RECENT DEVELOPMENTS IN FEDERAL INCOME TAXATION

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

By

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I. ACCOUNTING

A. Accounting Methods

B. Inventories

C. Installment Method

D. Year of Inclusion or Deduction

1. Let's hope this tax services firm has more success on behalf of its clients. Amounts received from customers had to be included in income despite a promise to return the funds if the taxpayer did not obtain a successful result, and costs incurred on behalf of clients were not deductible. RJ Channels, Inc. v. Commissioner, T.C. Memo. 2018-27 (3/14/18). The taxpayer, a subchapter C corporation that used the accrual method of accounting, provided return preparation and other tax services. The taxpayer received payments from two different clients. It received approximately $215,000 in its taxable year ending May 31, 2012, and $153,000 in its taxable year ending May 31, 2013. The taxpayer represented to each client that, if it were unable to obtain a favorable result for the client through its provision of tax services, it would return the payment to the client. The taxpayer deposited the payments in its bank account and was able to use the funds without restriction. The taxpayer did not return either payment to the client and did not include either payment in gross income for the years in which it had received them. During its taxable year ending May 31, 2012, the taxpayer deducted certain costs it had paid on behalf of clients. The taxpayer characterized these amounts as "Legal and Professional Fees" and as "Taxes." The clients later reimbursed the taxpayer for these costs. The IRS issued a notice of deficiency with respect to the taxpayer's 2012 and 2013 tax years in which it included in the taxpayer's gross income the payments it had received from clients and disallowed the taxpayer's deduction of the costs paid on behalf of clients. The Tax Court (Judge Chiechi) ruled in favor of the IRS on both issues. With respect to the issue whether the payments received from clients were includible in income, the court characterized the question not as *whether* the payments should be included in income, but *when* the payments should be included in income. The court cited *Schlude v. Commissioner*, 372 U.S. 128 (1963), and *Charles Schwab Corp. v. Commissioner*, 107 T.C. 282 (1996), for the proposition that

> [t]he right of a taxpayer on the accrual method of accounting to receive income is fixed upon the earliest of (1) the taxpayer's receipt of payment, (2) the contractual due date of the payment, or (3) the taxpayer's performance.

The court also referred to the claim of right doctrine, under which a taxpayer that receives funds under a claim of right must include them in gross income in the year of receipt, even though the taxpayer might not be entitled to retain the funds and might be liable to return them. *See North American Oil Consolidated v. Burnet*, 286 U.S. 417 (1932). The court characterized the taxpayer's obligation to return the payments to its clients as a condition subsequent (rather than a condition precedent). Under this view, the taxpayer did not have a current obligation to return the funds, and under *Schlude* and *Charles Schwab*, was required to include them in gross income in the year of receipt. With respect to the issue whether the taxpayer could deduct amounts it had paid on behalf of clients, the court cited relied on *Interstate Transit Lines v. Commissioner*, 319 U.S. 590, 593 (1943), as well as other authorities, for the proposition that amounts a taxpayer pays for the obligations of another taxpayer are not ordinary and necessary expenses within the meaning of § 162(a).

- With respect to the issue whether the taxpayer had to include the payments from clients in its gross income, the court rejected the taxpayer's reliance on *Commissioner v. Indianapolis Power & Light Co.*, 493 U.S. 203 (1990), as "inapposite." In *Indianapolis Power*, the Court held that amounts a utility company had received from customers were deposits, rather than advance payments, and therefore were not included in the taxpayer's income. The Court in *Indianapolis Power* emphasized that the utility had an obligation to return the amounts it had received, and that the timing and amount of any refund were within the customer's control. The Tax Court characterized *Indianapolis Power* as inapposite because it addressed the question *whether* the amounts received by the taxpayer constituted income, rather than *when* the amounts received constituted income.

II. BUSINESS INCOME AND DEDUCTIONS

A. Income

B. Deductible Expenses versus Capitalization

C. Reasonable Compensation

D. Miscellaneous Deductions

E. Depreciation & Amortization

F. Credits

G. Natural Resources Deductions & Credits

H. Loss Transactions, Bad Debts, and NOLs

I. At-Risk and Passive Activity Losses

1. California taxpayer with "trashy" tenants qualifies as real estate professional, but another with a bogus calendar that conflicted with bank statements does not. Franco v. Commissioner, T.C. Summary Op. 2018-9 (03/06/18); and Pourmirzaie v. Commissioner, T.C. Memo 2018-26 (03/08/18). These two recent cases issued just days apart somewhat humorously demonstrate what it takes to avoid the passive loss rules by establishing real estate professional status under § 469(c)(7). Rental activity is per se passive under § 469(c)(2); however, pursuant to § 469(c)(7), certain taxpayers may qualify for the so-called "real estate professional" exception to the passive loss rules. A taxpayer qualifies as a real estate professional if the taxpayer adequately establishes that (i) more than half of the personal services the taxpayer performed in trades or businesses during the year were performed in real property trades or businesses, and (ii) the taxpayer performed more than 750 hours of services in real property trades or businesses in which the taxpayer materially participateed during the year. Contemporaneous daily time reports, logs, or similar documents are the best way to prove hours worked and material participation, but Reg. § 1.469-5T(f)(4) also provides that hours worked and material participation may be established by any "reasonable means." In *Franco v. Commissioner*, Special Trial Judge Guy ruled that a California taxpayer who testified that his tenants "were not attentive to trash disposal matters" and that he therefore had made weekly trips to his rental properties to ensure that "trash bins were set out for collection" and who could produce an activity log, numerous emails, and home improvement store receipts relating to his rental properties qualified under § 469(c)(7). On the other hand, in *Pourmirzaie v. Commissioner*, a California couple who attempted to establish material participation through testimony and by producing a calendar that was reconstructed from memory during the course of the audit did not qualify as a real estate professional. Although the couple's testimony and reconstructed calendar in *Pourmirzaie* would have established material participation, the IRS pointed the Tax Court to the couple's bank statements. The bank statements showed purchases in London, Dallas, Philadelphia, Boca Raton, and New York on the same dates that the couple's reconstructed calendar showed work at their rental properties. Judge Halpern held the couple did not qualify for the § 469(c)(7) exception because "[s]imply stated, we do not believe" their testimony or the reconstructed calendar.

