I. Nonrecognition Provisions

A. Section 1033: Deferral of Gain on Involuntary Conversion Followed by Reinvestment

1. Sale of spectrum rights as involuntary conversion

At several meetings, we reported on letter rulings—a total of six—which had held that sales of “spectrum-based content distribution rights” by providers of broadcast services would be considered sales under threat of involuntary conversion for purposes of section 1033. The sales were to be made to the Federal Communications Commission (FCC) because of FCC requirements imposed by the Middle Class Tax Relief and Job Creation Act of 2012, P.L. 112-96, 126 Stat. 156. In each case, the Internal Revenue Service concluded that participation in an Incentive Auction pursuant to the Middle Class Tax Act was not a real choice for the taxpayer—hence the involuntary conversion conclusion. Assuming the taxpayer would satisfy other statutory requirements—reinvesting an amount at least equal to the proceeds of the conversion into property “similar or related in service or use” within a prescribed period—all realized gain would be deferred and reflected in a correspondingly lower basis in the replacement property.

And there’s now another favorable ruling issued on a similar set of facts. See PLR 202001016 (Oct. 8, 2019). The beat goes on.

2. Forced sales of cattle resulting from drought conditions

Drought continues in significant parts of United States cattle country. As a result, farmers and ranchers have been forced to sell cattle much earlier than would otherwise have been the case, and the weather conditions have made quick replacement of the cattle economically unfeasible. In order to get the benefit of gain deferral on the forced sales—treated as involuntary conversions under section 1033(e)(1)—section 1033(e)(2)(A) generally provides for a four-year period to replace converted cattle. Pursuant to statutory authority, however, the Internal Revenue Service has several times extended the replacement period in particular U.S. counties until the end of the taxable year that follows the initial drought-free year in each county. Notice 2019-54, 2019-42 I.R.B. 935, does that again, and lists the counties for which the 12-month period ending on August 31, 2019, was not considered a drought-free year.
B. Sections 1400Z-1 and 1400Z-2: Deferral of Capital Gain Invested in Qualified Opportunity Zone Funds

In T.D. 9889, RIN 1545-BP04, 85 Fed. Reg. 1866 (Jan. 13, 2020), the Service and the Treasury issued a new set of final regulations dealing with qualified opportunity zones. Because o-zones are the subject of other panels at this meeting, you are directed to the outlines for those other programs.

C. Section 121: Exclusion of Gain on Sale of Principal Residence

In Private Letter Ruling 201944006 (July 31, 2019), the Service ruled that, subject to the dollar limitations set out in the statute, a couple could exclude gain on the sale of land on which their former principal residence had sat when it was destroyed by a fire. The couple had converted the residence into rental investment property when, before the fire, they moved to another principal residence, but so long as the ownership and use tests of section 121 were satisfied as of the date of sale of the land, that section could still apply. In addition, the ruling noted that section 1031 might be available to defer the amount of any gain not excluded by section 121, assuming the requirements of section 1031 are satisfied, although the Service didn’t rule on whether section 1031 would be applicable in this particular instance.

D. Section 104(a)(2): Recoveries on Account of Personal Physical Injuries or Sickness

In Private Letter Ruling 201950004 (Sept. 13, 2019), the Service ruled that section 104(a)(2) would apply to exclude a settlement award paid to a taxpayer because of a clinic’s failure to test an egg from an anonymous donor for negative genetic conditions. The clinic implanted the donor egg, and taxpayer gave birth to a child suffering from physical, cognitive, and behavioral disabilities. Given the personal physical injuries involved, the entire amount of the award was ruled to be excludable from taxpayer’s gross income (including the amount for emotional distress attributable to those physical injuries), except for any amount representing a recovery of previously deducted medical expenses (that is, to the extent the inclusionary tax benefit rule applies).

II. Realization and Related Issues

A. Income

1. Cryptocurrencies

Revenue Ruling 2019-24, 2019-44 I.R.B. 1004, considered a couple of important issues dealing with income arising from the use of cryptocurrencies. The Service concluded that (1) a taxpayer has no income for tax purposes arising from a hard fork of a cryptocurrency owned by the taxpayer so long as the taxpayer receives no units of a new cryptocurrency, but that (2) a taxpayer does have income from an airdrop of a new cryptocurrency following a hard fork if the taxpayer receives units of new cryptocurrency. An “airdrop” is a mechanism for distributing cryptocurrency to multiple digital wallets. Airdrops may or may not be preceded by a hard fork.
A “hard fork” is a change in a blockchain’s protocol that results in a permanent diversion from the existing blockchain and may result in the creation of a new cryptocurrency on a new blockchain.

