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TAX SECTION
STATE BAR OF TEXAS

www.texastaxsection.org

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Dear Fellow Tax Section Members:

As we near the end of this 2019-2020 State Bar year we do so in a sudden era of unprecedented uncertainty due to the business, legal, personal, and tax effects of the global public health crisis. New legislation, regulations, and administrative updates on tax filing, litigation, economic stimulus actions, assistance for businesses, and procedures are coming out every day. Our annual meeting of the Tax Section is going "virtual." It's a brave new world.

Welcome to Our Incoming Editor

It is with much wistfulness that we send a fond farewell and a big THANK YOU to **Michelle Humphrey**, our long-time editor of the *Texas Tax Lawyer*, who has generously offered continued commitment and hard work to deliver an outstanding *Texas Tax Lawyer*. Michelle has joined her husband in their growing litigation practice at Humphrey Law PLLC. Her practice has expanded into a variety of litigation projects – not just tax law – so **Aaron Borden** has graciously agreed to take over as editor for 2020-2021 season.

Tax Section Annual Meeting GOES VIRTUAL!!! Registration Open!

The Tax Section Annual Meeting, which was originally scheduled to be held during the State Bar Annual Meeting in Dallas on **Friday, June 26, 2020,** is going virtual! The State Bar Annual Meeting has been cancelled, but a virtual option is in progress. The Tax Section Annual Meeting program includes a presentation by the Commissioner of Internal Revenue **Charles P. Rettig**; the interview of nationally-acclaimed Texas Tax Legend **Emily A. Parker** of Thompson & Knight LLP in Dallas by our favorite interviewer, **William D. Elliott**; and a panel collaboration with the Immigration and Naturalization Law Section on Pre-Immigration Tax Planning by **John Strohmeyer** of the Tax Section and **Matthew Myers** of the Immigration and Naturalization Section. You must register for the Tax Section meeting to receive the link and must attend the entire program to get CLE credit.

All Tax Section members are also invited to join us for the Annual Member Meeting and awards ceremony, which will be online on **Friday, June 26, 2020, at 8:00 a.m.** During the meeting we will recognize our scholarship recipients and our award recipients for 2019-2020. Registration for the meeting and CLE is available online at https://us02web.zoom.us/webinar/register/WN_ooxYtMp8SkSnC_f3kyUmcA.

Congratulations to Outstanding Texas Tax Lawyer David G. Glickman!

The Texas Tax Section has selected **David G. Glickman**, Senior Counsel at the Dallas office of Baker & McKenzie LLP, as the 2020 Outstanding Texas Tax Lawyer. David Glickman is well-versed in matters relating to tax planning—especially with respect to domestic and foreign mergers and acquisitions — and tax controversy. He has lectured in various tax institutes and meetings throughout the US, and has taught tax courses in a number of universities. Mr. Glickman has also written key articles for different taxation journals. He served as Deputy Assistant Secretary of Treasury (Tax Policy) in the US Department of the Treasury, and is a recipient of its Exceptional Service Award. He was interviewed in 2010 as a Texas Tax Legend. His interview is available online at:

- http://www.texastaxsection.org/DrawLegalLegendVideos.aspx?VideoID=15 (Part 1)
- http://www.texastaxsection.org/DrawLegalLegendVideos.aspx?VideoID=14 (Part 2)

Congratulations Scholarship Recipients!

The Tax Section received several scholarship applications and selected four recipients for the Law Students Pursuing Tax Scholarship. This year's winners will be honored at the virtual tax section meeting. Congratulations to:

- Jasmine DiLucci – SMU Dedman School of Law
- Charles Kelly – South Texas College of Law
- Sarah Husbands – University of Houston Law Center
- Ryan Ault – University of North Texas Dallas College of Law

Election of Officers and Electronic Voting on Incoming Council Members

At the last council meeting held on April 3, 2020, by Zoom, we amended our bylaws to allow for an electronic or voice vote of Section members in a telephonic or virtual meeting, or by electronic mail or similar means. The nominating committee nominated the following officers:

Chair:	Lora G. Davis (Dallas)
Chair-Elect:	Daniel G. Baucum (Dallas)
Secretary:	Henry Talavera (Dallas)
Treasurer:	Robert C. Morris (Houston)

The election of officers was made by the council at the April 3, 2020 meeting.

Election of council members is done at the Annual Meeting, after review by the council of the recommendations from the nominating committee. As set forth in the bylaws, copied in part below, the nominations period has closed. Because the in-person annual meeting has been cancelled and the State Bar is recommending prerecording of the sessions to be broadcast at our virtual meetings, please be on the lookout for an e-mail asking you to vote on the council members. The council members selected by the nominating committee for a three-year term from 2020-2023 are:

Lee Meyercord (Dallas)
Carol Warley (Houston)
Michael A. Villa, Jr. (Dallas)

We will need a vote of Tax Section members to confirm these nominations, so please contact Christi Mondrik cmondrik@mondriklaw.com to cast your vote before the virtual annual meeting. **Votes will be collected through 2:00 p.m. on Thursday, June 25, 2020.** In addition to the Tax Section bylaws change referenced below, the State Bar of Texas has also provided emergency procedures to allow voting by e-mail. Our voting will also include approval of last year's annual meeting minutes. Tax Section members registering to attend the virtual annual meeting will receive a separate e-mail with the minutes from last year's annual meeting for approval.

<u>Section 4.3</u> Elections. At the annual meeting of the Section, the members of the Section present in person shall by plurality vote (which may be determined at the discretion of the Chair to be a voice vote, visible vote, or written ballot) elect the members of the Elected Council to succeed those whose terms will expire at the close of that annual meeting. <u>If the Section is unable to hold an in-person annual meeting the Chair may, at the Chair's discretion, conduct an electronic or voice vote of Section members in a telephonic or virtual meeting, or by electronic mail or other similar means.</u>

<u>Section 4.1</u> Nominations. Any member of the Section may submit nominations for the offices of Chair-Elect, Secretary, Treasurer and the three Elected Council members for the succeeding year. Nominations may be submitted to any member of the Nominating Committee or to any Officer. The Nominating Committee shall confirm whether any person whose name is submitted as a candidate on or before March 1st of the year following the annual meeting wishes to be considered for election as an Officer or Elected Council member and is a qualified candidate (within the meaning of Section 4.4.2). The Nominating Committee may also require that nominees complete a candidate questionnaire (which shall be in such form as determined from time to time by the Nominating Committee). From the qualified candidates who are nominated and, if required, submit timely completed candidate questionnaires, and any additional qualified candidates deemed appropriate by the members of the Nominating Committee, the Nominating Committee shall make nominations for the offices of Chair-Elect, Secretary and Treasurer and the three Elected Council members to succeed those whose term will expire at the close of the Section's fiscal year. The Nominating Committee shall prepare a written report of recommended nominations for Officers and the three Elected Council members. The written report shall also identify all other qualified candidates for such positions who were nominated, submitted timely candidate questionnaires if required, and wish to stand for election. The Nominating Committee's written report shall be delivered to the Council by electronic mail, U.S. mail, or overnight delivery service, or a combination of the above, at least ten days before a regular or special meeting of the Council that precedes by at least 30 days the Section's annual meeting for the year. The Council, at that meeting, shall elect the Chair-Elect, Secretary, and Treasurer to succeed those whose terms will expire at the close of the Section's fiscal year. The Nominating Committee's written report also shall be delivered to the Section members by electronic mail, U.S. mail, overnight delivery service, or posting on the Section's website (or combination thereof) at least 20 days before the Section's annual meeting. No other nominations for the office of Officers or the Elected Council members can be made except through this process.

Pro Bono Committee

The Pro Bono Committee has been hopping with numerous training events, calendar call appearances, and representation at settlement days under the guidance of **Rachael Rubenstein** and **Bob Probasco**. The committee has set up a SignUpGenius page for volunteers.

The Tax Section Pro Bono Committee completed the VITA Adopt-a-Base program before closures began with volunteers devoted to training at Fort Bliss, Fort Hood, Fort Sam Houston, Lackland AFB, and Goodfellow AFB. Tax Section volunteers also assisted taxpayers at Tax Court calendar calls and settlement days, as well as at various events in Houston, Dallas, and San Antonio. **Bob Probasco** attended a State Bar pro bono workgroup meeting in Austin on November 6, 2019, at which the group provided very positive feedback on an overview of the Tax Section pro bono programs.

Property Tax Committee Presentation at Texas State Bar Virtual Annual Meeting

The Tax Section will contribute a property tax panel to the virtual annual meeting of the State Bar of Texas, for which planning is in progress. The program will be held on **Thursday, June 25, 2020**. The Tax Section panel is:

Property Tax: Protesting Values During a Public Health Crisis

PRESENTERS

Daniel R. Smith
Popp Hutcheson, PLLC
Austin, TX
Represents Property Owners

Sandy Griffin
Perdue Brandon Fielder Collins & Mott, LLP
Austin, TX
Represents Appraisal Districts

Please watch your email for updates on registration information and list of all of the CLE programming that will be available.

As you may know, the Texas State Bar Property Tax Committee Meeting & Legal Seminar was originally scheduled to be held on Friday, March 27, 2020, at the Thompson Conference Center at the University of Texas at Austin, and was cancelled as a result of the growing public health concerns. The program was planned to include a case law update, an overview of delinquent tax matters, chief appraisers' panel, ethics, and sessions on exhaustion of administrative remedies and presenting expert appraisers. The spring has been a very busy time for the Property Tax Committee with significant changes to procedures for challenging appraisals and managing other controversies.

First Wednesday Tax Update

The Tax Section continues its wildly popular free webcast series, “First Wednesday Tax Update.” The webcasts are offered the first Wednesday of each month, focus on recent developments in federal income taxation, and are presented by **Professor Bruce McGovern**, Professor of Law and Director, Tax Clinic, South Texas College of Law Houston (and may occasionally include other guest speakers). We hope you will make plans to watch the webcast each month, but if you miss it, check the Tax Section's 24/7 online library after a few weeks.

Committee on Governmental Submissions

Sam Megally has continued leading very effective, efficient monthly calls of the Committee on Governmental Submissions (COGS). The Tax Section has been busy issuing comments to the Internal Revenue Service and testifying on proposed regulations in Washington D.C. before Treasury transitioned to virtual telephonic and online testimony as a result of the public health crisis.

On March 9, 2020, Tax Section Treasurer, **Henry Talavera**, traveled to Washington D.C. to represent the Texas Tax Section by testifying in a public I.R.S. hearing regarding deductions for performance-based executive compensation. Mr. Talavera testified in support of comments the Texas Tax Section had issued pertaining to the proposed rulemaking in Certain Employee Remuneration in Excess of $1,000,000 Under Internal Revenue Code Section 162(m), 84 Federal Register 70356, published in 84 Fed. Reg. 70356–70391 (December 20, 2019), adding certain proposed regulations (the "Proposed Regulations") under section 162(m) of the Internal Revenue Code of 1986, as amended (the "Code"). He was the only presenter.

The panel bombarded Mr. Talavera with questions. He was questioned by Stephen Tackney and Ilya Enkishev. Mr. Talavera was also interviewed by Law360 following his presentation and a writeup of his testimony was included in Tax Notes. Mr. Talavera noted that he thinks our comments and discussion made a difference, and he is glad to be a part of the Texas Tax Section Employee Benefits Committee and involved in the COGS process in addition to the work he is doing as Treasurer.

You too can make a difference. The monthly COGS conference calls are scheduled for the third Friday of each month at 11:00 a.m. The calls are very brief and efficient. It is very important for at least one representative of each substantive committee to dial in to the monthly COGS call, even if there have been no specific projects identified by the committee. It is critical for us to be able to collaborate with other committees to ensure various stakeholders' interests are addressed. Even if you are not representing a committee, if you are interested in participating in COGS projects, please join the calls and volunteer to help. The details are included on the Tax Seciton calendar and in the monthly updates that each committee distributes to its members.

Law School Outreach

The Tax Section's Law School Outreach successfully visited nine of the ten law schools in Texas before most universities transitioned to e-learning for the remainder of the academic year. The Tax Section has provided panel presentations to law students at Texas Tech University School of Law, Texas A&M University School of Law, UNT Dallas College of Law, SMU Dedman School of Law, University of Houston Law Center, Baylor Law School, Thurgood Marshall School of Law at Texas Southern, and St. Mary's University School of Law. Many thanks to **Audrey Morris** and **Abbey Garber** for their continued hard work and dedication to this program.

2020-2021 Sponsorships are Available Now!

We are very grateful to the many sponsors of the Tax Section and our events and rely on those sponsorships to continue to provide high quality CLE and resources to our members. If your organization would like to become a sponsor, please contact Jim Roberts, Sponsorship

Chair, at jvroberts@gpm-law.com. The 2020-2021 sponsorship form is available now. A copy is included in this issue of the Texas Tax Lawyer.

Special Thanks

As I prepare to hand over the reins of the Tax Section to the new Chair, **Lora Davis**, I recognize and give special thanks to the many amazing tax lawyers who make the Tax Section so wonderful. Thank you to **Catherine Scheid**, immediate past chair, for her gracious support. Thank you to **Stephanie Schroepfer**, **Rob Morris**, **Gwen Fulcher**, and **Norton Rose Fulbright** in Houston and **Henry Talavera**, **Kayla LaRue**, and **Polsinelli** in Dallas for graciously hosting the Tax Section meetings this year. We greatly appreciate your hospitality! Thank you so much for the support and wisdom of **Elizabeth Copeland**, **Alyson Outenreath**, **Charolette Noel**, **Tina Green**, **Bill Elliott**, **Abbey Garber**, **Audrey Morris**, the officers, **Lora Davis**, **Dan Baucum**, and **Henry Talavera**, and the council members, Committee Chairs and Vice Chairs, project leaders, and everyone else involved with the Tax Section who tirelessly give their time, energy and resources to the various Tax Section activities. I look forward to recognizing many of the Tax Section's outstanding leaders at the virtual Tax Section Annual Meeting. I also extend a big thank you to **Anne Schwartz**, the Tax Section Administrator, and **Lyndsay Smith** and **Tracy Nuckols**, from the Big Bar for their endless support this year.

Join a Committee

We have an active set of committees, both substantive and procedural. Our substantive committees include: Corporate Tax, Employee Benefits, Energy and Natural Resources, Estate and Gift Tax, General Tax Issues, International Tax, Partnership and Real Estate, Property Tax, Solo and Small Firm, State and Local Tax, Tax Controversy, Tax- Exempt Finance, and Tax-Exempt Organizations. In addition, our facilitator committees include: the Committee on Governmental Submissions, Annual Meeting Planning Committee, Continuing Legal Education Committee, Newsletter Committee, and Tax Law in a Day Committee.

Any members interested in joining a committee can do so by visiting our website at www.texastaxsection.org. Tax Lawyers are a lot of fun!

Contact Information

Please feel free to contact me or our Tax Section Administrator, Anne Schwartz, if you have any questions or would like additional information about any of these items or the Tax Section in general:

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Houston, Texas

TAX SECTION
STATE BAR OF TEXAS

2020 Tax Section Virtual Annual Meeting
June 26, 2020
(8:00 a.m. – 12:00 p.m. via Zoom)

8:00 – 8:45 a.m.	**Welcome and Introductions**
9:00 – 10:00 a.m.	**Pre-Immigration Tax Planning** *1 hour* *Co-sponsored by the Immigration and Nationality Law Section* John R. Strohmeyer, *Houston* - Strohmeyer Law, PLLC Matthew Myers, *Austin* - Foster, LLP
10:00 – 10:45 a.m.	**Federal Tax Policy Update from the Commissioner of Internal Revenue** *.75 hour* Charles P. Rettig, *Washington, D.C.* - Commissioner of Internal Revenue, U.S. Internal Revenue Service
10:45 – 11:45 a.m.	**Texas Tax Legends Interview of Tax Legend Emily A. Parker** *1 hour* Emily A. Parker, *Dallas* - Thompson & Knight LLP William D. Elliott, *Dallas* - Elliott, Thomason & Gibson, LLP

TAX SECTION
STATE BAR OF TEXAS

Annual Sponsor Commitment Terms – Law Firm Sponsor

Instructions: Please fill out the section below, and check the appropriate level of sponsorship desired. Then please email or mail this completed Commitment Form to Henry Talavera, SBOT Tax Section Treasurer, Polsinelli PC, 2950 Harwood, Suite 2100. Dallas, Texas 75201 Email: HTalavera@polsinelli.com.

Name of Sponsor: ______________________________

Name of Contact Person: ______________________________

Mailing Address: ______________________________

City, State Zip: ______________________________

Phone number: ______________________________

Email: ______________________________

Check the appropriate level of sponsorship desired:

□ Ruby (2-year Diamond sponsor)	$8,000	3 free attendees at Listed Events (thru 5-31-22)
□ Diamond	$5,000	3 free attendees at Listed Events
□ Sapphire (2-year Platinum sponsor)	$4,000	2 free attendees at Listed Events (thru 5-31-22)
□ Platinum	$2,500	2 free attendees at Listed Events
□ Gold	$1,500	1 free attendee at Listed Events
□ Silver	$1,000	2 free attendees at 2 Listed Events**
□ Bronze	$750	1 free attendee at 3 Listed Events**
□ Patrons	$500	1 free attendee at 2 Listed Events**
□ Solo & Small Firm*	$350	1 free attendee at 1 Listed Event

*The Solo & Small Firm sponsorship level is only available for law firms of fewer than five attorneys.
**May use all free attendance rights at one Listed Event or at one or more different Listed Events.

The Ruby, Diamond, Sapphire, Platinum and Gold sponsorship levels include:

- FREE admission at all Listed Events, for the number of attendees indicated above;
- Continual recognition on the rotating banner on the Tax Section home page for the entire year;
- Inclusion of the firm name and logo on all Tax Section email blasts advertising listed events;
- Inclusion of the firm name and logo on a sponsor board at all listed events;
- Recognition of your firm in the Texas Tax Lawyer;
- Inclusion of the sponsor's name on flyers distributed at all listed events

Annual Sponsor Commitment Terms – Law Firm Sponsor

Sponsorship levels (other than Ruby, Diamond, Sapphire, Platinum and Gold) include:

- Continual recognition – link to a list of sponsors on the Tax Section home page for the entire year;
- FREE admission to the number of listed events indicated, for the number of attendees indicated, above;

Listed events include:

- Tax Section Annual Meeting (June 2020)
- International Tax Law Symposium (November 2020)
- Tax Law in a Day (January or February 2021)

Listed Events do not include the Advanced Tax Workshop (March) and the Property Tax Legal Seminar (March).

This sponsorship Commitment Form to be an Annual Sponsor for the Tax Section of the State Bar of Texas is an application for sponsorship. Acceptance shall be at the discretion of the Tax Section and is not guaranteed. The sponsor agrees to comply with, and be subject to, the terms and conditions contained in this document. The Tax Section reserves the right to refuse or deny sponsorships to prospective sponsors, with no explanation. The Applications for Annual Sponsorship of the Tax Section may be submitted at any time during the Tax Section year (June 1 – May 31) but the Tax Section cannot guarantee full recognition at any specific event unless the Commitment Form is received at least 30 days in advance of an event. The annual sponsorship amount is not prorated and so sponsors submitting a Commitment Form after June 1 are not entitled to a discount on the sponsorship amount. Upon receipt of an application for sponsorship and approval by the Tax Section, the Tax Section will issue an invoice to the sponsor and the amount of the sponsorship is due within 10 days of the date of the invoice. The Ruby and Sapphire 2-year discounted sponsorships are invoiced into separate invoices – one upon receipt of this commitment, payment on which is due within 10 days, and one on or around May 1 of next year, payment on which is due within 10 days of the date of that invoice. Sponsorships not paid for within that/those timeframe(s) may be canceled at the discretion of the Tax Section.

All sponsorships are non-exclusive. Several law firms are annual sponsors of the Tax Section and one or more displays may be in or around the meeting area with those law firms' names and logos.

Submitted on May 21, 2020

Who CARES About Tax Issues for Small Business: A Review of the Tax Forgiveness, Tax Deduction, and Other Tax Issues Associated with the CARES Act's Paycheck Protection Program ("PPP")

By: Juan F. Vasquez, Jr.,[1] Jaime Vasquez,[2] and Victor J. Viser,[3] Chamberlain, Hrdlicka, White, Williams & Aughtry, P.C.

The Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") provides emergency assistance to individuals and businesses affected by the Covid-19 pandemic through a series of measures including the Paycheck Protection Program.[4] The Paycheck Protection Program authorized the SBA to lend up to $349 billion in forgivable loans to small businesses during the crisis.[5] Congress subsequently passed the Paycheck Protection Program and Health Care Enhancement Act ("PPP Enhancement Act") after the program exhausted all committed funds. The PPP Enhancement Act appropriated another $310 billion to the Paycheck Protection Program.[6]

A Paycheck Protection Program loan ("PPP loan") can be up to $10 million and made to an eligible recipient if the business was in operation on February 15, 2020 and employs 500 or fewer employees, including individuals employed on a full-time, part-time, or other basis, subject to affiliation and industry rules.[7] If certain requirements are met (involving retaining employees, maintaining wages, and applying the funds toward eligible expenses) then the PPP loan may be forgiven, either partially or in full.[8] Borrowers should only apply for loan forgiveness after the covered period expires and the borrower gathers the required loan

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[1] Juan F. Vasquez, Jr. is a Shareholder in the Houston and San Antonio offices of Chamberlain Hrdlicka and serves as the Co-Chair of the Firm's nationwide Tax Controversy Section. He concentrates his practice on federal, state and local tax controversy matters, including in connection with examinations, administrative appeals and trial. He also represents clients in tax planning, ERISA and executive/deferred compensation, estate planning, and trust related matters. He also serves as an Adjunct Professor at the University of Houston Law Center, where he teaches Tax Procedure in the Fall and Tax Controversy & Litigation in the Spring. Mr. Vasquez has been honored by *The Best Lawyers in America*, *Texas Super Lawyers*, and *Chambers*.

[2] Jaime Vasquez is a Shareholder with Chamberlain Hrdlicka in San Antonio. Mr. Vasquez concentrates his practice on federal, state, and international transactional and tax controversy matters, including income, employment, sales, franchise, motor fuels, tobacco, and other excise matters before the IRS and state taxing authorities. Mr. Vasquez represents a broad range of clients including individuals, privately held businesses, and large Fortune 500 companies. Mr. Vasquez is also a Certified Public Accountant (CPA) and, prior to entering the practice of law, worked with a Big Four public accounting firm. Mr. Vasquez has been honored by *The Best Lawyers in America*, *Texas Super Lawyers*, *San Antonio Business Journal* and *Scene San Antonio* for Tax Litigation and Controversy.

[3] Victor J. Viser is a Tax Associate with Chamberlain Hrdlicka in San Antonio. Mr. Viser's practice focuses on federal, state, and international tax planning and controversy matters. Mr. Viser is a graduate of New York University School of Law with an LL.M. in Taxation and holds a J.D. from the University of Virginia School of Law.

[4] Pub. L. 116-136, Coronavirus Aid, Relief, and Economic Security Act (March 27, 2020) (hereinafter "CARES Act"); 85 F.R. 20811 (Apr. 15, 2020).

[5] CARES Act.

[6] *Id*.

[7] 15 U.S.C. §§ 636(a)(36) -(E), -(F)(ii), -(D). In certain instances, a business can employ more than 500 employees if it satisfies the affiliation rules and/or does not exceed the SBA size standard for the industry in which it is primarily engaged. *See* 85 F.R. 20817 (Apr. 15, 2020).

[8] CARES Act §§ 1106 -(b), -(d).

documentation.[9] Following an application for loan forgiveness, the lender has up to 60 days to issue its decision.[10] Loan amounts in excess of $2 million will be reviewed by the SBA in consultation with the Department of the Treasury.[11]

The number and amount of PPP loans that have been issued since the Paycheck Protection Program began on April 3, 2020 is both unprecedented and staggering. As of May 16, 2020, 4.3 million loans have been issued totaling more than $513 billion dollars.[12] The program's relative brevity compared to its size has led to an equally immense lack of clarity with regard to how it works, who is eligible, and the tax consequences of receiving a PPP loan. Lenders, borrowers, SBA, the IRS and Congress together are developing the program ad hoc, the consequence of which is a series of tax issues that small businesses should understand in order to more fully benefit from access to low-interest and/or forgivable loans available under the Paycheck Protection Program.

First, during the application process, some small business applicants may have been improperly denied a PPP loan due to having unpaid or delinquent taxes, or a tax lien. These tax-related issues are not disqualifying factors to be considered by the lender and therefore any small business that is otherwise eligible for a PPP loan should not be denied for having them.

Second, during the period when eligible expenses are being made, small businesses may be able to receive loan forgiveness for expenses incurred outside of, but paid during, the covered period, and vice versa.

Third, when small businesses file income tax returns, they may be able to both (i) exclude from gross income canceled indebtedness resulting from a forgiven PPP loan and (ii) deduct ordinary business expenses made with funds from the forgiven PPP loan, despite the current IRS position disallowing such deductions.

I. Tax Debt is not a Disqualifying Factor for PPP Loan Eligibility

Some small businesses that are otherwise eligible for a PPP loan have had their applications denied on the basis that they (i) have unpaid or delinquent state and/or federal taxes, or (ii) are subject to a tax lien (collectively "tax debt"). These denials are unjustified and incorrect as the Paycheck Protection Program and existing SBA 7(a) business loan program do not consider tax debt to be a disqualifying factor. Small businesses with tax debt are in fact eligible to receive a PPP loan.

The CARES Act modifies SBA's existing 7(a) business loan program to guarantee 100 percent of 7(a) loans issued under the Paycheck Protection Program.[13] The Paycheck Protection

[9] CARES Act § 1106(f) (providing "no eligible recipient shall receive loan forgiveness * * * without submitting to the lender that is servicing the covered loan the documentation required.").
[10] CARES Act § 1106(g).
[11] SBA, Paycheck Protection Program Loans Frequently Asked Questions (FAQs), # 39 (As of May 19, 2020).
[12] SBA, Paycheck Protection Program (PPP) Report: Approvals through 5/16/2020 (May 16, 2020).
[13] CARES Act § 1102(a)(1); 15 U.S.C. § 636(a)(2)(F).

Program offers 7(a) loans (known as PPP loans) to eligible recipients who apply during the period beginning on February 15, 2020 and ending on June 30, 2020, so long as committed funds are available.[14] An eligible recipient is an individual or entity that is eligible to receive a covered loan.[15] While the Paycheck Protection Program provides increased eligibility for certain businesses and organizations,[16] eligibility is also determined through existing SBA regulations and guidance because PPP loans are part of SBA's 7(a) business loan program rubric.[17]

a. Eligibility Rules do not Exclude Businesses with Tax Debt

The eligibility rules outlined in the CARES Act and interim final rules are fairly straightforward and small businesses can readily determine whether they satisfy them. These rules do not consider tax debt. In general, a small business applicant is eligible for a PPP loan if it can substantiate that the small business:

(i) has 500 or fewer employees whose principal place of residence is in the United States, or is a business that operates in a certain industry and meets the applicable SBA employee-based size standards for that industry;

(ii) is a small business concern, I.R.C. § 501(c)(3) non-profit organization, I.R.C. § 501(c)(19) veterans organization, Tribal business concern, or any other business; and

(iii) was in operation on February 15, 2020 and either had employees for whom it paid salaries and payroll taxes or paid independent contractors, as reported on a Form 1099-MISC.[18]

b. Ineligibility Rules do not Exclude Businesses with Tax Debt

In addition to the eligibility rules, subsequent SBA interim final rules, federal regulations and SBA's Statement of Procedure provide various ways in which an applicant can be ineligible for a PPP loan. While these rules take into consideration the existence of tax debt, they do so in order to expressly exclude tax debt from the eligibility determination. In other words, the ineligibility rules forbid consideration of tax debt by the lender. In general, a small business applicant is ineligible for a PPP loan if any of the following situations apply:

(i) The applicant is engaged in any activity that is illegal under Federal, state, or local law;

(ii) The applicant is a household employer;

[14] CARES Act § 1102(b).
[15] 15 U.S.C. § 636(a)(36)(A)(iv).
[16] 15 U.S.C. § 636(a)(36)(D).
[17] *Supra* note 1.
[18] 85 F.R. 20811, 20812 § (III)(2)(a) (Apr. 15, 2020).

(iii) An owner of 20 percent or more of the equity of the applicant is incarcerated, on probation, on parole; presently subject to an indictment, criminal information, arraignment, or other means by which formal criminal charges are brought in any jurisdiction; or has been convicted of a felony within the last five years; or

(iv) The applicant, or any business owned or controlled by the applicant, has ever obtained a direct or guaranteed loan from SBA or any other Federal agency that is currently delinquent or has defaulted within the last seven years and caused a loss to the government.[19]

The fourth situation appears to describe two scenarios wherein a small business applicant with tax debt could be determined to be ineligible: by having Delinquent Federal Debt or causing a Prior Loss to the Government. However, neither Delinquent Federal Debt nor Prior Loss to the Government apply to tax debt, as discussed in the ineligible businesses identified "in 13 CFR 120.110 and described further in Standard Operating Procedure (SOP) 50 10, Subpart B, Chapter 2 * * *."[20] 13 C.F.R. 120.110 provides a list of businesses that are ineligible for SBA business loans, including subsection (q) which describes a Prior Loss to the Government as involving a Federal loan or Federally assisted financing:

> "Unless waived by SBA for good cause, businesses that have previously defaulted on a Federal loan or Federally assisted financing, resulting in the Federal government or any of its agencies or Departments sustaining a loss in any of its programs, and businesses owned or controlled by an applicant or any of its Associates which previously owned, operated, or controlled a business which defaulted on a Federal loan (or guaranteed a loan which was defaulted) and caused the Federal government or any of its agencies or Departments to sustain a loss in any of its programs. For purposes of this section, a compromise agreement shall also be considered a loss * * * ."[21]

Because tax debt does not involve a Federal loan or Federally assisted financing, Prior Loss to the Government does not apply.

Delinquent Federal Debt is described in Standard Operating Procedure 50 10 5(k) ("SOP") which expressly excludes unpaid/delinquent taxes from debt that can be considered delinquent. According to the SOP, "[a] debt is considered 'delinquent' when any Federal loan or federally assisted financing has not been paid within 90 days of the payment due date. Federal loan or federally assisted financing does not include unpaid/delinquent taxes."[22] This exclusion of tax-related debt from Delinquent Federal Debt is confirmed in the regulation that SOP cites to for Delinquent Federal Debt, 31 C.F.R. 285.13, the scope of which includes "any person owing

[19] 85 F.R. 20811, 20812 § (III)(2)(b) (Apr. 15, 2020).
[20] 85 F.R. 20811, 20812 § (III)(2)(c) (Apr. 15, 2020) (referencing 13 C.F.R. § 120.110, What businesses are ineligible for SBA business loans?).
[21] 13 C.F.R. § 120.110(q).
[22] SOP 50 10(K) Subpart B, Ch. 2, § (III)(A)(16)(b)(i) and –(b)(iii).

delinquent nontax debt * * *,"[23] with "[n]ontax debt mean[ing] any debt other than a debt under the Internal Revenue Code of 1986 (*26 USC 1 et seq.*)."[24]

When presented with this line of reasoning, the SBA 7(a) Loan Guaranty Processing Center appeared to agree that tax debt is not a disqualifying factor for a PPP loan, stating "[t]here is no reference in the Interim Final Rule or the Federal Regulations at 13 CFR 120.110 to outstanding state and federal tax issues as a disqualifying factor under the PPP."[25] Lenders should therefore be prohibited from using the existence of (i) unpaid or delinquent state and/or federal taxes, or (ii) tax liens in their determination of a small business's eligibility for a PPP loan.

II. <u>Expenses Incurred or Paid Outside the Covered Period can Still Qualify as Eligible Expenses</u>

The CARES Act provides that a borrower is eligible for loan forgiveness equal to certain costs incurred and payments made during the covered period.[26] It is unclear, based on this language, whether payroll costs incurred before the covered period start date but paid during the covered period are eligible expenses. The answer to this issue is important for many small businesses because payroll typically does not cover prospective work, but rather is based on prior work already performed. Small businesses that received their PPP loan disbursement in the middle of a payroll period necessarily have a portion of each employee's work being incurred before and after the covered period start date. If payroll costs must be both incurred and paid during the covered period to be eligible for loan forgiveness, then the portion of each employee's work incurred before the covered period start date is not eligible and the administrative burden to account for this is increased.

Form 3508, *Paycheck Protection Program Loan Forgiveness Application*, partially addresses this by creating an Alternative Payroll Covered Period, wherein small businesses with a biweekly (every other week) or more frequent payroll schedule can elect to start their eight-week covered period, for purposes of payroll, on the first day of the first pay period after the PPP loan was disbursed.[27] This may prove beneficial for small businesses with more frequent payroll by easing the administrative burden of having to identify and substantiate eligible payroll expenses contained within a partial payroll period. For example, if a small business using a biweekly payroll schedule pays its employees every other Thursday and its PPP loan is disbursed on a Monday, by electing to use the alternative covered period, the small business can wait to start the eight-week period, for purposes of calculating eligible payroll expenses, until Friday, the first day of its next pay period. On the other hand, if no election is made, the small business will continue to use the normal covered period, which starts on the first day the loan was disbursed, in this case the Monday that is part of a prior payroll period. However, the Alternative Payroll

[23] 31 C.F.R. § 285.13(b)(5).
[24] 31 C.F.R. § 285.13(a).
[25] Email correspondence with SBA's 7(a) Loan Guaranty Processing Center (May 15, 2020).
[26] CARES Act § 1106(b).
[27] SBA Form 3508, Paycheck Protection Program Loan Forgiveness Application; *See also* Juan F. Vasquez, Jr., Jaime Vasquez, and Victor J. Viser, *INSIGHT: Tax Issues Associated with Paycheck Protection Program Loan Forgiveness*, Bloomberg Tax (May 21, 2020).

Covered Period is not available to all small businesses and also results in different covered periods for payroll and non-payroll expenses.

With regard to eligible payroll expenses, Form 3508 broadly interprets the CARES Act language (costs incurred and payments made during the covered period) to allow loan forgiveness for "payroll costs paid and payroll costs incurred" during the covered period.[28] While this language still contains some ambiguity that will hopefully be resolved by additional SBA guidance, it leaves open the possibility that payroll costs that were incurred before the covered period are eligible for loan forgiveness if they are paid during the eight-week covered period. Form 3508 does confirm payroll costs that are incurred during the last pay period of the covered period are eligible for loan forgiveness if they are paid on or before the next regular payroll date following the end of the covered period.[29]

With regard to non-payroll costs (such as mortgage interest, rent, or utilities with service beginning before February 15, 2020), Form 3508 provides that such costs are eligible for loan forgiveness if they are paid during the covered period or incurred during the covered period, so long as they are paid before the next billing date, even if the billing date is after the covered period.[30] This language is not as ambiguous and makes clear that non-payroll costs can be incurred or paid outside the covered period and still be eligible for loan forgiveness.

