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TAX INSTITUTE

RECENT DEVELOPMENTS IN FEDERAL INCOME TAXATION

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SESSION A

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Professor McGovern teaches and writes in the areas of business organizations and taxation. He is a co-author of the treatise *Federal Income Taxation of Individuals* (Thomson Reuters 2003 and Supp. 2023) (with Boris I. Bittker, Martin J. McMahon, Jr., and Lawrence A. Zelenak) and a co-author of the casebook *Agency, Partnerships, and Limited Liability Companies* (Carolina Academic Press 2013) (with Gary S. Rosin and Michael L. Closen). His courses include Federal Income Taxation, U.S. Taxation of International Transactions, Partnership and Subchapter S Taxation, and Federal Tax Procedure. He frequently speaks on recent developments in federal income taxation. Professor McGovern is a member of the Council of the State Bar of Texas Tax Section, a former Chair of the Houston Bar Association Section of Taxation, and a Fellow of the American College of Tax Counsel.

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Cass has played a significant role in shaping nonprofit and business law in Georgia. He co-founded the Nonprofit Law Section of the State Bar of Georgia and helped modernize Georgia’s Nonprofit Corporations Code. He was also involved in drafting Georgia’s Limited Liability Company Act, Limited Liability Partnership Act, and the state's benefit corporation legislation.

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RECENT DEVELOPMENTS IN FEDERAL INCOME TAXATION

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

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This recent developments outline discusses, and provides context to understand the significance of, the most important judicial decisions and administrative rulings and regulations promulgated by the Internal Revenue Service and Treasury Department during the most recent twelve months — and sometimes a little farther back in time if we find the item particularly humorous or outrageous. Most Treasury Regulations, however, are so complex that they cannot be discussed in detail and, anyway, only a devout masochist would read them all the way through; just the basic topic and fundamental principles are highlighted – unless one of us decides to go nuts and spend several pages writing one up. This is the reason that the outline is getting to be as long as it is. Amendments to the Internal Revenue Code are discussed to the extent that (1) they are of major significance, (2) they have led to administrative rulings and regulations, (3) they have affected items previously covered in the outline, or (4) they provide an opportunity to mock our elected representatives; again, sometimes at least one of us goes nuts and writes up the most trivial of legislative changes. The outline focuses primarily on topics of broad general interest (to us, at least) – income tax accounting rules, determination of gross income, allowable deductions, treatment of capital gains and losses, corporate and partnership taxation, exempt organizations, and procedure and penalties. It deals summarily with qualified pension and profit-sharing plans, and generally does not deal with international taxation or specialized industries, such as banking, insurance, and financial services.

There were many significant federal income tax developments in the last twelve months. The One Big Beautiful Bill Act, Pub. L. No. 119-21, enacted on July 4, 2025, restored 100-percent bonus depreciation and the deductibility of domestic research and experimentation expenditures, favorably modified the limit on deducting business interest, authorized several new deductions for individuals, and extended many expiring provisions of the legislation Congress enacted in late 2017,"An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018," Pub. L. No. 115-97, commonly known as the "2017 Tax Cuts and Jobs Act." The Treasury Department and the IRS provided significant administrative guidance and the courts issued many notable judicial decisions. This outline discusses the major administrative guidance issued in the last year, summarizes recent legislative changes that, in our judgment, are the most important, and examines significant judicial decisions rendered in the last twelve months.

I. ACCOUNTING

A. Accounting Methods

1. Who says land is not depreciable? Farmer-taxpayer's costs for "base acres" with rights to USDA subsidies might be amortizable, but the taxpayer's change from not amortizing to amortizing the base acres was an unauthorized "change in method of accounting" under § 446 and resulted in a positive § 481 adjustment. Conmac Investments, Inc. v. Commissioner, 139 F.4th 723 (8th Cir. 6/6/25), *aff'g* T.C. Memo. 2023-40. The taxpayer was in the business of farming, including leasing land to tenant farmers. In tax years 2004, 2006 through 2008, and 2010 through 2013, the taxpayer acquired farmland that came with "base acre" rights. Base acres rights entitle farmers, including tenant farmers, to subsidies from the U.S. Department of Agriculture ("USDA") for growing certain crops. Before 2009, the taxpayer did not allocate any of the purchase price of farmland to base acre rights associated with the farmland. Starting in 2009, though, the taxpayer began allocating part of the purchase price of the farmland to base acre rights and taking 15-year amortization deductions (presumably under § 197) for the portion of the purchase price allocated to base acres rights (instead of including such costs in the basis of the farmland). The taxpayer did not farm any of the base acres at issue; it leased them to tenant farmers. The amortization deductions attributable to base acres rights partially offset the taxpayer's rental income from its tenant farmers.[1] The tenant farmers, not the taxpayer, received the USDA base acre subsidies. The taxpayer neither (i) filed amended returns reflecting amortization of base acres costs for years before 2009, nor (ii) attached Form 3115, Application for Change in Accounting Method, to the taxpayer's 2009 return reflecting its amortization of base acres costs beginning that year. Years later, the IRS audited the taxpayer's 2013 and 2014 tax returns, eventually issuing a notice of deficiency dated December 18, 2017, proposing additional income taxes of $48,374 for 2013 and $44,980 for 2014. These proposed deficiencies resulted from disallowing the taxpayer's base acres amortization deductions for taxable years 2013 and 2014. Further, the IRS proposed an additional deficiency of $141,614 for tax year 2013 relating to the taxpayer's closed tax years 2009-2012. This additional 2013 deficiency attributable to closed tax years resulted from the IRS's determination that the taxpayer improperly changed its method of accounting for base acre costs in 2009 without obtaining the consent of the Commissioner as required by §446(e). According to the IRS, the taxpayer's unauthorized change in method of accounting in 2009 resulted in a positive § 481 adjustment to the taxpayer's taxable income for 2013, the "year of change" within the meaning of § 481, as a consequence of the IRS's audit. The taxpayer timely filed a petition in the Tax Court challenging the IRS's proposed deficiencies.

Tax Court. Before the Tax Court, the taxpayer argued that its amortization of base acre costs starting in 2009 was due to a change in "underlying facts," including applicable law, thereby qualifying for an exception (discussed further below) under which a change due to an underlying change in facts is not a change in the taxpayer's method of accounting. Moreover, the taxpayer argued that the IRS's proposed § 481 adjustment related to closed years 2009-2012 and thus was not permissible. The IRS countered that there was no change in "underlying facts" or law in 2009 relating to amortization of intangibles such as base acre subsidy rights. Instead, the taxpayer and its tax advisors merely failed to recognize that costs associated with base acre subsidy rights were amortizable until 2009. With respect to the proposed § 481 adjustment for closed tax years 2009-2012, the IRS relied upon several authorities, including *Huffman v. Commissioner*, 126 T.C. 332 (2006), *aff'd* 518 F.3d 357 (6th Circ. 2008), and Rev. Proc. 2015-13, 2015-5 I.R.B. 419 at 425 § 2.06(1), standing for the proposition that a § 481 adjustment may be attributable to closed tax years. The Tax Court (Judge Paris) rejected the taxpayer's arguments, primarily because the taxpayer had not shown any change in "underlying facts" or law in 2009 that would qualify for an

[1] The taxpayer apparently developed its own per acre methodology with respect to accounting for and amortizing base acres rights. Interested readers should refer to the Tax Court's opinion for an explanation of the methodology used by the taxpayer.

exception to the normal rule that a change in the treatment of an item as non-amortizable to amortizable (or vice versa) is a change in method of accounting. The taxpayer appealed to the Eighth Circuit.

Eighth Circuit: Before the Eighth Circuit, the taxpayer reemphasized its argument that an exception to the regulations under § 446 applied to permit the taxpayer to modify its treatment of costs for base acres rights. Specifically, the taxpayer argued that its discovery in 2009 of the ability to amortize costs (again, presumably under § 197) associated with base acre rights was a change in underlying facts, including applicable law, within the meaning of the regulations under § 446. The IRS reiterated the arguments it had made before the Tax Court. In an opinion by Judge Benton, a three-judge panel of the Eighth Circuit affirmed the Tax Court's decision in favor of the IRS. Judge Benton's analysis began by quoting Reg. § 1.446-1(e)(2)(ii)(d)(2), which provides in part:

> *Changes in depreciation or amortization that are a change in method of accounting*. Except as provided in paragraph (e)(2)(ii)(d)(3) of this section, a change in the treatment of an asset from nondepreciable or nonamortizable to depreciable or amortizable, or vice versa, is a change in method of accounting.

Judge Benton also quoted the exception relied upon by the taxpayer in paragraph (e)(2)(ii)(d)(3) of the regulations, which provides:

> [A] change in method of accounting does not include adjustment of any . . . deduction that does not involve the proper time for . . . the taking of a deduction . . . A change in method of accounting also does not include a change in treatment resulting from a change in underlying facts.

The taxpayer maintained that its amortization of costs associated with base acre rights beginning in 2009 either (i) was not a timing issue but rather merely an "adjustment" (within the meaning of the above-quoted exception) of the amount allowable as a deduction or (ii) was the result of a change in underlying facts because the taxpayer's CPAs had not previously identified base acre rights as a potentially amortizable intangible asset. The Eighth Circuit disagreed, with Judge Benton reasoning, "By beginning to deduct amortization of the base acres, [the taxpayer] changed the time it recovered the original cost by spreading the cost over the years before eventual disposition." 139 F.4th at 725. Furthermore, Judge Benton cited *Pinkston v. Commissioner*, T.C. Memo. 2020-44 at *22-23, holding that a taxpayer's "subjective misunderstanding of fact or law does not equate" to "a change in underlying facts" within the meaning of Reg. § 1.446-1(e)(2)(ii)(d)(3). Finally, the Eighth Circuit rejected the taxpayer's argument that the IRS's proposed § 481 adjustment for 2013 pertaining to closed tax years was improper. Section 481 allows an IRS adjustment "in the year of change." The taxpayer argued that the "year of change" for this purpose was 2009, not 2013. Again, the Eighth Circuit disagreed, concluding that the "year of change" under § 481 was 2013 (not 2009). The "year of change" was 2013 because that is when the IRS audited the taxpayer and changed the taxpayer's method of accounting for costs associated with base acre rights. Again, citing *Pinkston* at *9-10, Judge Benton wrote: "[B]ecause [§ 481] would be virtually useless if it did not affect closed years, courts have uniformly interpreted it to allow adjustments, in the year of change, to reflect adjustments to tax liabilities for years closed by the period of limitations." 139 F.4th at 727.

B. Inventories

C. Installment Method

D. Year of Inclusion or Deduction

II. BUSINESS INCOME AND DEDUCTIONS

A. Income

B. Deductible Expenses versus Capitalization

1. Legal expenses incurred to defend patent infringement suits are currently deductible. Actavis Laboratories, FL, Inc. v. United States, 161 Fed. Cl. 334 (8/19/22). The plaintiff in this case, Actavis Laboratories Florida, Inc. (Actavis), was the substitute agent for Watson Pharmaceuticals, Inc. (Watson). Watson manufactured both brand name and generic pharmaceutical drugs. To obtain approval of generic drugs, Watson submitted to the Food and Drug Administration abbreviated new drug applications (ANDAs). The ANDA 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 (commonly known as the Hatch-Waxman Act, 21 U.S.C. § 355) as patent infringement and the holder of the patent is entitled to bring suit in federal district court. Watson incurred substantial legal expenses in defending patent infringement lawsuits brought by the name-brand drug manufacturers against Watson in response to the notice letters that Watson sent. Watson deducted these legal expenses on its 2008 and 2009 tax returns. Following audits of these returns, the IRS issued a notice of deficiency disallowing Watson's deductions on the basis that the costs incurred in defending the patent infringement litigation were capital expenditures under § 263(a). Watson paid the amounts sought by the IRS and, after filing amended returns requesting refunds, brought this action in the U.S. Court of Federal Claims seeking refunds of $1.9 million for 2008 and $3.9 million for 2009.

The U.S. Court of Federal Claims (Judge Holte) held that the legal expenses incurred by Watson in defending the patent infringement litigation were currently deductible. The IRS argued that the costs were capital expenditures under Reg. § 1.263(a)-4(b)(1), which requires taxpayers to capitalize amounts paid to *acquire or create* an intangible and amounts paid to *facilitate* an acquisition or creation of an intangible. According to the government, the costs facilitated the acquisition of an intangible, specifically, an FDA-approved ANDA. The court, however, disagreed. The court relied on the "origin of the claim" test established by the U.S. Supreme Court in *United States v. Gilmore*, 372 U.S. 39 (1963). As interpreted by a later decision, *Woodward v. Commissioner*, 397 U.S. 572 (1970), the deductibility of litigation expenses under the origin of the claim test depends not on the taxpayer's primary purpose in incurring the costs, but "involves the simpler inquiry whether the origin of the claim litigated is in the process of acquisition [of a capital asset] itself." Here, the court reasoned, Watson's legal expenses arose from legal actions initiated by patent holders in an effort to protect their patents. The court followed a long line of decisions, including that of the U.S. Court of Appeals for the Third Circuit in *Urquhart v. Commissioner*, 215 F.2d 17 (3d Cir. 1954), which have held that 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 Watson's legal expenses arose out of the patent infringement claims initiated by the patent holders, the court held, they were currently deductible. The court further concluded that Reg. § 1.263(a)-4(b)(1) did not require the costs to be capitalized because Watson's defense of the patent infringement litigation was not a step in the FDA's approval process for a generic drug:

> The FDA's review of an ANDA does not include patent related questions. When a generic drug company files an ANDA with a Paragraph IV certification, it certifies the patents associated with the relevant [drug] are either invalid or will not be infringed by the proposed generic drug. The FDA performs no assessment of that certification as a part of its ANDA review process—"[a]ccording to the agency, it lacks 'both [the] expertise and [the] authority' to review patent claims[.]"

a. The Federal 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. Actavis Laboratories, FL, Inc. v. United States, 131 F.4th 1345 (Fed. Cir. 3/21/25), *aff'g*, 161 Fed. Cl. 334 (8/19/22). In an opinion by Judge Stark, the U.S. Court of Appeals for the Federal Circuit has affirmed the Claims 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.

As described earlier, the FDA approval process for an ANDA seeking approval of a generic drug requires the applicant to 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 type of certification is required to notify the holders of patents on the relevant brand name drug that it has made this certification. Such a certification is treated by statute (commonly known as the Hatch-Waxman Act, 21 U.S.C. § 355) as patent infringement and the holder of the patent is entitled to bring suit in federal district court.

The taxpayer incurred substantial legal fees ($3.89 million in 2008 and $8.48 million in 2009) 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 U.S. Court of Federal Claims 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. On appeal, the Federal Circuit affirmed the Claims Court's decision.

The parties disagreed regarding the appropriate method of analysis for determining the deductibility of the taxpayer's legal fees. The taxpayer asserted that the "origin of the claim" test established by the U.S. Supreme Court in *United States v. Gilmore*, 372 U.S. 39 (1963) applied. As interpreted by a later decision, *Woodward v. Commissioner*, 397 U.S. 572 (1970), the deductibility of litigation expenses under the origin of the claim test depends not on the taxpayer's primary purpose in incurring the costs, but rather on "whether the origin of the claim litigated is in the process of acquisition" of a capital asset. The government argued that whether the taxpayer could deduct its legal fees was governed by Reg. § 1.263(a)-4(b)(1), which requires taxpayers to capitalize amounts paid to *acquire or create* an intangible and amounts paid to *facilitate* an acquisition or creation of an intangible. The court ultimately concluded that it did not need to decide which of these two methods of analysis applied because, regardless of which method applied, the legal fees paid by the taxpayer were deductible as ordinary and necessary business expenses.

Regarding the origin of the claim test, the government asserted that origin of the claim giving rise to the legal fees was the taxpayer's filing of an ANDA with the FDA seeking approval of the generic version of the drug. The taxpayer argued that the origin of the claim was the commencement of litigation against the taxpayer by the holders of patents on the brand-name version of the drug. The court agreed with the taxpayer. The court acknowledged that the taxpayer, like all those who file an ANDA with the FDA, is pursuing a capital asset, i.e., is pursuing an FDA-approved ANDA. Nevertheless, the court reasoned that the patent-infringement litigation brought by the patent holders against the taxpayer would not determine whether the FDA approved the taxpayer's ANDA. Such litigation "typically proceeds in parallel with the FDA's regulatory review, but the two lanes are distinct." For example, the court pointed out, the FDA could approve an ANDA whether or not the patent holder prevailed in the patent infringement litigation against the applicant who filed the ANDA. Therefore, the court concluded, the origin of the claim was the commencement of the patent infringement litigation against the taxpayer. According to the court, it was undisputed that legal fees incurred in defending an ordinary patent infringement suit (i.e., one that did not arise as a result of an applicant's filing of an ANDA) are deductible business

expenses. Therefore, if the appropriate method of analysis was the origin of the claim test, the taxpayer was entitled to deduct its legal fees.

Regarding the government's position that the deductibility of the taxpayer's legal fees was governed by Reg. § 1.263(a)-4(b)(1), the key question 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 "intangible" in question is an FDA-approved ANDA, i.e., the right to market the generic drug. According to the court, however, 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 intangible asset sought by the ANDA filer is final, effective approval of the ANDA itself – and acquisition of that asset is not facilitated by Hatch-Waxman litigation. As we explained in connection with the origin of the claim standard, and as is equally true even if C.F.R. § 1.263 governs, that intangible asset is pursued through, and can be granted only by, the FDA. … Thus, the Hatch-Waxman litigation does not facilitate the acquisition of the FDA-approved ANDA, and hence it does not facilitate acquisition of an asset providing a significant future benefit.

- The court's analysis and conclusions in this case are consistent with those of the U.S. Court of Appeals for the Third Circuit in *Mylan, Inc. v. Commissioner*, 76 F.4th 230 (3d Cir. 7/27/23), *aff'g* 156 T.C. 137 (4/27/21).

2. Domestic research or experimental expenditures are now deductible; foreign research or experimental expenditures still must be capitalized and amortized over 15 years. The 2025 One Big Beautiful Bill Act, § 70302, added new Code § 174A to restore the deduction for domestic research or experimental expenditures. The deduction is available for amounts paid or incurred in taxable years beginning after December 31, 2024.

Background. Previously, the 2017 Tax Cuts and Jobs Act, § 13206, amended Code § 174 to require the capitalization and amortization of "specified research or experimental expenditures." The amortization period was 5 years for domestic expenditures and 15 years for expenditures attributable to foreign research, beginning at the midpoint of the year in which the expenditures are paid or incurred. The 2017 TCJA's requirement that specified research or experimental expenditures be capitalized and amortized applied to amounts paid or incurred in taxable years beginning after December 31, 2021. The 2025 OBBA added new Code § 174A, which allows full deduction of "domestic research or experimental expenditures," and made conforming amendments to § 174, which still requires that foreign research or experimental expenditures be capitalized and amortized over 15 years. Section 174A's allowance of a deduction for research or experimental expenditures applies to amounts paid or incurred in taxable years beginning after December 31, 2024.

Elective retroactive application to 2022-2024 for small businesses. The legislation allows an "eligible taxpayer" to elect to deduct to deduct domestic research or experimental expenditures paid or incurred in taxable years beginning after December 31, 2021. For this purpose, an eligible taxpayer is one that meets the gross receipts test of § 448(c) for the first taxable year beginning after December 31, 2024. A taxpayer meets the gross receipts test if it has average annual gross receipts (computed over 3 years) of $25 million or less, which for 2025 is $31 million after taking into account adjustments for inflation. A taxpayer is not an eligible taxpayer if it meets the definition of a tax shelter that is prohibited from using the cash receipts and disbursements method of accounting under § 448(a)(3). A taxpayer that elects to deduct domestic research or experimental expenditures retroactively is treated as experiencing a change in method of accounting that is made with the consent of the IRS.

Election to deduct unamortized domestic research or experimental expenditures. The legislation permits a taxpayer that capitalized and amortized domestic research or experimental expenditures paid or incurred in taxable years beginning after December 31, 2021, and before January 1, 2025, to elect to deduct the unamortized balance of such expenditures. A taxpayer can elect to deduct the unamortized balance either in the first taxable year beginning after December 31, 2024, or ratably over the 2-taxable year period beginning with the first taxable year beginning after December 31, 2024. A taxpayer that makes this election is treated as initiating a change in method of accounting with the consent of the IRS. The change is applied only on a cut-off basis and no § 481 adjustments are made.

Election not to deduct domestic research or experimental expenditures. Section 174A(c) allows a taxpayer that is eligible to deduct domestic research or experimental expenditures to elect instead to capitalize and amortize such expenditures over a period of not less than 60 months. The election is available for domestic research or experimental expenditures that would be capital expenditures in the absence of new § 174A(a) but are not chargeable to property of a character which is subject to the allowance for depreciation under § 167 or the allowance for depletion under § 611. Taxpayers will make this election in accordance with regulations or other published guidance. The election must be made for a taxable year not later than the due date (including extensions) of the return for such year. The election applies for all subsequent years and can be changed only with the approval of the IRS.

C. Reasonable Compensation

D. Miscellaneous Deductions

1. Standard mileage rates for 2025. Notice 2025-5, 2025-3 I.R.B. 426 (12/19/24). The standard mileage rate for business miles in 2025 goes up to 70 cents (from 67 cents in 2024) and the medical/moving rate is 21 cents per mile (unchanged from 2024). The charitable mileage rate remains fixed by § 170(i) at 14 cents. The portion of the business standard mileage rate treated as depreciation goes up to 33 cents per mile (from 30 cents in 2024). The maximum standard automobile cost may not exceed $61,200 (*down* from $62,000 in 2024) for passenger automobiles (including trucks and vans) for purposes of computing the allowance under a fixed and variable rate (FAVR) plan.

- The notice reminds taxpayers that (1) the business standard mileage rate cannot be used to claim an itemized deduction for unreimbursed employee travel expenses because, in the 2017 Tax Cuts and Jobs Act, Congress disallowed miscellaneous itemized deductions for 2025, and (2) the standard mileage rate for moving has limited applicability for the use of an automobile as part of a move during 2025 because, in the 2017 Tax Cuts and Jobs Act, Congress disallowed the deduction of moving expenses for 2025 (except for members of the military on active duty who move pursuant to military orders incident to a permanent change of station, who can still use the standard mileage rate for moving).

The following table summarizes the optional standard mileage rates:

Category	2023	2024	2025
Business miles	65.5 cents	67 cents	70 cents
Medical/moving	22 cents	21 cents	21 cents
Charitable mileage	14 cents	14 cents	14 cents

2. Here's a shocker. An attorney could not deduct the costs of racing a Dodge Viper automobile as an advertising expense for his law practice. Avery v. Commissioner, 134 A.F.T.R.2d 2024-6331 (10th Cir. 12/9/24), *aff'g*, T.C. Memo. 2023-18 (2/21/23). The taxpayer in

this case, an attorney, had his own personal injury law practice in Colorado. He married a woman from Indiana, moved there, and became licensed to practice law in Indiana. He failed to generate much business in Indiana and continued to maintain his practice in Colorado. In Indiana, he became involved in car-related activities as a way to meet potential clients. At first, he acquired a 30-year old Ferrari and one other collector car and began participating in car shows. Later, he became interested in car racing. He purchased and rebuilt a 2000 Dodge Viper and attended a racing school in Indianapolis. He later acquired a 2009 Dodge Viper and competed at road racing events in seven states. He won some local championships and, at one point, placed in the top 10 nationally. Although the taxpayer believed that his racing would enable him to meet clients, he was able to identify only two instances in which his racing connected with his law practice. On one occasion, he consulted with a Pizza Hut franchisee whom he met through racing, and on another, he met a surgeon who later served as an expert witness in a personal injury case he tried in Denver. The taxpayer's name appeared on small areas above the driver's window and the passenger window of his racing vehicle and a decal for his law practice, the Avery Law Firm, appeared on the back tail of the car. He maintained a web page for his "Viper Racing Team" that included videos and photos of his racing and that was linked to the Facebook page for his law practice. The years in issue were 2008 through 2013. The taxpayer initially failed to file returns for some of these years and the IRS prepared substitutes-for-returns (SFRs). Ultimately,he prepared and filed original or amended returns for all of the years. He claimed a large amount of advertising expenses for his law practice, including approximately $136,000 of costs that he was able to substantitate related to his car and his racing activity. The taxpayer never responded to notices of deficiancy for the years in question and the IRS issued both a notice of intent to levy and a notice of federal tax lien. The taxpayer requested a collection due process (CDP) hearing and, in the CDP hearing, sought to challenge the underlying tax liability. After the IRS issued a notice of determination upholding the collection action, the taxpayer filed a petition in the U.S. Tax Court. In the Tax Court, the IRS conceded that the taxpayer could challenge the underlying tax liability because he had never received the notices of deficiency. *See* I.R.C. § 6330(c)(2)(B). The Tax Court (Judge Lauber) held that the taxpayer could not deduct his car-related expenses as ordinary and necessay business expenses under § 162. The Tax Court observed that a cost is "ordinary" for this purpose if it is customary or common for the type of business involved, and is "necessary" if it is appropriate and helpful in carrying our the business activity. *See, e.g., Welch v. Helvering*, 290 U.S. 111, 113-14 (1933). In determining whether a cost is ordinary and necessary, the court stated, "the courts have focused on the taxpayer's primary motive for incurring the expense and on whether there is a reasonably proximate relationship between the expense and the taxpayer's occupation." If a cost "is primarily motivated by personal reasons, no deduction is allowed." In this case, the Tax Court concluded, the taxpayer's car-related costs were not ordinary and necessary business expenses:

> It is neither "necessary" nor "common" for attorneys to incur such costs. Petitioner greatly enjoyed car racing, which he found more exciting than his previous hobby of acquiring collector cars and participating in car shows. But we find that both activities were hobbies. No deduction is allowed for personal expenses of this kind.

On appeal, in an opinion by Judge Rossman, the U.S. Court of Appeals for the Tenth Circuit affirmed. The Tenth Circuit rejected the taxpayer's argument that the Tax Court had improperly considered his personal enjoyment of car racing in determining whether his costs were ordinary and necessary business expenses. The taxpayer asserted that this could lead "to a situation where expenses incurred in maintaining what is otherwise indisputably a work vehicle will be deemed by the Commissioner to be personal expenses simply because the owner enjoys driving the vehicle." The Tenth Circuit held that, even if the Tax Court had considered personal enjoyment as one factor in determining whether the costs were ordinary and necessary, the Tax Court had properly considered his primary motive in incurring the costs and his enjoyment of the activity was relevant to his primary motive.

3. Relief for those subject to the limit of § 163(j) on deducting business interest. The 2025 One Big Beautiful Bill Act, § 70303, amended Code § 163(j) to increase the limit on deducting business interest. Previously, § 163(j) was significantly amended by the 2017 Tax Cuts and Jobs Act, § 13301, to limit the deduction for business interest to the sum of: (1) business interest income, (2) 30 percent of "adjusted taxable income," and (3) floor plan financing interest. For this purpose, the term "adjusted taxable income" was defined essentially as earnings before interest, tax, depreciation and amortization (EBITDA) for taxable years beginning before January 1, 2022, and then as earnings before interest and taxes (EBIT) for subsequent years. Because EBIT is a smaller number than EBITDA, § 163(j) imposed a lower limit on deducting business interest for taxable years beginning on or after January 1, 2022. The 2025 OBBA amended the definition of adjusted taxable income in § 163(j)(8) so that it is again essentially equivalent to EBITDA. This change applies to taxable years beginning after December 31, 2024.

Under § 163(j)(8)(A), adjusted taxable income does not include subpart F income or GILTI (renamed Net CFC Tested Income by the 2025 One Big Beautiful Bill Act). Unlike the changes described above, this specific change applies to taxable years beginning after December 31, 2025.

- Recall that businesses with average annual gross receipts (computed over 3 years) of $25 million ($31 million for 2025) or less and businesses in certain industries (notably real estate if a proper election is made, but also floor plan financing of auto dealers and regulated utilities) are exempted from the limitations of § 163(j). Real estate businesses must accept slightly longer recovery periods by using the alternative depreciation system for certain depreciable property if they elect out of the § 163(j) limitation.

E. Depreciation & Amortization

1. Section 280F 2025 depreciation tables for business autos, light trucks, and vans. Rev. Proc. 2025-16, 2025-11 I.R.B. 1100 (2/12/25). Section 280F(a) limits the depreciation deduction for passenger automobiles. For this purpose, the term "passenger automobiles" includes trucks and vans with a gross vehicle weight of 6,000 pounds or less. The IRS has published depreciation tables with the 2025 depreciation limits for business use of passenger automobiles acquired after September 27, 2017, and placed in service during 2025:

2025 Passenger Automobiles with § 168(k) first year recovery:	
1st Tax Year	$20,200
2nd Tax Year	$19,600
3rd Tax Year	$11,800
Each Succeeding Year	$ 7,060
2024 Passenger Automobiles (no § 168(k) first year recovery):	
1st Tax Year	$12,200
2nd Tax Year	$19,600
3rd Tax Year	$11,800
Each Succeeding Year	$ 7,060

For leased vehicles used for business purposes, § 280F(c)(2) requires a reduction in the amount allowable as a deduction to the lessee of the vehicle. Under Reg. § 1.280F-7(a), this reduction in the lessee's deduction is expressed as an income inclusion amount. The revenue procedure provides a table with the income inclusion amounts for lessees of vehicles with a lease term beginning in 2025. For 2025, this income inclusion applies when the fair market value of the vehicle exceeds $62,000.

2. Congress has increased the limits under § 179 effective in 2025. The 2025 One Big Beautiful Bill Act, § 70306, amended Code § 179(b) to increase the maximum amount a taxpayer can deduct under § 179 to $2.5 million (previously $1.25 million in 2025). This limit is reduced dollar-for-dollar to the extent the taxpayer puts an amount of § 179 property in service that exceeds a specified threshold. The legislation increased this threshold to $4 million (previously $3.13 million in 2025). These changes apply to property placed in service in taxable years beginning after December 31, 2024. The legislation did not change the limit on a taxpayer's § 179 deduction for a sport utility vehicle, which remains at $25,000 ($31,300 in 2025 after inflation adjustments). The basic limit of $2.5 million and the phase-out threshold of $4 million will be adjusted for inflation for taxable years beginning after 2025. The sport utility vehicle limitation of $25,000 will continue to be adjusted for inflation for taxable years beginning after 2018. The following table summarizes these changes:

	2025 Before OBBA	2025 After OBBA
Limit on § 179 deduction	$1.25 million	$2.5 million
§ 179 deduction limit reduced to extent cost of § 179 property placed in service exceeds	$3.13 million	$4 million
Limit on a taxpayer's § 179 deduction for a sport utility vehicle	$31,300	$31,300

Definition of qualified real property. The 2025 One Big Beautiful Bill Act did not change the definition of "qualified real property," the cost of which can be deducted under § 179 (subject to the applicable limits just discussed). Previously, the 2017 Tax Cuts and Jobs Act, § 13101, simplified and expanded the definition of "qualified real property." Prior to amendment by the 2017 Tax Cuts and Jobs Act, § 179(f) defined qualified real property as including "qualified leasehold improvement property," "qualified restaurant property," and "qualified retail improvement property." The 2017 TCJA revised the definition of qualified real property by replacing these three specific categories with a single category, "qualified improvement property" as defined in § 168(e)(6). Section 168(e)(6) defines qualified improvement property (subject to certain exceptions) as "any improvement to an interior portion of a building which is nonresidential real property if such improvement is placed in service after the date such building was first placed in service." In addition, the 2017 TCJA expanded the category of qualified real property by defining it to include the following improvements to nonresidential real property placed in service after the date the property was first placed in service: (1) roofs, (2) heating, ventilation, and air-conditioning property, (3) fire protection and alarm systems, and (4) security systems.

3. Goodbye, basis; hello 100% § 168(k) bonus first-year depreciation! Congress has made permanent the ability of taxpayers to deduct 100% of the cost of qualifying property. The 2025 One Big Beautiful Bill Act, § 70301, amended Code § 168(k) to permit taxpayers to deduct 100 percent of the cost of qualified property for the year in which the property is placed in service. This change applies to property acquired after January 19, 2025. The 2025 OBBA also amended § 168(k)(10) to permit taxpayers to elect not to deduct 100 percent, and instead to deduct the percentage of a qualified property's adjusted basis that was previously in effect for the taxpayer's first taxable year ending after January 19, 2025. Previously, under the changes to § 168(k) made by the 2017 Tax Cuts and Jobs Act, § 13201, the percentage of the property's adjusted basis that could be deducted generally was 40 percent in 2025 and 20 percent in 2026.

Used property continues to be eligible for bonus depreciation. The 2025 One Big Beautiful Bill Act did not change the rule that used property is eligible for bonus depreciation. Previously, the 2017 Tax Cuts and Jobs Act, § 13201, amended Code § 168(k)(2)(A) and (E) to make used property eligible for bonus depreciation under § 168(k). Prior to the changes made by the 2017 TCJA, property was eligible for bonus depreciation only if the original use of the property commenced with the taxpayer. Note, however, that used property is eligible for bonus depreciation only if it is acquired "by purchase"

as defined in § 179(d)(2). This means that used property is *not* eligible for bonus depreciation if the property (1) is acquired from certain related parties (within the meaning of §§ 267 or 707(b)), (2) is acquired by one component member of a controlled group from another component member of the same controlled group, (3) is property the basis of which is determined by reference to the basis of the same property in the hands of the person from whom it was acquired (such as a gift), or (4) is determined under § 1014 (relating to property acquired from a decedent). In addition, property acquired in a like-kind exchange is not eligible for bonus depreciation.

4. Certain nonresidential real property used for manufacturing, production, or refining is now eligible for elective 100% first-year bonus depreciation. The 2025 One Big Beautiful Bill Act, § 70307, added new § 168(n) of the Code. New § 168(n) authorizes taxpayers to deduct 100 percent of the cost of "qualified production property" in the year the property is placed in service.

Qualified production property. The term "qualified production property" (QPP) is generally defined in § 168(n)(2) as nonresidential real property used by the taxpayer as an integral part of a "qualified production activity" that is placed in service within the United States (or a U.S. possession). For this purpose, property is not considered to be used by the taxpayer as part of a qualified production activity if the taxpayer leases the property to a lessee. The taxpayer must make an election that designates the property as QPP. To constitute QPP, the original use of the property must commence with the taxpayer (i.e., it must be new property), construction of the property must begin after January 19, 2025, and before January 1, 2029, and the taxpayer must place the property in service before January 1, 2031. Although generally the property must be new property that the taxpayer constructs, an exception in § 168(n)(2)(B) permits property that the taxpayer *acquires* after January 19, 2025, and before January 1, 2029, to be QPP if it otherwise meets the definition of QPP and if three further requirements are satisfied: (1) the property was not used in a qualified production activity (generally the manufacturing, production, or refining of a qualified product) by any person at any time during the period beginning on January 1, 2021, and ending on May 12, 2025; (2) the property was not used by the taxpayer at any time prior to acquisition; and (3) the acquisition of the property was by "purchase" as defined in § 179(d)(2) and meets the requirements of § 179(d)(3).[2] QPP does not include property "used for offices, administrative services, lodging, parking, sales activities, research activities, software development or engineering activities, or other functions unrelated to the manufacturing, production, or refining of tangible personal property." Thus, taxpayers must identify and quantify the portion of nonresidential real property that is not QPP in determining the allowable deduction for the year the property is placed in service. Under § 168(n)(1)(B), taxpayers must reduce the adjusted basis of the property by the amount of the 100-percent deduction before computing the amount otherwise allowable as a depreciation deduction for the first taxable year and subsequent taxable years. For example, if a taxpayer acquires or constructs nonresidential real property for a cost of $1 million, and if 30 percent of the property is used for offices, parking, or other nonqualifying uses, then the taxpayer's first-year deduction under § 168(n) would be $700,000 ($1 million - $300,000 of cost allocable to nonqualifying uses), which would reduce the adjusted basis of the property to $300,000. The taxpayer then would calculate regular depreciation for the first year the property was placed in service and subsequent years using a basis of $300,000. Under § 168(n)(4)(B), any property subject to the alternative depreciation system of § 168(g) is not QPP.

[2] Section 179(d)(2) provides that an acquisition is by purchase only if the property was not acquired from certain related persons, it was not acquired by one component member of a controlled group from another component member of the same controlled group, and the taxpayer's basis in the property is not determined either by reference to the adjusted basis of the property in the hands of the person from whom it was acquired—such as in the case of a gift—or by § 1014(a) for inherited property. Section 179(d)(3) provides that the cost of property does not include any portion of the basis of the property that is determined by reference to the basis of other property held at any time by the person acquiring the property. Thus, property the taxpayer acquired in a like-kind § 1031 exchange appears to be ineligible to be QPP.

Qualified production activity. Under § 168(n)(2)(D), a "qualified production activity" (QPA) is defined as "the manufacturing, production, or refining of a qualified product." For this purpose, a taxpayer's activities do not constitute the manufacturing, production or refining of a qualified product unless the taxpayer's activities "result in a substantial transformation of the property comprising the product." Further, under § 168(n)(2)(E), "[t]he term 'production' shall not include activities other than agricultural production and chemical production." A "qualified product" is "any *tangible personal property* if such property is not a food or beverage prepared in the same building as a retail establishment in which such property is sold." (emphasis added). Thus, a restaurant, coffee shop, or bakery that produces its own baked goods and sells them on the premises is ineligible to deduct the cost of the building (or portion thereof) in which the baked goods are produced.

Deduction allowed in computing AMT. Section 168(n)(3) provides that the deduction for QPP is allowed not only for purposes of the regular tax, but also for purposes of the alternative minimum tax imposed by § 55. Further, the deduction is allowed without any adjustment under § 56.

Recapture. Pursuant to § 168(n)(5), § 1245 recapture applies as if there had been a disposition of the property if, during the 10-year period beginning on the date the property is placed in service: (1) the property ceases to be used in a QPA, and (2) is used by the taxpayer in a productive use that is not a QPA. In applying § 1245, the fair market value of the property is treated as being not less than the taxpayer's recomputed basis. Recomputed basis, under § 1245(a)(2), is the taxpayer's adjusted basis recomputed by adding back all depreciation and amortization deductions reflected in the adjusted basis. Generally, recomputed basis is equal to the taxpayer's original cost for the property. For example, assume a taxpayer acquires or constructs QPP for a cost of $1 million and deducts $700,000 as first-year depreciation under § 168(n). This would reduce the taxpayer's adjusted basis in the property to $300,000. Further assume the taxpayer deducts another $10,000 as regular depreciation in the year the property is placed in service using straight-line depreciation over thirty-nine years, which would further reduce the adjusted basis of the property to $290,000. Finally, assume the fair market value of the property drops to $500,000 because of a market downturn. If the taxpayer ceases to use the property in a QPA and continues to use the property for some other activity, then under § 1245(a)(1), the taxpayer must treat as ordinary income the amount by which the lower of (1) recomputed basis, or (2) the amount realized (in the case of a sale, exchange or involuntary conversion) or the fair market value of the property (in the case of any other disposition), exceeds the adjusted basis. In this example, the recomputed basis is the adjusted basis ($290,000) increased by adding back all of the depreciation deductions ($710,000), or $1 million. The fair market value of the property is treated as being not less than the recomputed basis of $1 million. Therefore, the taxpayer must treat as ordinary income in the year the property is no longer used by the taxpayer in a QPA the amount by which the recomputed basis ($1 million) exceeds the adjusted basis ($290,000), or $710,000. This is true even though the fair market value of the property is $500,000 and § 1245(a)(1) would normally require the taxpayer to use the lower of the $1 million recomputed basis or the $500,000 fair market value in determining the amount of ordinary income. The provision appears to have the effect of recapturing not only the $700,000 of so-called "bonus depreciation," but also the additional $10,000 of regular depreciation. If the taxpayer is required to recognize ordinary income under the recapture rule, then, under § 168(n)(5)(B), the taxpayer must adjust the basis of the property to reflect the recaptured amount. In the example just given, if the taxpayer recognizes $710,000 of ordinary income, then the taxpayer's basis in the property would again become $1 million. By its terms, the recapture rule applies only if two conditions are satisfied: (1) the property ceases to be used in a QPA, and (2) is used by the taxpayer in a productive use that is not a QPA. Necessarily, then, the recapture rule does not apply if the taxpayer sells or disposes of the property to a third party and no longer uses it. In that case, the normal recapture rules of § 1250 should apply. Under the rules of § 1250, a taxpayer must treat their gain on the sale as ordinary income to the extent the gain is attributable to depreciation taken in excess of straight-line depreciation. Any remaining gain attributable to depreciation is unrecaptured section 1250 gain that is subject to tax at a 25 percent rate. Because

depreciation taken on QPP is an accelerated method of depreciation, taxpayers will commonly have ordinary income under § 1250 upon a sale or disposition of the QPP.

Election. According to § 168(n)(6), the election to deduct 100 percent of the cost of QPP must specify the nonresidential real property subject to the election and the portion of it designated as QPP. The election must be made on the taxpayer's tax return in the manner prescribed by the Secretary of the Treasury. Once made, the election can be revoked only with the consent of the Secretary, who is directed to give such consent only in extraordinary circumstances.

Regulations or other guidance. Section 168(n)(7) directs Treasury to issue such regulations or other guidance as may be necessary, including regulations or other guidance providing (1) rules regarding what constitutes substantial transformation of the property that are consistent with the rules under § 954(d), and (2) for the application of the recapture rule described above with respect to a change in use of the property following a fully or partially tax-free transfer of the property.

F. Credits

G. Natural Resources Deductions & Credits

H. Loss Transactions, Bad Debts, and NOLs

1. Good advice for law students: read each word in the statute. A corporation that paid $1.6 billion as a fee for backing out of a proposed corporate combination was not stuck with a capital loss under § 1234A, says the Tax Court. AbbVie Inc. v. Commissioner, 164 T.C. No. 10 (6/17/25). The taxpayer in this case, a domestic, publicly traded corporation, entered into several agreements with a foreign publicly limited company, including a "Co-operation Agreement" that set forth the steps each party would take to accomplish a proposed combination of the two parties. This agreement required the taxpayer to pay a fee if it failed to carry out its agreed responsibilities and, as a result, the proposed combination did not occur. After the Treasury Department issued guidance that would have produced adverse tax results for the combination, the taxpayer's board of directors declined to recommend the transaction to the corporation's shareholders. The two parties entered into a termination agreement that required the taxpayer to pay a fee to the other party of $1.6 billion. The taxpayer treated this $1.6 billion fee as an ordinary loss. The government argued that § 1234A(a)(1) required the taxpayer to treat the $1.6 billion loss as a capital loss. Section 1234A provides that:

> Gain or loss attributable to the cancellation, lapse, expiration, or other termination of—
>
> > (1) a right or obligation (other than a securities futures contract, as defined in section 1234B) with respect to property which is (or on acquisition would be) a capital asset in the hands of the taxpayer, or
> >
> > (2) a section 1256 contract (as defined in section 1256) not described in paragraph (1) which is a capital asset in the hands of the taxpayer,
>
> shall be treated as gain or loss from the sale of a capital asset. The preceding sentence shall not apply to the retirement of any debt instrument (whether or not through a trust or other participation arrangement).

The Tax Court (Judge Toro) rejected the government's argument. The court reasoned that a right or obligation is "'with respect to property'" within the meaning of section 1234A [when it] is a right or obligation to exchange (i.e., to buy, sell, or otherwise transfer or receive) an interest in property." 164 T.C. No. 10, at 10. The taxpayer's rights and obligations under the Co-Operation Agreement, the court concluded, were fundamentally in the nature of services:

> AbbVie's core obligations under the Co-operation Agreement were in the nature of services to increase the likelihood that a combination would occur. For example, the Co-operation Agreement required AbbVie, among other things, to pursue necessary regulatory approvals for the combination and use best efforts to secure

> those approvals, to recommend the combination to its shareholders, and to host a shareholder meeting for a vote on the combination before a specified date. These are important obligations to be sure, but they are not obligations with respect to property within the meaning of section 1234A(1). Rather, they are simply promises to provide services to clear the way for a desired exchange of stock.

164 T.C. No. 10, at 13. Because the taxpayer's rights or obligations that were terminated were not with respect to property, § 1234A did not apply and the taxpayer's loss was an ordinary loss rather than a capital loss.

I. At-Risk and Passive Activity Losses

III. INVESTMENT GAIN AND INCOME

A. Gains and Losses

B. Interest, Dividends, and Other Current Income

C. Profit-Seeking Individual Deductions

D. Section 121

E. Section 1031

F. Section 1033

G. Section 1035

H. Miscellaneous

IV. COMPENSATION ISSUES

A. Fringe Benefits

1. State family and medical leave programs might provide relief to employees, but they cause major headaches for tax advisors! Rev. Rul. 2025-4, 2025-7 I.R.B. 758 (1/16/25). This revenue ruling addresses the income and employment tax treatment of contributions to and benefits paid from a state paid family and medical leave (PFML) program and related reporting requirements.

The PFML program. The ruling describes a PFML program established by state statute and administered by the state. The PFML program is intended to provide wage replacement to workers for periods in which they need to take time off from work due to their own non-occupational injuries, illnesses, or medical conditions, or to care for a family member due to the family member's serious health condition or other prescribed circumstance. Under the program, all in-state employers are required to contribute a specified percentage of each employee's weekly wages. The state deposits these contributions into the PFML fund to provide benefits under the program. The ruling assumes that, for 2025, the contribution rate is 1% of each employee's weekly wages. Employers are required to withhold from each employee's wages an amount no greater than 60% of the standard contribution rate (1%) multiplied by the employee's weekly wages. Employers also are required to contribute from their own funds an amount equal to 40% of the standard contribution rate (1%) multiplied by each employee's weekly wages. The PFML program permits an employer to voluntarily pay from its own funds all or a portion of its employees' mandatory contributions instead of withholding such amounts from the employees' wages. This voluntary employer contribution is referred to as the "employer pick-up." The ruling provides that, under state law, the employer pick-up is not included in an employee's wages for purposes of determining wages under the PFML program. Benefits are payable under the PFML program for qualifying medical leave or family leave at a rate equal to 80% of an employee's average weekly wages for up to 12 weeks. *Qualifying medical leave* is defined as time off from work taken by an eligible employee that is made necessary by the individual's own serious health condition and requires the health condition to be substantiated. *Qualifying family leave* is defined as time off

from work taken by an eligible employee to bond with a child, to care for a family member with a serious health condition, to deal with certain exigencies related to the active-duty military service of a spouse, domestic partner, child, or parent, or to address certain medical or non-medical needs of certain family members arising from domestic violence. As an alternative to participating in the PFML program, an employer can establish and maintain a private plan for the payment of family and medical leave benefits that are comparable to those under the state PFML program, but the ruling does not address the tax treatment of contributions to and benefits paid from such private programs. The ruling describes six specific situations that address the tax treatment of contributions to and benefits paid from the PFML program.

