RECENT DEVELOPMENTS IN FEDERAL INCOME TAXATION

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

By

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State Bar of Texas Tax Section
First Wednesday Tax Update
June 3, 2020

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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. Oh, come on! No more deductions for taking a client to a professional sports game? The 2017 Tax Cuts and Jobs Act, § 13304, amended Code § 274(a) to disallow deductions for costs "[w]ith respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation." Similarly, no deduction is allowed for membership dues with respect to any club organized for business, pleasure, recreation or other social purposes. This rule applies to taxable years beginning after 2017.

What is "entertainment"? Regulations issued before the Tax Cuts and Jobs Act (Reg. § 1.274-2(b)(1)) provide that whether an activity constitutes entertainment is determined using an objective test and set forth the following definition of the term "entertainment":

> [T]he term "entertainment" means any activity which is of a type generally considered to constitute entertainment, amusement, or recreation, such as entertaining at night clubs, cocktail lounges, theaters, country clubs, golf and athletic clubs, sporting events, and on hunting, fishing, vacation and similar trips, including such activity relating solely to the taxpayer or the taxpayer's family. The term "entertainment" may include an activity, the cost of which is claimed as a business expense by the taxpayer, which satisfies the personal, living, or family needs of any individual, such as providing food and beverages, a hotel suite, or an automobile to a business customer or his family. The term "entertainment" does not include activities which, although satisfying personal, living, or family needs of an individual, are clearly not regarded as constituting entertainment, such as (a) supper money provided by an employer to his employee working overtime, (b) a hotel room maintained by an employer for lodging of his employees while in business travel status, or (c) an automobile used in the active conduct of trade or business even though used for routine personal purposes such as commuting to and from work. Reg. § 1.274-2(b)(1).

The complete disallowance of deductions for costs of activities of a type generally considered to constitute entertainment will give rise to some difficult issues. Activities can be thought of as falling on a spectrum. At one end of the spectrum are activities that clearly are not entertainment. At the other end are activities that clearly are entertainment. The difficult issues will arise for the many activities that fall somewhere in the middle, as illustrated by the following examples.

> **Example 1:** A self-employed CPA travels out of town to perform an audit. The CPA flies to the client's location and stays at a hotel for several days. While there, the CPA buys breakfast, lunch, and dinner each day. The meals are not "entertainment" and therefore are not subject to disallowance under amended § 274(a). They are, however, subject to the 50 percent limitation of § 274(n)(1).

> **Example 2:** A self-employed attorney invites a client to attend a professional sports game and pays the entire cost associated with attending. The cost of attending will be regarded as entertainment and therefore not deductible.

> **Example 3:** The client of a self-employed attorney spends the day in the attorney's office to review strategy for an upcoming IRS Appeals conference. They take a break for lunch at a restaurant down the street. During lunch, they continue their discussion. The attorney pays for the meal. Is the meal nondeductible "entertainment"? Or is it (at least in part) a deductible business expense subject to the 50 percent limitation of § 274(n)(1)?

a. Business meals are not "entertainment" and are still deductible subject to the normal 50 percent limitation, says the IRS. Notice 2018-76, 2018-42 I.R.B. 599 (10/3/18). In this notice, the IRS announced that Treasury and the IRS will issue proposed regulations under § 274 that will include guidance on the deductibility of expenses for certain business meals. According to the notice, the 2017 TCJA did not change the definition of "entertainment" under § 274(a)(1), and therefore the regulations under § 274(a)(1) that define entertainment continue to apply. Further, the notice states that, although the 2017 TCJA did not address the circumstances in which the provision of food and beverages might constitute entertainment, its legislative history "clarifies that taxpayers generally may continue to deduct 50 percent of the food and beverage expenses associated with operating their trade or business." The notice provides that, until proposed regulations are issued, taxpayers can rely on this notice and can deduct 50 percent of an otherwise allowable business meal expense if five requirements are met: **(1)** the expense is an ordinary and necessary expense under § 162(a) paid or incurred during the taxable year in carrying on any trade or business; **(2)** the expense is not lavish or extravagant under the circumstances; **(3)** the taxpayer, or an employee of the taxpayer, is present at the furnishing of the food or beverages; **(4)** the food and beverages are provided to a current or potential business customer, client, consultant, or similar business contact; and **(5)** in the case of food and beverages provided during or at an entertainment activity, the food and beverages are purchased separately from the entertainment, or the cost of the food and beverages is stated separately from the cost of the entertainment on one or more bills, invoices, or receipts. The notice also provides that the entertainment disallowance rule may not be circumvented through inflating the amount charged for food and beverages. The notice provides the following examples:

Example 1.

1. Taxpayer A invites B, a business contact, to a baseball game. A purchases tickets for A and B to attend the game. While at the game, A buys hot dogs and drinks for A and B.
2. The baseball game is entertainment as defined in § 1.274-2(b)(1)(i) and, thus, the cost of the game tickets is an entertainment expense and is not deductible by A. The cost of the hot dogs and drinks, which are purchased separately from the game tickets, is not an entertainment expense and is not subject to the § 274(a)(1) disallowance. Therefore, A may deduct 50 percent of the expenses associated with the hot dogs and drinks purchased at the game.

Example 2.

1. Taxpayer C invites D, a business contact, to a basketball game. C purchases tickets for C and D to attend the game in a suite, where they have access to food and beverages. The cost of the basketball game tickets, as stated on the invoice, includes the food and beverages.

2. The basketball game is entertainment as defined in § 1.274-2(b)(1)(i) and, thus, the cost of the game tickets is an entertainment expense and is not deductible by C. The cost of the food and beverages, which are not purchased separately from the game tickets, is not stated separately on the invoice. Thus, the cost of the food and beverages also is an entertainment expense that is subject to the § 274(a)(1) disallowance. Therefore, C may not deduct any of the expenses associated with the basketball game.

Example 3.

1. Assume the same facts as in Example 2, except that the invoice for the basketball game tickets separately states the cost of the food and beverages.

