RECENT DEVELOPMENTS IN FEDERAL INCOME TAXATION

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

By

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

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Note: This outline was prepared jointly with Cassady V. ("Cass") Brewer, Professor of Law, Georgia State University College of Law, Atlanta, GA.

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I. ACCOUNTING

II. BUSINESS INCOME AND DEDUCTIONS

A. Income

B. Deductible Expenses versus Capitalization

1. Legal expenses incurred related to the preparation of applications to the FDA for approval of generic drugs are capital expenditures while legal expenses incurred to defend patent infringement suits are currently deductible. Mylan, Inc. v. Commissioner, 156 T.C. 137 (4/27/21). The taxpayer, Mylan, Inc., and its subsidiaries manufacture both brand name and generic pharmaceutical drugs. Mylan incurred substantial legal expenses in two categories. First, Mylan incurred legal expenses in connection with its applications to the FDA seeking approval of generic drugs. To obtain this approval, Mylan submitted abbreviated new drug applications (ANDAs). The FDA's application process for generic drugs includes a requirement that the applicant certify the status of any patents covering the respective brand name drug previously approved by the FDA (referred to as a "paragraph IV certification"). One option available to the applicant is to certify that the relevant patent is invalid or will not be infringed by the sale or use of the generic version of the drug. An applicant making this certification is required to send notice letters to the holders of the patents informing them of the certification. Such a certification is treated by statute as patent infringement and the holder of the patent is entitled to bring suit in federal district court. Mylan incurred substantial legal expenses to prepare the notice letters it sent in connection with its FDA applications. Second, Mylan incurred substantial legal expenses in defending patent infringement lawsuits brought by the name-brand drug manufacturers against Mylan in response to the notice letters that Mylan sent. Mylan claimed deductions for both categories of legal expenses. The IRS, however, determined that all of Mylan's expenses were capital expenditures under § 263(a). The Tax Court (Judge Urda) held that the legal expenses incurred by Mylan to prepare notice letters were capital expenditures but the legal expenses Mylan incurred to defend patent infringement suits were currently deductible business expenses.

FDAs applications for generic drugs and notice letter costs. The court first addressed the issue of whether the costs Mylan incurred to prepare the notice letters it sent in connection with its ANDA's should be capitalized under § 263. The court's analysis focused in large part on the regulations under § 263 regarding intangibles. These regulations require a taxpayer to capitalize both amounts paid to *create* an intangible and amounts paid to *facilitate* an acquisition or creation of an intangible. Reg. § 1.263(a)-4(b)(1)(ii), (v). With respect to creation of an intangible, Reg. § 1.263(a)-4(d)(5)(I) provides:

> A taxpayer must capitalize amounts paid to a governmental agency to obtain, renew, renegotiate, or upgrade its rights under a trademark, trade name, copyright, license, permit, franchise, or other similar right granted by that governmental agency.

With respect to facilitating the acquisition or creation of an intangible, Reg. § 1.263(a)-4(e)(1) provides:

> [A]n amount is paid to facilitate the acquisition or creation of an intangible (the transaction) if the amount is paid in the process of investigating or otherwise pursuing the transaction. Whether an amount is paid in the process of investigating or otherwise pursuing the transaction is determined based on all of the facts and circumstances.

Mylan and the IRS disputed whether Mylan's legal fees were incurred to "facilitate" the acquisition of a right obtained from a governmental agency and therefore were required to be capitalized. They agreed that the relevant "transaction" was *acquisition* of an FDA-approved ANDA with a paragraph IV certification. But they disagreed on when this acquisition occurs. Mylan argued that the acquisition of an FDA-approved ANDA occurs when the FDA completes its scientific investigation and issues an approval letter. The IRS asserted that the acquisition of an FDA approved ANDA with a paragraph IV certification occurs only when the approval letter issued by the FDA becomes effective. The distinction is that the FDA may issue an approval letter but the approval does not grant any rights to the applicant until it becomes effective. Only when the approval becomes effective does the applicant have the right to begin delivery of a generic drug. *See* 21 U.S.C. § 355(a). With respect to Mylan's legal fees incurred in preparing the notice letters relating to the filing of its ANDA's with paragraph IV certifications, the court concluded that these costs were capital expenditures. The notice is a required step in securing FDA approval of an ANDA. According to the court, because the notice requirement was a prerequisite to securing FDA approval, "the legal expenses Mylan incurred to prepare, assemble, and transmit such notice letters constitute amounts incurred 'investigating or otherwise pursuing' the transaction of creating FDA-approved ANDAs … and must be capitalized."

Litigation expenses. The court reached a different conclusion regarding Mylan's litigation expenses, holding that they were currently deductible. The IRS argued that a patent infringement suit is a step in obtaining FDA approval of an ANDA. The court disagreed, however, and reasoned that the outcome of a patent litigation action has no effect on the FDA's review of a generic drug application. The FDA continues its review process during the course of a patent infringement action and may issue a tentative or final approval of an application before the infringement action is finally decided. A successful patent dispute does not guarantee that a generic drug manufacturer will obtain FDA approval of an ANDA. While it is true that a successful challenge by a patent holder will result in a prohibition of the marketing of a generic drug found to infringe, the court reasoned that the coordination of the FDA approval process with the outcome of related patent litigation does not insert the patent litigation into the FDA's ANDA approval process. A patent on a name brand drug does not prevent FDA approval of a generic version of the drug and patent litigation on the part of the patent holder is not a step in the FDA's approval process for a generic drug. In reaching its conclusion that the litigation expenses incurred by Mylan were currently deductible as ordinary and necessary expenses, the court also applied the "origin of the claim" test, which inquires as to "'whether the origin of the claim litigated is in the process of acquisition", enhancement, or other disposition of a capital asset." *Woodward v. Commissioner*, 397 U.S. 572, 577 (1970); see also *Santa Fe Pac. Gold Co. v. Commissioner*, 132 T.C. 240, 264-265 (2009). Here, the court reasoned, Mylan's legal expenses arose from legal actions initiated by patent holders in an effort to protect their patents. The court followed the decision of the U.S. Court of Appeals for the Third Circuit in *Urquhart v. Commissioner*, 215 F.2d 17 (3d Cir. 1954), which held that patent litigation arises out of the exploitation of the invention embodied in the patent and, therefore, costs incurred to defend a patent infringement suit are not capital expenditures because they are not costs incurred to defend or protect title but rather are expenses incurred to protect business profits. Because Mylan's legal expenses arose out of the patent infringement claims initiated by the patent holders, the court held, they were currently deductible.

a. The Third Circuit has agreed that legal expenses incurred by a taxpayer seeking FDA approval of a generic drug to defend patent infringement suits are currently deductible. Mylan, Inc. v. Commissioner, __F.4th, __, 132 A.F.T.R.2d 2023-____ (3d

Cir. 7/27/23), *aff'g* 156 T.C. 137 (4/27/21). In an opinion by Judge Jordan, the U.S. Court of Appeals for the Third Circuit has affirmed the Tax Court's decision and has held that legal expenses incurred by a taxpayer seeking FDA approval of a generic drug to defend patent infringement suits are currently deductible.

