deduction under section 168(k), and that are subject to the depreciation limitations under section 280F(a).

Section 280F limits deductions for depreciation for passenger automobiles used in a trade or business, with a schedule of limits for each year. Recent tax law changes (commonly referred to as the Tax Cuts and Jobs Act, or TCJA) changed the yearly limits. Section 280F establishes a $10,000 limit for depreciation in the year the vehicle is placed in service, then allows $16,000 in year two, $9,600 for year three, and $5,760 for year four and any remaining years. When bonus depreciation is available, section 168(k)(2)(F)(i) increases the first year limitation amount under section 280F(a)(1)(A)(i) by $8,000. Rev. Proc. 2018-25 provides tables for taxpayers’ use in determining the permitted yearly depreciation deductions.
Rev. Proc. 2019-13 addresses situations in which a taxpayer has a passenger automobile that is eligible for 100% bonus depreciation but that is otherwise subject to Section 280F, which would otherwise result in limiting the depreciation deduction able to be claimed in the placed in service year by the applicable Section 280F limit and further requiring that depreciation on the remaining basis not commence until after the automobile’s recovery period. The IRS offers the example of a $50,000 passenger automobile placed in service in 2018. Section 280F(a)(1)(A)(i) limits the first year depreciation deduction plus section 179 deduction to $18,000. The excess amount of $32,000 cannot be recovered until 2024, subject to the annual limitation of $5,760 under section 280F(a)(1)(B)(ii).

Due to the odd result detailed above, the IRS introduced a safe harbor method to allow recovery on a more tenable schedule. Under the safe harbor method, taxpayers take the full deduction allowed by section 280F(a)(1)(A)(i) in the year an automobile is placed in service. For each subsequent year in the recovery period, the taxpayer multiplies the remaining adjusted depreciable basis of the passenger automobile by the annual depreciation rate for each subsequent taxable year (subject to the limits in section 280F(a)(1)(A)). Note that depreciation deductions must be adjusted for short taxable years.

The adjusted depreciable basis of the passenger automobile as of the first taxable year following the recovery period is treated as a deductible depreciation expense for that taxable year—subject to the limitation under section 280F(a)(1)(B)(ii). Any excess would be carried into the succeeding tax year(s) and deductible subject to the yearly limitations.

The safe harbor method does not apply in any year that section 280F(b) applies (i.e., business use of the property is 50 percent or less).

While the safe harbor method may be very favorable, it does not apply to all passenger automobiles. Rev. Proc. 2019-13 applies to a passenger automobile (other than a leased passenger automobile):

- Acquired and placed in service after Sept. 27, 2017;
- That is qualified property under section 168(k) for which bonus depreciation is allowable;
- That has an unadjusted depreciable basis greater than the limitation amount in section 280F(a)(1)(A)(i); and
- For which the taxpayer did not elect to use section 179 expensing.

c. Notice 2019-22

The IRS released Notice 2019-22, announcing the credit phase-out schedule for new qualified plug-in electric drive motor vehicles sold by General Motors, LLC.

Section 30D(a) provides for a credit for certain new qualified plug-in electric drive motor vehicles. The credit begins to phase out after a manufacturer sells or leases at least 200,000 qualifying vehicles in the United States. The phase out begins in the second calendar quarter after the calendar quarter in which the 200,000 threshold is reached. Taxpayers who purchase such vehicles during the first two calendar quarters of the phase-out period may claim 50 percent of the credit. Taxpayers who purchase the vehicles during the third and fourth calendar quarters of the phase-out period may claim 25 percent of the credit. After the fourth calendar quarter, taxpayers may no longer claim a credit.

General Motors, LLC submitted reports indicating that its cumulative sales of qualified vehicles reached the 200,000-vehicle limit during the calendar quarter ending December 31, 2018. Accordingly, the credit for all new qualified plug-in electric drive motor vehicles sold by General Motors, LLC will begin to phase out April 1, 2019.

For vehicles purchased for use or lease from April 1, 2019, through September 30, 2019, taxpayers may take 50 percent of the otherwise allowable amount determined under section 30D(b). For vehicles purchased for use or lease from October 1, 2019, through March 31, 2020, the credit is 25 percent. No credit is available beginning April 1, 2020.
d. PLR 201906002

In PLR 201906002, the IRS ruled that the anti-churning rules in section 197(f)(9) do not prevent the amortization of certain increases to the basis of an intangible asset under section 743(b) made in connection with a partnership’s conversion to a corporation.

