for calendar year 1986. The figures appeared at page 381 of the committee of the Joint Committee on Taxation. That had the effect of causing Congress to go to work on slimming down the revenue losses almost immediately.

But even before the JCT publication appeared, the media was publishing estimates as early as late September. One early assessment appeared in the Des Moines Register based on interviews the previous day. I had been interviewed and was quoted in saying that "[T]here is 'no hope of covering the deficit' that is being created by the Reagan tax cut . . . that cut will come to be viewed "as the most irresponsible Congressional act of the century." I added, "and I pick these words intentionally." The morning that was published, I was in Des Moines to give an all-day seminar on the 1981 Tax Act sponsored by Bankers Trust Company for attorneys and Certified Public Accountants. As the passage was later published in a book,[4] the seminar was set to run from 8:30 a.m. to 4:30 p.m. I arrived at the seminar site at about 7:45 a.m. and ". . . was greeted by a flying wedge of Republican stalwarts." The question came thick and fast – what are you trying to do to our President? Why can't you let his plan work without being so critical? Are you sure of this? The underlying theme of most of the remarks was "who are you to be questioning the best minds in Washington?"

Little did I know then, but the tax cuts were, indeed, a huge fiscal experiment, David Stockman's "highly imaginative vision of a new statist age."[5] As Stockman later wrote –

> "The size of the tax cut just kept growing beyond 1984. It was like a fiscal volcano, rising steadily against the distant horizon. . .. In truth, not six of the six hundred players in the game of fiscal governance in the spring and summer of 1981 would have willed this outcome. Yet, caught up in the powerful forces unleashed by the dangerous experiment of a few supply siders who had gotten the President's ear, they let it happen just the same."[6]

Lessons for present day decision makers

The fiscal situation is really little different today than in 1981. Those with sound economic analysis are shunted aside; those with harebrained ideas can marshal sufficient support to prevail. However, the country survived the 1980s; it will probably eventually prevail in 2018 and, possibly, beyond.

ENDNOTES

[1] See Harl, *The Farm Debt Crisis of the 1980s*, Iowa State University Press, 1990.

[2] Pub. L. No. 97-34, 95 Stat. 172 (1981), signed into law on August 13, 1981.

[3] Joint Committee on Taxation, General Explanation of the Economic Recovery Tax Act of 1981 (December 29, 1981), pages 379-401).

[4] Harl, *The Farm Debt Crisis of the 1980s*, Iowa State University Press, pp.8-9.

[5] David A. Stockman, *The Triumph of Politics: Why the Reagan Revolution Failed* (New York: Harper and Row (1986).

[6] *Id*, at 267-268.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

ANIMALS

COWS. The plaintiffs were injured when their vehicle struck a cow on a public highway. The cow was owned by one defendant and kept on property owned by a nursery owned by the other defendant. The plaintiffs sued and claimed that the defendants violated Ala. Code § 3-5-1 *et seq.* by knowingly or willfully putting or placing the cow on a public roadway. Ala. Code § 3-5-3(a) provides, in pertinent part: "[T]he owner of any stock or animal shall not be liable for any damages to any motor vehicle or any occupant thereof suffered, caused by or resulting from a collision with such stock or other animal, unless it be proven that such owner knowingly or willfully put or placed such stock." The plaintiffs argued that the defendant failed to properly construct and maintain the fence and that such failure amounted to knowingly or willfully allowing the cow to wander onto the highway. The court stated that, to constitute "willful or intentional injury," there must be knowledge of danger accompanied with a design or purpose to inflict injury, whether the act be one of omission or commission. ALA. Code § 3-5-3(a) requires knowing or willful conduct on the part of the livestock owner and requires proof that the livestock owner had a design or purpose to inflict injury. Thus, even proof that the defendants acted wantonly, i.e., that they were conscious of the danger of the cow wandering free because of the allegedly defective fence, is insufficient to establish liability under Ala. Code § 3-5-3(a). In addition, Ala. Code § 3-5-3(a) requires proof not only that the owner acted knowingly or willfully, but also that the owner "put or placed such stock upon such public highway." Thus, the court held that, absent proof that the defendants knowingly or willfully placed the cow on the highway, summary judgment for the defendants was proper. **Brewer v. Atkinson, 2018 Ala. Civ. App. LEXIS 39 (Ala. Ct. App. 2018)**.

