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.

Although relatively little tax legislation was enacted in the last twelve months, there have nevertheless 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 American Rescue Plan Act of 2021, Pub. L. No. 117-2, enacted on March 11, 2021, made several significant changes. The changes made by this legislation include expanding credits such as the child tax credit and earned income credit, suspending the requirement to repay excess advance premium tax credit payments for 2020, and providing exclusions for up to $10,200 of unemployment compensation received in 2020 and for cancellation of student loans. The Infrastructure Investment and Jobs Act, Pub. L. No. 117-58, enacted on November 15, 2021, contains relatively few significant tax provisions but ends the employee retention credit of Code § 3134 for the fourth quarter of 2021. The Inflation Reduction Act, Pub. L. No. 117-169, enacted 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. 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. Required amortization of specified research or experimental expenditures incurred after 2021. The 2017 Tax Cuts and Jobs Act, § 13206, amended Code § 174 to require the capitalization and amortization of specified research or experimental expenditures. The amortization period is 5 years (15 years for expenditures attributable to foreign research), beginning at the midpoint of the year in which the expenditures are paid or incurred. The term "specified research or experimental

expenditures" is defined as research or experimental expenditures paid or incurred by the taxpayer during a taxable year in connection with the taxpayer's trade or business. The term includes expenditures for software development. Expenditures paid or incurred for the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral (including oil and gas) are not subject to the required capitalization and amortization of § 174. Expenditures for the acquisition or improvement of land or for the acquisition or improvement of property that is depreciable under § 167 or subject to depletion under § 611 also are not subject to the required capitalization and amortization of § 174; however, allowances for depreciation under § 167 or for depletion under § 611 are treated as expenditures subject to § 174. For further explanation and details, the complete Conference Report accompanying TCJA may be found here. Amended § 174 applies to amounts paid or incurred in taxable years beginning after 2021.

2. Legal expenses incurred to defend patent infringement suits are currently deductible. Actavis Laboratories, FL, Inc. v. United States, 130 A.F.T.R.2d 2022-5601 (Ct. Fed. Cl. 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. No. 10 (4/27/21).

C. Reasonable Compensation

D. Miscellaneous Deductions

1. Seinfeld warned us: no double-dipping (with your PPP money)! Or, on second thought, maybe you can! Notice 2020-32, 2020-21 I.R.B. 1 (5/1/20). Section 1102 of the CARES Act, in tandem with § 7(a)(36) of the Small Business Act (15 U.S.C. § 636(a)(36)), establishes the much-touted Paycheck Protection Program ("PPP"). The PPP was created to combat the devastating economic impact of the coronavirus pandemic. Generally speaking, the PPP facilitates bank-originated, federally-backed loans ("covered loans") to fund payroll and certain other trade or business expenses ("covered expenses") paid by taxpayers during an eight-week period following the loan's origination date. Moreover, § 1106(b) of the CARES Act allows taxpayers to apply for debt forgiveness with respect to all or a portion of a covered loan used to pay covered expenses. Section 1106(i) of the CARES Act further provides that any such forgiven debt meeting specified requirements may be excluded from gross income by taxpayer-borrowers.

Background. The CARES Act does not address whether covered expenses funded by a forgiven covered loan are deductible for federal income tax purposes. Normally, of course, covered expenses would be deductible by a taxpayer under either Code § 162, § 163, or similar provisions; however, a long-standing provision of the Code, § 265(a)(1), disallows deductions for expenses allocable to one or more classes of income "wholly exempt" from federal income tax. Put differently, § 265(a)(1) generally prohibits taxpayers from double-dipping: taking deductions for expenses attributable to tax-exempt income. Section 265 most often has been applied to disallow deductions for expenses paid to seek or obtain tax-exempt income. (For example, a taxpayer claiming nontaxable social security disability benefits pays legal fees to pursue the claim. The legal fees are not deductible under Code § 265(a)(1). *See* Rev. Rul. 87-102, 1987-2 C.B. 78.) Covered expenses, on the other hand, presumably would have been incurred by taxpayers (at least in part) regardless of the PPP. The question arises, therefore, whether covered expense deductions are disallowed by Code § 265 when all or a portion of a PPP covered loan *subsequently* is forgiven.

Notice 2020-32. The notice sets forth the IRS's position that covered expenses funded by the portion of a PPP covered loan subsequently forgiven are not deductible pursuant to § 265. The IRS reasons that regulations under § 265 define the term "class of exempt income" as any class of income (whether or not any amount of income of such class is received or accrued) that is either wholly excluded from gross income for federal income tax purposes or wholly exempt from federal income taxes. *See* Reg. § 1.265-1(b)(1). Thus, because the forgiven portion of a covered loan is nontaxable (i.e., "wholly exempt") and is tied to the taxpayer's expenditure of the loan proceeds for covered expenses, § 265 disallows a deduction for those expenses. The IRS also cites several cases in support of its position. *See Manocchio v. Commissioner*, 78 T.C. 989 (1982) (taxpayer-pilot's flight-training expenses funded with a nontaxable Veteran's Administration allowance not deductible pursuant to § 265(a)(1)), *aff'd on other grounds*, 710 F.2d 1400 (9th Cir. 1983); *Banks v. Commissioner*, 17 T.C. 1386 (1952) (deduction for business-related educational expenses disallowed under § 265(a)(1) when paid by the Veterans' Administration and not taxable to taxpayer); *Heffelfinger v. Commissioner*, 5 T.C. 985 (1945) (Canadian income taxes on income exempt from U.S. tax are not deductible in computing U.S. taxable income pursuant to § 265(a)(1)'s statutory predecessor). As if to convince itself, though, the IRS also cites as support—but without analysis—several arguably inapposite cases that do not rely upon § 265(a)(1). Instead, these cases hold that expenditures reimbursed from or directly tied to nontaxable funds are not deductible. *See, e.g., Burnett v. Commissioner*, 356 F.2d 755, 759-60 (5th Cir. 1966) (living expenses advanced by personal injury attorney to clients pending outcome of lawsuit not deductible because the expenses will be reimbursed from the lawsuit proceeds); *Wolfers v. Commissioner*, 69 T.C. 975 (1978) (taxpayer cannot deduct relocation costs funded with

nontaxable proceeds from Federal Reserve Bank); *Charles Baloian Co. v. Commissioner*, 68 T.C. 620 (1977) (similar).

A possible legislative solution? The authors doubt that Notice 2020-32 is the last word on the tax treatment of PPP covered loans and covered expenses. Apparently, many practitioners and at least a few members of Congress believe that the IRS's position in Notice 2020-32 contravenes congressional intent. *See* Chamseddine and Yauch, *Neal Plans PPP Fix to Provide Expenses Deduction*, 2020 TNTF 86-5 (5/4/20). Treasury Secretary Mnuchin, though, has defended the IRS's position. *See* Chamseddine, "Tax 101": Mnuchin Defends Nondeductibility of PPP Expenses, 2020 TNTF 87-2 (5/5/20). Furthermore, what happens to capitalized covered expenses? Are taxpayers forced to reduce basis when a portion of a covered loan is forgiven? What about outside basis adjustments for S corporations and partnerships that have paid covered expenses with the proceeds of a subsequently forgiven covered loan? Remember *Gitlitz v. Commissioner*, 531 U.S. 206 (2001) (excludable cancellation of indebtedness increases S corporation shareholder's outside basis allowing use of previously suspended losses) followed by enactment of § 108(d)(7)(A) (legislatively overruling *Gitlitz*)?

A broader perspective. Perhaps the unstated but no less unsettling aspect of Notice 2020-32 is that the Notice fails to address adequately the inconsistent application of § 265 by the IRS and Treasury. It is well established that § 265(a)(1) disallows so-called "forward looking" deductions allocable to "wholly exempt" income (i.e., expenses paid to earn or obtain exempt income). For instance, as mentioned above § 265(a)(1) disallows a deduction for legal fees paid to pursue a nontaxable social security disability award. *See* Rev. Rul. 87-102, 1987-2 C.B. 78. Less established, however, is whether § 265 disallows so-called "backward looking" deductions (i.e., expenses funded with tax-exempt income but not paid to obtain such tax-exempt income). *Cf.* Rev. Rul. 75-232, 1975-1 C.B. 94 (taxpayer can exclude from income under § 104(a)(2) a settlement, including the portion allocated to future medical expenses, but cannot deduct that portion of the future medical expenses when incurred). For example, a taxpayer might receive an excludable bequest of artwork but nonetheless is allowed a charitable contribution deduction upon donating the artwork to a tax-exempt museum. For a thorough analysis, see Dodge, *Disallowing Deductions Paid with Excluded Income*, 32 Va. Tax Review 749 (2013).

a. Don't think you can avoid having deductions disallowed just because your PPP loan has not yet been forgiven, says the IRS. Rev. Rul. 2020-27, 2020-50 I.R.B. 1552 (11/18/20). Following the IRS's issuance of Notice 2020-32, which provides that costs are not deductible to the extent they are paid with the proceeds of a PPP loan that is forgiven, many taxpayers questioned whether they could take deductions for costs paid in 2020 with the proceeds of a PPP loan if the loan is not forgiven in 2020. In this revenue ruling, the IRS has crushed the hopes of many taxpayers. According to the ruling:

> A taxpayer … [that paid expenses with the proceeds of a PPP loan] may not deduct those expenses in the taxable year in which the expenses were paid or incurred *if, at the end of such taxable year, the taxpayer reasonably expects to receive forgiveness of the covered loan* on the basis of the expenses it paid or accrued during the covered period."

(Emphasis added.) The revenue ruling illustrates this rule in two situations. In the first, the taxpayer paid qualifying costs (payroll, mortgage interest, utilities, and rent) in 2020 with the proceeds of a PPP loan, satisfied all requirements for forgiveness of the loan, and applied for forgiveness of the loan, but the lender did not inform the taxpayer by the end of 2020 whether the loan would be forgiven. In the second situation, the facts were the same except that the taxpayer did not apply for forgiveness of the loan in 2020 and instead expected to apply for forgiveness of the loan in 2021. The ruling concludes that, in both situations, the taxpayers have a reasonable expectation that their loans will be forgiven and therefore cannot deduct the expenses they paid with the proceeds of their PPP loans. The ruling relies on two distinct lines of authority to support this conclusion. One line involves taxpayers whose deductions are disallowed because they have a reasonable expectation of reimbursement at the time they pay the costs in question. *See, e.g.*, *Burnett v. Commissioner*, 356 F.2d 755 (5th Cir. 1966) (attorney who advanced costs for client and was entitled to reimbursement if successful in the client's

matter); *Canelo v. Commissioner*, 53 T.C. 217 (1969), *aff'd*, 447 F.2d 484 (9th Cir. 1971) (same). The IRS reasons in the ruling that the taxpayers in the two situations described have a reasonable expectation of reimbursement in the form of forgiveness of their PPP loans. The second line of authority is under § 265(a)(1), which disallows deductions for any amount otherwise deductible that is allocable to one or more classes of tax-exempt income regardless of whether the tax-exempt income is received or accrued. *See* Reg. § 1.265-1(a)(1), (b). Thus, according to the ruling, the fact that the loans in the two situations have not yet been forgiven does not preclude the costs paid by the taxpayers from being allocable to tax-exempt income.

b. But taxpayers can deduct expenses paid with the proceeds of a PPP loan to the extent their applications for loan forgiveness are denied or to the extent they decide not to seek forgiveness of the loan. Rev. Proc. 2020-51, 2020-50 I.R.B. 1599 (11/18/20). This revenue procedure provides a safe harbor that allows taxpayers to claim deductions in a taxable year beginning or ending in 2020 for otherwise deductible expenses paid with proceeds of a PPP loan that the taxpayer expects to be forgiven after 2020 to the extent that, after 2020, the taxpayer's request for loan forgiveness is denied or the taxpayer decides not to request loan forgiveness. The deductions can be claimed on a timely filed (including extensions) original 2020 income tax return or information return, an amended 2020 return (or, in the case of a partnership, an administrative adjustment request for 2020), or timely filed original income tax return or information return for the subsequent year in which the request for loan forgiveness is denied or in which the taxpayer decides not to seek loan forgiveness. The deductions the taxpayer claims cannot exceed the principal amount of the PPP loan for which forgiveness was denied or will not be sought. To be eligible for the safe harbor, the taxpayer must attach a statement (titled "Revenue Procedure 2020-51 Statement") to the return on which the taxpayer claims the deductions. The statement must include information specified in the revenue procedure. The revenue procedure seems to acknowledge that, for taxpayers claiming the deductions in the subsequent taxable year in which loan forgiveness is denied, the safe harbor is unnecessary because such taxpayers would be able to deduct the expenses in the subsequent taxable year under general tax principles.

c. Congress finally has stepped in and provided legislative relief. A provision of the Taxpayer Certainty and Disaster Tax Relief Act of 2020, Division EE, Title I, § 276 of the 2021 Consolidated Appropriations Act, provides that, for purposes of the Internal Revenue Code:

> no deduction shall be denied, no tax attribute shall be reduced, and no basis increase shall be denied, by reason of the exclusion from gross income [of the forgiveness of a PPP loan]

The legislation also provides that, in the case of partnerships and subchapter S corporations, any amount forgiven is treated as tax-exempt income, which has the effect of providing a basis increase to the partners or shareholders. The provision applies retroactively as if it had been included in the CARES Act. In a related development, Rev. Rul. 2021-2, 2021-4 IRB 495 (1/25/2021) obsoletes Notice 2020-32 and Rev. Rul. 2020-27 discussed above. Further, Notice 2021-6, 2021-6 IRB 822 (1/19/21) waives any requirement that lenders file information returns or furnish payee statements under § 6050P (Form 1099-C, cancellation of debt) reporting the amount of qualifying forgiveness with respect to covered PPP loans (thereby obsoleting Announcement 2020-12, 2020-41 I.R.B. 893 (9/22/2020)). Finally, Announcement 2021-2, 2021-8 I.R.B. 892 (2/1/21) notifies lenders who have filed with IRS or furnished to a borrower a Form 1099-MISC, Miscellaneous Information, reporting certain payments on loans subsidized by the Administrator of the U.S. Small Business Administration as income of the borrower that the lenders must file and furnish corrected Forms 1099-MISC that exclude these subsidized loan payments.

d. But, this seems a little weird to us. Rev. Proc. 2021-20, 2021-19 I.R.B. 1150 (4/22/21). In an unusual move arguably inconsistent with annual accounting principles, the IRS has announced a safe harbor for taxpayers who did not deduct PPP loan expenses on a previously filed 2020 tax return. Taxpayers may not have deducted such expenses based upon the IRS's prior position announced in Notice 2020-32, 2020-21 I.R.B. 1 (5/1/20) and Rev. Rul. 2020-27, 2020-50 I.R.B. 1552 (11/18/20), as discussed above. Under Rev. Proc. 2021-20, "covered taxpayers" (as defined) who have not previously claimed deductions for PPP loan expenses paid or incurred between March 27, 2020 (the date the PPP loan program initially was authorized), and December 27, 2020 (the date Congress

legislatively overruled the IRS) may elect to deduct those previously unclaimed expenses on their 2021 returns. Although this solution may be practical, it runs counter to annual accounting principles. *Of course, we're sure nothing can go wrong with allowing taxpayers who paid or incurred deductible expenses in 2020 to elect to deduct those expenses on their 2021 returns, right?* Granted, Rev. Proc. 2021-20 has narrow applicability. Most taxpayers would not have filed their 2020 federal income tax returns prior to December 27, 2020, when, as noted above, Congress granted legislative relief for deducting PPP loan expenses. Rev. Proc. 2021-20 also obsoletes Rev. Proc. 2020-51 discussed above.

e. The IRS has provided guidance on the timing of reporting tax-exempt income resulting from the forgiveness of PPP loans. Rev. Proc. 2021-48, 2021-49 I.R.B. 835 (11/18/21). Section 1106(i) of the CARES Act provides that the forgiveness of any PPP loan may be excluded from gross income by taxpayer-borrowers. In the case of partnerships and subchapter S corporations, any amount forgiven is treated as tax-exempt income, which has the effect of providing a basis increase to the partners or shareholders. (The clarification that the amount forgiven is treated as tax-exempt income was made with retroactive effect by a provision of the Taxpayer Certainty and Disaster Tax Relief Act of 2020, Division EE, Title I, § 276 of the 2021 Consolidated Appropriations Act.) A similar basis adjustment is required when one member of a consolidated group of corporations holds stock of another member and the other member has tax-exempt income. To apply these rules, and to take into account tax-exempt income for other purposes, such as including tax-exempt income in gross receipts, taxpayers must determine *when* the tax-exempt income resulting from forgiveness of a PPP loan should be taken into account. The IRS has provided guidance on this issue in Rev. Proc. 2021-48. According to the revenue procedure, taxpayers may treat such income as received or accrued when (1) expenses eligible for forgiveness are paid or incurred; (2) an application for PPP loan forgiveness is filed; or (3) PPP loan forgiveness is granted. Taxpayers may report tax-exempt income on a timely filed original or amended federal income tax return, information return or administrative adjustment request (AAR) under § 6227 of the Code. If a partner or subchapter S corporation shareholder receives an amended Schedule K-1, the partner or shareholder must file an amended return to the extent necessary to reflect the amended K-1. If a taxpayer reports tax-exempt income resulting from forgiveness of a PPP loan and subsequently receives forgiveness of less than the full amount reported as tax-exempt income, the taxpayer must make appropriate adjustments on an amended return. The revenue procedure indicates that form instructions for the 2021 filing season will detail how taxpayers can report tax-exempt income consistently with this guidance, but that taxpayers do not need to wait until the instructions are published to apply the guidance provided by this revenue procedure.

f. Guidance for partnerships and consolidated groups regarding amounts excluded from gross income and deductions relating to PPP loans. Rev. Proc. 2021-49, 2021-49 I.R.B. 838 (11/18/21). In this revenue procedure, the IRS has provided guidance for partnerships and their partners regarding (1) allocations under § 704(b) of tax-exempt income arising from the forgiveness of PPP loans and the receipt of certain other COVID-related relief, (2) allocations under § 704(b) of deductions resulting from expenditures attributable to forgiven PPP loan proceeds and the proceeds of certain other COVID-related relief, and (3) the corresponding adjustments to the partners' bases in their partnership interests (so-called "outside basis") under § 705. The revenue procedure also provides guidance for consolidated groups of corporations regarding the corresponding adjustments to the basis of stock of subsidiary members of the group held by other group members to reflect tax-exempt income resulting from the forgiveness of PPP loans and the receipt of certain other COVID-related relief.

With respect to partnerships, the revenue procedure generally provides that, if the partnership satisfies specified requirements and complies with certain information reporting requirements, the IRS will treat the taxpayer's allocation of tax-exempt income and deductions as made in accordance with § 704(b), i.e., will respect the allocation. The requirements the partnership must satisfy are: (1) the allocation of deductions resulting from expenditures giving rise to the forgiveness of a PPP Loan is determined under Reg. § 1.704-1(b)(3), according to the partners' overall economic interests in the partnership, (2) the allocation of amounts treated as tax exempt is made in accordance with the allocation of the deductions just described, and (3) the partnership complies with special rules if any expenditure giving rise to the forgiveness of a PPP Loan is required to be capitalized. To comply with information reporting requirements, a partnership must report to the IRS all partnership items whose

tax treatment is described in the revenue procedure as required by the IRS in forms, instructions, or other guidance.

With respect to consolidated groups, section 5 of the revenue procedure provides that the IRS will treat the forgiveness of a PPP loan (and the receipt of certain other COVID-related relief) as tax-exempt income for purposes of Reg. § 1.1502-32(b)(2)(ii). The result of this treatment is that a member of a consolidated group of corporations that holds stock of another member must adjust its basis in the stock for the PPP loan forgiveness (or other COVID-related relief) received by the other group member. A member of a consolidated group can rely on this treatment only if the consolidated group attaches a signed statement to its consolidated tax return indicating that all affected taxpayers in the consolidated group are relying on section 5 of the revenue procedure and are reporting consistently.

Taxpayers can apply this revenue procedure for any taxable year ending after March 27, 2020.

g. Partnerships subject to the centralized audit regime that experienced PPP loan forgiveness and that filed returns before Rev. Proc. 2021-48 and Rev. Proc. 2021-49 were issued can file amended returns on or before December 31, 2021. Rev. Proc. 2021-50, 2021-49 I.R.B. 844 (11/18/21). Generally, § 6031(b) prohibits partnerships subject to the centralized audit regime enacted by the Bipartisan Budget Act of 2015 (BBA partnerships) from amending the information required to be furnished to their partners on Schedule K-1 after the due date of the partnership return, unless specifically authorized by the Secretary of the Treasury or her delegate. This revenue procedure provides such authorization. Specifically, the revenue procedure authorizes BBA partnerships to file amended partnership returns and furnish amended Schedules K-1 to partners if they filed partnership tax returns on Form 1065 and furnished Schedules K-1 to partners prior to the issuance of Rev. Proc. 2021-48 or Rev. Proc. 2021-49 (discussed above) for partnership taxable years ending after March 27, 2020. To take advantage of this opportunity, a BBA partnership must file a Form 1065 (with the "Amended Return" box checked) and furnish corresponding amended Schedules K-1 to its partners on or before December 31, 2021. The BBA partnership must clearly indicate the application of this revenue procedure on the amended return and write "FILED PURSUANT TO REV PROC 2021-50" at the top of the amended return and attach a statement with each amended Schedule K-1 furnished to its partners with the same notation.

2. Go ahead and deduct 100 percent of the cost of that business meal, at least through 2022. A provision of the Taxpayer Certainty and Disaster Tax Relief Act of 2020, Division EE, Title I, § 210 of the 2021 Consolidated Appropriations Act, amends § 274(n)(2), which sets forth exceptions to the normal 50 percent limitation on deducting business meals, to add an additional exception. The exception is for the cost of food or beverages provided by a restaurant paid or incurred before January 1, 2023. This rule applies to amounts paid or incurred after December 31, 2020.

a. *Seriously, it's come to this?* Whole Foods and Costco are not "restaurants," but your favorite food truck and street vendor are. As for your "go to" catering company, who knows? Notice 2021-25, 2021-17 I.R.B. 1118 (4/8/21). According to the IRS, a "restaurant" within the meaning of amended § 274(n)(2) means "a business that prepares and sells food or beverages to retail customers for immediate consumption, regardless of whether the food or beverages are consumed on the business's premises." Notice 2021-25 further states that a "restaurant" does not include a business primarily selling "pre-packaged food or beverages not for immediate consumption, such as a grocery store; specialty food store; beer, wine, or liquor store; drug store; convenience store; newsstand; or a vending machine or kiosk." Notice 2021-25 goes on to provide that regardless of whether the facility is operated by a third-party under contract with an employer, a § 274(n)(2) "restaurant" is neither (i) an employer's on-premises eating facility used in furnishing meals excluded from its employees' gross income under § 119 nor (ii) an employer-operated eating facility treated as a de minimis fringe under § 132(e)(2).

b. Are your employees traveling on business getting by on Slim Jims from the 7-Eleven? No worries! Go ahead and treat the meal portion of the per diem rate as being attributable to food or beverages provided by a restaurant. Notice 2021-63, 2021-49 I.R.B. 835 (11/16/21). Generally, taxpayers must comply with the substantiation requirements of § 274(d) in order to deduct traveling expenses, including meals while away from home. Taxpayers can use a per diem rate to substantiate the amount of ordinary and necessary business expenses paid or incurred for

lodging, meals, and incidental expenses. *See* Rev. Proc. 2019-48, 2019-51 I.R.B. 1392. Nevertheless, the meal portion of the per diem rate is normally subject to the 50 percent limitation of § 274(n)(1) on deducting meals as business expenses. Congress's authorization of a 100 percent deduction for the cost of meals provided by a restaurant created a dilemma for employers using a per diem rate because employees receiving per diems normally are not required to turn in receipts, which means that employers providing per diems don't have any basis for determining whether the meal portion of the per diem rate is subject to a 50-percent or a 100-percent limitation. The IRS has resolved this issue in Notice 2021-63, which provides that, if an employer properly applies the rules of Rev. Proc. 2019-48, the employer can treat the meal portion of a per diem rate or allowance as being attributable to food or beverages provided by a restaurant. This means that, even if an employee traveling on business gets take-out sandwiches from a convenience store, or stays in an extended stay hotel room with a kitchen and cooks his or her own meals, the employer can deduct 100 percent of the meal portion of the per diem. This rule applies to costs paid or incurred after December 31, 2020, and before January 1, 2023.

- *Self-employed individuals*. The notice indicates that this same rule applies (and for the same period of time) to the meal portion of the per diem rate for self-employed individuals traveling away from home.

