RECENT DEVELOPMENTS IN FEDERAL INCOME TAXATION

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

By

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The Consolidated Appropriations Act, 2021, Pub. L. No. 116-260, enacted on December 27, 2020, made permanent several Code provisions that previously had been temporarily extended for many years, temporarily extended several expiring provisions, and provided tax relief to those in areas affected by certain natural disasters.

I. ACCOUNTING

II. BUSINESS INCOME AND DEDUCTIONS

A. Income

B. Deductible Expenses versus Capitalization

C. Reasonable Compensation

D. Miscellaneous Deductions

E. Depreciation & Amortization

1. We suppose it makes sense that racehorses have a swift recovery period. A provision of the Taxpayer Certainty and Disaster Tax Relief Act of 2020, Division EE, Title I, § 137 of the 2021 Consolidated Appropriations Act, extended the § 168(e)(3)(A)(i) classification of racehorses as 3-year MACRS property so that the classification applies to racehorses placed in service before January 1, 2022. A racehorse placed in service after December 31, 2021, qualifies for the 3-year recovery period only if it is more than two years old when placed in service. This provision allowing classification of all racehorses as 3-year property regardless of age had expired for racehorses placed in service after December 31, 2017, and was retroactively extended by the Taxpayer Certainty and Disaster Tax Relief Act of 2019, Division Q, Title I, § 114 of the 2020 Further Consolidated Appropriations Act.

2. For real property trades or businesses that elect out of the § 163(j) limitation on deducting business interest, the recovery period for residential rental properties under the alternative depreciation system is 30 years instead of 40 years for properties placed in service before 2018. Section 163(j), enacted by the 2017 Tax Cuts and Jobs Act, § 13301, generally limits the deduction for business interest expense to the sum of: (1) business interest income, (2) 30 percent of "adjusted taxable income," and (3) floor plan financing interest. (Section 163(j)(10), enacted by the CARES Act, increases to 50 percent (instead of 30 percent) the "adjusted taxable income" component of the § 163(j) limitation for taxable years beginning in 2019 and 2020.) The § 163(j) limit applies to businesses with average annual gross receipts (computed over 3 years) of more than $25 million. Real property trades or businesses that are subject to § 163(j) can elect out of the limitation imposed by that provision. The cost of doing so, however, is that, pursuant to § 168(g)(1)(F) and (g)(8), a real property trade or business that elects out of the interest limitation of § 163(j) must use the alternative depreciation system (ADS) for nonresidential real property, residential rental property, and qualified improvement property. The 2017 Tax Cuts and Jobs Act, § 13204, modified the ADS to provide a recovery period of 30 years (rather than the former 40 years) for residential rental property subject to the ADS. This modification of the recovery period for residential rental property, however, applied only to property placed in service after December 31, 2017. This meant that, if a real property trade or business elected out of the interest limitation of § 163(j) in 2018 or future years, and if the business had placed residential rental property in service before January 1, 2018, it had to use the ADS for such property with a recovery period of 40 years. *See* Rev. Proc. 2019-8, § 4, 2019-3 I.R.B. 347. In the Taxpayer Certainty and Disaster Tax Relief Act of 2020, Division EE, Title I, § 202 of the 2021 Consolidated Appropriations Act, Congress amended the 2017 Tax Cuts and Jobs Act, § 13204, to provide that the 30-year ADS recovery period applies to residential rental property that is held by an electing real property trade or business and that was placed in service before January 1, 2018. The effect of this amendment is that real property trades or businesses that elect out of the interest limitation of § 163(j) and therefore are subject to the ADS with respect to residential rental property can use a recovery period of 30 years for that property regardless of when the property was originally placed in service. This change applies retroactively to taxable years beginning after December 31, 2017.

F. Credits

1. Congress gives a "thumbs up" to new energy efficient homes. Section 45L provides a credit of $2,000 or $1,000 (depending on the projected level of fuel consumption) an eligible contractor can claim for each qualified new energy efficient home constructed by the contractor and acquired by a person from the contractor for use as a residence during the tax year. The provision had expired for homes acquired after December 31, 2017, and was retroactively extended by a provision of the Taxpayer Certainty and Disaster Tax Relief Act of 2019, Division Q, Title I, § 129 of the 2020 Further Consolidated Appropriations Act. Most recently, Congress extended the credit through a provision in the Taxpayer Certainty and Disaster Tax Relief Act of 2020, Division EE, Title I, § 115 of the 2021 Consolidated Appropriations Act. As extended, the credit is available for homes acquired before January 1, 2022.