Employer and employee contributions to the PFML program (Situation 1). In situation 1, Employer A, a corporation, employs Employee B for the entire 2025 calendar year. Employee B's weekly wages for purposes of the PFML program are $2,000 ($104,000 for the calendar year). Because the stated contribution rate under the PFML program for 2025 is 1%, Employer A remits $1,040 to the program with respect to Employee B. Of this amount, Employer A withholds and remits $624 (60% of $1,040) from Employee B's wages and pays the remaining $416 (40% of $1,040) from its own funds. The ruling concludes that the $624 withheld from Employee B's wages is a state income tax and therefore deductible by Employee B under § 164(a)(3) as an itemized deduction subject to the § 164(b)(6) limit on deducting state and local taxes. The ruling clarifies that, although the $624 is withheld from Employee B's wages, Employee B must include this amount in gross income because the withheld amount satisfies Employee B's own tax liability and that the amount is treated as wages for federal employment tax purposes. Employer A, the ruling concludes, must include the $624 on Employee B's W-2 for 2025. The ruling also concludes that the $416 paid from Employer A's own funds is an excise tax that is deductible by the employer under § 164(a). The $416 paid from Employer A's funds, however, is not included in the gross income of Employee B because this amount satisfies Employer A's own tax liability (rather than Employee B's tax liability).

Employer and employee contributions to the PFML program with employer pick-up (Situation 4). In situation 4, the facts are the same as situation 1, *i.e.*, Employer A remits $1,040 (1% of Employee B's wages of $104,000) to the PFML program with respect to Employee B, except that, instead of withholding $624 from Employee B's wages, Employer A withholds only $350 and voluntarily pays the remaining $274 from Employer A's own funds. The ruling concludes that the $274 voluntarily paid by Employer A is deductible by Employer A as a business expense under § 162. The ruling also concludes that the $274 is additional compensation to Employee B under the rationale of *Old Colony Trust Co. v. Commissioner*, 279 U.S. 716 (1929), because Employer A is satisfying Employee B's obligation to contribute to the PFML program. The $274 of additional compensation constitutes wages subject to federal employment tax and must be included on Employee B's W-2. Employee B, the ruling concludes, can deduct the $274 (as well as the $350 withheld from Employee B's wages) as a state income tax under § 164(a)(3) if Employee B itemizes deductions.

Family leave benefits with and without employer pick-up (Situations 2 and 5). In *situation 2*, the underlying facts are the same as in situation 1, *i.e.*, during 2025 Employer A remits $1,040 (1% of Employee B's wages of $104,000) to the PFML program, of which $624 (60% of $1,040) is withheld from Employee B's wages and the remaining $416 (40% of $1,040) is paid from Employer A's own funds. Employee B is eligible in 2026 for 12 weeks of family leave under the PFML program. Employee B receives in 2026 $1,600 per week for 12 weeks (a total of $19,200), which is 80% of Employee B's weekly wages of $2,000. The ruling concludes that Employee B must include the $19,200 in gross income because this represents a clearly realized accession to wealth and no exclusion applies. Specifically, the ruling concludes that the $19,200 in family leave benefits is not an amount received through accident or health insurance for personal injuries or sickness excludable under § 104(a)(3) because the benefits are paid "for a variety of conditions or events that are unrelated to the employee's own health condition." Further, such family leave benefits "are not received from a sickness and disability fund for employees within the meaning

of § 105(e)(2), are not paid for personal injuries or sickness, and as a result, for purposes of §§ 104 and 105, cannot be treated as amounts received through accident or health insurance." Although the family leave benefits are included in Employee B's gross income, the ruling concludes, they are not wages subject to federal employment taxes and do not constitute either sick pay (as defined in § 3402(o)) or a disability leave payment like those described in Rev. Rul. 72-191, 1972-1 C.B. 45. Rather, the ruling states, the family leave payments are analogous to Social Security benefits that are partially taxable and are not considered to have been paid as remuneration from employment. According to the ruling, the state must file with the IRS and furnish to Employee B a Form 1099 to report the payments.

- The ruling assumes in *situation 5* that the underlying facts are the same as situation 4, *i.e.*, during 2025 Employer A remits $1,040 (1% of Employee B's wages of $104,000) to the PFML program with respect to Employee B but, instead of withholding $624 from Employee B's wages, Employer A withholds only $350 and voluntarily pays the remaining $274 from Employer A's own funds. The ruling concludes that these facts do not alter the IRS's conclusions in situation 2, *i.e.*, Employee B must include the $19,200 of family leave benefits in gross income but such amounts do not constitute wages subject to federal employment taxes.

Medical leave benefits with and without employer pick-up (Situations 3 and 6). In *situation 3*, the underlying facts are the same as in situation 1, *i.e.*, during 2025 Employer A remits $1,040 (1% of Employee B's wages of $104,000) to the PFML program, of which $624 (60% of $1,040) is withheld from Employee B's wages and the remaining $416 (40% of $1,040) is paid from Employer A's own funds. Employee B is eligible in 2026 for 12 weeks of medical leave because of Employee B's serious health condition. Employee B receives in 2026 $1,600 per week for 12 weeks (a total of $19,200), which is 80% of Employee B's weekly wages of $2,000. The ruling explains that determining the tax consequences of the medical leave benefits requires distinguishing between the portion of the benefits attributable to the employee's contributions and the portion attributable to the employer's contributions. The portion of the medical leave benefits attributable to Employee B's contributions, the ruling concludes, are excluded from Employee B's gross income under § 104(a)(3), which excludes from gross income amounts received through accident or health insurance for personal injuries or sickness. The portion attributable to Employer A's contributions, however, is included in Employee B's gross income under § 105(a) except to the extent they are excluded under other provisions of § 105. (It appears to the authors that such medical leave benefits would normally not be excluded under other provisions of § 105 because the PMFL program is intended to provide wage replacement to workers and does not require an employee to incur any medical expenses in order to be eligible for medical leave benefits.) The portion of medical leave benefits attributable to Employer A's contributions, the ruling states, are wages analogous to the disability leave benefit payments described in Rev. Rul. 72-191, 1972-1 C.B. 45, for federal employment tax purposes and are third-party payments of sick pay as defined in § 3402(o). The state must comply with reporting requirements.[3] The ruling provides that the portion of the benefits attributable to Employer A's contributions and Employee B's contributions is determined by the ratio of such contributions. Accordingly, 60% ($624/$1,040) of the benefits, or $11,520, is excluded from Employee B's gross income under § 104(a)(3) and the remaining 40% ($416/$1,040), or $7,680, is included in Employee B's gross income under § 105.

- The ruling assumes in *situation 6* that the underlying facts are the same as situation 4, *i.e.*, during 2025 Employer A remits $1,040 (1% of Employee B's wages of $104,000) to the

[3] For the applicable reporting requirements, see Notice 2015-6, 2015-5 I.R.B. 412. Generally, the state is responsible for issuing a W-2 for the amount of the taxable medical benefits. The payments are not subject to mandatory income tax withholding, but employees can request voluntary withholding. The state is liable for the employee portion of FICA and is also liable for the employer portion of FICA and FUTA, unless the liability for the employer portion of FICA and FUTA is transferred to the employer.

PFML program with respect to Employee B but, instead of withholding $624 from Employee B's wages, Employer A withholds only $350 and voluntarily pays the remaining $274 from Employer A's own funds. The ruling concludes that these facts do not alter the IRS's conclusions in situation 3, *i.e.*, Employee B can exclude from gross income under § 104(a)(3) the $11,520 portion of the medical leave benefits attributable to Employee B's contributions and must include in gross income under § 105 the $7,680 portion of the medical leave benefits attributable to Employer A's contributions.

Effective date and transition rules for 2025. The revenue ruling is effective for payments made on or after January 1, 2025. Calendar year 2025, however, is a transition period intended to provide states and employers time to configure their reporting and other systems. During calendar year 2025:

- *Contributions:* an employer is not required to treat the employer pick-up (amounts the employer voluntarily pays from its own funds of any part of an employee's otherwise required contribution to a state PFML program) as wages for federal employment tax purposes under §§ 3121(a), 3306(b), and 3401(a).
- *Medical leave benefits:* neither the state nor the employer will be liable for penalties for failure to report or withhold taxes. (Note that the state still must issue Form 1099 to report any *family* leave benefits.)

Summary. The following tables, reproduced from Rev. Rul. 2025-4, summarize the ruling's conclusions regarding the tax treatment of contributions to and benefits paid from the PFML program:

Table 1. Summary of the Federal Income Tax Consequences of Contributions to State Paid Family and Medical Leave Programs

Types of contributions	Consequence to employer	Consequence to employee
Employer contribution	Employer may deduct the employer contribution as an excise tax under § 164.	Employee does not include the employer contribution in employee's Federal gross income.
Employee contribution	Employer must include the employee contribution as wages on employee's Form W-2.	The employee contribution is included in employee's Federal gross income as wages. Employee may deduct the employee contribution as State income tax under § 164, if employee itemizes deductions on employee's Federal income tax return, but only to the extent the deduction for State tax paid does not exceed the SALT deduction limitation provided under § 164(b)(6).
Employer pick-up of employee contribution	Employer may deduct the employer pick-up payment that employer pays from employer's funds as an ordinary and necessary	The employer pick-up is additional compensation to employee and is included in employee's Federal gross income as wages.

	business expense under § 162. Employer must include the employer voluntary payment as wages on employee's Form W-2.	Employee may deduct the employer pick-up of the employee contribution as State income tax under § 164, if employee itemizes deductions on employee's Federal income tax return, but only to the extent the deduction for State tax paid does not exceed the SALT deduction limitation provided under § 164(b)(6).

Table 2. Summary of the Federal Income Tax Consequences of Family and Medical Leave Benefits Paid by State Paid Family and Medical Leave Programs

Type of benefits	**Amount attributable to employer contribution**	**Amount attributable to employee contribution**
Family leave benefits	Employee must include the amount attributable to the employer contribution in employee's Federal gross income (employer contribution not previously included in employee's Federal gross income). This amount is not wages. State must file with the IRS and furnish to employee a Form 1099 to report these payments.	Employee must include the amount attributable to the employee contribution, as well as to any employer pick-up of the employer pick-up of the employee contribution, in employee's Federal gross income. This amount is not wages. State must file with the IRS and furnish to employee a Form 1099 to report these payments.
Medical leave benefits	Employee must include the amount attributable to the employer contribution in employee's Federal gross income (employer contribution not previously included in employee's Federal gross income) except as otherwise provided in § 105. This amount is wages. The sick pay reporting rules apply to the medical leave benefits attributable to employer contributions. These payments are third-party payments (by a party that is not an agent of the employer) of sick pay.	The amount attributable to the employee contribution, as well as to any employer pick-up of the employee contribution, are excluded from employee's federal gross income.

B. Qualified Deferred Compensation Plans

1. Individuals who are ages 60-63 will be able to make additional catch-up contributions to employer-sponsored plans beginning in 2025. Section 414(v) allows individuals who are age 50 and older to make so-called "catch-up" contributions to employer-sponsored retirement plans such as § 401(k) plans in addition to the basic amount ($22,500 in 2023) that individuals are allowed to contribute. The limit on catch-up contributions to employer plans other than SIMPLE plans is $7,500 in 2023, 2024, and 2025 and is adjusted annually for inflation. For SIMPLE plans, the limit on catch-up contributions is $3,500 in 2023, 2024, and 2025 and is adjusted annually for inflation. A provision of the SECURE 2.0 Act, Division T, Title I, § 109 of the Consolidated Appropriations Act, 2023, amended Code § 414(v)(2) to allow individuals who are ages 60 to 63 at the close of the taxable year to make larger catch-up contributions up to the "adjusted dollar amount," which is defined in new § 414(v)(2)(E). As defined, the adjusted dollar amount for employer plans other than SIMPLE plans is the greater of $10,000 or 150 percent of the regular catch-up contribution amount for 2024. For SIMPLE plans, the adjusted dollar amount is the greater of $5,000 or 150 percent of the regular catch-up contribution limit for 2025. The increased limits on catchh-up contributions will be adjusted annually for inflation after 2025. This change is effective for taxable years beginning after 2024.

- The ability of those ages 60 to 63 to make larger catch-up contributions to employer-sponsored plans takes effect in 2025. In that year, the limit on such catch-up contributions for plans other than SIMPLE plans is the greater of $10,000 or 150 percent of the regular catch-up contribution limit for 2024. For SIMPLE plans, the limit on such increased catch-up contributions is the greater of $5,000 or 150 percent of the regular catch-up contribution limit for 2025. Because the regular catch-up contribution limit for plans other than SIMPLE plans is $7,500 in 2024, and 150 percent of that figure is $11,250, the larger catch-up contribution limit for those ages 60 to 63 in 2025 is greater than $10,000 in the first year it is effective. Similarly, because the regular catch-up contribution limit for SIMPLE plans is $3,500 in 2025, and 150 percent of that figure is $5,250, the larger catch-up contribution limit for SIMPLE plans for those ages 60 to 63 in 2025 is greater than $3,500 in the first year it is effective.

a. Proposed regulations provide guidance on the increased limits for catch-up contributions made by those ages 60-63. REG-101268, Catch-Up Contributions, 90 F.R. 2645 (1/13/25). Treasury and the IRS have issued proposed regulations addressing the increased limits for taxable years beginning after 2024 on catch-up contributions reflected in the amendments to Code § 414(v)(2) enacted by the SECURE 2.0 Act for those ages 60 to 63. Section 1.414(v)-1(c)(2)(i) of the proposed regulations sets forth the increased limit on catch-up contributions for employer plans other than SIMPLE plans. This provision specifies that, for taxable years beginning after 2024, the limit on catch-up contributions for participants in plans other than SIMPLE plans who attain ages 60-63 during the year is $11,250 (150 percent of the $7,500 limit that was in effect for 2024). Section 1.414(v)-1(c)(2)(ii) of the proposed regulations sets forth the increased limit on catch-up contributions for employer plans that are SIMPLE plans. This provision specifies that, for taxable years beginning after 2024, the limit on catch-up contributions for participants in SIMPLE plans who attain ages 60-63 during the year is $5,250 (150 percent of the $3,500 limit that is in effect for 2025). The proposed regulations also provide that the $11,250 and $5,250 figures will be adjusted for inflation for taxable years beginning after 2025. Prop. Reg. § 1.414(v)(1)-(c)(2)(iii)(B). According to Prop. Reg. § 1.414-1(i)(2)(i), these rules apply to contributions in taxable years beginning after the date that is six months after the date of publication of final regulations or, at the election of the taxpayer, taxable years beginning after December 31, 2024.

2. 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 contributions until taxable years beginning after 2025. Notice 2023-62, 2023-37 I.R.B. 817 (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.

b. Proposed regulations provide guidance on the requirement that catch-up contributions to employer-sponsored plans by participants who had wages over $145,000 in the preceding year must be designated Roth contributions. REG-101268-24, Catch-Up Contributions, 90 F.R. 2645 (1/13/25). Treasury and the IRS have issued proposed regulations addressing new Code § 414(v)(7) enacted as part of the SECURE 2.0 Act. Section 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 rule is reflected in Prop. Reg. § 1.414(v)-2(a). Section 1.414(v)-2(a)(4) of the proposed regulations specifies, consistent with Code § 414(v)(7)(C), that this Roth-only rule does not apply to a SEP arrangement or a SIMPLE IRA plan. Among other guidance, the proposed regulations set forth the rules that were previewed in Notice 2023-62:

- Section 1.414(v)-2(a)(2) of the proposed regulations provides that the Roth-only rule does not apply in the case of an eligible participant who did 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. The proposed regulations also clarify that the $145,000 wage threshold need not be prorated for the first year of hire. Thus, if an employee worked for the employer sponsoring the plan for only part of the preceding calendar year, the employee is subject to the Roth-only rule only if the employee had wages in the preceding year that exceeded the full $145,000 threshold.
- Section 1.414(v)-2(b)(3) and (b)(4) of the proposed regulations provides that, if applicable employer plan is maintained by more than one employer (including a multiemployer plan), then 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). Similarly, if an eligible participant is subject to the Roth-only rule 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.
- Sections 1.401(k)-1(f)(5)(iii) and 1.403(b)-3(c)(1) of the proposed regulations provide that in the case of an eligible participant who is subject to the Roth-only rule, the plan administrator and the employer are 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. This approach permits 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.

- Section 1.414(v)-2(a)(5)(i) of the proposed regulations provides that, if a participant subject to the Roth-only rule is permitted to make catch-up contributions to a Roth account, then the plan must permit all employees eligible to make catch-up contributions to make those contributions to a Roth account.

For plans that are not maintained pursuant to a collective bargaining agreement, these rules would apply to contributions in taxable years beginning more than six months after the date of publication of final regulations in the Federal Register. A slightly different effective date applies to plans that are maintained pursuant to a collective bargaining agreement. Nevertheless, all plans are permitted to apply these rules with respect to contributions in taxable years beginning after December 31, 2023.

3. Subject to certain exceptions, § 401(k) and § 403(b) plans established on or after December 29, 2022, must automatically enroll eligible participants beginning in 2025. A provision of the SECURE 2.0 Act, Division T, Title I, § 101 of the Consolidated Appropriations Act, 2023, amended the Code by adding new § 414A. New § 414A requires that § 401(k) and § 403(b) plans automatically enroll participants, i.e., participants are enrolled unless they elect not to participate. To meet the requirements of § 414A, the percentage of compensation contributed by participants must be at least 3 percent and not more than 10 percent in the first year of participation. Whatever the initial percentage of compensation contributed, the plan must provide that the percentage is increased by 1 percentage point per year until the percentage contributed is at least 10 percent and not more than 15 percent of compensation. A participant can elect not to participate or to contribute less than these amounts. Certain plans are not subject to new § 414A. These include (1) § 401(k) and § 403(b) plans established before the date of enactment of the SECURE 2.0 Act (December 29, 2022), (2) plans maintained by employers that have been in existence fewer than 3 years, (3) plans maintained by employers that normally employ 10 or fewer employees, and (4) governmental plans (within the meaning of § 414(d)) and church plans (within the meaning of § 414(e)). The new rules apply to plan years beginning after December 31, 2024.

a. Proposed regulations provide guidance on the requirement that § 401(k) and § 403(b) plans established on or after December 29, 2022, must automatically enroll eligible participants beginning in 2025. REG-100669-24, Automatic Enrollment Requirements Under Section 414A, 90 F.R. 3092 (1/14/25). Treasury and the IRS have issued proposed regulations addressing new Code § 414A, enacted as part of the SECURE 2.0 Act. Section 414A provides that § 401(k) and § 403(b) plans must automatically enroll participants, i.e., participants are enrolled unless they elect not to participate. This requirement applies to plan years beginning after December 31, 2024. Prop. Reg. § 1.414A-1(f). Plans enacted before the date of enactment of § 414A are not subject to this requirement. Specifically, the proposed regulations provide that the automatic enrollment requirement does not apply to (1) any plan that includes a qualified cash or deferred arrangement if the plan terms were adopted initially before December 29, 2022, even if the plan terms are effective after that date, or (2) any § 403(b) plan adopted initially before December 29, 2022, without regard to the date of adoption of plan terms providing for salary reduction agreements. Prop. Reg. § 1.414A-1(e). If a plan was adopted on or after December 29, 2022, it is not subject to the automatic enrollment requirement if it falls within one of five exceptions. Prop. Reg. § 1.414A-1(d). The exceptions are for (1) SIMPLE 401(k) plans described in § 401(k)(11) and Reg. § 1.401(k)-4, (2) governmental plans (within the meaning of § 414(d)), (3) church plans (within the meaning of § 414(e)), (4) plans maintained by employers that have been in existence fewer than 3 years, and (5) plans maintained by employers that normally employ 10 or fewer employees. Readers should consult the proposed regulations for further details.

4. Some inflation-adjusted numbers for 2025. Notice 2024-80, 2024-47 I.R.B. 1120 (11/1/24).

- The limit on elective deferrals in §§ 401(k), 403(b), and 457 plans is increased to $23,500 (from $23,000) with a catch-up provision for employees aged 50 or older that is $7,500 (unchanged from 2024). For individuals who attain ages 60-63 in 2025, the limit on catch-up contributions is $11,250.

- The limit on contributions to an IRA is increased to $7,000 (unchanged from 2024) with a catch-up provision for those aged 50 or older that is $1,000 (unchanged from 2024). The AGI phase-out range for contributions to a traditional IRA by employees covered by a workplace retirement plan is increased to $79,000-$89,000 (from $77,000-$87,000) for single filers and heads of household, increased to $126,000-$146,000 (from $123,000-$143,000) for married couples filing jointly in which the spouse who makes the IRA contribution is covered by a workplace retirement plan, and increased to $236,000-$246,000 (from $230,000-$240,000) for an IRA contributor who is not covered by a workplace retirement plan and is married to someone who is covered. The phase-out range for contributions to a Roth IRA is increased to $236,000-$246,000 (from $230,000-$240,000) for married couples filing jointly, and increased to $150,000-$165,000 (from $146,000-$161,000) for singles and heads of household.

- The limit on the annual benefit from a defined benefit plan under § 415 is increased to $280,000 (from $275,000).

- The limit for annual additions to defined contribution plans is increased to $70,000 (from $69,000).

- The amount of compensation that may be taken into account for various plans is increased to $350,000 (from $345,000), and is increased to $520,000 (from $505,000) for government plans.

- The AGI limit for the retirement savings contribution credit for low- and moderate-income workers is increased to $79,000 (from $76,500) for married couples filing jointly, increased to $59,250 (from $57,375) for heads of household, and increased to $39,500 (from $38,250) for singles and married individuals filing separately.

The following table summarizes key figures from the notice:

Category	2023	2024	2025
Elective deferrals - 401(k) plans	$22,500	$23,000	$23,500
Catch-up contributions to employer-sponsored plans (age 50+)	$7,500	$7,500	$7,500[4]
IRA contribution limit	$6,500	$7,000	$7,000
Catch-up contributions to IRAs (age 50+)	$1,000	$1,000	$1,000

[4] $11,250 if ages 60-63.

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

D. Individual Retirement Accounts

1. Crime doesn't pay except, perhaps, when the government seizes your IRA under criminal forfeiture laws that relate back to the time your criminal activity funded your IRA. Hubbard v. Commissioner, 132 F.4th 437 (6th Cir. 3/19/25), *rev'g* T.C. Memo. 2024-16. This opinion from the Sixth Circuit (Judge Murphy) irresistibly opens as follows:

> After a jury convicted Lonnie Hubbard of operating an illegal "pill mill," the government punished him in the expected ways. The district court ordered Hubbard to serve decades in prison. The government also confiscated his homes, vehicles, watercraft, and financial accounts using the criminal-forfeiture laws. Years later, though, the Internal Revenue Service (IRS) sought to punish Hubbard in an unexpected way. As part of the earlier forfeiture, the IRS had seized over $400,000 from Hubbard's individual retirement account (or IRA, in the vernacular of retirement planning). The IRS suggested that the transfer of this money into its own coffers qualified as "income" for Hubbard that he should have paid taxes on from prison. The tax court agreed and ordered Hubbard to pay over $180,000 in taxes and penalties.

132 F.4th at 437.

At the time the government seized the taxpayer's IRA in 2017, he was incarcerated. The IRA custodian, T. Rowe Price, issued Form 1099-R for 2017 reporting a taxable distribution to the taxpayer. The taxpayer did not file a return for 2017. The IRS prepared a substitute for return (commonly known as an SFR) and later issued a notice of deficiency. The notice of deficiency asserted that the taxpayer owed income tax, late-filing and late-payment penalties, an underpayment penalty, and a 10 percent penalty for a premature withdrawal from the IRA. The taxpayer responded by timely filing a petition in the Tax Court. (The IRS later conceded in the Tax Court that it did not seek to impose the 10 percent early withdrawal penalty.)

Mr. Hubbard, a pro se taxpayer, contended before the Tax Court and the Eighth Circuit that it was improper for the IRS to assess back taxes and penalties of over $180,000 attributable to the forfeiture to the U.S. government of the approximately $400,000 balance in his "simplified employee pension" (SEP) IRA connected to his trade or business. The taxpayer's income from his criminal "pill mill" trade or business as a pharmacist in Kentucky, funded his IRA.

Section 408(d)(1) provides that the "payee or distributee" of IRA funds must include in gross income funds withdrawn from an IRA. The taxpayer argued that, due to the government forfeiture, he was not the "payee or distributee" of the funds withdrawn from his IRA within the meaning of § 408(d)(1). The Tax Court (Judge Marshall) disagreed, holding that the taxpayer was the "payee or distributee" and therefore responsible for income taxes and penalties relating to the forfeiture of his IRA. The Eighth Circuit, however, reversed, with Judge Murphy explaining in his opinion that the Tax Court had misinterpreted the criminal forfeiture laws at play in the case. Judge Murphy recounted that two types of criminal forfeitures generally are authorized under U.S. law. One type, which applied to the taxpayer, allows the government to seize and take ownership of a criminal defendant's assets connected to a crime. Moreover, this type of forfeiture can trigger a "relation-back doctrine," which means the government has "[a]ll right, title, and interest" in the criminal defendant's property, including his IRA, as of the time the defendant committed his crimes. The other type of criminal forfeiture, which did not apply to the taxpayer in this case, allows the government to enforce a "personal money judgment" against a criminal defendant. According to the Eighth Circuit, this distinction matters when a criminal defendant forfeits his or her IRA. For IRA forfeitures used to satisfy a "personal money judgment," the Eighth Circuit would agree with the IRS and the Tax Court that imposing back taxes and penalties on a deemed distribution of the IRA is proper. But, if the nature of the forfeiture is instead a seizure of the criminal defendant's IRA triggering the "relation-back doctrine," then the government becomes the owner of the IRA

as of the time the defendant funds the IRA with his criminal activity. Imposing back taxes and penalties upon the criminal defendant for this type of forfeiture of a criminal defendant's IRA is improper because the taxpayer is not the owner and therefore is not the "payee or distributee" of the funds withdrawn from the IRA. Judge Murphy's opinion summarizes:

> Hubbard forfeited his IRA to the IRS under the district court's forfeiture order. The forfeiture laws made the IRS—not Hubbard—the owner of this IRA at the time of the order, and the agency gained the kind of control over this account that any normal owner would possess. [Citations omitted.] Not only that, the forfeiture order triggered the relation-back doctrine, which meant that the IRS also had "[a]ll right, title, and interest" in the IRA as of the earlier time that Hubbard committed his crimes. 21 U.S.C. § 853(c). Exercising this ownership interest, the IRS liquidated the IRA and deposited the money in another government fund.
>
> We fail to see why Hubbard must pay taxes on the IRS's choice to withdraw the funds given that he no longer owned or controlled the IRA. … The IRA was not Hubbard's. He should no more have to pay taxes on its funds than a person randomly selected from the Kentucky voter rolls.

132 F.4th at 444.

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 can envision the late-night condom ads now: "Hurry while supplies last! IRS-approved, pre-tax prophylactics on sale today!" Notice 2024-71, 2024-44 I.R.B. 1026 (10/17/24). Perhaps embarrassed by the prospect of truly analyzing the matter (or perhaps pushed by the prophylactic industry), the IRS has pronounced with scant discussion that amounts paid for condoms will be treated as amounts paid for medical care under section 213(d). *What's the backstory, you ask?* Well, as many of our readers know, amounts paid for "medical care" as defined in § 213(d) are deductible as itemized expenses to the extent such expenditures exceed 7.5 percent of a taxpayer's adjusted gross income and are not compensated by insurance or otherwise. *See* IRC § 263(a). These days, of course, given the ubiquitous nature of health insurance and the increase in the standard deduction, relatively few taxpayers claim itemized deductions for medical care expenses. Nevertheless, to be eligible for payment from or reimbursement by a health flexible spending arrangement (health FSA), Archer medical savings account (Archer MSA), health reimbursement arrangement (HRA), or health savings account (HSA), a taxpayer's medical expenses must qualify as amounts paid for "medical care" within the meaning of § 213(d). Section 213(d) provides in relevant part that "medical care" expenses are "amounts paid for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body." Regulation § 1.213-1(e)(1)(ii) further provides that deductions for medical care expenses under § 213 are limited to expenses "incurred primarily for the prevention or alleviation of a physical or mental defect or illness" and do not include deductions for expenses that are merely beneficial to an individual's general health. The Tax Court held over 70 years ago that whether an expense is incurred for the prevention of disease, or other form of medical care under § 213(d) depends upon the facts and circumstances. *See Stringham v. Commissioner*, 12 T.C. 580, 584 (1949). After citing and summarizing § 213(d), Reg. § 1.213-1(e)(1)(ii), and *Stringham*, Notice 2024-71 reasons that "depending on the specific facts and circumstances, amounts paid for condoms may or may not be considered medical expenses under section 213(d)." Then, under the heading of "SAFE HARBOR"—talk about a double-entendre—with no other discussion, Notice 2024-71 concludes: "The Treasury Department and the IRS will treat amounts

paid for condoms as amounts paid for medical care under section 213(d).” The IRS obviously doesn’t want to discuss the issue any further so neither will we.

2. Standard deduction for 2025. The 2025 One Big Beautiful Bill Act, § 70102, amended Code § 63(c)(7) to increase the standard deduction for 2025. The standard deduction for 2025 will be $15,750 for unmarried individuals and married individuals filing separately (previously $15,000), $23,625 for heads of households (previously $22,500), and $31,500 for joint returns and surviving spouses (previously $30,000). These figures will be adjusted for inflation for tax years beginning after 2025. Readers will recall that the 2017 Tax Cuts and Jobs Act significantly increased the standard deduction for 2018 through 2025. Unlike the increases enacted by the 2017 TCJA, which were temporary, those enacted by the 2025 OBBA are permanent.

The following table sets forth the standard deduction for each filing status a taxpayer might have:

Filing Status	2023	2024	2025 Before OBBA	2025 After OBBA
Single/MFS	$13,850	$14,600	$15,000	$15,750
Head-of-Household	$20,800	$21,900	$22,500	$23,625
MFJ and Surviving Spouses	$27,700	$29,200	$30,000	$31,500

The legislation did not change the standard deduction for dependents or the additional standard deduction for the aged or blind. For individuals who can be claimed as dependents, the standard deduction for 2025 cannot exceed the greater of $1,350 (increased from $1,300 in 2024) or the sum of $450 (unchanged from 2024) and the individual’s earned income. The additional standard deduction amount for those who are legally blind or who are age 65 or older is $2,000 (increased from $1,900 in 2024) for those with the filing status of single or head of household (and who are not surviving spouses) and is $1,600 (increased from $1,550 in 2024) for married taxpayers ($3,200 on a joint return if both spouses are age 65 or older).

3. The deduction for personal exemptions has permanently disappeared and a new, temporary deduction for seniors makes its first appearance in 2025. The 2025 One Big Beautiful Bill Act, § 70103, amended Code § 151(d)(5) to make permanent the elimination of the deduction for personal exemptions. Previously, the 2017 Tax Cuts and Jobs Act, § 11041, amended Code § 151(d) by adding § 151(d)(5), which reduced the exemption amount to zero for taxable years beginning after 2017 and before 2026. The amendments enacted by the 2025 OBBA omit the ending date, so that the reduction of the exemption amount to zero applies to taxable years beginning after 2017.

The 2025 OBBA, § 70103, also amended § 151(d)(5) to add § 151(d)(5)(C), which provides a new deduction for seniors for 2025 through 2028. The deduction is available to a “qualified individual,” defined as a taxpayer who has attained the age of 65 by the close of the taxable year and, in the case of a joint return, the taxpayer’s spouse if the spouse has attained the age of 65 by the close of the taxable year. The deduction is $6,000 for each qualified individual. Thus, if a married couple files a joint return and if each spouse has reached the age of at least 65 by the close of the taxable year, the deduction is $12,000. This deduction is in addition to the additional standard deduction for those who are legally blind or who have reached age 65. For example, if a married couple files a joint return for 2025 and if they each are at least 65 years old by the close of 2025, their standard deduction would be $34,700 ($31,500 basic standard deduction plus $3,200 additional standard deduction) and, in addition, they would be entitled to another $12,000 deduction for a total of $46,700. There are certain limitations on the new deduction. *First*, the deduction is phased out for taxpayers whose modified adjusted gross income exceeds $75,000

($150,000 for joint returns). The reduction is 6 percent of the amount by which the taxpayer's modified adjusted gross income exceeds $75,000 ($150,000 for joint returns). Thus, the deduction is eliminated for a single taxpayer with modified adjusted gross income of $175,000 or higher and for married taxpayers filing jointly with modified adjusted gross income of $250,000 or higher. *Second*, the deduction is available to a qualified individual only if the individual has (and includes on the return) a Social Security Number issued by the due date of the return. *Third*, if an individual is married, the new deduction is available only if the individual files jointly with his or her spouse.

4. Some good news for workers who depend on tips: up to $25,000 of tip income can be deducted, at least through 2028. The 2025 One Big Beautiful Bill Act, § 70201, added new § 224 of the Code (and renumbered existing § 224 as § 225). New § 224(a) authorizes an individual to deduct the amount of "qualified tips" that the individual receives.

Qualified tips. The term "qualified tips" is defined in § 224(d)(1) as the *cash tips* an individual receives in an occupation that "customarily and regularly received tips on or before December 31, 2024," as provided in guidance to be published by the IRS. The legislation directs the Secretary of the Treasury to publish a list of such occupations not later than 90 days after the date of enactment. Because the date of enactment was July 4, 2025, the list should be published by October 2, 2025. A "cash tip," according to § 224(d)(3), includes "tips received from customers that are paid in cash or charged and, in the case of an employee, tips received under any tip-sharing arrangement." An amount received is not a qualified tip, under § 224(d)(2)(A), unless the amount is "paid voluntarily without any consequence in the event of nonpayment, is not the subject of negotiation, and is determined by the payor." Further, under § 224(d)(2)(B), an amount is not a qualified tip if it is received in a specified service trade or business as defined in § 199A(d)(2), even if the tip is received by an employee in the trade or business. Readers will recall that a specified service trade or business for this purpose includes most professional services, including the practice of law, medicine, and accounting. In addition, under § 224(d)(2)(C), an amount can be a qualified tip only if it meets any other requirements established by the IRS in published guidance. Finally, to be considered a qualified tip, an amount must either be reported on certain statements furnished to the individual, such as a W-2 or 1099 form, or be reported by the individual on Form 4137, which is the form used to determine Social Security and Medicare tax owed on tips the individual did not report to the individual's employer.

Self-employed individuals. Section 224(c) makes clear that the deduction is available not only to employees, but also to those who are self-employed. In the case of a self-employed individual, however, the deduction cannot exceed the amount by which the taxpayer's gross income from the trade or business for the year (including tip income) exceeds the deductions allocable to the trade or business. This effectively means that the deduction for tip income can reduce income from the trade or business to zero, but cannot create a loss. For example, if a self-employed individual has $150,000 of gross income from the trade or business, including $20,000 of tip income, and has $140,000 of other allowable deductions for the trade or business, the taxpayer's deduction for tips is limited to $10,000 ($150,000-$140,000). In addition, § 224(d) provides that any amount for which a deduction is allowed under § 224 is excluded from the taxpayer's qualified business income for purposes of § 199A. Thus, in the example just given, if the self-employed individual has $20,000 of tip income and is able to deduct $10,000 of it under § 224, then only the remaining $10,000 of the tip income is taken into account in determining the taxpayer's qualified business income.

Limitations on the deduction. Section 224(b) provides that the amount allowed as a deduction under new § 224 cannot exceed $25,000. This limit is reduced by $100 for each $1,000 by which the taxpayer's modified adjusted gross income exceeds $150,000 ($300,000 for joint returns). This means that the deduction is completely phased out when a taxpayer's modified AGI reaches $400,000 ($550,000 for joint returns). These amounts are not adjusted for inflation.

Deduction available to non-itemizers. The deduction authorized by new § 224 is *not* an itemized deduction on Schedule A. Instead, it is a deduction that is available regardless of whether

the taxpayer itemizes deductions or takes the standard deduction. The deduction necessarily will be taken on Form 1040, similar to the existing deduction for qualified business income under § 199A, and will *not* be taken on Schedule C for self-employed individuals.

Other requirements. If an individual is married, then, according to § 224(f), the deduction for tip income is allowed only if the individual files a joint return with his or her spouse. One situation in which this rule would not apply is when a married person is eligible for head-of-household filing status because they support a child and live apart (and file separately) from their spouse. Such an individual is treated as not being married under § 7703(b). In addition, to claim the deduction for tip income, an individual must have (and include on the return) a Social Security Number issued by the due date of the return. Therefore, an individual with an Individual Taxpayer Identification Number (ITIN) is not eligible for the deduction.

Will we see large amounts of income being reclassified as "tips"? Maybe. But § 224(g) directs the Secretary of the Treasury to "prescribe such regulations or other guidance as may be necessary to prevent reclassification of income as qualified tips, including regulations or other guidance to prevent abuse of the deduction allowed by this section."

Reporting by employers. The legislation directs employers reporting compensation to employees on Form W-2 or to independent contractors on Form 1099 to provide "a separate accounting of any such amounts reasonably designated as cash tips and the occupation described in section 224(d)(1) of the person receiving such tips." For tips required to be reported for periods before January 1, 2026, employers "may approximate a separate accounting of amounts designated as cash tips by any reasonable method specified by the Secretary." Guidance on the reporting requirements should be forthcoming.

State tax considerations. Although new § 224 allows deduction of tip income (subject to the limitations and requirements described above), states that impose an income tax on individuals may not allow the deduction, which means that tip income could be subject to state taxation.

Effective date. New § 224 applies to taxable years beginning after December 31, 2024. According to § 224(h), no deduction is allowed under § 224 for any taxable years beginning after December 31, 2028.

a. Proposed regulations provide guidance on the § 224 deduction for tips, including a list of occupations that customarily received tips on or before December 31, 2024. REG-110032-25, Occupations That Customarily and Regularly Received Tips; Definition of Qualified Tips, 90 F.R. 45340 (9/22/25). As discussed above, new § 224(a), enacted as part of the 2025 One Big Beautiful Bill Act, authorizes an individual to deduct the amount of "qualified tips" that the individual receives. To constitute qualified tips, they must be received in an occupation that "customarily and regularly received tips on or before December 31, 2024," as provided in guidance to be published by the IRS. The legislation directed the Secretary of the Treasury to publish a list of occupations. These proposed regulations both identify occupations that customarily and regularly received tips on or before December 31, 2024, and provide a definition of ''qualified tips'' for purposes of the new deduction for qualified tips. The regulations are proposed to apply for taxable years beginning after December 31, 2024. Taxpayers can rely on the proposed regulations for taxable years beginning after December 31, 2024, and on or before the date these regulations are published as final regulations in the Federal Register, provided that taxpayers follow the proposed regulations in their entirety and in a consistent manner.

5. ♪♫ You get up every morning from your alarm clock's warning, Take the 8:15 into the city … Taking care of business and working overtime, work out.♫♪ Individuals can deduct up to $12,500 ($25,000 if MFJ) of overtime income, at least through 2028. The 2025 One Big Beautiful Bill Act, § 70202, added new § 225 of the Code (and renumbered existing § 225 as § 226). New § 225(a) authorizes an individual to deduct the amount of "qualified overtime compensation" that the individual receives and that is reported on certain statements furnished to the individual, such as a W-2 or 1099 form.

Qualified overtime compensation. The term "qualified overtime compensation" is defined in § 225(c)(1) as "overtime compensation paid to an individual required under section 7 of the Fair Labor Standards Act of 1938 *that is in excess of the regular rate* (as used in such section) at which such individual is employed" (emphasis added). Section 7 of the Fair Labor Standards Act (FLSA) requires that non-exempt employees be paid at least 1.5 times their regular rate for hours worked over 40 hours during the week. Thus, if a covered employee's regular rate of pay is $10 per hour, the employee must be paid at least $15 per hour for any hour worked over 40 hours. The language of new § 225(c)(1) indicates that only the amount in excess of the regular rate, i.e., $5 in this example, is qualified overtime compensation that can be deducted. Any amount that is a qualified tip within the meaning of new § 224(d), discussed earlier in this outline, is excluded from the category of qualified overtime compensation. Because qualified overtime compensation is defined as compensation required under the FLSA, any overtime compensation that is required by state law but not required by the FLSA would not qualify for the deduction.

Limitations on the deduction. Section 225(b) provides that the amount allowed as a deduction under new § 225 cannot exceed $12,500 ($25,000 for joint returns). This limit is reduced by $100 for each $1,000 by which the taxpayer's modified adjusted gross income exceeds $150,000 ($300,000 for joint returns). This means that the deduction is completely phased out when a taxpayer's modified AGI reaches $275,000 ($550,000 for joint returns). These amounts are not adjusted for inflation.

Deduction available to non-itemizers. The deduction authorized by new § 225 is *not* an itemized deduction on Schedule A. Instead, it is a deduction that is available regardless of whether the taxpayer itemizes deductions or takes the standard deduction. The deduction necessarily will be taken on Form 1040, similar to the existing deduction for qualified business income under § 199A.

Other requirements. If an individual is married, then, according to § 225(e), the deduction for overtime compensation is allowed only if the individual files a joint return with his or her spouse. One situation in which this rule would not apply is when a married person is eligible for head-of-household filing status because they support a child and live apart (and file separately) from their spouse. Such an individual is treated as not being married under § 7703(b). In addition, to claim the deduction for overtime compensation, an individual must have (and include on the return) a Social Security Number issued by the due date of the return. Therefore, an individual with an Individual Taxpayer Identification Number (ITIN) is not eligible for the deduction.

Administrative guidance to be issued. Section 225(f) directs the Secretary of the Treasury to "issue such regulations or other guidance as may be necessary or appropriate to carry out the purposes of this section, including regulations or other guidance to prevent abuse of the deduction allowed by this section."

Reporting by employers. The legislation directs employers issuing Form W-2 to employees to include "the total amount of qualified overtime compensation (as defined in section 225(c)." Similarly, the legislation directs those making payments to persons not treated as employees for tax purposes "a separate accounting of any amount of qualified overtime compensation (as defined in section 225(c)." For overtime compensation required to be reported for periods before January 1, 2026, employers "may approximate a separate accounting of amounts designated as qualified overtime compensation by any reasonable method specified by the Secretary." Guidance on the reporting requirements should be forthcoming.

State tax considerations. Although new § 225 allows deduction of overtime compensation (subject to the limitations and requirements described above), states that impose an income tax on individuals may not allow the deduction, which means that overtime compensation could be subject to state taxation.

Effective date. New § 225 applies to taxable years beginning after December 31, 2024. According to § 225(g), no deduction is allowed under § 225 for any taxable years beginning after December 31, 2028.

6. An enhanced child tax credit and the credit for dependents other than a qualifying child have become permanent. The 2025 One Big Beautiful Bill Act, § 70104, amended Code § 24(h) to enhance and make permanent changes to the child tax credit enacted in 2017. Previously, the 2017 Tax Cuts and Jobs Act, § 11022, added Code § 24(h), which significantly increased the child tax credit and established a new credit for dependents other than qualifying children for taxable years beginning after 2017 and before 2026. Before enactment of the 2025 OBBA, the changes made by the 2017 TCJA were set to expire after 2025.

Child Tax Credit. The 2025 OBBA increased the child tax credit from $2,000 to $2,200 per qualifying child for 2025. The $2,200 credit will be adjusted for inflation for taxable years beginning after 2025. The legislation also maintained the rule that the refundable portion of the credit is $1,400 per qualifying child, which continues to be adjusted for inflation. For 2025, the refundable portion of the child tax credit is $1,700. The refundable portion of the credit is determined in the same manner as under current law; the earned income threshold for determining the refundable portion continues to be $2,500. The legislation retains the current-law age limit for the credit, i.e., a person can be a qualifying child only if he or she has not attained age 17 by the end of the taxable year. To claim the child tax credit (either the refundable or nonrefundable portion), a taxpayer must include on the return *both* the taxpayer's Social Security Number (or, in the case of a joint return, the Social Security Number of at least one spouse) *and* the Social Security Number of the qualifying child. For this purpose, a Social Security Number must have been issued before the due date for filing the return. If the child tax credit is not available with respect to a qualifying child because of the absence of the child's Social Security Number, the taxpayer can claim the new, nonrefundable credit described below with respect to that child.

Nonrefundable $500 Credit for Dependents Other Than a Qualifying Child. The 2025 OBBA also makes permanent (as an increase to the basic child tax credit) the nonrefundable credit of $500 for each dependent other than a qualifying child. The $500 amount is not adjusted for inflation. This credit applies, for example, with respect to a parent who is the taxpayer's dependent and therefore a qualifying relative. The nonrefundable credit is available only with respect to a dependent who is a citizen, national, or resident of the U.S., i.e., the credit is not available with respect to a dependent who is a resident of the contiguous countries of Canada and Mexico.

Increased Phase-out Thresholds. The 2025 OBBA continues and makes permanent the modified adjusted gross income thresholds at which the credits (both the child tax credit and the $500 nonrefundable credit) begin to phase out. Before the 2017 TCJA, the child tax credit was phased out by $50 for each $1,000 by which the taxpayer's modified AGI exceeded $55,000 for married taxpayers filing separately, $75,000 for single taxpayers or heads of household, and $110,000 for married taxpayers filing a joint return. Thus, under pre-TCJA law, the credit was phased out entirely for married taxpayers filing a joint return once modified AGI reached $130,000. The 2017 TCJA increased the phase-out thresholds to $400,000 for married couples filing a joint return and $200,000 for all other taxpayers. The 2025 OBBA maintains these increased phase-out thresholds. The increased thresholds significantly increase the number of taxpayers who benefit from the credits.

7. The deduction for state and local taxes not paid or accrued in carrying on a trade or business or an income-producing activity is increased to $40,000 for 2025 and to slightly higher amounts for 2026 through 2029. The 2025 One Big Beautiful Bill Act, § 70120, amended Code § 163(b)(6) and added § 164(b)(7) to increase the limit for individuals on deducting state and local taxes as an itemized deduction on Schedule A.

Previously, the 2017 Tax Cuts and Jobs Act, § 11042, amended Code § 164(b) by adding § 164(b)(6). For individual taxpayers, this provision generally (1) eliminated the deduction for foreign real property taxes, and (2) limited to $10,000 ($5,000 for married individuals filing

separately) a taxpayer's itemized deductions on Schedule A for the aggregate of state or local property taxes, income taxes, and sales taxes deducted in lieu of income taxes. This provision applied to taxable years beginning after 2017 and before 2026.