Costs of preparing and sending notice letters to holders of patents on brand-name drugs. As described earlier, the FDA's approval process for an ANDA requires the applicant to make one of certain types of certifcations regarding the status of any existing patents on the relevant brand-name drug. One option available to the applicant is to certify that the relevant patent is invalid or will not be infringed by the sale or use of the generic version of the drug. An applicant making this type of certification is required by the FDA's approval process to notify the holders of patents on relevant brand-name drugs that it has made this certification. In this case, Mylan incurred legal fees to prepare and send such notice letters. The Tax Court held that these costs were capital expenditures because they facilitated the acquisition of an intangible (an FDA-approved application) within the meaning of Reg. § 1.263(a)-4(b)(1)(v). Neither party appealed this aspect of the Tax Court's decision and the Third Circuit's opinion therefore does not address it.

Costs of defending patent infringement litigation. As described earlier, the taxpayer incurred substantial legal fees in defending patent infringement litigation brought by holders of patents on brand-name drugs in response to the notice letters that the taxpayer sent. The Tax Court held that these costs were not capital expenditures and that the taxpayer therefore could deduct them currently as ordinary and necessary business expenses. The government appealed this aspect of the Tax Court's decision. On appeal, the Third Circuit affirmed the Tax Court's decision. The court reviewed at length the FDA's approval process for an ANDA. The key question, the court observed, was whether the costs incurred by the taxpayer to defend patent infringement litigation *facilitated* the acquisition or creation of an intangible within the meaning of Reg. §§ 1.263(a)-4(b)(1)(v) and 1.263(a)-4(e)(1)(i). The court noted that the IRS, beginning in 2011, had issued several non-binding memoranda asserting that generic drug companies must capitalize and amortize the costs of defending patent infringement suits filed in response to the type of certifications made by the taxpayer. The court disagreed with the IRS's position. According to the court, whether the FDA approves (or disapproves) an application for approval to market a generic drug does not depend on the outcome of the patent infringement litigation: "The FDA can approve an ANDA for an infringing generic and deny an ANDA for a non-infringing generic." The court quoted with approval the following summary from the Tax Court's opinion:

> The outcome of a [patent infringement] suit has no bearing on the FDA's safety and bioequivalence review. The FDA continues its review process during the pendency of the patent infringement suit and may issue a tentative or final approval before the suit is resolved. The FDA does not analyze patent issues as part of its review, and neither the statute nor regulations suggest that patent issues might block approval of an ANDA. And winning a patent litigation suit does not ensure that the generic drug manufacturer will receive approval, as the FDA can disapprove an ANDA for not meeting safety and bioequivalence standards

C. Reasonable Compensation

D. Miscellaneous Deductions

E. Depreciation & Amortization

F. Credits

G. Natural Resources Deductions & Credits

H. Loss Transactions, Bad Debts, and NOLs

I. At-Risk and Passive Activity Losses

III. INVESTMENT GAIN AND INCOME

IV. COMPENSATION ISSUES

A. Fringe Benefits

B. Qualified Deferred Compensation Plans

1. Proposed regulations on required minimum distributions. REG-105954-20, Required Minimum Distributions, 87 F.R. 10504 (2/24/22). Treasury and the IRS have issued proposed regulations that address required minimum distributions (RMDs) from qualified retirement plans and annuity contracts and related matters. The proposed regulations would update existing regulations to reflect a number of statutory changes. The most significant of these statutory changes were made by the SECURE Act, enacted on December 20, 2019, as Division O of the 2020 Further Consolidated Appropriations Act. Among other changes, the SECURE Act amended Code § 401(a)(9)(E) to modify the RMD rules for inherited retirement accounts (defined contribution plans and IRAs). The proposed regulations are lengthy and address these and a number of other issues. This outline will focus on only the guidance provided by the proposed regulations on the change made by the SECURE Act to RMDs for inherited retirement accounts. Readers should consult the proposed regulations for additional guidance.

The SECURE Act changes to RMDs from inherited retirement accounts. A provision of the SECURE Act, Division O, Title IV, § 401 of the 2020 Further Consolidated Appropriations Act, amended Code § 401(a)(9)(E) to modify the required minimum distribution (RMD) rules for inherited retirement accounts (defined contribution plans and IRAs). The amendments require all funds to be distributed by the end of the 10th calendar year following the year of death (the "10-year rule"). The statute contains no requirement to withdraw any minimum amount before that date. Section 401(a)(9)(H)(i)(II), as also amended by the SECURE Act, provides that this rule applies whether or not RMDs to the employee or IRA owner have begun. The current rules, which permit taking RMDs over life expectancy, continue to apply to a designated beneficiary who is an "eligible designated beneficiary," which is any of the following: (1) a surviving spouse, (2) a child of the participant who has not reached the age of majority, (3) disabled within the meaning of § 72(m)(7), (4) a chronically ill individual within the meaning of § 7702B(c)(2) with some modifications, or (5) an individual not in any of the preceding categories who is not more than 10 years younger than the deceased individual. These changes generally apply to distributions with respect to those who die after December 31, 2019.

The proposed regulations' interpretation of the SECURE Act. The proposed regulations adopt an interpretation of the 10-year rule that appears to differ from the plain language of the statute and from the interpretation of the legislation of most advisors. The statute provides that, when the designated beneficiary is *not* an eligible designated beneficiary, all funds must be distributed by the end of the 10th calendar year following the year of death and that this rule applies whether or not RMDs to the employee or IRA owner have begun. There appears to be no requirement to withdraw any minimum amount before that date. The preamble to the proposed regulations, however, explains that the proposed regulations distinguish between situations in which the employee or IRA owner dies before the required beginning date for distributions, and situations in which death occurs after such date. When the employee or IRA owner dies *before* the required beginning date for distributions, the proposed regulations provide that no distribution is required before the 10th calendar year following the year of death. However, in situations in which the employee or IRA owner dies *after* the required beginning date for distributions, the proposed regulations provide that a designated beneficiary who is *not* an eligible designated beneficiary must take RMDs before the 10th calendar year following the year of death:

> For example, if an employee died after the required beginning date with a designated beneficiary who is not an eligible designated beneficiary, then the designated beneficiary would continue to have required minimum distributions calculated using the beneficiary's life expectancy as under the existing regulations for up to nine calendar years after the employee's death. In the tenth year following

> the calendar year of the employee's death, a full distribution of the employee's remaining interest would be required.