III. Deduction Issue

While the CARES Act allows small businesses to exclude from gross income expenses that are forgiven under a PPP loan, the IRS intends to offset this benefit, having taken the position that ordinary business expenses that were forgiven as part of a PPP loan are not deductible. This position appears contrary to congressional intent and may be subject to court challenge, and/or it may change going forward, especially in light of recent filed legislation that would ensure deductibility of certain PPP loan amounts received and paid for covered expenses.[31]

Section 1106(b) of the CARES Act provides that small businesses are eligible for forgiveness of indebtedness on a covered loan in an amount equal to the sum of payroll costs, mortgage interest, rent, and utility payments made or incurred during the covered period, subject to limits based on reductions in the number of employees and reductions to wages of certain employees.[32] Forgiven amounts are considered "canceled indebtedness" by the lender.[33] Section

[28] SBA Form 3508, Paycheck Protection Program Loan Forgiveness Application (May 2020).
[29] *Id*.
[30] *Id*.
[31] Juan F. Vasquez, Jr. and Peter A. Lowy, *Challenging Temporary Treasury Regulations: An Analysis of the Administrative Procedure Act, Legislative Reenactment Doctrine, Deference, and Invalidity*, III Hous. Bus. Tax L. J. 248 (2003) (Showing that when the IRS issues guidance that is inconsistent with congressional intent, such item may be challenged and invalidated. "In the tax arena, wide arrays of regulations (without regard to the level of deference) have been declared invalid. This array includes legislative regulations, interpretive regulations, and temporary questions.").
[32] CARES Act §§ 1106(b), -(d)(2)–(3).
[33] CARES Act § 1106(c)(1).

1106(i) of the CARES Act excludes this canceled indebtedness from gross income, providing "any amount which (but for this subsection) would be includible in gross income of the eligible recipient by reason of forgiveness described in [1106(b)] shall be excluded from gross income."[34]

In general, small businesses are able to deduct ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.[35] Rent, utility payments, and payroll costs comprise typical trade or business expenses for which a deduction under section 162 of the Code generally is appropriate.[36] If these costs were also excluded from gross income because they were eligible expenses as part of a PPP loan, then small businesses may receive a double tax benefit, by both excluding and deducting the expense from gross income.

IRS Notice 2020-32 clarifies that this double tax benefit will not be permitted, providing "no deduction is allowed under the Internal Revenue Code for an expense that is otherwise deductible if the payment of the expense results in forgiveness of a covered loan pursuant to section 1106(b) of the CARES Act and the income associated with the forgiveness is excluded from gross income for purposes of the Code pursuant to section 1106(i) of the CARES Act.[37] The Notice cites in support to section 265(a)(1) of the Code, which provides that no deduction is allowed for any amount otherwise allowable as a deduction [that is allocable] to one or more classes of income other than interest (whether or not any amount of income of that class or classes is received or accrued) wholly exempt from the taxes imposed by subtitle A of the Code.[38]

Under the IRS position, small businesses would only be able to exclude the expense from gross income, and would then be required to include it. This position was subject to immediate criticism by Congress as going against congressional intent and legislation has been introduced clarifying the intent to maintain the double tax benefit.

a. *Congressional Intent*

Following IRS Notice 2020-32, multiple senators made their opposition to the notice known as the intent of the CARES Act was to provide emergency assistance and health care response for individuals, families, and businesses affected by the Covid-19 pandemic.[39] Senate Finance Committee Chairman Chuck Grassley stated, "When we developed and passed the Paycheck Protection Program, our intent was clearly to make sure small businesses had the liquidity and the help they needed to get through [the Covid-19 pandemic]. Unfortunately, Treasury and the IRS interpreted the law in a way that's preventing businesses from deducting expenses associated with PPP loans. That's just the opposite of what we intended and should be fixed." [40]

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[34] CARES Act § 1106(i).
[35] I.R.C. § 162.
[36] IRS Notice 2020-32 (2020).
[37] *Id*.
[38] *Id*.; I.R.C. § 265(a)(1); Treas. Reg. § 1.265-1(b)(1).
[39] 85 F.R. 20811 (Apr. 15, 2020).
[40] Chuck Grassley, *Bipartisan Senators Introduce Bill to Clarify Small Business Expense Deductions Under PPP* (May 6, 2020).

The Small Business Expense Protection Act of 2020 was introduced in the Senate on May 5, 2020 by a bipartisan group of Senators including Chuck Grassley (R-Iowa), John Cornyn (R-Texas), Ron Wyden (D-Ore.), Marco Rubio (R-Fla.), and Tom Carper (D-Del.).[41] The Act clarifies the treatment of business expenses forgiven under section 1106(i) of the CARES Act by amending that section to read:

> For purposes of the Internal Revenue Code of 1986— (1) any amount which (but for this subsection) would be includible in gross income of the eligible recipient by reason of forgiveness described in [section 1106(b)] shall be excluded from gross income, and (2) no deduction shall be denied or reduced, no tax attribute shall be reduced, and no basis increase shall be denied, by reason of the exclusion from gross income provided by paragraph (1)."[42]

In support, Senator Cornyn stated, "The Paycheck Protection Program has been a lifeline to small businesses in Texas during the coronavirus pandemic. This legislation would erase any confusion by clarifying that expenses paid with a forgiven PPP loan can still be deducted from small businesses' taxes."[43]

b. *Exclusion vs. Exemption*

A plain reading of section 265(a)(1) of the Code does not support the IRS's position. This section applies to prevent deductions only for a class of income which is:

(i) wholly excluded from gross income under any provision of Subtitle A, or

(ii) wholly exempt from the taxes imposed by subtitle A under the provisions of any other law.

Section 1106(i) of the CARES Act "excludes" cancelled indebtedness due to loan forgiveness from gross income; it does not exempt such amounts. Were the CARES Act to have amended language similar to what was done in section 1102(a), then (i) may have applied. This is not the case. Similarly were section 1106(i) to "exempt" from gross income cancelled indebtedness due to loan forgiveness, then (ii) may have applied. This is also not the case.

The following excerpt is a helpful description of the important difference between an exemption and an exclusion:

> [A] tax exemption is a provision that exempts from tax a transaction that would, in the absence of the exemption, otherwise be subject to tax. That is, there has

[41] S. 3612 – 116th Cong. (May 5, 2020).
[42] *Id*.
[43] Richard Rubin, *Tax Deductions Tied to Forgiven Small Business Loans Draw Support*, Wall Street Journal (May 5, 2020).

> been a statutory decision not to tax a certain transaction that is clearly within the ambit and authority of the taxing statutes to tax. … An exclusion, on the other hand, relates to a transaction that is not taxable because it falls outside the scope of the statute giving rise to the tax, ab initio. Transactions excluded from the tax are those which, by the language of the statutes, are defined as beyond the reach of the tax.[44]

If the Small Business Expense Protection Act of 2020 or similar legislation is not passed, the IRS position laid out in IRS Notice 2020-32 will be subject to Court challenge as being inconsistent with congressional intent, and may ultimately be entitled to little or no deference.[45] Further, there will be an added element of confusion to an already interesting 2020 filing season. Consider, for example, a CPA tax preparer taking a return position that PPP loan amounts forgiven were also deductible business expenses. Technically that position would be inconsistent with IRS guidance. Would the CPA need to report the position on a Form 8275 Disclosure Statement? Should the CPA request an opinion of counsel that the position more likely than not comports with legislative intent?

Furthermore, there will be unintended disadvantages for certain flow-through entities. For example, in the case of certain S corporations the owner-shareholder may receive a Form W-2 that includes as income some portion of the forgiven loan while also receiving a Form K-1 reporting income that is grossed up for the forgiven portion (because no deduction was allowed). Contrast that with a partnership return where the partner just receives a K-1 with the applicable grossed up portion. If Congress does not fix this unintended disadvantage for S corporations Treasury should.

Conclusion

While the Paycheck Protection Program has been a measured success, having issued 4.3 million forgivable loans totaling more than $513 billion, it has been marked by a continual lack of guidance that has resulted in many issues of concern to small businesses, three of which were discussed herein:

First, during the application process, some small business applicants may have been improperly denied a PPP loan due to having unpaid or delinquent taxes, or a tax lien. These tax-related issues are not disqualifying factors to be considered by the lender and therefore any small business that is otherwise eligible for a PPP loan should not be denied for having them.

Second, during the period when eligible expenses are being made, small businesses may be able to receive loan forgiveness for expenses incurred outside of, but paid during, the covered period, and vice versa.

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[44] Jaye Calhoun and William J. Kolarik, II, Kean Miller, *Sales and Use Tax Laws – Differentiating Between Exemptions and Exclusions Under Louisiana Law*, American Bar Association, citing *Bridges v. Nelson Indus. Steam. Co.*, 190 So.3d 276, 280 (2016) (citing Bruce J. Oreck, Louisiana Sales & Use Taxation § 3.1 (2d ed. 1996)).
[45] Juan F. Vasquez, Jr., *Judicial Deference for Revenue Rulings in a Post-Mead World*, J. Tax Practice & Proc. (Aug/Sep 2004). *See also*, *supra* note 31.

Finally, when small businesses file income tax returns, they may be able to both (i) exclude from gross income canceled indebtedness resulting from a forgiven PPP loan and (ii) deduct ordinary business expenses made with funds from the forgiven PPP loan, despite the current IRS position disallowing such deductions.

FOREIGN INBOUND INVESTMENT IN A CORONAVIRUS WORLD: BEWARE THE US ESTATE TAX

As the ongoing COVID-19 pandemic continues to wreak havoc on global financial markets, adversely impacting many currency exchange rates, many non-US persons may view the United States as a safe haven or ripe for opportunistic investment. Although the US tax system is well known around the world as being complex and far reaching in its application, it also provides several tax advantages to non-US investors. Chief among them is the exemption from US income taxation of capital gains arising from sales or dispositions of most US non-real estate investments by non-US tax residents. As a result, many non-US investors have US investments, such as stock in US public companies, as part of their investment portfolio.

Despite these meaningful income tax advantages afforded to non-US investors, the significant downside to such investors if their investment in US property is not properly structured is the US federal estate tax. To the surprise of many non-US families, the US federal estate tax applies to the value of US situs assets owned by a person who is neither a citizen nor a domiciliary of the United States (hereinafter, a "non-US person") at death. The maximum US estate tax rate is currently 40% and applies quite differently to US versus non-US persons.

With US and foreign financial institutions actively enforcing the collection of the US estate tax from non-US persons, a growing need for tax revenue to offset pandemic-induced government stimulus spending, and worldwide increases in COVID-19 mortality rates, non-US persons should deliberately structure new investments into, and revisit their existing investment holdings in, the United States to mitigate the adverse application of US estate tax. Without proper care, the US government is essentially a silent 40% partner in the US investment holdings of many non-US persons. With proper advanced planning – before death – non-US persons owning US property are able to completely mitigate the adverse impact of US estate taxation.

WHO IS SUBJECT TO US ESTATE TAX (40%)

The United States imposes a tax – US federal estate tax – upon the transfer of property at death, whether by bequest or devise. Such tax applies to US citizens and US domiciliaries on the value of all interests in property at death, wherever located. For US citizens and domiciliaries (hereinafter, "US persons"), the US estate tax applies to their worldwide assets owned or controlled at death at a maximum rate of 40%. However, US persons benefit from an exclusion of USD $11.58 million for tax year 2020, with increases each year through 2025 to account for inflation, and which is scheduled to return to pre-2018 levels in 2026.

Persons who are neither a citizen nor a domiciliary of the United States (hereinafter, a "non-US person"), on the other hand, are only subject to US estate tax on the value of their US gross estate, or US situs property owned or controlled by them, at death. Whether someone is domiciled in the United States is a function of whether that person resides in the United States and has the intent to remain there indefinitely. As a result, this is a subjective test that hinges on factors such as the location of family, homes and personal property, and where someone receives medical care or engages in religious, political and social activities, to name a few. One's status as a US resident taxpayer or lawful permanent resident (*i.e.*, a green card holder) does *not* prevent that person from being classified as a non-US person for estate tax purposes.

Significantly, unlike the substantial estate tax exclusion available to US persons, only the first USD $60,000 of US situs assets owned by non-US persons are exempt from US estate tax (unless an applicable tax treaty provides additional relief), with the remaining value subject to the 40% estate tax and the estate of the non-US person obligated to file IRS Form 706-NA, *United States Estate (and Generation-Skipping Transfer) Tax Return for Estate of Nonresident Not a Citizen of the United States*. This 40% tax bite out of the fair market value of the non-US person's US investment holdings at the time of death is not only tax inefficient, but also creates obstacles in transferring those assets to the non-US person's intended beneficiaries (often requiring an IRS transfer certificate for financial institutions to release financial assets and satisfactory evidence for title companies to facilitate real estate transfers) and in finding liquidity to pay the tax liability.

ASSETS SUBJECT TO US ESTATE TAX: US SITUS PROPERTY

In the context of determining the US gross estate for a non-US person, or the asset base which may be subject to the 40% US federal estate tax, US situs property generally includes US real estate, shares in US companies, tangible personal property such as automobiles, furnishings, and jewelry physically located in the United States, and US brokerage accounts. Conversely, non-US situs property for estate tax purposes often includes savings accounts, checking accounts or certificates of deposit with a US bank (if such accounts are not used in a US trade or business); proceeds of a life insurance policy on the life of the non-US person, owned by the non-US person and issued by a US insurance company; non-US real estate; and shares in non-US corporations.

Cash and physical currency are considered tangible personal property for estate tax purposes and will be taxable if located in the United States at the decedent's death. Other assets are not so easily categorized as US situs or non-US situs for US estate tax purposes. For example, the US estate tax classification of partnership interests owned by non-US persons is not entirely clear. US bank accounts, while in many cases exempt from US estate tax, can easily be tainted by US trade or business activities and therefore converted into US situs property subject to US estate tax. Notably, even investments in US companies held through an account with a *non-US financial institution*, such as a bank in Hong Kong or Panama, may still be subject to US estate tax.

Where the foregoing US situs assets are owned directly by a non-US person, the estate tax exposure is clear. But what if such assets are owned through a Delaware limited liability company, a Texas corporation, a revocable trust, or even an offshore trust? The estate tax exposure of such assets is less clear and requires an analysis of the ownership chain leading from the US situs property to the non-US person. In the case of trusts, even irrevocable trusts, non-US persons should solicit advice from a US attorney, who may then review the trust agreement or deed creating the trust and other trust documents, to ensure that no US estate tax exposure exists. To be clear, what may avoid the US probate process – often, a revocable trust – or what may work for foreign legal or tax purposes, may not, by itself, yield any benefit from a US estate tax perspective.

WHAT'S A NON-US INVESTOR TO DO?

The potential for 40% US estate tax exposure to non-US persons is not a theoretical risk. A non-US person who owns a US vacation home, a US rental property, shares or other interests in a US company, or a US or non-US investment portfolio comprised of shares in US companies, in any case worth USD $560,000 at the time of his or her death, can generally expect to have a US estate tax liability of USD $200,000 (*i.e.*, [USD $560,000 value of US situs property – USD $60,000 exemption] x 40% estate tax rate). Depending upon how the US investment is owned, additional costs beyond this USD $200,000 tax bill may arise, including hiring a lawyer to prepare and file an estate tax return and to guide the non-US person's family through the US probate process. All of these costs, including the substantial US estate tax liability, can be completely mitigated where ownership of the US investments is properly structured before the non-US person owner's death.

The ideal time to structure a non-US person's investment into US property is before the US property is acquired. However, even with existing US investments, non-US persons should work with a qualified US attorney to (i) confirm their status as a non-US person, and (ii) ensure that their current manner of holding the US investments will not give rise to US estate tax (and ideally will not be subject to US probate) upon their death. Several options exist for shielding a non-US person's US investments from estate tax, ranging from simple to complex, and many of such options have the effect of addressing the non-US person's other concerns, such as optimizing income taxes, enhancing confidentiality, and achieving estate planning goals.

CLOSING THOUGHTS

Global volatility in financial markets, forex and asset values make the United States to many an attractive and relative safe haven for new investment. As a result of the expansive application of the US estate tax – particularly to non-US persons given the modest USD $60,000 exemption – non-US persons and their families should take action now to ensure that they are safe from the application of this 40% tax. Opportunities are available prior to death to ensure that US estate tax exposure as to non-US persons' investments in the United States (*e.g.*, stock, real estate, and other business interests) will be eliminated.

With COVID-19 induced mortality rates on the rise, now represents an ideal time to deliberately structure new inbound investments into the United States and to revisit existing holdings. Without taking any action, or by taking ill-advised actions such as ownership of US investments through either a US company alone or an improperly structured trust, non-US persons and their families may continue to be subject to US estate tax and remain a long-term investment partner with the United States government receiving its 40% share.

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Mr. Keen is a US tax and private client attorney based in Houston, Texas. He works with clients across the United States and around the world to solve problems and provide legal counsel on all aspects of domestic and international private client matters, ranging from estate and trust planning, business and investment structuring, asset protection, pre-immigration and cross-border planning, expatriation, and global mobility. Prior to joining Winstead, Mr. Keen worked with international law firms in Zurich, Switzerland and Miami, Florida, and maintains law licenses in Texas, Florida and the District of Columbia. He is an affiliate member of the UK-based Society of Trust and Estate Practitioners (STEP) and serves as Vice Chair of the International Tax Committee of the State Bar of Texas's Tax Law Section.

ABOUT WINSTEAD

Winstead PC is a national business law firm with more than 300 attorneys and advisors. The firm provides a full range of business legal services to some of the most recognized and respected companies across the country and throughout the world, as well as a suite of services to affluent global families and business owners with respect to their personal planning. Winstead has offices in Austin, Dallas, Fort Worth, Houston, San Antonio and The Woodlands, Texas; Charlotte, North Carolina; and New York, New York.

Wealth transfer planning – how volatility creates opportunity

INSIGHT ARTICLE | March 23, 2020

With everyday life so unsettled and markets and interest rates so volatile, wealth transfer planning is probably not top of mind these days, even to high net worth individuals. However, the very conditions that are causing such uncertainty today have created the opportunity to transfer wealth to the next generations at historically low tax cost.

Among the factors creating this opportunity are depressed asset values that reduce the gift tax cost of transferring them, bottoming of the interest rates variously associated with valuing a gift or setting the bar for appreciation needed to make the transfer successful, the continuing availability of popular planning techniques, valuation discounts and other tools that can reduce the gift tax cost of wealth transfer. Finally, although today's high estate, gift and generation-skipping transfer ("GST") tax exemptions are not scheduled to sunset until 2026, the upcoming election could accelerate that sunset and, with it, the elimination of some of those popular wealth transfer planning techniques.

Here are some of the planning techniques that benefit today from one or more of the factors we noted earlier. RSM tax professionals can describe and illustrate these techniques, showing you how they can be tailored according to your own objectives and circumstances and what types of assets tend to work best in the respective techniques. Of course, no individual, even a very wealthy individual, should consider giving away significant amounts of principal or income unless he or she is both philosophically and empirically confident that they won't miss the money. Discretion is the better part of regret.

Gifts. Remove all future appreciation in an asset's value from your taxable estate from the date of the transfer. An asset with a currently depressed value but an impressive future is a good candidate for a gift. However, the donee of the gift takes your income tax basis in the asset, as opposed to the stepped-up basis currently available for an asset inherited from a decedent. For that reason alone, you might keep the asset and pass it at death.

Make that gift to an IDGT. An "IDGT" or "intentionally defective grantor trust" is an irrevocable trust designed so assets transferred to it are completed gifts that remove appreciation from your estate but any income or capital gains tax incurred by the IDGT are payable by you, the grantor. Along with removing appreciation from your estate, a principal benefit of the IDGT is that your payment of the IDGT's income tax is not a taxable gift. Therefore, the IDGT's assets can grow faster and the tax payments can "defund" your estate with no gift tax cost.

Make a loan to an IDGT. Once the IDGT is established, you can make a loan to the IDGT at the applicable federal rate (the "AFR") for the month the loan is made. The April AFR for a long-term loan, meaning longer than nine years, is only 1.44 percent. The IRS announces the changes in AFRs for the upcoming month early enough for you to determine if you should make the loan in the current month or hold off until the next month. Properly structured, the transaction has no income tax implications and, aside from the small seed gift made to give the IDGT some commercial viability as a borrower, there are no gift or GST tax implications. At the end of the day, the IDGT's investment return above the interest rate on the note is excluded from your estate. The intra-family loan can be an appropriate wealth transfer technique if you do not want to make an outright transfer of property, want to retain some income and would just as soon keep things relatively simple.

Renegotiate intra-family loans. If you made an intra-family loan some years ago when the AFRs were higher than they are today, you might ask your advisors if the loan documentation would allow for a renegotiation of the terms of the note, with an eye towards reducing the interest rate.

Lend money to irrevocable life insurance trusts "ILITs" or renegotiate existing loans. If you are making large taxable gifts to an ILIT, you might consider lending the funds instead. If properly structured and at the appropriate AFR, there would be no gift or GST tax implications to the loan. What's more, so long as the ILIT is a grantor trust, there would be no income tax implications because the income tax is paid by the grantor. Meanwhile, if you previously implemented one of these loan arrangements with your ILIT at a higher interest rate, you may want to consider renegotiating the terms of those loans.

Grantor Retained Annuity Trust "GRAT". GRATs can appeal to individuals who want to do wealth transfer, retain income and take a measured approach to tax risk. You can transfer an asset to an irrevocable trust, reserving the right to receive a payment from the trust (the annuity) for a term of years. If you survive the term, assets remaining in the GRAT at the end of the term pass to your children and will not be included in your estate for estate tax purposes. If you do not survive the term, the assets in the GRAT will be included in your estate. GRATs are typically designed to virtually eliminate any taxable gift when the GRAT is funded, something that is a lot easier to do when asset values are depressed and the interest rate the IRS uses to determine the value of the annuity is low. For April 2020, that rate is only 1.2 percent but, as noted, you should wait to see the rate for May to decide when to fund the GRAT. If the GRAT succeeds, any appreciation above the returned annuity passes to the remainderman, gift and estate tax free.

Sale to an IDGT. You create an IDGT and "seed" it with a taxable gift. You then sell an asset to the IDGT for an installment note bearing interest at the AFR for the month in which the transaction occurs. The transaction freezes the value in your estate by converting an appreciating asset into a fixed income instrument. Appreciation above the interest rate on the note remains in the trust, excluded from your estate. Properly structured, meaning among other things that the sale and note are respected as such by the IRS, there is no capital gain triggered on the sale, the interest payments are not taxable to you or deductible by the trust and your payment of the IDGT's income tax is not a gift. Only the unpaid balance of the note is included in your estate, which contrasts favorably with the GRAT and its mortality risk. Here again, you should wait to do the transaction until you see the AFRs for the following month. Of course, if you implemented this transaction when interest rates were higher, you might consider renegotiating the interest rate.

Exercise ""swap"" powers in an IDGT. Many IDGTs used in the above-described transaction provide that the grantor can exchange or "swap" assets of equal value with the IDGT without income tax implications. In many of those transactions, the asset sold to the IDGT was highly appreciated at the time but had a low basis. Today, the asset may have lost value but still has the same basis. You, the grantor, can now use the power to bring that low basis asset back into your estate so that it will get a step-up in basis when you die. What's more, such a swap may enable you to exchange a poorly performing asset inside the IDGT for one with a more promising future.

Charitable lead annuity trust "CLAT". This is a vehicle for charitably inclined individuals to make transfers to children at a reduced gift tax value. CLATs work well when interest rates are low. You can transfer property to a trust that will pay an income stream to a charity for a specified number of years or for your lifetime, or both. At the end of the trust term, the assets in the CLAT pass to your children or a trust for their benefit. A properly designed CLAT will have minimal gift tax implications and, if funded with a discounted asset that generates a robust yield, there will be some excess to pass to your children free of gift tax.

Roth IRA conversion. Conversion of traditional IRA to a Roth is not typically thought of as a wealth transfer planning technique. However, if you are willing to pay the income tax on the conversion now, preferably with money from outside the Roth, and are able to let it incubate without withdrawals for five years, and you are 59½ or older, then all withdrawals from the account will be tax free, forever. What's more, you and your spouse will not have to take required minimum distributions from the account when you reach age 72. If and when you leave the Roth IRA to your child, your child will also take out the money tax free. Of course, after the SECURE Act, the money will have to come out of the account by the 10th year after you pass away. Conventional wisdom is that the ideal setting for the Roth conversion is where you are in a low income year (or period of years) and the value of the traditional IRA is down, as it might be as of this writing.

Even in times of uncertainty, you have a variety of planning techniques to choose from that can help you strike a balance between near-term concerns and longer-term objectives. As always, the key is to work with your advisors to make well informed decisions with respect to both the selection and design of these techniques.

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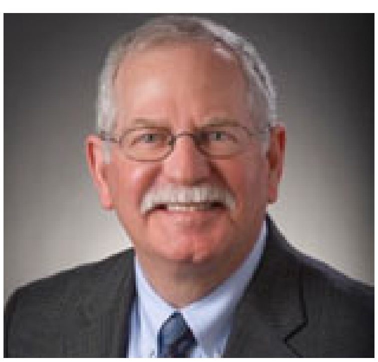

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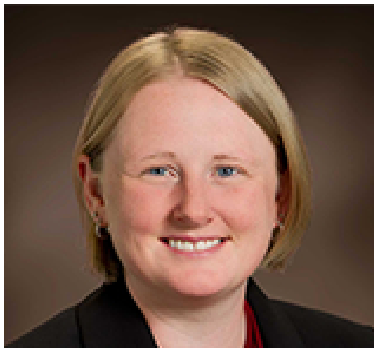

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RECENT DEVELOPMENTS IN FEDERAL INCOME TAXATION

"Recent developments are just like ancient history, except they happened less long ago."

By

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Note: This outline was prepared jointly with Cassady V. ("Cass") Brewer, Associate Professor of Law, Georgia State University College of Law, Atlanta, GA, and James M. Delaney, Winston S. Howard Distinguished Professor of Law at the University of Wyoming College of Law.

I. ACCOUNTING

II. BUSINESS INCOME AND DEDUCTIONS

A. Income

B. Deductible Expenses versus Capitalization

C. Reasonable Compensation

D. Miscellaneous Deductions

1. Standard mileage rates for 2020. Notice 2020-5, 2020-4 I.R.B. 380 (12/31/19). The standard mileage rate for business miles in 2020 goes down slightly to 57.5 cents per mile (from 58.0 cents in 2019) and the medical/moving rate goes down to 17 cents per mile (from 20 cents in 2019). The charitable mileage rate remains fixed by § 170(i) at 14 cents. The portion of the business standard mileage rate treated as depreciation goes up to 27 cents per mile for 2020 (from 26 cents in 2019). The maximum standard automobile cost may not exceed $50,400 (unchanged from 2019) 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 2020, and (2) the standard mileage rate for moving has limited applicability for the use of an automobile as part of a move during 2020 because, in the 2017 Tax Cuts and Jobs Act, Congress disallowed the deduction of moving expenses for 2020 (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).

E. <u>Depreciation & Amortization</u>

F. <u>Credits</u>

G. <u>Natural Resources Deductions & Credits</u>

H. <u>Loss Transactions, Bad Debts, and NOLs</u>

I. <u>At-Risk and Passive Activity Losses</u>

III. INVESTMENT GAIN AND INCOME

A. <u>Gains and Losses</u>

B. <u>Interest, Dividends, and Other Current Income</u>

C. <u>Profit-Seeking Individual Deductions</u>

D. <u>Section 121</u>

E. <u>Section 1031</u>

F. <u>Section 1033</u>

G. <u>Section 1035</u>

H. <u>Miscellaneous</u>

1. No depositors, no regulation, no "bank," no bad debt deduction for worthless asset-backed securities. An otherwise profitable victim of the financial meltdown can't deduct any of over $500,000,000 of losses on asset-back securities. This one ain't funny. MoneyGram International, Inc. v. Commissioner, 144 T.C. 1 (1/7/15). MoneyGram's core business is to provide consumers and financial institutions with payment services that involve the movement of money through three main channels: money transfers, money orders, and payment processing services. MoneyGram derives its revenue from the transaction fees paid by its customers and from management of currency exchange spreads on international money transfers. When a customer purchases a money order by giving cash to a MoneyGram agent, the agent must remit these funds to MoneyGram immediately. However, MoneyGram typically enters into agreements with its agents allowing them to retain and use these funds for an agreed-upon period. MoneyGram also derives revenue from the temporary investment of funds remitted from its financial institution customers until such time as the official checks and money orders clear. MoneyGram is not subject to regulation as a bank and it has never been regulated as a bank by any Federal banking regulator. On its 2007 and 2008 Forms 1120, MoneyGram classified its business as "nondepository credit intermediation." During 2007 and 2008, MoneyGram undertook a recapitalization that included writing down or writing off a substantial volume of partially or wholly worthless securities. MoneyGram claimed ordinary § 166(a) bad debt deductions with respect to the partial or complete worthlessness of hundreds of millions of dollars of non-REMIC asset-backed securities in which it had invested. (Treating these losses as capital losses would have generated no current tax benefit for MoneyGram because it had no capital gain net income during 2007 and 2008 against which capital losses could be offset.) The IRS determined that these securities were "debts evidenced by a security" under § 165(g)(2)(C) and that MoneyGram was entitled to ordinary bad debt deductions (via § 582(a)), as opposed to capital losses, only if it were a "bank" within the meaning of § 581 and that MoneyGram was not a "bank;" thus the IRS disallowed the bad debt deductions. The Tax Court (Judge Lauber) upheld the deficiency. To qualify as a "bank" under § 581, a taxpayer must meet three distinct requirements. First, it must be "a bank or trust company incorporated and doing business" under federal or state law. Second, "a substantial part" of its business must "consist[] of receiving deposits and making loans and discounts." Third, it must be "subject by law to supervision and examination" by federal or state authorities having supervision over banking institutions. Under this test, during 2007 and 2008 MoneyGram did not qualify as a "bank" because it did not display the essential characteristics of a bank as that term is commonly understood and because a substantial part of its business did not consist of receiving bank deposits or making bank loans. Because MoneyGram was not a "bank" within the meaning of § 581, it was ineligible to claim ordinary loss deductions on account of the worthlessness of its securities under § 582. The losses were capital losses.

a. Maybe MoneyGram is a bank. The Fifth Circuit has reversed and remanded for consideration of whether MoneyGram was receiving "deposits" and whether it was making "loans and discounts." MoneyGram International, Inc. v. Commissioner, 664 F. App'x 386 (5th Cir. 11/15/16), *rev'g and remanding* 144 T.C. 1 (1/7/15). In a per curiam oinion, the U.S. Court of Appeals for the Fifth Circuit has reversed the Tax Court and remanded for further proceedings. One requirement to qualify as a "bank" under § 581 is that "a substantial part" of the taxpayer's business must "consist[] of receiving deposits and making loans and discounts." Section 581 does not define the terms "deposits" or "loans." The Tax Court held that the term "deposits" as used in § 581 means "funds that customers place in a bank for the purpose of safekeeping," that are "repayable to the depositor on demand or at a fixed time," and which are held "for extended periods of time." The Tax Court concluded that the funds received by MoneyGram in exchange for issuing money orders and the funds received from its financial institution customers were not "deposits" because MoneyGram did not hold these funds for safekeeping or for an extended period of time. The Tax Court also held that a "loan" as that term is used in § 581 "is memorialized by a loan instrument, is repayable with interest, and generally has a fixed (and often lengthy) repayment period." The Tax Court concluded that the funds MoneyGram permitted its agents to keep temporarily, which were reflected on MoneyGram's books as accounts receivable, were not loans but merely accounts receivable typical of any business that provides goods or services. The Fifth Circuit disagreed with the definitions the Tax Court assigned to the terms "deposits" and "loans." With respect to the term "deposits," the Fifth Circuit held that the Tax Court had erred by interpreting it to require that MoneyGram hold funds received "for an extended period of time." With respect to the term "loans," the Fifth Circuit disagreed entirely with the definition used by the Tax Court. According to the Fifth Circuit, the "central inquiry" for determining if a transaction is a loan for tax purposes is whether the parties intend that the money advanced be repaid. The Fifth Circuit noted that is has adopted a non-exhaustive, seven-factor test to determine whether the parties to a transaction intended an arrangement to be a loan. Finally, the Fifth Circuit observed that § 581 requires as a condition of "bank" status that the taxpayer make loans *and* discounts. The Tax Court had not addressed whether MoneyGram nade discounts. Because the Tax Court had applied incorrect definisitions of the terms "deposits" and "loans" and had not addressed whether MoneyGram made "discounts," the Fifth Circuit reversed the Tax Court and remanded for reconsideration.

b. We got it right the first time, says the Tax Court. MoneyGram is not a bank. MoneyGram International, Inc. v. Commissioner, 153 T.C. No. 9 (12/3/19). On remand, in a lengthy opinion by Judge Lauber, the Tax Court concluded that MoneyGram neither received deposits nor made loans. The court also concluded that MoneyGram did not make discounts. Therefore, the court held, MoneyGram was not a "bank" within the meaning of § 581 and its losses were capital rather than ordinary losses. With respect to the issue whether MoneyGram received deposits, the Tax Court held that MoneyGram did not receive funds "for the purpose of safekeeping." Although it received funds from its agents who issued money orders and received funds from its financial institution customers (such as banks) in connection with processing checks, in neither case, the court held, did MoneyGram receive the funds for the purpose of safekeeping. The Tax Court also concluded that MoneyGram did not make "loans" when it allowed its agents that issued money orders to keep the funds for short periods of time before remitting them to MoneyGram. The court was influenced in part by the fact that MoneyGram had argued in several cases involving bankruptcy of its agents that "the agent's obligation to it arises by operation of law upon the agent's defalcation as Trustee, not from a debtor-creditor relationship of the sort created by an ordinary secured loan." Finally, the Tax Court held that MoneyGram did not make discounts. The court described the term "making discounts" in § 581, which provides a definition of "bank" that dates from 1936, as "somewhat old-fashioned terminology." The term describes a practice more common at that time of a bank customer who held a bill or promissory note who would ask the bank to "discount" the note by paying the customer a lesser amount, say 90 cents on the dollar. The court analyzed MoneyGram's investments in asset-backed securities and its purchase of commerical paper and concluded that neither activity constituted making discounts within the meaning of § 581.

IV. COMPENSATION ISSUES

A. Fringe Benefits

B. Qualified Deferred Compensation Plans

1. Proposed regulations provide guidance under § 401 relating to new life expectancy and distribution period tables used to calculate minimum distributions from qualified plans, IRAs, and annuities. REG-132210-18, Updated Life Expectancy and Distribution Period Tables Used for Purposes of Determining Minimum Required Distributions, 84 F.R. 60812 (11/8/19). The Treasury Department and the IRS have issued proposed regulations that provide guidance on the use of updated life expectancy and distribution period tables under Reg. § 401(a)(9)-9. In general, the proposed regulations seek to update the existing tables using current mortality data based on mortality rates for 2021. The new tables allow for longer life expectancies than the current tables under the existing regulations and generally result in a reduction of required minimum distributions. In turn, this allows for retention of larger amounts in retirement accounts in contemplation of participants having slightly longer lives. The updated life expectancy and distribution period tables arer proposed to apply to distributions on or after January 1, 2021. Thus, for an individual who attains the age at which required minimum distributions must begin in 2020, the proposed regulations would not apply to the distribution for the 2020 calendar year (which is due by April 1, 2021). The proposed regulations would apply to the required minimum distribution for the individual's 2021 calendar year, which is due by December 31, 2021. As an aside, while the proposed regulations indicate age 70-½ as the age at which required mimumum distributions must begin, the authors note that a provision of the SECURE Act, Division O, Title I, § 114 of the 2020 Further Consolidated Appropriations Act, amended Code § 401(a)(9)(C)(i)(I) to increase the age at which requried minimum distributions must begin to 72. Presumably, these proposed regulations will be amended to reflect this change. The proposed regulations also include a transition rule that applies under certain circumstances if an employee dies prior to January 1, 2021. The transition rule applies in three situations: (1) the employee died before the required beginning date with a non-spousal designated beneficiary; (2) the employee died after the required beginning date without a designated beneficiary; and (3) the employee, who is younger than the designated beneficiary, died after the required beginning date. Under these circumstances, a set of specific rules applies in relation to the distribution period for calendar years following the calendar year of the employee's death.