3. Standard mileage rates for 2022. Notice 2022-3, 2022-2 I.R.B. 308 (12/17/21). The standard mileage rate for business miles in 2022 goes up to 58.5 cents per mile (from 56 cents in 2021) and the medical/moving rate goes up to 18 cents per mile (from 16 cents in 2021). The charitable mileage rate remains fixed by § 170(i) at 14 cents. The portion of the business standard mileage rate treated as depreciation is unchanged compared to 2021 and remains 26 cents per mile for 2022. The maximum standard automobile cost may not exceed $56,100 (up from $51,100 in 2021) 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 2022, and (2) the standard mileage rate for moving has limited applicability for the use of an automobile as part of a move during 2022 because, in the 2017 Tax Cuts and Jobs Act, Congress disallowed the deduction of moving expenses for 2022 (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).

a. Given the price at the pumps, it's no surprise the IRS has increased the standard mileage rate for 2022 effective July 1, 2022. Announcement 2022-13, 2022-26 I.R.B. 1185 (6/10/22). Because of recent increases in the price of fuel, the IRS has increased the standard mileage rates for 2022. The increased standard mileage rates apply to deductible transportation expenses paid or incurred for business, medical, or moving expense purposes on or after July 1, 2022, and to mileage allowances that are paid both (1) to an employee on or after July 1, 2022, and (2) for transportation expenses paid or incurred by the employee on or after July 1, 2022. Taking into account these increases, the standard mileage rates for 2022 are as follows:

Category	Jan. 1-Jun. 30, 2022	Jul. 1-Dec. 31, 2022
Business miles	58.5 cents	62.5 cents
Medical/moving	18 cents	22 cents
Charitable mileage	14 cents	14 cents

The announcement modifies Notice 2022-3, 2022-2 I.R.B. 308. Except as modified, all other provisions of Notice 2022-3 continue to apply.

4. 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.

E. Depreciation & Amortization

1. Section 280F 2022 depreciation tables for business autos, light trucks, and vans. Rev. Proc. 2022-17, 2022-13 I.R.B. 930 (3/16/22). 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 2022 depreciation limits for business use of passenger automobiles acquired after September 27, 2017, and placed in service during 2022:

2022 Passenger Automobiles with § 168(k) first year recovery:	
1st Tax Year	$19,200
2nd Tax Year	$18,000
3rd Tax Year	$10,800
Each Succeeding Year	$ 6,460
2022 Passenger Automobiles (no § 168(k) first year recovery):	
1st Tax Year	$11,200
2nd Tax Year	$18,000
3rd Tax Year	$10,800
Each Succeeding Year	$ 6,460

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 2022. For 2022, this income inclusion applies when the fair market value of the vehicle exceeds $56,000.

F. Credits

1. More guidance on the employee retention credit. Notice 2021-49, 2021-34 I.R.B. 316 (8/4/21). Section 9651 of the 2021 American Rescue Plan added Code § 3134, which provides an employee retention credit against specified payroll taxes for eligible employers, including tax-exempt organizations, that pay qualified wages (including certain health plan expenses) to employees after June 30, 2021, and before January 1, 2022. Previously, Congress had provided for an

employee retention credit in § 2301 of the CARES Act, which applies to qualified wages paid after March 12, 2020, and before January 1, 2021, and in § 207 of the Taxpayer Certainty and Disaster Tax Relief Act of 2020, Division EE of the 2021 Consolidated Appropriations Act, which applies to qualified wages paid after December 31, 2020, and before July 1, 2021. Thus, the CARES Act provided an employee retention credit for much of 2020, the Taxpayer Certainty and Disaster Tax Relief Act of 2020 provided an employee retention credit for the first two quarters of 2021, and the 2021 American Rescue Plan provided an employee retention credit for the last two quarters of 2021. This notice provides guidance on the employee retention credit authorized by Code § 3134, which is available during the last two quarters of 2021. The notice also amplifies two earlier notices, Notice 2021-20, 2021-11 I.R.B. 922, which addresses the employee retention credit in effect for 2020, and Notice 2021-23, 2021-16 I.R.B. 1113, which addresses the employee retention credit in effect for the first two quarters of 2021.

As originally enacted in the CARES Act, the employee retention credit was not available to an employer if the employer or any member of its controlled group received a Paycheck Protection Program (PPP) loan. The Taxpayer Certainty and Disaster Tax Relief Act of 2020, Division EE of the 2021 Consolidated Appropriations Act, enacted in December 2020, changed this rule retroactively. Under the revised rule, an employer that receives a PPP loan can still qualify for an employee retention credit, but cannot use the same wages to qualify for both forgiveness of the PPP loan and the employee retention credit.

Notice 2021-49 provides guidance on several important issues, including:

- The definition of a "full-time employee" for purposes of the employee retention credit.
- Whether cash tips can be treated as qualified wages.
- Whether wages paid to an employee who owns more than 50 percent (majority owner) or to the spouse of a majority owner may be treated as qualified wages.

***Note*:** the Infrastructure Investment and Jobs Act, enacted on November 15, 2021, ends the employee retention credit for the fourth quarter of 2021.

a. The IRS has provided a safe harbor permitting taxpayers to exclude the forgiveness of a PPP loan and certain other items from gross receipts for purposes of determining eligibility for the employee retention credit. Rev. Proc. 2021-33, 2021-34 I.R.B. 327 (8/10/21). An employer may be eligible for the employee retention credit if its gross receipts for a calendar quarter decline by a certain percentage as compared to a prior calendar quarter. The method used to determine if an employer is an eligible employer based on experiencing the required percentage decline in gross receipts varies depending on the calendar quarter for which the employer is determining its eligibility for the employee retention credit. For example, according to section III.C of Notice 2021-23, 2021-16 I.R.B. 1113, for the first and second calendar quarters of 2021, an employer generally is an eligible employer based on a decline in gross receipts if its gross receipts for the calendar quarter are less than 80 percent of its gross receipts for the same calendar quarter in 2019. For this purpose, a taxable employer's gross receipts are determined under the rules of § 448(c) and the gross receipts of a tax-exempt employer are determined by reference to § 6033. Under these rules, the forgiveness of a PPP loan would be included in an employer's gross receipts, which could have the effect of making the employer ineligible for the employee retention credit. This revenue procedure provides a safe harbor under which an employer can exclude the forgiveness of a PPP loan from gross receipts for purposes of determining eligibility for the employee retention credit. An employer can take advantage of the safe harbor by consistently applying it in determining eligibility for the employee retention credit. According to the revenue procedure, an employer consistently applies the safe harbor by (1) excluding the amount of the forgiveness of any PPP loan from gross receipts for each calendar quarter in which gross receipts for that calendar quarter are relevant in determining eligibility to claim the employee retention credit, and (ii) applying the safe harbor to all employers treated as a single employer under the employee retention credit aggregation rules. Employers are required to retain in their records support for the employee retention credit claimed, including their use of the safe harbor.

- *Safe harbor also applies to shuttered venue operator grants and restaurant revitalization grants.* The safe harbor provided by Rev. Proc. 2021-33 also applies to two congressionally authorized grants. The first, known as shuttered venue operator grants, were authorized by section 324 of

the Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act, enacted in December 2020 as part of the Consolidated Appropriations Act, 2021. This legislation authorized the Small Business Administration to make grants to eligible live venue, performing arts, and museum operators and promoters to be used for certain qualifying expenses, including payroll costs. The second grant is the restaurant revitalization grant, which was authorized by section 5003 of the American Rescue Plan Act of 2021, enacted in March 2021. Restaurant revitalization grants are authorized to be made to qualifying restaurants and food vendors to be used for certain qualifying expenses, including payroll costs. Like forgiveness of PPP loans, these two grants normally would be included in gross receipts in determining eligibility for the employee retention credit. According to Rev. Proc. 2021-33, employers receiving these grants can use the safe harbor provided by the revenue procedure to exclude them from gross receipts in determining eligibility for the employee retention credit.

b. Employers that had the employee retention credit rug pulled out from under them can avoid penalties. Notice 2021-65, 2021-51 I.R.B. 880 (12/6/21). Employers eligible for the employee retention credit had two options to receive the credit. They could (1) receive advance payment of the credit, or (2) reduce employment tax deposits in anticipation of receiving the credit. An advance payment of any portion of the employee retention credit to an employer in excess of the amount to which the employer is entitled is an erroneous refund that the employer must repay. In this notice, the IRS has provided relief from penalties for employers that used one of these options in anticipation of receiving an employee retention credit for the fourth quarter of 2021. The Infrastructure Investment and Jobs Act, Pub. L. No. 117-58, enacted on November 15, 2021, ends the employee retention credit of Code § 3134 for the fourth quarter of 2021 (except for so-called "recovery startup businesses"). This notice clarifies steps employers (other than recovery startup businesses) should take if they (1) paid wages after Sept. 30, 2021, (2) received an advance payment of the employee retention credit for those wages or reduced employment tax deposits in anticipation of the credit for the fourth quarter of 2021, and (3) are now ineligible for the credit due to the repeal of the employee retention credit. The notice provides that employers (other than recovery startup businesses) that received advance payments for fourth quarter wages of 2021 will avoid failure-to-pay penalties if they repay those amounts by the due date of their employment tax returns. Employers (other than recovery startup businesses) that reduced deposits on or before Dec. 20, 2021, for wages paid during fourth calendar quarter of 2021 in anticipation of receiving the employee retention credit, will not be subject to a failure-to-deposit penalty with respect to the retained deposits if they take specified steps.

- The notice provides that employers that do not qualify for penalty relief under the notice may reply to an IRS notice about a penalty with an explanation and the IRS will consider reasonable cause relief pursuant to § 6656(a).

2. 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.

G. Natural Resources Deductions & Credits

H. Loss Transactions, Bad Debts, and NOLs

1. Disallowance of excess business losses of noncorporate taxpayers extended through 2028. The 2017 Tax Cuts and Jobs Act enacted Code § 461(*l*), which disallows the deduction

of "excess business losses" (over $250,000 for single filers and $500,000 for joint filers) of noncorporate taxpayers. Losses disallowed by § 461(*l*) are carried over to the next taxable year and are treated as NOL carryforwards. As enacted, the provision was effective for tax years beginning before January 1, 2027. The Inflation Reduction Act, § 13903, extends the effective date of § 461(*l*) through tax years ending before January 1, 2029.

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 2023. Rev. Proc. 2022-24, 2022-20 I.R.B. 1075 (4/29/22). The IRS has issued the inflation-adjusted figures for contributions to health savings accounts. For calendar year 2023, the annual limitation on deductions under § 223(b)(2)(A) for an individual with self-only coverage under a high deductible health plan is $3,850. For calendar year 2023, the annual limitation on deductions under § 223(b)(2)(B) for an individual with family coverage under a high deductible health plan is $7,750. For this purpose, for calendar year 2023, 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 $1,500 for self-only coverage or $3,000 for family coverage, and for which the annual out-of-pocket expenses (deductibles, co-payments, and other amounts, but not premiums) do not exceed $7,500 for self-only coverage or $15,000 for family coverage.

2. There are no adverse tax consequences for employees if they forgo their vacation, sick, or personal leave in exchange for the employer's contributions to charitable organizations providing aid to victims of the further Russian invasion of Ukraine. Notice 2022-28, 2022-3 I.R.B. 1182 (5/19/22). In this notice, the IRS has provided guidance on the tax treatment of cash payments that employers make pursuant to leave-based donation programs to aid victims of the further Russian invasion of Ukraine that began on February 24, 2022. For this purpose, victims of the further Russian invasion of Ukraine include citizens and residents of Ukraine, individuals working, traveling, or currently present in Ukraine, and refugees from Ukraine. Under leave-based donation programs, employees can elect to forgo vacation, sick, or personal leave in exchange for cash payments that the employer makes to charitable organizations described in § 170(c). The notice provides that: (1) cash payments an employer makes before January 1, 2023, to charitable organizations described in § 170(c) to aid victims of the further Russian invasion of Ukraine in exchange for vacation, sick, or personal leave that its employees elect to forgo will not be treated as gross income, wages, or compensation of the employees; and (2) employees making or having the opportunity to make such an election will not be treated as having constructively received gross income, wages, or compensation. Employers are permitted to deduct these cash payments either under the rules of § 170 as a charitable contribution or under the rules of § 162 as a business expense if the employer otherwise meets the requirements of either provision. Employees who make the election cannot claim a charitable contribution deduction under § 170 for the value of the forgone leave. The employer should not include cash payments made pursuant to the program in Box 1, 3 (if applicable), or 5 of the employee's Form W-2.

B. Qualified Deferred Compensation Plans

1. Some inflation-adjusted numbers for 2022. Notice 2021-61, 2021-47 I.R.B. 738 (11/4/21).

- The limit on elective deferrals in §§ 401(k), 403(b), and 457 plans is increased to $20,500 (from $19,500) with a catch-up provision for employees aged 50 or older that remains unchanged at $6,500.

- The limit on contributions to an IRA remains unchanged at $6,000. The AGI phase-out range for contributions to a traditional IRA by employees covered by a workplace retirement plan is increased to $68,000-$78,000 (from $66,000-$76,000) for single filers and heads of household, increased to $109,000-$129,000 (from $105,000-$125,000) for married couples filing jointly in which the spouse who makes the IRA contribution is covered by a workplace retirement plan, and increased to $204,000-$214,000 (from $198,000-$208,000) 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 $204,000-$214,000 (from $198,000-$208,000) for married couples filing jointly, and increased to $129,000-$144,000 (from $125,000-$140,000) for singles and heads of household.

- The limit on the annual benefit from a defined benefit plan under § 415 is increased to $245,000 (from $230,000).

- The limit for defined contribution plans is increased to $61,000 (from $58,000).

- The amount of compensation that may be taken into account for various plans is increased to $305,000 (from $290,000), and is increased to $450,000 (from $430,000) for government plans.

- The AGI limit for the retirement savings contribution credit for low- and moderate-income workers is increased to $68,000 (from $66,000) for married couples filing jointly, increased to $51,000 (from $49,500) for heads of household, and increased to $34,000 (from $33,000) for singles and married individuals filing separately.

2. Some inflation-adjusted numbers for 2023. Notice 2022-55, 2022- __ I.R.B. (10/21/22).

- The limit on elective deferrals in §§ 401(k), 403(b), and 457 plans is increased to $22,500 (from $20,500) with a catch-up provision for employees aged 50 or older that is increased to $7,500 (from $6,500).

- The limit on contributions to an IRA is increased to $6,500 (from $6,000). The AGI phase-out range for contributions to a traditional IRA by employees covered by a workplace retirement plan is increased to $73,000-$83,000 (from $68,000-$78,000) for single filers and heads of household, increased to $116,000-$136,000 (from $109,000-$129,000) for married couples filing jointly in which the spouse who makes the IRA contribution is covered by a workplace retirement plan, and increased to $218,000-$228,000 (from $204,000-$214,000) 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 $218,000-$228,000 (from $204,000-$214,000) for married couples filing jointly, and increased to $138,000-$153,000 (from $129,000-$144,000) for singles and heads of household.

- The limit on the annual benefit from a defined benefit plan under § 415 is increased to $265,000 (from $245,000).

- The limit for annual additions to defined contribution plans is increased to $66,000 (from $61,000).

- The amount of compensation that may be taken into account for various plans is increased to $330,000 (from $305,000), and is increased to $490,000 (from $450,000) for government plans.

- The AGI limit for the retirement savings contribution credit for low- and moderate-income workers is increased to $73,000 (from $68,000) for married couples filing jointly, increased to $54,750 (from $51,500) for heads of household, and increased to $36,500 (from $34,000) for singles and married individuals filing separately.

3. 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.

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

D. Individual Retirement Accounts

1. There are a lot of reasons not to establish a self-directed IRA. This is one of them. McNulty v. Commissioner, 157 T.C. 120 (11/18/21). The taxpayers in this case, a married couple, established self-directed individual retirement accounts (IRAs). To establish her self-directed IRA, Ms. McNulty used the services of Check Book IRA LLC (Check Book), through its website. The IRA became the sole member of a limited liability company (LLC) and transferred assets to the LLC. Ms. McNulty and her husband were the LLC's managers. The LLC invested in American Eagle Gold coins. The coins were shipped to the taxpayers' residence and kept in a safe there. The IRS audited the taxpayers' 2015 and 2016 tax returns and asserted that the taxpayers had received taxable distributions equal to the cost of the American Eagle Gold coins. With respect to Ms. McNulty, the IRS asserted that she had received taxable distributions of $374,000 and $37,380 for 2015 and 2016, respectively. The Tax Court (Judge Goeke) agreed with the IRS. According to the court, "an owner of a self-directed IRA may not take actual and unfettered possession of the IRA assets." Although the LLC was the nominal owner of the coins, the court reasoned, Ms. McNulty had unfettered possession of them. Accordingly, the court held, she had received a taxable distribution equal to the value of the coins. The court also upheld accuracy-related penalties for substantial understatement of income tax. The taxpayers, according to the court, were unable to establish a reasonable cause defense based on reliance on professional advice because they had received no such advice. The court "question[ed] whether Check Book's website and/or services could constitute professional advice upon which a reasonable person could rely for purposes of section 6664(c)(1)." In summary, the court stated:

> Petitioners are both professionals. They liquidated nearly $750,000 from their existing qualified retirement accounts to invest in a questionable internet scheme without disclosing the transactions to their C.P.A. They are not entitled to the reasonable cause defense, and we sustain the penalties for both years.

V. PERSONAL INCOME AND DEDUCTIONS

A. Rates

B. Miscellaneous Income

1. ♪♫To everything (turn, turn, turn), There is a season (turn, turn, turn) … ♫♪ And this is the season to have your student loans cancelled. The cancellation of student loans from 2021 through 2025 is excluded from gross income. Section 9675 of the 2021 American Rescue Plan amends Code § 108(f) by striking § 108(f)(5) and replacing it with new § 108(f)(5), which provides that gross income does not include any amount resulting from the cancellation of certain loans to finance postsecondary educational expenses regardless of whether the loan is provided through the

educational institution or directly to the borrower. This rule applies to several different kinds of loans, including loans made by federal or state governments, private educational loans (as defined in § 140(a)(7) of the Truth in Lending Act), and loans made by educational institutions. The definition of qualifying loans is broad enough to cover the vast majority of postsecondary educational loans. The exclusion does not apply if the lender is an educational organization or a private lender and the cancellation is on account of services performed for the lender. New § 108(f)(5) applies to discharges of loans that occur after December 31, 2020 and before January 1, 2026.

a. The IRS has instructed lenders that cancel student loans not to issue Form 1099-C. Notice 2022-1, 2022-2 I.R.B. 304 (12/21/21). Generally, § 6050P and the regulations issued pursuant to it require a lender that discharges at least $600 of a borrower's indebtedness to file Form 1099-C, Cancellation of Debt, with the IRS and to furnish a payee statement to the borrower. In this notice, the IRS has instructed those normally required to issue Form 1099-C not to do so for any student loan described in § 108(f)(5) (as amended by the 2021 American Rescue Plan) that is discharged after 2020 and before 2026. The notice explains the rationale for the IRS's decision as follows:

> The filing of an information return with the IRS, although not required, could result in the issuance of an underreporter notice (IRS Letter CP2000) to the borrower through the IRS's Automated Underreporter program, and the furnishing of a payee statement to the borrower could cause confusion for a taxpayer with a tax-exempt discharge of debt.

2. The taxpayer's attorneys might have committed malpractice, but the settlement she received from the law firm was not on account of her physical injuries and therefore was not excludable from her gross income. Blum v. Commissioner, 129 A.F.T.R.2d 2022-1170 (9th Cir. 6/2/22), *aff'g*, *Blum v. Commissioner*, T.C. Memo. 2021-18 (2/18/21). The taxpayer allegedly fell to the floor when she attempted to sit in a broken wheelchair while in the hospital for knee replacement surgery. She brought legal action against the hospital for personal injuries. The trial court in that action granted summary judgment for the hospital and the trial court's decision was affirmed on appeal. The taxpayer then brought a malpractice suit against the attorneys who had represented her. The law firm settled the malpractice action by paying the taxpayer $125,000. According to the court, the settlement agreement provided:

> "Blum maintains, and … [her former attorneys] do not dispute, that Blum did not sustain any physical injuries as a result of the alleged negligence of either ... [of her former attorneys]" and that "Blum's physical injuries are ... alleged to have resulted from the … [hospital] incident, which did not occur as a result of any fault or negligence by … [her former attorneys]."

The taxpayer excluded the $125,000 from gross income under § 104(a)(2) as damages received on account of personal physical injury or physical sickness. She argued that, but for the alleged negligence of her attorneys, she would have received damages from the hospital that would have been excluded from her income under § 104(a)(2). In a memorandum opinion, the U.S. Court of Appeals for the Ninth Circuit affirmed the decision of the U.S. Tax Court and held that the settlement proceeds the taxpayer received were not excludable from gross income under § 104(a)(2). In its prior decision in *Rivera v. Baker W., Inc.*, 430 F.3d 1253 (9th Cir. 2005), the Ninth Circuit had held that damages are received on account of a personal, physical injury within the meaning of § 104(a)(2) only if there is a direct causal link between the damages and the personal injury sustained. In this case, the court concluded, the settlement agreement pursuant to which the taxpayer received the settlement proceeds stated that the settlement was to settle a malpractice claim and that she had not suffered any physical injuries as a result of the alleged negligence of her attorneys. Accordingly, the court held, the taxpayer could not exclude the settlement proceeds from gross income under § 104(a)(2).

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

D. Deductions and Credits for Personal Expenses

1. Standard deduction for 2022. Rev. Proc. 2021-45, 2021-48 I.R.B. 764 (11/10/21). The standard deduction for 2022 will be $25,900 for joint returns and surviving spouses (increased from $25,100), $12,950 for unmarried individuals and married individuals filing separately

(increased from $12,550), and $19,400 for heads of households (increased from $18,800). For individuals who can be claimed as dependents, the standard deduction cannot exceed the greater of $1,150 (increased from $1,100) or the sum of $400 (increased from $350) 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 $1,750 (increased from $1,700) for those with the filing status of single or head of household (and who are not surviving spouses) and is $1,400 (increased from $1,350) for married taxpayers ($2,800 on a joint return if both spouses are age 65 or older).

2. Standard deduction for 2023. Rev. Proc. 2022-38, 2022-__ I.R.B. __ (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).

3. Home mortgage interest is deductible despite the fact that the taxpayers received a discharge in bankruptcy, which converted the debt to nonrecourse debt, and sold their home in a short sale. Milkovich v. United States, 28 F.4th 1 (9th Cir. 3/2/22). The taxpayers purchased their home in Renton, Washington, using the proceeds of a mortgage loan and subsequently refinanced the loan. They later filed for Chapter 7 bankruptcy. The taxpayers received a discharge in the bankruptcy proceeding. The taxpayers and the government agreed that the effect of the discharge was to change their home mortgage loan from recourse to nonrecourse because it eliminated the ability of the lender, CitiMortgage, to enforce the mortgage debt personally against the taxpayers. Instead, the lender was able to enforce only the value of its lien against the property. The taxpayers were unable to make the mortgage payments and the value of their home was significantly less than their outstanding mortgage debt. Given this situation, the lender agreed to a short sale of the property, i.e., a sale for less than the amount of mortgage debt owed. From the sale, CitiMortgage received just over $522,000, of which it credited approximately $115,000 towards accumulated unpaid interest on the loan. CitiMortgage issued Form 1098 reporting the amount of mortgage interest paid and the taxpayers claimed a deduction for the mortgage interest, presumably on Schedule A of their return. The IRS mailed a notice of deficiency to the taxpayers disallowing their deduction of mortgage interest. The taxpayers never received the notice of deficiency because the IRS mailed it to the address of the home they had sold. The taxpayers paid the tax allegedly due and brought this action seeking a refund. The IRS argued in this litigation that the taxpayers' deduction for the mortgage interest was disallowed by § 265(a)(1), which disallows deductions "allocable to one or more classes of income ... wholly exempt from the taxes imposed by [subtitle A of the Code]." The U.S. District Court dismissed the taxpayers' refund action not on the basis of § 265(a)(1), but instead on the basis that they had engaged in a transaction that lacked economic substance analogous to the transaction in *Estate of Franklin v. Commissioner*, 544 F.2d 1045 (9th Cir. 1976). In *Estate of Franklin*, the taxpayer acquired property using the proceeds of nonrecourse debt that significantly exceeded the value of the property acquired. Although the taxpayers in this case did not acquire their property using nonrecourse debt that exceeded the value of the property, the District Court reasoned that their position was analogous to that of the taxpayer in *Estate of Franklin* and therefore disallowed their mortgage interest deductions. In an opinion by Judge Collins, the U.S. Court of Appeals for the Ninth Circuit reversed the District Court's decision. According to the Ninth Circuit, the District Court erred in extending the holding of *Estate of Franklin* to the taxpayers' situation. There was no suggestion, the court observed, that the taxpayers had acquired their mortgage loan in a transaction that lacked economic substance. According to the court:

> Nothing in *Estate of Franklin* suggests that, without more, a subsequent collapse in real estate values means that the now-underwater mortgage should be considered a sham debt that cannot support a mortgage interest deduction.

The fact that the discharge the taxpayers received in bankruptcy changed the debt to nonrecourse debt, the court reasoned, did not alter the fact that the debt was bona fide debt that supported an interest deduction.

