# 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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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

# III. INVESTMENT GAIN AND INCOME

# IV. COMPENSATION ISSUES

## A. Fringe Benefits

## B. Qualified Deferred Compensation Plans

**1. Effective in 2024, all catch-up contributions to employer-sponsored plans must be deposited in a Roth account if the participant had wages in the preceding year of more than $145,000.** A provision of the SECURE 2.0 Act, Division T, Title VI, § 603 of the Consolidated Appropriations Act, 2023, amended Code § 414(v) by adding new § 414(v)(7). New § 414(v)(7) provides that, if a participant in an employer-sponsored retirement plan had wages in the preceding calendar year from the employer sponsoring the plan that exceeded $145,000, then the participant cannot make catch-up contributions unless those contributions are designated Roth contributions. This $145,000 figure will be adjusted for inflation in tax years beginning after 2024. The legislation further provides that, if this new "Roth-only" rule applies to any participant for the year, then no participant in the plan can make catch-up contributions unless the plan offers all participants a Roth option. This rule effectively will force employer-sponsored plans to offer Roth options to their participants. These changes apply to taxable years beginning after December 31, 2023.

**a. Apparently the IRS can simply ignore the effective date of a legislative change. The IRS has announced a two-year "administrative transition period" that has the effect of delaying the effective date of the "Roth-only" rule for catch-up contribuitions until taxable years beginning after 2025.** Notice 2023-62, 2023-37 I.R.B. ___ (8/25/23). In response to concerns expressed by taxpayers regarding the timely implementation of the new "Roth-only" rule (new § 414(v)(7)) enacted as part of the Consolidated Appropriations Act, 2023, for catch-up contributions by employees with wages in the preceding calendar year that exceeded $145,000, the IRS has effectively delayed the effective date of the Roth-only rule. As enacted, the Roth-only rule applies to taxable years beginning after December 31, 2023. In this notice, however, the IRS has announced a two-year "administrative transition period." Specifically, until taxable years beginning after December 31, 2025:

> (1) … catch-up contributions will be treated as satisfying the requirements of section 414(v)(7)(A), even if the contributions are not designated as Roth

contributions, and (2) a plan that does not provide for designated Roth contributions will be treated as satisfying the requirements of section 414(v)(7)(B).

The notice also announces that the Treasury Department and the IRS plan to issue further guidance to assist taxpayers with the implementation of the new Roth-only rule. The guidance expected to be issued includes:

- "Guidance clarifying that section 414(v)(7)(A) of the Code would not apply in the case of an eligible participant who does not have wages as defined in section 3121(a) (that is, wages for purposes of the Federal Insurance Contributions Act (FICA)) for the preceding calendar year from the employer sponsoring the plan." Thus, a partner or other self-employed person, neither of whom receives wages from the business, would not be subject to the Roth-only rule.
- "Guidance providing that, in the case of an eligible participant who is subject to section 414(v)(7)(A), the plan administrator and the employer would be permitted to treat an election by the participant to make catch-up contributions on a pre-tax basis as an election by the participant to make catch-up contributions that are designated Roth contributions." Apparently, this approach would permit the plan administrator and the employer to treat an employee as having elected to make catch-up contributions to a Roth account even though the employee actually elected to make catch-up contributions on a pre-tax basis.
- "Guidance addressing an applicable employer plan that is maintained by more than one employer (including a multiemployer plan). The guidance would provide that an eligible participant's wages for the preceding calendar year from one participating employer would not be aggregated with the wages from another participating employer for purposes of determining whether the participant's wages for that year exceed $145,000 (as adjusted). For example, under that guidance, if an eligible participant's wages for a calendar year were: (1) $100,000 from one participating employer; and (2) $125,0000 from another participating employer, then the participant's catch-up contributions under the plan for the next year would not be subject to section 414(v)(7)(A) (even if the participant's aggregate wages from the participating employers for the prior calendar year exceed $145,000, as adjusted). The guidance also would provide that, even if an eligible participant is subject to section 414(v)(7)(A) because the participant's wages from one participating employer in the plan for the preceding calendar year exceed $145,000 (as adjusted), elective deferrals made on behalf of the participant by another participating employer that are catch-up contributions would not be required to be designated as Roth contributions unless the participant's wages for the preceding calendar year from that other employer also exceed that amount."

The Treasury Department and the IRS have invited comments regarding the matters discussed in the notice and any other aspect of the new Roth-only rule. Comments must be submitted on or before October 24, 2023.