2. Use of installment method

In Joyner Family Limited Partnership v. Comm’r, T.C. Memo. 2019-159, the court held that the installment method of reporting gain was not available on the sale of mobile homes by the partnership (JFLP) because JFLP was a dealer in such homes. But the court also concluded that JFLP appropriately used the installment method to report gain on land-only sales that had been made, before JFLP began selling mobile homes, to purchasers who intended to permanently place mobile homes on the purchased land. The court found the testimony by JFLP representatives credible that JFLP had made no improvements to the land before the sale (despite the Commissioner’s claim to the contrary)—such as septic tanks, driveways, and electrical hookups. These were, that is, purely sales of land.

Interestingly, despite the conclusion that the installment method was not available for reporting gain on the mobile home sales, the result in the case wasn’t that JFLP had gain to recognize in the year of sale of each mobile home. The sales were made to high-risk, low-income people, and the court concluded that the notes given by the purchasers had no ascertainable value in the year of disposition of the property. (Later foreclosures were more the norm than the exception in these circumstances.) If JFLP was receiving no value when a mobile home was sold, there was no income to be recognized at that time. Instead, income would be recognized only if and when payments were received on the notes.

3. Cash-method taxpayers unaffected by Tax Cuts Act changes to section 451

This really shouldn’t have been an issue in that the statutory language is clear, but ECC 202002013 (Oct. 22, 2019) states that changes to section 451 made by the Tax Cuts and Jobs Act of 2017, P.L. 115-97, 131 Stat. 2054 (Tax Cuts Act)—among other things, generally requiring accrual-method taxpayers to recognize income under the all-events test no later than revenue is reflected on an applicable financial statement—have no application to cash-method taxpayers.

B. Losses and Deductions

1. SALT cap litigation

In a prior discussion of a new regulation directed at state attempts to circumvent the $10,000 cap on the deductibility of nonbusiness state and local taxes (SALT) included in the Tax Cuts Act, § 11042(a) (adding I.R.C. § 164(b)(6)), we noted suits by several states and the Village of Scarsdale challenging that regulation. See Complaint, New Jersey v. Mnuchin, case 1:19-cv-06642 (S.D. N.Y., filed July 17, 2019), [https://www.law360.com/articles/1179194/attachments/0](https://www.law360.com/articles/1179194/attachments/0). And we mentioned New York v. Mnuchin, see Complaint, New York v. Mnuchin, case 1:18-cv-6427 (S.D. N.Y., filed July 17, 2018), [https://ag.ny.gov/sites/default/files/salt_complaint_asFiled_with_exhibits.pdf](https://ag.ny.gov/sites/default/files/salt_complaint_asFiled_with_exhibits.pdf), a case filed in 2018 in which four states challenged the constitutionality of the cap itself. We noted that,
during the proceedings, Judge Oetken had made a comment suggesting that he might be sympathetic to the states’ argument that the cap was unconstitutionally coercing the states into changing their tax policies. Whatever his inner feelings, however, on September 20, 2019, the judge rejected the challenge to the constitutionality of the cap. See New York v. Mnuchin, 2019 U.S. Dist. LEXIS 168754 (S.D. N.Y. 2019). He found nothing in the Constitution that would require an unlimited deduction for SALT. See, e.g., slip op. at 26 (“The States have cited no constitutional principle that would bar Congress from exercising its otherwise plenary power to impose an income tax without a limitless SALT deduction.”). And he was unwilling to speculate that Congress was acting in bad faith to coerce the affected states “into bringing their tax policies in line with the federal government’s preferences.” Id. at 29-30. Some members of Congress may have had bad intentions, of course, but a federal judge is unlikely to view the congressional process as so tainted that a constitutional violation would result.

This litigation isn’t over, of course—an appeal has been filed—but your correspondent continues to believe that the states’ positions, whatever their merits as a policy matter, fail to demonstrate any constitutional defect in the cap on SALT deductions.