2. As in Example 2, the basketball game is entertainment as defined in § 1.274-2(b)(1)(i) and, thus, the cost of the game tickets, other than the cost of the food and beverages, is an entertainment expense and is not deductible by C. However, the cost of the food and beverages, which is stated separately on the invoice for the game tickets, is not an entertainment expense and is not subject to the § 274(a)(1) disallowance. Therefore, C may deduct 50 percent of the expenses associated with the food and beverages provided at the game.

b. Proposed regulations issued. REG-100814-19, Meals and Entertainment Expenses Under Section 274, 85 F.R. 11020 (2/26/20). Treasury and the IRS have issued proposed regulations to implement the changes made to § 274(a) by § 13304 of the 2017 Tax Cuts and Jobs Act. Specifically, new Prop. Reg. § 1.274-11 sets forth the rules for entertainment expenses. New Prop. Reg. § 1.274-12 sets forth the separate rules for business meals, travel meals, and employer-provided meals. The proposed regulations affect taxpayers who pay or incur expenses for meals or entertainment in taxable years beginning after December 31, 2017, and will apply to those taxpayers for taxable years that begin on or after the date of publication of final regulations in the Federal Register. Meanwhile, pending the issuance of final regulations, taxpayers may rely upon the proposed regulations for the proper treatment of entertainment expenditures and food or beverage expenses, as applicable, paid or incurred after December 31, 2017. In addition, taxpayers may rely upon the guidance in Notice 2018-76 until the proposed regulations are finalized. Set forth below is a high-level summary of the proposed regulations, but affected taxpayers and their advisors should study the new guidance carefully rather than rely upon this summary.

Entertainment expenses. With respect to § 274(a) *entertainment expenses*, Prop. Reg. § 1.274-11 restates the new deduction-disallowance rule under § 274(a), including the application of the disallowance rule to dues or fees relating to any social, athletic, or sporting club or organization. The proposed regulations substantially incorporate the existing definition of "entertainment" in § 1.274-2(b)(1), with minor modifications to remove outdated language. The proposed regulations also confirm that the nine exceptions to § 274(a), which are set forth in § 274(e) (e.g., entertainment costs or club dues reported as employee-compensation, recreational expenses for employees, employee or stockholder business meeting expenses, etc.) continue to apply to entertainment expenses. Importantly, like Notice 2018-76, the proposed regulations clarify that separately-stated, separately-charged food or beverage expenses are not considered entertainment expenses subject to disallowance under § 274(a).

Business meal expenses. With respect to § 274(k) *business meal expenses*, Prop. Reg. § 1.274-12(a)(1)-(3) incorporates the guidance published in Notice 2018-76 as well as incorporates other statutory requirements taxpayers must meet to deduct 50 percent of an otherwise allowable business meal expense. For instance, under § 274(k) the food or beverage expense at a business meal must not be lavish or extravagant under the circumstances, and the taxpayer, or an employee of the taxpayer, must be present at the furnishing of the food or beverages. Further, the expense must be a § 162 ordinary and necessary expense paid or incurred during the taxable year in carrying on any trade or business; and the food and beverages must be provided to a current or potential business customer, client, consultant, or similar business contact.

Further guidance. In addition, new Prop. Reg. § 1.274-12 goes beyond Notice 2018-76 in several respects. ***One***, even though the rules for travel expenses were not amended by the 2017 Tax Cuts and Jobs Act, new Prop. Reg. § 1.274-12(a)(4) provides further guidance under § 274(n) regarding food and beverage expenses paid or incurred with respect to travel, including the substantiation requirements in § 274(d). Accordingly, the proposed regulations provide that such travel meal expenses, in addition to being subject to certain special rules in § 274(m) (cruise expenses, education travel expenses, and spouse and dependent travel expenses), are subject to the 50 percent deduction limitation of § 274(n). ***Two***, new Prop. Reg. § 1.274-12 clarifies the treatment of food or beverages provided to employees as *de minimis* fringe benefits excludable by employees under § 132(e). Under Reg. § 1.132-7, employee meals provided on a nondiscriminatory basis by an employer qualify under § 132(e) if (1) the eating facility is owned or leased by the employer; (2) the facility is operated by the employer; (3) the facility is located on or near the business premises of the employer; (4) the meals furnished at the facility are provided during, or immediately before or after, the employee's workday; and (5) the annual revenue derived from the facility normally equals or exceeds the direct operating costs of the facility. Such employer-provided meals previously were fully deductible by the employer and fully excludable by employee; however, the 2017 Tax Cuts and Jobs Act, § 13304, amended Code § 274(n) to limit the employer's deduction to 50 percent of the cost of employee meals provided at an employer-operated eating facility (unless, as discussed immediately below, an exception applies). Beginning in 2026, the costs of such employer-provided meals will be *entirely disallowed* as deductions pursuant to new Code § 274(o). ***Three***, new Prop. Reg. § 1.274-12(c) addresses the six exceptions to the 50 percent food and beverage disallowance rule set forth in § 274(n)(2) (e.g., food or beverage expenses treated as compensation to employee, recreational expenses for employees, etc.). ***Four***, in response to practitioner concerns, Prop. Reg. § 1.274-12(c) also addresses by way of examples several common scenarios, including the deductibility of expenses for (i) food or beverages provided to food service workers who consume the food or beverages while working in a restaurant or catering business; (ii) snacks available to employees in a pantry, break room, or copy room; (iii) refreshments provided by a real estate agent at an open house; (iv) food or beverages provided by a seasonal camp to camp counselors; (v) food or beverages provided to employees at a company cafeteria; and (vi) food or beverages provided at company holiday parties and picnics.

E. Depreciation & Amortization

F. Credits

1. Take some COVID-19 sick leave (or maybe some family leave) on the Treasury! The Families First Coronavirus Response Act provides refundable tax credits that reimburse (smaller?) employers for providing paid sick and family leave wages to their employees. The Families First Coronavirus Response Act (FFCRA), signed into law on March 18, 2020, authorizes refundable tax credits to eligible employers to offset the cost of paid sick and family leave provided to employees for COVID-19 related leave. Under the FFCRA, eligible employers must offer paid leave to their employees under two separate sets of temporary, emergency provisions. First, the Emergency Paid Sick Leave Act (EPSLA), which is Division E of the FFRCA, entitles workers to as much as 80 hours of paid sick leave ("qualified sick leave wages") under specific circumstances related to COVID-19. Second, the Emergency Family and Medical Leave Expansion Act ("Expanded FMLA"), which is Division C of the FFRCA, entitles workers to paid family and medical leave ("qualified family leave wages") again under specified circumstances related to COVID-19. Eligible employers who are required to pay employees for leave under these emergency provisions are allowed a tax credit to fully refund the cost of the leave that is required under these emergency provisions. The amount of these tax credits generally is increased by any qualified health plan expenses allocable to and the eligible employer's share of Medicare tax on the qualified leave wages.