The 2025 OBBA maintained the disallowance of foreign real property taxes and increased the limit on deducting state and local taxes on Schedule A to the "applicable limitation amount." The applicable limitation amount, according to § 164(b)(7)(A), is as follows:

Taxable Year Beginning in	Applicable Limitation Amount[5]
2025	$40,000
2026	$40,400
2027	$40,804
2028	$41,212
2029	$41,624
2030 and future years	$10,000

For married individuals filing separate returns, the applicable limitation amounts are one-half of the amounts set forth in the table. Further, the applicable limitation amount is phased out for higher-income taxpayers. Specifically, the applicable limitation amount is reduced by 30 percent of the excess of the taxpayer's modified adjusted gross income over the "threshold amount" (or, in the case of a married individual filing a separate return, one-half of the threshold amount). Regardless of the taxpayer's modified AGI, the applicable limitation amount is not reduced below $10,000. The applicable limitation amount, according to § 164(b)(7)(B), is as follows:

Taxable Year Beginning in	Threshold Amount[6]
2025	$500,000
2026	$505,000
2027	$510,050
2028	$515,151
2029	$520,302

As an illustration of the phaseout, if a taxpayer's modified AGI in 2025 is $600,000 or higher, the taxpayer's deduction for state and local taxes will be reduced to $10,000:

2025-All Filing Statuses Other Than MFS	
Applicable limitation amount:	$40,000
Assumed modified AGI:	$600,000
Threshold amount:	$500,000
Excess of MAGI over threshold amount:	$100,000

[5] For 2027 through 2029, § 164(b)(7)(A)(iii) provides that the applicable limitation amount is 101% of the amount in effect for the previous year. The figures in the table for 2027 through 2029 are calculated using this guidance.

[6] For 2027 through 2029, § 164(b)(7)(B)(ii)(III) provides that the applicable limitation amount is 101% of the amount in effect for the previous year. The figures in the table for 2027 through 2029 are calculated using this guidance.

Reduction in applicable limitation amount (30% of excess of MAGI over threshold amount):	$30,000
Limit on deduction for state and local taxes:	$10,000

If a taxpayer's filing status is married filing separately, and if the taxpayer's modified AGI in 2025 is $283,333 or higher, the taxpayer's deduction for state and local taxes will be reduced to $10,000:

2025-Filing Status of MFS	
Applicable limitation amount:	$20,000
Assumed modified AGI:	$283,333
Threshold amount:	$250,000
Excess of MAGI over threshold amount:	$33,333
Reduction in applicable limitation amount (30% of excess of MAGI over threshold amount):	$10,000
Limit on deduction for state and local taxes:	$10,000

The limitation described above does *not* affect the deduction of state or local property taxes or sales taxes that are paid or accrued in carrying on a trade or business or an income-producing activity (i.e., an activity described in § 212) that are properly deductible on Schedules C, E, or F. For example, property taxes imposed on residential rental property located in the U.S. continue to be deductible without limitation on Schedule E. As under current law, an individual cannot deduct state or local income taxes as a business expense even if the individual is engaged in a trade or business as a sole proprietor. *See* Reg. § 1.62-1T(d).

8. ♪♫Baby, you can drive my car, Yes, I'm gonna be a star, And maybe I'll [get a deduction for my car loan interest.]♫♪ Individuals can deduct up to $10,000 of interest on loans incurred after 2024 to acquire new cars, at least through 2028. The 2025 One Big Beautiful Bill Act, § 70203, added new § 163(h)(4) of the Code (and renumbered existing § 163(h)(4) as § 163(h)(5)). The effect of this amendment is to allow an individual to deduct a limited amount of "qualified passenger vehicle loan interest."

Background. Section 163(a) allows as a deduction "all interest paid or accrued within the taxable year on indebtedness." For taxpayers other than corporations, however, § 163(h)(1) provides that no deduction is allowed for "personal interest." Personal interest is defined in § 163(h)(3) as all interest other than specific categories of interest, such as interest properly allocable to a trade or business, qualified residence interest, and certain student loan interest. New § 163(h)(4) excludes "qualified passenger vehicle loan interest" from the category of personal interest. The effect is to make qualified passenger vehicle loan interest deductible.

Qualified passenger vehicle loan interest. The term "qualified passenger vehicle loan interest" is defined in § 163(h)(4)(B) as interest paid or accrued on indebtedness incurred by the taxpayer after December 31, 2024, for the purchase of an "applicable passenger vehicle" for personal use. To qualify, the loan must be secured by a first lien on the vehicle. An "applicable passenger vehicle" is defined in § 163(h)(4)(D) as any vehicle the original use of which commences with the taxpayer and that meets certain other requirements. This requirement makes clear that the deduction is not available for interest on loans used to acquire used cars and instead is available only for loans used to acquire new cars. The other requirements are that the vehicle must (1) be manufactured primarily for use on public streets, roads, and highways, (2) have at least two wheels, (3) be a car, minivan, van, sport utility vehicle, pickup truck, or motorcycle, (4) be treated as a motor vehicle for purposes of title II of the Clean Air Act, (5) have a gross vehicle weight of less than 14,000 pounds, and (6) have its final assembly occur within the United States. Finally, the

vehicle identification number, or VIN, of the vehicle must be included on the taxpayer's return in order to qualify for the deduction. According to § 163(h)(4)(E)(ii), if interest on indebtedness meets the definition of qualified passenger vehicle loan interest, any refinancing of such indebtedness is treated in the same way as the refinanced indebtedness to the extent it does not exceed the amount of the refinanced indebtedness.

Interest that does not qualify for the deduction. According to § 163(h)(4)(B)(ii), interest paid on the following types of loans does *not* qualify for the deduction: (1) a loan to finance fleet sales, (2) a loan for the purchase of a commercial vehicle not for personal use, (3) any lease financing, (4) a loan to finance a vehicle with a salvage title, (5) a loan to finance the purchase of a vehicle to be used for scrap or parts.

Limitations on the deduction. Section 163(h)(4)(C) provides that the amount treated as qualified passenger vehicle loan interest cannot exceed $10,000. This limit is reduced by $200 for each $1,000 by which the taxpayer's modified adjusted gross income exceeds $100,000 ($200,000 for joint returns). This means that the deduction is completely phased out when a taxpayer's modified AGI reaches $150,000 ($250,000 for joint returns). These amounts are not adjusted for inflation.

Deduction available to non-itemizers. The deduction for qualified passenger vehicle loan interest is *not* an itemized deduction on Schedule A. Instead, it is a deduction that is available regardless of whether the taxpayer itemizes deductions or takes the standard deduction. The deduction necessarily will be taken on Form 1040, similar to the existing deduction for qualified business income under § 199A.

Reporting by businesses receiving interest. Form 1098-CAR? The legislation adds new § 6050AA, which requires businesses receiving $600 or more of interest that is qualified passenger vehicle loan interest to report specific information to the IRS and to furnish a written statement to the taxpayer paying the interest. This statement presumably will be similar to the statements taxpayers commonly receive for mortgage interest paid (Form 1098).

State tax considerations. Although the legislation allows deduction of qualifying interest on car loans (subject to the limitations and requirements described above), states that impose an income tax on individuals may not allow the deduction, which means that such interest would not be deductible for state tax purposes.

Effective date. New § 163(h)(4) applies to indebtedness incurred after December 31, 2024. According to § 163(h)(4)(A), the deduction is allowed for taxable years beginning after December 31, 2024, and before January 1, 2029.

E. Divorce Tax Issues

F. Education

1. Changes to § 529 accounts in the 2025 One Big Beautiful Bill Act.

a. Congress has expanded the definition of "qualified higher education expenses" and increased the limit on withdrawals for K-12 education. The 2025 One Big Beautiful Bill Act, § 70413, amended Code § 529(c)(7) and § 529(e), which permit a limited amount of tax-free distributions from § 529 accounts to pay expenses "in connection with enrollment or attendance at an elementary or secondary public, private, or religious school." The legislation makes two changes, discussed below.

Expanded definition of K-12 qualified higher education expenses for 2025 and future years. Funds can be withdrawn from a 529 account tax-free for "qualified higher education expenses." Before the legislative change, § 529(c)(7) provided that the term "qualified higher education expense" included expenses for K-12 tuition. As amended, § 529(c)(7) provides that the term "qualified higher education expenses" includes not only expenses for K-12 tuition, but also expenses for the following: (1) curriculum and curricular materials, (2) books or other instructional

materials, (3) online educational materials, (4) fees for a nationally standardized norm-referenced achievement test, an advanced placement examination, or any examinations related to college or university admission, (5) fees for dual enrollment in an institution of higher education, (6) educational therapies for students with disabilities provided by a licensed or accredited practitioner or provider, including occupational, behavioral, physical, and speech-language therapies, and (7) tuition for tutoring or educational classes outside of the home, including at a tutoring facility, if certain requirements are met. For tutoring, the instructor must not be related to the student and must meet one of the following requirements: (1) is a licensed teacher in the state, (2) has taught at an eligible educational institution, or (3) is a subject matter expert in the relevant subject. The expanded definition of K-12 qualified higher education expenses applies to distributions made after the date of enactment (July 4, 2025).

Increased limit on distributions for K-12 expenses after 2025. The legislation increases the limit on tax-free distributions for K-12 expenses. Prior to the change, § 529(e)(3) provided that the annual limit on distributions for qualifying K-12 expenses was $10,000. As amended, the annual limit on such distributions is $20,000. This limit applies per student, not per account. Thus, if a student is a designated beneficiary of more than one § 529 account, the student can receive only $20,000 free of tax for this purpose in a given year regardless of whether the funds are distributed from multiple accounts. The increased $20,000 limit is effective for taxable years beginning after December 31, 2025.

b. Taxpayers can now make tax-free withdrawals from § 529 accounts for "qualified postsecondary credentialing expenses." It's now less expensive to become a licensed plumber, HVAC repair person, or software developer. The 2025 One Big Beautiful Bill Act, § 70414, amended Code § 529(e)(3) and added new § 529(f) to expand the definition of "qualified higher education expenses" for which taxpayers can make tax-free withdrawals from § 529 accounts. As amended, the term "qualified higher education expenses" includes "qualified postsecondary credentialing expenses."

Qualified postsecondary credentialing expenses. The term "qualified postsecondary credentialing expenses" is defined in § 529(f)(1) as follows:

> A. tuition, fees, books, supplies, and equipment required for the enrollment or attendance of a designated beneficiary in a recognized postsecondary credential program, or any other expense incurred in connection with enrollment in or attendance at a recognized postsecondary credential program if such expense would, if incurred in connection with enrollment or attendance at an eligible educational institution, be covered under subsection (e)(3)(A) [i.e., would be considered a qualified higher education expense],
>
> B. fees for testing if such testing is required to obtain or maintain a recognized postsecondary credential, and
>
> C. fees for continuing education if such education is required to maintain a recognized postsecondary credential.

Recognized postsecondary credential program/recognized postsecondary credential. Under the definition set forth above, an expense is a qualified postsecondary credentialing expense only if it is incurred in connection with enrollment in or attendance at a *recognized postsecondary credential program.* The term "recognized postsecondary credential program" is defined as a program to obtain a *recognized postsecondary credential* if the program meets one of the following four requirements: (1) it is included on a state list prepared under section 122(d) of the Workforce Innovation and Opportunity Act (29 U.S.C. § 3152(d)), (2) it is listed in the public directory of the Web Enabled Approval Management System (WEAMS) of the Veterans Benefits Administration, (3) an examination (developed or administered by an organization widely recognized as providing reputable credentials in the occupation) is required to obtain or maintain the credential and the organization that developed or administers the exam recognizes the program as providing training

or education that prepares individuals to take such examination, or (4) it is identified by the Secretary of the Treasury, after consultation with the Secretary of Labor, as being a reputable program for obtaining a recognized postsecondary credential. A *recognized postsecondary credential* is defined in § 529(f)(3) as any one of the following: (1) any postsecondary employment credential that is industry recognized and that meets one of three requirements;[7] (2) any certificate of completion of an apprenticeship that is registered and certified with the Secretary of Labor under the National Apprenticeship Act (29 U.S.C. 50 et seq.); (3) any occupational or professional license issued or recognized by a state or the federal government (and any certification that satisfies a condition for obtaining such a license), or (4) any recognized postsecondary credential as defined in section 3(52) of the Workforce Innovation and Opportunity Act (29 U.S.C. 3102(52)), provided through a recognized postsecondary credential program.

This change, which permits tax-free distributions from § 529 accounts for qualified postsecondary credentialing expenses, applies to distributions made after the date of enactment (July 4, 2025).

G. Alternative Minimum Tax

VI. CORPORATIONS

A. Entity and Formation

B. Distributions and Redemptions

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D. S Corporations

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F. Corporate Divisions

G. Affiliated Corporations and Consolidated Returns

H. Miscellaneous Corporate Issues

1. Much ado about nothing . . . or an open can of worms full of you know what flung against a fan?!?! A U.S. corporation with a tax year straddling the effective date of the TCJA was entitled to a deduction under § 245A for a deemed dividend from a CFC the U.S. corporation was required to include in income under § 78. Varian Medical Systems Inc. v. Commissioner, 163 T.C. 76 (8/26/24). Candidly, we are not sure if this reviewed case of first impression from the Tax Court is a yawner or a gobsmacker. Only time will tell. The taxpayer took advantage of *both* § 78 *and* § 245A for its 2018 tax year due to conflicting effective date language in the 2017 Tax Cuts and Jobs Act (TCJA). Except in circumstances almost identical to this case (where a multinational corporate taxpayer's taxable year straddles the enactment of the TCJA), taking advantage of both § 78 and § 245A is expressly prohibited. *See* IRC § 78. *Yes, we told you the case has extremely narrow application, but that's not really the important part, so keep reading.* The Tax Court's precedential opinion does not entirely settle the case, but it does resolve competing cross-motions for summary judgment filed by the taxpayer and the IRS.

Broader implications of the case. On one hand, the Tax Court addressed an unusually narrow set of facts, largely ruling in favor of a clever multinational corporate taxpayer who for *one taxable*

[7] The three requirements are: (1) the credential is issued by a program that is accredited by the Institute for Credentialing Excellence, the National Commission on Certifying Agencies, or the American National Standards Institute, (2) the credential is included in the Credentialing Opportunities On-Line (COOL) directory of credentialing programs (or successor directory) maintained by the Department of Defense or by any branch of the Armed Forces, or (3) the credential is identified by the Secretary of the Treasury, after consultation with the Secretary of Labor, as being industry recognized.

year took advantage of a known, limited-time loophole: a mismatch in the TCJA's effective date provisions concerning § 78 and § 245A. On the other hand, the Tax Court reached its decision by completely disregarding a Treasury regulation that purported to close the loophole. The Treasury regulation sought to close the loophole retroactively as had been proposed in technical corrections legislation that our dysfunctional Congress drafted but never passed. The authors believe that the Tax Court, as explained in a well-written opinion by Judge Toro, reached the correct result, especially considering the straightforward but conflicting effective date language in the relevant statutes. Nevertheless, the real significance of the case is the Tax Court's willingness to completely disregard the loophole-closing Treasury regulation on point. Going forward, it seems clear that the Tax Court (and other federal courts as well) will exercise independent judgment when evaluating government agency interpretations of statutes. Thus, the Tax Court no longer will defer to Treasury's admittedly self-interested interpretation of ambiguous, or arguably ambiguous, Code provisions. Instead, interpretative (as opposed to legislative) Treasury regulations and other administrative guidance not satisfying the new *Loper Bright* "best interpretation" standard adopted by the U.S. Supreme Court may be disregarded or invalidated. We elaborate below.

Factual Background. The taxpayer was the parent company of a consolidated group of medical device and software manufacturers headquartered in the U.S. The taxpayer also operated internationally, including through controlled foreign corporation ("CFC") subsidiaries within the meaning of subpart F of the Code. *See* IRC § 957.[8] The taxpayer and its CFC subsidiaries previously had adopted a fiscal (as opposed to a calendar) taxable year for federal income tax purposes. The taxpayer's fiscal taxable year in this case ran from September 30, 2017, through September 28, 2018 (the "2018 tax year"). The TCJA was enacted late in 2017. Thus, the taxpayer's 2018 tax year straddled the enactment of the TCJA. Reading between the lines, we believe that for its 2018 tax year the taxpayer was subject to the § 965 "Mandatory Repatriation Tax" ("MRT") enacted by the TCJA as part of Congress's overhaul of subpart F of the Code.[9] Accordingly, the taxpayer was keen to ameliorate the adverse impact of the MRT. Regardless, the taxpayer's international operations via its CFC subsidiaries for its 2018 tax year permitted the taxpayer to claim approximately $161 million in § 901 foreign tax credits. Those claimed foreign tax credits in turn implicated § 78 (deemed dividends relating to claimed foreign tax credits) and § 245A (deduction relating to dividends received from specified 10-percent owned foreign corporations).

Legal Background. As noted above, § 245A was enacted at the end of 2017 as part of the TCJA's extensive revisions to subpart F of the Code. Generally, § 245A grants a dividends-received deduction ("DRD") to a domestic corporation that is a United States shareholder with

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[8] Under § 957(a), a CFC generally is a non-U.S. corporation if, on any day during the corporation's taxable year, "United States shareholders" own stock possessing more than 50 percent of either the total voting power of all classes of stock entitled to vote or the total value of the corporation's stock. Pursuant to § 957(b), a "United States shareholder" is a "United States person" (see § 7701(a)(30)) who owns 10 percent or more of the total combined voting power of all classes of stock entitled to vote (before 2018) or 10 percent or more of the total value of shares of all classes of stock of the foreign corporation (after 2017).

[9] We previously summarized the MRT in connection with our discussion of SCOTUS's decision in Moore v. United States, 602 U.S. ___ (6/20/2024). The MRT imposes "a one-time pass-through tax" that is "backward-looking" on the accumulated but undistributed income of "American-controlled foreign corporations." *Moore*, 144 S. Ct. at 1686. Put differently, the MRT effectuates a deemed repatriation (in corporate tax parlance, "deemed dividend") of earnings and profits to U.S. shareholders holding 10 percent or more of the controlled foreign corporation's stock. Longstanding provisions of subpart F have operated the same way for decades, but before the TCJA-enacted MRT, subpart F mainly applied to passive income. The MRT was enacted in 2017 to correct a perceived abuse by taxing U.S. shareholders on their share of post-1986 accumulated but undistributed trade or business income of "controlled foreign corporations" (as defined) even though a dividend had not been declared. Otherwise, if the income earned by the foreign corporation was never repatriated, it remained indefinitely untaxed by the U.S. The MRT also operates prospectively after 2017 with respect to "global intangible low-taxed income" (a/k/a "GILTI") *See* IRC § 951A.

respect to any "specified 10-percent owned foreign corporation" for any dividend received from the foreign corporation. *See* § 245A(a). Importantly, § 245A became effective for "distributions made after December 31, 2017." Thus, § 245A applied to any dividends received by the taxpayer from its CFC subsidiaries on or after January 1, 2018. The dividends-received deduction authorized by § 245A eliminates U.S. taxation of distributions (or deemed distributions) of untaxed foreign-source income. Contrastingly, § 78 has been a part of the Code since 1962. Section 78 was enacted to achieve tax parity between U.S. corporations operating internationally through foreign branches vis-a-vis those operating through CFCs. Section 78 achieves this tax parity by "grossing up" a U.S. corporate CFC shareholder's dividends received by the amount of foreign taxes imposed on the foreign earnings and deemed paid and claimed by the U.S. corporate shareholder as a foreign tax credit under § 960. For example, if the U.S. corporate shareholder receives a dividend of $70 from a CFC and the CFC has paid $30 in foreign taxes for which the U.S. corporate shareholder claims a foreign tax credit under § 960, then, under § 78, the U.S. corporate shareholder would be treated as receiving a dividend of $100 ($70 + $30) and would claim a foreign tax credit of $30 against the corporation's U.S. tax liability.[10] In this example, § 78 treats the $30 of foreign tax deemed paid as a dividend received by the U.S. corporate shareholder. This gross-up of the dividend is designed to prevent the U.S. corporate shareholder from effectively obtaining both a deduction and a credit for foreign tax deemed paid. The deemed dividend under § 78, however, has never been eligible for the normal § 245 DRD and, except as applied in this case, was not supposed to be eligible for the § 245A DRD. (The normal § 245 DRD was not relevant to this case.) Specifically, before the TCJA, § 78 stated that the foreign taxes deemed paid by the U.S. corporate shareholder "shall be treated for purposes of this title (*other than section 245*) as a dividend received by such domestic corporation from the foreign corporation." *See* IRC § 78 (2016) (emphasis added). Therefore, in connection with enacting new § 245A, the TCJA amended the above-quoted parenthetical in § 78 to add a cross-reference to § 245A as follows: "(other than sections 245 *and 245A*)." *See* § 78 (2024) (emphasis added). Nonetheless amended § 78's effective date provision under the TCJA — and here's the big "*Oops*" at the crux of the case — states that the revised statute applies for "taxable years of foreign corporations beginning after December 31, 2017, and . . . taxable years of United States shareholders in which or with which such taxable years of foreign corporations end." TCJA § 14301(d), 131 Stat. at 2225. As noted above, then, § 245A applies to "distributions made after December 31, 2017." Thus, as Judge Toro put it in the Tax Court's opinion, the TCJA's mismatched effective date language left a narrow "gap" during which both § 78 and § 245A theoretically could apply to taxpayers with a fiscal year straddling the enactment of TCJA. 163 T.C. at ___. As a result, a U.S. corporation exploiting this gap could claim a foreign tax credit for foreign taxes actually paid by the foreign corporation paying the dividend (and deemed paid by the U.S. corporation receiving the dividend) and simultaneously deduct the dividend received. However, as discussed below, a corporation claiming a deduction under § 245A for the deemed dividend required by § 78 must reduce the amount of its foreign tax credit by virtue of § 245A(d)(1).

Treasury's Attempted "Gap" Fix. Treasury, the IRS, and Congress were well aware of this unintended "gap" in the TCJA's mismatched effective date language concerning §§ 78 and 245A. On January 2, 2019, the House Ways and Means Committee published a *Tax Technical and Clerical Corrections Act Discussion Draft* that would have retroactively closed the "gap" as of the enactment of the TCJA. The proposed fix, however, was never passed by Congress. Regardless, Treasury published on June 21, 2019, a revised, interpretative regulation under § 78 that disallowed the § 245A deduction for the deemed dividend engineered by § 78. The revised

[10] Stating the obvious, perhaps, we have greatly oversimplified the tax analysis pertaining to foreign tax credits and subpart F of the Code, including the deemed dividend, increase to taxable income, the § 245A DRD, and the tax parity achieved by § 78. Judge Toro's opinion, however, provides a helpful but also somewhat simplified illustration at 163 T.C. ___ -___. We commend it to readers curious about the interrelationship between subpart F, foreign tax credits, § 78, and § 245A.

regulation under § 78 purported to be retroactively effective to § 78 deemed dividends occurring on or after January 1, 2018, despite the contrary effective date language (as quoted above) in the TCJA regarding amended § 78. *See* Reg. 1.78-1 (stating in part and emphasis added: "A section 78 dividend is treated as a dividend for all purposes of the Code, except that it is not treated as a dividend for purposes of sections 245 *or 245A* . . . .").

The Arguments. Because the case has such narrow applicability regarding potentially affected taxpayers, we have minimized our discussion of the taxpayer's and the IRS's arguments regarding whether §§ 78 and 245A could apply to the taxpayer's 2018 fiscal tax year. Essentially, the taxpayer relied on the plain language of the statutes, including the TCJA effective date provisions, while the IRS was left to make the following unsuccessful "should be" arguments:

- § 245A should be read to apply, even for the "gap" period, only to dividends *actually* received rather than deemed § 78 dividends;
- § 275(a)(4) (disallowing a deduction for foreign or territorial taxes for which tax credits are claimed) and § 261 (referencing Code §§ 262 through 280H, which consist of a long list of prohibited deductions for specified items such as personal expenses, capital expenditures, entertainment expenses, etc.) should be read broadly (*somehow?*) to disallow the taxpayer's § 245A DRD for the "gap" period; and
- allowing a DRD under § 245A for a § 78 deemed dividend only within the "gap" period should be considered absurd and contrary to congressional policy and intent.

None of the foregoing arguments were found persuasive by the Tax Court. If you are incurably curious and must understand why the Tax Court rejected the above IRS arguments, read Judge Toro's opinion.

Here's the "Beef"—Impact of Loper Bright on Treasury Regulations. Finally, the IRS argued that Reg. § 1.78-1 (as cited and quoted above) closed the effective date "gap" retroactive to January 1, 2018. Judge Toro wrote in response to this argument:

> The rule adopted by the revised regulations essentially gives one of the TCJA's amendments to section 78 an earlier effective date than provided for in the TCJA to prevent taxpayers like Varian from deducting section 78 dividends. But, as we have already observed, the plain text of the statutes provides for the deduction. As the Supreme Court has said, "self-serving regulations never 'justify departing from the statute's clear text.'"

163 T.C. at ___. The IRS argued in response that its interpretation of §§ 78 and 245A, as reflected in Reg. § 1.78-1, nevertheless should be considered "permissible" and entitled to deference. 163 T.C. at ___. Judge Toro disagreed, though, based upon the U.S. Supreme Court's recent *Loper Bright* decision overturning so-called "*Chevron* deference" previously granted by the courts to administrative interpretations of statutes and promulgation of interpretative regulations. *See Loper Bright Enterprises v. Raimonda*, 603 U.S. ___ (2024), *overruling in part Chevron, U.S.A., Inc. v. Natural Resources Council, Inc.*, 467 U.S. 837 (1984). Instead, Judge Toro flatly refused to apply Reg. § 1.78-1 to close the "gap" against the taxpayer in this case, concluding:

> As the Supreme Court observed in *Loper Bright*, "statutes, no matter how impenetrable, do—in fact, must—have a single, best meaning. That is the whole point of having written statutes; 'every statute's meaning is fixed at the time of enactment.' And, in cases involving ambiguity, "instead of declaring a particular party's reading 'permissible' . . . , courts [must] use every tool at their disposal to determine the best reading of the statute and resolve the ambiguity." Put another way, "in an agency case as in any other . . . even if some judges might (or might not) consider the statute ambiguous, there is a best reading all the same—the reading the court would have reached if no agency were involved."

> In short, "[i]n the business of statutory interpretation, if it is not the best, it is not permissible." And, as we have shown above, the best (indeed the unambiguous) reading of the provisions at issue here permits [the taxpayer's] deduction.

163 T.C. at ___.

The IRS's Consolation Prize. Although the Tax Court rejected the IRS's arguments that § 245A should not apply to a § 78 deemed dividend arising within the "gap" period created by the TCJA's relevant effective date provisions, the Tax Court did embrace the IRS's argument relating to the determination of the taxpayer's allowed foreign tax credits. As mentioned above, the taxpayer claimed roughly $161 million in foreign tax credits for its 2018 tax year. The IRS's position was that, if the Tax Court determined the taxpayer could take the § 245A DRD attributable to the § 78 deemed dividend for its 2018 tax year, then the taxpayer's claimed foreign tax credits must be reduced under § 245A(d)(1). Section 245A(d)(1) provides: "No credit shall be allowed under section 901 [(foreign taxes)] for any taxes paid or accrued (or treated as paid or accrued) with respect to any dividend for which a deduction is allowed under this section." The taxpayer contended that § 245A(d)(1) was not relevant to a § 78 deemed dividend but was only meant to apply to foreign taxes paid *on* a dividend (whether actual or deemed). The taxpayer paid $0 foreign taxes "on" its § 78 deemed dividend for 2018. Judge Toro, however, was not persuaded by the taxpayer's argument. Instead, Judge Toro adopted the IRS's position that the phrase "with respect to" in § 245A(d)(1) should be read broadly to mean "concerning" or "related to," not simply "on." Therefore, because the taxpayer's § 78 deemed dividend unquestionably relates to the foreign tax credits claimed by the taxpayer, the § 245A(d)(1) limitation applies. Further, because the amount of the § 78 deemed dividend "represents the share of a foreign corporation's earnings that were paid out to a foreign country as tax," Judge Toro likewise adopted the IRS's proposed formula for calculating the § 245A(d)(1) disallowance of a portion of the taxpayer's otherwise allowable foreign tax credits for its 2018 tax year. The formula considers the taxpayer's § 78 deemed dividend and the taxpayer's § 965 subpart F income to reduce the taxpayers claimed § 901 foreign tax credits for its "gap"-controlled 2018 taxable year as follows:

$$\text{Disallowed Foreign Tax Credit} = \text{Deemed Paid Foreign Tax Credit} \times \left(\frac{\text{Section 78 gross-up}}{\text{Net section 965 inclusion + section 78 gross-up}}\right)$$

The same analysis would apply if a U.S. corporation included in income its share of subpart F income of a CFC under the general subpart F inclusion rule of § 951(a) rather than an amount calculated pursuant to the MRT of § 965.

Comment: Kudos if you have read the foregoing summary and fully appreciate the somewhat disguised significance of the Tax Court's recent decision in *Varian Medical Systems*. Query whether we will begin referring to the "*Varian* test" for Treasury regulations or the "*Varian* formula" where § 245A(d)(1) applies to "gap"-controlled taxable years of multinational corporate taxpayers. One author guesses that the *Varian* formula or some variation thereof will appear in future Treasury regulations interpreting § 245A(d)(1). Of course, the opportunity to apply § 245A, including subsection (d)(1), in the context of a § 78 deemed dividend is limited (at least according to the Tax Court) to those multinational U.S. corporate taxpayers with CFC subsidiaries claiming foreign tax credits within a fiscal taxable year that straddled the enactment of the TCJA. In any event, we strongly suspect other taxpayers will be emboldened by the Tax Court's pronouncement in *Varian Medical Systems* that interpretive (as opposed to legislative) Treasury regulations must satisfy the new *Loper Bright* "best interpretation" standard adopted by SCOTUS. *Let the games (a/k/a litigation) begin . . . .*

- The authors understand that other corporations with tax years that straddle the effective date of the TCJA are now examining their eligibility to deduct under § 245A the deemed

dividend required by § 78. For example, the Tax Court recently entered an order granting the motion for partial summary judgment filed by Sysco Corporation on the basis that the court's opinion in *Varian Medical* fully resolved Sysco's eligibility for a deduction under § 245A for the deemed dividend required by § 78. *Sysco Corporation v. Commissioner*, No. 5728-23 (9/13/24).

2. Cash grants to a corporation from the New York State were not nontaxable contributions to capital, were not gifts, and were not qualified disaster relief payments, and therefore were includible in gross income, says the Tax Court. CF Headquarters Corporation v. Commissioner, 164 T.C. No. 5 (3/4/25). In a unanimous, reviewed opinion by Judge Kerrigan, the Tax Court has held that cash grants received by a corporation from the State of New York were not nontaxable contributions to capital, were not gifts, and were not qualified disaster relief payments, and therefore were includible in gross income.

The taxpayer in this case is part of a group of corporations owned by Cantor Fitzgerald, L.P. (collectively, the Cantor Group). Prior to the September 11, 2001, terrorist attack on the World Trade Center, the Cantor Group occupied several floors in the north tower of the World Trade Center. Six hundred and fifty-eight of their approximately 1,000 employees were killed in the attack. Following the attack, the Cantor Group used other office space in Manhattan.

In response to the September 11 attack, the State of New York established certain grant programs under which cash proceeds were distributed to aid businesses that were adversely affected by the attacks. The Empire State Development Corporation (Empire State) established the World Trade Center Job Creation and Retention Program (the JCRP). Under the JCRP, grant proceeds were awarded to businesses that had incurred expenses after the September 11 attack in at least one of five eligible categories, including rent, and that committed to retain employees in New York City and specifically in lower Manhattan.

Empire State entered into a binding grant disbursement agreement that authorized a cash grant, the proceeds of which were to be used by the taxpayer solely for expenses in the five eligible categories incurred after September 11, 2001. In 2007, the taxpayer requested and received $3.1 million in distributions under the agreement as reimbursement for rent. The IRS contended that the taxpayer had to include these cash distributions in gross income under § 61. The taxpayer argued that the grant proceeds were excluded from gross income: (1) as a contribution to capital under § 118(a); (2) as a gift under §102(a); or (3) as a qualified disaster relief payment under § 139(a). The court disagreed with each of the taxpayer's three arguments.

Whether the grant proceeds qualified as a nonshareholder contribution to capital. During the year in question (2007), under § 118, any contribution, including a nonshareholder contribution, to the capital of a corporation was generally excluded from the corporation's gross income.[11] This exclusion, however, does not apply to any money transferred to a corporation in consideration for goods or services rendered. *See* Reg. § 1.118-1. Further, in determining whether a transfer qualifies as a tax-free contribution to capital, the transferor must intend that the transfer be a contribution to capital. *United States v. Chicago, Burlington & Quincy R.R. Co.*, 412 U.S. 401, 411 (1973). The Supreme Court's decision in *Chicago, Burlington & Quincy R.R.* established five characteristics of a nonshareholder contribution to capital. The first four of these characteristics have been interpreted by some courts to be requirements that all must be satisfied for a payment to constitute a contribution to capital. *See AT&T, Inc. v. United States*, 629 F.3d 505, 513 (5th Cir. 2011). The first of these characteristics is that the payment must become a permanent part of the recipient's working capital structure. In this case, the Tax Court relied on the Third Circuit's decision in *Commissioner v. BrokerTec Holdings, Inc.*, 967 F.3d 317 (3d Cir. 2020), *rev'g* T.C. Memo. 2019-

[11] The 2017 Tax Cuts and Jobs Act, § 13312, amended Code § 118 effective after December 22, 2017, to provide that nonshareholder contributions to the capital of corporations made by governmental entities or civic groups no longer are excludable from the recipient corporation's gross income. Accordingly, the result in this case would have been the same (but for a different reason) if the years involved had been subject to amended § 118.

32. In *BrokerTec*, the Third Circuit held that similar grant payments by the State of New Jersey's Economic Development Plan in response to the September 11 attack were not nontaxable, nonshareholder contributions to capital under § 118. The Third Circuit reasoned that a payment becomes a permanent part of the recipient's working capital structure only when the payment is "in some way … designated for use as capital—whether by an explicit restriction on the use of the funds, or by tying the amount of funds to the amount of a capital investment required of the company. The Third Circuit in *BrokerTec* held that the grant payments in that case were unrestricted, which indicated intent on the part of the grantor to provide income and not a capital contribution. 967 F.3d at 324. The taxpayer in this case attempted to distinguish *BrokerTec* on two grounds. First, unlike the JCRP, the New Jersey grant program in *BrokerTec* did not restrict how the taxpayer could use the cash. Second, the New Jersey grants in *BrokerTec* were based on income tax revenue that the new jobs would generate and that the JCRP had no such requirements. In disagreeing with these distinctions, the Tax Court emphasized that § 118 applies only where a transferor of grant funds intends to make a capital contribution. Evidence of such intent is reflected by the manner in which the funds are used by the recipient. For example, if the funds might be used for payment of dividends, operating expenses, capital charges, or any other purpose for which operating revenue might be used, it would not reflect an intent to make a capital contribution. Following *BrokerTec's* reasoning, the Tax Court held that the grants received by the taxpayer in this case were not linked to capital improvements and were not restricted to the use of capital assets. The Tax Court observed that the terms of the JCRP allowed a grantee to request payment of, or reimbursement for, eligible expenses in five categories, all tied to employment: (1) wages, (2) payroll taxes, (3) employee benefits, (4) rent, and (5) movable equipment and furniture. The Tax Court concluded that, like the taxpayer in *BrokerTec*, the taxpayer here received cash grants for creating jobs after the World Trade Center terrorist attacks. The amount of the grant was based on the number of full time employment positions created. Because the grant proceeds at issue were intended to reimburse petitioner for expenses it had already incurred and the proceeds could be used at the taxpayer's discretion, the grant proceeds were not intended to become part of the taxpayer's working capital. The Tax Court specifically concluded that the grant proceeds were distributed to reimburse the taxpayer for subcategory (2) of the JCRP relating to rents. In coming to this conclusion the Tax Court was not persuaded by the taxpayer's evidence at trial to the contrary that the payments were used for moveable equipment and furniture. Because the grant payments were found to be reimbursements for rent, the proceeds were not intended to become a permanent part of the recipient's working capital structure and were not contributions to capital.

Whether the grant proceeds were excludable gifts under § 102(a). The taxpayer also argued that the grant proceeds received under the JCRP were excludable from gross income as gifts. Section 102(a) provides that gross income does not include the value of property acquired by gift. In disagreeing with the taxpayer's argument, the Tax Court concluded that the evidence established that Empire State's motive for granting the funds was not detached, disinterested generosity as required under the Supreme Court's decision in *Commissioner v. Duberstein*, 363 U.S., 278, 285-86 (1960). Instead, Empire State's goals in making the grants to the taxpayer turned on how many jobs were created and maintained in Manhattan during the years after the terrorist attacks. The grants were found to be incentives to get something back for the State of New York. The Tax Court was persuaded that the grantors of the funds did not, therefore, possess the requisite donative intent to conclude that the grant proceeds were in the nature of a gift. The Tax Court additionally relied on the legislative history of the congressional authorization of the federal funding for the program, which emphasized "the tremendous human losses suffered by those businesses located in the World Trade Center, particularly those firms which suffered the greatest loss of life in the attacks" and indicated that the funds were meant "to support the redevelopment of the areas of New York City affected by the attacks …." H.R. Rep. No. 107-593, at 180 (2002) (Conf. Rep.), *reprinted in* 2002 U.S.C.C.A.N. 544, 613. Thus, reasoned the Tax Court, the congressional intent of the acts that provided the funding made it clear that the main objective of the JCRP was economic revitalization and not simply detached and disinterested generosity. Based on this

reasoning, the court found that the grants were not excludable from gross income as gifts under § 102(a).

Whether the grant proceeds were excludable as qualified disaster relief payments under § 139. The taxpayer also argued that the grant proceeds received under the JCRP were excludable from gross income under § 139 as qualified disaster relief payments. The court summarily rejected this argument because the exclusion of § 139 is available only to individuals.

Penalties. The Tax Court declined to uphold the imposition of accuracy-related penalties on the taxpayer because, in the court's view, the taxpayer had substantial authority for excluding the payments from gross income.

Conclusion. The court held that the taxpayer failed to establish that the grant proceeds were excludable under any statutory provision and were, therefore, includible in the taxpayer's gross income in 2007.

VII. PARTNERSHIPS

A. Formation and Taxable Years

B. Allocations of Distributive Share, Partnership Debt, and Outside Basis

1. ♫♪ A long, long time ago . . . I can still remember how [those proposed recourse debt allocation regs] used to make me smile. ♪♫ T.D. 10014, Recourse Partnership Liabilities and Related Party Rules, 89 F.R. 95108 (12/2/24). Perhaps anticipating a pending regulatory freeze under the new administration, Treasury and the IRS have finalized amendments to regulations under § 752 concerning partnership recourse liabilities. Proposed regulations were published way back in 2013. *See* REG-136982-12, 78 F.R. 76092 (12/16/13). The now-final amendments primarily make technical changes and corrections to existing regulations concerning the § 752 economic risk of loss analysis for allocating recourse debt among partners, including corresponding rules pertaining to tiered partnerships and related persons. The preamble to the newly-issued final regulations acknowledges Treasury's and the IRS's delay (and perhaps implicitly acknowledges the sudden urgency) in finalizing Reg. § 1.752-2, stating in part:

> The Treasury Department and the IRS are mindful that the proposed regulations were issued approximately eleven years ago. However, no intervening legislative changes regarding allocations of partnership liabilities have been made, no subsequent changes to regulatory rules concerning allocations of partnership liabilities address the issues in the proposed regulations, and the issues raised by the commenters continue to remain relevant. For these reasons, the Treasury Department and the IRS have determined that a new notice of proposed rulemaking or a further opportunity for public comment would be unlikely to generate different comments. *Furthermore, issuing the same rules again as a notice of proposed rulemaking would unnecessarily delay further this rulemaking to the continued detriment of taxpayers desiring to apply these rules to allocate their partnership liabilities*.

89 F.R. at 95109 (emphasis added).

Brief background. Generally, of course, subchapter K requires partnerships and partners to take into account liabilities in determining outside basis and for certain other purposes. For instance, § 752 operates in tandem with §§ 722 and 733 to adjust a partner's outside basis up or down, respectively, for an increase or decrease, respectively, in the partner's share of partnership liabilities. Reg. § 1.752-1(a)(4) defines liabilities for this purpose in existing Reg. § 1.752-1(a)(4) as obligations that (i) create or increase the basis of any of the obligor's assets (including cash); (ii) give rise to an immediate deduction to the obligor; or (iii) give rise to an expense that is not deductible in computing the obligor's taxable income and is not properly chargeable to capital. Traditional bank debt is a classic "liability" that partnerships and partners must take into account for outside basis and other purposes under subchapter K. Furthermore, a partner's share of a

partnership's liabilities under subchapter K depends upon whether the liability is recourse or nonrecourse for federal income tax purposes. A "recourse" liability is one for which any partner or "related person" (as defined) bears an "economic risk of loss" ("EROL," as defined), while a "nonrecourse" liability is one for which no partner or "related person" (as defined) bears an EROL. *See* Reg. § 1.752-1(a)(1) & (2).

Final regulations. The final regulations reiterate the general rule (as discussed above) in the existing regulations: "[a] partner's share of recourse partnership liability equals the portion of that liability, if any, for which the partner or related person bears the economic risk of loss." Reg. § 1.752-2(a)(1). In other respects, the final regulations make only a few changes from the proposed regulations. The modifications in the final regulations are highly technical, responding to comments from only two practitioners. At face value, the modifications appear to be taxpayer-favorable (or at least taxpayer-neutral). We summarize below the most consequential—in our opinion—aspects of the final regulations: (i) correcting an oversight in the proposed regulations by listing in one section of the final regulations those situations where a person directly bears the EROL [Reg. § 1.752-2(a)(3)]; (ii) resolving overlapping EROL among multiple partners [Reg. § 1.752-2(a)(2)]; and (iii) providing a new ordering rule clarifying how the "proportionality rule" (discussed below) interacts with the multiple partner rule and related partner exception [Reg. § 1.752-4(e)]. The final regulations, like the proposed regulations, also provide guidance for determining EROL in tiered partnership structures (see Reg. § 1.752-2(i)) and in circumstances where partners are related to a lender or other person (or deemed not related à la *IPO II v. Commissioner*, 122 T.C. 295 (2004), due to the exception in Reg. § 1.752-4(b)(2)); however, we leave the detailed examination of those aspects of the regulations to our readers' discretion.

Reg. § 1.752-2(a)(3) comprehensive listing of situations where a person directly bears the EROL. As noted above, the final regulations correct what Treasury describes as an "oversight" in the proposed regulations by listing in one section the circumstances under which a person directly bears the EROL. Specifically, new Reg. § 1.752-2(a)(3) provides as follows to identify and define EROL for partnership recourse liabilities:

> For purposes of this section and § 1.752-4, a person directly bears the economic risk of loss for a partnership liability if that person has a payment obligation under [existing Reg. § 1.752–2(b)] (except as provided in [existing Reg. § 1.752–2(d)(2), de minimis exception] for certain partner guarantees), is a lender as provided in [existing § 1.752–2(c) (except as provided in [existing Reg. § 1.752–2(d)(1), de minimis exception] for certain partner loans), guarantees payment of interest on a partnership nonrecourse liability as described in [existing Reg. § 1.752–2(e)], or pledges property as a security as provided in [existing Reg. § 1.752–2(h)].

Reg. § 1.752-2(a)(2) regarding overlapping EROL. Suppose partners bear overlapping EROL with respect to the same recourse liability. In that case, the final regulations (like the proposed regulations) take the liability into account only once, and if the total amount of EROL borne by the partners exceeds the total amount of the liability, the final regulations use the following formula to determine the share of such liability allocated to each partner for purposes of subchapter K: multiply (i) the total amount of the recourse liability by (ii) a fraction determined by dividing (a) the amount of a partner's EROL by (b) the sum of EROL borne by all partners.

> **Example:** A and B are unrelated equal members of limited liability company, AB. AB is treated as a partnership for Federal tax purposes. AB borrows $1,000 from Bank. A guarantees payment for the entire amount of AB's $1,000 liability, and B guarantees payment of up to $500 of the liability, if any amount of the full $1,000 liability is not recovered by Bank. Under [existing Reg. § 1.752-2(b)(1)], A bears $1,000 of economic risk of loss for AB's liability, and B bears $500 of economic risk of loss for AB's liability. A and B have not entered into a loss-sharing agreement addressing their status as co-guarantors, and local law does not clearly establish responsibility as between them for the liability. Because the aggregate

> amount of A's and B's economic risk of loss under [amended Reg. § 1.752-2(a)(1)] ($1,500) exceeds the amount of AB's liability ($1,000), the economic risk of loss borne by each of A and B is determined under [amended Reg. § 1.752-2(a)(2)]. Under [amended Reg. § 1.752-2(a)(2)], A's economic risk of loss equals $1,000 multiplied by $1,000/$1,500, or $667, and B's economic risk of loss equals $1,000 multiplied by $500/$1,500, or $333. *See* Reg. 1.752-2(f) Ex. 9.

Reg. § 1.752-4(e) ordering rule. Before amendments made by the final regulations, the proposed regulations under § 752 were unclear regarding the order in which the numerous rules therein apply to allocate liabilities for related and unrelated parties. In particular, the proportionality rule in Prop. Reg. § 1.752-2(a) addressed when partners have overlapping EROL, the related partner exception in Prop. Reg. § 1.752-4(b)(2) described when partners with direct EROL are not treated as related to other partners, and the multiple partner rule in Prop. Reg. § 1.752-4(b)(3) provided how EROL is shared when multiple partners are related to a person who is a lender or has a payment obligation. Treasury agreed with one commenter that the interaction of these rules was confusing. Accordingly, new Reg. § 1.752-4(e) provides a three-step ordering rule. The first step is to determine whether any partner (direct or indirect) directly bears the EROL (under amended Reg. § 1.752-2(a)(3)) for the partnership liability and then apply the related partner exception in Reg. § 1.752-4(b)(2) (which treats partners as unrelated in certain circumstances). After applying the related partner exception (if relevant), the next step is to determine the amount of EROL each partner is considered to bear under Reg. § 1.752-4(b)(3) when multiple partners are related to a person that directly bears the EROL for a partnership liability. The final step is to apply the proportionality rule in Reg. § 1.752-2(a)(2) to determine the amount of EROL that each partner is considered to bear when the amount of EROL that multiple partners bear exceeds the amount of the partnership liability. Reg. § 1.752-4(f) contains a helpful example illustrating the application of the new ordering rules.

Effective dates. Generally, the amendments made by the final regulations are effective as of the date of publication in the federal register (12/2/24). Commenters, though, had concerns, desiring under certain circumstances to apply the final regulations to pre-existing recourse liabilities and, in other circumstances, to grandfather modified or refinanced recourse debt under pre-amendment regulations. Treasury accommodated these commenters' concerns, providing a somewhat complicated effective date provision for pre-existing, modified, or refinanced recourse liabilities in Reg. § 1.752-5(a) (which, again, we leave to our readers' discretion).

C. Distributions and Transactions Between the Partnership and Partners

1. Is the Code provision on disguised sales of partnership interests self-executing? Now it is. Congress clarified this in the 2025 One Big Beautiful Bill Act. The 2025 One Big Beautiful Bill Act, § 70602, amended Code § 707(a)(2) to clarify that the provision is self-executing and does not depend on the issuance of regulations to be effective. Section 707(a)(2)(B) treats a partner's contribution of money or property to a partnership and a related transfer of money or property by the partnership to the partner (or another partner) as either a disguised sale of property or a disguised sale of a partnership interest.