2. Safe harbor for treating rental real estate enterprise as trade or business for section 199A purposes

In Notice 2019-7, 2019-09 I.R.B. 740, the Service had floated a proposed revenue procedure to create a safe harbor for determining when a rental real estate enterprise will be treated as a trade or business for purposes of section 199A, the passthrough entity deduction. The safe harbor was finalized as Revenue Procedure 2019-38, 2019-42 I.R.B. 942, with some embellishments and with rules governing the procedures for electing the safe harbor. The safe harbor generally applies if separate books and records are kept for each rental real estate enterprise; 250 or more hours of rental services are performed annually; and contemporaneous records of relevant information (time reports, descriptions of services performed, etc.) are maintained. The final procedure clarifies that an interest in a mixed-use property can be considered one real estate enterprise under the safe harbor, but certain rental real estate activities are specifically made ineligible for the election, including real estate used by the taxpayer as a residence; real estate rented or leased under a triple net lease; real estate rented to a trade or business conducted by the taxpayer or to a trade or business conducted by a commonly controlled entity; or the entire interest if any portion of the interest is treated as a specified service trade or business (SSTB) under Regulation section 1.199A-5(c)(2). That regulation applies, in general, if a trade or business provides property or services to an SSTB and there is 50 percent or more common ownership of the two trades or businesses. In that case, the trade or business of providing property or services to the commonly owned SSTB is treated as a separate SSTB for these purposes. Treas. Reg. § 1.199A-5(c)(2)(ii).

On that last point, an SSTB, with some exceptions, involves the performance of services in health care, law, accounting, actuarial services, performing arts, consulting, athletics, financial services, or brokerage services; investment management or trading or dealing in securities or commodities; and any other business (other than engineering or architecture) where the principal asset is the reputation or skill of one or more of its employees or owners. Treas. Reg. § 1.199A-5(b)(1)(i)-(xiii). Each of those categories has its own definitional quirks set out in the regulation.
The last category encompasses service businesses where compensation is paid for endorsements; use of an individual’s image, name, voice, etc.; or appearing at an event or in some form of media. Treas. Reg. § 1.199A-5(b)(2)(xiv).

The revenue procedure generally applies to taxable years ending after 2017, although for 2018 taxpayers can rely on the safe harbor in the form set out in Notice 2019-7.

3. Regulations on the section 165(i) election to accelerate a casualty loss deduction

Under section 165(i), a taxpayer who has suffered a casualty loss attributable to a federally declared disaster may elect to treat the loss as having occurred in the preceding taxable year. The election can be a benefit in at least two ways: (1) an accelerated deduction means more cash will be on hand when the taxpayer needs it after the casualty, and (2) for a personal casualty loss, the taxpayer can calculate which of the two possible years of deduction provides a better tax result, given the generally applicable 10-percent-of-adjusted-gross-income threshold applicable to such losses.

In T.D. 9878, RIN 1545-BP44, 84 Fed. Reg. 55,245 (Oct. 16, 2019), the Service and Treasury issued final regulations on making and revoking such elections. The final regulations adopt, with no substantial changes, positions taken in proposed and temporary regulations issued in 2016, see T.D. 9789, 81 Fed. Reg. 70,938 (Oct. 14, 2016), and there’s nothing surprising in the new regulations. An election must be made either on the original tax return for the year preceding the disaster or on an amended return for that year, Treas. Reg. § 1.165-11(e), and the election must be made within six months after the due date for filing the return for the disaster year (not taking into account any extensions). Treas. Reg. § 1.165-11(f). An election may be revoked within ninety days after the due date for making the election. Treas. Reg. § 1.165-11(g). And a taxpayer obviously may not claim the same loss in both the disaster year and the preceding year. Treas. Reg. § 1.165-11(d).

4. Thresholds for, and limitations on, qualified disaster losses

In ECC 202002014 (Oct. 22, 2019), the Service provided that a qualified disaster loss (generally a personal casualty loss arising after December 31, 2015, in an area declared by the president to be a major disaster area pursuant to the Robert T. Stafford Disaster Relief and Emergency Assistance Act) can generally be taken into account only to the extent it exceeds $500 (rather than the $100 figure otherwise provided for in section 165(h)(1))) and that the 10-percent-of-adjusted-gross-income limitation of section 165(h)(2) does not apply to such losses. That result isn’t necessarily mandated by the Internal Revenue Code itself, but is the result of section 11018(c) of the Tax Cuts Act, section 504(b) of the Disaster Tax Relief and Airport and Airway Extension Act of 2017, Pub. L. No. 115-63, 131 Stat. 1168; and the Bipartisan Budget Act of 2018, Pub. L. No. 115-123, 132 Stat. 64.
5. Deductions for contributions of conservation easements

   a. Constructive denial clause doesn’t limit deductibility of conservation easement donation