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

**1. The taxpayer took a shot at a deduction for deferred compensation but only scored an A-I-R B-A-L-L! A-I-R B-A-L-L! A-I-R B-A-L-L!** Hoops, LP v. Commissioner, T.C. Memo. 2022-9 (2/23/22). In a memorandum opinion, the Tax Court (Jude Nega) has held that an accrual method partnership could not deduct unpaid salary and wages relating to deferred compensation owed to two players (Zach Randolph and Michael Conley) for the Memphis Grizzlies of the NBA. The taxpayer-partnership, Hoops, LP ("Hoops") sold the Memphis Grizzlies' NBA franchise and substantially all of its assets to a buyer in 2012. The buyer assumed substantially all of the liabilities and obligations of Hoops as part of the acquisition, including the obligation to pay approximately $10.7 million (discounted to present value) in nonqualified deferred compensation to the two players. Hoops had included the accrued $10.7 million liability in its amount realized in connection with the sale. Hoops did not deduct the $10.7 million on its originally filed partnership tax return on Form 1065 for 2012. Instead, Hoops filed an amended return on Form 1065-X for 2012 in October of 2013 claiming the $10.7 million accrued liability as a deduction. Following an audit, the IRS issued a notice of final partnership administrative adjustment disallowing the deduction, and Hoops petitioned the Tax Court. The parties stipulated that the $10.7 million accrued liability was nonqualified deferred compensation governed by the catch-all "other plans" provision of § 404(a)(5). Section 404(a)(5) and the regulations under that provision allow a deduction for payments under such nonqualified deferred compensation plans "only in the taxable year of the employer in which or with which ends the taxable year of an employee in which an amount attributable to such contribution is includible in [the employee's] gross income." Reg. § 1.404(a)-12(b)(1). Hoops argued that the timing rule in § 404(a) is incorporated into the economic performance requirement of § 461(h), and due to the sale, the deduction was accelerated under Reg. § 1.461-4(d)(5)(i) which provides:

> If, in connection with the sale or exchange of a trade or business by a taxpayer, the purchaser expressly assumes a liability arising out of the trade or business that the taxpayer but for the economic performance requirement would have been entitled to incur as of the date of the sale, economic performance with respect to that liability occurs as the amount of the liability is properly included in the amount realized on the transaction by the taxpayer.

Alternatively, Hoops argued that if the $10.7 million liability was not deductible upon the sale, then it should not have been included in Hoops's amount realized as part of the sale. The IRS argued in response that Reg. § 1.404(a)-12(b)(1), not § 461(h) or Reg. § 1.461-4(d)(5)(i), controlled to allow the deduction only when the deferred compensation is paid and includable in the players' gross income regardless of whether economic performance had occurred or whether the liability was considered part of Hoops's amount realized in connection with the sale.

*Judge Nega's Opinion*. Judge Nega agreed with the IRS and relied on the regulations under § 461 and § 446, which provide that "[a]pplicable provisions of the Code, the Income Tax Regulations, and other guidance published by the Secretary prescribe the manner in which a liability that has been incurred [under § 461(h)] is taken into account." Reg. §§ 1.461-1(a)(2)(i), 1.446-1(c)(1)(ii)(A). Judge Nega therefore reasoned that § 404(a)(5) and Reg. § 1.404(a)-12(b)(1) controlled to disallow the partnership's deduction unless and until the deferred compensation was paid and includable in the gross income of the players. Judge Nega cited the Ninth Circuit's decision in *Albertson's, Inc. v. Commissioner*, 42 F.3d 537, 543 (9th Cir. 1994), *aff'g* 95 T.C. 415 (1990), as support. In *Albertson's*, the Ninth Circuit relied upon legislative history to determine that Congress enacted § 404(a) expressly to match the timing of an employer's deduction and an employee's inclusion of nonqualified deferred compensation. Furthermore, regarding whether the $10.7 million deferred compensation liability should have been included in Hoops's amount realized upon the sale, Judge Nega determined that it should, citing the general rules of §§ 1001(a), 1001(b), and Reg. § 1.1001-2(a)(1), which provide that a taxpayer's amount realized includes liabilities from which the taxpayer is discharged as a result of transferring property.

*Comment*. Hoops argued that the $10.7 million nonqualified deferred compensation arrangement should not be considered a "liability" includable in amount realized under § 1001(b) and Reg. § 1.1001-2(a)(1). Support for this position can be found in § 108(e)(2), which provides that "[n]o income shall be realized from the discharge of indebtedness to the extent that payment of the liability would have given rise to a deduction." Similarly, § 357(c)(3)(i) provides that an obligation is not treated as a liability for purposes of § 351 if the payment thereof "would give rise to a deduction." And, Reg. § 1.752-1 provides that an obligation is not treated as a liability for purposes of § 752 unless it (i) creates or increases the basis of any of the obligor's assets (including cash); (ii) gives rise to an immediate deduction to the obligor; or (iii) gives rise to an expense that is not deductible in computing the obligor's taxable income and is not properly chargeable to capital. The court, however, rejected Hoops's argument and held that, under the general rules of

§ 1001(b) and Reg. § 1.1001-2(a)(1), "Hoops was required to take into account the amount of the deferred compensation liability in computing its gain or loss from the sale."

*Appeal*: Hoops has appealed to the U.S. Court of Appeals for the Seventh Circuit.