Background. Prior to 1984, the government had unsuccessfully asserted in several cases that a partner's contribution of appreciated property or money to the partnership, followed by the partnership's distribution of money to that partner or another partner, were in substance disguised sales of property or an interest in the partnership. The courts rejected the government's argument that these transactions were subject to the general rules of the Code that apply to sales, rather than the more favorable rules of subchapter K that govern contributions to and distributions from partnerships.[12] *See Otey v. Comm'r*, 70 T.C. 312, 321-22 (1978) (alleged disguised sale of property

[12] The government supported its argument by referring to two Treasury Regulations, both of which still contain the provisions on which the government relied. The first states that a partner's sale of property to a partnership will be treated as a sale rather than a tax-free contribution of the property, and that "[i]n all cases, the substance of the

by partner), *aff'd*, 634 F.2d 1046 (6th Cir. 1980) (per curiam); *Communications Satellite Corp. v. United States*, 625 F.2d 997, 1000-01 (Ct. Cl. 1980) (alleged disguised sale of partnership interest by partner); *Jupiter Corp. v. United States*, 2 Cl. Ct. 58, 78-82 (1983) (alleged disguised sale of partnership interest). As part of the Deficit Reduction Act of 1984, Congress enacted § 707(a)(2)(B), which provided that, "[u]nder regulations prescribed by the Secretary,"

> "If—
>
> (i) there is a direct or indirect transfer of money or other property by a partner to a partnership,
>
> (ii) there is a related direct or indirect transfer of money or other property by the partnership to such partner (or another partner),
>
> (iii) and the transfers described in clauses (i) and (ii), when viewed together, are properly characterized as a sale or exchange of property,
>
> such transfers shall be treated either as a transaction [between the partnership and one who is not a partner] or as a transaction between 2 or more partners acting other than in their capacity as members of the partnership."

In the legislative history accompanying § 707(a)(2)(B), Congress specifically disapproved of the results in *Otey*, *Communications Satellite Corp*. and *Jupiter Corp.*, *supra*. The reports accompanying the legislation indicated that taxpayers had "deferred or avoided tax on sales of property (including partnership interests) by characterizing sales as contributions of property (including money) followed (or preceded) by a related partnership distribution." S. Prt. No. 169, 98th Cong., 2d Sess. (1984); *see also* H.R. Rep. No. 432, 98th Cong., 2d Sess. 1218 (1984).

Regulations on disguised sales of property. Pursuant to § 707(a)(2)(B), Treasury issued final regulations on disguised sales of *property* to and by a partnership. *See* Reg. §§ 1.707-3 through 1.707-9. These regulations do not address disguised sales of partnership interests.

Guidance on disguised sales of partnership interests. In 2001, the Service announced that it was considering issuing proposed regulations under § 707(a)(2)(B) regarding disguised sales of partnership interests, and asked for comments on the scope and substance of the proposed regulations. I.R.S. Notice 2001-64, 2001-2 C.B. 16. Proposed regulations on disguised sales of partnership interests were issued in 2004. See REG-149519-03 69 F.R. 68838 (11/26/04). After studying the comments on the proposed regulations, the IRS withdrew the proposed regulations in 2009 and stated that it would continue to study the area and might issue guidance in the future. *See* REG-149519-03, Withdrawal of notice of proposed rulemaking, 74 F.R. 3508 (01/21/09).

Is § 707(a)(2)(B) self-executing? Section 707(a)(2)(B) provides that certain transactions can be treated as disguised sales of partnership interests "*[u]nder regulations prescribed by the Secretary*." Although the government had not yet issued regulations on point, it took the position in three written determinations that it could recharacterize specific transactions as disguised sales of partnership interests. I.R.S. Field Serv. Adv. 200024001 (Feb. 8, 2000); I.R.S. Tech. Adv. Mem. 200037005 (May 18, 2000); ILM 200250013 (Aug. 30, 2002). Further, when it withdrew the proposed regulations on disguised sales of partnership interests, the Service stated:

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transaction will govern rather than its form." *See* Treas. Reg. § 1.721-1(a). The second provides that § 731, which governs distributions by a partnership, may not apply if there is a contribution of property to a partnership and, within a short period, "(i) [b]efore or after such contribution other property is distributed to the contributing partner and the contributed property is retained by the partnership, or (ii) [a]fter such contribution the contributed property is distributed to another partner." Reg. § 1.731-1(c)(3). This same regulation further provides that "[s]ection 731 does not apply to a distribution of property if, in fact, the distribution was made to effect an exchange of property between two or more of the partners or between the partnership and a partner. Such a transaction shall be treated as an exchange of property." *Id*.

> Until new guidance is issued, any determination of whether transfers between a partner or partners and a partnership is a transfer of a partnership interest will be based on the statutory language, guidance provided in legislative history, and case law.

Thus, the government's view is that § 707(a)(2) is self-executing and does not depend on the issuance of regulations. Some practitioners, however, have taken the contrary position and asserted that § 707(a)(2) is not effective without implementing regulations. *See* Miles Johnson, Greg Leiserson, and Thalia Spinrad, *Clarity for Disguised Sales of Partnership Interests*, 187 Tax Notes 1917 (6/9/25) (discussing the opposing views).

Change made by the OBBA. The 2025 One Big Beautiful Bill Act, § 70602, amended Code § 707(a)(2) by striking the words "Under regulations prescribed" and replacing them with "Except as provided." Thus, the statute now reads "Except as provided by the Secretary …" This change makes clear that the statute is self-executing. The amendment applies to services performed and property transferred after the date of enactment (July 4, 2025). Further, the legislation provides that nothing in the amendment is to be construed to create any inference regarding the proper treatment under § 707(a) of payments from a partnership to a partner for services performed or property transferred before the date of enactment. In other words, the legislation provides that the amendment should not be construed as implying that § 707(a)(2) was not self-executing before the change.

D. Sales of Partnership Interests, Liquidations and Mergers

E. Inside Basis Adjustments

1. Channeling one-hit-wonder Meghan Trainor, Treasury and IRS sing ♪♫"I'm all about that bas[is], no treble"♫♪ -- especially for "overlooked" partnerships and partners "exploiting" inside/outside basis adjustments (a/k/a "tax technology"???). To understand the recent developments discussed immediately below, some deeper background is necessary regarding basis adjustments allowed by subchapter K. Normally under subchapter K, the aggregate basis of the partners of a partnership in their partnership interests ("outside basis") equals the partnership's aggregate basis in the assets held inside the partnership ("inside basis"). This typical inside/outside basis equilibrium is one of the hallmarks of "flow-through taxation" reflected in subchapter K. Knowledgeable readers know, though, that even if a partnership's aggregate outside basis equals aggregate inside basis, a partnership may have certain assets with a high basis relative to their fair market value and other assets with a low basis relative to their fair market value. Generally, such assets can be distributed in-kind to partners without the partnership or the partners recognizing gain or loss. *See* § 731. Carefully planning and targeting such in-kind distributions to partners with a relatively high or low outside basis compared to the asset's fair market value can have federal income tax advantages. These advantages include increased cost recovery deductions or, upon disposition of an asset, reduced sale or exchange gain or increased sale or exchange loss. Further, under certain circumstances, the usual partnership inside/outside basis equilibrium does not hold true. For example, the death of a partner and the resulting basis step-up in the decedent's partnership interest under § 1014(a)(1) often creates an inside/outside basis disparity. A transfer of an interest in a partnership also can result in an inside/outside basis disparity—because the buyer of a partnership interest obtains a cost basis, but (absent an election under § 754) the transfer does not alter the partnership's inside basis in its assets. *See* § 743. Moreover, a current or liquidating in-kind distribution of partnership property may result in an inside/outside basis disparity under § 732(a), (b), or (c). Inside/outside basis disparities created upon partner contributions of property to partnerships (including upon formation) are somewhat rare, but nevertheless possible. *See* §§ 731(a); 732(a), (b), (d); 733; 734; 743. An optional election under § 754 (adjustment to basis of partnership property), coupled with the application of § 755 (rules for allocation of basis), can rectify these inside/outside basis disparities when it is beneficial from a federal income tax standpoint to do so. The inside/outside basis disparities are (*imperfectly?*) rectified via adjustments to the basis of distributed property, partnership property,

or both. *See* §§ 734(b); 743(b); 754; 755. Of course, clever taxpayers, especially related parties, tax-indifferent parties, or parties with a common economic interest, can obtain significant federal income tax advantages (such as increased cost recovery deductions, reduced gain, or increased loss) by manipulating the inside/outside basis adjustment rules of subchapter K. For instance, an in-kind distribution of partnership property to a partner by a partnership with a § 754 election in effect, or with respect to which there is a "substantial basis reduction" (as described in § 734(d)), may result in an adjustment to the basis of the partnership's remaining property under § 734(b). A transfer of a partnership interest in a sale or exchange (or upon the death of a partner) where a § 754 election is in effect, or with respect to which there is a "substantial built-in loss" (as described in § 743(d)(1)), may result in an adjustment to the basis of partnership property under § 743(b) with respect to the transferee partner. These longstanding basis adjustment rules under subchapter K are well-accepted (albeit complicated), but at least according to Treasury and the IRS, are subject to abuse, especially where taxpayer-partners are not bargaining at arm's length.

a. Treasury and IRS plan to audit more partnerships and challenge "basis-shifting" transactions. IRS News Release 2024-166 (6/17/2024); IRS Fact Sheet 2024-21 (6/17/24); Notice 2024-54, 2024-28 I.R.B. 24 (6/17/24); Rev. Rul. 2024-14, 2024-28 I.R.B. 18 (6/17/24); T.D. 10028, Certain Partnership Related-Party Basis Adjustment Transactions as Transactions of Interest, 90 F.R. 2958 (1/14/25). Treasury and the IRS have finalized proposed regulations regarding related-party basis adjustments as transactions of interest. *See* REG-124593-23, Certain Partnership Related-Party Basis Adjustment Transactions as Transactions of Interest, 89 F.R. 51476 (6/17/24). Apparently, Treasury and the IRS have been hard at work understanding and combatting "carefully structured" partnership transactions that "exploit the [above-described] mechanical basis-adjustment provisions of subchapter K to produce significant tax benefits." *See* Notice 2024-54, § 3.04. According to the IRS, "these transactions may employ several steps over a period of years and use sophisticated tax technology to ensure that little or no tax is paid while large amounts of tax basis is 'stripped' from certain assets and shifted to other assets to generate tax benefits," thereby allowing "increased depreciation deductions or reduced gain on the sale of an asset with little or no substantive economic consequence." *See* IRS Fact Sheet 2024-21 cited above. In connection with issuing the new guidance, IRS Commissioner Werfel stated: "This announcement signals the IRS is accelerating our work in the partnership arena, which has been overlooked for more than a decade and allowed tax abuse to go on for far too long. We are building teams and adding expertise inside the agency so we can reverse long-term compliance declines that have allowed high-income taxpayers and corporations to hide behind complexity to avoid paying taxes. Billions are at stake here." *See* IRS News Release 2024-166 cited above. The new guidance issued by Treasury and the IRS, with more coming soon in the form of proposed regulations, is summarized below. Of course, with a new administration taking over in January 2025, we cannot be certain that any such proposed new guidance ultimately will be published and finalized.

b. Soon-to-be-issued proposed regulations regarding (i) related-party basis adjustments under subchapter K and (ii) basis-shifting among partner-members of a consolidated group. Notice 2024-54, 2024-28 I.R.B. 24 (6/17/24). This notice announces that Treasury and the IRS intend to publish two sets of proposed regulations addressing certain "basis-shifting" transactions concerning partnerships and related parties. The arrangements targeted by Notice 2024-54 ("covered transactions") involve increases to the basis of property by partnerships and partners under §§ 732 (basis of distributed property other than money), 734(b) (special adjustment to basis of undistributed partnership property), or 743(b) (special basis adjustments relating to transfers of partnership interests). The first set of regulations ("Related-Party Basis Adjustments" or "RPBA"), to be issued under the authority of §§ 482, 732, 734(b), 743(b), 755, and 7805, will create special rules concerning cost recovery deductions attributable to "covered transactions." The RPBA regulations will implement mechanical rules applicable to all "covered transactions" without regard to the taxpayer's intent or whether the transactions could be considered abusive or lacking in economic substance. (See the further discussion below regarding

Rev. Rul. 2024-14 and the application of the economic substance doctrine.) The second set of regulations, to be issued under the authority of the consolidated return provisions of §§ 1501 and 1502, will apply a "single-entity approach" to interests in a partnership held by members of a consolidated group. This "single-entity approach" will be designed to prevent direct or indirect basis shifts from "covered transactions" among the partner members of the consolidated group. The to-be-published proposed regulations previewed in Notice 2024-54 potentially could have retroactive effect, applying to taxable years ending on or after June 17, 2024. Further, Notice 2024-54 states that the regulations, once finalized, will "govern the availability and amount of cost recovery deductions and gain or loss calculations for taxable years ending on or after June 17, 2024, even if the relevant 'covered transaction' was completed in a prior year. The potential retroactive effect of the proposed regulations previewed by Notice 2024-54 has engendered strong objections from some commentators. For further analysis of Notice 2024-54, see New York State Bar Association Tax Section, Report on Proposed Regulations Regarding Partnership Basis Adjustments and Application of Notice 2024-54 to Previously Effected Transactions, Report #1498 (Aug. 16, 2024).

c. Meanwhile, as we anxiously await the RPBA regulations under subchapter K and the "single-entity approach" regulations for consolidated groups, exactly what types of partnership transactions are now "transactions of interest" potentially subject to heightened disclosure rules and penalties? T.D. 10028, Certain Partnership Related-Party Basis Adjustment Transactions as Transactions of Interest, 90 F.R. 2958 (1/14/25). Distinct from the soon-to-be-issued RPBA and consolidated return regulations mentioned above, Treasury and IRS have finalized proposed regulations under § 6011 concerning partnership basis adjustment transactions identified as "reportable transactions."[13] Taxpayers participating in "reportable transactions" are required to file special disclosures with the IRS. *See also Form 8886, Reportable Transaction Disclosure Statement*. Material advisors (as defined) to such participating taxpayers also are subject to special disclosure and list maintenance requirements under §§ 6111(a) and 6012(a). *See also Form 8918, Material Advisor Disclosure Statement*. In addition, affected taxpayers and their material advisors are potentially subject to enhanced penalties for failure to properly disclose, and for participating in, such transactions. See §§ 6662A; 6707; 6707A; 6708. New Reg. § 1.6011-18 identifies certain related-party basis adjustment transactions as "transactions of interest" ("TOI") a type of "reportable transaction," subject to these heightened disclosure and penalty rules.

Overall, the final regulations are more narrowly tailored than the proposed regulations, thereby targeting partnership basis adjustment transactions that have a high potential for tax avoidance (at least according to Treasury and the IRS). The most significant differences from the proposed regulations are as follows:

- *Increased Threshold Amount for Reporting*: The proposed regulations included a $5 million minimum threshold requirement for reporting. The final regulations increase this amount to $10 million for TOIs on or after the effective date of the regulations (1/14/2025) and $25 million for TOIs occurring within a six-year lookback period from January 1, 2025. The final regulations also clarify that the $10 million/$25 threshold in a "basis-stripping" § 734(b) transaction—see below—is measured solely by the aggregate increase

[13] *See* REG-124593-23, Certain Partnership Related-Party Basis Adjustment Transactions as Transactions of Interest, 89 F.R. 51476 (6/17/24). For extensive analysis of the proposed regulations, see New York State Bar Association Tax Section, Report on Proposed Regulations Regarding Partnership Basis Adjustments and Application of Notice 2024-54 to Previously Effected Transactions, Report #1498 (Aug. 16, 2024). The proposed regulations prompted many practitioner comments, and the IRS responded with final regulations that incorporated some of those practitioner concerns. *See* T.D. 10028, Certain Partnership Related-Party Basis Adjustment Transactions as Transactions of Interest, 90 F.R. 2958 (1/14/2025). The final regulations are set forth in new Reg. § 1.6011-18, effective January 14, 2025 (the date of publication in the Federal Register).

in the shares of inside basis enjoyed by the continuing partners who are related to the distributee partner. Similarly, for a partner "basis boosting" liquidating distribution under § 732(b)—see below—the $10 million/$25 threshold is measured by the increase in basis to the distributee partner net of basis decreases suffered by unrelated partners (other than "tax indifferent"—see below—partners).

- *Relatedness Standard*: Generally, parties are considered related for purposes of the TOI regulations if they have a relationship described in §§ 267(b) (without regard to the attribution rules of § 267(c)(3)) or § 707(b)(1). Accordingly, related parties under Reg. § 1.6011-18 include the following: members of a person's family (siblings, spouse, ancestors, lineal descendants); certain trust grantors, fiduciaries, and beneficiaries; certain estates, executors, and beneficiaries; and more-than-50-percent-controlled corporations and partnerships. The proposed TOI regulations defined "related partners" broadly, including both directly and indirectly related partners. The final regulations narrow the "relatedness standard" to include only directly related partners for partnership basis-adjustment TOIs.
- *Substantially Similar Transactions*: The proposed regulations treated a partnership basis-adjustment TOI involving a "tax-indifferent party" as substantially similar to a related-party TOI. A "tax indifferent party" includes a person (other than a partnership or S corporation) that "is either not liable for Federal income tax by reason of the person's tax-exempt or, in certain cases, foreign status," but also may include a person who is not liable for federal income tax due to tax attributes unique to the person (such as a net operating loss carryforward or capital loss carryforward). The final regulations retain this approach but include a knowledge qualifier, so that a counter-party to a TOI must either know or have reason to know that a partner is a tax-indifferent party.
- *Subsequent Realization of Tax Benefit Rule*: The proposed regulations provided that a participating partnership, participating partner, or related subsequent transferee engaged in a TOI in any taxable year in which its tax return reflected the consequences of a prior year's basis increase, regardless of how long ago such basis increase occurred. The final regulations limit the application of this rule to TOIs occurring within the six-year lookback period.

According to Treasury and the IRS, the above-mentioned changes from the proposed regulations, especially the increase in the threshold amount, are expected to limit the application of the new TOI regulations (i.e., Reg. § 1.6011-18) to less than one percent of all partnerships filing returns for any given tax year. (**Note:** Recall, though that the proposed regulations previewed by Notice 2024-54 and mentioned further above will implement mechanical cost recovery rules applicable to all partnership basis-adjustment "covered transactions," even those not TOIs.)

d. The IRS will not be shy about applying the economic substance doctrine to related-party basis adjustment transactions involving consolidated group partnerships and partners. Rev. Rul. 2024-14, 2024-28 I.R.B. 18 (6/17/24). This revenue ruling clarifies that the IRS may apply the "economic substance doctrine" of § 7701(o) to disallow tax benefits (such as increased cost recovery deductions, reduced gain, or increased loss) arising from related-party partnerships taking advantage of inside and outside basis adjustments (particularly in the consolidated return context). Recall that § 7701(o)(5)(A) defines the economic substance doctrine as "the common law doctrine under which tax benefits . . . with respect to a transaction are not allowable if the transaction does not have economic substance or lacks a business purpose." Further recall that § 7701(o)(1) generally treats a transaction as having economic substance only if "(A) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and (B) the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction." Achieving a financial accounting benefit is not considered a valid "purpose" (within the meaning of § 7701(o)) if the origin of such financial accounting benefit is a reduction of Federal income tax. *See* § 7701(o)(4). Under § 7701(o)(5)(D),

a "transaction" (within the meaning of § 7701(o)) includes a series of transactions. Finally, § 7701(o)(2)(A) provides that if a taxpayer relies on profit potential to prove a transaction has economic substance, the potential profit will be considered probative "only if the present value of the reasonably expected pre-tax profit of the transaction is substantial in relation to the present value of the expected net tax benefits" otherwise allowable. Rev. Rul. 2024-14 describes three different scenarios in the consolidated return context in which partnerships owned and controlled by members of the consolidated group either make (i) liquidating distributions of property under § 732(b) or (ii) engage in contributions or distributions (via partnerships with selective § 754 elections in effect) to obtain basis adjustments in contributed or distributed property under §§ 734(b) or 743(b). The corresponding basis adjustments to property held within the consolidated group provide enhanced tax benefits (i.e., increased cost recovery deductions, reduced gain, or increased loss) to the group. Importantly, however, Rev. Rul. 2024-14 stipulates two critical facts in this regard: (1) previous "contributions, distributions, and allocations" to partnerships held within the consolidated group "were undertaken intentionally with a view to creating" future inside/outside basis adjustments and (2) the purported financial "cost savings" (i.e., profit potential) from subsequent in-kind partnership contributions and distributions vis-à-vis the consolidated group members are "insubstantial in relation to the reduction in the aggregate Federal income liability" of the group. *Talk about loading the dice!* Rev. Rul. 2024-14 then unsurprisingly concludes that all three "basis shifting" scenarios lack economic substance, thereby allowing the IRS to disallow any enhanced tax benefits claimed by the consolidated group as a result of the transactions.

e. In the words of SNL's Emily Litella (Gilda Radner), "Ohhhh, that's very different. Never mind." Notice 2025-23, 2025-19 I.R.B. 1428 (4/14/25). This notice announces Treasury's and the IRS's intention that final regulations regarding the identification of certain partnership related-party basis adjustment transactions as transactions of interest will be withdrawn via forthcoming proposed and final regulations. See REG-124593-23, Certain Partnership Related-Party Basis Adjustment Transactions as Transactions of Interest, 89 F.R. 51476 (6/17/24), discussed above. Taxpayers and material advisors may rely on the notice for relief from applicable penalties for failure to file any otherwise required disclosure statements. In addition, Notice 2025-23 revokes Notice 2024-54, which announced forthcoming proposed regulations that would provide substantive technical rules to discourage basis shifting among related partners. See Notice 2024-54, 2024-28 I.R.B. 24 (6/17/24), also discussed above. Interestingly, however, the notice makes no mention of Rev. Rul. 2024-14, 2024-28 I.R.B. 18 (6/17/24). This revenue ruling, which also is discussed above, clarifies that the IRS may apply the "economic substance doctrine" of § 7701(o) to disallow tax benefits (such as increased cost recovery deductions, reduced gain, or increased loss) arising from related-party partnerships taking advantage of inside and outside basis adjustments (particularly in the consolidated return context). Notice 2025-23 was published as a direct result of Executive Order 14219, Ensuring Lawful Governance and Implementing the President's "Department of Government Efficiency" Deregulatory Initiative (2/19/25).

F. Partnership Audit Rules

G. Miscellaneous

1. Hot penalty relief for "hot asset" reporting by partnerships with respect to 2024 § 751(a) exchanges. Notice 2025-2, 2025-3 I.R.B. 418 (12/13/24). This notice announces penalty relief under § 6722 (failure to furnish correct payee statements) for partnerships that missed the January 31, 2025, deadline for providing a copy of the recently revised IRS Form 8308 (Report of a Sale or Exchange of Certain Partnership Interests) to the transferor and transferee of a "751(a) exchange" occurring during calendar year 2024. Form 8308 is required to be filed as an attachment to a partnership's Form 1065 (U.S. Return of Partnership Income) for the taxable year of the partnership that includes the last day of the calendar year in which the "§ 751(a) exchange" took place. Form 8308 is due at the time for filing the partnership return, *including extensions*;

however, Form 8308 was revised in October of 2023, and new Part IV of Form 8308 requires a partnership to report, among other items, the partnership's and the transferor partner's share of § 751 gain and loss, collectibles gain under § 1(h)(5), and unrecaptured § 1250 gain under § 1(h)(6). The newly released Part IV of Form 8308 prompted concerns from tax advisors that the affected partnerships might not have the information required by Part IV of Form 8308 by the January 31 due date. These concerns resulted in the penalty relief announced in Notice 2025-2. Previously, the IRS announced similar penalty relief for partnerships that failed to timely provide a copy of Form 8308 for sales of partnership interests that occurred in 2023. See Notice 2024-19, 2024-5 I.R.B. 627 (1/11/24).

By way of background, a "751(a) exchange" within the meaning of the notice is defined as "a sale or exchange of an interest in the partnership (or portion thereof) in which any money or other property received by a transferor from a transferee in exchange for all or part of the transferor's interest in the partnership is attributable to § 751 property." As readers undoubtedly know, § 751 property of a partnership consists of so-called "hot assets" -- unrealized receivables or inventory items described in § 751(a). Code § 6050K and Reg. § 1.6050K-1 generally require a partnership with § 751 property to provide information to each transferor and transferee of a sale or exchange of an interest in the partnership (or portion thereof). The required information is contained in a properly completed IRS Form 8308, including Part IV thereof, which ordinarily should be attached to the partnership's Form 1065 for the year of the 751(a) exchange. Reg. § 1.6050K-1(c)(1) further provides that each partnership required to file a Form 8308 must furnish a statement to the transferor and transferee by the later of (a) January 31 of the year following the calendar year in which the § 751(a) exchange occurred, or (b) 30 days after the partnership has received notice of the exchange as specified under Code § 6050K and Reg. § 1.6050K-1. A partnership must use a copy of the completed Form 8308 as the required statement unless the Form 8308 contains information for more than one § 751(a) exchange. Reg. § 1.6050K-1(c)(1) provides that if the partnership does not use a copy of the Form 8308 as the required statement, the partnership must furnish a statement that includes the information required to be shown on the Form 8308 with respect to the § 751(a) exchange to which the person to whom the statement is furnished is a party. Subject to a reasonable cause exception in § 6724, Code § 6722 imposes a penalty for failure to furnish correct payee statements on or before the required date, and for any failure to include the information required to be shown on the statement or the inclusion of incorrect information. For this purpose, "payee statements" include statements required to be furnished to transferors and transferees under § 6050K. *See* § 6724(d)(2)(P). The penalty relief from § 6722 announced in Notice 2025-2 is subject to certain conditions as follows:

- The relief only applies to failure to timely furnish a copy of the Form 8308 (or the required information contained therein) to the transferor and transferee as required by § 6722. The notice does not provide penalty relief under § 6721 for failure to timely file Form 8308 as an attachment to a partnership's Form 1065.
- The relief applies solely for failure to furnish Form 8308 with a completed Part IV by the due date specified in Reg. § 1.6050K-1(c)(1) for a partnership that
    1. timely and correctly furnishes to the transferor and transferee a copy of Parts I, II, and III of Form 8308, or a statement that includes the same information, by the later of (a) January 31, 2025, or (b) 30 days after the partnership is notified of the § 751(a) exchange, and
    2. furnishes to the transferor and transferee a copy of the complete Form 8308, including Part IV, or a statement that includes the same information and any additional information required under Reg. § 1.6050K-1(c), by the later of (a) the due date of the partnership's Form 1065 (including extensions), or (b) 30 days after the partnership is notified of the § 751(a) exchange.

a. Proposed regulations would require partnerships to furnish Form 8308 with only parts I, II, and III completed by January 31 of the year following the year in which

the relevant partnership interest is sold or exchanged, and to file a complete Form 8308 (including Part IV) as an attachment to the partnership's return (Form 1065). REG-108822-25, Returns Relating to Sales or Exchanges of Certain Partnership Interests, 90 F.R. 40269 (8/19/25). Treasury and the IRS have issued proposed regulations that would eliminate the requirement that partnerships furnish the information required in Part IV of the Form 8308 by January 31 of the year following the calendar year in which a § 751(a) exchange occurred. As a result of the proposed changes to Reg. § 1.6050K–1 (and the associated changes in the instructions to Form 8308), a partnership would be required to furnish the information reported on only Parts I, II, and III of Form 8308 (or a statement that includes the same information) to the transferor and transferee partners in a § 751(a) exchange by the later of (1) January 31 of the year following the calendar year in which the section 751(a) exchange occurred, or (2) 30 days after the partnership has received notice of the exchange as specified under § 6050K and Reg. § 1.6050K-1. Further, a partnership would be required to file the completed Form 8308, including Part IV, as an attachment to its partnership return on Form 1065 for the taxable year of the partnership that includes the last day of the calendar year in which the § 751(a) exchange took place. The partnership will also continue to be required to report the information required of the transferor in Reg. § 1.751-1(a)(3) to the transferor (including the information required in Part IV of the Form 8308), in the Schedule K–1 issued to the transferor partner. In essence, the proposed changes adopt the approach of the two prior notices, Notice 2024-19, 2024-5 I.R.B. 627 (1/11/24), and Notice 2025-2, 2025-3 I.R.B. 418 (12/13/24), discussed above. Although the proposed changes would apply to returns filed for taxable years ending on or after the date final regulations are published, taxpayers can rely on the proposed regulations with respect to § 751(a) exchanges occurring on or after January 1, 2025, and before the date on which final regulations are published in the Federal Register.

VIII. TAX SHELTERS

A. Tax Shelter Cases and Rulings

B. Identified "tax avoidance transactions"

C. Disclosure and Settlement

D. Tax Shelter Penalties

IX. EXEMPT ORGANIZATIONS AND CHARITABLE GIVING

A. Exempt Organizations

1. Tax-exempt organizations that filed Form 990-T to receive payments of renewable energy credits and, in doing so, adopted a taxable year, have IRS approval to change that taxable year to conform to their annual accounting period. Rev. Proc. 2025-6, 2025-6 I.R.B. 713 (1/16/25). Code § 6417 allows certain tax-exempt entities to receive direct payments from the IRS for specific, refundable tax credits enacted as part of the Inflation Reduction Act of 2022. The credits for which direct payments are allowed include the alternative fuel vehicle refueling credit (§ 30C), the energy credit (§ 48), and other renewable energy and carbon sequestration credits. Section 6417 and the regulations thereunder contemplate that an "applicable entity" (as defined in § 6417(d)(1)(A), but generally including entities exempt from federal income tax such as § 501(c)(3) organizations, state and local governments, Native American Tribes, etc.) may claim these refundable credits and secure direct payments from the IRS by filing a Form 990-T (Exempt Organization Business Income Tax Return). Ordinarily, exempt organizations use Form 990-T to report and potentially pay federal income tax on so-called unrelated business income; however, § 6417 and the regulations thereunder use Form 990-T as the vehicle for "applicable [tax-exempt] entities" to claim one or more of the Inflation Reduction Act credits mentioned above, even if the exempt organization has no unrelated business income and has never filed a Form 990-T. *What's the rub, you ask?* Form 990-T requires the filer to specify a taxable year, yet some "applicable entities" may have never previously filed a tax return or adopted a taxable year. On the one hand, many (if not most) tax-exempt organizations file an annual

information return, IRS Form 990 (Return of Organization Exempt from Income Tax), regardless of whether they have unrelated business income requiring a Form 990-T. Those tax-exempt organizations previously have adopted a taxable year for filing their Forms 990 even if they have never filed a Form 990-T to report unrelated business income. On the other hand, certain tax-exempt organizations, such as state and local governments, Native American Tribes, and others, are not required to file an annual information return such as a Form 990 and may have never adopted a taxable year. Nonetheless, to claim an IRS direct payment attributable to one of the Inflation Reduction Act credits, these special types of exempt organizations must file a Form 990-T. Rev. Proc. 2025-6 labels these special types of exempt organizations "in-scope applicable entities," a subset of § 6417(d)(1)(A)'s "applicable [tax-exempt] entities." Some of these "in-scope applicable entities" apparently have claimed Inflation Reduction Act credits by filing a Form 990-T designating a taxable year that does not correspond to their annual accounting periods (if any). Now, however, these "in-scope applicable entities" wish to "change" their taxable year to correspond to their annual accounting periods. Normally, of course, IRS consent (using Form 1128) is required for a taxpayer to change its taxable year under § 441 (assuming the taxpayer is permitted to have a taxable year other than the calendar year). Therefore, to assist these "in-scope applicable entities," Rev. Proc. 2025-6 provides automatic IRS consent to select a taxable year that is different from any taxable year the entity may have designated on an IRS Form 990-T used to claim one or more of the Inflation Reduction Act credits. For interested readers, Rev. Proc. 2025-6 contains helpful examples. *Caveat*: The Inflation Reduction Act credits are on the chopping block as part of the "One Big Beautiful Bill Act" currently being considered by Congress.

B. Charitable Giving

1. There are so many lessons for taxpayers and advisors in this charitable contribution case that it's hard to know where to begin. Brooks v. Commissioner, 109 F.4th 205 (4th Cir. 7/15/24), *aff'g* T.C. Memo. 2022-122. The facts of this charitable contribution case are relatively simple. The husband-and-wife taxpayers were the controlling members of a family LLC classified as a partnership for federal tax purposes. The LLC bought roughly 85 acres of land in Georgia for $1.35 million in December of 2006. Shortly thereafter, the LLC subdivided the land into two parcels: one consisting of about 44 acres and the other consisting of about 41 acres. A little over one year later, in December of 2007, the LLC donated a conservation easement over the 41-acre parcel (but not the 44-acre parcel) to Liberty County, Georgia, which is a "qualified [charitable] organization" within the meaning of § 170(h)(3). (Note: The family LLC was neither formed for nor participated in any syndicated conservation easement transaction.) As a result of the donation, the taxpayers reported a $5.1 million charitable contribution deduction for their 2007 taxable year. Charitable contribution limits under § 170 allowed the taxpayers to claim only a $750,000 (approximately) deduction for 2007, so the taxpayers carried forward the remaining $4.35 million deduction to future years. Subsequently, the taxpayers took a carryforward deduction of about $1 million in 2009. Then, beginning in 2010, the taxpayers took the following carryforward deductions contested by the IRS: $657,135 in 2010; $763,835 in 2011; and $743,862 in 2012. The IRS issued a notice of deficiency to the taxpayers in 2015 completely disallowing the 2010-2012 carryforward deductions. The notice of deficiency asserted that the value of the taxpayer's claimed 2007 charitable contribution was only $470,000, thereby eliminating the taxpayer's carryforward deductions for taxable years 2010-2012. (The taxpayers' 2007-2009 taxable years were closed.) The IRS also sought back taxes, interest, and a § 6662(h) 40% gross valuation misstatement penalty for the taxpayers' taxable years 2010-2012. The taxpayers timely filed a petition in the Tax Court. After a trial based upon stipulated facts and a typical "battle of the experts," the Tax Court (Judge Wells) sustained the IRS's asserted deficiencies for taxable years 2010-2012 on multiple grounds, including the § 6662(h) 40% gross valuation misstatement penalty. *See Brooks v. Commissioner*, T.C. Memo. 2022-122. The taxpayers appealed, and a three-judge panel of the Fourth Circuit, in an option written by Judge Niemeyer, upheld the Tax Court's decision in all respects. The high points of the Fourth Circuit's affirmance of the Tax Court, including the disposition of the taxpayer's arguments, are summarized below.

Fourth Circuit Opinion. As mentioned above, the Tax Court sustained and the Fourth Circuit affirmed on three *independent* grounds the IRS's disallowance of the taxpayers' carryforward charitable contribution deductions for years 2010-2012: (1) contrary to § 170(f)(8), the taxpayers did not obtain a contemporaneous written acknowledgement (a/k/a "no return goods or services letter" or "CWA") from the charitable donee for their 2007 contribution; (2) contrary to Reg. § 1.170A-14(g)(5), the taxpayers' documentation substantiating the conservation purposes served by the easement was found significantly lacking in detail; and (3) contrary to Reg. § 1.170A-13(c)(2), the taxpayers' IRS Form 8283 (Noncash Charitable Contributions) included with their 2007 return substantially overstated the LLC's basis in the subject parcel, reporting a $1.35 million basis (the LLC's cost basis in the entire 85-acre property) instead of $652,000, which was the apportioned basis attributable to the 41-acre parcel subject to the conservation easement. Moreover, the Fourth Circuit upheld the Tax Court's imposition of a § 6662(h) 40% gross valuation misstatement penalty for the taxpayers' years 2010-2012 as asserted by the IRS. See below for further details.

Mistake #1—CWA required under § 170(f)(8). The taxpayers could not produce a CWA for their 2007 tax year. Essentially, a CWA from a donee charity acknowledges that a donor received no return consideration (money, goods, or services) for the donation. Section § 170(f)(8) requires a CWA for any charitable contribution (cash or property) of $250 or more. Otherwise, "[n]o deduction shall be allowed" under § 170(a). *See* § 170(f)(8)(A). In lieu of producing a CWA, the taxpayers argued that the conservation easement deed itself substituted for the otherwise required CWA. The Tax Court has allowed taxpayers to satisfy the CWA requirement of § 170(f)(8) with a deed; however, the deed on its face must effectively foreclose the possibility of any return consideration having been paid to a charitable donor. *See, e.g., Big River Dev., L.P. v. Commissioner*, T.C. Memo. 2017-166; *310 Retail, LLC v. Commissioner*, T.C. Memo. 2017-164; *French v. Commissioner*, T.C. Memo. 2016-53. Unfortunately for the taxpayers in this case, the conservation easement deed recited in relevant part that the easement was granted to the charitable donee "for and in consideration of ten dollars ($10.00) and other good and valuable consideration." T.C. Memo. 2022-122 at *1 (Westlaw). Moreover, even if such language is meaningless boilerplate, as the taxpayer argued, the deed did not contain a so-called "entire agreement" clause legally confirming that the taxpayers' LLC received no return consideration in connection with the donation. As the Fourth Circuit pointed out in its opinion, there "could well have been an agreement [outside the deed] by [the charitable donee] to modify zoning, . . . to reduce [property taxes], or to provide . . . infrastructure support" to benefit the LLC and the taxpayers in connection with the conservation easement donation. 109 F.4th at 212. Thus, the absence of the CWA was fatal to the deduction in this case.

Mistake #2—inadequate documentation required under Reg. § 1.170A-14(g)(5). The taxpayers' LLC reserved certain rights over the 41-acre parcel subject to the easement, including but not limited to the following: the right to construct and use a barn and paddocks; to harvest or remove timber and brush in connection therewith; to maintain or replace road beds; and to use the property for personal purposes. Reg.§ 1.170A-14 applies generally to charitable contributions of conservation easements, placing numerous conditions and restrictions on a taxpayer's ability to claim a deduction for a conservation easement, particularly where the taxpayer reserves rights over the subject property. One such condition, contained in Reg. § 1.170A-14(g)(5), provides as follows:

> [F]or a deduction to be allowable under this section, the donor must make available to the donee, prior to the time the donation is made, documentation sufficient to establish the condition of the property at the time of the gift. Such documentation is designed to protect the conservation interests associated with the property, which although protected in perpetuity by the easement, could be adversely affected by the exercise of the reserved rights.

Reg. § 1.170A-14(g)(5) further suggests information to include in the required documentation, such as geological surveys of the property, a map of the property showing improvements and

identifying flora and fauna or other distinct features, an aerial photograph at an appropriate scale, and representative photographs of the particular conservation features of the property. The taxpayers' LLC obtained and provided to the charitable donee a "baseline report" intended to satisfy Reg. § 1.170A-14(g)(5); however, the baseline report included only general information concerning the area surrounding the subject parcel. The report contained little detail concerning how the taxpayer's reserved rights (via the LLC) would not interfere with the easement's conservation purposes. Accordingly, Judge Wells found numerous flaws in the baseline report—especially the lack of specificity concerning how much timber existed on the parcel and how much might be removed to construct the potential improvements (a barn and paddocks). The taxpayers, citing *Bond v. Commissioner*, 100 T.C. 32 (1993) (holding that substantial rather than technical compliance with regulatory requirements for charitable contributions can be adequate), argued that their "baseline report" substantially complied with the requirements of Reg. § 1.170A-14(g)(5). The Fourth Circuit, though, agreed with Judge Wells's assessment, declaring that the taxpayers' Reg. § 1.170A-14(g)(5) documentation was "woefully inadequate, providing virtually no mechanism by which a reasonable person could delineate the [taxpayers'] reserved rights from rights conveyed to [the charitable donee] in the easement." 109 F.4th at 217.

Mistake #3—significantly overstated basis in subject property. To take a charitable contribution deduction for a donation of property (other than money or publicly traded securities) exceeding $500,000 in value, § 170(f)(11)(D) and Reg. § 1.170A-13(c) impose extensive and highly technical substantiation rules, including a requirement for a "qualified appraisal." The qualified appraisal alongside a completed Form 8283 (Noncash Charitable Contributions) must be filed with a donating taxpayer's return for the year of the claimed charitable contribution deduction. One part of Form 8283 requires disclosure of the taxpayer's basis in the donated property (or, in the case of a donated conservation easement, the basis of the property subject to the easement). The taxpayers' LLC provided the taxpayers with a Form 8283, which they filed with their 2007 return; however, the Form 8283 reported a basis of $1.35 million in the parcel subject to the easement. The reported $1.35 million was the LLC's cost basis in the *entire 85 acres* acquired in 2006, *not* the LLC's basis in the 41-acre subdivided parcel subject to the easement. Assuming, as the Fourth Circuit opined, that the basis in the subject parcel should equal approximately $652,000 [41/85 x $1.35 million], the LLC's reported basis on Form 8283 was more than double what it should have been. 109 F.4th at 217. The taxpayers argued that the overstated basis was "scrivener's error" and that their mistake was "due to reasonable cause and not to willful neglect" as contemplated by § 170(f)(11)(A)(ii)(II). T.C. Memo. 2022-122 at *10 (Westlaw). The Fourth Circuit, though, found no clear error in Judge Wells's determination under § 170(f)(11)(A)(ii)(II) that reporting a basis over twice the correct amount does not meet a reasonable cause standard and could be considered willful neglect. Furthermore, the Fourth Circuit reasoned, "The consequences of the misstatement were not insignificant. It worked to conceal just how excessive the valuation of the easement in this case was." 109 F.4th at 218.

Finally—40% gross valuation misstatement penalty. Section § 6662(h)(1) imposes a penalty equal to 40% of the portion of any underpayment of federal income tax attributable to a "gross valuation misstatement." Generally, a valuation misstatement is "gross" if the value claimed on a taxpayer's return is 200 percent or more of the value that should have been reported (as finally determined for federal tax purposes). *See* IRC § 6662(h)(2). In determining the application of the § 6662(h)(1) penalty, Judge Wells found (as detailed at length in his opinion) that the taxpayer's valuation expert made unrealistic assumptions regarding the potential development of the 41-acre parcel to support a $5.1 million charitable conservation easement deduction, especially if the LLC paid only $1.35 million for the entire 85 acres just one year earlier. Judge Wells determined that the IRS's valuation expert, who appraised the conservation easement at $470,000, used more realistic assumptions and was more credible. Accordingly, the Tax Court upheld the IRS's imposition of the § 6662(h)(1) penalty against the taxpayers for taxable years 2010-2012. Before the Fourth Circuit, the taxpayers argued that Judge Wells erred by questioning their valuation expert's methodology. In the taxpayers' view, a court may disagree with an expert's final determination of value but cannot question a professional expert's *methodology* used to determine

value. Judge Niemeyer's Fourth Circuit opinion, though, clarified that Judge Wells questioned the factual assumptions used by the taxpayers' expert, not the methodology itself. The taxpayer also attempted to argue that a technical foot fault by the IRS with respect to admitting into evidence the properly executed IRS Civil Penalty Approval Form only seven days before trial should prohibit imposition of the § 6662(h)(1) penalty. Judge Wells allowed the form into evidence notwithstanding a Standing Pre-Trial Order that required evidentiary documents to be submitted at least fourteen days before trial. The Fourth Circuit refused to adopt the taxpayer's argument in this regard, emphasizing that a trial court has broad latitude regarding evidentiary matters, and admitting the form into evidence in this case was not an abuse of Judge Wells's discretion.

X. TAX PROCEDURE

A. Interest, Penalties, and Prosecutions

1. What's the point of a penalty if the IRS is precluded from collecting it? The Tax Court has held that there is no statutory authority for the IRS to assess penalties imposed by § 6038(b) for failure to file information returns with respect to foreign business entities and that the IRS therefore cannot proceed to collect the penalties through a levy. Farhy v. Commissioner, 160 T.C. 399 (4/3/23). Section 6038(a) requires every United States person to provide information with respect to any foreign business entity the person controls (defined in § 6038(e)(2) as owning more than 50 percent of all classes of stock, measure by vote or value). The form prescribed for providing this information is Form 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations. Section 6038(b)(1) imposes a penalty of $10,000 for each annual accounting period for which a person fails to provide the required information. In addition, § 6038(b)(2) imposes a continuation penalty of $10,000 for each 30-day period that the failure continues up to a maximum continuation penalty of $50,000 per annual accounting period. In this case, the taxpayer was required to file Form 5471 for several years with respect to two wholly-owned corporations organized in Belize but failed to do so. The IRS assessed a penalty under § 6038(b)(1) of $10,000 and a continuation penalty of $50,000 for each of the years in issue. In response to a notice of levy, the taxpayer requested a collection due process (CDP) hearing. In the CDP hearing, the taxpayer argued that the IRS had no legal authority to assess § 6038 penalties. Following the CDP hearing, the IRS issued a notice of determination upholding the proposed collection action and the taxpayer challenged this determination by filing a petition in the Tax Court. The Tax Court (Judge Marvel) agreed with the taxpayer and held that there is no statutory authority for the IRS to assess § 6038 penalties. The IRS argued that § 6201(a), which authorizes the Secretary of the Treasury to make the "assessments of all taxes (including interest, additional amounts, additions to the tax, and assessable penalties) imposed by this title" authorizes assessment of penalties imposed by § 6038. The court disagreed, however, and reasoned that the term "assessable penalties" in § 6201(a) does not automatically apply to all penalties in the Code. The court observed that (1) §§ 6671(a) and 6665(a)(1) provide that penalties imposed by specified Code sections shall be assessed and collected in the same manner as taxes and (2) Code sections other than those specified by §§ 6671(a) and 6665(a)(1) commonly provide that the penalty is a tax or assessable penalty for purposes of collection or are expressly covered by (or contain a cross-reference to) one of the specified Code sections. In contrast, the court explained, § 6038 is not one of the Code sections specified by §§ 6671(a) and 6665(a)(1) and contains only a cross-reference to a criminal penalty provision. The court also rejected the IRS's argument that § 6038 penalties are "taxes" within the meaning of § 6201(a) and therefore subject to assessment. In short the court held, although § 6038(b) provides penalties for failure to provide the information required by § 6038(a), there is no statutory authority for assessment of those penalties and the IRS therefore is unable to collect those penalties through a levy.

- The court's holding that there is no authority for assessment of § 6038 penalties suggests that (1) the IRS would be precluded from exercising its other administrative collection powers, such as a lien or a refund offset, and (2) the mechanism for the IRS to collect § 6038 penalties is a civil action under 28 U.S.C. § 2461(a).