The court also rejected the government's argument that § 265(a)(1) disallowed the taxpayers' deduction. The court reviewed basic principles under which a taxpayer experiences discharge of indebtedness income if the taxpayer engages in a short sale of property subject to recourse indebtedness followed by cancellation of the remaining balance owed. *See* Reg. §§ 1.1001-2(a)(2), 1.1001-2(c) (ex. 8). In contrast, if the debt is nonrecourse, the entire amount of the debt is included in the taxpayer's amount realized. *See, e.g.*, *Commissioner v. Tufts*, 461 U.S. 300 (1983); *Simonsen v. Commissioner*, 150 T.C. 201 (2018); Reg. §§ 1.1001-2(a)(1), 1.1001-2(c) (ex. 7). When the debt is nonrecourse and fully included in amount realized, the taxpayer does not experience cancellation of indebtedness income. Accordingly, the taxpayers did not have any cancellation of indebtedness that was excluded from their income and therefore it was inappropriate to disallow their mortgage interest deduction under § 265(a)(1). The court also concluded that, even if a discharge of indebtedness had occurred in the context of the bankruptcy proceeding, § 265(a)(1) did not preclude the taxpayer's deduction of the mortgage interest in question. The court reasoned that taxpayers who exclude cancellation of indebtedness income from gross income pursuant to § 108(a)(1)(A) because the cancellation occurred in a bankruptcy proceeding must reduce favorable tax attributes pursuant to § 108(b) by the amount of cancelled debt they excluded from gross income. For this reason, the court observed, the "exclusion" from gross income provided by § 108(a)(1)(A) is not a true exclusion, but rather a deferral of income. For this reason, the court concluded, "cancellation-of-indebtedness income exempted under § 108(a)(1)(A) is not 'wholly exempt' from income taxation within the meaning of § 265(a)(1)."

Dissenting opinion by Judge Stearns. Judge Stearns dissented, primarily on the basis that the taxpayers had not actually "paid" the mortgage interest in question.

4. 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.

5. 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 a 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.

6. 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.

E. Divorce Tax Issues

1. A taxpayer can deduct as alimony his payments of his wife's health insurance premiums even though he paid the premiums with amounts excluded from his gross income, says the Tax Court. Leyh v. Commissioner, 157 T.C. 86 (10/4/21). The taxpayer and his wife signed an agreement pursuant to which he agreed to pay alimony until their final decree of divorce, which was granted in a later year. As part of the agreement, the taxpayer agreed to pay the premiums for his wife's health and vision insurance. In 2015 he paid $10,683 for his wife's health insurance premiums as pretax payroll reductions from his wages through his employer's cafeteria plan. The taxpayer excluded from his gross income the health care coverage premiums he and his wife received through his employer's cafeteria plan and also claimed a deduction for the $10,683 as alimony. The IRS did not dispute that the taxpayer's payments constituted alimony but asserted that he could not deduct the payments as alimony because he had paid it from funds that he excluded from income. The Tax Court (Judge Greaves) disagreed and upheld the taxpayer's deduction of alimony. The court noted that, absent a clear declaration of congressional intent, double deductions or their equivalent are not permitted, but reasoned that the taxpayer's situation did not present such a scenario. The court explained that the tax consequence to the payee was relevant to the question whether the husband, the payor, was entitled to a deduction. Under the regime that applied to alimony in 2015, § 215 permitted an above-the-line deduction for the payor of alimony and § 71 required the recipient to include the alimony in gross income. According to the court, under this matching regime, if the taxpayer's wife was required to include the alimony payments in gross income, then the taxpayer should be entitled to a deduction for the payments. This result is consistent, the court reasoned, with the result that would have occurred had the taxpayers, who were still married at the time, filed a joint return rather than separate returns. If they had filed a joint return, the health insurance premiums would have been excluded from their gross income, the husband would have had no deduction, and the wife would not have had any income. The court also rejected the IRS's argument that § 265 precluded the husband's deduction. Section 265(a)(1) generally provides that an amount may not be deducted if it is allocable to wholly tax-exempt income (other than interest). According to the court:

> Our decisions broadly interpreting section 265(a)(1) have instead generally shared the same basic concern: But for the application of section 265, a taxpayer would have recognized a double tax benefit where one was not otherwise available to him. See, e.g., Induni v. Commissioner, 98 T.C. 618, 623 (1992), aff'd, 990 F.2d 53 (2d Cir.

> 1993); Rickard v. Commissioner, 88 T.C. 188, 193 (1987); Manocchio v. Commissioner, 78 T.C. at 994-995, 997. Such application is consistent with the text of the statute. As we have explained supra, this threat does not exist here given the special nature of the alimony regime. Furthermore, the alimony payments are not considered allocable to wholly tax-exempt income for section 265 purposes as Ms. Leyh was required to include it in her income. For these reasons, we decline to extend the reach of section 265 to petitioner's alimony deduction.

- In the 2017 Tax Cuts and Jobs Act, Congress repealed §§ 71 and 215 for divorce or separation instruments executed or modified after 2018.

F. Education

G. Alternative Minimum Tax

VI. CORPORATIONS

A. Entity and Formation

B. Distributions and Redemptions

1. Tax Court holds management fees paid by C corporation to its shareholders were constructive dividends. Aspro, Inc. v. Commissioner, T.C. Memo. 2021-8 (1/21/21). The issue in this case was whether Aspro, Inc. (Aspro) was entitled to deduct management fees paid to its shareholders. Aspro was an Iowa C corporation for federal tax purposes and was engaged in the asphalt paving business. The company had three shareholders: Jackson Enterprises, Corp. (40%) (Jackson), Mannatt's Enterprises, Ltd. (40%), and Mr. Dakovich, Aspro's president (20%). In each year relevant to this dispute, the shareholders received, among other forms of payment, substantial management fees that Aspro deducted. In examining whether the payments were in fact distributions of earnings rather than compensation for services rendered, the Tax Court (Judge Pugh) turned for guidance to Reg. § 162-7(b)(1), which governs the classification of such payments. This regulation provides:

> Any amount paid in the form of compensation, but not in fact as the purchase price of services, is not deductible. An ostensible salary paid by a corporation may be a distribution of a dividend on stock. This is likely to occur in the case of a corporation having few shareholders, practically all of whom draw salaries. If in such a case the salaries are in excess of those ordinarily paid for similar services and the excessive payments correspond or bear a close relationship to the stockholdings of the officers or employees, it would seem likely that the salaries are not paid wholly for services rendered, but that the excessive payments are a distribution of earnings upon the stock.

The Tax Court concluded that Aspro had failed to show the management fees were paid purely or wholly for services and agreed with the IRS that Aspro could not deduct the fees. The Tax Court came to this conclusion for numerous reasons. Aspro did not enter into any written agreement and did not agree on any management fee rate or billing structure with any one or more of its shareholders. Rather, the board of directors approved management fees each year. The minutes of the board of directors meetings did not reflect how the directors determined to approve the management fees paid to the shareholders. The board did not attempt to value or quantify any of the management services performed. The management fees paid to each shareholder were approximately the same each year even though the services provided by each shareholder varied from year to year. The percentage of management fees paid roughly corresponded to each of the three shareholders' respective ownership interests. Aspro paid the management fees as a lump sum at the end of each year even though services were rendered throughout the year. Another circumstance that influenced the Tax Court was the coincidence that Aspro had very little income after deducting management fees. Finally, it was unfortunate for Aspro that none of the witnesses that testified could explain how the company had determined the appropriate amount of management fees. The testimony regarding how management fees were valued was vague and contradictory. No expert testimony was introduced to aid the court in establishing the reasonableness of the amounts paid for the purported management services. For these reasons, Aspro failed to prove that the management fees it had paid to shareholders qualified as compensation for services rendered.

Whether management fees along with other compensation paid to Mr. Dakovich was reasonable compensation. Having found at every turn that Aspro had failed to provide any evidence to support its deduction for management fees as compensation for services rendered, the court then turned to whether the payments to Mr. Dakovich in his capacity as president of the company were deductible as reasonable compensation. With respect to shareholder-employees, one approach to determining reasonable compensation commonly used by courts is a multi-factor test. *See, e.g.,* Charles Schneider & Co. v. Commissioner, 500 F.2d 148, 152 (8th Cir. 1974). The Tax Court relied on these factors and on the analysis in the report of the IRS's expert, Mr. Nunes (the Nunes Report), which the court found persuasive. Mr. Dakovich had decades of experience as Aspro's top executive. He had wide ranging duties and worked long hours. Only this factor was found to weigh in favor of treating Mr. Dakovich's compensation as reasonable. On the other hand, under the prevailing economic conditions, which were found to be stable, Aspro's sales declined by 7 percent. Further, the Nunes Report supported a finding that individuals with positions similar to Mr. Dakovich within the same industry had an upper quartile compensation rate substantially less than Mr. Dakovich did. Because the management fees paid to Mr. Dakovich were in addition to his salary, and his salary was in excess of that paid to individuals in comparable positions, this factor weighed heavily against treating the management fees as reasonable compensation. In computing compensation paid to shareholders as a percentage of net income before shareholder compensation is paid, the Tax Court found that Aspro's shareholder compensation was 90 percent, over 100 percent, and 67 percent of net income for the years in issue. These high percentages were found to weigh against treating the amounts paid to Mr. Dakovich as reasonable compensation. Finally, the Tax Court observed that Aspro had never paid dividends. By paying such high shareholder compensation, Aspro was less profitable than its industry peers. Low profits led to low retained earnings which, in turn, led to low returns for Aspro shareholders. Needless to say, the Tax Court found Mr. Dakovich's compensation to be unreasonably high.

Aftermath and observations. Because the management fees that Aspro paid to its shareholders did not constitute reasonable compensation, the court upheld the IRS's disallowance of the corporation's deductions and treated the management fees as nondeductible distributions to shareholders. The decision presents a roadmap of how not approach compensation of shareholders who provide services to the corporation. In the inverse, this case provides an excellent menu of how a closely held C corporation can structure reasonable compensation and avoid or survive a challenge by the IRS. Given the court's heavy reliance on the Nunes Report, one of the most important steps that might be taken is to seek a qualified valuation expert who can support the compensation paid by the corporation to a employee-shareholders in high level positions.

a. The Eighth Circuit agrees: management fees paid by C corporation to its shareholders were constructive dividends. Aspro, Inc. v. Commissioner, 32 F.4th 673 (8th Cir. 4/26/22). In an opinion by Judge Gruender, the U.S. Court of Appeals for the Eighth Circuit has affirmed the Tax Court's decision that disallowed the deductions taken by Aspro, Inc., a subchapter C corporation, for "management fees" paid to its shareholders. As previously discussed, the corporation had three shareholders: Jackson Enterprises, Corp. (40%) (Jackson), Mannatt's Enterprises, Ltd. (40%) (Mannatt's), and Mr. Dakovich, Aspro's president (20%). The court first considered the management fees paid to Jackson and Mannatt's. The court concluded that the Tax Court had not clearly erred in finding that Aspro had failed to meet its burden to show that these management fees were reasonable. Aspro, the court observed, had failed to quantify the value of services provided, failed to produce documentary evidence of a service relationship with Jackson and Mannatt's, and produced no evidence of how it had determined the amount of the management fees. Further, the court agreed with the Tax Court that the management fees paid to Jackson and Mannatt's were not purely for services rendered and instead were disguised distributions of profit. The court noted that Aspro had not paid dividends since the 1970s and that the management fees were roughly proportional to the ownership interests of these two shareholders. The court next considered the management fees that Aspro had paid to its president, Mr. Dakovich, and concluded, for similar reasons, that Aspro could not deduct the management fees. According to the court, Aspro had not quantified the value of the management services provided by Mr. Dakovich. The government's expert, the court observed, had concluded that the salary and bonus that Aspro paid to him exceeded the industry average and median by a substantial margin and that the management fees, which were paid in addition to his salary and bonus, were not reasonable. In addition, the court noted, the sum of the management fees plus the excess salary and

bonus paid to Mr. Dakovich was roughly proportional to his ownership interest in the corporation. Finally, the court concluded, the management fees paid to Mr. Dakovich were not purely for services rendered and instead were disguised distributions of profit:

> Aspro paid the management fees as lump sums at the end of the tax year even though the purported services were performed throughout the year, had an unstructured process of setting the management fees that did not relate to the services performed, and had a relatively small amount of taxable income after deducting the management fees.

Accordingly, the court concluded, the Tax Court did not clearly err in finding that Aspro had failed to carry its burden of showing that the management fees were reasonable and purely for services actually performed.

2. More than thirty years after the Technical and Miscellaneous Revenue Act of 1988, the regulations under § 301 are updated to make conforming changes. T.D. 9954, Treatment of Distributions of Property from a Corporation to a Shareholder, 86 F.R. 52612 (9/22/21). The IRS and the Treasury Department have finalized with no substantive changes proposed regulations issued in 2019 under § 301 regarding corporate distributions to reflect statutory changes made by the Technical and Miscellaneous Revenue Act of 1988. See REG-21694-16, Updating Section 301 Regulations to Reflect Statutory Changes, 84 F.R. 11263 (3/26/19). The Technical and Miscellaneous Revenue Act of 1988 amended § 301(b)(1) and § 301(d), effective as if the amendments had been included in the Tax Reform Act of 1986, to eliminate certain distinctions that previously existed between corporate and non-corporate distributees and certain special rules for distributions to or from foreign corporations. As amended, these statutory provisions state that the amount of a corporate distribution is the amount of money received plus the fair market value of property received (§ 301(b)(1)), and that the basis of property received from a corporation is the fair market value of that property (§ 301(d)). These final amendments update Reg. § 1.301-1 to reflect these changes and make certain non-substantive changes including modifying cross-references and reorganizing some provisions. Although the final regulations apply to distributions made after September 22, 2021, the statutory changes that they reflect are already effective and apply to distributions made in taxable years beginning after December 31, 1986.

3. 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, 2021.

C. Liquidations

D. S Corporations

E. Mergers, Acquisitions and Reorganizations

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.

VII. PARTNERSHIPS

A. Formation and Taxable Years

1. A partnership that was made profitable by the availability of a tax credit was a bona fide partnership, says the DC Circuit. Cross Refined Coal, LLC v. Commissioner, 45 F.4th 150 (D.C. Cir. 8/5/22). In an opinion by Judge Katsas, the U.S. Court of Appeals for the District of Columbia Circuit has affirmed a decision of the U.S. Tax Court and held that a partnership that was made profitable only by the availability of tax credits was a bona fide partnership. Congress enacted a refined-coal tax credit in 2004 to encourage the production of cleaner-burning coal. The credit, which was set forth in former § 45(c)(7)(A), was available to those who opened refined coal production facilities before 2012. Eligible taxpayers could claim the credit for each ton of refined coal sold for a ten-year period. AJG Coal, Inc. (AJG), sought to take advantage of the new credit by forming Cross Refined Coal, LLC (Cross), to operate a refined coal production facility in South Carolina. Cross entered into certain agreements with Santee Cooper, a state-owned electric and water utility that owned the power station where the new refined coal production facility would be located. These agreements included a lease that allowed Cross to build and operate a coal refining facility at the power station and a purchase-and-sale agreement under which Cross would purchase unrefined coal from Santee, refine it, and then sell it back to Santee for $0.75 *less* per ton than Cross had paid for it. This guaranteed that Cross would lose money on each purchase and sale. Cross also entered into a license agreement with AJG under which Cross obtained the right to use AJG's coal-refining technology. The lease, the purchase-and-sale agreement, and the license agreement all had ten-year terms that matched the ten-year period during which the refined coal tax credit was available. AJG formed two other LLCs that entered into similar agreements with Santee and AJG at two other power stations owned by Santee. The business model of Cross could produce a profit only by taking into account the refined-coal tax credit:

> Considering (1) the operating expenses that Cross incurred to refine coal, (2) the losses it sustained in buying and then re-selling the coal, and (3) the royalties it paid to obtain the necessary technology, Cross's operations inevitably would produce a pre-tax loss. Its sole opportunity to turn a profit was to claim a tax credit that exceeded these costs.

Within a few months after Cross built and began operating the new coal-refining facility, AJG recruited two other investors, who became members of Cross. One of the new members purchased a 51-percent interest in Cross for $4 million and the other purchased a 25-percent interest for $1.8 million. Because of limitations on the refined-coal tax credit, AJG could use only a portion of the available credit each year and had to carry forward the excess. Bringing in new members who could use the credit effectively allowed AJG to monetize the credit by selling interests in Cross and minimizing the credits it carried forward. The two new members of Cross also contributed to Cross a total of approximately $1.6 million to cover the business's operating expenses. All three members were actively involved in Cross's operations. Because of lengthy shutdowns attributable to various factors, Cross failed to produce the $140 million in profits that AJG had projected over the relevant ten-year period. Nevertheless, Cross did generate $19 million in after-tax profits over the four years during which the two additional

members AJG had recruited were members. During 2011 and 2012, Cross claimed more than $25.8 million in refined-coal tax credits and $25.7 million in ordinary business losses. Cross, which was classified as a partnership for federal tax purposes, allocated the credits and losses among its members. Following an audit, the IRS issued a final notice of partnership administrative adjustment in which it concluded that Cross was not a partnership and, accordingly, only AJG could claim the refined-coal tax credits. The IRS:

> determined that Cross was not a partnership for federal tax purposes "because it was not formed to carry on a business or for the sharing of profits and losses," but instead "to facilitate the prohibited transaction of monetizing 'refined coal' tax credits."

Cross challenged the final notice of partnership administrative adjustment by filing a petition in the U.S. Tax Court. In a ruling from the bench, the Tax Court (Judge Gustafson) held that Cross was a bona fide partnership because all three members had made substantial contributions, participated in management, and shared in profits and losses.

The U.S. Court of Appeals for the D.C. Circuit affirmed the Tax Court's decision. For guidance, the court relied on the U.S. Supreme Court's decisions in *Commissioner v. Tower*, 327 U.S. 280 (1946), and *Commissioner v. Culbertson*, 337 U.S. 733 (1949). According to the court, *Tower* and *Culbertson* provided a definition of a partnership that has two requirements: (1) those involved must intend to carry on a business as a partnership, *i.e.*, the enterprise must be undertaken for profit or for another legitimate nontax business purpose, and (2) those involved must intend to share in profits, losses, or both. The court concluded that Cross satisfied this definition. *First*, the court held that the Tax Court had correctly concluded that AJG and the two other members of Cross intended to carry on a business jointly. The court observed that AJG had legitimate, non-tax reasons for forming Cross and recruiting investors, including AJG's "spreading its investment risk over a larger number of projects." Further, the court added,

> there was nothing untoward about seeking partners who could apply the refined-coal credits immediately, rather than carrying them forward to future tax years. Low-tax entities (like AJG) often use the prospect of tax credits to attract high-tax entities … into a partnership, and in return, the high-tax partners provide the financing needed to make the tax-incentivized project possible.

The court also emphasized that the two other investors, although motivated by the availability of tax credits, made substantial contributions of capital and were actively involved in Cross's day-to-day operations. The court rejected the government's argument that Cross's members did not have the requisite intent to carry on a business because there was no expectation of a *pre-tax* profit. After reviewing relevant judicial decisions, the court concluded that transactions that are profitable only on a *post-tax basis* can still have a "nontax business purpose." Congress's objective in enacting the refined-coal tax credit, the court explained, was to encourage investments that would not otherwise have been made, and if the government is permitted to treat a partnership as a sham simply because there is no expectation of a pre-tax profit, then the only investments that would be made are those that would have been made without the congressional incentive. According to the court, this approach would undermine Congress's ability to use tax credits to encourage socially desirable activities.

Second, the court held that the Tax Court had correctly concluded that all members of Cross shared in profits and losses. The two investors that AJG recruited for Cross, the court concluded, clearly shared in profits and faced downside risk from Cross's business. The court rejected the government's argument that the investors did not face meaningful downside risk given the expected tax benefits. The government argued that the imbalance between the amounts of capital contributed by the investors and their expected tax benefits demonstrated that the investors merely bought tax credits and did not become true equity partners. The court emphasized that the amount of tax credits available to the partners depended on the amount of refined coal sold by Cross and that it was entirely possible that the investors would not recover much of their capital. In fact, the court observed, these same investors lost substantial amounts of money on their investments in another LLC formed by AJG to produce refined coal and that had the same investment structure as Cross.

In summary, the court held that Cross was a bona fide partnership for federal tax purposes.

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

1. Are partners not keeping track of outside basis? It could come back to bite them. New compliance campaigns by the IRS focus on losses and distributions that exceed a partner's outside basis. The IRS has announced compliance campaigns focusing on losses and distributions that exceed a partner's outside basis. Pursuant to the limitation set forth in § 704(d), a partner can deduct the partner's share of partnership losses only to the extent of the partner's basis in the partnership interest, as determined under § 705. Under the rules that apply to distributions in § 731(a), a partner's basis in the partnership interest functions as a limitation on the partner's ability to receive certain liquidating and non-liquidating distributions without the recognition of gain. In February 2022, the IRS announced a compliance campaign focusing on the allocation of losses to a partner that exceed the partner's outside basis. The identification of this issue as the focus of a compliance campaign is available on the IRS website through the following link: https://perma.cc/5BX8-GZJP. In August 2022, the IRS announced a compliance campaign focusing on distributions to a partner that exceed the partner's outside basis. The identification of this issue as the focus of a compliance campaign is available on the IRS website through the following link: https://perma.cc/M4PR-UERJ.

- Partnerships now must report annually a partner's tax capital account on Schedule K-1. Query whether the IRS plans to use a partner's tax capital account as a proxy for the partner's basis in the partnership interest. This possibility combined with the new compliance campaigns reinforce the importance of partners having records to support the determination of their basis in the partnership interest.

C. Distributions and Transactions Between the Partnership and Partners

D. Sales of Partnership Interests, Liquidations and Mergers

E. Inside Basis Adjustments

1. The IRS has finally recognized that partnership returns are filed electronically. Section 754 elections no longer require a partner's signature. T.D. 9963, Streamlining the Section 754 Election Statement, 87 F.R. 47931 (8/5/22). The Treasury Department and the IRS have finalized, without changes, proposed regulations that eliminate the requirement that a § 754 election made by the partnership be signed by one of the partners. *See* REG-116256-17, Streamlining the Section 754 Election Statement, 82 F.R. 47408 (10/12/17). If a partnership wishes to make a § 754 election, the former regulations (Reg. § 1.754-1(b)) required the partnership to attach to its return a written statement that (i) set forth the name and address of the partnership making the election, (ii) was signed by one of the partners, and (iii) contained a declaration that the partnership elects under § 754 to apply the provisions of §§ 734(b) and 743(b). Many partnership returns are filed electronically with § 754 elections that, in the IRS's view, do not comply with the requirement that the election be signed by one of the partners. As a result, the IRS received many requests for so-called "9100 relief" to make a late § 754 election. In these final regulations, the IRS has eliminated the requirement that a partnership's § 754 election be signed by one of the partners. Pursuant to this amendment, a § 754 election must comply only with the other two requirements to be a valid election. This change applies to taxable years ending on or after August 5, 2022, but taxpayers can apply the change to taxable years ending before that date. Therefore, partnerships filing their returns electronically with an otherwise valid § 754 election need not request 9100 relief.