**a. Upon replay reviw, the call on the court is confirmed by the Seventh Circuit: No basket (a/k/a deduction)!** Hoops, LP v. Commissioner, ___ F.4th ___ (7th Cir. 8/9/23) *aff'g* T.C. Memo. 2022-9 (2/23/22). On appeal, in an opinion by Judge Scudder, the U.S. Court of Appeals for the Seventh Circuit agreed with the Tax Court that § 404(a)(5) controlled the outcome in this case and disallowed any deduction for Hoops unless and until the deferred compensation is included in the gross income of the players. Hoops made the same argument to the Seventh Circuit that it made in the Tax Court, i.e., that Reg. § 1.461-4(d)(5)(i) allows acceleration of the deduction for the deferred compensation obligation in the context of a sale of a trade or business. As noted earlier, Reg. §1.461-4(d)(5)(i) provides:

> If, in connection with the sale or exchange of a trade or business by a taxpayer, the purchaser expressly assumes a liability arising out of the trade or business that the taxpayer but for the economic performance requirement would have been entitled to incur as of the date of the sale, economic performance with respect to that liability occurs as the amount of the liability is properly included in the amount realized on the transaction by the taxpayer.

Judge Scudder disagreed, though, reasoning that the above-quoted regulation applies where economic performance has not occurred. Here, there was no dispute that economic performance had occurred because the deferred compensation was attributable to the players' past services rendered in prior NBA seasons. Judge Scudder wrote:

> Therein lies the fundamental flaw in Hoops's argument: it was not § 461(h)'s economic performance requirement that prevented Hoops from taking the deduction in 2012, but the rule in § 404(a)(5) governing nonqualified deferred-compensation plans.

Hoops further urged the Seventh Circuit to consider the practical implications of its decision. Specifically, Hoops argued that the deduction could be lost altogether (even though it clearly would be allowed if Hoops paid the deferred compensation at the time of sale) if the buyer, the Memphis Grizzlies, fails to pay the players or fails to communicate to Hoops the fact that the players have been paid. Judge Scudder responded:

> But any risk of losing the deferred compensation deduction is foreseeable, especially given the clear instructions from Congress in § 404(a)(5). We agree with the Commissioner's suggestion that Hoops could have avoided this tax-deduction problem in many ways—by adjusting the sales price to reflect the deductibility, contributing to qualified plans for the players to take earlier deductions, or renegotiating the players' contracts and accelerating their compensation to the date of the sale.

*Comment*. As noted above, Hoops argued in the Tax Court that the $10.7 million nonqualified deferred compensation arrangement should not be considered a "liability" includable in amount realized under § 1001(b) and Reg. § 1.1001-2(a)(1) in connection with the sale. Hoops apparently did not make this argument before the Seventh Circuit, so Judge Scudder did not address the issue. In the authors' opinion, the problem in this case stems from Hoops's inclusion of the $10.7 million deferred compensation obligation in amount realized upon the sale to the Memphis Grizzlies. If Hoops had not so included the $10.7 million "liability" in amount realized—based upon the authorities discussed by the authors above—then Hoops's gain on the sale would have been correspondingly decreased, thereby avoiding the adverse effect of § 404(a)(5).

## D. Individual Retirement Accounts

## V. PERSONAL INCOME AND DEDUCTIONS

### A. Rates

### B. Miscellaneous Income

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

### D. Deductions and Credits for Personal Expenses

**1. We agree: "The facts of this case are undisputed and disturbing." The taxpayers could not deduct $1.2 million they paid to their daughter/stepdaughter, who defrauded them and other individuals and is now in prison.** Gomas v. United States, 132 A.F.T.R.2d 2023-5165, 2023 WL 4562503 (M.D. Fla. 7/17/23). Normally, the authors do not report on many U.S. District Court cases; however, with a line like the above taken directly from the court's opinion, at least one of us became too curious to resist. Essentially, the taxpayers in this case, a retired, married couple, were swindled out of nearly $2 million by their ne'er-do-well daughter/step-daughter, Suzanne Anderson (Anderson), over a two-year period. To pay this amount to Anderson, the taxpayers withdrew nearly $1.2 million from an IRA and a separate pension account in 2017. The taxpayers' original return for 2017 reported the amounts withdrawn as income and they paid the corresponding income tax liability. In 2020, the taxpayers filed an amended return seeking a refund of approximately $412,000 by claiming a deduction equal to the withdrawn amounts. The IRS denied their claim for a refund and the taxpayers brought this suit in U.S. District Court seeking a refund. As discussed below, the court, although sympathetic to the taxpayers' situation, denied their claim.

*Factual background.* The taxpayers had owned a business (operated through a limited liability company) that sold pet food online. In 2016, the taxpayers decided to retire and "turned the business over" to Anderson. According to the court's opinion, the limited liability company conducting the business was dissolved and its bank accounts closed. The assets of the business—presumably not significant due to online sales—were given to Anderson to carry on the business. Over the course of 2017 through 2019, Anderson convinced them, via numerous fraudulent misrepresentations, to withdraw about $1.2 million from their IRA and a separate pension fund and transfer the funds to her to support the business. Specifically, Anderson convinced the taxpayers that they were being sued by former customers and that she needed to hire an attorney to defend the business and to prevent the taxpayers from being arrested due to past business dealings. Anderson even forged documents and created a fake email address for the attorney she had "hired." Finally, in August of 2019, the taxpayers uncovered Anderson's elaborate scheme, she was arrested, and she currently is serving a 25-year sentence in a Florida state prison.