Eligible Employers. An eligible employer (referred to in the legislation as a "covered employer") is generally defined in § 5110(2)(B) of the FFRCA as a private business, including a tax-exempt organization, that employs fewer than 500 employees. In general, a business has fewer than 500 employees if, at the time the relevant leave is taken, the business employs less than 500 *full and part time* employees. Federal employees generally are covered by Title II of the Family and Medical Leave Act (FMLA). While the FMLA generally was not amended by the FFCRA, federal employees covered by Title II of the FMLA are covered by the FFRCA's paid sick leave provision. Small businesses employing fewer than 50 employees may qualify for exemption from the FFCRA's requirement to provide paid leave to employees required to take leave due to a school closure or when child care becomes unavailable.

Paid Sick Leave. Under the EPSLA (§ 5102(a) of the FFRCA), an employer is required to provide paid sick leave to an employee if the employee is unable to work (or telework) because the employee needed leave for any one of the following circumstances:

(1) The employee is subject to a federal, state, or local quarantine or isolation order related to COVID-19.

(2) The employee has been advised by a health care provider to self-quarantine due to concerns related to COVID-19.

(3) The employee is experiencing symptoms of COVID-19 and seeking a medical diagnosis.

(4) The employee is caring for an individual who is subject to an order as described in subparagraph (1) or has been advised as described in paragraph (2).

(5) The employee is caring for a son or daughter if the school or place of care of the son or daughter has been closed, or the child care provider of such son or daughter is unavailable, due to COVID-19 precautions.

(6) The employee is experiencing any other substantially similar condition specified by the Secretary of Health and Human Services.

The first three circumstances listed above generally are situations in which an employee's own health needs are in question. The following two circumstances are situations in which the employee is unable to work because he or she must care for another person, such as a child or dependent of the employee. Under § 5102(b)(2)(A) of the FFCRA, full-time employees who qualify under any of the circumstances above are entitled to receive up to 80 hours or 10 days of paid sick time. According to § 5102(b)(2)(B) of the FFRCA, a part-time employee is entitled to receive sick time equal to the average number of hours the employee worked over a two-week period. Section 3012 of the FFRCA, which amends the FMLA for this purpose, an "eligible employee" is an employee who has been employed for at least 30 calendar days. Paid sick time for all employees, according to FFCRA § 5110(b)(5), generally is compensated at an amount equal to the employee's regular rate of pay. The rate of pay for sick leave, however, is limited to a maximum amount depending on whether the employee qualifies under the first three or last three circumstances set out above. If the employee qualifies under one of the first three circumstances (applying to his or her own health needs), the rate of compensation for sick leave caps out at $511 per day and $5,110 total. The amount of compensation is lower if the employee qualifies under circumstances (4)-(6) above. In those circumstances, the rate of pay is 2/3 of the employee's regular rate of pay or, if higher, the federal or state applicable minimum wage up to $200 per day and $2,000 in the aggregate. Thus, total sick leave wages in circumstances (4)-(6) caps out at $200 per day or $2,000.

Paid Family Leave Credit. The FFRCA provides a tax credit for employers who pay qualified family leave wages to employees who cannot report to work or work remotely in order to care for a son or daughter if the school or place of care of the child has been closed, or if the child care provider is unavailable, due to COVID-19 precautions. These reasons match circumstance (5) listed above which is the only relevant and qualifying circumstance for family leave wages. In general, according to FFCRA § 7003(c), "qualified family leave wages" means wages that an eligible employer must pay to an eligible employee under the Expanded FMLA provisions of the FFRCA. Employees taking family leave are paid at 2/3 of their regular rate or 2/3 of the applicable minimum wage, whichever is higher. The amount of "qualified family leave wages" that are taken into account for purposes of the credit, however, are limited to $200 per day per employee. There is also a $10,000 per employee maximum aggregate allowed of qualified family leave wages that may be taken into account for purposes of the credit. Under this math, as much as ten weeks of family leave wages can be received by an employee. Note, however, that the first ten days of leave taken may be without pay. The reason for this rule is that it is anticipated that in the first ten-day period, the employee may receive qualified sick leave wages under the EPSLA as described above. Alternatively, an employee may choose to receive paid leave under the eligible employer's regular sick leave, vacation leave, or other policies allowing for paid time off. Thus, after ten days, the eligible employer must provide the employee with qualified family leave wages for up to ten weeks. In summary, employees taking family leave are paid at 2/3 their regular rate or 2/3 the applicable minimum wage, whichever is higher, up to $200 per day and $12,000 in the aggregate (over a twelve-week period—two weeks of paid sick leave followed by up to ten weeks of paid expanded family and medical leave).

Sick Leave and Family Leave Credit for Employers. An eligible employer who is required to pay qualified sick leave wages or qualified family leave wages under the FFCRA is entitled to a fully refundable tax credit. The amount of the credit is equal to the amount of qualified sick leave wages and qualified family leave wages paid to employees from April 1, 2020, through December 31, 2020. The credit is increased dollar-for-dollar by the employer's payment of qualified health plan expenses that relate to the employee's sick leave or family leave payments and the employer's share of the Medicare tax imposed on those payments.

Employers that pay qualified sick leave wages or qualified family leave wages are allowed to forego payment of federal employment taxes in an amount that is equal to the wages and qualified health plan expenses. In other words, when an employer pays its employees, the employer generally withholds and deposits federal income taxes on the employee's wages and the employee's share of Social Security and Medicare taxes. The employer also deposits the employer's share of Social Security and Medicare taxes. In depositing these employment taxes on a quarterly basis, employers must file employment tax returns (Form(s) 941, 943, 944, or CT-1) with the IRS. Eligible employers who pay qualified sick leave wages or qualified family leave wages that are eligible for the credit may retain (e.g., not remit) an amount of the employment taxes equal to the amount of qualified sick leave wages and qualified family leave wages paid during that quarter (plus certain related health plan expenses and the employer's share of the Medicare taxes on the qualified leave wages) rather than deposit these amounts with the IRS. If retention of these employment taxes is not sufficient to compensate the employer for the qualified leave wages, qualified health plan expenses, and the employer's share of Medicare taxes due, employers may additionally file for advance payments from the IRS. Stated otherwise, if quarterly employment taxes due in a particular quarter are less than the amount of the credit for which the employer is eligible, the employer may receive the remaining credit in advance by filing Form 7200. As discussed below, the FFCRA also provides similar credits for qualified self-employed taxpayers in similar circumstances. However, self-employed individuals are not eligible for advance payments.