2. Congress has extended through 2025 the credit for employers that pay wages to certain employees during periods of family and medical leave. The 2017 Tax Cuts and Jobs Act enacted Code § 45S, which provides that an "eligible employer" can include the "paid family and medical leave credit" among the credits that are components of the general business credit under § 38(b). The credit is equal to a percentage of the amount of wages paid to "qualifying employees" during periods in which the employees are on family and medical leave. The credit is available against both the regular tax and the alternative minimum tax. As enacted, the § 45S credit was available for wages paid in taxable years beginning after December 31, 2017, and before January 1, 2020. A provision of the Taxpayer Certainty and Disaster Tax Relief Act of 2019, Division Q, Title I, § 142 of the 2020 Further Consolidated Appropriations Act, extended the credit to wages paid in taxable years beginning before January 1, 2021. Most recently, a provision of the Taxpayer Certainty and Disaster Tax Relief Act of 2020, Division EE, Title I, § 119 of the 2021 Consolidated Appropriations Act, extended the credit to wages paid in taxable years beginning before January 1, 2026.

Amount of the credit. To be eligible for the credit, the employer must pay during the period of leave at a rate that is at least 50 percent of the wages normally paid to the employee. The credit is 12.5 percent of the wages paid, increased by 0.25 percentage points for each percentage point by which the rate of payment exceeds 50 percent. The maximum credit is 25 percent of wages. Thus, if an employer pays an employee at a rate that is 60 percent of the employee's normal wages, the credit is 15 percent of wages paid (12.5 percent plus 2.5 percentage points). The credit reaches 25 percent when the employer pays at a rate that is 100 percent of employee's normal wages. The credit cannot exceed the amount derived from multiplying the employee's normal hourly rate by the number of hours for which the employee takes leave. The compensation of salaried employees is to be prorated to an hourly wage under regulations to be issued by the Treasury Department. The maximum amount of leave for any employee that can be taken into account for purposes of the credit is twelve weeks per taxable year.

Eligible employer. An eligible employer is defined as one who has in place a written policy that (1) allows all full-time "qualifying employees" not less than two weeks of annual paid family and medical leave, and that allows all part-time qualifying employees a commensurate amount of leave on a pro rata basis, and (2) requires that the rate of payment under the program is not less than 50 percent of the wages normally paid to the employee.

Eligible employee. An eligible employee is defined as any employee as defined in section 3(e) of the Fair Labor Standards Act of 1938 who has been employed by the employer for one year or more and who, for the preceding year, had compensation not in excess of 60 percent of the compensation threshold for highly compensated employees. For 2019, the threshold for highly compensated employees (see § 414(q)(1)(B)) was $125,000. Thus, for purposes of determining the credit in 2020, an employee is an eligible employee only if his or her compensation for 2019 did not exceed $75,000 ($125,000 * 60 percent).

Family and medical leave. The term "family and medical leave" is defined as leave described under sections 102(a)(1)(a)-(e) or 102(a)(3) of the Family and Medical Leave Act of 1993. (Generally, these provisions describe leave provided because of the birth or adoption of a child, because of a serious health condition of the employee or certain family members, or because of the need to care for a service member with a serious injury or illness.) If an employer provides paid leave as vacation leave, personal leave, or other medical or sick leave, this paid leave is not considered to be family and medical leave.

No double benefit. Pursuant to Code § 280C(a), no deduction is allowed for the portion of wages paid to an employee for which this new credit is taken. Thus, if an employer pays $10,000 to an employee and takes a credit for 25 percent, or $2,500, the employer could deduct as a business expense only $7,500 of the wages.

Effective date. The credit is now available for wages paid in taxable years beginning after December 31, 2017, and before January 1, 2026.

