RECENT DEVELOPMENTS IN FEDERAL INCOME TAXATION

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

By

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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. Depreciation & Amortization

F. Credits

G. Natural Resources Deductions & Credits

H. Loss Transactions, Bad Debts, and NOLs

I. At-Risk and Passive Activity Losses

III. INVESTMENT GAIN AND INCOME

A. Gains and Losses

B. Interest, Dividends, and Other Current Income

C. Profit-Seeking Individual Deductions

D. Section 121

E. Section 1031

F. Section 1033

G. Section 1035

H. Miscellaneous

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. <u>Fringe Benefits</u>

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

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. <u>Nonqualified Deferred Compensation, Section 83, and Stock Options</u>

D. <u>Individual Retirement Accounts</u>

V. PERSONAL INCOME AND DEDUCTIONS

A. <u>Rates</u>

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. <u>Divorce Tax Issues</u>

F. <u>Education</u>

G. <u>Alternative Minimum Tax</u>

VI. CORRORATIONS

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. Charitable Giving

1. ♫♪"Workin' in the coal mine . . . Oops, about to slip down"♪♫ on the extinguishment clause requirement of Reg. § 1.170A-14(g)(6)(ii). Coal Property Holdings, LLC v. Commissioner, 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.