III. INVESTMENT GAIN AND INCOME

A. Gains and Losses

1. Taxpayer restores money-pit mansion to its former glory, but due to taxpayer's failure to rent or hold out for rental, gets "hammered" by capital loss. Keefe v. Commissioner, T.C. Memo 2018-28 (03/15/18). These married taxpayers, neither of whom was an architect or contractor, acquired and restored Wrentham House, a historic mansion in Newport, Rhode Island. From May of 2000 until May of 2008 the taxpayers spent approximately $10 million repairing and restoring the mansion with the ultimate goal of turning it into a luxury vacation rental property. Notwithstanding taxpayers' $10 million investment in the mansion, structural and other problems prevented the property from being marketable as a rental property until June of 2008. At that time, of course, the "Great Recession" was in full swing, and there was virtually no market and no prospect for luxury rentals. Consequently, the mansion was never rented or even seriously marketed for rental, and in August of 2009, the mansion was sold in a short sale for approximately $6 million. The taxpyer's claimed that the mansion was § 1231 property used in a trade or business thereby entitling them to ordinary loss treatment. The IRS contended that the mansion was not used in a trade or business but instead was a capital asset, so the loss on the short sale was a capital loss subject to the $3,000 per year limitation of § 1211(b). The Tax Court (Chief Judge Marvel) held for the IRS. Citing *Gilford v. Commissioner*, 201 F2d 735 (2d Cir. 1953) because the case would be appealable to the Second Circuit Court of Appeals, Judge Marvel explained that the taxpayers failed to show that their alleged rental activities were "sufficient, continous, and substantial enough to constitute a trade or business with respect to rental of the property." Accordingly, § 1231 did not apply to the mansion, so the mansion was a capital asset subject to the capital loss limitation of § 1211(b). The court also upheld the IRS's imposition of accuracy-related penalties.

B. Interest, Dividends, and Other Current Income

C. Profit-Seeking Individual Deductions

1. Say it isn't so! Miscellaneous itemized deductions are no longer deductible beginning in 2018. The 2017 Tax Cuts and Jobs Act, § 11045, amended Code § 67 by adding § 67(g), which disallows as deductions all miscellaneous itemized deductions for taxable years beginning after 2017 and before 2026. Miscellaneous itemized deductions are defined in § 67(b) and, prior to the Tax Cuts and Jobs Act, were deductible to the extent that, in the aggregate, they exceeded 2 percent of the taxpayer's adjusted gross income. The largest categories of miscellaneous itemized deductions are: (1) investment-related expenses such as fees paid for investment advice or for a safe deposit box used to store investment-related items, (2) unreimbursed employee business expenses, and (3) tax preparation fees.

a. But estates and non-grantor trusts can breathe a sigh of relief. Notice 2018-61, 2018-31 I.R.B. 278 (07/13/18). Under § 67(e), the adjusted gross income of an estate or trust generally is computed in the same manner as that of an individual. Furthermore, prior to the Tax Cut and Jobs Act, estates and non-grantor trusts were subject to the 2 percent floor on miscellaneous itemized deductions like individuals *unless* a cost paid or incurred by the estate or non-grantor trust "would not have been incurred if the property were not held in such estate or trust." Put differently, estates and non-grantor trusts avoided the 2 percent floor on miscellaneous itemized deductions if they paid or incurred a cost that "commonly or customarily" would not have been paid or incurred by a hypothetical individual holding the same property as the estate or non-grantor trust. For example, Reg. § 1.67-4(b)(3) provides as follows:

> Tax preparation fees. Costs relating to all estate and generation-skipping transfer tax returns, fiduciary income tax returns, and the decedent's final individual income tax returns are not subject to the 2-percent floor. The costs of preparing all other tax returns (for example, gift tax returns) are costs commonly and customarily incurred by individuals and thus are subject to the 2-percent floor.

If a fee (such as a tax preparation fee) paid or incurred by an estate or non-grantor trust was bundled so that it included costs that were both subject to the 2 percent floor (e.g., gift tax return) and not subject to the 2 percent floor (e.g., fiduciary income tax return), then the estate or non-grantor trust must allocate the bundled fee appropriately.

The enactment of new § 67(g), which states that "no miscellaneous itemized deduction" is allowed until 2026, left many estates and trusts wondering whether their investment-related and tax-related expenses (e.g., return preparation fees, trustee fees, financial advisor fees, etc.) peculiar to the administration of an estate or trust remain deductible either in whole or in part. Notice 2018-61 announces that Treasury and the IRS do not read new § 67(g) to disallow all investment- and tax-related expenses of estates and non-grantor trusts. Thus, the Treasury Department and the IRS intend to issue regulations clarifying that estates and non-grantor trusts may continue to deduct investment- and tax-related expenses just as they could prior to the enactment of new § 67(g). Notice 2018-61 also announces that Treasury and the IRS are aware of concerns surrounding whether new § 67(g) impacts a beneficiary's ability to deduct investment- and tax-related expenses pursuant to § 642(h) (unused loss carryovers and excess deductions) upon termination of an estate or non-grantor trust. Treasury and the IRS intend to issue regulations addressing these concerns as well.

D. Section 121

E. Section 1031

F. Section 1033

G. Section 1035

H. Miscellaneous

IV. COMPENSATION ISSUES

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

E. Divorce Tax Issues

F. Education

G. Alternative Minimum Tax

VI. CORPORATIONS

A. Rates

1. Back to the future: Remember the good ole days before 1986 when C corporations were tax shelters? By introducing a flat corporate tax rate of 21 percent, Congress has given new life to C corporations and will force us to relearn personal holding company, accumulated earnings tax, and other anti-abuse rules (e.g., § 269A) we've long ignored. The centerpiece of the 2017 Tax Cuts and Jobs Act is a permanent reduction in corporate tax rates effective for taxable years beginning after December 31, 2017. Section 13001 of the legislation amended § 11(b) to impose tax on taxable income of corporations, including personal service corporations, at a flat rate of 21 percent. Prior to this amendment, § 11(b) provided graduated rates with a top rate of 35 percent (which top rate applied to the first dollar of personal service corporation income). For personal service corporations and companies with significant profit from U.S. operations, the reduction in the corporate rate is a huge benefit. In fact, this rate reduction is estimated to reduce corporate income taxes by roughly $1.3 trillion over the next ten years. Prior to this change, most businesses avoided C corporation status unless they were (or planned to be) publicly traded, were so-called "blocker" corporations, or, in some cases, were taken private by investment funds. Venture capital backed companies also tended to choose C corporation status to simplify their capital structure and tax compliance obligations. Now, however, C corporation status may be a sensible choice for some personal service and other closely-held corporations, especially if the business will be held for the life of the major shareholders (thereby benefiting from the step-up in basis at death) or the shareholders will exit via a stock sale at some indeterminate time in the future. No doubt, the accumulated earnings tax (§§ 535-537) and the IRS's power to reallocate income between a shareholder and his or her personal service corporation (§ 269) will come into play to deter such strategies, but a 21 percent rate as compared to a 37 percent rate is tempting. Nevertheless, despite the reduced rate, subchapter C is still a double-tax regime. In particular, asset sales (or deemed asset sales at liquidation) by C corporations will continue to suffer a big tax bite notwithstanding the reduced corporate rate. Furthermore, new § 199A must be considered for any flow-through entities. *Bottom line:* Although the authors believe that flow-through status remains the best option in most situations, the choice-of-entity analysis just got more complicated and will require even more crystal-ball gazing.