BANKRUPTCY

CHAPTER 12

ELIGIBILITY. The debtor owned and operated a family farming operation through two general partnerships. The partnerships had each filed for Chapter 11 bankruptcy and received discharges. In those cases, land and several pieces of

farm equipment were sold, resulting in significant tax liability to the debtor. The debtor filed for Chapter 12 and a bank creditor challenged the debtor's eligibility for Chapter 12, arguing that less than half of the debtor's income in prior years came from farming. The creditor argued that the income from the partnerships, including the gains from the sale of the partnerships' land and equipment were not gross income from farming as to the debtor because the partnerships were separate entities. The court held that the pass through income from the partnerships, including the gain from the sale of the land and equipment was gross income from farming as to the debtor, making the debtor eligible for Chapter 12. The creditor also challenged the debtor's eligibility for Chapter 12 on the grounds that the debtor's debts exceeded the statutory debt limit of Section 101(18)(A). The creditor argued that the total debt included (1) claims listed on the bankruptcy schedules by the debtor, although some of the claims were not supported by any proof of claim; (2) the proofs of claims filed by creditors; and (3) the federal tax liability from the partnerships' sales of land and equipment. The court held that the determination of total debt was made as of the date of the petition, prior to the filing of the proofs of claim. The court held that the total debt did not include the post-petition filed proofs of claim because the debtor's schedules of debt were not shown to be fraudulent or filed in bad faith; therefore, the amount of scheduled debt controlled for purposes of Section 101 eligibility for Chapter 12. The court included the federal tax debt but that was insufficient to raise the amount of debt above the statutory limit. ***In re* Perkins, 2018 Bankr. LEXIS 706 (Bankr. 6th Cir. 2018), aff'g, 563 B.R. 229 (Bankr. W.D. Ky. 2016)**.

FEDERAL ESTATE AND GIFT TAXATION

GIFTS. On a date after August 5, 1997 and before January 1, 2001, the taxpayer husband created four irrevocable trusts for four children, with each child as the primary beneficiary of a separate trust for the benefit of the child and the child's children. Under each trust agreement, the income of that trust is to be paid to the child for whom the trust was created. On the child's death, the principal is to be held in further trust and distributed outright to her children upon their attaining age 35. The trusts were funded with cash. An accounting firm prepared the Forms 709, *United States Gift (and Generation-Skipping Transfer) Tax Returns*, for the taxpayers. On his and her respective timely filed Form 709, the husband and wife signified their consent to treat their gifts as having been made one-half by each spouse under I.R.C. § 2513. Nevertheless, the husband's Form 709 reported his portion of the total transfer to be three-quarters (rather than one-half) of the amount transferred to the trusts. The wife's Form 709 reported her portion of the total transfer to the trusts to be one-quarter (rather than one-half) of the amount transferred to the trusts. No amount of the husband's or the wife's available GST exemption was allocated to the transfers to the trusts on the Forms 709. Several years later, the accounting firm realized that no GST exemption had been allocated to the transfers to the trusts and advised the husband of the ability to make a late allocation of GST exemption to the transfers to the trusts. The accounting firm prepared the husband's second Form 709 to include the late allocation of GST exemption to the transfers to the trusts. The late allocation of the husband's GST exemption erroneously allocated an amount equal to 100 percent of the value of the transfers to the trusts. The notice of allocation attached to the husband's second Form 709 stated that, as a result of the late allocation, the inclusion ratio of the trusts was zero. The wife was not advised to make a late allocation of GST exemption to the wife's portion of the transfers to the trusts. The period of assessment of gift tax had expired by the time the husband had filed the second Form 709 with the GST allocation. Treas. Reg. § 25.2504-2(b) provides that if the time has expired under I.R.C. § 6501 within which a gift tax may be assessed on the transfer of property by gift made during a preceding calendar period, and the gift was made after August 5, 1997, the amount of the taxable gift or the amount of the increase in taxable gifts, for purposes of determining the correct amount of taxable gifts for the preceding calendar periods is the amount that is finally determined for gift tax purposes and such amount may not be thereafter adjusted. The rule applies to adjustments involving all issues relating to the gift including valuation issues and legal issues involving the interpretation of the gift tax law. I.R.C. § 2513(a)(1) provides, generally, that a gift made by one spouse to any person other than the donor's spouse is considered, for purposes of the gift tax, as made one-half by the donor and one-half by the donor's spouse. Treas. Reg. § 25.2513-1(b)(5) provides, in part, that the split-gift election may not be applied only to a non-one-half portion of the property interest constituting such gifts. If the election is effectively signified on either the husband's return or the wife's return, all gifts made by the spouses to third parties (except as described in Treas. Reg. § 25.2513-1(b)(1) through (4)), during the calendar period will be treated as having been made one-half by each spouse. Under I.R.C. § 2504(c) and Treas. Reg. § 25.2504-2(b), because the time has expired under I.R.C. § 6501 within which a gift tax may be assessed, the amount of the taxable gift is the amount that is finally determined for gift tax purposes and may not thereafter be adjusted. In this case, the disproportionate gift split reported on the husband's and the wife's respective Forms 709 represents the amounts that are finally determined for gift tax purposes; thus, 75 percent of the amount transferred to the trusts was deemed a gift by the husband and 25 percent by the wife. However, under Treas. Reg. § 26.2652-1(a)(4), the husband is regarded for GST tax purposes as the transferor of one-half of the total value of the property transferred to the trusts regardless of the interest the husband is treated as transferring under I.R.C. § 2513 for gift tax purposes. Accordingly, the IRS ruled that the husband's late allocation of GST exemption to the trusts on the second Form 709 was effective only to the one-half portion of the property transferred to the trusts, of which he is considered the transferor for GST tax purposes. See I.R.C. § 2631(a); Treas. Reg. § 26.2632-1(b)(4)(i) (an allocation of GST exemption to a trust is void to the extent the amount allocated exceeds the amount necessary to obtain an inclusion ratio of zero). **Ltr. Rul. 201811002, Nov. 27, 2017**.

