



# Current Federal Tax Developments

August 14, 2023

Kaplan Financial Education



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## This Week We Look At:

Deduction for non-qualified deferred compensation not accelerated for the seller when the liability is transferred to the buyer of a business

Tax professionals and taxpayers warned about issues with certain employee stock ownership plan (ESOP) arrangements

Reduction of non-recourse debt amount was added to sales proceeds, not a cancellation of debt so no §108 relief was available

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## Deferred Compensation Deduction Not Accelerated Due to Sale of NBA Basketball Team



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- *Hoops, LP v. Commissioner*, Case No. 22-2012, CA7, August 9, 2023
  - Case involves the 2012 sale of the Memphis Grizzlies of the NBA
  - Selling entity had nonqualified deferred compensation arrangements with two players with a present value of \$10.7 million
  - Under IRC §404(a)(5) nonqualified deferred compensation is not deductible by the employer until the year it is paid out and includable in income of the employee

<https://www.currentfederaltaxdevelopments.com/blog/2023/8/11/deferred-compensation-deduction-not-accelerated-due-to-sale-of-business>



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- *Hoops, LP v. Commissioner*, Case No. 22-2012, CA7, August 9, 2023
  - Reg. §1.461-4(d)(5) provides that upon the sale of a business, any item that would have been deductible except for a lack of current economic performance is deductible by the seller at that time
  - Key question: does this regulation override the rule found at IRC §404(a)(5)?
  - The taxpayer argued yes, and claimed a \$10.7 deduction in 2012

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- *Hoops, LP v. Commissioner*, Case No. 22-2012, CA7, August 9, 2023
  - The Tax Court had ruled against the seller, so they appealed to the Seventh Circuit Court of Appeals
  - Panel notes that economic performance had occurred when the players rendered their services
  - However, IRC §404(a)(5) prevented the seller from claiming a current deduction

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- *Hoops, LP v. Commissioner*, Case No. 22-2012, CA7, August 9, 2023
  - In analyzing tax law, a more specific IRC provision will take precedence over a more general provision of the law
  - Panel concluded that IRC §404(a)(5) was the more specific provision
  - Nothing in §404(a)(5) suggested the rule would be different if the liability was transferred to another party before payment

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- *Hoops, LP v. Commissioner*, Case No. 22-2012, CA7, August 9, 2023
  - Panel did not agree that IRC §404(a)(5) delayed the time of economic performance, but rather just delayed the deduction
  - Also concluded that Congress intended, for policy reasons, to disadvantage non-qualified deferred compensation in this manner
  - Seller will not get a deduction until the year the buyer pays the players on the seller's behalf

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## IRS Warns Professionals and Taxpayers to Be Wary of Certain ESOP Programs



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- “IRS cautions plan sponsors to be alert to compliance issues associated with ESOPs,” News Release IR-2023-144, August 9, 2023
- After concentrating attention on aggressive ERC claims, the IRS has now identified another problematical program
- Employee Stock Ownership Plans (ESOPs) are now the focus of the IRS due to various complex compliance issues with such programs
- Focus is part of the agency’s program to increase compliance for high income taxpayers

<https://www.currentfederaltaxdevelopments.com/blog/2023/8/11/as-part-of-a-focus-on-tax-compliance-of-high-income-taxpayers-irs-issues-warning-about-promotion-of-abusive-esop-programs>



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- “IRS cautions plan sponsors to be alert to compliance issues associated with ESOPs,” News Release IR-2023-144, August 9, 2023
- IRS identifies one specific structure
  - A related S corporation is formed by owners of the business
  - The S corporation provides vague management services to the business
  - It then loans these funds back to the owners of the original business

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## IRS Warns Professionals and Taxpayers to Be Wary of Certain ESOP Programs



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- “IRS cautions plan sponsors to be alert to compliance issues associated with ESOPs,” News Release IR-2023-144, August 9, 2023
- Promoters claim this eliminates tax on the business income but gives owners access to the cash that income generates
- IRS disagrees with this treatment
  - The “loans” should be taxable to the owners
  - Likely could also attempt to disallow the deduction for the management fees

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Disallowance of the management fee deduction for payments to a management company was the result in the Aspro case back in April of 2022. For more information read:

<https://www.currentfederaltaxdevelopments.com/blog/2022/4/27/amounts-paid-as-management-fees-by-c-corporation-not-deductible>



## Reduction in Nonrecourse Debt Found to Be Part of Sales Price, Not Eligible for §108 Exclusion



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- *Parker v. Commissioner*, TC Memo 2023-104, August 10, 2023
  - S corporation had acquired real property to be developed
  - Had nonrecourse debts secured by the land
  - Eventually abandoned completing the development and sold off the land
  - At the time of the sale, the nonrecourse debts on the land exceeded the price the buyer was willing to pay, so lenders agreed to reduce the debts

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  - Generally, if a property subject to a non-recourse debt is foreclosed upon by the lender, the entire debt is considered part of the sales price even if greater than the fair market value
  - The courts have found that the same rule applies to a short sale where the lender waives payment of the excess balance and clears the title (*2925 Briarpark, Ltd. v. Commissioner*, 163 F.3d 319)

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  - But if the lender simply reduces the balance of the debt owned by the borrower in a transaction not related to the sale, that is still a cancellation of debt
  - If the reduction is cancellation of debt, IRC §108(a) may allow excluding that amount from income
  - In this case the S corporation was insolvent at the time the debt was reduced, so §108(a)(2) would have excluded the income if this is COD

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- *Parker v. Commissioner*, TC Memo 2023-104, August 10, 2023
  - The court found that the facts of the case made it clear that reduction of the debt occurred specifically to facilitate the sale of the land
  - The reduction was added to the sales proceeds for tax purposes
  - No exclusion from income was allowed under §108 because there was no cancellation of indebtedness income

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