# 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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**1. Unless You Are the IRS, "I Am The Last Guy In The World That You Want To F[ool] With." James Caan as "Frank" in *Thief* (1981).** Estate of Caan v. Commissioner, 161 T.C. No. 6 (10/18/23). The estate of the well-known actor, James Caan, was the taxpayer in this case. James Caan died in 2022 while holding two IRAs with UBS as custodian. One of Caan's IRAs held a nontraditional asset, a partnership interest in a private hedge fund. Under § 408(i), the IRA custodian, UBS, was required to report annually to the IRS the fair market value of the IRA's interest in the hedge fund. Because the interest in the hedge fund was not publicly traded, the IRA custodial agreement required Mr. Caan to specify to UBS each year the fair market value of the hedge fund interest. In January 2015 and thereafter, Caan did not provide UBS with the value of the hedge fund interest for the year ended 2014. As a result, UBS subsequently alerted Caan in October 2015 that it would resign as IRA custodian of the hedge fund interest and distribute the interest to him. Then, in December 2015, UBS confirmed by letter to Caan that it has distributed the hedge fund interest to him. In this regard, the UBS IRA custodial agreement provided as follows: "The Client acknowledges, understands and agrees that if the Custodian does not receive a fair market value as of the preceding December 31, the Custodian shall distribute the Investment to the Client and issue an IRS Form 1099-R for the last available value of the Investment." Later, in accordance with the IRA custodial agreement, UBS issued Mr. Caan a 2015 Form 1099-R, Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., reflecting a November 25, 2015, IRA distribution of $1,910,903, the hedge fund interest's specified 2013 reportable year-end value. Meanwhile in June 2015, before UBS alerted Mr. Caan of its decision to resign and distribute the interest in the hedge fund, Caan's financial advisor moved from UBS to Merrill Lynch. In October of 2015, the financial advisor convinced Caan to transfer the assets in his two UBS IRAs to a rollover IRA at Merrill Lynch. Caan signed the necessary paperwork, and then UBS transferred the assets, except for the illiquid hedge fund interest, to Caan's Merrill Lynch rollover IRA. It was not until October 2016 that Caan and Merril Lynch discovered the hedge fund interest previously held in Caan's UBS IRA had not been transferred to Caan's Merrill Lynch rollover IRA. Then, in December 2016, Merrill Lynch instructed the hedge fund to liquidate Caan's interest for cash and transfer the cash to Caan's Merril Lynch rollover IRA. Cash transfers totaling $1,375,000 then were made in 2017 from the hedge fund to Caan's Merrill Lynch rollover IRA. Caan's 2015 federal income tax return reported the IRA rollovers from UBS to Merril Lynch, including the distribution of the hedge fund interest, but took the position that the hedge fund interest was rolled over to Merrill Lynch along with Caan's other IRA assets previously held at UBS. Upon examination—no doubt based upon the 2015 Form 1099-R issued by UBS—the IRS disagreed with Caan's position regarding the rollover of the hedge fund interest. Accordingly, the IRS in 2018 issued Caan a notice of deficiency for additional taxes, interest, and penalties for 2015 relating to the reported UBS IRA distribution of the hedge fund interest. Caan timely filed a petition in the Tax Court. Around the same time the petition was filed, Caan requested a private letter ruling from the IRS granting him a waiver of the 60-day IRA rollover period with respect to the distributed interest in the hedge fund. *See* § 408(d)(3)(I). The IRS denied the requested private letter ruling, citing the "same property" requirement for IRA rollovers according to § 408(d)(3)(A)(i) and (D) as interpreted by *Lemishow v. Commissioner*, 110 T.C. 110, 113 (1998), *as supplemented* 110 T.C. 346 (1998). Thus, the issues before the Tax Court were (1) whether UBS distributed the hedge fund interest to Caan in 2015 and (ii) if so, whether the distribution was taxable and in what amount.