87 F.R. 10514. This interpretation differs not only from the plain language of the statute and from the interpretation of the legislation of most advisors, but also from IRS Publication 590-B, which was issued for 2021. IRS Publication 590-B (page 11) provides:

> The 10-year rule requires the IRA beneficiaries who are not taking life expectancy payments to withdraw the entire balance of the IRA by December 31 of the year containing the 10th anniversary of the owner's death. For example, if the owner died in 2021, the beneficiary would have to fully distribute the IRA by December 31, 2031. The beneficiary is allowed, but not required, to take distributions prior to that date.
>
> The 10-year rule applies if (1) the beneficiary is an eligible designated beneficiary who elects the 10-year rule, if the owner died before reaching his or her required beginning date; or (2) the beneficiary is a designated beneficiary who is not an eligible designated beneficiary, regardless of whether the owner died before reaching his or her required beginning date.

Many of the comments on the proposed regulations urge the IRS to change its interpretation or at least to delay the effective date of the interpretation because many beneficiaries subject to the 10-year rule did not take distributions in 2021.

a. The IRS will not assert that the excise tax of § 4974 is due from those who failed to take certain RMDs from inherited retirement accounts in 2021 or 2022. Notice 2022-53, 2022-45 I.R.B. 437 (10/7/22). This notice announces that, when the proposed regulations described above become final, the final regulations will apply no earlier than the 2023 distribution calendar year. The notice also addresses the tax treatment of individuals who failed to take RMDs in 2021 or 2022 under the interpretation of the 10-year rule set forth in the proposed regulations. Section 4974 provides that, if the amount distributed from a qualified retirement plan during the year is less than the RMD for that year, then an excise tax is imposed equal to 50 percent (25 percent for tax years beginning after December 29, 2022) of the amount by which the RMD exceeds the amount actually distributed. The notice provides that the IRS will not assert that an excise tax is due under § 4974 from an individual who did not take a "specified RMD." It also provides that, if an individual paid an excise tax for a missed RMD in 2021 that constitutes a specified RMD, the taxpayer can request a refund of the excise tax paid. A "specified RMD" is defined as any distribution required to be made in 2021 or 2022 under a defined contribution plan or IRA if the payment would be required to be made to (1) a designated beneficiary of an employee or IRA owner who died in 2020 or 2021 and on or after the employee or IRA owner's required beginning date, and (2) the designated beneficiary is not taking lifetime or life expectancy payments as required by § 401(a)(9)(B)(iii). In other words, the IRS will not assert that the excise tax of § 4974 is due from a beneficiary who (1) is not an eligible designated beneficiary (and who therefore is subject to the 10-year rule), (2) inherited the retirement account from an employee or IRA owner who died in 2020 or 2021 and on or after the required beginning date of distributions, and (3) were required to take RMDs in 2021 or 2022 under the interpretation of the 10-year rule in the proposed regulations but failed to do so. The notice provides the same relief to beneficiaries of eligible designated beneficiaries if the eligible designated beneficiary died in 2020 or 2021 and was taking lifetime or life expectancy distributions.

- The notice does not explicitly address what RMD must occur in 2023. The issue is whether, in 2023, a beneficiary who failed to take an RMD in 2021 or 2022 must take the 2023 RMD and also any RMDs previously missed. The notice does not explicitly require missed RMDs to be withdrawn. The notice provides only that the IRS will not assert that an excise tax is due from those who failed to take RMDs in 2021 or 2022 under the interpretation of the 10-year rule in the proposed regulations. In the authors' view, the notice implies that, in 2023, only the 2023 RMD must be withdrawn. For example, if an employee or IRA owner died in 2021 with a designated beneficiary who was not an eligible designated beneficiary, that beneficiary should have begun taking

RMDS in 2022, which should continue through 2030 (the ninth year after the employee or IRA owner's death), and the remaining balance of the account should be fully withdrawn in 2031. The authors' interpretation is that the beneficiary in this example should simply begin taking RMDs in 2023 (calculated as if they had begun in 2022), which should continue through 2030, and the remaining balance of the account should be fully withdrawn in 2031. The final regulations may provide further guidance on this question.

b. The IRS has granted a further reprieve: the Service will not assert that the excise tax of § 4974 is due from those who failed to take certain RMDs from inherited retirement accounts in 2021, 2022, or 2023. Notice 2023-54, 2023-31 I.R.B. 382 (7/14/23). This notice announces that, when the proposed regulations described above become final, the final regulations will apply no earlier than the 2024 calendar year. The notice provides that the IRS will not assert that an excise tax is due under § 4974 from an individual who did not take a "specified RMD." A "specified RMD" is defined as any distribution required to be made in 2021 or 2022 under a defined contribution plan or IRA if the payment would be required to be made to (1) a designated beneficiary of an employee or IRA owner who died in 2020, 2021, or 2022 and on or after the employee or IRA owner's required beginning date, and (2) the designated beneficiary is not taking lifetime or life expectancy payments as required by § 401(a)(9)(B)(iii). In other words, the IRS will not assert that the excise tax of § 4974 is due from a beneficiary who (1) is not an eligible designated beneficiary (and who therefore is subject to the 10-year rule), (2) inherited the retirement account from an employee or IRA owner who died in 2020, 2021, or 2022 and on or after the required beginning date of distributions, and (3) were required to take RMDs in 2021, 2022, or 2023 under the interpretation of the 10-year rule in the proposed regulations but failed to do so. The notice provides the same relief to beneficiaries of eligible designated beneficiaries if the eligible designated beneficiary died in 2020, 2021, or 2022 and was taking lifetime or life expectancy distributions.

- The notice also grants relief to those who attained age 72 in 2023 and received distributions from January 1 through July 31, 2023, that are mischaracterized as RMDs. Taxpayers who attain age 72 in 2023 are not required to begin taking RMDs for 2023 because Congress increased the age at which RMDs must begin to age 73 for those who attain age 73 after 2022. The Notice gives such taxpayers until September 30, 2023, to deposit such amounts in an eligible retirement plan and treat the deposits as a tax-free rollover. This aspect of the notice is discussed in more detail below in connection with the discussion of the change in the age at which RMDs must begin.

