RECENT DEVELOPMENTS IN FEDERAL INCOME TAXATION

We apologize to our readers. If we had more time, this outline would be much shorter.

By

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

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 2021. Notice 2021-2, 2021-3 I.R.B. 478 (12/22/20). The standard mileage rate for business miles in 2021 goes down slightly to 56 cents per mile (from 57.5 cents in 2020) and the medical/moving rate goes down to 16 cents per mile (from 17 cents in 2020). The charitable mileage rate remains fixed by § 170(i) at 14 cents. The portion of the business standard mileage rate treated as depreciation goes down to 26 cents per mile for 2021 (from 27 cents in 2020). The maximum standard automobile cost may not exceed $51,100 (up from $50,400 in 2020) 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 2021, and (2) the standard mileage rate for moving has limited applicability for the use of an automobile as part of a move during 2021 because, in the 2017 Tax Cuts and Jobs Act, Congress disallowed the deduction of moving expenses for 2021 (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. <u>At-Risk and Passive Activity Losses</u>

III. INVESTMENT GAIN AND INCOME

IV. COMPENSATION ISSUES

A. <u>Fringe Benefits</u>

1. The exclusion for employer-provided dependent care assistance is increased to $10,500 for 2021. Code § 129(a) provides that a limited amount of dependent care assistance provided by an employer to an employee is excluded from gross income. Prior to 2021, the maximum amount of such assistance that an employee could exclude from gross income was $5,000 ($2,500 in the case of married individuals filing separately). Section 9632 of the American Rescue Plan of 2021 amends Code § 129(a)(2) to increase the limit on the exclusion to $10,500 ($5,250 in the case of married individuals filing separately). This change applies to taxable years ending after December 31, 2020, and before January 1, 2022 (i.e., generally to the 2021 tax year).

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

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>

B. <u>Miscellaneous Income</u>

1. An interest in a defined benefit pension plan is not an asset for purposes of determining whether a taxpayer is insolvent and therefore eligible to exclude COD income. Schieber v. Commissioner, T.C. Memo. 2017-32 (2/9/17). The taxpayer, a retired police officer, received monthly payments from the California Public Employees' Retirement System (CalPERS) defined benefit pension plan. During 2009, a creditor of the taxpayer cancelled $418,596 of debt. On the joint return for 2009 that the taxpayer and his wife filed, they excluded a portion of the cancelled debt from gross income on the basis that they were insolvent. The IRS issued a notice of deficiency in which the IRS determined that the taxpayers had to include in gross income the entire amount of the cancelled debt. Section 108(d)(3) defines "insolvent" as the amount by which a taxpayer's liabilities exceed the fair market value of the taxpayer's assets immediately before the debt is cancelled. The IRS argued that, in determining whether the taxpayers were insolvent, the taxpayers' interest in the CalPERS pension plan must be considered an asset. Taking into account this asset, the IRS argued, the taxpayers were not insolvent. The Tax Court (Judge Morrison) held that the taxpayers' interest in the plan was not an asset for purposes of the insolvency exclusion. The taxpayers' interest in the plan, the court noted, entitled them only to monthly payments, could not be converted to a lump-sum cash amount, and could not be sold or assigned. The taxpayers could neither borrow against the interest nor borrow from the plan. The relevant inquiry established in prior cases such as *Carlson v. Commissioner*, 116 T.C. 87 (2001), for determining whether an item is an asset for this purpose is whether the item gives the taxpayer the ability to pay an immediate tax on income from the cancelled debt, not whether it gives the taxpayer the ability to pay the tax gradually over time. Because the taxpayers' interest in the plan was not considered an asset, they were insolvent by $293,308 and entitled to exclude this portion of the $418,596 cancelled debt.