*Court's analysis.* On cross-motions for summary judgment, the District Court (Judge Barber) reluctantly held for the IRS and disallowed the taxpayers' refund claim. The court first noted that the taxpayers were precluded from claiming a theft-loss deduction. Section 165(h)(5), enacted as part of the 2017 Tax Cuts and Jobs Act, provides:

> [i]n the case of an individual, except as provided in subparagraph (B) [relating to personal casualty gains], any personal casualty loss which (but for this paragraph) would be deductible in a taxable year beginning after December 31, 2017, and before January 1, 2026, shall be allowed as a deduction under subsection (a) only to the extent it is attributable to a Federally declared disaster . . . .

The court reasoned that, although taxpayers historically were entitled to deduct theft losses in the year in which the loss was discovered (see § 165(e)), § 165(h)(5) precluded the taxpayers from claiming a theft loss deduction. The taxpayers in this case discovered the loss in 2019, a year to which § 165(h)(5) applies. The court then turned to the question whether the taxpayers were entitled to a deduction in 2017, the year for which they had filed the amended return. The taxpayers argued that they were entitled to deduct the amounts they had transferred to Anderson in 2017 under two theories. *First*, they asserted that they did not enjoy the benefit of the amounts withdrawn from the IRA and pension fund in 2017 and therefore should not be required to include the withdrawn amounts in gross income. Judge Barber recognized that Anderson, not the taxpayers, ultimately received the withdrawn funds; however, the taxpayers nevertheless were the "distributees" for federal income tax purposes under § 408. The taxpayers authorized and received the distributions before transferring the amounts to Anderson. The court contrasted the taxpayers' situation to that in *Roberts v. Commissioner*, 141 T.C. 569 (2013), in which the court held that a taxpayer was not the distributee with respect to amounts withdrawn from his IRAs by his wife through forged withdrawal requests and used exclusively by her. Thus, the taxpayers in this case were taxable on the distributions. *See Nice v. United States*, 124 A.F.T.R.2d 2019-6403, 2019 WL 5212281 (E.D. La. 2019) (finding elderly woman with dementia was the taxable distributee of IRA disbursements even though son used and spent mother's IRA funds for personal enjoyment). *Second*, the taxpayers argued that the amounts transferred to Anderson should be treated as deductible trade or business expenses under § 162. Judge Barber ruled, though, that the amounts transferred to Anderson were not deductible business expenses because, at the time the transfers were made, the taxpayers were retired and were no longer carrying on the trade or business. The fact that the taxpayers believed the amounts they paid to Anderson would be used to pay legal fees related to their past business operations, the court reasoned, did not entitle them to a deduction because none of the amounts paid were used to pay actual business expenses.

The taxpayers have appealed to the U.S. Court of Appeals for the Eleventh Circuit.

*Comment*: The court's opinion does not discuss, and neither the IRS nor the taxpayers may have cited, Rev. Rul. 2009-9, 2009-14 I.R.B. 735. Rev. Rul. 2009-9 famously was issued to benefit taxpayers who suffered so-called "Ponzi scheme" losses at the hands of Bernie Madoff. Rev. Rul. 2009-9 held that, although these losses were theft losses deductible in the year in which the theft was discovered, the losses were deductible under § 165(c)(2), <u>not</u> § 165(c)(3), because they were attributable to a "transaction entered into for profit." Therefore, the theft losses involved were not personal casualty losses and were not subject to the limitations on personal casualty losses in § 165(h). Under this reasoning, such losses would not be subject to the temporary disallowance rule of § 165(h)(5) quoted above. At least one author of this outline is curious as to whether the taxpayers' theft losses, especially given that they related to a former business conducted for profit, should be allowable in 2019 (the year of discovery) under § 165(c)(2) as interpreted by the IRS in Rev. Rul. 2009-9.

### 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. <u>Exempt Organizations</u>

### B. <u>Charitable Giving</u>

## X. TAX PROCEDURE

### A. <u>Interest, Penalties, and Prosecutions</u>

### B. <u>Discovery: Summonses and FOIA</u>

### C. <u>Litigation Costs</u>

### D. <u>Statutory Notice of Deficiency</u>

## E. Statute of Limitations

## F. Liens and Collections

## G. Innocent Spouse

**1. Better clean up those social media posts featuring sailboats or ski vacations before filing a petition in the Tax Court seeking innocent spouse relief. Such posts are "newly discovered evidence" within the meaning of § 6015(e)(7) and therefore admissible even if they existed before the taxpayer requested innocent spouse relief.** Thomas v. Commissioner, 160 T.C. No. 4 (2/13/23). The Taxpayer First Act, Pub. L. No. 116-25, § 1203, enacted in 2019, amended Code § 6015 to clarify the scope and standard of review in the Tax Court of any determination with respect to a claim for innocent spouse relief, i.e., any claim for relief under § 6015 from joint and several liability for tax liability arising from a joint return. Among other changes, the legislation added § 6015(e)(7), which provides:

> Any review of a determination made under this section shall be reviewed de novo by the Tax Court and shall be based upon—
>
> A. the administrative record established at the time of the determination, and
>
> B. any additional newly discovered or previously unavailable evidence.