G. Natural Resources Deductions & Credits

H. Loss Transactions, Bad Debts, and NOLs

I. At-Risk and Passive Activity Losses

III. INVESTMENT GAIN AND INCOME

IV. COMPENSATION ISSUES

A. Fringe Benefits

1. Despite the recent pandemic, we appear to be living longer! Final regulations provide guidance under § 401 relating to new life expectancy and distribution period tables used to calculate minimum distributions from qualified plans, IRAs, and annuities. T.D. 9930, Updated Life Expectancy and Distribution Period Tables Used for Purposes of Determining Minimum Required Distributions, 85 F.R. 72472 (11/12/20). The Treasury Department and the IRS have finalized proposed regulations that provide guidance on the use of updated life expectancy and distribution period tables under Reg. § 401(a)(9)-9. *See* REG-132210-18, Updated Life Expectancy and Distribution Period Tables Used for Purposes of Determining Minimum Required Distributions, 84

F.R. 60812 (11/8/19). In general, the proposed regulations seek to update the existing tables using current mortality data based on mortality rates for 2021. The new tables allow for longer life expectancies than the current tables under the existing regulations and generally result in a reduction of required minimum distributions. In turn, this allows for retention of larger amounts in retirement accounts in contemplation of participants having slightly longer lives. The preamble to the final regulations gives the following example:

> "[a] 72-year-old IRA owner who applied the Uniform Lifetime Table under formerly applicable § 1.401(a)(9)-9 to calculate required minimum distributions used a life expectancy of 25.6 years. Applying the Uniform Lifetime Table set forth in these regulations, a 72-year-old IRA owner will use a life expectancy of 27.4 years to calculate required minimum distributions."

The updated life expectancy and distribution period tables apply to distribution calendar years beginning on or after January 1, 2022. Thus, for an individual who attains the age at which required minimum distributions must begin (age 72) in 2021, the regulations would not apply to the distribution for the 2021 calendar year (which must be taken by April 1, 2022). The regulations would apply to the required minimum distribution for the individual's 2022 calendar year, which must be taken by December 31, 2022. The regulations also include a transition rule that applies under certain circumstances if an employee dies prior to January 1, 2022. The transition rule applies in three situations: (1) the employee died with a non-spousal designated beneficiary; (2) the employee died after the required beginning date without a designated beneficiary; and (3) the employee, who is younger than the designated beneficiary, died after the required beginning date. Under these circumstances, a set of specific rules applies in relation to the distribution period for calendar years following the calendar year of the employee's death. A similar transition rule applies if an employee's sole beneficiary is the employee's surviving spouse and the spouse died before January 1, 2022.

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

B. Qualified Deferred Compensation Plans

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

D. Individual Retirement Accounts

V. PERSONAL INCOME AND DEDUCTIONS

A. Rates

B. Miscellaneous Income

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

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

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

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

D. Deductions and Credits for Personal Expenses

1. For 2020, all individuals can use prior-year earned income to determine their earned income tax credit and child tax credit. A provision of the Taxpayer Certainty and Disaster Tax Relief Act of 2020, Division EE, Title I, § 211 of the 2021 Consolidated Appropriations Act, provides that individuals can elect to use prior-year earned income for purposes of determining the individual's earned income tax credit under § 32 and child tax credit under § 24. The election is available for individuals whose earned income for the taxpayer's first taxable year beginning in 2020 is lower than their earned income for the preceding tax year. For married couples filing a joint return, the earned income for the preceding year is the sum of the earned income in the preceding year of both spouses.

- Congress previously has allowed individuals affected by certain natural disasters to use prior-year earned income in this manner. In extending this privilege to all individuals, Congress presumably recognized the widespread effect on earned income of the COVID-19 pandemic.