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

D. Individual Retirement Accounts

V. PERSONAL INCOME AND DEDUCTIONS

A. Rates

1. Do we want kids to be entrepreneurial, or don't we? Congres has repealed the 2017 modification of the kiddie tax, which had applied the rates of tax applicable to trusts and estates to the unearned income of children. A provision of the SECURE Act, Division O, Title V, § 501 of the 2020 Further Consolidated Appropriations Act, has repealed Code § 1(j)(4). Section 1(j)(4) was added to the Code by § 11001(a) of the 2017 Tax Cuts and Jobs Act. For taxable years beginning after 2017 and before 2026, § 1(j)(4) modified the so-called "kiddie tax" by taxing the unearned income of children under the rate schedule that applies to trusts and estates. (The earned income of children continued to be taxed at the rates that normally apply to a single individual.) This changed the approach of prior law, under which the tax on unearned income of children was determined by adding it to the income of the child's parents and calculating a hypothetical increase in tax for the parents. Under the approach of former § 1(j)(4), the child's tax on unearned income was unaffected by the parents' tax situation. The 2017 Tax Cuts and Jobs Act did not change the categories of children subject to the kiddie tax. Congress has now repealed § 1(j)(4), which means that the regime in effect prior to the 2017 Tax Cuts and Jobs Act, reflected in § 1(g), now is back in effect. Congress also amended § 55(d)(4)(A) by adding § 55(d)(4)(A)(iii), which provies that, for purposes of the alternative minimum tax, subsection (j) of § 59 shall not apply. The effect of this amendment is to make inapplicable the limitation on the AMT exemption amount of a child to whom the kiddie tax applies. The repeal of former § 1(j)(4) generally applies to taxable years beginning after December 31, 2019, but taxpayers can elect, under procedures to be prescribed, for the repeal to apply also to taxable years beginning in 2018 alone, 2019 alone, or both 2018 and 2019. The elimination of the § 59(j) limit on a child's AMT exemption amount applies to taxable years beginning after December 31, 2017. Amendment of 2018 returns might be necessary.

B. Miscellaneous Income

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

D. Deductions and Credits for Personal Expenses

1. Has the federal deduction for your high property or state income taxes made them easier to bear? Brace yourself! The deduction for state and local taxes not paid or accrued in carrying on a trade or business or an income-producing activity is limited to $10,000. The 2017 Tax Cuts and Jobs Act, § 11042, amended Code § 164(b) by adding § 164(b)(6). For individual taxpayers, this provision generally (1) eliminates the deduction for foreign real property taxes, and (2) limits to $10,000 ($5,000 for married individuals filing separately) a taxpayer's itemized deductions on Schedule A for the aggregate of state or local property taxes, income taxes, and sales taxes deducted in lieu of income taxes. This provision applies to taxable years beginning after 2017 and before 2026. The provision does not affect the deduction of state or local property taxes or sales taxes that are paid or accrued in carrying on a trade or business or an income-producing activity (i.e., an activity described in § 212) that are properly deductible on Schedules C, E, or F. For example, property taxes imposed on residential rental property will continue to be deductible. With respect to income taxes, an individual can deduct only foreign income taxes paid or accrued in carrying on a trade or business or an income-producing activity. As under current law, an individual cannot deduct state or local income taxes as a business expense even if the individual is engaged in a trade or business as a sole proprietor. See Reg. § 1.62-1T(d).

a. The IRS is not going to give blue states a pass on creative workarounds to the new $10,000 limitation on the personal deduction for state and local taxes. Notice 2018-54, 2018-24 I.R.B. 750 (05/23/18). In response to new § 164(b)(6), many states—including Connecticut, New Jersey, and New York—have enacted workarounds to the $10,000 limitation. For instance, New Jersey reportedly has enacted legislation giving property owners a special tax credit against otherwise assessable property taxes if the owner makes a contribution to charitable funds designated by local governments. Connecticut reportedly has enacted a new provision that taxes the income of pass-through entities such as S corporations and partnerships, but allows the shareholders or members a corresponding tax credit against certain state and local taxes assessed against them individually. Notice 2018-54 announces that the IRS and Treasury are aware of these workarounds and that proposed regulations will be issued to "make clear that the requirements of the Internal Revenue Code, informed by substance-over-form principles, govern the federal income tax treatment of such transfers." In other words, blue states, don't bank on a charitable contribution or a flow-through income tax substituting for otherwise assessable state and local taxes to avoid new § 164(b)(6). The authors predict that this will be an interesting subject to watch over the coming months.

b. Speaking of looming trouble spots: The availability of a business expense deduction under § 162 for payments to charities is not affected by the recently issued proposed regulations, says the IRS. IRS News Release IR-2018-178 (9/5/18). This news release clarifies that the availability of a deduction for ordinary and necessary business expenses under § 162 for businesses that make payments to charities or government agencies and for which the business receives state tax credits is not affected by the proposed regulations issued in August 2018 that generally disallow a federal charitable contribution deduction under § 170 for charitable contributions made by an individual for which the individual receives a state tax credit. See REG-112176-18, Contributions in Exchange for State and Local Tax Credits, 83 F.R. 43563 (8/27/18). Thus, if a payment to a government agency or charity qualifies as an ordinary and necessary business expense under § 162(a), it is not subject to disallowance in the manner in which deductions under § 170 are subject to disallowance. This is true, according to the news release, regardless of whether the taxpayer is doing business as a sole proprietor, partnership or corporation. According to a "frequently asked question" posted on the IRS website, "a business taxpayer making a payment to a charitable or government entity described in § 170(c) is generally permitted to deduct the entire payment as an ordinary and necessary business expense under § 162 if the payment is made with a business purpose."

c. More about trouble spots: The IRS must be thinking, "Will this ever end?" Rev. Proc. 2019-12, 2019-04 I.R.B. 401 (12/29/18). Notwithstanding the above guidance, Treasury and the IRS obviously have continued to receive questions regarding the deductibility of business expenses that may indirectly bear on the taxpayer's state and local tax liability. In response, Rev. Proc. 2019-12 provides certain safe harbors. For C corporations that make payments to or for the use of § 170(c) charitable organizations and that receive or expect to receive corresponding tax credits against state or local taxes, the C corporation nevertheless may treat such payment as meeting the requirements of an ordinary and necessary business expense for purposes of § 162(a). A similar safe harbor rule applies for entities other than C corporations, but only if the entity is a "specified passthrough entity." A specified passthrough entity for this purpose is one that meets four requirements. First, the entity must be a business entity other than a C corporation that is regarded for all federal income tax purposes as separate from its owners under Reg. § 301.7701-3 (i.e., it is not single-member LLC). Second, the entity must operate a trade or business within the meaning of § 162. Third, the entity must be subject to a state or local tax incurred in carrying on its trade or business that is imposed directly on the entity. Fourth, in return for a payment to a § 170(c) charitable organization, the entity receives or expects to receive a state or local tax credit that the entity applies or expects to apply to offset a state or local tax imposed upon the entity. The revenue procedure applies to payments made on or after January 1, 2018.

C corporation example state and local income tax credit: A, a C corporation engaged in a trade or business, makes a payment of $1,000 to a § 170(c) charitable organization. In return for the payment, A receives or expects to receive a dollar-for-dollar state tax credit to be applied to A's state corporate income tax liability. Under the revenue procedure, A may treat the $1,000 payment as meeting the requirements of an ordinary and necessary business expense under § 162.

C corporation example state and local property tax credit: B, a C corporation engaged in a trade or business, makes a payment of $1,000 to a § 170(c) charitable organization. In return for the payment, B receives or expects to receive a tax credit equal to 80 percent of the amount of this payment ($800) to be applied to B's local real property tax liability. Under the revenue procedure, B may treat $800 as meeting the requirements of an ordinary and necessary business expense under § 162. The treatment of the remaining $200 will depend upon the facts and circumstances and is not affected by the revenue procedure. (In other words, the $200 could be a charitable contribution deductible under § 170, or the $200 could be a business expense deductible under § 162.)

Specified passthrough example state and local property tax credit: S is an S corporation engaged in a trade or business and is owned by individuals C and D. S makes a payment of $1,000 to a § 170(c) charitable organization. In return for the payment, S receives or expects to receive a state tax credit equal to 80 percent of the amount of this payment ($800) to be applied to S's local real property tax liability incurred by S in carrying on its trade or business. Under applicable state and local law, the real property tax is imposed at the entity level (not the owner level). Under the revenue procedure, S may treat $800 of the payment as meeting the requirements of an ordinary and necessary business expense under § 162. The treatment of the remaining $200 will depend upon the facts and circumstances and is not affected by this revenue procedure. (In other words, the $200 could be a charitable contribution deductible under § 170 by the owners of the specified passthrough entity, or the $200 could be a business expense deductible at the entity level under § 162.)

d. And like Rameses II in The Ten Commandments, Treasury says, "So let it be written; so let it (finally!) be done." T.D. 9864, Contributions in Exchange for State or Local Tax Credits, 84 F.R. 27513 (6/13/19). The Treasury Department and the IRS have finalized, with only minor changes, proposed amendments to the regulations under § 170 that purport to close the door on any state-enacted workarounds to the $10,000 limitation of § 164(b)(6) on a taxpayer's itemized deductions on Schedule A for the aggregate of state or local property taxes, income taxes, and sales taxes deducted in lieu of income taxes. (*See* REG-112176-18, Contributions in Exchange for State and Local Tax Credits, 83 F.R. 43563 (8/27/18).) Reg. § 1.170A-1(h)(3) generally requires taxpayers to reduce the amount of any federal income tax charitable contribution deduction by the amount of any corresponding state or local tax *credit* the taxpayer receives or expects to receive. The final regulations further provide that a corresponding state or local tax *deduction* normally will not reduce the taxpayer's federal deduction provided the state and local deduction does not exceed the taxpayer's federal deduction. To the extent the state and local charitable deduction exceeds the taxpayer's federal deduction, the taxpayer's federal deduction is reduced. Finally, the final regulations provide an exception whereby the taxpayer's federal charitable contribution deduction is not reduced if the corresponding state or local credit does not exceed 15 percent of the taxpayer's federal deduction. Pursuant to an amendment to Reg. § 1.642(c)-3(g), these same rules apply in determining the charitable contribution deductions of trusts and estates under § 642(c). Three examples illustrate the application of these rules:

Example 1. A, an individual, makes a payment of $1,000 to X, an entity listed in section 170(c). In exchange for the payment, A receives or expects to receive a state tax credit of 70% of the amount of A's payment to X. Under paragraph (h)(3)(i) of this section, A's charitable contribution deduction is reduced by $700 (70% × $1,000). This reduction occurs regardless of whether A may claim the state tax credit in that year. Thus, A's charitable contribution deduction for the $1,000 payment to X may not exceed $300.

Example 2. B, an individual, transfers a painting to Y, an entity listed in section 170(c). At the time of the transfer, the painting has a fair market value of $100,000. In exchange for the painting, B receives or expects to receive a state tax credit equal to 10% of the fair market value of the painting. Under paragraph (h)(3)(vi) of this section, B is not required to apply the general rule of paragraph (h)(3)(i) of this section because the amount of the tax credit received or expected to be received by B does not exceed 15% of the fair market value of the property transferred to Y. Accordingly, the amount of B's charitable contribution deduction for the transfer of the painting is not reduced under paragraph (h)(3)(i) of this section.

Example 3. C, an individual, makes a payment of $1,000 to Z, an entity listed in section 170(c). In exchange for the payment, under state M law, C is entitled to receive a state tax deduction equal to the amount paid by C to Z. Under paragraph (h)(3)(ii)(A) of this section, C is not required to reduce its charitable contribution deduction under section 170(a) on account of the state tax deduction.

Effective date. The final regulations are effective for charitable contributions made after August 27, 2018.

And another thing . . . . The final regulations do not discern between abusive "workarounds" enacted in response to § 164(b)(6) and legitimate state and local tax credit programs such as the Georgia Rural Hospital Tax Credit that preceded the 2017 Tax Cuts and Jobs Act. The Georgia Rural Hospital Tax Credit program was enacted in 2017 to combat the closure of many rural hospitals in Georgia due to financial difficulties. Under the program, individuals and corporations making contributions to designated rural hospitals receive a 90 percent dollar-for-dollar tax credit against their Georgia state income tax liability. Is the Georgia Rural Hospital Tax Credit program adversely affected by proposed regulations under § 164(b)(6)? In our view, the answer is "yes" and a Georgia taxpayer's federal charitable contribution deduction for a donation to a Georgia rural hospital is reduced by 90 percent. Treasury and the IRS have adopted this view, which is reflected in the preamble to the final regulations:

> The regulations are based on longstanding federal tax law principles that apply equally to all taxpayers. To ensure fair and consistent treatment, the final regulations do not distinguish between taxpayers who make transfers to state and local tax credit programs enacted after the [Tax Cuts and Jobs] Act and those who make transfers to tax credit programs existing prior to the enactment of the Act. Neither the intent of the section 170(c) organization, nor the date of enactment of a particular state tax credit program, are relevant to the application of the *quid pro quo* principle.

> We note, however, that it may be possible under state or local law for a taxpayer to waive any corresponding state or local tax credit and thereby claim a full charitable contribution for federal income tax purposes. *See* Rev. Rul. 67-246, 1967-2 C.B. 104. In the preamble to the final regulations, Treasury and the IRS noted that taxpayers might disclaim a credit by not applying for it if the credit calls for an application (or applying for a lesser amount) and requested comments as to how taxpayers may decline state or local tax credits in other situations. It is also possible, pursuant to a safe harbor established in Notice 2019-12, 2019-27 I.R.B. 57 (see below), for an individual who itemizes deductions to treat as a payment of state or local tax on Schedule A a payment made to a charitable organization for which the individual receives a state or local tax credit.

e. Down the rabbit hole we go. A safe harbor allows individuals who itemize to treat as payments of state or local tax any payments to § 170(c) charitable organizations that are disallowed as federal charitable contribution deductions because the individual will receive a state or local tax credit for the payment. Notice 2019-12, 2019-27 I.R.B. 57 (6/11/19). This notice announces that the Treasury Department and the IRS intend to publish a proposed regulation that will amend Reg. § 164-3 to provide a safe harbor for individuals who itemize deductions and make a payment to or for the use of an entity described in § 170(c) in return for a state or local tax credit. Until the proposed regulations are issued, taxpayers can rely on the safe harbor as set forth in the notice. Section 3 of the notice provides as follows:

> Under this safe harbor, an individual who itemizes deductions and who makes a payment to a section 170(c) entity in return for a state or local tax credit may treat as a payment of state or local tax for purposes of section 164 the portion of such payment for which a charitable contribution deduction under section 170 is or will be disallowed under final regulations. This treatment as a payment of state or local tax under section 164 is allowed in the taxable year in which the payment is made to the extent the resulting credit is applied, consistent with applicable state or local law, to offset the individual's state or local tax liability for such taxable year or the preceding taxable year. … To the extent the resulting credit is not applied to offset the individual's state or local tax liability for the taxable year of the payment or the preceding taxable year, any excess credit permitted to be carried forward may be treated as a payment of state or local tax under section 164 in the taxable year or years for which the carryover credit is applied, consistent with applicable state or local law, to offset the individual's state or local tax liability.

The safe harbor does not apply to a transfer of property and does not permit a taxpayer to treat the amount of any payment as deductible under more than one provision of the Code or regulations. The safe harbor applies to payments made after August 27, 2018. Three examples illustrate the application of these rules:

Example 1. In year 1, Taxpayer A makes a payment of $500 to an entity described in section 170(c). In return for the payment, A receives a dollar-for-dollar state income tax credit. Prior to application of the credit, A's state income tax liability for year 1 was $500 or more; A applies the $500 credit to A's year 1 state income tax liability. Under section 3 of this notice, A treats the $500 payment as a payment of state income tax in year 1 for purposes of section 164. To determine A's deduction amount, A must apply the provisions of section 164 applicable to payments of state and local taxes, including the limitation under section 164(b)(6).

Example 2. In year 1, Taxpayer B makes a payment of $7,000 to an entity described in section 170(c). In return for the payment, B receives a dollar-for-dollar state income tax credit, which under state law may be carried forward for three taxable years. Prior to application of the credit, B's state income tax liability for year 1 was $5,000; B applies $5,000 of the $7,000 credit to B's year 1 state income tax liability. Under section 3 of this notice, B treats $5,000 of the $7,000 payment as a payment of state income tax in year 1 for purposes of section 164. Prior to application of the remaining credit, B's state income tax liability for year 2 exceeds $2,000; B applies the excess credit of $2,000 to B's year 2 state income tax liability. For year 2, B treats the $2,000 as a payment of state income tax for purposes of section 164. To determine B's deduction amounts in years 1 and 2, B must apply the provisions of section 164 applicable to payments of state and local taxes, including the limitation under section 164(b)(6).

Example 3. In year 1, Taxpayer C makes a payment of $7,000 to an entity described in section 170(c). In return for the payment, C receives a local real property tax credit equal to 25 percent of the amount of this payment ($1,750). Prior to application of the credit, C's local real property tax liability in year 1 was $3,500; C applies the $1,750 credit to C's year 1 local real property tax liability. Under section 3 of this notice, for year 1, C treats $1,750 as a payment of local real property tax for purposes of section 164. To determine C's deduction amount, C must apply the provisions of section 164 applicable to payments of state and local taxes, including the limitation under section 164(b)(6).

f. Proposed regulations reflect previously issued guidance on payments to § 170(c) charitable organizations that result in state or local tax credits and provide additional guidance. REG-107431-19, Treatment of Payments to Charitable Entities in Return for Consideration, 84 F.R. 68833 (12/17/19). The Treasury Department and the IRS have issued proposed regulations that reflect previously issued guidance, including safe harbors, regarding payments to § 170(c) charitable organizations that result in state or local tax credits. The proposed regulations generally provide the following guidance.

Safe harbors for payments by C corporations and specified pass-through entities to § 170(c) entities. The proposed regulations propose amending Reg. § 1.162-15(a) to incorporate the safe harbors previously set forth in Rev. Proc. 2019-12, 2019-04 I.R.B. 401 (12/29/18). One safe harbor provides that C corporations that make payments to or for the use of § 170(c) charitable organizations and that receive or expect to receive corresponding tax credits against state or local taxes may treat such payments as meeting the requirements of an ordinary and necessary business expense for purposes of § 162(a). A similar safe harbor rule applies for entities other than C corporations, but only if the entity is a "specified passthrough entity." A specified passthrough entity for this purpose is one that meets four requirements. First, the entity must be a business entity other than a C corporation that is regarded for all federal income tax purposes as separate from its owners under Reg. § 301.7701-3 (i.e., it is not single-member LLC). Second, the entity must operate a trade or business within the meaning of § 162. Third, the entity must be subject to a state or local tax incurred in carrying on its trade or business that is imposed directly on the entity. Fourth, in return for a payment to a § 170(c) charitable organization, the entity receives or expects to receive a state or local tax credit that the entity applies or expects to apply to offset a state or local tax imposed upon the entity. These safe harbors apply only to payments of cash and cash equivalents. These amendments are proposed to apply to payments on or after December 17, 2019, but taxpayers may continue to apply Rev. Proc. 2019-12, which applies to payments made on or after January 1, 2018.

Amendments to clarify the standard for payments to a charitable organization to qualify as a business expense. The proposed regulations also propose amending Reg. § 1.162-15(a) to provide:

> A payment or transfer to or for the use of an entity described in section 170(c) that bears a direct relationship to the taxpayer's trade or business and that is made with a reasonable expectation of financial return commensurate with the amount of the payment or transfer may constitute an allowable deduction as a trade or business expense rather than a charitable contribution deduction under section 170.

This proposed revision is intended to more clearly reflect current law regarding when payments from a business to a charitable organization qualify as a business expense (rather than as a charitable contribution). The proposed regulations provide two examples, both of which involve businesses making payments to § 170(c) charitable organization in exchange for advertising (e.g., a half-page advertisement in the program for a church concert) or to generate name recognition and goodwill (e.g., donating 1 percent of gross sales to charity each year). These amendments are proposed to apply to payments or transfers on or after December 17, 2019, but taxpayers may rely on the proposed regulations for payments and transfers made on or after January 1, 2018, and before the date final regulations are published in the Federal Register.

A safe harbor for individuals who itemize deductions. The proposed regulations propose amending Reg. § 1.164-3(j) to incorporate the safe harbor previously provided in Notice 2019-12, 2019-27 I.R.B. 57 (6/11/19). Under this safe harbor, an individual who itemizes deductions and who makes a payment to a § 170(c) entity in return for a state or local tax credit may treat as a payment of state or local tax for purposes of § 164 the portion of the payment for which a charitable contribution deduction under § 170 is disallowed by Reg. § 1.170A-1(h)(3). This latter regulation generally disallows a taxpayer's federal charitable contribution deduction to the extent the taxpayer receives a state or local tax credit in exchange for a payment to a § 170(c) entity. For example, this safe harbor would permit an individual who makes a $1,000 payment to a § 170(c) entity and who, in exchange, receives a $700 state or local tax credit to treat the $700 that is disallowed as a federal charitable contribution deduction as a payment of state or local tax that is deductible on Schedule A, subject to the $10,000 limit of § 164(b)(6). These amendments are proposed to apply to payments made on or after June 11, 2019 (the date the IRS issued Notice 2019-12), but individuals can rely on the proposed regulations for payments made after August 27, 2018, and before the date final regulations are published in the Federal Register.

Amendments to clarify the effect of benefits provided to a donor that are not provided by the § 170(c) entity. The proposed regulations propose amending Reg. § 1.170A-1(h)(4)(i) to provide:

> A taxpayer receives goods or services in consideration for a taxpayer's payment or transfer to an entity described in section 170(c) if, at the time the taxpayer makes the payment to such entity, the taxpayer receives or expects to receive goods or services from that entity or any other party in return.

This amendment is intended to clarify that the *quid pro quo* principle, under which a taxpayer's charitable contribution deduction is disallowed to the extent the taxpayer receives goods or services in return, applies regardless of whether the goods or services are provided by the § 170(c) entity receiving the contribution. The preamble to the proposed regulations discusses judicial decisions that have adopted this approach, such as *Singer v. United States*, 449 F.2d 413(Ct. Cl. 1971) and *Wendell Falls Development, LLC v. Commissioner*, T.C. Memo. 2018-45. The IRS reached a similar result in example 11 of Rev. Rul. 67-246, 1967-2 C.B. 104, in which a taxpayer who made a $100 payment to a specific charity and, in return, received a transistor radio worth $15 from a local store could take a charitable contribution deduction of only $85. The proposed regulations also propose to amend Reg. § 1.170A-1(h)(4)(ii) to define "goods or services" for this purpose as "cash, property, services, benefits, and privileges." These amendments are proposed to apply to amounts paid or property transferred after December 17, 2019. Nevertheless, because the amendments are intended to reflect current law, they effectively apply immediately.

E. Divorce Tax Issues

F. Education

G. Alternative Minimum Tax

VI. CORRUPTIONS

A. Entity and Formation

B. Distributions and Redemptions

C. Liquidations

D. S Corporations

1. If you're a cash-method S corp pining to be a C corp, here's your chance! The 2017 Tax Cuts and Jobs Act, § 13543, added new § 481(d) and new § 1371(f) to make it easier for cash-method S corporations to convert to C corporations (which typically, but not always, especially after TCJA's revisions to § 448, are accrual-method taxpayers). Specifically, new § 481(d) provides that any adjustment (such as changing from the cash to the accrual method) otherwise required under § 481(a)(2) with respect to an S to C conversion may be taken into account ratably over six years starting with the year of the change (instead of taking into account the adjustment entirely in the year of change) if three conditions are met: (i) the converting S corporation existed prior to December 22, 2017 (the date of TCJA's enactment); (ii) the conversion from S to C status takes place prior to December 22, 2019 (two years from the date of TCJA's enactment); and (iii) all of the shareholders of the S corporation on December 22, 2017, are "in identical proportions" the shareholders of the C corporation. New § 1371(f) further provides that "money" distributed by the above-described converted S corporations *after* the "post-termination transition period" (generally one year) is allocable to and chargeable against the former S corporation's accumulated adjustments account ("AAA") in the same ratio as AAA bears to accumulated earnings and profits ("E&P"). Thus, new § 1371(f) is more favorable to S corporations converting to C status than the normal rule of § 1371(e), which allows distributions of money *during* the "post-termination transition period," but not after, to be allocable to and chargeable against AAA. As a practical matter, then, S corporations converting to C corporations within the confines of new § 481(d) and § 1371(f) may make nontaxable, stock-basis reducing distributions of money out of their AAA during the one-year period following the conversion (pursuant to § 1371(e)) as well as wholly or partially (depending upon AAA as compared to E&P) nontaxable, basis-reducing distributions of money after the normal one-year, post-termination transition period. These changes to § 481 and § 1371 are permanent, but of course, will apply only to S to C conversions that meet the criteria of § 481(d) (i.e., pre-TCJA existing S corporations that convert to C status before December 22, 2019, and that have the same shareholders in the same proportions post-conversion).

a. Guidance concerning the adjustments required under new § 481(d). Rev. Proc. 2018-44, 2018-37 I.R.B. 426 (9/10/18) modifies Rev. Proc. 2018-31, 2018-22 I.R.B. 637, to provide that an "eligible terminated S corporation," as defined in § 481(d)(2), required to change from the overall cash method of accounting to an overall accrual method of accounting as a result of a revocation of its S corporation election, and that makes this change in method of accounting for the C corporation's first taxable year after such revocation, is required to take into account the resulting positive or negative adjustment required by § 481(a)(2) ratably during the six-year period beginning with the year of change. Rev. Proc. 2018-44 also provides that an eligible terminated S corporation permitted to continue to use the cash method after the revocation of its S corporation election, and that changes to an overall accrual method for the C corporation's first taxable year after such revocation, may take into account the resulting positive or negative adjustment required by § 481(a)(2) ratably during the six-year period beginning with the year of change.

b. Proposed regulations for "ETSCs" issued just under the wire. REG-131071-18, Proposed Regulations Regarding Eligible Terminated S Corporations, 84 F.R. 60011 (11/7/19). As noted above, one of the requirements for "eligible terminated S corporation" status is conversion to C corporation status before December 22, 2019. For those S corporations that met the deadline and otherwise satisfied the above-mentioned requirements of § 481(d)—and who consequently have earned the new moniker "ETSCs"—Treasury has issued further guidance in the form of proposed regulations. The proposed regulations were issued on November 7, 2019, beating the December 22, 2019, deadline by a little over a month. *Whew!* Generally, the proposed regulations provide rules regarding (i) the definition of an ETSC; (ii) distributions of money by an ETSC after the "post-termination transition period" ("PTTP"); and (iii) the allocation of current C corporation current earnings and profits to distributions of money and other property to the shareholders of ETSCs. The proposed regulations will apply to tax years beginning after the date that final regulations are published; however, the proposed regulations include a transition rule allowing corporations to apply certain existing regulations (*see* Reg. §§ 1.316-2, 1.481-5, 1.1371-1, 1.1371-2, and 1.1377-2, *to the extent applicable*) to distributions made after the PTTP but during open tax years (i.e., those tax years within the § 6511(a) claim for refund period). We commend these proposed regulations to further study by those tax advisors with affected clients.

E. Mergers, Acquisitions and Reorganizations

F. Corporate Divisions

1. Proposed regulations provide guidance under § 355(e) regarding predecessors, successors, and limitation on gain recognition. T.D. 9888, Guidance Under Section 355(e) Regarding Predecessors, Successors, and Limitation on Gain Recognition; Guidance Under Section 355(f), 84 F.R. 69308 (12/18/19). The IRS has finalized proposed and temporary regulations issued in 2016 under § 355(e) providing guidance to taxpayers in determining whether a corporation is a predecessor or successor of a distributing or controlled corporation for purposes of the gain recognition exception under § 355(e). See T.D. 9805, Guidance Under Section 355(e) Regarding Predecessors, Successors, and Limitation on Gain Recognition; Guidance Under Section 355(f), 81 F.R. 91738 (12/19/16). Generally, under § 355(a), in a spin-off or like transaction no gain or loss is recognized by a corporation ("Distributing") that distributes the stock of a controlled corporation ("Controlled") to Distributing's shareholders. Similarly, nonrecognition is allowed under § 355(c) if certain "qualified property" is distributed from Distributing to its shareholders. Qualified property is generally defined § 361(c) to include stock, stock rights, or obligations of either Distributing or Controlled.. However, § 355(e) provides an exception to nonrecognition (requiring recognition of gain) where stock or securities are distributed by Controlled pursuant to a plan under which one or more persons acquires a 50-percent or greater interest (as defined in § 355(d)(4)(A)) in the stock of Distributing or Controlled. The general theory applied to transfers subject to § 355(e) is that gain recognition is appropriate if a distribution is effectuated to combine a tax-free division of the assets of a corporation *other than* Distributing or Controlled (divided corporation) with a planned acquisition of 50 percent or more of the divided corporation. Such transactions more closely resemble a corporate-level disposition of the portion of the business that is acquired. For these purposes, any predecessor or successor entity of either Controlled or Distributing is treated the same as and referred to as Controlled or Distributing. The final regulations add a new definition and detailed rules regarding the treatment of a predecessor of Distributing. To oversimplify, the final regulations apply if there is a plan in place to acquire 50 percent or more of Distributing. Distributing will benefit from a gain limitation rule only if a Predecessor of Distributing (POD) exists and the POD does not also undergo a 50 percent acquisition pursuant to a plan. If no POD exists, then the gain must generally be recognized. If a POD exists but also undergoes a 50 percent acquisition pursuant to a plan, then Distributing must recognize gain with respect to acquisition of the POD (subject to certain gain limitation rules). Reg. § 1.355-8 (e)(1)(ii). The final regulations apply to distributions occurring after December 15, 2019. For distributions occurring on or before December 15, 2019, a set of transition rules applies.

G. Affiliated Corporations and Consolidated Returns

H. Miscellaneous Corporate Issues

VII. PARTNERSHIPS

A. Formation and Taxable Years

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

1. They were just kidding! Treasury and the Service have removed temporary regulations regarding the allocation of partnership liabilities for purposes of the § 707 disguised sale rules. T.D. 9876, Removal of Temporary Regulations on a Partner's Share of a Partnership Liability for Disguised Sale Purposes, 84 F.R. 54027 (10/9/19). In 2016, Treasury and the Service published temporary regulations (707 Temporary Regulations) regarding the allocation of partnership liabilities for purposes of applying the disguised sale rules of § 707. T.D. 9788, Liabilities Recognized as Recourse Partnership Liabilities Under Section 752, 81 F.R. 69282 (10/5/16). On April 21, 2017, President Trump issued Executive Order 13789 directing the Secretary of the Treasury to review "all significant tax regulations" issued on or after January 1, 2016, that "impose an undue financial burden," "add undue complexity," or "exceed [the Service's] statutory authority," and to submit two reports to the President. The second report, issued by Treasury Secretary Mnuchin on October 2, 2017, recommended certain actions with respect to eight sets of regulations, one of which was the 707 Temporary Regulations. The second report stated that the novel approach implemented in the 707 Temporary Regulations should be studied systematically and that the Treasury Department and the Service therefore would consider removing the 707 Temporary Regulations and reinstating prior regulations. Treasury and the Service proposed removing the 707 Temporary Regulations in 2018 (see REG-131186-17, Proposed Removal of Temporary Regulations on a Partner's Share of a Partnership Liability for Disguised Sale Purposes, 83 F.R. 28397 (6/19/18)) and now have done so.

The 707 Temporary Regulations Issued in 2016. Temp. Reg. § 1.707-5T(a)(2), published in 2016, provided that, for purposes of the disguised sale rules, a partner's share of any partnership liabilities, regardless of whether they are recourse or nonrecourse under Reg. § 1.752-1 through 1.752-3, must be allocated by applying the same percentage used to determine the partner's share of "excess nonrecourse liabilities" under Reg. § 1.752-3(a)(3), "but such share shall not exceed the partner's share of the partnership liability under section 752 and applicable regulations (as limited in the application of § 1.752-3(a)(3) to this paragraph (a)(2))." Reg. § 1.752-3(a)(3) (as amended in T.D. 9787, 81 F.R. 69291 (10/5/16)), provided that, for purposes of the disguised sale rules of Reg. § 1.707-5(a)(2), a partner's share of an excess nonrecourse liability is determined solely in accordance with the partner's interest in partnership profits and that the significant item method, alternative method, and additional method do not apply. The combined effect of these rules was that, for purposes of the disguised sale rules, and regardless of whether a liability was recourse or nonrecourse, (1) a contributing partner's share of a partnership liability was determined solely by the partner's share of partnership profits and could not be determined either under the other methods normally authorized for allocating excess nonrecourse liabilities or with reference to that partner's economic risk of loss under Reg. § 1.752-2, and (2) no portion of any partnership liability for which another partner bore the risk of loss could be allocated to the contributing partner under the profit-share method. Treasury and the Service expressed the belief that, for purposes of the disguised sale rules, this allocation method reflected the overall economic arrangement of the partners. According to the preamble to the 707 Temporary Regulations, "[i]n most cases, a partnership will satisfy its liabilities with partnership profits, the partnership's assets do not become worthless, and the payment obligations of partners or related persons are not called upon." These rules were designed to be the death knell of leveraged partnership disguised sale transactions ala *Canal Corp. v. Commissioner*, 135 T.C. 199 (2010), to which reference is made in the 2016 preamble.

The Withdrawal of the 707 Temporary Regulations. The Treasury Department and the Service have now removed the 707 Temporary Regulations and reinstated the rules under Reg. § 1.707-5(a)(2) as in effect prior to the 707 Temporary Regulations. Under these rules, (1) a partner's share of a partnership's recourse liability is the partner's share of the liability under § 752 and the regulations thereunder, i.e., recourse liabilities are allocated for purposes of the disguised sale rules under the normal rules for allocating recourse liabilities, and (2) nonrecourse liabilities are allocated by applying the same percentage used to determine the partner's share of "excess nonrecourse liabilities" under Reg. § 1.752-3(a)(3), which means that a contributing partner's share of a nonrecourse liability is determined for purposes of the disguised sale rules solely by the partner's share of partnership profits and that the significant item method, alternative method, and additional method do not apply. The regulations also reinstate the rule in former Reg. § 1.707-5(a)(2)(i) and (ii) for so-called § 1.752-7 contingent liabilities that a partnership liability is a recourse or nonrecourse liability to the extent that the obligation would be a recourse liability under Reg. § 1.752-1(a)(1) or a nonrecourse liability under § 1.752-1(a)(2), respectively, if the liability was treated as a partnership liability for purposes of section 752. The preamble to the proposed regulations indicated that "[t]he Treasury Department and the Service continue to study the issue of the effect of contingent liabilities with respect to section 707, as well as other sections of the Code." Finally, the regulations reinstate Examples 2, 3, 7, and 8 under Reg. § 1.752-1-5(f) with a modification to the language in Example 3 to reflect an amendment made in 2016 to Reg. § 1.707-5(a)(3) regarding an anticipated reduction in a partner's share of a liability that is not subject to the entrepreneurial risks of partnership operations.