- The court's decision is appealable to the U.S. Court of Appeals for the D.C. Circuit.

a. The Tax Court has again held that the IRS lacks authority to assess penalties under § 6038(b) and has held that penalties imposed by § 6677 for failure to file information returns regarding foreign trusts are not fines and therefore do not violate the Excessive Fines clause of the Eighth Amendment. Mukhi v. Commissioner, 162 T.C. 177 (4/8/24). The taxpayer in this case held controlling interests in a foreign trust and a foreign corporation. The taxpayer failed to comply with three reporting requirements:

- Section 6038(a) requires every United States person to provide information with respect to any foreign business entity the person controls (defined in § 6038(e)(2) as owning more than 50 percent of all classes of stock, measure by vote or value). The form prescribed for providing this information is Form 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations.
- Section 6048(a) requires written notice to the IRS of either the creation of a foreign trust by a United States person or the transfer of money or property to a foreign trust by a United States person. The form prescribed for complying with § 6048(a) is Forms 3520, Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts.
- Section 6048(b) requires every United States person to provide information with respect to any foreign trust of which the person is treated as the owner. The form prescribed for complying with § 6048(b) is Form 3520-A, Annual Information Return of Foreign Trust With a U.S. Owner.

As previously discussed in connection with the *Farhy* decision, § 6038(b) imposes significant penalties for failure to file Form 5471 to provide information with respect to any foreign business entity the person controls. In addition, § 6677(a)-(b) imposes penalties for failure to file an information return disclosing ownership of a foreign trust (Form 3520-A). For returns required to be filed after December 31, 2009, the penalty is the greater of $10,000 or 5 percent of the gross value of the portion of the trust assets that a United States person is treated as owning. Section 6677(a) imposes penalties for failure to file an information return disclosing the transfer of money or property to a trust (Form 3520). For returns required to be filed after December 31, 2009, the penalty is the greater of $10,000 or 35 percent of the money or property transferred to the foreign trust.

The IRS assessed approximately $5 million in penalties for the taxpayer's failure to file Form 3520, $5.9 million in penalties for failure to file Form 3520-A, and $120,000 in penalties for failure to file Form 5471.

After the IRS issued a final notice of intent to levy and a notice of federal tax lien, the taxpayer requested a collection due process (CDP) hearing. Based on the IRS's estimate of the taxpayer's reasonable collection potential, the Settlement Officer who conducted the CDP hearing rejected the taxpayer's alternative requests for an installment agreement or an offer-in-compromise. The Settlement Officer issued a notice of determination sustaining the collection action and the taxpayer responded by filing a petition in the Tax Court.

In the Tax Court, the taxpayer argued principally that (1) the IRS had violated his Fifth Amendment due process rights because the Settlement Officer was not independent, (2) the Settlement Officer had abused his discretion in rejecting the taxpayer's offer-in-compromise, and (3) the foreign reporting penalties imposed by §§ 6038(b) and 6677 violate the Excessive Fines Clause of the Eighth Amendment. The Tax Court (Judge Greaves) efficiently disposed of the taxpayer's first two arguments and, because they are highly fact-specific, this discussion will not address those arguments. The significance of the Tax Court's opinion is its holding regarding the third argument.

Section 6038(b) penalties. The Tax Court declined to address whether the penalties imposed by § 6038(b) for failure to timely file Form 5471 violated the Excessive Fines clause of the Eighth Amendment because the court had previously concluded in *Farhy* that the IRS lacks the authority to assess the penalties imposed by § 6038(b). Because the IRS is precluded, in the Tax Court's view, from assessing the penalties, it is precluded from collecting them through a lien or levy. The court declined to reconsider its decision in *Farhy*. The court noted that its decision in *Farhy* was on appeal to the D.C. Circuit and reasoned that, even if the D.C. Circuit reversed the Tax Court's decision in *Farhy*, the holding of the D.C. Circuit would not be binding in this case because any appeal in the current case would be heard by the Eighth Circuit. *See Golsen v. Comm'r*, 54 T.C. 742, 757 (1970), *aff'd*, 445 F.2d 985 (10th Cir. 1971). The Tax Court then granted summary judgment to the taxpayer and held that the IRS was precluded from collecting the penalties imposed by § 6038(b).

Section 6677 penalties. The Tax Court held that the penalties imposed by § 6677 are not fines and therefore do not violate the Excessive Fines Clause of the Eighth Amendment. In its prior decisions, including its decision in *Thompson v. Commissioner*, 148 T.C. 59, 66 (2017), the Tax Court held that the purpose of civil tax penalties and additions to tax is to encourage voluntary compliance and that such penalties or additions therefore are not punitive. Similarly, the court noted, the U.S. Court of Appeals for the First Circuit concluded in *United States v. Toth*, 33 F.4th 1, 19 (1st Cir. 2022), that penalties for failure to file a Foreign Bank Account Report (FBAR) are not fines. The Eighth Circuit, the court noted, has not ruled on whether the penalties imposed by § 6677 are fines. Because the penalties imposed by § 6677 are civil penalties designed to encourage voluntary compliance, the court held, they are not fines and therefore do not violate the Excessive Fines Clause of the Eighth Amendment. Further, the court held, even if the penalties imposed by § 6677 are fines, they do not violate the Eighth Amendment because they are not excessive. The court reasoned that, under the U.S. Supreme Court's decision in *United States v. Bajakajian*, 524 U.S. 321 (1998):

> To pass the constitutional proportionality inquiry under the Excessive Fines Clause, the amount of the forfeiture or fine must bear some relationship to the gravity of the offense that it is designed to punish. See *Bajakajian*, 524 U.S. at 334. A fine violates the Excessive Fines Clause if "the amount of the forfeiture is grossly disproportional to the gravity of the defendant's offense." *Id*. at 337

The court noted that it had consistently concluded that penalties similar to the penalties imposed by § 6677 are not disproportionate. Accordingly, the court held, even if the penalties imposed by § 6677 are fines, they do not violate the Eighth Amendment.

b. The Tax Court got it wrong, says the D.C. Circuit. Despite the absence of explicit language authorizing the assessment of penalties imposed by § 6038(b), the text, structure, and function of § 6038(b) indicate that the penalties it imposes are assessable. Farhy v. Commissioner, 100 F.4th 223 (D.C. Cir. 5/3/24), *rev'g* 160 T.C. 399 (4/3/23). In an opinion by Judge Pillard, the U.S. Court of Appeals for the D.C. Circuit has reversed the Tax Court and held that statutory authority exists for the assessment of penalties imposed by § 6038(b) and that the IRS therefore is able to collect those penalties through its administrative collection powers, such as a levy. The court first rejected the parties' competing readings of § 6201(a), which authorizes the Secretary of the Treasury to make the "assessments of all taxes (including interest, additional amounts, additions to the tax, and assessable penalties) imposed by this title." The IRS argued that § 6201(a) authorizes the assessment of all taxes and penalties unless the Code expressly requires a different process for a given exaction. The taxpayer argued that § 6201(a) authorizes the assessment of a penalty only if the penalty is explicitly characterized as a "tax" or designated as assessable. The court declined to adopt either interpretation of § 6201(a) and instead based its holding on the text, structure, and function of the specific provision at issue, § 6038(b). The court placed primary emphasis on the history and legislative purpose underlying § 6038(b). Congress enacted § 6038 in 1960. As originally enacted, the penalty for failure to file the required informational return regarding a foreign corporation was a 10-percent reduction in the U.S.

taxpayer's foreign tax credit. Congress amended § 6038 in the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, Title III, § 338, 96 Stat. 324, 631, commonly known as TEFRA. The 1982 amendments moved the 10-percent reduction of a taxpayer's foreign tax credit to current § 6038(c) and amended § 6038(b) to impose a new, fixed-dollar penalty for failure to file the required informational return. Amended § 6038(c)(3) coordinates the two penalties by providing that the § 6038(c) reduction of a taxpayer's foreign tax credit is reduced by any fixed-dollar penalty imposed by § 6038(b). These changes, the court observed, were intended to bolster and streamline enforcement of the penalty. The parties in this case agreed that the penalty imposed by § 6038(c) is assessable because a reduction of a taxpayer's foreign tax credit has the effect of increasing a taxpayer's tax liability, and § 6201(a) authorizes the assessment of all taxes imposed by the Internal Revenue Code. The remaining question was whether authority exists for the IRS to assess the penalty imposed by § 6038(b). The court emphasized that Congress's purpose in amending § 6038 in 1982 to add the fixed-dollar penalty currently provided by § 6038(b) was to streamline collection of the penalty. Under the interpretation of § 6038 advanced by the taxpayer, the IRS can assess and therefore collect through its administrative collection powers the penalty imposed by § 6038(c) (the 10-percent reduction in a taxpayer's foreign tax credit) but must instead enforce the fixed-dollar penalty imposed by § 6038(b) by bringing legal action against the taxpayer in a United States District Court. Such an interpretation, the court concluded, does not make sense:

> It would be "highly anomalous" for Congress to have responded to the identified problem of the underuse of subsection (c) penalties by promulgating a penalty that, while simpler to calculate, is much harder to enforce. … That view is contradicted by the clear congressional purpose behind the enactment of subsection (b).

The court also reasoned that the availability of a reasonable cause defense to the penalty imposed by § 6038(b) suggests that the penalty is assessable. A taxpayer can avoid the penalty imposed by § 6038(b) by showing reasonable cause for the noncompliance. See I.R.C. § 6038(c)(4); Reg. § 1.6038-2(k)(3)(ii). Section 6038(c)(4)(B), the court reasoned, "expressly treats the reasonable cause showing for failure to file the relevant informational returns as within the purview of the Service." Further, the court observed, "[i]f the subsection (b) penalty were not assessable, there would be no post-assessment administrative process in which the taxpayer could make a reasonable cause showing to the Secretary." The express contemplation of § 6038 that the Secretary of the Treasury will determine the availability of a reasonable cause defense to the penalties imposed by § 6038 supports treating the penalties imposed by both § 6038(b) and § 6038(c) as assessable. Finally, the court, observed, interpreting the § 6038(b) penalty as not being assessable and therefore collectible only through an action in U.S. District Court and the § 6038(c) penalty as being assessable and collectible through the IRS's administrative collection powers with judicial review of the collection process (following a collection due process hearing) in the Tax Court could lead to inconsistent holdings in the two courts for the same taxpayer and would raise other potential issues:

> We decline to adopt a reading of section 6038(b) that attributes to Congress the intent to respond to the problem it identifies in a manner that is not only ineffective, but counterproductive.

c. The Tax Court has reaffirmed its decision in *Mukhi* and held that the IRS lacks authority to assess the penalties imposed by § 6038(b) and therefore may not collect the penalties through a lien or levy. Mukhi v. Commissioner, 163 T.C. 150 (11/18/24). In its prior decision in this case, *Mukhi v. Commissioner*, 162 T.C. 177 (4/8/24) (*Mukhi I*), the Tax Court granted summary judgment in the taxpayer's favor and held that the IRS lacked statutory authority to assess the penalties imposed by § 6038(b)(1) for failure to file Form 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations. In doing so, the court relied on its earlier decision in *Farhy v. Commissioner*, 160 T.C. 399 (4/3/23), which reached the same conclusion. The U.S. Court of Appeals for the D.C. Circuit reversed the Tax Court's decision in

Farhy and held that the IRS does have statutory authority to assess the penalties imposed by § 6038(b)(1). *Farhy v. Commissioner*, 100 F.4th 223 (D.C. Cir. 5/3/24). After the D.C. Circuit's reversal in *Farhy*, the government filed in the Tax Court a motion for reconsideration of the court's decision in *Mukhi I*. In a reviewed opinion (16-0-1) by Judge Greaves, the Tax Court adhered to its decision in *Mukhi I* and held that the IRS lacks statutory authority to assess the penalty imposed by § 6038(b)(1).

Whether the IRS lacks statutory authority to assess § 6038(b)(1) penalties. The Tax Court first noted that, under § 6201(a), the IRS is authorized to assess "all taxes (including interest, additional amounts, additions to the tax, and assessable penalties)." Only after formal assessment may the IRS engage in administrative actions to collect a tax by lien or levy. See §§ 6502(a), 6322. For the same reasons given in its decision in *Farhy*, the Tax Court again declined to agree with the IRS's argument that § 6201(a) should be read expansively and that the word "taxes," as used in this section, should be interpreted to include all exactions provided for in the Code unless otherwise specified. The court acknowledged that the word "including," which is used in the parenthetical language of § 6201(a), "typically denotes an illustrative list," but reasoned that interpreting § 6201(a) as authorizing assessment of all exactions in the Code would render superfluous the reference in the parenthetical language to "assessable penalties." In other words, the court explained,

> if Congress intended all exactions provided for in the Code—and specifically all penalties—to be assessable by the IRS, the adjective "assessable" would be unnecessary to modify "penalties." The use of the word "assessable" denotes that the IRS's assessment authority is more limited than all penalties set forth in the Code.

Citing its previous decision in *Chadwick v. Commissioner*, 154 T.C. 84 (2020), the Tax Court further reasoned that to read the word "taxes" in § 6201(a) as including all exactions would also make useless a number of provisions in the Code that define penalties to be taxes for specific purposes. For example, the court noted, § 6665(a)(2) deems any reference in the Code to "taxes" to also refer to the additions to tax provided by chapter 68 of subtitle F. Under this theory, reasoned the court, there would be no need for such provisions if all such penalties were included in the definition of "taxes."

The Court also declined to agree with the IRS's argument that, in recodifying the Code in 1954, Congress did not intend to change the scope of the IRS's assessment authority from what it was in the 1939 version of the Code. In the recodification, § 3640 of the 1939 Code was the predecessor of today's § 6201(a). Former § 3640 provided "[t]he Commissioner is authorized and required to make the inquiries, determinations, and assessments of *all taxes and penalties* imposed by this title." (Emphasis added). The Tax Court then characterized the issue as whether in 1954 Congress intended to enact substantive change to the IRS's assessment authority by modifying the language of former § 3640 when it enacted current § 6201(a), which provides:

> [T]he Secretary or his delegate is authorized and required to make the inquiries, determinations and assessments of *all taxes (including interest, additional amounts, additions to the tax, and assessable penalties)* imposed by this title….

(Emphasis added). Guided by these changes in the text, the court reasoned that Congress did intend to change the IRS's authority. The 1954 version of § 6201(a) specified that the IRS only had assessment authority over "taxes." The court reasoned that this new text reduced the scope of the IRS's assessment authority because the text no longer provided complete power to assess all penalties and limited the IRS's power to assess only "all taxes." In removing complete assessment authority over "all penalties," the court explained, Congress included the word "assessable" before the word "penalties" in the parenthetical language of § 6201(a) as a condition that limits the IRS's assessment authority to only those penalties that are assessable. The Tax Court then turned to the question of whether the § 6038(b)(1) penalty is an "assessable penalty." After highlighting several

sections of the Code containing specific text that indicates the IRS has authority to assess a penalty, the court concluded that nothing in the text of § 6038(b)(1) expressly authorizes the IRS to assess the penalty. It therefore became clear to the court that Congress did not grant the IRS authority to assess the § 6038(b)(1) penalty.

The IRS's legislative history arguments. The IRS argued that the Senate Finance Committee's report indicates that Congress intended the § 6038(b)(1) penalty to be assessable because of the interaction between § 6038(b)(1) penalty and the §6038(c) penalty. In 1960, § 6038 was added to the Code and, at that time, it included only the § 6038(c) penalty. See Act of Sept. 14, 1960, Pub. L. No. 86-780, § 6(a), 74 Stat. 1010, 1014 (codified at section 6038). Section 6038(c) was the sole enforcement mechanism for failure to comply with reporting obligations. The court noted that, because it was difficult to administer, the IRS rarely used it as an enforcement mechanism. When Congress added § 6038(b) in 1982, the Senate Finance Committee report explained that the § 6038(c) penalty was rarely imposed in part because the penalty was complicated and unduly harsh in certain cases. S. Rep. No. 97-494 (Vol. 1), at 299 (1982), reprinted in 1982 U.S.C.C.A.N. 781, 1042. The Tax Court disagreed with the IRS's argument that, if Congress intended to provide the IRS with a simpler penalty to administer, it could have achieved its goal by making the § 6038(b) penalty assessable. The court again turned to the plain language of the statue and concluded that nothing in the Senate Finance Committee's report provides that the § 6038(b) penalty is assessable nor does it specify the manner in which the IRS may collect the penalty. The court gave an example in relation to the § 6700 penalty for tax shelter promoters, whereby "[t]he penalty for promoting an abusive tax shelter is an *assessable penalty*…" *Citing*, S. Rep. No. 97-494 (Vol. 1), at 267, 277, 1982 U.S.C.C.A.N. at 267 (emphasis added). Thus, reasoned the court, because Congress specified the IRS's assessment authority with respect to other penalties and did not specify the IRS's authority to assess the § 6038(b)penalty, Congress did not intend for § 6038(b) to be an "assessable" penalty.

Whether the reasonable cause exception of § 6038 can be met. The IRS next argued that by holding that the § 6038(b)(1) penalty is not assessable, it has been deprived of the tools needed to determine whether the taxpayer meets the reasonable cause exception. Under § 6038(c)(4)(B), for purposes of § 6038(b) and (c), "…the time prescribed…to furnish information (and the beginning of the 90-day period after notice by the Secretary) shall be treated as being not earlier than the last day on which (as shown *to the satisfaction of the Secretary*) reasonable cause existed for failure to furnish such information." (emphasis added). Narrowly, the IRS argued that the tools needed to determine reasonable cause are all found in § 6201(a). In rejecting this argument, the court reasoned that the IRS's broad enforcement authority does not come exclusively from § 6201(a). Rather, the IRS's enforcement authority comes from § 7602. *See U.S. v. Arthur Young & Co*., 465 U.S. 805, 816 (1984). Section 7602 grants the IRS broad authority to examine, among other things, the correctness of any return, the making of any return where none is filed, the liability of any person for any internal revenue tax, and to collect such liability. Focusing on the D.C. Circuit's opinion in *Farhy*, which concluded that the words "to the satisfaction of the Secretary" in § 6038(c)(4)(B) would make sense only if the § 6038(b)(1) penalty was assessable, the Tax Court disagreed. The Tax Court was not persuaded by this rationale because the IRS can still make a reasonable cause determination even if the § 6038 penalty is not assessable. The Tax Court reasoned that the D.C. Circuit's reliance on a collection due process hearing as the intended forum for the IRS to make a reasonable cause determination is incorrect. Congress added § 6038 to the Code in 1960 and included only what is now § 6038(c), including the reasonable cause language of current § 6038(c)(4)(B). The Tax Court pointed out that the § 6038(b)(1) penalty was added to the Code in 1982 and that the collection due process regime was not added until 1998. Therefore, at the time of enactment in 1960, Congress could not have intended that the IRS make a reasonable cause determination in a collection due process as it relates to the § 6031(b)(1) penalty. The court explained:

> The IRS can still make a reasonable cause determination if the section 6038(b)(1) penalty is not assessable. This determination could come before the referral. There

> is nothing in the statute's text that demands that the IRS make the reasonable cause determination after assessment of the penalty.

Administrative burden of collecting § 6038(b)(1) penalties, canons of construction, and other policy considerations. The court also rejected the IRS's other arguments, including its position that holding the § 6038(b)(1) penalty not assessable would create a significant administrative burden and would create preclusion issues.

Conclusion. In conclusion, the court held that the IRS assessed the penalties imposed by § 6038(b)(1) without statutory authority to do so. Because the IRS lacked statutory authority to assess the penalties, it was precluded from collecting them through a lien or levy. Thus, the Court reaffirmed its prior holding in *Mukhi I* that the IRS may not proceed with any collection action.

Dissent and non-participation. Judge Nega dissented without a separate dissenting opinion. Judge Jenkins did not participate in the case.

2. Seventh Circuit Court of Appeals affirms Tax Court's jurisdiction and decision to sustain civil fraud penalties where taxpayer husband fabricated income and tax withheld over several years. Bachner v. Commissioner, 124 F.4th 1066 (7th Cir. 1/15/25), *aff'g*, T.C. Memo. 2023-148. The taxpayers, a married couple, appealed from a decision of the U.S. Tax Court upholding the IRS's imposition of civil fraud penalties under § 6663(a) for underpayments for the years 2005 through 2007. During those years, Mr. Bachner falsely claimed hundreds of thousands of dollars in improper refunds by filing returns with fake W-2s that inflated his income and the income tax withheld. The returns were joint returns with his wife, but the IRS granted innocent spouse protection to his wife under § 6015(b). It likely did not help Mr. Bachner's case that he had placed multiple orders for a deadly neurotoxin and took out a $20 million dollar life insurance policy (for a three-month period) on his wife. Mr. Bachner was criminally prosecuted and pleaded guilty to one count of wire fraud, one count of possessing a biological agent for use as a weapon, and one count of making or presenting a false claim to the IRS (for 2005). He served seven years in federal prison. Upon his release, the IRS issued a notice of deficiency to both Bachner and his wife but identified only Mr. Bachner as a liable party. Among other items, the notice of deficiency determined that Mr. Bachner was liable for the civil-fraud penalty imposed by § 6663(a). Initially, the Seventh Circuit raised the issue of its own jurisdiction over the appeal and quickly concluded that it had jurisdiction over Mr. Bachner's appeal but lacked jurisdiction over Mrs. Bachner's appeal because the IRS had granted her innocent spouse relief. Therefore, the court dismissed her from the appeal. Accordingly, this discussion will refer to Mr. Bachner as the "taxpayer."

The taxpayer's arguments. On appeal, the taxpayer first argued that the Tax Court lacked jurisdiction because the IRS never found a "deficiency" in tax payments. Further, he argued, the IRS could not impose fraud penalties because he did not "underpay" his tax. The court concluded that both arguments lacked merit.

(1) *Whether there was a valid notice of deficiency.* Section 6211(a) and (b)(1) generally define a "deficiency" as the amount by which the tax imposed exceeds the amount shown as tax on the taxpayer's return. This determination is made without regard to any credits for withholding on wages. *See Murray v. Comm'r*, 24 F.3d 901, 903 (7th Cir. 1994). The court acknowledged that a deficiency generally results from a taxpayer's *understatement* of tax liability, and in this case the taxpayer *overstated* his tax liability. There was thus no deficiency in tax. The notice of deficiency listed only penalties. Nevertheless, the court reasoned, § 6665(a) provides that penalties in chapter 68 of the Code, of which § 6663 is a part, shall be treated "in the same manner as taxes." Therefore, the court reasoned, by issuing a notice of deficiency, the IRS properly treated those penalties in the same manner as it would a tax deficiency. The court concluded that

> a deficiency that satisfies § 6211 is not a jurisdictional necessity. The notice advising [the taxpayer] of the penalties owed, and the Bachners' timely petition contesting it, combined to provide the Tax Court with jurisdiction over the

administrative deficiency proceeding. See I.R.C. § 6213(a) (providing the Tax Court with jurisdiction upon the receipt of a timely petition for redetermination); T.C.R. 13(a) (making clear that the Tax Court lacks jurisdiction without a notice of deficiency).

(2) *Whether the taxpayer underpaid his taxes*. The taxpayer argued that he did not "underpay" his taxes and that the civil fraud penalty of § 6663(a), which applies to an "underpayment" of tax, did not apply. The court noted that § 6664(a) provides that, for the purposes of a fraud penalty, an underpayment occurs when the amount that the IRS determines a taxpayer owes is greater than what the taxpayer reports as owed. The court also observed that under the relevant regulations, to calculate an underpayment of tax, the amount of tax reported is reduced by the amount by which withholdings reported exceed the amount of withholdings actually withheld. Where a taxpayer inflates withholdings, to the extent that the reported withholdings exceed the actual withholdings, it increases the underpayment. *See* Reg. §§ 1.6664-2(c)(1), 1.6664-2(g) (example 3). The language is difficult to interpret without an example. Using the taxpayer's 2005 tax year as an example, the court observed that the taxpayer had a total understatement of $110,105. The taxpayer actually owed $10,396 in taxes but falsely reported that he owed $122,798. He then overstated his withholding credits by $222,905. Subtracting the overstatement of withholding ($222,905) from the amount of taxes the taxpayer claimed he owed ($122,798) yields a negative $100,107, which is an amount Bachner owes back to the IRS. The taxpayer also owed $10,396 of taxes he did not pay on his actual income. Adding the $100,107 to the $10,396, Bachner has a total underpayment of $110,105. Based on this calculation, as applied to all three of the years in issue, the Seventh Circuit sustained the Tax Court's findings that the fraudulent underpayments resulted in penalties under § 6663(a).

The court rejected the taxpayer's remaining arguments and affirmed the Tax Court's decision, which concluded that the taxpayer was liable for the civil fraud penalty of § 6663(a).

B. Discovery: Summonses and FOIA

C. Litigation Costs

D. Statutory Notice of Deficiency

E. Statute of Limitations

1. Tax Court retains jurisdiction holding that the 90-day period to file a petition for redetermination of a notice of employment tax determination is a nonjurisdictional claim processing rule. Belagio Fine Jewelry, Inc. v. Commissioner, 162 T.C. 243 (6/25/24). The IRS audited the taxpayer, a corporation, to determine the employment status of individuals performing services for the taxpayer. After determining that the taxpayer had an employee, the IRS issued and mailed a notice of employment tax determination (the Notice) dated August 24, 2021. Pursuant to the 90-day rule provided in § 7436(b)(2), the Notice stated that the last day for the taxpayer to file a petition for redetermination of employment status was November 22, 2021. Taxpayer mailed its petition via FedEx Express Saver on November 18, 2021, which arrived at the Tax Court on November 23, 2021, one day after the 90-day deadline. When the petition arrives after the deadline, however, § 7502(a) provides that a petition is considered to be timely if the taxpayer delivered the petition to the U.S. Postal Service (USPS) before the end of the 90-day period. Under this rule, the petition is considered timely filed if it is timely deposited in the USPS mail before the deadline. Under § 7502(f) this "timely mailed is timely filed" rule continues to apply if certain specifically designated delivery services are used by the taxpayers. The FedEx Express Saver service used by the taxpayer, however, was not, during the year in question, a specifically designated private delivery service. *See* IRS Notice 2016-30, 2016-18 I.R.B. 676. The IRS argued that, because the petition was received a day late, the Tax Court lacked jurisdiction to hear the case. In order to determine whether the petition was a day late, the court first needed to determine the date that the IRS had mailed the notice of employment tax determination to the taxpayer to begin the 90-day period.

Burden of Proof. An IRS agent issuing a notice is required to complete USPS Form 3877, Firm Mailing Book for Accountable Mail, to establish the date of mailing of the notice. See I.R.M. 4.8.10.8.2 (Apr. 20, 2018). Having never previously addressed the issue of which party (the IRS or the taxpayer) has the burden of proving when a notice of employment tax determination was mailed, the Tax Court (Judge Greaves) relied on its prior decisions relating to the mailing of notices of deficiency. In relation to notices of deficiency, the Commissioner has the burden of proving the date of mailing because (1) it was the Commissioner's motion, and (2) the relevant information is within the Commissioner's knowledge. *Casqueira v. Comm'r*, T.C. Memo. 1981-428. *See also S. Cal. Loan Assoc. v. Comm'r*, 4 B.T.A. 223, 224-25 (1926). Placing the burden on the IRS, the Tax Court concluded that the Form 3877 in this case was incomplete because it did not bear a USPS date stamp. However, even though the Form 3877 did not bear a proper USPS stamp, the court concluded that the form was valid because the IRS agent filled out and initialed the form on August 24, 2021. The IRS also provided evidence that the mailing number listed on the USPS Form 3877 matched the stamp on the Notice. Further, the IRS submitted a sworn declaration by the IRS employee that she completed the forms on the same day. This evidence supported the Court's finding that the IRS carried its burden of proof that the Notice was mailed on August 24, 2021. The issue then became whether the Tax Court had jurisdiction to determine whether the taxpayer's petition had been filed within the 90-day period of § 7436(a).

Clear Statement Standard. The Tax Court began with the Supreme Court's rule that, where a federal court's subject matter jurisdiction depends on a filing deadline, failure by a litigant to comply with the deadline deprives the court of jurisdiction to hear the case. *Kontrick v. Ryan*, 540 U.S. 443, 455 (2004). However, where a party is required under a rule to complete specific procedural steps at certain specified times but the rule does not condition a court's authority to hear the case on compliance with such steps, the rule is treated as a nonjurisdictional "claims processing" rule. *See Boechler, P.C. v. Comm'r*, 142 S. Ct. 1493, 1497 (2022). Such claims processing rules do not deprive a court of its jurisdiction to hear a case. *U.S. v. Wong*, 575 U.S. 402, 410 (2015). A procedural requirement is treated as jurisdictional if Congress "clearly states" that a deadline is jurisdictional. In order to determine whether Congress has clearly stated that a requirement is jurisdictional, the Court must examine the (1) text, (2) context, and (3) historical treatment of the requirement. *See Reed Elsevier, Inc. v. Muchnick*, 559 U.S. 154, 166 (2010). The Tax Court first addressed the "text" of § 7436(b)(2) finding that, while the statute provides the 90-day deadline, it does not use the word "jurisdiction". Rather, the statute provides only that a proceeding may not be initiated in the Tax Court if the 90-day rule is not complied with. Thus, nothing in the statute textually restricts the Court's ability to hear the case. Second, the court reasoned that the statutory "context" of the statute supports the conclusion that Congress did not "clearly state" that the 90-day deadline in the statute. The court noted that mere proximity of the jurisdictional grant and the procedural requirement does not indicate that the requirement is jurisdictional. Here, the jurisdictional grant is found in § 7436(a) whereas the 90-day deadline is found in subsection (b)(2). Such a separation without a clear tie of the jurisdictional grant to the 90-day rule supported the court's conclusion that the 90-day deadline is not jurisdictional. In addition to the separation of the jurisdictional grant from the deadline, the court concluded that § 7436(b)(2) has limited applicability because the 90 day deadline applies only to a subset of cases covered by § 7436. Further, the 90-day deadline applies only to cases in which the Commissioner sends a notice of employment tax determination to the taxpayer by certified mail. In cases in which the Commissioner fails to properly send its determination via the mail, the 90-day rule is inapplicable. The Court reasoned that its jurisdiction is based on the IRS determination and not on whether the notice of determination was actually mailed, or not. Third, from a historical context, the Court reasoned that § 7436, as well as similarly worded statutes, lack any historical precedent interpreting deadlines as jurisdictional. As such, the court held, the relevant historical treatment of § 7436 does not reflect an intent on the part of Congress that the 90-day rule be jurisdictional.

Conclusion. After considering the text, statutory context, and history of the statute, the court reasoned that it was not deprived of jurisdiction because of the taxpayer's late filing. The court therefore denied the IRS's motion to dismiss based on a lack of jurisdiction.

a. The 90-day period of § 7436(b)(2) for filing a Tax Court petition in response to a notice of employment determination is subject to equitable tolling, but the taxpayer's garden variety negligence did not warrant equitable tolling. Belagio Fine Jewelry, Inc. v. Commissioner, 164 T.C. No. 7 (4/15/25). As previously discussed, following an employment tax audit, the IRS issued a notice of employment tax determination in which it concluded that the taxpayer had an employee. Pursuant to § 7436(b)(2), the taxpayer had 90 days to challenge this determination by filing a petition in the U.S. Tax Court. The notice stated that the last day for the taxpayer to file a Tax Court petition was November 22, 2021. The taxpayer mailed its petition via FedEx Express Saver on November 18, 2021, which arrived at the Tax Court on November 23, 2021, one day after the 90-day deadline. When the petition is delivered by U.S. mail after the deadline, § 7502(a) provides that the petition is considered to be timely if it is postmarked on or before the deadline. Under § 7502(f) this "timely mailed is timely filed" rule continues to apply if certain specifically designated private delivery services are used by the taxpayer. The FedEx Express Saver service used by the taxpayer, however, was not, during the year in question, a specifically designated private delivery service. *See* Notice 2016-30, 2016-18 I.R.B. 676. Therefore, the taxpayer's petition was filed late. In a previous opinion, the Tax Court held that the 90-day deadline of § 7436(b)(2) to file a petition for redetermination is a nonjurisdictional claim-processing rule. *See Belagio Fine Jewelry, Inc. v. Commissioner*, 162 T.C. 243, 250-60 (6/25/24) (*Belagio I*). In *Belagio I*, the Tax Court denied the IRS's motion to dismiss for lack of jurisdiction but reserved judgment on the question of whether the 90-day deadline of § 7436(b)(2) is subject to equitable tolling. In this case (*Belagio II*), in an opinion by Judge Greaves, the Tax Court addressed the IRS's subsequent motion to dismiss for failure to state a claim upon which relief can be granted. In its motion, the IRS argued that the 90 day deadline is not subject to equitable tolling. In the alternative, the IRS argued, if equitable tolling applies, equitable tolling was not warranted on the facts of this case. The taxpayer argued that, had the taxpayer's attorney's legal staff sent the petition via FedEx Priority Overnight, the petition would have been treated as timely under the "timely mailed, timely filed" rule of § 7502(a). Due to the error in selecting a method of delivery, the taxpayer sought equitable tolling of the 90-day deadline.

Whether equitable tolling applies to the 90-day deadline. The court first addressed whether the 90-day deadline of § 7436(b)(2) is subject to equitable tolling, an issue of first impression for the court. Under the doctrine of equitable tolling, a nonjurisdictional statutory deadline is presumed to be subject to equitable tolling. *See Irwin v. Dep't Veterans Affairs*, 498 U.S. 89, 95-96 (1990). This presumption, however, may be rebutted if equitable tolling is inconsistent with the text of the statute or the applicable statutory regime. *Id.* In beginning its analysis, the Tax Court observed that the U.S. Supreme Court, in *United States v. Brockamp*, 519 U.S. 347, 354 (1997), had held that the period of limitations set forth in § 6511 for filing an administrative claim for refund is not subject to equitable tolling.[14] In *Brockamp*, the Court held that the presumption of equitable tolling was rebutted with respect to the limitations periods of § 6511. The Court in *Brockamp* reasoned that § 6511 sets forth the relevant time limits in an "unusually emphatic form" and in a "highly detailed technical manner" that "cannot easily be read as containing implicit exceptions." Further, the Court reasoned in *Brockamp*, permitting equitable tolling would result in serious administrative problems for the IRS given the more than 90 million refund claims processed each year. The Tax Court then compared the facts and reasoning in *Brockamp* to the Supreme Court's later decision in *Boechler, P.C. v. Commissioner*, 596 U.S. 199, 210-211 (2022). In *Boechler*, the Supreme Court held that the 30-day time limitation in § 6330(d)(1) for filing a Tax Court petition seeking review of an IRS determination following a collection due process hearing was subject to equitable tolling. The presumption of equitable tolling, the Court held in *Boechler*, was not rebutted in the case of § 6330(d)(1). The Court in *Boechler* reasoned that nothing in the text of § 6330 prohibited equitable tolling. Further, the Court observed, the short 30-day deadline of § 6330(d)(1) was

[14] *See generally* Bruce A. McGovern, *The New Provision for Tolling the Limitations Periods for Seeking Tax Refunds: Its History, Operation and Policy, and Suggestions for Reform*, 65 Mo. L. Rev. 797 (2000).

directed to the taxpayer rather than the court. In addition, § 6330 is unusually protective of taxpayers and the taxpayers who file such petitions are often *pro se*. Also distinct was the fact that § 6330 has only one exception (related to suspending the time to file a petition in the event of bankruptcy) compared to § 6511, which has six exceptions. The Court in *Boechler* also concluded that, unlike the refund claim context in which over 90 million claims are filed annually, equitable tolling for the much smaller number of Tax Court petitions filed in collection due process cases would not be a significant administrative burden on the government. In light of this guidance from the *Brockamp* and *Boechler* decisions, the Tax Court analyzed the 90-day deadline of § 7436(b)(2) and concluded that there is nothing in the text of § 7436(b)(2) that expressly prohibits equitable tolling. Further, the Tax Court observed, the wording of the statute is neither highly detailed nor technical. The Tax Court declined to agree with the IRS's argument that restrictions on assessment and collection that are tied to the 90-day deadline indicate that Congress did not intend equitable tolling to apply under § 7436(b)(2). Instead, the court concluded that there is nothing inconsistent with permitting equitable tolling in relation to the filing deadline and allowing the IRS to proceed with assessment and collection after the expiration of the 90-day deadline. The Tax Court also reasoned that, unlike the situation in *Brockamp*, equitable tolling of the 90-day period of § 7436(b)(2) would not significantly increase the government's administrative burden. Very few petitions are filed annually for redetermination of employment status compared to the more than 90 million refund claims that the IRS processes annually. Based on this analysis, the Tax Court concluded that the 90-day period of § 7436(b)(2) is subject to equitable tolling.

Whether equitable tolling should apply in the circumstances of this case. After concluding that the 90-day period of § 7436(b)(2) is subject to equitable tolling, the Tax Court turned to the issue of whether equitable tolling applied in the taxpayer's circumstances. Under the Supreme Court's holding in *Menominee Indian Tribe of Wis. v. U.S.* 577 U.S. 250, 255 (2016), for equitable tolling to apply, a taxpayer must establish (1) that it pursued its rights diligently, and (2) that extraordinary circumstances outside of its control prevented it from filing on time. With respect to the first element of the *Menominee* test, the taxpayer did not present any evidence to support an argument that it diligently pursued its rights. Under § 7502(f), when a taxpayer files using a private delivery service rather than the U.S. mail, the "timely mailed, timely filed" rule of § 7502(a) applies only if the service is a "designated delivery service." During the year in question, FedEx Priority Overnight service was a designated delivery service, but the FedEx Express Saver service used by the taxpayer was not. *See* Notice 2016-30, 2016-18 I.R.B. 676. The taxpayer argued that its failure to meet the filing deadline was due to negligence on the part of its attorney or the attorney's staff. The Tax Court concluded, however, that the taxpayer did not diligently pursue its rights because there was no indication that it followed up with its attorney to ensure the petition was timely filed. Thus, the taxpayer did not meet the first requirement necessary to obtain equitable tolling. This alone was sufficient for the court to conclude that the taxpayer was not entitled to equitable tolling. The court went on, however, to inquire whether the taxpayer satisfied the second requirement to obtain equitable tolling, i.e., that extraordinary circumstances outside of its control prevented it from filing on time. The Tax Court concluded that the taxpayer failed to satisfy this second requirement as well. The Tax Court classified the error by the attorney's staff in selecting a delivery service was a "garden variety" type of negligence that does not warrant equitable tolling. *Citing Irwin v. Department of Veterans Affairs*, 498 U.S. 89, 96 (1990).

Conclusion. The Tax Court held that the 90-day period of § 7436(b)(2) is subject to equitable tolling but the taxpayer's circumstances did not warrant equitable tolling. Accordingly, the court granted the IRS's motion to dismiss for failure to state a claim on which relief can be granted.

2. If only I had cashed the check sooner! A taxpayer was not entitled to keep over $277,000 erroneously refunded to him because the government's action to recover it was timely: the two-year limitations period for the government to sue to recover an erroneous refund under § 7405 starts to run when the refund check clears the Federal Reserve. United States v. Page, 116 F.4th 822 (9th Cir. 9/12/24). Due to a clerical error, the IRS issued to the taxpayer a refund check in the amount of $491,104 when his refund should have been

only $3,463, which meant that the government had overpaid the taxpayer by $487,641. After the government demanded the return of the erroneous refund the taxpayer returned $210,000 but kept the remaining $277,641. The government brought legal action against the taxpayer in a U.S. District Court under § 7405 to recover the balance. Section 7405(a) authorizes the government to recover an erroneous refund through a civil action. According to § 7405(d), the limitations period for the government to bring such an action is specified in § 6532(b). Section 6532(b) provides that a suit to recover an erroneous refund is allowed if it is "begun within 2 years after the making of such refund." The District Court dismissed the government's complaint based on its view that the two-year limitations period began to run when the taxpayer received the refund check. Although the exact date on which the taxpayer received the check was not known, the government's complaint asserted that the refund check had been mailed on May 5, 2017, and that the taxpayer had cashed the check on April 5, 2018. The government brought legal action to recover the refund on March 31, 2020. The District Court apparently reasoned that the taxpayer must have received the check before March 31, 2018 (the date two years before the government brought legal action) because "it defies common sense to believe it took 330 days [from the date of mailing] for Page to receive the check in the mail." In an opinion by Judge Desai, the U.S. Court of Appeals for the Ninth Circuit reversed and remanded. The court held that a refund is "made" within the meaning of § 6532(b) "when the refund check clears the Federal Reserve and payment to the taxpayer is authorized by the Treasury." The taxpayer cashed the check on April 5, 2018, which meant that the check cleared on or after April 5, 2018. Therefore, the government's action to recover the erroneous refund, brought on March 31, 2020, was timely. In reaching this conclusion, the court relied on the U.S. Supreme Court's decisions in *United States v. Wurts*, 303 U.S. 414 (1938), in which the Court held that a refund is "made" within the meaning of the statute when it is paid (rather than when it is allowed), and *O'Gilvie v. United States*, 519 U.S. 79 (1996), in which the Court held that the limitations period of § 6532(b) begins to run when the taxpayer receives the refund check rather than when the check is mailed. The Court in *O'Gilvie* stated that "t]he date the check clears . . . sets an outer bound," but neither *Wurts* nor *O'Gilvie* expressly considered whether the date the check clears (rather than the date on which the check is received) should control the running of the two-year limitations period. According to the Ninth Circuit, both *Wurts* and *O'Gilvie* "made clear that *payment* triggers the statute of limitations under § 6532(b)." Further, the court stated, "[t]he date the check clears is the more appropriate benchmark for defining when a refund is paid." The court noted that "payment cannot be made until the funds change hands," and that funds do not change hands until the check is presented to the Federal Reserve and the Secretary of the Treasury authorizes payment. For example, the court observed, if the taxpayer had returned or shredded the refund check, the government would have no basis for bringing legal action against him. The court also was persuaded by the ability to determine with certainty when the check clears. In contrast, the precise date on which a taxpayer receives a refund check if often (as in this case) unknown. In addition, the court observed, treating the date the check clears as the date on which the refund is made avoids an unnecessary split among the U.S. Courts of Appeals. The two U.S. Courts of Appeals that have considered this question both concluded that the date on which the check clears is the date on which the refund is made. *United States v. Greene-Thapedi*, 398 F.3d 635 (7th Cir. 2005); *United States v. Commonwealth Energy System*, 235 F.3d 11 (1st Cir. 2000). Finally, the court observed that its prior decision in *United States v. Carter*, 906 F.2d 1375 (9th Cir. 1990), did not dictate a different result. Although in *Carter* the court had held that the date on which the refund check was received triggered the running of the two-year limitations period of § 6532(b), it had not addressed the current question of whether the date on which the check clears controls because, in *Carter*, the parties had asked the court to decide only whether the date of mailing or the date of receipt controlled. Because the government brought its action against the taxpayer in *Carter* within two years of the date of receipt, the court had not considered the question whether the date on which the check clears should control.

F. Liens and Collections

1. Third Circuit Holds the Tax Court has jurisdiction to review a taxpayer's tax liabilities regardless of the IRS's attempted use of refund offsets to moot the taxpayer's case. Zuch v. Commissioner, 97 F.4th 81 (3d Cir. 3/22/24). In this case, in an opinion by Judge Jordan, the U.S. Court of Appeals for the Third Circuit vacated the Tax Court's decision to dismiss as moot the taxpayer's petition to review a determination by the IRS's Office of Appeals in a collection due process (CDP) hearing. The main issue was whether, during the course of a Tax Court proceeding, the IRS can deprive the Tax Court of jurisdiction by taking the taxpayer's refunds in later years and applying them to her tax liability in an earlier year that is the subject of the Tax Court proceeding.

Background on deficiency proceedings versus collection due process proceedings. This case is heavy on tax procedure, leading us to include a brief review of the difference between Tax Court deficiency proceedings and CDP proceedings. With respect to a deficiency proceeding, when the IRS asserts that a taxpayer owes more than what was reflected on his or her tax return, the IRS will provide the taxpayer with a notice of deficiency. The taxpayer may then choose to file a petition in the Tax Court to dispute what they owe. If the Tax Court determines that the deficiency is less than the amount the taxpayer has paid, then pursuant to § 6512(b)(1), the court may order a refund of any overpayment. Alternatively, with respect to CDP proceedings, if a taxpayer does not pay the amount the IRS has calculated is due, the IRS may levy (seize and sell) a taxpayer's property. § 6331(a). However, prior to levying on a taxpayer's property, the IRS must provide notice of its intent to levy and give the taxpayer 30 days to request a CDP hearing with IRS Appeals. § 6330(a)(3)(B). In a CDP hearing, a taxpayer may raise "any relevant issue relating to the *unpaid tax* or the proposed levy." § 6330(c)(2)(A). Further, a taxpayer may challenge the existence or amount of his or her underlying *tax liability* for any period if he or she did not receive any notice of deficiency for such liability or did not otherwise have an opportunity to dispute such tax liability. § 6330(c)(2)(B). In essence, if the taxpayer had no opportunity to commence a deficiency proceeding, the CDP hearing provides an opportunity to challenge the *unpaid tax*, the proposed levy, *and* the underlying *tax liability*.

Background on unpaid tax versus tax liability. In this case, the Third Circuit examined the issue of and clarified the difference between an "unpaid tax" and a "tax liability." A tax liability is the "total amount of tax owed to the IRS after the allowance of any credits." Citing, *Tax Liability*, *West's Tax Law Dictionary* § T830. The court then gave a simple example to illustrate the difference: if a taxpayer owed $20 to the IRS and the taxpayer has already paid that $20, his or her tax liability is $0. Thus, a challenge by a taxpayer to an IRS determination of *tax liability* means the taxpayer disputes the IRS's determination of what he or she owes. § 6330(c)(2)(B). Alternatively, an issue relating to *unpaid tax* does not directly concern the amount or existence of the liability. § 6330(c)(2)(A). Rather, such an issue concerns the IRS's proposed collection activity. In this regard, the court provided a second example: if the IRS assesses $20 in taxes, then the unpaid tax is the $20 the IRS asserts is owed. However, in a further proceeding, the amount of unpaid tax might change. Thus, if a CDP hearing establishes that a taxpayer should have been credited $5 toward the $20 balance, the taxpayer's unpaid tax becomes $15.

Facts. In 2010, the taxpayer and her then husband made a $20,000 estimated tax payment. The taxpayer filed for divorce later in 2010 and elected married-filing-separately status. In 2011, the taxpayer's ex-husband made an additional $30,000 estimated tax payment for the 2010 tax year. However, when the taxpayer and her ex-husband made both of these estimated payments, they did not specify how they wanted the IRS to apply the payments in relation to each of their separate tax liabilities. The IRS later notified the taxpayer's ex-husband that it had applied all $50,000 of the estimated payments to the tax liability on the ex-husband's separate 2010 tax return. In 2012, the taxpayer amended her 2010 return to include additional income from a retirement distribution, which resulted in $27,682 of additional tax due. In relation to this additional tax, the taxpayer claimed the benefit of the $50,000 of estimated tax payments that the IRS had applied to her ex-husband's separate 2010 tax return. However, the IRS did not credit the $50,000 of estimated tax

payments to the taxpayer. Instead, the IRS took the position that the taxpayer still owed the $27,682 of additional tax. In 2013, the taxpayer's ex-husband amended his 2010 separate return and included a statement to the IRS that the $50,000 of estimated tax payments should be allocated to the taxpayer consistent with the taxpayer's 2010 request on her amended tax return. Instead of crediting the taxpayer, however, the IRS notified the ex-husband again that it had credited the full $50,000 to the ex-husband's account. In 2013, the IRS notified the taxpayer that it intended to levy on her property to collect unpaid tax.