LIENS. The decedent owned 40 percent interests in two limited partnerships when the decedent died in 2006. The IRS assessed federal estate taxes against the decedent's estate for unpaid taxes, interest, penalties and costs. In 2010 and 2016, the IRS recorded

notices of estate tax liens. In 2015 the partnerships sold the assets of the partnerships to an unrelated company. The buyer purchased all the assets, rights, obligations, and liabilities of the partnerships. Under the partnership agreements, the decedent was entitled to a 40 percent share of the proceeds of the sale. However, the remaining partners filed suit in state court against the estate and objected to the estate receiving the full 40 percent because they alleged that the decedent had outstanding loans from the partnerships at death which should offset the decedent's share of the proceeds. However, the state court noted that the sale included all rights of the partnerships, including the right to receive the loan payments from the decedent. Thus, the partners no longer had any right to offset the decedent's loans against the decedent's share of the proceeds. The case was removed to federal court by the IRS which claimed that the tax liens covered the decedent's share of the sale proceeds to offset the taxes owed by the estate. The partners then argued that the decedent's loans were "excessive distributions" which were required to be equalized as to the other partners by offsetting the decedent's share of the proceeds against the loans. Thus, the decedent's share of the proceeds were not estate property and not subject to the tax liens. The court found, however, that the partners did not provide any evidence to support the claim that the loans were actually distributions. The court noted that both partnerships had promissory notes for the loans and that the estate acknowledged the loan obligations by submitting partial payments. Thus, the court held that the loans were *bona fide* and the partners no longer had any right to collect on the loans. The remaining issue was whether the buyer of the partnerships' assets or the IRS tax lien had priority as to the decedent's share of the proceeds. The buyer argued that it had obtained a strict foreclosure of the decedent's loans under Kentucky law, Ky. Rev. Stat. § 355.9-620(3)(b)(3), by proposing to the estate that the collateral be accepted in satisfaction of the loan and the estate fails to object within 20 days. The evidence showed that the buyer did send a proposal to the estate but that the estate's attorney replied that the buyer did not have any right to the proceeds. Thus, the court held that the buyer did not obtain any rights to the proceeds by "strict foreclosure" under state law and the federal tax lien could attach to the proceeds. However, I.R.C. § 6323(a) states that a federal tax lien is not valid as to a "holder of a security interest" perfected prior to attachment of the tax lien. In this case, the court found that the buyer had no perfected security interest in the sale proceeds; therefore, the court held that the federal tax lien had priority against the buyer's interest in the proceeds and could collect the decedent's share to satisfy the estate taxes owed. **Bennett v. Bascom, 2018-1 U.S. Tax Cas. (CCH) ¶ 60,704 (E.D. Ky. 2018)**.