F. Partnership Audit Rules

G. Miscellaneous

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. What does "protected in perpetuity" mean? These cases provide some answers in the context of conservation easements. It is well known that the IRS is battling syndicated conservation easements. Moreover, after recent victories, the IRS has announced a time-limited settlement offer to certain taxpayers with pending Tax Court cases involving syndicated conservation easements. *See* IR 2020-130 (6/25/20). Other than challenging valuations, the IRS's most successful strategy in combating syndicated conservation easements generally has centered around the "protected in perpetuity" requirement of § 170(h)(2)(C) and (h)(5)(A). The IRS has argued successfully in the Tax Court that the "protected in perpetuity" requirement is not met where the taxpayer's easement deed fails to meet the strict requirements of the "extinguishment regulation." *See* Reg. § 1.170A-14(g)(6)(ii). The extinguishment regulation ensures that conservation easement property is protected in perpetuity because, upon destruction or condemnation of the property and collection of any proceeds therefrom, the charitable donee must proportionately benefit. According to the IRS's and Tax Court's reading of the extinguishment regulation, the charitable donee's proportionate benefit must be determined by a fraction determined at the time of the gift as follows: the value of the conservation easement as compared to the total value of the property subject to the conservation easement (hereinafter the "proportionate benefit fraction"). *See Coal Property Holdings, LLC v. Commissioner*, 153 T.C. 126 (10/28/19). Thus, upon extinguishment of a conservation easement due to an unforeseen event such as condemnation, the charitable donee must be entitled to receive an amount equal to the product of the proportionate benefit fraction multiplied by the proceeds realized from the disposition of the property. As part of its litigation strategy against syndicated conservation easements, the IRS pounces upon any technical flaws in the deed's extinguishment clause/proportionate benefit fraction language. In fact, the IRS recently has been successful in challenging extinguishment clause/proportionate benefit fraction language that either (i) would allow the donor to reclaim from the charitable donee property subject to a conservation easement by conveying to the donee substitute property in exchange therefor or (ii) would reduce the charitable donee's benefit upon extinguishment of the conservation easement by the fair market value of post-contribution improvements made to the subject property after the date of the taxpayer-donor's deductible gift. *See, e.g., Pine Mountain Preserve, LLLP v. Commissioner*, 151 T.C. 247 (12/27/18), including its companion case, *Pine Mountain Preserve, LLLP v. Commissioner*, T.C. Memo. 2018-214 (12/27/18) (deed allowed substituted property), *aff'd in part, vac'd in part, rev'd in part*, 978 F.3d 1200 (11th Cir. 10/22/20); and *PBBM Rose Hill, Ltd. v. Commissioner*, 900 F.3d 193 (5th Cir. 9/14/18) (deed reduced charitable donee's benefit for subsequent improvements made by taxpayer donor). The latter argument by the IRS—that a properly-drafted extinguishment clause/proportionate benefit fraction cannot give the donor credit for post-contribution improvements to the conservation easement property—is particularly potent. This argument by the IRS is the subject of the two Tax Court companion opinions rendered in *Oakbrook Land Holdings, LLC v. Commissioner*, as discussed below. Reportedly, many conservation easement deeds have such language, especially syndicated conservation easement deeds originating in the southeastern U.S. Hence, the Tax Court's opinions in *Oakbrook Land Holdings, LLC v. Commissioner* are very important to the conservation easement industry. For a discussion of other IRS and Tax Court developments relating to conservation easements, see the Agricultural Law and Taxation Blog post of July 8, 2020, available here.

a. A crack in the IRS's armor with respect to syndicated conservation easements? Or, a death knell for taxpayers? You be the judge. Oakbrook Land Holdings LLC v. Commissioner, 154 T.C. 180 (5/12/20), including the companion memorandum opinion Oakbrook Land Holdings LLC v. Commissioner, T.C. Memo 2020-54 (5/12/20). In these companion opinions totaling 172 pages, the Tax Court disallowed a taxpayer-donor's charitable contribution deduction because the language in the conservation easement deed was found to be defective under either of two theories argued by the IRS and supported by the Tax Court's reading of Reg. § 1.170A-14(g)(6)(ii). See below for further discussion. The taxpayer-donor's counter arguments, that the conservation easement deed's language was correct and that Reg. § 1.170A-14(g)(6)(ii) is invalid, failed to persuade the Tax Court. Just to keep us on our toes, perhaps, the Tax Court's decision resulted in two lengthy

opinions. Judge Lauber wrote the majority opinion for the Tax Court's reviewed decision regarding one theory of the case, while Judge Holmes wrote a memorandum decision based upon another theory of the case. Interestingly, *Oakbrook Land Holdings* did not arise out of a syndicated conservation easement; however, it is very informative as to the IRS's litigation strategy with respect to syndicated conservation easements as well as the Tax Court's view of the law applicable to conservation easements generally.

Facts. The facts of *Oakbrook Land Holdings* are typical of recent conservation easement cases litigated in the Tax Court. The taxpayer-donor, Oakbrook Holdings LLC, acquired a 143-acre parcel of property near Chattanooga, Tennessee in 2007 for $1.7 million. The plan was to develop the property for "higher-end, single family residences." In late 2008 Oakbrook Holdings LLC transferred approximately 37 acres of the property to related entities to allow a portion of the property to be developed without restrictions relating to the remainder of the property. The remaining 106 acres of the property then was subjected to a conservation easement in favor of Southeast Regional Land Conservancy (the "Conservancy"), a § 501(c)(3) organization. The taxpayer-donor, Oakbrook Holdings LLC, claimed a charitable contribution deduction of over $9.5 million for the donated conservation easement even though the contribution occurred only a little over a year after Oakbrook Holdings LLC had acquired the property for $1.7 million.

Oakbrook Holdings LLC, the taxpayer-donor, largely relied upon the charitable donee, the Conservancy, and its attorneys to draft the conservation easement deed. The Conservancy in turn relied upon language found in similar conservation easement deeds that have been executed and approved by numerous taxpayers and their attorneys. The deed provided as follows in relevant part:

> This Conservation Easement gives rise to a real property right and interest immediately vested in [the Conservancy]. For purposes of this Conservation Easement, the fair market value of [the Conservancy]'s right and interest shall be equal to the difference between (a) the fair market value of the Conservation Area as if not burdened by this Conservation Easement and (b) the fair market value of the Conservation Area burdened by this Conservation Easement, as such values are determined as of the date of this Conservation Easement, (c) less amounts for improvements made by O[akbrook] in the Conservation Area subsequent to the date of this Conservation Easement, the amount of which will be determined by the value specified for these improvements in a condemnation award in the event all or part of the Conservation Area is taken in exercise of eminent domain as further described in this Article VI, Section B(3) below. If a change in conditions makes impossible or impractical any continued protection of the Conservation Area for conservation purposes, the restrictions contained herein may only be extinguished by judicial proceeding. Upon such proceeding, [the Conservancy], upon a subsequent sale, exchange or involuntary conversion of the Conservation Area, shall be entitled to a portion of the proceeds equal to the fair market value of the Conservation Easement as provided above. [The Conservancy] shall use its share of the proceeds in a manner consistent with the conservation purposes set forth in the Recitals herein.

Article VI, Section B(3) of the deed further stated:

> Whenever all or part of the Conservation Area is taken in exercise of eminent domain * * * so as to abrogate the restrictions imposed by this Conservation Easement, * * * [the] proceeds shall be divided in accordance with the proportionate value of [the Conservancy]'s and O[akbrook]'s interests as specified above; all expenses including attorneys fees incurred by O[akbrook] and [the Conservancy] in this action shall be paid out of the recovered proceeds to the extent not paid by the condemning authority.

First argument of the IRS and taxpayer's response. The IRS's first argument to disallow the taxpayer-donor's charitable contribution deduction was that the above-quoted language of the conservation easement deed only entitled the charitable donee, the Conservancy, to a fixed (not proportionate) benefit (i.e., historical value of the conservation easement at the time of the gift) upon the destruction or condemnation of the subject property. According to the IRS, Reg. § 1.170A-14(g)(6)(ii) requires that the charitable donee be entitled to a *proportionate* (i.e., fractional) benefit

upon extinguishment of a conservation easement. Further, the IRS's position is that the amount of the benefit must be determined by applying the proportionate benefit fraction against the fair market value of the subject property at the time of the extinguishment. Put differently, the IRS contends that Reg. § 1.170A-14(g)(6)(ii) does not merely establish a baseline amount equal to the value of the conservation easement as the amount of the benefit to be received by the charitable donee upon extinguishment of a conservation easement. Rather, upon extinguishment of the easement, if the subject property has appreciated in value the charitable donee must be entitled to receive more than the claimed charitable contribution value of the conservation easement. (It is not entirely clear what the IRS's position would be under Reg. § 1.170A-14(g)(6)(ii) if upon extinguishment of the easement the subject property has decreased in value after the taxpayer-donor's gift, although consistency would argue that the charitable donee should receive less than the claimed charitable contribution value.)

On the other hand, the taxpayer-donor argued, of course, that the above-quoted language in the deed complied with Reg. § 1.170A-14(g)(6)(ii) because the regulation should be read to require only a fixed (not fractional) amount that must be received by the charitable-donee upon extinguishment of a conservation easement. In other words, the taxpayer-donor believed that Reg. § 1.170A-14(g)(6)(ii) was meant to protect the chartable donee's downside risk: i.e., that the event extinguishing the conservation easement would result in proceeds much less than the taxpayer-donor's claimed charitable contribution deduction. The taxpayer-donor's reading of Reg. § 1.170A-14(g)(6)(ii) was that the extinguishment clause in a conservation easement deed must entitle the charitable donee to an amount equal to the previously claimed charitable contribution deduction (or, if less, all of the proceeds from the disposition of the property).

Memorandum Opinion of Judge Holmes. In Oakbrook Land Holdings LLC v. Commissioner, T.C. Memo 2020-54 (5/12/20), Judge Holmes, citing the Tax Court's prior decision in *Coal Property Holdings, LLC v. Commissioner*, 153 T.C. 126 (10/28/19), agreed with the IRS's position regarding Reg. § 1.170A-14(g)(6)(ii) and the conservation easement language at issue, thereby disallowing the taxpayer-donor's more than $9.7 million charitable contribution deduction. Judge Holmes reasoned that the language in the deed did not grant a fractional proportionate benefit to the Conservancy. It granted only a minimum benefit equal to the amount of the taxpayer-donor's claimed charitable contribution deduction. Judge Holmes agreed with the IRS that Reg. § 1.170A-14(g)(6)(ii) requires a fractional benefit, not a fixed amount. Other cases also have interpreted Reg. § 1.170A-14(g)(6) to require a fractional, not fixed, benefit in favor of the charitable donee. *See, e.g.*, *PBBM Rose Hill, Ltd. v. Commissioner*, 900 F.3d 193 (5th Cir. 9/14/18). This aspect of the Tax Court's decision in *Oakbrook Land Holdings* is not novel, and presumably this lack of novelty is the reason for this memorandum decision written separately from the Tax Court's reviewed opinion written by Judge Lauber.

Second argument of the IRS and taxpayer's response. Alternatively, the IRS argued that the above-quoted language in the conservation easement deed was flawed in another respect. Specifically, the IRS contended that the deed's extinguishment language, which required that the charitable-donee's benefit upon destruction or condemnation of the property be reduced by the value of improvements to the property made by the taxpayer-donor after the contribution, was not allowed by the strict requirements of Reg. § 1.170A-14(g)(6)(ii). This position of the IRS is not explicitly supported by Reg. § 1.170A-14(g)(6)(ii) and is a novel argument by the IRS. The taxpayer-donor responded that to the extent Reg. § 1.170A-14(g)(6)(ii) is read to disallow such a reduction in the charitable-donee's benefit upon extinguishment of a conservation easement, the extinguishment regulation violates either the procedural or substantive requirements of the Administrative Procedures Act ("APA") and is invalid. This alternative argument by the IRS, and the taxpayer-donor's response, was the subject of the Tax Court's reviewed opinion by Judge Lauber, discussed below.

Reviewed opinion of Judge Lauber. In Oakbrook Land Holdings LLC v. Commissioner, 154 T.C. 180 (5/12/20), a reviewed opinion (12-4-1) by Judge Lauber, the Tax Court agreed with the IRS's position concerning Reg. § 1.170A-14(g)(6)(ii) and post-contribution improvements to conservation easement property by a taxpayer-donor. We will spare the reader pages and pages of arguments and counter-arguments regarding the requirements of the APA. Suffice it to say that a majority of the Tax Court held that Reg. § 1.170A-14(g)(6)(ii) reflects a reasonable interpretation of the "protected in perpetuity" requirement of § 170(h)(2)(C) and (h)(5)(A). The majority also agreed with the IRS's position that Reg. § 1.170A-14(g)(6)(ii) does not permit the extinguishment clause of a conservation

easement deed to reduce the charitable donee's proportionate benefit by the fair market value of post-contribution improvements to the subject property made by the donor. Hence, the majority disallowed the taxpayer-donor's claimed $9.7 million plus charitable contribution deduction based upon the IRS's alternative argument (in addition to the grounds expressed in Judge Holmes's separate memorandum opinion).

Concurring opinion of Judge Toro. In a concurring opinion, Judge Toro, joined by Judge Urda and in part by Judges Gustafson and Jones, wrote that, although the majority reached the correct result for the reasons expressed in Judge Holmes's memorandum decision, the majority was mistaken concerning whether Reg. § 1.170A-14(g)(6)(ii) violates the APA and whether the IRS's interpretation of the extinguishment regulation (regarding post-contribution improvements made by a taxpayer-donor) was permissible.

Dissenting opinion of Judge Holmes. In an interesting twist, Judge Holmes (who held in favor of the IRS in his memorandum opinion) dissented from the Tax Court's reviewed opinion. Judge Holmes wrote: "Our decision today will likely deny any charitable deduction to hundreds or thousands of taxpayers who donated the conservation easements that protect perhaps millions of acres." And Judge Holmes made his views clear regarding the IRS's interpretation of Reg. § 1.170A-14(g)(6)(ii) to prohibit reduction of a charitable donee's extinguishment benefit for the value of improvements made by a taxpayer-donor and Treasury's compliance with the APA: "[I]f the majority is right, the Treasury Department can get by with the administrative-state equivalent of a quiet shrug, a knowing wink, and a silent fleeting glance from across a crowded room."

b. The Eleventh Circuit has agreed that a conservation easement with an extinguishment clause that does not allow the charitable donee, in the event the easement is extinguished, to share in appreciation of the property due to improvements does not comply with applicable regulations. TOT Property Holdings, LLC v. Commissioner, 1 F.4th 1354 (11th Cir. 6/23/21). The taxpayer in this case donated to a qualifying organization (a land conservancy) a conservation easement on 652 acres of undeveloped land in Van Buren County, Tennessee. As required by Reg. § 1.170A-14(g)(6)(ii), the deed granting the easement addressed the rights of the donee organization in the event the easement was extinguished. The deed provided that, upon extinguishment of the easement, the donee organization would be entitled to a proportionate share of the sale proceeds resulting from the extinguishment. The proportionate share was to be determined by comparing, at the time of donation, (i) the value of the easement to (ii) the value of the property subject to the easement without reduction by the value of the easement. In other words, the donee's proportionate share of extinguishment proceeds would be determined by constructing a fraction, the numerator of which was the value of the easement at the time of donation and the denominator of which was the value of the entire property (without reduction by the value of the easement) at the time of donation. So far, so good. However, the deed provided that, if the easement were extinguished, the donee's proportionate share of sale proceeds would be determined by applying this fraction to:

> the fair market value of the Property unencumbered by this Easement (minus any increase in value after the date of this grant attributable to improvements) …

The effect of this language was to preclude the charitable donee from sharing, upon extinguishment of the easement, in any increase in value of the property attributable to post-donation improvements. In an opinion by Judge Anderson, the U.S. Court of Appeals for the Eleventh Circuit agreed with the IRS that this provision in the deed conveying the easement did not comply with Reg. § 1.170A-14(g)(6)(ii):

> Appellants do not seriously dispute that the formula in … the deed is different from [the] regulatory formula. Nor could they plausibly do so…. [T]he regulation does not allow for "any increase in value after the date of th[e] grant attributable to improvements" to be subtracted from the extinguishment (e.g. condemnation) proceeds before the fraction is applied to the proceeds. No such "minus" language is included in the formula set out in § 1.170A-14(g)(6)(ii). Thus, the deed is different from and out of compliance with the formula set out in the regulation.

The court noted that its holding was consistent with the holding of the Fifth Circuit in *PBBM Rose Hill, Ltd. v. Commissioner*, 900 F.3d 193 (5th Cir. 2018), and that of the Tax Court in *Coal Property Holdings, LLC v. Commissioner*, 153 T.C. 126 (2019).

The court also rejected the taxpayer's argument that the language in the deed complied with the applicable regulation because it stated that the donee organization's proportionate share of proceeds resulting from extinguishment of the easement would be determined either in accordance with the deed or in accordance with Reg. § 1.170A-14 "if different." The court referred to this provision as the "Treasury Regulation Override." "For federal tax purposes," the court observed, "courts and the IRS have refused to enforce a clause that purports to save an instrument from being out of compliance with the tax laws if the clause is operative by way of a condition subsequent." The court concluded that the Treasury Regulation Override was a condition subsequent savings clause that did not bring the language in the deed into compliance with the applicable regulation.

The court also upheld the Tax Court's valuation of the easement in question, the Tax Court's imposition of accuracy-related penalties, and held that the IRS had complied with § 6751(b) by obtaining the required supervisory approval of the penalties.

- The taxpayer in this case did not challenge the validity of the regulation in question, Reg. § 1.170A-14(g)(6)(ii), under the Administrative Procedure Act (APA). In a subsequent case, *Hewitt v. Commissioner*, 21 F.4th 1336 (11th Cir. 12/29/21), the Eleventh Circuit held that the regulation was arbitrary and capricious under the APA for failing to comply with the APA's procedural requirements and therefore is invalid.

c. According to the Eleventh Circuit, Reg. § 1.170A-14(g)(6)(ii), as interpreted by the IRS, is arbitrary and capricious under the Administrative Procedure Act for failing to comply with procedural requirements and therefore is invalid. Hewitt v. Commissioner, 21 F.4th 1336 (11th Cir. 12/29/21), *rev'g*, T.C. Memo. 2020-89 (6/17/20). In an opinion by Judge Lagoa, the U.S Court of Appeals for the Eleventh Circuit has held that Reg. § 1.170A-14(g)(6)(ii), as interpreted by the IRS, violates the Administrative Procedure Act (APA) and therefore is invalid. The taxpayers in this case donated to a qualifying organization a conservation easement on land in Randolph County, Alabama. Like the deed in *TOT Property Holdings, LLC v. Commissioner*, 1 F.4th 1354 (11th Cir. 6/23/21) (discussed above), the deed conveying the easement in this case provided that, in the event of judicial extinguishment of the easement, the value of post-donation improvements to the property would be subtracted from the extinguishment proceeds before determining the donee's share of the proceeds. The IRS argued that this subtraction of the value of post-donation improvements is not permitted by the relevant regulation, Reg. § 1.170A-14(g)(6)(ii). The Eleventh Circuit had agreed with the IRS on this issue in *TOT Property Holdings, LLC*. In this case, however, the taxpayers, unlike the taxpayers in *TOT Property Holdings, LLC*, argued that the regulation was invalid under the APA. 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 taxpayer argued that, in issuing Reg. § 1.170A-14(g)(6)(ii), Treasury had not complied with the second step because seven commenters, including the New York Land Conservancy (NYLC), had expressed concern about the required allocation of proceeds upon extinguishment of the easement reflected in the proposed version of the regulation. The NYLC specifically had commented on the issue of whether post-donation improvements to the property subject to the easement should be taken into account in determining the charitable donee's proportionate share of extinguishment proceeds and had argued that such a requirement was undesirable to prospective donors and that the proposed version of the regulation should be revised. When the Treasury Department issued the final version of the regulation, the preamble stated that Treasury had considered all comments submitted but did not specifically address or respond to the comments submitted on allocation of post-extinguishment proceeds. The Eleventh Circuit agreed with the taxpayer:

> Simply put, NYLC's comment was significant and required a response by Treasury to satisfy the APA's procedural requirements. And the fact that Treasury stated that it had

> considered “all comments,” without more discussion, does not change our analysis, as it does not “enable [us] to see [NYLC’s] objections and why [Treasury] reacted to them as it did.”

(quoting Lloyd Nolan Hosp. & Clinic v. Heckler, 762 F.2d1561, 1566 (11th Cir. 1985).) Accordingly, the court held that the IRS’s interpretation of Reg. § 1.170A-14(g)(6)(ii) as precluding the subtraction of post-donation improvements to the easement property in determining the donee organization’s proportionate share of extinguishment proceeds is arbitrary and capricious and therefore invalid under the APA’s procedural requirements. The court therefore reversed the Tax Court’s decision that had disallowed the taxpayer’s charitable contribution deduction.

d. The Sixth Circuit has disagreed with the Eleventh Circuit and has held that Treasury complied with the Administrative Procedure Act in issuing Reg. § 1.170A-14(g)(6)(ii) and that the regulation is valid. Oakbrook Land Holdings, LLC v. Commissioner, 28 F.4th 700 (6th Cir. 3/14/22), *aff’g*, 154 T.C. 180 (5/12/20). The taxpayers in this case donated to a qualifying organization a conservation easement on 106 acres of land on White Oak Mountain, an outcropping of the Appalachians near Chattanooga, Tennessee. As discussed above, the deed conveying the easement provided that, if the easement were to be extinguished, the done organization’s proportionate share of the extinguishment proceeds would be determined by subtracting the value of any post-donation improvements to the property. The Tax Court had held in a reviewed opinion that Treasury had complied with the Administrative Procedure Act (APA) in issuing the regulation. In an opinion by Judge Moore, the U.S. Court of Appeals for the Sixth Circuit has affirmed the Tax Court’s decision. The taxpayers in this case, like those in *Hewitt v. Commissioner*, 21 F.4th 1336 (11th Cir. 12/29/21), argued that Treasury had failed to comply with the APA in issuing the regulation. 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 taxpayer argued that, in issuing Reg. § 1.170A-14(g)(6)(ii), Treasury had not complied with the either the second or third steps. With respect to the third step, the taxpayer argued that Treasury had not adequately explained the purpose and basis of the regulations because the preamble to the final version of the regulations stated only that the regulations “provide necessary guidance to the public for compliance with the law and affect donors and donees of qualified conservation contributions.” The court rejected this argument. Even without an ideal statement of basis and purpose for regulations, the court explained, a regulation can meet the requirement of including a concise statement of its basis and purpose if the basis and purpose are obvious. In its notice of proposed rulemaking for Reg. § 1.170A-14, Treasury had discussed the legislative history of § 170(h) and had described how Congress had shifted from limiting the deductibility of conservation easements to allowing them when the easement was perpetual. Here, the court reasoned,

> the statutory text and the legislative history that Treasury contemplated in promulgating Treas. Reg. § 1.170A-14(g)(6)(ii) illuminate the regulation’s basis and purpose: to provide an administrable mechanism that would ensure that an easement’s conservation purpose as per I.R.C. § 170(h)(5)(A) continued to be protected should the interest be extinguished.

With respect to the second step for notice-and-comment rulemaking, the taxpayers argued that several commenters, including the New York Land Conservancy (NYLC), had expressed concern about the required allocation of proceeds upon extinguishment of the easement reflected in the proposed version of the regulation. The NYLC specifically had commented on the issue of whether post-donation improvements to the property subject to the easement should be taken into account in determining the charitable donee’s proportionate share of extinguishment proceeds and had argued that such a requirement was undesirable to prospective donors and that the proposed version of the regulation should be revised. When the Treasury Department issued the final version of the regulation, the preamble stated that Treasury had considered all comments submitted but did not specifically address or respond to the comments submitted on allocation of post-extinguishment proceeds. The court held that none of the comments identified by the taxpayers required a response by Treasury. None of the

comments, the court observed, raised a concern that Reg. § 1.170A-14(g)(6)(ii), which addresses allocation of proceeds to the donee organization upon extinguishment of the easement, failed to satisfy the perpetuity requirement of § 170(h)(2)(C) and (h)(5)(A), which was Congress's central concern. The court rejected as unpersuasive the contrary decision of the Eleventh Circuit in *Hewitt v. Commissioner*, 21 F.4th 1336 (11th Cir. 12/29/21).

The court also rejected the taxpayer's argument that Reg. § 1.170A-14(g)(6)(ii) reflects an impermissible construction of § 170(h). The court assessed the validity of the regulation by applying the two-step analysis of *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). The court concluded in *Chevron* step one that the statute, § 170(h)(5)(A), is ambiguous, and in step two that Reg. § 1.170A-14(g)(6)(ii) is a reasonable interpretation of the statute.

Finally, the court rejected as unpersuasive the taxpayer's argument that Treasury had acted arbitrarily or capriciously in issuing Reg. § 1.170A-14(g)(6)(ii) because it had provided no explanation for why it adopted the rule, and because it had failed to consider a variety of alternatives.

Concurring opinion by Judge Guy. In a concurring opinion, Judge Guy concluded that Reg. § 1.170A-14(g)(6)(ii) is procedurally invalid under the APA for substantially the same reasons articulated by the Eleventh Circuit in *Hewitt v. Commissioner*, 21 F.4th 1336 (11th Cir. 12/29/21). Nevertheless, Judge Guy concurred in the court's judgment affirming the Tax Court's decision. Judge Guy reasoned that the relevant statute, § 170(h)(2)(C), requires that the donee organization receive the fair market value of the easement upon judicial extinguishment of the easement, that this right be protected in perpetuity, and that the provisions in the deed conveying the easement in this case failed to comply with this requirement. In other words, Judge Guy reasoned that it is unnecessary to rely on Reg. § 1.170A-14(g)(6)(ii) to conclude that the easement in this case failed to satisfy the statutory requirement. The majority declined to consider this argument by the government because the government had failed to raise it in the Tax Court. Judge Guy observed that parties can be permitted to raise arguments for the first time on appeal in exceptional cases, and concluded that this was an exceptional case.