The amendment was generally consistent with the Tax Court's holding in *Porter v. Commissioner*, 132 T.C. 203 (2009), but resolved conflicting decisions in cases in which the taxpayer sought equitable innocent spouse relief under § 6015(f), some of which had held that the Tax Court's review was limited to the administrative record and that the Tax Court's standard of review was for abuse of discretion.

*Procedural history.* In this case, the taxpayer filed joint returns with her husband for the years 2012, 2013, and 2014 but some of the tax liability reported on those returns remained unpaid. Her husband died in 2016. The taxpayer submitted to the IRS a request for innocent spouse relief for those years, which the IRS denied. The taxpayer responded by filing a petition in the Tax Court seeking review pursuant to § 6015(e) and asking the court to determine that she was entitled to innocent spouse relief under § 6015(f). At trial, the IRS sought to introduce into evidence Exhibit 13-R, which consisted of a series of blog posts from the taxpayer's personal blog. These posts ranged in date from November 2, 2016, to January 5, 2022. The taxpayer moved to strike all blog posts that existed before September 8, 2020, the date on which the taxpayer submitted her administrative request for innocent spouse relief, on the ground that the posts had not been in the administrative record and were not "newly discovered evidence" within the meaning of § 6015(e)(7).

*Tax Court's analysis.* In a unanimous, reviewed opinion by Judge Toro, the Tax Court concluded that the blog posts were "newly discovered evidence" within the meaning of § 6015(e)(7). The court began with the language of the statute and concluded that § 6015 does not define the term "newly discovered evidence." Accordingly, the court reasoned, "[w]e must therefore discern the ordinary meaning of that phrase in 2019." The court turned to the dictionary definition of the phrase "*newly discovered*" and concluded that the ordinary meaning of the phrase as of 2019 "was 'recently obtained sight or knowledge of for the first time.'" The court concluded that the blog posts the IRS sought to introduce into evidence were "newly discovered evidence" because the IRS had first discovered them by searching the internet after the taxpayer had filed her petition in the Tax Court. In reaching this conclusion, the court rejected the taxpayer's argument that § 6015(e)(7)(B) should be read to incorporate an additional limitation similar to that in Federal Rule of Civil Procedure (FRCP) 60(b)(2). Rule 60(b)(2) provides that a court can relieve a party from a final judgement, order, or proceeding on the basis of "newly discovered evidence *that, with reasonable diligence, could not have been discovered in time to move for a new trial.*" (emphasis added). The taxpayer argued that the IRS could have discovered the blog posts that existed before

September 8, 2020, once she had submitted her administrative request for innocent spouse relief on that date and that they therefore should not be considered "newly discovered evidence." The court rejected this argument. The court reasoned that Congress had not included a reasonable diligence standard in the language of § 6015(e)(7)(B) and, in fact, the statute's use of the phrase "*any* additional newly discovered evidence" counseled against reading such a limitation into the statute. The court also observed that the statute's specification that the Tax Court's standard of review of an IRS determination concerning innocent spouse relief is de novo (rather than an abuse-of-discretion standard) supported "the conclusion that evidence unknown to a participant in the innocent spouse administrative proceeding should be admissible if that participant (now a party in our Court) offers it in the proceedings before us." Finally, the court noted that § 6015(e)(7) applies in a context entirely different from that of FRCP 60(b)(2). When a party moves for relief from a judgment under FRCP 60(b)(2), both parties have had an opportunity to conduct discovery and introduce evidence at trial. In contrast, "in the context of section 6015(e)(7), the Court considers a case for the first time following a relatively limited administrative proceeding." Accordingly, the court concluded that the blog posts offered into evidence by the IRS were admissible.

- *Concurring opinion of Judge Buch*. In a concurring opinion joined by Judges Ashford and Copeland, Judge Buch emphasized that, although the court's holding was faithful to the language of § 6015(e)(7), that language "may not have captured what Congress intended." Specifically, Judge Buch reasoned that the statute's language permitting the introduction of "newly discovered or previously unavailable evidence" might be a one-way street that benefits only the government. Judge Buch gave an example of a spouse who is abused by her husband, posts about the abuse on social media, and submits an administrative request for innocent spouse relief that does not mention the social media posts. Such a spouse might be precluded from introducing the social media posts at trial in a subsequent Tax Court proceeding because she created the posts and therefore it might be difficult for her to establish that the posts were "newly discovered or previously unavailable" to her. This problem, he observed, is not limited to social media posts but could apply to "a vast array of evidence" that could be helpful to a requesting spouse to prove entitlement to innocent spouse relief.