FEDERAL FARM PROGRAMS

REAL ESTATE LENDING. The Rural Housing Service has adopted as final regulations removing as obsolete regulations governing the compliance of real estate settlement procedures under the Truth in Lending Act (TILA) regulations. 7 CFR part 1940, subpart I, provides instruction for compliance with TILA as implemented by Regulation Z of the Federal Reserve System, and with Real Estate Settlement Procedures Act (RESPA) as implemented by Regulation X of the Department of Housing and Urban Development. In 2010, Congress signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The Dodd-Frank Act directed the Consumer Financial Protection Bureau (CFPB) to integrate the mortgage loan disclosures under TILA and RESPA Sections 4 and 5. The CFPB's TRID rule requires easier-to-use mortgage disclosure forms that clearly lay out the terms of a mortgage for a homebuyer; the rule consolidated the four disclosures required under TILA and RESPA into two forms: A Loan Estimate and a Closing Disclosure. With the TRID rule, 7 CFR part 1940, subpart I, has become functionally obsolete since it refers to outdated processes, forms, and governing bodies. **83 Fed. Reg. 12657 (March 23, 2018)**.

FEDERAL INCOME TAXATION

BUSINESS EXPENSES. The taxpayer was an attorney whose work was primarily as a litigation consultant. In 2014 the taxpayer provided 100 hours of free *pro bono* legal research services to clients. The taxpayer did not incur or pay any expenses incurred as part of the *pro bono* work. Based on the taxpayer regular hourly rate and the number of hours spent on the legal research, the taxpayer claimed the value of the *pro bono* work as a research expense deduction on Schedule C but the deduction was denied by the IRS. The court upheld the denial of the deduction, holding that longstanding case precedent has established that labor expended in a trade or business is not deductible because there is no payment of an expense involved. *See, e.g., Maniscalco v. Comm'r, 632 F.2d 6, 7 (6th Cir. 1980), aff'g T.C. Memo. 1978-274*. I.R.C. § 174(a)(1) provides that a taxpayer may deduct "research or experimental expenditures which are paid or incurred by him during the taxable year in connection with his trade or business." As used in Section 174, the term "research and experimental" expenditures involve only those incurred "in the experimental or laboratory sense." See Treas. Reg. § 1.174-2(a). The taxpayer conceded and the court agreed that the taxpayer did not conduct research in the experimental or laboratory sense. Thus, because the taxpayer's activities did not meet the requirements of I.R.C. § 174, the court held that the taxpayer was not entitled to a deduction under this section. **Bradley v. Comm'r, T.C. Summary Op. 2018-13**.

DEPRECIATION. The taxpayer corporation was a member of an affiliated group of corporations. Another corporation acquired the parent corporation of the affiliated group and became the new parent corporation of the affiliated group. The change necessitated the filing of a short year return for the period up to the change in parent corporations. The short tax year, the taxpayer placed in service 7-year property for which the parent corporation intended to make the election not to claim

the additional first year depreciation under I.R.C. § 168(k)(1).The tax return preparer hired by the taxpayer filed the return for the short tax year and included the election not to claim additional first year depreciation; however, the return preparer failed to file the return before its due date, thus rendering the election void. Treas. Reg. § 1.168(k)-1(e)(3)(i) provides that the election not to deduct additional first year depreciation must be made by the due date (including extensions) of the federal tax return for the taxable year in which the property is placed in service by the taxpayer. Treas. Reg. § 1.168(k)-1(e)(3)(ii) provides that the election not to deduct additional first year depreciation must be made in the manner prescribed on Form 4562, *Depreciation and Amortization*, and its instructions. The instructions to Form 4562 provide that the election not to deduct the additional first year depreciation is made by attaching a statement to the taxpayer's timely filed tax return indicating that the taxpayer is electing not to deduct the additional first year depreciation and the class of property for which the taxpayer is making the election. The IRS granted the taxpayer an extension of time to make the election, essentially by considering the return as timely filed. **Ltr. Rul. 201811007, Dec. 12, 2018; Ltr. Rul. 201811006, Dec. 15, 2018**.

