RECENT DEVELOPMENTS IN FEDERAL INCOME TAXATION

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

By

Bruce A. McGovern
Professor of Law and Director, Tax Clinic
South Texas College of Law Houston
Houston, Texas 77002
Tele: 713-646-2920
e-mail: bmcgovern@stcl.edu

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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.

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 **2**

II. BUSINESS INCOME AND DEDUCTIONS **2**

A. Income 2
B. Deductible Expenses versus Capitalization 2
C. Reasonable Compensation 2
D. Miscellaneous Deductions 2
E. Depreciation & Amortization 4
F. Credits 5
G. Natural Resources Deductions & Credits 5
H. Loss Transactions, Bad Debts, and NOLs 5
I. At-Risk and Passive Activity Losses 7

III. INVESTMENT GAIN AND INCOME **7**

IV. COMPENSATION ISSUES **7**

A. Fringe Benefits 7
B. Qualified Deferred Compensation Plans 7
C. Nonqualified Deferred Compensation, Section 83, and Stock Options 7
D. Individual Retirement Accounts 7

V. PERSONAL INCOME AND DEDUCTIONS 7
VI. CORPORATIONS 7
VII. PARTNERSHIPS 7
VIII. TAX SHELTERS 7
IX. EXEMPT ORGANIZATIONS AND CHARITABLE GIVING 7
X. TAX PROCEDURE 7
A. Interest, Penalties, and Prosecutions 7
B. Discovery: Summonses and FOIA 8
C. Litigation Costs 9
D. Statutory Notice of Deficiency 9
E. Statute of Limitations 9
F. Liens and Collections 9
G. Innocent Spouse 10
H. Miscellaneous 10
XI. WITHHOLDING AND EXCISE TAXES 11
XII. TAX LEGISLATION 11
A. Enacted 11

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 returement 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