RECENT DEVELOPMENTS IN FEDERAL INCOME TAXATION

We apologize to our readers. If we had more time, this outline would be much shorter.

By

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This recent developments outline discusses, and provides context to understand the significance of, the most important judicial decisions and administrative rulings and regulations promulgated by the Internal Revenue Service and Treasury Department during the most recent twelve months — and sometimes a little farther back in time if we find the item particularly humorous or outrageous. Most Treasury Regulations, however, are so complex that they cannot be discussed in detail and, anyway, only a devout masochist would read them all the way through; just the basic topic and fundamental principles are highlighted – unless one of us decides to go nuts and spend several pages writing one up. This is the reason that the outline is getting to be as long as it is. Amendments to the Internal Revenue Code are discussed to the extent that (1) they are of major significance, (2) they have led to administrative rulings and regulations, (3) they have affected items previously covered in the outline, or (4) they provide an opportunity to mock our elected representatives; again, sometimes at least one of us goes nuts and writes up the most trivial of legislative changes. The outline focuses primarily on topics of broad general interest (to us, at least) – income tax accounting rules, determination of gross income, allowable deductions, treatment of capital gains and losses, corporate and partnership taxation, exempt organizations, and procedure and penalties. It deals summarily with qualified pension and profit-sharing plans, and generally does not deal with international taxation or specialized industries, such as banking, insurance, and financial services.

In the last twelve months, there have been many significant federal income tax developments. The Treasury Department and the IRS provided an abundance of administrative guidance and the courts issued many significant judicial decisions. The Inflation Reduction Act, Pub. L. No. 117-169, enacted on August 16, 2022, imposes a 15 percent alternative minimum tax on corporations with "applicable financial statement income" over $1 billion, imposes an excise tax of 1 percent on redemptions of stock by publicly traded corporations, extends through 2025 certain favorable changes to the premium tax credit of § 36B, and extends through 2028 the § 461(*l*) disallowance of "excess business losses" for noncorporate taxpayers. The Consolidated Appropriations Act, 2023, Pub. L. No. 117-328, enacted on December 29, 2022, includes the SECURE 2.0 Act of 2022, which increases the age at which required minimum distributions (RMDs) must begin to age 73, reduces the penalty for failure to take RMDs, modifies the rules for catch-up contributions to qualified retirement plans, and makes many other significant changes that affect retirement plans. This outline discusses the major administrative guidance issued in the last year, summarizes recent legislative changes that, in our judgment, are the most important, and examines significant judicial decisions rendered in the last twelve months.

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I. ACCOUNTING

A. Accounting Methods

B. Inventories

C. Installment Method

D. Year of Inclusion or Deduction

II. BUSINESS INCOME AND DEDUCTIONS

A. Income

B. Deductible Expenses versus Capitalization

1. Legal expenses incurred related to the preparation of applications to the FDA for approval of generic drugs are capital expenditures while legal expenses incurred to defend patent infringement suits are currently deductible. Mylan, Inc. v. Commissioner, 156 T.C. 137 (4/27/21). The taxpayer, Mylan, Inc., and its subsidiaries manufacture both brand-name and generic pharmaceutical drugs. Mylan incurred substantial legal expenses in two categories. First, Mylan incurred legal expenses in connection with its applications to the FDA seeking approval of generic drugs. To obtain this approval, Mylan submitted abbreviated new drug applications (ANDAs). The FDA's application process for generic drugs includes a requirement that the applicant certify the status of any patents covering the respective brand name drug previously approved by the FDA (referred to as a "paragraph IV certification"). One option available to the applicant is to certify that the relevant patent is invalid or will not be infringed by the sale or use of the generic version of the drug. An applicant making this certification is required to send notice letters to the holders of the patents informing them of the certification. Such a certification is treated by statute as patent infringement and the holder of the patent is entitled to bring suit in federal district court. Mylan incurred substantial legal expenses to prepare the notice letters it sent in connection with its FDA applications. Second, Mylan incurred substantial legal expenses in defending patent infringement lawsuits brought by the name-brand drug manufacturers against Mylan in response to the notice letters that Mylan sent. Mylan claimed deductions for both categories of legal expenses. The IRS, however, determined that all of Mylan's expenses were capital expenditures under § 263(a). The Tax Court (Judge Urda) held that the legal expenses incurred by Mylan to prepare notice letters were capital expenditures but the legal expenses Mylan incurred to defend patent infringement suits were currently deductible business expenses.

FDA applications for generic drugs and notice letter costs. The court first addressed the issue of whether the costs Mylan incurred to prepare the notice letters it sent in connection with its ANDAs should be capitalized under § 263. The court's analysis focused in large part on the regulations under § 263 regarding intangibles. These regulations require a taxpayer to capitalize both amounts paid to *create* an intangible and amounts paid to *facilitate* an acquisition or creation of an intangible. Reg. § 1.263(a)-4(b)(1)(ii), (v). With respect to creation of an intangible, Reg. § 1.263(a)-4(d)(5)(I) provides:

> A taxpayer must capitalize amounts paid to a governmental agency to obtain, renew, renegotiate, or upgrade its rights under a trademark, trade name, copyright, license, permit, franchise, or other similar right granted by that governmental agency.

With respect to facilitating the acquisition or creation of an intangible, Reg. § 1.263(a)-4(e)(1) provides:

> [A]n amount is paid to facilitate the acquisition or creation of an intangible (the transaction) if the amount is paid in the process of investigating or otherwise pursuing the transaction. Whether an amount is paid in the process of investigating or otherwise pursuing the transaction is determined based on all of the facts and circumstances.

Mylan and the IRS disputed whether Mylan's legal fees were incurred to "facilitate" the acquisition of a right obtained from a governmental agency and therefore were required to be capitalized. They agreed that the relevant "transaction" was the *acquisition* of an FDA-approved ANDA with a paragraph IV certification. But they disagreed on when this acquisition occurs. Mylan argued that the acquisition of an FDA-approved ANDA occurs when the FDA completes its scientific investigation and issues an approval letter. The IRS asserted that the acquisition of an FDA-approved ANDA with a paragraph IV certification occurs only when the approval letter issued by the FDA becomes effective. The distinction is that the FDA may issue an approval letter but the approval does not grant any rights to the applicant until it becomes effective. Only when the approval becomes effective does the applicant have the right to begin delivery of a generic

drug. *See* 21 U.S.C. § 355(a). With respect to Mylan's legal fees incurred in preparing the notice letters relating to the filing of its ANDAs with paragraph IV certifications, the court concluded that these costs were capital expenditures. The notice is a required step in securing FDA approval of an ANDA. According to the court, because the notice requirement was a prerequisite to securing FDA approval, "the legal expenses Mylan incurred to prepare, assemble, and transmit such notice letters constitute amounts incurred 'investigating or otherwise pursuing' the transaction of creating FDA-approved ANDAs … and must be capitalized."

Litigation expenses. The court reached a different conclusion regarding Mylan's litigation expenses, holding that they were currently deductible. The IRS argued that a patent infringement suit is a step in obtaining FDA approval of an ANDA. The court disagreed, however, and reasoned that the outcome of a patent litigation action has no effect on the FDA's review of a generic drug application. The FDA continues its review process during the course of a patent infringement action and may issue a tentative or final approval of an application before the infringement action is finally decided. A successful patent dispute does not guarantee that a generic drug manufacturer will obtain FDA approval of an ANDA. While it is true that a successful challenge by a patent holder will result in a prohibition of the marketing of a generic drug found to infringe, the court reasoned that the coordination of the FDA approval process with the outcome of related patent litigation does not insert the patent litigation into the FDA's ANDA approval process. A patent on a name-brand drug does not prevent FDA approval of a generic version of the drug and patent litigation on the part of the patent holder is not a step in the FDA's approval process for a generic drug. In reaching its conclusion that the litigation expenses incurred by Mylan were currently deductible as ordinary and necessary expenses, the court also applied the "origin of the claim" test, which inquires as to "'whether the origin of the claim litigated is in the process of acquisition", enhancement, or other disposition of a capital asset." *Woodward v. Commissioner*, 397 U.S. 572, 577 (1970); see also *Santa Fe Pac. Gold Co. v. Commissioner*, 132 T.C. 240, 264-265 (2009). Here, the court reasoned, Mylan's legal expenses arose from legal actions initiated by patent holders in an effort to protect their patents. The court followed the decision of the U.S. Court of Appeals for the Third Circuit in *Urquhart v. Commissioner*, 215 F.2d 17 (3d Cir. 1954), which held that patent litigation arises out of the exploitation of the invention embodied in the patent and, therefore, costs incurred to defend a patent infringement suit are not capital expenditures because they are not costs incurred to defend or protect title but rather are expenses incurred to protect business profits. Because Mylan's legal expenses arose out of the patent infringement claims initiated by the patent holders, the court held, they were currently deductible.

a. Legal expenses incurred to defend patent infringement suits are currently deductible. Actavis Laboratories, FL, Inc. v. United States, 161 Fed. Cl. 334 (8/19/22). The plaintiff in this case, Actavis Laboratories Florida, Inc. (Actavis), was the substitute agent for Watson Pharmaceuticals, Inc. (Watson). Watson manufactured both brand-name and generic pharmaceutical drugs. To obtain approval of generic drugs, Watson submitted to the Food and Drug Administration abbreviated new drug applications (ANDAs). The ANDA application process for generic drugs includes a requirement that the applicant certify the status of any patents covering the respective brand name drug previously approved by the FDA (referred to as a "paragraph IV certification"). One option available to the applicant is to certify that the relevant patent is invalid or will not be infringed by the sale or use of the generic version of the drug. An applicant making this certification is required to send notice letters to the holders of the patents informing them of the certification. Such a certification is treated by statute as patent infringement and the holder of the patent is entitled to bring suit in federal district court. Watson incurred substantial legal expenses in defending patent infringement lawsuits brought by the name-brand drug manufacturers against Watson in response to the notice letters that Watson sent. Watson deducted these legal expenses on its 2008 and 2009 tax returns. Following audits of these returns, the IRS issued a notice of deficiency disallowing Watson's deductions on the basis that the costs incurred in defending the patent infringement litigation were capital expenditures under § 263(a). Watson paid the amounts sought by the IRS and, after filing amended returns requesting refunds,

brought this action in the U.S. Court of Federal Claims seeking refunds of $1.9 million for 2008 and $3.9 million for 2009.

The U.S. Court of Federal Claims (Judge Holte) held that the legal expenses incurred by Watson in defending the patent infringement litigation were currently deductible. The IRS argued that the costs were capital expenditures under Reg. § 1.263(a)-4(b)(1), which requires taxpayers to capitalize amounts paid to *acquire or create* an intangible and amounts paid to *facilitate* an acquisition or creation of an intangible. According to the government, the costs facilitated the acquisition of an intangible, specifically, an FDA-approved ANDA. The court, however, disagreed. The court relied on the "origin of the claim" test established by the U.S. Supreme Court in *United States v. Gilmore*, 372 U.S. 39 (1963). As interpreted by a later decision, *Woodward v. Commissioner*, 397 U.S. 572 (1970), the deductibility of litigation expenses under the origin of the claim test depends not on the taxpayer's primary purpose in incurring the costs, but "involves the simpler inquiry whether the origin of the claim litigated is in the process of acquisition [of a capital asset] itself." Here, the court reasoned, Watson's legal expenses arose from legal actions initiated by patent holders in an effort to protect their patents. The court followed a long line of decisions, including that of the U.S. Court of Appeals for the Third Circuit in *Urquhart v. Commissioner*, 215 F.2d 17 (3d Cir. 1954), which have held that costs incurred to defend a patent infringement suit are not capital expenditures because they are not costs incurred to defend or protect title but rather are expenses incurred to protect business profits. Because Watson's legal expenses arose out of the patent infringement claims initiated by the patent holders, the court held, they were currently deductible. The court further concluded that Reg. § 1.263(a)-4(b)(1) did not require the costs to be capitalized because Watson's defense of the patent infringement litigation was not a step in the FDA's approval process for a generic drug:

> The FDA's review of an ANDA does not include patent related questions. When a generic drug company files an ANDA with a Paragraph IV certification, it certifies the patents associated with the relevant [drug] are either invalid or will not be infringed by the proposed generic drug. The FDA performs no assessment of that certification as a part of its ANDA review process—"[a]ccording to the agency, it lacks 'both [the] expertise and [the] authority' to review patent claims[.]"

- The court's analysis and conclusions in this case are consistent with those of the Tax Court in *Mylan, Inc. & Subsidiaries v. Commissioner*, 156 T.C. 137 (4/27/21).

b. The Third Circuit has agreed that legal expenses incurred by a taxpayer seeking FDA approval of a generic drug to defend patent infringement suits are currently deductible. Mylan, Inc. v. Commissioner, 76 F.4th 230 (3d Cir. 7/27/23), *aff'g* 156 T.C. 137 (4/27/21). In an opinion by Judge Jordan, the U.S. Court of Appeals for the Third Circuit has affirmed the Tax Court's decision and has held that legal expenses incurred by a taxpayer seeking FDA approval of a generic drug to defend patent infringement suits are currently deductible.

Costs of preparing and sending notice letters to holders of patents on brand-name drugs. As described earlier, the FDA's approval process for an ANDA requires the applicant to make one of certain types of certifications regarding the status of any existing patents on the relevant brand-name drug. One option available to the applicant is to certify that the relevant patent is invalid or will not be infringed by the sale or use of the generic version of the drug. An applicant making this type of certification is required by the FDA's approval process to notify the holders of patents on relevant brand-name drugs that it has made this certification. In this case, Mylan incurred legal fees to prepare and send such notice letters. The Tax Court held that these costs were capital expenditures because they facilitated the acquisition of an intangible (an FDA-approved application) within the meaning of Reg. § 1.263(a)-4(b)(1)(v). Neither party appealed this aspect of the Tax Court's decision and the Third Circuit's opinion therefore does not address it.

Costs of defending patent infringement litigation. As described earlier, the taxpayer incurred substantial legal fees in defending patent infringement litigation brought by holders of patents on

brand-name drugs in response to the notice letters that the taxpayer sent. The Tax Court held that these costs were not capital expenditures and that the taxpayer therefore could deduct them currently as ordinary and necessary business expenses. The government appealed this aspect of the Tax Court's decision. On appeal, the Third Circuit affirmed the Tax Court's decision. The court reviewed at length the FDA's approval process for an ANDA. The key question, the court observed, was whether the costs incurred by the taxpayer to defend patent infringement litigation *facilitated* the acquisition or creation of an intangible within the meaning of Reg. §§ 1.263(a)-4(b)(1)(v) and 1.263(a)-4(e)(1)(i). The court noted that the IRS, beginning in 2011, had issued several non-binding memoranda asserting that generic drug companies must capitalize and amortize the costs of defending patent infringement suits filed in response to the type of certifications made by the taxpayer. The court disagreed with the IRS's position. According to the court, whether the FDA approves (or disapproves) an application for approval to market a generic drug does not depend on the outcome of the patent infringement litigation: "The FDA can approve an ANDA for an infringing generic and deny an ANDA for a non-infringing generic." The court quoted with approval the following summary from the Tax Court's opinion:

> The outcome of a [patent infringement] suit has no bearing on the FDA's safety and bioequivalence review. The FDA continues its review process during the pendency of the patent infringement suit and may issue a tentative or final approval before the suit is resolved. The FDA does not analyze patent issues as part of its review, and neither the statute nor regulations suggest that patent issues might block approval of an ANDA. And winning a patent litigation suit does not ensure that the generic drug manufacturer will receive approval, as the FDA can disapprove an ANDA for not meeting safety and bioequivalence standards

C. Reasonable Compensation

1. Pigs get fat but hogs get slaughtered? Fourth Circuit upholds Tax Court decision that a portion of compensation paid to a C corporation shareholder-employee was unreasonable and nondeductible, but vacates the Tax Court's imposition of underpayment penalties. Clary Hood, Inc. v. Commissioner, 69 F.4th 168 (4th Cir. 5/31/23). The taxpayer in this case was a C corporation formed in 1980 to engage in the land excavation and grading business. The CEO, Clary Hood, and his spouse were 50/50 shareholders of the taxpayer and the sole members of the board of directors. Since its inception, the taxpayer-corporation never paid dividends. (*Uh, oh.*) From 2000 to 2010, the taxpayer-corporation averaged approximately $21 million in annual gross revenue and less than $1 million per year in net income before taxes. During those years, Mr. Hood's annual salary was roughly $130,000, and in some of those years, Mr. Hood received a bonus, the largest of which was approximately $321,000. Then in 2011, at Mr. Hood's direction, the taxpayer-corporation shifted away from residential to commercial projects, and the taxpayer-corporation's revenues grew substantially. By 2015, the taxpayer-corporation's annual revenue grew to $44 million. By 2016, annual revenue grew to $69 million. Nevertheless, Mr. Hood's annual salary was only $168,559 for 2015 and only $196,500 for 2016. (*Uh, oh.*) Accordingly, the taxpayer-corporation decided to pay Mr. Hood a bonus of $5 million for 2015 and another $5 million for 2016. (*Uh, oh.*) The taxpayer-corporation, in consultation with its accountants, determined that the $5 million bonuses paid to Mr. Hood in each of the years 2015 and 2016 were appropriate to reflect the taxpayer-corporation's recent success and to remedy undercompensating Mr. Hood in prior years. On audit, the IRS challenged the taxpayer-corporation's bonuses to Mr. Hood as unreasonable and therefore nondeductible to the extent of $1.3 million for 2015 and $3.6 million for 2016. The IRS also imposed substantial underpayment penalties for years 2015 and 2016 under § 6662.

The Tax Court's Decision. The Tax Court (Judge Greaves) largely sided with the IRS after a six-day trial. *See Clary Hood, Inc. v. Commissioner*, T.C. Memo. 2022-15 (3/2/22). The IRS's expert testified that, although Mr. Hood was undercompensated for the years 2000 to 2012, the taxpayer-corporation had begun to address this discrepancy in 2013 when Mr. Hood was paid $1.4 million in salary and bonuses. The IRS's expert further concluded that by the end of 2014, Mr.

Hood had been undercompensated approximately $2.3 million in prior years. The IRS expert's report concluded that reasonable compensation amounts for Mr. Hood would have been roughly $3.7 million for 2015 and roughly $1.4 million for 2016. The taxpayer-corporation submitted two opposing expert reports; however, Judge Greaves determined that the taxpayer-corporation's expert reports deserved "little to no weight" due to "dubious assumptions" underlying the reports and the lack of supporting calculations. Consequently, in a 64-page opinion, Judge Greaves held for the IRS and concluded that the taxpayer-corporation could deduct about $3.7 million of Mr. Hood's $5 million bonus for 2015 and about $1.4 million of Mr. Hood's $5 million bonus for 2016. The Tax Court further determined that the taxpayer-corporation should not be subject to a § 6662 substantial understatement penalty for 2015 because it reasonably relied on professional tax advice in good faith, but for 2016, the taxpayer-corporation could not show reasonable cause and should be subject to a § 6662 substantial understatement penalty for that year. The taxpayer-corporation appealed to the Fourth Circuit.

The Fourth Circuit's Decision. The Fourth Circuit, in an opinion written by Judge Niemeyer, initially recited the applicable law of § 162(a)(1) limiting a taxpayer's deduction for salaries and other compensation to a "reasonable allowance . . . for personal services actually rendered." Judge Niemeyer then highlighted the directive of Reg. § 1.162-7(b) that reasonable compensation is determined by taking into account "all the circumstances." The Fourth Circuit further observed that compensation paid by closely held corporations is subject to "close scrutiny" because such payments may be disguised dividends. Ultimately, the Fourth Circuit stated, the reasonableness of compensation is determined based upon a multi-factor analysis which considers the "totality of the circumstances," including:

> the employee's qualifications; the nature, extent and scope of the employee's work; the size and complexities of the business; a comparison of salaries paid with gross income and net income; the prevailing general economic conditions; comparison of salaries with distributions to stockholders; the prevailing rates of compensation for comparable positions in comparable concerns; [and] the salary policy of the taxpayer as to all employees.

Moreover, the Fourth Circuit noted that the reasonableness of compensation in closely-held corporations may take into account additional factors such as pay for prior years as well as shareholder-employee guarantees of corporate debt. The Fourth Circuit agreed that the Tax Court (Judge Greaves) properly adopted the multi-factor analysis described above as the test for determining reasonable compensation.

The Fourth Circuit acknowledged that the various factors used to determine reasonable compensation may be viewed from the perspective of a hypothetical independent investor (i.e., whether such an investor would be willing to compensate an employee at the same level). The court declined, however, to accept the taxpayer-corporation's argument that the Fourth Circuit should reverse the Tax Court and adopt the Seventh Circuit's "independent investor" test as the exclusive approach to deciding reasonable compensation cases. In *Menard, Inc. v. Commissioner*, 560 F.3d 620 at 622-623 (7th Cir. 2009), and *Exacto Spring Corp. v. Commissioner*, 196 F.3d 833 at 839 (7th Cir. 1999), Judge Posner used the "independent investor" test to allow a taxpayer to establish a "rebuttable presumption" that compensation is reasonable so long as the corporation's shareholders are receiving a sufficiently high rate of return on their investment in the stock of the corporation. According to the taxpayer-corporation, if the Tax Court and the Fourth Circuit adopted the Seventh Circuit's "independent investor" test, they would conclude that Mr. Hood's compensation was reasonable because the taxpayer-corporation generated a 22% rate of return on equity for its shareholders in 2015 and a 36% rate of return on equity for 2016.

The Fourth Circuit then found no error in the Tax Court's application of the multi-factor approach to determining reasonable compensation for Mr. Hood. The Fourth Circuit emphasized, as did the Tax Court, that the taxpayer-corporation had never declared or paid a dividend to its shareholders. The Fourth Circuit also emphasized Mr. Hood's testimony that in 2015 he became aware of the

taxpayer-corporation's need from an "income tax" perspective to begin "getting money out of [the] corporation" to prepare for a "changing of the guard." The Tax Court also found that the taxpayer-corporation had no "structured system in place" for determining compensation and that Mr. Hood's compensation was determined for the years in issue solely by himself and his wife as the only members of the board of directors. The Fourth Circuit considered this finding by the Tax Court to be significant, stating it was "glaring" that the taxpayer-corporation's other officers each received bonuses of $100,000 or less for 2015 and 2016, while Mr. Hood received bonuses of $5 million for each of those years. In addition, the Fourth Circuit thought that the Tax Court's reliance on comparability data provided by the IRS's expert was appropriate. The IRS's expert acknowledged that, based on comparability data, Mr. Hood deserved compensation in the 99th percentile for similarly situated taxpayers, but that the $5 million bonuses paid in 2015 and 2016 exceeded even that amount. In sum, the Fourth Circuit found that the taxpayer-corporation had not demonstrated on appeal that the Tax Court's findings or the IRS expert's report were clearly erroneous.

The Fourth Circuit did, however, agree with the taxpayer-corporation that the Tax Court erred in upholding the IRS's imposition of a § 6662 substantial understatement penalty for 2016. The Fourth Circuit believed that the taxpayer-corporation's reliance upon the professional advice of its accountants for 2016 established reasonable cause, just as the Tax Court had found reasonable cause for 2015 based upon the same professional advice provided to the taxpayer-corporation for that year.

Observation. Of course, hindsight is always 20/20, but the authors cannot help but wonder why the taxpayer-corporation in this case was not an S corporation. Perhaps the capital-intensive nature of the excavation and grading business conducted by the taxpayer-corporation argued for C corporation status and lower corporate-level income tax rates. Yet, the taxpayer-corporation had only two individual shareholders, Mr. Hood and his wife, and seemingly could have been an S corporation. Presumably, because the taxpayer is a C corporation, the IRS will assert that the amount of excess compensation paid to Mr. Hood for 2015 and 2016 constitutes disguised dividends to Mr. Hood and his wife for those years. Thus, the taxpayer-corporation's and Mr. Hood's IRS troubles may not be over.

D. Miscellaneous Deductions

1. Standard mileage rates for 2023. Notice 2023-3, 2023-3 I.R.B. 388 (12/29/22). The standard mileage rate for business miles in 2023 goes up to 65.5 cents per mile (from 62.5 cents in the second half of 2022) and the medical/moving rate goes up to 22 cents per mile (unchanged from the second half of 2022). The charitable mileage rate remains fixed by § 170(i) at 14 cents. The portion of the business standard mileage rate treated as depreciation goes up to 28 cents per mile (from 26 cents in 2022). The maximum standard automobile cost may not exceed $60,800 (up from $56,100 in 2022) for passenger automobiles (including trucks and vans) for purposes of computing the allowance under a fixed and variable rate (FAVR) plan.

- The notice reminds taxpayers that (1) the business standard mileage rate cannot be used to claim an itemized deduction for unreimbursed employee travel expenses because, in the 2017 Tax Cuts and Jobs Act, Congress disallowed miscellaneous itemized deductions for 2023, and (2) the standard mileage rate for moving has limited applicability for the use of an automobile as part of a move during 2023 because, in the 2017 Tax Cuts and Jobs Act, Congress disallowed the deduction of moving expenses for 2023 (except for members of the military on active duty who move pursuant to military orders incident to a permanent change of station, who can still use the standard mileage rate for moving).

The following table summarizes the optional standard mileage rates:

Category	2021	2022		2023
		Jan.-Jun.	Jul.-Dec.	
Business miles	56 cents	58.5 cents	62.5 cents	65.5 cents
Medical/moving	16 cents	18 cents	22 cents	22 cents
Charitable mileage	14 cents	14 cents	14cents	14 cents

2. Congress has modified the § 179D deduction for making commercial buildings energy efficient for taxable years beginning after December 31, 2022. Section 179D provides a limited deduction for the cost of energy-efficient commercial building property. Generally, these are improvements designed to reduce energy and power costs with respect to the interior lighting systems, heating, cooling, ventilation, and hot water systems of a commercial building by a specified percentage in comparison to certain standards. The deduction was made permanent by the Taxpayer Certainty and Disaster Tax Relief Act of 2020, Division EE, Title I, § 102 of the 2021 Consolidated Appropriations Act. Under current law, the lifetime limit on deductions under § 179D is $1.80 per square foot, which is adjusted for inflation for taxable years beginning after 2020. For 2022, this figure is $1.88 per square foot. As in effect for 2022, the improvements must reduce energy and power costs by 50 percent or more in comparison to certain standards. In the Inflation Reduction Act, § 13303, Congress amended § 179D for taxable years beginning after December 31, 2022. As amended, the statute provides that the improvements must reduce energy and power costs by 25 percent in comparison to certain standards (rather than by 50 percent). The amendments also reduce the amount of the deduction to $0.50 per square foot, increased by $0.02 for each percentage point above 25 percent by which the energy improvements reduce energy and power costs, with a maximum amount of $1.00 per square foot. For projects that meet certain prevailing wage and apprenticeship requirements, the deduction is increased to $2.50 per square foot, increased by $0.10 for each percentage point above 25 percent by which the energy improvements reduce energy and power costs, with a maximum amount of $5.00 per square foot. The maximum deduction amount is the total deduction available with respect to the building less deductions claimed with respect to the building in the preceding three years. In the case of buildings to which energy-efficient improvements are made owned by a tax-exempt entity, § 179D(d)(3) of the amended statute directs the Treasury Department to issue regulations that allow the tax-exempt entity to allocate the deduction to the person primarily responsible for designing the property.

- For guidance on the prevailing wage and apprenticeship requirements that make the taxpayer eligible for an increased deduction under § 179D, including proposed regulations issued in August 2023, see item II.D.3 in this outline.

3. Administrative guidance on the prevailing wage and apprenticeship requirements that apply to credits and deductions enacted or modified by the Inflation Reduction Act. The Inflation Reduction Act amended §§ 30C, 45, 45L, 45Q, 48, 48C, and 179D to provide increased credit or deduction amounts for taxpayers who satisfy certain requirements. The same legislation added §§ 45U, 45V, 45Y, 45Z, and 48E to the Code to provide new credits, which also contain provisions for increased credit amounts for taxpayers who satisfy certain requirements. Specifically, increased credit amounts are available under sections 30C, 45, 45Q, 45V, 45Y, 45Z, 48, 48C, and 48E, and an increased deduction is available under section 179D, for taxpayers satisfying certain *prevailing wage and apprenticeship* requirements. Increased credit amounts are available under sections 45L and 45U for taxpayers satisfying certain *prevailing wage* requirements. Generally, if a taxpayer satisfies the prevailing wage and apprenticeship requirements or the prevailing wage requirements, whichever one applies (or meets an exception

to these requirements), the amount of the credit or deduction is equal to the otherwise determined amount of the credit or deduction multiplied by five.

a. The IRS has provided initial guidance on the prevailing wage and apprenticeship requirements. Notice 2022-61, 2022-52 I.R.B. 560 (11/30/22). This notice provides guidance on the prevailing wage and apprenticeship requirements that generally apply to certain provisions of the Code, as amended by the Inflation Reduction Act. As amended by the Inflation Reduction Act, these provisions generally authorize an increased credit or deduction if a taxpayer meets either prevailing wage requirements (as in the case of the credit authorized by § 45L) or prevailing wage and apprenticeship requirements. A facility generally must meet the prevailing wage and apprenticeship requirements to receive the increased credit or deduction amounts under §§ 30C, 45, 45Q, 45V, 45Y, 48, 48E, and 179D if construction (or installation for purposes of § 179D) of the facility begins on or after the date 60 days after the Secretary publishes guidance with respect to the prevailing wage and apprenticeship requirements of the Code. The notice serves as the published guidance establishing the 60-day period and provides that the date that is 60 days after the Secretary published guidance is January 30, 2023. The notice also provides guidance for determining the beginning of construction of a facility for certain credits allowed under the Code, and the beginning of installation of certain property with respect to the energy efficient commercial buildings deduction under the Code. The notice provides that Treasury and the IRS anticipate issuing proposed regulations and other guidance with respect to the prevailing wage and apprenticeship requirements.

b. Proposed regulations provide further guidance on the prevailing wage and apprenticeship requirements. REG-100908-23, Increased Credit or Deduction Amounts for Satisfying Certain Prevailing Wage and Registered Apprenticeship Requirements, 88 F.R. 60018 8/30/23). The Treasury Department and the IRS have issued proposed regulations under a variety of Code provisions to reflect legislative changes enacted in August 2022 by the Inflation Reduction Act. The Inflation Reduction Act amended §§ 30C, 45, 45L, 45Q, 48, 48C, and 179D to provide increased credit or deduction amounts for taxpayers who satisfy certain requirements. The same legislation added §§ 45U, 45V, 45Y, 45Z, and 48E to the Code to provide new credits, which also contain provisions for increased credit amounts for taxpayers who satisfy certain requirements. Specifically, increased credit amounts are available under sections 30C, 45, 45Q, 45V, 45Y, 45Z, 48, 48C, and 48E, and an increased deduction is available under section 179D, for taxpayers satisfying certain *prevailing wage and apprenticeship* requirements. Increased credit amounts are available under sections 45L and 45U for taxpayers satisfying certain *prevailing wage* requirements. Generally, if a taxpayer satisfies the prevailing wage and apprenticeship requirements or the prevailing wage requirements, whichever one applies (or meets an exception to these requirements), the amount of the credit or deduction is equal to the otherwise determined amount of the credit or deduction multiplied by five.

Prevailing wage and apprenticeship requirements. Generally, a taxpayer satisfies the *prevailing wage* requirements if the taxpayer ensures that laborers and mechanics employed by the taxpayer (or by any contractor or subcontractor) in the construction, alteration, or repair of a facility are paid wages at rates not less than those set forth in applicable wage determinations issued by the Secretary of Labor. Prop. Reg. § 1.45-7(b)(1). For this purpose, the applicable general wage determination is the wage determination in effect for the specified type of construction in the geographic area when the construction, alteration, or repair of the facility begins. Prop. Reg. § 1.45-7(b)(2). A taxpayer satisfies the *apprenticeship requirement* by ensuring that two basic requirements are met. *First*, qualified apprentices must perform not less than the "applicable percentage" of the total labor hours of the construction, alteration, or repair work of any qualified facility (referred to as the labor hours requirement). For this purpose, the applicable percentage is 10 percent, 12.5 percent, or 15 percent, depending on when construction of the facility begins. Prop. Reg. § 1.45-8(b). *Second*, a taxpayer, contractor, or subcontractor who employs four or more individuals to perform construction, alteration, or repair work with respect to the construction of a qualified facility must employ one or more qualified apprentices to perform

the work (referred to as the participation requirement). Prop. Reg. § 1.45-8(d). The proposed regulations provide that construction, alteration, or repair does not include *maintenance work* that occurs after the facility is placed in service. For this purpose, maintenance is work that is ordinary and regular in nature and designed to maintain the existing functionality of a facility as opposed to an isolated or infrequent repair of a facility to restore specific functionality or adapt it for a different or improved use. Prop. Reg. § 1.45-7(d)(2).

Correction of failure to satisfy the prevailing wage and apprenticeship requirements. The proposed regulations permit a taxpayer who claims the increased credit or deduction and who fails to satisfy the *prevailing wage* requirement to cure the failure. To do so, a taxpayer must (1) pay any laborer or mechanic who was not paid a prevailing wage the difference between the prevailing wage required and the amount actually paid plus interest at the federal short-term rate plus 6 percentage points, and (2) pay a penalty of $5,000 for each laborer or mechanic who was not paid a prevailing wage. Prop. Reg. § 1.45-7(c)(1)(i)-(ii). The penalty generally is waived with respect to a laborer or mechanic if the taxpayer makes a correction payment by the earlier of 30 days after the taxpayer becomes aware of the error or the date on which the increased credit is claimed and if certain other requirements are met. Prop. Reg. § 1.45-7(c)(6)(i). The correction payment is increased to three times the normal amount and the penalty is increased to $10,000 per laborer or mechanic if the IRS determines that the failure to satisfy the prevailing wage requirement was intentional. Prop. Reg. § 1.45-7(c)(3). The proposed regulations also provide a mechanism for a taxpayer to cure a failure to satisfy the *apprenticeship requirement*. Prop. Reg. § 1.45-8(e). Generally, a taxpayer can cure such a failure either by submitting requests for apprentices or paying a penalty equal to $50 for each labor hour for which the apprenticeship requirements (either the labor hours requirement or participation requirement) were not satisfied. The $50 per hour penalty is increased to $500 per hour if the IRS determines that the failure to satisfy the apprenticeship requirements was intentional. Prop. Reg. § 1.45-8(e)(2)(ii).

Recordkeeping requirements. The proposed regulations provide guidance on the types of records taxpayers should maintain to demonstrate compliance with the prevailing wage and apprenticeship requirements. At a minimum, to demonstrate compliance with the *prevailing wage* requirement, those records include payroll records for each laborer and mechanic (including each qualified apprentice) employed by the taxpayer, contractor, or subcontractor in the construction, alteration, or repair of the qualified facility. Prop. Reg. § 1.45-12(b). In addition, the proposed regulations provide that records sufficient to demonstrate compliance with the prevailing wage requirement may include eight other categories of records, including identifying information (such as name, social security or tax identification number, address, telephone number, and email address) for each laborer or mechanic (including qualified apprentices) employed. The proposed regulations provide that sufficient records to demonstrate compliance with the apprenticeship requirements may include (1) any written requests for the employment of apprentices from registered apprenticeship programs, including any contacts with the Department of Labor or state apprenticeship agency regarding requests for apprentices, (2) any agreements entered into with registered apprenticeship programs with respect to the construction, alteration or repair of the facility, (3) documents reflecting the standards and requirements of any registered apprenticeship program, including the ratio requirement prescribed by each program, (4) the total number of labor hours worked by apprentices, and (5) records reflecting the daily ratio of apprentices to journeyworkers. Prop. Reg. § 1.45-12(d).

Effective date and period for comments. The proposed regulations would apply to facilities, property, projects, or equipment placed in service in taxable years ending after the date on which final regulations are published as final in the Federal Register and the construction or installation of which begins after the date on which final regulations are published. Nevertheless, taxpayers can rely on the proposed regulations with respect to construction or installation of a facility, property, project, or equipment beginning on or after January 29, 2023, and on or before the date final regulations are published, provided that, beginning after the date that is 60 days after August 29, 2023, taxpayers follow the proposed regulations in their entirety and in a consistent manner.

Treasury and the IRS have invited comments on the proposed regulations. Any comments must be submitted by October 30, 2023. A public hearing on the proposed regulations is scheduled for November 21, 2023.

E. Depreciation & Amortization

1. Section 280F 2023 depreciation tables for business autos, light trucks, and vans. Rev. Proc. 2023-14, 2023-6 I.R.B. 466 (1/18/23). Section 280F(a) limits the depreciation deduction for passenger automobiles. For this purpose, the term "passenger automobiles" includes trucks and vans with a gross vehicle weight of 6,000 pounds or less. The IRS has published depreciation tables with the 2023 depreciation limits for business use of passenger automobiles acquired after September 27, 2017, and placed in service during 2023:

2023 Passenger Automobiles with § 168(k) first year recovery:	
1st Tax Year	$20,200
2nd Tax Year	$19,500
3rd Tax Year	$11,700
Each Succeeding Year	$ 6,960
2023 Passenger Automobiles (no § 168(k) first year recovery):	
1st Tax Year	$12,200
2nd Tax Year	$19,500
3rd Tax Year	$11,700
Each Succeeding Year	$ 6,960

For leased vehicles used for business purposes, § 280F(c)(2) requires a reduction in the amount allowable as a deduction to the lessee of the vehicle. Under Reg. § 1.280F-7(a), this reduction in the lessee's deduction is expressed as an income inclusion amount. The revenue procedure provides a table with the income inclusion amounts for lessees of vehicles with a lease term beginning in 2023. For 2023, this income inclusion applies when the fair market value of the vehicle exceeds $60,000.

F. Credits

1. Congress has modified and extended through 2032 the § 45L credit for eligible contractors that build and sell new energy-efficient homes. Under current law, § 45L provides a credit of $2,000 or $1,000 (depending on the projected level of fuel consumption) an eligible contractor can claim for each qualified new energy-efficient home constructed by the contractor and acquired by a person from the contractor for use as a residence during the tax year. The Inflation Reduction Act, § 13304, extends the credit through 2032 and modifies it for homes acquired after December 31, 2022. As modified, the credit is $2,500 for new homes that meet certain Energy Star efficiency standards and is $5,000 for new homes that are certified as zero-energy ready homes (generally, a home that is able to generate as much (or more) energy onsite than the total amount of energy it consumes). For multifamily dwellings that meet certain Energy Star efficiency standards, the credit is $500 per unit and is $1,000 per unit for zero-energy ready multifamily dwellings. The credit for multifamily dwelling units is increased to $2,500 per unit (or $5,000 per unit for zero-energy ready multifamily dwellings) if the taxpayer ensures that laborers and mechanics employed by contractors and subcontractors in the construction of the residence are paid wages not less than prevailing wages as determined by the Secretary of Labor.