E. Divorce Tax Issues

F. Education

G. Alternative Minimum Tax

VI. CORPORATIONS

A. Entity and Formation

B. Distributions and Redemptions

C. Liquidations

D. S Corporations

1. Kentucky nonstock, nonprofit corporation may not elect S corporation status and president of the corporation may not deduct the corporation's losses. Deckard v. Commissioner, 155 T.C. No. 7 (9/9/20). This case presents two issues. First, whether a Kentucky nonstock, nonprofit corporation validly elected S corporation status and, second, whether the taxpayer, Mr. Deckard, was a shareholder of the corporation during the years at issue. The Tax Court (Judge Thornton) agreed with the IRS regarding the second issue and held that Mr. Deckard was not a shareholder of the corporation for purposes of subchapter S. Because he was not a shareholder, he was not entitled to deduct the corporation's losses on his individual income tax returns. The court therefore did not address the first issue, i.e., whether the corporation had made a valid subchapter S election. Waterfront Fashion Week, Inc. ("Waterfront") was formed as a Kentucky nonstock, nonprofit corporation. Its purpose was initially intended to be charitable with its primary mission to raise money for, among other things, conservation and maintenance of Waterfront Park in Louisville, Kentucky. In 2012, Waterfront produced an event at the park that resulted in financial losses. After being administratively dissolved in 2013, reformed, and dissolved again in 2014 by the Kentucky Secretary of State, Mr. Deckard, in his capacity as Waterfront's president, attempted to file an election with the IRS to treat Waterfront as an S corporation. In 2015, Mr. Deckard filed late returns on Form 1120S for 2012 and 2013 for Waterfront as well as late income tax returns on Form 1040 for himself for the same years. On his own individual income tax returns, Mr. Deckard reported substantial losses from Waterfront. Judge Thornton declined to accept Mr. Deckard's argument that Waterfront was an S corporation for federal income tax purposes and that he was a shareholder of Waterfront. Initially, the court addressed whether Mr. Deckard was a shareholder. Although courts have frequently considered whether a person is a shareholder by virtue of being a beneficial owner of the corporation's stock, Judge Thornton noted, neither party cited any authority and the court could not find any authority regarding beneficial ownership of a nonstock, nonprofit corporation for purposes of subchapter S. The court reasoned that nonprofit corporations generally do not have owners and, consequently, a pass-through system of taxation cannot be used to report income tax for such entities. Nonprofit corporations do not have owners because the members are prohibited from receiving the profits or assets of a nonprofit for their own benefit. The Kentucky statutes that govern the formation of nonstock, nonprofit corporations reflect this prohibition by defining a "nonprofit corporation" as a corporation that may not distribute any part of its profit to its members, directors, or officers. Such nonprofits are also not allowed to have or issue any shares of stock. Judge Thornton concluded that Waterfront, as a Kentucky nonstock, nonprofit corporation had no stock and could not issue any stock. Accordingly, the court concluded, Mr. Deckard could not be a shareholder of Waterfront within the meaning of Reg. § 1.1361-1(e)(1), which provides that "[o]rdinarily, the person who would have to include in gross income dividends distributed with respect to the stock of the corporation (if the corporation were a C corporation) is considered to be the shareholder of the corporation." Judge Thornton also declined to adopt any of a number of other arguments made by Mr. Deckard. The court rejected Mr. Deckard's argument that he had intended to form a for-profit corporation and had operated Waterfront as a for-profit corporation and therefore the court should treat Waterfront as a for-profit corporation under the substance over form doctrine. The court observed that taxpayers are generally bound by the form they choose and that Mr. Deckard had purposefully organized Waterfront as a nonprofit corporation. The court also rejected Mr. Deckard's argument that, because Waterfront had never applied for or obtained tax-exempt status, it must be treated as a for-profit corporation. This argument, the court observed, confuses federal tax-exempt status with status as a nonprofit corporation under state law. In summary, the court concluded, Mr. Deckard was not a shareholder of Waterfront during any of the years at issue and therefore was not entitled to deduct the corporation's losses on his individual federal income tax returns. The court therefore did not have to decide, and expressly declined to decide, whether the Tax Court would have jurisdiction in a case such as this, brought by an individual who was not a shareholder of the putative S corporation, to determine whether Waterfront made a valid S corporation election.