Effective Date. The 707 Temporary Regulations expire on October 4, 2019. The amendments to Reg. § 1.707-5 apply to any transaction with respect to which all transfers occur on or after October 4, 2019. (These effective dates represent a change from the proposed regulations, which were proposed to apply thirty days following the date the proposed regulations were published as final regulations.) Nevertheless, taxpayers can apply these regulations instead of the 707 Temporary Regulations to any transaction with respect to which all transfers occur on or after January 3, 2017.

2. Final regulations address deficit restoration obligations, when partnership liabilities are treated as recourse liabilities, and bottom dollar guarantees. T.D. 9877, Liabilities Recognized as Recourse Partnership Liabilities Under Section 752, 84 F.R. 54014 (10/9/19). The Treasury Department and the IRS have finalized proposed and temporary regulations that address when certain obligations to restore a deficit balance in a partner's capital account are disregarded under § 704, when partnership liabilities are treated as recourse liabilities under § 752, and the treatment of so-called bottom dollar guarantees. The proposed and temporary regulations were issued in 2016. See T.D. 9788, Liabilities Recognized as Recourse Partnership Liabilities Under Section 752, 81 F.R. 69282 (10/5/16); REG-122855-15, Liabilities Recognized as Recourse Partnership Liabilities Under Section 752, 81 F.R. 69301 (10/5/16) (2016 proposed regulations).

Background—Under Reg. § 1.752-1(a)(1), a partnership liability is recourse to the extent that any partner or related person bears the economic risk of loss (EROL) for the liability under Reg. § 1.752-2. Under Reg. § 1.752-2, a partner or related person bears the EROL to the extent the partner or related person would have a payment obligation if the partnership liquidated in a worst-case scenario in which all partnership liabilities are due and all partnership assets generally are worthless. For purposes of determining the extent to which a partner or related person has an obligation to make a payment, an obligation to restore a deficit capital account upon liquidation of the partnership under the § 704(b) regulations is taken into account. Further, for this purpose, Reg. § 1.752-2(b)(6) presumes that partners and related persons who have payment obligations actually perform those obligations, irrespective of their net worth, unless the facts and circumstances indicate a plan to circumvent or avoid the obligation. Prior to these regulations, this presumption was subject to an anti-abuse rule in § 1.752-2(j) pursuant to which a payment obligation of a partner or related person could be disregarded or treated as an obligation of another person if facts and circumstances indicated that a principal purpose of the arrangement was to eliminate the partner's EROL with respect to that obligation or create the appearance of the partner or related person bearing the EROL when the substance was otherwise. This presumption was also subject to a disregarded entity net value requirement under Reg. § 1.752-2(k) pursuant to which, for purposes of determining the extent to which a partner bears the EROL for a partnership liability, a payment obligation of a disregarded entity was taken into account only to the extent of the net value of the disregarded entity as of the allocation date.

2014 Proposed Regulations Under § 752—In 2014, Treasury and the Service issued proposed amendments to Reg. § 1.752-2 (2014 proposed amendments) providing that obligations to make a payment with respect to a partnership liability (excluding those imposed by state law) would not be recognized for purposes of § 752 unless certain recognition factors were present. These factors were intended to ensure that the terms of a payment obligation were not designed solely to obtain tax benefits. For example, one factor required a partner or related person to either maintain a commercially reasonable net worth during the term of the payment obligation or be subject to commercially reasonable restrictions on asset transfers for inadequate consideration. The 2014 proposed amendments to Reg. § 1.752-2 also provided generally that a payment obligation would be recognized only to the extent of the net value of a partner or related person as of the allocation date.

2016 Proposed Regulations Under § 752—The 2016 proposed regulations partially withdrew the 2014 proposed regulations and adopted an approach that is now reflected, with some modifications, in the final regulations.

Final Regulations Under § 752—In response to comments expressing concern about the "all or nothing" approach of the 2014 proposed regulations, the final regulations move the list of recognition factors to an anti-abuse rule in Reg. § 1.752-2(j)(3) (other than the recognition factors concerning bottom dollar guarantees and indemnities, which are addressed in concurrently issued final regulations under § 752). Under the anti-abuse rule, the factors are weighed to determine whether a payment obligation (other than an obligation to restore a deficit capital account upon liquidation) should be respected. The list of factors in the anti-abuse rule is nonexclusive, and the weight to be given to any particular factor depends on the particular case. The final regulations state that the presence or absence of any particular factor, in itself, is not necessarily indicative of whether or not a payment obligation is recognized under Reg. § 1.752-2(b). The final regulations modify the recognition factors in various ways in response to comments on the 2014 and 2016 proposed regulations. The 2016 proposed regulations also proposed to remove Reg. § 1.752-2(k), which provided that a payment obligation of a disregarded entity is taken into account only to the extent of the net value of the disregarded entity as of the allocation date, and proposed to create a new presumption under the anti-abuse rule in Reg. § 1.752-2(j). In contrast, the final regulations retain Reg. § 1.752-2(k) but modify it to provide that an obligation of a partner or related person to make a payment is not recognized if the facts and circumstances indicate that there is not a reasonable expectation that the payment obligor will have the ability to make the required payments if the payment obligation becomes due and payable. For purposes of this rule, a payment obligor includes disregarded entities (including grantor trusts). The final regulations contain two examples to illustrate the application of Reg. § 1.752-2(k).

Bottom Dollar Guarantees—Reg. § 1.752-2(b)(3) continues to provide that "[t]he determination of the extent to which a partner or related person has an obligation to make a payment under [Reg.] § 1.752-2(b)(1) is based on the facts and circumstances at the time of the determination," and that "[a]ll statutory and contractual obligations relating to the partnership liability are taken into account." However, the regulation now carves out an exception under which "bottom dollar" guarantees and indemnities (or their equivalent, termed "bottom dollar payment obligations") will not be recognized. Reg. § 1.752-2(b)(3)(ii)(A). According to Reg. § 1.752-2(b)(3)(ii)(C)(1), a *bottom dollar payment obligation* is a payment obligation that is the same or similar to one described in Reg. § 1.752-2(b)(3)(ii)(C)(1) as follows:

1. "With respect to a guarantee or similar arrangement, any payment obligation other than one in which the partner or related person is or would be liable up to the full amount of such partner's or related person's payment obligation if, and to the extent that any amount of the partnership liability is not otherwise satisfied."

2. "With respect to an indemnity or similar arrangement, any payment obligation other than one in which the partner or related person is or would be liable up to the full amount of such partner's or related person's payment obligation, if, and to the extent that, any amount of the indemnitee's or benefited party's payment obligation that is recognized under this paragraph (b)(3) is satisfied."

3. "With respect to an obligation to make a capital contribution or to restore a deficit capital account upon liquidation of the partnership as described in § 1.704-1(b)(2)(ii)(b)(3) …, any payment obligation other than one in which the partner is or would be required to make the full amount of the partner's capital contribution or to restore the full amount of the partner's deficit capital account."

4. "An arrangement with respect to a partnership liability that uses tiered partnerships, intermediaries, senior and subordinate liabilities, or similar arrangements to convert what would otherwise be a single liability into multiple liabilities if, based on the facts and circumstances, the liabilities were incurred pursuant to a common plan, as part of a single transaction or arrangement, or as part of a series of related transactions or arrangements, and with a principal purpose of avoiding having at least one of such liabilities or payment obligations with respect to such liabilities being treated as a bottom dollar payment obligation."

As long as a partner or related person has a payment obligation that would be recognized but for the effect of an indemnity, reimbursement agreement, or similar arrangement, the payment obligation will be recognized under Reg. § 1.752-2(b)(3) if, taking into account the indemnity, reimbursement agreement, or similar arrangement, that partner or related person is liable for at least 90 percent of the initial payment obligation. Reg. § 1.752-2(b)(3)(ii)(B). Also, a payment obligation is not a bottom dollar payment obligation merely because a maximum amount is placed on the partner's or related person's payment obligation, a partner's or related person's payment obligation is stated as a fixed percentage of every dollar of the partnership liability to which such obligation relates, or there is a right of proportionate contribution running between partners or related persons who are co-obligors with respect to a payment obligation for which each of them is jointly and severally liable. Reg. § 1.752-2(b)(3)(ii)(C)(2). Guarantees of a vertical slice of a partnership liability will be recognized.

Disclosure requirement—Reg. § 1.752-2(b)(3)(ii)(D) requires the partnership to disclose to the IRS all bottom dollar payment obligations with respect to a partnership liability on a completed Form 8275, Disclosure Statement, attached to the partnership return for the taxable year in which the bottom dollar payment obligation is undertaken or modified.

Final Regulations Under § 704—Prior to these amendments, the regulations under § 704 provided that a partner's deficit restoration obligation was not respected if the facts and circumstances indicated a plan to circumvent or avoid the partner's deficit restoration obligation. The final regulations retain this rule in Reg. § 1.704-1(b)(2)(ii)(c)(4) and provide that a partner's deficit restoration obligation also will not be respected if it is a bottom dollar payment obligation that is not recognized under Reg. § 1.752–2(b)(3). The final regulations also add a nonexclusive list of factors to Reg. § 1.704-1(b)(2)(ii)(c)(4)(B) that are similar to the factors in the anti-abuse rule of Reg. § 1.752–2(j)(3). However, these factors are specific to deficit restoration obligations and are intended to indicate when a plan to circumvent or avoid a deficit restoration obligation exists. The weight to be given to any particular factor depends on the particular case and the presence or absence of any particular factor is not, in itself, necessarily indicative of whether or not the obligation is respected. The factors are: (1) the partner is not subject to commercially reasonable provisions for enforcement and collection of the obligation; (2) the partner is not required to provide (either at the time the obligation is made or periodically) commercially reasonable documentation regarding the partner's financial condition to the partnership; (3) the obligation ends or could, by its terms, be terminated before the liquidation of the partner's interest in the partnership or when the partner's capital account as provided in § 1.704-1(b)(2)(iv) is negative other than when a transferee partner assumes the obligation; and (4) the terms of the obligation are not provided to all the partners in the partnership in a timely manner.

Effective Date—Subject to some exceptions, the final regulations generally apply to liabilities incurred or assumed by a partnership and to payment obligations imposed or undertaken with respect to a partnership liability on or after October 9, 2019, other than liabilities incurred or assumed by a partnership and payment obligations imposed or undertaken pursuant to a written binding contract in effect prior to that date.

C. Distributions and Transactions Between the Partnership and Partners

D. Sales of Partnership Interests, Liquidations and Mergers

E. Inside Basis Adjustments

F. Partnership Audit Rules

G. Miscellaneous

VIII. TAX SHELTERS

IX. EXEMPT ORGANIZATIONS AND CHARITABLE GIVING

A. Exempt Organizations

1. Provisions of the Taxpayer First Act affecting tax-exempt organizations.

a. Mandatory e-filing by tax-exempt organizations. The Taxpayer First Act, Pub. L. No. 116-25, § 3101, amends Code § 6033 by redesignating subsection (n) as subsction (o) and adding new subsection (n). New § 6033(n) requires all organizations that are exempt from tax under

§ 501(a) and that are requried by § 6033 to file returns to do so electonically. The legislation also amends Code § 527(j)(7) to require e-filing of all reports required by § 527(j)(2) (Form 8872, Political Organization Report of Contributions and Expenditures) and amends Code § 6011 by adding new § 6011(h), which requires e-filing of all unrelated business income tax returns. The legislation also amends Code § 6104(b) to require the IRS to make available in machine readable format as soon as practicable all annual returns e-filed under § 6033(n). Generally, all of these amendments apply to taxable years beginning after July 1, 2019 (the date of enactment). Transitional relief is provided for certain organizations. First, for certain small organizations or other organizations for which the Secretary of the Treasury determines that application of the e-filing requirement would "cause undue burden without further delay," the Secretary of the Treasury has discretion to delay the application of the requirement to file electronically, provided that the delay does not apply to any taxable year later than the taxable year beginning two years following July 1, 2019 (the date of enactment). Second, the Secretary of the Treasury has discretion to delay the effective date not later than taxable years beginning two years after the date of enactment for the filing of Form 990-T (reports of unrelated business taxable income or the payment of a proxy tax under § 6033(e) by certain tax-exempt organizations that incur nondeductible lobbying and political expenses).

b. The IRS must provide notice to tax-exempt organizations before revocation of tax-exempt status for failure to file required returns. Under § 6033(j)(1), if an organization fails to file a required Form 990-series return or notice for three consecutive years, the organization's tax-exempt status is automatically revoked. The Taxpayer First Act, Pub. L. No. 116-25, § 3102, amends Code § 6033(j)(1) to require the IRS to notify a tax-exempt organization that fails to file a required return or notice for two consecutive years that the IRS has no record of having received such returns or notices and that the organization's tax-exempt status will be revoked if the organization fails to file the next required return or notice by the applicable due date. The notification must contain information about how to comply with the annual information return and notice requirements under § 6033(a)(1) and § 6033(i). This requirement applies to failures to file returns or notices for two consecutive years if the return or notice for the second year is required to be filed after December 31, 2019.

B. <u>Charitable Giving</u>

1. ♫♪"Workin' in the coal mine . . . Oops, about to slip down"♪♫ on the extinguishment clause requirement of Reg. § 1.170A-14(g)(6)(ii). <u>Coal Property Holdings, LLC v. Commissioner</u>, 153 T.C. No. 7 (10/28/19). The IRS seems to have found a silver (coal?) bullet to kill a number of the conservation easement cases in the form of Reg. § 1.170A-14(g)(6)(ii), which provides that a deduction is allowed for the donation of a conservation easement only if the donor agrees that the donee will receive a portion of any proceeds from the subsequent extinguishment of the easement at least equal to the proportionate value of the perpetual conservation restriction (sometimes referred to as the "extinguishment clause" requirement). The extinguishment clause requirement forms part of the rule set forth in § 170(h)(5)(A), which provides that a contribution shall not be treated as exclusively for conservation purposes unless the conservation purpose is protected in perpetuity. We previously have reported on a number of similar conservation easement cases decided against taxpayers. *See, e.g.*, *Pine Mountain Preserve, LLLP v. Commissioner*, 151 T.C. No. 14 (12/27/18); *Pine Mountain Preserve, LLLP v. Commissioner*, T.C. Memo. 2018-214 (12/27/18); *PBBM Rose Hill, Ltd. v. Commissioner*, 900 F.3d 193 (5th Cir. 9/14/18); Belk v. Commissioner, 140 T.C. 1 (2013), *aff'd*, 774 F.3d 221 (4th Cir. 2014). In this latest case, the Tax Court (Judge Lauber) largely followed the reasoning adopted in the prior cases to disallow the taxpayer's claimed $155.5 million charitable contribution deduction. For the details, see below.

Facts. The taxpayer, Coal Property Holdings, LLC, acquired 3,713 acres of property in September 2013. The property had been used in the past for the surface mining of coal. Three weeks later an "entity owned by an investor"—we're guessing an LLC formed to facilitate the intended conservation easement charitable deduction—acquired a 99 percent interest in the taxpayer for $32.5 million. Three days later, the taxpayer donated a conservation easement over the property to a Tennessee land trust. The conservation easement deed prohibited any future surface mining on the property (as required by Code § 170(h)(5)); however, as discussed further below, the deed reserved to the taxpayer certain other rights with respect to the property. The taxpayer subsequently claimed a $155.5 million charitable contribution deduction on its 2013 federal income tax return. Upon audit, the IRS completely disallowed the taxpayer's $155.5 million deduction. The taxpayer timely petitioned the Tax Court, and the IRS moved for partial summary judgment on the basis that the "extinguishment clause" in the conservation easement deed failed to satisfy the strict requirements of Reg. § 1.170A-14(g)(6)(ii). The "extinguishment clause" in issue (apparently one that is commonly used by taxpayers and charitable grantees) provided in relevant part that in the event of judicial termination of the conservation easement "the proceeds to which the Grantee shall be entitled, *after the satisfaction of prior claims*, . . . shall be the stipulated fair market value of this Easement" (emphasis added). Further, the easement deed provided that the "stipulated fair market value" of the easement at the time of any such sale would be determined as follows:

> This Easement constitutes a real property interest immediately vested in Grantee, which * * * the parties stipulate to have a fair market value determined by multiplying (a) 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*) by (b) a fraction, the numerator of which is the value of this Easement at the time of the grant and the denominator of which is the value of the Property without deduction of the value of this Easement at the time of this grant. * * * For purposes [hereof], the ratio of the value of this Easement to the value of the Property unencumbered by this Easement shall remain constant.[] It is intended that this Section 9.2 be interpreted to adhere to and be consistent with * * * [section] 1.170A- 14(g)(6)(ii)[, Income Tax Regs]. (Emphasis added.)

When the easement was granted, the improvements to the property included 20 natural gas wells, two cell phone towers, various roads, and various electrical installations. Further, other sections of the easement deed reserved to the taxpayer the right to preserve and maintain existing utility structures on the property, the right to provide underground utilities to any future permitted structures, and the right to install and maintain roads to existing structures or future improvements. The easement deed also permitted the taxpayer to access the property via an adjacent tract of land for the purpose of engaging in subsurface coal mining unless in the reasonable discretion of the grantee such activity would impair or interfere with the conservation purposes of the easement. The appraisal relating to the conservation easement determined that the highest and best use of the property would be an "owner operated coal mining operation." Assuming such a mining operation, the value of the property without the conservation easement was appraised at $160.5 million while the value of the property subject to the conservation easement was determined to be $5 million. The difference, $155.5 million, was the amount of the taxpayer's claimed charitable contribution deduction. Of note, a technical report appended to the appraisal concluded that subsurface mining for coal on the property using a "room-and-pillar" technique would have "minimal" surface effects on the property. Without expressly so stating, Judge Lauber's opinion implies that the taxpayer intended to mine coal from the property via subsurface methods notwithstanding the conservation easement.

The IRS's Position. The IRS argued that the above-quoted language in the conservation easement deed failed the "extinguishment clause" requirement of Reg. § 1.170A-14(g)(6)(ii) and thus failed the "protected in perpetuity" rule of § 170(h)(5)(A). According to the IRS, Reg. § 1.170A-14(g)(6)(ii) would require in this case that the grantee of the property receive 96.885% ($155.5M/$160.5M) of any sales proceeds from the property if the easement was judicially extinguished. The language in the easement deed at issue, however, reduces the sales proceeds due to the grantor by "prior claims" and by "any increase in value after the date of the grant attributable to improvements." Hence, the IRS argued, the grantee would not receive 96.885% of any theoretical sales proceeds (but instead something less than 96.885%), and thus the $155.5 million charitable contribution deduction must be disallowed.

The Taxpayer's Position. The taxpayer argued that despite any technical deficiency in the "extinguishment clause" advanced by the IRS, the savings clause in the easement deed, which provided that "Section 9.2 be interpreted to adhere to and be consistent with * * * [section] 1.170A- 14(g)(6)(ii)," prevented any such technical deficiency from being fatal to the taxpayer's charitable contribution deduction.

The Tax Court. Citing the cases mentioned above, Judge Lauber essentially agreed with the IRS's position, rejecting the taxpayer's contention that the "savings clause" remedied any technical deficiency with the extinguishment clause in the taxpayer's easement deed. In particular, Judge Lauber ruled that the taxpayer's savings clause argument was inapposite for two reasons: First, the savings clause language only operates to the extent that the language of the easement deed itself is ambiguous, and in this case, Judge Lauber held that the language was unambiguous. Second, and perhaps more importantly, Judge Lauber explained that courts have routinely held such "savings clause" language to be ineffectual. Courts have declined to respect such tax-related "savings clauses" because they impose a condition subsequent—a condition that can only arise subsequent to the act (here, the conveyance) that determines the proper tax consequences of the transaction. Put differently, a savings clause cannot undo something that, from a tax standpoint, already has been done.

The upshot. As we have seen from the decided cases, the IRS takes a very dim view of conservation easements where the claimed charitable contribution deduction is far in excess of a recent acquisition price for the subject property. Even if the IRS had lost its partial summary judgment motion in this case, Judge Lauber's opinion notes that the IRS would have asserted other reasons (e.g., valuation, Form 8283 deficiencies, etc.) for disallowing the $155.5 million charitable contribution deduction. Taxpayers presumably would do themselves a favor by crafting an "extinguishment clause" that forfeits to the grantee all proceeds from a judicial sale of the property. In this case, for example, it seems unlikely that the taxpayer really intended to preserve to itself 3.115% (100% - 96.885%) of the sales proceeds received in a judicial extinguishment of the conservation easement granted to the donee.

X. TAX PROCEDURE

A. <u>Interest, Penalties, and Prosecutions</u>

1. Filing an income tax return more than sixty days late just got more expensive. A provision of the SECURE Act, Division O, Title IV, § 402 of the 2020 Further Consolidated Appropriations Act, amended Code § 6651(a) to increase the penalty for filing an income tax return late. Prior to amendment, § 6651(a) provided that, in the case of an income tax return, if a taxpayer filed the return more than sixty days late, the minimum late-filing penalty was the lesser of $330 or 100 percent of the amount required to be shown as tax on the return. This legislative change increases the $330 figure to $435. Pursuant to § 6651(j)(1), the $435 figure is adjusted for inflation for returns required to be filed in a calendar year after 2020. The increased late-filing penalty applies to returns the due date for which (including extensions) is after December 31, 2019.

2. Filing certain retirement plan registration statements and returns late and for providing certain notices late is now ten times more expensive. A provision of the SECURE Act, Division O, Title IV, § 403 of the 2020 Further Consolidated Appropriations Act, amended Code § 6652(d), 6652(e) and 6652(h) to increase the penalties for filing certain retirement plan registration statements and returns late and for providing certain notices late. Prior to amendment, § 6652(d)(1) provided that the penalty for filing a statement required under § 6057(a) for annual registration of certain plans was $1 per participant per day with a maximum penalty of $5,000. The legislation increased these figures to $10 and $50,000, respectively. Similarly, prior to amendment, § 6652(d)(2) provided that the penalty for filing a notification required under § 6057(b) regarding a change of status was $1 per day with a maximum penalty of $1,000. The legislation increased these figures to $10 and $10,000, respectively. Prior to amendment, § 6652(e) provided that the penalty for filing specified retirement plan returns late was $25 per day with a maximum penalty of $15,000. The legislation increased these figures to $250 and $150,000, respectively. Prior to amendment, § 6652(h) provided that the penalty for failure to provide notices required by § 3405(e)(10)(B) relating to elections regarding withholding from distributions was $10 for each failure with a maximum penalty of $5,000. The legislation increased these figures to $100 and $50,000, respectively. These changes apply to returns, statements, and notifications required to be filed, and notices required to be provided, after December 31, 2019.

B. Discovery: Summonses and FOIA

1. Non-government attorneys KEEP OUT! REG-132434-17, Proposed Regulations on Certain Non-Government Attorneys Not Authorized to Participate in Examinations of Books and Witnesses as a Section 6103(n) Contractor, 83 F.R. 13206 (3/28/18). Treasury and the Service have issued a notice of proposed rulemaking that would significantly narrow final regulations issued in 2016 that permit service providers with whom the Service contracts to receive books and records provided in response to a summons and participate in a summons interview. Section 6103(n) and Reg. § 301.6103(n)-1(a) permit the disclosure of returns and return information to any person for purposes of tax administration to the extent necessary in connection with the acquisition of property or certain services (such as processing, storage and reproduction) related to returns or return information. The final regulations issued in 2016 clarified that such persons with whom the Service or Chief Counsel contracts for services could not only receive and review books, papers, and records produced in compliance with a summons issued by the Service, but also in the presence and under the guidance of an IRS officer or employee, participate fully in the interview of a witness summoned by the Service to provide testimony under oath. *See* T.D. 9778, Participation of a Person Described in Section 6103(n) in a Summons Interview Under Section 7602(a)(2) of the Internal Revenue Code, 81 F.R. 45409 (7/14/16). Commentators, including the State Bar of Texas Tax Section, had recommended removing the provisions permitting contractors to participate in a summons interview because, among other reasons, doing so would "avoid the unsettled question of whether a private contractor has the legal authority to examine a witness." 2014 TNT 180-24 (9/16/14). After publishing Notice 2017-38, 2017-30 I.R.B. 147 (7/7/17) [which related to the subsequently issued Second Report to the President on Identifying and Reducing Tax Regulatory Burdens, Dep't of Treasury, Press Release (10/2/17), and Department of the Treasury, 2017-2018 Priority Guidance Plan (10/20/17)], the Service identified eight sets of regulations that "impose an undue financial burden," "add undue complexity," or "exceed [the Service's] statutory authority." The above-mentioned final regulations under § 7602 were one of the eight targeted for revision. Accordingly, Prop. Reg. § 301.7602-1(b)(3) provides new rules that significantly narrow the scope of the current regulations under § 7602 by excluding non-government attorneys from receiving summoned books, papers, records, or other data or from participating in the interview of a witness summoned by the Service to provide testimony under oath. The proposed regulations contain a limited exception for an attorney hired by the Service as a specialist in foreign, state, or local law, including tax law, or in non-tax substantive law that is relevant to an issue in the examination, such as patent law, property law, or environmental law, or is hired for knowledge, skills, or abilities other than providing legal services as an attorney. The preamble to the proposed regulations explains the change as follows:

> The Summons Interview Regulations require the Service to retain authority over important decisions when section 6103(n) contractors question witnesses, but there is a perceived risk that the Service may not be able to maintain full control over the actions of a non-government attorney hired by the Service when such an attorney, with the limited exception described below, questions witnesses. The actions of the non-governmental attorney while questioning witnesses could foreclose IRS officials from independently exercising their judgment. Managing an examination or summons interview is therefore best exercised solely by government employees, including government attorneys, whose only duty is to serve the public interest. These concerns outweigh the countervailing need for the Service to use non-government attorneys, except in the limited circumstances set forth in proposed paragraph (b)(3)(ii). Treasury and the Service remain confident that the core functions of questioning witnesses and conducting examinations are well within the expertise and ability of government attorneys and examination agents.

The proposed regulations apply to examinations begun or administrative summonses served by the Service on or after March 27, 2018.

- The Service's position in the proposed regulations represents a change in policy. The Service made a controversial decision to engage the law firm Quinn Emanuel Urquhart & Sullivan, LLP, as a private contractor to assist in the Service's examination of Microsoft's 2004 to 2006 tax years. A federal district court expressed concern about this practice, but upheld enforcement of the summonses issued by the Service to Microsoft. *See United States v. Microsoft Corp.*, 154 F. Supp. 3d (W.D. Wash. 2015).

a. Congress has stepped in to narrow the information the Service can provide to a tax administration contractor and to prohibit such contractors from questioning a witness under oath whose testimony was obtained by summons. The Taxpayer First Act, Pub. L. No. 116-25, § 1208, amends § 7602 by adding new § 7602(f), which provides that the Service shall not, under the authority of § 6103(n), provide to any tax administation contractor any books, papers, records, or other data obtained by summons, "except when such person requires such information for the sole purpose of providing expert vealuation and assistance to the IRS." The legislation also provides that no person other than an employee of the Service or the Office of Chief Counsel may question a witness under oath if the witness's testimony was obntained by summons. These changes are effective on July 1, 2019, the date of enactment.

2. A John Doe summons must seek information that is narrowly tailored and that pertains to the failure of the targeted person or group to comply with the internal revenue laws. A summons that does not identify the taxpayer whose liability is being investigated is commonly referred to as a "John Doe" summons. For example, the IRS might issue a summons to credit card companies to obtain customer records of unnamed United States taxpayers with accounts in certain countries. Because the person being investigated has no opportunity to seek to quash the summons or intervene in an enforcement proceeding, § 7609(f) requires the IRS to obtain judicial approval before issuing the summons. According to § 7609(f), in the judicial proceeding, the IRS must establish that:

1. The summons relates to the investigation of a particular person or ascertainable group or class of persons;
2. There is a reasonable basis for believing that such person or group or class of persons may fail or may have failed to comply with any provision of any internal revenue law; and
3. The information sought to be obtained from the examination of the records or testimony (and the identity of the person or persons with respect to whose liability the summons is issued) is not readily available from other sources.

The Taxpayer First Act, Pub. L. No. 116-25, § 1204, amends § 7609(f) to preclude the IRS from issuing a John Doe summons unless the information sought to be obtained is narrowly tailored and pertains to the failure (or potential failure) of the relevant person or group or class of persons to comply with one or more provisions of the internal revenue law that have been identified. This change applies to summonses served after August 15, 2019 (the date that is 45 days after the date of enactment).

C. Litigation Costs

D. Statutory Notice of Deficiency

1. ♪♫Should I stay or should I go?♫♪ A divided Tax Court has held that a notice of deficiency mailed to a corporate taxpayer, the intitial pages of which identified the taxpayer but the latter pages of which identified a related entity, was not a valid notice of deficiency and therefore did not confer jurisdiction on the Tax Court. U.S. Auto Sales, Inc. v. Commissioner, 153 T.C. No. 5 (10/28/19). The Service mailed to the taxpayer a notice of deficiency dated May 15, 2012. This notice of deficiency determined deficiencies of approximately $24,000 and $31,000 for the taxable years ending June 30, 2003 and 2007, respectively. The notice of deficiency was an eleven-page document, the first four pages of which identified the taxpayer and the remaining seven pages of which identified a related entity as the taxpayer. The Service mailed to the taxpayer a second notice of deficiency dated August 2, 2012. This notice of deficiency identified only the taxpayer and determined deficiencies for the taxable years ending June 30, 2007 and 2008 of approximately $3.4 million and $3 million, respectively. The taxpayer filed timely petitions in the Tax Court in response to both notices of deficiency. This proceeding arises from the petition filed in response to the first (May 15) notice of deficiency. The Service moved to dismiss on the ground that the May notice of deficiency failed to identify a specific taxpayer and therefore was not a valid notice of deficiency that could confer jurisdiction on the Tax Court. The taxpayer argued that the May notice of deficiency was valid. In a reviewed opinion (9-0-6) by Judge Marvel, the Tax Court held that the May notice of deficincy was invalid and granted the Services's motion to dismiss. For guidance on the validity of a notice of deficiancy, the court relied on its prior opinion in *Dees v. Commissioner*, 148 T.C. 1 (2017). In *Dees*, the court reviewed its prior decisions regarding the validity of notices of deficiency and framed the analysis as follows:

> In the holdings of these cases we see a two-pronged approach to the question of the validity of the notice of deficiency. First, we look to see whether the notice objectively put a reasonable taxpayer on notice that the Commissioner determined a deficiency in tax for a particular year and amount. If the notice, viewed objectively, sets forth this information, then it is a valid notice. ... Accordingly, if the notice is sufficient to inform a reasonable taxpayer that the Commissioner has determined a deficiency, our inquiry ends there; the notice is valid. But what if, as here, the notice is ambiguous? Then our caselaw requires the party seeking to establish jurisdiction to establish that the Commissioner made a determination and that the taxpayer was not misled by the ambiguous notice.

The court in this case concluded that the May notice of deficiency was ambiguous under the first step of the two-step analysis required by *Dees*. The cover letter and the Form 4089 (Notice of Deficiency-Waiver) identified the taxpayer but the Form 5278 statement of changes and the Form 886-A explanation of changes identified a related entity, U.S. Auto Finance. The court characterized the notice as "fatally inconsistent as to the identity of the taxpayer against whom the deficiencies are determined" and therefore ambiguous. In the second step of the *Dees* two-step analysis, the taxpayer, as the party seeking to establish jurisdiction, bore the burden of proving that the May notice reflected a determination with respect to the taxpayer. According to the court, the taxpayer had failed to meet this burden. The court indicated that, in step two of the *Dees* analysis, it "may consider evidence from outside the four corners of the notice to establish whether the Commissioner made a taxpayer-specific determination." The Service relied on the taxpayer's tax returns, which were introduced in support of the government's motion to dismiss, to support its argument that the May notice could not have related to the taxpayer. The taxpayer admitted that the May notice reflected determinations with respect to its related entity, U.S. Auto Finance, and the court concluded that it was "clear that petitioner has not been prejudiced by the erroneous notice." In concluding that the taxpayer had failed to meet its burden in this second step, the court rejected the taxpayer's argument that *Benzvi v. Commissioner*, 787 F.2d 1541 (11th Cir. 1986), a decision of the U.S. Court of Appeals for the Eleventh Circuit, to which this case is appealable, does not require a notice of deficiency to identify a specific taxpayer in order to be valid.

Concurring opinion of Judges Marvel and Lauber. Judges Marvel and Lauber wrote a concurring opinion joined by Judges Thornton, Buch and Copeland. The opinion responds to a harshly worded dissenting opinion of Chief Judge Foley and Judge Urda, which suggests that the court's opinion "bends over backward to clean up the IRS's mess." The concurring opinion emphasizes that the controlling precedent is *Dees* and not, as the dissent contends, the court's opinion in *Scar v. Commissioner*, 81 T.C. 855 (1983), *rev'd*, 814 F.2d 1363 (9th Cir. 1987). In *Scar*, the Tax Court had upheld the validity of a notice of deficiency, but the Ninth Circuit reversed and held that the notice was invalid for lack of a "determination" because it was based on a tax shelter partnership in which the taxpayers were not partners and calculated tax at the highest marginal rate rather than the actual rates applicable to the taxpayers. Judges Marvel and Lauber characterized the notice of deficiency in *Scar* as one that "did not involve an ambiguity regarding the identity of the taxpayer against whom the deficiency was determined," but rather as one that "did not involve a determination at all, at least according to the U.S. Court of Appeals for the Ninth Circuit …."

Concurring opinion of Judge Buch. Judge Buch wrote a concurring opinion joined by Judges Marvel, Paris, Lauber, Nega, and Copeland. Judge Buch also emphasized that *Scar* is "inapposite." He expressed the view that *Scar* might be considered controlling if this case, which is appealable to the Eleventh Circuit, were instead appealable to the Ninth Circuit. But the notice of deficiency in this case, unlike the notice of deficiency in *Scar*, he emphasized, "is ambiguous as to perhaps the most critical element of such a notice: the identity of the taxpayer about whom the Commissioner determined a deficiency." The court's decision in *Dees*, he stated, sets forth the framework for deciding whether the notice of deficiency is valid.

Dissenting opinion of Chief Judge Foley and Judge Urda. Chief Judge Foley and Judge Urda wrote a dissenting opinion joined by Judges Gale, Gustafson, Pugh, and Ashford. The opinion argues that the notice of deficiency in this case satisfied the "minimal jurisdictional hurdles," which are that "[t]he notice must advise a taxpayer that the IRS has determined a deficiency for a specific year and in a particular amount." The dissenting opinion also argues that the Tax Court's opinion in *Scar* (referred to as *Scar I*) is the controlling precedent and that the situation in *Dees*, in which the notice of deficiency stated that the deficiency that had been determined was zero, "does not resemble this case." The dissenting opinion rejects as unconvincing the position set forth in the concurring opinions that this case is distinguishable from *Scar* because it involves an ambiguity as to the identity of the taxpayer. Judges Foley and Urda also expressed concern that the approach set forth in the court's opinion "contemplates an examination of extrinsic evidence in order to decide our jurisdiction." Under the court's approach, they stated, "[u]nless the notice indubitably demonstrates that a deficiency determination has been made, we are to rifle through extrinsic evidence to sniff out what really happened." Such an approach, they argued, is neither warranted by precedent nor prudent. They argued that the court's approach should be much simpler:

> In other words, once the IRS sends a taxpayer a slip of paper informing the taxpayer that the IRS has determined a deficiency against it for a particular year, that taxpayer can come to this Court to challenge the determination.