   In ILM 202002011 (Nov. 26, 2019), the Service advised that a constructive denial clause in a conservation easement deed is not inconsistent with the requirement that, for a deduction to be available, the donated easement must be “exclusively for conservation purposes,” I.R.C. § 170(h)(1)(C), and the “conservation purpose [must be] protected in perpetuity.” I.R.C. § 170(h)(5)(A). (A constructive denial clause provides that the property owner’s uses of land are permitted only with the express approval of the easement holder and that a nonresponse to a request is treated as a denial.) That section would therefore not limit deductibility on the contribution to a charitable institution of an easement subject to such a clause.

   b. Valuation of conservation easements and effect of override provision in deed

   In a bench opinion issued on November 22, 2019, in TOT Property Holdings LLC v. Comm’r, Tax Ct. Docket No. 5600-17, https://www.ustaxcourt.gov/InternetOrders/DocumentViewer.aspx?IndexSearchableOrdersID=309852&Todays=Y, Judge Gustafson concluded that a partnership had grossly overvalued a conservation easement donated to charity ($6.9 million versus a real value of about $496,000) for purposes of the claimed charitable contribution deduction and that, as a result, the gross valuation penalty applied. The court rejected the partnership’s contention about what was realistically the “highest and best use” for this property.

   The valuation exercise was undertaken only for purposes of determining the amount of the penalty due, since the court had also held that no deduction was permissible because the perpetuity requirement of section 170(h)(5)(A) had not been satisfied. The deed didn’t make the donee absolutely entitled to any share of proceeds should the easement be terminated by judicial action. The deed did contain an override provision, calling for a different formula to apply if the primary formula was deemed to be inconsistent with the perpetuity requirement, but that override provision was itself a condition subsequent inconsistent with the perpetuity requirement. The override provision in this case was similar to that considered in Coal Property Holdings v. Comm’r, 153 T.C. No. 7 (2019), in which a deduction was similarly disallowed.

6. Loss deduction to partnership on worthlessness of related family real estate development business

   In MCM Investment Management, LLC v. Comm’r, T.C. Memo. 2019-158, the Tax Court concluded that MCM had satisfied its burden of showing the worthlessness of its interest in a related real estate development business, and it was therefore entitled to a loss deduction under section 165(a) in the year of worthlessness, 2009. MCM was able to demonstrate the lack of any liquidating value at that time (even though MCM had a positive capital account in the related business) and the lack of any potential future value in the related business. On the latter point, MCM was able to point to “identifiable events” showing worthlessness, including the significant
decline in cash flow from the business’s projects, the inability to attract equity investment, going concern opinions from a major accounting firm, and the severe recession at the time.

7. Cert denial in Feinberg: Limits on deductibility of expenses of a marijuana business that is legal under state law

We earlier reported on the decision in Feinberg v. Comm’r, 916 F.3d 1330 (10th Cir. 2019), concluding that a medical marijuana company, formed as an S corporation, wasn’t entitled to the cost of goods sold (COGS) figure it claimed to reduce the income passed through to its shareholders. That was because of section 280E, which disallows deductions for amounts paid or incurred in connection with trafficking in controlled substances. On October 7, 2019, the Supreme Court denied certiorari in Feinberg. 2019 U.S. LEXIS 5479 (2019).

This is an issue that isn’t going away so long as there’s a conflict between federal and state law. Marijuana is legal under many state laws, and, where that is the case, expenses of producing it generally ought to be deductible in computing a taxpayer’s net income subject to taxation. But marijuana remains illegal—a controlled substance—under federal law.

8. Foreign currency transaction losses

In Nsame v. Comm’r, T.C. Summ. Op. 2019-26, a Tax Court summary case, taxpayers took a number of unsupported positions, including a claimed foreign currency loss of over $50,000 on mortgage payments made on a Canadian home. To be eligible for such a loss under section 988, they would have had to show that there had been changes in the exchange rate between their primary currency and the currency in which the debt was denominated. Since they made no showing whatsoever as to the amount of payments made on the mortgage during the relevant period, their position was a clear loser.