2. Congress has increased the age at which RMDs must begin to 73 and eventually to age 75. A provision of the SECURE 2.0 Act, Division T, Title I, § 107 of the Consolidated Appropriations Act, 2023, amended Code § 401(a)(9)(C)(i)(I) to increase the age at which required minimum distributions (RMDs) from a qualified plan (including IRAs) must begin from 72 to 73. Pursuant to this amendment, RMDs must begin by April 1 of the calendar year following the later of the calendar year in which the employee attains age 73 or, in the case of an employer plan, the calendar year in which the employee retires. This latter portion of the rule allowing deferral of RMDs from employer plans until retirement does not apply to a 5-percent owner (as defined in § 416). The increase in the age at which RMDs must begin to age 73 applies to distributions required to be made after December 31, 2022, with respect to individuals who attain age 73 after such date. Thus, an individual who attained age 72 in 2022 must take his or her first RMD by April 1, 2023, but an individual who attains age 72 in 2023 need not take the first RMD until April 1, 2025. The legislation further increases the age at which RMDs must begin to age 75 for individuals who attain age 75 after 2032.

a. Those born in 1951 (and who therefore attain age 72 in 2023) and who received distributions from January 1 through July 31, 2023, that are mischaracterized as RMDs have until September 30, 2023, to deposit such amounts in an eligible retirement plan and treat the deposit as a tax-free rollover. Notice 2023-54, 2023-31 I.R.B. 382 (7/14/23). Plan administrators and other payors made the Service aware that automated payment systems would need to be updated to reflect the legislative change in the age at which RMDs must begin. Because such changes could take time, it is possible that those born in 1951 and who therefore attain age 72 in 2023 would receive distributions in 2023 that are mischaracterized as RMDs (and therefore normally ineligile for rollover). This notice grants relief targeted at this situation. For employer-sponsored plans, the notice provides that (1) payors or plan administrators will not be treated as having failed to satisfy applicable requirements based on failure to treat a distribution as an eligible rollover distribution merely because the plan made a distribution from January 1, 2023, through July 31, 2023, to a participant born in 1951 (or the participant's surviving spouse) that would have been an RMD if Congress had not increased the age at which RMDs must begin from 72 to 73, and (2) participants born in 1951 who received such a distribution have until September 30, 2023, to roll over the mischaracterized distribution. For IRAs, the notice provides similar relief and specifies that IRA owners born in 1951 (or the owner's surviving spouse) who received a distribution from the IRA from January 1, 2023, through July 31, 2023, that would have been an RMD if Congress had not increased the age at which RMDs must begin from 72 to 73 can roll over the mischaracterized distribution to an eligible retirement plan if they do so by September 30, 2023. Although IRA owners normally can make only one tax-free rollover in a 12-month period, the notice provides that IRA owners entitled to the relief provided by the notice can roll over the mischaracterized distribution even if they have already rolled over a distribution in the previous 12 months. A rollover of the mischaracterized distribution, however, will preclude the IRA owner from rolling over another distribution in the succeeding 12 months (but could still make a direct trustee-to-trustee transfer as described in Rev. Rul. 78-406, 1978-2 CB 157).

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

D. Individual Retirement Accounts

V. PERSONAL INCOME AND DEDUCTIONS

A. Rates

B. Miscellaneous Income

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

1. Taxpayer's horse-breeding activity is a hobby subject to deduction limitations under § 183 because the taxpayer covered year-over-year losses from his trust fund, ignored cost-saving strategies because he was "not so much [concerned about] income and expenses," threw "pretty lavish parties" attended by people "you would never meet otherwise," intermingled personal and company expenses (including wedding costs), and lived rent-free on the company farm. Skolnick v. Commissioner, 62 F.4th 95 (3rd Cir. 3/8/23) *aff'g* T.C. Memo. 2021-139. The headline more or less sums up this case from the U.S. Court of Appeals for the Third Circuit in which the court affirmed the Tax Court's decision. The taxpayers were owners of a horse-breeding farm conducted through an LLC classified as a partnership for federal income tax purposes. The LLC had operated at a loss for twelve consecutive years before the taxpayers were audited by the IRS for losses claimed via the LLC with respect to their taxable years 2010-2013. The IRS assessed a deficiency on the grounds that IRC § 183 applied to disallow any deductions in excess of the income from the LLC for years 2010-2013. The taxpayers petitioned the Tax Court, which upheld the proposed deficiency. *See Skolnick v. Commissioner*, T.C. Memo. 2021-139 (Judge Lauber). The taxpayers appealed to the Third Circuit, alleging that the Tax Court misapplied the nine-factor test under Reg. § 1.183-2(b) for determining whether an activity is engaged in for profit: (1) the manner in which the taxpayer carries on the activity; (2) the expertise of the taxpayer or his advisors; (3) the time and effort expended by the taxpayer in carrying on the activity; (4) the expectation that assets used in the activity may appreciate in value; (5) the success of the taxpayer in carrying on other similar or dissimilar activities; (6) the taxpayer's history of income or losses with respect to the activity; (7) the amount of occasional profits, if any; (8) the financial status of the taxpayer; and (9) elements of personal pleasure or recreation. Judge Lauber of the Tax Court found that five factors (1, 6, 7, 8, and 9) favored the IRS, three factors (3, 4, and 5) were neutral, and only one factor (2) favored the taxpayers. The Third Circuit, in an opinion written by Judge Hardiman, essentially agreed with Judge Lauber's analysis of the nine factors and found no clear error in the Tax Court's ultimate conclusion that the taxpayers' horse breeding activity was not engaged in for profit for years 2010-2013 within the meaning of IRC § 183. On the one hand, Judge Hardiman reiterated the facts stated in the headline above, especially the LLC's long history of operating losses prior to and after the period 2010-2013 (factor 6). Judge Hardiman also reasoned that, as Judge Lauber emphasized, factor 8 (financial status of the taxpayer) favored the IRS because the taxpayers continually used trust funds and income from other activities to prop up the LLC's year-over-year losses. On the other hand, Judge Hardiman was mildly critical of Judge Lauber's analysis of factor 7 (occasional profits) because the taxpayers were able to show that a third-party paid $325,000 for a 15% interest in the LLC in 2001 and the LLC made a small profit in 2016 from the sale of an interest in one breeding horse. Ultimately, though, Judge Hardiman ruled that Judge Lauber had not erred in holding that factor 7 favored the IRS. Similarly, Judge Hardiman critiqued Judge Lauber's analysis of factor 9 (elements of personal pleasure or recreation). Judge Hardiman did not view the evidence as supporting the conclusion that the opportunity for socializing, as opposed to making a profit, was the primary motive of the taxpayers vis-à-vis the LLC's activities. Nevertheless, considering that the LLC's farm was used rent-free by the taxpayers as a residence and that personal expenditures (including wedding costs) were intermingled with horse-breeding expenses, Judge Hardiman agreed with Judge Lauber that factor 9 favored the IRS. Lastly, concerning a separate issue of whether the taxpayers were entitled to NOL carryforwards from years prior to 2010, Judge Hardiman ruled that Judge Lauber had not clearly erred in finding that the taxpayers failed to adequately substantiate such carryforward losses.