- For guidance on the prevailing wage requirements that make the taxpayer eligible for an increased credit under § 45L, including proposed regulations issued in August 2023, see item II.D.3 in this outline.

G. Natural Resources Deductions & Credits

H. Loss Transactions, Bad Debts, and NOLs

I. At-Risk and Passive Activity Losses

III. INVESTMENT GAIN AND INCOME

A. Gains and Losses

B. Interest, Dividends, and Other Current Income

C. Profit-Seeking Individual Deductions

D. Section 121

E. Section 1031

F. Section 1033

G. Section 1035

H. Miscellaneous

IV. COMPENSATION ISSUES

A. Fringe Benefits

1. Limits for contributions to health savings accounts for 2024. Rev. Proc. 2023-23, 2023-22 I.R.B. 883 (5/16/23). The IRS has issued the inflation-adjusted figures for contributions to health savings accounts. For calendar year 2024, the annual limitation on deductions under § 223(b)(2)(A) for an individual with self-only coverage under a high deductible health plan is increased to $4,150 (from $3,850 in 2023). For calendar year 2024, the annual limitation on deductions under § 223(b)(2)(B) for an individual with family coverage under a high deductible health plan is increased to $8,300 (from $7,750 in 2023). For this purpose, for calendar year 2024, a "high deductible health plan" is defined under § 223(c)(2)(A) as a health plan with an annual deductible that is not less than $1,600 (increased from $1,500 in 2023) for self-only coverage or $3,200 (increased from $3,000 in 2023) for family coverage, and for which the annual out-of-pocket expenses (deductibles, co-payments, and other amounts, but not premiums) do not exceed $8,050 for self-only coverage (increased from $7,500 in 2023) or $16,100 for family coverage (increased from $15,000 in 2023).

The following table summarizes the limits for contributions to health savings accounts:

Health Savings Account Limitations				
Category	**Self-Only Coverage**		**Family Coverage**	
	2023	**2024**	**2023**	**2024**
Limit on Deductions for Contributions to HSAs	$3,850	$4,150	$7,750	$8,300
High-Deductible Health Plan				
Minimum Deductible	$1,500	$1,600	$3,000	$3,200
Limit on Out-of-Pocket Expenses	$7,500	$8,050	$15,000	$16,100

B. Qualified Deferred Compensation Plans

1. Some inflation-adjusted numbers for 2024. Notice 2023-75, 2023-__ I.R.B. __ (11/1/2023).

- The limit on elective deferrals in §§ 401(k), 403(b), and 457 plans is increased to $23,000 (from $22,500) with a catch-up provision for employees aged 50 or older that is $7,500 (unchanged from 2023).

- The limit on contributions to an IRA is increased to $7,000 (from $6,500) with a catch-up provision for those aged 50 or older that is $1,000 (unchanged from 2023). The AGI phase-out range for contributions to a traditional IRA by employees covered by a workplace retirement plan is increased to $77,000-$87,000 (from $73,000-$83,000) for single filers and heads of household, increased to $123,000-$143,000 (from $116,000-$136,000) for married couples filing jointly in which the spouse who makes the IRA contribution is covered by a workplace retirement plan, and increased to $230,000-$240,000 (from $218,000-$228,000) for an IRA contributor who is not covered by a workplace retirement plan and is married to someone who is covered. The phase-out range for contributions to a Roth IRA is increased to $230,000-$240,000 (from $218,000-$228,000) for married couples filing jointly, and increased to $146,000-$161,000 (from $138,000-$153,000) for singles and heads of household.

- The limit on the annual benefit from a defined benefit plan under § 415 is increased to $275,000 (from $265,000).

- The limit for annual additions to defined contribution plans is increased to $69,000 (from $66,000).

- The amount of compensation that may be taken into account for various plans is increased to $345,000 (from $330,000), and is increased to $505,000 (from $490,000) for government plans.

- The AGI limit for the retirement savings contribution credit for low- and moderate-income workers is increased to $76,500 (from $73,000) for married couples filing jointly, increased to $57,375 (from $54,740) for heads of household, and increased to $38,250 (from $36,500) for singles and married individuals filing separately.

2. Proposed regulations on required minimum distributions. REG-105954-20, Required Minimum Distributions, 87 F.R. 10504 (2/24/22). Treasury and the IRS have issued proposed regulations that address required minimum distributions (RMDs) from qualified retirement plans and annuity contracts and related matters. The proposed regulations would update existing regulations to reflect a number of statutory changes. The most significant of these statutory changes were made by the SECURE Act, enacted on December 20, 2019, as Division O of the 2020 Further Consolidated Appropriations Act. Among other changes, the SECURE Act amended Code § 401(a)(9)(E) to modify the RMD rules for inherited retirement accounts (defined contribution plans and IRAs). The proposed regulations are lengthy and address these and a number of other issues. This outline will focus on only the guidance provided by the proposed regulations on the change made by the SECURE Act to RMDs for inherited retirement accounts. Readers should consult the proposed regulations for additional guidance.

The SECURE Act changes to RMDs from inherited retirement accounts. A provision of the SECURE Act, Division O, Title IV, § 401 of the 2020 Further Consolidated Appropriations Act, amended Code § 401(a)(9)(E) to modify the required minimum distribution (RMD) rules for inherited retirement accounts (defined contribution plans and IRAs). The amendments require all funds to be distributed by the end of the 10th calendar year following the year of death (the "10-year rule"). The statute contains no requirement to withdraw any minimum amount before that date. Section 401(a)(9)(H)(i)(II), as also amended by the SECURE Act, provides that this rule applies whether or not RMDs to the employee or IRA owner have begun. The current rules, which permit taking RMDs over life expectancy, continue to apply to a designated beneficiary who is an

"eligible designated beneficiary," which is any of the following: (1) a surviving spouse, (2) a child of the participant who has not reached the age of majority, (3) disabled within the meaning of § 72(m)(7), (4) a chronically ill individual within the meaning of § 7702B(c)(2) with some modifications, or (5) an individual not in any of the preceding categories who is not more than 10 years younger than the deceased individual. These changes generally apply to distributions with respect to those who die after December 31, 2019.

The proposed regulations' interpretation of the SECURE Act. The proposed regulations adopt an interpretation of the 10-year rule that appears to differ from the plain language of the statute and from the interpretation of the legislation of most advisors. The statute provides that, when the designated beneficiary is *not* an eligible designated beneficiary, all funds must be distributed by the end of the 10th calendar year following the year of death and that this rule applies whether or not RMDs to the employee or IRA owner have begun. There appears to be no requirement to withdraw any minimum amount before that date. The preamble to the proposed regulations, however, explains that the proposed regulations distinguish between situations in which the employee or IRA owner dies before the required beginning date for distributions, and situations in which death occurs after such date. When the employee or IRA owner dies *before* the required beginning date for distributions, the proposed regulations provide that no distribution is required before the 10th calendar year following the year of death. However, in situations in which the employee or IRA owner dies *after* the required beginning date for distributions, the proposed regulations provide that a designated beneficiary who is *not* an eligible designated beneficiary must take RMDs before the 10th calendar year following the year of death:

> For example, if an employee died after the required beginning date with a designated beneficiary who is not an eligible designated beneficiary, then the designated beneficiary would continue to have required minimum distributions calculated using the beneficiary's life expectancy as under the existing regulations for up to nine calendar years after the employee's death. In the tenth year following the calendar year of the employee's death, a full distribution of the employee's remaining interest would be required.

87 F.R. 10514. This interpretation differs not only from the plain language of the statute and from the interpretation of the legislation of most advisors, but also from IRS Publication 590-B, which was issued for 2021. IRS Publication 590-B (page 11) provides:

> The 10-year rule requires the IRA beneficiaries who are not taking life expectancy payments to withdraw the entire balance of the IRA by December 31 of the year containing the 10th anniversary of the owner's death. For example, if the owner died in 2021, the beneficiary would have to fully distribute the IRA by December 31, 2031. The beneficiary is allowed, but not required, to take distributions prior to that date.
>
> The 10-year rule applies if (1) the beneficiary is an eligible designated beneficiary who elects the 10-year rule, if the owner died before reaching his or her required beginning date; or (2) the beneficiary is a designated beneficiary who is not an eligible designated beneficiary, regardless of whether the owner died before reaching his or her required beginning date.

Many of the comments on the proposed regulations urge the IRS to change its interpretation or at least to delay the effective date of the interpretation because many beneficiaries subject to the 10-year rule did not take distributions in 2021.

a. The IRS will not assert that the 50% excise tax of § 4974 is due from those who failed to take certain RMDs from inherited retirement accounts in 2021 or 2022. Notice 2022-53, 2022-45 I.R.B. 437 (10/7/22). This notice announces that, when the proposed regulations described above become final, the final regulations will apply no earlier than the 2023 distribution calendar year. The notice also addresses the tax treatment of individuals who failed to

take RMDs in 2021 or 2022 under the interpretation of the 10-year rule set forth in the proposed regulations. Section 4974 provides that, if the amount distributed from a qualified retirement plan during the year is less than the RMD for that year, then an excise tax is imposed equal to 50 percent of the amount by which the RMD exceeds the amount actually distributed. The notice provides that the IRS will not assert that an excise tax is due under § 4974 from an individual who did not take a "specified RMD." It also provides that, if an individual paid an excise tax for a missed RMD in 2021 that constitutes a specified RMD, the taxpayer can request a refund of the excise tax paid. A "specified RMD" is defined as any distribution required to be made in 2021 or 2022 under a defined contribution plan or IRA if the payment would be required to be made to (1) a designated beneficiary of an employee or IRA owner who died in 2020 or 2021 and on or after the employee or IRA owner's required beginning date, and (2) the designated beneficiary is not taking lifetime or life expectancy payments as required by § 401(a)(9)(B)(iii). In other words, the IRS will not assert that the excise tax of § 4974 is due from a beneficiary who (1) is not an eligible designated beneficiary (and who therefore is subject to the 10-year rule), (2) inherited the retirement account from an employee or IRA owner who died in 2020 or 2021 and on or after the required beginning date of distributions, and (3) were required to take RMDs in 2021 or 2022 under the interpretation of the 10-year rule in the proposed regulations but failed to do so. The notice provides the same relief to beneficiaries of eligible designated beneficiaries if the eligible designated beneficiary died in 2020 or 2021 and was taking lifetime or life expectancy distributions.

- The notice does not explicitly address what RMD must occur in 2023. The issue is whether, in 2023, a beneficiary who failed to take an RMD in 2021 or 2022 must take the 2023 RMD and also any RMDs previously missed. The notice does not explicitly require missed RMDs to be withdrawn. The notice provides only that the IRS will not assert that an excise tax is due from those who failed to take RMDs in 2021 or 2022 under the interpretation of the 10-year rule in the proposed regulations. In the authors' view, the notice implies that, in 2023, only the 2023 RMD must be withdrawn. For example, if an employee or IRA owner died in 2021 with a designated beneficiary who was not an eligible designated beneficiary, that beneficiary should have begun taking RMDS in 2022, which should continue through 2030 (the ninth year after the employee or IRA owner's death), and the remaining balance of the account should be fully withdrawn in 2031. The authors' interpretation is that the beneficiary in this example should simply begin taking RMDs in 2023 (calculated as if they had begun in 2022), which should continue through 2030, and the remaining balance of the account should be fully withdrawn in 2031. The final regulations may provide further guidance on this question.

b. The IRS has granted a further reprieve: the Service will not assert that the excise tax of § 4974 is due from those who failed to take certain RMDs from inherited retirement accounts in 2021, 2022, or 2023. Notice 2023-54, 2023-31 I.R.B. 382 (7/14/23). This notice announces that, when the proposed regulations described above become final, the final regulations will apply no earlier than the 2024 calendar year. The notice provides that the IRS will not assert that an excise tax is due under § 4974 from an individual who did not take a "specified RMD." A "specified RMD" is defined as any distribution required to be made in 2021 or 2022 under a defined contribution plan or IRA if the payment would be required to be made to (1) a designated beneficiary of an employee or IRA owner who died in 2020, 2021, or 2022 and on or after the employee or IRA owner's required beginning date, and (2) the designated beneficiary is not taking lifetime or life expectancy payments as required by § 401(a)(9)(B)(iii). In other words, the IRS will not assert that the excise tax of § 4974 is due from a beneficiary who (1) is not an eligible designated beneficiary (and who therefore is subject to the 10-year rule), (2) inherited the retirement account from an employee or IRA owner who died in 2020, 2021, or 2022 and on or after the required beginning date of distributions, and (3) were required to take RMDs in 2021, 2022, or 2023 under the interpretation of the 10-year rule in the proposed regulations but failed to do so. The notice provides the same relief to beneficiaries of eligible designated beneficiaries if the eligible designated beneficiary died in 2020, 2021, or 2022 and was taking lifetime or life expectancy distributions.

- The notice also grants relief to those who attained age 72 in 2023 and received distributions from January 1 through July 31, 2023, that are mischaracterized as RMDs. Taxpayers who attain age 72 in 2023 are not required to begin taking RMDs for 2023 because Congress increased the age at which RMDs must begin to age 73 for those who attain age 73 after 2022. The Notice gives such taxpayers until September 30, 2023, to deposit such amounts in an eligible retirement plan and treat the deposits as a tax-free rollover. This aspect of the notice is discussed in more detail below in connection with the discussion of the change in the age at which RMDs must begin.

3. Congress has increased the age at which RMDs must begin to 73 and eventually to age 75. A provision of the SECURE 2.0 Act, Division T, Title I, § 107 of the Consolidated Appropriations Act, 2023, amended Code § 401(a)(9)(C)(i)(I) to increase the age at which required minimum distributions (RMDs) from a qualified plan (including IRAs) must begin from 72 to 73. Pursuant to this amendment, RMDs must begin by April 1 of the calendar year following the later of the calendar year in which the employee attains age 73 or, in the case of an employer plan, the calendar year in which the employee retires. This latter portion of the rule allowing deferral of RMDs from employer plans until retirement does not apply to a 5-percent owner (as defined in § 416). The increase in the age at which RMDs must begin to age 73 applies to distributions required to be made after December 31, 2022, with respect to individuals who attain age 73 after such date. Thus, an individual who attained age 72 in 2022 must take his or her first RMD by April 1, 2023, but an individual who attains age 72 in 2023 need not take the first RMD until April 1, 2025. The legislation further increases the age at which RMDs must begin to age 75 for individuals who attain age 75 after 2032.

a. Those born in 1951 (and who therefore attain age 72 in 2023) and who received distributions from January 1 through July 31, 2023, that are mischaracterized as RMDs have until September 30, 2023, to deposit such amounts in an eligible retirement plan and treat the deposit as a tax-free rollover. Notice 2023-54, 2023-31 I.R.B. 382 (7/14/23). Plan administrators and other payors made the Service aware that automated payment systems would need to be updated to reflect the legislative change in the age at which RMDs must begin. Because such changes could take time, it is possible that those born in 1951 and who therefore attain age 72 in 2023 would receive distributions in 2023 that are mischaracterized as RMDs (and therefore normally ineligible for rollover). This notice grants relief targeted at this situation. For employer-sponsored plans, the notice provides that (1) payors or plan administrators will not be treated as having failed to satisfy applicable requirements based on failure to treat a distribution as an eligible rollover distribution merely because the plan made a distribution from January 1, 2023, through July 31, 2023, to a participant born in 1951 (or the participant's surviving spouse) that would have been an RMD if Congress had not increased the age at which RMDs must begin from 72 to 73, and (2) participants born in 1951 who received such a distribution have until September 30, 2023, to roll over the mischaracterized distribution. For IRAs, the notice provides similar relief and specifies that IRA owners born in 1951 (or the owner's surviving spouse) who received a distribution from the IRA from January 1, 2023, through July 31, 2023, that would have been an RMD if Congress had not increased the age at which RMDs must begin from 72 to 73 can roll over the mischaracterized distribution to an eligible retirement plan if they do so by September 30, 2023. Although IRA owners normally can make only one tax-free rollover in a 12-month period, the notice provides that IRA owners entitled to the relief provided by the notice can roll over the mischaracterized distribution even if they have already rolled over a distribution in the previous 12 months. A rollover of the mischaracterized distribution, however, will preclude the IRA owner from rolling over another distribution in the succeeding 12 months (but could still make a direct trustee-to-trustee transfer as described in Rev. Rul. 78-406, 1978-2 CB 157).

4. The penalty for failing to take an RMD is now 25% (and possibly 10%) rather than 50 percent. If a taxpayer fails to take the full amount of a required minimum distribution (RMD) from a qualified retirement plan (including an IRA), § 4974(a) imposes an excise tax. The tax is a percentage of the amount by which the RMD exceeds the actual amount

distributed during the year. Before legislative changes made in 2022, the percentage was 50 percent. A provision of the SECURE 2.0 Act, Division T, Title III, § 302 of the Consolidated Appropriations Act, 2023, amended Code § 4974(a) to reduce the percentage to 25 percent. New § 4974(e) further reduces the percentage to 10 percent if an individual receives all of their past-due RMDs and files a tax return that reflects the excise tax on such RMDs before the earliest of three dates: (1) the date of mailing of a notice of deficiency with respect to the excise tax, (2) the date on which the excise tax is assessed, or (3) the last day of the second taxable year that begins after the close of the taxable year in which the excise tax is imposed (apparently, the close of the second taxable year after the year of the missed RMD). These changes apply to taxable years beginning after December 29, 2022, the date of enactment of the SECURE 2.0 Act.

5. RMDs are no longer required for Roth accounts in employer-sponsored plans. A provision of the SECURE 2.0 Act, Division T, Title III, § 325 of the Consolidated Appropriations Act, 2023, amended Code § 402A(d) by adding new § 402A(d)(5), which makes Roth accounts in employer-sponsored retirement plans exempt from the requirement that required minimum distributions (RMDs) begin at age 73. Before this change, although RMDs were not required for Roth IRAs, they were required for Roth accounts in employer-sponsored retirement plans. This change is effective for taxable years beginning after December 31, 2023, but does not apply to distributions required for 2023 that are permitted to be paid after 2023.

6. Go ahead and steal your spouse's identity, at least for purposes of receiving RMDs. A provision of the SECURE 2.0 Act, Division T, Title III, § 327 of the Consolidated Appropriations Act, 2023, amended Code § 401(a)(9)(B)(iv) to provide that, if a retirement account participant dies before reaching the age at which RMDs must begin and has designated a spouse as the sole beneficiary, then the spouse may make an irrevocable election to be treated as the participant for purposes of receiving RMDs. Making this election allows the surviving spouse to defer RMDs until the deceased spouse would have reached the age at which RMDs must begin. For example, if a husband passes away at age 63 and is survived by his wife who is age 68 and is his sole designated beneficiary, then she can elect to be treated as her husband for purposes of receiving RMDs. This means that she can defer taking RMDs from the account until her husband would have reached age 73 (a period of 10 years in this example) rather than when she attains age 73. This change is effective for calendar years beginning after December 31, 2023.

7. Individuals who are ages 60-63 will be able to make additional catch-up contributions to employer-sponsored plans beginning in 2025. Section 414(v) allows individuals who are age 50 and older to make so-called "catch-up" contributions to employer-sponsored retirement plans such as § 401(k) plans in addition to the basic amount ($22,500 in 2023) that individuals are allowed to contribute. The limit on catch-up contributions is $7,500 in 2023 and is adjusted annually for inflation. A provision of the SECURE 2.0 Act, Division T, Title I, § 109 of the Consolidated Appropriations Act, 2023, amended Code § 414(v)(2) to allow individuals who are ages 60 to 63 at the close of the taxable year to make larger catch-up contributions up to the "adjusted dollar amount," which is defined in new § 414(v)(2)(E). As defined, the adjusted dollar amount is equal to the greater of $10,000 or 150 percent of the regular catch-up contribution amount for 2024. This $10,000 figure will be adjusted annually for inflation after 2025. This change is effective for taxable years beginning after 2024.

- The ability of those ages 60 to 63 to make larger catch-up contributions to employer-sponsored plans will take effect in 2025. In that year, the limit on such catch-up contributions will be the greater of $10,000 or 150 percent of the regular catch-up contribution limit for 2024. Because the regular catch-up contribution limit is already $7,500 in 2023, and 150 percent of that figure is $11,250, the larger catch-up contribution limit for those ages 60 to 63 will be greater than $10,000 in the first year it is effective.

8. Effective in 2024, all catch-up contributions to employer-sponsored plans must be deposited in a Roth account if the participant had wages in the preceding year of more than $145,000. A provision of the SECURE 2.0 Act, Division T, Title VI, § 603 of the Consolidated Appropriations Act, 2023, amended Code § 414(v) by adding new § 414(v)(7). New § 414(v)(7) provides that, if a participant in an employer-sponsored retirement plan had wages in the preceding calendar year from the employer sponsoring the plan that exceeded $145,000, then the participant cannot make catch-up contributions unless those contributions are designated Roth contributions. This $145,000 figure will be adjusted for inflation in tax years beginning after 2024. The legislation further provides that, if this new "Roth-only" rule applies to any participant for the year, then no participant in the plan can make catch-up contributions unless the plan offers all participants a Roth option. This rule effectively will force employer-sponsored plans to offer Roth options to their participants. These changes apply to taxable years beginning after December 31, 2023.

a. Apparently, the IRS can simply ignore the effective date of a legislative change. The IRS has announced a two-year "administrative transition period" that has the effect of delaying the effective date of the "Roth-only" rule for catch-up contributions until taxable years beginning after 2025. Notice 2023-62, 2023-37 I.R.B. 817 (8/25/23). In response to concerns expressed by taxpayers regarding the timely implementation of the new "Roth-only" rule (new § 414(v)(7)) enacted as part of the Consolidated Appropriations Act, 2023, for catch-up contributions by employees with wages in the preceding calendar year that exceeded $145,000, the IRS has effectively delayed the effective date of the Roth-only rule. As enacted, the Roth-only rule applies to taxable years beginning after December 31, 2023. In this notice, however, the IRS has announced a two-year "administrative transition period." Specifically, until taxable years beginning after December 31, 2025:

> (1) … catch-up contributions will be treated as satisfying the requirements of section 414(v)(7)(A), even if the contributions are not designated as Roth contributions, and (2) a plan that does not provide for designated Roth contributions will be treated as satisfying the requirements of section 414(v)(7)(B).

The notice also announces that the Treasury Department and the IRS plan to issue further guidance to assist taxpayers with the implementation of the new Roth-only rule. The guidance expected to be issued includes:

- "Guidance clarifying that section 414(v)(7)(A) of the Code would not apply in the case of an eligible participant who does not have wages as defined in section 3121(a) (that is, wages for purposes of the Federal Insurance Contributions Act (FICA)) for the preceding calendar year from the employer sponsoring the plan." Thus, a partner or other self-employed person, neither of whom receives wages from the business, would not be subject to the Roth-only rule.
- "Guidance providing that, in the case of an eligible participant who is subject to section 414(v)(7)(A), the plan administrator and the employer would be permitted to treat an election by the participant to make catch-up contributions on a pre-tax basis as an election by the participant to make catch-up contributions that are designated Roth contributions." Apparently, this approach would permit the plan administrator and the employer to treat an employee as having elected to make catch-up contributions to a Roth account even though the employee actually elected to make catch-up contributions on a pre-tax basis.
- "Guidance addressing an applicable employer plan that is maintained by more than one employer (including a multiemployer plan). The guidance would provide that an eligible participant's wages for the preceding calendar year from one participating employer would not be aggregated with the wages from another participating employer for purposes of determining whether the participant's wages for that year exceed $145,000 (as adjusted). For example, under that guidance, if an eligible participant's wages for a calendar year

were: (1) $100,000 from one participating employer; and (2) $125,0000 from another participating employer, then the participant's catch-up contributions under the plan for the next year would not be subject to section 414(v)(7)(A) (even if the participant's aggregate wages from the participating employers for the prior calendar year exceed $145,000, as adjusted). The guidance also would provide that, even if an eligible participant is subject to section 414(v)(7)(A) because the participant's wages from one participating employer in the plan for the preceding calendar year exceed $145,000 (as adjusted), elective deferrals made on behalf of the participant by another participating employer that are catch-up contributions would not be required to be designated as Roth contributions unless the participant's wages for the preceding calendar year from that other employer also exceed that amount."

The Treasury Department and the IRS have invited comments regarding the matters discussed in the notice and any other aspect of the new Roth-only rule. Comments must be submitted on or before October 24, 2023.

9. Subject to certain exceptions, § 401(k) and § 403(b) plans established on or after December 29, 2022, must automatically enroll eligible participants beginning in 2025. A provision of the SECURE 2.0 Act, Division T, Title I, § 101 of the Consolidated Appropriations Act, 2023, amended the Code by adding new § 414A. New § 414A requires that § 401(k) and § 403(b) plans automatically enroll participants, i.e., participants are enrolled unless they elect not to participate. To meet the requirements of § 414A, the percentage of compensation contributed by participants must be at least 3 percent and not more than 10 percent in the first year of participation. Whatever the initial percentage of compensation contributed, the plan must provide that the percentage is increased by 1 percentage point per year until the percentage contributed is at least 10 percent and not more than 15 percent of compensation. A participant can elect not to participate or to contribute less than these amounts. Certain plans are not subject to new § 414A. These include (1) § 401(k) and § 403(b) plans established before the date of enactment of the SECURE 2.0 Act (December 29, 2022), (2) plans maintained by employers that have been in existence fewer than 3 years, (3) plans maintained by employers that normally employ 10 or fewer employees, and (4) governmental plans (within the meaning of § 414(d)) and church plans (within the meaning of § 414(e)). The new rules apply to plan years beginning after December 31, 2024.

10. Is a water bottle or a low-value gift card all it takes to get employees to participate in an employer-sponsored retirement plan? Go ahead and offer these sorts of de minimis financial incentives, says Congress. Generally, § 401(k)(4) and § 403(b)(12)(A) preclude a § 401(k) or § 403(b) plan from being tax-qualified if the employer offers any benefit that is conditioned on an employee's election to defer (or not defer) amounts to the plan. This prohibition is subject to limited exceptions and does not preclude employers from offering matching contributions. A provision of the SECURE 2.0 Act, Division T, Title I, § 113 of the Consolidated Appropriations Act, 2023, amended § 401(k)(4) and § 403(b)(12)(A) to provide that the prohibition on offering benefits conditioned on the employee's participation does not apply to a "de minimis financial incentive" as long as the incentive is not paid for with plan assets. The legislation does not define the term "de minimis financial incentive." The legislative history of the provision suggests that low-value gift cards would qualify. The new rules apply to plan years beginning after the date of enactment of the SECURE 2.0 Act (December 29, 2022).

11. Beginning in 2024, the § 72(t) 10% penalty for early withdrawal from a retirement plan will not apply to distributions of up to $1,000 for "necessary personal or family emergency expenses." Subject to certain exceptions, § 72(t)(1) provides that, if a taxpayer who has not attained age 59-1/2 receives a distribution from a retirement plan, the taxpayer's tax must be increased by 10 percent of the distribution. A provision of the SECURE 2.0 Act, Division T, Title I, § 115 of the Consolidated Appropriations Act, 2023, amended § 72(t)(2) by adding § 72(t)(2)(I), which allows an individual to treat one distribution per calendar year as an "emergency personal expense distribution" that is not subject to the 10-percent additional tax. An individual who takes an emergency personal expense distribution can repay it during the 3-year

period beginning on the day after the date on which the distribution was received to any eligible retirement plan to which a rollover contribution could be made. The maximum amount that can be treated as an emergency personal expense distribution is $1,000. An individual who treats a distribution as an emergency personal expense distribution cannot treat a distribution in any of the three succeeding taxable years as such a distribution unless either (1) the previous distribution is fully repaid to the plan, or (2) the aggregate contributions by the employee to the plan after the previous distribution equal or exceed the amount of the previous distribution that has not been repaid. An emergency personal expenses distribution is defined as

> any distribution from an applicable eligible retirement plan … to an individual for purposes of meeting unforeseeable or immediate financial needs relating to necessary personal or family emergency expenses.

These rules apply to distributions made after December 31, 2023.

12. Beginning in 2024, survivors of domestic abuse can withdraw up to $10,000 from a retirement plan without being subject to the § 72(t) 10% penalty for early withdrawal. Subject to certain exceptions, § 72(t)(1) provides that, if a taxpayer who has not attained age 59-1/2 receives a distribution from a retirement plan, the taxpayer's tax must be increased by 10 percent of the distribution. A provision of the SECURE 2.0 Act, Division T, Title III, § 314 of the Consolidated Appropriations Act, 2023, amended § 72(t)(2) by adding § 72(t)(2)(K), which allows an individual to treat a distribution as "an eligible distribution to a domestic abuse victim" that is not subject to the 10-percent additional tax. An individual who takes such a distribution can repay it during the 3-year period beginning on the day after the date on which the distribution was received to any eligible retirement plan to which a rollover contribution could be made. The maximum amount that can be treated as an eligible distribution to a domestic abuse victim is the lesser of $10,000 or 50 percent of the present value of the accrued benefit of the employee under the plan. The $10,000 limitation will be adjusted for inflation for taxable years beginning after 2024. An eligible distribution to a domestic abuse victim is defined as a

> distribution … from an applicable eligible retirement plan [that] is made to an individual during the 1-year period beginning on any date on which the individual is a victim of domestic abuse by a spouse or domestic partner."

For this purpose, "domestic abuse" is defined as

> physical, psychological, sexual, emotional, or economic abuse, including efforts to control, isolate, humiliate, or intimidate the victim, or to undermine the victim's ability to reason independently, including by means of abuse of the victim's child or another family member living in the household.

These rules apply to distributions made after December 31, 2023.

13. Beginning in 2023, terminally ill individuals can withdraw funds from a retirement plan without being subject to the § 72(t) 10% penalty for early withdrawal. Subject to certain exceptions, § 72(t)(1) provides that, if a taxpayer who has not attained age 59-1/2 receives a distribution from a retirement plan, the taxpayer's tax must be increased by 10 percent of the distribution. A provision of the SECURE 2.0 Act, Division T, Title III, § 326 of the Consolidated Appropriations Act, 2023, amended § 72(t)(2) by adding § 72(t)(2)(L), which provides that distributions to a terminally ill individual on or after the date on which a physician has certified the individual as having a terminal illness are not subject to the 10-percent additional tax. An individual who takes such a distribution can repay it during the 3-year period beginning on the day after the date on which the distribution was received to any eligible retirement plan to which a rollover contribution could be made. The term "terminally ill individual" has the same meaning as it does in § 101(g)(4)(A) except that "84 months" is substituted for "24 months," which means that a "terminally ill individual" is defined as

> an individual who has been certified by a physician as having an illness or physical condition which can reasonably be expected to result in death in 84 months or less after the date of the certification.

New § 72(t)(2)(L)(iii) provides that an employee is not considered to be a terminally ill individual unless the employee provides sufficient evidence to the plan administrator in the form and manner required by the Secretary of the Treasury.

These rules apply to distributions made after the date of enactment of the SECURE 2.0 Act, which was December 29, 2022.

C. Nonqualified Deferred Compensation, Section 83, and Stock Options

1. The taxpayer took a shot at a deduction for deferred compensation but only scored an A-I-R B-A-L-L! A-I-R B-A-L-L! A-I-R B-A-L-L! Hoops, LP v. Commissioner, T.C. Memo. 2022-9 (2/23/22). In a memorandum opinion, the Tax Court (Jude Nega) has held that an accrual method partnership could not deduct unpaid salary and wages relating to deferred compensation owed to two players (Zach Randolph and Michael Conley) for the Memphis Grizzlies of the NBA. The taxpayer-partnership, Hoops, LP ("Hoops") sold the Memphis Grizzlies' NBA franchise and substantially all of its assets to a buyer in 2012. The buyer assumed substantially all of the liabilities and obligations of Hoops as part of the acquisition, including the obligation to pay approximately $10.7 million (discounted to present value) in nonqualified deferred compensation to the two players. Hoops had included the accrued $10.7 million liability in its amount realized in connection with the sale. Hoops did not deduct the $10.7 million on its originally filed partnership tax return on Form 1065 for 2012. Instead, Hoops filed an amended return on Form 1065-X for 2012 in October of 2013 claiming the $10.7 million accrued liability as a deduction. Following an audit, the IRS issued a notice of final partnership administrative adjustment disallowing the deduction, and Hoops petitioned the Tax Court. The parties stipulated that the $10.7 million accrued liability was nonqualified deferred compensation governed by the catch-all "other plans" provision of § 404(a)(5). Section 404(a)(5) and the regulations under that provision allow a deduction for payments under such nonqualified deferred compensation plans "only in the taxable year of the employer in which or with which ends the taxable year of an employee in which an amount attributable to such contribution is includible in [the employee's] gross income." Reg. § 1.404(a)-12(b)(1). Hoops argued that the timing rule in § 404(a) is incorporated into the economic performance requirement of § 461(h), and due to the sale, the deduction was accelerated under Reg. § 1.461-4(d)(5)(i) which provides:

> If, in connection with the sale or exchange of a trade or business by a taxpayer, the purchaser expressly assumes a liability arising out of the trade or business that the taxpayer but for the economic performance requirement would have been entitled to incur as of the date of the sale, economic performance with respect to that liability occurs as the amount of the liability is properly included in the amount realized on the transaction by the taxpayer.

Alternatively, Hoops argued that if the $10.7 million liability was not deductible upon the sale, then it should not have been included in Hoops's amount realized as part of the sale. The IRS argued in response that Reg. § 1.404(a)-12(b)(1), not § 461(h) or Reg. § 1.461-4(d)(5)(i), controlled to allow the deduction only when the deferred compensation is paid and includable in the players' gross income regardless of whether economic performance had occurred or whether the liability was considered part of Hoops's amount realized in connection with the sale.

Judge Nega's Opinion. Judge Nega agreed with the IRS and relied on the regulations under § 461 and § 446, which provide that "[a]pplicable provisions of the Code, the Income Tax Regulations, and other guidance published by the Secretary prescribe the manner in which a liability that has been incurred [under § 461(h)] is taken into account." Reg. §§ 1.461-1(a)(2)(i), 1.446-1(c)(1)(ii)(A). Judge Nega therefore reasoned that § 404(a)(5) and Reg. § 1.404(a)-12(b)(1) controlled to disallow the partnership's deduction unless and until the deferred compensation was

paid and includable in the gross income of the players. Judge Nega cited the Ninth Circuit's decision in *Albertson's, Inc. v. Commissioner*, 42 F.3d 537, 543 (9th Cir. 1994), *aff'g* 95 T.C. 415 (1990), as support. In *Albertson's*, the Ninth Circuit relied upon legislative history to determine that Congress enacted § 404(a) expressly to match the timing of an employer's deduction and an employee's inclusion of nonqualified deferred compensation. Furthermore, regarding whether the $10.7 million deferred compensation liability should have been included in Hoops's amount realized upon the sale, Judge Nega determined that it should, citing the general rules of §§ 1001(a), 1001(b), and Reg. § 1.1001-2(a)(1), which provide that a taxpayer's amount realized includes liabilities from which the taxpayer is discharged as a result of transferring property.

Comment. Hoops argued that the $10.7 million nonqualified deferred compensation arrangement should not be considered a "liability" includable in amount realized under § 1001(b) and Reg. § 1.1001-2(a)(1). Support for this position can be found in § 108(e)(2), which provides that "[n]o income shall be realized from the discharge of indebtedness to the extent that payment of the liability would have given rise to a deduction." Similarly, § 357(c)(3)(i) provides that an obligation is not treated as a liability for purposes of § 351 if the payment thereof "would give rise to a deduction." And, Reg. § 1.752-1 provides that an obligation is not treated as a liability for purposes of § 752 unless it (i) creates or increases the basis of any of the obligor's assets (including cash); (ii) gives rise to an immediate deduction to the obligor; or (iii) gives rise to an expense that is not deductible in computing the obligor's taxable income and is not properly chargeable to capital. The court, however, rejected Hoops's argument and held that, under the general rules of § 1001(b) and Reg. § 1.1001-2(a)(1), "Hoops was required to take into account the amount of the deferred compensation liability in computing its gain or loss from the sale."

Appeal: Hoops has appealed to the U.S. Court of Appeals for the Seventh Circuit.

a. Upon replay review, the call on the court is confirmed by the Seventh Circuit: No basket (a/k/a deduction)! Hoops, LP v. Commissioner, 77 F.4th 557 (7th Cir. 8/9/23) *aff'g* T.C. Memo. 2022-9 (2/23/22). On appeal, in an opinion by Judge Scudder, the U.S. Court of Appeals for the Seventh Circuit agreed with the Tax Court that § 404(a)(5) controlled the outcome in this case and disallowed any deduction for Hoops unless and until the deferred compensation is included in the gross income of the players. Hoops made the same argument to the Seventh Circuit that it made in the Tax Court, i.e., that Reg. § 1.461-4(d)(5)(i) allows acceleration of the deduction for the deferred compensation obligation in the context of a sale of a trade or business. As noted earlier, Reg. §1.461-4(d)(5)(i) provides:

> If, in connection with the sale or exchange of a trade or business by a taxpayer, the purchaser expressly assumes a liability arising out of the trade or business that the taxpayer but for the economic performance requirement would have been entitled to incur as of the date of the sale, economic performance with respect to that liability occurs as the amount of the liability is properly included in the amount realized on the transaction by the taxpayer.

Judge Scudder disagreed, though, reasoning that the above-quoted regulation applies where economic performance has not occurred. Here, there was no dispute that economic performance had occurred because the deferred compensation was attributable to the players' past services rendered in prior NBA seasons. Judge Scudder wrote:

> Therein lies the fundamental flaw in Hoops's argument: it was not § 461(h)'s economic performance requirement that prevented Hoops from taking the deduction in 2012, but the rule in § 404(a)(5) governing nonqualified deferred-compensation plans.

Hoops further urged the Seventh Circuit to consider the practical implications of its decision. Specifically, Hoops argued that the deduction could be lost altogether (even though it clearly would be allowed if Hoops paid the deferred compensation at the time of sale) if the buyer, the

Memphis Grizzlies, fails to pay the players or fails to communicate to Hoops the fact that the players have been paid. Judge Scudder responded:

> But any risk of losing the deferred compensation deduction is foreseeable, especially given the clear instructions from Congress in § 404(a)(5). We agree with the Commissioner's suggestion that Hoops could have avoided this tax-deduction problem in many ways—by adjusting the sales price to reflect the deductibility, contributing to qualified plans for the players to take earlier deductions, or renegotiating the players' contracts and accelerating their compensation to the date of the sale.