Substantiation. To claim the tax credit for qualified sick leave wages or qualified family leave wages, an employer must maintain documentation supporting the amounts paid to each employee. Employers must retain all Forms 941, Employer's Quarterly Federal Tax Return, and Forms 7200, Advance Of Employer Credits Due to Covid-19, and any other relevant tax filings with the IRS that relate to the credit.

Self-Employed Individuals. The FFCRA makes also provides a tax credit for eligible self-employed individuals. Under § 1402 of the FFRCA, an "eligible self-employed individual" is defined as an individual who regularly carries on any trade or business who would otherwise be entitled to receive qualified sick leave wages or qualified family leave wages if the individual were an employee of an eligible employer as described above. Like an eligible employer, an eligible self-employed individual is allowed a credit to offset their federal self-employment tax in an amount equal to their "qualified sick leave equivalent amount" or "qualified family leave equivalent amount." There are specific and different methods to calculate these two amounts.

With respect to calculating the "qualified sick leave equivalent amount," § 7002(c)(1) of the FFRCA provides that an eligible self-employed individual who is unable to work or telework under circumstances (1)-(3) listed above in relation to employee sick leave wages qualifies for an amount of sick leave equal to the number of days during the taxable year that the individual cannot perform services in the applicable trade or business multiplied by the lesser of $511 or 100 percent of the "average daily self-employment income" of the individual for the taxable year. Average daily self-employment income is equal to net earnings from self-employment for the year divided by 260. Net earnings from self-employment are based on gross income less ordinary and necessary trade or business expenses of the self-employed individual's trade or business. Similar to the method described above for employee sick leave, if the self-employed individual is unable to work or telework because of one of circumstances (4)-(6) above, the qualified sick leave equivalent amount is equal to the number of days during the taxable year that the individual cannot perform services in the applicable trade or business for one of the three above reasons, multiplied by the lesser of $200 or 2/3 of the "average daily self-employment income" of the individual for the taxable year. Regardless of the manner in which a person qualifies, the maximum number of days a self-employed individual may take into account in determining the qualified sick leave equivalent amount is ten days.

The "qualified family leave equivalent amount" is defined as an amount equal to the number of days (up to 50) during the taxable year that the self-employed individual cannot perform services (similar to the above described family leave), multiplied by the lesser of: (1) $200, or (2) 2/3 of the average daily self-employment income of the individual for the taxable year.

A self-employed individual may receive both qualified sick leave wages and qualified family leave wages. However, if a self-employed individual is both self-employed and also works as an employee of another, there cannot be a double benefit. If a self-employed individual receives sick leave wages from a separate employer, such individual's qualified sick leave equivalent amount must be offset or reduced by the sick leave wages received from his or her employer. Thus, a self-employed individual's qualified sick leave equivalent must be reduced (but not below zero) by up to $5,110 if circumstances (1) through (3) apply or $2,000 in the case of circumstances (4)-(6). Similarly, a self-employed individual must reduce any qualified family leave equivalent amount by the amount by which the sum of the qualified family leave equivalent amount and the qualified family leave wages received by the exceed $10,000. The IRS has provided guidance on its website in the form of frequently asked questions entitled COVID-19-Related Tax Credits: Special Issues for Employees and Additional Questions FAQs. Q&A 64 provides an example that illustrates this calculation:

> Assume that an eligible self-employed individual's qualified family leave equivalent amount is $5,000, but the individual also works for an Eligible Employer and received qualified family leave wages of $9,000 to care for the individual's child while school was closed due to COVID-19. The individual's qualified family leave equivalent amount would be reduced by $4,000 [i.e., ($5,000 + $9,000) - $10,000], resulting in a credit for the qualified family leave equivalent of $1,000 [i.e., $5,000 - $4,000].

Self-employed individuals generally make quarterly estimated tax payments. Accordingly, a self-employed individual may not recover leave amounts by not remitting employment tax. Self-employed individuals instead must claim the credit on their 2020 federal income tax returns. It is also possible for a self-employed individual to estimate and properly adjust their quarterly estimated tax payments downward to solve or improve cash flow.

G. Natural Resources Deductions & Credits

H. Loss Transactions, Bad Debts, and NOLs

I. At-Risk and Passive Activity Losses

III. INVESTMENT GAIN AND INCOME

IV. COMPENSATION ISSUES

A. Fringe Benefits

B. Qualified Deferred Compensation Plans

1. It's okay to discriminate on the basis of age! The § 72(t) 10 percent for those receiving distributions prior to age 59-½ does not violate the Fifth Amendment's Due Process Clause. Conard v. Commissioner, 154 T.C. No. 6 (3/10/20). In general, under § 72(t)(1), a taxpayer who receives a distribution from a qualified retirement plan must pay an additional tax equal to 10 percent of the total distributions for that year. Pursuant to § 72(t)(2)(A), the 10 percent additional tax, commonly referred to as a penalty, does not apply to specified types of distributions, including those made to a taxpayer who has attained the age of 59-½ or who is disabled (as defined in § 72(m)(7)) at the time of the distribution. The taxpayer in this case, Ms. Conard, was not yet age 59-½ nor was she eligible for any other exceptions to the penalty when she received nine distributions totaling $61,777 from her qualified retirement plan in 2008. While Ms. Conard properly reported the total amount of the distributions, she neither reported nor paid the additional 10 percent tax. Instead, Ms. Conard attached a statement to her Form 1040 taking the position that the additional tax was abitrary and capricious. The IRS determined a deficiency of $6,177 attributable to the additional 10 percent tax on premature distributions. Representing herself in the Tax Court, Ms. Conard argued that the exception for distributions made to taxpayers who are at least age 59-½ violated "the U.S. Constitution's guarantee of equal treatment under the law."