a. "Pease" limitation of § 67 regarding miscellaneous itemized deductions sinks hobby loss expenses otherwise allowable under § 183(b)(2) for taxpayer's yacht chartering activity. Gregory v. Commissioner, 69 F.4th 762 (5/30/2023) *aff'g* T.C. Memo. 2021-115 (Judge Jones). The taxpayer in this case engaged in a yacht chartering activity where expenses equaled or exceeded the taxpayer's gross income from the activity during taxable years 2014 and 2015. During the audit and in Tax Court, the taxpayer and the IRS agreed that the taxpayer's yacht chartering activity during the years in issue was subject to the hobby loss rules of IRC § 183. Consequently, the taxpayer and the IRS further agreed that any deductible expenses from the yacht chartering activity during those years were subject to the gross income limitation of § 183(b)(2). The taxpayer and the IRS disagreed, however, whether the deductions otherwise allowable under § 183(b)(2) are (i) permitted above-the-line as an offset against gross income in determining adjusted gross income under IRC § 62 or (ii) subject to the so-called "Pease" limitation of IRC 67(a) (allowing "miscellaneous itemized deductions" below-the-line only to the extent the deductions exceed a floor of 2 percent of the taxpayer's adjusted gross income). Because the taxpayer earned substantial taxable income during the years in issue—over $19 million in 2014 and over $80 million in 2015—the "Pease" limitation had the effect of disallowing the taxpayer's yacht chartering expenses entirely, even if the expenses were allowable in part under IRC § 183(b)(2). [*Note*: The 2-percent "Pease" limitation applied to the taxable years at issue in this case, but beginning in 2018 through 2025, "miscellaneous itemized deductions" are completely disallowed under IRC § 67(g). Thus, under current law, the taxpayer's yacht chartering expense deductions otherwise allowable under § 183(b)(2) would be disallowed entirely under § 67(g) regardless of the taxpayer's adjusted gross income.] The taxpayer moved for partial summary judgment in Tax Court arguing that the "Pease" limitation does not apply to hobby loss deductions under § 183(b)(2). The IRS argued to the contrary, and Judge Jones of the Tax Court agreed with the IRS, thereby disallowing the taxpayer's hobby loss deductions that otherwise would be permitted under IRC § 183(b)(2).

Appeal: On appeal to the Eleventh Circuit, the taxpayer made several arguments that § 183(b)(2) hobby loss deductions are not "miscellaneous itemized deductions" subject to § 67. First and foremost, the taxpayer argued that IRC § 183 should be read on a stand-alone basis to allow hobby activity expenses as above-the-line deductions offsetting hobby activity gross income. Put differently, the taxpayer argued that § 183 should be read as a corollary to § 162 which allows trade or business expenses above the line as an offset against trade or business gross income in determining adjusted gross income under § 62. Thus, according to the taxpayer, § 183 is merely a qualifier designed to limit hobby activity deductions to hobby activity gross income, but otherwise § 183 operates like § 162. The Eleventh Circuit (Judge Brasher), however, disagreed, stating: "Section 183(b)(2) permits a deduction otherwise disallowed by Section 183(a) and identifies its amount. But the deduction allowed by Section 183(b)(2) is its own thing, not a trade or business expense." Further, Judge Brasher reasoned that, as Judge Jones of the Tax Court had concluded, that § 183(b)(2) "is a benchmark for capping the deduction—it is not a command to apply hobby loss deductions against a taxpayer's total gross income." Judge Brasher then turned to the statutory scheme of IRC §§ 62 (defining "adjusted gross income"), 63 (defining "itemized deductions"), and 67 (defining "miscellaneous itemized deductions"). Judge Brasher concluded that because § 62 does not list § 183 as one of the deductions allowable in computing adjusted gross income, and because § 63 does not carve out § 183 deductions for special treatment (unlike the special treatment given the standard deduction, the § 199A QBI deduction, and the § 170 charitable deduction), hobby loss deductions are subject to the "Pease" limitation of § 67. Judge Brasher cited as support (i) Reg. § 1.67-1T(a)(1)(iv) ["expenses for an activity for which a deduction is otherwise allowable under section 183"]; (ii) two lower-court cases [i.e., *Purdey v. United States*, 39 Fed. Cl. 413, 417 (1997); *Strode v. Comm'r*, 109 T.C.M. (CCH) 1599 (2015)]; and (iii) commentary [i.e., B. Bittker & L. Lokken, Federal Taxation of Income, Estates and Gifts ¶ 30.4.2 (July 2022)].

Next, the taxpayer argued that the Eleventh Circuit's opinion in *Brannen v. Commissioner*, 722 F.2d 695 (11th Cir. 1984), compelled the conclusion that § 183 deductions are above-the-line and not subject to the "Pease" limitation. The court in *Brannen* held that § 183 applies to allow deductions, not to exceed gross income, for expenses connected with an activity that is not "entered into with the dominant hope and intent of realizing a profit." Judge Brasher clarified, though, that *Brannen* was decided before the enactment of the "Pease" limitation of § 67, and *Brannen* should not be read to mean that § 183 allows an above-the-line deduction for hobby activity expenses notwithstanding the statutory scheme of §§ 62, 63, and 67.

Next, the taxpayer argued that subjecting § 183(b)(2) deductions to the "Pease" limitation of § 67 contravenes Congressional intent. Pointing to legislative history, the taxpayer contended that § 183 originally was enacted to prevent wealthy taxpayers from generating artificial losses, not to prevent taxpayers from deducting legitimate hobby loss expenses. Judge Brasher countered, though, that by enacting the "Pease" limitation of § 67, Congress explicitly intended to limit a taxpayer's ability to benefit from already-existing deductions that the Code otherwise provided.

Finally, the taxpayer made additional arguments that the Tax Court's and the Eleventh Circuit's interpretation of § 183 is inconsistent with other principles of statutory construction; however, Judge Brasher found none of the taxpayer's arguments convincing, primarily because the court did not find that § 183 and the statutory scheme of §§ 62, 63, and 67 were ambiguous.

Judge Wilson concurred with Judge Brasher's opinion but wrote separately to clarify that he would reach the same result by examining the legislative history of the Tax Cuts and Jobs Act of 2017 ("TCJA"). In relevant part, the Conference Report to the TCJA lists "[h]obby expenses, but generally not more than hobby income," as one type of deduction that would be disallowed under § 67(g) until 2026. *See* H.R. Rep. No. 115-466, at 273, 276 (2017).