The dissenting opinion also argues that the concurring opinions had failed to address fully the court's opinion in *Campbell v. Commissioner,* 90 T.C. 110 (1998):

> [I]n attempting to dodge Scar I, the concurrences fail to fully take into account Campbell. In that case, the IRS sent a deficiency notice in which the first two pages related to the Campbells and the attachments related to a person named Dan Daigle. … We did not treat the notice as ambiguous. Rather, we concluded that the notice did not reveal on its face that the IRS had failed to make a determination and exercised jurisdiction.

The better approach, the dissent argued, would be to hold that the notice of deficiency was valid, freely allow the Service to amend its answer, and for the court to resolve the issues.

Dissenting opinion of Judge Ashford. Judge Ashford wrote a dissenting opinion in which she argued, as she did in her concurring opinion in *Dees*, that the relevant statutory provisions, §§ 6212, 6213 and 6214, do not support the two-step analysis of *Dees*. Judge Ashford distinguished between the IRS's determination of a deficiency and its issuance of the notice of deficiency. In her view, it is the IRS's determination of a deficiency that confers jurisdiction on the Tax Court.

> [W]e have jurisdiction over a deficiency determination, as a substantive matter, regardless of whether the notice of deficiency understandably reflects it or not, as long as a notice of deficiency was in fact issued, as a procedural matter.

Judge Ashford expressed the view that the appropriate remedy for a notice of deficiency with inadequate information is not to decline jurisdiction over the case, but to shift to the IRS the burden of proof on any matter not reflected in the notice or stated incorrectly in the notice.

E. Statute of Limitations

1. A U.S. District Court has declined to dismiss a taxpayer's refund action as untimely despite the taxpayer's failure to submit the specific documentation required by Rev. Proc. 99-21. Stauffer v. IRS, 120 A.F.T.R.2d 2017-6119 (D. Mass. 9/29/17). The taxpayer did not file federal icome tax returns for the years 2006 through 2012. Upon the taxpayer's death at the age of 90 in 2012, his son was appointed as adminstrator of the estate. As administrator, the son filed the missing returns and sought a refund of tax for the year 2006 of more than $137,000. The IRS denied the claim as untimely under § 6511. 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. The taxpayer's claims for refund were filed within three years of the time the returns were filed (and therefore were timely under § 6511(a)) because they were submitted simultaneously with the returns. However, § 6511(b)(2)(A) provides that, when a claim for refund is timely under the three-years-from-filing period of § 6511(a), the taxpayer can recover only the portion of the tax paid within the three-year period ending on the date the claim for refund was filed (plus the period of any extension the taxpayer obtained). In this case, § 6511(b)(2)(A) barred the taxpayer from obtaining the 2006 refund because the taxpayer had paid all of the tax more than three years before the claims for refund were filed. The taxpayer, through his son as administrator, asserted that, notwithstanding the normal limitations periods, he was entitled to relief under § 6511(h), which suspends the running of the periods in § 6511(a), (b), and (c) during any period that the taxpayer is "financially disabled." The term "financially disabled" is defined as being "unable to manage … financial affairs by reason of a medically determinable phyiscal or mental impairment of the individual which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months." The son filed an administrative appeal and asserted that the limitations periods of § 6511 had been tolled because his father had been financially disabled within the meaning of § 6511(h). With the administrative appeal, the son submitted a statement from the taxpayer's psychologist attesting that the taxpayer had suffered from a variety of ailments that had affected his mental capacity and had prevented him from managing his financial affairs from at least 2006 until his death in 2012. The IRS's guidance on § 6511(h) is set forth in Rev. Proc. 99-21, 1999-1 C.B. 960. The revenue procedure requires, among other things, that the taxpayer submit (1) a physician's statement attesting to the specific time period during which the physical or mental impairment prevented the taxpayer from managing his or her financial affairs, and (2) a statement that no person was authorized to act on the taxpayer's behalf in financial matters during the specified period of disability. The IRS concluded that the taxpayer had not complied with the requirement of Rev. Proc. 99-21 that the taxpayer submit the statement of a "physician" and denied the claim as untimely. The revenue procedure provides that the term "physician" has the same meaning as in § 1861(r)(1) of the Social Security Act, 42 U.S.C. § 1395x(r), which sets forth five categories of professionals considered to be physicians, none of which includes psychologists. The District Court (Judge Wolf) held that the IRS had failed to establish that its adoption of the Social Security Act's definiton of a physician in Rev. Proc. 99-21 was the product of reasoned decision making as required by Administrative Procedure Act § 706(2)(A) and *Motor Vehicle Manufacturers Association of the United States v. State Farm Mutual Automobile Insurance Co.*, 463 U.S. 29 (1983):

> The government … has not submitted any evidence of the IRS's rationale in adopting the definition in 42 U.S.C. § 1395x(r). … The IRS, therefore, has not provided any explanation for its decision, let alone a "rational connection between the facts found and the choice made." *State Farm*, 463 U.S. at 43. The IRS may conceivably view doctors without medical degrees to be generally unqualified to make the determination required under section 6511, and may have determined that, in view of the "need to fairly and efficiently process a potentially large number of [refund] claims," *Abston*, 691 F.3d at 996, a case-by-case determination of whether a given psychologist is nevertheless qualified is unwarranted. However, as explained earlier, at least where the IRS's reasoning is not obvious, the court may not supply an explanation for the IRS's choice that the agency itself has not given. *See State Farm*, 463 U.S. at 43.

The court also rejected the government's argument that the taxpayer was not entitled to relief under § 6511(h) because the taxpayer had submitted the psychologist's statement in the course of the administrative appeal, rather than with the claim for refund as required by Rev. Proc. 99-21. When refund claims are technically deficient, the court noted, courts generally accept the missing information at a later stage. Accordingly, the court denied the government's motion to dismiss without prejudice.

a. But the same District Court has dismissed the taxpayer's refund action as untimely on the basis that his son was authorized to act for him for a period of time and therefore he was not "financially disabled" within the meaning of § 6511(h) during that period. Stauffer v.

Internal Revenue Service, 122 A.F.T.R.2d 2018-6129 (D. Mass. 9/29/18). The government again moved to dismiss as untimely the taxpayer's complaint seeking a tax refund for the year 2006. The government argued that the running of the limitations period on seeking a tax refund for that year was not tolled on the basis of the taxpayer being "financially disabled" within the meaning of § 6511(h). Under §6511(h)(2)(B), "[a]n individual shall not be treated as financially disabled during any period that such individual's spouse or any other person is authorized to act on behalf of such individual in financial matters." (This same requirement is reflected in Rev. Proc. 99-21, 1999-1 C.B. 960, which provides that, to obtain relief under § 6511(h), the taxpayer must submit a statement that no person was authorized to act on the taxpayer's behalf in financial matters during the specified period of disability.) The District Court (Judge Wolf) found that the taxpayer's son had authority pursuant to a durable power of attorney to act on his father's behalf in financial matters from October 2005 until his father's death in October 2012. Although the son had had a falling out with his father and had told his father "that he would no longer be exercising any rights granted to him under the [Durable] POA," he later reconciled with this father and exercised powers under the power of attorney. The court concluded that the son had never effectively renounced the power of attorney. The court rejected the taxayer's argument that a person should be considered "authorized" to act on the taxpayer's behalf within the meaning of §6511(h)(2)(B) only when that person has a duty to act on the taxpayer's behalf and knowledge that action is necessary, i.e., a duty to file tax returns claiming refunds and knowledge that such returns have not been filed. Accordingly, the court concluded, the limitations period on seeking a tax refund was not tolled, the taxpayer's refund claim was untimely, and the government's motion to dismiss was granted.

- The result in this case is consistent with that in *Estate of Kirsch v. United States*, 265 F. Supp. 3d 315 (W.D.N.Y. 7/13/17), in which the court held that the period of limitations on seeking a tax refund was not tolled due to the taxpayer's financial disability under § 6511(h) because the taxpayer's son held a durable power of attorney authorizing him to act on behalf of the taxpayer, his mother.

b. The First Circuit has affirmed and concluded that the limitations period on seeking a tax refund was not tolled by reason of the taxpayer's financial disability. Stauffer v Internal Revenue Service, 939 F.3d 1 (1st Cir. 9/16/19), *aff'g* 122 A.F.T.R.2d 2018-6129 (D. Mass. 9/29/18). In an opinion by Judge Torruella, the U.S. Court of Appeals for the First Circuit has affirmed the District Court's dismissal of the taxpayer's refund action. Like the District Court, the First Circuit concluded that the taxpayer's son was authorized to act for the taxpayer in financial matters within the meaning of § 6511(h)(2)(B) and that the taxpayer therefore was not financially disabled. The court also concluded that the father had never revoked the power of attorney and that the son had never renounced it. The taxpayer argued that a person should be treated as authorized to act on the taxpayer's behalf in financial matters within the meaning of § 6511(h)(2)(B) "only if he or she has: (1) authority to file the financially disabled taxpayer's tax returns; (2) a duty to file the financially disabled taxpayer's tax returns; and (3) actual or constructive knowledge that the tax returns for a particular year have to be filed on behalf of the disabled taxpayer." The court concluded that it did not need to decide whether the first proposed requirement must be met because, even if it is required, the power of attorney in this case explicitly gave the son authority to file his father's tax returns. The court rejected the latter two proposed requirements on the ground that they "find[] no support in § 6511(h)(2)(B)'s plain language or its statutory context." Because the taxpayer was not finacially disabled within the meaning of § 6511(h), the taxpayer's refund claim was untimely and the court affirmed the District Court's grant of the government's motion to dismiss for lack of subject matter jurisdiction

F. Liens and Collections

1. According to the Eleventh Circuit, the IRS is required to make a pre-assessment determination of a taxpayer's liability as a responsible person under § 6672 when the taxpayer submits a protest, and its failure to do so might render the assessment invalid. Romano-Murphy v. Commissioner, 816 F.3d 707 (11th Cir. 3/7/16), *vacating and remanding* T.C. Memo. 2012-330 (11/29/12). The taxpayer served as the chief operating officer of a healthcare staffing business. The IRS sent to her a Letter 1153 (notice of proposed assessment) informing her that the IRS intended to hold her responsible for a penalty equal to more than $346,000 of the business's unpaid employment taxes pursuant to § 6672(a). The taxpayer submitted a written protest and requested a conference with IRS Appeals. Due to an unexplained error, the IRS never forwarded the protest to IRS Appeals and the taxpayer was not provided with a pre-assessment conference or a final administrative determination as to her protest. Instead, the IRS assessed the tax and issued a notice of intent to levy and notice of federal tax lien, in response to which the taxpayer requested a collection due process hearing. During the CDP hearing, the IRS Appeals Office observed that the taxpayer had not had a pre-assessment opportunity to contest her liability and therefore conducted a post-assessment review of the issues the taxpayer had raised in her protest. Following this review, the IRS issued a notice of determination sustaining the proposed collection. The taxpayer sought review in the Tax Court, which sustained the IRS's determination. The taxpayer moved to vacate on the ground that the IRS can collect a tax only after a valid assessment, and that the assessment in her case was invalid because the IRS had failed to give her a pre-assessment hearing and determination when she filed her timely protest. The Tax Court (Judge Morrison) concluded that, notwithstanding the IRS's failure to make a pre-assessment determination of liability under § 6672(a) in response to the taxpayer's protest, § 6672 did not prohibit the IRS's assessment. The Tax Court accordingly denied the taxpayer's motion to vacate. In an opinion by Judge Jordan, the Eleventh Circuit held that the IRS erred in failing to make a pre-assessment determination of the taxpayer's liability under § 6672(a) in response to her protest. The Eleventh Circuit vacated the Tax Court's judgment and remanded for a determination whether the IRS's error was harmless or instead rendered the assessment invalid (or required some lesser form of corrective action). In reaching its conclusion that the IRS was required to make a pre-assessment determination of liability in response to the taxpayer's protest, the court relied on several sources of authority. The court first concluded that § 6672(b)(3)—which provides that, "if there is a timely protest of the proposed assessment," the period of limitations on assessment shall not expire before "the date 30 days after the Secretary makes a final administrative determination with respect to such protest"—contemplates a pre-assessment determination of liability (and notice of such determination to the taxpayer) if a timely protest has been filed. The court therefore rejected the IRS's argument "that it may simply ignore, disregard, or discard a taxpayer's timely protest to a § 6772(b) pre-assessment notice if it so chooses." Assuming for the sake of argument that the language of the statute is ambiguous, the court reviewed the relevant regulations and concluded that Reg. §§ 301.7430-3(d) and 301.6320-1(e)(4) "require the IRS to make a pre-assessment determination (though not necessarily through the provision of a hearing) about a taxpayer's § 6672(a) liability when timely protest is made." These regulations, the court concluded, are entitled to *Chevron* deference and are binding on the government as well as the taxpayer. Finally, the court regarded Reg. § 601.106(a)(1)(iv) and relevant provisions of the Internal Revenue Manual as persuasive authority that supported its conclusion.

a. On remand, the Tax Court held that the Service's failure to make a pre-assessment determination of the taxpayer's liability under § 6672(a) for the trust fund recovery penalty in response to the taxpayer's protest rendered the assessment invalid and that the error was not harmless. Romano-Murphy v. Commissioner, 152 T.C. No. 16 (5/21/19). On remand, in a lengthy opinion by Judge Morrison, the Tax Court first concluded that the requirement that the IRS make a preassessment, final administrative determination about a taxpayer's § 6672(a) liability when the taxpayer submits a timely protest is a "requirement[] of applicable law or administrative procedure" within the meaning of § 6330(c)(1). Section 6330(c)(1) requires an IRS Appeals Officer conducting a collection due process hearing following the Service's issuance of a final notice of intent to levy to obtain verification "that the requirements of applicable law or administrative procedure have been met." (By virtue of § 6320(c), this same requirement applies to CDP hearings conducted following the IRS's issuance of a notice of federal tax lien.) In this case, the court observed, the Service had not made the required pre-assessment determination. Second, the court held that the IRS's failure to make the required pre-assessment, final administrative determination regarding the taxpayer's § 6672(a) liability in response to the taxpayer's protest rendered the assessment invalid. In reaching this conclusion, the court drew an analogy to its prior holdings that the Service's failure to issue a notice of deficiency when required by § 6213(a) renders a subsequent assessment invalid. See *Hoyle v. Commissioner*, 131 T.C. 197, 205 (2008), *supplemented by* 136 T.C. 463 (2011); *Freije v. Commissioner*, 125 T.C. 14, 36-37 (2005). Because the assessment was invalid, the court concluded, it was an abuse of discretion for the IRS Appeals Officer to uphold the proposed levy and filing of notice of lien to collect the trust fund recovery penalty from the taxpayer. Finally, the court concluded that the Service's failure to make the required pre-assessment determination of liability was not harmless error. Accordingly, the court declined to sustain the notice of determination issued by IRS Appeals.

2. ♫♪You can't hurry love.♪♫ Or is it a levy you can't hurry? When it comes to beginning the statute of limitations for a wrongful levy action, a levy is "fixed" when performance is complete and "determinable" if the amount that will be owed to the taxpayer can reasonbly be determined, says the Sixth Circuit. Gold Forever Music, Inc. v. United States, 920 F.3d 1096 (6th Cir. 5/10/19), *rev'g and remanding* 122 A.F.T.R.2d 2018-5126 (E.D. Mich. 7/11/18). Gold Forever Music, Inc. (Gold Forever), a music publishing company, entered into contracts pursuant to which it was entitled to half of the royalties collected for the sale and performance of works by various artists. Gold Forever contracted with Broadcast Music, Inc. (BMI) and Universal Music Publishing (Universal) who engaged directly in licensing the musicians' works to others. BMI and Universal collected royalties and remitted the royalties to Gold Forever. Edward Holland, Jr., a Motown artist, was the sole owner of Gold Forever. He was involved in authoring a number of famous songs such as "You Can't Hurry Love" by the Supremes and Phil Collins. In 2012, the IRS served two notices of levy, one each to BMI and Universal in relation to taxes owed by Holland. The notices of levy required the two companies to remit to the IRS amounts they were "already obligated to pay [Gold Forever]." Beginning on October 6, 2016, through the date of the complaint, BMI and Universal remitted amounts to the IRS. On December 6, 2017, Gold Forever filed a wrongful levy action for amounts remitted beginning on October 6, 2016. The government moved to dismiss Gold Forever's wrongful levy suit on the basis that it had been filed after the statute of limitations had run. The District Court agreed with the government and granted the motion to dismiss. Gold Forever appealed. Prior to amendment of the statute by the 2017 Tax Cuts and Jobs Act, § 6532(c)(1) provided that a wrongful levy action must be brought within nine months from the date of the levy. (As a result of the 2017 amendment, this period is now two years.) With respect to intangible property such as the property involved here, the date of the notice of levy in 2012 is treated as the "date of the levy" for purposes of starting the running of the limitations period for a wrongful levy action. See *State Bank of Fraser v. United States*, 861 F.2d 954, 967 (6th Cir. 1988). Nevertheless, a levy may be imposed only on obligations that exist at the time of the levy. § 6331(b). For example, if a bank account is the subject of a levy, the levy attaches only to the assets of the bank account at the time of the levy. See Reg. § 601.6331-1(a). If there is a later deposit to the bank account, the levy does not apply to or reach the later deposit. Importantly, an obligation, such as the obligation to pay royalties here, comes into existence "when the liability of the obligor is fixed and determinable" and this is true even though the right to receive payment thereof may be deferred until a later date." *Id*.; see also *Tull v. United States*, 69 F.3d 394 (9th Cir. 1995). Therefore, the question in this case was whether the 2012 notices of levy applied to royalties recieved *after* 2012. That question depended on whether the post 2016 royalties remitted to the IRS by BMI and Universal were fixed and determinable in 2012 when the notices of levy were initially issued. Based upon this premise, the court narrowed the issue to whether the obligation to pay future royalties to Gold Forever was sufficiently fixed and determinable such that the 2012 levy attached to the later royalty payments. In addressing this question, the court compared the holdings of the U.S. Court of Appeals for the Ninth Circuit in *Tull v. United States* and in *United States v. Hemmen*, 51 F.3d 883 (9th Cir. 1995). In *Tull*, the taxpayer engaged an auctioneer to auction the taxpayer's assets. Thereafter, the auctioneer received a notice of levy seeking the auction proceeds. The issue was whether the future auction proceeds were fixed and determinable at the time of the agreement between the taxpayer and the auctioneer. The Ninth Circuit found that "an obligation to attempt to sell some as yet undetermined amount of property for an as yet undetermined price to as yet undetermined buyers" was not fixed and determinable. In *Hemmen*, the court held that an administrative claim in a bankruptcy proceeding was fixed and determinable because the underlying performance giving rise to the claim was complete. The mere possibility that the claim might later be disallowed (or defeased) bears no relation as to whether the obligation was determinable. Following the reasoning in *Tull*, the court in this case ruled that "a contractual obligation to pay money…to the taxpayer after the date of the levy is 'fixed' where performance is complete and all that remains under the contract is payment…to the taxpayer, and 'determinable' if, at the time the levy is served, the amount that the taxpayer will be owed can be ascertained with reasonable accuracy, regardless of whether that amount is subject to potential defeasance." Applying this rule, the court concluded that that post 2016 royalties remitted to the IRS were not obligations owed to Gold Forever in 2012. The court reasoned that in 2012, Gold Forever's agreements with Universal and BMI should have been construed as merely an obligation to attempt to sell some undetermined amount of property for an undetermined price to yet-to-be-determined buyers. The earliest the statute of limitations could have begun running on Gold Forever's claim was when the IRS seized Gold Forever's funds held by BMI and Universal. Gold Forever's complaint alleged that it had filed requests for the return of those funds within the requisite nine-month period. Thus, the court held, the IRS notices of levy in 2012 (again treated as the date of the levy) did not apply to any royalties generated after the notices were served and the statute of limitations therefore did not bar Gold Forever's wrongful levy action.

3. Congress has excluded certain categories of tax debts from the clutches of private debt collectors. Section 6306 authorizes the IRS to enter into "qualified tax collection contracts" with private debt collectors to locate and contact taxpayers, make payment arrangements, and obtain financial information. Nevertheless, § 6306(d) provides that certain tax receivables are not eligible for collection under qualified tax collection contracts, including receivables subject to a pending or active installment agreement or offer-in-compromise, those classified as innocent spouse cases, and those involving a taxpayer identified as being deceased or under the age of 18. The Taxpayer First Act, Pub. L. No. 116-25, § 1205, amends § 6306(d)(3) to add two new categories of receivables that are excluded from qualified tax collection contracts. New § 6306(d)(3)(D) excludes tax receivables involving a taxpayer substantially all of whose income consists of Social Security disability insurance benefits or supplemental security income benefits, and new § 6306(d)(3)(E) excludes tax receivables involving a taxpayer whose adjusted gross income (for the most recent taxable year for which information is available) does not exceed 200 percent of the applicable poverty level. These amendments apply to tax receivables identified by the IRS after December 31, 2020.

4. Congress has codified the waiver of fees for low-income taxpayers submitting an offer-in-compromise. Generally, under § 7122(c)(1)(A), a taxpayer making a lump-sum offer-in-compromise must submit with the offer a payment of 20 percent of the amount offered. A taxpayer also must pay a user fee (currently $186) for processing the offer-in-compromise. Through administrative guidance, the up-front partial payment and the user fee are waived for low-income taxpayers. The Taxpayer First Act, Pub. L. No. 116-25, § 1102, amends § 7122(c) by adding new § 7122(c)(3), which codifies these waivers. Section 7122(c)(3) provids that the up-front partial payment and user fee do not apply to an offer-in-compromise submitted by a taxpayer whose adjusted gross income, for the most recent taxable year for which adjusted gross income is available, does not exceed 250 percent of the applicable poverty level. This change applies to offers-in-compromise submitted after July 1, 2019, the date of enactment.

G. Innocent Spouse

1. Congress has clarified the scope and standard of review in the Tax Court of determinations with respect to innocent spouse relief and has specified limitations periods for seeking equitable innocent spouse relief under § 6015(f). The Taxpayer First Act, Pub. L. No. 116-25, § 1203, amends Code § 6015(a) to clarify the scope and standard of review in the Tax Court of any determination with resepct to a claim for innocent spouse relief, i.e., any claim for relief under § 6015 from joint and several liablity for tax liability arising from a joint return. Pursuant to the amendment, the Tax Court's scope of review is based on the administrative record *and* "any additional newly discovered or previously unavailable evidence." The standard of review in the Tax Court is de novo. This amendment is consistent with the Tax Court's holding in *Porter v. Commissioner*, 132 T.C. 203 (2009), but resolves conflicting decsisions on this issue in cases in which the taxpayer sought equitable innocent spouse relief under § 6015(f), some of which had held that the Tax Court's review is limited to the administrative record and that the Tax Court's standard of review is for abuse of discretion. The legislation also amends § 6015(f) by adding new § 6015(f)(2), which specifies the time within which a taxpaayer can assert a claim for equitable innocent spouse relief under § 6015(f). With respect to any unpaid tax, a taxpayer can assert such a claim within the limitations period provided in § 6502 on collection of tax (generally within ten years after assessment). With respect to any tax that has been paid, the taxpayer can assert a claim for equitable innocent spouse relief within period within which the taxpayer could have submitted a timely claim for refund. Generally, this period is set forth in § 6511(a)-(b). All of these amendments apply to petitions or requests for innocent spouse relief filed or pending on or after July 1, 2019, the date of enactment.

H. Miscellaneous

1. The Tax Court trashes the IRS's understanding of what's a legislative regulation and what's an interpretive regulation and thus requires tax lawyers to learn all the APA stuff that other administrative law lawyers have to know. Altera Corp. v. Commissioner, 145 T.C. 91 (7/27/15). In a reviewed, unanimous opinion by Judge Marvel, the Tax Court invalidated regulations under § 482 (Reg. § 1.482-7(d)(2)) requiring participants in qualified cost-sharing arrangements to include stock-based compensation costs in the cost pool in order to comply with the arm's length standard. The court found that the regulations, which overturned the Tax Court's decision in *Xilinx Inc. v. Commissioner*, 125 T.C. 37 (2005), *aff'd*, 598 F.3d 1191 (9th Cir. 2010), holding that, under the 1995 cost-sharing regulations, controlled entities entering into qualified cost-sharing agreements need not share stock-based compensation costs because parties operating at arm's length would not do so, were not the product of reasoned decision making as required by Administrative Procedure Act § 706(2)(A) and *Motor Vehicle Manufacturers Association of the United States v. State Farm Mutual Automobile Insurance Co.*, 463 U.S. 29 (1983). According to Professor Kristin Hickman, "From top to bottom, the *Altera* opinion reads like a treatise on general administrative law requirements and norms." The Tax Court's opinion has a number of potential implications, which Professor Hickman has summarized as follows.[1]

> Since the Supreme Court decided the *Mayo Foundation* case in 2011 [*Mayo Foundation for Medical Research v. United States*, 562 U.S. 44 (2011)], the government has done everything it can to limit the scope of the Supreme Court's 2011 *Mayo Foundation* decision. Even though the *Mayo Foundation* Court declined "to carve out an approach to administrative review good for tax law only" and otherwise signaled fealty to general administrative law norms in the tax context, the IRS and the Department of Justice have repeatedly pursued a narrow construction of *Mayo Foundation*, and the Tax Court has often been happy to play along. Not today.
>
> First, notwithstanding the Supreme Court's conclusion in *Mayo Foundation* that general authority Treasury regulations issued under Section 7805(a) carry the force of law, in the Internal Revenue Manual and elsewhere, the IRS has continued to assert that most of its regulations are interpretative rules exempt from APA notice-and-comment procedural requirements. Applying the Ninth Circuit's version of the *American Mining Congress* [*Am. Mining Cong. v. Mine Safety & Health Admin*., 995 F.2d 1106, 1109 (D.C. Cir. 1993)] standard for distinguishing between legislative regulations that require notice-and-comment rulemaking and interpretative regulations that do not [*Hemp Indus. Ass'n v. DEA*, 333 F.3d 1082, 1087 (9th Cir. 2003) (Generally, interpretive rules merely explain preexisting substantive law. Substantive (or legislative) rules by contrast, "create rights, impose obligations, or effect a change in existing law".)], the Tax Court held that the Treasury regulation at issue in *Altera* was a legislative rule because the regulation was necessary to sustain an adjustment to the taxpayer's income and because Treasury expressly invoked general rulemaking authority under Section 7805(a) in promulgating the regulation. In reaching that decision, moreover, the Tax Court also concluded more broadly that regulations promulgated pursuant to Section 7805(a) "carry the force of law" and that "the Code imposes penalties for failing to follow them," such that "'Congress has delegated legislative power to' Treasury" through that grant of general rulemaking authority—i.e., making regulations promulgated under that authority legislative rules subject to

[1] Kristin Hickman, *The Tax Court Delivers An APA-Based Smackdown*, https://perma.cc/3HEE-XVZ5 (7/28/15). We are indebted to Professor Hickman for granting us permission to crib from her; she understands this stuff a lot better than we do.

notice-and-comment rulemaking requirements. Elsewhere in the opinion, the Tax Court acknowledged that its past practice of referring "to regulations issued pursuant to specific grants of rulemaking authority as legislative regulations and regulations issued pursuant to Treasury's general rulemaking authority, under sec. 7805(a), as interpretive regulations" was inconsistent with general administrative law use of the legislative and interpretive labels.

Second, notwithstanding the Supreme Court's refusal in *Mayo Foundation* to approach judicial review in general (rather than merely *Chevron* [*Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984)] review) differently in tax cases, the IRS in *Altera* resisted the taxpayer's argument that the regulation in question had to satisfy the reasoned decision making requirements of APA § 706(2)(A) and *State Farm*. The IRS claimed that *Chevron*, rather than *State Farm*, provided the appropriate evaluative standard. The precise relationship between *Chevron* and *State Farm* standards is unclear, with some courts and scholars contending that they overlap considerably, and others maintaining they are conceptually distinct. Regardless, courts and scholars generally would agree that agency regulations must satisfy both *Chevron*'s demand that they be substantively reasonable and *State Farm*'s requirement that they be the product of reasoned decisionmaking. Consistent with some appellate court decisions and a bit of dicta from the Supreme Court in *Judulang v. Holder*, 132 S. Ct. 476, 483 n.7 (2011), the Tax Court collapsed the two standards, reasoning that "the final rule must satisfy *State Farm*'s reasoned decisionmaking standard" because, even if *Chevron* provided the appropriate evaluative standard, *State Farm's* analysis is part of *Chevron* step two. *State Farm* analysis is very case by case, requiring both specific allegations as to where the agency's contemporaneous justification of its decisions is lacking and careful examination of the administrative record to support those allegations. Consequently, *State Farm* analysis is at least somewhat dependent upon interested parties raising issues and endeavoring to engage the agency in the rulemaking process itself. Commentators did so here. And examining the rulemaking record meticulously and at some length, the *Altera* court concluded that Treasury and the IRS simply failed to satisfy *State Farm's* reasoned decisionmaking requirements. In particular, the court noted that Treasury's assumptions in adopting the rule were unsupported by evidence regarding real-world practices; that commentators introduced "significant evidence" in the rulemaking process that contradicted Treasury's assumptions; and that Treasury failed to respond to much of that evidence.

Finally, the Tax Court rejected the government's claim that deficiencies in Treasury's reasoning represented harmless error for purposes of APA § 706. According to the court, it was not clear from the administrative record that Treasury would have adopted the same regulation had Treasury determined the inclusion of stock-based compensation costs in the cost pool to be inconsistent with the arm's length standard.

Altera represents a natural extension of the Supreme Court's reasoning in the *Mayo Foundation* case, reflecting the spirit of that decision's rejection of tax exceptionalism from general administrative law requirements, doctrines, and norms. Given the *Altera* court's reasoning, it is difficult to imagine the IRS being able to argue successfully ever again that any Treasury regulation—whether promulgated under specific or general authority—is exempt from APA notice-and-comment rulemaking requirements as an interpretative rule. The *Altera* court's analysis therefore removes a layer of uncertainty risk for attorneys seeking to challenge Treasury regulations on APA grounds. Separately, as Pat Smith has documented [Patrick J. Smith, *The APA's Arbitrary and Capricious Standard and IRS Regulations*, 136 Tax Notes 271 (July 16, 2012)], many IRS regulations lack the sort of extensive contemporaneous justification of IRS policy choices that *State Farm* requires, and thus are susceptible to taxpayer claims that they fail to satisfy *State Farm*'s reasoned decisionmaking standard. Taken comprehensively, the *Altera* litigation is an exemplar for attorneys seeking to challenge other Treasury regulations under APA § 706(2)(A) and *State Farm*.

Whether and to what extent the Tax Court will extend general administrative law doctrines beyond Treasury regulations to other IRS actions remains to be seen. For example, some Tax Court judges have been reluctant to extend *State Farm* analysis to deficiency notices and other IRS determinations respecting individual taxpayers, accepting IRS claims that *Mayo Foundation* applies only to Treasury and IRS rulemaking and not to IRS adjudications (even though *Judulang v. Holder* involved an agency adjudication).

Regardless, the fact that the Tax Court unanimously backed such a thorough and unequivocal application of general administrative law principles in reviewing a Treasury regulation is truly remarkable. The Tax Court's decision in *Altera* should send a very powerful message to Treasury and the IRS that they need to be more attentive to administrative law requirements in promulgating tax regulations.

a. The Tax Court got it wrong, says the Ninth Circuit. The regulations at issue are entitled to *Chevron* deference and were not arbitrary and capricious under the Administrative Procedure Act. Altera Corp. v. Commissioner, 926 F.3d 1061 (9th Cir. 6/7/19), *rev'g* 145 T.C. 91 (7/27/15). In an opinion by Judge Thomas, the U.S. Court of Appeals for the Ninth Circuit has reversed the Tax Court and held that Reg. § 1.482-7(d)(2) is valid. The regulation requires related business entities to share the cost of employee stock compensation in order for their cost-sharing arrangements to be classified as qualified cost-sharing arrangements. In essence, the taxpayer's primary challenge to the regulation was that taking stock-based compensation into account in the manner required is inconsistent with the arm's length standard under § 482 without evidence that parties acting at arm's length take stock-based compensation into account in similar circumstances. The court first 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, § 482, is ambiguous, and in step two that Reg. § § 1.482-7(d)(2) 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 legislative history. (The U.S. Supreme Court's decision in *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120 (2000), suggests that courts should consider legislative history in connection with *Chevron* step one rather than step two, but there is some uncertainty on this point.) The court then examined whether the procedures Treasury used in issuing the regulation complied with the Administative Procedure Act. The court rejected the taxpayer's argument that the regulation was arbitrary and capricious under *Motor Vehicle Manufacturers Ass'n of the United States, Inc. v. State Farm Mutual Automobile Insurance Co*., 463 U.S. 29 (1983). The standard in *State Farm* requires the agency issuing the regulation to "examine the relevant data and articulate a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.'" *Id*. (quoting *Burlington Truck Lines v. United States*, 371 U.S. 156 (1962)). The regulation in question satisfied this standard:

> Thus, the 2003 regulations are not arbitrary and capricious under the standard of review imposed by the APA. Treasury's regulatory path may be reasonably discerned. Treasury understood § 482 to authorize it to employ a purely internal, commensurate with income approach in dealing with related companies. It provided adequate notice of its intent and adequately considered the objections. Its conclusion that stock based compensation should be treated as a cost was adequately supported in the record, and its position did not represent a policy change under [*FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 513 (2009)].

2. IRS expands voluntary IP PIN program to a total of nine states and the District of Columbia. An Identity Protection Personal Identification Number (IP PIN) is a six-digit number assigned to eligible individuals that must be used on a tax return, in addition to the individual's Social Security number (SSN), to verify the individual's identity. The IP PIN helps prevent a taxpayer's SSN from being used on a fraudulent federal income tax return. The IRS assigns an IP PIN to taxpayers who are victims of identity theft or those who are suspected of being victims of identity theft. For the 2016 filing season, the IRS implemented a pilot program under which taxpayers who filed returns during the prior year from the District of Columbia, Florida and Georgia are eligible to obtain an IP PIN on a voluntary basis even though they have not experienced identity theft. FL-2016-03 (1/26/16). For the 2019 filing season, the IRS expanded this program to include California, Delaware, Illinois, Maryland, Michigan, Nevada, and Rhode Island. The IRS selected these nine states and the District of Columbia because they have higher levels of identity theft. Taxpayers who filed returns from these jurisdictions in the prior year can obtain an IP PIN by using the IRS's online Get An IP PIN tool. To obtain an IP PIN, taxpayers will need to complete successfully the IRS's identity verification secure access process. If its systems can handle the expansion, the IRS plans eventually to offer the voluntary IP PIN program to taxpayers in all states, a move that is supported by the AICPA.

a. Congress has required annual expansion of the voluntary IP PIN program each year and full implementation within five years. Section 2005 of the Taxpayer First Act, Pub. L. No. 116-25, directs the Secretary of the Treasury or the Secretary's delegate to establish a program to issue an IP PIN to any individual residing in the United States who requests one to assist the Secretary in verifying the individual's identity. For each calendar year beginning after July 1, 2019 (the date of enactment), the legislation requires the Secretary to provide IP PINs to individuals residing in such states as the Secretary deems appropriate, provided that the total number of states served by the program increases each year. The legislation also requires that the program be available to all individuals within the United States not later than five years after the date of enactment.

