

# **Recent Developments in Federal Income Taxation**

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To obtain today's outline and slides:

<https://tinyurl.com/outline10-2021>

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CLE Number for Today's Webcast:

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**Mylan, Inc. v. Commissioner,  
156 T.C. No. 10 (4/27/21)  
Outline: item B.1, page 2**

- The taxpayer was a manufacturer of brand-name and generic drugs.
- The taxpayer sought FDA approval of generic drugs by submitting an Abbreviated New Drug Applications (ADNAs).
- As required by the ANDA process, the taxpayer:
  - Certified to the FDA that existing patents on the drugs were invalid or would not be infringed by the sale or use of the generic version of the drug, and
  - Sent notice letters to the holders of the patents informing them of the certification
- Issues: (1) were legal expenses incurred to prepare the notice letters capital expenditures? (2) were legal expenses incurred to defend patent infringement suits brought in response to the notice letters capital expenditures?
- Held: (1) Yes. The legal expenses facilitated acquisition of an intangible (an FDA-approved ANDA); (2) No. The legal expenses are a cost incurred to protect business profits, not to defend or perfect title.

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**De Los Santos v. Commissioner,  
156 T.C. No. 9 (4/12/21)  
Outline: item A.1, page 4**

- The taxpayer was the sole shareholder of an S corporation. He and his wife were employees of the corporation.
- Pursuant to a welfare benefit plan, the S corporation paid the premiums on a life insurance contract insuring the taxpayer's life.
- The court had previously ruled that the plan was a compensatory split-dollar life-insurance arrangement.
- Issue: are the economic benefits of the split dollar life-insurance arrangement treated as compensation to the taxpayer or instead as corporate distributions?
- Held: As compensation to the taxpayer. If a corporation provides a benefit to a shareholder in the shareholder's capacity as an employee, the payment does not constitute a distribution subject to the rules of § 301.
  - Court rejects the Sixth Circuit's contrary conclusion in *Machacek v. Commissioner*, 906 F.3d 429 (6th Cir. 2018).

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**Plentywood Drug, Inc. v. Commissioner,  
T.C. Memo. 2021-45 (4/26/21)  
*Outline: item B.1, page 7***

- Plentywood Drug, Inc. is a Montana C corporation that operates a pharmacy in a building that the corporation occupies as a tenant.
- The corporation leased the building from its four shareholders (two married couples).
- The corporation paid rent of \$83,548 in one year and \$192,000 in two other years.
- Issue: is the rent paid by the corporation a fair market rent?
- Held: No.
  - The court did not accept the expert methodology used by either side.
  - Instead, court focused on the Post Office building in the small town in which the pharmacy was located as the most comparable property.
  - A fair market rent was \$171,187.50. Additional amounts paid by the corporation were constructive dividends to the shareholders.
  - Court declined to impose accuracy-related penalties.

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**Hohl v. Commissioner,  
T.C. Memo. 2021-5 (1/13/21)  
*Outline: item C.1, page 8***

- A partner transferred substantial amounts to a partnership with four partners.
- Issue: were the transfers capital contributions or loans?
- Held: Loans. When the partnership ceased business, the result was cancellation of indebtedness income for the partners with negative capital account balances.

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**Andrews v. United States,  
15 Fed. Cl. 665 (5/12/21)**

***Outline: item A.1, page 9***

- The executor of an estate authorized an attorney to file a request for an automatic 6-month extension of time to file the estate's return on Form 706.
- The attorney allegedly failed to do so and filed the return late reporting tax liability of \$3 million.
- The IRS assessed a late-filing penalty of just over \$400,000 and a late-payment penalty of just over \$75,000.
- Issue: did the estate have a reasonable cause defense to the penalties because it had relied on counsel?
- Held: No. Under the U.S. Supreme Court's decision in *United States v. Boyle*, 469 U.S. 241 (1985), relying on an agent to file a return does not excuse late filing. The estate did not rely on mistaken legal advice, which can give rise to reasonable cause.

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**Lindsay v. United States,  
4 F.4th 292 (5<sup>th</sup> Cir. 7/9/21)**

***Outline: item A.2, page 10***

- The taxpayer was incarcerated and appointed an individual (Bertelson) as his attorney-in-fact to manage his affairs.
- Bertelson failed to file the taxpayer's tax returns and embezzled hundreds of thousands of dollars.
- The IRS assessed late-filing and late-payment penalties of more than \$400,000.
- Issue: did the taxpayer have a reasonable cause defense to the penalties because he was under a disability (incarceration)?
- Held: No. Under the U.S. Supreme Court's decision in *United States v. Boyle*, 469 U.S. 241 (1985), relying on agent to file a return does not excuse late filing. The taxpayer did not rely on mistaken legal advice, which can give rise to reasonable cause.

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**Seminole Nursing Home, Inc. v. Comm’r,**

**\_\_ F.4th \_\_ (9/2/21)**

***Outline: item F.1, page 10***

- In response to a final notice of intent to levy for unpaid employment taxes, the taxpayer, a corporation, requested a collection due process hearing.
- In the CDP hearing, the taxpayer requested relief from the levy on the grounds of economic hardship.
  - The IRS Settlement Officer refused to consider economic hardship because, under Reg. § 301.6343-1(b)(4)(i), such relief is available only to individual taxpayers.
- Issue: is the regulation a valid interpretation of the statute?
- Held: Yes. The regulation is entitled to Chevron deference and, in Chevron step 2, is a permissible construction of the statute.

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**Rowen v. Commissioner,**

**156 T.C. No. 8 (3/30/21)**

***Outline: item H.1.a, page 12***

- The petitioner was a medical doctor licensed in California who frequently traveled to developing countries to offer medical services free of charge to underserved populations.
- He had unpaid federal tax liabilities for more than two decades of \$500,000.
- Pursuant to § 7345, the IRS issued a notice of certification of a “seriously delinquent tax debt” and notified the Secretary of State that his passport should be revoked.
- The taxpayer petitioned the Tax Court for review of the certification.
- Issues: (1) is § 7345 unconstitutional because it prohibits international travel in violation of the Due Process Clause of the Fifth Amendment; (2) does the statute violate taxpayer’s human rights under the Universal Declaration of Human Rights?
- Held: No. Section 7345 authorizes the IRS Commissioner only to certify that an individual has a seriously delinquent tax debt and leaves all passport-related decisions to the Secretary of State.

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**Maehr v. United States,  
5 F.4<sup>th</sup> 1100 (10th Cir. 7/20/21)**

***Outline: item H.1.b, page 12***

- The plaintiff had unpaid federal tax liabilities of roughly \$250,000.
- Pursuant to § 7345, the IRS issued a notice of certification of a “seriously delinquent tax debt” and notified the Secretary of State.
- The State Department revoked the plaintiff’s passport.
- The plaintiff challenged the revocation in a U.S. District Court.
- Issues: (1) do the Privileges and Immunities clauses limit the federal government’s right to restrict travel, (2) should the court review the revocation under a standard similar to that used in reviewing a writ of *ne exeat republica*, and (3) is § 7345 unconstitutional because it violates the Due Process Clause of the Fifth Amendment?
- Held: (1) No. The Privileges and Immunities clauses apply only to the states, not the federal government; (2) No. Passport revocation is different from a writ of *ne exeat republica*; (3) No. International travel is not a “fundamental right,” and therefore a rational basis standard of review applies, which § 7345 meets.

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