Comment. As noted above, Hoops argued in the Tax Court that the $10.7 million nonqualified deferred compensation arrangement should not be considered a "liability" includable in amount realized under § 1001(b) and Reg. § 1.1001-2(a)(1) in connection with the sale. Hoops apparently did not make this argument before the Seventh Circuit, so Judge Scudder did not address the issue. In the authors' opinion, the problem in this case stems from Hoops's inclusion of the $10.7 million deferred compensation obligation in amount realized upon the sale to the Memphis Grizzlies. If Hoops had not so included the $10.7 million "liability" in amount realized—based upon the authorities discussed by the authors above—then Hoops's gain on the sale would have been correspondingly decreased, thereby avoiding the adverse effect of § 404(a)(5).

D. Individual Retirement Accounts

1. Want to give the funds in your IRA to charity? Congress has made it even easier. Section 408(d)(8)(A) permits individuals who have reached age 70-1/2 to transfer up to $100,000 per year directly from one or more IRAs to one or more public charities or private operating foundations and treat the amounts transferred as tax-free distributions from the IRA. A provision of the SECURE 2.0 Act, Division T, Title III, § 307 of the Consolidated Appropriations Act, 2023, amended Code § 408 by adding § 408(d)(8)(G), which indexes the $100,000 annual limit for inflation for taxable years beginning after 2023. In addition, the legislation permits a taxpayer, beginning in 2023, to make a one-time $50,000 distribution directly from an IRA to a "split-interest entity" and make a one-time election to treat the contributions as if they were qualified charitable distributions made directly to a charitable entity. For this purpose, a split-interest entity is defined as (1) a charitable remainder unitrust that is funded exclusively by qualified charitable distributions, (2) a charitable remainder annuity trust that is funded exclusively by qualified charitable distributions, or (3) charitable gift annuity trust that is funded exclusively by qualified charitable distributions and that begins fixed payments of 5 percent or greater not more than one year from the date of funding.

2. The $1,000 limit on catch-up contributions to IRAs will be indexed for inflation beginning in 2024. Section 219(b)(5)(B) allows individuals who are age 50 or older to make so-called "catch-up" contributions to IRAs in addition to the basic amount that individuals are allowed to contribute ($6,500 in 2023). According to § 219(b)(5)(B)(ii), the limit on catch-up contributions is $1,000. The limit on the basic amount that individuals are permitted to contribute has long been adjusted annually for inflation but, until recent legislation, the limit on catch-up contributions was not. A provision of the SECURE 2.0 Act, Division T, Title I, § 108 of the Consolidated Appropriations Act, 2023, amended Code § 219(b)(5)(C) by adding § 219(b)(5)(C)(iii), which indexes the $1,000 annual limit on catch-up contributions for inflation for taxable years beginning after 2023.

3. Unless You Are the IRS, "I am the last guy in the world that you want to f[ool] with." James Caan as "Frank" in *Thief* (1981). Estate of Caan v. Commissioner, 161 T.C. No. 6 (10/18/23). The estate of the well-known actor, James Caan, was the taxpayer in this case. James Caan died in 2022 while holding two IRAs with UBS as custodian. One of Caan's IRAs held a nontraditional asset, a partnership interest in a private hedge fund. Under § 408(i), the IRA custodian, UBS, was required to report annually to the IRS the fair market value of the IRA's interest in the hedge fund. Because the interest in the hedge fund was not publicly traded, the IRA

custodial agreement required Mr. Caan to specify to UBS each year the fair market value of the hedge fund interest. In January 2015 and thereafter, Caan did not provide UBS with the value of the hedge fund interest for the year ended 2014. As a result, UBS subsequently alerted Caan in October 2015 that it would resign as IRA custodian of the hedge fund interest and distribute the interest to him. Then, in December 2015, UBS confirmed by letter to Caan that it has distributed the hedge fund interest to him. In this regard, the UBS IRA custodial agreement provided as follows: "The Client acknowledges, understands and agrees that if the Custodian does not receive a fair market value as of the preceding December 31, the Custodian shall distribute the Investment to the Client and issue an IRS Form 1099-R for the last available value of the Investment." Later, in accordance with the IRA custodial agreement, UBS issued Mr. Caan a 2015 Form 1099-R, Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., reflecting a November 25, 2015, IRA distribution of $1,910,903, the hedge fund interest's specified 2013 reportable year-end value. Meanwhile in June 2015, before UBS alerted Mr. Caan of its decision to resign and distribute the interest in the hedge fund, Caan's financial advisor moved from UBS to Merrill Lynch. In October of 2015, the financial advisor convinced Caan to transfer the assets in his two UBS IRAs to a rollover IRA at Merrill Lynch. Caan signed the necessary paperwork, and then UBS transferred the assets, except for the illiquid hedge fund interest, to Caan's Merrill Lynch rollover IRA. It was not until October 2016 that Caan and Merril Lynch discovered the hedge fund interest previously held in Caan's UBS IRA had not been transferred to Caan's Merrill Lynch rollover IRA. Then, in December 2016, Merrill Lynch instructed the hedge fund to liquidate Caan's interest for cash and transfer the cash to Caan's Merril Lynch rollover IRA. Cash transfers totaling $1,375,000 then were made in 2017 from the hedge fund to Caan's Merrill Lynch rollover IRA. Caan's 2015 federal income tax return reported the IRA rollovers from UBS to Merril Lynch, including the distribution of the hedge fund interest, but took the position that the hedge fund interest was rolled over to Merrill Lynch along with Caan's other IRA assets previously held at UBS. Upon examination—no doubt based upon the 2015 Form 1099-R issued by UBS—the IRS disagreed with Caan's position regarding the rollover of the hedge fund interest. Accordingly, the IRS in 2018 issued Caan a notice of deficiency for additional taxes, interest, and penalties for 2015 relating to the reported UBS IRA distribution of the hedge fund interest. Caan timely filed a petition in the Tax Court. Around the same time the petition was filed, Caan requested a private letter ruling from the IRS granting him a waiver of the 60-day IRA rollover period with respect to the distributed interest in the hedge fund. *See* § 408(d)(3)(I). The IRS denied the requested private letter ruling, citing the "same property" requirement for IRA rollovers according to § 408(d)(3)(A)(i) and (D) as interpreted by *Lemishow v. Commissioner*, 110 T.C. 110, 113 (1998), *as supplemented* 110 T.C. 346 (1998). Thus, the issues before the Tax Court were (1) whether UBS distributed the hedge fund interest to Caan in 2015 and (ii) if so, whether the distribution was taxable and in what amount.

Tax Court Opinion. The Tax Court, in an opinion written by Judge Copeland, first held that the IRS properly denied Caan's private letter ruling request for a waiver of the 60-day rollover period concerning the hedge fund interest. Judge Copeland agreed with the IRS that because cash, not the hedge fund interest, was transferred to Caan's Merrill Lynch IRA, the "same property" requirement of § 408(d)(3)(A)(i) and (D) applied, thereby making the purported rollover ineffective. Judge Copeland cited *Lemishow v. Commissioner* as further support for the court's holding. With respect to Caan's argument that the hedge fund interest should have been treated as rolled over to Merrill Lynch in October or November of 2015 (or by the 60-day deadline of January 25, 2016) after Caan executed the necessary paperwork, Judge Copeland wrote (in perhaps the understatement of the year):

> There are three problems with the way the [hedge fund interest] was handled. First, and most importantly, in liquidating the [hedge fund interest] Mr. Caan changed the character of the property; yet section 408(d)(3)(A)(i) required him to contribute the [hedge fund interest] itself, not cash, to another IRA in order to preserve its tax-deferred status. See *Lemishow*, 110 T.C. at 113; Treas. Reg. § 1.408-4(b)(1). Second, the contribution of the cash proceeds from the liquidation occurred long

> after the January 25, 2016, deadline. And finally, the [hedge fund's] three transfers [of cash] to the Merrill Lynch IRA constituted three separate contributions; yet section 408(d)(3)(B) allows for only one rollover contribution in any one-year period, making only the first transfer potentially eligible for a tax-free rollover.

Furthermore, Judge Copeland wrote:

> The text of section 408(d)(3)(A)(i), the legislative history behind section 408(d)(3), our caselaw, and the regulations all make clear that Mr. Caan was required to contribute the P&A Interest, not cash, to the Merrill Lynch IRA in order to preserve its tax-deferred status. Because he did not do so, we hold that the cash proceeds from the liquidation of the P&A Interest were not contributed in a manner that would qualify as a nontaxable rollover contribution under section 408(d)(3)(A)(i).

Finally, for purposes of determining the amount of Caan's 2015 IRA distribution of the hedge fund interest, Judge Copeland decided that the interest should be valued at $1,548,010.

V. PERSONAL INCOME AND DEDUCTIONS

A. Rates

B. Miscellaneous Income

1. If you can understand half of the terminology in this ruling, you are ahead of the game. A cash method taxpayer who receives additional units of cryptocurrency as a reward for participating in a validation process by staking the taxpayer's holdings through a cryptocurrency exchange has gross income equal to the fair market value of the units received in the year in which the taxpayer gains dominion and control over the validation rewards. Rev. Rul. 2023-14, 2023-33 I.R.B. 484 (7/31/23). This ruling addresses the tax consequences for a cash-method taxpayer who receives units of cryptocurrency as a reward for performing so-called validation services in connection with cryptocurrency transactions. Many cryptocurrencies such as Bitcoin use blockchain technology. Generally, blockchain, which is one form of distributed ledger technology, is a storage technology that is used for saving data on decentralized networks. Blockchain stores information in batches called blocks, which are linked together in a sequential way. The creation of new blocks on a blockchain requires the participation of multiple validators who validate the legitimacy of transactions. The validators receive as a reward one or more newly-created units of the cryptocurrency native to the blockchain. In one form of this validation process, those validating stake their holdings in cryptocurrency. If the validation is successful, the validator receives a reward. If the validation is unsuccessful, the validator may forfeit some or all of the staked units. The ruling addresses a set of facts in which a cash method taxpayer stakes 200 units of a cryptocurrency, validates a new block of transactions, and receives 2 units of cryptocurrency asa reward. The ruling concludes as follows:

> If a cash-method taxpayer stakes cryptocurrency native to a proof-of-stake blockchain and receives additional units of cryptocurrency as rewards when validation occurs, the fair market value of the validation rewards received is included in the taxpayer's gross income in the taxable year in which the taxpayer gains dominion and control over the validation rewards. The fair market value is determined as of the date and time the taxpayer gains dominion and control over the validation rewards. The same is true if a taxpayer stakes cryptocurrency native to a proof-of-stake blockchain

The ruling cautions that it does not address issues that might arise under any rules not cited in the ruling, including § 83.

2. Are those refunds of state or local taxes or other payments received from state governments included in gross income? Maybe, says the IRS. Notice 2023-56, 2023-38 I.R.B. 824 (8/30/23). In 2022, some states made payments to individuals residing in those states. The payments generally were related to the COVID-19 pandemic. The IRS issued a news release

on February 10, 2023, IR-2023-23, to provide certainty for the 2023 filing season for 2022 returns. The news release provided that, in the best interest of sound tax administration, the IRS would not challenge a taxpayer's exclusion of these payments from gross income. The news release identified 17 states that qualified for this treatment. That guidance, however, applied only for tax year 2022. This notice provides guidance for 2023 and future years. The notice addresses the general tax treatment of a state refund of tax. If the payment is a refund of tax, then it is not included in a taxpayer's gross income except to the extent required by the tax benefit rule, i.e., to the extent the taxpayer deducted the payment and received a tax benefit from the deduction in a prior year. (A state payment if considered a refund of tax only to the extent that the payment is limited to taxes paid. *See, e.g.*, *Maines v. Commissioner*, 144 T.C. 123 (2015).) The notice also addresses payments received from states that are eligible for exclusion under the general welfare exclusion. To qualify for the general welfare exclusion, state payments must (1) be paid from a governmental fund, (2) be for the promotion of general welfare (that is, based on the need of the individual or family receiving such payments), and (3) not represent compensation for services absent a specific Federal income tax exclusion. The notice provides examples of payments that qualify, such as payments to eligible residents under an "Energy Relief Payment Program" to help those low-income residents who may not otherwise be able to afford to pay their heating bills.

C. Hobby Losses and § 280A Home Office and Vacation Homes

1. Taxpayer's horse-breeding activity is a hobby subject to deduction limitations under § 183 because the taxpayer covered year-over-year losses from his trust fund, ignored cost-saving strategies because he was "not so much [concerned about] income and expenses," threw "pretty lavish parties" attended by people "you would never meet otherwise," intermingled personal and company expenses (including wedding costs), and lived rent-free on the company farm. Skolnick v. Commissioner, 62 F.4th 95 (3rd Cir. 3/8/23) *aff'g* T.C. Memo. 2021-139. The headline more or less sums up this case from the U.S. Court of Appeals for the Third Circuit in which the court affirmed the Tax Court's decision. The taxpayers were owners of a horse-breeding farm conducted through an LLC classified as a partnership for federal income tax purposes. The LLC had operated at a loss for twelve consecutive years before the taxpayers were audited by the IRS for losses claimed via the LLC with respect to their taxable years 2010-2013. The IRS assessed a deficiency on the grounds that IRC § 183 applied to disallow any deductions in excess of the income from the LLC for the years 2010-2013. The taxpayers petitioned the Tax Court, which upheld the proposed deficiency. *See Skolnick v. Commissioner*, T.C. Memo. 2021-139 (Judge Lauber). The taxpayers appealed to the Third Circuit, alleging that the Tax Court misapplied the nine-factor test under Reg. § 1.183-2(b) for determining whether an activity is engaged in for profit: (1) the manner in which the taxpayer carries on the activity; (2) the expertise of the taxpayer or his advisors; (3) the time and effort expended by the taxpayer in carrying on the activity; (4) the expectation that assets used in the activity may appreciate in value; (5) the success of the taxpayer in carrying on other similar or dissimilar activities; (6) the taxpayer's history of income or losses with respect to the activity; (7) the amount of occasional profits, if any; (8) the financial status of the taxpayer; and (9) elements of personal pleasure or recreation. Judge Lauber of the Tax Court found that five factors (1, 6, 7, 8, and 9) favored the IRS, three factors (3, 4, and 5) were neutral, and only one factor (2) favored the taxpayers. The Third Circuit, in an opinion written by Judge Hardiman, essentially agreed with Judge Lauber's analysis of the nine factors and found no clear error in the Tax Court's ultimate conclusion that the taxpayers' horse breeding activity was not engaged in for profit for years 2010-2013 within the meaning of IRC § 183. On the one hand, Judge Hardiman reiterated the facts stated in the headline above, especially the LLC's long history of operating losses prior to and after the period 2010-2013 (factor 6). Judge Hardiman also reasoned that, as Judge Lauber emphasized, factor 8 (financial status of the taxpayer) favored the IRS because the taxpayers continually used trust funds and income from other activities to prop up the LLC's year-over-year losses. On the other hand, Judge Hardiman was mildly critical of Judge Lauber's analysis of factor 7 (occasional profits) because the taxpayers were able to show that a third-party paid $325,000 for a 15% interest in the LLC in 2001 and the LLC made a small profit in 2016 from the sale of an interest in one breeding

horse. Ultimately, though, Judge Hardiman ruled that Judge Lauber had not erred in holding that factor 7 favored the IRS. Similarly, Judge Hardiman critiqued Judge Lauber's analysis of factor 9 (elements of personal pleasure or recreation). Judge Hardiman did not view the evidence as supporting the conclusion that the opportunity for socializing, as opposed to making a profit, was the primary motive of the taxpayers vis-à-vis the LLC's activities. Nevertheless, considering that the LLC's farm was used rent-free by the taxpayers as a residence and that personal expenditures (including wedding costs) were intermingled with horse-breeding expenses, Judge Hardiman agreed with Judge Lauber that factor 9 favored the IRS. Lastly, concerning a separate issue of whether the taxpayers were entitled to NOL carryforwards from years prior to 2010, Judge Hardiman ruled that Judge Lauber had not clearly erred in finding that the taxpayers failed to adequately substantiate such carryforward losses.

a. "Pease" limitation of § 67 regarding miscellaneous itemized deductions sinks hobby loss expenses otherwise allowable under § 183(b)(2) for taxpayer's yacht chartering activity. Gregory v. Commissioner, 69 F.4th 762 (11th Cir. 5/30/23) *aff'g* T.C. Memo. 2021-115 (Judge Jones). The taxpayer in this case engaged in a yacht chartering activity where expenses equaled or exceeded the taxpayer's gross income from the activity during taxable years 2014 and 2015. During the audit and in the Tax Court, the taxpayer and the IRS agreed that the taxpayer's yacht chartering activity during the years in issue was subject to the hobby loss rules of IRC § 183. Consequently, the taxpayer and the IRS further agreed that any deductible expenses from the yacht chartering activity during those years were subject to the gross income limitation of § 183(b)(2). The taxpayer and the IRS disagreed, however, whether the deductions otherwise allowable under § 183(b)(2) are (i) permitted above-the-line as an offset against gross income in determining adjusted gross income under IRC § 62 or (ii) subject to the so-called "Pease" limitation of IRC 67(a) (allowing "miscellaneous itemized deductions" below-the-line only to the extent the deductions exceed a floor of 2 percent of the taxpayer's adjusted gross income). Because the taxpayer earned substantial taxable income during the years in issue—over $19 million in 2014 and over $80 million in 2015—the "Pease" limitation had the effect of disallowing the taxpayer's yacht chartering expenses entirely, even if the expenses were allowable in part under IRC § 183(b)(2). [*Note*: The 2-percent "Pease" limitation applied to the taxable years at issue in this case, but beginning in 2018 through 2025, "miscellaneous itemized deductions" are completely disallowed under IRC § 67(g). Thus, under current law, the taxpayer's yacht chartering expense deductions otherwise allowable under § 183(b)(2) would be disallowed entirely under § 67(g) regardless of the taxpayer's adjusted gross income.] The taxpayer moved for partial summary judgment in Tax Court arguing that the "Pease" limitation does not apply to hobby loss deductions under § 183(b)(2). The IRS argued to the contrary, and Judge Jones of the Tax Court agreed with the IRS, thereby disallowing the taxpayer's hobby loss deductions that otherwise would be permitted under IRC § 183(b)(2).

Appeal: On appeal to the Eleventh Circuit, the taxpayer made several arguments that § 183(b)(2) hobby loss deductions are not "miscellaneous itemized deductions" subject to § 67. First and foremost, the taxpayer argued that IRC § 183 should be read on a stand-alone basis to allow hobby activity expenses as above-the-line deductions offsetting hobby activity gross income. Put differently, the taxpayer argued that § 183 should be read as a corollary to § 162 which allows trade or business expenses above the line as an offset against trade or business gross income in determining adjusted gross income under § 62. Thus, according to the taxpayer, § 183 is merely a qualifier designed to limit hobby activity deductions to hobby activity gross income, but otherwise § 183 operates like § 162. The Eleventh Circuit (Judge Brasher), however, disagreed, stating: "Section 183(b)(2) permits a deduction otherwise disallowed by Section 183(a) and identifies its amount. But the deduction allowed by Section 183(b)(2) is its own thing, not a trade or business expense." Further, Judge Brasher reasoned that, as Judge Jones of the Tax Court had concluded, that § 183(b)(2) "is a benchmark for capping the deduction—it is not a command to apply hobby loss deductions against a taxpayer's total gross income." Judge Brasher then turned to the statutory scheme of IRC §§ 62 (defining "adjusted gross income"), 63 (defining "itemized deductions"),

and 67 (defining "miscellaneous itemized deductions"). Judge Brasher concluded that because § 62 does not list § 183 as one of the deductions allowable in computing adjusted gross income, and because § 63 does not carve out § 183 deductions for special treatment (unlike the special treatment given the standard deduction, the § 199A QBI deduction, and the § 170 charitable deduction), hobby loss deductions are subject to the "Pease" limitation of § 67. Judge Brasher cited as support (i) Reg. § 1.67-1T(a)(1)(iv) ["expenses for an activity for which a deduction is otherwise allowable under section 183"]; (ii) two lower-court cases [i.e., *Purdey v. United States*, 39 Fed. Cl. 413, 417 (1997); *Strode v. Comm'r*, 109 T.C.M. (CCH) 1599 (2015)]; and (iii) commentary [i.e., B. Bittker & L. Lokken, Federal Taxation of Income, Estates and Gifts ¶ 30.4.2 (July 2022)].

Next, the taxpayer argued that the Eleventh Circuit's opinion in *Brannen v. Commissioner*, 722 F.2d 695 (11th Cir. 1984), compelled the conclusion that § 183 deductions are above-the-line and not subject to the "Pease" limitation. The court in *Brannen* held that § 183 applies to allow deductions, not to exceed gross income, for expenses connected with an activity that is not "entered into with the dominant hope and intent of realizing a profit." Judge Brasher clarified, though, that *Brannen* was decided before the enactment of the "Pease" limitation of § 67, and *Brannen* should not be read to mean that § 183 allows an above-the-line deduction for hobby activity expenses notwithstanding the statutory scheme of §§ 62, 63, and 67.

Next, the taxpayer argued that subjecting § 183(b)(2) deductions to the "Pease" limitation of § 67 contravenes Congressional intent. Pointing to legislative history, the taxpayer contended that § 183 originally was enacted to prevent wealthy taxpayers from generating artificial losses, not to prevent taxpayers from deducting legitimate hobby loss expenses. Judge Brasher countered, though, that by enacting the "Pease" limitation of § 67, Congress explicitly intended to limit a taxpayer's ability to benefit from already-existing deductions that the Code otherwise provided.

Finally, the taxpayer made additional arguments that the Tax Court's and the Eleventh Circuit's interpretation of § 183 is inconsistent with other principles of statutory construction; however, Judge Brasher found none of the taxpayer's arguments convincing, primarily because the court did not find that § 183 and the statutory scheme of §§ 62, 63, and 67 were ambiguous.

Judge Wilson concurred with Judge Brasher's opinion but wrote separately to clarify that he would reach the same result by examining the legislative history of the Tax Cuts and Jobs Act of 2017 ("TCJA"). In relevant part, the Conference Report to the TCJA lists "[h]obby expenses, but generally not more than hobby income," as one type of deduction that would be disallowed under § 67(g) until 2026. *See* H.R. Rep. No. 115-466, at 273, 276 (2017).

D. Deductions and Credits for Personal Expenses

1. Standard deduction for 2023. Rev. Proc. 2022-38, 2022-45 I.R.B. 445 (10/18/22). The standard deduction for 2023 will be $27,700 for joint returns and surviving spouses (increased from $25,900), $13,850 for unmarried individuals and married individuals filing separately (increased from $12,950), and $20,800 for heads of households (increased from $19,400). For individuals who can be claimed as dependents, the standard deduction cannot exceed the greater of $1,250 (increased from $1,150) or the sum of $400 (unchanged from 2022) and the individual's earned income. The additional standard deduction amount for those who are legally blind or who are age 65 or older is $1,850 (increased from $1,750) for those with the filing status of single or head of household (and who are not surviving spouses) and is $1,500 (increased from $1,400) for married taxpayers ($3,000 on a joint return if both spouses are age 65 or older).

2. Congress has increased and made more widely available the § 36B premium tax credit for 2021 and 2022, eliminated the need to repay excess advance premium tax credits for 2020, and has made the credit available for 2021 to those who receive unemployment compensation. The 2021 American Rescue Plan made several significant changes to the premium tax credit authorized by § 36B. This credit is available to individuals who meet certain eligibility requirements and purchase coverage under a qualified health plan through a health insurance exchange. *First*, for taxable years beginning in 2021 or 2022, § 9661 of the

legislation amends Code § 36B(b)(3)(A) by adding new clause (iii), which increases the amount of the credit at every income level and makes the credit available to those whose household income is 400 percent or higher of the federal poverty line. *Second*, for any taxable year beginning in 2020, § 9662 of the legislation suspends the rule of § 36B(f)(2)(B), which requires repayment of excess premium tax credits. An individual who receives advance premium tax credit payments is required by § 36B(f)(1) to reconcile the amount of the advance payments with the premium tax credit calculated on the individual's income tax return for the year and, normally, pursuant to § 36B(f)(2)(B), must repay any excess credit received. This repayment obligation does not apply for 2020. *Third*, for taxable years beginning in 2021, § 9663 of the legislation amends § 36B by adding new subsection (g), which caps the household income of those receiving unemployment compensation at 133 percent of the federal poverty line. This has the effect of making such persons eligible for the maximum amount of premium tax credit.

a. Congress has extended certain changes related to the § 36B premium tax credit through 2025. The Inflation Reduction Act, § 12001, extends through 2025 the effective date of Code §§ 36B(b)(3)(A)(iii) and 36B(c)(1)(E), which increase the amount of the credit at every income level and make the credit available to those whose household income is 400 percent or higher of the federal poverty line.

3. Congress has modified and extended through 2032 the § 25C credit for certain energy-efficient improvements to a taxpayer's principal residence. The changes apply to property placed in service after December 31, 2022. The Inflation Reduction Act, § 13301, extended with some modifications the § 25C credit for certain energy-efficient home improvements to a taxpayer's principal residence. As modified, the credit is 30 percent (increased from 10 percent) of the amount paid or incurred by a taxpayer for qualified energy efficiency improvements (such as insulation materials or systems, exterior windows, and exterior doors), 30 percent of the amount paid or incurred by a taxpayer for residential energy property expenditures (such as high-efficiency furnaces, water heaters, and air conditioning systems), and 30 percent of the amount paid or incurred for a home energy audit. Although energy-efficient roofs formerly were treated as qualified energy efficiency improvements, they are no longer treated in this manner (and therefore are not eligible for the § 25C credit) under the revised statute. The credit is subject to an annual per-taxpayer limit of $1,200 and an annual $600 per-item limit. In addition, the maximum annual credit is $600 for all exterior windows and skylights and $500 for all exterior doors (with a per-door limit of $250). The maximum credit for a home energy audit is $150. For geothermal and air source heat pumps and biomass stoves, the annual limit on the credit is $2,000. The changes made by the Inflation Reduction Act generally apply to property placed in service after December 31, 2022. As extended, the credit is available for property placed in service before January 1, 2033.

4. Congress has extended through 2034 the § 25D credit for residential clean energy property. The Inflation Reduction Act, § 13302, extended the § 25D credit for qualified solar electric property, qualified solar water heating property, qualified fuel cell property, qualified small wind energy property, qualified geothermal heat pump property, and qualified biomass fuel property. Generally, these properties must be installed in a dwelling unit located in the United States that is used by the taxpayer as a residence. In the case of qualified fuel cell property, the dwelling unit must be used by the taxpayer a as a principal residence. For qualified biomass fuel property, the credit is available only for property placed in service through 2022. Beginning in 2023, a credit is available for a new category, qualified battery storage technology. The credit for all categories of eligible property is 30 percent for property placed in service in 2022 through 2032 and phases down to 26 percent for property placed in service in 2033 and to 22 percent for property placed in service in 2034.

5. We agree: "The facts of this case are undisputed and disturbing." The taxpayers could not deduct $1.2 million they paid to their daughter/stepdaughter, who defrauded them and other individuals and is now in prison. Gomas v. United States, 132

A.F.T.R.2d 2023-5165, 2023 WL 4562503 (M.D. Fla. 7/17/23). Normally, the authors do not report on many U.S. District Court cases; however, with a line like the above taken directly from the court's opinion, at least one of us became too curious to resist. Essentially, the taxpayers in this case, a retired, married couple, were swindled out of nearly $2 million by their ne'er-do-well daughter/step-daughter, Suzanne Anderson (Anderson), over a two-year period. To pay this amount to Anderson, the taxpayers withdrew nearly $1.2 million from an IRA and a separate pension account in 2017. The taxpayers' original return for 2017 reported the amounts withdrawn as income and they paid the corresponding income tax liability. In 2020, the taxpayers filed an amended return seeking a refund of approximately $412,000 by claiming a deduction equal to the withdrawn amounts. The IRS denied their claim for a refund and the taxpayers brought this suit in U.S. District Court seeking a refund. As discussed below, the court, although sympathetic to the taxpayers' situation, denied their claim.

Factual background. The taxpayers had owned a business (operated through a limited liability company) that sold pet food online. In 2016, the taxpayers decided to retire and "turned the business over" to Anderson. According to the court's opinion, the limited liability company conducting the business was dissolved and its bank accounts closed. The assets of the business—presumably not significant due to online sales—were given to Anderson to carry on the business. Over the course of 2017 through 2019, Anderson convinced them, via numerous fraudulent misrepresentations, to withdraw about $1.2 million from their IRA and a separate pension fund and transfer the funds to her to support the business. Specifically, Anderson convinced the taxpayers that they were being sued by former customers and that she needed to hire an attorney to defend the business and to prevent the taxpayers from being arrested due to past business dealings. Anderson even forged documents and created a fake email address for the attorney she had "hired." Finally, in August of 2019, the taxpayers uncovered Anderson's elaborate scheme, she was arrested, and she currently is serving a 25-year sentence in a Florida state prison.

Court's analysis. On cross-motions for summary judgment, the District Court (Judge Barber) reluctantly held for the IRS and disallowed the taxpayers' refund claim. The court first noted that the taxpayers were precluded from claiming a theft-loss deduction. Section 165(h)(5), enacted as part of the 2017 Tax Cuts and Jobs Act, provides:

> [i]n the case of an individual, except as provided in subparagraph (B) [relating to personal casualty gains], any personal casualty loss which (but for this paragraph) would be deductible in a taxable year beginning after December 31, 2017, and before January 1, 2026, shall be allowed as a deduction under subsection (a) only to the extent it is attributable to a Federally declared disaster . . . .

The court reasoned that, although taxpayers historically were entitled to deduct theft losses in the year in which the loss was discovered (see § 165(e)), § 165(h)(5) precluded the taxpayers from claiming a theft loss deduction. The taxpayers in this case discovered the loss in 2019, a year to which § 165(h)(5) applies. The court then turned to the question whether the taxpayers were entitled to a deduction in 2017, the year for which they had filed the amended return. The taxpayers argued that they were entitled to deduct the amounts they had transferred to Anderson in 2017 under two theories. *First*, they asserted that they did not enjoy the benefit of the amounts withdrawn from the IRA and pension fund in 2017 and therefore should not be required to include the withdrawn amounts in gross income. Judge Barber recognized that Anderson, not the taxpayers, ultimately received the withdrawn funds; however, the taxpayers nevertheless were the "distributees" for federal income tax purposes under § 408. The taxpayers authorized and received the distributions before transferring the amounts to Anderson. The court contrasted the taxpayers' situation to that in *Roberts v. Commissioner*, 141 T.C. 569 (2013), in which the court held that a taxpayer was not the distributee with respect to amounts withdrawn from his IRAs by his wife through forged withdrawal requests and used exclusively by her. Thus, the taxpayers in this case were taxable on the distributions. *See Nice v. United States*, 124 A.F.T.R.2d 2019-6403, 2019 WL 5212281 (E.D. La. 2019) (finding elderly woman with dementia was the taxable distributee of IRA disbursements even though son used and spent mother's IRA funds for personal enjoyment).

Second, the taxpayers argued that the amounts transferred to Anderson should be treated as deductible trade or business expenses under § 162. Judge Barber ruled, though, that the amounts transferred to Anderson were not deductible business expenses because, at the time the transfers were made, the taxpayers were retired and were no longer carrying on the trade or business. The fact that the taxpayers believed the amounts they paid to Anderson would be used to pay legal fees related to their past business operations, the court reasoned, did not entitle them to a deduction because none of the amounts paid were used to pay actual business expenses.

The taxpayers have appealed to the U.S. Court of Appeals for the Eleventh Circuit.

Comment: The court's opinion does not discuss, and neither the IRS nor the taxpayers may have cited, Rev. Rul. 2009-9, 2009-14 I.R.B. 735. Rev. Rul. 2009-9 famously was issued to benefit taxpayers who suffered so-called "Ponzi scheme" losses at the hands of Bernie Madoff. Rev. Rul. 2009-9 held that, although these losses were theft losses deductible in the year in which the theft was discovered, the losses were deductible under § 165(c)(2), not § 165(c)(3), because they were attributable to a "transaction entered into for profit." Therefore, the theft losses involved were not personal casualty losses and were not subject to the limitations on personal casualty losses in § 165(h). Under this reasoning, such losses would not be subject to the temporary disallowance rule of § 165(h)(5) quoted above. At least one author of this outline is curious as to whether the taxpayers' theft losses, especially given that they related to a former business conducted for profit, should be allowable in 2019 (the year of discovery) under § 165(c)(2) as interpreted by the IRS in Rev. Rul. 2009-9.

E. Divorce Tax Issues

1. A hedge fund manager's deductions of $18 million and $33 million for alimony were properly disallowed, says the Eighth Circuit. Redleaf v. Commissioner, 43 F.4th 825 (8th Cir. 8/5/22). Andrew and Elizabeth Redleaf were married in 1984. Following Andrew's initiation of divorce proceedings in a Minnesota state court in 2007, they entered into and submitted to the court with jurisdiction over their divorce proceeding a Marital Termination Agreement (MTA). The MTA, which provided that its terms would become part of any subsequent divorce decree, provided for division of the extensive marital assets, including a home in Telluride, Colorado, valuable artwork, and five vehicles. Among other requirements, the MTA provided, in a section entitled "Property Settlement," that Andrew, the founder and manager of a hedge fund, would pay to Elizabeth $1.5 million per month for sixty months and that, on March 15, 2013, he would pay her $30 million. Pursuant to these provisions, Andrew paid Elizabeth $18 million in 2012 and $33 million in 2013. Under the regime that applied to alimony for divorce or separation instruments entered into before 2019, § 215 permitted an above-the-line deduction for the payor of alimony and § 71 required the recipient to include the alimony in gross income. On his federal income tax returns for 2012 and 2013, Andrew deducted these payments as alimony. Elizabeth did not report them as income. The IRS issued a notice of deficiency to each spouse. The notice of deficiency issued to Andrew disallowed his deductions on the basis that the payments were not alimony but rather a nondeductible property settlement. The notice of deficiency issued to Elizabeth increased her income by the amount of the payments she received on the basis that the payments constituted alimony. Both parties filed petitions in the U.S. Tax Court, where the cases were consolidated. In the Tax Court, the IRS changed its position with respect to Elizabeth and argued that she was entitled to summary judgment because the payments were a nondeductible property settlement. The Tax Court (Judge Holmes) held that the payments were not alimony within the meaning of § 71(b). Accordingly, the Tax Court granted Elizabeth's motion for summary judgment and granted the government's motion for summary judgment with respect to Andrew. In an opinion by Judge Loken, the U.S. Court of Appeals for the Eighth Circuit affirmed the Tax Court's decision. Under former § 71(b)(1), the term "alimony or separate maintenance payment" was defined to mean any payment in cash that met four requirements. One of these requirements, set forth in former § 71(b)(1)(D), was that the payor could not have any liability to make the payments (or any substitute for the payments) after the recipient's death. The court observed that the approach used by many courts to determine whether there is any obligation to

make the payments after the recipient's death is to look first for any unambiguous termination provision in the parties' agreement and, if there is no such provision, to look to state law. If state law is ambiguous, then the court will look solely to the parties' divorce or separation instrument. In this case, the court concluded, the MTA did not plainly state whether the payments would continue after Elizabeth's death. Turning to state law, the court observed that Minnesota law provides that "maintenance" payments do not continue after the recipient's death, but concluded that these payments were not maintenance payments under Minnesota law, which requires a showing of need on the part of the recipient for payments to constitute maintenance. Despite Andrew's argument that Elizabeth needed tens of millions of dollars "to self-support her extravagant lifestyle," the court concluded that there was no showing of need. Accordingly, the court disallowed Andrew's deductions on the basis that the payments were part of a property settlement.

F. Education

1. Beginning in 2024, beneficiaries of § 529 college savings plans that have been open for more than 15 years will be able to roll over up to $35,000 during their lifetime from the 529 plan to a Roth IRA (subject to annual Roth IRA contribution limits). A provision of the SECURE 2.0 Act, Division T, Title I, § 126 of the Consolidated Appropriations Act, 2023, amended Code § 529(c)(3) by adding § 529(c)(3)(E), which permits distributions from a § 529 college savings account to be tax-free if they are rolled over to a Roth IRA maintained for the benefit of the designated beneficiary of the § 529 account provided that certain requirements are met. The requirements are that (1) the § 529 account must have been maintained for the 15-year period ending on the date of the distribution, (2) the distribution does not exceed the amount contributed to the § 529 plan (plus earnings) during the 5-year period ending on the date of the distribution, and (3) the distribution is paid in a direct trustee-to-trustee transfer to a Roth IRA maintained for the benefit of the designated beneficiary of the § 529 account. The amount rolled over each year is subject to two limitations. *First*, the amount rolled over cannot exceed the annual limit on Roth IRA contributions for the designated beneficiary reduced by the aggregate contributions made during the year to all IRAs maintained for the benefit of the designated beneficiary. For example, the limit on Roth IRA contributions for 2023 is $6,500. If the designated beneficiary of a § 529 account contributes $1,000 to a traditional IRA for the year, then the maximum amount that the individual could roll over from the § 529 account to the Roth IRA would be $5,500. *Second*, the amount rolled over in the current year and in all prior years cannot exceed $35,000, i.e., the lifetime limit on rollovers from the § 529 account to a Roth IRA is $35,000. This change applies to distributions from § 529 accounts made after December 31, 2023.

G. Alternative Minimum Tax

VI. CORPORATIONS

A. Entity and Formation

B. Distributions and Redemptions

1. A new excise tax of 1% on redemptions of stock by publicly traded corporations. The Inflation Reduction Act, § 138102, adds new Code § 4501, which imposes on a publicly traded U.S. corporation a 1 percent excise tax on the value of any of its stock that is repurchased by the corporation during the taxable year. The term "repurchase" means a redemption within the meaning of Code § 317(b) with regard to the stock of the corporation and any other economically similar transaction as determined by the Secretary of Treasury. The amount of repurchases subject to the tax is reduced by the value of any new issuance to the public and stock issued to the employees of the corporation. A subsidiary of a publicly traded U.S. corporation that performs the buyback for its parent or a U.S. subsidiary of a foreign corporation that buys back its parent's stock is subject to the excise tax. The provision excludes certain repurchases from the excise tax. The provision applies to repurchases of stock after December 31, 2022.

a. Yay! We get to teach corporate redemptions again. Notice 2023-2, 2023-2 I.R.B. 374 (12/27/22). The Treasury Department and the IRS have announced interim guidance under § 4501 in the form of Notice 2023-2. The notice is extensive and foreshadows the inevitably complicated regulations that ultimately will be promulgated under § 4501. Section 2 of Notice 2023-2 summarizes relevant law and provides introductory guidance, including the meaning of a "covered corporation" and "covered repurchases." Section 2 further identifies certain transactions that trigger the tax even if § 317(b) technically may not apply, such as stock purchases by a "specified affiliate" and "transactions economically similar to a § 317(b) redemption." Section 2 of Notice 2023-2 also clarifies that, pursuant to § 275(a)(6), any tax paid under § 4501 is not deductible by the covered corporation. Section 3 of Notice 2023-2 comprises the bulk of the new guidance. Section 3 provides rules concerning amounts includable in the excise tax base, amounts excludable from the excise tax base, and other aspects of the application of § 4501. Section 3 also includes twenty-six helpful examples, a few of which are reproduced here regarding preferred stock redemptions, stock dividends, boot in acquisitive reorganization transactions, cash paid for fractional shares in an acquisitive reorganization, corporate liquidations, and purchases by a disregarded entity.