2. If you are donating a used motor vehicle, boat, or airplane, you better not neglect to obtain and attach to your return Form 1098-C, says the Tax Court. Izen v. Commissioner, 148 T.C. 71 (3/1/17). On April 14, 2016, during a pending Tax Court proceeding, the taxpayer filed an amended federal income tax return for 2010 and claimed a charitable contribution deduction of $338,080 for his donation of a 50 percent interest in a 1969 model Hawker-Siddley DH125-400A private jet to the Houston Aeronautical Heritage Society (Society), an organization exempt from tax under § 501(c)(3), which operates a museum at the William P. Hobby Airport. The taxpayer included with his amended return: (1) an acknowledgment letter dated December 30, 2010, and signed by the president of the Society; (2) a Form 8283, *Noncash Charitable Contributions*, dated April 13, 2016, and executed by the managing director of the Society; (3) a copy of an "Aircraft Donation Agreement" allegedly executed on December 31, 2010, by the president of the Society (but not by the taxpayer); and (4) an appraisal dated April; 7, 2011, stating that the fair market value of the taxpayer's 50 percent interest in the aircraft, as of December 30, 2010, was $338,080. The IRS moved for summary judgment and asserted that the taxpayer was not entitled to the charitable contribution deduction because he had failed to satisfy the substantiation requirements of § 170(f)(12), which applies to contributions of used motor vehicles, boats, and airplanes. Section 170(f)(8) requires a contemporaneous written acknowledgement from the donee organization as a condition for deducting charitable contributions of $250 or more, but § 170(f)(12) imposes more stringent substantiation requirements. Section 170(f)(12) requires a more detailed contemporaneous written acknowledgment and, unlike § 170(f)(8), requires the taxpayer to include the acknowledgment with the return that includes the deduction. The statute directs the donee organization to provide to the government the information contained in the acknowledgment, and the IRS has designated for this purpose Form 1098-C, *Contributions of Motor Vehicles, Boats, and Airplanes*, a copy of which is to be provided to the donor. The taxpayer did not submit Form 1098-C with his amended return. The Tax Court (Judge Lauber) concluded that the documentation the taxpayer did submit with his amended return did not comply with the requirements of § 170(f)(12). Accordingly, the court disallowed the taxpayer's deduction.

a. The Fifth Circuit has agreed: no 1098-C, no deduction. Izen v. Commissioner, 129 A.F.T.R.2d 2022-2171 (5th Cir. 6/29/22), *aff'g* 148 T.C. 71 (3/1/17). In a per curiam opinion, the U.S. Court of Appeals for the Fifth Circuit has affirmed the Tax Court's decision. Section 170(f)(12) requires a taxpayer to attach Form 1098-C to the return in order to claim a deduction for a charitable contribution of used motor vehicles, boats, and airplanes. The court rejected the taxpayer's argument that he had substantially complied with the statute's requirements by attaching to the return the documentation that he did:

> The doctrine of substantial compliance may support a taxpayer's claim where he or she acted in good faith and exercised due diligence but nevertheless failed to meet a regulatory requirement. We cannot accept the argument that substantial compliance satisfies statutory requirements. Congress specifically required the contemporaneous written acknowledgment include the taxpayer identification number, but that is lacking here.

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 procedure 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 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 chips 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.

2. Tax Court holds IRS does not need written supervisory approval to apply the § 72(t) 10% penalty for early withdrawal from a retirement plan. Grajales v. Commissioner, 156 T.C. 55 (1/25/21). In general, under § 7491(c), the IRS has the burden of production with respect to "any penalty, addition to tax, or additional amount." To satisfy this burden, § 6751(b)(1) requires the IRS to prove that "the initial determination of [the] assessment … [of any penalty was] personally approved (in writing) by the immediate supervisor of the individual making such determination." *See, e.g.*, *Frost v. Commissioner*, 154 T.C. 23, 34-35 (2020). Pursuant to § 6751(c), the term "penalties" as used in § 6571 includes "any addition to tax or any additional amount." In this case, the taxpayer, Ms. Grajales, who was in her early 40s, took loans in connection with her New York State pension plan (the "Plan"). The Plan sent her a Form 1099-R that reflected total distributions of $9,026. 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. In filing her tax return, Ms. Grajales did not report any retirement plan distributions as income. The IRS determined that she should have included the $9,026 of Plan distributions in her income and that the distributions were subject to the 10-percent additional tax on early distributions under § 72(t). The issue in this case was whether the 10 percent exaction of § 72(t) is a penalty, addition to tax, or additional amount within the meaning of § 6751(c). If so, then the IRS was required by § 6751(b) to have written, supervisory approval in order to impose the 10-percent additional amount provided for in § 72(t). The Tax Court (Judge Thornton) held that the § 72(t) exaction is a "tax" and not a "penalty," "addition to tax," or "additional amount." Because it is a "tax," the court held, it is not subject to the § 6751(b) written supervisory approval requirement. In reaching this conclusion, Judge Thornton acknowledged that none of the court's prior decisions have expressly addressed whether the § 6751(b) written supervisory approval requirement applies to the 10-percent exaction of § 72(t). Judge Thornton relied on several Tax Court decisions that have held that the § 72(t) exaction is a "tax." The court previously had held that the § 72(t) exaction is not a "penalty, addition to tax, or additional amount" within the meaning of § 7491(c) for purposes of imposing the burden of production. *See, e.g., Williams v. Commissioner*, 151 T.C. 1 (2018). Further, in *El v. Commissioner*, 144 T.C. 140, 148 (2015), the Tax Court had concluded that the exaction under §72(t) was a tax for the following reasons:

> First, section 72(t) calls the exaction that it imposes a "tax" and not a "penalty", "addition to tax", or "additional amount". Second, several provisions in the Code expressly refer to the additional tax under section 72(t) using the unmodified term "tax". See secs. 26(b)(2), 401(k)(8)(D), (m)(7)(A), 414(w)(1)(B), 877A(g)(6). Third, section 72(t) is in subtitle A, chapter 1 of the Code. Subtitle A bears the descriptive title "Income Taxes", and chapter 1 bears the descriptive title "Normal Taxes and Surtaxes". Chapter 1 provides for several income taxes, and additional income taxes are provided for elsewhere in subtitle A. By contrast, most penalties and additions to tax are in subtitle F, chapter 68 of the Code.

In following the court's prior holdings, Judge Thornton rejected the taxpayer's argument that the exaction of § 72(t) is an "additional amount" within the meaning of § 6751(c), reasoning that use of the phrase "additional amounts" when used in a series that also includes "tax" and "additions to tax" is a term of art that refers exclusively to civil penalties. Judge Thornton rejected several other arguments made by the taxpayer, including the assertion that the Tax Court must employ the "functional approach" under which the U.S. Supreme Court applied a constitutional analysis to conclude that the § 72(t) exaction was a "penalty" and not a "tax." *See Nat'l Fed'n of Indep. Bus. (NFIB) v. Sebelius*, 567 U.S. 519 (2012). Judge Thornton distinguished *NFIB* on the basis that the circumstances in this case presented no constitutional issue. Further, neither party argued that § 72(t) is unconstitutional in this case. According to the Tax Court, for purposes of § 6751(b) and (c), the § 72(t) exaction is a "tax," not a "penalty," "addition to tax," or "additional amount." Therefore, § 6751(b) did not require written supervisory approval.

a. The Second Circuit has agreed: the IRS need not comply with the § 6751(b) supervisory approval requirement to apply the § 72(t) 10% penalty for early

withdrawal from a retirement plan. Grajales v. Commissioner, 47 F.4th 58 (2d Cir. 8/24/22), *aff'g Grajales v. Commissioner*, 156 T.C. 55 (1/25/21). In an opinion by Judge Wesley, the U.S. Court of Appeals for the Second Circuit has affirmed the Tax Court's decision and held that the 10-percent additional amount imposed by § 72(t) on early distributions from a retirement plan is not a penalty and therefore is not subject to the supervisory approval requirement of § 6751(b). The court emphasized that the plain language of § 72(t) indicates that the exaction it imposes is a tax and not a penalty. That language, the court observed, states that a "taxpayer's tax … *shall be increased* by an amount equal to 10 percent of the portion of such amount which is includible in gross income." (emphasis added). The terms "penalty," additional amount," and "addition to tax," the court reasoned, do not appear in the language of § 72(t). The court rejected the taxpayer's argument that the exaction of § 72(t) is a penalty because it is calculated by adding 10 percent to the taxpayer's tax, and therefore is not calculated in the same way as the underlying tax and is a separate exaction based on income that has already been taxed. According to the court, the fact that the exaction of § 72(t) is calculated differently from the regular income tax does not mean that it is not a tax:

> Like various other taxes, the Exaction is calculated differently than regular income tax. But that does not make it a penalty—it is a feature, not a bug in the Code triggering the written supervisory approval requirement.

Similarly, the court rejected the taxpayer's argument that the purpose of § 72(t) is to discourage individuals from making early withdrawals from retirement plans and therefore is penal in nature. What is determinative, the court reasoned, is not the purpose of the statute, but rather the meaning that Congress ascribed to it. The court observed that at least six other provisions of the Code refer to the exaction of § 72(t) as a tax. The court concluded:

> Together with the substantive text of Section 72(t)(1), the plain language of Section 72(t) considered in connection with the rest of the Code is unambiguous: the Exaction is a tax, not a penalty.

3. Can't we cut this guy a break? No, says the Fifth Circuit. Even though the taxpayer was incarcerated and the person he appointed as his attorney-in-fact to file his returns and manage his affairs failed to do so and embezzled hundreds of thousands of dollars, the taxpayer could not establish a reasonable cause defense to penalties. Lindsay v. United States, 4 F.4th 292 (5th Cir. 7/9/21). The taxpayer was incarcerated from 2013 to 2015. He appointed an individual, Keith Bertelson, to act as his attorney-in-fact under a power of attorney that gave Bertelson authority to manage the taxpayer's affairs. Bertelson failed to file the taxpayer's returns and pay taxes due as he had been directed. Bertelson also embezzled the taxpayer's funds. The taxpayer ultimately recovered more than $700,000 in actual damages from Bertelson and $1 million in punitive damages. After being released, the taxpayer filed late returns for 2012 through 2015. The IRS assessed late-filing and late-payment penalties of more than $400,000. After filing an administrative claim for refund of the penalties, the taxpayer brought this action seeking a refund on the basis that his incarceration qualified as a "disability." In an opinion by Judge Stewart, the U.S. Court of Appeals for the Fifth Circuit rejected the taxpayer's argument. The court relied on the U.S. Supreme Court's decision in *United States v. Boyle*, 469 U.S. 241 (1985). In *Boyle*, the Court held that "failure to make a timely filing of a tax return is not excused by [a] taxpayer's reliance on an agent." The Court in *Boyle* distinguished relying on an agent from situations in which a taxpayer relies on the mistaken advice of counsel concerning a question of tax law, which courts have held can constitute reasonable cause. In this case, the Fifth Circuit concluded, the taxpayer had not relied on mistaken advice of counsel, but rather had delegated responsibility for filing his tax returns. Under the standard set forth in *Boyle*, the court held, such delegation to an agent does not give rise to a reasonable cause defense to penalties. The court also concluded that this was not a situation in which the taxpayer was incapable of meeting his filing obligations and therefore did not fall into the category of situations in which courts have recognized a reasonable cause defense for taxpayers who are not physically or mentally capable of complying with a filing deadline. Accordingly, the court granted the government's motion to dismiss.

4. Updated instructions on how to rat yourself out. Rev. Proc. 2021-52, 2021-51 I.R.B. 883 (12/16/21). This revenue procedure updates Rev. Proc. 2020-54, 2020-53 I.R.B. 1806, and identifies circumstances under which the disclosure on a taxpayer's income tax return with respect to

an item or a position is adequate for the purpose of reducing the understatement of income tax under § 6662(d), relating to the substantial understatement aspect of the accuracy-related penalty, and for the purpose of avoiding the tax return preparer penalty under § 6694(a), relating to understatements due to unreasonable positions. There have been no substantive changes. The revenue procedure does not apply with respect to any other penalty provisions, including § 6662(b)(1) accuracy-related penalties. If this revenue procedure does not include an item, disclosure is adequate with respect to that item only if made on a properly completed Form 8275 or 8275-R, as appropriate, attached to the return for the year or to a qualified amended return. A corporation's complete and accurate disclosure of a tax position on the appropriate year's Schedule UTP, Uncertain Tax Position Statement, is treated as if the corporation had filed a Form 8275 or Form 8275-R regarding the tax position. The revenue procedure applies to any income tax return filed on a 2021 tax form for a taxable year beginning in 2021 and to any income tax return filed on a 2021 tax form in 2022 for a short taxable year beginning in 2022.

5. According to Ronald Regan, "The nine most terrifying words in the English language are 'I'm from the government and I'm here to help.'" Well, this time they're true! The IRS has provided relief from late-filing and other penalties with respect to certain 2019 and 2020 returns. Notice 2022-36, 2022-36 I.R.B. 188 (8/24/22). This notice provides relief for certain taxpayers from certain late-filing penalties and certain international information return penalties with respect to tax returns for taxable years 2019 and 2020 that are filed on or before September 30, 2022. More specifically, the notice provides relief from late-filing penalties imposed by § 6651(a) for failure to timely file several types of income tax returns, including individual income tax returns (Form 1040 series), income tax returns of trusts and estates (Form 1041 and Form 1041-QFT), corporate income tax returns (Form 1120 series), and certain returns of exempt organizations (Forms 990-PF and 990-T). The notice also provides relief from late-filing penalties for partnership returns (Form 1065) and returns of subchapter S corporations (Form 1120-S). In addition, the notice provides relief from certain information return penalties with respect to taxable year 2019 returns that were filed on or before August 1, 2020, and with respect to taxable year 2020 returns that were filed on or before August 1, 2021. This latter relief applies to most information returns on Form 1099. The notice provides relief only from specific penalties and with respect to specific returns. Accordingly, readers should consult the notice in determining whether relief is available in specific situations. The penalties to which the notice applies will be automatically abated, refunded, or credited, as appropriate without any need for taxpayers to request relief. The IRS issued this notice pursuant to the emergency declaration issued by the President on March 13, 2020, in response to the COVID-19 pandemic. That declaration instructed the Secretary of the Treasury "to provide relief from tax deadlines to Americans who have been adversely affected by the COVID-19 emergency, as appropriate, pursuant to 26 U.S.C. 7508A(a)."

B. Discovery: Summonses and FOIA

C. Litigation Costs

1. A taxpayer who offered to concede 100 percent of the proposed tax and penalties but who reserved the right to seek innocent spouse protection was not entitled to reasonable litigation costs under §7430(a)(2) because her offer was not a qualified offer and the IRS's position was substantially justified. Lewis v. Commissioner, 158 T.C. No. 3 (3/3/22). The issue in this case is whether the taxpayer was a prevailing party and therefore entitled to recover reasonable litigation costs from the IRS pursuant to § 7430(a)(2). Generally, § 7430(a) provides that, in an administrative or court proceeding brought by or against the government in connection with the determination, collection, or refund of any tax, interest or penalty, the *prevailing party* is entitled to recover reasonable administrative costs in connection with an administrative proceeding within the IRS and reasonable litigation costs incurred in connection with a court proceeding. The taxpayer here sought only reasonable litigation costs. The taxpayer filed joint returns with her former husband for 2008, 2009, and 2010. The IRS audited the returns and proposed adjustments and penalties. The taxpayer responded by sending a letter to the IRS that stated she was making a qualified offer pursuant to § 7430(g). If a taxpayer makes a qualified offer, and if the liability of the taxpayer pursuant to the judgment in the court proceeding is equal to or less than the liability of the taxpayer that would have resulted if the government had accepted the qualified offer, then, pursuant to § 7430(c)(4)(E), the taxpayer is treated as a prevailing party. In her letter to the IRS, the taxpayer offered to concede 100 percent of the tax and penalties proposed by the IRS for the years in question and to agree to immediate

assessment of the tax and penalties, but she reserved all collection rights, including (among others) the right to seek innocent spouse relief and to submit an offer-in-compromise. The IRS neither accepted nor rejected the taxpayer's offer, which accordingly lapsed. The IRS later issued a notice of deficiency, in response to which the taxpayer filed a petition in the U.S. Tax Court in which she asserted that she was entitled to innocent spouse protection under § 6015(b) and (c). In its answer, the IRS admitted that the taxpayer had sought innocent spouse protection and committed to review her request and make a determination regarding her eligibility for it. Although the taxpayer refused to submit a claim for innocent spouse protection on Form 8857 as the IRS requested, the IRS ultimately determined that she was entitled to innocent spouse protection for all years in question under § 6015(c) and moved for entry of a decision granting her relief from joint and several liability. The taxpayer moved for an award of reasonable litigation costs.

The Tax Court (Judge Pugh) denied the taxpayer's motion for an award of reasonable litigation costs. The court first considered whether the taxpayer had submitted a qualified offer and therefore treated as a prevailing party under § 7430(c)(4)(E). The court noted that one requirement of a qualified offer, specified in § 7430(g)(1)(B), is that the offer must "specif[y] the offered amount of the taxpayer's liability (determined without regard to interest)." The relevant regulation, Reg. § 301.7430-7(c)(3), provides that the offer may be expressed as a specific dollar amount or as a percentage and "must be an amount, the acceptance of which by the United States will fully resolve the taxpayer's liability, and only that liability … for the type or types of tax and the taxable year or years at issue in the proceeding." The court agreed with the IRS that the taxpayer's offer was not a qualified offer because her offer reserved the right to challenge the assessed liability by seeking innocent spouse relief. The text of the Code provision that authorizes innocent spouse relief (§ 6015), the court reasoned, makes clear that it does not relate to collection of tax, but rather provides relief from liability for tax. For this reason, the court concluded, the taxpayer's offer did not specify the offered amount of the taxpayer's liability. The court noted that, if the IRS had accepted the taxpayer's offer to agree to assessment of 100 percent of the proposed tax and penalties, the acceptance would not have fully resolved the taxpayer's liabilities because her reserved right to seek innocent spouse relief could (and in fact did) result in her liability for the years in question being reduced to zero.

After concluding that the taxpayer could not be considered a prevailing party pursuant to § 7430(c)(4)(E) because she had not submitted a qualified offer, the court turned to the issue whether the taxpayer was a prevailing party under the generally applicable rules of § 7430(c)(4) for determining status as a prevailing party. Under § 7430(c)(4)(B), a party is not considered a prevailing party if the IRS's position is "substantially justified." The relevant regulation, Reg. § 301.7430-5(d)(1), provides:

> A significant factor in determining whether the position of the Internal Revenue Service is substantially justified as of a given date is whether, on or before that date, the taxpayer has presented all relevant information under the taxpayer's control and relevant legal arguments supporting the taxpayer's position to the appropriate Internal Revenue Service personnel. …

The IRS's position, reflected in its answer in the Tax Court proceeding, was a concession that the taxpayer had sought innocent spouse protection and a commitment to review her request and make a determination regarding her eligibility for it. The court concluded that the IRS's position was substantially justified because the taxpayer had not submitted all relevant information regarding her request:

> A reasonable person could require information such as Form 8857 or other documentation supporting petitioner's claim for innocent spouse relief before making a determination.

Because the taxpayer had not submitted a qualified offer, and because the IRS's position was substantially justified, the court concluded, that taxpayer was not a prevailing party and therefore was not entitled to reasonable litigation costs under § 7430(a)(2).

D. Statutory Notice of Deficiency

E. Statute of Limitations

1. ♪♫Eight miles high and when you touch down, you'll find that it's stranger than known.♫♪ These United Airlines employees paid FICA taxes on the present value of future retirement benefits they will never receive and filed their refund claims too late. Koopman v. United States, 129 A.F.T.R.2d 2022-1445 (Fed. Cir. 4/11/22). In 2000 and 2001, these taxpayers retired from their positions as employees of United Airlines. Pursuant to § 3121(v)(2), the present values of their future retirement benefits (approximately $348,000 and $415,000 respectively) were included in their FICA bases for the years of their retirement. Section 3121(v)(2) provides that amounts deferred under a nonqualified deferred compensation plan must be taken into account for FICA purposes as of the later of the time the services are performed or the time when there is no substantial risk of forfeiture of the right to such amounts. The regulations issued under § 3121(v)(2), Reg. § 31.3121(v)(2)-(1)(c)(2)(ii), prescribe the method of determining the present value of the future retirement benefits and provide that the present value cannot be discounted to take into account the risk of the future benefits not being paid. United Airlines entered bankruptcy proceedings in 2002 and its liability for the taxpayer's retirement benefits was ultimately discharged in 2006. The taxpayers received only a portion of the promised benefits. The taxpayers brought this action in the U.S. Court of Federal Claims seeking refunds of the FICA taxes they paid on the retirement benefits they never received. In a prior decision, the U.S. Court of Appeals for the Federal Circuit had upheld the method of determining present that is set forth in Reg. § 31.3121(v)(2)-(1)(c)(2)(ii) and declined to order a refund for a similarly situated United Airlines employee. *Balestra v. United States*, 803 F.3d 1363 (Fed. Cir. 2015).

In this litigation, the government moved to dismiss for lack of subject matter jurisdiction on the ground that the taxpayers had filed their administrative claims for refund late. Section § 7422(a) provides that no suit or proceeding for a refund of tax can be maintained unless an administrative claim for refund has been "duly filed." Accordingly, if a taxpayer has not filed a timely administrative claim for a tax refund, the taxpayer is barred from bringing legal action seeking the refund. Section 6511(a) provides that a claim for refund must be filed within the later of two years from the time tax was paid or three years from the time the return was filed.

In a per curiam opinion, the U.S. Court of Appeals for the Federal Circuit affirmed the Claims Court's decision that the taxpayers had not filed timely administrative claims for refunds. In the case of FICA taxes, the court explained, pursuant to § 6513(c), a return for any quarterly period ending in a calendar year is considered filed on April 15 of the following year; and a tax with respect to any quarterly period is considered paid on the following April 15 (as long as it was actually paid before that date). In this case, the two taxpayers paid the FICA taxes in 2000 and 2001, which means the quarterly returns filed by United Airlines were filed on April 15, 2001, and April 15, 2002, respectively. Therefore, the deadline to file administrative claims for refunds were April 15, 2004, and April 15, 2005, respectively. The taxpayers did not file their administrative claims for refunds until 2007. Accordingly, the court held, the taxpayers had not duly filed administrative claims for refunds and were barred by § 7422 from brining legal action for refunds. This was so even though United Airlines' obligation to pay their retirement benefits was not discharged until 2006. In reaching this conclusion, the court rejected various arguments by the taxpayers that they should be entitled to equitable exceptions to the limitations period on claims for refunds. Among other authorities, the court relied on the U.S. Supreme Court's decision in *United States v. Brockamp*, 519 U.S. 347 (1997), in which the Court held that the limitations periods of § 6511(a) on claims for refund are not subject to equitable exceptions. The court concluded:

> But, ultimately, to the extent this case illustrates that there may be a problem of unfairness in the way that the Internal Revenue Code operates with respect to taxes paid on deferred compensation retirement benefits when an employer later goes bankrupt, that would be a problem for Congress and the Treasury Department to address.

F. Liens and Collections

1. The 30-day period for requesting review in the Tax Court of a notice of determination following a CDP hearing is jurisdictional and not subject to equitable tolling. Boechler, P.C. v. Commissioner, 967 F.3d 760 (8th Cir. 7/24/20), *aff'g* Boechler, P.C. v. Commissioner, No. 18578-17L (U.S. Tax Court (2/15/19)). Following a collection due process hearing, the IRS issued a notice of determination upholding proposed collection action. The notice informed the taxpayer, a law firm in Fargo, North Dakota, that, if it wished to contest the determination, it could do so by filing a petition with the United States Tax Court within a 30-day period beginning the day after the date of the letter. The IRS mailed the notice on July 28, 2017. The 30-day period expired on August 27, 2017, but because this date fell on a Sunday, the taxpayer had until the following day, August 28, to file his petition. The taxpayer mailed its petition to the Tax Court on August 29, 2017, which was one day late. The Tax Court (Judge Carluzzo) granted the government's motion to dismiss for lack of subject matter jurisdiction. On appeal, the taxpayer argued that the 30-day period specified in § 6330(d)(1) for filing his Tax Court petition should be equitably tolled. In an opinion by Judge Erickson, the U.S. Court of Appeals for the Eighth Circuit affirmed the Tax Court's decision. The court held that the 30-day period specified in § 6330(d)(1) is jurisdictional and therefore is not subject to equitable tolling. In reaching this conclusion, the court relied on the plain language of § 6330(d)(1), which provides:

> The person may, within 30 days of a determination under this section, petition the Tax Court for review of such determination (and the Tax Court shall have jurisdiction with respect to such matter).

This provision, the court reasoned, "is a rare instance where Congress clearly expressed its intent to make the filing deadline jurisdictional." According to the court, the parenthetical expression regarding the Tax Court's jurisdiction "is clearly jurisdictional and renders the remainder of the sentence jurisdictional." Because the 30-day period specified in § 6330(d)(1) is jurisdictional, the court concluded, it is not subject to equitable tolling. In reaching this conclusion, the court found persuasive the reasoning of the U.S. Court of Appeals for the Ninth Circuit in *Duggan v. Commissioner*, 879 F.3d 1029 (9th Cir. 2018), in which the Ninth Circuit similarly held that the 30-day period specified in § 6330(d)(1) is jurisdictional and therefore not subject to equitable tolling. *See also Cunningham v. Commissioner*, 716 Fed. Appx. 182 (4th Cir. 2018) (holding that, assuming without deciding that the 30-day period specified in § 6330(d)(1) is not jurisdictional and therefore is subject to equitable tolling, the taxpayer had not established circumstances warranting equitable tolling). The Eighth Circuit found unpersuasive the taxpayer's reliance on *Myers v. Commissioner*, 928 F.3d 1025 (D.C. Cir. 2019), in which the D.C. Circuit held that a similarly worded 30-day limitations period in § 7623(b)(4) for filing a Tax Court petition to challenge an adverse IRS determination regarding entitlement to a whistleblower award was not jurisdictional and was subject to equitable tolling.

a. We are sure that Justice Barrett was thrilled to be assigned to write, as one of her first opinions, an opinion on a technical issue of tax procedure. The U.S. Supreme Court has reversed the Eighth Circuit and held that the 30-day period for requesting review in the Tax Court of a notice of determination following a CDP hearing is not jurisdictional and is subject to equitable tolling. Boechler, P.C. v. Commissioner, 142 S. Ct. 1493, 129 A.F.T.R.2d 2022-1489 (4/21/22). In a unanimous opinion by Justice Barrett, the U.S. Supreme Court has reversed the Eighth Circuit and 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 CDP hearing is not jurisdictional and is subject to equitable tolling. The Court began with the proposition that a procedural requirement is jurisdictional only if Congress clearly states that the provision is jurisdictional. The provision in question, § 6330(d)(1), provides:

> The person may, within 30 days of a determination under this section, petition the Tax Court for review of such determination (and the Tax Court shall have jurisdiction with respect to such matter).