D. <u>Deductions and Credits for Personal Expenses</u>

E. <u>Divorce Tax Issues</u>

F. <u>Education</u>

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

VI. CORPORATIONS

VII. PARTNERSHIPS

VIII. TAX SHELTERS

IX. EXEMPT ORGANIZATIONS AND CHARITABLE GIVING

A. Exempt Organizations

B. 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

1. The 90-day period specified in § 6213(a) for filing a petition in the U.S. Tax Court is jurisdictional and is not subject to equitable tolling, according to the Tax Court. Hallmark Research Collective v. Commissioner, 159 T.C. No. 6 (11/29/22). In a unanimous, reviewed opinion by Judge Gustafson, the Tax Court has held that the 90-day period specified by § 6213(a) within which taxpayers can challenge a notice of deficiency by filing a petition in the Tax Court is jurisdictional and is not subject to equitable tolling. In this case, the IRS sent a notice of deficiency to the taxpayer. Pursuant to § 6213(a), the taxpayer then had 90 days within which to challenge the notice of deficiency by filing a petition in the U.S. Tax Court. The last day of this 90-day period was September 1, 2021. The taxpayer electronically filed its petition on September 2, 2021, which was one day late. In the petition, the taxpayer stated: "My CPA . . . contracted COVID/DELTA over the last 40 days and kindly requests additional time to respond." In other words, it appears that the taxpayer was requesting an extension of the § 6213(a) 90-day period.

Procedural history. The Tax Court issued an order to show cause in which it ordered the parties to respond as to why the court should not, on its own motion, dismiss the action for lack of jurisdiction. The taxpayer requested that the court defer ruling on the matter until the U.S. Supreme Court issued its opinion in *Boechler, P.C. v. Commissioner*, 142 S. Ct. 1493 (4/21/22), which was pending in the Supreme Court. The Tax Court declined to defer ruling and dismissed the taxpayer's action. After the U.S. Supreme Court issued its opinion in *Boechler*, the taxpayer moved to vacate the court's order of dismissal. After receiving briefing, the court issued a unanimous, reviewed opinion denying the motion to vacate its prior order of dismissal.

Tax Court' s holding. In a lengthy (57-pages) and extraordinarily thorough opinion, the Tax Court examined the text and history of § 6213(a) and concluded that Congress had clearly indicated that the 90-day period specified in the statute is jurisdictional. The court observed that the Tax Court is a court of limited jurisdiction and has only whatever jurisdiction it has been granted by Congress. Accordingly, because the 90-day period is jurisdictional, in the court's view, the court must dismiss cases, such as this one, in which the taxpayer's petition is filed late. And because the statute is jurisdictional, the court concluded, it is not subject to equitable tolling, i.e., taxpayers cannot argue for exceptions on the basis that they had good cause to meet the deadline. The court also concluded rather briefly that its view on the jurisdictional nature of § 6213(a) was not affected by the U.S. Supreme Court's decision in in *Boechler, P.C. v. Commissioner*, 142 S. Ct. 1493 (4/21/22). In *Boechler,* the Court held that the 30-day period specified in § 6330(d)(1) for requesting review in the Tax Court of a notice of determination following a collection due process hearing is *not* jurisdictional and *is* subject to equitable tolling. According to the Tax Court, *Boechler* "emphatically teaches that" § 6213(a) and § 6330(d)(1) "are different sections" that "[e]ach must be analyzed in light of its own text, context, and history." The fact that, in *Boechler*, the Supreme Court concluded that the 30-day period specified in § 6330(d)(1) is *not* jurisdictional did not change the Tax Court's view that the 90-day period specified in § 6213(a) *is* jurisdictional. Accordingly, the Tax Court dismissed the taxpayer's action.

a. The Third Circuit disagrees. The 90-day period specified in § 6213(a) for filing a petition in the U.S. Tax Court is *not* jurisdictional and *is* subject to equitable tolling. Culp v. Commissioner, ___ F.4th ___, 132 A.F.T.R.2d 2023-____ (3d Cir. 7/19/23). In an opinion by Judge Ambro, the U.S. Court of Appeals for the Third Circuit has held that the 90-day period specified by § 6213(a) within which taxpayers can challenge a notice of deficiency by filing a petition in the Tax Court is *not* jurisdictional and *is* subject to equitable tolling. Although the Third Circuit's opinion does not provide specific dates, it states that the IRS mailed a notice of deficiency to the taxpayers, a married couple, as well as a second notice of deficiency, both with respect to the taxable year 2015. The taxpayers filed a petition in the Tax Court seeking redetermination of the deficiency well outside the 90-day period specified in § 6213(a) for doing so. In an unpublished order, the Tax Court dismissed the taxpayers' petition for lack of juridiction. On appeal, the taxpayers, backed by amicus curiae represented by the Legal Services Center of Harvard Law School, argued that the 90-day period provided by § 6213(a) is not juridictional and is subject to equitable tolling in appropriate circumstances. The court framed the issue in this way:

> The central question in this appeal is whether the Culps' late filing deprives the Tax Court of jurisdiction to consider their petition. Put another way, is § 6213(a)'s 90-day requirement jurisdictional or is it a claims-processing rule?

The court first analyzed the text of § 6213(a), which provides in part:

> Within 90 days … after the notice of deficiency authorized in section 6212 is mailed …, the taxpayer may file a petition with the Tax Court for a redetermination of the deficiency. … The Tax Court shall have no jurisdiction to enjoin any action or proceeding or order any refund under this subsection unless a timely petition for a redetermination of the deficiency has been filed and then only in respect of the deficiency that is the subject of such petition.

The court concluded that the provision's text did not indicate that the 90-day period specified in § 6213(a) is jurisdictional. The language Congress used, the court reasoned, does not link the 90-day deadline to the Tax Court's jurisdiction. The statute provides that the Tax Court has no jurisdiction to enjoin actions or order a refund if the taxpayer's petition is not timely filed, which indicates that "Congress knew how to limit the scope of the Tax Court's jurisdiction." But the provision does not similarly limit the Tax Court's jurisdiction to review petitions that are not timely filed. Further, according to the court, neither the context of the statute nor the court's own precedent interpreting § 6213(a) indicates that the 90-day period is jurisdictional.

After holding that the 90-day period specified in § 6213(a) is not jurisdictional, the court considered whether the period is subject to equitable tolling. According to the court, neither the text nor context of the statute suggests that Congress intended the period not to be subject to equitable tolling. Accordingly, the court remanded the case to the Tax Court with instructions for the Tax Court to consider whether the taxpayers could demonstrate sufficient grounds for the 90-day period to be equitably tolled.