ELECTRICITY PRODUCTION CREDIT. Section 40408 of Division A of the Bipartisan Budget Act of 2018, *Pub. L. No. 115-123*, extends the credit period for the Indian coal production credit from an 11-year period beginning on January 1, 2006, to a 12-year period beginning on January 1, 2006. This provision is effective for coal produced in the United States or a possession thereof after December 31, 2016 and before January 1, 2018. The 2017 inflation-adjustment factor used in determining the availability of the credit for Indian coal production under I.R.C. § 45 for qualified energy resources and refined coal is 1.2115. The amount of the credit for calendar year 2017 is $2.423 per ton of Indian coal sold in 2017. **83 Fed. Reg. 13346 (March 28, 2018).**

PENALTIES. I.R.C. § 162(f)(1), as amended by the TCJA 2017, disallows a deduction for amounts paid or incurred (whether by suit, agreement, or otherwise) to, or at the direction of, a government or governmental entity in relation to the violation of any law or the investigation or inquiry by such government or entity into the potential violation of any law. I.R.C. § 162(f)(2) provides an exception to the general rule under § 162(f)(1), allowing a deduction if

(1) the taxpayer establishes that the amount paid or incurred (a) constitutes restitution (including remediation of property) for damage or harm that was or may be caused by violation of any law or the potential violation of any law, or (b) is paid to come into compliance with any law that was violated or otherwise involved in the investigation or inquiry into the potential violation of any law (the "establishment requirement");

(2) the amount paid or incurred be identified as restitution or as an amount paid to come into compliance with such law in the court order or settlement agreement (the "identification requirement"); and

(3) in the case of any amount of restitution for failure to pay any tax imposed under the Code, the amount is treated as if such amount were such tax if it would have been allowed as a deduction had it been timely paid. Section 162(f)(2)(A) further provides that meeting the identification requirement alone is not sufficient to meet the establishment requirement under § 162(f)(2)(A)(i).

The new law generally applies to amounts paid or incurred on or after December 22, 2017, except that they do not apply to amounts paid or incurred under any binding order or agreement entered into before that date. The IRS intends to issue regulations to support the new law and has issued a *Notice* to provide transitional guidance until the regulations can be proposed. Until proposed regulations under I.R.C. § 162(f) are issued, the identification requirement in I.R.C. § 162(f)(2)(A)(ii) is treated as satisfied for an amount if the settlement agreement or court order specifically states on its face that the amount is restitution, remediation, or for coming into compliance with the law. Even if the identification requirement under this is treated as satisfied under this *Notice*, taxpayers must also meet the establishment requirement in order to qualify for the I.R.C. § 162(f)(2) exception. **Notice 2018-23, I.R.B. 2018-15**.

The taxpayer was a lawyer whose returns for 2013 and 2014 were audited, resulting in disallowance of deductions and increases in taxable income. The taxpayer had hired a CPA firm to prepare the 2013 and 2014 returns but the taxpayer provided the preparer only with cancelled checks and the taxpayer's description of the purpose of the checks. No receipts or other evidence of the purpose of the checks was provided. After the audit, the IRS assessed the substantial understatement penalty. The taxpayer argued that the penalty was improper because the taxpayer relied on the return preparer to properly prepare the returns. The court noted that the taxpayer did not object to the disallowance of the deductions and that the deductions were disallowed for lack of substantiation. I.RC. § 6662(a) and (b) impose a 20 percent accuracy-related penalty on any underpayment of federal income tax which is attributable to negligence, disregard of rules or regulations, or a substantial understatement of income tax. I.R.C. § 6662(d)(1)(A) provides that an understatement of income tax is substantial if it exceeds the greater of 10 percent of the tax required to be shown on the return or $5,000. I.R.C. § 6664(c)(1) provides an exception where the taxpayer demonstrated that the taxpayer relied on the advice of a tax professional in treatment of a tax item. The court found that the taxpayer failed to demonstrate that the taxpayer provided the return preparer with complete information about the taxpayer's expenses and that the return preparer provided any advice as to the tax items. Therefore, the court held that the taxpayer did not demonstrate reasonable cause and good faith in reliance on the advice of the tax return preparer and the penalty was properly assessed. **Larson v. Comm'r, T.C. Memo. 2018-30**.