a. The IRS has nonacquiesced in the holding in *Schieber*. A.O.D. 2021-1, 2021-15 I.R.B. 985 (4/12/21). The IRS has nonacquiesced in the holding in *Schieber v. Commissioner*, T.C. Memo. 2017-32 (2/9/17), which leaves open the issue of whether the value of an interest in a defined benefit pension plan must be included as an asset in determining whether a taxpayer is insolvent for purposes of the insolvency exclusion of § 108(a)(1)(B). In A.O.D. 2021-1, the IRS has taken the position that the Tax Court erred in interpreting § 108. In *Schieber*, the Tax Court reasoned that the test for determining whether an item is an asset for purposed of determining insolvency "is whether it gives the taxpayer the 'ability to pay an immediate tax on income' from the cancelled debt—

not to pay the tax gradually over time." According to the IRS, the court "erred by taking language from the legislative history of section 108 that the court used in interpreting the statute in [prior cases] and turning that language into a threshold test not found in the statute itself." The IRS's position is that the language in the statute's legislative history explains why Congress enacted the insolvency exclusion, i.e., to provide debtors with a fresh start and to avoid burdening debtors with immediate tax liability. Instead, Congress required taxpayers taking advantage of the insolvency exclusion to reduce certain favorable tax attributes, which has the effect of increasing their tax burden in the future. According to the IRS, the quoted language was not meant to indicate that the term "asset" in the definition of "insolvent" in § 108(d) does not include the right to a stream of payments over the taxpayer's lifetime. Finally, the IRS indicated that the Tax Court's holding in *Schieber* is internally inconsistent in that it does not address the possibility that current year distributions from a defined benefit plan might be included in determining whether a taxpayer is insolvent in a given year. Accordingly:

> the Service will not follow Schieber in excluding assets from the definition of asset under section 108(d)(3) on the grounds that they cannot be converted into a lump-sum cash amount, sold, assigned or borrowed against.

2. Unemployed during 2020? Finally, some good news: for 2020, gross income does not include $10,200 of unemployment compensation received by individuals with adjusted gross income below $150,000. Section 9042 of the 2021 American Rescue Plan amends Code § 85 by adding new § 85(c), which provides that gross income does not include $10,200 of unemployment compensation received by an individual whose adjusted gross income, determined without the unemployment compensation, is below $150,000. In the case of a married couple filing jointly, the $10,200 ceiling applies separately to each spouse. The statute is not entirely clear as to whether, in the case of a joint return, the $150,000 AGI ceiling applies separately to the income of each spouse, or to the spouses' combined income; the more likely reading, however, is that the ceiling applies to the combined income. This rule applies only to taxable years beginning in 2020.

- The state treatment of unemployment compensation received in 2020 varies. Some states are conforming to the federal exclusion provided by new § 85(c), and others are not.

3. ♪♫To everything (turn, turn, turn), There is a season (turn, turn, turn) … ♫♪ And this is the season to have your student loans cancelled. The cancellation of student loans from 2021 through 2025 is excluded from gross income. Section 9675 of the 2021 American Rescue Plan amends Code § 108(f) by striking § 108(f)(5) and replacing it with new § 108(f)(5), which provides that gross income does not include any amount resulting from the cancellation of certain loans to finance postsecondary educational expenses regardless of whether the loan is provided through the educational institution or directly to the borrower. This rule applies to several different kinds of loans, including loans made by federal or state governments, private educational loans (as defined in § 140(a)(7) of the Truth in Lending Act), and loans made by educational institutions. The definition of qualifying loans is broad enough to cover the vast majority of postsecondary educational loans. The exclusion does not apply if the lender is an educational organization or a private lender and the cancellation is on account of services performed for the lender. New § 108(f)(5) applies to discharges of loans that occur after December 31, 2020 and before January 1, 2026.

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

D. Deductions and Credits for Personal Expenses

1. For 2021, the child tax credit is expanded and a portion of it will be paid in advance.[1] The 2021 American Rescue Plan made several significant changes to the child tax credit authorized by § 24. Section 9661 of the legislation amends Code § 24 to add new subsection 24(i). Section 24(i), which applies only in 2021, increases the child tax credit amount to $3,600 in the case of a qualifying child younger than 6 at the end of 2021, and to $3,000 in the case of other qualifying

[1] The authors thank Professor Lawrence A. Zelenak of the Duke University School of Law for this summary of the changes to the child tax credit and for allowing us to include it in this outline.