In challenging the levy at the agency level, the taxpayer argued that she and her ex-husband had prepaid the tax that the IRS claimed was due in relation to her 2010 amended income tax return. The IRS Office of Appeals disagreed with the taxpayer and issued a notice of determination sustaining the levy. In September of 2014, the taxpayer challenged the notice of determination by filing a petition in the Tax Court. During the pendency of the Tax Court proceeding, the IRS withheld tax refunds that were owed to the taxpayer for the years 2013, 2014, 2015, 2016, and 2019. The IRS applied the refunds to the taxpayer's 2010 liability until it was reduced to zero. With no unpaid tax remaining on the taxpayer's 2010 tax year upon which to execute a levy, the IRS moved for, and the Tax Court granted, dismissal of the case.

Third Circuit's analysis: credit setoffs. The court initially found that the taxpayer's claim was not moot because the IRS's setoffs were invalid. In general, the IRS must refund any tax payments in excess of a taxpayer's tax liability. I.R.C. § 6402(a). The IRS is also allowed to apply a refund amount as a setoff against a taxpayer's unpaid tax. The IRS argued here that § 6512(b)(4) deprives the Tax Court of jurisdiction to review any reduction made by the IRS under § 6402 and that § 6512(b)(4) specifically blocks the Tax Court's jurisdiction to review setoffs and that this denial of jurisdiction extends to the Tax Court power to review setoffs in a CDP case. The court declined to agree with the IRS's argument, reasoning that, while Congress did not affirmatively grant the Tax Court power to review setoffs, it did implicitly grant the Tax Court authority to review setoffs in CDP cases. In coming to this conclusion, the court agreed with the Tax Court's reasoning that § 6402(a) is a statutory counterpart to the common law right to offset. *Boyd v. Comm'r*, 124 T.C. 296, 300 (2005). The common law of setoffs provides for judicial review of a claim being raised as an offset of government debt. *Agility Pub. Warehousing Co. K.S.C.P. v. U.S.*, 969 F.3d 1355, 1365 (Fed. Cir. 2020). Because § 6402 continues the common law rules of setoffs, the Tax Court has the power to review setoffs in a CDP proceeding. Having concluded that the Tax Court may review setoffs, the court then held that the IRS violated common law when it offset the taxpayer's later refunds against her original 2010 tax liability. The court followed the reasoning of the U.S. Court of Appeals for the Seventh Circuit, which indicated that setoffs are allowed only when debts are mutual. *Soo Line R.R. Co. v. Escanaba & Lake Superior R.R. Co.*, 840 F.2d 546, 551 (7th Cir. 1988). Regardless of the fact that § 6402 allows the IRS to credit overpayments to "any liability" of the taxpayer, the court adopted the taxpayer's argument that she did not have any tax liability. The IRS cannot simply declare that a taxpayer does have a tax liability and then take the position that it is allowed to effect a setoff. The court concluded that the IRS's actions here were an affront to the purposes of a CDP hearing and that the IRS's setoffs in this case violated Article III mootness principles. The IRS cannot unilaterally deprive the Tax Court of jurisdiction where a defendant, such as the taxpayer in this case, still has an avenue of relief. This is true even if the IRS had the taxpayer's estimated tax payments in its possession.

Third Circuit's analysis: §6330(c)(2)(B). The court then turned back to § 6330(c)(2)(B) and came to the same conclusion that the taxpayer's claim is not moot because the Tax Court retained jurisdiction to review her tax liability. The court reasoned that the taxpayer's claim under § 6330(c)(2)(B) allows her to also challenge at the CDP hearing the existence or amount of the tax liability. Thus, if a taxpayer does not receive a statutory notice of deficiency, she may contest the tax liability in the CDP hearing. In this regard, the court noted that its conclusions are at odds with those of the Fourth Circuit and the D.C. Circuit. *See McLane v. Comm'r*, 24th F.4th 316, 319 (4th Cir. 2022) (the phrase "underlying tax liability" in § 6330(c)(2)(B) must be read in the specific context of the IRS's attempt to collect via lien or levy); *Willson v. Comm'r*, 805 F.3d 316, 321

(D.C. Cir. 2015) ("all the relief that § 6330 authorizes the Tax Court to grant" is relief from levy and that, consequently, there is "no appropriate course of action for the Tax Court to take but to dismiss [a case] as moot" when the IRS withdraws its proposed levy). The court then concluded that, after the IRS Office of Appeals considers a taxpayer's claims in a CDP hearing and issues its notice of determination concerning a levy and the taxpayer's liability, the Tax Court obtains jurisdiction to review those determinations. Thus, the court concluded, a taxpayer's challenge to the tax liability at issue in a § 6330(c)(2)(B) action cannot be rendered moot where the IRS unilaterally applies refunds to the tax liability at issue as it did in this case.

In this case, the Tax Court had dismissed the taxpayer's case as moot because there was no unpaid liability in relation to the taxpayer's year at issue upon which a levy could be based. In reaching this conclusion, the Tax Court overruled the Tax Court's prior holding in *Greene-Thapedi v. Comm'r*, 126 T.C. 1 (2006). In *Greene-Thapedi*, on facts very similar to this case, the Tax Court relied on its prior precedents. See *Chocallo v. Comm'r*, T.C.M. 2004-152, *Gerakios v. Comm'r*, T.C.M. 2004-203. However, recently, in *Vigon v. Comm'r*, 149 T.C. 97 (2017), the Tax Court held that the IRS cannot unilaterally moot a case by withdrawing a proposed collection activity where the Tax Court had already obtained jurisdiction of a liability challenge when the petition was filed. *Vigon*, 149 T.C. at 107. The Tax Court reasoned that the case could not be rendered moot because the issue of liability remained even after collection issues had been resolved. *Id*. However, the Third Circuit distinguished *Vigon* from *Greene-Thapedi* because it involved a liability that had not been satisfied. The *Vigon* court reasoned that once jurisdiction to resolve a liability has been obtained, the Tax Court cannot be deprived of jurisdiction simply because the IRS decides to satisfy the asserted liability with the taxpayer's own funds. Finally, the Third Circuit held that the Tax Court is not required to have repayment or refund jurisdiction for a live dispute to be present. The Third Circuit adopted the analysis in a leading tax-procedure treatise which stated and explained the following:

> "[A] taxpayer's full payment of the previously unpaid tax liability should not render the entire case "moot" if the Tax Court otherwise has jurisdiction over the underlying liability. Full payment does not necessarily resolve the dispute as the Tax Court held.

Michael I. Saltzman & Leslie Book, IRS Practice & Procedure, para. 14B.16[4][a](West 2023).

Conclusion. The Third Circuit held that, in order to show mootness, the IRS has the burden of proving that the taxpayer here could not receive relief in any form if the Tax Court were to declare that she had a right to the estimated payments that she made. Further, in order to carry this burden, the IRS must prove that a determination by the Tax Court of the taxpayer's rights in her CDP case would not have preclusive effect on a future refund claim. While the IRS argued that such a determination would not have preclusive effect, the court found this argument to be unpersuasive citing a Chief Counsel notice indicating that "[a] judicial determination in a CDP case of taxpayer's underlying tax liability for a taxable year (which may be less than the taxpayer's payments for that year) may be subject to estoppel principles in a subsequent refund action[.]" I.R.S. Notice CC-2006-005 (Nov. 21, 2005), see also I.R.S. Notice CC-2009-010 (Feb. 13, 2009). Accordingly, the court vacated the Tax Court's order of dismissal and remanded the case to the Tax Court to determine whether the taxpayer is entitled to receive credit for the $50,000 of estimated payments that the taxpayer requested to have credit to her account.

a. *Zuch* a mess: SCOTUS resolves a circuit split concerning the Tax Court's (non?) jurisdiction over CDP cases in which the IRS ceases to pursue the collection action. Commissioner v. Zuch, 605 U.S. 422 (6/12/25), *rev'g and remanding* 97 F.4th 81 (3d Cir. 2024). The issue in this U.S. Supreme Court decision (8-1) on appeal from the Third Circuit was the same as in a few prior cases: Does the Tax Court retain jurisdiction under § 6330(d)(1) in collection due process ("CDP") cases when the IRS ceases to pursue the collection action (here a proposed levy) that gave rise to the CDP hearing. *See McLane v. Commissioner*, 24 F.4th 316 (4th Cir. 2022); *Willson v. Commissioner*, 805 F.3d 316 (D.C. Cir. 2015); *Greene-Thapedi v.*

Commissioner, 126 T.C. 1 (2006). In those prior CDP cases, the courts held that the Tax Court loses jurisdiction when there is no longer a tax liability and the IRS ceases to pursue the collection action that led to the CDP hearing. In this case, the Tax Court similarly held that it had lost jurisdiction to hear the taxpayer's case when, during the Tax Court proceedings, the IRS reduced the taxpayer's tax liability for the year in question (2010) to zero by offsetting (i.e., retaining) the taxpayer's refunds for later years and applying them as payments to her 2010 liability. The U.S. Court of Appeals for the Third Circuit reversed the Tax Court's decision and concluded that the dispute was not rendered moot by the IRS's application of her refunds as payments to 2010 and that the Tax Court continued to have jurisdiction to hear the case. The U.S. Supreme Court granted certiorari to resolve the split with the Fourth and D.C. Circuits.

How did we get here? Back in 2012, the taxpayer and her then-husband filed separate but untimely 2010 federal income tax returns. The taxpayer's return showed no balance due and her husband's return showed a substantial balance due. Subsequently, the taxpayer's then-husband negotiated an offer in compromise ("OIC") with the IRS to settle his 2010 liability as well as other outstanding tax liabilities. The OIC "implicated" (according to the Court) $50,000 in estimated tax payments for 2010 that had been paid by the taxpayer and her former husband. The IRS applied the full $50,000 to the husband's past due account, not the taxpayer's, because neither specified otherwise.[15] *See* 97 F.4th at 89. Later, in connection with divorce proceedings, the taxpayer was required to amend her 2010 tax return to report additional income from a previously unreported retirement distribution,[16] which resulted in another $28,000 in tax she owed for 2010. The taxpayer maintained, though, that the IRS should have credited the $50,000 in estimated tax payments to her IRS account (not her former husband's), entitling her to a $22,000 refund for 2010. The IRS disagreed and sought to collect the taxpayer's unpaid 2010 taxes by issuing a notice of intent to levy against her property under § 6331(a). The taxpayer contested the levy pursuant to § 6330(b) by demanding a CDP hearing with an IRS appeals officer. In the CDP hearing, the appeals officer rejected the taxpayer's argument regarding the allegedly misapplied $50,000 tax payment and issued a Notice of Determination under § 6330(c)(3) sustaining the levy. The taxpayer then appealed by filing a petition with the Tax Court under § 6330(d)(1). During the multi-year proceedings before the IRS and the Tax Court, the taxpayer filed annual federal income tax returns showing overpayments. Each time, the IRS applied these overpayments to the taxpayer's outstanding 2010 tax liability rather than issuing refunds. *See* IRC § 6402(a). Once the taxpayer's outstanding 2010 liability reached zero, the IRS moved to dismiss the Tax Court proceeding as moot, arguing that the Tax Court lacked jurisdiction because the IRS no longer had grounds to levy on the taxpayer's property. The Tax Court agreed with the IRS and dismissed the taxpayer's case. On appeal, however, the Third Circuit vacated the dismissal, holding that the IRS's abandonment of the levy did not moot the Tax Court proceedings. The Third Circuit stated: "Nothing in the plain language of § 6330 suggests a taxpayer's challenge to a tax liability under § 6330(c)(2)(B) can be rendered moot by the unilateral action of the IRS." 97 F.4th at 97. The Third Circuit's decision, however, arguably was contrary to the holdings of the Fourth and D.C. Circuits in *McLane v. Commissioner*, 24 F.4th 316 (4th Cir. 2022) and Willson v. Commissioner, 805 F.3d 316 (D.C. Cir. 2015), leading the U.S. Supreme Court to grant certiorari.

SCOTUS's 8-to-1 Decision. In an opinion by Justice Barrett, joined by seven other Justices, the Supreme Court framed the issue as follows. Section 6330(d)(1) grants the Tax Court

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[15] During an ABA webinar held on August 5, 2025, the attorney, Frank Agostino, who represented the taxpayer in *Commissioner v. Zuch* maintained that the husband's $50,000 payment was funded by an unauthorized distribution from his then-spouse's pension plan and, without going into details, that the husband had in fact directed the IRS to credit the payment to the taxpayer-spouse's account. The Third Circuit, though, stated that the taxpayer and her husband had not directed the IRS as to the allocation of the $50,000 payment. 97 F.4th at 89.

[16] Again, the fact that the taxpayer was required to amend her 2010 return in connection with divorce proceedings is not in the Supreme Court's opinion but was asserted by Mr. Agostino in the above-referenced ABA webinar.

jurisdiction to review a "determination" made by an IRS appeals officer in a CDP hearing as to whether a levy under § 6331(a) may proceed. The question in the case, therefore, was whether an adverse "determination" remained to be reviewed by the Tax Court when there was no longer a tax liability to be collected via a levy under § 6331(a). The IRS argued that because the taxpayer's 2010 tax liability had been satisfied (due to application of her subsequent overpayments against the liability under § 6402(a)) and the IRS would no longer levy her assets, there was no longer a "determination" to be reviewed by the Tax Court—meaning the Tax Court had no jurisdiction under § 6330(d)(1). The taxpayer argued that a "determination" within the meaning of § 6330(d)(1) should be read more broadly to encompass all the issues raised by the taxpayer in the CDP action, including misapplication of the $50,000 in estimated tax payments and the taxpayer's right to a refund with respect to 2010. The Court sided with the IRS, reasoning that a "determination" under § 6330(d)(1) refers to "the binary decision whether a levy may proceed." 605 U.S. at 429. Without an underlying levy, the "determination" no longer exists for the Tax Court to review under its limited § 6330(d)(1) jurisdiction.. Justice Barrett's opinion on behalf of the majority concludes:

> Of course, none of this means that [the taxpayer] lacks recourse against the IRS. Like any taxpayer, she may file a postdeprivation suit for a refund, see 28 U.S.C. §§ 1346(a)(1), 1491(a)(1), which she has in fact already done, see Complaint in Zuch v. United States, No. 2:25–cv–01900 (D NJ, Mar. 14, 2025).
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> Because there was no longer a proposed levy, the Tax Court properly concluded that it lacked jurisdiction to resolve questions about [the taxpayer's] disputed tax liability. The judgment of the Third Circuit is reversed, and the case is remanded for further proceedings consistent with this opinion.

The Court's opinion observed that the taxpayer was not left without a remedy. Had the IRS not sought to collect the tax via levy under § 6331(a), the Court pointed out, the taxpayer's only remedy vis-à-vis the IRS would have been to pursue an administrative claim for a refund. The IRS's denial of the taxpayer's refund claim then would have cleared the way for the taxpayer to file a refund suit in either a U.S. District Court or the U.S. Court of Federal Claims under 28 U.S.C. § 1346. The taxpayer, the Court stated, had already begun pursuing this remedy. *See* Complaint in *Zuch v. United States*, No. 2:25–cv–01900 (D.N.J. Mar. 14, 2025).

Gorsuch Dissent. Justice Gorsuch penned a lone dissenting opinion longer than Justice Barrett's 8-to-1 majority opinion deciding the case. Although his dissenting opinion rambles a bit—at least in the eyes of one author—Justice Gorsuch essentially did not buy into the majority's view that a "determination" under § 6330(d)(1) refers only to "the binary decision whether a levy may proceed." Like the Third Circuit, Justice Gorsuch stated in his dissent, "Nothing in the statute before us suggests that the IRS can deprive the Tax Court of jurisdiction simply by withdrawing a levy." 605 U.S. at 435. Instead, Justice Gorsuch reasoned that § 6330(d)(1) contains three key features arguing for preservation of the Tax Court's jurisdiction over a CDP case even when the § 6331(a) levy no longer is pursued by the IRS. *First*, "[h]ad Congress wished the Tax Court's jurisdiction to rise and fall with a levy, it obviously knew how to say so" because the term "levy" is used almost thirty times in § 6330 other than in § 6330(d)(1). 605 U.S. at 435. Justice Gorsuch illustrates his point by explaining that § 6330(d)(1) only refers to a "determination," not a "determination whether the levy may go forward." 605 U.S. at 438. *Second*, the Tax Court has recognized that if a challenge to the existence or amount of a taxpayer's liability is raised before IRS Appeals in a CDP hearing, then the Tax Court has jurisdiction to review those substantive challenges after an adverse decision by the IRS appeals officer conducting the CDP hearing. According to Justice Gorsuch, the authority granted to the Tax Court to hear substantive challenges to an underlying tax liability in the CDP context means that the Tax Court's "determination" review is more than merely an "up-or-down decision on a levy." 605 U.S. at 436. *Third*, § 6331(e)(1) states in part that "[n]otwithstanding the provisions of section 7421" (the general,

default anti-injunction statute), the Tax Court may enjoin "any action or proceeding" by the IRS. The use of the disjunctive "or" in § 6331(e)(1) regarding any action or proceeding implies, at least in Justice Gorsuch's view, that the existence or nonexistence of a pending levy does not necessarily deprive the Tax Court of jurisdiction under § 6330(d)(1). 605 U.S. at 436-37. He also pointed out that, if her case is not heard in the Tax Court, the taxpayer may not have the remedy (a refund action) that the majority suggests she does because of the limitations periods that apply to filing administrative claims for refund. *See* § 6511. Justice Gorsuch's dissenting opinion concludes:

> The short of it all is this. The IRS seeks, and the Court endorses, a view of the law that gives that agency a roadmap for evading Tax Court review and never having to answer a taxpayer's complaint that it has made a mistake. After today, § 6330 proceedings are essentially risk-free for the IRS. It may pursue a levy and argue its case to the Tax Court. Then, if the Tax Court seems likely to side with the taxpayer, the IRS can drop the levy and avoid an unfavorable ruling on the taxpayer's underlying tax liability. Doing so will often prove only a small setback for the IRS because the agency remains free to pursue other collection methods—including keeping, rather than refunding, a taxpayer's later overpayments. And the taxpayer will often find herself without any way to challenge the IRS's error or prevent the agency from keeping more of her money than it is lawfully due. Seeing nothing in the law compelling any of those results, I respectfully dissent.

605 U.S. at 442.

2. The government can collect unpaid FBAR penalties from an individual's monthly Social Security benefits and need not provide a CDP hearing before doing so, says the Tax Court. Jenner v. Commissioner, 163 T.C. 145 (10/22/24). The government assessed penalties against the petitioners, a married couple, for their alleged failure to file foreign bank account reports (FBARs) for 2005 through 2009. Each petitioner received a letter from the Treasury Department's Bureau of the Fiscal Service (BFS) informing them that the Treasury Offset Program would withhold funds from their monthly Social Security benefits. The letters directed the petitioners to contact BFS's Debt Management Servicing Center to prevent the collection from taking place. The petitioners requested a collection due process (CDP) hearing by submitting Forms 12153 to the Debt Management Servicing Center. Subsequently, the IRS informed the petitioners by letter that they did not qualify for a CDP hearing because the FBAR penalties that had been assessed were not "taxes" and therefore the procedural protection of the CDP hearing, which is authorized by § 6330, did not apply. In response, the petitioners filed a petition in the Tax Court. The Tax Court (Judge Foley) granted the government's motion to dismiss for lack of jurisdiction. The court agreed with the government that FBAR penalties are not taxes and that the court therefore had no jurisdiction to hear the cases. The court observed that section 6330(a)(1) requires the government to issue a notice before levying for the taxable period to which the "unpaid tax" relates. Similarly, § 6330(a)(3) requires the notice to inform the taxpayer of "the amount of unpaid tax." Section 6330(c)(1) permits the taxpayer to raise at the CDP hearing "any relevant issue relating to the unpaid tax." FBAR penalties, however, are imposed by 31 U.S.C. § 5321(a)(5), a provision outside of title 26 of the United States Code, and are not a "tax" and no lien or levy is authorized to collect the penalties. Because FBAR penalties are not a tax and no lien or levy is available to the government to collect them, the procedural protection of a CDP hearing is not available. The Tax Court is a court of limited jurisdiction and, pursuant to § 6330(d)(1), has jurisdiction to review any determination made by the IRS following a CDP hearing. The court observed that it had consistently held that the issuance of a valid notice of determination is required in order for the court to have jurisdiction pursuant to § 6330(d)(1). *See Goza v. Commissioner*, 114 T.C. 176, 182 (2000). Further, the court explained, it has jurisdiction under § 6330(d)(1) to review a petition only "where the administrative determination concerns a tax over which the Court generally has jurisdiction." *Id.* Because the government had not issued a valid notice of determination concerning a tax in this case, the court held, it had no jurisdiction to hear the petitioner's case.

3. A taxpayer has no right to a CDP hearing when the IRS files a notice of federal tax lien pursuant to article 26A of the U.S.-Canada tax treaty, which authorizes the IRS to collect Canadian tax assessments on behalf of Canada. Ryckman v. Commissioner, 163 T.C. 46 (8/1/24). The taxpayer in this case resided in Arizona. In 2017, pursuant to article 26A(2) of the U.S.-Canada tax treaty, the Canada Revenue Agency sent to the IRS a mutual collection assistance request seeking assistance in collecting approximately $200,000 in Canadian tax owed by the taxpayer for 1994 and 1995. The U.S. Competent Authority, an office within the IRS, granted the request and an IRS revenue officer mailed a notice of federal tax lien to the Maricopa County Recorder in Phoenix. The revenue officer also mailed to the taxpayer a letter informing her that the notice of federal tax lien had been filed. The letter stated both "that you have the right to a hearing to discuss collection options" and that a hearing under Code § 6320(b), commonly known as a collection due process (CDP) hearing, was "NOT available to you as a Canadian taxpayer in the United States." Nevertheless, the taxpayer requested a CDP hearing by filing Form 12153, Request for a Collection Due Process or Equivalent Hearing. The request indicated that the taxpayer could not pay the balance due and asked the IRS to consider an installment agreement. The revenue officer responded to the taxpayer's request by sending a letter denying the request for a CDP hearing for the following reason:

> Because the foreign tax liability is treated as a finally determined U.S. tax liability, your procedural rights to restrain collection under U.S. law through a CDP hearing under Internal Revenue Code Sections 6320 or 6330 are treated as lapsed or exhausted.

The letter also informed the taxpayer that she could request review under the IRS's Collection Appeal Program. The taxpayer filed a petition in the Tax Court asking the court to determine that the IRS had erred in denying her request for a CDP hearing and that the case should be remanded to IRS Appeals for a CDP hearing.

Tax Court's opinion. In a reviewed opinion (7-1-6) by Judge Copeland, the Tax Court held that the taxpayer had no right to a CDP hearing, that the IRS letter denying her request for a CDP hearing was not a determination regarding her request, and that the court therefore had no jurisdiction to consider her petition. Accordingly, the court granted the government's motion to dismiss for lack of jurisdiction. In general, §§ 6320(a) (liens) and 6330(a) (levies) require the IRS to notify the taxpayer when the IRS has filed a federal tax lien or proposes to levy on the taxpayer's assets to collect tax and to inform the taxpayer of the taxpayer's right to request a CDP hearing. According to § 6330(d)(1), a taxpayer who requests a CDP hearing can, "within 30 days of a determination under this section, petition the Tax Court for review of such determination." The court observed that treaties to which the U.S. is a party and statutes such as the Internal Revenue Code are on equal footing, that courts should endeavor to construe treaties and statutes to give effect to both when they relate to the same subject, and that if a treaty and a statute are inconsistent with each other, then the one that is later in time controls.[17] Article 26A(4)(a) of the U.S.-Canada tax treaty provides that, when the U.S. accepts a Canadian revenue claim, the U.S. must treat the claim "as an assessment under United States laws against the taxpayer," which means, the court stated, that the U.S. must treat the accepted claim as a U.S. tax assessment. However, Article 26A(3) provides that an accepted revenue claim

[17] See, e.g., I.R.C. § 894(a) ("the provisions of this title shall be applied to any taxpayer with due regard to any treaty obligation of the United States which applies to the taxpayer."); I.R.C. § 7852(d)(1) ("For purposes of determining the relationship between a provision of a treaty and any law of the United States affecting revenue, neither the treaty nor the law shall have preferential status by reason of its being a treaty or law."); *Whitney v. Robertson*, 124 U.S. 190, 194 (1888) (courts should attempt to harmonize treaties and statutes, but, when the two conflict, the later in time controls).

> shall be collected by the requested State as though such revenue claim were the requested State's own revenue claim finally determined in accordance with the laws applicable to the collection of the requested State's own taxes.

A claim is "finally determined" for this purpose, according to Article 26A(2),

> when the applicant State has the right under its internal law to collect the revenue claim and all administrative and judicial rights of the taxpayer to restrain collection in the applicant State have lapsed or been exhausted.

The court interpreted these provisions to mean that that "when the United States accepts a Canadian revenue claim, the claim must be treated as a U.S. tax assessment for which all rights to restrain collection have lapsed or been exhausted." In other words, the U.S. must treat the revenue claim as a U.S. tax assessment for which the taxpayer's administrative and judicial rights to restrain collection, including the right to a CDP hearing, have been exhausted. Therefore, the court concluded, the taxpayer had no right to a CDP hearing and the IRS's letter denying her request for a CDP hearing was not a "determination" within the meaning of Code § 6330(d)(1). Because there was no determination by the IRS, the court reasoned, the court had no jurisdiction to consider the taxpayer's petition.

In reaching these conclusions, the court rejected the taxpayer's argument that the statutes providing for the right to a CDP hearing and the provisions of the U.S.-Canada tax treaty were in conflict. The statutes in question, §§ 6320 and 6330, were enacted in 1998, and article 26A of the U.S.-Canada tax treaty became effective in 1995. Thus, if the treaty conflicts with the statutes, the statutes, which were later in time, would control. The court, however, reasoned that the statutes and the treaty were not in conflict. The statutes, the court explained, provide taxpayers with the right to restrain collection by requesting a CDP hearing but also limit administrative and judicial review. In the same way, according to the court, article 26A of the treaty "forecloses those default rights in the context of Canadian revenue claims accepted by the IRS." Thus, the court concluded, "it is entirely possible to construe the CDP statutes and Treaty Article XXVI A so as to give effect to both, and we are therefore bound to do so."

Concurring opinion of Judge Jones. In a concurring opinion, Judge Jones emphasized the importance of adhering to the text of a treaty, "which is an agreement that was negotiated and duly enacted pursuant to the authority vested in the political branches under our constitutional scheme." The court's opinion, she stated, is consistent with the court's "role in interpreting treaties[, which] is to faithfully interpret the text of the agreement. The dissenting opinion, in her view, "misses the forest for the trees in its effort to create friction between the Code and the Court's interpretation of the Treaty."

Dissenting opinion. In a dissenting opinion, Judge Urda (joined by Judges Buch, Pugh, Ashford, Toro, and Weiler) argued that the court's interpretation of the U.S.-Canada tax treaty as foreclosing procedural protections to taxpayers who receive a notice of federal tax lien results in an irreconcilable conflict with the procedural protections later enacted by Congress in sections 6320 and 6330. The court's opinion, in his view, "makes a half-hearted attempt to harmonize the two authorities, but the clash remains." But, he asserted, it does not have to be this way. He argued that it is possible to read the treaty provisions in a way that does not result in such a conflict. Specifically, Judge Urda argued, the treaty provisions in question distinguish between the *substance* of a revenue claim and the *procedures* by which the claim is to be collected. With respect to the substance of a revenue claim, the treaty uses the law of the applicant country. And with respect to the procedures by which the claim is collected, the treaty uses the law of the requested country. Under this reading of the treaty, when the treaty refers to a revenue claim as being "finally determined" in the sense that "all administrative and judicial rights of the taxpayer to restrain collection in the applicant State have lapsed or been exhausted," the treaty forecloses any inquiry in the requested state into the substantive validity of the claim. But the treaty does not, in his view, take away the procedural protection of a CDP hearing in the requested state (here the U.S.):

> The most apt reading of the relevant provisions together is that the exhaustion text of Paragraph 2 is confined to that Paragraph and that the normal collection procedures of the requested state apply. Under this reading, there is no conflict with the CDP safeguards, including the requirements of a hearing and judicial review.

In summary, the dissent argued that the treaty provisions and the relevant provisions of the Code do not conflict and preserve the taxpayer's right to a CDP hearing.

4. Ninth Circuit affirms the Tax Court, holding that the taxpayer's offer in compromise (OIC) was not deemed to be accepted but was instead rejected by operation of law when the Service returned the OIC within the statutory period of time. Brown v. Commissioner, 116 F.4th 861 (9th. Cir. 8/29/24). In general, a taxpayer who challenges a notice of federal tax lien or the IRS's intent to levy is entitled to a collection due process (CDP) hearing before the IRS Office of Appeals. See §§ 6320, 6330. Included among the issues that can be raised in a CDP hearing is a taxpayer's offer in compromise (OIC). At the conclusion of a CDP hearing, the assigned Appeals Officer must issue a notice of determination that, among other things, addresses all issues raised by the taxpayer, including any OIC made by the taxpayer. § 6330(c)(3), Reg. § 301.6330-1(e)(3). Under a separate statutory authorization, § 7122, Compromises, the IRS may compromise the amount of tax, interest or certain penalties assessed. § 7122(b). Under the § 7122 regime, a taxpayer submits an OIC and the offer remains pending until it is "accepted for processing" by the IRS. Reg. § 601.7122-1(d)(2). If an offer is accepted for processing and the IRS later returns the offer, the IRS's acceptance is deemed to be pending only during the period between the date the offer is accepted for processing and the date the IRS returns the offer to the taxpayer. *Id*. Under § 7122(f), an OIC is deemed to be accepted if the OIC is not rejected by the IRS before the date which is 24 months after the date the OIC was submitted. *Id*. Thus, if the IRS fails to act on a taxpayer's OIC within two years of the taxpayer's submission of the OIC, the IRS may not then reject the offer. However, "[a]n offer will not be deemed to be accepted if the offer is, within the 24-month period, rejected by the Service, [or] *returned* by the Service..." Notice 2006-68, § 1.07, 2006-2 C.B. 105, 106 (emphasis added). Brown, the taxpayer in this case, was served with a notice of tax lien on his property for unpaid taxes. The taxpayer requested a CDP hearing and submitted an OIC. Within seven months, the IRS returned Taxpayer's OIC because it was not processable. More than twenty-four months after the OIC was submitted, the IRS Appeals Officer sustained the notice of tax lien, ruling against the taxpayer.

Taxpayer's argument and history: The taxpayer brought his claim initially in the Tax Court (Brown I). In *Brown I*, the taxpayer argued that the IRS had not formally rejected his OIC within the 24-month period after he had submitted the OIC. See *Brown v. Comm'r (Brown I)*, T.C. Memo. 2016-82. Therefore, argued the taxpayer, the OIC was "deemed accepted" by operation of law under § 7122(f). *Id.* In *Brown II*, Taxpayer appealed the Tax Court's decision in *Brown I*. On appeal, the U.S. Court of Appeals for the Ninth Circuit agreed with the Tax Court's conclusion that, because the IRS had returned Brown's OIC within one year after Brown had submitted his OIC, Brown's offer was not accepted by operation of law under § 7122(f). *Brown v. Comm'r (Brown II)*, 826 Fed. App'x 673, 674 (9th Cir. 2020). In *Brown II*, the Ninth Circuit explained that an OIC "will not be deemed to be accepted if the offer is, within the 24-month period, rejected by the IRS or returned to the taxpayer as nonprocessable or no longer processable." *Brown II*, 826 Fed. App'x at 674. The Ninth Circuit concluded in Brown II that, because "the IRS returned Brown's offer well before the 24 months had elapsed since the submission of the offer-in-compromise," the OIC was not accepted by operation of law under § 7122(f). In this case, the taxpayer argued that, because he submitted his OIC during a CDP hearing, only a notice of determination from the Office of Appeals can serve as a rejection which would terminate the 24-month rejection period.

Ninth Circuit's analysis: In disagreeing with Brown's argument, the Ninth Circuit held that the return of an OIC constitutes a "rejection" under § 7122(f). The Ninth Circuit reasoned that, because the OIC was "returned by the Service to the taxpayer as "nonprocessable" less than seven months after the offer was submitted, the offer was not pending for more than 24 months and, therefore,

was not "deemed to be accepted" for purposes of § 7122(f). *See* Notice 2006-68, § 1.07, 2006-2, C.B. 105-106. In coming to this conclusion, the Ninth Circuit specifically agreed with the statement made in § 1.07 of Notice 2006-68, which provides, "[t]he period during which the Office of Appeals considers a rejected offer in compromise is not included as part of the 24 month period because the offer was rejected within the meaning of section 7122(f) prior to consideration of the offer by the Office of Appeals." Stated otherwise, the Ninth Circuit did not agree with the taxpayer's argument that § 6330 operates such that only the Office of Appeals' notice of determination can result in a § 7122(f) rejection because it is a notice of determination. Further, the Ninth Circuit did not agree that the Collection Division's return of the OIC to the taxpayer is not a rejection that is final and appealable. The Ninth Circuit, therefore, did not agree with the Taxpayer's argument that the requirements imposed on the Office of Appeals under § 6330 render the Collection Division's role in the context of a CDP hearing procedurally meaningless. In this regard, the Ninth Circuit reasoned that the taxpayer here (as well as the dissenting judge in this case) mistakenly combine the two separate statutory requirements into one. The Ninth Circuit reasoned that the requirement under § 6330 that the Office of Appeals issue a final notice of determination following a CDP hearing is separate and distinct from the requirement under § 7122(f) that the IRS act on an OIC within 24 months to prevent a "deemed acceptance." The Ninth Circuit ruled that when the Collection Division returned the Taxpayer's OIC as nonprocessable, the Taxpayer's offer was considered closed. As it was considered closed, the Taxpayer's OIC cannot be deemed to be accepted under § 7122(f) based on the Office of Appeals not issuing a notice of determination.

Concurrence: In concurring with Judge Wardlaw, who wrote the majority opinion, Judge Lee distinguished the process under § 7122 from that of § 6330. Judge Lee reasoned that § 7122 creates an administrative process meant to address a taxpayer's standalone submission of an OIC. Under that process, the IRS has assigned processing and investigation of OICs to the IRS's Centralized Offer-in Compromise (COIC) Unit and Collection Division. If the COIC Unit and the Collection Division reject a taxpayer's OIC then, under § 7122, the taxpayer can appeal only to the Office of Appeals, an independent organization within the IRS. In contrast to the procedures under § 7122, § 6330 provides for a more thorough process incorporating due process concerns and, therefore, CDP hearings. Under § 6330, the Office of Appeals is not bound to any timeline. However, once the Office of Appeals issues a determination, the taxpayer is allowed to judicial review. Judge Lee noted that the taxpayer here requested a longer, more robust, CDP hearing under § 6330 but improperly contends that the § 7122(f) twenty-four-month limitation applies. However, nothing in the text of § 6330 allows for the incorporation of § 7122's procedural requirements into § 6330. In short, the 24-month time clock cannot be imported into the requirements of a CDP hearing. Thus, according to Judge Wardlaw, § 7122(f) does not apply to an OIC submitted during a CDP hearing.

Dissent: Judge Bumatay, on the other hand, engaged in a labyrinth of analysis and observed in a dissenting opinion that the Ninth Circuit panel (consisting of Judges, Wardlaw, Lee, and Bumatay) was split three ways. Judge Bumatay therefore concluded that none of the findings and pronouncements in this case are precedential. Rather, based on his reading of the Code, Judge Bumatay would have reversed the Tax Court and held that the appeals officer in this case needed to return Brown's OIC within the 24-month period. Upon expiration of the 24-month period in this case, he reasoned, the taxpayer's OIC should have been deemed accepted.

G. Innocent Spouse

H. Miscellaneous

1. Yet another *Green* decision under the APA regarding listed transaction notices has the IRS and Treasury seeing red, but final regulations provide a blackletter law counterpunch. We previously have written about successful taxpayer challenges to the IRS process of issuing administrative notices identifying "listed transactions" (a subset of "reportable transactions") under Reg. § 1.6011-4(b)(2), thereby potentially triggering enhanced penalties for

noncompliance. Generally, taxpayers participating in such listed transactions must file special disclosures with the IRS under § 6011(a). *See Form 8886, Reportable Transaction Disclosure Statement*. Material advisors (as defined) to such participating taxpayers are also subject to special disclosure and list maintenance requirements under § 6112(a). *See Form 8918, Material Advisor Disclosure Statement*. In addition, taxpayers and their material advisors may be subject to enhanced penalties and criminal sanctions for failing to properly disclose, and for participating in, such transactions. *See* §§ 6662A; 6707; 6707A; 6708. At least three courts have held that the IRS violated the Administrative Procedures Act ("APA") by issuing certain listed transaction notices. Specifically, the Sixth Circuit, the U.S. District Court for the Eastern District of Tennessee, and the U.S. Tax Court have determined that the three distinct listed transaction notices at issue in those cases were "legislative rules" subject to the notice-and-comment procedures of the APA. Further, because the IRS did not publish an advanced notice of proposed rulemaking inviting public comment before issuing the notices, the courts invalidated them. *See Mann Construction, Inc. v. United States*, 27 F.4th 1138 (6th Cir. 2022) (invalidating Notice 2007-83, 2007-2 C.B. 960, which identified certain business trust arrangements utilizing cash value life insurance purportedly to provide welfare benefits as listed transactions); *CIC Services, LLC v. Internal Revenue Service*, 592 F. Supp. 3d 677 (E.D. Tenn. 2022), *as modified by unpublished opinion*, 2022 WL 2078036 (2022) (invalidating Notice 2016-66, 2016-47 I.R.B. 745, as modified by Notice 2017-8, 2017-3 I.R.B. 423, which identified certain micro-captive insurance arrangements as listed transactions); *Green Valley Investors, LLC v. Commissioner*, 159 T.C. 80 (2022) (invalidating Notice 2017-10, 2017-4 I.R.B. 544, which identified post-2009 syndicated conservation easements as listed transactions). After initially contesting the application of the APA to the listed transaction notices at issue in *Mann Construction*, *CIC Services*, and *Green Valley Investors*, the IRS and Treasury practically have conceded, responding in at least two instances with proposed APA-compliant listed transaction regulations in place of invalidated notices. *See* REG-109309-22, Micro-Captive Listed Transactions and Micro-Captive Transactions of Interest, 88 FR 21547 (4/11/23) and REG-106134-22, Syndicated Conservation Easements as Listed Transactions, 87 F.R. 75185 (12/8/22). The latter proposed regulations regarding syndicated conservation easements have been finalized and are discussed further below. For additional background, see Announcement 2023-11, 2023-17 I.R.B. 798. The recent developments summarized immediately below are another installment in the APA tug-of-war between taxpayers and the IRS concerning listed transaction notices under Reg. § 1.6011-4(b)(2) that may implicate enhanced penalties under §§ 6662A; 6707; 6707A; 6708.

a. IRS and Treasury see red after *Green*(s). Green Rock LLC v. Internal Revenue Service, 104 F.4th 220 (11th Cir. 6/4/24), *aff'g* 654 F. Supp. 3d 1249 (2023). The taxpayer in this case was a promoter/material advisor of syndicated conservation easements. As such, the taxpayer was subject to Notice 2017-10, 2017-4 I.R.B. 544, which identified post-2009 syndicated conservation easements as one type of listed transaction under Reg. § 1.6011-4(b)(2). Further, as a promoter/material advisor to a listed transaction, the taxpayer potentially was subject to enhanced penalties under § 6707A. The taxpayer complied with Notice 2017-10 and the reportable transaction regime throughout the relevant years, including filing *Form 8886, Reportable Transaction Disclosure Statement*, and *Form 8918, Material Advisor Disclosure Statement*. Nevertheless, the taxpayer filed suit in the U.S. District Court for the Northern District of Alabama in 2021, alleging that Notice 2017-10 was invalid under the APA. Like taxpayers in previous similar cases, the taxpayer argued that the IRS had failed to comply with the APA by issuing Notice 2017-10 without providing a formal notice of proposed rulemaking inviting public comment. The district court agreed, setting aside Notice 2017-10 as applied to the taxpayer. *See Green Rock LLC v. Internal Revenue Service*, 654 F. Supp. 3d 1249 (2023). The taxpayer undoubtedly was emboldened by the Tax Court's 2022 decision against the IRS in another "Green" case, *Green Valley Investors* (cited above). By an 11-4-2 vote, the Tax Court invalidated Notice 2017-10 under the APA in that case.

IRS's implicit APA exemption and slippery slope arguments: On appeal before the Eleventh Circuit, the IRS argued, as it had in similar cases, that Notice 2017-10 is exempt from the APA's

notice-and-comment procedures because Congress was aware of the IRS's practice of identifying listed transactions by administrative notice when it enacted § 6707A (and other such enhanced penalties) *in 2004 after* the reportable transaction regime of Reg. § 1.6011-4 was finalized *in 2003*. More precisely, Reg. § 1.6011-4(b)(2) allows the IRS to identify listed transactions "by notice, regulation, or other form of published guidance." Thus, according to the IRS, Congress implicitly approved the process of identifying listed transactions by administrative notice without requiring the IRS to comply with the APA because Congress enacted § 6707A (and other such enhanced penalties) with the above-quoted language of Reg. § 1.6011-4(b)(2) in mind. Moreover, to bolster its position before the Eleventh Circuit, the IRS also made a classic "slippery slope" argument: upholding the district court's decision would "eliminate every listed transaction to date" identified by the IRS. (For a complete list, see the IRS website, "Recognized abusive and listed transactions" (last accessed 12/1/2024).)

Eleventh Circuit Opinion: A three-judge panel of the Eleventh Circuit, in an opinion by Chief Judge Pryor, rejected the IRS's arguments and affirmed the district court, invalidating Notice 2017-10 under the APA as applied to the taxpayer. *First*, the Eleventh Circuit was not persuaded by the IRS's implicit APA exemption argument because, as Chief Judge Pryor wrote, "Congress may choose to exempt an agency from notice and comment if 'it does so expressly,'" but "[n]o such express language appears in [§ 6707A]." 104 F.4th at 226-27. Further examining § 6707A, Chief Judge Pryor pointed out that the statute expressly defines the terms "reportable transaction" and "listed transaction." A reportable transaction is defined in § 6707A(c)(1) as "any transaction with respect to which information is required to be included with a return or statement because, *as determined under regulations prescribed under section 6011*, such transaction is of a type which the Secretary determines as having a potential for tax avoidance or evasion." (Emphasis added.) A listed transaction is defined in § 6707A(c)(2) as "a reportable transaction which is the same as, or substantially similar to, a transaction specifically identified by the Secretary as a tax avoidance transaction for purposes of section 6011." The Eleventh Circuit was unwilling to accept the IRS's argument that the phrase "as determined under regulations prescribed under section 6011" in the § 6707A(c)(1) definition of reportable transaction incorporated by reference the above-quoted language in Reg. § 1.6011-4(b)(2) authorizing the IRS to identify listed transactions (a subset of reportable transactions) by administrative notice. Instead, relying in part upon the Sixth Circuit's decision in *Mann Construction* (cited above) and the Tax Court's decision in *Green Valley Investors* (cited above), the Eleventh Circuit determined that "an indirect series of cross-references hardly suffices as the 'express' indication [by Congress] necessary to supplant the baseline *procedures* of the [APA]." 104 F.4th at 228.

Second, concerning the IRS's slippery slope argument, the Eleventh Circuit reasoned that pre-2004 listed transactions—28 out of 34 according to the court based upon the IRS's website—were not backed by enhanced statutory penalties and criminal sanctions at the time of their issuance; however, the 2004 enactment of § 6707A (and other related provisions) authorized higher penalties and criminal sanctions. The Eleventh Circuit determined that the IRS's power beginning in 2004 to impose enhanced penalties and criminal sanctions for noncompliance by agency pronouncement implicated the APA notice-and-comment requirements, notwithstanding the pre-existing administrative notice process contemplated by Reg. § 1.6011-4(b)(2). According to the Eleventh Circuit, the APA notice-and-comment requirements applied because the listed transaction notices issued by the IRS during or after 2004 were "legislative" (not "procedural") rules due to the potentially applicable enhanced penalties and criminal sanctions that did not exist before 2004. 104 F.4th at 228. Arguably, then, pre-2004 listed transaction notices issued by the IRS need not comply with the APA, whereas IRS listed transaction notices issued in 2004 and thereafter must abide by the APA, presumably not by administrative notice but by the issuance of Treasury regulations subject to the notice-and-comment process. In fact, Chief Judge Pryor read the Tax Court's opinion in *Green Valley Investors* (cited above), especially Judge Pugh's concurrence, to suggest as much because Judge Pugh wrote in a footnote:

> Our holding does not invalidate notices that had been issued before Congress enacted penalties. Those notices are not before us today and the circumstances surrounding their issuance are distinguishable. And Congress would be presumed to know about and adopt pre-existing notices when it adopted pre-existing procedures for identifying listed transactions.

159 T.C. at 111 n. 5. Nevertheless, Chief Judge Pryor concluded by clarifying and narrowing the scope of the Eleventh Circuit's opinion, writing:

> [W]e do not purport to rule on the validity of any listed transaction not before us. Our decision is specific to Notice 2017-10. Because the notice was a legislative rule and Congress did not expressly exempt the Service from notice-and-comment rulemaking, Notice 2017-10 is not binding on [the taxpayer].

104 F.4th at 229.

Concurring Opinion: Judge Jordan concurred in the court's opinion and judgment affirming the district court, but wrote separately to explain that he would have held for the taxpayer on slightly different grounds. Judge Jordan reasoned that by enacting § 170(h)(7) in 2022 restricting charitable deductions via syndicated conservation easements,[18] Congress "effectively eliminated, on a going-forward basis, the deductions that Notice 2017-10 would have made subject to disclosure." 104 F.4th at 229. Accordingly, Jordan agreed with Judge Toro's concurring Tax Court opinion in *Green Valley Investors* (cited above) that, as the IRS argued, there is little doubt Congress enacted § 6707A in 2004 with the 2003 pre-existing Reg. § 1.6011-4(b)(2) listed transaction notice process in mind. (Chief Judge Pryor's opinion on behalf of the Eleventh Circuit did not concede this aspect of the IRS's implicit APA exemption argument.) Nonetheless, Judge Jordan agreed that Congress must have intended the APA to apply to Notice 2017-10 because of the way § 6707A(c)(1)-(2) are written. The phrase "as determined under regulations prescribed under section 6011" used in § 6707A(c)(1)'s definition of a reportable transaction is omitted from § 6707A(c)(2)'s definition of a listed transaction. Thus, Judge Jordan surmised that Congress must have envisioned the IRS complying with both the APA and Reg. § 1.6011-4 when issuing listed transaction notices. Judge Jordan's concurring opinion does not elaborate, but presumably he would not confine the listed transaction notice process of Reg. § 1.6011-4(b)(2) to pre-2004 IRS sub-regulatory guidance. Instead, Judge Jordan apparently believes that a future listed transaction notice or other sub-regulatory guidance issued by the IRS (instead of Treasury regulations) is permissible provided the publication of the notice follows the notice-and-comment process mandated by the APA.