QUALIFIED BUSINESS INCOME. The Tax Cut and Jobs Act of 2017 (TCJA) enacted a new deduction for pass-through entities and sole proprietorships of 20 percent of qualified business income, generally net income from a trade or business, except for capital gains and specified other income, for example, publicly traded partnership income. Under the TCJA as originally enacted, the 20 percent deduction for cooperatives was based on *gross* income of the cooperative less qualified cooperative dividends

(includes patronage dividend, per-unit retains and qualified written notices of allocation). Patron farmers who generated income from sales to a cooperative were also eligible to take the QBI deduction from the income from the sales, and if the cooperative passed on a portion of its QBI deduction, the farmer could potentially obtain more than a 20 percent QBI deduction, subject to other limitations on the QBI deduction. This additional deduction would not be available for sales to non-cooperative buyers, thus producing an incentive for sales to cooperatives. The Consolidated Appropriations Act of 2018, *Pub. L. No. 115-141*, modified some aspects of the advantage to cooperatives in the TCJA by changing the deduction for agricultural/horticultural cooperatives to a deduction that is 9 percent of the lesser of (1) the cooperative's qualified production activities income QPAI (see I.R.C. § 199, the domestic production activities deduction) or (2) its taxable income excluding any I.R.C. § 199A(g) deduction and any deduction allowable under I.R.C. § 1382(b) and (c), relating to qualified cooperative dividends. In addition, for farmers who sell to cooperatives, their QBI deduction is reduced by the smaller of (1) 9 percent of net income attributable to cooperative sales or (2) 50 percent of W-2 wages they paid to earn that income from the cooperative. Thus, if the farmer did not pay any wages to generate the income from the sale, no reduction of the QBI deduction results. If the cooperative passes on to the farmer a portion of the cooperative's QBI deduction, the farmer adds that portion to the farmer's own QBI deduction, subject, of course, to the other limitations on QBI.

REFUNDS. The taxpayers, husband and wife, timely filed their 2014 income tax return and received a notice from the IRS in October 2016 that additional taxes were due. The taxpayers submitted an installment agreement request which was rejected because the monthly payment was too low. The taxpayers paid only $445 of the $11,000 in additional taxes owed. In February 2016, the taxpayers filed suit against the IRS for return of the $445 and claiming that the IRS had improperly retained a refund from an unidentified prior tax year. The taxpayers filed an amended return claiming a refund in May 2017, 15 months after filing the petition in this case. I.R.C. § 7422 grants a waiver of sovereign immunity to permit jurisdiction of federal district courts under 28 U.S.C. § 1346 for tax refund suits. However, federal district courts have no jurisdiction over suits for a tax refund unless the taxpayer (1) has paid the contested tax assessment in full, and (2) has filed a claim for refund which the IRS has either rejected or not acted upon in six months. Thus, district courts are prohibited from entertaining refund suits before the expiration of six months from the date of filing the claim or after the expiration of two years from the date of mailing of the claim, which can be an amended return claiming a refund. See 26 U.S.C. § 6532. Thus, the court held that the case must be dismissed because the court did not have jurisdiction since the taxpayers had not fully paid the original taxes assessed and the petition was not filed at least six months after the submission of the amended return claiming a refund. The case is designated as not for publication. **Massbaum v. United States, 2018-1 U.S. Tax Cas. (CCH) ¶ 50,195 (9th Cir. 2018),** ***aff'g unpub. D. Ct. dec.***