a. Although we will have to relearn some old C corporation anti-abuse provisions, here's something we can forget: the corporate AMT. The 2017 Tax Cuts and Jobs Act, § 12001, repealed the corporate alternative minimum tax (by amending Code § 55) effective for taxable years beginning after 2017. Corporations that incurred AMT in past years will want to be sure to claim that amount as a credit against regular tax going forward. A special rule regarding the refundable portion of the AMT credit is designed to allow a corporation to use fully in 2018 through 2021 any AMT credits carried forward. Also, corporations that have had other credits (e.g, the R&D credit) limited in past years by the AMT may be able to claim those credits going forward.

b. Although we will have to relearn some old C corporation anti-abuse provisions, here's something we can forget: the corporate AMT. The 2017 Tax Cuts and Jobs Act, § 12001, repealed the corporate alternative minimum tax (by amending Code § 55) effective for taxable years beginning after 2017. Corporations that incurred AMT in past years will want to be sure to claim that amount as a credit against regular tax going forward. A special rule regarding the refundable portion of the AMT credit is designed to allow a corporation to use fully in 2018 through 2021 any AMT credits carried forward. Also, corporations that have had other credits (e.g, the R&D credit) limited in past years by the AMT may be able to claim those credits going forward.

c. But wait! Nothing about federal income taxation is ever simple, right? Notice 2018-38, 2018-18 I.R.B. 522 (04/16/18). The IRS has provided guidance to non-calendar taxable year C corporations with regard to the 2017 Tax Cuts and Jobs Act's reduction in the corporate rate and repeal of the AMT effective as of December 31, 2017. Essentially, in the case of a C corporation with a fiscal taxable year that includes (but does not start with) January 1, 2018, § 15 mandates that a blended rate apply for purposes of calculating regular income tax and the AMT for such fiscal taxable year. Notice 2018-38 provides the following examplesof the application of § 15:

> Example. Corporation X, a subchapter C corporation, uses a June 30 taxable year. For its taxable year beginning July 1, 2017, and ending June 30, 2018, X's taxable income is $1,000,000, and its [alternative mimimum taxable income or "AMTI"] in excess of its AMT exemption amount is $2,000,000.
>
> Computation under § 11
>
> Corporation X's corporate tax under § 11 of the Code is computed by applying § 15(a) as follows:

1) Taxable income (Line 30, Form 1120)	$ 1,000,000
2) Tax on Line 1 amount using § 11(b) rates before the Act	340,000
3) Number of days in Corporation X's taxable year before January, 1, 2018	184
4) Multiply Line 2 by Line 3	62,560,000
5) Tax on Line 1 amount using § 11(b) rate after the Act	210,000
6) Number of days in the taxable year after December 31, 2017	181
7) Multiply Line 5 by Line 6	38,010,000
8) Divide Line 4 by total number of days in the taxable year	171,397
9) Divide Line 7 by total number of days in the taxable year	104,137
10) Sum of Line 8 and Line 9	$ 275,534

> Under § 15(a), Corporation X's corporate tax for its taxable year ending June 30, 2018 is $275,534.
>
> Computation under § 55
>
> Corporation X's [tenative minimum tax or "TMT" under § 55] and resulting AMT under § 55 of the Code is computed by applying § 15(a) as follows:

1) AMTI in excess of AMT exemption amount (Line 9, Form 4626)	$2,000,000
2) TMT on Line 1 amount using § 55(b)(1)(B) rate before the Act	400,000
3) Number of days in Corporation X's taxable year before January, 1, 2018	184
4) Multiply Line 2 by Line 3	73,600,000
5) Divide Line 4 by total number of days in the taxable year	$ 201,644

It is unnecessary to compute a TMT for the portion of the taxable year beginning on and after the effective date of § 12001 of the Act because the TMT is repealed as of the effective date for purposes of applying § 15(a). Corporation X's TMT for its taxable year ending June 30, 2018 is $201,644. Because this TMT amount for the taxable year does not exceed Corporation X's corporate tax amount of $275,534, Corporation X does not have an AMT liability for its taxable year ending June 30, 2018.

B. Entity and Formation

C. Distributions and Redemptions

D. Liquidations

E. S Corporations

F. Mergers, Acquisitions and Reorganizations

G. Corporate Divisions

H. Affiliated Corporations and Consolidated Returns

I. Miscellaneous Corporate Issues

VII. PARTNERSHIPS

A. Formation and Taxable Years

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

C. Distributions and Transactions Between the Partnership and Partners

D. Sales of Partnership Interests, Liquidations and Mergers

E. Inside Basis Adjustments

F. Partnership Audit Rules

1. A disregarded LLC is a pass-thru partner for purposes of the small partnership exception to the TEFRA audit rules. Seaview Trading, LLC v. Commissioner, 858 F.3d 1281 (9th Cir. 6/7/17). Seaview Trading, LLC, a Delaware limited liability company that was classified as a partnership for federal tax purposes, had two members, each of which was a single-member LLC. One of these was AGK Investments LLC, which was wholly owned by Robert Kotick, and the other was KMC Investments LLC, wholly owned by Mr. Kotick's father. The IRS audited Mr. Kotick's 2001 return and disallowed certain deductions with respect to his investment in Seaview, but did not disallow his share of a loss passed through from Seaview, which arose from Seaview's investment in a common trust fund. After the limitations period on assessment for 2001 with respect to Mr. Kotick had expired, the IRS audited Seaview and issued a Final Partnership Administrative Adjustment (FPAA) in which the IRS disallowed Seaview's loss from its trust investment. Mr. Kotick challenged the FPAA by filing a petition in the Tax Court. AGK, Mr. Kotick's wholly owned LLC, filed a separate petition. Mr. Kotick argued that the FPAA was invalid because Seaview was not subject to the TEFRA audit rules pursuant to the small partnership exception of § 6231(a)(1)(B)(i). The Tax Court (Judge Foley) dismissed Mr. Kotick's petition on the grounds that (1) Seaview did not fall within the § 6231(a)(1)(B)(i) small partnership exception to the TEFRA audit rules, and (2) AGK, rather than Mr. Kotick, was the TMP of Seaview and therefore the court lacked jurisdiction to consider the petition filed by Mr. Kotick. In an opinion by Judge Smith, the U.S. Court of Appeals for the Ninth Circuit affirmed. Absent a contrary election by the partnership, the § 6231(a)(1)(B)(i) small partnership exception excludes from the TEFRA audit rules "any partnership having 10 or fewer partners each of whom is an individual (other than a nonresident alien), a C corporation, or an estate of a deceased partner." However, pursuant to Reg. § 301.6231(a)(1)-1(a)(2), the small partnership exception does not apply "if any partner in the partnership during the taxable year is a pass-thru partner" as defined in § 6231(a)(9). Section 6231(a)(9) defines a pass-thu partner as "a partnership, estate, trust, S corporation, nominee, or other similar person through whom other persons hold an interest in the partnership …." The court acknowledged that the two single-member LLCs, AGK and KMC, were disregarded for federal tax purposes pursuant to the check-the-box regulations. Nevertheless, the court held, these LLCs were pass-thru partners. In reaching this conclusion, the court gave *Skidmore* deference to Rev. Rul. 2004-88, 2004-2 C.B. 165. *See Skidmore v. Swift & Co.*, 323 U.S. 134 (1944). In Rev. Rul. 2004-88, the IRS ruled that, because a disregarded LLC held legal title to a partnership interest it was "a similar person through whom other persons hold an interest in the partnership" and therefore a pass-thru partner. The court also held that Mr. Kotick lacked standing to file a Tax Court petition on behalf of Seaview because he was not Seaview's TMP. Seaview had failed to designate a TMP for 2001, and therefore AGK, as the holder of the largest profits interest, was the TMP pursuant to § 6231(a)(7)(B). Accordingly, the court upheld the Tax Court's dismissal of Mr. Kotick's petition for lack of jurisdiction.