Although the parenthetical expression at the end of the provision refers to the Tax Court having jurisdiction, the Court reasoned that whether the provision is jurisdictional depends on whether the phrase "such matter" at the end of the provision refers to the entire first clause of the sentence (as the

government argued) or instead refers to the immediately preceding phrase that states "petition the Tax Court" (as the taxpayer argued). In other words, the question is whether the provision indicates that the Tax Court has jurisdiction over the taxpayer's petition, or instead indicates that the Tax Court has jurisdiction only if the taxpayer complies with the 30-day period for requesting review. The Court reasoned that the provision "does not clearly mandate the jurisdictional reading," but that the non-jurisdictional reading "is hardly a slam dunk for Boechler." Nevertheless, the Court concluded that "Boechler's interpretation has a small edge." According to the Court, there are multiple plausible interpretations of the phrase "such matter," and "[w]here multiple plausible interpretations exist—only one of which is jurisdictional—it is difficult to make the case that the jurisdictional reading is clear." Further, the Court reasoned, other tax provisions enacted around the same time as § 6330(d)(1) are much more clear that the filing deadlines they contain are jurisdictional. For example, § 6015(e)(1)(A), which governs the filing of petitions in the Tax Court by taxpayers seeking innocent spouse protection, provides:

> In addition to any other remedy provided by law, the individual may petition the Tax Court (and the Tax Court shall have jurisdiction) to determine the appropriate relief available to the individual under this section *if such petition is filed* … [within a 90-day period]

(Emphasis added.) Such provisions "accentuate the lack of clarity in § 6330(d)(1)."

Having concluded that the 30-day period specified in § 6330(d)(1) is not jurisdictional, the Court turned to the issue of whether this 30-day period is subject to equitable tolling. The Court previously had held in *Irwin v. Department of Veterans Affairs*, 498 U.S. 89 (1990), that non-jurisdictional limitations periods are presumptively subject to equitable tolling, and the Court saw "nothing to rebut the presumption here." The Court rejected the government's argument that the 30-day limitations period set forth in § 6330(d)(1) is similar to the limitations periods for filing claims for refund in § 6511, which the Court had held were not subject to equitable tolling in *United States v. Brockamp*, 519 U.S. 347 (1997):[1]

> Section 6330(d)(1)'s deadline is a far cry from the one in *Brockamp*. This deadline is not written in "emphatic form" or with "detailed" and "technical" language, nor is it reiterated multiple times. The deadline admits of a single exception (as opposed to *Brockamp's* six), which applies if a taxpayer is prohibited from filing a petition with the Tax Court because of a bankruptcy proceeding. §6330(d)(2). That makes this case less like *Brockamp* and more like *Holland v. Florida*, 560 U. S. 631 (2010), in which we applied equitable tolling to a deadline with a single statutory exception.

Accordingly, the Court reversed the judgment of the Eighth Circuit and remanded for further proceedings, which will require a determination of whether the taxpayer's circumstances warrant equitable tolling of § 6330(d)(1)'s 30-day period.

2. Economic hardship relief from a levy is not available to a corporate taxpayer. Seminole Nursing Home, Inc. v. Commissioner, 12 F.4th 1150 (10th Cir. 9/2/21), *aff'g* T.C. Memo. 2017-102 (6/5/17). The taxpayer, a corporation that operated a nursing home in rural Oklahoma, failed to pay its federal withholding and employment taxes in the amount of just over $60,000 for the fourth quarter of 2013. In response to the Service's final notice of intent to levy, the taxpayer requested a collection due process (CDP) hearing, proposed an installment agreement, and submitted a letter to the IRS settlement officer challenging the appropriateness of the levy on the grounds of economic hardship. The taxpayer argued that it was operating at a loss and could not "'provide essential care services to the patients residing at [its] nursing facility'" if the Service were permitted to levy. The taxpayer's assets included more than $313,000 in accounts receivable from Medicare and Medicaid. At the CDP hearing, the IRS settlement officer rejected the proposed installment agreement on the grounds that the taxpayer had sufficient assets to pay its outstanding tax liability and that the taxpayer

[1] *See generally* Bruce A. McGovern, *The New Provision for Tolling the Limitations Periods for Seeking Tax Refunds: Its History, Operation and Policy, and Suggestions for Reform*, 65 Mo. L. Rev. 797 (2000) (discussing equitable tolling and the U.S. Supreme Court's decision in *Brockamp*).

was not current with its federal employment tax deposits for 2014. The IRS settlement officer also declined to consider the economic hardship argument because, under the relevant regulation, Reg. § 301.6343-1(b)(4)(i), relief is available only on account of economic hardship of an individual taxpayer. The regulation provides that the Service must release a levy if one of several conditions is satisfied, including the following:

> The levy is creating an economic hardship due to the financial condition of an individual taxpayer. This condition applies if satisfaction of the levy in whole or in part will cause an individual taxpayer to be unable to pay his or her reasonable basic living expenses.

The IRS settlement officer issued a notice of determination upholding the collection action. The taxpayer filed a petition in the Tax Court and moved for summary judgment on the grounds that the regulation's limitation of economic hardship relief to individuals is contrary to the statute (§ 6343(a)(1)(D)) and therefore invalid and that the settlement officer had abused her discretion by failing to consider its request for economic hardship relief. The Tax Court previously had upheld the validity of Reg. § 301.6343-1(b)(4)(i) in *Lindsay Manor Nursing Home, Inc. v. Commissioner*, 148 T.C. 235 (2017), *vacated as moot*, 725 Fed. Appx. 713 (10th Cir. 2018), and in this case the Tax Court (Judge Paris) adhered to its prior decision. Following a remand to the IRS Appeals Office and the IRS's issuance of a supplemental notice of determination upholding the collection action, the Tax Court, in an unpublished order, sustained the IRS's notice of determination. *Seminole Nursing Home, Inc. v. Commissioner*, No. 24577-14L (2/21/20).

On appeal, in an opinion by Judge Hartz, the U.S. Court of Appeals for the Tenth Circuit upheld the validity of the regulation and concluded that the settlement officer had not abused her discretion in sustaining the collection action. The relevant statute, § 6343(a)(1)(D), provides that, "under regulations prescribed by the secretary," a levy shall be released if "the Secretary has determined that such levy is creating an economic hardship due to the financial condition of the taxpayer." The regulation in question interprets the economic hardship exception as being available only to individual taxpayers. The court assessed the validity of the regulation by applying the two-step analysis of *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). The court concluded in *Chevron* step one that the statute, § 6343(a)(1)(D), is ambiguous, and in step two that Reg. § 301.6343-1(b)(4)(i) is a permissible construction of the statute. In its analysis of *Chevron* step one, the court examined not only the plain language of the statute but also its structure and apparent purpose. The court reasoned:

> In what sense, though, might a corporation suffer economic hardship that could reasonably excuse releasing a tax levy on its assets? Say the corporation is in absolutely dire straits; it cannot survive even if the levy is released, or even if the tax liability is canceled altogether. In that circumstance, what purpose could possibly be served by preventing the IRS from seizing corporate assets under the levy? Perhaps another creditor of the corporation would benefit because it could collect through assets that would otherwise be seized by the IRS. But benefiting other creditors (likely at the expense of the IRS) could hardly be the purpose of the economic-hardship exception. This example points up an essential difference between an individual and a nonindividual entity.

Accordingly, the court affirmed the decision of the Tax Court.

3. If a taxpayer responds to a notice of intent to levy by timely filing Form 12153 to request a hearing, the taxpayer has requested a collection due process hearing, not an equivalent hearing, even if the taxpayer checks the box indicating they are requesting an equivalent hearing. Ruhaak v. Commissioner, 157 T.C. 103 (11/16/21). The IRS issued a final notice of intent to levy with respect to the taxpayer's 2013 and 2014 taxable years. In response, the taxpayer filing Form 12153, which is the form used to request a collection due process (CDP) hearing before an IRS Appeals Officer. The taxpayer submitted Form 12153 within the 30-day period required by § 6330(a)(2), (a)(3), and (b)(1) to request a CDP hearing. On Form 12153, the taxpayer checked the box on the line labeled "Equivalent Hearing" that states "I would like an Equivalent Hearing - I would like a hearing equivalent to a CDP Hearing if my request for a CDP hearing does not meet the requirements for a timely CDP Hearing." Although a CDP hearing and an equivalent hearing are

conducted in the same manner, there are two principal differences: (1) a request for a CDP hearing suspends the running of the limitations period for the IRS to collect tax but a request for an equivalent hearing does not, and (2) when the IRS issues a notice of determination that reflects its decision following a CDP hearing, the taxpayer has the right to seek review in the Tax Court pursuant to § 6330(d)(1), but the taxpayer has no right of judicial review following an equivalent hearing. The taxpayer in this case explained

> that he had requested an equivalent hearing so that he could present to Appeals his views on the morality of paying Federal income tax but without the possibility of subsequent Tax Court litigation or a fine.

The Tax Court (Judge Gale) observed that one reason the taxpayer may have requested an equivalent hearing was to avoid the $5,000 penalty of § 6702(b) for making a "specified frivolous submission." The IRS's position, as reflected in the Internal Revenue Manual, is that, although the penalty can apply to a timely requested CDP hearing, the IRS will not impose the penalty when the taxpayer has requested an equivalent hearing. When the taxpayer failed to submit information requested by the IRS Appeals Officer assigned to conduct the hearing, the IRS issued a notice of determination upholding the collection action. The taxpayer then sought review of the notice of determination in the Tax Court. The taxpayer argued that he had requested an equivalent hearing because he had complied with Reg. § 301.6330-1(i)(1), (2), Q&A-I7, Q&A-I9, which provides that a taxpayer who fails to timely request a CDP hearing may instead request a similar administrative hearing, called an "equivalent hearing," within the one-year period following the mailing date of the written levy notice. In other words, the taxpayer argued that a request submitted within the 30-day period for requesting a CDP hearing is necessarily submitted within the one-year period following the mailing date of the written levy notice, and that he had indicated on Form 12153 that he was requesting an equivalent hearing. The Tax Court rejected this argument and held that the taxpayer's timely request on Form 12153 was a request for a CDP hearing, and not a request for an equivalent hearing, despite the taxpayer's indication on Form 12153 that he was requesting an equivalent hearing in the event his request did not meet the requirements for a timely CDP hearing. The court interpreted Reg. § 301.6330-1(i)(1) to mean that

> only those taxpayers who fail to timely request a CDP hearing are eligible to request an equivalent hearing. Logically, a taxpayer cannot yet have failed to make a timely request for a CDP hearing before the 30-day period for requesting a CDP hearing has expired.

After concluding that the taxpayer had requested a CDP hearing, the court reviewed the IRS's determination that the levy against the taxpayer should be upheld. The court upheld the IRS's position. The court also considered whether to impose penalties under § 6673, which authorizes the Tax Court to impose a penalty of up to $25,000 against a taxpayer who advances a frivolous or groundless position in proceedings before the court or who institutes such proceedings primarily for delay. The court observed that this was the third CDP case that the taxpayer had filed in the Tax Court and that the court had imposed penalties under § 6673 in the taxpayer's most recent case. The court determined, however, that the taxpayer's position in this case that he had requested an equivalent hearing was not frivolous. At the same time, the court made clear to the taxpayer that "advancing frivolous arguments relating to his conscientious objection to the payment of Federal taxes is likely to result in the imposition of a significant section 6673 penalty against him."

4. When a taxpayer seeks review in the Tax Court of an IRS determination to uphold proposed collection action, the Tax Court does not have jurisdiction to consider the taxpayer's refund claim if the proposed collection action becomes moot. McLane v. Commissioner, 24 F.4th 316 (4th Cir. 1/25/22), *aff'g* T.C. Memo. 2018-149. The issue in this case was whether the Tax Court had jurisdiction to consider the taxpayer's claim for a refund. After the taxpayer filed his 2008 return, the IRS disallowed his claimed business deductions on Schedule C and determined that he had underreported his tax liability by $23,615. The IRS issued a notice of deficiency, but the taxpayer and the IRS agreed that the taxpayer never received it. After assessing the tax allegedly due, the IRS issued a notice of federal tax lien. In response, the taxpayer requested a collection due process (CDP) hearing. In a CDP hearing, § 6330(c)(2)(B) permits a taxpayer to challenge the existence or amount of the taxpayer's underlying tax liability only "if the person did not

receive any statutory notice of deficiency for such tax liability or did not otherwise have an opportunity to dispute such tax liability." Because the taxpayer had not received the notice of deficiency, the IRS Settlement Officer allowed the taxpayer to present evidence to substantiate his business deductions and allowed approximately one-half of the deductions, which reduced the amount of tax allegedly due. Following the CDP hearing, the IRS issued a notice of determination sustaining the notice of federal tax lien and the taxpayer filed a petition in the Tax Court. In the Tax Court, the taxpayer presented evidence of his claimed deductions and the IRS ultimately conceded that (1) the taxpayer was entitled to deductions that exceeded those he initially claimed, (2) there was no tax due, and (3) the taxpayer was entitled to abatement of his tax liability for 2008 and release of the lien. The taxpayer's petition to the Tax Court did not claim that he was entitled to a refund. Following these concessions, in a conference call with the court, the taxpayer asserted for the first time that he was entitled to a refund of tax paid for 2008. The Tax Court (Judge Halpern) concluded that it did not have jurisdiction to consider the taxpayer's refund claim. In an opinion by Judge Motz, the U.S. Court of Appeals for the Fourth Circuit affirmed the Tax Court's decision. According to the Fourth Circuit, the question was whether § 6330(c)(2)(B) (which applies in CDP hearings held to review a notice of federal tax lien pursuant to § 6320(c)) gives the Tax Court jurisdiction to hear a claim for refund. Section 6330(c)(2)(B) provides:

> The person may also raise at the [CDP] hearing challenges to the existence or amount of the *underlying tax liability* for any tax period if the person did not receive any statutory notice of deficiency for such tax liability or did not otherwise have an opportunity to dispute such tax liability.

(Emphasis added.) Further, § 6330(d)(1) provides that the Tax Court has jurisdiction to review the IRS's determination following the CDP hearing. The Fourth Circuit reasoned that "the phrase 'underlying tax liability' does not provide the Tax Court jurisdiction over independent overpayment claims when the collection action no longer exists." Here, the court explained:

> When as here, the Commissioner has already conceded that a taxpayer has no tax liability and that the lien should be removed, any appeal to the Tax Court of the Appeals Office's determination as to the collection action is moot. No collection action remains, for which there is underlying tax liability, to appeal.

Accordingly, the Fourth Circuit affirmed the Tax Court's decision that the Tax Court did not have jurisdiction to consider the taxpayer's refund claim.

- The analysis required to conclude that the Tax Court did not have jurisdiction to consider the taxpayer's refund claim is far more nuanced than the Fourth Circuit's opinion suggests. The Tax Court's opinion in this case engages in an extensive analysis of the relevant statutory provisions and of the Tax Court's prior decision in *Greene-Thapedi v. Commissioner*, 126 T.C. 1 (2006). In *Greene-Thapedi*, the taxpayer filed a petition in the Tax Court seeking review of the IRS's determination in a CDP hearing to uphold a proposed levy, but the proposed levy became moot because the IRS applied the taxpayer's refund from a later year to the year in question, which reduced her tax liability to zero. The taxpayer sought a refund of accrued interest on the liability. The Tax Court concluded that, in enacting § 6330, Congress did not intend to provide for the allowance of tax refunds. In this case, the Tax Court declined to reconsider its holding in *Greene-Thapedi* and rejected the taxpayer's arguments that *Greene-Thapedi* was distinguishable. The Fourth Circuit's opinion in this case discusses *Greene-Thapedi* in a footnote and concludes that it is unnecessary to consider whether § 6330 *ever* allows a taxpayer to claim a refund because the limited holding in this case is that § 6330 does not permit a claim for refund when the IRS's proposed collection action that provides the basis for the Tax Court's jurisdiction becomes moot.

5. A taxpayer cannot avoid the trust fund recovery penalty by claiming innocent spouse relief, says the Tax Court. Chavis v. Commissioner, 158 T.C. No. 8 (6/15/22). The taxpayer and her former husband were officers of Oasys Information Systems, Inc., a subchapter C corporation. Her former husband was the president of the corporation, and she was the secretary. The corporation withheld payroll taxes from the wages of its employees but did not pay those taxes to the government. After attempting unsuccessfully to collect the taxes from the corporation, the IRS determined that the taxpayer and her former husband were responsible for total penalties equal to $146,682 of the business' unpaid employment taxes pursuant to § 6672(a). This provision imposes a penalty (commonly referred

to as the trust fund recovery penalty) on responsible persons who willfully fail to collect or pay over any tax due. The IRS sent to the taxpayer by certified mail a Letter 1153 (notice of proposed assessment) informing her that the IRS intended to hold her responsible for a penalty equal to the unpaid employment taxes pursuant to § 6672(a). The letter informed the taxpayer that she had the right to appeal the proposed assessment within sixty days to the IRS Office of Appeals. Although the taxpayer received the Letter 1153, she did not appeal the proposed assessment. The IRS assessed the penalties and issued Letter 3172, Notice of Federal Tax Lien Filing. The taxpayer requested a collection due process (CDP) hearing with the IRS Office of Appeals. In her request for a CDP hearing, she indicated that she could not pay the balance due and that she was requesting innocent spouse relief. She sought removal of the lien. Shortly after requesting the CDP hearing, the taxpayer filed a request for innocent spouse relief on Form 8857. The IRS's Cincinnati Centralized Innocent Spouse Operation (CCISO) determined that the taxpayer did not qualify for innocent spouse relief because the provision that authorizes such relief, § 6015, applies to jointly filed income tax returns and not to liability for payroll taxes. In the CDP hearing, the IRS Settlement Officer explained that the taxpayer was not entitled to innocent spouse relief. The Settlement Officer also advised the taxpayer that she could not challenge the underlying tax liability in the CDP hearing because she had received a prior opportunity to challenge the liability when she received IRS Letter 1153. The taxpayer also requested currently not collectible (CNC) status, but the IRS Settlement Officer, after reviewing financial information submitted by the taxpayer and consulting with an IRS collection specialist, determined that the taxpayer did not qualify for CNC status because she could pay $1,685 per month. Following the CDP hearing, the IRS issued a notice of determination upholding the collection action and the taxpayer filed a petition in the Tax Court. The Tax Court (Judge Lauber) granted the IRS's motion for summary judgment. First, Judge Lauber concluded that the taxpayer was precluded from challenging the underlying tax liability in the CDP hearing. Section 6330(c)(2)(B) permits a taxpayer to challenge the existence or amount of the taxpayer's underlying tax liability in a CDP hearing only "if the person did not receive any statutory notice of deficiency for such tax liability or did not otherwise have an opportunity to dispute such tax liability." In this case, although the IRS did not issue (and was not required to issue) a notice of deficiency with respect to the § 6672(a) penalty it assessed, the court reasoned that the taxpayer had received a prior opportunity to challenge the liability when she received IRS Letter 1153 and had declined to do so. Accordingly, the court held, the IRS Settlement Officer had properly determined that the taxpayer could not challenge the underlying liability in the CDP hearing. Because the taxpayer was precluded from challenging the underlying tax liability, the court concluded, it was required to apply an abuse-of-discretion standard in reviewing the Settlement Officer's decision to uphold the proposed collection action. The court agreed with the IRS that the taxpayer could not avoid the trust fund recovery penalty by claiming innocent spouse relief:

> Petitioner's TFRP liabilities were not shown on, and did not arise from the filing of, a joint Federal income tax return. Rather, her TFRP liabilities arose from her failure to discharge her duty, as an officer of Oasys, to ensure that payroll taxes collected from the company's workers were properly paid over to the Department of the Treasury. Petitioner was therefore not eligible for relief under section 6015(b) or (c).

The court similarly concluded that the taxpayer was not eligible for innocent spouse relief under § 6015(f) (equitable relief). Finally, the court concluded that there was no abuse of discretion in the Settlement Officer's rejection of collection alternatives.

G. Innocent Spouse

1. If you miss the deadline to file a petition in the Tax Court seeking review of the IRS's denial of the taxpayer's request for innocent spouse protection, you just might want to submit a second request. If the IRS responds with a final determination regarding the second request, you can seek review by filing a petition in the Tax Court. Vera v. Commissioner, 157 T.C. 78 (8/23/21). The taxpayer filed joint returns with her then-husband for 2010 and 2013. She later submitted to the IRS a claim on Form 8857 seeking innocent spouse relief for 2013. The IRS issued a final determination denying her request. The taxpayer filed a petition in the Tax Court seeking review of this determination, but the Tax Court dismissed the petition for lack of jurisdiction because, pursuant to § 6015(e)(1), petitions seeking review of innocent spouse determinations must be filed no later than the 90th day after the date the IRS mails the determination, and the taxpayer had filed her petition on

the 91st day after the IRS mailed the determination. The taxpayer later submitted to the IRS on Form 8857 a request for innocent spouse relief for 2010, but she included with her request a number of documents related to 2013, including the previous request for innocent spouse relief she had submitted for 2013. The IRS issued a final determination denying her request. The determination, issued as Letter 3288, Final Appeals Determination, referred in the header only to 2010, but the substance of the determination addressed both 2010 and 2013. For example, the letter stated "For tax year 2013, you didn't comply with all income tax laws for the tax years that followed the years that are the subject of your claim." The taxpayer filed a timely petition in the Tax Court seeking review of this determination and specified in her petition that she was contesting the determination as to both 2010 and 2013. The IRS moved to dismiss as to 2013 on the basis that the IRS's determination was not a second determination for 2013. The Tax Court (Judge Buch) denied the motion and held that the court had jurisdiction as to both 2010 and 2013 because the IRS's determination was a final determination as to both years. Under § 6015(e)(1), the Tax Court has jurisdiction to review a "final determination" by the IRS regarding the taxpayer's eligibility for innocent spouse relief. The court noted that "[f]inal determinations in innocent spouse cases are typically singular, conclusive decisions." Nevertheless, the court observed, there is no prohibition on the issuance of more than one final determination and the regulations under § 6015 contemplate that the IRS will issue a second final determination in some circumstances. The court recognized the policy concern that taxpayers should not be able to defeat or extend the 90-day period for filing a petition in the Tax Court by submitting duplicative claims for innocent spouse relief. In this case, the court reasoned, the IRS could have avoided this policy concern by issuing something other than a final determination in response to the taxpayer's second request for innocent spouse relief for 2013. The IRS had done so in *Barnes v. Commissioner*, 130 T.C. 248 (2008). In that case, after the IRS issued a final determination denying the taxpayer's request for innocent spouse relief, the taxpayer submitted a second request for the same year. The IRS responded by issuing Letter 3657C, No Consideration Innocent Spouse, stating that the taxpayer had not met the basic eligibility requirements for relief because her claim had previously been considered and denied. The court in *Barnes* concluded that this letter was not a final determination and that the court therefore had no jurisdiction to consider the taxpayer's petition. In the same way, the IRS could have avoided issuing a second final determination in this case for 2013 by issuing Letter 3657C for that year. The IRS argued that its references to 2013 in the final determination were an error. "Error or not," the court responded, "the Commissioner's notice is unambiguous in its denial as to both 2010 and 2013." Accordingly, the court concluded, it had jurisdiction to consider the taxpayer's petition regarding both years.