Constitutional Analysis. The Due Process Clause of the Fifth Amendment to the United States Constitution provides that no person shall be "deprived of life, liberty, or property, without due process of law." The Due Process Clause imposes on the federal government requirements similar to those that the Equal Protection Clause of the Fourteenth Amendment imposes on the individual states. *See, Regan v. Taxation With Representation of Wash*., 461 U.S. 540, 542 n.2 (1983). Section 1 of the Fourteenth Amendment prohibits states from "deny[ing] to any person within its jurisdiction the equal protection of the laws." In determining whether Ms. Conard's right to equal protection was violated in this case, the Tax Court (Judge Toro) relied on the Seventh Circuit's framework in *Estate of Kunze*, 233 F.3d 948 (7th Cir. 2000), reasoning that where a statute affects economic rights and neither infringes on a substantive constitutional right nor discriminates on the basis of a suspect classification such as race, the statute is subject to judicial scrutiny only under the lower rational basis test. *Estate of Kunze*, 233 F.3d at 954. Under that test "a statute will be sustained if the legislature could have reasonably concluded that the challenged classification would promote a legitimate state purpose." *Id*. (citing *Exxon Corp. v. Eagerton*, 462 U.S. 176, 195-96 (1983)). According to *Estate of Kunze*, legislatures have broad authority to enact tax statutes that create distinctions and classifications among taxpayers and the Constitution does not require either perfect equality or absolute logical consistency as between taxpayers. With respect to a tax statute, there is a presumption of constitutionality that may be overcome only by demonstrating that a classification "is a hostile and oppressive discrimination against particular persons and classes." *Regan*, 461 U.S. at 547.

Court's Reasoning. Judge Toro applied the framework discussed above in evaluating Ms. Conard's equal protection challenge to the additional tax imposed by § 72(t) and concluded that the proper standard of review is the rational-basis test. Under this test, the issue narrowly becomes whether the classification bears a reasonable relationship to some legitimate government purpose. *See Ruggere v. Commissioner*, 78 T.C. 979, 987 (1982). The court turned to the legislative history of § 72(t). In proposing the enactment of § 72, the Senate Finance Committee reasoned that "[t]he absence of withdrawal restrictions in the case of some tax-favored arrangements allows participants in those arrangements to treat them as general savings accounts with favorable tax features rather than as retirement savings arrangements." S. Rept. No. 99-313, at 612 (1985), 1986-3 C.B. (Vol. 3) 612 (1985). The Committee explained its reasoning as follows:

> Although the committee recognizes the importance of encouraging taxpayers to save for retirement, the committee also believes that tax incentives for retirement savings are inappropriate unless the savings generally are not diverted to nonretirement uses. One way to prevent such diversion is to impose an additional income tax on early withdrawals from tax-favored retirement savings arrangements in order to discourage withdrawals and to recapture a measure of the tax benefits that have been provided. Accordingly, the Committee believes it appropriate to apply an early withdrawal tax to all tax-favored retirement arrangements. * * * S. Rept. No. 99-313, supra at 613, 1986-3 C.B. (Vol. 3) at 613.

Judge Toro reasoned that this explanation, among other explanations in the legislative history, are entirely rational. If taxpayers were allowed to withdraw amounts from qualified retirement plans prior to their retirement years, such withdrawals could be "diverted to nonretirement uses," which would frustrate the congressional objective of encouraging taxpayers to save for retirement. Thus, although § 72(t) provides different rules for differently situated taxpayers, it did not violate the taxpayer's constitutional rights. Because Ms. Conard was not yet age 59-½ and did not qualify for any other exception, she was subject to the additional 10 percent tax of § 72(t).

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

D. Individual Retirement Accounts

V. PERSONAL INCOME AND DEDUCTIONS

VI. CORPORATIONS

A. Entity and Formation

B. Distributions and Redemptions

1. Proposed regulations address the items of income and deduction that are included in the calculation of built-in gains and built-in losses under § 382(h). REG-125710-18, Regulations Under Section 382(h) Related to Built-In Gain and Loss, 84 F.R. 47455 (9/10/19). In an effort to minimize tax-motivated tax-free acquisitions, Congress has enacted various provisions that limit an acquiring corporation's ability to make use of an acquired corporation's tax attributes, such as its net operating losses and tax credits. One such provision, § 382, in very simplified terms, limits an acquiring corporation's ability to use an acquired corporation's pre-acquisition net operating losses. Somewhat more accurately, § 382 limits the ability of a ''loss corporation'' to offset its taxable income in periods subsequent to an ''ownership change'' with losses attributable to periods prior to that ownership change. The § 382 limitation imposed on a loss corporation's use of pre-change losses for each year subsequent to an ownership change generally is equal to the fair market value of the loss corporation immediately before the ownership change, multiplied by the applicable long-term tax-exempt rate as defined in § 382(f). A loss corporation's built-in gains and built-in losses affect its § 382 limitation. Section 382(h) provides rules relating to the determination of a loss corporation's built-in gains and losses as of the date of the ownership change. Generally, built-in gains recognized during the five-year period beginning on the date of the ownership change allow a loss corporation to increase its § 382 limitation, and built-in losses recognized during this same period are subject to the loss corporation's § 382 limitation. These proposed regulations address the items of income and deduction that are included in the calculation of built-in gains and losses under § 382 and reflect numerous changes made by the 2017 Tax Cuts and Jobs Act, which generated significant uncertainty regarding the application of § 382. The preamble to the proposed regulations indicates that Treasury and the IRS propose to withdraw the following IRS notices and incorporate their subject matter into the proposed regulations: Notice 87-79, Notice 90-27, Notice 2003-65, and Notice 2018-30. The proposed withdrawal of the prior IRS notices would be effective on the day after the proposed regulations are published as final regulations in the Federal Register. The proposed regulations generally would be effective for ownership changes occurring after the date on which they are published as final regulations in the Federal Register. However, taxpayers and their related parties (within the meaning of §§ 267(b) and 707(b)(1)) may apply the proposed regulations to any ownership change occurring during a taxable year with respect to which the period described in § 6511(a) (the limitations period on refund claims) has not expired, as long as the taxpayers and all of their related parties consistently apply the rules of these proposed regulations to such ownership change and all subsequent ownership changes that occur before the effective date of final regulations.