### 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.

**2. Misinformation in your W-2 information returns can result in civil liability for damages, especially if you have a puzzling STD—*not what you think*—plan.** Doherty v. Turner Broadcasting Systems, Inc., 72 F.4th 324 (D.C. Cir. 6/30/2023). The plaintiff in this case, a photojournalist, was an employee of the defendant, Turner Broadcasting Systems, Inc. (TBS) when the plaintiff injured his back in late 2012 loading camera equipment while at work. Thereafter, the plaintiff remained on the TBS's payroll and was paid certain amounts under the defendant's short-term disability ("STD") plan. Puzzlingly, though, TBS's STD plan consisted of two distinct policies. The first policy, J.A. 388, was for "job-related" injuries or illnesses and paid an injured employee a predetermined amount (*or such greater amount as required by applicable workers' compensation law*) over the 26-week period following the injury. After the 26-week period, TBS's workers' compensation insurance carrier funds any payments to an injured or ill employee. The second policy, J.A. 383, was for employees "absent from work due to [their] own medical needs." The predetermined payments to be made to injured or ill employees under either J.A. 388 or J.A. 383 were largely the same, except that J.A. 383 did not provide for increased payments due to workers' compensation law). (The court's opinion does not indicate whether payments under J.A. 383 continued beyond the 26-week period following injury.) TBS apparently considered all disability-related payments made to the plaintiff as falling under its J.A. 383 policy (non-workers' compensation portion of its STD plan), while the plaintiff believed that the disability-related payments he received fell under J.A. 388 (workers' compensation portion of STD plan). The distinction was important because any workers' compensation payments made to the plaintiff would be excludable from gross income under § 104(a)(1); however, employer-funded disability payments to an employee that are not workers' compensation are not excludable from gross income by the employee. TBS apparently believing that the payments to the plaintiff were not workers' compensation payments, reported all amounts paid to the plaintiff during the years in issue as gross income on the Forms W-2 issued to the plaintiff. The plaintiff alerted TBS to the alleged error, but TBS either did not agree with the plaintiff or did not fully appreciate the significance of issuing inaccurate Forms W-2. Subsequently, the plaintiff sued TBS in federal district court under § 7434, which authorizes a private civil action for damages against "any person

[who] willfully files a fraudulent information return with respect to payments purported to be made to any other person." Section 7434 applies to information returns listed in § 6724(d)(1)(A), including Forms W-2, 1099-MISC, 1099-INT, and 1099-DIV among others. The district court had granted TBS's motion for summary judgment, ruling that the Forms W-2 issued to the plaintiff were not fraudulent under any of three theories: (i) that the Forms W-2 filed by the defendant had the accurate gross amount of payments to the plaintiff, even if some portion of the payments should have been designated as excludable from gross income; (ii) that no reasonable jury could conclude that the plaintiff's payments were workers' compensation; or (iii) that the defendant's error was not intentional and thus lacked the specific intent to deceive required for willfulness under § 7434. The U.S. Court of Appeals for the D.C. Circuit reversed and remanded the case for further proceedings, concluding that the District Court had erred under all three of its theories for granting summary judgment to TBS. In an opinion by Judge Wilkins, the D.C. Circuit held (i) that an information return may be false under § 7434 even if the gross amount of the payment is correct; (ii) that the confusion surrounding TBS's STD plan, consisting of a workers' compensation policy (J.A. 388) and non-workers' compensation policy (J.A. 383), could lead a reasonable jury to find that the payments the plaintiff received were workers' compensation; and (iii) that a knowing or reckless action, as opposed to specific intent to deceive, is sufficient to meet the willfulness requirement of § 7434. Of course, because the case was remanded to the federal district court for further proceedings, we do not know if the plaintiff ultimately will prevail in his § 7434 action for damages against the defendant. Nevertheless, the case is instructive regarding the care an employer (or its agent) should take in preparing and filing information returns subject to § 7434.

**3. A return was a joint return despite the fact that one spouse did not personally sign it, says the Second Circuit.** Soni v. Commissioner, ___ F.4th ___, 132 A.F.T.R.2d 2023-5365 (2d Cir. 7/27/23), *aff'g Soni v. Commissioner*, T.C. Memo. 2021-37 (12/1/21). The taxpayers in this case were a married couple. The husband, Om, was experienced in business and established several businesses with large accounting and finance departments. His wife, Anjali, took care of the home and relied on her husband to handle all financial and tax matters. According to the opinion of the Tax Court (Judge Copeland), Anjali was reluctant to sign documents because a family member had forged her father's signature to steal money, and she therefore was "leary of signing documents and made it an ordeal to get her signature on any document." Again according to the Tax Court's opinion, she

> chose to not take part in the financial matters of the home, including tax matters. Since the time of their marriage, Anjali has never signed a tax return or asked anyone to sign a tax return for her. She did not pay attention to tax issues.