children. The provision also enlarges the definition of a qualifying child to include children who have not attained the age of 18 by the end of 2021 (rather than 17, as under the usual child tax credit rules). The total amount of the 2021 child tax credit (not the amount of the credit with respect to each child considered separately) is reduced by $50 for each $1,000 by which the taxpayer's modified AGI exceeds $150,000 (joint return), $112,500 (head of household), or $75,000 (any other case). Although the per child credit amounts under the 2021 rules are considerably larger than the usual $2,000 per child credit amount (in 2018 through 2025), the phaseout thresholds under the 2021 rules are much lower than the usual (2018 through 2025) thresholds of $400,000 (joint return) and $200,000 (any other case). Thus, the 2021 rules would actually produce smaller credit amounts (or no credit at all) for many higher-income parents than would be produced by the usual rules. Section 24(i)(4) includes an incredibly convoluted (even by Internal Revenue Code standards) "limitation on reduction" provision intended to insure that such parents are not disadvantaged by the special rules for 2021. The basic idea is simple enough–that parents in 2021 should be entitled to child tax credits based on the usual rules or based on the 2021 special rules, whichever produce a larger credit–but the statutory elaboration of the rule is almost impenetrable.

The following example of how all this is supposed to work is based on an example in the House Report on the legislation (H. Rept. 117-7, at 730). The taxpayer is a head of household with modified AGI of $140,500, and with one qualifying child, age 7. Under the usual rules, the taxpayer would be allowed a $2,000 credit. Under the special 2021 rules, without regard to the "limitation on reduction" provision, the taxpayer would be entitled to a credit of $3,000, reduced by $1,400 to $1,600. (The $1,400 reduction is calculated as [($140,500 - $112,500)/$1,000] x $50 = $1,400.) However, with the "limitation on reduction" applying the reduction will be only $1,000, and the taxpayer will be entitled to a $2,000 credit (reduced from $3,000 by the phaseout). The "limitation on reduction" rules provide that the phaseout reduction cannot exceed the lesser of (1) the difference between the 2021 full credit amount and the usual full credit amount (here, $3,000 - $2,000 = $1,000), or (2) 5 percent of the difference between the usual phaseout threshold and the 2021 phaseout threshold (here, 0.05 x ($200,000 - $112,500) = $4,375). The result on these facts is that the reduction is limited to $1,000, and the credit is $2,000.

Section 7527A, also added by the 2021 legislation, provides for advance payment of 2021 child tax credits, in periodic equal amounts totaling 50 percent of the taxpayer's anticipated total child tax credits for 2021. The anticipated credits are determined based on a taxpayer's modified AGI for a "reference year," and on the taxpayer's qualifying children in the reference year (with the children's ages adjusted to reflect the passage of time). The reference year is generally the preceding year (2020), but it is the second preceding year (2019) if the taxpayer has not (or not yet) filed a return for the preceding year. The IRS may modify the annual advance payment amount–and thus the amount of the periodic payments–during the year to take into account a return newly filed by the taxpayer, or any other information provided by the taxpayer. The statute directs the IRS to establish an online information portal which taxpayers can use to provide credit-relevant information to the IRS, and to elect out of advance payments (in which case taxpayers can still claim their child tax credits on their 2021 returns, in the usual way).

Section 24(j) provides for reconciliation between the amount of the advance payments and the proper amount of credits (as determined after all information for 2021 is known). As one would expect, advance payments received under § 7527A reduce the amount of the credit a taxpayer can claim on her return, dollar-for-dollar. If advance payments exceed the proper credit amount based on actual 2021 results (which should not be common, given the 50 percent ceiling on advance payments), reconciliation (i.e., repayment by the taxpayer of the excess) is generally required. But if the taxpayer's actual modified AGI for 2021 does not exceed $60,000 (joint return), $50,000 (head of household), or $40,000 (any other case), reconciliation is not required to the extent of the "safe harbor amount," defined as $2,000 multiplied by the excess (if any) of the number of qualifying children taken into account in determining the amount of the advance payments, over the number of qualifying children actually taken into account under § 24. The safe harbor is phased out, ratably, as modified AGI rises between the income threshold and 200 percent of the threshold.