Example 1: Redemption of preferred stock-

a) Facts. Corporation X has outstanding common stock that is traded on an established securities market, as well as mandatorily redeemable preferred stock that is not traded on an established securities market. The preferred stock is stock for Federal tax purposes. On January 1, 2023, Corporation X redeems the preferred stock pursuant to its terms.

b) Analysis. The redemption by Corporation X of its mandatorily redeemable preferred stock is a repurchase because (i) Corporation X redeemed an instrument that is stock for Federal tax purposes (that is, mandatorily redeemable preferred stock issued by Corporation X), and (ii) the redemption by Corporation X is a § 317(b) redemption.

Example 5: Pro rata stock split -

a) Facts. On October 1, 2023, Corporation X distributes three shares of Corporation X common stock with respect to each existing share of its outstanding common stock (Corporation X Stock Split).

b) Analysis. The common stock distributed by Corporation X to its shareholders through the Corporation X Stock Split is not an issuance because Corporation X distributed the stock to its shareholders with respect to its outstanding common stock. See section 3.08(4)(b) of this notice. Therefore, the stock distributed by Corporation X is not taken into account for purposes of the netting rule. See section 3.08(4)(a) of this notice (disregarding such types of issuances). Accordingly, Corporation X's stock repurchase excise tax base for its 2023 taxable year is not reduced by the Corporation X Stock Split.

Example 6: Acquisition of a target corporation in an acquisitive reorganization -

a) Facts. On October 1, 2023, Target merges into Corporation X (Target Merger). The Target Merger qualifies as an A reorganization. On the date of the Target Merger, the fair market value of Target's outstanding stock is $100x. In the Target Merger, Target's shareholders exchange $60x of their Target stock for Corporation X common stock, and $40x of their Target stock for $40x of cash.

b) Analysis regarding repurchase treatment, timing, and amount. The exchange by the Target shareholders of their Target stock for the consideration received in the Target Merger is a repurchase by Target because that exchange is an economically similar transaction. See section 3.04(4)(a)(i) of this notice. This repurchase occurs on October

1, 2023 (that is, the date on which the Target shareholders exchange their Target shares as part of the Target Merger). See section 3.06(1)(b) of this notice. The amount of this repurchase by Target is $100x, which equals the aggregate fair market value of the Target stock at the time that stock is exchanged by the Target shareholders as part of the Target Merger (that is, October 1, 2023). See section 3.06(2)(a) of this notice.

c) Analysis regarding impact of Target Merger on Target's stock repurchase excise tax base. Target's stock repurchase excise tax base for its 2023 taxable year is initially increased by $100x on account of the Target Merger. Under the qualifying property exception, the fair market value of the Target stock exchanged by the Target shareholders for Corporation X stock in the Target Merger (that is, $60x of Target stock) is a qualifying property repurchase that reduces Target's stock repurchase excise tax base. See sections 3.03(3)(a) and 3.07(2)(a) of this notice (regarding acquisitive reorganizations). However, the fair market value of the Target stock exchanged by the Target shareholders for the $40x of cash in the Target Merger does not qualify for the qualifying property exception. See sections 3.03(3)(a) and 3.07(2)(a) of this notice. Therefore, Target's stock repurchase excise tax base for its 2023 taxable year is increased by $40x ($100x repurchase - $60x exception = $40x).

d) Analysis regarding Corporation X's stock repurchase excise tax base. Corporation X's transfer of Corporation X stock to Target in the Target Merger is not an issuance for purposes of the netting rule because Corporation X's issuance of that stock is part of a transaction to which the qualifying property exception applies. See generally section 3.08(4)(d) of this notice. Specifically, Corporation X's transfer of Corporation X stock to Target is not an issuance for purposes of the netting rule because (i) the Corporation X stock constitutes property permitted to be received under § 354 without the recognition of gain, (ii) the Corporation X stock is used by a covered corporation (that is, Target) to repurchase its stock in a transaction that is a repurchase under section 3.04(4)(a)(i) of this notice, and (iii) the repurchase by Target is not included in Target's stock repurchase excise tax base because it is a qualifying property repurchase. See section 3.08(4)(d) of this notice. Therefore, Corporation X does not take into account any of the $60x of its stock transferred to Target in the Target Merger to reduce its stock repurchase excise tax base for Corporation X's 2023 taxable year. See section 3.08(4)(a) of this notice (disregarding such types of issuances).

Example 7: Cash paid in lieu of fractional shares -

a) Facts. The facts are the same as in section 3.09(6)(a) of this notice (Example 6). Additionally, the exchange ratio in the Target Merger is 1.25 shares of Corporation X stock for each share of Target stock. As part of the Target Merger, Shareholder A, who owns two shares of Target stock, receives two shares of Corporation X stock as well as additional cash in lieu of a 0.5 fractional share in Corporation X. The payment by Corporation X to Shareholder A of cash in lieu of a fractional share of Corporation X stock (i) was not separately bargained-for consideration (that is, the cash paid by Corporation X in lieu of a fractional Corporation X share represented a mere rounding off of the two Corporation X shares issued in the exchange), (ii) was carried out solely due to administrative necessity (and therefore, solely for non-tax reasons), and (iii) was for an amount of cash with regard to a fractional share of Corporation X stock that did not exceed the value of one share.

b) Analysis. The payment by Corporation X of cash to Shareholder A in lieu of a fractional share of Corporation X stock is treated for Federal income tax purposes as though the 0.5 fractional share were (i) distributed by Corporation X to Shareholder A as part of the Target Merger, and then (ii) redeemed by Corporation X for cash. Corporation X's deemed redemption of the fractional share treated as received by Shareholder A in the Target Merger is not a repurchase because, in addition to the facts

described in section 3.09(7)(a) of this notice (this Example 7), the payment of cash by Corporation X is carried out as part of a transaction that qualifies as an acquisitive reorganization (that is, the Target Merger). See section 3.04(3)(b) of this notice. In addition, Corporation X's deemed issuance of the fractional share to Shareholder A is not taken into account for purposes of the netting rule. See section 3.08(4)(f) of this notice.

Example 16: Distribution in complete liquidation of a covered corporation -

a) Facts. Corporation X adopts a plan of complete liquidation that becomes effective on March 1, 2023 (Corporation X Liquidation). Corporation X has 100x shares of common stock outstanding. On April 1, 2023, all shareholders of Corporation X receive a liquidating distribution by Corporation X in full payment for their Corporation X common stock. At the time at which Corporation X distributes all of its corporate assets to its shareholders in complete liquidation (that is, April 1, 2023), Corporation X stock trades at $1x per share. Each distribution in complete liquidation is subject to § 331.

b) Analysis. A distribution in complete liquidation of a covered corporation (that is, Corporation X) to which § 331 (but not § 332(a)) applies is not a repurchase by the covered corporation. See section 3.04(4)(b)(i) of this notice. Therefore, none of the distributions by Corporation X in complete liquidation is a repurchase by Corporation X, and Corporation X's stock repurchase excise tax for its 2023 taxable year is not increased as a result of the Corporation X Liquidation.

Example 17: Complete liquidation of a covered corporation to which both §§ 331 and 332(a) apply -

a) Facts. The facts are the same as in section 3.09(16)(a) of this notice (Example 16), except that one of Corporation X's shareholders is a corporation (Corporation Z). As of the date of adoption of the plan of liquidation of Corporation X (that is March 1, 2023), Corporation Z has continued to be at all times until the receipt of the Corporation X liquidating distribution the owner of 80x shares of Corporation X common stock. In other words, Corporation Z has continued to be at all times until the receipt of the Corporation X liquidating distribution the owner of stock in Corporation X meeting the requirements of § 1504(a)(2) (that is, Corporation Z is an 80-percent distributee within the meaning of § 337(c)). Therefore, the liquidating distribution by Corporation X to Corporation Z as part of the Corporation X Liquidation qualifies as a liquidation under § 332(a). The liquidating distributions by Corporation X to the other shareholders described in section 3.09(16)(a) of this notice (Example 16) are distributions in liquidation subject to § 331.

b) Analysis. In the case of a complete liquidation of a covered corporation, if §§ 331 and 332(a), respectively, apply to component distributions of the complete liquidation, (i) a distribution to which § 331 applies is a repurchase by the covered corporation, and (ii) the distribution to which § 332(a) applies is not a repurchase by the covered corporation. See section 3.04(4)(a)(v) of this notice. Therefore, as a result of the component liquidating distributions of the Corporation X Liquidation to which § 331 applies, Corporation X repurchased 20x shares of its stock on April 1, 2023. Accordingly, the Corporation X Liquidation results in a $20x increase in Corporation X's stock repurchase excise tax base for its 2023 taxable year because the fair market value of Corporation X's stock at the time of repurchase (that is, April 1, 2023) was $1x per share (20x shares x $1x = $20x). See section 3.06(2)(a) of this notice.

Example 18: Acquisition by disregarded entity -

a) Facts. Corporation X owns all the interests in LLC, a domestic limited liability company that is disregarded as an entity separate from its owner for Federal tax purposes (disregarded entity) under § 301.7701-3 of the Procedure and Administration

Regulations (26 CFR part 301). On May 31, 2023, LLC purchases shares of Corporation X's stock for cash from an unrelated shareholder.

b) Analysis. Because LLC is a disregarded entity, the May 31, 2023, acquisition of Corporation X stock is treated as an acquisition by Corporation X. Accordingly, the acquisition is a § 317(b) redemption and is therefore a repurchase. See section 3.04(2) of this notice. Section 301.7701-2(c)(2)(v) (treating disregarded entities as corporations for purposes of certain excise taxes) does not apply to treat LLC as a corporation because § 4501 is not described in § 301.7701-2(c)(2)(v)(A).

Affected taxpayers may rely upon Notice 2023-2 until proposed regulations are issued.

C. Liquidations

D. S Corporations

E. Mergers, Acquisitions and Reorganizations

1. Wait, what? A taxpayer gets a "do-over"? This corporate taxpayer was allowed to disavow the form of its two-step acquisition transaction by subsequently treating the separate steps as a single § 351 transaction with boot, thereby *post hoc* generating a partial basis step-up in intangible assets it received in exchange for its stock and resulting in larger amortization deductions. Complex Media, Inc. v. Commissioner, T.C. Memo. 2021-14 (3/31/21). This lengthy and complex 100-plus page Tax Court memorandum decision could well have been a reviewed opinion, and as the reader will discover below, perhaps should have been. Essentially, the corporate taxpayer, Complex Media, Inc., engaged in two separate acquisitive transactions. The first was a § 351 exchange in which the taxpayer acquired certain intangible assets from a partnership in exchange for the taxpayer's common stock. In the second transaction, the taxpayer paid cash (approximately $2.7 million) and granted a "deferred payment" obligation ($300,000) to the partnership to redeem some of the common stock issued in the § 351 exchange. (The cash and deferred payment obligation then were used by the partnership to redeem one reluctant partner's partnership interest.) Complex Media and the partnership from it acquired the intangible assets agreed in the relevant documentation of the transaction to treat the partnership's contribution of assets in exchange for Complex Media's stock as a transaction eligible for nonrecognition pursuant to § 351(a) and to treat Complex Media's redemption of a portion of the shares issued to the partnership as a separate redemption of stock. On its corporate tax return for the year in which the § 351 exchange took place, Complex Media treated the transaction consistently with the manner in which it had agreed to do so (i.e., as a transaction eligible for nonrecognition pursuant to § 351(a) and as a separate redemption of some of the stock it had issued in the § 351 exchange) by reporting that it had taken a carryover basis in the acquired intangible assets pursuant to § 362(a). On its corporate tax returns for the subsequent three years, however, Complex Media effectively treated the two separate steps as a single § 351 exchange, reporting the cash and deferred payment obligation as § 351(b)(1) boot paid for a portion of the intangible assets of the partnership acquired in the exchange. Doing so allowed the taxpayer to step up its basis in the acquired intangible assets under § 362(a), leading to larger amortization deductions with respect to the intangibles under § 197. The taxpayer would not have been entitled to step up the basis in the intangible assets if the cash and deferred payment obligation were not boot in the § 351 exchange but instead were funds used to redeem some of the taxpayer's stock issued in the § 351 exchange. Over the IRS's objection, the taxpayer argued, and the Tax Court (Judge Halpern) agreed, that the two steps could be treated as one, even if the taxpayer's chosen form was a § 351 exchange of property solely for stock followed by a separate redemption of some of the stock issued in the § 351 exchange. Thus, with Judge Halpern's blessing, the taxpayer in *Complex Media* was able to *post hoc* recast the taxpayer's chosen form of a corporate acquisition to obtain a better tax result than as originally structured and agreed. We will spare the reader pages and pages of analysis regarding the relatively low bar the courts have set for the IRS to recast a taxpayer's chosen form of a transaction for tax purposes versus the much higher bar set for taxpayers to disavow their chosen form to achieve more favorable tax treatment. Suffice it to say that taxpayers

are rarely allowed "do-overs" to report transactions for tax purposes in a manner that is inconsistent with their chosen form. Judge Halpern also agreed with Complex Media that the $300,000 deferred payment obligation granted to the partnership could be valued at its face amount rather than at a discount. Valuing the deferred payment obligation at face increased the § 351(b)(1) boot, thereby increasing subsequent amortization deductions taken by the taxpayer. Thus, *Complex Media* is a relatively important and surprising case, albeit a Tax Court memorandum decision.

a. Although it took a while, the IRS has decided to "disavow" Judge Halpern's decision in *Complex Media*. A.O.D. 2023-11 I.R.B. 529 (3/13/23). The IRS has announced that it will not follow *Complex Media* regarding a taxpayer's ability to disavow the chosen form of a transaction for tax purposes, especially if the taxpayer "does not fully, properly, and consistently report the transaction." Furthermore, the IRS will not follow *Complex Media* in determining the fair market value of debt (i.e., the deferred payment obligation) for purposes of § 351(b)(1).

F. Corporate Divisions

G. Affiliated Corporations and Consolidated Returns

H. Miscellaneous Corporate Issues

1. Congress has revived the corporate AMT for corporations with "applicable financial statement income" over $1 billion. The corporate alternative minimum tax (AMT) was repealed by the 2017 Tax Cuts and Jobs Act. The Inflation Reduction Act, § 10101, amends Code § 55(b) to reinstate a corporate AMT. Specifically, the legislation imposes a 15 percent minimum tax on corporations (other than S corporations, regulated investment companies, and real estate investment trusts) with average "adjusted financial statement income" measured over three years of over $1 billion. Adjusted financial statement income (AFSI) is the net income or loss stated on the taxpayer's "applicable financial statement" with certain modifications. One modification is that AFSI is adjusted to allow depreciation deductions calculated for tax purposes rather than book purposes. An "applicable financial statement" is defined as (1) a financial statement that is certified as being prepared in accordance with generally accepted accounting principles that is (a) a 10-K or annual statement to shareholders required to be filed with the Securities and Exchange Commission, (b) an audited financial statement used for credit purposes, reporting to shareholders, partners, other proprietors, or beneficiaries, or for any other substantial nontax purpose, or (c) filed with any other federal agency for purposes other than federal tax purposes; (2) certain financial statements made on the basis of international financial reporting standards and filed with certain agencies of a foreign government; or (3) a financial statement filed with any other regulatory or governmental body specified by IRS. The corporate AMT applies for tax years beginning after December 31, 2022.

a. Guidance on the revived corporate AMT. Notice 2023-7, 2023-3 IRB 390 (12/27/22). Pending forthcoming proposed regulations, the Treasury Department and the IRS have announced interim guidance on "time-sensitive" issues under newly amended § 55(b). Notice 2023-7 also provides that Treasury and the IRS intend to issue additional interim guidance to address other corporate AMT issues, particularly concerning unintended adverse consequences to the insurance industry and certain other industries. Taxpayers may rely upon this interim guidance until proposed regulations are issued.

2. A new fast-track program for corporate private letter rulings can result in rulings being issued in a compressed timeframe, generally 12 weeks. Rev. Proc. 2023-26, 2023-33 I.R.B. 486 (7/26/23). The IRS has made permanent its fast-track program for private letter rulings solely or primarily under the jurisdiction of the Associate Chief Counsel (Corporate). The new program replaces, with minor changes, the pilot program established in Rev. Proc. 2022-10, 2022-6 I.R.B. 473. If fast-track processing is available, then

> the IRS will endeavor to complete the processing of the letter ruling request and, if appropriate, to issue the letter ruling within the time period specified by the branch representative or branch reviewer. The specified period will be 12 weeks unless a shorter or longer period is designated by the branch reviewer …

The revenue procedure specifies that a taxpayer seeking fast-track processing must request a pre-submission conference and must submit required information before the conference, including the reason for requesting fast-track processing and the length of time requested (if other than 12 weeks). The revenue procedure strongly recommends that taxpayers submit fast-track requests as an encrypted e-mail attachment in order to avoid delays resulting from submitting requests by mail or by delivery in physical form. The new fast-track program is available for letter ruling requests received by the IRS after July 26, 2023.

VII. PARTNERSHIPS

A. Formation and Taxable Years

1. An investor entitled to interest measured by the net cash flow from real property owned by a partnership and by the appreciation in value of the partnership's assets was a lender and not a participant in a joint venture with the partnership; therefore, the partnership was entitled to deduct the interest paid. Deitch v. Commissioner, T.C. Memo. 2022-86 (8/25/22). The issue in this case was whether a party that provided financing for a partnership's acquisition and renovation of real property was a lender or instead a participant in a joint venture with the partnership. Two individuals, Mr. Deitch and Mr. Barry, formed West Town Square Investment Group, LLC (WTS), which was classified as a partnership for federal tax purposes. These two individuals, along with Mr. Barry's wife, were the petitioners in this case. They formed WTS to acquire commercial real property in Rome, Georgia, renovate it, and lease a portion of the property to a hospital that sought space in which to provide physical therapy services. Protective Life Insurance Co. (PLI) provided financing for the project. PLI offered both conventional loans and participating loans. In this case, PLI agreed to lend $4.4 million to WTS in the form of a participating loan. The loan documents consisted of a promissory note providing for a fixed rate of interest (6.25%), a security agreement giving PLI a security interest in the property, and an "Additional Interest Agreement" that obligated WTS to pay additional interest of two types: NCF Interest (50 percent of net cash flow from the property) and Appreciation Interest (50 percent of the appreciation in value of the property if it was ever sold or the loan was terminated). Both the promissory note and the Additional Interest Agreement provided that the relationship between PLI and WTS "shall be solely that of creditor and debtor" and that nothing in any of the loan documents would be construed to create a partnership, joint venture, "or any relationship other than that of creditor and debtor." From 2006 to 2014, WTS paid interest on the loan, including NCF Interest, which it reported on Form 1065, the partnership's tax return. In 2014, WTS sold the property and reported (1) a net § 1231 gain of $2.6 million, which it allocated equally between WTS's two members, and (2) a deduction of approximately $1 million for Appreciation Interest, which had the effect of producing a net rental loss of approximately $1.2 million for 2014. The Schedule K-1s issued to Mr. Deitch and Mr. Barry for 2014 each reported one-half of the $1.3 million net § 1231 gain and one-half of the $1.2 million net rental loss. The IRS audited the 2014 returns filed by the two individuals and took the position that each of them had a share of WTS's net rental loss of approximately $100,000 rather than $600,000 because they had not established that the $1 million of Appreciation Interest deducted by WTS was either interest or an ordinary and necessary business expense. Accordingly, the IRS increased each individual's taxable income by approximately $500,000. Mr. Deitch and Mr. and Mrs. Barry each challenged the IRS's position by filing petitions in the U.S. Tax Court. In the Tax Court, the government argued that the Additional Interest Agreement created a joint venture between WTS and PLI and that the $1 million of Appreciation Interest paid by WTS was a nondeductible return on PLI's equity interest in the joint venture. The Tax Court (Judge Gustafson) held that PLI and WTS had not formed a joint venture classified as a partnership and that their relationship was that of creditor-debtor. The

court observed that the government had stipulated that the original promissory note, later amendments to the note, and the security agreement constituted genuine indebtedness and that the Additional Interest Agreement could not be separated from those three agreements. These stipulations contradicted the government's position that PLI and WTS had formed a joint venture. Nevertheless, the court analyzed whether PLI and WTS had formed a joint venture by applying the eight factors from the court's decision in *Luna v. Commissioner*, 42 T.C. 1067 (1964). The *first factor*, the agreement of the parties and their conduct in executing its terms, the court observed, weighed against the existence of a joint venture because the agreements between PLI and WTS expressly provided that their relationship was creditor-debtor and expressly disclaimed the existence of a joint venture. The *second factor*, the contributions (if any) that each party has made to the venture, weighed against the existence of a joint venture because PLI provided capital in its capacity as an arm's-length lender. The *third factor*, the parties' control over income and capital and the right of each to make withdrawals, weighed in favor of the existence of a joint venture because, in the court's view, PLI had significant control over the capital, was guaranteed to receive more than half of the income from the property (because of the manner in which net cash flow was defined), and was not liable for operating losses, which meant that its interest resembled that of a preferred equity holder. The *fourth factor* is

> whether each party was a principal and coproprietor, sharing a mutual proprietary interest in the net profits and having an obligation to share losses, or whether one party was the agent or employee of the other, receiving for his services contingent compensation in the form of a percentage of income.

This fourth factor, the court reasoned, weighed against the existence of a joint venture because, although PLI shared in profits, it did not share in operating losses. The *fifth factor*, whether the business was conducted in the joint names of the parties, weighed against the existence of a joint venture because, as the government conceded, the business was conducted under the name WTS and not that of PLI or any other entity. The *sixth factor*, whether the parties filed federal partnership returns or otherwise represented to the IRS or to persons with whom they dealt that they were joint venturers, weighed against the existence of a joint venture because, as the government conceded, WTS and PLI did not file partnership tax returns indicating they were partners and did not otherwise represent that they were partners. The *seventh factor*, whether separate books of account were maintained for the venture, weighed against the existence of a joint venture because, although the parties agreed on how books and records would be kept, this was solely for purposes of calculating the interest due to PLI and "WTS and PLI did not jointly maintain books of account that would normally be expected in the operation of a business." The *eighth factor*, whether the parties exercised mutual control over and assumed mutual responsibilities for the enterprise, weighed against the existence of a joint venture because, although PLI exercised control over the capital it provided to WTS, WTS exercised primary responsibility for and control over the rental operations of the property and most of the terms set forth in the security agreement were standard terms present in an arm's-length secured commercial loan. In short, seven of the eight Luna *factors* weighed against the existence of a joint venture. Accordingly, the court held that the relationship between PLI and WTS was that of creditor-debtor and that the Appreciation Interest paid by WTS was interest that WTS was entitled to deduct under § 163(a).

B. Allocations of Distributive Share, Partnership Debt, and Outside Basis

C. Distributions and Transactions Between the Partnership and Partners

D. Sales of Partnership Interests, Liquidations and Mergers

1. Judge Gustafson revisits *Grecian Magnesite*, but this time rules against this non-U.S. taxpayer selling her partnership interest due to § 751. Rawat v. Commissioner, T.C. Memo 2023-14 (2/7/23). We previously have written about the entity-theory versus aggregate-theory dust-up between the IRS and non-U.S. persons selling interests in partnerships conducting business in the U.S. For example, in *Grecian Magnesite Mining, Industrial & Shipping Co., S.A. v. Commissioner*, 149 T.C. 63 (2017), the Tax Court (Judge Gustafson) ruled against the IRS (and

against the IRS's position in Rev. Rul. 91-32, 1991-1 C.B. 107) to hold that a non-U.S. person's gain from the sale of an interest in a partnership conducting a U.S. trade or business is not U.S.-source income (because the partnership interest is personal property) and therefore is not subject to U.S. taxation unless such gain (i) is captured by § 897(g) (gain attributable to U.S. real property) or (ii) is captured by § 865(e)(2) (gain attributable to a U.S. office or fixed place of business). The IRS in *Grecian Magnesite* had argued that a non-U.S. person's gain from the sale of an interest in a partnership conducting business in the U.S. should be analyzed under the aggregate-theory of partnership taxation, meaning that the gain would be considered U.S. source income because it is attributable to the underlying U.S. assets held by the partnership. *See* Rev. Rul. 91-32, 1991-1 C.B. 107. Nevertheless, Judge Gustafson declined to adopt the IRS's reasoning (labeling the IRS's analysis in Rev. Rul. 91-32 as "cursory") and ruled for the taxpayer. Importantly, *Grecian Magnesite* did not address whether the result might be different if the partnership conducting business in the U.S. held inventory items subject to § 751.

Rawat Decision by Judge Gustafson. In *Rawat v. Commissioner*, T.C. Memo 2023-14 (2/7/23), Judge Gustafson got the chance to address the issue left open in *Grecian Magnesite*: whether gain from a non-U.S. person's sale of an interest in a partnership holding inventory items and conducting business in the U.S. is considered U.S. source income by virtue of § 751 and the U.S. income-sourcing rules of §§ 861-865. This time, the Tax Court (again, Judge Gustafson) adopted the IRS's aggregate-theory argument and held against the taxpayer. The taxpayer in *Rawat* was a Canadian citizen and nonresident of the U.S. during 2007 and 2008. In 2008, the taxpayer sold her interest in a partnership doing business in the U.S. in exchange for a promissory note with a face amount of $438 million. The principal of the promissory note was not payable until 2028. The IRS sought to tax $6.5 million of the taxpayer's gain ("inventory gain") in 2008 because that amount was attributable to § 751 inventory items held by the partnership and allocable to the taxpayer's partnership interest. The taxpayer argued that, because the inventory gain was realized and recognized prior to the enactment of § 864(c)(8) (see below), the Tax Court's decision in *Grecian Magnesite* controlled. The IRS disagreed, arguing that the inventory gain, unlike the gain in *Grecian Magnesite*, was subject to § 751, thereby rendering the gain as U.S. source income under §§ 861-865 and the IRS's aggregate theory asserted in *Grecian Magnesite*. This time around, Judge Gustafson ruled for the IRS and against the taxpayer. Judge Gustafson reasoned that, although § 751 is not a sourcing rule, the rule in § 741 generally treating the sale of a partnership interest as the disposition of a capital asset is expressly subject to the § 751 carve-out for inventory items. Then, examining the special sourcing rules under §§ 861(a)(6) (sale or exchange of inventory property) and 865(b) (exception for inventory property), Judge Gustafson concluded that the taxpayer's inventory gain from the sale of her partnership interest should be considered U.S.-source income subject to U.S. tax notwithstanding the Tax Court's holding in *Grecian Magnesite* regarding more general § 741 gain.

The final word: 2017 Tax Cuts and Jobs Act Overturns Grecian Magnesite and Supports the Tax Court's Holding in Rawat. Regardless of the Tax Court's holdings in *Grecian Magnesite* and *Rawat*, readers may recall that the 2017 Tax Cuts and Jobs Act, § 13501, amended § 864(c) by adding § 864(c)(8) effective for dispositions after November 27, 2017. Section § 864(c)(8) provides that gain or loss (after 11/27/17) on the sale or exchange of all (or any portion of) a partnership interest owned by a nonresident alien individual or a foreign corporation in a partnership engaged in any trade or business within the U.S. is treated as effectively connected with a U.S. trade or business (and therefore taxable by the U.S. unless provided otherwise by treaty) to the extent that the transferor would have had effectively connected gain or loss had the partnership sold all of its assets at fair market value as of the date of the sale or exchange. The amount of gain or loss treated as effectively connected under this rule is reduced by the amount of such gain or loss that is already taxable under § 897 (relating to U.S. real property interests). Thus, § 864(c)(8) overturns the Tax Court's holding in *Grecian Magnesite* effective for partnership-interest gain recognized after November 27, 2017, and supports the Tax Court's holding in *Rawat* for partnership-interest inventory gain recognized before or after November 27, 2017.

E. Inside Basis Adjustments

F. Partnership Audit Rules

1. ♪♫ Ooh, a storm is threatening … my very life today. If I don't get some shelter … ooh yeah, I'm gonna fade away. ♫♪ Keene-Stevens v. Commissioner, 72 F.4th 1015 (9th Cir. 7/3/23), *rev'g and remanding* T.C. Memo 2020-118. The Ninth Circuit (holding for the IRS) has reversed the Tax Court (which had held for the taxpayers) in a case in which the taxpayers were "sheltering" between the normal deficiency determination procedures of §§ 6213 and 6214 and the now-repealed TEFRA "oversheltered return" procedures of § 6234 (hereinafter "TEFRA § 6234). Essentially, prior TEFRA § 6234 provided a procedural solution in the unusual situation where (i) the taxpayer was contesting in the Tax Court (pursuant to §§ 6213 and 6214) a proposed IRS individual-level deficiency assessment based upon items attributable solely to the taxpayer's personal return for a taxable year or years ("non-partnership items") and (ii) regardless of the outcome of the individual-level proceeding in Tax Court under §§ 6213 and 6214, the taxpayer ultimately might not be found to have a "deficiency" for the taxable year or years due to pass-through losses claimed as a partner in a partnership subject to a pending TEFRA partnership audit for the same taxable year or years ("partnership items"). TEFRA § 6234(a) solved the problem by authorizing a special declaratory judgment action in the Tax Court concerning non-partnership items upon the taxpayer's receipt of an IRS "notice of adjustment" if:

1. a taxpayer files an oversheltered return for a taxable year,
2. the Secretary makes a determination with respect to the treatment of items (other than partnership items) of such taxpayer for such taxable year, and
3. the adjustments resulting from such determination do not give rise to a deficiency (as defined in section 6211) but would give rise to a deficiency if there were no net loss from partnership items.

An "oversheltered return" was defined by TEFRA § 6234(b) as a partner's return that showed no taxable income for a taxable year and showed a "net loss from partnership items." The term "net loss from partnership items" was not defined in the statute. Lastly, as contemplated by TEFRA § 6234(c), the taxpayer eventually could file a petition in Tax Court seeking a readjustment of the taxpayer's "deficiency" (as preliminarily determined in the TEFRA § 6234(a) declaratory judgment action) once the taxpayer's allocable share of partnership items finally was determined in the TEFRA-partnership-level proceeding. (TEFRA § 6234 was enacted in 1997 to overturn the Tax Court's 1989 decision in *Munro v. Commissioner*, 92 T.C. 71 (1989), in which the Tax Court held that claimed partnership losses must be "completely ignored" in a deficiency proceeding concerning the taxpayer's non-partnership losses.)

Facts: In this case, taxpayers, a married couple, did not timely file federal income tax returns for the years 2006 through 2012. More precisely, and importantly for the outcome in the case, the taxpayers did not file any federal income tax returns whatsoever for 2007 and 2012 (because the returns provided were unsigned). The taxpayers filed late returns for 2006 and the years 2008 through 2011. None of the returns showed a federal tax liability because the taxpayers used current and carryforward losses from a TEFRA partnership in which they were partners to offset any gross income reported on their personal returns. After audit, the IRS issued individual-level notices of deficiency to the taxpayers for the years in issue, asserting both back taxes and penalties. The taxpayers timely filed petitions in the Tax Court. Before trial, the Tax Court (Judge Halpern) granted the IRS's motion to dismiss for lack of jurisdiction so much of the case as related to partnership items and ordered the IRS to provide recomputed deficiencies reflecting the dismissal of partnership items from the case. At trial, the taxpayers presented no evidence that any of the IRS's proposed recomputed deficiencies with respect to non-partnership items for the years in issue were erroneous. Presumably, the taxpayers were not concerned with the IRS's proposed non-partnership item adjustments because they had more than enough partnership-item losses (from the TEFRA partnership in which they were partners) to offset any such adjustments. Regardless, over the IRS's objection, Judge Halpern upheld only the IRS's proposed non-partnership item

adjustments against the taxpayers for 2006 and 2008. Judge Halpern did not sustain the IRS's proposed non-partnership item deficiencies or penalties for the other years in issue (2007 and years 2009 through 2012), reasoning as follows:

> The oversheltered return rules provided in [TEFRA § 6234] do not apply for petitioners' 2007 and 2012 taxable years because they did not file returns for those years. And section 6234 does not apply for petitioners' 2009, 2010, or 2011 taxable years because the adjustments in the notice of deficiency for each year would not result in a deficiency in petitioners' joint income tax liability even if petitioners had not claimed a net loss from partnerships for the year.

The taxpayers appealed to the Ninth Circuit and the IRS cross-appealed. The taxpayers' appeal was dismissed for failure to prosecute, which resulted in the IRS's adjustments for 2006 and 2008 being upheld. Thus, only the IRS's proposed adjustments for 2007 and 2009 through 2012 were the subject of the Ninth Circuit's decision.

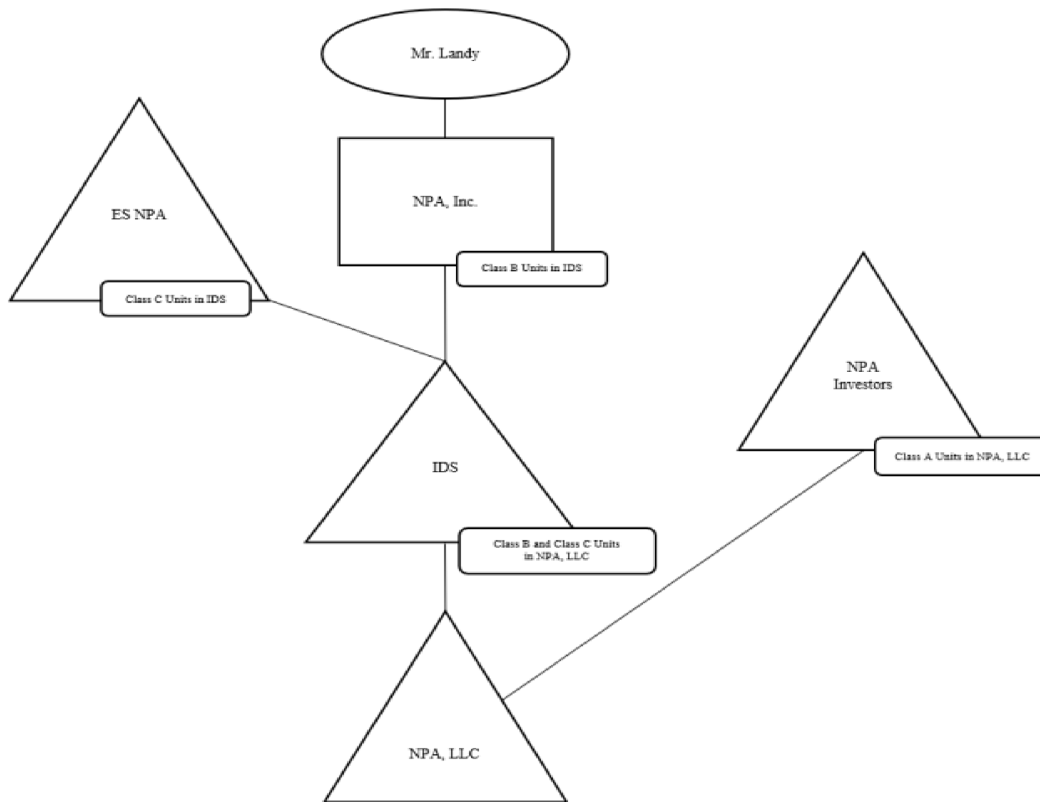
Ninth Circuit: The Ninth Circuit, in an opinion by Judge Clifton, reversed and remanded the case to the Tax Court for redetermination of the taxpayers' deficiencies and penalties for 2007 and years 2009-2012. With respect to tax years 2007 and 2012, the Ninth Circuit held that the unsigned, unfiled tax returns, on which the TEFRA partnership losses were reported by the taxpayers, were legally invalid because they had not been filed and executed under penalties of perjury. Therefore, those unsigned, unfiled returns could not be used to offset non-partnership item income in an individual deficiency proceeding with respect to those years. Furthermore, with respect to 2009-2011, the Ninth Circuit determined that the Tax Court erred by concluding that the oversheltered return rules of TEFRA § 6234 did not apply. Instead, the Ninth Circuit determined that Judge Halpern should have included in the calculation of "net loss from partnership items" (one of the requirements for triggering Tax Court jurisdiction under TEFRA § 6234) the portions of the net-operating-loss carryover deductions that were composed of eligible partnership losses in prior years. If Judge Halpern had done so, then the Tax Court would have had jurisdiction under TEFRA § 6234 to decide the IRS proposed non-partnership item adjustments, if any, to the taxpayer's returns for 2009-2011.

G. Miscellaneous

1. This memorandum opinion from the Tax Court affirms the applicability of Rev. Proc. 93-27 (partnership profits interest issued for services) in a tiered partnership structure, but the real dispute was whether there was a proper "book up" of the partners' capital accounts. ES NPA Holding, LLC v. Commissioner, T.C. Memo. 2023-55 (5/3/23). The authors discuss relatively few memorandum opinions of the Tax Court; however, this case is one which the authors believe is noteworthy—perhaps more so for what the opinion does not address than what it does. The ostensible dispute in the case concerned whether a partnership interest issued for services met the safe harbor of Rev. Proc. 93-27, 1993-2 C.B. 343, as clarified by Rev. Proc. 2001-43, 2001-2 C.B. 191. As readers may recall, Rev. Proc. 93-27 and Rev. Proc. 2001-43 generally provide that the receipt of a partnership interest for services is nontaxable to the recipient so long as the interest in question does not share in liquidation proceeds assuming a hypothetical liquidation of the partnership immediately following the grant of the partnership interest (i.e., that the partnership interest is a true "profits interest," not a "capital interest"). If the requirements of Rev. Proc. 93-27 are met, then the IRS will not contest that the issuance of a partnership profits interest in exchange for services is nontaxable.[1] In this case, the Tax Court (Judge Weiler) held over the IRS's objection that Rev. Proc. 93-27 applied in the context of an intricate tiered-partnership structure used in an acquisitive transaction. For details, see below.