2. The Tax Court loses jurisdiction over a taxpayer's petition seeking innocent spouse relief if a refund action is filed for the years in question. Coggin v. Commissioner, 157 T.C. 144 (12/8/21). Prior to his death, the taxpayer's late husband filed joint federal income tax returns late for the years 2001 through 2009 and made late full or partial payments for those years but did not pay any interest or penalties. Following her husband's death, the taxpayer learned for the first time of the joint returns and the tax liabilities arising from them. She filed returns for all years in question with the filing status of married filing separately. The court's opinion is not clear whether these returns were original returns or amended returns. The returns filed by the taxpayer claimed refunds for the years 2001 through 2007. The IRS issued a notice of disallowance as to three of the years for which the taxpayer sought refunds and, in response, the taxpayer filed a complaint in a federal district court seeking refunds for 2001 through 2007. Her complaint asserted that the joint returns filed by her late husband had been filed without her knowledge or consent and therefore were invalid and that she was entitled to refunds based on the separate returns she had filed. In its answer in federal district court, the government asserted counterclaims seeking to reduce the taxpayer's liabilities for 2002 through 2009 to judgment. The federal district court granted the government's motion for summary judgment and dismissed the taxpayer's refund claims on the basis that the returns filed by the taxpayer's late husband were valid joint returns. The court also ordered that the government's counterclaims proceed to trial. However, the federal district court did not enter a final appealable order or judgment as to the taxpayer's refund claims. The taxpayer then filed an administrative claim for innocent spouse relief for 2001 through 2009 on Form 8857 pursuant to § 6015. The federal district court granted the taxpayer's motion for a stay of proceedings pending the outcome of the taxpayer's request for innocent spouse relief. The IRS did not issue a notice of determination denying the taxpayer's request for innocent spouse relief; instead, the U.S. Justice Department Tax Division sent a letter to the taxpayer's attorney

denying her request for innocent spouse relief. In response, the taxpayer filed a petition in the Tax Court asking the court to determine that she is entitled to innocent spouse relief for 2001 through 2009. The Tax Court (Judge Weiler) granted the IRS's motion to dismiss for lack of jurisdiction. Section 6015(e)(1) provides that the Tax Court has jurisdiction to determine whether a taxpayer is entitled to innocent spouse relief if the taxpayer files a petition within specified time periods. However, § 6015(e)(3) provides that, if either individual who filed the joint return in question files a suit for refund in a federal district court or the United States Court of Federal Claims, then the Tax Court loses jurisdiction over the taxpayer's petition seeking innocent spouse relief to the extent the court in which the refund action was filed acquires jurisdiction over the years that are the subject of the refund suit. In this case, the Tax Court concluded, the federal district court in which the taxpayer had filed her refund action acquired jurisdiction over her refund claims for the years 2001 through 2007 and retained jurisdiction because that court had not entered judgment as to her refund claims. Although the taxpayer had not asserted her entitlement to innocent spouse protection in the federal district court action, the Tax Court also observed that the federal district court had not ruled on the taxpayer's request for innocent spouse relief. As to the years 2008 and 2009, however, the Tax Court observed that the federal district court did not have or claim to have jurisdiction over refund claims of the taxpayer for 2008 and 2009. Accordingly, the Tax Court retained jurisdiction over the taxpayer's petition seeking innocent spouse protection for these years.

3. When a taxpayer raises innocent spouse relief as an affirmative defense in a petition filed in the Tax Court, can the IRS Chief Counsel attorneys litigating the case refer the matter to the IRS's Centralized Innocent Spouse Operation but then ignore CCISO's conclusion that the taxpayer is entitled to innocent spouse protection? Yes, says the Tax Court. DelPonte v. Commissioner, 158 T.C. No. 7 (5/5/22). The taxpayer's former husband, William Goddard, was an attorney whom the Tax Court's opinion characterized as "a lawyer who sold exceptionally aggressive tax-avoidance strategies with his business partner David Greenberg and became very wealthy in the process." The taxpayer filed joint returns with her former husband for the years 1999, 2000, and 2001 and therefore became jointly and severally liable with him pursuant to § 6013(d)(3) for several million dollars of tax liability associated with those returns. In response to a notice of deficiency issued in 2004, the taxpayer's former husband, who never told her about the notice of deficiency, filed a petition on her behalf in the Tax Court raising as an affirmative defense that she was entitled to innocent spouse protection under § 6015. (Similar notices of deficiency were issued in 2005 and 2009 and the taxpayer's former husband filed similar petitions in the Tax Court on her behalf.) In 2011, the IRS Office of Chief Counsel referred the taxpayer's request for innocent spouse relief to the IRS's Cincinnati Centralized Innocent Spouse Operation (CCISO) for a determination of whether she was entitled to innocent spouse protection. CCISO asked the taxpayer to submit a request for innocent spouse relief on Form 8857, which she did. In December 2011, CCISO concluded that she should be granted innocent spouse relief for all of the years in question. Rather than send a determination letter to the taxpayer, CCISO sent a letter explaining its conclusion to the Office of Chief Counsel. The IRS attorneys handling the case decided that more information was necessary to determine whether the taxpayer was entitled to innocent spouse relief and asked the taxpayer to provide it. The taxpayer declined on the basis that CCISO ha already determined that she was entitled to innocent spouse relief. With a new team of lawyers, she ultimately did provide additional information to the Chief Counsel attorneys but insisted that doing so was unnecessary. The taxpayer moved for entry of a decision in her favor. The Tax Court (Judge Holmes) agreed with the IRS that, when a request for innocent spouse relief is raised as an affirmative defense for the first time in a petition that invokes the court's deficiency jurisdiction, the IRS Office of Chief Counsel has final authority to concede or settle the issue with the taxpayer and that the IRS Office of Chief Counsel therefore was not bound by CCISO's conclusion. The court reviewed the history of innocent spouse protection and the relevant statutory provisions in detail. The court also reviewed relevant provisions of the Internal Revenue Manual and certain Chief Counsel Notices. Specifically, the court focused on IRM 25.15.12.25.2(1) (Nov. 9, 2007), which provides:

> if innocent-spouse relief is raised for the first time in a case already docketed in court, "[j]urisdiction is retained by … Counsel, and a request is sent to CCISO to consider the request for relief. … Counsel … has functional jurisdiction over the matter and

> handles the case and request for relief, and either settles or litigates the issue on its merits, as appropriate.

The court reasoned that this provision, as well as other relevant guidance, directs CCISO to provide assistance rather than to make a determination of entitlement to innocent spouse relief. The court concluded:

> The Chief Counsel in these cases has considered the determination of CCISO to grant DelPonte relief and decided not to adopt it without further investigation. That is his prerogative, and we will not force him to do otherwise.

H. Miscellaneous

1. You say "FBAR." We say "FUBAR." Although Treasury has failed to update relevant FBAR regulations, the penalty for willful violations is not capped at $100,000 per account, says the Federal Circuit. Norman v. United States, 942 F.3d 1111 (Fed. Cir. 11/8/19), *aff'g* 138 Fed. Cl. 189 (7/31/18). The issue in this case is whether substantial foreign bank account reporting ("FBAR") penalties assessed by the Service were reduced. Under 31 U.S.C. § 5321(a)(5)(A), the Secretary of the Treasury "may impose" a penalty for FBAR violations, and pursuant to administrative orders, the authority to impose FBAR penalties has been delegated by the Secretary to the Service. Further, under the *current* version of 31 U.S.C. § 5321(a)(5)(B)(i), the normal penalty for an FBAR violation is $10,000 per offending account; however, the penalty for a *willful* FBAR violation "shall be increased to the greater of" $100,000 or 50 percent of the balance in the offending account at the time of the violation. *See* 31 U.S.C. § 5321(a)(5)(C). These minimum and maximum penalties for willful FBAR violations were changed by the American Jobs Creation Act of 2004 ("AJCA"), Pub. L. No. 108-357, § 821, 118 Stat. 1418 (2004). The prior version of 31 U.S.C. § 5321(a)(5) provided that the penalty for *willful* FBAR violations was the greater of $25,000 or the balance of the unreported account up to $100,000. Treasury regulations issued under the pre-AJCA version of 31 U.S.C. § 5321(a)(5), reflecting the law at the time, capped the penalty for willful FBAR violations to $100,000 per account. *See* 31 C.F.R. § 1010.820(g). In this case, the government assessed a penalty of $803,500 for failure to file an FBAR in 2007 with respect to a Swiss Bank account. The taxpayer argued that the "may impose" language of the relevant statute, 31 U.S.C. § 5321(a)(5), provides the Secretary of the Treasury with discretion to determine the amount of assessable FBAR penalties and that, because the outdated Treasury regulations had not been amended to reflect the AJCA's increase in the minimum and maximum FBAR penalties, the Service's authority was limited to the amount prescribed by the existing regulations. The court reasoned that the amended statute, which provides that the amount of penalties for willful FBAR violations *shall be* increased to the greater of $100,000 or 50 percent of the account value, is mandatory and removed Treasury's discretion to provide for a smaller penalty by regulation. According to the court, the statute gives Treasury discretion *whether* to impose a penalty in particular cases, but not discretion to set a cap on the penalty that is different than the cap set forth in the statute.

- *Recklessness as willfulness*. The relevant statute provides an enhanced penalty for a person who "willfully" fails to comply with the requirement to file an FBAR. The court considered whether a taxpayer who *recklessly* fails to comply with the requirement to file an FBAR can be treated as having committed a *willful* violation. The taxpayer argued "that willfulness in this context require[d] a showing of actual knowledge of the obligation to file an FBAR." The court disagreed. The court relied on the U.S. Supreme Court's decision in *Safeco Ins. Co. of Am. v. Burr*, 551 U.S. 47, 57 (2007), in which the Court had observed that, when willfulness is a statutory condition of civil (as opposed to criminal) liability, the Court had "generally taken it to cover not only knowing violations of a standard, but reckless ones as well." Accordingly, in this case, the court held, "willfulness in the context of [31 U.S.C.] § 5321(a)(5) includes recklessness." The court observed that its interpretation of the statute was consistent with prior decisions of the U.S. Courts of Appeals for the Third and Fourth Circuits. See *Bedrosian v. United States*, 912 F.3d 144 (3d Cir. 2018); *United States v. Williams*, 489 F. Appx. 655 (4th Cir. 2012). The court examined the taxpayer's conduct, which included false statements to the IRS about her foreign account, and concluded that the U.S. Court of Federal Claims had not clearly erred in determining that she had willfully violated the requirement to file an FBAR. Specifically, the court rejected

the taxpayer's argument that her failure could not be willful because she had not read her federal income tax return before signing it.

- *Other courts have concluded that the penalty for willful violations is not capped at $100,000*. Several federal district courts have considered whether the outdated Treasury regulation limits the penalty for a willful FBAR violation to $100,000 per account and reached different conclusions. For cases holding that the outdated FBAR regulations limit the penalty for willful FBAR violations to $100,000 per account, see *United States v. Wadhan*, 325 F. Supp. 3d 1136 (D. Colo. 7/18/18); *United States v. Colliot*, 121 A.F.T.R.2d 2018-1834 (W.D. Tex. 5/16/18). For cases holding that the outdated FBAR regulations do *not* limit the penalty for willful FBAR violations, see *United States v. Schoenfeld*, 396 F. Supp. 3d 1064 (M.D. Fla. 6/25/19); *United States v. Park*, 389 F. Supp. 3d 561 (N.D. Ill. 5/24/19); *United States v. Garrity*, 123 A.F.T.R.2d 2019-941 (D. Conn. 2/28/19); *Kimble v. United States*, 141 Fed. Cl. 373 (12/27/18).

a. The Fourth Circuit agrees that recklessness is sufficient to establish a willful FBAR violation and that the penalty for a willful FBAR violation is not capped at $100,000. United States v. Horowitz, 978 F.3d 80 (4th Cir. 10/10/20). In an opinion by Judge Niemeyer, the U.S. Court of Appeals for the Fourth Circuit held that (1) recklessness is sufficient to establish a willful FBAR violation, and (2) the penalty for a willful FBAR violation is not capped at $100,000. With respect to the first issue, the court adopted the same line of reasoning as the U.S. Court of Appeals for the Federal Circuit in *Norman v. United States*, 942 F.3d 1111 (Fed. Cir. 11/8/19), i.e., the court relied on the U.S. Supreme Court's decision in *Safeco Ins. Co. of Am. v. Burr*, 551 U.S. 47, 57 (2007), in which the Court had observed that, when willfulness is a statutory condition of civil (as opposed to criminal) liability, the Court had "generally taken it to cover not only knowing violations of a standard, but reckless ones as well." The court provided further guidance on the meaning of the term "recklessness":

> In the civil context, "recklessness" encompasses an objective standard—specifically, "[t]he civil law generally calls a person reckless who acts or (if the person has a duty to act) fails to act in the face of an unjustifiably high risk of harm that is either known or so obvious that it should be known." *Farmer v. Brennan*, 511 U.S. 825, 836 (1994); *see also Safeco*, 551 U.S. at 68 (same). In this respect, civil recklessness contrasts with criminal recklessness and willful blindness, as both of those concepts incorporate a subjective standard.

In this case, the court concluded, the taxpayers, who were aware that their Swiss bank account was earning interest and that interest was taxable income and who failed to disclose the foreign account to the accountant preparing their tax return, had been reckless and therefore willful in failing to file an FBAR.

The court also rejected the taxpayer's argument that, because the "may impose" language of 31 U.S.C. § 5321(a)(5)(A) leaves the amount of assessable FBAR penalties to the discretion of the Secretary of the Treasury and the (albeit outdated) Treasury regulations had not been amended to reflect the AJCA's increase in the minimum and maximum FBAR penalties, the IRS's authority was limited to the amount prescribed by the existing regulations. The existing regulations limit the FBAR penalty for willful violations to $100,000 per unreported account. The court reasoned that the relevant statute did not authorize the Secretary of the Treasury to impose a lower maximum penalty for willful FBAR operations. According to the court, "the 1987 regulation on which the Horowitzes rely was abrogated by Congress's 2004 amendment to the statute and therefore is no longer valid."

b. The Eleventh Circuit agrees: recklessness is sufficient to establish a willful FBAR violation and the penalty for a willful FBAR violation is not limited to $100,000. United States v. Rum, 995 F.3d 882 (11th Cir. 4/23/21). In a per curiam opinion, the U.S. Court of Appeals for the Eleventh Circuit has held that (1) recklessness is sufficient to establish a willful FBAR violation, and (2) the penalty for a willful FBAR violation is not capped at $100,000. With respect to the first issue, the court adopted the same line of reasoning as the U.S. Courts of Appeals for the Federal and Fourth Circuits in *Norman v. United States*, 942 F.3d 1111 (Fed. Cir. 11/8/19), and *United States v. Horowitz*, 978 F.3d 80 (4th Cir. 10/10/20), i.e., the court relied on the U.S. Supreme Court's decision in *Safeco Ins. Co. of Am. v. Burr*, 551 U.S. 47, 57 (2007), in which the Court had observed that, when

willfulness is a statutory condition of civil (as opposed to criminal) liability, the Court had "generally taken it to cover not only knowing violations of a standard, but reckless ones as well." For purposes of determining whether a reckless (and therefore willful) FBAR had violation occurred, the Eleventh Circuit adopted the meaning of recklessness set forth in *Safeco*:

> The Safeco Court stated that "[w]hile the term recklessness is not self-defining, the common law has generally understood it in the sphere of civil liability as conduct violating an objective standard: action entailing an unjustifiably high risk of harm that is either known or so obvious that it should be known." 551 U.S. at 68, 127 S. Ct. at 2215 (internal quotations and citations omitted).

In this case, the taxpayer had filed tax returns for many years on which he indicated that he had no interest in a foreign financial account despite the fact that he had a Swiss bank account at UBS. He also reported the account for some purposes, such as to demonstrate his financial strength when obtaining a mortgage, but not for others, such as applying for financial aid for his children's college costs. According to the Eleventh Circuit, the District Court had not erred in granting summary judgment to the government on the issue of whether the taxpayer had acted recklessly and therefore willfully in failing to file FBARs.

The court also rejected the taxpayer's argument that, because the "may impose" language of 31 U.S.C. § 5321(a)(5)(A) leaves the amount of assessable FBAR penalties to the discretion of the Secretary of the Treasury and the (albeit outdated) Treasury regulations had not been amended to reflect the AJCA's increase in the minimum and maximum FBAR penalties, the IRS's authority was limited to the amount prescribed by the existing regulations:

> The plain text of § 5321(a)(5)(C) makes it clear that a willful penalty may exceed $100,000 because it states that the maximum penalty "shall be . . . the greater of (I) $100,000, or (II) 50 percent of the amount determined under subparagraph (D)," which is the balance of the account.

c. The Second Circuit also holds that the penalty for a willful FBAR violation is not capped at $100,000. United States v. Kahn, 5 F.4th 167 (2d Cir. 7/13/21). In an opinion by Judge Kearse, the U.S. Court of Appeals for the Second Circuit has agreed with the other federal courts of appeal that have considered the issue and held that the penalty for willful FBAR violations is not capped at $100,000 per account. The court concluded that the 2004 amendments to 31 U.S.C. § 5321(a)(5)(C) rendered invalid the 1987 Treasury regulation that limits the penalty for willful FBAR violations to $100,000 per account.

- *Dissenting opinion by Judge Menashi*. In a dissenting opinion, Judge Menashi argued that the regulation does not conflict with the statute and that the Treasury Department was bound by its own regulation:

> The Treasury Department's current regulations provide that the penalty for Harold Kahn's willful failure to file a Report of Foreign Bank and Financial Accounts ("FBAR") may not exceed $100,000. *See* 31 C.F.R. § 1010.820(g)(2). This penalty falls within the statutorily authorized range. *See* 31 U.S.C. § 5321(a)(5). While the governing statute also authorizes penalties greater than $100,000, it nowhere mandates that the Secretary impose a higher fine. *See id.* In fact, the statute gives the Secretary discretion to impose no fine at all. *See id.* § 5321(a)(5)(A). The current regulation therefore does not conflict with the governing statute and the Secretary must adhere to that regulation as long as it remains in effect.

d. Better late than never? FinCEN finally has amended the relevant regulations to remove the provision that limited the penalty for a willful FBAR violation. RIN 1507-AB54, Bank Secrecy Act Regulations—Reports of Foreign Financial Accounts Civil Penalties, 86 F.R. 72844 (12/23/21). More than seventeen years after Congress changed the minimum and maximum penalties for willful FBAR violations in the American Jobs Creation Act of 2004, the Financial Crimes Enforcement Network (FinCEN) has amended the relevant regulations to remove 31 C.F.R. § 1010.820(g), which limited the penalty for willful FBAR violations to $100,000 per account. The stated rationale for the removal is that the 2004 amendments to the statute, 31 U.S.C. § 5321(a)(5),

rendered this part of the regulation obsolete. The Administrative Procedure Act permits an agency to find that notice and public procedure on the notice are impracticable, unnecessary, or contrary to the public interest. Because the statutory change rendered this provision of the regulations obsolete, FinCEN "determined that publishing a notice of proposed rulemaking and providing opportunity for public comment [were] unnecessary." This amendment of the regulations is effective on December 23, 2021. Nevertheless, because the prior regulation was rendered obsolete by a 2004 statute, the government's position presumably is that the statutory rule, rather than the now-repealed provision of the regulations, applies for prior years as well beginning on the effective date of the statutory change.

e. The First Circuit has agreed: the penalty for a willful FBAR violation is not capped at $100,000. United States v. Toth, 33 F.4th 1 (1st Cir. 4/29/22). In an opinion by Judge Baron, the U.S. Court of Appeals for the First Circuit has agreed with every other federal court of appeals and held that the penalty for willful FBAR violations is not capped at $100,000 per account. The court concluded that the 2004 amendments to 31 U.S.C. § 5321(a)(5)(C) superseded the 1987 Treasury regulation that limits the penalty for willful FBAR violations to $100,000 per account:

> Thus, when Congress amended § 5321(a)(5)(C)-(D) to permit the IRS to impose a penalty in excess of $100,000, the 1987 regulation was superseded because the regulation -- as merely a regulation parroting a then-operative statutory maximum -- could have no effect once a new statutory maximum had been set.

2. Tax Court retains jurisdiction in a § 7345 passport revocation case to review IRS's certification of taxpayer's "seriously delinquent" tax liability, but finds case is moot. Ruesch v. Commissioner**,** 154 T.C. 289 (6/25/20). 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). 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 certification may petition the Tax Court to determine if it was made erroneously. § 7345(e)(1). If the Tax Court finds the certification was either made in error or that the IRS has since reversed its certification, the court may then notify the State Department that the revocation of the taxpayer's passport should be cancelled. § 7345(c). This is a case of first impression in which the Tax Court interprets the requirements of § 7345. The Tax Court (Judge Lauber) held that, while the Tax Court had jurisdiction to review Ms. Ruesch's challenge to the IRS's certification of her tax liabilities as being a "seriously delinquent tax debt," the controversy was moot because the IRS had reversed its certification as being erroneous. Further, the IRS had properly notified the Secretary of State of its reversal. The IRS had assessed $160,000 in penalties for failing to file proper information returns for a period of years. *See* § 6038. Thereafter, the IRS sent a final notice of intent to levy and Ms. Ruesch properly appealed the penalty amounts with the IRS's Collection Appeals Program (CAP). In a series of errors, the IRS mistakenly misclassified the CAP appeal as a Collection Due Process (CDP) hearing. Committing yet further errors, the IRS failed to properly record Ms. Ruesch's later request for a CDP hearing and never offered Ms. Ruesch her CDP hearing. The IRS then certified Ms. Ruesch's liability to the Secretary of State as a "seriously delinquent tax debt" under § 7345(b). Discovering their many errors as well as the oversight of Ms. Ruesch's timely requested a CDP hearing, the IRS determined her tax debt was not "seriously delinquent" and reversed the certification. Because, under § 7345, the Tax Court's jurisdiction in passport revocation cases is limited to reviewing the IRS's certification of the taxpayer's liabilities as "seriously delinquent," the only relief the Tax Court may grant is to issue an order to the IRS to notify the Secretary of State that the IRS's certification was in error. Since the IRS had already notified the Secretary of State of the error, the Tax Court could not offer any additional relief. Judge Lauber, therefore, found the controversy was not ripe to be heard and the issues were moot.

a. The Second Circuit has agreed with the Tax Court that the taxpayer's challenge to the IRS's certification that she had a seriously delinquent tax debt was moot, but has reminded the Tax Court that determinations of mootness must precede determinations of subject matter jurisdiction. Ruesch v. Commissioner, 25 F.4th 67 (2d Cir. 1/27/22), *aff'g in part,*

vacating and remanding in part 154 T.C. 289 (6/25/20). In a per curiam opinion, the U.S. Court of Appeals for the Second Circuit has affirmed the Tax Court's decision to the extent that the Tax Court's decision dismissed as moot the taxpayer's challenge to the IRS's certification pursuant to § 7345(a) that she had a seriously delinquent tax debt. The Second Circuit agreed with the Tax Court that, because the IRS had reversed its certification, her challenge to the certification in the Tax Court was moot. In reaching this conclusion, the Second Circuit rejected the taxpayer's argument that an exception to mootness, the voluntary cessation doctrine, allowed the taxpayer to continue to pursue her challenge in the Tax Court. The voluntary cessation doctrine applies when a defendant voluntarily ceases the offending conduct and is intended to prevent defendants from avoiding judicial review temporarily changing their behavior. According to the Second Circuit, however, the voluntary cessation doctrine is not absolute and a case can still be moot if two requirements are met: (1) the defendant demonstrates that interim relief or events have irrevocably and completely eradicated the effects of the alleged violation, and (2) there is no reasonable expectation that the allegedly offending conduct will recur. In this case, the court reasoned, both requirements were satisfied. The IRS's reversal of its certification completely eradicated the effect of the erroneous certification and there was no reasonable expectation that the alleged offending conduct will recur because the IRS was barred by statute from certifying her as having a seriously delinquent tax debt while her collection due process hearing with IRS Appeals was pending.

The taxpayer also had sought in the Tax Court to contest the underlying penalties the IRS had imposed and that led to certification of a seriously delinquent tax debt. The Tax Court had dismissed these claims for lack of subject matter jurisdiction because § 7345 does not confer jurisdiction on the Tax Court to consider challenges to the underlying liabilities that lead to certification. The Second Circuit, however, held that the Tax Court should instead have dismissed those claims as moot. The taxpayer, the court reasoned, had already received all the relief to which she was entitled under § 7345, i.e., reversal of the IRS's certification, which rendered moot any challenges to the underlying liability for penalties. According to the court:

> questions relating to Article III jurisdiction, including those concerning the doctrine of mootness, … are antecedent to and should ordinarily be decided before other issues such as statutory jurisdiction or the merits ….

3. 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. 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). 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 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). In the following cases, the courts have addressed the constitutionality of this regime.

a. Section 7345 does not prohibit international travel and therefore cannot violate either the Due Process Clause of the Fifth Amendment or the Universal Declaration of Human Rights, says the Tax Court. Rowen v. Commissioner, 156 T.C. 101 (3/30/21). The opinion of the Tax Court (Judge Toro) in this case begins as follows:

> For more than two decades, petitioner, Robert Rowen, failed to pay his Federal tax as required by law. The Internal Revenue Service ("IRS") attempted to collect the outstanding amounts through its usual means—sending demands, filing liens, attempting to levy on assets--all without much success. In 2018, when Dr. Rowen's outstanding tax balance was close to $500,000, the Commissioner of Internal Revenue turned to a new tool in his collection toolbox--section 7345.