2. Congress has increased and made more widely available the § 36B premium tax credit for 2021 and 2022, eliminated the need to repay excess advance premium tax credits for 2020, and has made the credit available for 2021 to those who receive unemployment compensation. The 2021 American Rescue Plan made several significant changes to the premium tax credit authorized by § 36B. This credit is available to individuals who meet certain eligibility requirements and purchase coverage under a qualified health plan through a health insurance exchange. *First*, for taxable years beginning in 2021 or 2022, § 9661 of the legislation amends Code § 36B(b)(3)(A) by adding new clause (iii), which increases the amount of the credit at every income level and makes the credit available to those whose household income is 400 percent or higher of the federal poverty line. *Second*, for any taxable year beginning in 2020, § 9662 of the legislation suspends the rule of § 36B(f)(2)(B), which requires repayment of excess premium tax credits. An individual who receives advance premium tax credit payments is required by § 36B(f)(1) to reconcile the amount of the advance payments with the premium tax credit calculated on the individual's income tax return for the year and, normally, pursuant to § 36B(f)(2)(B), must repay any excess credit received. This repayment obligation does not apply for 2020. *Third*, for taxable years beginning in 2021, § 9663 of the legislation amends § 36B by adding new subsection (g), which caps the household income of those receiving unemployment compensation at 133 percent of the federal poverty line. This has the effect of making such persons eligible for the maximum amount of premium tax credit.

3. Significant changes to the earned income credit beginning in 2021. The 2021 American Rescue Plan made several significant changes to the premium tax credit authorized by § 32.

First, for taxable years beginning in 2021, § 9621 of the legislation adds Code § 32(n), which provides that, for those *without* qualifying children, (i) the usual maximum age limitation (age 65) does not apply, (ii) instead of the usual minimum age requirement (age 25), the credit is generally available to taxpayers 19 or older (24 or older in the case of a "specified student," and 18 or older in the case of a "qualified foster youth" or "qualified homeless youth"), (iii) the credit percentage is doubled from 7.65 to 15.3, as is the phaseout percentage, and (iv) the earned income amount (the maximum amount of credit-generating earned income) is increased to $9,820, and the phaseout threshold is increased to $11,610. Under the 2021 rules the maximum earned income credit for those without qualifying children is $1,502 and the credit is fully phased out at AGI (or earned income, if greater) of $21,430.

Second, § 9622 of the legislation repeals Code § 32(c)(1)(F), which provided that a taxpayer with a child who would be a qualifying child for purposes of the earned income credit except for the fact that the child did not have a Social Security Number was precluded from claiming the earned income credit that is available to those without qualifying children. Generally, for a child to be taken into account for purposes of the earned income credit, the child must have a Social Security Number that was issued before the due date of the return. For this purpose, an Individual Taxpayer Identification Number, or ITIN, is not sufficient. Thus, before the repeal of § 32(c)(1)(F), an individual with one or more otherwise qualifying children who either were not eligible for Social Security Numbers or did not obtain them before the due date of the return could not claim the earned income credit on the basis of having qualifying children and also could not claim the earned income credit available to those without qualifying children. The repeal of § 32(c)(1)(F) allows such individuals to claim the earned income credit available to those without qualifying children. The repeal is effective for taxable years beginning after 2020.

Third, § 9623 of the legislation amends Code § 32(d) to modify the rules that apply to married couples. Section 32(d)(1) provides that a married individual can claim the earned income credit only if the individual files a joint return for the year, i.e., a married individual is precluded from claiming the earned income credit if the individual files separately from his or her spouse. As amended, § 32(d)(2)(B) provides that a married individual who does not file a joint return is *not* treated as married if the individual (i) resides with a qualifying child of the individual for more than one-half of the taxable year, and (ii) either does not have the same principal place of abode as the individual's spouse during the last six months of the year *or* "has a decree, instrument, or agreement (other than a decree of divorce) described in section 121(d)(3)(C) with respect to the individual's spouse and is not a member of the same household with the individual's spouse by the end of the taxable year." The latter situation generally would mean that the individual has a written separation agreement or a temporary support order and is living separately from the individual's spouse by the end of the year. This amendment applies to taxable years beginning after 2020.

- A married individual with a qualifying child who lives apart from his or her spouse for the last six months of the year and who pays more than half the cost of keeping up the home is "considered unmarried" and is entitled to file with head-of-household filing status. Such individuals therefore are not precluded from claiming the earned income credit by the rule of §32(d)(1), which generally bars married individuals from claiming the credit if they do not file a joint return. The amendment made by the 2021 American Rescue Plan seems unnecessary to make the earned income credit available to such individuals. Accordingly, the significance of the amendment appears to be to make the credit available to those who are *not* considered unmarried, i.e., to those who have a written separation agreement or a temporary support order and live separately from the individual's spouse by the end of the year.