a. ♪♫They call me mellow yellow.♫♪ Well, actually, the D.C. Circuit calls it a TEFRA partnership. Mellow Partners v. Commissioner, 890 F.3d 1070 (D.C. Cir. 5/22/18). In an opinion by Judge Edwards, the U.S. Court of Appeals for the District of Columbia Circuit held that a partnership with two partners, each of which was a single-member LLC, was a TEFRA partnership that was subject to the TEFRA audit regime. The issue in the case was the same one presented in *Seaview Trading, LLC v. Commissioner*, 858 F.3d 1281 (9th Cir. 6/7/17), i.e., whether a partnerhip with a disregarded entity as a partner qualifies for the § 6231(a)(1)(B)(i) small partnership exception, which excludes from the TEFRA audit rules "any partnership having 10 or fewer partners each of whom is an individual (other than a nonresident alien), a C corporation, or an estate of a deceased partner." Pursuant to Reg. § 301.6231(a)(1)-1(a)(2), the small partnership exception does not apply "if any partner in the partnership during the taxable year is a pass-thru partner" as defined in § 6231(a)(9). Section 6231(a)(9) defines a pass-thu partner as "a partnership, estate, trust, S corporation, nominee, or other similar person through whom other persons hold an interest in the partnership …." Like the Ninth Circuit in *Seaview Trading*, the D.C. Circuit held that a single-member LLC that is a disregarded entity is a pass-thru partner as defined in § 6231(a)(9). Therefore, the partnership did not qualify for the small partnership exception and was subject to the TEFRA audit rules. The court also rejected the taxpayer's challenge to the accuracy-related penalties that had been upheld by the Tax Court. The taxpayer challenged the penalties on the ground that the IRS had not obtained the written supervisory approval of the penalties as required by § 6751(b)(1). *See Chai v. Commissioner*, 851 F.3d 190 (2d Cir. 3/20/17). The court declined to consider this argument because the taxpayer had failed to raise it in the Tax Court and therefore had not preserved it for appeal.

G. Miscellaneous

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. Successful private colleges and universities really must be in the dog house because, in addition to taxing them for highly-paid coaches, Congress has decided to tax their endowments too! And, just to keep us on our toes, the legislative history says the statute turns on the number of an institution's "tuition paying" students, but § 4968 simply reads "students." The

2017 Tax Cuts and Jobs Act, § 13701, adds § 4968 which imposes a new 1.4 percent annual excise tax upon the net investment income of certain private colleges and universities and affiliated organizations with endowments worth $500,000 or more per full-time student. The excise tax imposed by new § 4968 is similar in many respects to the annual excise tax imposed upon private foundations under § 4940. In particular, new § 4968 applies to an "applicable educational institution" which is defined as institution: (i) that is an "eligible educational institution" as described in § 25A(f)(2) (which in turn refers to 20 U.S.C. § 1088); (ii) that has at least 500 students during the preceding taxable year more than 50 percent of which are in the U.S.; (iii) that is not described in the first section of § 511(a)(2)(B) (state colleges and universities); and (iv) that has assets (other than assets used directly in carrying out the institution's exempt purpose) with an aggregate fair market value as of end of the preceding taxable year of at least $500,000 per student. For this latter purpose, the number of students of an institution is based on the daily average number of full-time students attending the institution, with part-time students taken into account on a full-time student equivalent basis. Moreover, the legislative history of new § 4968 states that the $500,000 per student figure should be calculated based upon "tuition paying" students; however, the Senate Parliamentarian struck that language from § 4968 immediately before it was passed by the House and Senate. Whether regulations can fill in the gap is anybody's guess. New § 4968 is permanent and effective for taxable years beginning after 2017, again giving fiscal-year private colleges and universities time to cope.

a. Maybe students negotiating for scholarships at private colleges and universities now have a little more leverage. As originally passed late in 2017, new § 4968 taxed private colleges and universities (and affiliates) with endowments worth $500,000 or more per "student" (as defined in the statute to account for full and part-time students); however, the legislative history of new § 4968 stated that the $500,000 per student figure should be calculated based upon "tuition-paying" students. The discrepancy between the statute and the legislative history was created because the Senate Parliamentarian struck the "tuition-paying" language from § 4968 immediately before the 2017 Tax Cuts and Jobs Act ultimately was passed by Congress. Thanks to the Bipartisan Budget Act of 2018, § 41109, though, § 4968 is amended to include the "tuition-paying" modifying language. Thus, only those private colleges and universities (and affiliates) with endowments worth $500,000 or more per tuition-paying student will be subject to the new 1.4 percent annual excise tax.

b. Then again . . . maybe not! Notice 2018-55, 2018-26 I.R.B. 773 (06/08/18). The IRS has announced that proposed regulations under new § 4968 will determine "net investment income" gains and losses of an "applicable educational institution" by reference to an endowment asset's fair market value as of December 31, 2017, not its historical adjusted basis (unless historical adjusted basis is greater than fair market value as of December 31, 2017). This special rule allowing an applicable educational institution to use the *greater of* (i) fair market value as of the end of the taxable year of enactment of the statute or (ii) historical adjusted basis for purposes of calculating net investment income is patterned after the approach taken in 1969 with respect to private foundations subject to § 4940. *See* § 4940(c)(1) (greater of adjusted basis or fair market value as of December 31, 1969). Therefore, net investment income of applicable educational institutions subject to new § 4968 should be minimal for the next year or so. Notice 2018-55 further announces that proposed regulations under new § 4968 (i) will take into account net investment losses only to the extent of net investment gains (with no allowance for capital loss carryovers or carrybacks) and (ii) will permit related organizations described in § 4968(d)(2) to consolidate gains and losses for purposes of calculating net investment income. Notice 2018-55 also invites comments by September 6, 2018, regarding the to-be-proposed regulations under new § 4968.