Facts. The facts of the case are complex, and to fully appreciate the issues and arguments at stake, the intricacies of the tiered partnership structure must be understood. The ownership diagram provided by Judge Weiler is very helpful in this regard and easily worth a thousand words:

[1] Technically speaking, the safe harbor of Rev. Proc. 93-27 applies to partnership profits interests issued for services only if certain limiting conditions are met: (1) the profits interest must not relate to a substantially certain and predictable stream of income from partnership assets, such as income from high-quality debt securities or a high-quality net lease; (2) the recipient partner must not dispose of the profits interest within two years of receipt; and (3) the profits interest is not in a "publicly traded partnership" within the meaning of § 7704(b). These limiting conditions were not applicable to the facts of the case.



The tiered partnership structure depicted above related to the acquisition of a seventy-percent interest in a consumer loan portfolio held by Joshus Landy through a wholly-owned corporation, NPA, Inc. Oversimplifying to avoid writer's cramp, the capital for the acquisition was provided by a group of outside investors (NPA Investors, LLC). Mr. Landy's corporation, NPA, Inc., contributed its entire consumer loan portfolio to a second-tier partnership, IDS, LLC, which in turn contributed the portfolio to a first-tier partnership, NPA, LLC. Then, the investors, through NPA Investors, LLC, purchased a seventy-percent interest in the consumer loan portfolio by paying cash of roughly $21 million to the second-tier partnership, IDS, LLC, in exchange for a seventy-percent partnership interest in NPA, LLC. NPA, Inc., Mr. Landy's corporation, retained the remaining thirty-percent interest in the consumer loan portfolio by holding the residual thirty-percent interest (valued at approximately $9 million) in the second-tier partnership, IDS, LLC. In connection with the acquisition, certain advisors to the transaction, as members of a third-tier partnership, ES NPA Holding, LLC, were issued a partnership interest in the second-tier partnership, IDS, LLC, in exchange for past and future services provided to the first-tier acquisition partnership, NPA, LLC. The central issue in the case was whether the partnership interest issued to the advisors via ES NPA Holding, LLC was in fact a "profits interest" qualifying as nontaxable under the safe harbor rules of Rev. Proc. 93-27.

IRS Arguments. The IRS made two arguments as to why Rev. Proc. 93-27 did not apply. The IRS's primary argument was that Rev. Proc. 93-27 was inapplicable because the partnership interest issued to the third-tier partnership, ES NPA Holding, LLC, was granted by the second-tier partnership, IDS, LLC, *not* the first-tier partnership, NPA, LLC, for which the past and future services were performed. With respect to this argument, Judge Weiler held that Rev. Proc. 93-27 nonetheless applied because the IRS's reading of the ruling was too narrow. Specifically, Judge Weiler pointed to other language in Rev. Proc. 93-27 supporting a broader reading. Section 4.01 of Rev. Proc. 93-27 states that "if a person receives a profits interest for the provision of services to or for the benefit of a partnership in a partner capacity or in anticipation of being a partner, the [IRS] will not treat the receipt of such an interest as a taxable event for the partner or the

partnership." Judge Weiler held that the above-quoted language supported the broader reading of Rev. Proc. 93-27 advocated by ES NPA Holding, LLC, the recipient of the partnership interest. The IRS's alternative argument, and perhaps the IRS's real concern, is that the partnership interest issued by the second-tier partnership, IDS, LLC, to the third-tier partnership, ES NPA Holding, LLC, was in fact a "capital interest" because the consumer loan portfolio acquired by the first-tier partnership, NPA, LLC, was undervalued. The IRS, supported by a valuation expert, contended that the consumer loan portfolio should have been valued at approximately $48.5 million, meaning that ES NPA Holding, LLC would receive as much as $12 million upon a hypothetical liquidation of the tiered partnership structure, not $0 as reflected in ES NPA Holding, LLC's capital account in the second-tier partnership, IDS, LLC. In other words, the IRS was arguing that the "book up" performed in connection with the formation of the tiered partnership structure was insufficient, so the service provider, ES NPA Holding, LLC, received a "capital interest" not a "profits interest" within the meaning of Rev. Proc. 93-27. Judge Weiler, though, disagreed, holding that the valuation agreed to by the parties to the transaction—roughly $21 million purchased by the investors via NPA Investors, LLC plus approximately $9 million in value retained by Mr. Landy via NPA, Inc.'s thirty-percent interest in the second-tier partnership, IDS, LLC—was the best evidence of the valuation of the consumer loan portfolio. Hence, Judge Weiler concluded that Rev. Proc. 93-37 applied, and the service provider, ES NPA Holding, LLC, received a nontaxable partnership profits interest in connection with the transaction.

Comment: Perhaps the real import of ES NPA Holding, LLC v. Commissioner is not that Rev. Proc. 93-37 applies in a tiered partnership structure. The authors believe that most practitioners have assumed as much. Instead, perhaps the most important lesson of the case is that partnerships issuing interests in exchange for the performance of services should take care to accurately substantiate capital account "book ups," thereby safeguarding against an argument by the IRS that the interest so issued was a taxable "capital interest" instead of a nontaxable "profits interest."

VIII. TAX SHELTERS

A. Tax Shelter Cases and Rulings

B. Identified "tax avoidance transactions"

C. Disclosure and Settlement

D. Tax Shelter Penalties

IX. EXEMPT ORGANIZATIONS AND CHARITABLE GIVING

A. Exempt Organizations

B. Charitable Giving

1. After 2022, syndicated conservation easements are on life support if not DOA. A well-hidden provision of the SECURE 2.0 Act, Division T, Title VI, § 605 of the Consolidated Appropriations Act, 2023, amended Code § 170(h) to add a new subsection (7) severely restricting charitable deductions for "qualified conservation contributions" by partnerships, S corporations, and other pass-through entities. "Qualified conservation contributions" are defined by § 170(h)(1) to include (but are not limited to) conservation easements granted to charitable organizations in connection with syndicated conservation easements. As described in Notice 2017-10, 2017-4 I.R.B. 544, a typical syndicated conservation easement involves a promoter offering prospective investors the possibility of a charitable contribution deduction in exchange for investing in a partnership. The partnership subsequently grants a conservation easement to a qualified charity, allowing the investing partners to claim a charitable contribution deduction under § 170.

New "2.5 times" proportionate outside basis rule will limit the charitable deduction for conservation contributions by pass-through entities. New § 170(h)(7)(A) generally provides that a partner's charitable contribution deduction for a qualified conservation contribution by a

partnership (whether via a direct contribution or as an allocable share from a lower-tier partnership) cannot exceed "2.5 times the sum of [such] partner's relevant basis" in the partnership. The term "relevant basis" is defined by new § 170(h)(7)(B)(i) to mean that portion of a partner's "modified basis" which is allocable (under rules similar to those used under § 755) to the real property comprising the qualified conservation contribution. "Modified basis" (defined in § 170(h)(7)(B)(ii)) essentially refers to a partner's outside basis exclusive of the partner's share of partnership liabilities under § 752. Thus, reading between the lines and subject to further guidance, relevant basis appears to equate to an investor's cash investment (a/k/a initial tax and book capital account) in a syndicated conservation easement partnership. Many syndicated conservation easement partnerships claim that investors may secure a charitable deduction that is five times their cash investment. New § 170(h)(7)(A) thus limits the charitable deduction to "2.5 times" an investor's cash contribution, making a syndicated conservation easement much less attractive. New § 170(h)(7) also contains three exceptions: (i) partnerships making conservation easement contributions after a three-year holding period applicable at the partnership- and partner-level, including through tiered partnerships; (ii) "family partnerships" (as defined) making conservation easement contributions; and (iii) partnerships making conservation easement contributions relating to historic structures. *See* IRC §§ 170(f)(19), 170(h)(7)(C)-(E). Moreover, new § 170(h)(7)(F) authorizes Treasury to issue regulations applying similar rules to S corporations and other pass-through entities. Related provisions of the legislation make dovetailing amendments to (i) § 170(f) (charitable contribution substantiation and reporting requirements); (ii) §§ 6662 and 6664 (underpayment penalties attributable to valuation misstatements); (iii) § 6011 (reportable transactions); and (vi) §§ 6235 and 6501 (statute of limitations). New § 170(h)(7) applies to qualified conservation contributions made by partnerships and other pass-through entities after December 29, 2022.

Some welcome news for non-syndicated conservation easement donors? In an uncodified provision (*see* § 605(d)), the legislation directs Treasury to publish "safe harbor deed language for extinguishment clauses and boundary line adjustments" relating to qualified conservation contributions (whether via partnerships or otherwise). Treasury is directed to publish such safe harbor deed language within 120 days of the date of enactment of new § 170(h)(7) (i.e., by April 28, 2023), and donors have 90 days after publication of the safe harbor language to execute and file corrective deeds. This special, uncodified relief provision seems to be targeted toward donors like those who lost battles with the IRS over highly technical language in their conservation easement deeds. *See* *Oakbrook Land Holdings LLC v. Commissioner*, 154 T.C. 180 (5/12/20) (deed's extinguishment clause violated the proportionate benefit rule), *aff'd*, 28 F.4th 700 (6th Cir. 3/14/22), and *Pine Mountain Preserve, LLLP v. Commissioner*, T.C. Memo. 2018-214 (12/27/18) (deed improperly allowed substituted property), *rev'd in part, aff'd in part, and vacated and remanded*, 978 F.3d 1200 (5th Cir. 10/22/20). Importantly, however, the foregoing uncodified relief provision does not apply to syndicated conservation easements as described in Notice 2017-10 or to conservation easement cases (and related penalty disputes) docketed in the federal courts before the date a corrective deed is filed.

a. Safe harbor conservation easement deed language published by the IRS with a short (now passed) deadline to file amended deeds. Notice 2023-30, 2023-17 I.R.B. 766 (4/10/23). As directed by Congress, the IRS has published safe harbor deed language for extinguishment and boundary line adjustment clauses relating to conservation easements. In *Section 1.04* of the notice, the IRS sets forth its position, established in litigation, that upon destruction or condemnation of conservation easement property and the collection of any proceeds therefrom, Reg. § 1.170A-14(g)(6)(ii) (the "extinguishment regulation") requires that the charitable donee share in the proceeds according to a "proportionate benefit fraction" set forth in the conservation easement deed. The IRS's view of the allowed language in the conservation easement deed has been fairly narrow, requiring that the proportionate benefit fraction be fixed and unalterable *as of the date of the donation* according to the following ratio: the value of the conservation easement as compared to the total value of the property subject to the conservation easement. Therefore, according to the IRS and as upheld by several court decisions, if the

conservation easement deed either (i) allows the donor to reclaim from the charitable donee any portion of the donated conservation easement property in exchange for substitute property of equivalent value or (ii) grants the donor credit for the fair market value of subsequent improvements to the donated conservation easement property, the proportionate benefit fraction language in the deed is flawed and the charitable deduction must be disallowed. *See, e.g., Pine Mountain Preserve, LLLP v. Commissioner*, 151 T.C. 247 (2018), including its companion case, *Pine Mountain Preserve, LLLP v. Commissioner*, T.C. Memo. 2018-214 (deed allowed substituted property), *aff'd in part, vac'd in part, rev'd in part*, 978 F.3d 1200 (11th Cir. 2020); *PBBM Rose Hill, Ltd. v. Commissioner*, 900 F.3d 193 (2018) (deed reduced charitable donee's benefit for subsequent improvements made by taxpayer donor); *Coal Property Holdings, LLC v. Commissioner*, 153 T.C. 126 (2019). *Section 4* of the Notice then sets forth what the IRS considers acceptable language regarding the proportionate benefit fraction as is relates to extinguishment and boundary line adjustment clauses in conservation easement deeds. *Section 3* of the Notice sets forth the process and timeline for amending an original "flawed" (in the eyes of the IRS) conservation easement deed to adopt the IRS-approved proportionate benefit fraction language. Corrective, amended deeds must be properly executed by the donor and the donee, must be recorded by July 24, 2023, and must relate back to the effective date of the original deed.

2. Capital gain income but no charitable deduction: The taxpayer waited too long to pull the trigger on a charitable donation of stock and ends up shooting himself in the foot. Estate of Hoensheid v. Commissioner, T.C. Memo. 2023-34 (3/15/23). This fact-intensive and fact-sensitive case reminds us that the anticipatory assignment of income doctrine is alive and well, especially in connection with last minute donations of stock to charity before closing. The idea in these transactions, of course, is to donate a portion of a taxpayer's highly-appreciated, low-basis stock to charity in advance of a planned sale of the stock, claim the charitable contribution deduction for the fair market value of the donated stock, and then have the charity sell the donated stock (simultaneously with the sale of the donor's retained stock) at the subsequent closing of the stock purchase transaction. The taxpayer thereby obtains a charitable contribution deduction for the fair market value of the donated stock while avoiding tax on the inherent capital gain in the contributed stock. *See, e.g., Rauenhorst v. Commissioner*, 119 T.C. 57 (2002). *See also* Rev. Rul. 78-197, 1978-1 C.B. 83. The conventional wisdom in this area is that a taxpayer may wait to donate the stock to charity until after a letter of intent has been signed but should donate before the definitive stock acquisition agreement is executed. In this case, however, the Tax Court (Judge Nega) determined that the taxpayer nevertheless waited too late, even though he donated the stock sometime before the execution of the stock purchase agreement and the simultaneous closing. It did not help the taxpayer's case that he had sent an email to his tax advisor stating "I do not want to transfer the stock until we are 99% sure we are closing." The taxpayer apparently was concerned that if he gave away a portion of his stock too soon, his brothers, who owned the remaining stock in the corporation, might outvote him in connection with the anticipated sale. Furthermore, the documents and facts were unclear and there was a substantial dispute between the taxpayer and the IRS as to the precise date of the transfer of the donated stock to the charity. Even worse, it appeared that some of the documents may have been backdated by the taxpayer. After a lengthy analysis of the facts, Judge Nega ultimately determined that the transfer of the donated shares took place two days before closing. It also did not help the taxpayer's case that he and his brothers stripped the corporation of virtually all of its cash via a declared dividend (colloquially known as a "boot-strap" sale) one day before the closing, yet the charity, which according to the taxpayer received a stock certificate for the donated shares previously, received no portion of the dividend. In eventually holding for the IRS regarding the anticipatory assignment of income issue, Judge Nega concluded:

> To avoid an anticipatory assignment of income on the contribution of appreciated shares of stock followed by a sale by the donee, a donor must bear at least some risk at the time of the contribution that the sale will not close. On the record before us, viewed in the light of the realities and substance of the transaction, we are

> convinced that [the taxpayer's] delay in transferring the [donated] shares until two days before closing eliminated any such risk and made the sale a virtual certainty.

Judge Nega also determined that the taxpayer, as argued by the IRS, had not satisfied the qualified appraisal requirements of § 170(f)(11)(A)(i). Judge Nega therefore denied the taxpayer's claimed charitable contribution deduction for the donated shares, even though the charity received a portion of the proceeds of the stock sale attributable to the shares it held as of closing. *Ouch!* We commend the case to readers who are advising taxpayers in connection with these transactions, but we decline to try to capture here and discuss the myriad factual nuances of a forty-nine page Tax Court Memorandum decision. For a more detailed analysis of the facts and Judge Nega's reasoning, see Zaritsky, *Bad Timing of Charitable Gift and Sale Creates Major Income Tax Problems*, 35 Tax'n Exempts 27 (July/Aug. 2023).

X. TAX PROCEDURE

A. Interest, Penalties, and Prosecutions

1. Is the IRS ever going to learn that the § 6751(b) supervisory approval requirement is not met unless the required supervisory approval of a penalty occurs *before* the initial determination that formally communicates the penalty to the taxpayer? Laidlaw's Harley Davidson Sales, Inc. v. Commissioner, 154 T.C. 68 (1/16/20). The taxpayer, a C corporation, failed to disclose its participation in a listed transaction as required by § 6011 and Reg. § 1.6011-4(a). The IRS revenue agent examining the taxpayer's return issued a 30-day letter to the taxpayer offering the opportunity for the taxpayer to appeal the proposal to the IRS Office of Appeals (IRS Appeals). The 30-day letter proposed to assess a penalty under § 6707A for failing to disclose a reportable transaction. Approximately three months after the 30-day letter was issued, the revenue agent's supervisor approved the penalty by signing a Civil Penalty Approval Form. Following unsuccessful discussions with IRS Appeals, the IRS assessed the penalty and issued a notice of levy. The taxpayer requested a collection due process (CDP) hearing with Appeals, following which Appeals issued a notice of determination sustaining the proposed levy. In response to the notice of determination, the taxpayer filed a petition in the Tax Court. In the Tax Court, the taxpayer filed a motion for summary judgment on the basis that the IRS had failed to comply with the supervisory approval requirement of § 6751(b). Section 6751(b)(1) requires that the "initial determination" of the assessment of a penalty be "personally approved (in writing) by the immediate supervisor of the individual making such determination." The Tax Court (Judge Gustafson) granted the taxpayer's motion. The court first concluded that the supervisory approval requirement of § 6751(b) applies to the penalty imposed by § 6707A. Next, the court concluded that the supervisory approval of the §6707A penalty in this case was not timely because it had not occurred before the IRS's initial determination of the penalty. The parties stipulated that the 30-day letter issued to the taxpayer reflected the IRS's initial determination of the penalty. The supervisory approval of the penalty occurred three months later and therefore, according to the court, was untimely. The IRS argued that the supervisory approval was timely because it occurred before the IRS's *assessment* of the penalty. In rejecting this argument, the court relied on its prior decisions interpreting § 6751(b), especially *Clay v. Commissioner*, 152 T.C. 23 (2019), in which the court held in a deficiency case "that when it is 'communicated to the taxpayer formally … that penalties will be proposed', section 6751(b)(1) is implicated." In *Clay*, the IRS had issued a 30-day letter when it did not have in hand the required supervisory approval of the relevant penalty. The IRS can assess the penalty imposed by § 6707A without issuing a notice of deficiency. Nevertheless, the court observed "[t]hough Clay was a deficiency case, we did not intimate that our holding was limited to the deficiency context." The court summarized its holding in the present case as follows:

> Accordingly, we now hold that in the case of the assessable penalty of section 6707A here at issue, section 6751(b)(1) requires the IRS to obtain written supervisory approval before it formally communicates to the taxpayer its determination that the taxpayer is liable for the penalty.

The court therefore concluded that it had been an abuse of discretion for the IRS Office of Appeals to determine that the IRS had complied with applicable laws and procedures in issuing the notice of levy. The court accordingly granted the taxpayer's motion for summary judgment.

a. "We are all textualists now," says the Ninth Circuit. When the IRS need not issue a notice of deficiency before assessing a penalty, the language of § 6751(b) contains no requirement that supervisory approval be obtained before the IRS formally communicates the penalty to the taxpayer. Laidlaw's Harley Davidson Sales, Inc. v. Commissioner, 29 F.4th 1066 (9th Cir. 3/25/22), *rev'g* 154 T.C. 68 (1/16/20). In an opinion by Judge Bea, the U.S. Court of Appeals for the Ninth Circuit has reversed the decision of the Tax Court and held that, when the IRS need not issue a notice of deficiency before assessing a penalty, the IRS can comply with the supervisory approval requirement of § 6751(b) by obtaining supervisory approval of the penalty before assessment of the penalty provided that approval occurs when the supervisor still has discretion whether to approve the penalty. As previously discussed, the taxpayer, a C corporation, failed to disclose its participation in a listed transaction as required by § 6011 and Reg. § 1.6011-4(a). The IRS revenue agent examining the taxpayer's return issued a 30-day letter to the taxpayer offering the opportunity for the taxpayer to appeal the proposal to the IRS Office of Appeals (IRS Appeals). The 30-day letter proposed to assess a penalty under § 6707A for failing to disclose a reportable transaction. After the taxpayer had submitted a letter protesting the proposed penalty and requesting a conference with IRS Appeals, and approximately three months after the revenue agent issued the 30-day letter, the revenue agent's supervisor approved the proposed penalty by signing Form 300, Civil Penalty Approval Form. The Tax Court held that § 6751(b)(1) required the IRS to obtain written supervisory approval before it formally communicated to the taxpayer its determination that the taxpayer was liable for the penalty, i.e., before the revenue agent issued the 30-day letter. On appeal, the government argued that § 6751(b) required only that the necessary supervisory approval be secured before the IRS's *assessment* of the penalty as long as the supervisory approval occurs at a time when the supervisor still has discretion whether to approve the penalty. The Ninth Circuit agreed. In agreeing with the government, the court rejected the Tax Court's holding that § 6751(b) requires supervisory approval of the *initial determination* of the assessment of the penalty and therefore requires supervisory approval before the IRS formally communicates the penalty to the taxpayer. According to the Ninth Circuit, "[t]he problem with Taxpayer's and the Tax Court's interpretation is that it has no basis in the text of the statute." The court acknowledged the legislative history of § 6751(b), which indicates that Congress enacted the provision to prevent IRS revenue agents from threatening penalties as a means of encouraging taxpayers to settle. But the text of the statute as written, concluded the Ninth Circuit, does not support the interpretation of the statute advanced by the Tax Court and the taxpayer. The court summarized its holding as follows:

> Accordingly, we hold that § 6751(b)(1) requires written supervisory approval before the assessment of the penalty or, if earlier, before the relevant supervisor loses discretion whether to approve the penalty assessment. Since, here, Supervisor Korzec gave written approval of the initial penalty determination before the penalty was assessed and while she had discretion to withhold approval, the IRS satisfied § 6751(b)(1).

The court was careful to acknowledge that supervisory approval might be required at an earlier time when the IRS must issue a notice of deficiency before assessing a penalty because, "once the notice is sent, the Commissioner begins to lose discretion over whether the penalty is assessed." The IRS can assess the penalty in this case, imposed by § 6707A, without issuing a notice of deficiency.

Dissenting opinion by Judge Berzon. In a dissenting opinion, Judge Berzon emphasized that the 30-day letter the revenue agent sent to the taxpayer was an operative determination. The letter indicated that, if the taxpayer took no action in response, the penalty would be assessed. Judge Berzon analyzed the text of the statute and its legislative history and concluded as follows:

> In my view, then, the statute means what it says: a supervisor must personally approve the "initial determination" of a penalty by a subordinate, or else no penalty can be assessed based on that determination, whether the proposed penalty is objected to or not. 26 U.S.C. §§ 6751(b)(1). That meaning is consistent with Congress's purpose of preventing threatened penalties never approved by supervisory personnel from being used as a "bargaining chip" by lower-level staff, S. Rep. No. 105-174, at 65 (1998); see *Chai v. Commissioner*, 851 F.3d 190, 219 (2d Cir. 2017), which is exactly what happened here.

Because the 30-day letter was an operative determination, according to the dissent, "supervisory approval was required at a time when it would be meaningful-before the letter was sent."

b. Is the tide turning in favor of the government? The Eleventh Circuit has held that, when the IRS must issue a notice of deficiency before assessing tax, the government can comply with the requirement of § 6751(b) that there be written supervisory approval of penalties by securing the approval at any time before assessment of the penalty. Kroner v. Commissioner, 48 F. 4th 1272 (11th Cir. 9/13/22), *rev'g* T.C. Memo. 2020-73. In an opinion by Judge Marvel, the U.S. Court of Appeals for the Eleventh Circuit has held that, when the IRS must issue a notice of deficiency before assessing a penalty, the IRS can comply with the supervisory approval requirement of § 6751(b) by obtaining supervisory approval at any time before assessment of the penalty. The court's holding is contrary to a series of decisions of the Tax Court and contrary to a decision of the U.S. Court of Appeals for the Second Circuit. Section 6751(b)(1) provides:

> No penalty under this title shall be assessed unless the initial determination of such assessment is personally approved (in writing) by the immediate supervisor of the individual making such determination or such higher level official as the Secretary may designate.

Second Circuit's reasoning in Chai v. Commissioner. In *Chai v. Commissioner*, 851 F.3d 190 (2d Cir. 2017), the Second Circuit focused on the language of § 6751(b)(1) and concluded that it is ambiguous regarding the timing of the required supervisory approval of a penalty. Because of this ambiguity, the court examined the statute's legislative history and concluded that Congress's purpose in enacting the provision was "to prevent IRS agents from threatening unjustified penalties to encourage taxpayers to settle." That purpose, the court reasoned, undercuts the conclusion that approval of the penalty can take place at any time, even just prior to assessment. The court held "that § 6751(b)(1) requires written approval of the initial penalty determination no later than the date the IRS issues the notice of deficiency (or files an answer or amended answer) asserting such penalty." Further, the court held "that compliance with § 6751(b) is part of the Commissioner's burden of production and proof in a deficiency case in which a penalty is asserted. … Read in conjunction with § 7491(c), the written approval requirement of § 6751(b)(1) is appropriately viewed as an element of a penalty claim, and therefore part of the IRS's prima facie case."

Tax Court's prior decisions in other cases. In *Graev v. Commissioner*, 149 T.C. 485 (2017), a reviewed opinion by Judge Thornton, the Tax Court (9-1-6) reversed its earlier position and accepted the interpretation of § 6751(b)(1) set forth by the Second Circuit in *Chai v. Commissioner*, 851 F.3d 190 (2d Cir. 2017). Since *Graev*, the Tax Court's decisions have focused on what constitutes the *initial determination* of the penalty in question. These decisions have concluded that the initial determination of a penalty occurs in the document through which the IRS Examination Division notifies the taxpayer in writing that the examination is complete and it has made a decision to assert penalties. *See, e.g.*, *Belair Woods, LLC v. Commissioner*, 154 T.C. 1 (2020); *Beland v. Commissioner*, 156 T.C. 80 (2021). Accordingly, if the IRS notifies the taxpayer that it intends to assert penalties in a document such as a revenue agent's report, and if the IRS fails to secure the required supervisory approval before that notification occurs, then § 6751(b)(1) precludes the IRS from asserting the penalty.

Facts of this case. In the current case, *Kroner v. Commissioner*, the taxpayer failed to report as income just under $25 million in cash transfers from a former business partner. The IRS audited and, at a meeting with the taxpayer's representatives on August 6, 2012, provided the taxpayer with a letter (Letter 915) and revenue agent's report proposing to increase his income by the cash he had received and to impose just under $2 million in accuracy-related penalties under § 6662. The letter asked the taxpayer to indicate whether he agreed or disagreed with the proposed changes and provided him with certain options if he disagreed, such as providing additional information, discussing the report with the examining agent or the agent's supervisor, or requesting a conference with the IRS Appeals Office. The letter also stated that, if the taxpayer took none of these steps, the IRS would issue a notice of deficiency. The IRS later issued a formal 30-day letter (Letter 950) dated October 31, 2012, and an updated examination report. The 30-day letter provided the taxpayer with the same options as the previous letter if he disagreed with the proposed adjustments and stated that, if the taxpayer took no action, the IRS would issue a notice of deficiency. The 30-day letter was signed by the examining agent's supervisor. On that same day, the supervisor also signed a Civil Penalty Approval Form approving the accuracy-related penalties. The IRS subsequently issued a notice of deficiency and, in response, the taxpayer filed a timely petition in the U.S. Tax Court.

Tax Court's reasoning in this case. The Tax Court (Judge Marvel) upheld the IRS's position that the cash payments the taxpayer received were includible in his gross income but held that the IRS was precluded from imposing the accuracy-related penalties. The Tax Court reasoned that the August 6 letter (Letter 915) was the IRS's initial determination of the penalty and that the required supervisory approval of the penalty did not occur until October 31, and therefore the IRS had not complied with § 6751(b).

Eleventh Circuit's reasoning in this case. The Eleventh Circuit rejected the reasoning of the Tax Court as well as the reasoning of the Second Circuit in *Chai v. Commissioner*:

> We disagree with Kroner and the Tax Court. We conclude that the IRS satisfies Section 6751(b) so long as a supervisor approves an initial determination of a penalty assessment before it assesses those penalties. *See Laidlaw's Harley Davidson Sales, Inc. v. Comm'r*, 29 F.4th 1066, 1071 (9th Cir. 2022). Here, a supervisor approved Kroner's penalties, and they have not yet been assessed. Accordingly, the IRS has not violated Section 6751(b).

The Eleventh Circuit first reasoned that the phrase "determination of such assessment" in § 6751(b) is best interpreted not as a reference to communications to the taxpayer, but rather as a reference to the IRS's conclusion that it has the authority and duty to assess penalties and its resolution to do so. The court explained:

> The "initial" determination may differ depending on the process the IRS uses to assess a penalty. … But we are confident that the term "initial determination of such assessment" has nothing to do with communication and everything to do with the formal process of calculating and recording an obligation on the IRS's books.

The court then turned to the question of *when* a supervisor must approve a penalty in order to comply with § 6751(b). The court analyzed the language of § 6751(b) and concluded: "We likewise see nothing in the text that requires a supervisor to approve penalties at any particular time before assessment." Thus, according to the Eleventh Circuit, the IRS can comply with § 6751(b) by obtaining supervisory approval of a penalty at any time, even just before assessment.

Finally, the court reviewed the Second Circuit's decision in *Chai v. Commissioner*, 851 F.3d 190 (2d Cir. 2017), in which the court had interpreted § 6751(b) in light of Congress's purpose in enacting the provision, which, according to the Second Circuit, was to prevent IRS agents from threatening unjustified penalties to encourage taxpayers to settle. According to the Eleventh Circuit, the *Chai* decision did not take into account the full purpose of § 6751(b). The purpose of the statute, the court reasoned, was not only to prevent unjustified threats of penalties, but also to

ensure that only accurate and appropriate penalties are imposed. There is no need for supervisory approval to occur at any specific time before the assessment of penalties, the court explained, to ensure that penalties are accurate and appropriate and therefore carry out this aspect of Congress's purpose in enacting the statute. Further, the Eleventh Circuit concluded, there is no need for a pre-assessment deadline for supervisory approval to reduce the use of penalties as a bargaining chip by IRS agents. This is so, according to the court, because negotiations over penalties occur even after a penalty is assessed, such as in administrative proceedings after the IRS issues a notice of federal tax lien or a notice of levy. (This latter point by the court seems to us to be a stretch. Although it is possible to have penalties reduced or eliminated post-assessment, such post-assessment review does not meaningfully reduce the threat of penalties by IRS agents to encourage settlement at the examination stage.)

Concurring opinion by Judge Newsom. In a concurring opinion, Judge Newsom cautioned against interpreting statutes by reference to their legislative histories: "Without much effort, one can mine from § 6751(b)'s legislative history other—and sometimes conflicting—congressional 'purposes.'" The legislative history, according to Judge Newsom, is "utterly unenlightening." Statutes, in his view, should be interpreted by reference to their text.

c. Yes, the tide seems to be turning. The Tenth Circuit has held that, when the IRS must issue a notice of deficiency before assessing tax, the government can comply with the requirement of § 6751(b) that there be written supervisory approval of penalties by securing the approval no later than the date the IRS issues the notice of deficiency formally asserting a penalty. Minemyer v. Commissioner, 131 A.F.T.R.2d 2023-364 (10th Cir. 01/19/23), aff'g in part and rev'g in part T.C. Memo. 2020-99 (7/1/20). In an unpublished order and judgment by Judge Tymkovich, the U.S. Court of Appeals for the Tenth Circuit has held that, when the IRS must issue a notice of deficiency before assessing a penalty, the IRS can comply with the supervisory approval requirement of § 6751(b) by obtaining supervisory approval on or before the date on which the IRS issues a notice of deficiency.

The taxpayer in this case was indicted on two counts of tax evasion for the years 2000 and 2001. The taxpayer pleaded guilty with respect to the year 2000 and, in exchange, the government dismissed the count for 2001. Subsequently, the IRS asserted deficiencies for 2000 and 2001 and § 6663 civil fraud penalties for both years. In 2010, an IRS revenue agent visited the taxpayer in prison and obtained his signature on Form 4549, Income Tax Examination Changes, in which the IRS proposed the deficiencies and penalties for 2000 and 2001. At that time, the agent's supervisor had not approved the penalties. The taxpayer later requested that his agreement to the deficiencies and penalties be withdrawn. The IRS agreed to the withdrawal and later issued a 30-day letter (Letter 950) asserting the same deficiencies and penalties. The 30-day letter was signed by the revenue agent's supervisor. The IRS later issued a notice of deficiency asserting the deficiencies and penalties for both years.

Tax Court's Analysis. The taxpayer challenged the notice of deficiency by filing a petition in the U.S. Tax Court. The Tax Court (Judge Kerrigan) granted summary judgment in favor of the IRS as to the deficiencies for both years and as to the fraud penalty for 2000. Following a trial, the Tax Court held that the IRS was precluded from asserting the fraud penalty for 2001 by § 6751(b)(1). (The court also held that conviction for tax evasion on the 2000 count collaterally estopped the taxpayer from challenging the civil fraud penalty for 2000.) Section 6751(b)(1) provides:

> No penalty under this title shall be assessed unless the initial determination of such assessment is personally approved (in writing) by the immediate supervisor of the individual making such determination or such higher level official as the Secretary may designate.

The Tax Court's prior decisions have focused on what constitutes the *initial determination* of the penalty in question. These decisions have concluded that the initial determination of a penalty occurs in the document through which the IRS Examination Division notifies the taxpayer in

writing that the examination is complete and it has made a decision to assert penalties. *See, e.g.*, *Belair Woods, LLC v. Commissioner*, 154 T.C. 1 (2020); *Beland v. Commissioner*, 156 T.C. 80 (2021). Accordingly, if the IRS notifies the taxpayer that it intends to assert penalties in a document such as a revenue agent's report, and if the IRS fails to secure the required supervisory approval before that notification occurs, then § 6751(b)(1) precludes the IRS from asserting the penalty. In this case, the Tax Court held, the IRS had failed to comply with § 6751(b)(1) because the Form 4549 the revenue agent presented to the taxpayer in prison was the initial determination of the penalties, and the IRS had not secured the required supervisory approval before the agent presented the form to the taxpayer.

Tenth Circuit's Analysis. On appeal, the U.S. Court of Appeals for the Tenth Circuit affirmed the Tax Court's grant of summary judgment to the government as to the deficiencies for both years and as to the fraud penalty for 2000 but reversed the Tax Court's decision as to the penalty for 2001. The court observed that the U.S. Courts of Appeal for the Ninth and Eleventh Circuits have disagreed with the Tax Court's position that the supervisory approval before the IRS first communicates to the taxpayer that it intends to assert penalties. See *Laidlaw's Harley Davidson Sales, Inc. v. Commissioner*, 29 F.4th 1066 (9th Cir. 3/25/22); *Kroner v. Commissioner*, 48 F. 4th 1272 (11th Cir. 9/13/22). The court agreed with the Ninth and Eleventh Circuits:

> We agree with these assessments of § 6751(b)(1) and hold that its plain language does not require approval before proposed penalties are communicated to a taxpayer.

The Tenth Circuit then addressed the question of what timing requirement, if any, § 6751(b)(1) imposes on the government to obtain the necessary supervisory approval. The court analyzed the Second Circuit's decision in *Chai v. Commissioner*, 851 F.3d 190 (2d Cir. 2017), and agreed with the Second Circuit's analysis:

> We are persuaded by the Second Circuit's reasoning and hold that with respect to civil penalties, the requirements of § 6751(b)(1) are met so long as written supervisory approval of an initial determination of an assessment is obtained on or before the date the IRS issues a notice of deficiency.

Because the revenue agent's supervisor had approved the 2001 civil fraud penalty before the IRS issued the notice of deficiency, the Tenth Circuit reversed the Tax Court's decision as to the 2001 penalty and remanded a determination of whether the taxpayer was liable for the penalty.

2. Is what happened in this complicated taxpayer deposit case the tax equivalent of a shell game? Dillon Trust Company, LLC v. U.S., 162 Fed. Cl. 708 (11/10/22), *motion for reconsideration denied*, 164 Fed. Cl. 92 (2/9/23). The facts and holding in this Court of Federal Claims case remind us of a street-corner shell game, only the stakes were roughly $10 million of underpayment/overpayment interest arbitrage. Essentially, the IRS held for over two years almost $72 million of a § 6603 deposit made by a trustee on behalf of numerous trusts, but nevertheless, the IRS charged the taxpayer trusts with § 6621(a)(2) underpayment interest during those two years at a higher rate than the deposits earned in § 6611 overpayment interest. Read on for more details, but the upshot appears to be that any § 6603 deposits with the IRS should be made separately by each potentially liable taxpayer, and the taxpayer must ensure that the deposit is credited to the taxpayer's account as a payment of tax. The IRS is not legally required to honor, and may not properly account for, a lump sum deposit made under § 6033 on behalf of several different taxpayers, even if those taxpayers are trusts with a common trustee.

Factual Background. The facts of the case are exceedingly complicated, but the following summary should suffice. The taxpayers were nine original trusts (the "Original Trusts") that eventually became thirty continuing and successor trusts (each with distinct taxpayer identification numbers) during the period of the IRS examination. All the trusts were potentially liable for taxes, penalties, and interest as transferees under § 6901. The trusts' potential transferee liability apparently stemmed from distributions they received from a corporate taxpayer with large unpaid

liabilities for taxes, interest, and penalties. The IRS examination of the Original Trusts began in 2014, but six of the Original Trusts already had been terminated by that time and their assets moved to successor trusts. The IRS was aware of the termination of the six Original Trusts and that the successor trusts would remain liable as secondary transferees under § 6901. The subsequent events leading to the dispute are as follows:

- First, in May of 2015, while the IRS examination remained ongoing, the trustee paid to the IRS a total of approximately $72 million as deposits pursuant to § 6603 to stop the running of potential underpayment interest under § 6621 against the remaining three Original Trusts and the successor trusts to the six terminated Original Trusts. Oddly (but perhaps practically), instead of writing multiple deposit checks (one for each trust) totaling almost $72 million, the trustee wrote one check for approximately $72 million and asked the IRS to credit each trust with their respective deposit shares according to an allocation schedule.
- The IRS, however, did not allocate the $72 million across the thirty separate trusts. Instead, the IRS deposited the $72 million to a "general ledger account," not the taxpayer accounts for each distinct trust.
- Next, in 2016, the IRS issued statutory notices of liability under § 6901 to the nine Original Trusts (but not the successor trusts). As noted above, though, six of the Original Trusts were no longer in existence with their assets being held by successor trusts. The IRS was fully aware of the circumstances involving the Original Trusts and the successor trusts.
- After receipt of the notices of transferee liability, the trustee then filed protests with IRS Appeals on behalf of all the trusts.
- Next, in early March 2017, the trustee again requested that roughly $20 million of the total $72 million deposit be allocated across the three remaining Original Trusts, and that the balance of approximately $52 million continue to be held as a deposit for the successor trusts.
- Still, the IRS did not allocate any portion of the $72 million across the separate taxpayer accounts for the trusts. The IRS Agent involved in the examinations explained that no amounts were allocated because "[IRS] procedures do not authorize a person to direct the [IRS] to apply a deposit to another person's liability," citing Rev. Proc. 2005-18, 2005 C.B. 798.
- Shortly thereafter, on March 16, 2017, the trustee requested the return of approximately $20 million of the $72 million deposit.
- By May 2017, though, the IRS had not returned any portion of the $72 million deposit. The IRS had, however, credited two of the Original Trusts with deposits of roughly $250,000 each (a total of approximately $500,000). The remaining $71.5 million was not credited to any taxpayer accounts for the other trusts.
- Next, in July 2017, the IRS agreed to return the full $72 million along with approximately $1 million of interest.
- Nevertheless, the $72 million deposit was not actually returned by the IRS until October of 2017.
- During the interim period between July 2017 and October 2017, the trustee paid the IRS approximately $79 million in assessed § 6901 transferee liabilities (including accrued underpayment interest) on behalf of the trusts. A short time thereafter, the trustee paid approximately another $4 million in assessed § 6901 transferee liabilities (including accrued underpayment interest) on behalf of the trusts.
- The trustee then filed suit in the Court of Federal Claims alleging that, because the IRS did not stop the accrual of underpayment interest against all the trusts as of May 2015

when the original $72 million deposit was made, the trusts were owed roughly $10 million of underpayment interest that they should not have been required to pay.