Fourth, § 9624 of the legislation amends Code § 32(i), which provides that the earned income credit is not available to taxpayers with investment income that exceeds a specified threshold. For 2020, that threshold, as adjusted for inflation, was $3,650. As amended by the 2021 American Rescue Plan, the § 32(i) limit on investment income is increased to $10,000. This change applies to taxable years beginning after 2020. The $10,000 limit will be adjusted for inflation for taxable years beginning after 2021.

Fifth, § 9626 of the legislation, an uncodified provision, provides that an individual can elect to use his or her 2019 earned income for purposes of determining the individual's earned income credit under § 32 for 2021. The election is available for individuals whose earned income for the taxpayer's first taxable year beginning in 2021 is lower than their earned income for the taxpayer's first taxable year beginning in 2019. For married couples filing a joint return, the earned income for 2019 is the sum of the earned income in 2019 of both spouses.

4. Congress continues stimulating. Recovery rebates or "credits" for individuals. The 2021 American Rescue Plan, § 9601, adds new Code § 6428B, which provides for what the Treasury Department publicly refers to as "economic impact payments" and what the Code describes as an advance refund of a credit for which individuals may be eligible for 2021. Nonresident aliens, dependent children, and estates and trusts are not eligible for the credit. Distribution of the funds is to be automatic and, for most taxpayers who have previously filed a 2019 or 2020 tax return, there are no steps that need to be taken to receive a payment. The amount of the advance payment to which an individual is entitled is to be determined based on the individual's 2020 federal income tax return or, if the 2020 return has not filed, the individual's 2019 return. If an individual has filed neither a 2019 nor 2020 return, then the amount of the advance payment may be determined based on social security information (Form SSA-1099 or RRB-1099). In general, the advance refunds are to be received in the form of a direct deposit into taxpayers' bank accounts. According to § 6428B(f), such payments are, in effect, advance refunds of the amount to be allowed as a "recovery rebate" or tax credit on each recipient's 2021 federal income tax return. Generally, a taxpayer who is an eligible taxpayer will be treated as having made tax payments equal to the credit to which the taxpayer is entitled.

Amount of the credit. According to Code § 6428B(b), eligible individualswill receive an advance refund of the projected rebate or credit equal to $1,400 ($2,800 in the case of eligible individuals filing a joint return) plus an additional $1,400 for each dependent of the taxpayer if the taxpayer's adjusted gross income (AGI) is below a certain threshold amount. The amount of the credit is phased out based on the taxpayer's AGI. Under § 6428B(d), the amount of the projected credit (and therefore the advance refund amount sent to taxpayers) is reduced to the extent that the taxpayer's AGI exceeds $150,000 (in the case of a joint return), $112,500 (in the case of a head of household), and $75,000 in all other cases. The credit is completely phased out for taxpayers who have AGI of: $160,000 (joint filers), $120,000 (head of household), and $80,000 (all others including single filers). Divorce Tax Issues