E. Mergers, Acquisitions and Reorganizations

F. Corporate Divisions

G. Affiliated Corporations and Consolidated Returns

H. Miscellaneous Corporate Issues

VII. PARTNERSHIPS

VIII. TAX SHELTERS

IX. EXEMPT ORGANIZATIONS AND CHARITABLE GIVING

A. Exempt Organizations

B. Charitable Giving

1. Provisions of the CARES Act that affect charitable contributions.

a. "CARE" for a charitable panacea (at least in part) for a pandemic? A limited above-the-line deduction in 2020 and a deduction for non-itemizers in 2021 for contributions to public charities. It took a pandemic, but Congress has reversed itself, at least partially, with respect to non-itemizers and charitable contributions. To wit, the CARES Act, § 2204, added new Code § 62(a)(22), which allows individual taxpayers who claim the standard deduction (i.e., non-itemizers) to deduct up to $300 in above-the-line "qualified charitable contributions." The legislation also adds new Code § 62(f), which defines "qualified charitable contributions" as donations of cash to organizations described in Code § 170(b)(1)(A)—primarily, so-called "public charities" such as churches, schools, hospitals, and publicly-supported nonprofits, but not non-operating private foundations, donor-advised funds, and Type III supporting organizations. New Code §§ 62(a)(22) and 62(f) are effective for taxable years beginning after 2019. This above-the-line deduction for qualified charitable contributions applies to "taxable years beginning in 2020" and thus is in effect for 2020.

- Congress has extended this deduction, in modified form, to 2021. A provision of the Taxpayer Certainty and Disaster Tax Relief Act of 2020, Division EE, Title I, § 212(a) of the 2021 Consolidated Appropriations Act, amends Code § 170 by enacting new § 170(p). Section 170(p) provides that, if an individual does not elect to itemize deductions, then the deduction authorized by § 170 is equal to the deduction that would be determined, not in excess of $300 ($600 for joint filers), for cash contributions to public charities. The legislation simultaneously repeals § 62(a)(22) and § 62(f), both enacted by the CARES Act, and amends the definition of taxable income in § 63(b) to make clear that the limited deduction authorized by § 170(p) is subtracted from adjusted gross income to arrive at taxable income. Thus, the $300 deduction for cash contributions to public charities will no longer be an above-the-line deduction but nevertheless will be available to non-itemizers. This change applies to taxable years beginning after December 31, 2020.

- These changes for non-itemizers partially reverse a significant effect of the 2017 Tax Cuts and Jobs Act. Specifically, the 2017 Tax Cuts and Jobs Act substantially increased the standard deduction such that many taxpayers no longer needed to itemize deductions starting in 2018. In 2020, for instance, the standard deduction is $24,800 for joint returns and surviving spouses, $12,400 for unmarried individuals and married individuals filing separately, and $18,650 for heads of households. *See* Rev. Proc. 2019-44, 2019-47 I.R.B. 1093 (11/6/19). Many charities predicted that the increased standard deduction would lead to decreased charitable giving, and a study by Giving USA found this to be true for 2018. *See* Eisenberg, *Charitable Giving Took a Hit Due to Tax Reform*, Forbes (6/18/19) (*available online here*).

b. Also new for 2020 and 2021: You can elect to "CARE" less about charitable contribution limits on donations of cash to public charities. The CARES Act, § 2205, an uncodified provision, temporarily suspends for 2020 the charitable contribution limits of Code § 170(b) for electing individual and corporate taxpayers. The legislation provides that "qualified contributions" by an individual are not subject to the normal limits, and instead are allowed, if the individual so elects, up to the amount by which the taxpayer's contribution base (generally, adjusted gross income) exceeds the other charitable contributions the taxpayer makes, i.e., those subject to the normal limits. In effect, this permits individual taxpayers to elect to deduct qualified contributions up to 100 percent of the taxpayer's contribution base (AGI) after taking into account other charitable contributions. A corporation may elect to deduct qualified contributions up to the amount by which 25 percent of its taxable income exceeds the corporation's other charitable contributions, i.e., the corporation can deduct qualified contributions up to 25 percent of taxable income after taking into account other charitable contributions. Qualified contributions by an individual or a corporation that exceed the relevant limit can be carried forward five years. A *qualified contribution* is defined as a contribution paid in cash during 2020 to an organization described in § 170(b)(1)(A) with respect to which the taxpayer elects to have the increased limits apply. As noted above, Code § 170(b)(1)(A) organizations primarily consist of so-called "public charities" such as churches, schools, hospitals, and publicly-supported nonprofits, but not non-operating private foundations, donor-advised funds, and Type III supporting organizations. Section 2205 of the CARES Act does not specify precisely how individuals and corporations elect into the temporary charitable contribution limits for donations of cash made in 2020. The legislation also temporarily increases from 15 percent to 25 percent the § 170(e)(3)(C) limit on contributions of food inventory made in 2020.