A publicly traded partnership (PTP) and another partnership (UTP) formed a lower-tier partnership (LTP). In the formation, PTP contributed cash and property and UTP contributed certain intangible assets. Both transfers were solely in exchange for partnership interests in LTP. The intangible assets that UTP contributed were subject to the anti-churning rules of section 197(f)(9), and therefore were not amortizable in the hands of LTP. PTP and UTP were not related for the purposes of applying the anti-churning rules of section 197(f)(9)(C)(i). PTP has had a section 754 election in place since its formation. After the formation of LTP, Taxpayer estimates that at least 95 percent of the ownership of PTP has changed through normal public trading and other issuances of partnership interests. Additionally, through an undescribed right in UTP, ownership interests in LTP have been distributed to certain partners of UTP, who would then sell or transfer those interests to PTP. Taxpayer represented that this was not as a part of a plan in connection with the formation of LTP.

PTP subsequently decided to convert to a corporation by transferring all of its assets, including its interest in LTP, to a newly formed corporation (Newco). Because of that transaction, a section 743(b) adjustment to the basis of LTP assets was computed for the benefit of Newco and was allocated to the assets of LTP, including the anti-churning intangible asset. Taxpayer requested a ruling that any section 743(b) basis adjustments related to the anti-churning intangible would be amortizable, to the extent that they were related to LTP interests acquired from the partners in UTP, or indirectly acquired by public investors after the formation of LTP.

Pursuant to Treas. Reg. § 1.197-2(h)(12)(v)(A)(2), there is a three-part test to determine if a section 743(b) adjustment related to an anti-churning intangible is amortizable: (1) the partnership acquired the intangible after August 10, 1993, and the intangible is not amortizable by the partnership; (2) the partnership interest received by the transferee was previously held after the partnership acquired the intangible by a person that is not related to the transferor; and (3) the acquisition of the partnership interest by such other person was not as a part of a series of transactions in which the transferor received the partnership interest.

Based on the facts and representations presented, the IRS concluded that the first and third parts of the test were satisfied. In analyzing the second test, the IRS applied the concepts of Rev. Rul. 87-115 and the aggregate theory, as specified in section 197(f)(9)(E). Accordingly, when PTP interests were transferred, it was treated as a transfer of PTP’s interests in LTP, and the basis adjustment was allocated to such transferee of the PTP interest. Thus, such interests are held by persons unrelated to the owners when LTP was formed. The IRS further concluded that the portion of LTP held by PTP that it had acquired from the partners of UTP also satisfied the second test, because of the representation that PTP and UTP were unrelated.

Therefore, the ruling concludes that the increases to tax basis of the anti-churning intangible pursuant to the section 743(b) adjustment are amortizable. The ruling highlights that the ant-churning rules continue to require consideration in partnership transactions, and that the transfer of an anti-churning intangible to an unrelated party may “cleanse” the transferred interest.

e. PLR 201907003

In PLR 201907003 the IRS allowed a taxpayer additional time under Treas. Reg. § 301.9100-3 to file an application for certification of historic status with the Department of the Interior for purposes of claiming the rehabilitation credit under section 47(a)(2).
Section 47 provides a credit for qualified rehabilitation expenditures with respect to certified historic structures and buildings other than certified historic structures. Treas. Reg. § 1.48-12(d)(1) provides that a building may be considered a certified historic structure for purposes of the credit at the time it is placed in service if:

1. On that date the taxpayer reasonably believes that the Department of the Interior will certify the building as a certified historic structure,
2. On or before the date, the taxpayer has requested such a determination, and
3. The Department of the Interior later determines the building is a certified historic structure.

The taxpayer sought to rehabilitate a certain property in a manner that would qualify for the section 47 credit. The taxpayer relied on a consultant to provide assistance to prepare and file the application for certification of historic status. The taxpayer’s attorney determined that the consultant did not file the application, so taxpayer later filed the application. The taxpayer requested an extension of time to file the application so that it would meet the requirements under the treasury regulations as being timely filed for purposes of claiming the section 47 credit.

The IRS ruled that based on the facts and representations made by the taxpayer that the taxpayer acted reasonable and in good faith, and that the grant of relief would not prejudice the interests of the Government, and therefore granted the extension of time to file the application. However, the IRS did not express an opinion on whether the Taxpayer’s rehabilitation expenditures with respect to the property meet the requirements as qualified rehabilitation expenditures under section 47 or whether the other requirements to claim the credit were met.