E. Education

F. Alternative Minimum Tax

VI. CORPORATIONS

VII. PARTNERSHIPS

VIII. TAX SHELTERS

IX. EXEMPT ORGANIZATIONS AND CHARITABLE GIVING

X. TAX PROCEDURE

A. Interest, Penalties, and Prosecutions

1. Tax Court holds IRS does not need written supervisory approval to apply the § 72(t) 10% penalty for early withdrawal from a retirement plan. Grajales v. Commissioner, 156 T.C. No. 3 (1/25/21). In general, under § 7491(c), the IRS has the burden of production with respect to "any penalty, addition to tax, or additional amount." To satisfy this burden, § 6751(b)(1) requires the IRS to prove that "the initial determination of [the] assessment … [of any penalty was] personally approved (in writing) by the immediate supervisor of the individual making such determination." *See, e.g., Frost v. Commissioner*, 154 T.C. 23, 34-35 (2020). Pursuant to § 6751(c), the term "penalties" as used in § 6571 includes "any addition to tax or any additional amount." In this case, the taxpayer, Ms. Grajales, who was in her early 40s, took loans in connection with her New York State pension plan (the "Plan"). The Plan sent her a Form 1099-R that reflected total distributions of $9,026. Subject to certain exceptions, § 72(t)(1) provides that, if a taxpayer who has not attained age 59-1/2 receives a distribution from a retirement plan, the taxpayer's tax must be increased by 10 percent of the distribution. In filing her tax return, Ms. Grajales did not report any retirement plan distributions as income. The IRS, however, determined that she should have included the $9,026 of Plan distributions in her income and that the distributions were subject to the 10-percent additional tax on early distributions under § 72(t). The issue in this case was whether the 10 percent exaction of § 72(t) is a penalty, addition to tax, or additional amount within the meaning of § 6751(c). If so, then the IRS was required by § 6751(b) to have written, supervisory approval in order to impose the 10-percent additional amount provided for in § 72(t). The Tax Court (Judge Thornton) held that the § 72(t) exaction is a "tax" and not a "penalty," "addition to tax," or "additional amount." Because it is a "tax," the court held, it is not subject to the § 6751(b) written supervisory approval requirement. In reaching this conclusion, Judge Thornton acknowledged that none of the court's decisions up to this point in time have expressly addressed whether the § 6751(b) written supervisory approval requirement applies to the 10-percent exaction of § 72(t). Judge Thornton relied on several Tax Court decisions that have held that the § 72(t) exaction is a "tax." The court previously had held that the § 72(t) exaction is not a "penalty, addition to tax, or additional amount" within the meaning of § 7491(c) for purposes of imposing the burden of production. *See, e.g., Williams v. Commissioner*, 151 T.C. 1 (2018). Further, in *El v. Commissioner*, 144 T.C. 140, 148 (2015), the Tax Court had concluded that the exaction under §72(t) was a tax for the following reasons:

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

In following the court's prior holdings, Judge Thornton rejected the taxpayer's argument that the exaction of § 72(t) is an "additional amount" within the meaning of § 6751(c), reasoning that use of the phrase "additional amounts" when used in a series that also includes "tax" and "additions to tax" is a term of art that refers exclusively to civil penalties. Judge Thornton rejected several other arguments made by the taxpayer, including the assertion that the Tax Court must employ the "functional approach" under which the U.S. Supreme Court applied a constitutional analysis to conclude that the § 72(t) exaction was a "penalty" and not a "tax." *See Nat'l Fed'n of Indep. Bus.*

(NFIB) v. Sebelius, 567 U.S. 519 (2012). Judge Thornton distinguished *NFIB* on the basis that the circumstances in this case presented no constitutional issue. Further, neither party argued that § 72(t) is unconstitutional in this case. According to the Tax Court, for purposes of § 6751(b) and (c), the § 72(t) exaction is a "tax," a "penalty," "addition to tax," or "additional amount." Therefore, § 6751(b) did not require written supervisory approval.