2. Has so-called "dark money" become virtually invisible (except to the IRS, of course)? Rev. Proc. 2018-38, 2018-31 I.R.B. ____ (07/16/18). Oversimplifying a bit for the sake of convenience, since 1969 § 6033(b)(5) has required § 501(c)(3) organizations to disclose on their annual information returns (Forms 990) certain contributions as well as "the names and addresses of [the organization's] substantial contributors" for the year. Section 507(d)(2) defines a "substantial contributor" as any person contributing $5,000 or more to an organization if such amount is greater than 2 percent of the total contributions to the organization during the taxable year. Section 1.6033-2 of the regulations extended this disclosure requirement to other types of organizations exempt under § 501(a), including § 501(c)(4) "social welfare" organizations and § 501(c)(6) "trade associations." In particular, some § 501(c)(4) social welfare organizations have been created and funded to engage in lobbying and political campaign activity that is prohibited to § 501(c)(3) organizations. This use of § 501(c)(4) organizations has been termed "dark money" by some and is controversial. Although the names and addresses of "dark money" contributors were supposed to be redacted on the organization's Form 990 made publicly available by the IRS pursuant to § 6104(b), some inadvertent disclosures have occurred. Reportedly, a few of the largest organizations impacted have been entities affiliated with the National Rifle Association, the U.S. Chamber of Commerce, and Americans for Prosperity, the latter being tied to billionaires Charles and David Koch. *See* R. Rubin, "U.S. Treasury Restricts Donor Disclosure Requirement for Some Nonprofit Groups," Wall St. J. (July 16, 2018). After Rev. Proc. 2018-38, though, substantial contributors' names and addresses are no longer required to be disclosed on a non-(c)(3) organization's annual Form 990. As stated in the revenue procedure, "The IRS does not need personally identifiable information of [such] donors to be reported . . . in order for it to carry out its responsibilities. The requirement to report such information increases compliance costs for some private parties, consumes IRS resources in connection with the redaction of such information, and poses a risk of inadvertent disclosure of information that is not open to public inspection." The reporting changes announced by Rev. Proc. 2018-38 are effective for taxable years ending on or after December 31 2018. Notwithstanding this relief from disclosure granted to § 501(a) organizations other than (c)(3)s, Rev. Proc. 2018-38 states that the affected organizations must maintain donor information in the organization's books and records in case such information is requested by the IRS.

B. Charitable Giving

X. TAX PROCEDURE

A. Interest, Penalties, and Prosecutions

1. A majority of the Tax Court refuses to call a procedural foot-fault on the IRS, but not all the judges see it that way. Graev v. Commissioner, 147 T.C. No. 16 (11/30/16). The taxpayers had claimed a charitable contribution deduction for the donation of a facade conservation easement that ultimately was disallowed by the Tax Court (140 T.C. 377 (2013)). The IRS examining agent determined that the taxpayers were liable for the § 6662(h) 40 percent gross valuation misstatement penalty, and he prepared a penalty approval form for which he obtained written approval from his immediate supervisor. On that form only the § 6662(h) 40 percent penalty was asserted. The agent prepared a notice of deficiency that included the 40 percent penalty. However, before the notice of deficiency was issued, a Chief Counsel attorney reviewed a draft and, through a memorandum approved by his supervisor, the attorney advised that an alternative § 6662(a) 20 percent accuracy-related penalty should be added to the notice. The notice of deficiency was revised to include the 20 percent § 6662(a) accuracy-related penalty, the calculation of which in the notice of deficiency yielded a zero 20 percent penalty to avoid stacking with the 40 percent penalty. The notice of deficiency was issued as revised, but the revised notice with the alternative 20 percent penalty was not reviewed or approved by the examining agent's supervisor. After the IRS conceded that the 40 percent gross valuation misstatement penalty did not apply, it asserted the alternative 20 percent accuracy-related penalty as a non-zero amount, sine the stacking issue no longer existed. The taxpayers argued that, because the notice of deficiency showed a zero amount for the § 6662(a) 20 percent penalty, the IRS failed to comply with the requirements of § 6751(a), which requires that a computation of the penalty be included in the notice of deficiency, and § 6751(b), which requires that the "initial determination of ... [the] assessment" of the penalty be "personally approved (in writing) by the immediate supervisor ... or such higher level official as the Secretary may designate," and that these failures barred assessment of the 20 percent penalty. In a reviewed opinion by Judge Thornton, the Tax Court (9-3-5) held that: (1) the notice of deficiency complied with the requirements of § 6751(a); (2) because the penalty had not yet been assessed, the taxpayers' argument that the IRS failed to comply with § 6751(b)(1) was premature; and (3) the 20 percent accuracy-related penalty for a substantial understatement applied. With respect to the first holding, regarding compliance with § 6751(a), the court reasoned as follows:

> The notice of deficiency clearly informed petitioners of the determination of the 20% penalty (as an alternative) and clearly set out the computation (albeit reduced to zero,

> as it had to be then, to account for the greater 40% penalty). The notice of deficiency thus complied with section 6751(a).
>
> Moreover, even if petitioners were correct that the IRS failed to include a computation of a penalty as required by section 6751(a), such a failure would not invalidate a notice of deficiency. In similar contexts this Court has held that procedural errors or omissions are not a basis to invalidate an administrative act or proceeding unless there was prejudice to the complaining party.

With respect to the third holding regarding application of the 20 percent accuracy-related penalty, the court rejected the taxpayers' defenses and concluded that: (1) the taxpayers had not established that they had reasonable cause for claiming the charitable contribution deductions and acted in good faith; (2) "the authorities that support [the taxpayers'] deductions for the cash and conservation easement contributions are not substantial when weighed against the contrary authorities;" and (3) the taxpayers had no reasonable basis for their return position and had not adequately disclosed on their return the relevant facts concerning their deductions because they had not disclosed a side letter from the National Architectural Trust (NAT) (the easement holder) obligating the NAT to refund the taxpayers' cash contribution and work to remove the easement if the IRS disallowed entirely their charitable contribution deductions for the easement.

- A concurring opinion by Judge Nega (with whom Judges Goeke and Pugh joined) would have reached the same result as the majority on the ground that the taxpayers were not prejudiced, and would have left "to another case the more detailed statutory analysis performed by both the majority and the dissent."