*Tax Court Opinion*. The Tax Court, in an opinion written by Judge Copeland, first held that the IRS properly denied Caan's private letter ruling request for a waiver of the 60-day rollover period concerning the hedge fund interest. Judge Copeland agreed with the IRS that because cash, not the hedge fund interest, was transferred to Caan's Merrill Lynch IRA, the "same property" requirement of § 408(d)(3)(A)(i) and (D) applied, thereby making the purported rollover ineffective. Judge Copeland cited *Lemishow v. Commissioner* as further support for the court's holding. With respect to Caan's argument that the hedge fund interest should have been treated as rolled over to Merrill Lynch in October or November of 2015 (or by the 60-day deadline of January 25, 2016) after Caan executed the necessary paperwork, Judge Copeland wrote (in perhaps the understatement of the year):

> There are three problems with the way the [hedge fund interest] was handled. First, and most importantly, in liquidating the [hedge fund interest] Mr. Caan changed the character of the property; yet section 408(d)(3)(A)(i) required him to contribute the [hedge fund interest] itself, not cash, to another IRA in order to preserve its tax-

> deferred status. See *Lemishow*, 110 T.C. at 113; Treas. Reg. § 1.408-4(b)(1). Second, the contribution of the cash proceeds from the liquidation occurred long after the January 25, 2016, deadline. And finally, the [hedge fund's] three transfers [of cash] to the Merrill Lynch IRA constituted three separate contributions; yet section 408(d)(3)(B) allows for only one rollover contribution in any one-year period, making only the first transfer potentially eligible for a tax-free rollover.

Furthermore, Judge Copeland wrote:

> The text of section 408(d)(3)(A)(i), the legislative history behind section 408(d)(3), our caselaw, and the regulations all make clear that Mr. Caan was required to contribute the P&A Interest, not cash, to the Merrill Lynch IRA in order to preserve its tax-deferred status. Because he did not do so, we hold that the cash proceeds from the liquidation of the P&A Interest were not contributed in a manner that would qualify as a nontaxable rollover contribution under section 408(d)(3)(A)(i).

Finally, for purposes of determining the amount of Caan's 2015 IRA distribution of the hedge fund interest, Judge Copeland decided that the interest should be valued at $1,548,010.

## V. PERSONAL INCOME AND DEDUCTIONS

### A. <u>Rates</u>

### B. <u>Miscellaneous Income</u>

**1. Are those refunds of state or local taxes or other payments received from state governments included in gross income? Maybe, says the IRS.** Notice 2023-56, 2023-38 I.R.B. 824 (8/30/23). In 2022, some states made payments to individuals residing in those states. The payments generally were related to the COVID-19 pandemic. The IRS issued a news release on February 10, 2023, IR-2023-23, to provide certainty for the 2023 filing season for 2022 returns. The news release provided that, in the best interest of sound tax administration, the IRS would not challenge a taxpayer's exclusion of these payments from gross income. The news release identified 17 states that qualified for this treatment. That guidance, however, applied only for tax year 2022. This notice provides guidance for 2023 and future years. The notice addresses the general tax treatment of a state refund of tax. If the payment is a refund of tax, then it is not included in a taxpayer's gross income except to the extent required by the tax benefit rule, i.e., to the extent the taxpayer deducted the payment and received a tax benefit from the deduction in a prior year. (A state payment if considered a refund of tax only to the extent that the payment is limited to taxes paid. *See, e.g.*, *Maines v. Commissioner*, 144 T.C. 123 (2015).) The notice also addresses payments received from states that are eligible for exclusion under the general welfare exclusion. To qualify for the general welfare exclusion, state payments must (1) be paid from a governmental fund, (2) be for the promotion of general welfare (that is, based on the need of the individual or family receiving such payments), and (3) not represent compensation for services absent a specific Federal income tax exclusion. The notice provides examples of payments that qualify, such as payments to eligible residents under an "Energy Relief Payment Program" to help those low-income residents who may not otherwise be able to afford to pay their heating bills.