B. Discovery: Summonses and FOIA

C. Litigation Costs

D. Statutory Notice of Deficiency

1. ♪♫If you want my love, leave your name and address …♫♪ A notice of deficiency mailed to the address on the taxpayers' tax return was mailed to the taxpayers' last known address despite their filing of a power of attorney and a request for an extension using their new address. Gregory v. Commissioner, 152 T.C. No. 129 (3/13/19). Section 6212(b)(1) provides that a notice of deficiency in respect of a tax imposed by subtitle A shall be sufficient if "mailed to the taxpayer at his last known address." For this purpose, a taxpayer's last known address is "the address that appears on the taxpayer's most recently filed and properly processed Federal tax return, unless the Internal Revenue Service (IRS) is given clear and concise notification of a different address". Reg. § 301.6212-2(a). The taxpayers in this case, a married couple, moved from Jersey City, New Jersey to Rutherford, New Jersey, on June 30, 2015. They filed their 2014 federal income tax return on October 15, 2015. The return incorrectly reflected their old, Jersey City address. In November 2015, a power of attorney on Form 2848 was submitted to the IRS that had their new, Rutherford address. In April 2016, they filed a request for an automatic extension of time to file their 2015 federal income tax return on Form 4868 that also had their new, Rutherford address. The IRS sent a notice of deficiency with respect to tax year 2014 by certified mail to the taxpayers' old, Jersey City address on October 13, 2016. The U.S. Postal Service returned the notice of deficiency to the IRS as unclaimed; the taxpayers never received it. They first became aware of the notice of deficiency on January 17, 2017, and, in response, filed a petition in the Tax Court that same day. The IRS moved to dismiss for lack of jurisdiction because the taxpayers had filed their petition late (outside the 90-day time period of § 6213(a)), and the taxpayers moved to dismiss for lack of jurisdiction on the ground that the petition had not been mailed to their last known address and therefore was invalid. The Tax Court (Judge Buch) held that the notice of deficiency had been mailed to the taxpayers' last known address and granted the government's motion to dismiss. The court first reasoned that neither the Form 2848 nor the Form 4868 submitted by the taxpayers was a "return" within the meaning of the last known address rule of Reg. § 301.6212-2(a). These forms, the court reasoned, are not returns under the four-part test of *Beard v. Commissioner*, 82 T.C. 766 (1984), *aff'd*, 793 F.2d 139 (6th Cir. 1986). Further, the court explained, Reg. § 301.6212-2(a) provides that additional information on what constitutes a return for purposes of the last known address rule can be found in procedures published by the IRS, and Rev. Proc. 2010-16, 2010-19 I.R.B. 664, specifically provides that Forms 2848 and 4868 are not returns for this purpose. The court next concluded that the Forms 2848 and 4868 submitted by the taxpayers had not provided the IRS with clear and concise notification of their new address. The instructions to both forms, the court reasoned, explicitly provide that the forms will not update a taxpayer's address of record with the IRS. That these forms do not constitute clear and concise notification of a new address, the court explained, is implicit in Rev. Proc. 2010-16, which provides that Forms 2848 and 4868 are not returns and that they "will not be used by the IRS to update the taxpayer's address of record." Finally, the court distinguished earlier decisions holding that a Form 2848 filed with the IRS does give clear and concise notification of a new address. See *Hunter v. Commissioner*, T.C. Memo. 2004-81; *Expanding Envelope & Folder Corp. v. Shotz*, 385 F.2d 402 (3d Cir. 1997). The court reasoned that these decisions were based on prior versions of Form 2848 and that "[s]ince 2004 the Commissioner has issued clear guidance informing taxpayers of what actions will and will not change their last known address with the Commissioner."

- The taxpayers, represented by the Legal Services Center of Harvard Law School, have appealed this decision to the U.S. Court of Appeals for the Third Circuit, the same court that held in *Expanding Envelope & Folder Corp.* that a prior version of Form 2848 did provide clear and concise notification of a taxpayer's new address. Stay tuned.

a. The IRS should have known of the taxpayers' new address, says the Third Circuit. The Tax Court's decision is reversed and remanded. Gregory v. Commissioner, 839 Fed. Appx. 745 (3d Cir. 12/30/20), *vacating* 152 T.C. 129 (3/13/19). In a brief opinion by Judge Roth, the U.S. Court of Appeals for the Third Circuit has vacated and remanded the Tax Court's decision. The court first noted that "Form 8822 [the IRS's change-of-address-form] has not been consistently required to notify the IRS of an address change." The court observed that the Tax Court twice had conlcuded that a power of attorney on Form 2848 filed with the IRS did provide the IRS with clear and concise notification of a new address. See *Hunter v. Commissioner*, T.C. Memo. 2004-81; *Downing v. Commissioner*, T.C. Memo. 2007-291. Curiously, the court did not cite its own opinion in *Expanding Envelope & Folder Corp. v. Shotz*, 385 F.2d 402 (3d Cir. 1997), in which the Third Circuit had reached the same conclusion. The court then emphasized that, "[i]n determining whether the IRS had clear and concise notification of an address change, the proper inquiry is what the IRS knew or should have known." In this case, the court noted, before the IRS issued the notice of deficiency in question, the taxpayers' CPA had informed the IRS agent conducting the audit of the taxpayers' return that the taxpayers had moved. Based on this actual notice to the IRS, combined with the filing of both an extension request on Form 4868 and a power of attorney on Form 2848, both of which reflected the taxpayers' new address, the court concluded that "the IRS knew or should have known that the Gregorys had changed addresses."