- A dissent by Judge Gustafson (joined by Judges Colvin, Vasquez, Morrison and Buch) would not have sustained the penalty on the ground that the IRS failed to comply with § 6751(b)(1) because "the responsible revenue agent included a 20% accuracy-related penalty on the notice of deficiency without first obtaining the 'approv[al] (in writing)' of his 'immediate supervisor'."

a. But the Second Circuit serves the Tax Court some *Chai*. Chai v. Commissioner, 851 F.3d 190 (2d Cir. 3/20/17), *aff'g in part, vacat'g in part, and rev'g in part* T.C. Memo. 2015-42 (3/11/15). The taxpayer in this case received in 2003 a $2 million payment for serving as an accommodation party in connection with tax shelters. The taxpayer did not report the payment as income and took the position that the $2 million was a nontaxable return of capital. The IRS issued a notice of deficiency for 2003 increasing the taxpayer's income by the $2 million payment and asserting both a deficiency in self-employment tax and a 20 percent accuracy-related penalty. (The notice of deficiency did not assert a deficiency in income tax because the taxpayer had offsetting losses from a partnership subject to the TEFRA audit rules. Those losses ultimately were disallowed at the partnership level and the IRS amended its answer in this Tax Court proceeding to assert a deficiency in income tax. This sequence of events led to several interesting procedural issues with respect to the deficiency in income tax.) In his post-trial briefing in the Tax Court, the taxpayer raised for the first time the same argument regarding the penalty as the taxpayer had raised in *Graev v. Commissioner*, 147 T.C. No. 16 (11/30/16), i.e., that the IRS was barred from assessing the 20 percent accuracy-related penalty because it had failed to comply with the requirement of § 6751(b) that the "initial determination of ... [the] assessment" of the penalty must be "personally approved (in writing) by the immediate supervisor ... or such higher level official as the Secretary may designate." The Tax Court (Judge Cohen) refused to address this argument on the basis that it was untimely because the taxpayer had raised it for the first time post-trial. In an opinion by Judge Wesley, the Second reversed the Tax Court's ruling on the penalty issue. (The Second Circuit affirmed the Tax Court's ruling that the $2 million payment was subject to self-employment tax and vacated its ruling that it had no jurisdiction to consider the increased deficiency in income tax asserted by the IRS. In light of the taxpayer's concession that the $2 million was includible in gross income, the Second Circuit remanded with instructions to uphold the additional income tax deficiency.) The Second Circuit found the view of the majority in *Graev* on the penalty issue unpersuasive and sided with the dissenting judges in *Graev*. The court focused on the language of § 6751(b) and concluded that it is ambiguous regarding the timing of the required supervisory approval of a penalty. Because of this ambiguity, the court examined the statute's legislative history and concluded that Congress's purpose in enacting the provision was "to prevent IRS agents from threatening unjustified penalties to encourage taxpayers to settle." That purpose, the court reasoned, undercuts the *Graev* majority's conclusion that approval of the penalty can take place at any time, even just prior to assessment. The court held "that § 6751(b)(1) requires written approval of the initial penalty determination no later than the date the IRS issues the notice of deficiency (or files an answer or amended answer) asserting such penalty." Further, the court held "that compliance with § 6751(b) is part of the Commissioner's burden of production and proof in a deficiency case in which a penalty is asserted. … Read in conjunction with § 7491(c), the written approval requirement of § 6751(b)(1) is appropriately viewed as an element of a penalty claim, and therefore part of the IRS's *prima facie* case."

b. The Tax Court has adopted the Second Circuit's approach to the required supervisory approval of penalties, but nevertheless upheld the imposition of penalties on these taxpayers. Graev v. Commissioner, 149 T.C. No. 23 (12/20/17). In a reviewed, supplemental opinion by Judge Thornton, the Tax Court (9-1-6) has reversed the portions of its opinion in *Graev v. Commissioner*, 147 T.C. No. 16 (11/30/16) that held it was premature to consider whether § 6751(b) barred assessment of the § 6662(a) accuracy-related penalties asserted by the IRS. In *Chai v. Commissioner*, 851 F.3d 190 (2d Cir. 3/20/17), the U.S. Court of Appeals for the Second Circuit held "that § 6751(b)(1) requires written approval of the initial penalty determination no later than the date the IRS issues the notice of deficiency (or files an answer or amended answer) asserting such penalty." Further, the Second Circuit held "that compliance with § 6751(b) is part of the Commissioner's burden of production and proof in a deficiency case in which a penalty is asserted." Because this case is appealable to the Second Circuit, and in the interest of promoting uniformity on an issue that affects many cases, the Tax Court accepted the Second Circuit's holding. Accordingly, the question in this case was whether the IRS had obtained the required written approval of the accuracy-related penalties by the date the notice of deficiency was issued or by the date the IRS filed an answer or amended answer asserting the penalty. The IRS asserted the 20 percent accuracy-related penalty with respect to both the taxpayers' non-cash charitable contribution (the façade conservation easement) and their cash charitable contribution. The penalty with respect to the cash contribution was asserted for the first time in an amended answer by the IRS Chief Counsel attorney handling the litigation, and the taxpayers conceded that this penalty received the requisite approval by the Associate Area Counsel. The taxpayers contended that § 6751(b)(1) barred assessment of the 20 percent penalty with respect to the their noncash charitable contribution. The IRS had prepared a proposed notice of deficiency that asserted a 40 percent accuracy-related penalty under § 6662(h), which was the penalty proposed by the Revenue Agent who had conducted the audit and approved by the Revenue Agent's immediate supervisor. An attorney in the IRS Chief Counsel's Office reviewed the proposed notice of deficiency and recommended that the IRS assert an alternative position with respect to the penalty, i.e., that the § 6662(a) 20 percent penalty applied. The recommendation was approved by the attorney's immediate supervisor (the Associate Area Counsel) and included in the final notice of deficiency, which was signed by an IRS Technical Services Territory Manager. The taxpayers made the following three-part argument: (1) the Office of IRS Chief Counsel serves in only an advisory capacity until proceedings begin in the Tax Court, (2) the IRS Chief Counsel attorney who recommended the alternative penalty in this case accordingly had no authority to make an initial determination of a penalty that appeared in the notice of deficiency, and therefore (3) the IRS had not complied with the requirement of § 6751(b)(1) that there be an "initial determination of [the] assessment" of the penalty that is approved by the immediate supervisor of the person making the initial determination. In essence, the taxpayers attempted to distinguish between advice, as had been provided by the IRS Chief Counsel attorney who recommended the penalty, and an "initial determination," which is required by the statute. The court rejected the taxpayers' arguments and held that § 6751(b)(1) did not bar assessment of the alternative 20 percent penalty because the IRS Chief Counsel attorney who first recommended the penalty made the requisite "initial determination," which was approved by the attorney's immediate supervisor, the Associate Area Counsel.