The initial subject matter jurisdiction issue. In response to the trustee's suit, the IRS moved for partial summary judgment, arguing that the trustee's $10 million interest claim on behalf of the trusts should be dismissed for lack of subject matter jurisdiction. The taxpayer trusts, of course, objected, arguing that § 7422 permitting refund claims should apply. The taxpayer trusts also cited 28 U.S.C. § 1491, which grants the Federal Court of Claims jurisdiction over "any claim against the United States founded … upon … any act of Congress." After analyzing relevant precedent, Judge Bruggink decided the jurisdictional issue for the trusts and against the IRS, holding that the Court of Federal Claims had subject matter jurisdiction over the trusts' interest claim. Judge Bruggink then turned to the merits of the dispute.

IRS argument. In further support of its motion for partial summary judgment, the IRS argued that, although the accrual of underpayment interest can be suspended by a cash deposit under § 6603, subsection (b) of the statute requires the deposit to be "used by the Secretary to pay tax." Therefore, according to the IRS, the accrual of underpayment interest is not suspended under § 6033 if the IRS does not actually use a deposit as a tax payment. The IRS argued that this is precisely what happened in this case: the deposit was never credited as a tax payment during the two-year period it was in the hands of the IRS. The deposit was not so credited because "[IRS] procedures do not authorize a person to direct the [IRS] to apply a deposit to another person's liability." *See* Rev. Proc. 2005-18, 2005 C.B. 798, at § 6.91. Moreover, § 6603(c) contemplates that to the extent the deposit is not used by the IRS as a tax payment, the IRS is not obligated to return the deposit or any portion thereof absent a written request by the taxpayer. The IRS acknowledged that Section 4.02 of Rev. Proc. 2005-18 allows a § 6033 deposit to be posted to a taxpayer's account as a tax payment after the taxpayer has received a notice of deficiency, but Rev. Proc. 2005-18 does not address an IRS notice of transferee liability and therefore could not be used to compel the IRS to credit the trusts' taxpayer accounts in this case.

The taxpayer trusts. The taxpayer trusts argued that the foregoing position by the IRS constituted an abuse of administrative agency discretion, especially given the "parade of IRS mistakes" in handling the examinations and the $72 million deposit. The taxpayer trusts also argued that the IRS should have followed its own internal guidance, which suggests that, like notices of deficiency, the notices of transferee liability for a terminated entity should be sent to the terminated entity's successor in interest—here, the successor trusts to the six terminated Original Trusts. If the IRS had followed its own internal guidance, the taxpayer trusts asserted, then there would have been no administrative impediment to the IRS crediting the deposit to various taxpayer trust accounts as the IRS does in accordance with Section 4.02 of Rev. Proc. 2005-18 after issuing notices of deficiency.

The court. The Court of Federal Claims (Judge Bruggink) seemed sympathetic to the plight of the taxpayer trusts; however, Judge Bruggink could not find that the IRS had violated any law or abused its discretion in failing to credit the deposit to the various taxpayer accounts. Judge Bruggink reasoned that § 6033(a), which authorizes deposits, is permissive—using the term "may" not "shall." Thus, the IRS is authorized to accept deposits for the purpose of suspending underpayment interest, but the IRS was not required to treat the deposit as a payment of tax under the unique circumstances before the court. Judge Bruggink concluded:

> For the IRS collection of underpayment interest here to have violated the law, one of two things must have been true: either the I.R.C. mandates applying a deposit as a tax payment when the taxpayer makes such a request (thus triggering interest suspension under § 6603(b)), or the I.R.C. requires suspension of interest when a § 6603 deposit is made, even if the Secretary does not use the deposit for a payment of tax. The plain language of the I.R.C. does not allow for either result.

3. What's the point of a penalty if the IRS is precluded from collecting it? The Tax Court has held that there is no statutory authority for the IRS to assess penalties imposed by § 6038(b) for failure to file information returns with respect to foreign business entities and that the IRS therefore cannot proceed to collect the penalties through a levy. Farhy v. Commissioner, 160 T.C. No. 6 (4/3/23). Section 6038(a) requires every United States person to provide information with respect to any foreign business entity the person controls (defined in § 6038(e)(2) as owning more than 50 percent of all classes of stock, measure by vote or value). The form prescribed for providing this information is Form 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations. Section 6038(b)(1) imposes a penalty of $10,000 for each annual accounting period for which a person fails to provide the required information. In addition, § 6038(b)(2) imposes a continuation penalty of $10,000 for each 30-day period that the failure continues up to a maximum continuation penalty of $50,000 per annual accounting period. In this case, the taxpayer was required to file Form 5471 for several years with respect to two wholly-owned corporations organized in Belize but failed to do so. The IRS assessed a penalty under § 6038(b)(1) of $10,000 and a continuation penalty of $50,000 for each of the years in issue. In response to a notice of levy, the taxpayer requested a collection due process (CDP) hearing. In the CDP hearing, the taxpayer argued that the IRS had no legal authority to assess § 6038 penalties. Following the CDP hearing, the IRS issued a notice of determination upholding the proposed collection action and the taxpayer changed this determination by filing a petition in the Tax Court. The Tax Court (Judge Marvel) agreed with the taxpayer and held that there is no statutory authority for the IRS to assess § 6038 penalties. The IRS argued that § 6201(a), which authorizes the Secretary of the Treasury to make the "assessments of all taxes (including interest, additional amounts, additions to the tax, and assessable penalties) imposed by this title" authorizes assessment of penalties imposed by § 6038. The court disagreed, however, and reasoned that the term "assessable penalties" in § 6201(a) does not automatically apply to all penalties in the Code. The court observed that (1) §§ 6671(a) and 6665(a)(1) provide that penalties imposed by specified Code sections shall be assessed and collected in the same manner as taxes and (2) Code sections other than those specified by §§ 6671(a) and 6665(a)(1) commonly provide that the penalty is a tax or assessable penalty for purposes of collection or are expressly covered by (or contain a cross-reference to) one of the specified Code sections. In contrast, the court explained, § 6038 is not one of the Code sections specified by §§ 6671(a) and 6665(a)(1) and contains only a cross-reference to a criminal penalty provision. The court also rejected the IRS's argument that § 6038 penalties are "taxes" within the meaning of § 6201(a) and therefore subject to assessment. In short the court held, although § 6038(b) provides penalties for failure to provide the information required by § 6038(a), there is no statutory authority for assessment of those penalties and the IRS therefore is unable to collect those penalties through a levy.

- The court's holding that there is no authority for assessment of § 6038 penalties suggests that (1) the IRS would be precluded from exercising its other administrative collection powers, such as a lien or a refund offset, and (2) the mechanism for the IRS to collect § 6038 penalties is a civil action under 28 U.S.C. § 2461(a).

4. Trustee learns that frivolity can be costly when it comes to filing and signing his trust's tax returns. Stanojevich v. Commissioner, 160 T.C. No. 7 (4/10/23). In a case of first impression, the Tax Court, in an opinion by Chief Judge Kerrigan, has determined that the $5,000 per taxable year frivolous return penalty of § 6702(a) can be imposed personally (apparently not limited to the trust's assets) against a trustee filing and signing an IRS Form 1041 (U.S. Income Tax Return for Estates and Trusts) as an "authorized representative." The case arose out of a collection due process hearing after the IRS sent the taxpayer a notice of federal tax lien relating to the assertion of the § 6702(a) frivolous return penalty across multiple years. The taxpayer was the trustee of, in Judge Kerrigan's words, a "grantor-type trust." (The opinion does not elaborate on the precise federal income tax status of the trust—i.e., disregarded grantor trust within the meaning of Reg. § 1.671-4 or another type trust—except to state in a footnote that the IRS disputed the validity of the trust, but the Tax Court assumed it was valid for purposes of the opinion.) The trust in question reported gross income across multiple years but simultaneously

reported tax withheld for those years equal to or exceeding the amount of reported gross income. The returns reported that the trust had no tax liability and that it had made overpayments equal to the tax withheld. The IRS previously announced in Section III(22) of Notice 2010-33, 2010-17 I.R.B. 609, 611, its position that such facially incorrect returns are considered frivolous within the meaning of § 6702. The trustee argued that the § 6702(a) frivolous return penalty should not apply to him personally, even if he filed and signed the multi-year returns as an "authorized representative of the trust, because the frivolous returns were returns of the trust, not the trustee as an individual. Judge Kerrigan disagreed, relying on the plain terms of § 6702(a) which states that a "person shall pay a penalty of $5,000 if (1) such person files [a frivolous return, as defined]." Judge Kerrigan reasoned further that nothing in the statute conditions the imposition of the penalty on a person's filing of his or her personal return and that Congress, because it did not provide otherwise, must have considered it appropriate to impose the § 6702(a) penalty personally on a trustee who files a return on behalf of a trust.

B. Discovery: Summonses and FOIA

C. Litigation Costs

D. Statutory Notice of Deficiency

E. Statute of Limitations

1. If you're on "island time," or think you might be, here's why you might want to "meticulously" and "intentionally" file a U.S. federal income return even if you think you have $0 U.S. gross income and $0 U.S. tax liability. Tice v. Commissioner, 160 T.C. No. 8 (4/10/23). In a case with extremely narrow application, the Tax Court (Judge Pugh), in a unanimous, reviewed opinion, has held that filing a return solely with the U.S. Virgin Islands Bureau of Internal Revenue ("VIBIR") does not trigger the limitations period under § 6501 for the IRS to assess tax. The taxpayer in this case claimed to be a bona fide resident of the U.S. Virgin Islands (USVI) for tax years 2002 and 2003. Accordingly, pursuant to § 932(c) (coordination of U.S. and USVI income taxes), the taxpayer filed his Form 1040 for those years only with the VIBIR (the USVI's IRS counterpart). The IRS audited the taxpayer and challenged his status as a bona fide resident of the USVI but did not issue a notice of deficiency until 2015. The taxpayer petitioned the Tax Court and moved for summary judgment on the grounds that the IRS's notice of deficiency was time-barred under § 6501(a), which generally provides that the IRS can assess tax within three years after a return is filed. Nevertheless, the Tax Court held that the IRS's notice of deficiency was timely and that the § 6501 limitations period had not begun to run against the IRS because the taxpayer did not show "meticulous compliance" by *intentionally* filing a return with the IRS. In so holding, the Tax Court aligned itself with decisions of the Eighth and Eleventh Circuits. *See Coffey v. Commissioner*, 987 F.3d 808 (8th Cir. 2021), *reversing and remanding Hulett v. Commissioner*, 150 T.C. 60 (2018), and *Commissioner v. Estate of Sanders*, 834 F.3d 1269 (11th Cir. 2016).

Appleton and Hulett distinguished. The Tax Court distinguished its holding in *Tice* from its seemingly contrary holding in *Appleton v. Commissioner*, 140 T.C. 273 (2013). The taxpayer in *Appleton* also filed returns for 2002-2004 with the VIBIR only; however, the IRS had subsequently received copies of the taxpayer's USVI returns from the VIBIR. The IRS had received the *Appleton* taxpayer's USVI returns through the so-called "cover-over" process whereby the VIBIR requests that taxes paid to the U.S. by USVI residents be remitted (i.e., "covered over") to the USVI. The VIBIR invokes the cover-over process by sending critical portions of a taxpayer's return information to the IRS. A cover-over request typically includes a partial or complete copy of a taxpayer's USVI return. The IRS conceded in *Appleton* that "the taxpayer's subjective intent has no role to play" in determining whether a return has been properly filed. The taxpayer and the IRS in *Appleton* also stipulated that the taxpayer was a bona fide resident of the USVI for the years in issue. Thus, the taxpayer contended, and the Tax Court in *Appleton* agreed, that the copies of the taxpayer's USVI returns for years 2002-2004 transmitted to the IRS started the § 6501 limitations period vis-à-vis the IRS. The *Hulett* taxpayer made an argument similar to that made by the

taxpayer in *Appleton* about the cover-over process triggering the § 6501 limitations period, and the lead Tax Court opinion in *Hulett* adopted this argument to hold for the taxpayer regarding the § 6501 limitations period. As noted above, however, the Eighth Circuit reversed the Tax Court's decision in *Hulett*, holding that the VIBIR-IRS cover-over process is not sufficient to "meticulously comply with the requirements to file with the IRS." *See Coffey v. Commissioner*, 987 F.3d 808 (8th Cir. 2021). Similarly, the Eleventh Circuit in *Commissioner v. Estate of Sanders*, 834 F.3d 1269 (11th Cir. 2016), also rejected the cover-over argument, holding that "a taxpayer who files a return only with the VIBIR does not trigger the statute of limitations unless he actually is a bona fide resident of the USVI." The taxpayer in *Tice* reserved making a similar argument as the taxpayer in *Appleton* (i.e., that VIBIR return copies sent to the IRS start the statute of limitations against the IRS under § 6501), so expect another Tax Court decision on this issue soon.

Reading between the lines and clarifying. It appears that, if in addition to the taxpayer's USVI return filed with the VIBIR, the taxpayer had *meticulously* and *intentionally* filed a Form 1040 with the IRS for 2002 and 2003—even if the return so filed listed $0 gross income, $0 deductions, and $0 tax—the statute of limitations of § 6501 would have run against the IRS. Further, for USVI returns filed for 2006 and later tax years, Reg. § 1.932-1(c)(2)(ii) expressly provides that the § 6501 limitations period begins running against the IRS based solely upon filing a return with the VIBIR in which the taxpayer takes the position that he or she is a bona fide resident of the USVI.

a. Wow! That was fast. Estate of Tanner v. Commissioner, T.C. Memo 2023-54 (5/1/23). In a case appealable to the Eleventh Circuit and with facts virtually identical to *Tice*, the Tax Court (Judge Buch), in a memorandum decision, refused to grant summary judgment to a taxpayer who argued that the cover-over process between the VIBIR and IRS triggers the § 6501 limitations period on assessment of tax for the IRS. Instead, Judge Buch ruled that a genuine issue of material fact remained to be determined: whether the taxpayer "intended the VIBIR's transmission of the cover-over requests to be the filing of his returns." In both *Tice* and *Estate of Tanner*, the IRS neither (i) conceded that the taxpayer's subjective intent has no role to play in determining whether a return has been properly filed, nor (ii) stipulated that the taxpayer was a bona fide resident of the USVI. Thus, Judge Buch's opinion noted that both *Appleton* and *Hulett* are distinguishable. Judge Buch further noted that the *Estate of Tanner* case is appealable to the Eleventh Circuit and governed by the *Estate of Sanders* decision mentioned above. Therefore, the Tax Court's decision in *Estate of Tanner* also supports the conclusion that, if a taxpayer wishes to ensure the running of the § 6501 statute of limitations against the IRS, the taxpayer would be well advised to file a return in the U.S. even if that return shows $0 gross income, $0 deductions, and $0 tax. Again, with respect to USVI returns filed for 2006 and later tax years, Reg. § 1.932-1(c)(2)(ii) expressly provides that the § 6501 limitations period begins running against the IRS based solely upon filing a return with the VIBIR in which the taxpayer takes the position that he or she is a bona fide resident of the USVI.

2. The 90-day period specified in § 6213(a) for filing a petition in the U.S. Tax Court is jurisdictional and is not subject to equitable tolling, according to the Tax Court. Hallmark Research Collective v. Commissioner, 159 T.C. No. 6 (11/29/22). In a unanimous, reviewed opinion by Judge Gustafson, the Tax Court has held that the 90-day period specified by § 6213(a) within which taxpayers can challenge a notice of deficiency by filing a petition in the Tax Court is jurisdictional and is not subject to equitable tolling. In this case, the IRS sent a notice of deficiency to the taxpayer. Pursuant to § 6213(a), the taxpayer then had 90 days within which to challenge the notice of deficiency by filing a petition in the U.S. Tax Court. The last day of this 90-day period was September 1, 2021. The taxpayer electronically filed its petition on September 2, 2021, which was one day late. In the petition, the taxpayer stated: "My CPA . . . contracted COVID/DELTA over the last 40 days and kindly requests additional time to respond." In other words, it appears that the taxpayer was requesting an extension of the § 6213(a) 90-day period.

Procedural history. The Tax Court issued an order to show cause in which it ordered the parties to respond as to why the court should not, on its own motion, dismiss the action for lack of jurisdiction. The taxpayer requested that the court defer ruling on the matter until the U.S. Supreme

Court issued its opinion in *Boechler, P.C. v. Commissioner,* 142 S. Ct. 1493 (4/21/22), which was pending in the Supreme Court. The Tax Court declined to defer ruling and dismissed the taxpayer's action. After the U.S. Supreme Court issued its opinion in *Boechler*, the taxpayer moved to vacate the court's order of dismissal. After receiving briefing, the court issued a unanimous, reviewed opinion denying the motion to vacate its prior order of dismissal.

Tax Court's holding. In a lengthy (57 pages) and extraordinarily thorough opinion, the Tax Court examined the text and history of § 6213(a) and concluded that Congress had clearly indicated that the 90-day period specified in the statute is jurisdictional. The court observed that the Tax Court is a court of limited jurisdiction and has only whatever jurisdiction it has been granted by Congress. Accordingly, because the 90-day period is jurisdictional, in the court's view, the court must dismiss cases, such as this one, in which the taxpayer's petition is filed late. And because the statute is jurisdictional, the court concluded, it is not subject to equitable tolling, i.e., taxpayers cannot argue for exceptions on the basis that they had good cause for failing to meet the deadline. The court also concluded rather briefly that its view on the jurisdictional nature of § 6213(a) was not affected by the U.S. Supreme Court's decision in *Boechler, P.C. v. Commissioner,* 142 S. Ct. 1493 (4/21/22). In *Boechler*, the Court held that the 30-day period specified in § 6330(d)(1) for requesting review in the Tax Court of a notice of determination following a collection due process hearing is *not* jurisdictional and *is* subject to equitable tolling. According to the Tax Court, *Boechler* "emphatically teaches that" § 6213(a) and § 6330(d)(1) "are different sections" that "[e]ach must be analyzed in light of its own text, context, and history." The fact that, in *Boechler*, the Supreme Court concluded that the 30-day period specified in § 6330(d)(1) is *not* jurisdictional did not change the Tax Court's view that the 90-day period specified in § 6213(a) *is* jurisdictional. Accordingly, the Tax Court dismissed the taxpayer's action.

a. The Third Circuit disagrees. The 90-day period specified in § 6213(a) for filing a petition in the U.S. Tax Court is *not* jurisdictional and *is* subject to equitable tolling. Culp v. Commissioner, 75 F.4th 196 (3d Cir. 7/19/23). In an opinion by Judge Ambro, the U.S. Court of Appeals for the Third Circuit has held that the 90-day period specified by § 6213(a) within which taxpayers can challenge a notice of deficiency by filing a petition in the Tax Court is *not* jurisdictional and *is* subject to equitable tolling. Although the Third Circuit's opinion does not provide specific dates, it states that the IRS mailed a notice of deficiency to the taxpayers, a married couple, as well as a second notice of deficiency, both with respect to the taxable year 2015. The taxpayers filed a petition in the Tax Court seeking redetermination of the deficiency well outside the 90-day period specified in § 6213(a) for doing so. In an unpublished order, the Tax Court dismissed the taxpayers' petition for lack of jurisdiction. On appeal, the taxpayers, backed by amicus curiae represented by the Legal Services Center of Harvard Law School, argued that the 90-day period provided by § 6213(a) is not jurisdictional and is subject to equitable tolling in appropriate circumstances. The court framed the issue in this way:

> The central question in this appeal is whether the Culps' late filing deprives the Tax Court of jurisdiction to consider their petition. Put another way, is § 6213(a)'s 90-day requirement jurisdictional or is it a claims-processing rule?

The court first analyzed the text of § 6213(a), which provides in part:

> Within 90 days … after the notice of deficiency authorized in section 6212 is mailed …, the taxpayer may file a petition with the Tax Court for a redetermination of the deficiency. … The Tax Court shall have no jurisdiction to enjoin any action or proceeding or order any refund under this subsection unless a timely petition for a redetermination of the deficiency has been filed and then only in respect of the deficiency that is the subject of such petition.

The court concluded that the provision's text did not indicate that the 90-day period specified in § 6213(a) is jurisdictional. The language Congress used, the court reasoned, does not link the 90-

day deadline to the Tax Court's jurisdiction. The statute provides that the Tax Court has no jurisdiction to enjoin actions or order a refund if the taxpayer's petition is not timely filed, which indicates that "Congress knew how to limit the scope of the Tax Court's jurisdiction." But the provision does not similarly limit the Tax Court's jurisdiction to review petitions that are not timely filed. Further, according to the court, neither the context of the statute nor the court's own precedent interpreting § 6213(a) indicates that the 90-day period is jurisdictional.

After holding that the 90-day period specified in § 6213(a) is not jurisdictional, the court considered whether the period is subject to equitable tolling. According to the court, neither the text nor the context of the statute suggests that Congress intended the period not to be subject to equitable tolling. Accordingly, the court remanded the case to the Tax Court with instructions for the Tax Court to consider whether the taxpayers could demonstrate sufficient grounds for the 90-day period to be equitably tolled.

3. IRS bait and switch? Partnership's 2001 tax year remains open until 2010 because no original return was filed and neither a copy faxed to an IRS agent in 2005 nor a second copy mailed to an IRS attorney in 2007 started the three-year limitations period on assessment of tax. Seaview Trading, LLC v. Commissioner, 62 F.4th 1131 (9th Cir. 3/10/23) (en banc), *vacating* 34 F.4th 666 (9th Cir. 2022), *and aff'g* T.C. Memo. 2019-122 (2019). As evidenced by the citation above, the procedural history of this case demonstrates the Tax Court's and the Ninth Circuit's struggles to determine the proper outcome. First, the Tax Court held for the IRS. Then, a three-judge panel of the Ninth Circuit (by a two to one vote) reversed the Tax Court and held for the taxpayer. Finally, an *en banc* panel of the Ninth Circuit (by a ten to one vote) vacated the three-judge panel's prior decision and held for the IRS, affirming the Tax Court. Notwithstanding the procedural complexities, the facts of the case are relatively straightforward. Seaview Trading, LLC, a TEFRA partnership, mistakenly failed to file its original 2001 Form 1065 even though the return apparently had been timely prepared and signed. (Seaview's return preparer may have mailed a related entity's original tax return in the envelope that was meant to contain Seaview's 2001 Form 1065.) In July of 2005, an IRS agent in South Dakota notified the tax matters partner that there was no record of Seaview having filed a return for 2001. Next, in September of 2005, Seaview faxed a copy of its original return to the IRS agent; however, the agent did not forward the faxed return to the IRS Service Center in Ogden, Utah, which was the proper place for filing Seaview's 2001 return. Subsequently, in July of 2007 while an IRS audit was ongoing, Seaview mailed a copy of its original 2001 return to an IRS attorney in Minnesota; but again, the attorney did not forward the copy to the Ogden Service Center. Lastly, in October of 2010, the IRS issued a notice of final partnership administrative adjustment ("FPAA") to Seaview disallowing a $35.5 million claimed loss for 2001. Seaview responded by filing a petition in the Tax Court contending that the IRS's proposed adjustment was untimely. Seaview asserted that, under § 6229(a)(1), the IRS has only three years from the time the partnership return is filed to assess tax, and that this period had expired no later than July 2010 (three years after the copy of the taxpayer's return was mailed to the IRS attorney in Minnesota and before the FPAA was received). The IRS, of course, argued that the statute of limitations never began to run because Seaview did not properly file an original return with the Ogden Service Center. As the case wound its way through the Tax Court up to the Ninth Circuit, the record established that Seaview's original 2001 Form 1065 (nor a copy thereof) was ever sent to or received by the Ogden Service Center. Thus, the only question before the Ninth Circuit was whether the IRS's FPAA, issued in October 2010, was issued before the three-year limitations period on assessment of tax had expired.

The Arguments. The IRS argued that a return is properly "filed" for statute of limitation purposes only when it is submitted to, or eventually received by, the proper IRS Service Center, which in this case was in Ogden, Utah. The IRS relied upon then-applicable regulations (Reg. § 1.6031(a)-1(e)) and instructions to the 2001 Form 1065, which designated the Ogden Service Center as the proper place for filing Seaview's return. Seaview countered that the then-applicable regulations and instructions to the 2001 Form 1065 should be read to apply to returns filed on time,

not late-filed returns or copies thereof delivered to an IRS agent or attorney. For delinquent returns, Seaview argued, there is no specific instruction regarding where such returns should be filed in the Code, applicable regulations, or the instructions for Form 1065. Therefore, Seaview urged the Ninth Circuit to hold that its delinquent 2001 return on Form 1065 was "filed" no later than July 2007, when it was mailed to the IRS attorney in Minnesota. In support of its position, Seaview cited IRS documents (a 1999 advice memorandum, the 2005 Internal Revenue Manual, and a 2006 policy statement) which permitted IRS personnel to receive and "accept" delinquent returns during an examination. The 2005 Internal Revenue Manual went further to state that such accepted but delinquent returns should be forwarded "to the appropriate campus." Seaview also cited as support for its position the Tax Court's decision in *Dingman v. Commissioner*, T.C. Memo 2011-116. In *Dingman*, the Tax Court held that delinquent, original returns delivered to IRS investigators, not an IRS Service Center, were considered properly "filed" when checks accompanying the delinquent returns were credited to the taxpayer's account.

Ninth Circuit Majority. The Ninth Circuit majority was not persuaded by Seaview's arguments. Judge Waterford, writing on behalf of the ten-judge majority, reasoned that, although the Code, regulations, and instructions for Form 1065 did not dictate where delinquent tax returns (or copies thereof) should be filed, limitation statutes barring the collection of taxes are strictly construed in favor of the government. Thus, a taxpayer's "meticulous compliance" with return filing requirements is necessary to start the statute of limitations running against the IRS. The court reasoned that the failure of the IRS agent and attorney to forward copies of Seaview's 2001 Form 1065 to the Ogden Service Center according to IRS policy did not relieve Seaview of its return filing obligations. Judge Waterford concluded:

> Because Seaview did not meticulously comply with the regulation's place-for-filing requirement, it is not entitled to claim the benefit of the three-year limitations period. Having never properly filed its return, Seaview is instead subject to the provision allowing taxes attributable to partnership items to be assessed "at any time."

Dissenting opinion of Judge Bumatay. Judge Bumatay dissented, arguing that the majority's decision "throws our tax system into disarray" by allowing "bureaucrats," not law, to control when a return filing starts the statute of limitations running against the IRS. Judge Bumatay reasoned that, in the absence of clear regulations or other published guidance, the IRS should be bound by its stated policy directing IRS personnel to forward "accepted" but delinquent returns to the appropriate IRS Service Center. Therefore, in Judge Bumatay's view, a late partnership return should be considered "filed" for statute-of-limitations purposes

> when (1) an IRS representative authorized to obtain and receive delinquent returns informs a partnership that a tax return is missing and requests that tax return, (2) the partnership responds by giving the IRS representative the tax return in the manner requested, and (3) the IRS representative receives the tax return.

4. Better be aware of your time zone when you e-file your Tax Court petition, says the Tax Court. A petition e-filed at 11:05 p.m. central time, which is 12:05 a.m. eastern time, was late and the Tax Court therefore had no jurisdiction to hear the matter. Nutt v. Commissioner, 160 T.C. No. 10 (5/2/23). The taxpayers in this case received a notice of deficiency with respect to tax year 2019. The last day of the 90-day period specified by § 6213(a) within which the taxpayers could challenge the notice of deficiency by filing a petition in the U.S. Tax Court was July 18, 2022. The taxpayers, who resided in Alabama, e-filed their petition at 11:05 p.m. central time on July 18. The IRS moved to dismiss for lack of jurisdiction on the basis that the taxpayers had not filed their petition by the last day of the 90-day period specified by § 6213(a). The Tax Court (Judge Buch) agreed with the government and granted the motion to dismiss. The court reasoned that "a petition is ordinarily 'filed' when it is received by the Tax Court in Washington, D.C." In this case, the court observed, the Tax Court, which is in the Eastern time zone, had received the taxpayers' petition at 12:05 a.m. on July 19, which was one day late.

Further, the court observed, the "timely mailing" rule of § 7502(a) does not apply to petitions filed electronically:

> Under section 7502(a), a document that is mailed before it is due but received after it is due is deemed to have been received when mailed. But that rule applies only to documents that are delivered by U.S. mail or a designated delivery service. I.R.C. § 7502(a)(1), (f). Because an electronically filed petition is not delivered by U.S. mail or a designated delivery service, the exception of section 7502 does not apply.

If the timely mailing rule does not apply, the court stated, then a taxpayer's petition is filed when it is received by the Tax Court. In this case, the court reasoned, although it was still July 18 where the taxpayers resided and where they e-filed their petition, it was July 19 in the Eastern time zone and their petition therefore was filed one day late. Accordingly, the court granted the government's motion to dismiss for lack of jurisdiction.

- *Observation*: the court's holding could work to the advantage of a taxpayer who resides abroad. (Keep in mind that taxpayers residing abroad normally have 150 days (rather than 90) to file their petitions.) If a U.S. citizen resides, say, in England, and the last day to file the petition is July 18, then, assuming a 5-hour time difference, the taxpayers presumably would have until 4:59 a.m. on July 19 to e-file their petition because the petition would be received by the Tax Court in the eastern time zone at 11:59 p.m. on July 18.

5. This promoter was SOL because there is no SOL for promoter penalties. Crim v. Commissioner, 66 F.4th 999 (D.C. Cir. 5/2/2023) *aff'g* T.C. Memo. 2021-117. The taxpayer-promoter in this case was convicted of certain tax crimes in 2008 and sentenced to prison, where he remained until his release in 2014. In 2010 and within the three-year limitations period on assessment provided by § 6501, the IRS assessed penalties against the taxpayer under IRC § 6700 (promoting abusive tax shelters). Then, in 2011, the IRS recorded a Notice of Federal Tax Lien ("NFTL") against the taxpayer's California property and delivered to the taxpayer a Letter 3172, Notice of Federal Tax Lien Filing and Your Right to a Hearing ("lien notice"). The letter instructed the taxpayer to submit his request for a collection due process ("CDP") hearing by December 30, 2011. The taxpayer did not respond to the lien notice and did not request a CDP hearing. The IRS then suspended collection activities against the taxpayer while he was incarcerated. Next, in 2017, approximately three years after the taxpayer was released from prison but within the ten-year collection period of § 6502, the IRS issued a notice of determination to the taxpayer sustaining the collection action and delivered a Letter 1058, Notice of Intent to Levy and Your Right to a Hearing ("levy notice") relating to the § 6700 penalties. Through his representative, the taxpayer requested a CDP hearing. In the CDP hearing, the IRS Settlement Officer issued a notice of determination upholding the proposed collection action. The taxpayer challenged this determination by filing a petition in the Tax Court. The taxpayer first filed a motion to recuse and disqualify all Tax Court judges on separation of powers grounds. The Tax Court denied that motion in July 2019. Next, in December 2019, the IRS filed a motion for summary judgment, and the taxpayer filed a cross-motion for summary judgment arguing alternatively that the statute of limitations had run against the IRS under both § 6501 (three-year limit on assessment) and § 6502 (ten-year limit on collection). The Tax Court (Judge Lauber) decided in favor of the IRS and issued its opinion sustaining the IRS's collection actions in October 2021. The taxpayer appealed to the D.C. Circuit.

Appeal: On appeal to the D.C. Circuit, the taxpayer again made his separation of powers and statute of limitations arguments. The D.C. Circuit, in an opinion by Judge Rogers, ruled two-to-one against the taxpayer on both arguments. We omit discussion of the taxpayer's separation of powers argument. Concerning the taxpayer's statute of limitations argument, Judge Rogers held for the IRS noting that the D.C. Circuit is joining the Second, Fifth, and Eighth Circuits in holding that § 6501 does not apply to the assessment of promoter penalties under § 6700. *See Barrister Assocs. v. United States*, 989 F.2d 1290, 1296-97 n.1 (2d Cir. 1993); *Sage v. United States*, 908 F.2d 18, 24-25 (5th Cir. 1990); *Lamb v. United States*, 977 F.2d 1296, 1296-97 (8th Cir. 1992).

According to Judge Rogers, the primary reason that the three-year limitation on *assessment* under § 6501 does not apply is because the § 6700 penalty turns on the promoter's conduct, *not the filing of a return by the promoter's client*. The taxpayer also made a statute of limitations argument under 28 U.S.C. 2462 which imposes a five-year limitation period on any action to enforce a "civil fine, penalty, or forfeiture." With regard to this argument, Judge Rogers agreed with the Second and Eighth Circuits that 28 U.S.C. 2462 does not apply to § 6700 penalties because Congress "otherwise provided" for the ten-year limitation on *collection* in § 6502. *See Capozzi v. United States*, 980 F.2d 872, 874-75 (2d Cir. 1992); *Lamb v. United States*, 977 F.2d 1296 at 1297 (8th Cir. 1992). The D.C. Circuit thus upheld the Tax Court's summary judgment in favor of the IRS and against the taxpayer.

Dissenting opinion of Judge Walker. In a dissenting opinion, Judge Walker indicated that he would remand the case to the Tax Court for further proceedings because he believed that the taxpayer's statute-of-limitations argument "has some merit." Judge Walker wrote: "Rather than deciding, as the majority does, that no return can ever trigger § 6501(a)'s statute of limitations in a tax-shelter-promotion case, I would let the Tax Court determine, on a case-by-case basis, whether a tax return has triggered the limitations clock."

6. The common-law mailbox rule has been displaced by regulations, says the Fourth Circuit, but the taxpayer nevertheless plausibly alleged that his claim for refund was physically delivered to the IRS. Pond v. United States, 69 F.4th 155 (4th Cir. 5/26/23). The IRS audited the taxpayer's 2012 return. The audit revealed that the taxpayer was entitled to a refund but the IRS mistakenly sent the taxpayer a letter stating that he owed additional tax and interest, which he paid. After the taxpayer's accountant discovered the error, the taxpayer mailed a claim for refund for 2012 and, in the same envelope, mailed an amended return for 2013 claiming a refund for 2013 as a result of certain adjustments to his 2012 return. The taxpayer mailed the envelope containing the claims for refund for 2012 and 2013 by first class mail. After a great deal of effort on the taxpayer's part, the IRS issued the refund for 2012. But the IRS took the position that it had never received the taxpayer's claim for refund for 2013. The taxpayer brought this action for a refund in the U.S. District Court. Under § 7422(a), the jurisdiction of both U.S. District Courts and the U.S. Court of Federal Claims to hear tax refund actions is limited to those cases in which the taxpayer has "duly filed" a claim for refund with the IRS. The issue in this case was how the taxpayer could prove that he had filed the necessary timely refund claim for 2013.

The taxpayer argued that he could rely on the so-called common-law mailbox rule developed and applied by some courts. Under the narrow version of this rule, if a taxpayer can show that a document was actually delivered, but can't prove precisely when delivery occurred, a court can presume that physical delivery occurred within the ordinary time after mailing. Under a broader version of this rule adopted by some courts, proof of proper mailing (including by testimonial or circumstantial evidence) gives rise to a rebuttable presumption that the document was physically delivered to the addressee in the time the mailing would ordinarily take to arrive. In other words, the narrow version requires the taxpayer to prove delivery and assists the taxpayer only in establishing the time of delivery. The broader version of the rule requires the taxpayer only to prove timely mailing and, if timely mailing occurred, gives rise to a rebuttable presumption that the document was delivered.

The government moved to dismiss the taxpayer's refund action for lack of jurisdiction and argued that the common-law mailbox rule, the court held, has been displaced by § 7502. Under § 7502(a) (which reflects the narrower version of the common-law mailbox rule), the postmark stamped on the cover in which a return or claim is mailed is deemed to be the date of delivery if the return or claim (1) is deposited in the mail in the United States within the time prescribed for filing in a properly addressed, postage prepaid envelope or other appropriate wrapper and bears a postmark date that falls within the time prescribed for filing, and (2) is delivered by United States mail after the prescribed time for filing to the agency with which it is required to be filed. In § 7502(c)(1), the statute also reflects the broader version of the common law mailbox rule and provides that, if the return or claim is mailed by United States registered mail, the date of registration is treated as

the postmark date and the registration is prima facie evidence that the return or claim was delivered to the agency to which it was addressed. Section 7502(c)(2) authorizes the Secretary of the Treasury to issue regulations providing the same treatment of returns or claims sent by certified mail, which Treasury and the IRS have done. *See* Reg. § 301.7502-1(c)(2). Section 301.7502-1(e)(2)(i) of the regulations further provides that, except for direct proof of actual delivery, proof of proper use of registered or certified mail (or a designated private delivery service) is the *exclusive means* to establish prima facie evidence of delivery and that "[n]o other evidence of a postmark or of mailing will be prima facie evidence of delivery or raise a presumption that the document was delivered."

The Fourth Circuit agreed with the IRS that the common-law mailbox rule has been displaced by § 7502. Because the taxpayer had not sent his claims for refund by registered or certified mail, he could not rely on the presumption of delivery provided by § 7502(c). In reaching this conclusion, the court did *not* give deference to Reg. § 301.7502-1(e)(2)(i) under the two-step analysis of *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). The court concluded that the statute was not ambiguous on this question (*Chevron* step one) and that giving deference to the regulation was therefore unnecessary.

According to the Fourth Circuit, however, this did not end the inquiry:

> Is Pond out of luck just because he cannot rely on a *presumption* of delivery? No. He can still proceed if he has plausibly alleged that his claim was physically delivered to the IRS.

The court concluded that the taxpayer had plausibly alleged that his claim was physically delivered to the IRS and had supported his claim with three factual allegations. The taxpayer had alleged: (1) that the envelope containing the 2013 claim was postmarked on a specific date, which suggests that the document made it to its destination; (2)that his 2012 and 2013 claims were sent in a single envelope, and the IRS paid his 2012 claim; and (3) that the letter he received from the IRS denying his 2013 claim listed the "date of claims received" as a specific date.