*The 2004 return and proceedings in the Tax Court*. The taxpayers' tax returns were prepared by an accounting firm. The returns for the years 1999-2003 and for 2005-2015 were joint returns. For the year in question, 2004, the firm prepared a joint return, which Om signed. Although their son often signed his mother's name on documents, including tax-related documents, the record was unclear as to who signed Anjali's name on the 2004 return. The parties stipulated on appeal, however, that Anjali did not personally sign the 2004 return. On the 2004 return, the taxpayers deducted a loss of over $1.7 million from a subchapter S corporation in which Om held an ownership interest. Following an audit, the IRS disallowed the loss deduction because, according to the IRS, the taxpayers had failed to provide documentation to establish their basis in the S corporation's stock. The IRS issued a notice of deficiency asserting that the taxpayers were jointly and severally liable for additional tax of $642,629 and a late-filing penalty under § 6651(a)(1) of $28,835. The taxpayers filed a petition in the Tax Court, where they argued that the return filed for 2004 was not a valid joint return. In an amended answer, the IRS asserted that the taxpayers also were liable for an accuracy-related penalty under § 6662 of $128,526. The Tax Court concluded that, although Anjali had not personally signed the return, it was nevertheless a valid joint return. Judge Copeland concluded that Anjali had tacitly consented to filing a joint return for 2004 because she had "approved or at least acquiesced in the joint filing of their 2004 return."

*Second Circuit's Analysis.* In an opinion by Judge Cabranes, the U.S. Court of Appeals for the Second Circuit affirmed the Tax Court's decision. The court relied on its prior decision in *O'Connor v. Commissioner*, 412 F.2d 304 (2d Cir. 1969), in which the court had provided guidance on the determination of whether a return is a joint return. According to *O'Connor*, a determination that a return is a joint return "is a factual issue of the intention of the parties and must be affirmed unless clearly erroneous." *Id.* at 309. Although normally a presumption of correctness attaches to the IRS's determination that a return is a joint return, that presumption does not apply if one spouse has not signed a purported joint return. *Id*. When one spouse has not signed, the IRS bears the burden of proving that the intent of the parties was to file jointly. *Id*. The court in this case observed that four circumstances present in *O'Connor*, in which the court had concluded that the return was a joint return, were also present here. *First*, the non-signing spouse knew that a return had to be filed because the evidence showed that Anjali was aware that a return had to be filed and simply chose not to engage. *Second,* the non-signing spouse knew of the signing spouse's expert knowledge concerning preparing and filing tax returns because Anjali knew of Om's expert knowledge and relied on him to handle the family's finances, including the filing of tax returns. *Third*, the parties filed a joint petition in the Tax Court. Fourth, the taxpayers asserted only a delayed challenge to the return's characterization as a joint return because they had not disavowed its joint status until trial. The court also noted that the taxpayers had filed joint returns for every other year from 1999 through 2003 and from 2005 through 2014. Accordingly, the court concluded that the Tax Court had not clearly erred in in finding that the taxpayers intended to file a joint return.

*Other issues*. The taxpayers also argued that the three-year limitations period on assessment of tax provided by § 6501(a) had expired before the IRS issued the notice of deficiency. The notice of deficiency for the year in question, 2004, was issued on March 12, 2015. The IRS received a total of eight consents to extend the limitations period on assessment on Form 872, which ostensibly had been signed by the taxpayers or by their CPA, Mr. Grossman. The taxpayers argued that the consents were invalid for a variety of reasons, such as their contention that they had not signed a power of attorney on Form 2848 authorizing Grossman to act on their behalf and that he had forged Om's signature on the power of attorney, and therefore any consents executed by him on their behalf were invalid. The Second Circuit affirmed the Tax Court's decision that the period of limitations on assessment had not expired before the notice of deficiency was issued. The court affirmed the Tax Court's finding that Om had signed the power of attorney on Form 2848 and its conclusion that both Om and Anjali had authorized Grossman to act on their behalf in consenting to extend the limitations period on assessment. Finally, the court affirmed the IRS's imposition of the late-filing penalty and the accuracy-related penalty because the taxpayers had not established a reasonable cause defense to the penalties.