a. In response to taxpayer concerns regarding the effective date of the proposed regulations on the calculation of built-in gains and built-in losses under § 382(h), the Treasury Department and the IRS have provided a delayed effective date and transition relief for eligible taxpayers. Revised Applicability Dates for Regulations Under Section 382(h) Related to Built-in Gain and Loss, 85 F.R. 2061 (1/14/20). The preamble to the proposed regulations published in the Federal Register on September 10, 2019 (2019 proposed regulations), indicated that Treasury and the IRS proposed to withdraw certain IRS notices, including Notice 2003-65, 2003-2 C.B. 747, and that the withdrawal would be effective on the day after the proposed regulations are published as final regulations in the Federal Register. The 2019 proposed regulations further provided that they generally would be effective for ownership changes occurring after the date on which they are published as final regulations in the Federal Register. Section V of Notice 2003-65 provides that taxpayers may rely on either of two safe harbor approaches for applying § 382(h) to an ownership change "prior to the effective date of temporary or final regulations under section 382(h)." Taxpayers and practitioners expressed two concerns regarding these effective dates: (1) they would impose a significant burden on taxpayers who are evaluating and negotiating business transactions because of uncertatinty regarding both when the transactions will close and the date on which the final regulations will be published, and (2) as stated in the preamble, "transition relief limited to transactions for which a binding agreement is in effect on or before the applicability date of final regulations would be inadequate, because pending transactions regularly are modified or delayed prior to closing." In response to these concerns, Treasury and the IRS have withdrawn the text of Prop. Reg. §§ 1.382-2(b)(4) and 1.382-7(g) contained in the 2019 proposed regulations and have proposed revised effective dates. Under the revised rules, subject to two exceptions, Prop. Reg. § 1.382-2(b)(4) provides that the proposed regulations apply to any ownership change that occurs after the date that is 30 days after the date on which on which final regulations are published in the Federal Register. The first exception is that, according to the preamble, Treasury and the IRS expect that Prop. Reg. § 1.382-7(d)(5) will be made final before other portions of the 2019 proposed regulations as part of the Treasury Decision that finalizes proposed regulations issued under § 163(j). Prop. Reg. § 1.382-7(d)(5) provides that certain carryforwards of business interest expense disallowed under § 163(j) are not treated as recognized built-in losses under § 382(h)(6)(B) if they were allowable as deductions during a specified five-year recognition period. The second exception, set forth in Prop. Reg. § 1.382-7(g)(2), is that the final regulations would not apply to certain ownership changes that occur *after* the generally applicable effective date (30 days after the date on which on which final regulations are published in the Federal Register) if the ownership change occurs in one of five specified circumstances. For transactions to which the final regulations do not apply (because of either the 30-day delayed effective date or the transition relief for ownership changes occurring after the delayed effective date), Notice 2003-65, including its safe harbors, would remain applicable. For ownership changes that occur after the delayed effective date and to which the final regulations would not apply pursuant to the transition relief, taxpayers can elect instead to apply the final regulations.

C. Liquidations

D. S Corporations

E. Mergers, Acquisitions and Reorganizations

F. Corporate Divisions

G. Affiliated Corporations and Consolidated Returns

H. Miscellaneous Corporate Issues

VII. PARTNERSHIPS

VIII. TAX SHELTERS

IX. EXEMPT ORGANIZATIONS AND CHARITABLE GIVING

X. TAX PROCEDURE

A. Interest, Penalties, and Prosecutions

B. Discovery: Summonses and FOIA

C. Litigation Costs

D. Statutory Notice of Deficiency

E. Statute of Limitations

F. Liens and Collections

1. 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.

a. Final regulations increase the user fee for processing an offer in compromise by 10 percent. T.D. 9894, User Fees for Offers in Compromise, 85 F.R. 14567 (3/13/20). The Treasury Department and the IRS have finalized, with some changes, proposed regulations that set the user fees for processing an offer in compromise. See REG-108934-16, User Fees for Offers in Compromise, 81 F.R. 70654 (10/13/16). Prior to these regulations, the general user fee for an offer in compromise was $186. However, no fee was charged for an offer in compromise based solely on doubt as to liability, or if the taxpayer was a low income taxpayer (defined as a taxpayer who has income at or below 250 percent of the federal poverty guidelines). The proposed regulations would have increased the general fee for an offer in compromise to $300, but did not propose a change for offers in compromise based on doubt as to liability or those submitted by low income taxpayers. Since the proposed regulations were issued, Congress codified the waiver of the user fee for low-income taxpayers through amendments to § 7122(c)(3) that apply to offers-in-compromise submitted after July 1, 2019. The final regulations increase the general user fee for processing an offer in compromise to $205, which is a 10-percent increase. This fee appies to offers in compromise submitted on or after April 27, 2020. The final regulations continue to waive the user fee for offers in compromise based solely on doubt as to liability. They also provide a waiver of the user fee for low income taxpayers that is consistent with amended § 7122(c)(3). The preamble to the final regulations provides a great amount of detail on how the increased user fee was determined, including the cost of the services provided.