### C. <u>Hobby Losses and § 280A Home Office and Vacation Homes</u>

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## VI. CORPORATIONS

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### C. Liquidations

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### F. Corporate Divisions

### G. Affiliated Corporations and Consolidated Returns

### H. Miscellaneous Corporate Issues

**1. A new fast-track program for corporate private letter rulings can result in rulings being issued in a compressed timeframe, generally 12 weeks.** Rev. Proc. 2023-26, 2023-33 I.R.B. 486 (7/26/23). The IRS has made permanent its fast-track program for private letter rulings solely or primarily under the jurisdiction of the Associate Chief Counsel (Corporate). The new program replaces, with minor changes, the pilot program established in Rev. Proc. 2022-10, 2022-6 I.R.B. 473. If fast-track processing is available, then

> the IRS will endeavor to complete the processing of the letter ruling request and, if appropriate, to issue the letter ruling within the time period specified by the branch representative or branch reviewer. The specified period will be 12 weeks unless a shorter or longer period is designated by the branch reviewer …

The revenue procedure specifies that a taxpayer seeking fast-track processing must request a pre-submission conference and must submit required information before the conference, including the reason for requesting fast-track processing and the length of time requested (if other than 12 weeks). The revenue procedure strongly recommends that taxpayers submit fast-track requests as an encrypted e-mail attachment in order to avoid delays resulting from submitting requests by mail or by delivery in physical form. The new fast-track program is available for letter ruling requests received by the IRS after July 26, 2023.

## 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. ♪♬ Ooh, a storm is threatening … my very life today. If I don't get some shelter … ooh yeah, I'm gonna fade away. ♬♪** Keene-Stevens v. Commissioner, 72 F.4th 1015 (9th Cir. 7/3/23), *rev'g and remanding* T.C. Memo 2020-118. The Ninth Circuit (holding for the IRS) has reversed the Tax Court (which had held for the taxpayers) in a case in which the taxpayers were "sheltering" between the normal deficiency determination procedures of §§ 6213 and 6214 and the now-repealed TEFRA "oversheltered return" procedures of § 6234 (hereinafter "TEFRA § 6234). Essentially, prior TEFRA § 6234 provided a procedural solution in the unusual situation where (i) the taxpayer was contesting in the Tax Court (pursuant to §§ 6213 and 6214) a proposed IRS individual-level deficiency assessment based upon items attributable solely to the taxpayer's personal return for a taxable year or years ("non-partnership items") and (ii) regardless of the outcome of the individual-level proceeding in Tax Court under §§ 6213 and 6214, the taxpayer ultimately might not be found to have a "deficiency" for the taxable year or years due to pass-through losses claimed as a partner in a partnership subject to a pending TEFRA partnership audit for the same taxable year or years ("partnership items"). TEFRA § 6234(a) solved the problem by authorizing a special declaratory judgment action in the Tax Court concerning non-partnership items upon the taxpayer's receipt of an IRS "notice of adjustment" if:

1. a taxpayer files an oversheltered return for a taxable year,
2. the Secretary makes a determination with respect to the treatment of items (other than partnership items) of such taxpayer for such taxable year, and
3. the adjustments resulting from such determination do not give rise to a deficiency (as defined in section 6211) but would give rise to a deficiency if there were no net loss from partnership items.

An "oversheltered return" was defined by TEFRA § 6234(b) as a partner's return that showed no taxable income for a taxable year and showed a "net loss from partnership items." The term "net loss from partnership items" was not defined in the statute. Lastly, as contemplated by TEFRA § 6234(c), the taxpayer eventually could file a petition in Tax Court seeking a readjustment of the taxpayer's "deficiency" (as preliminarily determined in the TEFRA § 6234(a) declaratory judgment action) once the taxpayer's allocable share of partnership items finally was determined in the TEFRA-partnership-level proceeding. (TEFRA § 6234 was enacted in 1997 to overturn the Tax Court's 1989 decision in *Munro v. Commissioner*, 92 T.C. 71 (1989), in which the Tax Court held that claimed partnership losses must be "completely ignored" in a deficiency proceeding concerning the taxpayer's non-partnership losses.)