- *These same rules apply for 2021.* Congress has extended these increased limits on cash contributions to public charities to 2021. A provision of the Taxpayer Certainty and Disaster Tax Relief Act of 2020, Division EE, Title I, § 213 of the 2021 Consolidated Appropriations Act, amends § 2205 of the CARES Act to provide that the increased limits also apply in 2021.

- *The individual limit already had been increased slightly.* Prior to the CARES Act, Congress, in the 2017 Tax Cuts and Jobs Act, had increased the limit on deducting charitable contributions for individual donations from its historical norm without requiring an election into the new rules. Under Code §§ 170(b)(1)(G) and (H), as amended by § 11023 of the 2017 Tax Cuts and Jobs Act, individuals can take a charitable contribution deduction of up to 60 percent of their contribution base for cash donations made to Code § 170(b)(1)(A) organizations in taxable years beginning after 2017 but before 2026. Beginning in 2026 and thereafter, the charitable contribution limit for individuals reverts to its historical norm of 50 percent of an individual's contribution base.

- *This is not a revolutionary idea.* Increasing charitable contribution deduction limits on an elective basis during times of crisis is not a new idea. For instance, Section 504(a) of the 2017 Disaster Relief Act increased the charitable contribution limits for donations that benefitted those affected by Hurricanes Harvey, Irma, or Maria for eligible and electing taxpayers. Similarly, the Bipartisan Budget Act of 2018, § 20104(a) of Division B, increased the limit on deductions for charitable contributions towards relief efforts in areas affected by the California wildfires for eligible and electing taxpayers. Most recently, a provision of the Taxpayer Certainty and Disaster Tax Relief Act of 2019, Division Q, Title II, § 204(a) of the 2020 Further Consolidated Appropriations Act, provided special rules for charitable contributions for relief efforts in qualified disaster areas.

X. TAX PROCEDURE

A. Interest, Penalties, and Prosecutions

B. Discovery: Summonses and FOIA

C. Litigation Costs

D. Statutory Notice of Deficiency

E. Statute of Limitations

1. Tax Court holds that a rejected e-filed return still triggers the three-year limitations period of § 6501(a) on assessment of tax. Fowler v. Commissioner, 155 T.C. No. 7 (9/9/20). In a unanimous, reviewed opinion by Judge Greaves, the Tax Court has addressed whether an electronically filed return that was rejected for electronic filing triggered the § 6501(a) three-year limitations period on assessment of tax. The IRS rejected the return for lack of an Identity Protection Personal Identification Number ("IP PIN"). An IP PIN is a six-digit number assigned to eligible individuals that must be used on a tax return, in addition to the individual's Social Security number (SSN), to verify the individual's identity. Mr. Fowler properly filed to extend the due date of his 2013 tax return on Form 1040 until October 15, 2014. His CPA prepared and e-signed Mr. Fowler's Form 1040 with a Practitioner Personal Identification Number. The CPA electronically transmitted or "e-filed" Mr. Fowler's return with the IRS on October 15, 2014. On the same day, the IRS rejected the e-filed return for failure to include an IP PIN. Three days later, on October 28, 2014, the CPA again electronically submitted Mr. Fowler's return and also sent via the U.S. Postal Service a paper version of the return, which was signed for as received by the IRS. Nevertheless, in December 2014 Mr. Fowler received a notification letter indicating that the IRS had not received his return. On April 30, 2015, the CPA responded by again electronically refiling Mr. Fowler's 2013 return with a proper IP PIN. This return was accepted by the IRS on the same day. On April 5, 2018, the IRS issued a notice of deficiency to Mr. Fowler in relation to his 2013 return and he filed a petition in the Tax Court raising the three-year limitations period on assessment of tax in § 6501(a) as a defense. The narrow question before the court was whether either the first e-filed return or the paper tax return, both submitted in October 2014, triggered the running of the § 6501(a) three-year limitations period. The IRS generally is required to assess tax within a three-year period that begins when a return is filed. The filing of a return starts the running of this limitations period if the return was (1) "properly filed" and (2) a "required return." See *Appleton v. Commissioner*, 140 T.C. 273, 284 (2013).