9. Economic substance

a. Denial of cert in Tucker

We earlier reported on Tucker v. Comm’r, 2019 U.S. App. LEXIS 9852 (5th Cir. 2019), an unpublished per curiam decision, in which the Fifth Circuit summarily affirmed the Tax Court’s disallowance of deductions claimed from offsetting foreign currency options. The Tax Court had held that the underlying transactions failed the objective economic prong of the economic substance test because there was no reasonable possibility of profit from the transactions, and the Fifth Circuit agreed that the Tax Court properly understood economic substance doctrine. To the surprise of almost no one, the Supreme Court denied the certiorari petition in Tucker. 2019 U.S. LEXIS 6445 (Oct. 15, 2019).

b. Affirmance of Endeavor Partners Fund

In Endeavor Partners Fund, LLC v. Comm’r, 943 F.3d 464 (D.C. Cir. 2019), the D.C. Circuit affirmed the Tax Court’s conclusion disallowing losses from transactions that involved paired foreign currency options. The transactions lacked economic substance.
III. Character of Gain or Loss

A. Gain on Sale of Franchises

In *Greenteam Materials Recovery Facility PN v. Comm’r*, T.C. Memo. 2017-122, the Tax Court held that contractual rights to provide waste disposal and recycling services, within defined areas, to a county and city are “franchises” within the meaning of section 1253. See I.R.C. § 1253(b)(1) (“The term ‘franchise’ includes an agreement which gives one of the parties to the agreement the right to distribute, sell, or provide goods, services or facilities, within a specified area.”). Gain on disposition of the contracts was therefore capital gain so long as the transferor retained no “significant power, right, or continuing interest with respect to the subject matter of the franchise” transferred. I.R.C. § 1253(a). And the court held that the taxpayer in *Greenteam Materials Recovery* retained no such interest. The decision was taxpayer-friendly—providing for capital gain on the disposition of what, in substance, was rights to future streams of ordinary income. Two years later, the Commissioner has finally published his nonacquiescence “to the holding that the transfer of a non-capital asset is treated as the sale or exchange of a capital asset under I.R.C. § 1253(a) if the transferor does not retain any significant power, right, or continuing interest in the asset.” See AOD 2019-03, 2019-42 I.R.B. 934 n.1. (The AOD spells the taxpayer’s name with a capital T—GreenTeam—which differs from the spelling used in the Tax Court opinion. Someone—Brad Borden, maybe—needs to write a law review article on the spelling of parties’ names in judicial decisions.)

B. Bad Debt Deduction

Business bad debts lead to ordinary deductions in the year in which the lender can demonstrate the worthlessness or partial worthlessness of the debts. See IRC § 166(a). However, nonbusiness bad debts result in short-term capital losses, subject to all the limitations on deductibility of capital losses, and no deduction at all is available for a nonbusiness debt that has become only partially worthless. See I.R.C. § 166(d).

In *Bercy v. Comm’r*, T.C. Memo. 2019-118, there was no question that Bercy regularly made loans for his own account. (He was also active in an S corporation that he founded and controlled, a company that made mortgage loans secured by real estate.) Most of the loans were real estate related, but not all were, including the one at issue in the case—made to a furniture business (selling high-end furniture that “was popular among Los Angeles party-goers,” according to the judge, *Bercy*, slip op. at 4), the business plan of which impressed Bercy but, with the benefit of hindsight, probably shouldn’t have. The note was secured by the assets of the business, but that turned out not to be enough to protect Bercy’s interests.

The Commissioner argued that this particular bad debt was a nonbusiness one in that it was unrelated to Bercy’s typical lending in the real estate context. The Tax Court disagreed:

We are not persuaded to construe the term “trade or business” so narrowly in this context. When previously considering the stats of loans as “business debts” under [S]ection 166, we have not segmented the taxpayer’s lending business according to the nature of the loan or type of customer. Rather, we have simply asked whether the taxpayer was in the
business of lending money, separate and distinct from any other gainful employment he or she may have had.

Id. at 14. With the question asked in that way, the answer was clear: Bercy, who had made many business loans, was in the lending business. Because he was able to demonstrate the worthlessness of the bad debt in 2014, he was entitled to an ordinary deduction in that year.

C. Ordinary Loss Not Justified for Worthless Securities Held by Nonbank, But What’s a Bank?

In MoneyGram International, Inc. v. Comm’r, 153 T.C. No. 9 (2019), the Tax Court reconsidered its earlier decision that MoneyGram, a global payment services business, wasn’t entitled to an ordinary loss deduction from writing down or off partially and wholly worthless securities under section 582 because it was not a bank as defined in section 581. The Fifth Circuit had concluded that the Tax Court, in its first decision, had used an incomplete definition of “bank.” See 2016-2 USTC (CCH) ¶ 50,477 (5th Cir. 2016). On reconsideration, the Tax Court came to the same result as in its first decision, but also addressed one factor that the Fifth Circuit had concluded had impermissibly been ignored the first time around.