Therefore, according to the Fourth Circuit, the District Court, in ruling on the government's motion to dismiss, should have drawn all reasonable inferences in the light most favorable to the taxpayer. The District Court had not done so and therefore erred in granting the government's motion. The court remanded for further proceedings.

- *Use separate envelopes, and for God's sake, use registered or certified mail when a deadline is approaching!* This decision provides two valuable lessons to those filing documents with the IRS when a deadline is approaching. First, although it might be easier to send multiple filings in a single envelope, doing so runs the risk that the IRS will perceive the envelope as containing only one item. It is much better practice to mail one item per envelope. Second, if a deadline is approaching, it is imperative to send the document to the IRS using registered or certified mail. Doing so will provide prima facie evidence of mailing and will give rise to a statutory presumption that the document was delivered.

7. Better mind the clock too! A petition e-filed *eleven seconds* after midnight is late, so the Tax Court lacks jurisdiction to hear the case. Sanders v. Commissioner, 160 T.C. No. 16 (6/20/23). The 90-day deadline under § 6213 for this pro se taxpayer to file a petition in the Tax Court was midnight on December 12, 2022. The Tax Court's DAWSON e-filing system was available and fully operational at all relevant times on December 12, 2022, during which the taxpayer sought to e-file his petition. The taxpayer initially attempted to use his mobile telephone to e-file his petition on the evening of December 12, 2022; however, the taxpayer encountered technological problems using his mobile telephone. Next, after gaining access to a computer shortly before midnight, the taxpayer logged into the Tax Court's DAWSON e-filing system at 11:57 p.m. on December 12, 2022, and began the e-filing process. Several steps must be completed under the DAWSON system to e-file, and the taxpayer did not complete those steps prior to midnight. In fact, due to no fault of the DAWSON system, the upload process for the taxpayer's

e-filed petition did not begin until 12:00:09 am on December 13, 2022, and the petition was not electronically received by the Tax Court until 12:00:11 am on December 13, 2022, eleven seconds late. Because the taxpayer's petition was filed eleven seconds late, the IRS filed a motion to dismiss for lack of subject matter jurisdiction. The taxpayer objected, arguing that the Tax Court should treat his petition as timely filed when the taxpayer logged into the DAWSON system at 11:57 pm and began the filing process. Essentially, the taxpayer argued that logging into the DAWSON e-filing system at 11:57 p.m. on December 12, 2022, to meet the 90-day deadline under § 6213 was equivalent to timely mailing a petition prior to midnight on December 12, 2022, under the special mailbox rule of § 7502. The Center for Taxpayer Rights, represented by the Tax Clinic at the Legal Services Center of Harvard Law School, filed an amicus brief supporting the taxpayer's position. The Tax Court (Judge Buch) nonetheless ruled that e-filing a petition to meet the 90-day deadline under § 6213 is not equivalent to mailing a petition under § 7502 prior to the 90-day deadline. Judge Buch reasoned that the mailbox rule of § 7502 is a limited exception to the general rule that a Tax Court petition is not filed until it is received, citing *Nutt v. Commissioner*, 160 T.C. No. 10 (5/2/23), discussed above in this outline. Furthermore, Judge Buch determined that another special rule under § 7451(b) that tolls the deadline for filing a Tax Court petition when "a filing location is inaccessible or otherwise unavailable to the general public" did not apply because the DAWSON system was functioning normally at all relevant times on December 12, 2022. According to Judge Buch, the courts have consistently held that "inaccessibility" under § 7451(b) does not extend to "user error or technical difficulties on the user's side." Finally, Judge Buch noted that equitable tolling does not apply to the filing of a Tax Court petition in a deficiency case. The filing deadline under § 6213 is jurisdictional, and the Tax Court must enforce it "regardless of equitable considerations."

F. Liens and Collections

G. Innocent Spouse

1. Better clean up those social media posts featuring sailboats or ski vacations before filing a petition in the Tax Court seeking innocent spouse relief. Such posts are "newly discovered evidence" within the meaning of § 6015(e)(7) and therefore admissible even if they existed before the taxpayer requested innocent spouse relief. Thomas v. Commissioner, 160 T.C. No. 4 (2/13/23). The Taxpayer First Act, Pub. L. No. 116-25, § 1203, enacted in 2019, amended Code § 6015 to clarify the scope and standard of review in the Tax Court of any determination with respect to a claim for innocent spouse relief, i.e., any claim for relief under § 6015 from joint and several liability for tax liability arising from a joint return. Among other changes, the legislation added § 6015(e)(7), which provides:

> Any review of a determination made under this section shall be reviewed de novo by the Tax Court and shall be based upon—
>
> A. the administrative record established at the time of the determination, and
>
> B. any additional newly discovered or previously unavailable evidence.

The amendment was generally consistent with the Tax Court's holding in *Porter v. Commissioner*, 132 T.C. 203 (2009), but resolved conflicting decisions in cases in which the taxpayer sought equitable innocent spouse relief under § 6015(f), some of which had held that the Tax Court's review was limited to the administrative record and that the Tax Court's standard of review was for abuse of discretion.

Procedural history. In this case, the taxpayer filed joint returns with her husband for the years 2012, 2013, and 2014 but some of the tax liability reported on those returns remained unpaid. Her husband died in 2016. The taxpayer submitted to the IRS a request for innocent spouse relief for those years, which the IRS denied. The taxpayer responded by filing a petition in the Tax Court seeking review pursuant to § 6015(e) and asking the court to determine that she was entitled to innocent spouse relief under § 6015(f). At trial, the IRS sought to introduce into evidence Exhibit 13-R, which consisted of a series of blog posts from the taxpayer's personal blog. These posts

ranged in date from November 2, 2016, to January 5, 2022. The taxpayer moved to strike all blog posts that existed before September 8, 2020, the date on which the taxpayer submitted her administrative request for innocent spouse relief, on the ground that the posts had not been in the administrative record and were not "newly discovered evidence" within the meaning of § 6015(e)(7).

Tax Court's analysis. In a unanimous, reviewed opinion by Judge Toro, the Tax Court concluded that the blog posts were "newly discovered evidence" within the meaning of § 6015(e)(7). The court began with the language of the statute and concluded that § 6015 does not define the term "newly discovered evidence." Accordingly, the court reasoned, "[w]e must therefore discern the ordinary meaning of that phrase in 2019." The court turned to the dictionary definition of the phrase "*newly discovered*" and concluded that the ordinary meaning of the phrase as of 2019 "was 'recently obtained sight or knowledge of for the first time.'" The court concluded that the blog posts the IRS sought to introduce into evidence were "newly discovered evidence" because the IRS had first discovered them by searching the internet after the taxpayer had filed her petition in the Tax Court. In reaching this conclusion, the court rejected the taxpayer's argument that § 6015(e)(7)(B) should be read to incorporate an additional limitation similar to that in Federal Rule of Civil Procedure (FRCP) 60(b)(2). Rule 60(b)(2) provides that a court can relieve a party from a final judgement, order, or proceeding on the basis of "newly discovered evidence *that, with reasonable diligence, could not have been discovered in time to move for a new trial.*" (emphasis added). The taxpayer argued that the IRS could have discovered the blog posts that existed before September 8, 2020, once she had submitted her administrative request for innocent spouse relief on that date and that they therefore should not be considered "newly discovered evidence." The court rejected this argument. The court reasoned that Congress had not included a reasonable diligence standard in the language of § 6015(e)(7)(B) and, in fact, the statute's use of the phrase "*any* additional newly discovered evidence" counseled against reading such a limitation into the statute. The court also observed that the statute's specification that the Tax Court's standard of review of an IRS determination concerning innocent spouse relief is de novo (rather than an abuse-of-discretion standard) supported "the conclusion that evidence unknown to a participant in the innocent spouse administrative proceeding should be admissible if that participant (now a party in our Court) offers it in the proceedings before us." Finally, the court noted that § 6015(e)(7) applies in a context entirely different from that of FRCP 60(b)(2). When a party moves for relief from a judgment under FRCP 60(b)(2), both parties have had an opportunity to conduct discovery and introduce evidence at trial. In contrast, "in the context of section 6015(e)(7), the Court considers a case for the first time following a relatively limited administrative proceeding." Accordingly, the court concluded that the blog posts offered into evidence by the IRS were admissible.

- *Concurring opinion of Judge Buch*. In a concurring opinion joined by Judges Ashford and Copeland, Judge Buch emphasized that, although the court's holding was faithful to the language of § 6015(e)(7), that language "may not have captured what Congress intended." Specifically, Judge Buch reasoned that the statute's language permitting the introduction of "newly discovered or previously unavailable evidence" might be a one-way street that benefits only the government. Judge Buch gave an example of a spouse who is abused by her husband, posts about the abuse on social media, and submits an administrative request for innocent spouse relief that does not mention the social media posts. Such a spouse might be precluded from introducing the social media posts at trial in a subsequent Tax Court proceeding because she created the posts and therefore it might be difficult for her to establish that the posts were "newly discovered or previously unavailable" to her. This problem, he observed, is not limited to social media posts but could apply to "a vast array of evidence" that could be helpful to a requesting spouse to prove entitlement to innocent spouse relief.

H. Miscellaneous

1. The Tenth Circuit stirs the previously muddied water on whether a late-filed return is a "return" that will permit tax debt to be discharged in bankruptcy proceedings. In re Mallo, 774 F.3d 1313 (10th Cir. 12/29/14), *cert denied*, 135 S. Ct. 2889

(6/29/15). In an opinion by Judge McHugh, the Tenth Circuit held, with respect to taxpayers in two consolidated appeals, that a late return filed after the IRS had assessed tax for the year in question was not a "return" within the meaning of 11 U.S.C. § 523(a) and, consequently, the taxpayers' federal tax liabilities were not dischargeable in bankruptcy. The facts in each appeal were substantially the same. The taxpayers failed to file returns for the years 2000 and 2001. The IRS issued notices of deficiency, which the taxpayers did not challenge, and assessed tax for those years. The taxpayers subsequently filed returns, based on which the IRS partially abated the tax liabilities. The taxpayers then received general discharge orders in chapter 7 bankruptcy proceedings and filed adversary proceedings against the IRS seeking a determination that their income tax liabilities for 2000 and 2001 had been discharged. Section 523(a)(1) of the Bankruptcy Code excludes from discharge any debt for a tax or customs duty:

> (B) with respect to which a return, or equivalent report or notice, if required—
>
> (i) was not filed or given; or
>
> (ii) was filed or given after the date on which such return, report, or notice was last due, under applicable law or under any extension, and after two years before the date of filing of the petition;

An unnumbered paragraph at the end of Bankruptcy Code § 523(a), added by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, provides that, for purposes of § 523(a):

> the term 'return' means a return that satisfies the requirements of applicable nonbankruptcy law (including applicable filing requirements). Such term includes a return prepared under section 6020(a) of the Internal Revenue Code … but does not include a return made pursuant to section 6020(b) of the Internal Revenue Code ….

The court examined a line of conflicting cases in which the courts had applied a four-factor test, commonly known as the *Beard* test (*Beard v. Commissioner*, 793 F.2d 139 (6th Cir. 1986)), to determine whether a late-filed return constitutes a "return" for purposes of 11 U.S.C. § 523(a) and concluded that it did not need to resolve that issue. Instead, the court concluded that, unless it is prepared by the IRS with the assistance of the taxpayer under § 6020(a), a late return is not a "return" because it does not satisfy "the requirements of applicable nonbankruptcy law (including applicable filing requirements)" within the meaning of the language added to the statute in 2005.

- In reaching its conclusion, the Tenth Circuit agreed with the analysis of the Fifth Circuit in *In re McCoy*, 666 F.3d 924 (5th Cir. 2012), in which the Fifth Circuit concluded that a late-filed Mississippi state tax return was not a "return" within the meaning of 11 U.S.C. § 523(a).

- The Tenth Circuit's interpretation of 11 U.S.C. § 523(a) is contrary to the IRS's interpretation, which the IRS made clear to the court during the appeal. The IRS's interpretation, reflected in Chief Counsel Notice CC-2010-016 (9/2/10), is that "section 523(a) does not provide that every tax for which a return was filed late is nondischargeable." However, according to the Chief Counsel Notice, a debt for tax assessed before the late return is filed (as in the situations before the Tenth Circuit in *In re Mallo*) "is not dischargeable because a debt assessed prior to the filing of a Form 1040 is a debt for which is return was not 'filed' within the meaning of section 523(a)(1)(B)(i)."

a. The First Circuit aligns itself with the Fifth and Tenth Circuits and applies the same analysis to a late-filed Massachusetts state income tax return. In re Fahey, 779 F.3d 1 (1st Cir. 2/18/15). In an opinion by Judge Kayatta, the First Circuit aligned itself with the Fifth and Tenth Circuits and concluded that a late-filed Massachusetts state income tax return was not a "return" within the meaning of 11 U.S.C. § 523(a). In a lengthy dissenting opinion, Judge Thompson argued that the majority's conclusion was inconsistent with both the language of and policy underlying the statute: "The majority, ignoring blatant textual ambiguities and judicial

precedent, instead opts to create a per se restriction that is contrary to the goal of our bankruptcy system to provide, as the former President put it in 2005, 'fairness and compassion' to 'those who need it most.'"

b. A Bankruptcy Appellate Panel in the Ninth Circuit disagrees with the First, Fifth, and Tenth Circuits. The Ninth Circuit now might have an opportunity to weigh in. In re Martin, 542 B.R. 479 (B.A.P. 9th Cir. 12/17/15). In an opinion by Judge Kurtz, a Bankruptcy Appellate Panel in the Ninth Circuit disagreed with what it called the "literal construction" by the First, Fifth, and Ninth Circuits of the definition of the term "return" in Bankruptcy Code § 523(a). The court emphasized that the meaning of the language in the unnumbered paragraph at the end of Bankruptcy Code § 523(a), added by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, which provides that "the term 'return' means a return that satisfies the requirements of applicable nonbankruptcy law (including applicable filing requirements)," must be determined by taking into account the context of the surrounding words and also the context of the larger statutory scheme. Taking this context into account, the court reasoned, leads to the conclusion that the statutory language does not dictate that a late-filed return automatically renders the taxpayer's income tax liability non-dischargeable. "Why Congress would want to treat a taxpayer who files a tax return a month or a week or even a day late—possibly for reasons beyond his or her control—so much more harshly than a taxpayer who never files a tax return on his or her own behalf [and instead relies on the IRS to prepare it pursuant to § 6020(a)] is a mystery that literal construction adherents never adequately explain." The court also rejected the IRS's interpretation, reflected in Chief Counsel Notice CC-2010-016 (9/2/10) that, although not every tax for which a return is filed late is nondischargeable, a debt for tax assessed before the late return is filed (as in the situation before the court) is not dischargeable because the tax debt is established by the assessment and therefore arises before the return was filed. Instead, the court concluded that binding Ninth Circuit authority predating the 2005 amendments to Bankruptcy Code § 523(a) requires applying the four-factor *Beard* test (*Beard v. Commissioner*, 82 T.C. 766 (1984), *aff'd*, 793 F.2d 139 (6th Cir. 1986)) to determine whether a late-filed return constitutes a "return" for purposes of 11 U.S.C. § 523(a). The court concluded that the Bankruptcy Court, which had held that the taxpayers' late-filed returns were "returns" within the meaning of the statute, had relied on a version of the *Beard* test that did not reflect the correct legal standard. Accordingly, the court remanded to the Bankruptcy Court for further consideration.

c. The Eleventh Circuit declines to decide whether a late-filed return always renders a tax debt nondischargeable in bankruptcy. In re Justice, 817 F.3d 738 (11th Cir. 3/30/16). In an opinion by Judge Anderson, the Eleventh Circuit declined to adopt what it called the "one-day-late" rule embraced by the First, Fifth, and Tenth Circuits because it concluded that doing so was unnecessary to reach the conclusion that the taxpayer's federal income tax liability was nondischargeable in bankruptcy. The taxpayer filed his federal income tax returns for four tax years after the IRS had assessed tax for those years and between three and six years late. The court concluded that it need not adopt the approach of the First, Fifth and Tenth Circuits because, even if a late-filed return can sometimes qualify as a return for purposes of Bankruptcy Code § 523(a), a return must satisfy the four-factor *Beard* test (*Beard v. Commissioner*, 82 T.C. 766 (1984), *aff'd*, 793 F.2d 139 (6th Cir. 1986)) in order to constitute a return for this purpose, and the taxpayer's returns failed to satisfy this test. One of the four factors of the *Beard* test is that there must be an honest and reasonable attempt to satisfy the requirements of the tax law. The Eleventh Circuit joined the majority of the other circuits in concluding that delinquency in filing a tax return is relevant to whether the taxpayer made such an honest and reasonable attempt. "Failure to file a timely return, at least without a legitimate excuse or explanation, evinces the lack of a reasonable effort to comply with the law." The taxpayer in this case, the court stated, filed his returns many years late, did so only after the IRS had issued notices of deficiency and assessed his tax liability, and offered no justification for his late filing. Accordingly, the court held, he had not filed a "return" for purposes of Bankruptcy Code § 523(a) and his tax debt was therefore nondischargeable.

d. The Ninth Circuit holds that a taxpayer's tax debt cannot be discharged in bankruptcy without weighing in on the issue whether a late-filed return always renders a tax debt nondischargeable. In re Smith, 828 F.3d 1094 (9th Cir. 7/13/16). In an opinion by Judge Christen, the Ninth Circuit held that the tax liability of the taxpayer, who filed his federal income tax return seven years after it was due and three years after the IRS had assessed the tax, was not dischargeable in bankruptcy. The government did not assert the "one-day-late" rule embraced by the First, Fifth, and Tenth Circuits. Accordingly, the Ninth Circuit looked to its prior decision in *In re Hatton*, 220 F.3d 1057 (9th Cir. 2000), issued prior to the 2005 amendments to the Bankruptcy Code on which the First, Fifth, and Tenth Circuits relied. In *In re Hatton*, the Ninth Circuit had adopted the four-factor *Beard* test (*Beard v. Commissioner*, 82 T.C. 766 (1984), *aff'd*, 793 F.2d 139 (6th Cir. 1986)) to determine whether the taxpayer had filed a "return" for purposes of Bankruptcy Code § 523(a). The fourth factor of the *Beard* test is that there must be an honest and reasonable attempt to satisfy the requirements of the tax law. The Ninth Circuit concluded that the taxpayer had not made such an attempt:

> Here, Smith failed to make a tax filing until seven years after his return was due and three years after the IRS went to the trouble of calculating a deficiency and issuing an assessment. Under these circumstances, Smith's "belated acceptance of responsibility" was not a reasonable attempt to comply with the tax code.

The court noted that other circuits similarly had held that post-assessment filings of returns were not honest and reasonable attempts to satisfy the requirements of the tax law, but refrained from deciding whether any post-assessment filing could be treated as such an honest and reasonable attempt.

e. The Third Circuit also declines to consider whether a late-filed return always renders a tax debt nondischargeable and instead applies the *Beard* test. Giacchi v. United States, 856 F.3d 244 (3d Cir. 5/5/17). In an opinion by Judge Roth, the Third Circuit held that the tax liability of the taxpayer, who filed his federal income tax returns for 2000, 2001, and 2002 after the IRS had assessed tax for those years, was not dischargeable in bankruptcy. The court declined to consider whether the "one-day-late" rule embraced by the First, Fifth, and Tenth Circuits is correct. Instead, the court applied the four-factor *Beard* test (*Beard v. Commissioner*, 82 T.C. 766 (1984), *aff'd*, 793 F.2d 139 (6th Cir. 1986)) to determine whether the taxpayer had filed a "return" for purposes of Bankruptcy Code § 523(a). The fourth factor of the *Beard* test is that there must be an honest and reasonable attempt to satisfy the requirements of the tax law. The court stated:

> Forms filed after their due dates and after an IRS assessment rarely, if ever, qualify as an honest or reasonable attempt to satisfy the tax law. This is because the purpose of a tax return is for the taxpayer to provide information to the government regarding the amount of tax due. … Once the IRS assesses the taxpayer's liability, a subsequent filing can no longer serve the tax return's purpose, and thus could not be an honest and reasonable attempt to comply with the tax law.

f. The Eleventh Circuit has rejected the one-day late approach to determining whether a late-filed return renders a tax debt nondischargeable in bankruptcy. In re Shek, 947 F.3d 770 (11th Cir. 1/23/20). In a very thorough opinion by Judge Anderson, the Eleventh Circuit has held that a tax debt reflected on a late-filed Massachusetts tax return was discharged in bankruptcy. In reaching this conclusion, the court rejected the "one-day-late" rule embraced by the First, Fifth, and Tenth Circuits. The taxpayer filed his 2008 Massachusetts income tax return seven months late. The return reflected a tax liability of $11,489. Six years later, he filed for chapter 7 bankruptcy in Florida and received an order of discharge in January 2016. When the Massachusetts Department of Revenue subsequently sought to collect the tax debt, the taxpayer filed a motion to reopen his bankruptcy case to determine whether his tax debt had been discharged. The Bankruptcy Court held that his tax debt had been discharged. In affirming this conclusion, the Eleventh Circuit focused on the definition of the term "return" in § 523(a) of the

Bankruptcy Code, added by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, which provides that, for purposes of § 523(a):

> the term 'return' means a return that satisfies the requirements of applicable nonbankruptcy law (including applicable filing requirements). Such term includes a return prepared under section 6020(a) of the Internal Revenue Code … but does not include a return made pursuant to section 6020(b) of the Internal Revenue Code ….

The court emphasized that canons of statutory construction dictate the need to give effect to every word of a statute when possible and that the term "applicable filing requirements" must mean something different than all filing requirements. Further, the court reasoned, adopting the "one-day-late" approach and holding that the tax liability reflected on every late-filed return is not dischargeable would render a near nullity the language of § 523(a)(1)(B)(ii) of the Bankruptcy Code, which contemplates that the tax liability on a late-filed return can be discharged as long as the late return is not filed within the two-year period preceding the filing of the bankruptcy petition. The court also rejected the Department of Revenue's argument that the taxpayer's return did not constitute a return under Massachusetts law (which the court viewed as included among "the requirements of applicable nonbankruptcy law"). After rejecting the one-day late approach, the court held that the taxpayer's return was a "return" whether the relevant test is the four-factor *Beard* test (*Beard v. Commissioner*, 82 T.C. 766 (1984), *aff'd*, 793 F.2d 139 (6th Cir. 1986)) or instead the definition of a return under Massachusetts law. Accordingly, the court held, the taxpayer's tax liability had been discharged.

g. The First Circuit has applied the *Beard* test to conclude that a taxpayer's late-fled return was not a "return" and therefore the taxpayer's tax debt was not discharged in bankruptcy. Kriss v. United States, 53 F.4th 726 (1st Cir. 11/22/22). The taxpayer filed his federal income tax returns for 1997 and 2000 in 2007. In 2012, the taxpayer filed a petition in bankruptcy. After receiving a general discharge of his debts in bankruptcy, the issue arose whether the taxpayer's federal tax liability for 1997 and 2000 had been discharged. In an opinion by Judge Kayatta, the First Circuit held that the tax liability of the taxpayer, whose returns for 1997 and 2000 were filed after the IRS had assessed tax for those years, was not dischargeable in bankruptcy. The court declined to decide whether its prior decision in *In re Fahey*, 779 F.3d 1 (1st Cir. 2/18/15), was controlling. In *In re Fahey*, the court adopted the "one-day late" approach and held that a late-filed Massachusetts state income tax return was not a "return" for purposes of Bankruptcy Code § 523(a). Instead, the court applied the four-factor *Beard* test (*Beard v. Commissioner*, 82 T.C. 766 (1984), *aff'd*, 793 F.2d 139 (6th Cir. 1986)) to determine whether the taxpayer had filed a "return" for purposes of Bankruptcy Code § 523(a). The fourth factor of the *Beard* test is that there must be an honest and reasonable attempt to satisfy the requirements of the tax law. The court stated:

> Under the subjective version of the *Beard* test, Kriss's alleged facts, even viewed most favorably to him, fall well short of plausibly qualifying as descriptions of a reasonable effort to file timely returns. Kriss's only excuse for his very belated filings is that his wife falsely assured him that she had filed the returns for him. But the United States tells us that Kriss and his wife were filing separate returns -- an assertion that Kriss does not challenge. Kriss also makes no allegation explaining why he did not respond to notices sent by the IRS inquiring about the status of his unfiled returns. He does not even allege that he ever signed any returns for 1997 or 2000 until 2007. Therefore, applying the Beard test that Kriss urged the bankruptcy court to adopt, he never filed "returns" for the tax years relevant here.

2. In Notice 2007-83, the IRS concluded that certain trust arrangements involving cash-value life insurance policies are listed transactions. According to the Sixth Circuit, the IRS failed to comply with the Administrative Procedure Act in issuing Notice 2007-83 and the notice therefore is invalid. Mann Construction, Inc. v. United States, 27 F.4th 1138 (6th Cir. 3/3/22). In an opinion by Chief Judge Sutton, the U.S. Court of Appeals for the Sixth Circuit has held that the IRS failed to comply with the Administrative Procedure Act (APA) in issuing Notice 2007-83, 2007-2 C.B. 960, and that the notice therefore is invalid.

Notice 2007-83. In Notice 2007-83, the IRS examined certain trust arrangements being promoted to business owners. In these arrangements, a taxable or tax-exempt trust is established to provide certain benefits, such as death benefits, to owners of the business and to employees. The business makes contributions to the trust, which the trustees use to purchase cash-value life insurance policies on the lives of the owners and term insurance on the lives of non-owner employees. The arrangements are structured so that, upon termination of the plan, the owners of the business receive all or a substantial portion of the assets of the trust. According to the notice, those promoting the arrangements take the position that the business can deduct contributions to the trust and that the owners have no income as a result of the contributions or the benefits provided by the trust. The notice identifies these transactions as listed transactions that must be disclosed to the IRS. Accordingly, those who fail to disclose these transactions are subject to significant penalties pursuant to § 6707A.

Facts of this case. In this case, from 2013 to 2017, a corporation, Mann Construction, Inc., established an employee-benefit trust that paid the premiums on a cash-value life insurance policy benefitting the corporation's two shareholders. The corporation deducted these payments and the shareholders reported as income part of the insurance policy's value. Neither the individuals nor the company reported this arrangement to the IRS as a listed transaction. In 2019, the IRS concluded that this transaction fell within Notice 2007-83 and imposed a $10,000 penalty on the corporation and on both of its shareholders ($8,642 and $7,794) for failing to disclose their participation in the transaction. The corporation and the shareholders paid the penalties for the 2013 tax year, sought administrative refunds on the ground that the IRS lacked authority to penalize them, and ultimately brought legal action seeking a refund in a U.S. District Court. The District Court upheld the validity of Notice 2007-83 and held in favor of the government.

Sixth Circuit's analysis. The U.S. Court of Appeals for the Sixth Circuit reversed the District Court's holding and concluded that the IRS had failed to comply with the APA in issuing Notice 2007-83. The APA generally prescribes a three-step process for notice-and-comment rulemaking. First, the agency must issue a general notice of proposed rulemaking. Second, assuming notice is required, the agency must consider and respond to significant comments received during the period for public comment. Third, in issuing final rules, the agency must include a concise general statement of the rule's basis and purpose. *See, e.g.*, *Perez v. Mortgage Bankers Ass'n*, 575 U.S. 92, 96 (2015). The IRS did not comply with the first requirement in issuing Notice 2007-83 because it did not issue a notice of proposed rulemaking. The government made two principal arguments as to why it was not required to comply with the APA's notice-and-comment requirements. *First*, the government argued that Notice 2007-83 is an interpretive rule that is not subject to the APA's notice-and-comment procedures rather than a legislative rule that is subject to such procedures. The Sixth Circuit rejected this argument and concluded that Notice 2007-83 is a legislative rule. According to the court, the notice imposes new duties on taxpayers by requiring them to report certain transactions and imposes penalties for failure to do so. The notice also carries out an express delegation of authority from Congress, the court reasoned, because § 6011(a) provides that the Secretary of the Treasury is to determine by regulations when and how taxpayers must file returns and statements and § 6707A(c) delegates to the Secretary of the Treasury the authority to identify which transactions have the potential for tax avoidance or evasion and which transactions are substantially similar to such transactions. Because Notice 2007-83 imposes new duties and penalties on taxpayers and carries out an express delegation of congressional authority, the court concluded, the notice is a legislative rule that is subject to the APA's notice-and-comment

procedures. *Second*, the government argued that, even if Notice 2007-83 is a legislative rule, Congress had exempted it from the APA's notice-and-comment procedures. The Sixth Circuit rejected this argument as well. According to the court, nothing in the language of the relevant statutory provisions or their legislative history indicated a congressional intent to exempt the IRS from the APA's notice-and-comment procedures when the IRS identifies transactions that have the potential for tax avoidance or evasion and substantially similar transactions. Because the IRS was required to comply with the APA's notice-and-comment procedures in issuing Notice 2007-83 and failed to do so, the court concluded, the notice was invalid. Accordingly, the taxpayers are entitled to a refund of the penalties they paid for failing to disclose the transaction.

Broader implications. The effect of the Sixth Circuit's decision is to preclude the IRS from imposing penalties under § 6707A for failing to disclose a transaction that the IRS identifies in a notice issued without complying with the APA's notice-and-comment requirements. Because the IRS normally does not comply with the APA's requirements in issuing notices, the broader implication of the court's decision is that taxpayers, at least those whose appeals will be heard by the Sixth Circuit, can challenge penalties imposed pursuant to similar notices that identify transactions as listed or reportable transactions. These include Notice 2016-66, 2016-47 I.R.B. 745, which identifies certain captive insurance arrangements, referred to as "micro-captive transactions," as transactions of interest for purposes of Reg. § 1.6011-4(b)(6) and §§ 6111 and 6112 of the Code, and Notice 2017-10, 2017-4 I.R.B. 544, which identifies certain syndicated conservation easement transactions entered into after 2009 as listed transactions.

a. ♪♫"Hey, I'm gonna get you too. Another one bites the dust."♫♪ Notice 2017-10 held invalid for violating the APA. Green Valley Investors, LLC v. Commissioner, 159 T.C. No. 5 (11/9/22). Aligning with the Sixth Circuit's reasoning in *Mann Construction, Inc. v. United States*, 27 F.4th 1138 (6th Cir. 3/3/22), the Tax Court, in a reviewed opinion (11-4-2) by Judge Weiler, has held that another IRS notice identifying a transaction as a listed transaction violated the APA and therefore is invalid.

Notice 2017-10. As mentioned immediately above, the IRS announced in Notice 2017-10, 2017-4 I.R.B. 544, that 2010 and later syndicated conservation easements are another type of § 6707A listed transaction. A typical syndicated conservation easement involves a promoter offering prospective investors the possibility of a charitable contribution deduction in exchange for investing in a partnership. The partnership subsequently grants a conservation easement to a qualified charity, allowing the investing partners to claim a charitable contribution deduction under § 170. See Part IX item B.1. of the outline for a discussion of recent syndicated contribution easement cases.

Intended Effect of Notice 2017-10. The intended effect of Notice 2017-10 was to make syndicated conservation easements subject to special disclosure and list-maintenance obligations under §§ 6111 and 6112, as well as associated penalties for failure to comply. Section 6111 requires each "material advisor" (as defined) with respect to a § 6707A listed transaction to file an IRS Form 8918 (Material Advisor Disclosure Statement). Failure to file Form 8918 may result in penalties under § 6707. In addition, § 6112 requires material advisors to maintain lists of persons who were provided advice concerning a § 6707A listed transaction. Section 6662A, which is central to the *Green Valley Investors* case, imposes an accuracy-related penalty on an understatement of taxable income by a taxpayer participating in a § 6707A listed transaction. Furthermore, a taxpayer-participant in a listed transaction must file IRS Form 8886 (Reportable Transaction Disclosure Statement) with the taxpayer's return and also may be subject to penalties under § 6707A for failure to disclose required information. Willful failures to file Form 8886 or Form 8918 can result in criminal sanctions under § 7203 (fines and up to one year in prison).

Green Valley Investors. This consolidated case involves IRS examinations of four different syndicated conservation easement partnerships claiming approximately $90 million in combined charitable contribution deductions for tax years 2014 and 2015. In each of the four cases, the IRS filed motions for summary judgment claiming that certain penalties, including the accuracy-related

penalty under § 6662A, were properly assessed. The IRS argued that § 6662A applies because the syndicated conservation easements at issue are § 6707A listed transactions as described in Notice 2017-10. The taxpayers objected to the IRS's motions for summary judgment and filed cross-motions for summary judgment that § 6662A should not apply based upon two grounds: (i) because Notice 2017-10 was not issued until after the tax years at issue, the IRS cannot impose the § 6662A penalty retroactively, and (ii) the IRS failed to comply with the notice-and-comment rulemaking procedures of the APA when issuing Notice 2017-10. With respect to the taxpayers' argument that Notice 2017-10 and any corresponding penalties could not be assessed retroactively, the Tax Court declined to rule; however, Judge Weiler's opinion was skeptical of the taxpayers' argument, noting that (i) retroactive penalties have been upheld by the Tax Court in prior cases and (ii) Reg. § 1.6011-4(e)(2) imposes a duty on taxpayers to disclose any transaction that subsequently becomes a listed transaction as long as the period of limitations for assessment remains open. With respect to the taxpayers' second argument that the IRS failed to comply with the notice-and-comment rulemaking procedures of the APA when issuing Notice 2017-10, the Tax Court held for the taxpayers, thereby invalidating the notice. The Tax Court rejected the same arguments that the IRS made in *Mann Construction* and largely followed the reasoning of the Sixth Circuit. The court concluded that Notice 2017-10 is a legislative rule because it "creates new substantive reporting obligations for taxpayers and material advisors, including petitioner and the LLCs, the violation of which prompts exposure to financial penalties and sanctions." Because Notice 2017-10 is a legislative rule, the court concluded, it was subject to the APA's notice-and-comment procedures. The IRS had not complied with those procedures in issuing Notice 2017-10, and the notice therefore was invalid.

Concurring opinion of Judge Pugh. Judge Pugh wrote a lengthy concurring opinion joined by Judges Ashford, Copeland, Kerrigan, and Paris—essentially that the notice-and-comment procedures of the APA should not apply because Congress explicitly authorized Treasury and the IRS to identify listed transactions when Congress enacted the statutory scheme surrounding § 6707A—but ultimately agreed with the majority. Judge Pugh believed that the IRS could and should have invoked the "good cause exception" to the notice-and-comment procedures of the APA to issue temporary regulations (instead of merely a notice). Judge Pugh pointed out that the IRS previously had used the "good cause exception" when it issued Notice 2000-44 (Son-of-Boss transactions) followed by temporary regulations. *See* T.D. 9062, 2003-2 C.B. 46.

Dissenting opinions of Judges Gale and Nega. Judges Gale and Nega dissented from the majority's opinion, piggybacking on Judge Pugh's concurring opinion, but concluded that use of the "good cause exception" was unnecessary and that the APA's notice-and-comment procedures should not apply given the clear statutory scheme surrounding § 6707A.

b. ♪♫"I get knocked down, but I get up again. You're never gonna keep me down."♫♪ IRS issues proposed regulations identifying syndicated conservation easements as listed transactions. REG-106134-22, Syndicated Conservation Easements as Listed Transactions, 87 F.R. 75185 (12/8/2022). Perhaps following Judge Pugh's cue in *Green Valley Investors*, Treasury and the IRS have issued proposed regulations identifying syndicated conservation easements as listed transactions for purposes of § 6707A. The proposed regulations will be effective on the date they are published as final regulations in the Federal Register.

3. This bloke working in the Australian Outback reversed course to send Uncle Sam on a tricky § 911(a) foreign earned income exclusion walkabout, but Judge Toro's opinion demonstrates that the Tax Court is not a Kangaroo court. Smith v. Commissioner, 159 T.C. No. 3 (8/25/22). In the highly unusual circumstances of this case, the Tax Court held that a U.S. citizen working in Australia could not avoid U.S. tax by refuting the terms of a § 7121 advance closing agreement with the IRS to claim the benefits of the § 911(a) foreign earned income exclusion. The taxpayer was a U.S. citizen working as an engineer for Raytheon at "Pine Gap," a joint U.S.-Australian defense facility in the Outback. For the years in issue, 2016-2018, the taxpayer had signed a closing agreement with the IRS waiving the taxpayer's right to make an

election under § 911(a). Section 911(a) allows a "qualified individual" (as defined) to elect to exclude "foreign earned income" (as defined) from U.S. gross income. Thus, the taxpayer agreed in advance that his earnings while in Australia would be subject to U.S. federal income taxation (not Australia's income tax). This advance closing agreement arrangement between the taxing authorities of the U.S. and Australia is sanctioned by treaty and has been standard practice with U.S. citizens employed at Pine Gap for quite some time. Here's where things went "down under," so to speak. After filing his original U.S. income tax return on Form 1040 for the years 2016 and 2017 reporting U.S. taxable income and paying tax thereon, the taxpayer filed amended returns for those years claiming the foreign earned income exclusion under § 911(a). The taxpayer also filed an original return for 2018 claiming the exclusion under § 911(a). (Apparently, the enrolled agent advising the taxpayer suggested this course of action, and the opinion states that nineteen other similar cases are before the Tax Court involving the same enrolled agent. No doubt this is why the Tax Court's opinion is so lengthy and thorough.) The IRS then issued refunds to the taxpayer for 2016-2017 and initially accepted the taxpayer's Form 1040 claiming the § 911(a) exclusion for 2018. Not surprisingly, however, the IRS soon caught on to the taxpayer's course reversal, and the IRS issued notices of deficiency for the years 2016-2018. On cross-motions for summary judgment, the IRS argued before the Tax Court to uphold the closing agreement and the deficiency determinations, while the taxpayer made two principal arguments for invalidating the agreement and overturning the deficiency determinations. *First*, the taxpayer argued that the IRS director (the Director, Treaty Administration, in the IRS Large Business and International Division) who signed the closing agreement on behalf of the IRS was not properly delegated authority to sign by the "Secretary" as required by § 7121. *Second*, the taxpayer argued that, even if the IRS director was authorized to sign, the closing agreement should be set aside under § 7121(b) because the IRS committed malfeasance by disclosing confidential taxpayer information under § 6103 and because the IRS misrepresented material facts in the terms of the closing agreement. Section 7121(b) provides that the finality accorded a closing agreement can be avoided only "upon a showing of fraud or malfeasance or misrepresentation of a material fact." The Tax Court (Judge Toro) sided with the IRS and against the taxpayer on both arguments. With respect to the taxpayer's first argument, Judge Toro examined and analyzed the relevant Treasury delegation orders to uphold the IRS director's authority to sign the § 7121 closing agreement with the taxpayer. With respect to the taxpayer's second argument, Judge Toro assumed without deciding that willful disclosure of confidential return information in violation of § 6103 is an act of malfeasance for purposes of § 7121(b). Making that assumption, however, the court concluded that no malfeasance had occurred "'in the making of' the 2016–18 Closing Agreement either because no return information was disclosed in contravention of § 6103 or because any inappropriate disclosure did not affect the making of the agreement." Accordingly, the court found no fraud, malfeasance, misrepresentation, or other circumstances that would invalidate the closing agreement. The court therefore granted in part the government's motion for summary judgment.