2. This promoter was SOL because there is no SOL for promoter penalties. Crim v. Commissioner, 66 F.4th 999 (D.C. Cir. 5/2/2023) *aff'g* T.C. Memo. 2021-117. The taxpayer-promoter in this case was convicted of certain tax crimes in 2008 and sentenced to prison, where he remained until his release in 2014. In 2010 and within the three-year limitations period on assessment provided by § 6501, the IRS assessed penalties against the taxpayer under IRC § 6700 (promoting abusive tax shelters). Then, in 2011, the IRS recorded a Notice of Federal Tax Lien ("NFTL") against the taxpayer's California property and delivered to the taxpayer a Letter 3172, Notice of Federal Tax Lien Filing and Your Right to a Hearing ("lien notice"). The letter instructed the taxpayer to submit his request for a collection due process ("CDP") hearing by December 30, 2011. The taxpayer did not respond to the lien notice and did not request a CDP hearing. The IRS then suspended collection activities against the taxpayer while he was incarcerated. Next, in 2017, approximately three years after the taxpayer was released from prison but within the ten-year collection period of § 6502, the IRS issued a notice of determination to the taxpayer sustaining the collection action and delivered a Letter 1058, Notice of Intent to Levy and Your Right to a Hearing ("levy notice") relating to the § 6700 penalties. Through his representative, the taxpayer requested a CDP hearing. In the CDP hearing, the IRS Settlement Officer issued a notice of determination upholding the proposed collection action. The taxpayer challenged this determination by filing a petition in the Tax Court. The taxpayer first filed a motion to recuse and disqualify all Tax Court judges on separation of powers grounds. The Tax Court denied that motion in July 2019. Next, in December 2019, the IRS filed a motion for summary judgment, and the taxpayer filed a cross-motion for summary judgment arguing alternatively that the statute of limitations had run against the IRS under both § 6501 (three-year limit on assessment) and § 6502 (ten-year limit on collection). The Tax Court (Judge Lauber) decided in favor of the IRS and issued its opinion sustaining the IRS's collection actions in October 2021. The taxpayer appealed to the D.C. Circuit.

Appeal: On appeal to the D.C. Circuit, the taxpayer again made his separation of powers and statute of limitations arguments. The D.C. Circuit, in an opinion by Judge Rogers, ruled two-to-one against the taxpayer on both arguments. We omit discussion of the taxpayer's separation of powers argument. Concerning the taxpayer's statute of limitations argument, Judge Rogers held for the IRS noting that the D.C. Circuit is joining the Second, Fifth, and Eighth Circuits in holding that § 6501 does not apply to the assessment of promoter penalties under § 6700. *See Barrister Assocs. v. United States*, 989 F.2d 1290, 1296-97 n.1 (2d Cir. 1993); *Sage v. United States*, 908 F.2d 18, 24-25 (5th Cir. 1990); *Lamb v. United States*, 977 F.2d 1296, 1296-97 (8th Cir. 1992). According to Judge Rogers, the primary reason that the three-year limitation on *assessment* under § 6501 does not apply is because the § 6700 penalty turns on the promoter's conduct, *not the filing of a return by the promoter's client*. The taxpayer also made a statute of limitations argument under 28 U.S.C. 2462 which imposes a five-year limitation period on any action to enforce a "civil fine, penalty, or forfeiture." With regard to this argument, Judge Rogers agreed with the Second and Eighth Circuits that 28 U.S.C. 2462 does not apply to § 6700 penalties because Congress "otherwise provided" for the ten-year limitation on *collection* in § 6502. *See Capozzi v. United States*, 980 F.2d 872, 874-75 (2d Cir. 1992); *Lamb v. United States*, 977 F.2d 1296 at 1297 (8th Cir. 1992). The D.C. Circuit thus upheld the Tax Court's summary judgment in favor of the IRS and against the taxpayer.

Dissenting opinion of Judge Walker. In a dissenting opinion, Judge Walker indicated that he would remand the case to the Tax Court for further proceedings because he believed that the taxpayer's statute-of-limitations argument "has some merit." Judge Walker wrote: "Rather than deciding, as the majority does, that no return can ever trigger § 6501(a)'s statute of limitations in a tax-shelter-promotion case, I would let the Tax Court determine, on a case-by-case basis, whether a tax return has triggered the limitations clock."

3. The common-law mailbox rule has been displaced by regulations, says the Fourth Circuit, but the taxpayer nevertheless plausibly alleged that his claim for refund was physically delivered to the IRS. Pond v. United States, 69 F.4th 155 (4th Cir. 5/26/23). The IRS audited the taxpayer's 2012 return. The audit revealed that the taxpayer was entitled to a refund but the IRS mistakenly sent the taxpayer a letter stating that he owed additional tax and interest, which he paid. After the taxpayer's accountant discovered the error, the taxpayer mailed a claim for refund for 2012 and, in the same envelope, mailed an amended return for 2013 claiming a refund for 2013 as a result of certain adjustments to his 2012 return. The taxpayer mailed the envelope containing the claims for refund for 2012 and 2013 by first class mail. After a great deal of effort on the taxpayer's part, the IRS issued the refund for 2012. But the IRS took the position that it had never received the taxpayer's claim for refund for 2013. The taxpayer brought this action for a refund in the U.S. District Court. Under § 7422(a), the jurisdiction of both U.S. District Courts and the U.S. Court of Federal Claims to hear tax refund actions is limited to those cases in which the taxpayer has "duly filed" a claim for refund with the IRS. The issue in this case was how the taxpayer could prove that he had filed the necessary timely refund claim for 2013.

The taxpayer argued that he could rely on the so-called common-law mailbox rule developed and applied by some courts. Under the narrow version of this rule, if a taxpayer can show that a document was actually delivered, but can't prove precisely when delivery occurred, a court can presume that physical delivery occurred within the ordinary time after mailing. Under a broader version of this rule adopted by some courts, proof of proper mailing (including by testimonial or circumstantial evidence) gives rise to a rebuttable presumption that the document was physically delivered to the addressee in the time the mailing would ordinarily take to arrive. In other words, the narrow version requires the taxpayer to prove delivery and assists the taxpayer only in establishing the time of delivery. The broader version of the rule requires the taxpayer only to prove timely mailing and, if timely mailing occurred, gives rise to a rebuttable presumption that the document was delivered.

The government moved to dismiss the taxpayer's refund action for lack of jurisdiction and argued that the common-law mailbox rule, the court held, has been displaced by § 7502. Under § 7502(a) (which reflects the narrower version of the common-law mailbox rule), the postmark stamped on the cover in which a return or claim is mailed is deemed to be the date of delivery if the return or claim (1) is deposited in the mail in the United States within the time prescribed for filing in a properly addressed, postage prepaid envelope or other appropriate wrapper and bears a postmark date that falls within the time prescribed for filing, and (2) is delivered by United States mail after the prescribed time for filing to the agency with which it is required to be filed. In § 7502(c)(1), the statute also reflects the broader version of the common law mailbox rule and provides that, if the return or claim is mailed by United States registered mail, the date of registration is treated as the postmark date and the registration is prima facie evidence that the return or claim was delivered to the agency to which it was addressed. Section 7502(c)(2) authorizes the Secretary of the Treasury to issue regulations providing the same treatment of returns or claims sent by certified mail, which Treasury and the IRS have done. *See* Reg. § 301.7502-1(c)(2). Section 301.7502-1(e)(2)(i) of the regulations further provides that, except for direct proof of actual delivery, proof of proper use of registered or certified mail (or a designated private delivery service) is the *exclusive means* to establish prima facie evidence of delivery and that "[n]o other evidence of a postmark or of mailing will be prima facie evidence of delivery or raise a presumption that the document was delivered."