The analysis was as follows: MoneyGram doesn’t receive deposits, one important characteristic of a bank. (Money order sales aren’t deposits for this purpose.) And it doesn’t make loans, another important characteristic of a bank. The Fifth Circuit had instructed the Tax Court to consider whether MoneyGram makes “discounts,” a statutory term dating from 1936, and apparently intended to refer to a bank’s acquiring promissory notes for less than full face value. MoneyGram argued that its acquisition of asset-backed securities satisfied this standard, but, as Judge Lauber noted, if “making discounts” were interpreted so broadly, almost any investment could be considered as making a discount, and that can’t be what Congress had in mind. Judge Lauber also rejected the argument that MoneyGram’s acquisition of commercial paper from broker-dealers was making discounts. Even if that were technically correct, the judge concluded that this was such an insubstantial part of the business that it should be disregarded.

IV. Hobby Losses (or Not)

When a large amount of pleasure is associated with an activity, demonstrating that the activity is one engaged in for profit—and that the deductibility of losses from the activity therefore isn’t limited by section 183—can be difficult. And a lot can be at stake. Section 183 of course doesn’t limit deductions that would be available whether or not an activity is engaged in for profit, and in form section 183(b)(2) permits the deductibility of amounts up to the amount of income from an activity not engaged in for profit (reduced by the amount of any otherwise available deductions). But any deduction otherwise permitted by section 183(b)(2) is a miscellaneous itemized deduction, and for taxable years between 2018 and 2025, miscellaneous itemized deductions aren’t deductible at all. See I.R.C. 67(g). During those years characterizing an activity as one not engaged in for profit has particularly serious consequences.
A. Hobby Horses

Raising horses is perhaps the quintessential activity raising hobby loss issues; the lawbooks are filled with such cases. A prerequisite for claiming losses associated with a horse activity is presumably actually owning a horse or two—a threshold test failed by the taxpayer in *McMillan v. Comm’r*, T.C. Memo. 2019-108. McMillan, a regular litigant in the Tax Court about the status of her horse activity, reappeared to challenge the application of section 183 to her for taxable year 2010. The particular problem was that in 2010 she owned no horses at all, the last having died in 2008. Judge Holmes, provided a wonderful opportunity to draft a pun-filled opinion (one David Shechtman might have written), conceded that McMillan loved horses and may well have been interested in commencing a new horse activity. But it’s difficult to argue with a straight face—McMillan represented herself, with no help from Mr. Ed—that you’re in the business of breeding and raising horses if you don’t own a horse. Saying any more about this case would be like—well—beating a dead horse.

Horse activities really can be engaged in for profit, however. In *Den Besten v. Comm’r*, T.C. Memo. 2019-154 (2019), taxpayer was successful in convincing the court that his activity of breeding, raising, boarding, training, and selling cutting horses (horses adept at isolating single animals from a herd) was engaged in for profit. He satisfied most of the factual tests set out in the regulations, although he did pull back on his cutting horse activities when economic necessity forced him to (he had to sell assets to try to salvage a seed business that, the court said, was a distinct activity) and when age cut down on the effort he could put into the cutting horse activity. (On the other hand, the advancement of Father Time meant he also couldn’t do as much pleasurable horse-things, like riding the beasts.) Key favorable factors were the businesslike operation and recordkeeping of the activity; taxpayer’s expertise and time and effort spent on the activity; and the fact that he needed income from the activity.

B. Golf

Golf is something that folks do for pleasure, of course, so long as the putts are dropping. But operating a golf course isn’t something the average Joe would do to have a good time. *WP Realty LP v. Comm’r*, T.C. Memo. 2019-120, involved a golf course, Whispering Pines, operated by a partnership in which Corbin Robertson had a 99 percent interest. Robertson originally intended for Whispering Pines, opened in 2000, to be a nonprofit entity—to further amateur golf—but the activity soon morphed, he said, into a would-be profit-making activity. It has to this day yet to make a profit, however, in part because of the economic downturn in 2008, and at issue in the case was the deductibility of the annual losses allocated to the partners, primarily Robertson.