XI. WITHHOLDING AND EXCISE TAXES

XII. TAX LEGISLATION

A. Enacted

1. Congress has enacted the Taxpayer First Act. The Taxpayer First Act, Pub. L. No. 116-25, was signed by the President on July 1, 2019. This legislation codifies and renames the IRS appeals function as the IRS Independent Office of Appeals, requires the IRS to develop a comprehensive customer service strategy, requires the Treasury Department to develop a comprehensive written plan to reorganize the IRS, and makes several significant changes to procedural tax rules.

2. The Further Consolidated Appropriations Act produces a hodgepodge of tax provisions. The Further Consolidated Appropriations Act, 2020, Pub. L. No. 116-94, was signed by the President on December 20, 2019. This legislation repealed the taxes commonly known as the medical device tax and the Cadillac tax, modified the rules for contributions to and distributions from certain retirement plans, temporarily extended several expired or expiring provisions, and provided tax relief to those in areas affected by certain natural disasters.

RECENT DEVELOPMENTS IN FEDERAL INCOME TAXATION

"Recent developments are just like ancient history, except they happened less long ago."

By

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On March 27, 2020, Congress passed and the President signed into law the Coronavirus Aid, Relief, and Economic Security Act, Pub. L. No. 116-136 ("CARES Act"). This $2 trillion economic-stimulus legislation enacted in response to the Coronavirus (COVID-19) pandemic provides, among other things, targeted tax relief for individuals and businesses including (i) a one-time rebate to taxpayers; (ii) modification of the tax treatment of certain retirement fund withdrawals and charitable contributions; (iii) a delay of employer payroll taxes and taxes paid by certain corporations; and (iv) other changes to the tax treatment of business income, interest deductions, and net operating losses. Another important aspect of the CARES Act is that it reverses or temporarily suspends certain of the more significant changes to the Code enacted by the 2017 Tax Cuts and Jobs Act.

I. ACCOUNTING

II. BUSINESS INCOME AND DEDUCTIONS

A. Income

B. Deductible Expenses versus Capitalization

C. Reasonable Compensation

D. Miscellaneous Deductions

1. For now, some relief from the § 163(j) limitation on deducting business interest because Congress CARES! The CARES Act, § 2306, redesignates Code § 163(j)(10) as subsection (11) and inserts a new Code § 163(j)(10) to increase the limit on deductions for business interest expense for 2019 and 2020. New Code § 163(j)(10) increases the § 163(j) limit for 2019 and 2020 in two ways. *First*, recall that Code § 163(j), as modified by 2017 Tax Cuts and Jobs Act, generally (but subject to significant exceptions) limits the deduction for business interest expense to the sum of: (1) business interest income, (2) 30 percent of "adjusted taxable income," and (3) floor plan financing interest. The term "adjusted taxable income" is defined essentially as earnings before interest, tax, depreciation and amortization (EBITDA) for 2018 through 2021, and then as earnings before interest and taxes (EBIT) for subsequent years. New Code § 163(j)(10), however, increases to 50 percent (instead of 30 percent) the "adjusted taxable income" component of the § 163(j) limitation for taxable years beginning in 2019 and 2020. Taxpayers are permitted to elect out of the increased percentage pursuant to procedures to be prescribed by the IRS. Second, new Code § 163(j)(10) permits eligible taxpayers to elect to substitute their 2019 "adjusted taxable income" for 2020 "adjusted taxable income" when determining the § 163(j) limitation for taxable years beginning in 2020. Special rules in new Code § 163(j)(10) apply to (i) the application of the business interest expense limitation to partnerships and partners for their 2019 and 2020 tax years and (ii) application of the limitation to short taxable years.

E. Depreciation & Amortization

F. Credits

G. Natural Resources Deductions & Credits

H. Loss Transactions, Bad Debts, and NOLs

1. Those NOLs are not worth what they used to be (at least until 2026). The 2017 Tax Cuts and Jobs Act, § 11012, amended § 461 by adding § 461(*l*), which disallows "excess business losses" for noncorporate taxpayers for taxable years beginning in 2018. Such "excess business losses" are determined after application of the passive loss rules of § 469. Essentially, as the authors read the statute, losses disallowed for a taxable year under § 461(*l)* are carried over to the next taxable year and become NOL carryforwards subject to revised § 172(a) (discussed below). Thus, the practical effect of § 461(*l*) appears to be a one-year deferral of "excess business losses." An "excess business loss" is defined as the amount by which a noncorporate taxpayer's aggregate trade or business deductions exceed aggregate gross income from those trades or businesses, plus $250,000 ($500,000 for joint filers). The term "aggregate trade or business deductions" apparently does not include § 172 carryforwards, so NOLs carried forward from 2017 and prior taxable years are not limited by new § 461(*l*). Such carryforwards are, however, limited by the changes made to § 172(a) (as discussed below). For partnerships and S corporations, new § 461(*l*) applies at the partner or shareholder level, and for farmers, the prior limitation on "excess farm losses" under § 461(j) is suspended so that only § 461(*l*) applies to limit such losses. After 2018, the cap on "excess business losses" is adjusted annually for inflation. Mercifully, new § 461(*l*) sunsets for taxable years beginning on or after January 1, 2026.

a. Surely you jest . . . there's even more bad news for NOLs? The 2017 Tax Cuts and Jobs Act, § 13302(a), amended § 172(b)(1) such that, for taxable years beginning in 2018, NOLs (except "farming losses" and NOLs of non-life insurance companies) no longer may be carried back two years, and any carried forward NOLs are capped at 80 percent of taxable income (computed without regard to NOLs). This change to § 172(a) is permanent.

b. The good news: NOLs now are like BFFs; they stick with you until you die! The 2017 Tax Cuts and Jobs Act, § 13302(b), amended § 172(b)(1)(A)(ii) so that NOLs may be carried forward indefinitely (except by non-life insurance companies) rather than being limited to 20 years as under pre-TCJA law. This change to § 172(b) is permanent.

c. Wait for it . . . wait for it . . . IR-2018-254 (12/18/18). Treasury and the IRS have yet to release any official administrative guidance concerning the above changes to the rules for NOLs. The only new information we have regarding the above-described changes is the foregoing news release.

d. And . . . as the late, great "Emily Litella" (a/k/a Gilda Radner on SNL) once said . . . NEVERMIND! The CARES Act has allowed carrybacks of NOLs and suspended the limitation on excess business losses The CARES Act modifies several of the rules for NOLs that were introduced into the Code by the 2017 Tax Cuts and Jobs Act. Section 2303(b) of the CARES Act amends Code § 172(b)(1) by adding a new subparagraph (D) to allow NOL carrybacks previously barred by the 2017 Tax Cuts and Jobs Act. Under new § 172(b)(1)(D), NOLs arising in taxable years beginning after December 31, 2017, but before January 1, 2021 (generally, 2018, 2019, and 2020), may be carried back to each of the five preceding taxable years. Special rules and limitations apply to REITs, life insurance companies, and taxpayers subject to § 965 (controlled foreign corporations). Further, the CARES Act, § 2303(a), amends Code § 172(a) such that, for taxable years beginning before January 1, 2021 (generally, 2019 and 2020), the 80 percent taxable income limitation on NOL carryforwards enacted by the 2017 Tax Cuts and Jobs Act does not apply. Last but not least, the CARES Act, § 2304, amends Code § 461(*l*) to repeal temporarily the rule, added by the 2017 Tax Cuts and Jobs Act, that disallows and carries forward "excess business losses" of noncorporate taxpayers attributable to taxable years beginning in 2018 and subsequent years. The temporary repeal applies to taxable years beginning before January 1, 2021. Thus, noncorporate taxpayers (including partners and subchapter S shareholders) whose 2018 and 2019 "excess business losses" were limited and carried forward by the prior version of § 461(*l*) will need to file amended returns to claim "excess business losses" that were disallowed and carried forward from those years.

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. Costs for over-the-counter medicine and other products may now be reimbursed by FSAs and HSAs! Under Code § 223(d), organizations may create a U.S. trust as a "health savings account" (HSA) for the exclusive purpose of paying qualified medical expenses on behalf of the beneficiary. Qualified medical expenses are generally defined as amounts which are expended by the beneficiary for medical care of the beneficiary, his or her spouse, and any dependent as defined under § 52. Prior to the CARES Act, the last sentence of § 223(d)(2)(A) provided that qualified medical expenses included amounts paid for prescription medicines or drugs. Under the old rule, qualified medical expenses did not include so-called over-the-counter medicine or drugs which were not prescribed. As such, historically, there was no qualified reimbursement by the HSA for expenses associated with costs incurred for medicine or drugs that were not prescribed. The CARES Act, § 3702(a), amends the previous rules that apply to HSAs by removing the last sentence of § 223(d)(2)(A), which has the effect of including over-the-counter medicines and drugs that are not prescribed. The Act also replaces the original last sentence of § 223(d)(2)(A) by inserting, "[f]or purposes of this subparagraph, amounts paid for menstrual care products [as defined in new § 223(d)(2)(D)] shall be treated as paid for medical care." In general, the above changes allow all such expenses to be treated as qualified reimbursements by an HSA. The same rules also apply to reimbursements from flexible spending accounts, or FSAs. These changes apply to distributions from HSAs and reimbursements from FSAs after 2019.

B. <u>Qualified Deferred Compensation Plans</u>

1. Congress has made access to retirement plan funds easier for those affected by COVID-19. The CARES Act, § 2202, provides special rules that apply to distributions from qualified employer plans and IRAs and to loans from qualified employer plans for those affected by the Coronavirus.

Coronavirus-related distributions. Section 2202(a) of the legislation provides four special rules for "coronavirus-related distributions." **First**, the legislation provides that coronavirus-related distributions up to an aggregate amount of $100,000 for each year are not subject to the normal 10-percent additional tax of § 72(t) that applies to distributions to a taxpayer who has not reached age 59-1/2. **Second**, the legislation provides that, unless the taxpayer elects otherwise, any income resulting from a coronavirus-related distribution is reported ratably over the three-year period beginning with the year of the distribution. **Third**, the legislation permits the recipient of a coronavirus-related distribution to contribute up to the amount of the distribution to a qualified employer plan or IRA that would be eligible to receive a rollover contribution of the distribution. The contribution need not be made to the same plan from which the distribution was received, and must be made during the three-year period beginning on the day after the date on which the distribution was received. If contributed within the required three-year period, the distribution and contribution are treated as made in a direct trustee-to-trustee transfer within 60 days of the distribution. The apparent intent of this rule is to permit the taxpayer to exclude the distribution from gross income to the extent it is recontributed within the required period. Because the recontribution might take place in a later tax year than the distribution, presumably a taxpayer would include the distribution in gross income in the year received and then file an amended return for the distribution year upon making the recontribution. **Fourth**, coronavirus-related distributions are not treated as eligible rollover distributions for purposes of the withholding rules, and therefore are not subject to the normal 20 percent withholding that applies to eligible rollover distributions under § 3405(c). A coronavirus-related distribution is defined as any distribution from an eligible retirement plan as defined in § 402(c)(8)(B) (which includes qualified employer plans and IRAs) that was made: (1) on or after January 1, 2020, and before December 31, 2020, (2) to an individual who is diagnosed (or whose spouse or dependent is diagnosed) with the virus under an approved test or "who experiences adverse financial consequences as a result of being quarantined, being furloughed or laid off or having work hours reduced due to such virus or disease, being unable to work due to lack of child care due to such virus or disease, closing or reducing hours of a business owned or operated by the individual due to such virus or disease, or other factors as determined by the Secretary of the Treasury (or the Secretary's delegate). "

Loans. For qualified individuals, section 2202(b) of the legislation increases the limit on loans from qualified employer plans and permits repayment over a longer period of time. Normally, under § 72(p), a loan from a qualified employer plan is treated as a distribution unless it meets certain requirements. One requirement is that the loan must not exceed the lesser of (1) $50,000 or (2) the greater of one-half of the present value of the employee's nonforfeitable accrued benefit or $10,000. A second requirement is that the loan must be repaid within five years. In the case of a loan made to a "qualified individual" during the period from March 27, 2020 (the date of enactment) through December 31, 2020), the legislation increases the limit on loans to the lesser of (1) $100,000 or (2) the greater of *all* of the present value of the employee's nonforfeitable accrued benefit or $10,000. The legislation also provides that, if a qualified individual has an outstanding plan loan on the first day of the incident period of a qualified disaster with a due date for any repayment occurring during the period beginning on the first day of the incident period and ending on the date which is 180 days after the last day of the incident period, then the due date is delayed for one year. If an individual takes advantage of this delay, then any subsequent repayments are adjusted to reflect the delay in payment and interest accruing during the delay. This appears to require reamortization of the loan. A *qualified individual* is defined as an individual who would be eligible for the distribution rules described above.

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

D. Individual Retirement Accounts

V. PERSONAL INCOME AND DEDUCTIONS

A. Rates

B. Miscellaneous Income

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

D. Deductions and Credits for Personal Expenses

1. Maybe Congress really does CARE. Recovery rebates or "credits" for individuals. The CARES Act, § 2201, adds new Code § 6428, which provides for what the Treasury Department publicly refers to as "economic impact payments" and what the Code describes as an advance refund of a credit for which individuals may be eligible for 2020. Nonresident aliens, dependent children, and estates and trusts are not eligible for the credit. Treasury and the IRS announced on Monday, March 30, 2020, that many U.S. taxpayers will receive a distribution of funds pursuant to this statutory provision within the following three weeks. Distribution of the funds is to be automatic and, for most taxpayers who have previously filed a 2018 or 2019 tax return, there are no steps that need to be taken to receive a payment. The amount of the advance payment to which an individual is entitled is to be determined based on the individual's 2019 federal income tax return or, if the 2019 return has not filed, the individual's 2018 return. If an individual has filed neither a 2018 nor 2019 return, then the amount of the advance payment may be determined based on social security information (Form SSA-1099 or RRB-1099). In general, the advanced refunds are to be received in the form of a direct deposit into taxpayers' bank accounts. According to § 6428(f), such payments are, in effect, advance refunds of the amount to be allowed as a "recovery rebate" or tax credit on each recipient's 2020 federal income tax return. Generally, a taxpayer who is an eligible taxpayer will be treated as having made tax payments equal to the credit to which the taxpayer is entitled. Section 2201(d) of the CARES Act provides that advance payments of the credit are not subject to the reduction or offset set forth in specified provisions. The effect of this rule is to preclude the IRS from applying the advance payment of the credit to which a taxpayer is entitled to outstanding tax liabilities from other years.

Amount of the credit. According to Code § 6428(a), a taxpayer who filed an income tax return in 2018 or 2019 will receive an advance refund of the projected rebate or credit equal to $1,200 ($2,400 in the case of eligible individuals filing a joint return) plus an additional $500 for each qualifying child of the taxpayer if the taxpayer's adjusted gross income (AGI) is below a certain threshold amount. A qualifying child is a child with respect to whom the taxpayer would be entitled to the child tax credit provided by § 24. Pursuant to § 24(c), this means that the child must be a qualifying child of the taxpayer (as defined in § 152(c)) who has not attained age 17. The amount of the credit is phased out based on the taxpayer's AGI. Under § 6428(c), the amount of the projected credit (and therefore the advance refund amount sent to taxpayers) is reduced by 5 percent of the excess of the taxpayer's AGI over: $150,000 (in the case of a joint return), $112,500 (in the case of a head of household), and $75,000 in all other cases. The credit is completely phased out for taxpayers with no children who have AGI of: $198,000 (joint filers), $146,500 (head of household), and $99,000 (all others including single filers). According to § 6428(e)(2), with respect to joint returns, 50 percent of the credit is deemed to have been allowed to each spouse filing the return.

Adjusting the credit on the 2020 return. According to § 6428(a), a taxpayer who is eligible for the credit will be treated as having made an income tax payment for the 2020 taxable year in an amount equal to the amount of the credit to which he or she is entitled. An advance refund of the credit received by the taxpayer in 2020 reduces the credit to which he or she is entitled on the 2020 return. Thus, if a taxpayer's 2019 return is filed early enough in 2020 such that the IRS based the advance refund amount on the taxpayer's 2019 reported AGI, then the payment will be refunded (i.e., "advanced") for the first taxable year beginning in 2020 (et voilà, an advance refund electronic deposit is received by the taxpayer when most needed). However, because the advance refund amount is based upon the taxpayer's 2019 AGI, the amount of the credit may be adjusted up based upon the taxpayer's AGI as reported on his or her 2020 federal income tax return. Thus, for example, a taxpayer might receive an advance refund amount during 2020, based on his or her AGI as reported on a filed 2019 return, but the payment might have been partially phased out due to receiving a full year of wage income in 2019. Continuing with this example, the same taxpayer's AGI as reported on his or her 2020 return might be much lower due to loss of pay as a result of not being able to work during the pandemic. Such a taxpayer may then be entitled to a full (as opposed to a partial) credit based on his or her lower 2020 AGI. In such a case, when the taxpayer prepares his or her 2020 tax return, the full amount of the credit would only be partially offset by the lower advance refund payment (based on 2019 AGI). This, in turn, would allow for an additional refund of the difference. If a taxpayer receives an advance refund payment in 2020 which is more than the credit calculated on the taxpayer's 2020 tax return, there is no requirement for the taxpayer to pay back the excess advance refund.

Requirement of a Social Security Number. Section 6428(g) provides that no credit is allowed to taxpayers who do not include a "valid identification number" on the tax return for the taxpayer, the taxpayer's spouse, and qualifying children. The term "valid identification number is defined, by reference to § 24(h)(7), as a social security number issued before the due date of the return or an adoption taxpayer identification number in the case of a qualifying child who is adopted or placed for adoption. Thus, with respect to joint filers, both spouses must include their social security numbers on the return. However, a special rule applies to members of the armed forces under which only one spouse must include a valid social security number on the joint return.

E. Divorce Tax Issues

F. Education

1. Want to get rid of that student loan? Get the boss to pay it tax-free! Generally, Code § 127(a) excludes from the gross income of an employee up to $5,250 of employer-provided "educational assistance" as defined in § 127(c). The CARES Act, § 2206, amends Code § 127(c)(1) by redesignating subparagraph (B) as subparagraph (C) and adding a new subparagraph (B) that temporarily expands the definition of "educational assistance." New Code § 127(c)(1)(B) provides that, in the case of payments made before January 1, 2021, the term "educational assistance" within the meaning of § 127(c)(1) includes repayments of "qualified education loans" by an employer whether paid to the employee or to the lender. New Code § 127(c)(1)(B) is effective for payments made after March 27, 2020 (the date of enactment of the CARES Act).

G. Alternative Minimum Tax

VI. CORPORATIONS

A. Entity and Formation

B. Distributions and Redemptions

C. Liquidations

D. S Corporations

E. Mergers, Acquisitions and Reorganizations

F. **Corporate Divisions**

G. **Affiliated Corporations and Consolidated Returns**

H. **Miscellaneous Corporate Issues**

VII. PARTNERSHIPS

A. **Formation and Taxable Years**

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

C. **Distributions and Transactions Between the Partnership and Partners**

D. **Sales of Partnership Interests, Liquidations and Mergers**

E. **Inside Basis Adjustments**

F. **Partnership Audit Rules**

G. **Miscellaneous**

VIII. TAX SHELTERS

IX. EXEMPT ORGANIZATIONS AND CHARITABLE GIVING

A. **Exempt Organizations**

B. **Charitable Giving**

1. Provisions of the CARES Act that affect charitable contributions.

a. "CARE" for a charitable panacea (at least in part) for a pandemic? A limited above-the-line deduction for contributions to public charities. It took a pandemic, but Congress has reversed itself, at least partially, with respect to non-itemizers and charitable contributions. To wit, the CARES Act, § 2204, added new Code § 62(a)(22) which, for taxable years beginning in 2020, allows individual taxpayers who claim the standard deduction (i.e., non-itemizers) to deduct up to $300 in above-the-line "qualified charitable contributions." The legislation also adds new Code § 62(f), which defines "qualified charitable contributions" as donations of cash to organizations described in Code § 170(b)(1)(A)—primarily, so-called "public charities" such as churches, schools, hospitals, and publicly-supported nonprofits, but not non-operating private foundations, donor-advised funds, and Type III supporting organizations. New Code §§ 62(a)(22) and 62(f) are permanent and effective for taxable years beginning after 2019.

- This change for non-itemizers partially reverses a significant effect of the 2017 Tax Cuts and Jobs Act. Specifically, the 2017 Tax Cuts and Jobs Act substantially increased the standard deduction such that many taxpayers no longer needed to itemize deductions starting in 2018. In 2020, for instance, the standard deduction is $24,800 for joint returns and surviving spouses, $12,400 for unmarried individuals and married individuals filing separately, and $18,650 for heads of households. *See* Rev. Proc. 2019-44, 2019-47 I.R.B. 1093 (11/6/19). Many charities predicted that the increased standard deduction would lead to decreased charitable giving, and a study by Giving USA found this to be true for 2018. *See* Eisenberg, *Charitable Giving Took a Hit Due to Tax Reform*, Forbes (6/18/19) (*available online here*).

b. Also new for 2020: You can elect to "CARE" less about charitable contribution limits on 2020 donations of cash to public charities. The CARES Act, § 2205, an uncodified provision, temporarily suspends for 2020 the charitable contribution limits of Code § 170(b) for electing individual and corporate taxpayers. The legislation provides that "qualified contributions" by an individual are not subject to the normal limits, and instead are allowed, if the individual so elects, up to the amount by which the taxpayer's contribution base (generally, adjusted gross income) exceeds the other charitable contributions the taxpayer makes, i.e., those subject to the normal limits. In effect, this permits individual taxpayers to elect to deduct qualified contributions up to 100 percent of the taxpayer's contribution base (AGI) after taking into account other charitable contributions. A corporation may elect to deduct qualified contributions up to the amount by which 25 percent of its taxable income exceeds the corporation's other charitable contributions, i.e., the corporation can deduct qualified contributions up to 25 percent of taxable income after taking into account other charitable contributions. Qualified contributions by an individual or a corporation that exceed the relevant limit can be carried forward five years. A *qualified contribution* is defined as a contribution paid in cash during 2020 to an organization described in § 170(b)(1)(A) with respect to which the taxpayer elects to have the increased limits apply. As noted above, Code § 170(b)(1)(A) organizations primarily consist of so-called "public charities" such as churches, schools, hospitals, and publicly-supported nonprofits, but not non-operating private foundations, donor-advised funds, and Type III supporting organizations. Section 2205 of the CARES Act does not specify precisely how individuals and corporations elect into the temporary charitable contribution limits for donations of cash made in 2020. The legislation also temporarily increases from 15 percent to 25 percent the § 170(e)(3)(C) limit on contributions of food inventory made in 2020.

- *The individual limit already had been increased slightly.* Prior to the CARES Act, Congress, in the 2017 Tax Cuts and Jobs Act, had increased the limit on deducting charitable contributions for individual donations from its historical norm without requiring an election into the new rules. Under Code §§ 170(b)(1)(G) and (H), as amended by § 11023 of the 2017 Tax Cuts and Jobs Act, individuals can take a charitable contribution deduction of up to 60 percent of their contribution base for cash donations made to Code § 170(b)(1)(A) organizations in taxable years beginning after 2017 but before 2026. Beginning in 2026 and thereafter, the charitable contribution limit for individuals reverts to its historical norm of 50 percent of an individual's contribution base.

- *This is not a revolutionary idea.* Increasing charitable contribution deduction limits on an elective basis during times of crisis is not a new idea. For instance, Section 504(a) of the 2017 Disaster Relief Act increased the charitable contribution limits for donations that benefitted those affected by Hurricanes Harvey, Irma, or Maria for eligible and electing taxpayers. Similarly, the Bipartisan Budget Act of 2018, § 20104(a) of Division B, increased the limit on deductions for charitable contributions towards relief efforts in areas affected by the California wildfires for eligible and electing taxpayers. Most recently, a provision of the Taxpayer Certainty and Disaster Tax Relief Act of 2019, Division Q, Title II, § 204(a) of the 2020 Further Consolidated Appropriations Act, provided special rules for charitable contributions for relief efforts in qualified disaster areas.

X. TAX PROCEDURE

A. <u>Interest, Penalties, and Prosecutions</u>

B. <u>Discovery: Summonses and FOIA</u>

C. <u>Litigation Costs</u>

D. <u>Statutory Notice of Deficiency</u>

E. <u>Statute of Limitations</u>

F. <u>Liens and Collections</u>

G. <u>Innocent Spouse</u>

H. <u>Miscellaneous</u>

XI. WITHHOLDING AND EXCISE TAXES

A. <u>Employment Taxes</u>

1. Whether it's a good idea or not, no penalty will be imposed for failing to deposit the employer's share of employment taxes. In general, employers must withhold taxes due under the Federal Insurance Contributions Act (FICA). FICA taxes are a combination of Social Security taxes and Medicare taxes which are deducted or withheld by an employer from an employee's pay. Such withheld funds are remitted by the employer to the IRS on behalf of the employee. Correspondingly, an employer is responsible for paying its share of FICA taxes to the IRS including

Social Security taxes and Medicare taxes. These employer payments generally are due to be remitted to the IRS on a semi-weekly or monthly basis by electronic funds transfer. The CARES Act, § 2302, provides that remittance of the employer's share of both the social security portion of FICA tax and of the social security portion of Railroad Retirement Act (RRTA) tax incurred in 2020 may be deferred. Thus, FICA payments previously due between March 27, 2020, and before January 1, 2021, may now be paid in two equal installments. The first half of the payment may be deferred until December 31, 2021, and payment of the second half of the liability may be deferred until December 31, 2022. It is important to note that this deferral is not available to employers that have had debt forgiven with respect to the loans made available through the Small Business Administration pursuant to the CARES Act.

B. <u>Self-employment Taxes</u>

C. <u>Excise Taxes</u>

XII. TAX LEGISLATION

A. <u>Enacted</u>

RECENT DEVELOPMENTS IN FEDERAL INCOME TAXATION

"Recent developments are just like ancient history, except they happened less long ago."

By

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On March 27, 2020, Congress passed and the President signed into law the Coronavirus Aid, Relief, and Economic Security Act, Pub. L. No. 116-136 ("CARES Act"). This $2 trillion economic-stimulus legislation enacted in response to the Coronavirus (COVID-19) pandemic provides, among other things, targeted tax relief for individuals and businesses including (i) a one-time rebate to taxpayers; (ii) modification of the tax treatment of certain retirement fund withdrawals and charitable contributions; (iii) a delay of employer payroll taxes and taxes paid by certain corporations; and (iv) other changes to the tax treatment of business income, interest deductions, and net operating losses. Another important aspect of the CARES Act is that it reverses or temporarily suspends certain of the more significant changes to the Code enacted by the 2017 Tax Cuts and Jobs Act.

I. ACCOUNTING

II. BUSINESS INCOME AND DEDUCTIONS

A. Income

B. Deductible Expenses versus Capitalization

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).

E. Depreciation & Amortization

1. Goodbye, basis; hello 100 percent § 168(k) bonus first-year depreciation! The 2017 Tax Cuts and Jobs Act, § 13201, amended Code § 168(k)(1) and 168(k)(6) to permit taxpayers to deduct 100 percent of the cost of qualified property for the year in which the property is placed in service. This change applies to property *acquired and placed in service* after September 27, 2017, and before 2023. The percentage of the property's adjusted basis that can be deducted is reduced from 100 percent to 80 percent in 2023, 60 percent in 2024, 40 percent in 2025, and 20 percent in 2026. (These periods are extended by one year for certain aircraft and certain property with longer production periods). Property *acquired on or before September 27, 2017* and placed in service after that date is eligible for bonus depreciation of 50 percent if placed in service before 2018, 40 percent if placed in service in 2018, 30 percent if placed in service in 2019, and is ineligible for bonus depreciation if placed in service after 2019.

Used property eligible for bonus depreciation. The legislation also amended Code § 168(k)(2)(A) and (E) to make used property eligible for bonus depreciation under § 168(k). Prior to this change, property was eligible for bonus depreciation only if the original use of the property commenced with the taxpayer. This rule applies to property *acquired and placed in service* after September 27, 2017. Note, however, that used property is eligible for bonus depreciation only if it is acquired "by purchase" as defined in § 179(d)(2). This means that used property is *not* eligible for bonus depreciation if the property (1) is acquired from certain related parties (within the meaning of §§ 267 or 707(b)), (2) is acquired by one component member of a controlled group from another component member of the same controlled group, (3) is property the basis of which is determined by reference to the basis of the same property in the hands of the person from whom it was acquired (such as a gift), or (4) is determined under § 1014 (relating to property acquired from a decedent). In addition, property acquired in a like-kind exchange is not eligible for bonus depreciation.

Qualified property. The definition of "qualified property" eligible for bonus depreciation continues to include certain trees, vines, and plants that bear fruits or nuts (deductible at a 100 percent level for items planted or grafted after September 27, 2017, and before 2023, and at reduced percentages for items planted or grafted after 2022 and before 2027). The definition also includes a qualified film or television production. Excluded from the definition is any property used in a trade or business that has had floor plan financing indebtedness (unless the business is exempted from the § 163(j) interest limitation because its average annual gross receipts over a three-year period do not exceed $25 million).

Section 280F $8,000 increase in first-year depreciation. For passenger automobiles that qualify, § 168(k)(2)(F) increases by $8,000 in the first year the § 280F limitation on the amount of depreciation deductions allowed. The legislation continues this $8,000 increase for passenger automobiles *acquired and placed in service* after 2017 and before 2023. For passenger automobiles acquired *on or before* September 27, 2017, and placed in service after that date, the previously scheduled phase-down of the $8,000 increase applies as follows: $6,400 if placed in service in 2018, $4,800 if placed in service in 2019, and $0 after 2019.

Three categories consolidated into one. The legislation replaced the categories of "qualified leasehold improvement property," "qualified restaurant property," and "qualified retail improvement property" with a single category, "qualified improvement property." Code § 168(e)(6) defines qualified improvement property (subject to certain exceptions) as "any improvement to an interior portion of a building which is nonresidential real property if such improvement is placed in service after the date such building was first placed in service." Qualified improvement property is depreciable over 15 years using the straight-line method and is subject to the half-year convention. This change applies to property placed in service after 2017. **Note:** the Conference Agreement indicates that the normal recovery period for qualified improvement property is 15 years, but § 168 as amended does not reflect this change. This should be addressed in technical corrections.

a. The IRS has issued final regulations that provide guidance on § 168(k) first-year depreciation. T.D. 9874, Additional First Year Depreciation Deduction, 84 F.R. 50108 (9/24/19). The Treasury Department and the IRS have finalized, with some changes, proposed regulations issued under § 168(k) in 2018. See REG-104397-18, Additional First Year Depreciation

Deduction, 83 F.R. 39292 (8/8/18). These regulations provide guidance regarding the additional first-year depreciation deduction (so-called "bonus depreciation") under § 168(k) as amended by the 2017 Tax Cuts and Jobs Act. They affect taxpayers who deduct depreciation for qualified property acquired and placed in service after September 27, 2017. Generally, the regulations provide detailed guidance on the requirements that must be met, including specific requirements that apply to used property, for depreciable property to qualify for the additional first-year depreciation deduction provided by § 168(k). The preamble to the final regulations notes that some comments submitted on the proposed regulations had requested that the final regulations provide that "qualified improvement property" (discussed above) placed in service after 2017 is eligible for additional first-year depreciation under § 168(k). The Treasury Department and the IRS declined to adopt this suggested change because the relevant statutory provisions do not permit it. Although the Conference Agreement that accompanied the 2017 Tax Cuts and Jobs Act states that qualified improvement property is depreciable over 15 years, § 168 as amended by the 2017 Tax Cuts and Jobs Act does not reflect this change. Accordingly, the recovery period for qualified improvement property is 39 years. Because property that qualifies for the additional first-year depreciation deduction generally must have a revocery period of 20 years or less, qualified improvement property placed in servce after 2017 is not eligible for bonus depreciation. The final regulations are effective on September 24, 2019, but taxpayers can choose to apply them in their entirely to qualified property acquired and placed in service (or planted or grafted) after September 27, 2017, during taxable years ending on or after September 28, 2017. For qualified property acquired and placed in service (or planted or grafted) after September 27, 2017, during taxable years ending after that date and before September 24, 2019, taxpayers can rely on the proposed regulations.

b. Congress finally CARES about first-year bonus depreciation. The CARES Act, § 2307, amended Code § 168(e)(3)(E) by adding clause (viii), which adds qualified improvement property to the category of 15-year property. The effect of this change is to make qualified improvemenproperty eligible for 100 percent first-year, bonus depreciation. This change is effective retroactively, i.e., as if the change had been made by the 2017 Tax Cuts and Jobs Act.

c. The IRS has provided guidance for taxpayers to change their depreciation of qualifed improvement property for taxable years ending in 2018, 2019, and 2020. Rev. Proc. 2020-25, 2020-19 I.R.B. 785 (04/17/20). This notice provides guidance allowing a taxpayer to change its depreciation under § 168 for qualified improvement property placed in service by the taxpayer after December 31, 2017, in its taxable year ending in 2018 (2018 taxable year), 2019 (2019 taxable year), or 2020 (2020 taxable year). The notice also allows a taxpayer to make a late election, or to revoke or withdraw an election, under § 168(g)(7), (k)(5), (k)(7), or (k)(10) for the taxpayer's 2018 taxable year, 2019 taxable year, or 2020 taxable year.