- The Third Circuit's opinion is not entirely clear as to the basis of the court's decision. The court's opinion emphasizes that the taxpayers' CPA directly informed the IRS agent conducting the audit that the taxpayers had moved, but the opinion also relies on the extension request and power of attorney forms filed by the taxpayers. The court's opinion also does not mention the court's prior decision in *Expanding Envelope & Folder Corp. v. Shotz*, 385 F.2d 402 (3d Cir. 1997), which was a per curiam decision. Thus, the court's opinion does not directly address the question whether a power of attorney on Form 2848, by itself, would operate as clear and concise notification of a new address. In light of this uncertainty, advisors whose clients move should either counsel clients to file Form 8822, the IRS's change-of-address form, or file Form 8822 on behalf of their clients.

E. Statute of Limitations

1. Forms 1040 and 1099 filed by the taxpayer constituted a "return" that started the running of the limitations period on assessment of amounts the taxpayer failed to backup withhold from payments made to contractors, says the Fifth Circuit. Therefore, the IRS was barred from assessing $1.2 million. In re Quezada, 982 F.3d 931 (5th Cir. 12/11/20). The taxpayer, a debtor in bankruptcy proceedings, was a stone mason who hired subcontractors who provided their labor. For the years 2005 through 2008, he filed Forms 1099 to report the payments he made to the individuals he hired. Many of these Forms 1099, however, did not have taxpayer identification numbers (TINs) because the individuals had failed to provide them. The failure of these individuals to provide their TINs triggered an obligation on the part of the taxpayer under § 3406(a) to withhold at a flat rate from all payments made to these individuals and to remit the withheld amounts to the IRS. This is commonly referred to as "backup withholding." Under Reg. § 31.6011(a)-4(b), the taxpayer was required to file a return on Form 945 to report the amounts withheld through backup withholding. The taxpayer failed to withhold the required amounts and did not file Form 945. In 2014, more than three years after the taxpayer had filed Forms 1099 and his individual tax return on Form 1040 for 2008, the last year at issue, the IRS assessed approximately $1.2 million for the amounts the taxpayer had failed to withhold. The taxpayer subsequently filed a petition in bankruptcy and the IRS filed a proof of claim in the bankruptcy proceeding. The taxpayer asserted that the IRS was barred from assessing the amounts in question by the § 6501(a) limitations period on assessment of tax. Section 6501(a) generally requires the IRS to assess tax within a three-year period that begins when a return is filed. The issue was whether the Forms 1099 and Forms 1040 that the taxpayer filed for the years in question constituted a "return" that triggered the running of the § 6501(a) three-year limitations period. The IRS asserted that only Form 945, the return required by the relevant regulations, could be a "return" for this purpose and that, since the taxpayer had not filed Forms 945, the three-year limitations period on assessment never began to run. In an opinion by Judge Jolly, the Fifth Circuit agreed with the taxpayer. In reaching its conclusion, the court rejected the government's argument that the U.S. Supreme Court's decision in *Commissioner v. Lane-Wells Co.*, 321 U.S. 219 (1944), requires a taxpayer to file the return designated for the tax liability in question in order to start the running of the three-year limitations period. According to the Fifth Circuit, several other Circuit Courts of Appeal—including the Second, Sixth, Ninth, Eleventh, and Federal Circuits—have concluded that a form other than the one prescribed in regulations can constitute a "return" for this purpose. Instead, the court concluded, Lane Wells stands for the following proposition:

> "the return" is filed, and the limitations clock begins to tick, when the taxpayer files a return that contains data sufficient (1) to show that the taxpayer is liable for the tax at issue, and (2) to calculate he extent of the liability.

The Forms 1040 and 1099 filed by the taxpayer, the court concluded, met both of these requirements. The first requirement (showing that the taxpayer was liable for the tax) was met because he had filed Forms 1099 that did not contain TINs, which indicated that he was liable for backup withholding. The second requirement (allowing calculation of tax liability) was met because the Forms 1099 filed without TINs indicated that the taxpayer was liable for backup withholding at the statutory flat rate applied to the amount paid, which was, in fact, how the IRS had calculated his liability for backup withholding. Because the Forms 1040 and 1099 filed by the taxpayer constituted "returns" that triggered the running of the § 6501(a) three-year limitations period on assessment, the IRS was barred from assessing the $1.2 million in backup withholding that the taxpayer had failed to withhold and remit.

F. Liens and Collections

G. Innocent Spouse

H. Miscellaneous

XI. WITHHOLDING AND EXCISE TAXES

XII. TAX LEGISLATION