WP Realty prevailed in the dispute; the Tax Court concluded that most of the relevant factors in the Section 183 regulations favored the conclusion that the activity was one engaged in for profit. WP Realty developed, and regularly revised, a business plan. (The court noted that Robertson was unsure that Whispering Pines was going to make it as a business because of its rural location, so he decided to make improvements gradually and developed business plans accordingly.) In addition, WP otherwise operated the enterprise in a businesslike manner, including hiring experts experienced in running golf courses; Robertson had been successful in
operating other golf courses (although they were ones tied to real estate developments clearly intended to be profitable); and, although Robertson does indeed love golf, he played only three times at Whispering Pines during the tax years at issue. Whispering Pines was thus held to be an activity engaged in for profit for those years, although the court noted that that status wasn’t necessarily eternal. The characterization of an activity under section 183 depends on the facts, and facts can change.

C. Real Estate Consulting

Non-nerds don’t usually associate pleasure with real estate consulting—at least not in the same way as with horses and golf. In *Sarkin v. Comm’r*, T.C. Memo. 2019-131, a couple, both architects, had formed an architectural firm (Sarkin & Jain) in South Africa. In the early 2000s, the couple moved to the United States where the wife (Sarkin) had a position with an architectural firm and the husband (Jain) helped with childcare responsibilities and studied for an MBA at Columbia. Jain later worked for GE but, after he lost his job during the financial crisis, he returned to South Africa. Jain converted a portion of his apartment there into an office and, for U.S. tax purposes, claimed to have been operating a real estate consulting business based in New York, an offshoot of Sarkin & Jain. The Tax Court upheld the Commissioner’s disallowance of the losses claimed for the purported real estate consulting business, going through the factual analysis set out in the regulations, nearly all parts of which favored the Comm’r. Almost no indicia of an ongoing business were present. Jain kept almost no records of meetings and time spent on real estate activities; he didn’t keep a log of travels between the U.S. and South Africa; and he didn’t maintain a separate bank account or hire any specialists to help with the purported business. Oh yes, he also failed to make a profit in any year from his purported business activities. (The only positive factor for the taxpayers was that real estate consulting isn’t usually thought of as an inherently pleasurable activity.)

V. Basis and Depreciation

A. Shareholder Basis in Indebtedness of S Corporation

In a brief unpublished memorandum decision, the Ninth Circuit affirmed the Tax Court’s decision that taxpayers, shareholders in an S corporation (S1), had no basis in S1 attributable to a loan that had been made by a third party to S1 and that was then acquired by another S corporation (S2) which the taxpayers had formed for that purpose. *Messina v. Comm’r*, 2019 U.S. App. LEXIS 38704 (9th Cir. 2019), aff’g T.C. Memo. 2017-213. (Without basis credit for that loan, the taxpayers were unable to currently deduct their full shares of S1’s losses because of the limitations of section 1366(d)(1).) Taxpayers had argued that, given their ownership of S2, they should receive basis credit because, in substance, the indebtedness was theirs. The Ninth Circuit panel noted, however, that the Ninth Circuit had never held that taxpayers can invoke the substance-over-form argument to disregard the tax effects of a transaction the form of which they voluntarily entered. (With that understanding, substance-over-form is a doctrine that only the government can invoke.) And the court concluded, in the alternative, that even if taxpayers may invoke the substance-over-form doctrine in some cases, this wasn’t one of them. There were legitimate, substantive, non-tax reasons for having S2, rather than the individual taxpayers,
acquire the loan (such as avoiding foreclosure on a casino), and for all non-tax purposes the taxpayers had treated S2 as a legitimate, independent entity.

B. Depreciation: Property Not Public Utility Property Under Section 168(i)(10)

In Private Letter Ruling 201946007 (Aug. 8, 2019), the Service ruled that wind energy property that a utility company intends to acquire will not be public utility property, as defined in section 168(i)(10), and that the rule of section 168(f)(2), taking public utility property out of the scope of section 168 unless a normalization method of accounting is used, will therefore not apply. Although the property will be predominantly used in the business of furnishing or selling electric energy and the facility is subject to the jurisdiction of a governmental agency, the rates for the sale will be established or approved by one of the governmental agencies listed in the statute, the rates set by that agency won’t be established or approved on a rate-of-return basis. Rates will instead be set on a market basis, which takes the facility out of the category of public utility property as a result of a longtime understanding in interpreting other Code and former Code provisions that use that term.