F. Credits

G. Natural Resources Deductions & Credits

H. Loss Transactions, Bad Debts, and NOLs

1. Those NOLs are not worth what they used to be (at least until 2026). The 2017 Tax Cuts and Jobs Act, § 11012, amended § 461 by adding § 461(*l*), which disallows "excess business losses" for noncorporate taxpayers for taxable years beginning in 2018. Such "excess business losses" are determined after application of the passive loss rules of § 469. Essentially, as the authors read the statute, losses disallowed for a taxable year under § 461(*l)* are carried over to the next taxable year and become NOL carryforwards subject to revised § 172(a) (discussed below). Thus, the practical effect of § 461(*l*) appears to be a one-year deferral of "excess business losses." An "excess business loss" is defined as the amount by which a noncorporate taxpayer's aggregate trade or business deductions exceed aggregate gross income from those trades or businesses, plus $250,000 ($500,000 for joint filers). The term "aggregate trade or business deductions" apparently does not include § 172 carryforwards, so NOLs carried forward from 2017 and prior taxable years are not limited by new § 461(*l*). Such carryforwards are, however, limited by the changes made to § 172(a) (as discussed below). For partnerships and S corporations, new § 461(*l*) applies at the partner or shareholder level, and for farmers, the prior limitation on "excess farm losses" under § 461(j) is suspended so that only § 461(*l*) applies to limit such losses. After 2018, the cap on "excess business losses" is adjusted annually for inflation. Mercifully, new § 461(*l*) sunsets for taxable years beginning on or after January 1, 2026.

a. Surely you jest . . . there's even more bad news for NOLs? The 2017 Tax Cuts and Jobs Act, § 13302(a), amended § 172(b)(1) such that, for taxable years beginning in 2018, NOLs (except "farming losses" and NOLs of non-life insurance companies) no longer may be carried back two years, and any carried forward NOLs are capped at 80 percent of taxable income (computed without regard to NOLs). This change to § 172(a) is permanent.

b. The good news: NOLs now are like BFFs; they stick with you until you die! The 2017 Tax Cuts and Jobs Act, § 13302(b), amended § 172(b)(1)(A)(ii) so that NOLs may be carried forward indefinitely (except by non-life insurance companies) rather than being limited to 20 years as under pre-TCJA law. This change to § 172(b) is permanent.

c. Wait for it . . . wait for it . . . IR-2018-254 (12/18/18). Treasury and the IRS have yet to release any official administrative guidance concerning the above changes to the rules for NOLs. The only new information we have regarding the above-described changes is the foregoing news release.

d. And . . . as the late, great "Emily Litella" (a/k/a Gilda Radner on SNL) once said . . . NEVERMIND! The CARES Act has allowed carrybacks of NOLs and suspended the limitation on excess business losses The CARES Act modifies several of the rules for NOLs that were introduced into the Code by the 2017 Tax Cuts and Jobs Act. Section 2303(b) of the CARES Act amends Code § 172(b)(1) by adding a new subparagraph (D) to allow NOL carrybacks previously barred by the 2017 Tax Cuts and Jobs Act. Under new § 172(b)(1)(D), NOLs arising in taxable years beginning after December 31, 2017, but before January 1, 2021 (generally, 2018, 2019, and 2020), may be carried back to each of the five preceding taxable years. Special rules and limitations apply to REITs, life insurance companies, and taxpayers subject to § 965 (controlled foreign corporations). Further, the CARES Act, § 2303(a), amends Code § 172(a) such that, for taxable years beginning before January 1, 2021 (generally, 2019 and 2020), the 80 percent taxable income limitation on NOL carryforwards enacted by the 2017 Tax Cuts and Jobs Act does not apply. Last but not least, the CARES Act, § 2304, amends Code § 461(*l*) to repeal temporarily the rule, added by the 2017 Tax Cuts and Jobs Act, that disallows and carries forward "excess business losses" of noncorporate taxpayers attributable to taxable years beginning in 2018 and subsequent years. The temporary repeal applies to taxable years beginning before January 1, 2021. Thus, noncorporate taxpayers (including partners and subchapter S shareholders) whose 2018 and 2019 "excess business losses" were limited and carried forward by the prior version of § 461(*l*) will need to file amended returns to claim "excess business losses" that were disallowed and carried forward from those years.

e. The IRS has extended to June 30, 2020, the deadline to file Form 1139 or Form 1045 to carry back 2018 NOLs. Notice 2020-26, 2020-18 I.R.B. 744 (4/10/2020). To carry back a net operating loss, a taxpayer can either file an amended return or file for a quick quick refund using Form 1139 (Corporations) or Form 1045 (taxpayers other than corporations). The CARES Act did not change the due date of Forms 1139 or 1045. Normally, under § 6411, an application on Form 1139 or 1045 must be filed within 12 months of the close of the taxable year in which the NOL arose. As a result of the CARES Act, NOLs arising in 2018, 2019, and 2020 can now be carried back five yeears. For 2018 NOLs, Forms 1139 or 1045 would have been due December 31, 2019. Under § 6081, the Treasury Secretary can grant a reasonable extension of up to six months for filing any return declaration, or statement. This notice extends to June 30, 2020, the time to file Forms 1139 or 1045 for taxpayers with NOLs that arose in a taxable year that began during calendar year 2018 and that ended on or before June 30, 2019. The notice directs taxpayers to include the following language at the top of form: "Notice 2020-26, Extension of Time to File Application for Tentative Carryback Adjustment."

f. The IRS has issued guidance in the form of FAQs on its websiteregarding filing Forms 1139 or 1045. The IRS has issued guidance on its website on filing Forms 1139 and 1045 in the form of frequently asked questions (FAQs). The FAQs are available at https://perma.cc/5EXD-S2XN. According to the website, starting on April 17, 2020, and until further notice, the IRS will accept eligible refund claims on Form 1139 submitted via fax to 844-249-6236 and eligible refund claims on Form 1045 submitted via fax to 844-249-6237. The FAQs provide that it is not possible to file an amended return by faxing it to these numbers. Only Forms 1139 or 1045 may be faxed. One problem that practitioners may encounter is that it may be necessary to amend the return for a year prior to filing Form 1139 or 1045, but the amended return, which likely will be filed by mail, might not be processed by June 30, the deadline for filing Forms 1139 or 1045 for 2018. In such a case, the quick refund claim will not reflect figures on the return as it exists in the IRS system. The FAQs address this problem in Q&A 15, which provides:

> If you need to amend a previously filed return prior to filing Form 1139 or Form 1045, follow normal filing procedures by timely filing hard copy Forms 1120-X/1139 and hard copy Forms 1040-X/1045 as applicable, in order to adhere to any filing deadlines particular to your situation.

I. At-Risk and Passive Activity Losses

III. INVESTMENT GAIN AND INCOME

IV. COMPENSATION ISSUES

A. Fringe Benefits

B. Qualified Deferred Compensation Plans

1. Thinking about taking your RMD by the end of the year? You might want to rethink that. Congress has waived RMDs for 2020. The CARES Act, § 2203, amends Code § 401(a)(9) by adding § 401(a)(9)(I), which waives the requirement to take requried minimum distributions for 2020. If a taxpayer turned 70-½ in 2019, he or she was required take their 2019 minimum distribution by April 1, 2020. Such taxpayers, and others who previously had turned 70-½, also must take their 2020 RMD by December 31, 2020. The CARES Act suspends both RMDs that should have been taken by April 1, 2020, and those that normally would be taken by December 31, 2020. One issue that arises is how to treat RMDs that taxpayers took in 2020 before passage of the legislation waiving the requirement to take RMDs. The CARES act does not address this issue. Possibile ways to address this situation include depositing the funds in an eligible retirement plan within 60 days and treating the withdrawal and contribution as a tax-free rollover. Another possibility is treating the withdrawal as a coronavirus-related distribution if the applicable requirements are met, reporting the income ratably over three years, and redepositing within three years to treat the withdrawal and contribution as a tax-free withdrawal.

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

D. Individual Retirement Accounts

V. PERSONAL INCOME AND DEDUCTIONS

VI. CORPORATIONS

VII. PARTNERSHIPS

VIII. TAX SHELTERS

IX. EXEMPT ORGANIZATIONS AND CHARITABLE GIVING

X. TAX PROCEDURE

A. Interest, Penalties, and Prosecutions

1. Former IRS revenue agent who prepared tax returns for decades gets the Tax Court to clarify the burden of production with respect to the requirement of § 6751(b) that the individual initially determining accuracy-related penalties obtain written supervisory approval. Frost v. Commissioner, 154 T.C. No. 2 (1/7/20). Mr. Frost's poor efforts in substantiating his deductions for 2010-2012 resulted in the IRS imposing accuracy-related panealties under § 6672 for each year. The Tax Court (Judge Pugh) held that Mr. Frost, who was an IRS revenue agent for 15 years and who prepared tax returns as an enrolled agent for 25 years, failed to substantiate his deductions on his Schedule C, Profit or Loss from Business, and failed to establish his basis in a partnership interest to deduct his share of partnership losses, on his Schedule E, distributive share of partnership losses. However, the court held that the IRS had failed to meet its burden of production with respect to accuracy-related penalties for 2010 and 2011 and therefore declined to uphold the penalties.

Facts. As a result of the disallowance of Mr. Frost's deductions, the IRS determined penalties under § 6662(a), (b)(1), and (2) for both negligence and substantial understatements of income for the years 2010, 2011, and 2012. The examining agent prepared a Civil Penalty Approval Form (Form) on April 22, 2014. The Form included an electronic signature dated May 20, 2014, approving the substantial understatement penalty but pertained only to Mr. Frost's 2012 return. The examining agent did not similarly prepare or obtain approval for any penalties in relation to Mr. Frost's 2010 or 2011 returns. It has long been settled the IRS has the initial burden of production with respect to a taxpayer's liability for any penalty to come forward with sufficient evidence indicating the imposition of penalties is appropriate. *See* I.R.C. § 7491(c); *Higbee v. Commissioner*, 116 T.C. 438 (2001). As part of that burden, the Service must produce evidence that it complied with § 6751(b)(1), which requires that the initial determination of the assessment of a penalty be personally approved in writing by the immediate supervisor of the person making the determination. *See Graev v. Commissioner*, 149 T.C. 485 (2017). However, this case presents an issue of first impression for the Tax Court, which has not addressed the point in time when the burden shifts to the taxpayer to show otherwise.

Analysis of 2010-2012. The IRS failed to offer evidence that it had complied with the supervisory approval requirement of § 6751(b)(1) with respect to the penalties asserted for 2010 and 2011. Because the IRS had failed to meet its burden of production, the court held, the IRS was precluded from imposing those penalties. In contrast, the IRS introduced a signed penalty approval form in relation to Mr. Frost's 2012 return. The issue then became whether the form supported a finding that a supervisor approved Mr. Frost's penalty prior to formally communicating it to Mr. Frost in the notice of deficiency and whether the form was sufficient to satisfy the IRS's initial burden of production. If it was, the burden would shift to Mr. Frost to come forward with evidence to the contrary, e.g., that the penalty had been communicated to him before the supervisor's approval was obtained. The court held that the penalty approval form reflected approval of the 2012 *substantial underpayment penalty* prior to formal communication of it to the taxpayer. Therefore, the form was held sufficient to carry the IRS's initial burden of production under § 7491(c), including the supervisory approval requirement of § 6751(b)(1). With respect to the 2012 *negligence penalty*, however, the IRS was not able to provide similar evidence, and therefore the IRS failed to satisfy its burden of production as to supervisory approval of the negligence penalty. Because the IRS had met its burden of production with respect to the 2012 *substantial understatement penalty*, the court held, the burden shifted to Mr. Frost to offer evidence that the IRS's approval of the substantial understatement penalty was untimely. If he had done so, the court would have been left to weigh the evidence to determine whether the IRS had satisfied the supervisory approval requirement of § 6751(b)(1) prior to formally communicating the substantial understatement penalty to the taxpayer. Mr. Frost, however, did not claim and the court found no evidence indicating that the IRS communicated any penalty determination to Mr. Frost before the penalty approval form was signed. Accordingly, the court held that the IRS had complied with the requirements of § 6751(b)(1) and Mr. Frost was subject to the substantial understatement penalty determined by the IRS.

Policy. The court's holding protects the requirement that the IRS come forward initially with evidence of written penalty approval as required by § 6751(b)(1). Shifting the burden to the taxpayer after the IRS makes the initial showing avoids requiring the IRS to prove a negative, i.e., that no formal communication of the penalty took place before supervisory approval of the penalty was obtained. Thereafter, if the taxpayer introduces evidence to contradict the IRS's initial showing, then the IRS can respond with additional evidence leaving the court to weigh the evidence. Note further that any evidence of prior formal communication should have been received by the taxpayer. The taxpayer could introduce it to prove the untimeliness of the supervisory approval of the penalty.

B. Discovery: Summonses and FOIA

C. Litigation Costs

D. Statutory Notice of Deficiency

E. Statute of Limitations

F. Liens and Collections

1. The taxpayers' attempt to pay their federal tax liability went awry when the IRS levied on the bank account on which their check was drawn and applied the proceeds to other tax years. Following a CDP hearing, the appropriate standard of review is for abuse of discretion, says the Tax Court. Melasky v. Commissioner, 151 T.C. No. 8 (10/10/18). The taxpayers hand-delivered to the IRS at the IRS's office in Houston a check for $18,000 and requested that the check be applied against their 2009 federal income tax liability. The IRS accepted the check and initially applied it as the taxpayers had requested. A few days later, however, the IRS levied against the bank account on which the check had been drawn and applied the proceeds of the levy to an earlier tax year. The effect of the levy was that the taxpayers' check bounced. The IRS therefore reversed the payment against the 2009 liability and charged a $360 penalty for writing a bad check. On the same day as the levy, the IRS issued to the taxpayers a final notice of intent to levy with respect to certain years, including 2009. In response, the taxpayers requested a CDP hearing. The IRS's settlement officer issued a notice of determination concluding that the proceeds of the levy constituted an involuntary payment, rather than a voluntary payment, and that the IRS therefore was free to apply the payment as it wished. In response to the notice of determination, the taxpayers filed a petition in the Tax Court. The Tax Court (Judge Holmes) held that the appropriate standard of review in the Tax Court was for abuse of discretion. In its earlier decision in *Goza v. Commissioner*, 114 T.C. 176 (2000), the court had established that the standard of review in a CDP case is normally for abuse of discretion, but that the standard of review is *de novo* when the underlying tax liability is appropriately before the court. The parties agreed that the standard of review for the 2009 tax year was de novo because the taxpayers contended that they had no tax liability for that year. Nevertheless, the court held that the standard of review was for abuse of discretion because the taxpayers were not challenging the underlying tax liability, but rather were challenging whether the IRS properly applied a payment:

> The question for the Melaskys' 2009 tax year is about whether the IRS properly applied a check. A question about whether the IRS properly credited a payment is not a challenge to a tax liability; i.e., the amount of tax *imposed* by the Code for a particular year. It is instead a question of whether the liability remains *unpaid*. Section 6330(c)(2)(A) allows a taxpayer to raise at a CDP hearing "any relevant issue relating to the unpaid tax," whereas section 6330(c)(2)(B) says a taxpayer may challenge "the existence or amount of the *underlying tax liability*" (emphasis added) only if he didn't receive a notice of deficiency or otherwise have an opportunity to do so. See Kovacevich v. Commissioner, T.C. Memo. 2009-160, 2009 WL 1916351, at *6. We therefore hold here that the Melaskys aren't challenging their underlying liability for 2009. See also Chief Counsel Notice CC-2014-002 (May 5, 2014) (announcing similar IRS position).

a. A dishonored check is not a voluntary payment of tax and therefore the IRS need not apply the tendered check as directed by the taxpayer, even when the check is dishonored because an IRS levy depleted the funds in the bank account. Melasky v. Commissioner, 151 T.C. No. 9 (10/10/18). In this separate, reviewed opinion (9-2-2) by Judge Thornton involving the same facts as *Melasky v. Commissioner*, 151 T.C. No. 8 (10/10/18), the Tax Court considered whether it was an abuse of discretion for the IRS to decide: (1) not to apply against the taxpayers' 2009 income tax liability the proceeds of the levy on their bank account, and (2) to reject the taxpayers' proposed installment agreement. With respect to application of the levy proceeds, the court noted that the IRS's policy is to apply voluntary payments as directed by the taxpayer, but that involuntary payments generally may be applied against whatever unpaid tax liabilities the IRS chooses. The court rejected the taxpayers' argument that the check for $18,000 they hand-delivered to the IRS's office in Houston should be treated as a voluntary payment and therefore applied to 2009 as the taxpayers had directed. A payment by check, the court reasoned, is a conditional payment and is subject to the condition subsequent that the check be paid when presented to the drawee (the bank). If the condition subsequent is fulfilled, the court explained, "the payment generally becomes absolute and is deemed to relate back to the time when the check was provided." According to the court, acceptance of a check is not an absolute payment in the absence of an agreement that the check will be treated as an absolute payment. In this case, because the check was not honored, and there was no agreement that acceptance of the check would be treated as an absolute payment, the check was not a voluntary payment. The court rejected the taxpayers' argument that, because the IRS's levy on the bank account led to the check being dishonored, a different result was warranted. It was not unreasonable or inappropriate, the court stated, for the IRS to levy after approximately fifteen years of collection activity. The proceeds of the levy were an involuntary payment that the IRS could apply as it chose. With respect to the second issue, the court held that it was not an abuse of discretion for the IRS to reject the taxpayers' proposed partial-pay installment agreement.

- A concurring opinion by Judge Lauber (joined by Judges Thornton, Marvel, Gustafson, Kerrigan, Buch, Nega, Pugh, and Ashford) is highly critical of and responds to certain arguments in the dissenting opinion by Judge Holmes. Generally, the concurring opinion takes the position that the taxpayers did not raise in the CDP hearing the argument that the $18,000 check, although dishonored, should be treated as a voluntary payment, and therefore "[t]he SO did not commit legal error by failing to address an argument petitioners did not make."

- A concurring opinion by Judges Buch and Pugh (joined by Judges Gustafson and Paris) notes that Rev. Proc. 2002-26 requires the IRS to apply a voluntary payment as directed by the taxpayer, and that the court's opinion does not "foreclose finding an abuse of discretion if evidence were to show that, through negligence or malfeasance, the Commissioner circumvented his own revenue procedure for designating payments."

- Judge Holmes wrote a lengthy dissenting opinion that was joined by Judge Morrison. Judge Holmes agreed that the settlement officer did not abuse his discretion in rejecting the taxpayers' proposed installment agreement, although for different reasons than those set forth in the court's opinion. Judge Holmes dissented with respect to the treatment of the $18,000 dishonored check. According to the dissenting opinion, the check was a voluntary payment that the IRS should have applied as directed by the taxpayers.

b. Agreeing with the Tax Court, the Fifth Circuit reiterates that if other taxpayers do not want to run the same bounced-check risk as the Melaskys, they should use a certified check or money order when making designated, voluntary payments for past years' tax liabilities. Melasky v. Commissioner, 125 A.F.T.R.2d 2020-746 (5th Cir. 2/3/20), *aff'g* 151 T.C. No. 9 (10/10/18). The Fifth Circuit, in an opinion by Judge Owen, agreed with the Tax Court's prior decision that the taxpayer's payment was "involuntary" and that the IRS did not abuse its discretion. The Fifth Circuit declined to adopt an "equitable exception to the normal rules" regarding voluntary and involuntary tax payments. According to the Fifth Circuit, the Melaskys had notice of the IRS's intent to levy issued to them in 2001, long before the IRS's actual levy in 2009. Therefore, quoting language from the concurring opinion of Judges Buch and Pugh, the Fifth Circuit reasoned that "[b]y choosing . . . a personal check rather than a certified check or money order, the Melaskys ran [the] risk" that the IRS would levy on their bank accounts before the check representing their voluntary payment was presented to the bank by the IRS.

G. Innocent Spouse

H. Miscellaneous

1. Based upon a credible declaration from petitioner's attorney, the Tax Court has held that a petition sent in an envelope that had no postmark was timely filed even though it arrived after the 90-day period for filing. Seely v. Commissioner, T.C. Memo. 2020-6 (1/13/20). In general, under § 6213(a). a taxpayer must petition the Tax Court within 90 days after the date the notice of deficiency is mailed. There is, however, a "timely mailed timely filed" rule which provides that if a document is delivered by U.S. mail, it is deemed to be timely mailed (and, therefore, timely filed) if the envelope is properly addressed, postage is prepaid, and the postmark date on the envelope falls on or before the end of the 90 day period for mailing the petition. *See* § 7502(a). If all of these conditions are met, then the date of the postmark is deemed to be the date of delivery and date of filing. In this case, the Seelys' attorney prepared a petition and mailed it to the Tax Court. The Seelys and the IRS agreed that all the conditions were met except there was no postmark on the envelope containing the petition. The Seelys' 90-day period for filing the petition expired on June 26, 2017 (a weekday), but the Tax Court received the petition on July 17, 2017, a number of days after the expiration of the 90 day period. The IRS filed a motion to dismiss for lack of jurisdiction on the ground that the petition was not timely filed. The Seelys argued that their petition was timely filed because their attorney mailed the petition to the Tax Court on June 22, 2017, before the 90 day period expired. In support of their argument, the Seelys supplied a declaration from their attorney under penalty of perjury indicating that on June 22, 2017, he deposited the petition into a U.S. mailbox. While Treasury regulations prescribe specific rules for postmarks, they provide no rules regarding the situation where the envelope has no postmark whatsoever. In holding in favor of the Seelys, the Tax Court followed its prior precedents indicating that where the postmark is illegible, extrinsic evidence is allowed to ascertain the mailing date. See *Sylvan v. Commissioner*, 65 T.C. 548, 553-555 (1975); see also *Mason v. Commissioner*, 68 T.C. 354, 356 (1977). The issue, therefore, narrowly turned on whether the Seelys presented convincing evidence establishing that they timely mailed their petition. The IRS argued that it takes only 8 to 15 days for the United States Postal Service to deliver an item of mail to Washington D.C. Further, because the petition arrived at the Tax Court (16 as opposed to 15 days) later than expected, the IRS argued, the lawyer's declaration was not credible. Judge Vasquez disagreed that the attorney's declaration was not convincing evidence due in part to thefact that the Fourth of July holiday fell between the date of the alleged mailing and the delivery date. On the basis of the attoenry's sworn declaration and of the court's judicial notice of the Fourth of July holiday, the court concluded that, more likely than not, the petition was mailed on June 22, 2017, before the 90 day-period had expired. Accordingly, the IRS's motion to dismiss for lack of jurisdiction was denied.

2. The IRS has extended many filing and payment deadlines to July 15, 2020. Notice 2020-23, 2020-18 I.R.B. 742 (4/9/20). Following the national emergency declared in response to the COVID-19 pandemic, the IRS previously had exercised its authority under § 7508A, which authorizes the Secretary of the Treasury to postpone the time for performing certain acts in federally declared disaster areas, to extend several filing and payment deadlines. *See* Notice 2020-17, 2020-15 I.R.B. 590 (3/18/20) (income tax payments due on 4/16/20 instead due on 7/15/20); Notice 2020-18, 2020-15 I.R.B. 592 (3/23/20) (income tax returns due on 4/15/20 instead due on 7/15/20); Notice 2020-20, 2020-16 I.R.B. (3/27/20) (Form 709 and payments of federal gift and GST tax due on 4/15/20 instead due on 7/15/20). In this notice, the IRS has announced that all persons with *a federal tax payment obligation or form filing obligation due to be performed on or after April 2, 2020 and before July 15, 2020* are considered affected by COVID-19 for purposes of § 7508A. The notice extends specified filing and payment obligations to July 15, 2020, including the deadline to file Form 1040 series returns (individuals), 1120 series returns (corporations), Form 1065 (partnerships), 1041 (income tax return of trusts and estates), Form 706 (estate and generation-skipping transfer tax return)Form 709 (gift and generation-skipping transfer tax return), and Form 990-T (unrelated business income of tax-exempt organizations). It also extends to July 15, 2020, the payment deadline for payments of income tax, estate tax, gift tax, GST tax, UBIT, and quarterly estimated tax payments. This includes the quarterly estimated tax payment due on June 15, 2020. The notice goes further, however, and extends to July 15, 2020, the time for taking specified time-sensitive actions, including filing a claim for refund (e.g., 2016 refund claims), bringing suit for a refund, and filing a petition with the U.S. Tax Court. Finally, the notice extends the time for the IRS to perform time-sensitive acts by 30 days if the act must be performed on or after April 6, 2020 and before July 15, 2020, such as assessment of tax.

XI. WITHHOLDING AND EXCISE TAXES

XII. TAX LEGISLATION

A. Enacted

BE CAREFUL: NOT EVERYTHING YOU TELL YOUR ERISA LAWYER IS A SECRET

by

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And

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Not everything you tell your ERISA lawyer—and not everything your ERISA lawyer tells you--is a secret. This is especially true in the world of ERISA and employee benefit plans and fiduciaries and plan administrators.

An important corollary, however, is that nothing you tell your employee benefits advisor who is not a lawyer engaged in the practice of law is a secret.

This note is about the attorney-client privilege and how it applies in ERISA cases. The law here is discussed in an ongoing case called Advanced Physicians, S.C. vs. Connecticut General Life Insurance Company. You can find the opinion at this link: https://benefitslink.com/src/ctop/AdvancedPhysicians_NDTex_01032020.pdf

The court's opinion is an excellent resource for attorneys who are looking for the most up to date discussion of the attorney-client privilege in ERISA cases.

More importantly, the opinion is a good reminder to employers and their counsel, including especially in-house counsel, that the attorney-client privilege is a narrow exception to broad disclosure requirements in civil litigation. One rule of thumb is that communications between an ERISA plan administrator and a lawyer about plan administration are not covered by the attorney-client privilege and may be discoverable by a plan beneficiary, an assignee of a plan beneficiary or even the IRS or DOL.

Knowledge of the ERISA limitations of the attorney-client privilege may suggest the need to engage independent legal counsel for an employee benefit plan in appropriate cases. In addition, lawyers and clients should pay careful attention to their time-keeping and billing practices, especially where the attorney represents both the employer and the plan. Lawyers should alert clients in appropriate cases where the lawyer may believe that the privilege will not apply. And, lawyers and clients always should be careful to avoid sloppy and informal communications, especially in emails and text messages.

With those warnings out of the way, let's get into the details of the court's opinion written by Judge Fish in the United States District Court for the Northern District of Texas in Dallas. Judge Fish considered whether communications between an attorney and a plan administrator client must be turned over to a physician group that is suing the plan administrator. The immediate reaction may be that those communications are secret and protected from disclosure. After all, the United States Supreme Court has ruled that the attorney-client privilege promotes the observance of law and administration of justice by encouraging full and frank communications between attorneys and their clients. The attorney-client privilege is routinely upheld by the courts, but in the ERISA context, the words of ESPN GameDay commentator Lee Corso come to mind: "Not so fast my friend!"

On to the case.

Advanced Physicians (AP) as an assignee brought suit to recover amounts due to participants under the NFL Player Insurance Plan. AP initially filed a motion in October 2017 that sought to compel disclosure of communications between Connecticut General Life Insurance Company (Cigna) and its attorneys. Cigna, as the claims administrator, denied AP any access to its communications with its attorneys concerning the Plan based on the attorney-client privilege. AP argued that it could access communications between the two relying on the fiduciary exception to the attorney-client privilege.

The fiduciary exception states that a fiduciary, such as a trustee, cannot withhold attorney-client communications from the beneficiary of the trust. This exception has been widely adopted in the ERISA context to support claims by plan beneficiaries to receive communications between a plan administrator and counsel.

The sole issue considered by Judge Fish was whether or not AP, as an assignee of a beneficiary's claim, could trump the attorney-client privilege by asserting the fiduciary exception. A few circuit courts have addressed the attorney-client privilege in the ERISA context. However, no other court has decided a case on whether an assignee of the right to receive payments under an ERISA plan may assert the fiduciary exception to the attorney-client privilege.

The two primary rationales in previous cases to support the fiduciary exception to the attorney-client privilege are the "Duty Rationale" and the "Client Rationale."

The "duty rationale" comes from a trustee's duty to disclose information about plan administration to all plan beneficiaries.

The "client rationale" supports the notion that the trustee is not the real client, and therefore the fiduciary exception is not really an exception to the attorney-client privilege at all. The client rationale focuses on the idea that the plan administrator should not be able to use the attorney-client privilege. The thought is that a plan administrator is not even 'the real client,' so such a privilege would not be afforded to it at all.

Some courts have found that the Federal government (namely the IRS and DOL) may be allowed to use the fiduciary exception in the ERISA context as long as by doing so, the government would be serving the interests of the plan beneficiaries. Although a different situation, the court in this case found that AP's use of the fiduciary exception was similar to the cases where the government was asserting the exception. Because the right to receive payments was assigned under the Plan to AP, the court found that the beneficiaries and AP have similar interests, therefore allowing AP to assert the fiduciary exception.

The court ultimately concluded that not only that AP was allowed to assert the fiduciary exception against Cigna's attorney-client defense, but also that Cigna could not assert the privilege in the first place against AP as long as AP was asking about communications regarding plan administration, because it was technically not the client in this situation.

There are two important limitations on the fiduciary exception to the attorney-client privilege. The first is that the attorney-client privilege remains in effect to protect communications between an attorney and her ERISA plan client that are made in connection with defending an existing lawsuit. The second limitation is that the attorney-client privilege protects communications between an attorney and her ERISA plan client that do not relate to plan administration.

In summary, lawyers and their ERISA plan clients need to be very careful to understand the scope and limitations of the attorney-client privilege. In litigation, disclosure is broadly promoted and exceptions are narrowly applied. Plan administrators and their attorneys must be aware of their roles and the rules that apply to their communications and advice.

*The authors published a previous version of this article on LinkedIn on February 10, 2020.

TAX COURT DECISIONS ON CHARITABLE DEDUCTIONS BACK IRS POSITION THAT STRICT CONFORMITY WITH REGULATIONS IS REQUIRED

Charitable contributions, and the associated deductions, have long been a part of the federal income tax system and most taxpayers generally believe that all charitable contributions are deductible. However, the deductibility of charitable contributions is not automatic, as affirmed by two recent Tax Court decisions.

The Tax Court's recent decisions in *Oakhill Woods LLC v. Commissioner*, and *Loube v. Commissioner*, highlight that deduction of large charitable contributions requires strict compliance with the associated regulatory requirements.

The decisions address regulations that were issued by the Treasury because of Congressional concerns that taxpayers were overstating charitable deductions. The regulations mandate increased reporting associated with deducting charitable contributions.[1] For deductions of $5,000 or more arising from noncash charitable contributions, the regulations require more than a dozen items to be disclosed to the IRS.[2] The applicable regulations also require taxpayers to attach to their return an appraisal summary containing the required information. The IRS promulgated Form 8283, Noncash Charitable Contributions, to serve as the required appraisal summary.

Both *Oakhill* and *Loube* involved deductions in excess of $5,000 arising from noncash charitable contributions. In both cases, the charitable deductions were based on suspect valuations of the underlying contribution. In *Oakhill*, the taxpayer claimed a deduction on its 2010 income tax return for its donation of a conservation easement on undeveloped forest property. The valuation appeared suspect because the conservation easement was valued at $20,975 per acre despite the taxpayer's purchase of the land a few years earlier for approximately $2,500 per acre. In *Loube*, the taxpayers purchased property intending to construct a new residence on the property after demolishing the existing home. Less than a month after the acquisition, the taxpayers donated the existing house (but not the land) to a qualifying charity. The taxpayers claimed a deduction of $297,000 on their 2013 income tax return. The valuation appeared suspect because the value of the home that was to be demolished was based on the cost to construct the property as opposed to the fair market value of the property.

In addition to the valuation issues, the taxpayers in both cases failed to include the cost or adjusted basis of the donated property on Form 8283. Cost or adjusted basis is one of the items the regulations specifically requires to be included on the appraisal summary.

In both cases, the IRS disallowed the deductions for failing to establish the fair market value of the donated property and failing to strictly comply with all the reporting requirements associated with noncash charitable contributions. The taxpayers filed petitions with the Tax Court challenging the IRS's determinations. In both cases, the IRS filed motions for summary judgment, arguing that it was entitled to decisions in its favor without trial, because the taxpayers failed to include the cost or adjusted basis of the donated property on Form 8283 as required by the regulations. In opposition, the taxpayers argued that they

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[1] See T.D. 8199.
[2] Treas. Reg. § 1.170A-13.

substantially complied with the reporting requirement by including the required information elsewhere on their returns or in on an attachment to their returns.

In *Loube*, for example, the taxpayer attached a copy of an appraisal which contained the cost or adjusted-basis information that was missing from Form 8283. In *Oakhill* the taxpayer argued that the missing cost or adjusted-basis information was included on Schedule L, the balance sheet and schedules included with the return. In both cases, the Tax Court granted the IRS's requests for summary judgment.[3] In rejecting the taxpayers' substantial compliance arguments, the Tax Court noted that the regulations added the appraisal summary requirement so that the IRS could efficiently review and flag potentially overvalued charitable deductions from the face of Form 8283 without slogging through other aspect of the returns and attachments. As such, the Tax Court reasoned that taxpayers cannot substantially comply with the regulatory requirements without completely and accurately filling out Form 8283 with the required information.

The decisions are particularly noteworthy for those involved in planning future charitable deductions because the Tax Court's decisions did not turn on the suspect valuations. Instead, the Tax Court focused on strict compliance with the regulatory requirements. Thus, the IRS could argue in future cases that the court's holdings extend to deductions that, although properly valued, are not reported in strict compliance with the regulations. As such, taxpayers and their advisors should give careful attention to satisfying the reporting requirements when planning large charitable deductions.

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[3] The court's decisions were consistent with its holdings on this issue in 2017 and 2018. *See Bellair Woods, LLC v. Commission*er, T.C. Memo 2018-159 (Sep. 20, 2018), *RERI Holdings I, LLC v. Commissioner*, 149 T.C. 1 (Jul. 3, 2017).

PARTNERSHIPS CAN AMEND 2018 AND 2019 TAX RETURNS FOR COVID-19 RELIEF

by Abbey Garber, Lee Meyercord, and Jessica Kirk*

Revenue Procedure 2020-23[1] allows partnerships subject to the centralized audit regime to file amended tax returns to take advantage of retroactive tax relief provisions in the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act").[2]

The CARES Act was enacted to provide an immediate economic benefit to taxpayers during the COVID-19 emergency.[3] The CARES Act includes retroactive tax-related provisions, including allowing: qualified improvement property to qualify for 100% bonus deprecation; net operating losses that arose in a tax year that began in 2018, 2019, or 2020 to be carried back five years; and increased interest expense deductions.[4] These changes may benefit partnerships and their partners, but the benefits would be delayed by the centralized audit regime enacted in the Bipartisan Budget Act of 2015 (the "BBA").[5]

Under the BBA, partnerships are generally prohibited from filing amended partnership returns and providing amended Schedule K-1s to their partners.[6] Instead, BBA partnerships must file an Administrative Adjustment Request (AAR), and any reduction in tax liability for a prior tax year can only be taken as a credit against taxes owed in the current tax year (*i.e.*, 2020).[7] Thus, under the AAR process, any benefit that partners would receive from the retroactive CARES Act provisions would be deferred until sometime in 2021 when such partners can take the nonrefundable credit against their 2020 taxes.

Revenue Procedure 2020-23 ensures that partnerships (and their partners) can obtain the immediate economic relief that was intended by the CARES Act. The IRS recognized that the AAR "process would significantly delay the relief provided in the CARES Act intended to apply to the affected taxable years and provide an immediate benefit to taxpayers."[8] Thus, Revenue

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[1] Rev. Proc. 2020-23, 2020-18 IRB 749 (April 27, 2020).

[2] The Coronavirus Aid, Relief, and Economic Security Act, Public Law No. 116-136, 134 Stat. 281 (March 27, 2020) ("CARES Act").

[3] Rev. Proc. 2020-23, § 2.04.

[4] CARES Act, §§ 2303, 2306, 2307.

[5] Bipartisan Budget Act of 2015, Public Law No. 114-74, 129 Stat. 584, § 1101 (Nov. 2, 2015); I.R.C. §§ 6221-6241.

[6] *See* I.R.C. § 6031(b), 6222(a).

[7] *See* I.R.C. § 6227.

[8] Rev. Proc. 2020-23, § 2.04.

Procedure 2020-23 permits eligible partnerships to file amended tax returns for 2018 and 2019 in lieu of filing an AAR and allows their partners to file an amended return (or their 2019 original return if they have not yet filed) requesting a tax refund.[9]

Under the Revenue Procedure, a partnership may file an amended return for tax years beginning in 2018 and 2019 if the partnership filed a Form 1065, Return of Partnership Income, and issued Schedule K-1s to its partners for such years prior to the issuance of Revenue Procedure 2020-23.[10] Partnerships wishing to file amended returns should file a Form 1065 with the "Amended Return" box checked and issue amended Schedule K-1s to each partner before September 30, 2020.[11] Partnerships must clearly indicate the application of the Revenue Procedure by including the notation "FILED PURSUANT TO REV PROC 2020-23" at the top of the amended return and on an attachment to each partner's Schedule K-1.[12] In addition to the changes resulting from the CARES Act, such amended returns may include any other amendments permitted by the tax law.[13] The Revenue Procedure also suggests partnerships file electronically "for faster processing of the amended return."[14]

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[9] *Id*. at §§ 2.05, 3.