- In a concurring opinion, Judge Lauber, joined by Judges Marvel, Thornton, Pugh, and Ashford, emphasized that § 6751(b)(1) should be interpreted in light of its purpose, which, as discussed by the Second Circuit in *Chai v. Commissioner*, 851 F.3d 190 (2d Cir. 3/20/17), was to prevent IRS employees from threatening unjustified penalties in an effort to encourage taxpayers to settle. This purpose, Judge Lauber wrote, supports the Tax Court majority's approach of treating the action of the IRS official who first proposes that a penalty be asserted as the "initial determination" of the assessment of the penalty. In contrast, Judge Lauber argued, the position expressed in Judge Buch's dissenting opinion (that an initial determination can be made only by an IRS officer with the technical authority to make a penalty determination or issue a notice of deficiency) would mean that "an IRS official would be free to use penalties as a battering ram against taxpayers, without obtaining supervisory approval under section 6751(b), so long as he lacked authority to do what he was doing."

- In a lengthy opinion, Judge Holmes concurred in the result only. Judge Holmes advocated deciding this case under the rule of *Golsen v. Commissioner*, 54 T.C. 742 (1970), *aff'd*, 445 F.2d 985 (10th Cir. 1971), pursuant to which the court applies the precedent of the U.S. Court of Appeals to which its decision can be appealed. Judge Holmes predicted that, by adopting the holding and reasoning of the Second Circuit in *Chai v. Commissioner*, 851 F.3d 190 (2d Cir. 3/20/17), the majority decision will give rise to difficult issues of interpretation and "will even end up harming taxpayers unintentionally."

- In a dissenting opinion, Judge Buch, joined by Judges Foley, Vasquez, Goeke, Gustafson, and Morrison, agreed with the majority that the court should adopt the holding of the Second Circuit in *Chai v. Commissioner*, 851 F.3d 190 (2d Cir. 3/20/17), but disagreed "on the issue of whether a recommendation from an attorney within the IRS Office of Chief Counsel can constitute 'the initial determination' to impose a penalty for purposes of section 6751(b)(1)." Judge Buch emphasized that the IRS Office of Chief Counsel serves in an advisory capacity. "Because the [IRS Chief Counsel] attorney has the authority only to advise or recommend, we would hold that the attorney's recommendation to assert a penalty is not the initial determination that must be approved in writing."

c. In determining whether the § 6751(b)(1) supervisory approval requirement has been met, an IRS settlement officer need not read the mind of the supervisor; a signature is sufficient. Blackburn v. Commissioner, 150 T.C. No. 9 (4/5/18). A corporation, which apparently was the taxpayer's employer, failed to pay its employment tax liabilities and failed to file certain Forms 941, Employer's Quarterly Federal Tax Return. The IRS assessed trust fund recovery penalties against the taxpayer under § 6672. In a collection due process hearing, the IRS settlement officer determined to uphold the IRS's proposed collection of the penalty. The taxpayer sought review of the IRS's determination in the Tax Court and argued that the settlement officer had failed to comply with § 6330(c)(1), which provides:

> The appeals officer shall at the hearing obtain verification from the Secretary that the requirements of any applicable law or administrative procedure have been met.

The taxpayer argued that the settlement officer had not verified the IRS's compliance with the supervisory approval requirement of § 6751(b)(1). The IRS's evidence of supervisory approval was Form 4183, Recommendation re: Trust Fund Recovery Penalty, which was dated prior to assessment of the trust fund recovery penalty. The Form 4183, which was generated by the IRS's computer system, did not contain the supervisor's signature but showed the supervisor's name in the signature block for the supervisor. The taxpayer argued that the signature of the supervisor, by itself, was inadequate to comply with § 6751(b)(1), and that § 6330(c)(1) requires a settlement officer to verify compliance by engaging in "a factual analysis of the thought process of the supervisor" and to make "a determination that the thought process was 'meaningful.'" The IRS argued that (1) the supervisory approval requirement of § 6751(b)(1) does not apply to the § 6672 trust fund recovery penalty, and (2) even if it does apply, it was not an abuse of discretion for the settlement officer to find compliance because there was sufficient evidence of supervisory approval. The Tax Court (Judge Goeke) declined to address the legal question whether the supervisory approval requirement of § 6751(b)(1) applies to the § 6672 trust fund recovery penalty. The court held that, even if supervisory approval was required, a record of compliance existed in this case. The court reasoned that its prior decisions "have consistently upheld a settlement officer's verification of assessments when the administrative record reflects compliance with administrative procedures" and have permitted "reliance upon standard administrative records" to verify assessments. In *Davis v. Commissioner*, 115 T.C. 35 (2000), the court held in connection with a CDP hearing that it was not an abuse of discretion for the IRS to rely on Form 4340, Certificate of Assessment and Payments, to verify assessment of a tax where the taxpayer had not shown any irregularity in the assessment procedure that would raise a question. Form 4340, like the Form 4183 in this case, does not require a signature. Accordingly, the court held that it was not an abuse of discretion for the settlement officer to find that the IRS had met the requirements of applicable law and administrative procedure. The court therefore granted the IRS's motion for summary judgment.

B. Discovery: Summonses and FOIA

C. Litigation Costs

D. Statutory Notice of Deficiency

E. Statute of Limitations

F. Liens and Collections

G. Innocent Spouse

H. Miscellaneous

1. When the Tax Court reviews an IRS determination regarding a whistleblower award, the court will limit its review to the administrative record and the appropriate standard of review is for abuse of discretion. Kasper v. Commissioner, 150 T.C. No. 2 (1/9/18). The petitioner sought a whistleblower award of more than $11 million pursuant to § 7623 by informing the IRS that his former employer had failed to pay overtime wages to its employees and therefore had failed to pay FICA and FUTA taxes on the unpaid wages. The IRS determined that the petitioner's claim raised an issue for the Department of Labor rather than the IRS and denied his claim. In the employer's bankruptcy proceedings, the IRS filed a proof of claim and ultimately entered into a closing agreement with the employer pursuant to which the IRS received $37.5 million in settlement of all of the employer's tax liabilities. The petitioner asserted that the IRS made use of his information "to keep 'held open' its bankruptcy claim …." The petitioner sought review of the IRS's determination in the Tax Court pursuant to § 7623(b)(4), which provides:

> Any determination regarding an award … may, within 30 days of such determination, be appealed to the Tax Court (and the Tax Court shall have jurisdiction with respect to such matter).