The Fourth Circuit agreed with the IRS that the common-law mailbox rule has been displaced by § 7502. Because the taxpayer had not sent his claims for refund by registered or certified mail, he could not rely on the presumption of delivery provided by § 7502(c). In reaching this conclusion, the court did *not* give deference to Reg. § 301.7502-1(e)(2)(i) under the two-step analysis of *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). The court concluded that the statute was not ambiguous on this question (*Chevron* step one) and that giving deference to the regulation was therefore unnecessary.

According to the Fourth Circuit, however, this did not end the inquiry:

> Is Pond out of luck just because he cannot rely on a *presumption* of delivery? No. He can still proceed if he has plausibly alleged that his claim was physically delivered to the IRS.

The court concluded that the taxpayer had plausibly alleged that his claim was physically delivered to the IRS and had supported his claim with three factual allegations. The taxpayer had alleged: (1) that the envelope containing the 2013 claim was postmarked on a specific date, which suggests that the document made it to its destination; (2)that his 2012 and 2013 claims were sent in a single envelope, and the IRS paid his 2012 claim; and (3) that the letter he received from the IRS denying his 2013 claim listed the "date of claims received" as a specific date.

Therefore, according to the Fourth Circuit, the District Court, in ruling on the government's motion to dismiss, should have drawn all reasonable inferences in the light most favorable to the taxpayer. The District Court had not done so and therefore erred in granting the government's motion. The court remanded for further proceedings.

- *Use separate envelopes, and for God's sake, use registered or certified mail when a deadline is approaching!* This decision provides two valuable lessons to those filing documents with the IRS when a deadline is approaching. First, although it might be easier to send multiple filings in a single envelope, doing so runs the risk that the IRS will perceive the envelope as containing only one item. It is much better practice to mail one item per envelope. Second, if a deadline is approaching, it is imperative to send the document to the IRS using registered or certified mail. Doing so will provide prima facie evidence of mailing and will give rise to a statutory presumption that the document was delivered.

F. Liens and Collections

G. Innocent Spouse

H. Miscellaneous

1. By a five-to-four vote, SCOTUS demonstrates yet again that the FBAR penalty statute is totally FUBAR, but at least we think we know the law until Congress says otherwise: $10,000 max penalty per year for non-willful violations, but the greater of $100,000 or 50 percent of each foreign account for willful violations. Bittner v. United States, 598 U.S. ___, 142 S. Ct. 2833 (6/21/23). The Bank Secrecy Act provides in part that U.S. persons owning an interest in foreign accounts with an aggregate balance of more than $10,000 in deposits must file an annual disclosure report. *See* 31 U.S.C. 5314; 31 C.F.R. § 1010.306 (2021). The annual disclosure is filed on the Financial Crimes Enforcement Network's ("FinCEN") Form 114 — Report of Foreign Bank and Financial Accounts ("FBAR"). Failure to properly file FinCEN Form 114 may result in varying penalties under 31 U.S.C. 5321(a)(5) depending upon whether the failure was willful or non-willful. We have reported below on the numerous cases decided under 31 U.S.C. 5321(a)(5) regarding the controversy surrounding the FBAR penalty for *willful* violations of 31 U.S.C. 5314. Generally, however, the United States Courts of Appeal addressing the issue agree that the FBAR penalty for willful violations is the greater of $100,000 or 50 percent of each offending account. With regard to non-willful FBAR violations, there has been a split between the Ninth and Fifth Circuits. In United States v. Boyd, 991 F.3d 1077 (9th Cir. 3/24/2021), the Ninth Circuit held for the taxpayer that the FBAR penalty for non-willful violations of 31 U.S.C. 5314 should be limited to $10,000 per annual filing of FinCen Form 114 regardless of the number of foreign accounts the taxpayer failed to properly report. In United States v. Bittner, 19 F.4th 734 (5th Cir. 11/30/2021), the Fifth Circuit disagreed and held for the government that the FBAR penalty for non-willful violations is determined on a per-offending-account basis, similar to the FBAR penalty for willful violations. SCOTUS granted certiorari in United States v. Bittner, 19 F.4th 734 (5th Cir. 11/30/2021) to resolve the split between the circuits.

The taxpayer in Bittner v. United States, 598 U.S. ___, 142 S. Ct. 2833 (6/21/2023), had 61 foreign bank accounts in 2007, 51 in 2008, 53 in 2009 and 2010, and 54 in 2011. The government acknowledged that the taxpayer's failure to properly file FinCEN Forms 114 for the numerous accounts held over the five-year period was non-willful. Nevertheless, the government sought to impose an FBAR penalty of $2.72 million on the taxpayer due to the number of offending accounts over the five-year period. Therefore, the question before the U.S. Supreme Court was whether the taxpayer owed $2.72 million in FBAR penalties or only $50,000 ($10,000 per year). Justice Gorsuch wrote the opinion for the majority (Gorsuch, Roberts, Alito, Kavanaugh, and Jackson), holding that the FBAR penalty under 31 U.S.C. 5321(a)(5) should be limited to $10,000 per year for non-willful violations of 31 U.S.C. 5314. Justice Gorsuch reasoned that 31 U.S.C. 5314 "does not speak of accounts or their number," but instead refers to a duty to file annual "reports." Justice Gorsuch was not persuaded by the government's argument that because the penalty for *willful* violations of 31 U.S.C. 5321(a)(5) is determined on a per-offending-account basis, so should the lower penalty for non-willful violations. Instead, applying the *expressio unius est exclusio alterius* maxim of statutory construction (i.e., the use of different terms within a single statute implies a different meaning), Justice Gorsuch concluded that Mr. Bittner's maximum FBAR penalty for non-willfully violating 31 U.S.C. 5314 over five years should be only $50,000 ($10,000 per year). Justice Barret wrote for the dissenters (Barrett, Thomas, Sotomayor, and Kagan), arguing that although *expressio unius est exclusio alterius* is a general rule of statutory interpretation, it gives way where context suggests otherwise. In Justice Barrett's view, the FBAR penalties permitted under 31 U.S.C. 5321(a)(5), whether for willful or non-willful violations, only makes sense if they are determined on a per account basis. Otherwise, dissenting Justice Barrett wrote, the maximum annual penalty that the government may impose for a non-willful violation of 31 U.S.C. 5314 is $10,000 whether the taxpayer has one offending foreign bank account or one hundred such accounts.

XI. WITHHOLDING AND EXCISE TAXES

XII. TAX LEGISLATION

A. <u>Enacted</u>