*Facts*: In this case, taxpayers, a married couple, did not timely file federal income tax returns for the years 2006 through 2012. More precisely, and importantly for the outcome in the case, the taxpayers did not file any federal income tax returns whatsoever for 2007 and 2012 (because the returns provided were unsigned). The taxpayers filed late returns for 2006 and the years 2008 through 2011. None of the returns showed a federal tax liability because the taxpayers used current and carryforward losses from a TEFRA partnership in which they were partners to offset any gross income reported on their personal returns. After audit, the IRS issued individual-level notices of deficiency to the taxpayers for the years in issue, asserting both back taxes and penalties. The taxpayers timely filed petitions in the Tax Court. Before trial, the Tax Court (Judge Halpern) granted the IRS's motion to dismiss for lack of jurisdiction so much of the case as related to partnership items and ordered the IRS to provide recomputed deficiencies reflecting the dismissal of partnership items from the case. At trial, the taxpayers presented no evidence that any of the IRS's proposed recomputed deficiencies with respect to non-partnership items for the years in issue were erroneous. Presumably, the taxpayers were not concerned with the IRS's proposed non-partnership item adjustments because they had more than enough partnership-item losses (from the TEFRA partnership in which they were partners) to offset any such adjustments. Regardless, over the IRS's objection, Judge Halpern upheld only the IRS's proposed non-partnership item adjustments against the taxpayers for 2006 and 2008. Judge Halpern did not sustain the IRS's proposed non-partnership item deficiencies or penalties for the other years in issue (2007 and years 2009 through 2012), reasoning as follows:

> The oversheltered return rules provided in [TEFRA § 6234] do not apply for petitioners' 2007 and 2012 taxable years because they did not file returns for those years. And section 6234 does not apply for petitioners' 2009, 2010, or 2011 taxable years because the adjustments in the notice of deficiency for each year would not result in a deficiency in petitioners' joint income tax liability even if petitioners had not claimed a net loss from partnerships for the year.

The taxpayers appealed to the Ninth Circuit and the IRS cross-appealed. The taxpayers' appeal was dismissed for failure to prosecute, which resulted in the IRS's adjustments for 2006 and 2008 being upheld. Thus, only the IRS's proposed adjustments for 2007 and 2009 through 2012 were the subject of the Ninth Circuit's decision.

*Ninth Circuit*: The Ninth Circuit, in an opinion by Judge Clifton, reversed and remanded the case to the Tax Court for redetermination of the taxpayers' deficiencies and penalties for 2007 and years 2009-2012. With respect to tax years 2007 and 2012, the Ninth Circuit held that the unsigned, unfiled tax returns, on which the TEFRA partnership losses were reported by the taxpayers, were legally invalid because they had not been filed and executed under penalties of perjury. Therefore, those unsigned, unfiled returns could not be used to offset non-partnership item income in an individual deficiency proceeding with respect to those years. Furthermore, with respect to 2009-2011, the Ninth Circuit determined that the Tax Court erred by concluding that the oversheltered return rules of TEFRA § 6234 did not apply. Instead, the Ninth Circuit determined that Judge Halpern should have included in the calculation of "net loss from partnership items" (one of the requirements for triggering Tax Court jurisdiction under TEFRA § 6234) the portions of the net-operating-loss carryover deductions that were composed of eligible partnership losses in prior years. If Judge Halpern had done so, then the Tax Court would have had jurisdiction under TEFRA § 6234 to decide the IRS proposed non-partnership item adjustments, if any, to the taxpayer's returns for 2009-2011.