The petitioner, Dr. Rowen, was a medical doctor licensed in California who frequently traveled to developing countries to offer medical services free of charge to underserved populations. 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. As permitted by § 7345(e)(1), Dr. Rowen filed a petition in the Tax Court and asked the court to determine that the IRS's certification of his tax debt as seriously delinquent was erroneous. He argued that § 7345 is unconstitutional because it prohibits international travel in violation of his rights under the Due Process Clause of the Fifth Amendment. He also argued that the statute "violates his human rights under the Universal Declaration of Human Rights ('UDHR')." The Tax Court rejected both arguments. The court noted that an uncodified provision of the 2015 Fixing America's Surface Transportation Act (FAST Act) authorizes the *Secretary of State* to revoke or deny the passport of an individual who has been certified as having a seriously delinquent tax debt. The Tax Court reasoned that, because § 7345 authorizes the IRS Commissioner only to certify that an individual has a seriously delinquent tax and leaves all passport-related decisions to the Secretary of State for action pursuant to the uncodified provision of the FAST Act, § 7345 does not prohibit international travel and therefore cannot violate either the Due Process Clause of the Fifth Amendment or the Universal Declaration of Human Rights.

b. Section 7345 survives a constitutional challenge. Maehr v. United States, 5 F.4th 1100 (10th Cir. 7/20/21). The plaintiff in this case had approximately $250,000 in unpaid federal tax liabilities from 2011. In 2018, 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 brought this action in federal district court challenging the authority of the State Department to revoke passports on the basis of tax liabilities. The U.S. District Court concluded t it did not have subject-matter jurisdiction over the plaintiff's claims and granted the government's motion to dismiss for failure to state a claim. On appeal, in an opinion by Judge Lucero, the U.S. Court of Appeals for the Tenth Circuit first concluded that the District Court did have subject matter jurisdiction over the action. The court then addressed the merits of the plaintiff's claims. Specifically, the Tenth Circuit unanimously rejected two of the plaintiff's arguments. The plaintiff argued that "the Privileges and Immunities Clause of Article IV, Section 2 and the Privileges or Immunities Clause of the Fourteenth Amendment encompass the right to international travel and thereby limit the federal government's ability to restrict such travel." The court rejected this argument because the Privileges and Immunities clauses apply only to the states and not to the federal government and do not protect the right to international travel. The court also rejected the plaintiff's argument that the court should review the State Department's revocation of his passport under a standard similar to the standard used by courts to review a writ of *ne exeat republica*. "A writ of *ne exeat republica* is a form of injunctive relief ordering the person to whom it is addressed not to leave the jurisdiction of the court or the state, for example, to aid the sovereign to compel a citizen to pay his taxes." *United States v. Barrett*, 113 A.F.T.R.2d 2014-749 (D. Colo. 1/29/14). The court concluded that, for several reasons, a writ of *ne exeat republica*, an equitable, common-law remedy, is readily distinguishable from the legislatively-authorized passport revocation provided for in the 2015 FAST Act. In a separate opinion written by Judge Matheson that was the majority opinion of the court on the issue, the court also rejected the plaintiff's argument 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 a rational basis standard of review. Under this standard, the court noted, "we will uphold a law "if there is any reasonably conceivable state of facts that could provide a rational basis for the [infringement]." See *FCC v. Beach Comm'cns, Inc.*, 508 U.S. 307, 313 (1993)." Section 7345, the court concluded, meets this standard. The federal government has a legitimate interest in raising revenue throuh taxes and "Congress's decision to further this legitimate interest by providing for revocation of passports for those who have a "seriously delinquent tax debt," 26 U.S.C. § 7345(a), is rational."

- In a lengthy concurring opinion, Judge Lucero advocated the view that the proper standard of review for the plaintiff's Fifth Amendment claims is intermediate scrutiny, which falls

between the rational basis and strict scrutiny standards. Because neither party argued for that standard of review, Judge Lucero concurred in the court's judgment.

4. Married taxpayers who receive separate but substantially identical notices of certification of a "seriously delinquent" tax debt in a § 7345 passport revocation case may file a joint petition challenging the certification in the Tax Court. Garcia v. Commissioner, 157 T.C. 1 (7/19/21). 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). 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 to determine if the certification was made erroneously. § 7345(e)(1). If the Tax Court concludes the certification was either made in error or that the IRS has since reversed its certification, the court may then order the Secretary of the Treasury to notify the State Department that the certification was erroneous. § 7345(e)(2). In this case, the taxpayers, a married couple, filed a joint federal income tax return for 2012. The IRS issued a notice of certification of a seriously delinquent tax debt to the wife showing an unpaid tax liability of $583,803, and subsequently issued a substantially identical notice to the husband showing the same delinquent tax debt. The taxpayers jointly petitioned the Tax Court and sought review of the certifications. The taxpayers asserted that they had submitted an offer-in-compromise that the IRS had failed to consider. The IRS subsequently determined that the taxpayers' offer-in-compromise was processable and remained pending and that the pendency of their offer suspended collection of their tax debt so that the debt was not "seriously delinquent." Accordingly, the IRS reversed the certifications and notified the Secretary of State. Because the certifications had been reversed, the IRS moved to dismiss the case on the ground of mootness. The Tax Court (Judge Lauber) first addressed an issue of first impression, which was whether the taxpayers could file a joint petition seeking review of the IRS's certification of a seriously delinquent tax debt. Neither § 7345 nor the Tax Court's Rules provide guidance on this question. The court noted that Tax Court Rule 34(a)(1) permits a married couple to file a joint petition in a deficiency action, i.e., when the IRS has issued joint or separate notices of deficiency for a year to a married couple that has filed a joint return. The court concluded that "equity and common sense" support extending this permission to challenges to notices of certification of seriously delinquent tax debts:

> In this case petitioners received substantially identical notices of certification from the IRS. These notices informed them that they had a delinquent tax debt of $583,803, stemming from an unpaid joint Federal income tax liability for 2012, and that the IRS had certified to the State Department that they were persons owing a "seriously delinquent tax debt." Both petitioners presented the same question: "whether the certification was erroneous." See sec. 7345(e)(1). And both petitioners presented the same argument: that the certifications were "prematurely issued" because they had submitted an offer-in-compromise that remained pending at the IRS.
>
> …
>
> … It is natural for spouses to file a joint petition in these circumstances.

To hold that the taxpayers could not file a joint petition, the court reasoned, "would occasion unnecessary delay and expense."

Because, under § 7345, the Tax Court's jurisdiction in passport revocation cases is limited to reviewing the IRS's certification of the taxpayer's liabilities as "seriously delinquent," the only relief the Tax Court may grant is to issue an order to the IRS to notify the Secretary of State that the IRS's certification was in error. Since the IRS had already notified the Secretary of State of the error, the Tax Court could not offer any additional relief. The court therefore concluded that the issues were moot and granted the government's motion to dismiss.

- The Tax Court previously had ruled that a taxpayer's challenge to the IRS's certification of a tax debt as seriously delinquent should be dismissed as moot when the IRS had reversed the certification. See *Ruesch v. Commissioner*, 154 T.C. 289 (6/25/20).

5. Taxpayers did not duly file their refund claim because their attorney, rather than the taxpayers, signed their amended returns claiming refunds. Brown v. United States, 22 F 4th 1008 (Fed. Cir. 1/5/22). The taxpayers were U.S. citizens living and working in Australia for Raytheon Corporation. They filed amended returns for 2015 and 2016 claiming refunds on the basis that they were entitled to the foreign earned income exclusion of § 911. The amended returns were signed by their attorney but no power of attorney accompanied the returns. In this litigation, the U.S. Court of Federal Claims granted the government's motion to dismiss for lack of subject matter jurisdiction on the ground that the returns were not "duly filed" as required by § 7422, which provides:

> No suit or proceeding shall be maintained ... until a claim for refund ... has been duly filed with the Secretary, according to the provisions of law in that regard, and the regulations of the Secretary established in pursuance thereof.

The U.S. Court of Appeals for the Federal Circuit has affirmed the Claims Court's decision. The court held that the "duly filed" requirement of § 7422 is not jurisdictional, but rather more akin to a claims processing rule. Nevertheless, the court agreed with the government that the taxpayer's refund claims were not duly filed because the taxpayers had not personally signed the returns or signed them in a manner that complied with applicable regulations. The applicable regulations provide:

> No refund or credit will be allowed after the expiration of the statutory period of limitation applicable to the filing of a claim therefor except upon one or more of the grounds set forth in a claim filed before the expiration of such period. The claim must set forth in detail each ground upon which a credit or refund is claimed and facts sufficient to apprise the Commissioner of the exact basis thereof. *The statement of the grounds and facts must be verified by a written declaration that it is made under the penalties of perjury.* A claim which does not comply with this paragraph will not be considered for any purpose as a claim for refund or credit.

Reg. § 301.6402-2(b)(1) (emphasis added). This requirement can be satisfied when a taxpayer's legal representative certifies the claim if the representative attaches evidence of a valid power of attorney. In this case, however, the attorney who prepared and signed the returns in question did not submit a power of attorney to the IRS. Because the taxpayers had failed to comply with the regulation's requirement, they had not "duly filed" their claim for refund within the meaning of § 7422. Accordingly, the court affirmed on the basis that the taxpayers had failed to state a claim on which relief could be granted.

6. The Tax Court lacks jurisdiction to review the IRS Whistleblower Office's threshold rejection of an application for a whistleblower award for failure to meet minimum threshold criteria for such claims. Li v. Commissioner, 22 F.4th 1014 (D.C. Cir. 1/11/22). The petitioner, Ms. Li, filed Form 211, Application for Award for Original Information, with the IRS's Whistleblower Office (WBO) asserting four tax violations by a third party. The WBO concluded that Ms. Li's allegations were "speculative and/or did not provide specific or credible information regarding tax underpayments or violations of internal revenue laws," and that she therefore was not eligible for an award. Therefore, the WBO did not forward her form to an IRS examiner for any potential action against the target taxpayer. The IRS informed her of this in a letter that stated that she could appeal the decision to the U.S. Tax Court. Ms. Li filed a petition in the Tax Court, which held that the IRS did not abuse its discretion in rejecting her application for an award. On appeal, the U.S. Court of Appeals for the D.C. Circuit (Judge Sentelle) dismissed the appeal for lack of jurisdiction and remanded to the Tax Court with a direction for the Tax Court to do the same. For the Tax Court to have jurisdiction in a whistleblower case, the court reasoned, § 7623(b)(4) requires that there be a "determination" regarding an award. In this case, the court held, the IRS WBO's rejection of a claim for failure to meet the minimum threshold criteria for a claim is not a determination and therefore the Tax Court has no jurisdiction. In reaching this conclusion, the court rejected and characterized as "wrongly decided" the Tax Court's decisions in *Cooper v. Commissioner*, 135 T.C. 70 (2010), and *Lacey v. Commissioner*, 153 T.C. 146 (2019).

7. The IRS has provided simplified procedures for taxpayers who are not required to file 2021 federal income tax returns to claim the child tax credit, the 2021 recovery rebate credit, and the earned income credit. Rev. Proc. 2022-12, 2022-7 I.R.B. 494 (1/24/22). Whether a taxpayer must file a federal income tax return generally depends on the taxpayer's filing status and level of income. If a taxpayer has gross income that is less than the standard deduction for the taxpayer's filing status, then the taxpayer generally is not required to file a federal income tax return. For example, for 2021, a single individual under age 65 is not required to file a return if the individual's gross income is less than $12,550 and a married couple filing jointly where both spouses are under age 65 is not required to file a return if their gross income is less than $25,100. There are exceptions to this rule. The principal exception is that a self-employed individual with net income from self-employment of $400 or more is required to file a return.

An individual who is not required to file a federal income tax return might nevertheless want to file a return to claim certain tax benefits. This revenue procedure provides simplified filing procedures for individuals who are not required to file 2021 federal income tax returns to claim the child tax credit, 2021 recovery rebate credit, and earned income credit. Specifically, the revenue procedure provides the following simplified procedures:

- *Zero income taxpayers can file electronically.* The revenue procedure provides a method for taxpayers with adjusted gross income (AGI) of zero to e-file their returns. Normally, such taxpayers are precluded by most tax preparation software from filing electronically. The revenue procedure instructs taxpayers with zero AGI to list $1 of taxable interest income, $1 of total income, and $1 of AGI, all on the appropriate lines of Form 1040, Form 1040-SR, or 1040-NR. This procedure applies to returns filed after January 24, 2022.
- *Taxpayers claiming the child tax credit and 2021 recovery rebate credit.* The revenue procedure provides a method for taxpayers to claim the child tax credit and 2021 recovery rebate credit by making limited entries on the normal tax return, which can be e-filed or mailed to the IRS. For example, the revenue procedure instructs taxpayers to enter the taxpayer's filing status and personal information (name, address, Social Security Number, or ITIN), to indicate whether the taxpayer can be claimed as a dependent, to enter information about any qualifying children for purposes of the child tax credit, and to enter zero on or leave blank specific lines of the tax return. Taxpayers who file on paper are instructed to enter "Rev. Proc. 2022-12" at the top of the first page of the return. This procedure applies to returns filed after April 18, 2022.
- *Taxpayers claiming the earned income credit, the child tax credit, and the 2021 recovery rebate credit.* The revenue procedure provides a method for taxpayers with earned income to claim the earned income credit, the child tax credit and 2021 recovery rebate credit by making limited entries on the normal tax return, which can be e-filed or mailed to the IRS. For example, the revenue procedure instructs taxpayers to enter the taxpayer's filing status and personal information (name, address, Social Security Number, or ITIN), to indicate whether the taxpayer can be claimed as a dependent, to enter information about any qualifying children for purposes of the earned income credit and child tax credit, and to enter zero on or leave blank specific lines of the tax return. Taxpayers who file on paper are instructed to enter "Rev. Proc. 2022-12" at the top of the first page of the return. This procedure applies to returns filed after April 18, 2022.

The revenue procedure sets forth various criteria that taxpayers must meet to take advantage of each of these simplified methods.

8. 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 is 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.

9. The shared responsibility payment imposed by § 5000A for failure to maintain health insurance is a tax for bankruptcy purposes and is entitled to priority. Internal Revenue Service v. Juntoff, 636 B.R. 868 (B.A.P. 6th Cir. 3/21/22). Section 5000A of the Code, enacted as part of the Affordable Care Act, requires individuals to maintain health insurance that provides minimum essential coverage. Prior to tax-year 2019, the statute imposed a penalty, referred to as a shared responsibility payment, on individuals who did not maintain minimum essential coverage. The taxpayers in these two consolidated cases filed Chapter 13 bankruptcy petitions. The IRS filed a proof of claim in each proceeding for a shared responsibility payment based on their failure to maintain minimum essential coverage in 2017 and 2018. The proof of claim characterized the shared responsibility payment as an "excise/income tax." The taxpayers argued that the shared responsibility payment was a penalty and not a tax, and therefore was not entitled to priority in bankruptcy. In *NFIB v. Sebelius*, 567 U.S. 519 (2012), the U.S. Supreme Court held that the shared responsibility payment is a tax for constitutional purposes but is not a tax for purposes of the Anti-Injunction Act. In an opinion by Judge Stout, the court concluded that the penalty is a tax for bankruptcy purposes. The court also concluded that it is a tax described in § 507(a)(8) of the Bankruptcy Code and therefore entitled to priority in bankruptcy.

Dissenting opinion of Chief Judge Dales. In a dissenting opinion, Chief Judge Dales argued that the shared responsibility payment is not a tax. He argued that the general approach of courts to be sparing in permitting priority treatment and the text of the statute (§ 5000A), which consistently refers to the shared responsibility payment as a penalty, suggest that the shared responsibility payment is a penalty rather than a tax. Judge Dales also relied on prior decisions of the Sixth Circuit, which provide guidance on determining when a payment to a governmental entity is a tax:

> Where a State "compel[s] the payment" of "involuntary exactions, regardless of name," and where such payment is universally applicable to similarly situated persons or firms, these payments are taxes for bankruptcy purposes.

Yoder v. Ohio Bur. of Workers' Comp. (In re Suburban Motor Freight, Inc.), 998 F.2d 338, 342 (6th Cir. 1993). The shared responsibility payment, he argued, is not universally applicable to similarly situated persons because it is triggered only by default, i.e., by virtue of an individual's failure to maintain minimum essential coverage. Because the shared responsibility payment is not a tax, he concluded, it is not entitled to priority in bankruptcy.

a. The Third Circuit has agreed: the shared responsibility payment imposed by § 5000A for failure to maintain health insurance is a tax for bankruptcy purposes and is entitled to priority. In re Szczyporski, 34 F.4th 179 (3d Cir. 5/11/22). The taxpayers in this case, a married couple, filed a Chapter 13 bankruptcy petition. The IRS filed a proof of claim for a shared responsibility payment based on their failure to maintain minimum essential coverage in 2018. The proof of claim characterized the shared responsibility payment as an excise tax. The taxpayers argued that the shared responsibility payment was a penalty and not a tax, and therefore was not entitled to priority in bankruptcy. The U.S. Court of Appeals for the Third Circuit concluded that the penalty is a tax for bankruptcy purposes. The court also concluded that it is a tax described in § 507(a)(8) of the Bankruptcy Code and therefore entitled to priority in bankruptcy.

XI. WITHHOLDING AND EXCISE TAXES

A. Employment Taxes

B. Self-employment Taxes

C. Excise Taxes

1. Butane does not qualify as a liquified petroleum gas and therefore does not qualify for the alternative fuel mixture credit authorized by § 6426(e), says the Fifth Circuit. Vitol, Inc. v. United States, 30 F.4th 248 (5th Cir. 3/23/22). In an opinion by Judge Willett, the U.S. Court of Appeals for the Fifth Circuit has held that butane does not qualify as a liquified petroleum gas (LPG) and therefore does not qualify for the alternative fuel mixture credit authorized by § 6426(e). The taxpayer brought this action seeking a tax refund of $8.8 million on the basis that it was entitled to the credit provided by § 6426(e). Sections 4081 and 4041(a)(2)(A) impose excise taxes on fuel made from certain components. Section 6426(e) provides a credit for a fuel that is "a mixture of alternative fuel and taxable fuel." The term "alternative fuel" is defined in § 6426(d) to include LPG. The court adopted a textualist approach and declined to rely on legislative history. The court acknowledged that the common meaning of LPG includes butane. According to the court, however, § 4083 defines butane as a *taxable fuel* for purposes of the excise tax imposed by § 4081.

> the statutory framework is mutually exclusive: A given fuel is either taxable or alternative, but not both. The statutory context of § 6426 provides sound reason to depart from butane's common meaning.

If butane is a taxable fuel, the court reasoned, it cannot be an alternative fuel, and therefore cannot be LPG within the meaning of § 6426(d).

Dissenting opinion by Judge Elrod. In a thoughtful dissenting opinion, Judge Elrod rejected the statutory analysis set forth in the majority opinion. According to Judge Elrod, the majority was too quick to reject the ordinary meaning of the term LPG and the government had not persuasively shown that Congress meant to override the ordinary meaning of that term:

> As everyone in the oil and gas industry knows, and as the United States readily concedes, butane is an LPG. Indeed, the government's own witness testified that "butane is always an LPG." That should be the end of it: Vitol gets a tax credit.

2. The tax imposed by § 4611 on oil exported from the United States is a tax on exports in violation of Article I, § 9 of the U.S. Constitution and therefore is unconstitutional. Trafigura Trading, LLC v. United States, 29 F.4th 286 (5th Cir. 3/24/22), *aff'g* 485 F.Supp.3d 822 (S.D. Tex. 2020). The taxpayer, a commodity trading company, purchased and exported from the United States approximately 50 million barrels of crude oil between 2014 and 2017. Section 4611(b) of the Code imposes a tax on "any domestic crude oil [that] is used in or exported from the United States." The taxpayer paid over $4 million to the IRS based on the oil it exported and filed an administrative claim for a refund of the tax. When the IRS denied the claim, the taxpayer brought legal action seeking a refund in a federal district court. In the U.S. District Court for the Southern District of Texas, the taxpayer argued that the tax imposed on exported oil by § 4611(b) violates the Export Clause of the U.S. Constitution (Art. I, § 9, cl. 5), which provides: "No Tax or Duty shall be laid on Articles exported from any State." The U.S. District Court (Judge Hanen) granted summary judgment in favor of the taxpayer and the government appealed. In an opinion by Judge Ho, the U.S. Court of Appeals for the Fifth Circuit affirmed the District Court's decision. The Fifth Circuit observed that, according to the U.S. Supreme Court's decisions in *United States v. U.S. Shoe Corp.*, 523 U.S. 360 (1998), and *Pace v. Burgess*, 92 U.S. 372 (1876), the label Congress uses to describe an impost (e.g., as a tax) is not controlling and the Export clause does not bar a charge or user fee that lacks the attributes of a generally applicable tax and instead is "designed as compensation for Government-supplied services, facilities, or benefits." Thus, according to the Fifth Circuit, the question is whether § 4611(b) imposes an impermissible tax or instead a permissible user fee. According to § 9509(b)(1), proceeds from § 4611(b) go to the Oil Spill Liability Trust Fund. The Oil Spill Liability Trust Fund is used for several purposes, including reimbursing those held liable for the cleanup costs of an oil spill, covering costs incurred by federal, state, and Indian tribe trustees for natural resource damage assessment and restoration, and supporting certain environmental research and testing. The "tax" imposed by § 4611(b) therefore might be characterized as a user fee that provides a source of funds for these initiatives. After analyzing relevant precedent from the U.S. Supreme Court, Judge Ho summarized the guiding principles regarding whether an impost is a tax or instead a user fee as follows:

> First, we must consider whether the charge under § 4611(b) is based on the quantity or value of the exported oil—if so, then it is more likely a tax. Second, we must consider the connection between the Fund's services to exporters, if any, and what exporters pay for those services under § 4611(b). That connection need not be a perfect fit. See *Pace*, 92 U.S. at 375–76. But a user fee must "fairly match" or "correlate reliably with" exporters' use of government services. *U.S. Shoe*, 523 U.S. at 369–70. Finally, we apply "heightened scrutiny," *Matter of Buffets, LLC*, 979 F.3d 366, 380 (5th Cir. 2020), and strictly enforce the Export Clause's ban on taxes by "guard[ing] against . . . the imposition of a [tax] under the pretext of fixing a fee," *U.S. Shoe*, 523 U.S. at 370 (quotations omitted).

With respect to the first issue, the Judge Ho concluded that the charge imposed by § 4611(b) is based on the volume of oil transported and therefore is based on the quantity or value of the exported oil, which makes it more likely that the charge is a tax. With respect to the second issue, Judge Ho concluded that there is not a sufficient connection between exporters' payment of the charge imposed by § 4611(b) and their use if government services. He reasoned that "[a] user fee is a charge for a specific service provided to, and used by, the payor," and that the charge imposed by § 4611(b) does not meet this criterion. Section 4611(b) requires oil exporters to pay for several things that cannot be regarded as services provided to the oil exporters, such as reimbursements to federal, state, and Indian tribe trustees for assessing natural resource damage; research and development for oil pollution technology; studies into the effects of oil pollution; marine simulation research; and research grants to universities. Although oil exporters benefit indirectly from these initiatives, they do not receive a specific service in return for the amounts they pay. Society as a whole benefits from these initiatives. By analogy, Judge Ho reasoned, [t]he fact that people pay taxes to fund police and fire protection does not somehow turn those taxes into user fees." Accordingly, the court held that the charge imposed by § 4611(b) is a tax rather than a user fee, and because it is a tax on exports, it violates the Export clause and is unconstitutional.

Concurrence of Judge Wiener. Judge Wiener concurred in the judgment of the court.

Dissenting opinion of Judge Graves. In a dissenting opinion, Judge Graves concluded that there are genuine issues of material fact as to whether § 4611(b) imposes a user fee and that it was therefore inappropriate for the District Court to grant summary judgment in favor of the taxpayer. Judge Graves disagreed with Judge Ho's conclusion that the charge imposed by § 4611(b) is based on the quantity or value of the exported oil. In his view, the charge is a per-barrel fee that does not depend on the value of the exported oil. He also disagreed with Judge Ho's analysis regarding exporters' payment of the charge and their receipt of services:

> it is implausible to suggest that random taxpayers or random members of society are the primary beneficiaries of exporters simply being responsible for their own actions and business practices. There would be no oil spills, resulting damage, or need for research and development regarding oil pollution if oil was not exported. The oil was not exported by random taxpayers or random members of society, and they are neither responsible for any subsequent pollution/damage of precious natural resources nor the beneficiaries of any cap on liability. The oil is exported by exporters, who are not forced to share any resulting profit with random taxpayers or random members of society. To borrow from the plurality, exporters pay and exporters benefit.

XII. TAX LEGISLATION

A. Enacted

1. The American Rescue Plan provides significant tax benefits for many taxpayers. The American Rescue Plan Act of 2021, Pub. L. No. 117-2, signed by the President on March 11, 2021, made several significant changes. The changes made by this legislation include expanding credits such as the child tax credit and earned income credit, suspending the requirement to repay excess advance premium tax credit payments, and providing exclusions for up to $10,200 of unemployment compensation and for cancellation of student loans.

2. The Infrastructure Investment and Jobs Act ends the employee retention credit of Code § 3134 for the fourth quarter of 2021. The Infrastructure Investment and Jobs Act, Pub. L. No. 117-58, signed by the President on November 15, 2021, contains relatively few significant tax provisions but section 80604 of the legislation ends the employee retention credit of Code § 3134 for the fourth quarter of 2021.

3. 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.