[10] *Id*. at §§ 3.02-03.

[11] *Id*. at §§ 3.02, 4.01.

[12] *Id*. at § 4.01.

[13] *Id*. at § 3.02.

[14] *Id*. at § 4.01.

Section 139 Qualified Disaster Relief Payment for COVID-19

Hersh Verma, Norton Rose Fulbright US LLP

Section 139 of the Internal Revenue Code of 1986, as amended (the "Code") provides that "qualified disaster relief payments" made by an employer to an employee are not required to be reported or disclosed by employers or employees, including via Form W-2 or 1099, and they are not subject to U.S. federal income tax withholding obligations. "Qualified disaster relief payments" are defined as any amount paid to an individual to reimburse or pay for **reasonable and necessary personal, family, living, or funeral expenses** incurred as a result of a "qualified disaster" (as defined in Section 165(i)(5)(A) of the Code), provided that such expense is not covered by insurance or reimbursable. Based on Notice 2020-18 from the Internal Revenue Service ("IRS"), the IRS has determined that COVID-19 constitutes a "qualified disaster" under Section 165(i)(5)(A) of the Code.

The following are examples of qualified disaster relief payments that may be considered reasonable and necessary personal, family, living, or funeral expenses:

- Medical and other health-related expenses relating to COVID-19;
- Work-from-home expenses such as the cost to set up a home office (i.e. purchasing a printer, higher speed internet, a home phone, etc.);
- Dependent care expenses such as additional educational or childcare costs (i.e. hiring a tutor, online education subscriptions, etc.)
- Funeral expenses for an employee or family member; and
- Other living expenses related to the potential exposure to COVID-19 (i.e. hotel room due to quarantine, purchasing cleaning or sanitizing products, etc.).

Section 139 of the Code does not require employers to put in place a written plan or policy to make qualified disaster payments. However, as a best practice, employers should at minimum outline: (1) who is eligible; (2) what expenses will be reimbursed or paid; (3) any limits on the amount of payments; (4) any administrative requirements of the program; and (5) the duration of the program.

While there is no specified dollar limitation on the amount of qualified disaster relief payments that may be excluded from income, there are some general limitations. First, any payments that are unreasonable or considered excess will be included in an employee's income and may not be deductible. Second, the payments must be for a specific expense and are not intended to replace the employee's income. Third, payments are not treated as qualified to the extent any expense is reimbursed by insurance or another source. Fourth, an employee receiving a qualified disaster relief payment cannot claim a deduction or credit to the extent of the excluded amount. In conclusion, businesses should consider qualified disaster relief payments when evaluating how best to help their employees and communities during the ongoing COVID-19 crisis.

The Texas Supreme Court Denies a Cost of Goods Sold Deduction for Costs Associated with Picking up and Delivering Heavy Construction Rental Equipment

By David E. Colmenero and Alex J. Pilawski on April 21, 2020

 

In one of three recent decisions issued by the Texas Supreme Court involving the Texas franchise tax, the Court held that certain costs associated with the rental of heavy construction equipment could not be included in the cost of goods sold deduction. *See Sunstate Equipment* Co., LLC v. Hegar, Cause No. 17-044 (Tex. Apr. 3, 2020). The Court held these costs were not includable in cost of goods sold under the provisions dealing with either the rental of equipment or real property work. In doing so, the Court set some general parameters for the applicability of these provisions.

The taxpayer, Sunstate Equipment Co., LLC ("Sunstate") was engaged in the business of renting heavy construction equipment used at real property construction sites. Sunstate sought to include certain costs associated with picking up and delivering this equipment to job sites in its cost of goods sold ("COGS") deduction. Sunstate relied in part on subsection (k-1) of Section 171.1012 which reads: "Notwithstanding any other provision of this section, the following taxable entities may subtract as cost of goods sold the costs otherwise allowed by this section in relation to tangible personal property that the entity rents or leases in the ordinary course of business ... (2) heavy construction equipment rental or leasing company." Because the equipment was used at construction sites, Sunstate also argued that its costs were includable in cost of goods sold under subsection (i) of Section 171.1012, which reads in part, "A taxable entity furnishing labor or materials to a project for the construction, improvement, remodeling, repair, or industrial maintenance (as the term 'maintenance' is defined in 34 [Tex. Admin. Code] Section 3.357) of real property is considered to be an owner of that labor or materials and may include the costs, as allowed by this section, in the computation of cost of goods sold."

As an initial matter, the Court rejected the Comptroller's argument that the COGS deduction is tantamount to an exemption and should therefore be strictly construed against the taxpayer. The Court held that the franchise tax is a tax on an entity's "taxable margin" and not on revenue, and therefore the COGS deduction does not amount to an exemption. Rather, it is a subtraction to determine the amount subject to tax in the first place.

The Court also held that subsection (k-1) extends the COGS subtraction available under Section 171.1012 to heavy construction equipment rental or leasing companies but does not expand the types of costs this type of taxpayer can subtract as part of its taxable margin. The Court declined to construe the phrase "in relation to" expansively, holding that it should be construed as specifying only the types of entities that are entitled to the COGS subtraction rather than the types of costs that can be deducted. The Court also found the "notwithstanding" language at the beginning of subsection (k-1) to be consistent with this reading because, according to the Court, it creates an exception to the statute whereby a heavy construction equipment rental or leasing company can subtract COGS despite not actually selling equipment.

The Court then considered whether the costs at issue fell within the general provisions of Section 171.1012, including subsection (c), (d), (f) and concluded they did not. The costs were not deductible under any of these provisions, according to the Court, because the costs were not directly or indirectly related to acquiring or producing goods.

With respect to subsection (c), which permits a deduction for direct costs of acquiring or producing goods, the Court held the term "acquire" refers to direct costs associated with the initial receipt of goods that will ultimately be sold. The Court noted in particular that rehandling costs are excluded from COGS pursuant to subsection (e)(6) in support of this conclusion. Because the costs of picking up and delivering equipment were not derived from the initial acquisition of equipment, the Court held these costs could not be subtracted as direct costs for acquiring goods. Likewise, the Court held the costs did not fall within the definition of "production," because the statutory definition for that word did not include "delivery". Stated the Court, "[I]t seems the Legislature contemplated COGS subtractions for both the costs of acquiring goods ready to sell, as well as costs contributing directly to making goods sellable, while excluding costs associated with transporting goods for sale or goods sold (or, in the context of rental companies, goods rented out)."

Because the Court concluded that Sunstate was not engaged in "production," the insurance costs for pick-ups and deliveries were also not deductible under Section 171.1012(d)(6) as Sunstate alternatively argued. That subsection permits a cost of goods sold deduction for "the cost of insurance on a plant or a facility, machinery, equipment, or materials directly used in the production of goods." Likewise, none of the costs at issue could be deducted as administrative or overhead costs under subsection (f) because that provision requires a taxpayer to demonstrate the costs are "allocable to the acquisition or production of goods."

Turning to subsection (i), the Court held that to qualify for a deduction under this provision, "the labor or materials at issue must be furnished to a project that is of the specific type identified in the statute ... [*viz*] construction projects, improvement projects, remodeling projects, repair projects, and industrial maintenance projects." In other words, stated the Court, the question is whether the labor at issue was "furnished to the real property owner's construction project?" In this case, because the labor was furnished to move equipment from one project to another, it was furnished to meet Sunstate's own project of fulfilling its contractual obligations, rather than to a project for the construction or improvement of real property.

As with other recent franchise tax decisions issued by the Texas Supreme Court, the *Sunstate* decision carries significant implications for many taxpayers, particularly those involved in renting or leasing equipment. The decision is also important in evaluating the scope of the deduction available to taxpayers for real property work under Section 171.1012(i). The applicability of this decision to any given set of facts will of course depend on the particular circumstances. But prior and current reporting positions, particularly those within the statute of limitations, may need to at apilawski@meadowscollier.com. You can also reach both attorneys at (214)744-3700.

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The Texas Supreme Court Provides Important Guidance in Construing Two Statutory Provisions Dealing with Real Property Work for Texas Franchise Tax Purposes

By David E. Colmenero and Alex J. Pilawski on April 8, 2020


In one of three recent cases addressing the Texas franchise tax, the Texas Supreme Court held that a company engaged in performing work on offshore oil-and-gas drilling rigs could not claim a cost of goods sold deduction with respect to certain costs incurred with that work, but could exclude payments to subcontractors from total revenue. In doing so, the Court examined the relationship between two statutory provisions in the Texas franchise tax statutes specifically addressing real property work, namely Sections 171.1011(g)(3) and 171.1012(i). See Hegar v. Gulf Copper & Mfg Corp. v. Hegar, (Cause No. 17-0894) (Tex. Apr. 3, 2020). Taxpayers and practioners will want to carefully consider existing and future reporting positions in light of this recent decision.

Gulf Copper was engaged in surveying, repairing and upgrading offshore oil-and-gas well drilling rigs. Part of the work was performed by independent contractors who were paid on a hourly basis. Gulf Copper argued it could exclude payments to independent contractors from total revenue under Section 171.1011(g)(3), which permits an exclusion from total revenue for certain payments mandated by contract to be distributed to other entities, including subcontracting payments for services, labor or materials "in connection with the actual or proposed design, construction, remodeling, or repair of improvements on real property or the location of the boundaries of real property." Gulf Copper also claimed that other costs could be deducted under Section 171.1012(i), which permits a cost of goods sold deduction to taxable entities "furnishing labor or materials to a project for the construction, improvement, remodeling, repair, or industrial maintenance ... of real property...." Gulf Copper further argued it could deduct these items under the more general provisions of Section 171.1012(c) and (d).

In addressing the applicability of Section 171.1011(g)(3), the Court held that payments to independent contractors could be excluded from total revenue. The Court held that the phrase "in connection with ... requires more than a remote, tangential relationship to the requisite design, remodeling or repair of real-property improvements." The Court determined that payments to the independent contractors satisfied this requirement citing the district court's unchallenged findings of fact which established that the taxpayer's work was a necessary component of enabling the rigs to drill at specified wells.

The Court further held that, because the taxpayer was contractually obligated to pay its subcontractors to perform their work, amounts paid to the subcontractors were "mandated by contract" for purposes of Section 171.1011(g)(3) to flow through the taxable entity to the subcontractor. In rejecting the Comptroller's narrow interpretation of this provision the Court stated, the "mandated by contract" language does not require that funds be earmarked in a contract and "requires only that there be a contract or subcontract in place requiring that the taxable entity's subcontractors be paid."

With respect to the cost of goods sold deduction, the Court stated that, while the phrase "in connection with" in Section 171.1011(g)(3) is an expanding term, the phrase "furnishing to" in subsection (i) reflects restricting language. Under this more limiting language, the Court held that "the requisite labor or materials must be furnished to or incorporated into the real property itself." According to the Court, Gulf Copper did not satisfy this requirement because the labor and materials to survey, repair, and upgrade the rigs were not and did not become part of the wells or well sites.

The Court also rejected Gulf Coppers' broader argument under Section 171.1012(h) that it should be able to include all of its costs in cost of goods sold to the extent deductible for federal tax purposes subject only to the limitations in subsections (e) and (f). Subsection (h) requires a taxable entity to "determine its cost of goods sold, except was otherwise provided by [Section 171.1012], in accordance with the methods used on the federal income tax return on which the report ... is based." The Court construed this subsection to mean that "federal methods are to be used only where there are gaps in the Texas statute." For example, as the Court of Appeals had previously noted, the Tax Code gives no specific instruction as to what accounting method a taxable entity must use in calculating its costs (e.g., cash or accrual). Therefore, a taxable entity must use the same accounting method used on its federal return.

The Court remanded the case back to the district court to determine whether the remaining costs fall within the scope of the non-exhaustive list of costs allowed by subsections (c) and (d). Stated the Court, "whether a particularly cost may be included in the COGS subtraction is not dependent on whether a taxable entity engages in some qualifying activities but rather on whether that cost independently meets the requirements of Section 171.1012."

The Court's holding in Gulf Copper provides important guidance on the applicability of the two key statutory provisions addressing real property work: (Section 171.1011(g)(3) and Section 171.1012(i). These two sections have been the source of controversy between taxpayers and the Texas Comptroller and are likely to continue being so following the Court's holding. Current reporting practices should be examined in the context of this holding, not only with respect to prior reports, but particularly as the 2020 franchise tax reports become due.

Any questions regarding this case can be directed to either David Colmenero at dcolmenero@meadowscollier.com or Alex Pilawski at apilawski@meadowscollier.com. You can also reach both attorneys at (214)744-3700.

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The Texas Supreme Court Denies a Cost of Goods Sold Deduction to a Movie Theater Company in a Texas Franchise Tax Case

By David E. Colmenero and Alex J. Pilawski on April 13, 2020

 

In the recent case of *American Multi-Cinema, Inc. v. Hegar*, Cause No. 17-0464 (Tex. Apr. 3, 2020), the Texas Supreme Court held that a taxpayer engaged in exhibiting movies in movie theaters could not claim a cost of goods sold for the costs it incurred in exhibiting its movies. This case, which has been closely monitored by taxpayers and practitioners alike, addresses important questions regarding the definition of "tangible personal property" for cost of goods sold purposes. The Court ultimately concluded that American Multi-Cinema, Inc. ("AMC") did not qualify for the cost of goods sold deduction because it did not sell tangible personal property.

AMC argued that the cost of exhibiting movies could be included in cost of goods sold citing the broad definition of tangible personal property, which includes personal property that is "perceptible to the senses" (referred to by the Court as the "perceptibility prong") and "films ... intended or reasonably likely [to be] mass distributed ...."(referred to by the Court as the "film prong"). The Court rejected AMC's argument for several reasons. First, the Court held that the word "sold" for cost of goods sold purposes requires the transfer of property. Citing 19th Century case law, the Texas Business and Commerce Code and black letter law, the Court held, "Indeed, every sale must transfer property, and where no transfer occurs, nothing is sold." In connection with this initial holding, the Court also held that subsection (o) of Section 171.1012 did not override this requirement as to AMC. The Court stated subsection (o) applies to taxpayers engaged in the "production" or "distribution" of certain film products, and AMC was not involved in either of these activities under these terms' meaning within the film industry.

Second, the Court held that AMC was not involved in selling tangible personal property as contemplated by the statute. The Court stated, "We ... hold that property with a physical or demonstrable — that is, tangible —- presence must be transferred." The Court held that "[t]ransferring a film's creative content alone" did not satisfy this requirement. The Court stated that, while the Tax Code's definition of tangible personal property does not contemplate a particular medium, it does require that the "medium in which the property is embedded" be intended to or likely to be mass-distributed. In this case, the medium embodying exhibited films, which consisted of the auditoriums' speakers and screens according to AMC, were not mass-distributed or transferred.

Third, with respect to the "perceptibility prong", the Court similarly held that it requires a transfer of property with some physical or demonstrable presence, which did not occur in this case. The Court noted that the cost of goods sold provisions require that "personal property" be transferred, which is generally defined as "'everything that is subject to ownership' that is not real property." Stated the Court, "the 'sights and sounds' embodied in AMC's theaters are certainly perceptible to the senses, but are not 'subjected to ownership' and thus cannot be personal property."

In a footnote, the Court expressly disclaimed deciding whether the film exhibitions sold by AMC constituted the sale of a service or an intangible. The Court held that given its holding, it "need not decide whether film exhibition is a service."

The significance of the Court's holding to movie theaters may be significantly diminished by the fact that, in 2013, the Legislature amended the Tax Code to specifically permit movie theaters a cost of goods sold deduction for "costs ... in relation to the acquisition, production, exhibition, or use of a film or motion picture, including expenses for the right to use the film or motion picture." Tex. Tax. Code sec. 171.1012(t). Nevertheless, the Court's holding is potentially relevant in other contexts, particularly as it relates to the "perceptibility prong" within the definition of tangible personal property.

This decision is not yet final as the parties could still file a motion for rehearing. But, unless overruled or modified, this decision will soon reflect the law of the land in Texas. To the extent taxpayers have filed refund claims or taken reporting positions on prior franchise tax reports based on the potential outcome of this case, they may want to revisit those claims or reporting positions in light of this decision. Taxpayers and practitioners should be aware that the Comptroller may very well consider targeting for audit taxpayers and industries the Comptroller believes may have claimed a cost of goods sold deduction based on a definition of tangible personal property that is contrary to the Court's decision. Any questions regarding this case can be directed to either David Colmenero at dcolmenero@meadowscollier.com or Alex Pilawski at apilawski@meadowscollier.com. You can also reach both attorneys at (214)744-3700.

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Texas Supreme Court Issues Three Decisions Addressing Various Aspects of the Texas Franchise Tax

By David E. Colmenero and Alex J. Pilawski on April 6, 2020


In a monumental day for Texas franchise tax, the Texas Supreme Court issued on Friday, April 3rd, three much-anticipated decisions addressing different aspects of the Texas franchise tax. All three decisions address the cost of goods sold deduction. One of these decisions also addresses the applicability of the exclusion for real property work under Section 171.1011(g). These decisions are not yet final as the parties could still request a rehearing. However, once final, these decisions will be important in construing and applying the Texas franchise tax provisions for years to come.

One of these three cases involves the question of whether a movie theater chain could claim a cost of goods sold deduction for the cost of exhibiting movies. The Supreme Court held that, under the Tax Code as it existed for the tax years at issue, it could not. *See American Multi-Cinema, Inc. v. Hegar* (Case No. 17-0464). The second of these decisions involves the question of whether a taxpayer engaged in renting heavy-duty construction equipment could claim a deduction for the cost of delivering and picking up equipment from job sites. The Court held it could not. *See Sunstate Equipment Co., LLC v. Hegar*, (Cause No. 17-0444). The third decision addresses whether a taxpayer engaged in surveying, repairing and upgrading off-shore drilling rigs could claim a cost of goods sold deduction for the costs associated with that work. The Court held it could not. This latter case also addressed whether that same taxpayer could exclude payments made to independent contractors for work performed on the drilling rigs from total revenue as flow-through payments under Section 171.1011(g). On this issue, the Court held in favor of the taxpayer that the costs could be excluded. *See Hegar v. Gulf Copper & Manufacturing Corp.*, (Cause No. 17-0894).

Each of these decisions merits independent analysis. Over the next few days, we plan to issue a blog post addressing each in more detail. Meanwhile, any questions can be directed to either David Colmenero at dcolmenero@meadowscollier.com or Alex Pilawski at apilawski@meadowscollier.com. You can reach both attorneys by calling (214)744-3700.

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TAX SECTION OF
THE STATE BAR OF TEXAS

2019 – 2020 CALENDAR

June 2019	
Thurs - Fri 6/13-14/19	**SBOT Annual Meeting** JW Marriott Hotel 110 E 2nd St. Austin, Texas 78701 (512) 474-4777
Wed - Fri 6/12-14/19	**Leadership Academy Austin Session (with Annual Meeting)** Norton Rose Fulbright 98 San Jacinto Blvd, Ste 1100 Austin, Texas 78701 (512) 474-5201
Thursday 6/13/19	**Tax Section Council / Planning Retreat** JW Marriott Hotel Austin, Texas 78701 12:00 p.m. - 3:00 p.m.
Thursday 6/13/19	**2019 Tax Section Annual Meeting Speaker's Dinner** Second Bar + Kitchen 200 Congress Ave, Austin, TX 78701 (512) 827-2750
Thursday 6/13/19	**Presentation of Outstanding Texas Tax Lawyer** Award Presentation at State Bar Annual Meeting, Speakers' Dinner Second Bar + Kitchen 200 Congress Ave. Austin, TX 78701 (512) 827-2750
Friday 6/14/19	**2019 Tax Section Annual Meeting Program** JW Marriott Hotel 110 E 2nd St. Austin, Texas 78701 (512) 474-4777
Friday 6/14/19	**Interview of 2019 Tax Legend** **Presentation During Tax Section Annual Meeting Program** JW Marriott Hotel 110 E 2nd St. Austin, Texas 78701 (512) 474-4777

July 2019	
Thursday 7/4/19	**July 4th Holiday**
Thur - Sat 07/18-20/19	**Texas Bar College** Summer School Moody Gardens Hotel, Spa & Convention Center Seven Hope Boulevard Galveston, TX 77554
?	**Tax Section Budget Deadline** (Budget must be submitted to State Bar of Texas)
Monday 7/29/19	**SBOT Chair and Treasurer Training** Texas Law Center 1414 Colorado St. Austin, TX 78701 10:30 a.m. – 2:30 p.m.
August 2019	
Thurs – Fri 8/1-2/19	**Advanced Tax Law Course** Hilton Houston Westchase 9999 Westheimer Houston TX 77042 (713) 974-1000
Tuesday 8/6/19	**Officers' Call** 4:00 p.m.
Fri – Sat 8/8-9/19	**Officers' Retreat** Dallas, Texas
Thurs – Tues 8/8-13/19	**American Bar Association Annual Meeting** San Francisco Marriott Marquis, San Francisco, CA
Friday 8/16/19	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 1-800-270-2297 Conference Code: 15109392 11:00 a.m.
Friday 8/23/19	**Meeting of Council, Committee Chairs, and Committee Vice Chairs** Norton Rose Fulbright US LLP 1301 McKinney, Suite 5100 Houston, Texas 77010 (48th Floor) 10:30 a.m. – 12:30 p.m. w/lunch Dial In: 866-203-7023 Conference Code: 12777252# Security Passcode: None – at the prompt press *

Sept 2019	
?	**Deadline for Submissions to State Bar of Texas Board of Directors Meeting Agenda**
Monday 9/2/19	**Labor Day Holiday**
Wednesday 9/4/19	**Officers' Call** 2:00 p.m.
Monday 9/9/19	**Tax Court Pro Bono Calendar Call-El Paso**
Thurs – Sat 9/12-14/19	**ABA Business Law Section Annual Meeting** Washington DC
Thursday 9/12/19	**Deadline for Chair to Appoint Nominating Committee** (Bylaws 4.10029
Thursday 9/12/19	**Tax Court Pro Bono Calendar Call-Lubbock**
Thursday 09/12/19	**Law School Outreach – Texas Tech School of Law**
Thursday 9/12/19	**Deadline for Appointment of Tax Section Nominating Committee**
Friday 9/13/19	**Submission Deadline – Texas Tax Lawyer (Fall Edition)** Submit to TTL Editor: Michelle Spiegel michelle.spiegel@nortonrosefulbright.com
Thurs - Fri 9/19-20/19	**Leadership Academy Houston Session** **[cancelled due to flooding]**
Friday 9/20/19	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 1-800-270-2297 Conference Code: 15109392 11:00 a.m.
Thursday 9/26/19	**Law School Outreach – Texas A&M School of Law**
Sun - Tues 9/29 –10/1/19	**Rosh Hashanah (Religious Holiday)**

Oct 2019	
Thurs-Sat 10/3-5/19	**ABA Tax Section Joint Fall Meeting** San Francisco, CA
Tues - Weds 10/8-9/19	**Yom Kippur (Religious Holiday)**
Wednesday 10/9/19	**Law School Outreach – University of North Texas** 12:00 p.m.
Wednesday 10/9/19	**Officers' Call** 2:00 p.m.
Sun - Sun 10/13-20/19	**Sukkot (Religious Holiday)**
Monday 10/14/19	**Columbus Day Holiday**
Tuesday 10/15/19	**Tax Court Pro Bono Calendar Call –Dallas**
Friday 10/18/19	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 1-800-270-2297 Conference Code: 15109392 11:00 a.m.
Tues - Fri 10/22-25/19	**Council on State Taxation (COST) 50th Annual Meeting** JW Marriott, Washington DC
Friday 10/25/19	**Council of Chairs Meeting** Texas Law Center 1414 Colorado St. Austin, TX 78701 10:30 a.m. – 2:30 p.m.
Fri - Sat 10/25-26/19	**National Association of State Bar Tax Sections ("NASBTS") Annual Meeting** (members may attend at their own expense) Alston & Bird, LLP 950 F Street, NW Washington, DC 20004
Thursday 10/31/19	**Insurance Renewal is Due** **Note Premium Paid by Big Bar!**

Nov 2019	
Friday 11/1/19	**Meeting of Council** Norton Rose Fulbright US LLP 1301 McKinney, Suite 5100 Houston, Texas 77010 (48th Floor) 10:30 a.m. – 12:30 p.m. w/lunch Dial In: 866-203-7023 Conference Code: 12777252# Security Passcode: None – at the prompt press *
Monday 11/4/19	**Tax Court Pro Bono Calendar Call-Houston**
Wednesday 11/6/19	**Officers' Call** 2:00 p.m.
Thurs - Fri 11/7-8/19	**Austin Chapter CPA Annual Tax Conference** Norris Conference Center, Austin, Texas
Monday 11/11/19	**Veterans Day Holiday**
Tuesday 11/12/19	**Annual Meeting Deadline for submitting to SBOT date and time preferences for CLE programs, section meetings, council meetings, socials and special events**
Tuesday 11/14-15/19	**Texas Taxpayers and Research Association (TTARA) Annual Meeting** Austin, TX
Friday 11/15/19	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 1-800-270-2297 Conference Code: 15109392 11:00 a.m.
Monday 11/18/19	**Tax Court Pro Bono Calendar Call - Dallas**
Tuesday 11/20/19	**Comptroller Annual Briefing** 9 a.m. – 4:30 p.m. Robert E Johnson Legislative Office Building 1501 Congress Ave Austin, TX
Thurs-Fri 11/21-22/19	**International Tax Law Symposium** Houston, TX
Thursday 11/28-29/19	**Thanksgiving Day Holiday**

Dec. 2019	
Monday 12/2/19	**Tax Court Pro Bono Calendar Call-Dallas & San Antonio**
Wednesday 12/4/19	**Officers' Call** 2:00 p.m.
Wed - Thurs 12/4-6/19	**UT Law 66th Annual Taxation Conference** AT&T Conference Center, Austin, Texas
Monday 12/9/19	**Tax Court Pro Bono Calendar Call-Houston**
Friday 12/20/19	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 1-800-270-2297 Conference Code: 15109392 11:00 a.m.
Sun - Mon 12/22-30/19	**Hanukkah (Other Holiday)**
Wednesday 12/25/19	**Christmas (Other Holiday)**
Jan. 2020	
Wednesday 1/1/20	**New Year's Day Holiday**
?	**Nomination Period Opens for 2019 Outstanding Texas Tax Lawyer Award** • Nominations due April 1, 2020 • Nomination forms to be posted on website • Submit nomination forms to Tax Section Secretary: Dan Baucum
Wednesday 1/8/20	**Officers' Call** 2:00 p.m.
?	**Deadline for receipt of information for SBOT Board of Directors Meeting Agenda**
Monday 1/6/20	**Annual Meeting Deadline: Submit programming for the registration brochure, CLE topics, speakers, and speaker contact information and firms**
Monday 1/6/20	**Tax Court Pro Bono Calendar Call-Dallas**

Friday 1/10/20	**Meeting of Council, Committee Chairs, and Committee Vice Chairs** Polsinelli PC 2950 N. Harwood, Suite 2100 Dallas, Texas 75201
Saturday 1/11/20	**Pro Bono Day-Houston and San Antonio**
Friday 1/17/20	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 1-800-270-2297 Conference Code: 15109392 11:00 a.m.
Monday 1/20/20	**Martin Luther King Jr. Day (Holiday)**
Thurs - Fri 1/23-24/20	**Leadership Academy San Antonio Session (with Graduation Ceremony)** Chamberlain Hrdlicka 112 E Pecan St Ste 1450 San Antonio TX 78205 (210) 253-8383
Friday 1/24/20	**Submission Deadline – Texas Tax Lawyer (Winter Edition)** Submit to TTL Editor: Michelle Spiegel michelle.spiegel@nortonrosefulbright.com
Monday 1/27/20	**Tax Court Pro Bono Calendar Call-Houston**
Thurs - Sat 1/30-2/1/20	**American Bar Association Section of Taxation Midyear Meeting** Boca Raton, FL
Feb. 2020	
Saturday 2/1/20	**Register and make guest room reservations for Annual Meeting (www.texasbar.com/annualmeeting)**
Monday 2/3/20	**Tax Court Pro Bono Calendar Call-** **Dallas & San Antonio**
Wednesday 2/5/20	**Officers' Call** 2:00 p.m.
Friday 2/7/20	**SBOT Tax Section Tax Law in a Day CLE** Houston, Texas
Monday 2/17/20	**George Washington's Birthday (Holiday)**
Wednesday 2/19/20	**Law School Outreach – Texas Southern University**

Friday 2/21/20	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 1-800-270-2297 Conference Code: 15109392 11:00 a.m.
Monday 2/24/20	**Tax Court Pro Bono Calendar Call – Houston**
Wednesday 2/26/20	**Law School Outreach – St. Mary's University**
Thurs - Fri 2/27-28/20	**International Fiscal Association Annual Congress** Boston MA
Friday 2/28/20	**Council of Chairs Meeting and Section Representative Election** Texas Law Center 1414 Colorado St. Austin, TX 78701 10:30 a.m. – 2:30 p.m.
March 2020	
Sunday 3/1/20	**Nomination Deadline for Chair-Elect, Secretary, Treasurer, and 3 Elected Council Members**
Monday 3/2/20	**Annual Meeting Deadline: Order special awards, council and chair plaques, food and beverage and audio visuals**
Tuesday 3/3/20	**Law School Outreach – University of Texas School of Law**
Wednesday 3/4/20	**Officers' Call** 2:00 p.m.
Friday 3/20/20	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 1-800-270-2297 Conference Code: 15109392 11:00 a.m.
Tuesday 3/24/20	**Nominating Committee Report Due to Council** (Bylaws 4.1)
~~Friday~~ ~~3/27/20~~	**~~2020 State Bar of Texas Property Tax Committee Meeting & Legal Seminar~~** ~~Thompson Conference Center - UT Campus~~ ~~2405 Robert Dedman Dr.~~ ~~Austin, Texas 78712~~
~~Sun - Wed~~ ~~3/29-4/1/20~~	**~~Annual Meeting of Unclaimed Property Professionals Organization (UPPO)~~** ~~JW Marriott Starr Pass~~ ~~Tucson, AZ~~

~~Monday 3/30/20~~	**~~Tax Court Pro Bono Calendar Call-Dallas~~**
April 2020	
Wednesday 4/1/20	**Nominations for Outstanding Texas Tax Lawyer Due to Dan Baucum** Email**:** (dbaucum@baucumlaw.com)
Wednesday 4/1/20	**Officers' Call** 2:00 p.m.
Friday 4/3/20	**Meeting of Council – BY ZOOM** **Note: Council Vote and Selection of Recipient of 2020 Outstanding Texas Tax Lawyer Award**
Monday 4/6/20	**Law Student Scholarship Application Deadline**
Wed-Thurs 4/8-16/20	**Passover (Religious Holiday)**
Friday 4/10/20	**Submission Deadline – Texas Tax Lawyer (Spring Edition)** Submit to TTL Editors: Michelle Spiegel michelle.spiegel88@gmail.com and Aaron Borden Aaron.Borden@us.gt.com
Fri – Sun 4/10-12/20	**Good Friday, Easter (Religious Holiday)**
Friday 4/17/20	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 1-800-270-2297 Conference Code: 15109392 11:00 a.m.
Monday 4/15/20	**Annual Meeting Deadline: course materials for app; CLE articles, PowerPoints, speaker bios and photos**
~~Monday 4/20/20~~	**~~Tax Court Pro Bono Calendar Call – Houston~~**
Monday 4/22/20	**Annual Meeting Deadline: submit any final programming changes for onsite event guide; CLE topic titles, speakers, speaker contact information and firm**
~~Thurs – Sat 4/29-5/2/20~~	**~~American Bar Association Section of Taxation May Meeting~~** ~~Marriott Marquis, Washington, DC~~

May 2020	
Wednesday 5/6/20	**Officers' Call** 2:00 p.m.
Monday 5/11/20	**Last Day of Early Bird Registration for Annual Meeting**
~~Monday~~ ~~5/11/20~~	~~**Tax Court Pro Bono Calendar Call – Dallas**~~
Friday 5/15/20	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 1-800-270-2297 Conference Code: 15109392 11:00 a.m.
Monday 5/18/20	**Deadline to make guest room reservations for Annual Meeting at discounted rate (www.texasbar.com/annualmeeting)**
Monday 5/25/20	**Memorial Day Holiday**
June 2020	
Wednesday 6/3/20	**Officers' Call** 2:00 p.m.
~~Wed – Fri~~ ~~6/3-5/20~~	~~**Annual Texas Federal Tax Institute**~~ ~~La Cantera Resort, San Antonio, Texas~~
Tuesday 6/5/20	**Deadline to Deliver to Members or Post on Tax Section Website Notice of Annual Meeting** (Bylaws 7.1) **Nominating Committee Report to be Posted on Tax Section Website** (Bylaws 4.1)
~~Monday~~ ~~6/8/20~~	~~**Tax Court Pro Bono Calendar Call – Houston**~~
~~Monday~~ ~~6/15/20~~	~~**Tax Court Pro Bono Calendar Call – Dallas**~~
Friday 6/19/20	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 1-800-270-2297 Conference Code: 15109392 11:00 a.m.
Thurs – Fri 6/25-26/20	**SBOT Annual Meeting** Hilton Anatole, Dallas, Texas
TBD	**Tax Section Council Planning Retreat**

TBD	**Presentation of Outstanding Texas Tax Lawyer**
~~Thursday 6/25/20~~	~~**2020 Tax Section Annual Meeting Speaker's Dinner**~~
Friday 6/26/20	**2020 Tax Section Annual Meeting Program – VIRTUAL**
Friday 6/26/20	**Award Presentation to Council and Chairs During Tax Section Annual Meeting Program – VIRTUAL**
August 2020	
Thurs – Fri 8/27-28/20	**Tax Law 2020: A Practical Guide to Tax Law in the Real World** Citiplace Conference Center Dallas TX
Other Events Not Yet Scheduled	
TBD	**SBOT Tax Section Deep Dive Tax Workshop CLE**
TBD	**Additional Law School Outreach Programs**
Future Annual Meeting Dates and Locations	
Thurs-Fri 6/17-18/21	**State Bar of Texas Annual Meeting** Omni Hotel and Fort Worth Convention Center, Fort Worth,
Thurs-Fri 6/9-10/22	**State Bar of Texas Annual Meeting** Marriott Marquis, Houston
Thurs-Fri 6/22-23/23	**State Bar of Texas Annual Meeting** JW Marriott, Austin
Thurs-Fri 6/20-21/24	**State Bar of Texas Annual Meeting** Hilton Anatole, Dallas

Bylaws 7.4: Notice of regular meetings shall be delivered to the Council members by electronic mail, U.S. mail, overnight delivery service, or posting on the Section's website (or combination thereof) at least ten days prior to the date designated for such regular meeting.

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STATE BAR OF TEXAS

LEADERSHIP ROSTER

2019-2020

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THE STATE BAR OF TEXAS
COMMITTEE CHAIRS AND VICE CHAIRS
2019-2020

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