In a unanimous reviewed opinion by Judge Holmes (with Judge Paris not participating in the court's consideration of the opinion), the Tax Court held that the IRS did not abuse its discretion in rejecting the petitioner's whistleblower award claim. The court first considered the appropriate *scope of review* in a whistleblower award case and held that the court will limit its review to the administrative record but will permit the record to be supplemented if one of the recognized exceptions to the record rule applies. These exceptions are summarized in *Esch v. Yeutter*, 876 F.2d 976, 991 (D.C. Cir. 1989). The court reached this conclusion regarding the scope of review after considering, among other things, the language in § 7623(b)(4) and comparing it to the language in statutes that give the court jurisdiction to review IRS other determinations, such as those in innocent spouse cases and collection due process hearings. The court next held that the appropriate *standard of review* in a whistleblower award case is for abuse of discretion. The court reasoned in part that the underlying tax liability on which the whistleblower's claim is based is never at issue when the court reviews an IRS determination regarding a whistleblower award. Therefore, the court reasoned, applying an abuse of discretion standard is consistent with the court's approach in reviewing IRS determinations in CDP hearings, for which the court applies a de novo standard if the taxpayer's underlying tax liability is at issue and an abuse of discretion standard if it is not. Finally, the court applied the doctrine of *Securities and Exchange Commission v. Chenery Corp.*, 332 U.S. 194 (1947), 318 U.S. 80 (1943), which it described as "an administrative-law principle that says 'a reviewing court, in dealing with a determination or judgment which an administrative agency alone is authorized to make, must judge the propriety of such action solely by the grounds invoked by the agency.'" In this case, the court held, the IRS's letter denying the petitioner's claim was "a completely inadequate explanation—it has no reasoning specific to Kasper's claim, recites only boilerplate, and then states a conclusion." The court further held that, although it would not consider post hoc rationalizations for an agency's action, it could consider contemporaneous explanations by the agency for its decision. In this case, the records of the IRS Whistleblower Office reflected the reason for the IRS's denial of an award, i.e., that the petitioner's claim raised an issue for the Department of Labor rather than the IRS. Although the court viewed as an error the IRS's failure to consider certain evidence in considering the petitioner's claim, "the error was harmless because the rest of the record shows that the IRS did not proceed with any action resulting in the collection of proceeds using [the petitioner's] information."

XI. WITHHOLDING AND EXCISE TAXES

A. Employment Taxes

1. In this employment tax refund case concerning non-qualified stock options, Judge Posner tells railroads to take a hike, but Judge Manion dissents because "money remuneration" and "stock" were different in 1934; however, both apparently agree that "wampum" and "sheep" can be money (and no, we are not making this up)! Wisconsin Central Ltd. v. United States, 856 F.3d 490 (7th Cir. 5/8/17). Beginning in 1996, the taxpayer railroad companies began including non-qualified stock options in the compensation plans for their employees. The taxpayers previously had withheld and paid employment taxes (under the Railroad Retirement Tax Act, § 3231) when employees exercised non-qualified stock options, but subsequently the taxpayers filed claims for refunds with the IRS, which were denied. The United States District Court for the Northern District of Illinois (Judge Feinerman) also denied the taxpayers' refund claim, and the taxpayers appealed to the Seventh Circuit. The taxpayers argued that stock options are not "compensation" because they are not "money remuneration" within the meaning of § 3231. Section 3231(e)(1) defines taxable compensation as "any form of money remuneration paid to an individual for services rendered as an employee to one or more employers." Based upon this language, Judge Posner, writing for the majority, explained that even though the term "money remuneration" may not have commonly been understood to include stock when the Railroad Retirement Tax Act was passed in 1937, today stock and stock options are well-accepted forms of compensation and hence taxable under § 3231. Judge Posner wrote, "The dictionary definition of money may remain constant while the instruments that comprise it change over time: sheep may have once been a form of money; now stock is." In short, Judge Posner interprets the term "money remuneration" in § 3231 to be an evolving concept that changes with the times. Judge Manion, however, dissented, arguing that the 1934 edition of Webster's Dictionary defined money as "[a]nything customarily used as a medium of exchange and measure of value, as sheep, wampum, copper rings, quills of salt or of gold dust, shovel blades, etc." Thus, in Judge Manion's view, non-qualified stock options are not "money remuneration" and hence not subject to tax under § 3231. *We presume, somewhat sarcastically, that Judge Posner and Judge Manion would agree that "wampum" and "sheep" were taxable in 1937 under § 3231 and would be taxable today as well, although according to their opinions the law is unsettled on this point.*

a. The U.S. Supreme Court has reversd the Seventh Circuit and held that non-qualified stock options are not "money remuneration" and therefore are not taxable compensation for purposes of the Railroad Retirement Tax Act. Wisconsin Central Ltd. v. United States, ___ U.S. ___, 138 S. Ct. 2067 (6/21/18). In an opinion by Justice Gorsuch (joined by Justices Roberts, Kennedy, Thomas, and Alito), the U.S. Supreme Court reversed the decision of the Seventh Circuit and held that non-qualified stock options are not "compensation" within the meaning of § 3221 and therefore are not subject to taxation under the Railroad Retirement Tax Act. The Court focused on the definition of the term "compensation" in § 3231(e)(1), which defines compensation as "any form of money remuneration paid to an individual for services rendered as an employee to one or more employers." The Court looked for guidance to several dictionary definitions of the term "money" that existed contemporaneously with Congress's 1937 enactment of the Railroad Returement Tax Act. These definitions generally defined money as currency isued by a recognized authority and used as a medium of exchange. Stock options, the court reasoned,

> do not fall within that definition. While stock can be bought or sold for money, few of us buy groceries or pay rent or value goods and services in terms of stock. When was the last time you heard a friend say his new car cost "2,450 shares of Microsoft"? Good luck, too, trying to convince the IRS to treat your stock options as a medium of exchange at tax time.

The Court also noted the difference in the language used in the Railroad Retirement Tax Act and in the Federal Insurance Contributions Act (FICA), both of which were enacted by the same Congress. The Railroad Retirement Tax Act taxes "money remuneration." In contrast, FICA taxes "all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash." According to the Court, "[t]he Congress that enacted both of these pension schemes knew well the difference between 'money' and 'all' forms of remuneration." The Court declined to give *Chevron* deference to Reg. § 31.3231(e)-1, which provides, "except as specifically limited by the Railroad Retirement Tax Act," that the term "compensation" in the Railroad Retirement Tax Act has the same meaning as the term "wages" in FICA. The statutory definition of "compensation," the Court held, is clear and leaves no room for agency interpretation.

- Justice Breyer, joined by Justices Ginsburg, Sotomayor, and Kagan, dissented. Justice Breyer characterized the railroads as "engaging in (and winning) a war of 1930's dictionaries." In Justice Breyer's view, the statutory definition of "money remuneration" is ambiguous, and therefore the Court should have deferred to the Treasury Department's interpretation of the statute. The Treasury Department, Justice Breyer argued, has consistently interpreted the term "money remuneration" in a manner that supports treating stock options as a form of money remuneration.

- The authors cannot help but wonder: *How would the U.S. Supreme Court treat a payment in Bitcoin?*

B. Self-employment Taxes

C. Excise Taxes

XII. TAX LEGISLATION

A. Enacted

XIII. TRUSTS, ESTATES & GIFTS