## XI. WITHHOLDING AND EXCISE TAXES

## XII. TAX LEGISLATION

### A. <u>Enacted</u>

## XIII. TRUSTS, ESTATES & GIFTS

### A. <u>Gross Estate</u>

### B. <u>Deductions</u>

### C. <u>Gifts</u>

### D. <u>Trusts</u>

**1. "The gain disappearing act the [taxpayers] attribute to the CRATs is worthy of a Penn and Teller magic show. But it finds no support in the Code, regulations, or caselaw." Distributions from a CRAT were taxable and were ordinary income, says the Tax Court.** Gerhardt v. Commissioner, 160 T.C. No. 9 (4/20/23). Four married couples (collectively, the Gerhardts) had their cases consolidated in the Tax Court. In each case, the taxpayers contributed real property with a high value and a low basis to a charitable remainder annuity trust (CRAT). Shortly after contribution, each CRAT sold the real property and used the sale proceeds to purchase a single-premium immediate annuity (SPIA) owned by the CRAT. Pursuant to the terms of the trust, each CRAT paid to the taxpayers the payments received from the SPIA. The taxpayers took the position that the distributions from the CRAT were not taxable except to the extent of a small amount of interest income earned by the CRAT. For example, one couple contributed real properties with a total adjusted basis of $97,517 to their CRAT and the CRAT sold the properties for approximately $1.7 million. Their CRAT purchased a SPIA that would make five annual payments to the couple of $311,708. The CRAT distributed $311,708 to the couple in 2016 and again in 2017, the years at issue in the Tax Court. The CRAT issued Schedules K-1 to the couple in each year reporting only interest income of $4,052 (2,026 per person). Following an audit, the IRS asserted that the gain the CRAT realized on the sale of the real property was ordinary income pursuant to § 1245. The IRS also asserted that the $311,708 distribution to the couple in each year was fully included in their gross income and was ordinary income. The IRS issued a notice of deficiency to each couple for 2016 and 2017 and each couple filed a petition in the Tax Court.

*Backgroud on CRATs*. A CRAT is a common estate planning tool. Generally, to establish a CRAT, a grantor transfers cash or property to an irrevocable trust. The terms of the trust provide for specified payments, made at least annually, to the grantors or another noncharitable beneficiary for life or for a specified period of up to twenty years. Whatever remains in the trust is transferred to or held for the benefit of one or more qualified charitable organizations. At the time of the contribution to the CRAT, the grantor is entitled to a charitable contribution deduction equal to the value of the contributed property less the present value of the annuity payments to be received (and limited to the present value of the trust's remainder interest). The grantor does not recognize gain from the transfer of appreciated property to the CRAT. The CRAT takes the same basis in the contiributed property that the grantor had. The CRAT is tax-exempt and does not pay tax on any gain realized from its sale of contributed property. Nevertheless, gain realized by the CRAT on the sale of contributed property must be tracked and affects the tax treatment of distributions from the CRAT. Under § 664(b), distributions from the CRAT to its income beneficiaries are treated as distributed in the following order with the following character:

**(1)** as ordinary income, to the extent of the CRAT's current and previously undistributed ordinary income;

**(2)** as capital gain, to the extent of the CRAT's current and previously undistributed capital gain;

**(3)** as other income, to the extent of the CRAT's current and previously undistributed other income; and

**(4)** as a nontaxable distribution of trust corpus.

*Tax Court's analysis*. In the Tax Court, the taxpayers argued that any gain realized by a CRAT on the sale of contributed property effectively disappears and therefore does not make taxable any distributions by the CRAT that are funded with proceeds from the sale. The Tax Court (Judge Toro) rejected this argument. The court noted that it had considered and rejected this argument in *Furrer v. Commissioner*, T.C. Memo. 2022-100, and that the same advisers who advised the taxpayers in this case had been involved in *Furrer*. The court invited the Gerhardts to distinguish *Furrer* but, according to the court's opinion, their briefs failed to mention the case. The court summarized the taxpayers' argument as follows:

> As best we can tell, the Gerhardts maintain that the bases of assets donated to a CRAT are equal to their fair market values. … Section 1015 flatly contradicts their position. Section 1015(a) governs transfers by gift, and section 1015(b) governs

> transfers in trust (other than transfers in trust by gift). Under either provision, the basis in the property "shall be the same as it would be in the hands of the donor" under section 1015(a) or "in the hands of the grantor" under section 1015(b)

The court upheld the IRS's position that the CRATs involved had realized ordinary income from the sale of the contributed properties that resulted in the distributions from the CRATs to the Gerhardts being fully taxable and characterized as ordinary income. As the court put it, "[t]he gain disappearing act the Gerhardts attribute to the CRATs is worthy of a Penn and Teller magic show. But it finds no support in the Code, regulations, or caselaw."

*Issue concerning gain recognition in like-kind exchange.* In a separate transaction in 2017, one couple exchanged property (the Armstrong Site) for other property. The Armstrong site "comprised hog buildings and equipment as well as raw land." The couple treated this exchange as a like-kind exchange that qualified for nonrecognition of gain under § 1031. The IRS took the position that, although the exhange qualified under § 1031, the property exchanged was § 1245 property and § 1245 required the couple to recognize gain characterized as ordinary income on the exchange. The court agreed with the IRS. The flush language of § 1245(a)(1) provides that gain from the disposition of § 1245 property "shall be recognized notwithstanding any other provision of this subtitle." And Reg. 1.1245-6(b) explicitly provides that § 1245 overrides § 1031. Acordingly, the court held that the couple had to recognize the gain realized from the exchange and that the gain was orfinary income.