2. The government may enforce a tax lien in federal court and sell a taxpayer's property notwithstanding the taxpayer's right to redemption under state law. Arlin Geophysical Co. v. United States, 946 F.3d 1234 (10th Cir. 1/14/20). Utah state law allows the owner of real property to redeem or purchase back foreclosed property that has a mortgage debt associated with it. *See* Utah Code Ann. § 78B-6-906(1). At common law, the property owner's equitable right of redemption ended *upon* foreclosure. In contrast, Utah law provides a statutory right to redeem *after* foreclosure. *See Layton v. Thane*, 133 F.2d 287 (10th Cir. 1943). The general policy behind redemption is to protect the property holder's right to redeem the property to insure against a foreclosure sale that is well below fair market value. Carving out a federal exception to this rule, the Tenth Circuit has held that the Utah right of redemption does not apply to properties that are sold to satisfy a taxpayer's federal tax lien. In general, under § 6321, when a taxpayer fails to pay a tax liability after receiving a notice and demand for payment, a stautory federal tax lien arises automatically by operation of law and attaches to all of the taxpayer's property. After proper notification, the government can enforce such tax liens in a federal district court. Pursuant to § 7403, the federal district court in a tax lien foreclosure action may determine the merits of all claims on the property and decree a sale of the property. According to 28 U.S.C. § 2001(a), the sale must be transacted "upon such terms and conditions as the court directs." In this case, the taxpayer, Mr. John Worthen, owed the United States more than eighteen million dollars. In connection with this liability, the IRS filed a notice of federal tax lien that encumbered fifteen properties owned by, among others, Arlin Geophysical Company (Arlin). Arlin was owned by Mr. Worthen and his wife. Arlin brought an action to quiet title to these properties. The federal district court held that Worthen was liable for the eighteen million dollars plus interest and held in favor of the government in relation to 13 of the 15 properties. Properties 14 and 15 remained at issue with the U.S. government, Fujilyte (a company owned by Worthen), and several others claiming rights to these two properties. Initially concluding that Worthen's nominee, Arlin, held title to properties 14 and 15, the federal district court in this case granted summary judgment to the government and ordered that the two properties be sold. On appeal to the Tenth Circuit, Mr. Worthen argued that neither § 7403 nor 28 U.S.C. § 2001 expressly address Mr. Worthen's redemption rights under Utah law and, therefore, he had a right of redemption in the properties. He further argued that this statutory silence supports the conclusion that Congress did not intend to usurp his state-created right of redemption and he should be able, therefore, to redeem the properties. Stated otherwise, he argued that the statutory silence indicates congressional intent that his state right of redemption should operate as the rule of decision governing the federal court. The Tenth Circuit declined to adopt Mr. Worthen's argument and instead affirmed the lower court's denial of Mr. Worthen's right to redeem the property. The Tenth Circuit held that state created rights are not the rules of decision to be applied by a federal court where the government seeks to enforce a federal tax lien. Rather, the question of whether a state-law right constitutes "property" or "rights to property" is a matter of federal law. See *Drye v. U.S.*, 528 U.S. 49, 58 (1999). According to the court, congressional silence in §§ 7403 and 2001 should be distinguished from other sections of the Internal Revenue Code and federal procedural rules that specifically provide for redemption. For example, certain statutes provide that redemption is specifically authorized within a period of time after the sale of property subject to a lien or on which the government has levied. *See* § 6337(b); 28 U.S.C. 2410(c); *see also United States v. Heasley*, 283 F.2d 422, 427 (8th Cir. 1960) (distinguishing sale of property under levy and distraint proceeding, in which redemption is specifically authorized, from property sold pursuant to judicial decree, for which Congress did not provide for a right of redemption). Thus, when Congress intends to provide redemption rights, it does so explicitly and not by silence. In the current case, the court observed, redemption is not appropriate when taxpayers have had procedural protections such as the right to an administrative appeal of a lien under § 6326 and the right to a collection due process hearing upon filing of the lien under § 6320. Statutes such as § 6331 provide redemption rights when a taxpayer is entitled to only summary administrative proceedings. In the area of federal tax liens, the court reasoned, procedures providing for the "punctilious" protection of the rights of the parties in interest—such as the requirement that interested third parties receive notice and be made parties to the action—adequately protect the interests of delinquent taxpayers. The court therefore was not persuaded that Congress's silence regarding redemption rights in § 7403 should allow delinquent taxpayers to reclaim their properties through state-provided redemption rights. Accordingly, the court held, Mr. Worthen had no right to redeem property sold pursuant to § 7403 by a federal district court.

3. The Tax Court has held that audit reconsideration followed by a conference with IRS Appeals was a prior opportunity to challenge the taxpayers' underlying tax liability and therefore they were barred by § 6330(c)(2)(B) from challenging the liability in a CDP hearing. Lander v. Commissioner, 154 T.C. No. 11 (3/12/20). While this factually complex case has a lengthy set of dates, communications and meetings between the IRS and the taxpayer, the salient elements revolve around two copies of the notice of deficiency (NOD) that were mailed by the IRS to the taxpayers (a married couple) at their last known address and also to the address of the federal prison in which the husband, Mr. Lander, was incarcerated. The dispute began in April 2009, when the Landers filed a late initial 2005 income tax return and, shortly thereafter, an amended return. In July of 2011, the IRS sent the Landers a letter notifying them of two adjustments that substantially increased their 2005 tax liability. Several weeks later, in August 2011, the Landers formally protested the adjustments and requested that the IRS send any future questions or information to the address of the federal correctional institution where Mr. Lander was incarcerated. The IRS later informed the Landers that the large adjustments resulted in additions to tax and an accuracy-related penalty. The IRS then sent the two copies of the NOD mentioend previously to the Landers' home and the prison. However, in sending the NOD to each place, the IRS examiner recorded the two certified mail numbers improperly. He recorded the number for each parcel on the documentation in the IRS file for the other parcel. Regardless, each parcel was recorded by the U.S. Postal Service as having reached its destination. However, because Mr. Lander had been moved to another correctional facility and because Mrs. Lander had moved out of their home, the Landers did not receive either NOD. In July 2012, the IRS sent a notice and demand for payment. The taxpayers asked for reexamnation of their tax liability. The Examination Division reaffirmed the adjustments to their tax liability, following which the taxpayers requested and received a confierence with the IRS Appeals Office, which abated a substantial amount of the originally assessed tax but continued to demand a portion of the originally assessed amounts. In January 2015 the IRS sent the taxpayers a Notice of Federal Tax Lien Filing (NFTLF).

The taxpayers timely requested a collection due process (CDP) hearing and maintained their assertion that the IRS's underlying assessment of tax was invalid because they did not receive either copy of the original NOD. Following the CDP hearing, the IRS Appeals Office concluded that the NOD had been properly mailed to the last known address of the taxpayers and sustained the NFTLF.