Was Mr. Fowler's 2013 Form 1040 a "required return"? Judge Greaves first addressed whether Mr. Fowler's 2013 Form 1040 was a "required return" under the test applied by the court in *Beard v. Commissioner*, 82 T.C. 766, 777 (1984), *aff'd*, 793 F.2d 139 (1988). Beard, requires that (1) the document purport to be a return and provide sufficient data to calculate tax liability, (2) the taxpayer make an honest and reasonable attempt to satisfy the requirements of the tax law, and (3) the taxpayer execute the document under penalties of perjury. Mr. Fowler's return readily met the first element without much question. With respect to the second element, Judge Greaves concluded that Mr. Fowler's return was an honest and reasonable attempt to comply with the law because it included the taxpayer's income, deductions, exemptions and credits along with supporting documentation. The failure to include a proper IP PIN on the original October 2014 filings was not sufficient to disqualify the return as an honest and reasonable attempt to comply. Judge Greaves reasoned that this is especially true where the IRS does not explain why the IRS rejects an e-filed return but not a paper return without an IP PIN. The third element of the *Beard* test requires a taxpayer to sign or execute the return under penalties of perjury. The IRS argued that the October 15 electronic submission failed to satisfy the signature requirement because it did not include an IP PIN. Judge Greaves found this argument unpersuasive because the IP PIN is not a requirement in relation to what constitutes a valid signature. The regulations require only that each individual "shall sign" his or her return. *See* Reg. § 1.6061-1(a). The regulations further direct that a return preparer "electronically sign the return" consistent with guidance provided by the IRS. By including his practitioner PIN on the e-filed return, Mr. Fowler's CPA complied with the IRS's guidance on electronic return signatures. Just because the IRS's software rejects an e-filed return for lack of an IP PIN, the court concluded, does not mean that an IP PIN is part of the signature requirement. Thus, because there was no IRS guidance that characterized an IP PIN as part of the signature requirement, Mr. Fowler's return met the third element of the *Beard* test. Mr. Fowler's Form 1040 therefore was a "required return."

Was Mr. Fowler's Form 1040 a "properly filed" return? Whether a return is "properly filed" does not depend upon whether the IRS is informed, or what the IRS received and understood. *See Vento v. Commissioner*, 152 T.C. 1, 15-16 (2019). Rather, a return is properly filed when the taxpayer's mode of filing complies with the prescribed filing requirements. Delivery to the correct IRS office is when a return is "filed." A return that is delivered either physically through the U.S. Postal Service or electronically qualifies as "filed" even if the IRS does not accept the return. *Blount v. Commissioner*, 86 T.C. 383, 387-388 (1986). Judge Greaves reasoned that Mr. Fowler's return was properly filed because his CPA represented that he submitted the return on behalf of Mr. Fowler and he received a 20-digit submission ID as confirmation from the IRS. Moreover, the IRS acknowledged Mr. Fowler's return was submitted on October 15.

Holding & Afterthoughts. Judge Greaves held that the Mr. Fowler had satisfied the requirements for triggering the three-year limitations period on assessment set forth in § 6501(a). Because the limitations had been triggered by the October 2014 filing, the limitations period had expired before the IRS issued the notice of deficiency on April 5, 2018. The opinion contains a fair amount of description regarding the machinations of the IRS's software and how the software operates to reject returns. The opinion might be narrowly construed to stand for the proposition that the IRS's rejection of an e-filed return for lack of an IP PIN will not prevent the § 6501(a) limitations from beginning to run. However, Judge Greaves also noted that a signature serves an authentication function and that IRS guidance indicates that an element other than just an e-signature may be needed to authenticate an electronically filed return. The IP PIN would appear to have been what the IRS needed to distinguish between the true taxpayer and a fraudulent taxpayer. By strictly applying the elements of *Beard* to conclude it was a properly filed return, the court may be putting the IRS in the untenable position of forfeiting the protection of the statute of limitations in an effort to protect taxpayers from fraud. Finally, the opinion might also be broadly interpreted to support the proposition that where an e-filed return is rejected for any number of errors on the return, the limitations period on assessment continues to run.

F. Liens and Collections

G. Innocent Spouse

H. Miscellaneous

XI. WITHHOLDING AND EXCISE TAXES

XII. TAX LEGISLATION