S CORPORATIONS

PASSIVE INVESTMENT INCOME. The taxpayer was an S corporation with a trust as a shareholder. The trust grantor died and the beneficiaries of the trust were two distributing trusts and two tax exempt organizations described in I.R.C. § 170(c)(2). The beneficiaries of the distributing trusts were individuals and none of the beneficiaries of the trust or the distributing trusts acquired their interest by purchase such that the bases of their interests were determined by I.R.C. § 1014. The taxpayer's primary business activity consisted of farming and managing real property under four leases. The crop share leases provided that the taxpayer was a full participant in the management of the farm, including that the taxpayer was responsible for determining the crop plan, which the tenant could not deviate from unless agreed to in writing by the taxpayer. The tenant agreed to plant, cultivate, and harvest the farm in accordance with the crop plan and deliver the taxpayer's share of crops to a location determined by the taxpayer. The tenant also agreed to furnish reports concerning the date of planting, seed variety, rate of planting, cultivation practices, and the use of fertilizer, insecticide, fungicides, and other chemicals. The tenant also agreed that the farm would be operated in compliance with government programs unless the taxpayer elected to opt out of the program. The leases also provided that the taxpayer participated in some of the associated costs of farming the property. The tenant furnished all labor, equipment, and other expenses for the operation of the farm, except that expenses for fertilizer, insecticide, fungicides, and grain drying were divided between the taxpayer and the tenant in the same proportion as the crop share. The cost of lime was evenly divided between the taxpayer and the tenant, provided, however, that a *pro rata* refund of the tenant's share would be made for each year of a four-year period that the tenant did not have use of the land where the lime was applied. Governmental farm program payments relating to crop production were divided between the taxpayer and the tenant in the same proportions that the crop was divided. The taxpayer furnished materials and the tenant provided the labor for normal maintenance and repairs on buildings, fences, and other similar improvements on the farm. The tenant also agreed to seed, spray, and fertilizer all ditches at the request of the taxpayer with the taxpayer to furnish materials. The farm management services were originally performed by the trustee of the shareholder trust, but were performed by another individual, not identified in the ruling, after the death of the trustee. I.R.C. § 1362(d)(3)(A) provides that an S corporation election under I.R.C. § 1362(a) shall be terminated whenever the corporation has accumulated earnings and profits at the close of each of three consecutive taxable years, and has gross receipts for each of such taxable years more than 25 percent of which are passive investment income. I.R.C. § 1362(d)(3)(C)(i) provides that, except as otherwise provided, the term "passive investment income" means gross receipts derived from royalties, rents, dividends, interest, and annuities. Treas. Reg. § 1.1362-2(c)(5)(ii)(B)(1) provides that "rents" means the amounts received for the use of, or the right to use, property (whether real or personal) of the corporation. However, Treas. Reg. § 1.1362-2(c)(5)(ii)(B)(2) provides that "rents" does not include rents derived in the active trade or business of renting property. Rents received by a corporation are derived in an active trade or business of renting property only if, based on all the facts and circumstances, the corporation provides significant services or incurs substantial costs in the rental business. Generally, significant services are

not rendered and substantial costs are not incurred in connection with net leases. Whether significant services are performed or substantial costs are incurred in the rental business is determined based upon all the facts and circumstances including, but not limited to, the number of persons employed to provide the services and the types and amounts of costs and expenses incurred (other than depreciation). See also *Rev. Rul. 61-112, 1961-1 C.B. 399* (holding that amounts received by a corporation under share-farming agreements were not "rents" within the meaning of former I.R.C. § 1372(e)(5) where the corporation participated to a material degree in the production of farm commodities through physical work or management decisions, or a combination of both). Thus, the IRS ruled that the taxpayer performed substantial services for the crop share leases and the rental income was not passive investment income. **Ltr. Rul. 201812003, Dec. 15, 2017**.