### G. Miscellaneous

## VIII. TAX SHELTERS

## IX. EXEMPT ORGANIZATIONS AND CHARITABLE GIVING

### A. Exempt Organizations

### B. Charitable Giving

## X. TAX PROCEDURE

### A. Interest, Penalties, and Prosecutions

**1. What's the point of a penalty if the IRS is precluded from collecting it? The Tax Court has held that there is no statutory authority for the IRS to assess penalties imposed by § 6038(b) for failure to file information returns with respect to foreign business entities and that the IRS therefore cannot proceed to collect the penalties through a levy.** Farhy v. Commissioner, 160 T.C. No. 6 (4/3/23). Section 6038(a) requires every United States person to provide information with respect to any foreign business entity the person controls (defined in § 6038(e)(2) as owning more than 50 percent of all classes of stock, measure by vote or value). The form prescribed for providing this information is Form 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations. Section 6038(b)(1) imposes a penalty of $10,000 for each annual accounting period for which a person fails to provide the required information. In addition, § 6038(b)(2) imposes a continuation penalty of $10,000 for each 30-day period that the failure continues up to a maximum continuation penalty of $50,000 per annual accounting period. In this case, the taxpayer was required to file Form 5471 for several years with respect to two wholly-owned corporations organized in Belize but failed to do so. The IRS assessed a penalty under § 6038(b)(1) of $10,000 and a continuation penalty of $50,000 for each of the years in issue. In response to a notice of levy, the taxpayer requested a collection due process (CDP) hearing. In the CDP hearing, the taxpayer argued that the IRS had no legal authority to assess § 6038 penalties. Following the CDP hearing, the IRS issued a notice of determination upholding the proposed collection action and the taxpayer changed this determination by filing a petition in the Tax Court. The Tax Court (Judge Marvel) agreed with the taxpayer and held that there is no statutory authority for the IRS to assess § 6038 penalties. The IRS argued that § 6201(a), which authorizes the Secretary of the Treasury to make the "assessments of all taxes (including interest, additional amounts, additions to the tax, and assessable penalties) imposed by this title" authorizes assessment of penalties imposed by § 6038. The court disagreed, however, and reasoned that the term "assessable penalties" in § 6201(a) does not automatically apply to all penalties in the Code. The court observed that (1) §§ 6671(a) and 6665(a)(1) provide that penalties imposed by specified Code sections shall be assessed and collected in the same manner as taxes and

(2) Code sections other than those specified by §§ 6671(a) and 6665(a)(1) commonly provide that the penalty is a tax or assessable penalty for purposes of collection or are expressly covered by (or contain a cross-reference to) one of the specified Code sections. In contrast, the court explained, § 6038 is not one of the Code sections specified by §§ 6671(a) and 6665(a)(1) and contains only a cross-reference to a criminal penalty provision. The court also rejected the IRS's argument that § 6038 penalties are "taxes" within the meaning of § 6201(a) and therefore subject to assessment. In short the court held, although § 6038(b) provides penalties for failure to provide the information required by § 6038(a), there is no statutory authority for assessment of those penalties and the IRS therefore is unable to collect those penalties through a levy.