Comment: Although not expressly stated in Chief Judge Pryor's opinion—especially considering his concluding language quoted above—the practical implication of the Eleventh Circuit's reasoning in *Green Rock* (along with the Sixth Circuit's decision in *Mann Construction*, the U.S. District Court's decision in *CIC Services*, and the Tax Court's decision in *Green Valley Investors*) appears to be that the IRS's identification of listed transactions in 2004 and thereafter (i.e., after § 6707A and similar penalties were enacted) must proceed by regulations issued in full compliance with the APA, not merely IRS pronouncements or other sub-regulatory guidance. It is thus understandable, at least in the authors' view, that the additional burden imposed upon the IRS

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[18] New § 170(h)(7)(A) generally provides that a contribution by a partnership is not treated as a qualified conservation contribution (and therefore no deduction is allowed)—whether via a direct contribution or as an allocable share from a lower-tier partnership—if the amount of the contribution exceeds "2.5 times the sum of each partner's relevant basis" in the partnership. The term "relevant basis" is defined by new § 170(h)(7)(B)(i) to mean that portion of a partner's "modified basis" which is allocable (under rules similar to those used under § 755) to the real property comprising the qualified conservation contribution. "Modified basis" (defined in § 170(h)(7)(B)(ii)) essentially refers to a partner's outside basis exclusive of the partner's share of partnership liabilities under § 752. Thus, relevant basis appears to equate to an investor's cash investment (a/k/a initial tax and book capital account) in a syndicated conservation easement partnership.

and Treasury has those agencies seeing red after the decisions in *Mann Construction*, *CIC Services*, and *Green Valley Investors*. *See* Announcement 2023-11, 2023-17 I.R.B. 798 (cited above and stating, "The Department of the Treasury (Treasury Department) and the IRS disagree with the recent court decisions holding that listed transactions cannot be identified by notice or other subregulatory guidance. However, the Treasury Department and IRS will no longer take the position that transactions of interest can be identified without complying with APA notice-and-comment procedures.")

b. IRS admits losing the first several rounds but doesn't entirely give up the fight. A.O.D. 2024-1, 2024-52 I.R.B. 1354 (12/23/2024). Begrudgingly, perhaps, the IRS issued this action on decision late in 2024 admitting defeat in *Mann Construction*, *Green Valley Investors*, and *Green Rock*, but only with respect to listed transaction notices issued after enactment of the American Jobs Creation Act of 2004 (ACJA). Specifically, A.O.D. 2024-1 broadly provides the following, of which litigants should take particular notice:

> The Service will follow the Sixth and Eleventh Circuit and the Tax Court decisions in all circuits and will no longer defend post-AJCA reportable transaction notices. The Service will not enforce the disclosure and reporting requirements set forth in those notices and will not assert penalties under sections 6662A, 6707, 6707A, and 6708 resulting from identification of reportable transactions pursuant to post-AJCA guidance that did not go through notice-and-comment rulemaking procedures. The Service will also not take the position that transactions are reportable transactions solely due to being identified in post-AJCA guidance that did not go through notice-and-comment rulemaking procedures for purposes of other legal provisions; for example, the Service will not assert the exception to the assessment period of limitations under section 6501(c)(10) or the exception to the suspension of interest rules under section 6404(g)(2)(E) with respect to these transactions. Further, the Service will concede or abate penalties asserted under sections 6662A, 6707, 6707A, and 6708 in ongoing cases (whether pending in Tax Court and district courts or cases at any stage in which taxpayers request the abatement, removal, or refund of penalties administratively) resulting from identification of reportable transactions pursuant to post-AJCA notices that did not go through notice-and-comment rulemaking procedures. The Service will not take these steps in cases where there is a court-approved settlement or closing agreement relating to the aforementioned penalties, there is an existing final court decision, or the applicable statutes of limitations have expired. This AOD does not apply to pre-AJCA notices.

c. IRS and Treasury's blackletter law counterpunch for syndicated conservation easement transactions. T.D. 10007, Syndicated Conservation Easement Transactions as Listed Transactions, 89 F.R. 81341 (10/8/24). As mentioned above, before the Eleventh Circuit's decision in *Green Rock* (cited above), but after the Tax Court's decision in *Green Valley Investors* (cited above), Treasury and the IRS issued proposed regulations identifying syndicated conservation easements as a listed transaction for purposes of §§ 6111(a); 6012(a); 6662A; 6707; 6707A; and 6708. *See* REG-106134-22, Syndicated Conservation Easements as Listed Transactions, 87 F.R. 75185 (12/8/22). The required APA notice-and-comment period ensued and passed, resulting in the above-cited final regulations becoming effective as of October 8, 2024, the date of publication in the Federal Register. T.D. 10007 adds new Reg. § 1.6011-9, identifying certain syndicated conservation easements or substantially similar arrangements as listed transactions, a type of reportable transaction subject to enhanced disclosure rules and penalties for noncompliance. Reg. § 1.6011-9(b) defines syndicated conservation easement transactions subject to the new rules, while Reg. § 1.6011-9(c) provides related definitions, including the definition of "substantially similar" transactions. Reg. § 1.6011-9(d)(1) carves out from listed transaction treatment those syndicated conservation easements "for which the promotional materials offer the taxpayer the possibility of being allocated a charitable contribution deduction of only an amount less than 2.5 times the taxpayer's investment and for which the

taxpayer is actually allocated a charitable contribution deduction of an amount less than 2.5 times the taxpayer's investment." In other words, syndicated conservation easement transactions that are constrained by new (as of 2022) § 170(h)(7) ordinarily are not a listed transaction. Reg. §1.6011-9(d)(5) provides two examples of listed transactions subject to the new rules: one that is a syndicated conservation easement as defined in Reg. § 1.60119(b) and another that is a "substantially similar" transaction as defined in Reg. § 1.6011-9(c). Finally, the new regulations obsolete Notice 2017-10 for transactions occurring after October 8, 2024.

Comment: An unaddressed question under new Reg. § 1.6011-9 is the extent to which syndicated conservation easements or substantially similar arrangements can be retroactively identified as listed transactions via the regulations (even though Notice 2017-10 has been held invalid under the APA). Commenters to the proposed regulations raised this issue, opining that the new regulations cannot or should not retroactively designate syndicated conservation easements as listed transactions. In this regard, the preamble to the final regulations states that the Tax Court has not resolved whether a listed transaction designation can be applied retroactively. Accordingly, at least as far as the IRS is concerned, any commenter's theory that the regulations cannot be applied retroactively has not been judicially resolved. The preamble states in relevant part:

> The reporting rules for listed transactions are outside the scope of these final regulations, which merely identify a listed transaction. The reporting rules for listed transactions are found in § 1.6011-4, which was issued pursuant to notice and comment and finalized most recently in TD 9350 (72 FR 43146), published in 2007 and which is not amended by these final regulations. Section 1.6011-4(e)(2)(i) requires reporting of transactions entered into prior to the publication of guidance identifying a transaction as a listed transaction if the statute of limitations for assessment of tax is still open when the transaction becomes a listed transaction. While the reporting mandated by § 1.6011-4 may be with respect to prior periods, the disclosure obligation is itself not retroactive—it is a current reporting obligation. Thus, the comments regarding an impermissible retroactive burden required by § 1.6011-4 are without merit.

Furthermore, the preamble continues at length regarding this retroactivity issue and "open" tax years but also provides no crystal clear answers:

> Several commenters requested additional guidance on what constitutes an "open year" for purposes of reporting the listed transaction. These commenters opined that the final regulations should not be able to hold open (or re-open) a statute of limitations for a return that was filed before the relevant transaction became a listed transaction. One commenter stated that such a rule would result in taxpayers currently under audit and disputing penalties based on an expired statute of limitations finding one legal basis of their case evaporated, undoing months or years of analysis and evaluation.
>
> Guidance on open years for purposes of applying § 1.6011-4 is outside the scope of these final regulations, which merely identify a listed transaction. However, if a taxpayer who is required to disclose a listed transaction for a taxable year for which the statute of limitations has not expired prior to the identification of the listed transaction fails to do so, then the taxpayer's statute of limitations will continue to stay open for that taxable year as provided in section 6501(c)(10) of the Code. Section 6501(c)(10) provides that, if a taxpayer fails to include on any return or statement for any taxable year any information with respect to a listed transaction (as defined in section 6707A(c)(2) of the Code) which is required under section 6011 to be included with such return or statement, the time for assessment of any tax imposed by the Code with respect to such transaction does not expire before the date that is one year after the earlier of (1) the date the taxpayer provides the required information or (2) the date that a material advisor meets the requirements

of section 6112 with respect to a request by the Secretary under section 6112(b) relating to such transaction with respect to such taxpayer. Section 301.6501(c)-1(g)(3)(iii) of the Procedure and Administration Regulations (26 CFR part 301), which was issued pursuant to notice and comment and finalized most recently in TD 9718 (80 FR 16973), published in 2015, and which is not amended by these final regulations, provides (1) that the taxable years to which the failure to disclose relates include each taxable year that the taxpayer participated (as defined under section 6011 and the regulations thereunder) in a transaction that was identified as a listed transaction and for which the taxpayer failed to disclose the listed transaction as required under section 6011, and (2) if the taxable year in which the taxpayer participated in the listed transaction is different from the taxable year in which the taxpayer is required to disclose the listed transaction under section 6011, the taxable years to which the failure to disclose relates include each taxable year for which the taxpayer participated in the transaction.

Several commenters asked for guidance as to what constitutes an "open" tax year for taxpayers that took the position they were not required to file a Form 8886, Reportable Transaction Disclosure Statement, because Notice 2017-10 was invalidated. This requested guidance is also outside the scope of these final regulations for the reasons discussed in the prior paragraph.

d. IRS and Treasury's blackletter law counterpunch for micro-captive insurance arrangements. T.D. 10029, Micro-captive Listed Transactions and Micro-captive Transactions of Interest, 90 F.R. 3534 (1/14/25). As noted above, in response to the district court's decision in *CIC Services, LLC*, and losses in comparable cases, the IRS and Treasury proposed regulations in 2023 identifying certain micro-captive insurance arrangements as listed transactions and transactions of interest. *See* REG-109309-22, Micro-Captive Listed Transactions and Micro-Captive Transactions of Interest, 88 FR 21547 (4/11/23). The Treasury Department in 2024 foreshadowed publication of final regulations (*see* Department of Treasury, 2024-2025 Priority Guidance Plan (10/3/24) at 13 (last accessed 12/1/24)). The regulations are now final but with certain changes that (i) narrow the scope of the regulations concerning transactions with low loss ratios but eliminate the "commissions test" as a means to distinguish legitimate insurance arrangements from abusive micro-captive arrangements.

e. Extension for filing disclosure statements relating to micro-captive insurance arrangements. Notice 2025-24, 2025-19 I.R.B. 1429 (4/14/25). This notice provides relief from penalties under §§ 6707A(a) and 6707(a) for participants in and material advisors to micro-captive reportable transactions. Relief is provided for disclosure statements that, under final regulations published earlier this year, were required to be filed with the Office of Tax Shelter Analysis (OTSA) on or before April 14, 2025. See T.D. 10029, Micro-captive Listed Transactions and Micro-captive Transactions of Interest, 90 F.R. 3534 (1/14/25). The notice describes the types of disclosure statements qualifying for penalty relief as "Later Identified Micro-captive Listed Transactions" and "Later Identified Micro-captive Transactions of Interest." In other words, relief applies to particular micro-captive transactions that were "caught" by the final regulations published in January 2025. Note, however, that relief applies only if the required disclosure statements are filed with OTSA by July 31, 2025.

2. The Sixth Circuit joins other circuits in holding that recklessness is sufficient to establish a willful FBAR violation. United States v. Kelly, 92 F.4th 598 (6th Cir. 2/8/24). The U.S. Court of Appeals for the Sixth Circuit has held that for purposes of imposing an FBAR civil penalty, a "willful violation of the FBAR reporting requirements includes both knowing and reckless violations." With this holding, the Sixth Circuit joins all the other circuits that have addressed this issue. See, e.g., *United States v. Rum*, 995 F.3d 882 (11th Cir. 2021) (per curiam); *Kimble v. United States*, 991 F.3d 1238, 1242 (Fed. Cir. 2021); *United States v. Horowitz*, 978 F.3d 80, 88 (4th Cir. 2020); *Norman v. United States*, 942 F.3d 1111 (Fed. Cir. 2019);

Bedrosian v. United States, 912 F.3d 144, 153 (3d Cir. 2018). The Sixth Circuit here in *Kelly* adopted the same line of reasoning as the *Norman* and *Horowitz* courts, relying on the U.S. Supreme Court's decision in *Safeco Ins. Co. v. Burr*, 551 U.S. 47, 57 (2007). In *Safeco*, the Supreme Court observed that, when willfulness is a statutory condition of civil (as opposed to criminal) liability, the Court had "generally taken it to cover not only knowing violations of a standard, but reckless ones as well." For purposes of determining whether a reckless (and therefore willful) FBAR violation occurred, the Sixth Circuit also adopted the meaning of recklessness set forth in *Safeco.* Under *Safeco*, reckless conduct in the civil context is determined by application of an objective standard and is defined as an "…action entailing an unjustifiably high risk of harm that is either known or so obvious that it should be known." 551 U.S. at 685 (internal quotations and citations omitted). Based on this authority, the Sixth Circuit stated:

> …in the context of a civil FBAR penalty, the government can establish a willful violation "based on recklessness" by proving that "the defendant (1) clearly ought to have known that (2) there was a grave risk that an accurate FBAR was not being filed and [that] (3) he was in a position to find out for certain very easily."

92 F.4th at 603-04 (citing *Horowitz*, 978 F.3d at 89).

In this case, the taxpayer was a U.S. citizen who closed his U.S. domestic bank accounts and opened an interest-bearing account at Finter Bank in Switzerland, into which he deposited over $1.8 million. After an investigation, the IRS determined that the taxpayer had willfully failed to timely file FBARs for multiple years and imposed substantial penalties. When the taxpayer failed to pay the penalties, the government initiated an action against him in a U.S. District Court. The district court granted the IRS's motion for summary judgment. In affirming the district court, the Sixth Circuit concluded that the taxpayer had taken steps to intentionally evade his legal duties. The taxpayer designated his Finter account as "numbered" so that his name would not appear on the bank statements and he requested that the bank retain any account related communications. The Sixth Circuit concluded that these efforts allowed the taxpayer to shield his assets from U.S. authorities and that this evidenced more than mere negligence. Only after Finter notified the taxpayer that it would disclose his account to U.S. authorities did the taxpayer then begin complying with FBAR reporting obligations. The taxpayer did not seek professional advice about his reporting obligations or the tax implications of the assets in the Swiss bank account. Finter temporarily closed the taxpayer's account and warned him that it was required to report to U.S. authorities. Finter also recommended that the taxpayer get professional tax counsel. The taxpayer then requested to participate in the IRS's Offshore Voluntary Disclosure Program (OVPD). The government preliminarily accepted his voluntary disclosure. The taxpayer later transferred the funds in his Swiss bank account to an account with Bank Alpinum in Lichtenstein. He submitted a Form 433-A, Collection Information Statement, to the IRS that failed to disclose the Lichtenstein account. The government later removed the taxpayer from the OVDP because he had failed to provide information about his foreign assets. The court found that the taxpayer was aware of his reporting requirements and that he failed to file future FBAR reports. The taxpayer never consulted tax counsel. Because the taxpayer should have known about the risk of failing to comply and he could have found out by simply asking, the court held that his failure was, at a minimum, reckless. In summary, the court concluded that the taxpayer knew about his foreign account, took steps to keep it secret, did not consult with professionals about his tax obligations, and then, after learning that he had not met reporting requirements in the past, failed to file FBARs for the years at issue. Accordingly, the court held that the taxpayer's failure to satisfy his FBAR requirements for the years in issue was a willful violation of the Bank Secrecy Act.

a. The Ninth Circuit agrees with other circuits: objective recklessness is sufficient for the government to impose a "willful" FBAR penalty. United States v. Hughes, 113 F.4th 1158 (9th Cir. 8/21/24). In an opinion by Judge Koh, the Ninth Circuit has joined several other Circuit Courts of Appeal in holding that objective recklessness is sufficient to impose a "willful" FBAR penalty regardless of the taxpayer's subjective intent. As we have reported many times, 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 must file an annual disclosure report. *See* 31 U.S.C. 5314; 31 C.F.R. § 1010.306 (2021). The Financial Crimes Enforcement Network's ("FinCEN") Form 114 — Report of Foreign Bank and Financial Accounts ("FBAR") is used to file the report. The *pro se* taxpayer in this case was a U.S. citizen who owned wine businesses in New Zealand through wholly-owned limited liability companies. As the sole owner, the taxpayer had control over the businesses' bank accounts located in New Zealand. The taxpayer failed to file FBARs with the IRS for the years 2010 through 2013. 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. The penalty for willfully failing to file an FBAR disclosure is severe: the greater of $100,000 or 50 percent of each offending account per year. The IRS determined that the taxpayer's failure to file FBARs for the years in issue was "willful" and assessed civil penalties totaling $678,899 against the taxpayer. After a bench trial, the District Court (Judge Spero of the Northern District of California) held that the taxpayer recklessly disregarded the FBAR rules for 2012 and 2013 but not for 2010 or 2011. Although the taxpayer's failure to file FBARs for 2010 and 2011was found by the District Court to be non-willful, the taxpayer had checked a box on the taxpayer's 2012 and 2013 federal income tax returns indicating that she had foreign bank accounts for those years, but she did not file corresponding FBARs. The District Court therefore found that the taxpayer's actions for 2012 and 2013 amounted to "recklessness or willful blindness." Accordingly, the District Court imposed $238,125.19 in "willful" FBAR penalties against the taxpayer for the years 2012 and 2013. The *pro se* taxpayer appealed to the Ninth Circuit, arguing that the District Court applied the wrong legal standard because objective recklessness without regard to a taxpayer's subjective intent should not amount to willfulness under the FBAR penalty regime. The Fifth Circuit, agreeing with five other circuits that have addressed the issue, affirmed the District Court by holding that objective recklessness is sufficient to establish a "willful" FBAR violation. *See United States v. Kelly*, 92 F.4th 598 (6th Cir. 2/8/24); *United States v. Rum*, 995 F.3d 882 (11th Cir. 2021) (per curiam); *Kimble v. United States*, 991 F.3d 1238, 1242 (Fed. Cir. 2021); *United States v. Horowitz*, 978 F.3d 80, 88 (4th Cir. 2020); *Norman v. United States*, 942 F.3d 1111 (Fed. Cir. 2019); *Bedrosian v. United States*, 912 F.3d 144, 153 (3d Cir. 2018).

3. Here we go again as another front opens in the FUBAR-FBAR war, but the Eleventh Circuit's decision is only a pyrrhic victory for this particular taxpayer. United States v. Schwarzbaum, 134 F.4th 1319 (11th Cir. 8/30/24). Readers will recall that 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 must file an annual disclosure report. *See* 31 U.S.C. 5314; 31 C.F.R. § 1010.306 (2021). The Financial Crimes Enforcement Network's ("FinCEN") Form 114 — Report of Foreign Bank and Financial Accounts ("FBAR") is used to file the report. 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. The penalty for willfully failing to file an FBAR disclosure is severe: the greater of $100,000 or 50 percent of each offending account per year. Due to the severity of the FBAR penalty for willfully failing to file, an Eighth Amendment Excessive Fines Clause issue has been lurking beneath the surface of the litigated cases. The Excessive Fines Clause of the Eighth Amendment to the U.S. Constitution states, "Excessive bail shall not be required, nor excessive fines imposed, nor cruel and unusual punishments inflicted." U.S. Const. amend. VIII. The U.S. Court of Appeals for the First Circuit in *United States v. Toth*, 33 F.4th 1 (1st Cir. 2022) held (as explained further below) that FBAR penalties for willful failure to file are remedial, not punitive, in nature. In other words, the penalty safeguards the U.S. fisc by reimbursing the IRS and Treasury for the time and expense of investigating and uncovering a taxpayer's circumvention of U.S. tax laws. Because the nature of the willful FBR penalty is remedial, not punitive, the First Circuit determined that the penalty is not a "fine" subject to scrutiny under the Excessive Fines Clause of the Eighth Amendment. After the First Circuit's decision in *Toth*, the U.S. Supreme Court denied certiorari to review the court's holding. *See Toth v. United States*, 143 S. Ct. 552 (1/23/23). One might have thought that the U.S. Supreme Court's denial of certiorari in *Toth* settled the matter; yet, in this case, in an opinion by Judge Marcus, the Eleventh Circuit agreed with the taxpayer that the Eighth Amendment's

Excessive Fines Clause applies to willful FBAR penalties. As explained in detail below, however, the taxpayer's victory in the Eleventh Circuit was a pyrrhic one, as the court held that only $300,000 of a total of $12.5 million in FBAR penalties sought by the IRS were "excessive" within the meaning of the Eighth Amendment's Excessive Fines Clause. Regardless of the extent of the taxpayer's success before the Eleventh Circuit in *Schwarzbaum*, the court's holding that the Excessive Fines Clause applies to limit willful FBAR penalties creates a clear split with the First Circuit. Thus, notwithstanding the U.S. Supreme Court's decision in *Bittner v. United States*, 598 U.S. 85 (2023), in which the Court held that *non-willful* FBAR violations are subject to a maximum penalty of $10,000 regardless of the number of accounts the taxpayer falls to disclose, and its denial of certiorari in *Toth*, the Supreme Court may not be out of the FUBAR-FBAR war just yet.

Background of Schwarzbaum. The facts and procedural history of *Schwarzbaum* are somewhat complicated. The taxpayer was a wealthy German and U.S. citizen with multiple foreign bank accounts. Specifically, the taxpayer had seventeen Swiss and four Costa Rican bank accounts from 2006-2009. Accordingly, the taxpayer was required to file FBAR reports concerning his foreign accounts. The taxpayer filed a few FBAR reports for 2008 and 2009 but did not disclose all of his foreign bank accounts. Then, in 2010, the taxpayer's IRS troubles began in earnest when he finally reported all of his foreign bank accounts for the first time in connection with the IRS's Offshore Voluntary Disclosure Initiative ("OSVDI"). The taxpayer later opted out of the OSVDI program for unknown reasons. An IRS investigation of the taxpayer's foreign bank accounts ensued, and litigation followed in the U.S. District Court for the Southern District of Florida (Judge Bloom). After some procedural ups and downs (including a prior appeal to the Eleventh Circuit[19]), Judge Bloome upheld the IRS's imposition of roughly $12.5 million in *willful* FBAR penalties against the taxpayer for 2007-2009. The taxpayer subsequently appealed (*again!*) to the Eleventh Circuit.

Eighth Amendment Excessive Fines Clause Appeal. The taxpayer argued before the Eleventh Circuit that the IRS's imposition of approximately $12.5 million in FBAR penalties across his foreign accounts for 2007-2009 violated the Excessive Fines Clause of the Eighth Amendment. The taxpayer urged the Eleventh Circuit to conclude, contrary to *Toth*, that the FBAR penalties for willfully failing to disclose foreign bank accounts are punitive, not remedial. Therefore, the taxpayer argued, willful FBAR penalties are "fines" subject to the Eighth Amendment's Excessive Fines Clause. The IRS, of course, argued as it had in *Toth* that FBAR penalties are remedial—like other federal tax penalties intended to safeguard the fisc and reimburse the IRS and Treasury for the time and expense of investigating and uncovering circumvention of U.S. tax laws.

Eleventh Circuit Declines to follow Toth. Judge Marcus wrote the opinion on behalf of the Eleventh Circuit. After reviewing precedent interpreting the Excessive Fines Clause and surveying the legislative history of the FBAR regime, Judge Marcus reasoned: "The Government can impose a $1,000,000 penalty on a $2,000,000 account regardless of whether the Government spent a million dollars investigating the case or whether it spent nothing at all, or any number in between." __ F.4th at __. Judge Marcus also reasoned that, based upon precedent, a civil penalty such as that in the FBAR statute need only be *partially* punitive to be subject to the Excessive Fines Clause.[20]

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[19] The taxpayer has had several battles with the IRS, some of which have been discussed in prior versions of these materials. *See United States v. Schwarzbaum*, 24 F.4th 1355 (11th Cir. 2022) (vacating and remanding for penalty redetermination *United States v. Schwarzbaum*, 125 A.F.T.R.2d 2020-2109 (5/18/20). *See also United States v. Schwarzbaum*, 125 A.F.T.R.2d 2020-1323 (S.D. Fl. 3/20/20) (bench trial opinion).

[20] In this regard, although the U.S. Supreme Court denied certiorari in *Toth*, Justice Gorsuch dissented from the Court's refusal to hear the case, writing of the First Circuit's opinion:

> This decision is difficult to reconcile with our precedents . . . . The government did not calculate [the FBAR] penalty with reference to any losses or expenses it had incurred. The government imposed its penalty to punish [the taxpayer] and, in that way, deter others. Even supposing, however, that [the taxpayer's] penalty bore both punitive and compensatory purposes, it would still merit

Declining to follow *Toth*, Judge Marcus concluded: "No matter how you cut it, it's apparent that [the FBAR penalty] statute is designed to inflict punishment at least *in part* . . . . We hold, therefore, that the FBAR penalty is a fine subject to the Eighth Amendment's Excessive Fines Clause." __ F.4th at __ (emphasis added).

Account-by-Account Analysis: Having concluded that the willful FBAR penalty is a "fine" subject to the Eighth Amendment's Excessive Fines Clause, the Eleventh Circuit next had to determine whether the FBAR penalties asserted against the taxpayer in this case were "excessive." The Eleventh Circuit rejected the taxpayer's argument that the Excessive Fines Clause analysis should focus on the taxpayer's total FBAR penalties for 2007-2009. Instead, Judge Marcus wrote that the court must determine, *on an account-by-account basis*, whether the asserted FBAR penalties are "grossly disproportional" to the balances in the taxpayer's offending accounts across each of the years 2007-2009. *See United States v. Bajakajian*, 524 U.S. 321 (1998) (a punitive forfeiture of currency in a U.S. customs matter violates the Excessive Fines Clause if it is "grossly disproportional" to the gravity of the offense). Judge Marcus's opinion includes a comparison chart listing the taxpayer's offending accounts from 2007 through 2009. The chart, reproduced below, compares the taxpayer's maximum account balances (where known), June 30 balances (the FBAR due date for the years in issue, but now April 15), and the maximum allowable penalty per account per year.[21]

Bank Account	Maximum Balance (Prior Calendar Year) ($)	June 30 Balance ($)	Maximum Statutory Penalty ($)
2007			
Aargauische	15,809	11,872	100,000
UBS 6308	1,988,799	8,615,602	4,307,801
UBS 9250	15,022,514	(5,571)	100,000
UMB	672,185	*Unknown*	100,000
Scotiabank de Costa Rica 0588	*Unknown*	*Unknown*	100,000
2008			
Aargauische	13,487	10,601	100,000
Bank Linth	2,605,399	*Unknown*	100,000
BSI	3,880,596	*Unknown*	100,000
Clariden Leu	3,712,704	4,106,132	2,053,066
Raiffeisen	3,101,437	3,137,728	1,568,864
St. Galler	3,353,964	*Unknown*	100,000
UBS 6308	8,615,602	*Closed*	100,000
UBS 9250	15,630,205	*Closed*	100,000
UMB	672,185	*Unknown*	100,000

> constitutional review. Under our cases a fine that serves even "*in part* to punish" is subject to analysis under the Excessive Fines Clause.

143 S. Ct. at _____ (emphasis in original). In *Schwarzbaum*, Judge Marcus's opinion relied in part upon Justice Gorsuch's above-quoted dissent as support for the Eleventh Circuit's conclusion that willful FBAR penalties are subject to the Excessive Fines Clause of the Eighth Amendment.

[21] Notice that the maximum allowable FBAR penalty potentially assessable against the taxpayer according to Judge Marcus's chart (roughly $13.5 million) exceeds by about $1 million the FBAR penalty the IRS actually asserted in the case (roughly $12.5 million). Judge Marcus explained that the IRS asked the District Court to forgo the $1 million difference, and although the taxpayer attempted to argue that this was improper and triggered a statute of limitations question, the Eleventh Circuit ruled that it was permissible for the IRS to seek less than the maximum allowable FBAR penalty.

Bank Account	Maximum Balance (Prior Calendar Year) ($)	June 30 Balance ($)	Maximum Statutory Penalty ($)
Scotiabank de Costa Rica 0588	*Unknown*	*Unknown*	100,000
Scotiabank de Costa Rica 1472	*Unknown*	*Unknown*	100,000
2009			
Aargauische	15,758	9,966	100,000
Banca Arner	3,096,278	3,078,492	1,539,246
Bank Linth	2,955,271	*Unknown*	100,000
BSI	4,311,494	*Unknown*	100,000
Clariden Leu	4,374,222	4,504,702	2,252,351
Raiffeisen	3,139,508	*Closed*	100,000
St. Galler	4,267,212	*Unknown*	100,000

What Is "Excessive"? After setting forth the above chart, Judge Marcus's opinion examines the annual balances in each account to compare the balances against the maximum permissible FBAR penalties—a facts and circumstances analysis. Unfortunately for the taxpayer, Judge Marcus's facts and circumstances analysis concludes that only one account ("Aargauische") suffered "grossly disproportional" FBAR penalties in violation of the Excessive Fines Clause of the Eighth Amendment. A total of $300,000 in FBAR fines ($100,000 per year) were associated with the Aargauische account, but the account never had more than about a $16,000 balance throughout 2007-2009. Judge Marcus determined that a fine "over six times the greatest amount ever held in the account" is excessive. ____ F.4th ___. As for the rest of the taxpayer's accounts and associated FBAR penalties, Judge Marcus found that the penalties asserted were not "grossly disproportional" within the meaning of the Excessive Fines Clause. Summarizing, Judge Marcus wrote: "Going account by account, we are not persuaded that any of the remaining fines—even those taking fifty percent of an account in a given year—are excessive as applied to [the taxpayer]." __ F.4th at __. Lastly, after rejecting several procedural challenges raised by the taxpayer, the Eleventh Circuit remanded the case to the District Court to enter a judgment against the taxpayer for approximately $12.2 million in willful FBAR penalties ($300,000 less than initially determined by the IRS and the District Court) plus late fees and interest for the years 2007-2009.

Comment: In our view, even if one agrees with the result, Judge Marcus's Excessive Fines Clause analysis in this willful FBAR penalty case leaves much to be desired. The account-by-account, facts and circumstances analysis employed by the Eleventh Circuit provides no guiding principles or measuring rules (other than the "grossly disproportional" standard) for resolving future willful FBAR penalty cases. Theoretically, any taxpayer residing outside the First Circuit, especially those within the Eleventh Circuit, may challenge the IRS's imposition of willful FBAR penalties under the Eighth Amendment's Excessive Fines Clause. Presumably, outside the First Circuit, the IRS will be left to exercise its discretion regarding the "proportionality" of any willful FBAR penalty it asserts, hoping that the penalties imposed eventually will be sustained by the courts against an Excessive Fines Clause challenge.

4. While a bankruptcy proceeding may stay a Tax Court proceeding concerning tax liability, it will not automatically stay a whistleblower proceeding. Carter v. Commissioner, 163 T.C. 141 (10/3/24). In this case, the petitioner sought Tax Court review of the IRS Whistleblower Office's denial of his whistleblower award claim. After filing for review in the Tax Court under § 7623, the petitioner filed for bankruptcy. The issue addressed by the Tax Court was whether the petitioner's bankruptcy filing automatically stayed the Tax Court's review of the whistleblower proceeding. The Tax Court (Judge Goeke) held that the petitioner's bankruptcy filing does not operate to automatically stay a whistleblower case filed in the Tax Court. Section 362(a)(8) of the Bankruptcy Code (11 U.S.C. § 362(a)(8)) stays a Tax Court proceeding "concerning the tax liability of a debtor who is an individual for a taxable period ending before the date of the order for relief" under the Bankruptcy Code. In *Kovitch v. Commissioner*, 128 T.C. 108 (2007), the Tax Court previously had held that an automatic stay in bankruptcy should not apply to a Tax Court proceeding "unless the Tax Court proceeding would affect the tax liability of the debtor in bankruptcy." *Id.* at 112. Thus, if the Tax Court proceeding will affect the tax liability of the debtor in bankruptcy, then the stay applies. Whereas, if the Tax Court proceeding will not affect the tax liability of the debtor, then the automatic stay does not apply. In this case, the court concluded that, despite a 2005 amendment of section 362(a)(8) of the Bankruptcy Code that modified the language of that provision, the court's previous holding in *Kovitch* regarding when the automatic stay applies to a Tax Court proceeding remains valid.

In this case, the petitioner engaged in a transaction with a taxpayer who was the target of the whistleblower claim. The petitioner filed a whistleblower claim with the IRS asserting that the target taxpayer incorrectly reported the transaction. The petitioner argued that the whistleblower claim concerned his tax liability because the whistleblower claim and his tax liability arise from the same transaction and involve the same operative facts. Judge Goeke, however, concluded that a decision regarding the petitioner's whistleblower claim would not affect his tax liability. This remained true, the court reasoned, even if the whistleblower claim involved the same transaction and facts as his tax liability. Under § 7623(b), the Tax Court has jurisdiction to review the IRS's whistleblower award determinations. But the Tax Court does not have jurisdiction to review or determine the whistleblower target's tax liability. *See, e.g.*, *Cohen v. Commissioner*, 139 T.C. 299, 302 (2012), *aff'd*, 500 Fed. App'x 10 (D.C. Cir. 2014). Accordingly, the Tax Court concluded that, because its decision would not involve any factual findings about the transaction in which the petitioner and the target engaged or its proper tax treatment, the court's review of the IRS's denial of a whistleblower award could not affect the amount of the petitioner's pre-petition tax liability. The Tax Court also declined to adopt the petitioner's argument that the potential for setoff of any whistleblower award against the petitioner's unpaid tax liability supports an automatic stay of the whistleblower case in the Tax Court. The Bankruptcy Code stays the IRS's right to set off a taxpayer's whistleblower award against his tax liability. The IRS must first obtain relief from the stay in the Bankruptcy Court before the IRS can exercise any right to set off a whistleblower's award against the whistleblower's unpaid tax liability. In summary, Judge Goeke held that the bankruptcy filing does not prevent the Tax Court from determining whether the petitioner is entitled to a whistleblower award.

5. Federal Circuit Court of Appeals holds that, if the IRS dispenses with the formal requirements of a refund claim by investigating the merits of a claim, certain regulatory requirements may be waived. Vensure HR, Inc. v. United States, 119 F.4th 7 (Fed. Cir. 10/4/24). The taxpayer, Vensure, is an organization that provides, among other things, tax reporting services to other companies including withholding, reporting, and paying employment taxes on behalf of its client companies to the IRS. Vensure believed it had substantially overpaid employment taxes for the second quarter of 2014 and filed refund claims on Forms 843, Claim for Refund and Request for Abatement, with the IRS. The claims alleged that the overpayments led to Vensure's inability to timely pay taxes for later periods. The IRS assessed penalties on Vensure for those later periods. Vensure engaged tax counsel to represent it in a challenge to the penalties imposed. In order to represent a taxpayer before the IRS the taxpayer or its representative must file Form 2848, Power of Attorney and Declaration of Representative with the IRS. The

instructions to Form 2848 provide that if the taxpayer's authorized representative files Form 843, an original Form 2848 must be attached. Vensure did not attach Form 2848 to any of its refund claims on Form 843 at the time of filing. However, at various points in time before filing the refund claims on Form 843, Vensure's tax attorney filed with the IRS at least three properly executed Forms 2848. After the IRS denied the taxpayer's administrative claim for refund on the ground that the taxpayer had not established there was reasonable cause to have the penalties waived, Vensure filed a complaint in the U.S. Court of Federal Claims seeking a refund of the penalties imposed by the IRS. In response, the government filed a motion to dismiss, which the court granted for lack of subject matter jurisdiction. The Court of Federal Claims granted the motion to dismiss because it determined that Vensure had failed to duly file its refund claims, as required by § 7422. The Court of Federal Claims ruled that Vensure had not duly filed its refund claims because a valid power of attorney must be submitted together with a refund claim and Vensure had failed to attach any powers of appointment to the claims.

Vensure raised the following three issues on appeal to the Federal Circuit: (1) whether Reg. § 301.6402-2(e)'s requirement that "a power of attorney must accompany the claim" (the "accompany" requirement) means a power of attorney must be attached to the claim for refund; (2) whether Reg. § 301.6402-2(e)'s use of the term "accompany" is a statutory, non-waivable requirement or is regulatory and therefore waivable; and (3) whether the IRS waived the "accompany" requirement of the same regulation. Although the parties argued the meaning of the term "accompany" as used in the regulations, the Federal Circuit declined to base its decision on the meaning or use of the term "accompany" under the regulations. Rather, the Federal Circuit addressed the second issue and concluded that Reg. § 301.6402-2(e)'s "accompany" requirement is regulatory and, therefore, waivable.

The Federal Circuit followed the Supreme Court's decision in *Angelus Milling Co. v. Comm'r*, 325 U.S. 293, 296 (1945), which distinguished between "explicit statutory requirements" and "detailed administrative regulations" governing tax refund procedures. In general, when Congress makes statutory requirements that are explicit, such requirements must be complied with and are beyond the dispensing power of Treasury officials. *Id.* In contrast, if a requirement is regulatory in nature, the IRS may insist upon full compliance with the regulations. *Id.* However, when the IRS does not insist on full compliance, the requirements may be waived. The requirements are waived where, for example, the basis of the claim of waiver is that the Commissioner through his agents dispensed with the formal requirements of a claim by investigating the merits of the claim. *Id.* In *Angelus Milling*, the Supreme Court stated "[i]f the Commissioner chooses not to stand on his own formal or detailed requirements, it would be making an empty abstraction, and not a practical safeguard, of a regulation to allow the Commissioner to invoke technical objections after he has investigated the merits of a claim and taken action on it." *Id.* at 297. The Supreme Court in *Angelus Milling* determined that the specific informational requirements set forth in the applicable regulations were regulatory in nature and, therefore subject to waiver by the Commissioner. Stated otherwise, the requirements were not statutory requirements that the Commissioner had no discretion to waive. Applying the Supreme Court's analysis in *Angelus Milling*, the Federal Circuit in this case concluded that the "accompany" requirement of Reg. § 301.6402-2(e) is purely a regulatory requirement. The Federal Circuit reasoned that the "accompany" requirement presents a regulatory question of when, where, and how to file a power of attorney. Because the regulations do not speak to the when, where, and how of filing a power of attorney, the "accompany" requirement is waivable by the IRS. In coming to this conclusion, the Federal Circuit declined to follow the government's interpretation of the Federal Circuit's earlier decision in *Brown v. U.S.*, 22 F.4th 1008 (Fed. Cir. 2022). The government interpreted the *Brown* decision to require strict compliance with all signature and verification requirements. However, this interpretation was determined by the Federal Circuit in this case to be so broad that it conflicted with the Supreme Court's decision in *Angelus Milling*. The Federal Circuit noted that the relevant statutory provisions governing actions for refund include § 7422(a), § 6061(a), and § 6065. In *Brown*, the Federal Circuit concluded that each of these provisions impose a default rule that individual taxpayers must personally sign and verify their tax refund claim, and that such taxpayers may

authorize a legal representative to certify the claims and provide a valid power of attorney in place of the taxpayer signature. *Brown*, 22 F.4th at 1012-1013. The court reasoned that, because the signature and verification requirements derive from a statute, the IRS may not waive these requirements. However, such statutory provisions do not explain when, where, or how the taxpayer should comply with these requirements. Rather than appearing in a statutory provision, the requirements for when, where, and how a power of appointment may accompany a claim are derived from sub-regulatory IRS instructions and publications. Thus, for example, Reg. § 301.6042-2(e) requires claims for refund be accompanied by a power of attorney, but the regulation does not define "accompany" or "how" the form must be attached. The court further distinguished the facts in *Brown* in that the taxpayers in *Brown* admitted that they neither signed their refund claims nor tendered powers of attorney to permit their tax advisor to sign the claims on their behalf. *Brown*, 22 F.4th at 1013. In contrast, Vensure filed multiple powers of attorney that purported to cover the penalty refund claims as issue.

Conclusion. Based on the analysis described above, the court held that, when the IRS dispenses with the formal requirements of a claim by investigating the merits of the claim, the IRS may waive the regulatory requirements. The court clarified that the *Angelus Milling* waiver doctrine applies when (1) there is clear evidence that the Commissioner understood the claim that was made, even though there was a departure in form in the submission, (2) it is unmistakable that the Commissioner took action upon the claim, and (3) the Commissioner took action on the claim. Because the three-part test requires factual determinations, the Federal Circuit remanded the case. The court held that, assuming a valid power of attorney was filed with the IRS to cover the scope of representation for a claim, the lower court must determine whether the "accompany" requirement was waived by the IRS.

6. ♪♫Signed, sealed, delivered [the Tax Court has jurisdiction]♫♪. The Tax Court has rejected the government's argument that the court has no jurisdiction to hear petitions created using the court's online petition generator because they lack a handwritten signature. Donlan v. Commissioner, 164 T.C. 57 (2/19/25). After the IRS issued a notice of deficiency, the taxpayers timely filed a petition electronically with the Tax Court. The taxpayers were pro se, i.e., they represented themselves in the Tax Court. They created their petition using the court's online petition generator. The online petition generator became available to pro se taxpayers on July 31, 2024. (A similar option became available to practitioners on September 15, 2024.) Before the online petition generator became available, taxpayers had the option of creating their own petition or using a Form (Form 2) provided by the Tax Court. Both options required a handwritten signature. The online petition generator does not require a handwritten signature. Instead, it asks petitioners to answer a series of questions and automatically generates a Tax Court petition that has a signature block that states the name and contact information of each taxpayer. The IRS filed a motion to dismiss for lack of jurisdiction. In the motion, the government argued that the "document filed as a petition in this case was not signed by either taxpayer to which the notice of deficiency for tax year 2024 was issued" and that "[t]he Tax Court does not have jurisdiction to review a petition unless it is signed by the taxpayer, or someone lawfully authorized to act as petitioner's counsel." The Tax Court (Judge Buch) denied the government's motion to dismiss. Rule 23(a)(3) of the Tax Court's Rules of Practice and Procedure state: "A person's name on a signature block on a paper that the person authorized to be filed electronically, and that is so filed, constitutes the person's signature." This rule applies to petitions by virtue of Rule 34, which governs petitions and states in paragraph (e): "For the signature requirement of petitions filed electronically, see Rule 23(a)(3) and the Court's electronic filing instructions on the Court's website." The court's electronic filing instructions for pro se taxpayers state:

> If the document you are filing requires a signature: The combination of DAWSON username (email address) and password serves as the signature of the individual filing the document. … If you chose to autogenerate a Petition in DAWSON and your spouse has authorized you to file an electronic petition, then the signature

> block on the petition autogenerated by DAWSON will serve as your spouse's signature.

U.S. Tax Court, Self-Represented (Pro Se) Electronic Filing Instructions at 42. Thus, under the Tax Court's Rules of Practice and Procedure and its instructions for electronic filing, a taxpayer's name on a signature block of a document that the taxpayer authorized to be filed electronically is deemed to be the taxpayer's signature. Petitions created using the court's online petition generator satisfy this requirement. Because the taxpayers in this case created their petition using the court's online petition generator, the petition was validly signed and the court denied the government's motion to dismiss.

7. Maybe we should call it Form 1099-NVM. After years of delayed implementation of the reduced reporting thresholds for Form 1099-K enacted in the American Rescue Plan (2021), Congress has restored the reporting thresholds to their original amounts. The 2025 One Big Beautiful Bill Act, § 70432, amended § 6050W(e) to restore the reporting thresholds for Form 1099-K issued by third party settlement organizations to those that existed before Congress's reduction of the thresholds in the American Rescue Plan (March 2021).

Background. In 2008, Congress added § 6050W to the Code. Section 6050W became effective for the 2011 tax year. Generally, § 6050W requires payment card companies and online marketplaces (aka third-party settlement organizations or TPSOs) to report on Form 1099-K payments processed for goods and services. Third-party settlement organizations include eBay, gig-worker platforms like Uber and Lyft, and payment apps such as Venmo and Cash App (but not Zelle). There has never been a de minimis exception for payment card transactions, i.e., a payment card company must report all transactions processed for a participating payee. As enacted, § 6050W(e) set forth a de minimis exception under which third-party settlement organizations were required to issue Forms 1099-K only when gross payments to a participating payee for goods and services during the calendar year exceeded $20,000 *and* there were more than 200 transactions with that payee. The American Rescue Plan (March 2021) lowered the de minimis exception for third-party settlement organizations to $600 with no minimum number of transactions, effective in 2022. In Notice 2023-10, 2023-3 I.R.B. 403 (12/23/22), the IRS announced that 2022 would be a transition period for implementation of the reduced reporting threshold, i.e., the reduced threshold did not apply for 2022. Similarly, in Notice 2023-74, 2023-51 I.R.B. 1484 (11/21/23), the IRS announced that the reduced reporting thresholds for Form 1099-K enacted by the American Rescue Plan (March 2021) would not apply for 2023. For 2024, the IRS announced a transition period in Notice 2024-85, 2024-51 I.R.B. 1349 (11/27/24), during which third-party settlement organizations were not required to report payments in settlement of third-party network transactions with respect to a participating payee unless the gross amount of aggregate payments to be reported exceeded $5,000, regardless of the number of such transactions.

The OBBA's changes to the reporting thresholds. The OBBA amended § 6050W(e) to provide the original de minimis exception under which third-party settlement organizations are required to issue Forms 1099-K only when gross payments to a participating payee for goods and services during the calendar year exceed $20,000 *and* there are more than 200 transactions with that payee. This change is effective as if included in the American Rescue Plan (March 2021).

The OBBA's changes to back-up withholding. Section 3406(a) requires certain payors to perform backup withholding by deducting and withholding income tax from a reportable payment when, among other circumstances, the payee fails to furnish the payee's Taxpayer Identification Number (TIN) to the payor or the IRS has notified the payor that the TIN furnished by the payee is incorrect. Pursuant to § 3406(b)(3)(F), a reportable payment includes payments made by a third-party settlement organization that are required by § 6050W to be shown on a Form 1099-K. Section 3406(b)(4) provides that whether payments made in settlement of payment card transactions or third party network transactions are subject to withholding under section 3406 is determined without regard to the monetary thresholds found in § 6050W. *See also* Reg. § 31.3406(b)(3)-5(b).