Tax Court's Analysis. The Tax Court addressed whether the IRS Appeals Office erred in determining that the Landers were barred from challenging the assessed tax liability in the CDP hearing. The Tax Court narrowed the question to whether the NOD was properly mailed to the taxpayers at their last known address. Section 6330(c)(2)(B) permits a taxpayer to challenge the existence or amount of the taxpayer's underlying tax liability in a CDP hearing only "if the person did not receive any statutory notice of deficiency for such tax liability or did not otherwise have an opportunity to dispute such tax liability." Accepting the testimony of the IRS's witness, the court agreed with the IRS that it had properly mailed the NOD to the taxpayers' last known address in 2011. The court did not accept the Landers' argument that the discrepancies in the recording of the certified mail numbers of each parcel was not sufficient to undermine the evidence otherwise indicating that the NOD was properly mailed. The court also declined to accept the Landers' argument that they were not given an opportunity to dispute their tax liability. In reaching this conclusion, the Tax Court relied on its decision in *Lewis v. Commissioner*, in which the court reasoned:

> While it is possible to interpret section 6330(c)(2)(B) to mean that every taxpayer is entitled to one opportunity for a precollection judicial review of an underlying liability, we find it unlikely that this was Congress's intent. As we see it, if Congress had intended to preclude only those taxpayers who previously enjoyed the opportunity for judicial review of the underlying liability from raising the underlying liability again in a collection review proceeding, the statute would have been drafted to clearly so provide. The fact that Congress chose not to use such explicit language leads us to believe that Congress also intended to preclude taxpayers who were previously afforded a conference with the Appeals Office from raising the underlying liabilities again in a collection review hearing and before this Court. See Lewis v. Commissioner, 128 T.C. at 60-61.

Consistent with this reasoning, the Tax Court turned to whether the Landers were afforded a conference with the IRS Appeals Office and whether they had an opportunity to dispute their tax liability. The court found that the Landers had received a post-assessment conference in the form of the audit reconsideration process. The reconsideration process provided for an independent review of the Landers' underlying tax liability by the IRS Appeals Office, which resulted in significantly reducing their tax liability. Under these circumstances, the court held that the Landers had a prior opportunity to dispute their tax liability within the meaning of § 6330(c)(2)(B) and that they were therefore barred from challenging the amount of their underlying liability.

G. Innocent Spouse

H. Miscellaneous

1. The Tenth Circuit stirs the previously muddied water on whether a late-filed return is a "return" that will permit tax debt to be discharged in bankruptcy proceedings. In re Mallo, 774 F.3d 1313 (10th Cir. 12/29/14), *cert denied*, 135 S. Ct. 2889 (6/29/15). In an opinion by Judge McHugh, the Tenth Circuit held, with respect to taxpayers in two consolidated appeals, that a late return filed after the IRS had assessed tax for the year in question was not a "return" within the meaning of 11 U.S.C. § 523(a) and, consequently, the taxpayers' federal tax liabilities were not dischargeable in bankruptcy. The facts in each appeal were substantially the same. The taxpayers failed to file returns for the years 2000 and 2001. The IRS issued notices of deficiency, which the taxpayers did not challenge, and assessed tax for those years. The taxpayers subsequently filed returns, based on which the IRS partially abated the tax liabilities. The taxpayers then received general discharge orders in chapter 7 bankruptcy proceedings and filed adversary proceedings against the IRS seeking a determination that their income tax liabilities for 2000 and 2001 had been discharged. Section 523(a)(1) of the Bankruptcy Code excludes from discharge any debt for a tax or customs duty:

(B) with respect to which a return, or equivalent report or notice, if required—

(i) was not filed or given; or

(ii) was filed or given after the date on which such return, report, or notice was last due, under applicable law or under any extension, and after two years before the date of filing of the petition;

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

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

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

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

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

a. The First Circuit aligns itself with the Fifth and Tenth Circuits and applies the same analysis to a late-filed Massachusetts state income tax return. In re Fahey, 779 F.3d 1 (1st Cir. 2/18/15). In an opinion by Judge Kayatta, the First Circuit aligned itself with the Fifth and Tenth Circuits and concluded that a late-filed Massachusetts state income tax return was not a "return" within the meaning of 11 U.S.C. § 523(a). In a lengthy dissenting opinion, Judge Thompson argued that the majority's conclusion was inconsistent with both the language of and policy underlying the statute: "The majority, ignoring blatant textual ambiguities and judicial precedent, instead opts to create a per se restriction that is contrary to the goal of our bankruptcy system to provide, as the former President put it in 2005, 'fairness and compassion' to 'those who need it most.'"

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

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

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

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

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

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

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

f. The Eleventh Circuit has rejected the one-day late approach to determining whether a late-filed return renders a tax debt nondischargeable in bankruptcy. In re Shek, 947 F.3d 770 (11th Cir. 1/23/20). In a very thorough opinion by Judge Anderson, the Eleventh Circuit has held that a tax debt reflected on a late-filed Massachusetts tax return was discharged in bankruptcy. In reaching this conclusion, the court rejected the "one-day-late" rule embraced by the First, Fifth and Tenth Circuits. The taxpayer filed his 2008 Massachusetts income tax return seven months late. The return reflected a tax liability of $11,489. Six years later, he filed for chapter 7 bankruptcy in Florida and received an order of discharge in January 2016. When the Massachusetts Department of Revenue subsequently sought to collect the tax debt, the taxpayer filed a motion to reopen his bankruptcy case to determine whether his tax debt debt had been discharged. The Bankruptcy Court held that his tax debt had been discharged. In affirming this conclusion, the Eleventh Circuit focused on the definition of the term "return" in § 523(a) of the Bankruptcy Code, added by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, which provides that, for purposes of § 523(a):

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

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

2. The IRS has announced that individuals will be able to e-file amended returns on Form 1040-X for 2019. IR-2020-107 (5/28/20). Individuals who wish to amend a federal income tax return by filing Form 1040-X currently must mail the form to the IRS. The IRS has announced that, beginning sometime during the summer of 2020, individuals will be able to e-file Form 1040-X using available software products to amend Forms 1040 or 1040-SR for 2019. Whether the ability to e-file amended returns will be expanded to other years is not entirely clear. The announcement states that "[a]dditional enhancements are planned for the future." Taxpayers still will have the option to mail a paper version of Form 1040-X.

XI. WITHHOLDING AND EXCISE TAXES

XII. TAX LEGISLATION

A. Enacted

1. A Families Second Coronavirus Response Act just wouldn't do. Congress has enacted the Families First Coronavirus Response Act. The Families First Coronavirus Response Act, Pub. L. No. 116-127, was signed by the Presdient on March 18, 2020. Among other features, the legislation provides businesses with tax credits to cover certain costs of providing employees with required paid sick leave and expanded family and medical leave, for reasons related to COVID-19, from April 1 through December 31, 2020.