VIRTUAL CURRENCY. The IRS has published information for taxpayers about income from virtual currency transactions reportable on their income tax returns. Virtual currency transactions are taxable by law just like transactions in any other property. The IRS has issued guidance in *Notice 2014-21, 2014-1 C.B. 938,* for use by taxpayers and their return preparers that addresses transactions in virtual currency, also known as digital currency. Taxpayers who do not properly report the income tax consequences of virtual currency transactions can be audited for those transactions and, when appropriate, can be liable for penalties and interest. In more extreme situations, taxpayers could be subject to criminal prosecution for failing to properly report the income tax consequences of virtual currency transactions. Criminal charges could include tax evasion and filing a false tax return. Anyone convicted of tax evasion is subject to a prison term of up to five years and a fine of up to $250,000. Anyone convicted of filing a false return is subject to a prison term of up to three years and a fine of up to $250,000. Virtual currency, as generally defined, is a digital representation of value that functions in the same manner as a country's traditional currency. There are currently more than 1,500 known virtual currencies. Because transactions in virtual currencies can be difficult to trace and have an inherently pseudo-anonymous aspect, some taxpayers may be tempted to hide taxable income from the IRS. *Notice 2014-21* provides that virtual currency is treated as property for U.S. federal tax purposes. General tax principles that apply to property transactions apply to transactions using virtual currency. Among other things, this means that: (1) a payment made using virtual currency is subject to information reporting to the same extent as any other payment made in property; (2) payments using virtual currency made to independent contractors and other service providers are taxable, and self-employment tax rules generally apply. Normally, payers in virtual currency must issue Form 1099-MISC; (3) wages paid to employees using virtual currency are taxable to the employee, must be reported by an employer on a Form W-2 and are subject to federal income tax withholding and payroll taxes; (4) certain third parties who settle payments made in virtual currency on behalf of merchants that accept virtual currency from their customers are required to report payments to those merchants on Form 1099-K, *Payment Card and Third Party Network Transactions*; and (5) the character of gain or loss from the sale or exchange of virtual currency depends on whether the virtual currency is a capital asset in the hands of the taxpayer. **IR-2018-71**.

IN THE NEWS

WITHHOLDING TAXES. The IRS has updated the special Withholding Calculator tool on IRS.gov to reflect changes in the Tax Cuts and Jobs Act passed in December 2017. With most employees seeing withholding changes in their paychecks, the IRS recommends taxpayers use the Withholding Calculator to do a "paycheck checkup." This will help taxpayers check that they are having the correct amount of income tax withheld from their paychecks. Doing a checkup can help protect against having too little tax withheld and facing an unexpected tax bill or penalty at tax time in 2019. Some taxpayers might prefer to have less tax withheld up front and receive more in their paychecks, which would reduce their tax refund next year. The IRS encourages everyone to check their withholding as soon as possible, but it's especially important for these people to use the Withholding Calculator to make sure they have the right amount of tax withheld:

• Two-income families;

• People with two or more jobs at the same time or who only work for part of the year;

• People who claim credits such as the Child Tax Credit; and

• People who claim older dependents, including children age 17 or over.

• People who itemized deductions in 2017

• People with high incomes and more complex tax returns

• People with large tax refunds or large tax bills for 2017

Here are step-by-step instructions for using the calculator:

(1) Go to the main Withholding Calculator page on IRS.gov. Carefully read all information and click the blue Withholding Calculator button.

(2) Use the buttons at the bottom of each page to navigate through the calculator. The buttons allow users to continue inputting their information, reset the information on that page, or start over from the beginning.

(3) Input general tax situation information, including: filing status; whether anyone can claim the users as dependents; total number of jobs held during the year; contributions to a tax-deferred retirement, cafeteria or other pre-tax plan; scholarships or fellowship grants received that are included in gross income; and number of dependents.

(4) Input information about credits, including the child and dependent care credit; the child tax credit; and the earned income tax credit. (5) Enter the total estimated taxable income expected during the year. Amounts the user will enter include wages, bonuses, military retirement, taxable pensions, and unemployment compensation. Users should enter a "0" on lines asking for amounts that do not apply to them. (6) Enter an estimate of adjustments to income, including deductible IRA contributions and education loan interest. (7) Indicate standard deduction or itemized deductions. Users who plan to itemize will enter estimates of these deductions. (8) Print out the summary of results. The calculator will provide a summary of the taxpayer's information. Taxpayers use the results to determine if they need to complete a new Form W-4, which they give to their employer. **Tax Reform Tax Tips 2018-45 and 2018-47**.