In other words, the monetary threshold is considered solely for determining whether a TPSO has an information reporting obligation under § 6050W for payments made to a payee. However, in Notice 2011-42, 2011-23 I.R.B. 866, the IRS announced that no back-up withholding is required by a TPSO unless the aggregate number of transactions between the TPSO and a payee exceeds 200 within a calendar year. (According to Notice 2011-42, the monetary threshold for information reporting, which originally was $20,000, is not relevant in determining whether backup withholding is required.) In section 70432(b) of the OBBA, Congress amended Code § 3406(b) to add § 3406(b)(8). New § 3406(b)(8) provides that payments made in settlement of third party network transactions are subject to withholding under section 3406 only if the de minimis thresholds of § 6050W(e) are satisfied, i.e., when gross payments to a participating payee for goods and services during the calendar year exceed $20,000 *and* there are more than 200 transactions with that payee. This change is effective for calendar years beginning after December 31, 2024.

- *Note:* in Notice 2024-85, 2024-51 I.R.B. 1349 (11/27/24), the IRS announced that, for calendar year 2024, the IRS would *not* assert penalties under §§ 6651 or 6656 for a TPSO's failure to withhold and pay backup withholding tax during the calendar year. The notice reminded TPSOs that performed backup withholding during 2024 to file Form 945, *Annual Return of Withheld Federal Income Tax*, and issue Form 1099-K with the amount withheld in box 4. Notice 2024-85 also obsoleted Notice 2011-42, which announced that no back-up withholding was required by a third-party settlement organization unless the aggregate number of transactions between the TPSO and a payee exceed 200 within a calendar year.

XI. WITHHOLDING AND EXCISE TAXES

A. Employment Taxes

1. IRS updates guidance regarding employment taxes and Section 530 relief to reflect statutory changes made since 1986 and to amplify a 1985 revenue procedure. Rev. Proc. 2025-10, 2025-4 I.R.B. 492 (1/8/25) and Rev. Rul. 2025-3, 2025-4 I.R.B. 443 (1/8/25). These two recent sources of IRS guidance address so-called "Section 530 relief" in the context of withholding and employment tax controversies. Rev. Proc. 2025-10 modifies and supersedes Rev. Proc. 85-18, 1985-1 C.B. 518, to reflect amendments made to Section 530 since 1986. Rev. Proc. 2025-10 also amplifies the guidance originally provided in Rev. Proc. 85-18 concerning the definition of employee, the Section 530 requirement for filing required returns, the reasonable basis safe harbor rules found in Section 530(a)(2), and the criteria for assessing a taxpayer's past "treatment" of a worker as an independent contractor rather than as an employee. The second item, Rev. Rul. 2025-3, illustrates the application of amended Section 530 in five situations set forth in the ruling. The new guidance is effective as of the date of publication (1/8/25) and is comprehensive. For details, see the extensive discussion below.

Background. Section 530 of the Revenue Act of 1978, entitled "Controversies Involving Whether Individuals are Employees for Purposes of Employment Taxes," provides relief from federal employment tax obligations (including back taxes, interest, and penalties) for taxpayers meeting certain requirements set forth in the statute. Section 530 relief is available to taxpayers at any stage in the administrative or judicial review process if its requirements are met. *See* Rev. Proc. 2025-10 § 1.05. Section 530 principally applies to a taxpayer undergoing an employment tax audit where the IRS contends that the taxpayer misclassified workers as independent contractors rather than as employees. Section 530 does not grant relief to an individual worker himself or herself (who may, for instance, be held liable for unpaid income and self-employment taxes notwithstanding Section 530 relief granted to a taxpayer-payor). *See* Rev. Proc. 2025-10 § 2.02. Section 530 is not part of the Internal Revenue Code, but subsection (e)(3) of the statute requires the IRS to consider whether a taxpayer qualifies for Section 530 relief in an employment tax audit before reclassifying an individual worker's status from independent contractor to employee. *See also* Rev. Proc. 2025-10 § 3.05. Congress enacted Section 530 to "alleviate what it perceived as the 'overly zealous pursuit and assessment of taxes'" against employers who have, in good faith, classified their workers as independent contractors. *Ewens and Miller, Inc. v. Commissioner*, 117

T.C. 263, 276 (2001) (quoting *Boles Trucking, Inc. v. United States*, 77 F.3d 236, 239 (8th Cir.1996)). Although initially intended to be temporary, Section 530 relief was extended indefinitely by the Tax Equity & Fiscal Responsibility Act of 1982, Pub. L. 97–248, § 269(c), 96 Stat. 324, 552. In addition, Section 530 has been amended three times since it became permanent in 1982. Section 530(d) (exception for certain technical workers) was added by the Tax Reform Act of 1986, Pub. L. No. 99-514, Title XVII, § 1706(a), 100 Stat. 2085. Section 530(e) (burden of proof and other special rules) was added by the Small Business Job Protection Act of 1996, Pub. L. No. 104-188, Title I, § 1122(a), 110 Stat. 1755, 1766. Section 530(f) (test room supervisors and proctors for college entrance exams) was added by the Pension Protection Act of 2006, Pub. L. No. 109-280, Title VIII, § 864(a), 120 Stat. 780, 1024.

Rev. Proc. 2025-10 and Section 530 in general. Section 530(a)(1)(A)-(B) generally provide that, for purposes of the employment taxes under subtitle C of the Code, if a taxpayer "did not treat an individual as an employee for any period," then the individual will be deemed not to be an employee for that period unless "the taxpayer had no reasonable basis for not treating the individual as an employee." Put differently (i.e., *in more understandable and less double-negative words*), if a taxpayer (i) has been entirely consistent in treating an individual worker as an independent contractor for employment tax purposes and (ii) had a reasonable basis for doing so, Section 530 may relieve the taxpayer from an IRS assessment of unpaid employment taxes (including interest and penalties) that otherwise would result if the IRS successfully reclassified a taxpayer's worker as an employee. The legislative history states that the phrase "reasonable basis . . . for not treating the individual as an employee" is to "be construed liberally" by the IRS and the courts. *See* Rev. Proc. 2025-10 § 6.05. Nevertheless, a taxpayer's "reasonable basis" must exist before the taxpayer decides to treat a worker as a non-employee for employment tax purposes. *See* Rev. Proc. 2025-10 § 6.02. For this purpose, as detailed further below, a taxpayer may rely upon certain "reasonable basis" safe harbors specified in Section 530(a)(2) or upon some other legitimate grounds. For any period after December 31, 1978, relief applies only if, pursuant to section 530(a)(1)(B), all federal tax returns (including information returns) required to be filed by the taxpayer with respect to the individual for the period are filed on a basis consistent with the taxpayer's treatment of the individual as a non-employee, and pursuant to section 530(a)(3), the taxpayer has not treated any individual holding a substantially similar position as an employee for purposes of employment taxes for any period beginning after December 31, 1977. *See* Rev. Proc. 2025-10 § 2.03. Regardless, Section 530(d) provides that relief is not available with respect to specified third-party arrangements concerning technical workers (engineers, designers, drafters, computer programmers, systems analysts, or other similarly skilled workers engaged in a similar line of work). Thus, the usual common law rules (not Section 530) determine whether an individual retained by a taxpayer-payor providing such technical services to a third-party client is an employee or independent contractor of the taxpayer-payor. *See also* Rev. Proc. 2025-10 § 3.09. Moreover, Section 530 relief is not available to taxpayers that are federal agencies, and special considerations apply to "dual-status" workers (i.e., individuals separately compensated for providing services distinct from services provided as an employee). *See* Rev. Proc. 2025-10 §§ 3.07-.08 & 3.11.

Defining "employee" for purposes of Section 530. Rev. Proc. 2025-10 § 3.02 provides that the term "employee" for purposes of Section 530 includes:

(1) an officer of a corporation under §§ 3121(d)(1), 3306(i), or 3401(c) of the Code;

(2) an individual, who under the common law rules, has the status of an employee under §§ 3121(d)(2) or 3306(i);

(3) agent-drivers, commission-drivers, full-time life insurance salespersons, home workers, or traveling or city salespersons under §§ 3121(d)(3) (statutory employees) or 3306(i);

(4) an individual who performs services that are included under an agreement pursuant to Section 218 or Section 218A of the Social Security Act (218 Agreement) under § 3121(d)(4) of the Code; and

(5) an officer, employee or elected official of a State, or any political subdivision thereof, or the District of Columbia, or any agency or instrumentality of the foregoing under § 3401(c).

"Treatment" as an employee. Pursuant to Rev. Proc. 2025-10 § 3.03, the IRS will apply the following guidelines to determine whether the taxpayer's past and continuing "treatment" of an individual worker as an employee (as opposed to treating the worker as an independent contractor) disqualifies the taxpayer from Section 530 relief:

(1) The withholding of income tax or FICA taxes from any payments made to an individual, whether or not the tax is paid to the IRS, indicates "treatment" of the individual as an employee.

(2) Except as provided in paragraphs (6) and (7) below, the filing of an original or amended employment tax return (including a Form 940 "Employer's Annual Federal Unemployment Tax Return," 941 "Employer's Quarterly Federal Tax Return," 943 "Employer's Annual Tax Return for Agricultural Employees," or 944 "Employer's ANNUAL Federal Tax Return"), with respect to an individual, whether or not tax was withheld from the payments made to the individual, indicates "treatment" of the individual as an employee.

(3) The filing of Schedule H (Form 1040), Household Employment Taxes, with respect to an individual, whether or not tax was withheld from the payments made to the individual, indicates "treatment" of the individual as an employee.

(4) The filing of a Form W-2 "Wage and Tax Statement" with respect to an individual, or the furnishing of a Form W-2 to an individual, whether or not tax was withheld from the payments made to the individual, indicates "treatment" of the individual as an employee.

(5) Contracting with a third party to perform acts required of employers with respect to an individual, whether or not tax is withheld or paid to the IRS or the third party otherwise satisfies the terms of the contract, indicates "treatment" of the individual as an employee.

(6) The filing of a delinquent or amended employment tax return for a particular tax period with respect to an individual as a result of IRS collection or examination activities or other compliance procedures, does not indicate "treatment" of the individual as an employee for that period. IRS correspondence that merely advises the taxpayer that no return has been filed and requests information from the taxpayer is not a compliance procedure. However, if the taxpayer takes any of the actions identified [above] with respect to those individuals in a later period (for example, the taxpayer withholds employment taxes or files employment tax returns with respect to those individuals for the periods following the period audited), those actions indicate "treatment" of the individuals as employees for those later periods.

(7) A return prepared by the IRS under § 6020(b) (returns prepared or executed by the Secretary of the Treasury) for a period is not "treatment" of an individual as an employee for that period.

Prima facie case for Section 530 relief. Pursuant to Section 530(e)(4) and Rev. Proc. 2025-10 § 7, a taxpayer can establish a prima facie case for Section 530 relief, thereby shifting the burden of proof to the IRS, if the taxpayer meets three conditions: (i) the reporting consistency requirement; (ii) the substantive consistency requirement; and (iii) one of the reasonable basis safe harbors enumerated in Section 530(a)(2)(A), (B), and (C).

(1) *Reporting Consistency Requirement of Section 530(a)(1)(B).* The reporting consistency requirement is intended to ensure that a taxpayer acted in good faith in treating individuals as non-employees. Reporting consistency requires a taxpayer to file all required federal tax returns with respect to an individual for a relevant period on a basis consistent with the good faith treatment of the individual by the taxpayer as a non-employee. For instance, if a taxpayer's position is that an individual was an independent contractor for a taxable period, the

taxpayer must have filed all required Forms 1099 consistent with the taxpayer's position that the individual was an independent contractor for the period. Reporting consistency must be satisfied on a period-by-period basis. If a taxpayer filed information returns for one period but did not file information returns for a prior or subsequent period, the reporting consistency requirement is met only for the period for which the taxpayer filed information returns.

> *Example:* If a taxpayer whose position is that an individual was an independent contractor did not file Forms 1099-NEC "Nonemployee Compensation," in year 1, but did file Forms 1099-NEC in year 2, the taxpayer is not entitled to Section 530 relief in year 1 but may be entitled to Section 530 relief for year 2 if it otherwise meets the requirements of Section 530 for that year.

Further, the reporting consistency requirement must be satisfied on an individual-by-individual basis. A taxpayer filing information returns for some individual workers but not others may satisfy the reporting consistency requirement only for the individuals for whom it filed information returns.

> *Example*: If a taxpayer takes the position that individual workers A, B, and C in year 1 were independent contractors and filed Forms 1099-NEC for those workers in year 1, but did not file Forms 1099-NEC for individual workers D, E, and F in year 1, the taxpayer is not entitled to Section 530 relief for individuals D, E, and F for year 1. The taxpayer may be entitled to Section 530 relief for individual workers A, B, and C in year 1 if it otherwise meets the requirements for Section 530 relief for that year. If the taxpayer files Forms 1099-NEC for all the individuals in year 2, the taxpayer may be entitled to Section 530 relief for all the individuals in year 2 if it otherwise meets the requirements for Section 530 relief for that year.

Finally, a taxpayer will not fail the reporting consistency requirement if the taxpayer, in good faith, mistakenly files the wrong type of information return or, as long as the return demonstrates a good faith attempt to accurately report the amount paid, reports an inaccurate amount paid. Moreover, a taxpayer will not fail the reporting consistency requirement if the taxpayer was not required to file an information return because, for example, the taxpayer paid the individual less than the threshold amount required to file a Form 1099.

(2) *Substantive Consistency Requirement of Section 530(a)(3)*. The substantive consistency requirement is intended to ensure that Section 530 relief applies only to a taxpayer who has consistently treated all individuals holding substantially similar positions as non-employees. Substantive consistency prevents a taxpayer from changing its treatment of employees to non-employees in order to qualify for Section 530 relief, including through reincorporation, reorganization, name change, or otherwise. More specifically, substantive consistency means that a taxpayer or a predecessor has not treated an individual, or any individual holding a substantially similar position, as an employee for any period beginning after December 31, 1977. Pursuant to Section 530(e)(6), the determination of whether an individual holds a position substantially similar to a position held by another individual includes consideration of the relationship between the taxpayer and the individual. Accordingly, a substantially similar position exists if the job functions, duties, and responsibilities are substantially similar and the control and supervision of those duties and responsibilities are substantially similar. In determining if a taxpayer has treated an individual, or any individual holding a substantially similar position, as an employee for purposes of the substantive consistency requirement, the IRS will apply the same guidelines as described above regarding "treatment" of a worker as an independent contractor or employee. On the one hand, "treatment" of an individual, or an individual holding a substantially similar position, as an employee in a period subsequent to the period under audit will not cause a taxpayer to fail the substantive consistency requirement for the period under audit or prior periods under audit. On the other hand, entering into a Classification Settlement Program (CSP) or Voluntary Classification Settlement Program (VCSP) agreement with the IRS with respect to an individual will be

considered "treatment" of the individual as an employee for substantive consistency purposes from the effective date of the agreement.

(3) *Reasonable Basis Requirement of Section 503(a)(2)*. The reasonable basis requirement is intended to ensure that the taxpayer adequately considered the worker classification status of the individual as an employee or non-employee before making the classification decision. Reasonable basis requires a taxpayer to demonstrate that it reasonably relied on one of the safe harbors in Section 530(a)(2). (As as explained further below, however, a taxpayer who does not fall within one of the safe harbors may still satisfy the reasonable basis requirement for the year under audit. The taxpayer may do so by demonstrating through facts and circumstances that for the year under audit it considered and relied upon another legitimate reason before deciding to classify an individual as an independent contractor for employment tax purposes.) The IRS considers the following when determining whether there was reasonable reliance on a safe harbor:

(1) *First safe harbor*. Judicial precedent or published rulings, whether or not relating to the particular industry or business in which the taxpayer is engaged, or technical advice, a letter ruling, or a determination letter issued to the taxpayer under audit.

   (a) Reliance on judicial precedent or published rulings requires that the taxpayer reasonably relied upon the judicial precedent or published rulings at the time it began treating the individual as a non-employee for the tax period under audit.

   (b) Thus, a taxpayer does not meet this first safe harbor if the judicial precedent that the taxpayer relied on was issued after the tax period for which the taxpayer treated the individual as a non-employee.

(2) *Second safe harbor*. A past IRS audit that resulted in no assessment of employment taxes attributable to the employment status reclassification of individuals holding positions substantially similar to the position held by the individual.

   (a) If a taxpayer is relying on the results of an audit that began *before 1997*, the audit does not have to have been an audit of whether the same individuals, or individuals holding substantially similar positions, should have been treated as employees of the taxpayer, so long as the prior audit did not result in an assessment of employment taxes attributable to the IRS's reclassification of the same individuals, or individuals holding substantially similar positions.

   (b) If a taxpayer is relying on the results of an audit that began *after 1996*, the audit must have been an employment tax examination of the same individuals, or individuals holding substantially similar positions, that did not result in a reclassification of the same individuals or individuals holding substantially similar positions.

   (c) A taxpayer does not meet this second safe harbor if, in the conduct of the prior audit, a proposed assessment attributable to the IRS's reclassification of the individual was offset by other claims asserted by the taxpayer.

   (d) A taxpayer does not meet this second safe harbor if the relationship between the taxpayer and the individuals during the period under audit is different from that which existed at the time of the prior audit.

   (e) A taxpayer does not meet this second safe harbor if the prior audit began after 1996 and was only for purposes of determining a taxpayer's liability for failure to subject a reportable payment to backup withholding, as required by § 3406 of the Code and accompanying regulations, if the workers' underlying classification was not examined, since the imposition of backup withholding liabilities does not involve the reclassification of workers by the IRS.

(3) *Third safe harbor*. A long-standing recognized practice of a significant segment of the industry in which the individual was engaged.

(a) Reliance on industry practice requires that the taxpayer reasonably relied upon the industry practice at the time it began treating the individual as a non-employee for the tax period under audit.

(b) An industry generally consists of businesses located in the same geographic or metropolitan area that compete for the same customers. However, if the area includes only one or a few businesses in the same industry, or if the business competes in regional or national markets, the geographic area may be expanded.

(c) 25 percent of the taxpayer's industry (determined by not taking into account the taxpayer) is deemed to be a significant segment of the industry. A lower percentage may be a significant segment, depending on the facts and circumstances.

(d) A practice that has existed for 10 years is deemed to be long-standing. A shorter period may be long-standing, depending on the facts and circumstances.

(4) *Other reasonable basis grounds.* Outside the above safe harbors, a taxpayer must demonstrate by other facts and circumstances that it relied on another legitimate ground for treating the individual as a non-employee. Although the reasonable basis requirement should be construed liberally in favor of the taxpayer, the reporting consistency and substantive consistency requirements for obtaining section 530 relief are not liberally construed. Failure to satisfy the reporting consistency or substantive consistency requirements for section 530 relief is not cured by the application of liberal construction of the reasonable basis requirement. Moreover, the shift in the burden of proof does not apply with respect to the reasonable basis requirement if the taxpayer relied on a non-safe-harbor ground for treating the individual as a non-employee. *See* Section 530(e)(4)(B) and Rev. Proc. 2025-10 § 7.02. Furthermore, consistent with the legislative history of Section 530, a taxpayer is not considered to have a reasonable basis for its treatment of individuals as non-employees if the facts and circumstances indicate negligence, intentional disregard of rules and regulations, or fraud. *See* Rev. Proc. 2025-10 § 6.06. If the taxpayer's reasonable basis falls outside the safe harbors, the taxpayer and the IRS may consider whether, during the years under audit, the taxpayer:

(1) claimed income tax deductions, or treated payments made to or on behalf of the individual as excludable from income, under provisions of the Code that are applicable only to employees, including under §§ 62(a)(2)(A), 105, 106, 117(d), 119, 127, 129, 132 (portions thereof), or 137 of the Code;

(2) claimed employer credits such as credits for paid sick and/or family leave under sections 7001 and/or 7003 of the Families First Coronavirus Response Act or §§ 3131 through 3133 of the Code, the Employee Retention Credit under either § 2301 of the Coronavirus Aid, Relief, and Economic Security Act or § 3134 of the Code, or any other credits specified in future guidance that are calculated with respect to wages or compensation paid to an employee;

(3) complied with federal or state labor law including minimum wage and overtime pay rules with respect to the individual that are applicable to employees or treated workers as employees for purposes of state or non-tax federal laws;

(4) treated the individual as an employee for purposes of collectively bargained agreements entered into by the taxpayer;

(5) permitted participation of the individual in any qualified pension, profit-sharing, or stock bonus plan;

(6) permitted participation of the individual in any nonqualified deferred compensation plan if such participation is limited to employees of the taxpayer;

(7) provided state unemployment insurance or worker's compensation insurance coverage for such individual if the requirements for obtaining such state unemployment or worker's compensation insurance is that coverage is limited to individuals performing services for the taxpayer as common law employees under the common law rules or persons that would qualify as employees for federal employment tax purposes.

Rev. Rul. 2025-3 illustrates the application of Section 530. Rev. Rul. 2025-3 contains five situations (which are in substance variations on one fact pattern) illustrating the application of Section 530 considering the updated guidance announced in Rev. Proc. 2025-10. The five illustrations further clarify that Section 530 relief is not applicable to a dispute involving the proper characterization of particular payments where the IRS is not seeking to reclassify a worker from independent contractor to employee status. *See also* Rev. Proc. 2025-10 § 3.06. In other words, Section 530 does not apply to controversies concerning whether a particular type of remuneration (e.g., a bonus in addition to regular compensation) paid to a taxpayer's properly treated and classified "employee" constitutes "wages" as defined under FICA, FUTA, or income tax withholding provisions. The five illustrations also elaborate on whether a taxpayer failing to qualify for Section 530 relief from unpaid employment taxes (including interest and penalties) may be eligible for limited relief under § 3509 or Tax Court review under § 7436.

Code § 3509(a) allows an employer to remit unpaid taxes at reduced rates if an employer fails to deduct and withhold income tax or the employee's share of FICA tax with respect to any of its employees because the employer improperly treated the worker as a non-employee. Pursuant to § 3509(c), the reduced rates do not apply to the determination of the employer's liability for income tax withholding or the employee portion of FICA tax if such liability is due to the employer's intentional disregard of the requirement to deduct and withhold such taxes. For purposes of § 3509, the concept of "treatment" of an individual as a non-employee or employee is the same as the analysis under Section 530 (as discussed above). Thus, like Section 530, if a taxpayer treated and classified an individual as an employee, § 3509 will not apply since the worker is not being reclassified from non-employee to employee. Accordingly, also like Section 530, § 3509 is not applicable if the IRS determines that other or additional remuneration paid to an employee constitutes "wages" under FICA, FUTA, or income tax withholding provisions.

Code § 7436 provides that the Tax Court may review two types of employment tax determinations made by the IRS and the proper amount of employment tax, penalties, and additions to tax resulting from those determinations. To obtain Tax Court review under § 7436, the following elements must be met:

(1) an examination in connection with the audit of any person;
(2) a determination that —
  (a) one or more individuals performing services for such person are employees of such person for purposes of subtitle C, or
  (b) such person is not entitled to relief under Section 530 with respect to such an individual;
(3) an "actual controversy" involving the determination as part of an examination; and
(4) the filing of an appropriate pleading in the Tax Court.

See American Airlines Inc. v. Commissioner, 144 T.C. 24, at 32 (2015). When the first three elements are met, the IRS will issue a § 7436 Notice. A taxpayer satisfies the fourth element by filing a timely petition for review of the § 7436 Notice with the Tax Court. Rev. Proc. 2022-13, 2022-6 I.R.B. 477, superseding Notice 2002-5, 2002-1 C.B. 320, provides further guidance concerning when and how the IRS will issue a § 7436 Notice thereby allowing a taxpayer to petition for Tax Court review. The IRS will not issue a § 7436 Notice if the taxpayer has agreed

to the employment tax liabilities. Generally, an agreement is accomplished using Form 2504-T "Agreement to Assessment and Collection of Additional Employment Tax and Acceptance of Overassessment (Employment Tax Adjustments Subject to § 7436)."

Situation 1. Taxpayer (TP) hires individuals who provide services to TP during the year. For those services, TP pays each individual a weekly fixed amount and a weekly bonus amount. TP does not withhold or pay federal employment taxes with regard to any of the payments and reports the total amount of the fixed weekly amounts and the weekly bonus amounts on Form 1099-NEC "Nonemployee Compensation." During an audit of TP by the IRS for the year, the IRS determines (1) that TP does not meet the statutory requirements for Section 530 relief, and (2) that the individuals are employees of TP. The IRS proposes to assess federal employment taxes on the weekly fixed amounts and the weekly bonus amounts, which the IRS asserts should have been reported as wages on Form 941 "Employer's QUARTERLY Federal Tax Return," and Forms W-2 "Wage and Tax Statement." TP claims it satisfies the statutory requirements for Section 530 relief and does not agree that the individuals are its employees.

- *Held*. Section 530 applies because TP did not treat the individuals as employees, and the IRS is reclassifying the individuals as employees. Whether TP is entitled to Section 530 relief depends on whether TP satisfies the substantive consistency, reporting consistency, and reasonable basis requirements. If Section 530 does not apply, § 3509 of the Code may be applicable because TP treated the individuals as non-employees and did not deduct and withhold federal employment taxes from the weekly fixed amounts and bonus amounts that it paid to the individuals, and the IRS is attempting to reclassify the individuals as employees. Whether TP is entitled to §3509 reduced rates depends upon whether it meets the other statutory requirements of § 3509. The IRS will issue TP a § 7436 Notice at the conclusion of the audit or after Appeals consideration if no agreement is reached. A § 7436 Notice will be issued because (1) there was an examination in connection with an audit, (2) there were determinations that (a) the individuals were employees of TP, and (b) TP was not entitled to relief under Section 530 with respect to these individuals, and (3) the IRS and TP disagree on the employment status of the workers and whether the statutory requirements for Section 530 relief have been met (there is an actual controversy involving the determination as part of the audit).

Situation 2. The facts are substantially the same as Situation 1 except that TP treats the individuals as employees for withholding and employment tax purposes with respect to the weekly payments but not the weekly bonus amounts. TP does not withhold or pay employment taxes with regard to the bonus amounts but does report the bonus amounts on Forms 1099-NEC. TP claims it satisfies the statutory requirements for Section 530 relief with respect to the bonus amounts and does not agree that the bonus amounts are wages.

- *Held*. Section 530 is not applicable to this situation because the IRS is not reclassifying the individuals as employees. TP treated the individuals as employees for the services they performed and paid additional wages in the form of bonuses for the same services; there is no controversy over whether the individuals are employees or independent contractors with respect to their services. (That is, the controversy concerns whether the bonuses are "wages" subject to withholding and employment taxes, not the proper classification of the workers as employees or independent contractors.) The reduced rates under § 3509 of the Code are not applicable for the same reason. The IRS will issue TP a § 7436 Notice at the conclusion of the audit or after Appeals consideration if no agreement is reached. A § 7436 Notice will be issued because (1) there was an examination in connection with an audit, (2) a determination was made that TP was not entitled to relief under Section 530 with respect to the bonuses paid to the individuals, and (3) the IRS and TP disagree on whether the statutory requirements for Section 530 relief have been met (there is an actual controversy involving the determination as part of the audit).

Situation 3. The facts are the same as Situation 2 except TP does not report the weekly bonus amounts on Forms 1099-NEC or any other information return.

- *Held*. Neither Section 530 nor § 3509 are applicable to this situation for the same reasons stated in Holding 2. (That is, the controversy concerns whether the bonuses are "wages" subject to withholding and employment taxes, not the proper classification of the workers as employees or independent contractors.) The IRS will issue TP a § 7436 Notice at the conclusion of the audit or after Appeals consideration if no agreement is reached. A § 7436 Notice will be issued because (1) there was an examination in connection with an audit, (2) a determination was made that TP was not entitled to relief under Section 530 with respect to the bonuses paid to the individuals, and (3) the IRS and TP disagree on whether the statutory requirements for Section 530 relief have been met (there is an actual controversy involving the determination as part of the audit).

Situation 4. The facts are the same as Situation 2 except TP does not report the weekly bonus amounts on Forms 1099-NEC or any other information return and does not claim it satisfies the statutory requirements for Section 530 relief with respect to the bonus amounts.

- *Held*. Neither Section 530 nor § 3509 are applicable to this situation for the same reasons stated in Holding 2. (That is, the controversy concerns whether the weekly and bonus payments are "wages" subject to withholding and employment taxes, not the proper classification of the workers as employees or independent contractors.)The IRS will not issue TP a § 7436 Notice at the conclusion of the audit or after Appeals consideration if no agreement is reached because TP did not claim that TP was entitled to relief under Section 530 concerning the bonuses paid to the individuals, and there is no controversy over whether the individuals are employees or independent contractors.

Situation 5. TP employs individuals who perform services during the year. TP enters into a contract with a third party (3P) to pay each individual a weekly salary, withhold and pay federal employment taxes, and file federal employment tax returns. 3P pays the weekly salaries, withholds, pays federal employment taxes, and reports the weekly salaries and taxes on Form 941 and Forms W-2 using its own employer identification number (EIN). In December of that same year, TP pays a year-end bonus amount directly to each individual for the individual's services during the year but does not treat the year-end bonus amounts as wages. TP does not withhold or pay any federal employment taxes or report the bonus amounts on any information return. During an audit of TP by the IRS for the year, the IRS concludes that the bonus amounts are wages. The IRS proposes to assess federal employment taxes on the bonus amounts, which should have been reported as wages on Form 941 and Forms W-2. TP claims it satisfies the statutory requirements for Section 530 relief with respect to the bonus amounts and does not agree the bonus amounts are wages.

- *Held*. Section 530 is not applicable to this situation because the IRS is not reclassifying the individuals as employees. The year-end bonus amounts are additional wages for the same services performed by the individuals who were treated as employees by TP. The reduced rates under § 3509 of the Code are not applicable for the same reason. The IRS will issue TP a § 7436 Notice at the conclusion of the audit or after Appeals consideration if no agreement is reached. A § 7436 Notice will be issued because (1) there was an examination in connection with an audit, (2) a determination was made that TP was not entitled to relief under Section 530 with respect to the year-end bonus amounts paid to the individuals, and (3) the IRS and TP disagree on whether the statutory requirements for Section 530 relief have been met (there is an actual controversy involving the determination as part of the audit).

B. Self-employment Taxes

1. "Sticks and stones may break my bones but …" calling someone a limited partner in a state-law limited partnership does not necessarily exempt that person from self-employment tax on their distributive share of partnership income. Soroban Capital Partners LP v. Commissioner, 161 T.C. 310 (11/28/23). The petitioner in this case, Soroban Capital Partners LP (Soroban), is a limited partnership that, for the years in question, was subject to the former TEFRA unified audit and litigation procedures. Soroban had one general partner (a limited liability company) and three individual limited partners, Messrs. Mandelblatt, Kapadia, and Friedman. On its partnership tax returns for 2016 and 2017, Soroban included in net earnings from self-employment the guaranteed payments received by the three limited partners and the general partner's distributive share of the partnership's ordinary business income. On the other hand, Soroban excluded from net earnings from self-employment the limited partners' distributive shares of the partnership's ordinary business income. Following an audit, the IRS issued Notices of Final Partnership Administrative Adjustment for 2016 and 2017 in which the IRS proposed increasing net earnings from self-employment by the limited partners' distributive shares of the partnership's ordinary business income. On behalf of the partnership, the general partner filed a petition in the Tax Court challenging this adjustment. In the Tax Court, Soroban filed a motion for summary judgment asking the court to determine as a matter of law that the limited partners' shares of the partnership's ordinary business income were excluded from net earnings from self-employment or, alternatively, that any inquiry into the roles of the limited partners in the partnership's business did not concern a partnership matter and therefore could not be resolved in this TEFRA partnership-level proceeding. The government filed a motion for partial summary judgment asking the court to determine as a matter of law that an inquiry into the limited partners' roles could be determined in this partnership-level proceeding. The Tax Court (Judge Buch) denied Soroban's motion and granted the government's motion. Under § 1402(a), a partner's distributive share of partnership income generally is treated as net earnings from self-employment, but § 1402(a)(13) excludes from this treatment "the distributive share of any item of income or loss of a limited partner, as such …" (other than guaranteed payments for services). The court reviewed the legislative history of § 1402(a)(13) and the government's issuance of proposed regulations in 1997 that sought to define the scope of this limited partner exception and that led to a congressional moratorium on the issuance of regulations. The court also reviewed prior judicial interpretation of the limited partner exception in § 1402(a)(13), including the court's prior decision in *Renkemeyer, Campbell & Weaver, LLP v. Commissioner*, 136 T.C. 137 (2011). In *Renkemeyer*, the court held that partners in a law firm organized as a limited liability partnership were subject to self-employment tax on their distributive shares of partnership income because that income was derived from legal services performed by the partners in their capacity as partners, and therefore "they were not acting as investors in the law firm." The Tax Court had not previously addressed whether a limited partner in a state law limited partnership is automatically a "limited partner, as such" within the meaning of § 1402(a)(13) or instead must satisfy a functional analysis test like the one applied in *Renkemeyer* to be entitled to the limited partner exception. The partnership, Soroban, argued that, because Soroban was a state law limited partnership and its Limited Partnership Agreement identified Messrs. Mandelblatt, Kapadia, and Friedman as limited partners, § 1402(a)(13) was satisfied. The court, however, disagreed and concluded that "[a] functional analysis test should be applied when determining whether the limited partner exception under section 1402(a)(13) applies to limited partners in state law limited partnerships." Because this test requires analysis of the functions and roles of the limited partners, which are factual determinations, the court denied the partnership's motion for summary judgment. The court also held that this examination of the roles of the limited partners is a partnership item that the court had jurisdiction to determine in this TEFRA partnership-level proceeding.

a. In the wake of *Soroban*, the IRS has won the first round. State law limited partners were subject to self-employment tax on their distributive shares of partnership income, says the Tax Court. Denham Capital Management LP v. Commissioner, T.C. Memo. 2024-114 (12/23/24). The petitioner in this case, Denham Capital Management LP

(Denham), was a limited partnership organized under Delaware law. It provided investment advisory and management services to affiliated private equity funds that invested in the energy sector, specifically oil and gas, mining, and power. Denham had one general partner, a limited liability company that had elected to be treated as a partnership for federal tax purposes, and five individual limited partners. The five individual limited partners were Messrs. Porter, Tricoli, Mackin, Siddiqi, and Mayre. In addition, Denham had employees who were not limited partners. The five individual limited partners (referred to by the court as "Partners") were members of the LLC that served as the general partner. The limited partnership agreement of Denham required four of the five limited partners (all except Mr. Porter) to devote substantially all of their business time and attention to the affairs of Denham and its affiliates. All of the limited partners were actively involved in Denham's business in various ways. For example, three of them had authority to execute any type of agreement on behalf of Denham, they all had the ability to remove underperforming partners by consensus, four had the title of "managing partner" and led either deal teams or portfolio services groups, two had the title of "copresident," three were actively engaged in fostering and attracting investor relationships, and all served on Denham's management, valuation, or investment committees. Clients of Denham had the right to withdraw their investments early if one or more of the limited partners died, became disabled, or could no longer devote substantially all business time to the funds. All five limited partners were considered a key person by at least one of the funds active during the years in issue. One of the limited partners, Mr. Porter, contributed $8 million to acquire his limited partnership interest. The other limited partners did not contribute capital but rather acquired their limited partnership interests through grants of profits interests. There was testimony at trial that the other limited partners acquired their partnership interests by paying Mr. Porter directly for them pursuant to written agreements, but no written agreements were offered as evidence. Denham's income for the years in issue, 2016 and 2017, consisted solely of fees it received in exchange for services provided to investors such as advising and operating the private investment funds. On its partnership tax returns for 2016 and 2017, Denham included in net earnings from self-employment the guaranteed payments received by the five limited partners and the general partner's distributive share of the partnership's ordinary business income. On the other hand, Denham excluded from net earnings from self-employment the limited partners' distributive shares of the partnership's ordinary business income. Following an audit, the IRS issued Notices of Final Partnership Administrative Adjustment for 2016 and 2017 in which the IRS proposed increasing net earnings from self-employment by the limited partners' distributive shares of the partnership's ordinary business income. The Tax Court (Judge Kerrigan) held in favor of the government. Under § 1402(a), a partner's distributive share of partnership income generally is treated as net earnings from self-employment, but § 1402(a)(13) excludes from this treatment "the distributive share of any item of income or loss of a limited partner, as such …" (other than guaranteed payments for services). The court emphasized that, although Denham was a state law limited partnership and the five individuals were limited partners, its prior decision in Soroban Capital Partners LP v. Commissioner, 161 T.C. 310 (11/28/23), requires an analysis of the functions and roles of the limited partners:

> Our caselaw has continuously reinforced our position that determinations under section 1402(a)(13) require a factual inquiry into how the partnership generated the income in question and the partners' roles and responsibilities in doing so. …
>
> We need to perform a comprehensive inquiry that seeks to determine, on account of the pertinent facts and circumstances, whether the Partners were "*generally* akin" to passive investors. …. This standard does not preclude a partner from qualifying for the limited partner exception with respect to his distributive share of partnership income despite receiving a guaranteed payment for services actually rendered, as long as other circumstances of the partner's economic relationship with the partnership sufficiently indicate it is generally one of passive investment.

In applying this standard, the court observed that the limited partners other than Mr. Porter were required to (and did) devote substantially all of their time to the business affairs of the partnership,

that they were actively involved in the partnership's business in various ways, that their expertise and judgment were a significant draw for investors, and that they exercised significant control over personnel decisions. Perhaps most of all, the court emphasized that the partnership's income for 2016 and 2017 consisted solely of approximately $130 million for the two years combined in fees it received in exchange for services provided to investors (such as advising and operating the private investment funds) and that the limited partners' time, skills, and judgment were essential to the provision of these services. The court rejected Denham's argument that the distributive shares of income of the limited partners were returns on investment. Only Mr. Porter, the court observed, had contributed capital to the partnership, and given his level of involvement in the partnership's business, he could not be regarded as a passive investor. The court provided the following table to illustrate the point that the distributive shares of the limited partners did not represent a return on investment:

Partner	*Capital Contributions Since Inception*	*2016 and 2017 Distributive Share*	*2016 and 2017 Guaranteed Payments*	*2016 and 2017 Distributions*
Stuart Porter	$8,000,000	$16,581,463	$810,137	$15,814,809
Carl Tricoli	—	$13,822,459	$740,453	$12,972,886
Scott Mackin	—	$6,653,979	$421,269	$5,949,589
Riaz Siddiqi	—	$3,870,352	$429,995	$3,518,137
Jordan Marye	—	$9,467,801	$710,325	$7,756,881

In summary, the court held that the five limited partners were not "limited partners" within the meaning of § 1402(a)(13) and that their distributive shares of the partnership's income therefore were subject to self-employment tax.

b. Round two goes to the government as well. The Tax Court has again concluded that state law limited partners were subject to self-employment tax on their distributive shares of partnership income. Soroban Capital Partners LP v. Commissioner, T.C. Memo. 2025-52 (5/28/25). In its earlier opinion in this case (*Soroban Capital Partners LP v. Commissioner*, 161 T.C. 310 (11/28/23)), discussed above, the court denied the taxpayer's motion for summary judgment and held that determining whether limited partners in a state-law limited partnership are "limited partners" within the meaning of the limited partner exception in § 1402(a)(13) (and therefore not subject to self-employment tax on their shares of partnership income) requires a functional analysis of the roles of the limited partners in the partnership's business. The case was submitted for decision without trial pursuant to Tax Court Rule 122.

The facts of this case are very similar to those in *Denham Capital Management LP v. Commissioner*, T.C. Memo. 2024-114 (12/23/24), discussed above. The petitioner in this case, Soroban Capital Partners LP (Soroban), is a Delaware limited partnership that, for the years in question, was subject to the former TEFRA unified audit and litigation procedures. Soroban had one general partner (a limited liability company) and three individual limited partners, Messrs. Mandelblatt, Kapadia, and Friedman. Soroban earned its income from fees it charged its clients for managing investments. All of Soroban's gross receipts, sales, or other income during the years in issue were derived from its provision of investment management services. The limited partners all were actively involved in Soroban's business in various ways. Mr. Mandelblatt was Soroban's managing partner and chief investment officer (CIO). His duties included managing the investing

of the funds' portfolios on Soroban's behalf. He had "final discretion on all portfolio-related matters." Mr. Kapadia was Soroban's comanaging partner. His duties also included managing the investing of the funds' portfolios on Soroban's behalf. Mr. Friedman was Soroban's head of trading and risk management. His duties included executing the investing decisions made by the other two individuals. Soroban described him as responsible for "risk management" and "trade execution." All three individuals worked full-time in their positions. It was estimated that they each worked between 2,300 and 2,500 hours per year during the years in issue. They all served on committees that oversaw the operations of Soroban. One of them (Mr. Mandelblatt) had authority to bind Soroban to any type of agreement in his capacity as managing partner of Soroban's general partner. Only one of the limited partners, Mr. Mandelblatt, contributed assets (a total of $4.4 million) to Soroban. Soroban advertised the unique skills and talents of the three limited partners to potential investors. In its earlier opinion in this case (*Soroban Capital Partners LP v. Commissioner*, 161 T.C. 310 (11/28/23)), the court had emphasized that "[a] functional analysis test should be applied when determining whether the limited partner exception under section 1402(a)(13) applies to limited partners in state law limited partnerships." After reviewing the facts, the court applied that test and concluded that the three individuals were not limited partners within the meaning of § 1402(a)(13):

> Soroban's limited partners were limited partners in name only. They were essential to generating the business's income, they oversaw day-to-day management, they worked for the business full time, and they were held out to the public as essential to the business. Their capital accounts make clear that their earnings were not of an investment nature. They are not limited partners within the meaning of section 1402(a)(13), and their earnings constitute net earnings from self-employment for the years in issue.

C. Excise Taxes

1. ♫♪ Never ever had a lover who put the pedal to the metal and burn rubber on me. ♪♫ A U.S. corporation that purchased tires from China for resale in the United States was the importer of the tires and therefore liable for the excise tax imposed by § 4071. Texas Truck Parts & Tire, Inc. v. United States, 118 F.4th 687 (5th Cir. 10/8/24), *rev'g* 695 F.Supp.3d 899 (S.D. Texas 9/28/23). Section 4071(a) of the Code imposes an excise tax "on taxable tires sold by the manufacturer, producer, or importer thereof." The taxpayer, a wholesaler and retailer of truck parts and tires based in Houston, Texas, purchased tires from Chinese manufacturers, which shipped and delivered the tires to the taxpayer's doorstep in Houston from 2012 to 2017. The Chinese manufacturers arranged for the tires to be transported from China to the United States, clear U.S. Customs, and be delivered to the taxpayer. The taxpayer neither filed quarterly excise tax returns on Form 720 nor paid any excise tax on the tires. During an audit of these years, the IRS asserted that the taxpayer, rather than the Chinese manufacturers, was the importer of the tires within the meaning of § 4071 and therefore liable for approximately $1.9 million in unpaid excise tax. The taxpayer made a partial payment, filed a claim for refund and, after the IRS failed to act on it, brought suit for a refund in the U.S. District Court for the Southern District of Texas. The District Court granted the taxpayer's motion for summary judgment. On appeal, in an opinion by Judge Douglas, the U.S. Court of Appeals for the Fifth Circuit reversed, rendered judgment for the government, and remanded for a determination of damages. The Fifth Circuit concluded that the taxpayer was the "importer" of the tires under the definition of that term in the relevant regulations, which define an importer of an article as

> any person who brings such an article into the United States from a source outside the United States, or who withdraws such an article from a customs bonded warehouse for sale or use in the United States. If the nominal importer of a taxable article is not its beneficial owner (for example, the nominal importer is a customs broker engaged by the beneficial owner), the beneficial owner is the "importer" of the article for purposes of chapter 32 and is liable for tax on his sale or use of the article in the United States.

Reg. § 48.0-2(a)(4)(i). The District Court concluded that the taxpayer was not the importer of the tires because it did not "bring" the tires into the U.S. The Fifth Circuit agreed with the District's Court's conclusion, but the Fifth Circuit also expressed the view that the District Court had, "without explanation, failed to consider the second half [of the definition]—whether Texas Truck was the beneficial owner and the Chinese manufacturers merely nominal importers." The Fifth Circuit observed that the U.S. Supreme Court had defined importation as "the inducing and efficient cause of bringing the merchandise into the country." *Hooven & Allison Co. v. Evatt*, 324 U.S. 652, 661 (1945), *overruled on other grounds*, *Limbach v. Hooven & Allison Co.*, 466 U.S. 353 (1984). The IRS had applied this same definition, the court observed, in administrative guidance concerning the excise tax on manufacturers. Rev. Rul. 68-197, 1968-1 C.B. 455. In this case, the court concluded, the Chinese manufacturers were the nominal importers and the taxpayer was the beneficial owner of the tires and therefore the importer for purposes of the excise tax:

> There is no doubt that in this instance, the Chinese manufacturers did not act as any more than nominal importers: they did not ship the tires to sell them or initiate new sales to purchasers in the United States. They shipped them to an American entity, which then sold the tires. The Chinese manufacturers were importers in name only.

In reaching this conclusion, the court was persuaded by the reasoning of the U.S. Court of Appeals for the Federal Circuit, which reached the same conclusion on nearly identical facts. *See Terry Haggerty Tire Co., Inc. v. United States*, 899 F.2d 1199 (Fed. Cir. 1990).

XII. TAX LEGISLATION

A. Enacted

1. The SECURE 2.0 Act increases the age at which required minimum distributions must begin, modifies the rules regarding catch-up contributions, and makes many other significant changes that affect retirement plans. The Consolidated Appropriations Act, 2023, Pub. L. No. 117-328, signed by the President on December 29, 2022, includes the SECURE 2.0 Act of 2022, which increases the age at which required minimum distributions (RMDs) must begin to age 73, reduces the penalty for failure to take RMDs, modifies the rules for catch-up contributions to qualified retirement plans, and makes many other significant changes that affect retirement plans.

2. It might not be pretty, but it's called the One Big Beautiful Bill Act. The One Big Beautiful Bill Act, Pub. L. No. 119-21, was signed by the President on July 4, 2025. Among other changes, the legislation restored both 100-percent bonus depreciation and the deductibility of domestic research and experimentation expenditures, increased the limit on deducting the cost of § 179 property, favorably modified the § 163(j) limit on deducting business interest, authorized several new deductions for individuals, and extended many expiring provisions of the legislation Congress enacted in late 2017,"An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018," Pub. L. No. 115-97, commonly known as the "2017 Tax Cuts and Jobs Act."

XIII. TRUSTS, ESTATES & GIFTS

A. Gross Estate

B. Deductions

C. Gifts

D. Trusts