4. Surely, it's not constitutional for the government to revoke or refuse to issue an individual's passport just for having a seriously delinquent tax debt? Isn't there some sort of fundamental right to travel? Don't pack your bags just yet. Franklin v. United States, 49 F.4th 429 (5th Cir. 9/15/22). Section 7345, which addresses the revocation or denial of passports for seriously delinquent tax debts, was enacted in 2015 as section 32101(a) of the Fixing America's Surface Transportation Act, Pub. L. 114-94 (Dec. 4, 2015) (FAST Act). It provides that, if the IRS certifies that an individual has a "seriously delinquent tax debt," the Secretary of the Treasury must notify the Secretary of State "for action with respect to denial, revocation, or limitation of a passport." § 7345(a). In general, a seriously delinquent tax debt is an unpaid tax liability in excess of $50,000 for which a lien or levy has been imposed. § 7345(b)(1). A taxpayer who seeks to challenge such a certification may petition the Tax Court or bring an action in a U.S. District Court to determine if the certification was made erroneously. § 7345(e)(1). If the Tax Court or U.S. District Court concludes the certification was either made in error or that the IRS has since reversed its certification, the court may order the Secretary of the Treasury to notify the State Department that the certification was erroneous. § 7345(e)(2).

The IRS assessed $421,766 in penalties for the plaintiff's failure to file accurate tax returns and failure to report a foreign trust of which he was the beneficial owner. The IRS began collection efforts in 2018. These included issuing a notice of federal tax lien and levying on his Social Security benefits. Pursuant to § 7345, the IRS issued a notice of certification of a "seriously delinquent tax debt" and notified the Secretary of State that his passport should be revoked. The State Department then revoked his passport. The plaintiff attempted to eliminate his liability by submitting two separate offers-in-compromise for doubt as to liability, both of which were rejected by the IRS. He then brought an action in the U.S. District Court for the Northern District of Texas. Among other claims, he asserted various claims related to the IRS's alleged failure to obtain supervisory approval of the penalties as required by § 6751(b). He also challenged the constitutionality of the State Department's revocation of his passport and argued that the revocation violated his rights under the Fifth Amendment. The District Court dismissed the plaintiff's claims under § 6751(b) for lack of subject matter jurisdiction and concluded that, although it had subject matter jurisdiction over his constitutional claim, that claim did not have merit because the passport-revocation scheme of the FAST Act was constitutional under a rational-basis review.

Section 6751(b) claims. Section 6751(b)(1) requires that the "initial determination" of the assessment of a penalty be "personally approved (in writing) by the immediate supervisor of the individual making such determination." The Fifth Circuit concluded that the District Court had correctly dismissed the plaintiff's claims for lack of subject matter jurisdiction. Subject to certain exceptions, the full payment rule established by *Flora v. United States*, 362 U.S. 145 (1960), requires that a taxpayer pay the full amount of tax that the IRS seeks to collect and then seek a refund. A federal district court lacks jurisdiction to hear the claims of a taxpayer who seeks a refund of tax but who has not complied with the full-payment rule (or qualified under an exception to it). Further, the Anti-Injunction Act, 26 U.S.C. §7421(a) (AIA), bars lawsuits filed "for the purpose of restraining the assessment or collection of any tax" by the IRS. The Fifth Circuit concluded that each of the plaintiff's claims under § 6751(b) implicitly challenged the validity of the penalties the IRS had assessed and therefore violated the AIA. The court recognized that, in *CIC Services, LLC v. IRS*, 141 S. Ct. 1582 (2021), the U.S. Supreme Court had held that a challenge to a reporting requirement could proceed even if failure to comply with the reporting requirement resulted in penalties. But the Court in *CIC Services*, the Fifth Circuit observed, had reaffirmed that a challenge to the assessment or collection of a tax or penalty is still barred by the AIA. The plaintiff's claims in this case based on the IRS's alleged failure to obtain supervisory approval of the penalties as required by § 6751(b), the court concluded, implicitly challenged the validity of the penalties and were therefore barred by the AIA.

Constitutional claims. The Fifth Circuit also affirmed the District Court's dismissal of the plaintiff's constitutional challenge for failure to state a claim on which relief can be granted. The plaintiff argued that the State Department's revocation of his passport violated his rights under the Due Process Clause of the Fifth Amendment. Specifically, the court concluded that international travel is not a fundamental right that must be reviewed under so-called strict scrutiny. If the court's standard of review were strict scrutiny, then any legislative infringement of a fundamental right must be narrowly tailored to serve a compelling government interest. Instead, the court held, because international travel is not a fundamental right, the constitutionality of § 7345 must be determined under either a rational basis standard of review or under so-called intermediate scrutiny. Under a rational basis standard, the court observed, "the restriction at issue survives as long as it is 'rationally related to a legitimate government interest.'" *Reyes v. N. Tex. Tollway Auth.*, 861 F.3d 558 (5th Cir. 2017); *see also FCC v. Beach Comm'cns, Inc.*, 508 U.S. 307, 313 (1993). Under an intermediate-scrutiny standard, "the challenged restriction 'must serve important governmental objectives and must be substantially related to achievement of those objectives.'" *Craig v. Boren*, 429 U.S. 190 (1976). The Fifth Circuit declined to decide whether the passport-revocation scheme must be judged under rational-basis review or instead intermediate scrutiny because, the court held, even under the higher standard of intermediate scrutiny, the statute is constitutional. The federal government's interest in collecting taxes, the court concluded, "is

undoubtedly an important one." The passport-revocation scheme, the court held, is substantially related to achieving the government's objective:

> The passport-revocation scheme is also clearly connected to that goal: delinquent taxpayers will be well-incentivized to pay the government what it is owed to secure return of their passports, and those same taxpayers will find it much more difficult to squirrel away assets in other countries if they are effectively not allowed to legally leave the country.

a. This taxpayer apparently didn't get the memo about *Franklin* or *Ruesch* (see above and below), but regardless, the Tax Court determines that its jurisdiction under § 7345 is limited to deciding whether the IRS's certification is erroneous and does not extend to hearing substantive challenges to assessed taxes or constitutional claims. Adams v. Commissioner, 160 T.C. No. 1 (1/24/23). The taxpayer in this case owed more than $1.2 million in federal income taxes, penalties, and interest accumulated across eight taxable years. The taxpayer failed to file federal income tax returns for the relevant years, and the IRS prepared substitute returns for each year under § 6020(b). The IRS also filed a notice of federal tax lien for each year under § 6323(f) and had notified the taxpayer of his right to a collection due process (CDP) hearing under § 6320. The taxpayer did not request a CDP hearing for any of the years in issue and the time for doing so had passed. The IRS's subsequent collection efforts against the taxpayer failed, so the IRS issued the certification (via the Treasury Department) under § 7345(a) to the Secretary of State for purposes of denying, revoking, or limiting the taxpayer's passport. Later, the taxpayer apparently lost his passport and applied to the State Department for a replacement. The Secretary of State refused to issue a replacement passport due to the outstanding § 7345 certification of the taxpayer's "seriously delinquent tax debt" and so notified the taxpayer. Thereafter, the taxpayer petitioned the Tax Court, as permitted under § 7345(e)(1), to determine if the IRS's certification was erroneous. The taxpayer made two arguments that the IRS's § 7345 certification was erroneous. The taxpayer's first argument was that he did not have a "seriously delinquent tax debt" because "as a matter of law [the IRS] has failed to prove that any of the taxes [for the relevant years] were *properly assessed*." (Emphasis added.) Giving the *pro se* taxpayer the benefit of the doubt, the Tax Court liberally construed the taxpayer's first argument to raise two alternative positions: (1) that he should be allowed to substantively challenge his tax liabilities underlying the § 7345(a) certification in Tax Court or (2) that § 7345 requires the underlying tax liabilities to be "properly assessed," not merely "assessed," before the IRS certification can be issued. The Tax Court (Judge Toro) held that, as determined in *Ruesch v. Commissioner*, 154 T.C. 289 (6/25/20), *aff'd in part but vacated and remanded in part on other grounds* 25 F.4th 67 (2d Cir. 1/27/22), the Tax Court lacks jurisdiction under § 7345(e)(1) to review the tax liabilities underlying the certification of a "seriously delinquent tax debt." Moreover, Judge Toro noted that plain language of § 7345(e)(1), which allows the taxpayer to petition the Tax Court, only requires that the tax liability be "assessed" by the IRS. Here, the IRS clearly had "assessed" the tax liabilities against the taxpayer. Furthermore, the taxpayer had ample prior opportunity (either via a deficiency proceeding or a collection due process hearing) to substantively challenge the IRS's assessment. The taxpayer's second argument was identical to the taxpayer's argument in *Franklin v. United States*, 49 F.4th 429 (5th Cir. 9/15/22), but again Judge Toro relied upon the plain language of § 7345(e)(1). Judge Toro reasoned that § 7345(e)(1) does not grant the Tax Court jurisdiction to hear constitutional challenges relating to the refusal of the Department of State to issue a passport. Given its limited jurisdiction, the Tax Court does not have authority over the Secretary of State. Only a federal district court potentially has jurisdiction to hear the taxpayer's constitutional arguments against § 7345 and possibly compel the Department of State to issue a passport notwithstanding the IRS certification. Instead, the Tax Court's jurisdiction is limited, as § 7345(e)(1) provides, to correcting an erroneous IRS certification of a "seriously delinquent tax debt." Judge Toro did note, though, that a constitutional challenge to § 7345 was unsuccessful in *Franklin v. United States*, 49 F.4th 429 (5th Cir. 9/15/22).

b. ♪♫"Let's call the whole thing off."♫♪ Yet another Tax Court reviewed decision concerning IRC § 7345. Pugh v. Commissioner, 161 T.C. No. 2 (8/14/23). In this case under § 7345, the taxpayer applied for renewal of her passport after the IRS had certified (via the Treasury Department) to the Secretary of State that she had a "seriously delinquent tax debt." Accordingly, the Department of State declined to renew the taxpayer's passport. Thereafter, the *pro se* taxpayer petitioned the Tax Court under § 7345(e)(1). After clearing some procedural hurdles, the IRS moved for summary judgment against the taxpayer. The taxpayer never responded to the IRS's motion, even after two separate Tax Court orders were issued for her to do so. Eventually, the taxpayer filed a motion to dismiss her case, but failed to indicate whether the requested dismissal was with or without prejudice. The IRS initially objected to the taxpayer's motion to dismiss, but then consented. The Tax Court (Judge Copeland) construed the taxpayer's motion as one to dismiss without prejudice; however, the court then had to determine whether, as a matter of first impression, a taxpayer is permitted to withdraw without prejudice a petition filed under § 7345(e)(1). On the one hand, Judge Copeland noted that, in deficiency proceedings under § 6213, the Tax Court cannot grant taxpayer motions to dismiss without prejudice. *See Estate of Ming v. Commissioner*, 62 T.C. 519 (1974). On the other hand, Judge Copeland reasoned that, where the Tax Court's jurisdiction has been expanded, taxpayer motions to dismiss without prejudice have been allowed. See, e.g., *Wagner v. Commissioner*, 118 T.C. 330 (2002) (collection due process); *Davidson v. Commissioner*, 144 T.C. 273 (2015) (innocent spouse relief); *Jacobson v. Commissioner*, 148 T.C. 68 (2017) (whistleblower claim). Judge Copeland then looked to the Federal Rules of Civil Procedure for further guidance. The Federal Rules of Civil Procedure generally allow courts to grant motions to dismiss without prejudice unless dismissal would inflict "clear legal prejudice" on the non-moving party. Because the IRS consented to the dismissal, Judge Copeland determined that the IRS would not be harmed, and therefore granted the taxpayer's § 7345(e)(1) motion to dismiss without prejudice. Finally, Judge Copeland ruled that the IRS's prior summary judgment motion was moot and should be dismissed as well.

5. Either this taxpayer has the right "moves," the IRS is just too sneaky, or bad facts make bad law. You decide! U.S. v. Meyer, 50 F.4th 23 (11th Cir. 9/26/22). In an opinion by Judge Jordan (and joined by Judges Luck and Lagoa), the U.S. Court of Appeals for the Eleventh Circuit has held that, although the Anti-Injunction Act of 1867 (codified at IRC § 7421(a)) generally forecloses a "suit" against the IRS, it does not prohibit a defensive "motion" for a protective order in an IRS-initiated administrative action to assess penalties against a taxpayer-promoter. The taxpayer in this case, Michael L. Meyer, was sued in 2018 by the U.S. Department of Justice (the "2018 litigation") for promoting bogus charitable deduction tax-evasion schemes. See the linked article in Forbes for more background. After extensive discovery, including admissions by Mr. Meyer regarding his tax-evasion schemes, the 2018 litigation settled and ostensibly was "closed" in 2019 when the U.S. District Court entered a permanent injunction against Mr. Meyer. The injunction prohibited Mr. Meyer from (among other things) ever "representing anyone other than himself before the IRS; preparing federal tax returns for others; or furnishing tax advice regarding charitable contributions." Then, in 2020, the IRS assessed penalties against Mr. Meyer (the "2020 administrative action") under § 6700 (promoting abusive tax shelters). The IRS expressly relied upon the admissions that Mr. Meyer made in the 2018 litigation to support its assessment of penalties under § 6700 in the 2020 administrative action. Mr. Meyer objected, eventually filing a motion for a protective order in the same U.S. District Court that handled the 2018 litigation. Mr. Meyer's motion sought a protective order prohibiting the IRS from using his admissions connected to the 2018 litigation in the 2020 administrative action. The IRS argued in U.S. District Court that Mr. Meyer's motion for a protective order was barred by the Anti-Injunction Act, which, subject to very specific exceptions (e.g., Tax Court petitions under § 6213, jeopardy assessments under § 7429, etc.), prohibits any person from maintaining a "suit for the purpose of restraining the assessment or collection of any tax . . . in any court . . . whether or not such person is the person against whom such tax was assessed." The U.S. District Court held that Mr. Meyer's motion for a protective order was barred by the Anti-Injunction Act because, although a "motion" is not a "suit," granting the motion would have the practical effect of

restraining the IRS's assessment and collection of tax. Mr. Meyer appealed the U.S. District Court's decision to the Eleventh Circuit. Perhaps fatally, the IRS did not argue in the U.S. District Court that the 2018 litigation (which was with the U.S. Department of Justice) was closed and thus the court had no jurisdiction to hear Mr. Meyer's motion vis-à-vis the IRS.

The Eleventh Circuit's Decision. The Eleventh Circuit held that Mr. Meyer's motion was not barred by the Anti-Injunction Act. The Eleventh Circuit reasoned that the term "suit" used in the Anti-Injunction Act was itself specific—based upon the 1867 and 1954 usage of the term—and did not extend to a defensive motion filed in connection with the 2018 litigation. Thus, the Eleventh Circuit seems to have viewed Mr. Meyer's motion as part of his defense to the (*ostensibly closed?*) 2018 litigation initiated by the U.S. Department of Justice, not the IRS's separate 2020 administrative action. The Eleventh Circuit rejected the U.S. District Court's and the IRS's broader reading of the Anti-Injunction Act (which has been adopted by some courts) that entertaining or granting Mr. Meyer's motion for a protective order would have the practical effect of restraining the assessment or collection of tax and therefore should be denied. *See U.S. v. Dema*, 544 F.2d 1373 (7th Cir. 1976) (holding that motion to compel the IRS to withdraw a notice of deficiency was barred by the Anti-Injunction Act). Instead, the Eleventh Circuit reasoned that Mr. Meyer's motion was comparable to cases decided in the Second and Third Circuits. In both those cases, the taxpayer intervened in actions initiated by the IRS against a taxpayer's bank to access the taxpayer's safe deposit box. The Second and Third Circuits held in those cases that intervening in a suit between the IRS and the taxpayer's bank was not barred by the Anti-Injunction Act because the underlying action was not one for the assessment or collection of a tax. *See U.S. v. Mellon Bank*, N.A., 521 F.2d 708 (3d Cir. 1975), and *U.S. v. First National City Bank*, 568 F.2d 853 (2d Cir. 1977). The Eleventh Circuit thus vacated the U.S. District Court's decision and remanded the case for further proceedings consistent with its opinion. The Eleventh Circuit declined to hear the IRS's argument that the U.S. District Court had no jurisdiction to entertain Mr. Meyer's motion because the 2018 litigation was closed, determining that the argument was raised for the first time on appeal and therefore should be heard by the U.S. District Court first.

6. By a five-to-four vote, SCOTUS demonstrates yet again that the FBAR penalty statute is totally FUBAR, but at least we think we know the law until Congress says otherwise: $10,000 max penalty per year for non-willful violations, but the greater of $100,000 or 50 percent of each foreign account for willful violations. Bittner v. United States, 598 U.S. ___, 142 S. Ct. 2833 (6/21/23). The Bank Secrecy Act provides in part that U.S. persons owning an interest in foreign accounts with an aggregate balance of more than $10,000 in deposits must file an annual disclosure report. *See* 31 U.S.C. 5314; 31 C.F.R. § 1010.306 (2021). The annual disclosure is filed on the Financial Crimes Enforcement Network's ("FinCEN") Form 114 — Report of Foreign Bank and Financial Accounts ("FBAR"). Failure to properly file FinCEN Form 114 may result in varying penalties under 31 U.S.C. 5321(a)(5) depending upon whether the failure was willful or non-willful. We have reported below on the numerous cases decided under 31 U.S.C. 5321(a)(5) regarding the controversy surrounding the FBAR penalty for *willful* violations of 31 U.S.C. 5314. Generally, however, the United States Courts of Appeal addressing the issue agree that the FBAR penalty for willful violations is the greater of $100,000 or 50 percent of each offending account. With regard to non-willful FBAR violations, there has been a split between the Ninth and Fifth Circuits. In *United States v. Boyd*, 991 F.3d 1077 (9th Cir. 3/24/2021), the Ninth Circuit held for the taxpayer that the FBAR penalty for non-willful violations of 31 U.S.C. 5314 should be limited to $10,000 per annual filing of FinCen Form 114 regardless of the number of foreign accounts the taxpayer failed to properly report. In *United States v. Bittner*, 19 F.4th 734 (5th Cir. 11/30/2021), the Fifth Circuit disagreed and held for the government that the FBAR penalty for non-willful violations is determined on a per-offending-account basis, similar to the FBAR penalty for willful violations. SCOTUS granted certiorari in *United States v. Bittner*, 19 F.4th 734 (5th Cir. 11/30/2021) to resolve the split between the circuits.

The taxpayer in *Bittner v. United States*, 598 U.S. ___, 142 S. Ct. 2833 (6/21/2023), had 61 foreign bank accounts in 2007, 51 in 2008, 53 in 2009 and 2010, and 54 in 2011. The government

acknowledged that the taxpayer's failure to properly file FinCEN Forms 114 for the numerous accounts held over the five-year period was non-willful. Nevertheless, the government sought to impose an FBAR penalty of $2.72 million on the taxpayer due to the number of offending accounts over the five-year period. Therefore, the question before the U.S. Supreme Court was whether the taxpayer owed $2.72 million in FBAR penalties or only $50,000 ($10,000 per year). Justice Gorsuch wrote the opinion for the majority (Gorsuch, Roberts, Alito, Kavanaugh, and Jackson), holding that the FBAR penalty under 31 U.S.C. 5321(a)(5) should be limited to $10,000 per year for non-willful violations of 31 U.S.C. 5314. Justice Gorsuch reasoned that 31 U.S.C. 5314 "does not speak of accounts or their number," but instead refers to a duty to file annual "reports." Justice Gorsuch was not persuaded by the government's argument that because the penalty for *willful* violations of 31 U.S.C. 5321(a)(5) is determined on a per-offending-account basis, so should the lower penalty for non-willful violations. Instead, applying the *expressio unius est exclusio alterius* maxim of statutory construction (i.e., the use of different terms within a single statute implies a different meaning), Justice Gorsuch concluded that Mr. Bittner's maximum FBAR penalty for non-willfully violating 31 U.S.C. 5314 over five years should be only $50,000 ($10,000 per year). Justice Barret wrote for the dissenters (Barrett, Thomas, Sotomayor, and Kagan), arguing that although *expressio unius est exclusio alterius* is a general rule of statutory interpretation, it gives way where context suggests otherwise. In Justice Barrett's view, the FBAR penalties permitted under 31 U.S.C. 5321(a)(5), whether for willful or non-willful violations, only make sense if they are determined on a per-account basis. Otherwise, dissenting Justice Barrett wrote, the maximum annual penalty that the government may impose for a non-willful violation of 31 U.S.C. 5314 is $10,000 whether the taxpayer has one offending foreign bank account or one hundred such accounts.

7. Misinformation in your W-2 information returns can result in civil liability for damages, especially if you have a puzzling STD—*not what you think*—plan. Doherty v. Turner Broadcasting Systems, Inc., 72 F.4th 324 (D.C. Cir. 6/30/23). The plaintiff in this case, a photojournalist, was an employee of the defendant, Turner Broadcasting Systems, Inc. (TBS) when the plaintiff injured his back in late 2012 loading camera equipment while at work. Thereafter, the plaintiff remained on the TBS's payroll and was paid certain amounts under the defendant's short-term disability ("STD") plan. Puzzlingly, though, TBS's STD plan consisted of two distinct policies. The first policy, J.A. 388, was for "job-related" injuries or illnesses and paid an injured employee a predetermined amount (*or such greater amount as required by applicable workers' compensation law*) over the 26-week period following the injury. After the 26-week period, TBS's workers' compensation insurance carrier funds any payments to an injured or ill employee. The second policy, J.A. 383, was for employees "absent from work due to [their] own medical needs." The predetermined payments to be made to injured or ill employees under either J.A. 388 or J.A. 383 were largely the same, except that J.A. 383 did not provide for increased payments due to workers' compensation law). (The court's opinion does not indicate whether payments under J.A. 383 continued beyond the 26-week period following injury.) TBS apparently considered all disability-related payments made to the plaintiff as falling under its J.A. 383 policy (non-workers' compensation portion of its STD plan), while the plaintiff believed that the disability-related payments he received fell under J.A. 388 (workers' compensation portion of STD plan). The distinction was important because any workers' compensation payments made to the plaintiff would be excludable from gross income under § 104(a)(1); however, employer-funded disability payments to an employee that are not workers' compensation are not excludable from gross income by the employee. TBS apparently believing that the payments to the plaintiff were not workers' compensation payments, reported all amounts paid to the plaintiff during the years in issue as gross income on the Forms W-2 issued to the plaintiff. The plaintiff alerted TBS to the alleged error, but TBS either did not agree with the plaintiff or did not fully appreciate the significance of issuing inaccurate Forms W-2. Subsequently, the plaintiff sued TBS in federal district court under § 7434, which authorizes a private civil action for damages against "any person [who] willfully files a fraudulent information return with respect to payments purported to be made to any other person." Section 7434 applies to information returns listed in § 6724(d)(1)(A),

including Forms W-2, 1099-MISC, 1099-INT, and 1099-DIV among others. The district court had granted TBS's motion for summary judgment, ruling that the Forms W-2 issued to the plaintiff were not fraudulent under any of three theories: (i) that the Forms W-2 filed by the defendant had the accurate gross amount of payments to the plaintiff, even if some portion of the payments should have been designated as excludable from gross income; (ii) that no reasonable jury could conclude that the plaintiff's payments were workers' compensation; or (iii) that the defendant's error was not intentional and thus lacked the specific intent to deceive required for willfulness under § 7434. The U.S. Court of Appeals for the D.C. Circuit reversed and remanded the case for further proceedings, concluding that the District Court had erred under all three of its theories for granting summary judgment to TBS. In an opinion by Judge Wilkins, the D.C. Circuit held (i) that an information return may be false under § 7434 even if the gross amount of the payment is correct; (ii) that the confusion surrounding TBS's STD plan, consisting of a workers' compensation policy (J.A. 388) and non-workers' compensation policy (J.A. 383), could lead a reasonable jury to find that the payments the plaintiff received were workers' compensation; and (iii) that a knowing or reckless action, as opposed to specific intent to deceive, is sufficient to meet the willfulness requirement of § 7434. Of course, because the case was remanded to the federal district court for further proceedings, we do not know if the plaintiff ultimately will prevail in his § 7434 action for damages against the defendant. Nevertheless, the case is instructive regarding the care an employer (or its agent) should take in preparing and filing information returns subject to § 7434.

8. A return was a joint return despite the fact that one spouse did not personally sign it, says the Second Circuit. Soni v. Commissioner, 76 F.4th 49 (2d Cir. 7/27/23), *aff'g Soni v. Commissioner*, T.C. Memo. 2021-37 (12/1/21). The taxpayers in this case were a married couple. The husband, Om, was experienced in business and established several businesses with large accounting and finance departments. His wife, Anjali, took care of the home and relied on her husband to handle all financial and tax matters. According to the opinion of the Tax Court (Judge Copeland), Anjali was reluctant to sign documents because a family member had forged her father's signature to steal money, and she therefore was "leary of signing documents and made it an ordeal to get her signature on any document." Again according to the Tax Court's opinion, she

> chose to not take part in the financial matters of the home, including tax matters. Since the time of their marriage, Anjali has never signed a tax return or asked anyone to sign a tax return for her. She did not pay attention to tax issues.

The 2004 return and proceedings in the Tax Court. The taxpayers' tax returns were prepared by an accounting firm. The returns for the years 1999-2003 and for 2005-2015 were joint returns. For the year in question, 2004, the firm prepared a joint return, which Om signed. Although their son often signed his mother's name on documents, including tax-related documents, the record was unclear as to who signed Anjali's name on the 2004 return. The parties stipulated on appeal, however, that Anjali did not personally sign the 2004 return. On the 2004 return, the taxpayers deducted a loss of over $1.7 million from a subchapter S corporation in which Om held an ownership interest. Following an audit, the IRS disallowed the loss deduction because, according to the IRS, the taxpayers had failed to provide documentation to establish their basis in the S corporation's stock. The IRS issued a notice of deficiency asserting that the taxpayers were jointly and severally liable for additional tax of $642,629 and a late-filing penalty under § 6651(a)(1) of $28,835. The taxpayers filed a petition in the Tax Court, where they argued that the return filed for 2004 was not a valid joint return. In an amended answer, the IRS asserted that the taxpayers also were liable for an accuracy-related penalty under § 6662 of $128,526. The Tax Court concluded that, although Anjali had not personally signed the return, it was nevertheless a valid joint return. Judge Copeland concluded that Anjali had tacitly consented to filing a joint return for 2004 because she had "approved or at least acquiesced in the joint filing of their 2004 return."

Second Circuit's Analysis. In an opinion by Judge Cabranes, the U.S. Court of Appeals for the Second Circuit affirmed the Tax Court's decision. The court relied on its prior decision in *O'Connor v. Commissioner*, 412 F.2d 304 (2d Cir. 1969), in which the court had provided

guidance on the determination of whether a return is a joint return. According to *O'Connor*, a determination that a return is a joint return "is a factual issue of the intention of the parties and must be affirmed unless clearly erroneous." *Id*. at 309. Although normally a presumption of correctness attaches to the IRS's determination that a return is a joint return, that presumption does not apply if one spouse has not signed a purported joint return. *Id*. When one spouse has not signed, the IRS bears the burden of proving that the intent of the parties was to file jointly. *Id*. The court in this case observed that four circumstances present in *O'Connor*, in which the court had concluded that the return was a joint return, were also present here. *First*, the non-signing spouse knew that a return had to be filed because the evidence showed that Anjali was aware that a return had to be filed and simply chose not to engage. *Second,* the non-signing spouse knew of the signing spouse's expert knowledge concerning preparing and filing tax returns because Anjali knew of Om's expert knowledge and relied on him to handle the family's finances, including the filing of tax returns. *Third*, the parties filed a joint petition in the Tax Court. Fourth, the taxpayers asserted only a delayed challenge to the return's characterization as a joint return because they had not disavowed its joint status until trial. The court also noted that the taxpayers had filed joint returns for every other year from 1999 through 2003 and from 2005 through 2014. Accordingly, the court concluded that the Tax Court had not clearly erred in in finding that the taxpayers intended to file a joint return.

Other issues. The taxpayers also argued that the three-year limitations period on assessment of tax provided by § 6501(a) had expired before the IRS issued the notice of deficiency. The notice of deficiency for the year in question, 2004, was issued on March 12, 2015. The IRS received a total of eight consents to extend the limitations period on assessment on Form 872, which ostensibly had been signed by the taxpayers or by their CPA, Mr. Grossman. The taxpayers argued that the consents were invalid for a variety of reasons, such as their contention that they had not signed a power of attorney on Form 2848 authorizing Grossman to act on their behalf and that he had forged Om's signature on the power of attorney, and therefore any consents executed by him on their behalf were invalid. The Second Circuit affirmed the Tax Court's decision that the period of limitations on assessment had not expired before the notice of deficiency was issued. The court affirmed the Tax Court's finding that Om had signed the power of attorney on Form 2848 and its conclusion that both Om and Anjali had authorized Grossman to act on their behalf in consenting to extend the limitations period on assessment. Finally, the court affirmed the IRS's imposition of the late-filing penalty and the accuracy-related penalty because the taxpayers had not established a reasonable cause defense to the penalties.

XI. WITHHOLDING AND EXCISE TAXES

A. Employment Taxes

B. Self-employment Taxes

C. Excise Taxes

XII. TAX LEGISLATION

A. Enacted

1. The Inflation Reduction Act enacts a corporate AMT, imposes a 1 percent excise tax on redemptions of corporate stock by publicly traded corporations, and makes certain other changes. The Inflation Reduction Act, Pub. L. No. 117-169, signed by the President on August 16, 2022, imposes a 15 percent alternative minimum tax (AMT) on corporations with "applicable financial statement income" over $1 billion, imposes an excise tax of 1 percent on redemptions of stock by publicly traded corporations, extends through 2025 certain favorable changes to the premium tax credit of § 36B, and extends through 2028 the § 461(*l*) disallowance of "excess business losses" for noncorporate taxpayers.

2. The SECURE 2.0 Act increases the age at which required minimum distributions must begin, modifies the rules regarding catch-up contributions, and makes

many other significant changes that affect retirement plans. The Consolidated Appropriations Act, 2023, Pub. L. No. 117-328, signed by the President on December 29, 2022, includes the SECURE 2.0 Act of 2022, which increases the age at which required minimum distributions (RMDs) must begin to age 73, reduces the penalty for failure to take RMDs, modifies the rules for catch-up contributions to qualified retirement plans, and makes many other significant changes that affect retirement plans.

XIII. TRUSTS, ESTATES & GIFTS

A. Gross Estate

B. Deductions

C. Gifts

D. Trusts

1. No, you IDGT! You don't get a basis step-up at the grantor's death. Rev. Rul. 2023-2, 2023-16 I.R.B. 658 (3/29/23). A relatively common estate-planning strategy involves the use of a so-called "intentionally defective grantor trust" ("IDGT"). An IDGT exploits the mismatch between subchapter J (income taxation of trusts and estates) of chapter 1 of the IRC and subtitle B (estate and gift taxes) of chapter 11 of the IRC. Through an IDGT, a grantor can make a completed gift of property for estate and gift tax purposes under subtitle B, chapter 11 of the IRC but still be taxed on the income from the property under subchapter J chapter 1 of the IRC. More specifically, Rev. Rul. 2023-2 postulates the following facts:

> In Year 1, A, an individual, established irrevocable trust, T, and funded T with Asset in a transfer that was a completed gift for gift tax purposes. A retained a power over T that causes A to be treated as the owner of T for income tax purposes under subpart E of part I of subchapter J of chapter 1 (subpart E). A did not hold a power over T that would result in the inclusion of T's assets in A's gross estate under the provisions of chapter 11. By the time of A's death in Year 7, the fair market value (FMV) of Asset had appreciated. At A's death, the liabilities of T did not exceed the basis of the assets in T, and neither T nor A held a note on which the other was the obligor.

Normally, of course, when property is acquired from a decedent via a bequest or devise, § 1014(a) allows a step-up in basis equal to the value of the property includable in the decedent's gross estate under chapter 11 of the IRC. *See also* Reg. § 1.1014-1(a). Apparently, some taxpayers have taken the position that property acquired from an IDGT after the grantor's death is entitled to a basis step-up under § 1014(a). Rev. Rul. 2023-2 asserts the contrary, reasoning that the "Asset" (see above) was not acquired or passed from A (the decedent) within the meaning of IRC § 1014(a) as elaborated in subsections (b)(1)-(10). Instead, Rev. Rul. 2023-2 holds that the "Asset" was acquired from the IDGT, which was not includable in A's estate under § 2031 or otherwise under chapter 11. Notably, Rev. Rul. 2023-2 distinguishes an older ruling, Rev. Rul. 84-139, 1984-2 C.B. 168, where a non-citizen, non-resident person devised non-U.S. real property to a U.S. citizen. The non-U.S. real property was not subject to chapter 11 (estate and gift taxation) because it was owned by a non-US person. Nevertheless, Rev. Rul. 84-139 held that the non-U.S. property was "acquired from a decedent" under § 1014(b)(1) and thereby entitled to a basis step-up under § 1014(a).

2. "The gain disappearing act the [taxpayers] attribute to the CRATs is worthy of a Penn and Teller magic show. But it finds no support in the Code, regulations, or caselaw." Distributions from a CRAT were taxable and were ordinary income, says the Tax Court. Gerhardt v. Commissioner, 160 T.C. No. 9 (4/20/23). Four married couples (collectively, the Gerhardts) had their cases consolidated in the Tax Court. In each case, the taxpayers contributed real property with a high value and a low basis to a charitable remainder annuity trust (CRAT). Shortly after contribution, each CRAT sold the real property and used the sale proceeds to purchase a single-premium immediate annuity (SPIA) owned by the CRAT. Pursuant to the

terms of the trust, each CRAT paid to the taxpayers the payments received from the SPIA. The taxpayers took the position that the distributions from the CRAT were not taxable except to the extent of a small amount of interest income earned by the CRAT. For example, one couple contributed real properties with a total adjusted basis of $97,517 to their CRAT and the CRAT sold the properties for approximately $1.7 million. Their CRAT purchased a SPIA that would make five annual payments to the couple of $311,708. The CRAT distributed $311,708 to the couple in 2016 and again in 2017, the years at issue in the Tax Court. The CRAT issued Schedules K-1 to the couple in each year reporting only interest income of $4,052 (2,026 per person). Following an audit, the IRS asserted that the gain the CRAT realized on the sale of the real property was ordinary income pursuant to § 1245. The IRS also asserted that the $311,708 distribution to the couple in each year was fully included in their gross income and was ordinary income. The IRS issued a notice of deficiency to each couple for 2016 and 2017 and each couple filed a petition in the Tax Court.

Backgroud on CRATs. A CRAT is a common estate planning tool. Generally, to establish a CRAT, a grantor transfers cash or property to an irrevocable trust. The terms of the trust provide for specified payments, made at least annually, to the grantors or another noncharitable beneficiary for life or for a specified period of up to twenty years. Whatever remains in the trust is transferred to or held for the benefit of one or more qualified charitable organizations. At the time of the contribution to the CRAT, the grantor is entitled to a charitable contribution deduction equal to the value of the contributed property less the present value of the annuity payments to be received (and limited to the present value of the trust's remainder interest). The grantor does not recognize gain from the transfer of appreciated property to the CRAT. The CRAT takes the same basis in the contiributed property that the grantor had. The CRAT is tax-exempt and does not pay tax on any gain realized from its sale of contributed property. Nevertheless, gain realized by the CRAT on the sale of contributed property must be tracked and affects the tax treatment of distributions from the CRAT. Under § 664(b), distributions from the CRAT to its income beneficiaries are treated as distributed in the following order with the following character:

(1) as ordinary income, to the extent of the CRAT's current and previously undistributed ordinary income;

(2) as capital gain, to the extent of the CRAT's current and previously undistributed capital gain;

(3) as other income, to the extent of the CRAT's current and previously undistributed other income; and

(4) as a nontaxable distribution of trust corpus.

Tax Court's analysis. In the Tax Court, the taxpayers argued that any gain realized by a CRAT on the sale of contributed property effectively disappears and therefore does not make taxable any distributions by the CRAT that are funded with proceeds from the sale. The Tax Court (Judge Toro) rejected this argument. The court noted that it had considered and rejected this argument in *Furrer v. Commissioner*, T.C. Memo. 2022-100, and that the same advisers who advised the taxpayers in this case had been involved in *Furrer*. The court invited the Gerhardts to distinguish *Furrer* but, according to the court's opinion, their briefs failed to mention the case. The court summarized the taxpayers' argument as follows:

> As best we can tell, the Gerhardts maintain that the bases of assets donated to a CRAT are equal to their fair market values. … Section 1015 flatly contradicts their position. Section 1015(a) governs transfers by gift, and section 1015(b) governs transfers in trust (other than transfers in trust by gift). Under either provision, the basis in the property "shall be the same as it would be in the hands of the donor" under section 1015(a) or "in the hands of the grantor" under section 1015(b)

The court upheld the IRS's position that the CRATs involved had realized ordinary income from the sale of the contributed properties that resulted in the distributions from the CRATs to the

Gerhardts being fully taxable and characterized as ordinary income. As the court put it, "[t]he gain disappearing act the Gerhardts attribute to the CRATs is worthy of a Penn and Teller magic show. But it finds no support in the Code, regulations, or caselaw."

Issue concerning gain recognition in like-kind exchange. In a separate transaction in 2017, one couple exchanged property (the Armstrong Site) for other property. The Armstrong site "comprised hog buildings and equipment as well as raw land." The couple treated this exchange as a like-kind exchange that qualified for nonrecognition of gain under § 1031. The IRS took the position that, although the exhange qualified under § 1031, the property exchanged was § 1245 property and § 1245 required the couple to recognize gain characterized as ordinary income on the exchange. The court agreed with the IRS. The flush language of § 1245(a)(1) provides that gain from the disposition of § 1245 property "shall be recognized notwithstanding any other provision of this subtitle." And Reg. 1.1245-6(b) explicitly provides that § 1245 overrides § 1031. Acordingly, the court held that the couple had to recognize the gain realized from the exchange and that the gain was orfinary income.