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

## B. Discovery: Summonses and FOIA

## C. Litigation Costs

## D. Statutory Notice of Deficiency

## E. Statute of Limitations

**1. IRS bait and switch? Partnership's 2001 tax year remains open until 2010 because no original return was filed and neither a copy faxed to an IRS agent in 2005 nor a second copy mailed to an IRS attorney in 2007 started the three-year limitations period on assessment of tax.** Seaview Trading, LLC v. Commissioner, 62 F.4th 1131 (9th Cir. 3/10/23) (en banc), *vacating* 34 F.4th 666 (9th Cir. 2022), *and aff'g* T.C. Memo. 2019-122 (2019). As evidenced by the citation above, the procedural history of this case demonstrates the Tax Court's and the Ninth Circuit's struggles to determine the proper outcome. First, the Tax Court held for the IRS. Then, a three-judge panel of the Ninth Circuit (by a two to one vote) reversed the Tax Court and held for the taxpayer. Finally, an *en banc* panel of the Ninth Circuit (by a ten to one vote) vacated the three-judge panel's prior decision and held for the IRS, affirming the Tax Court. Notwithstanding the procedural complexities, the facts of the case are relatively straightforward. Seaview Trading, LLC, a TEFRA partnership, mistakenly failed to file its original 2001 Form 1065 even though the return apparently had been timely prepared and signed. (Seaview's return preparer may have mailed a related entity's original tax return in the envelope that was meant to contain Seaview's 2001 Form 1065.) In July of 2005, an IRS agent in South Dakota notified the tax matters partner that there was no record of Seaview having filed a return for 2001. Next, in September of 2005, Seaview faxed a copy of its original return to the IRS agent; however, the agent did not forward the faxed return to the IRS Service Center in Ogden, Utah, which was the proper place for filing Seaview's 2001 return. Subsequently, in July of 2007 while an IRS audit was ongoing, Seaview mailed a copy of its original 2001 return to an IRS attorney in Minnesota; but again, the attorney did not forward the copy to the Ogden Service Center. Lastly, in October of 2010, the IRS issued a notice of final partnership administrative adjustment ("FPAA") to Seaview disallowing a $35.5 million claimed loss for 2001. Seaview responded by filing a petition in the Tax Court contending that the IRS's proposed adjustment was untimely. Seaview asserted that, under § 6229(a)(1), the IRS has only three years from the time the partnership return is filed to assess tax, and that this period had expired no later than July 2010 (three years after the copy of the taxpayer's return was mailed to the IRS attorney in Minnesota and before the FPAA was received). The IRS, of course, argued that the statute of limitations never began to run because Seaview did not properly file an original return with the Ogden Service Center. As the case wound its way through the Tax Court up to the Ninth Circuit, the record established that Seaview's original 2001 Form 1065 (nor a copy thereof) was ever sent to or received by the Ogden Service Center. Thus, the only question before the Ninth Circuit was whether the IRS's FPAA, issued in

October 2010, was issued before the three-year limitations period on assessment of tax had expired.

*The Arguments.* The IRS argued that a return is properly "filed" for statute of limitation purposes only when it is submitted to, or eventually received by, the proper IRS Service Center, which in this case was in Ogden, Utah. The IRS relied upon then-applicable regulations (Reg. § 1.6031(a)-1(e)) and instructions to the 2001 Form 1065, which designated the Ogden Service Center as the proper place for filing Seaview's return. Seaview countered that the then-applicable regulations and instructions to the 2001 Form 1065 should be read to apply to returns filed on time, not late-filed returns or copies thereof delivered to an IRS agent or attorney. For delinquent returns, Seaview argued, there is no specific instruction regarding where such returns should be filed in the Code, applicable regulations, or the instructions for Form 1065. Therefore, Seaview urged the Ninth Circuit to hold that its delinquent 2001 return on Form 1065 was "filed" no later than July 2007, when it was mailed to the IRS attorney in Minnesota. In support of its position, Seaview cited IRS documents (a 1999 advice memorandum, the 2005 Internal Revenue Manual, and a 2006 policy statement) which permitted IRS personnel to receive and "accept" delinquent returns during an examination. The 2005 Internal Revenue Manual went further to state that such accepted but delinquent returns should be forwarded "to the appropriate campus." Seaview also cited as support for its position the Tax Court's decision in *Dingman v. Commissioner*, T.C. Memo 2011-116. In *Dingman*, the Tax Court held that delinquent, original returns delivered to IRS investigators, not an IRS Service Center, were considered properly "filed" when checks accompanying the delinquent returns were credited to the taxpayer's account.

*Ninth Circuit Majority*. The Ninth Circuit majority was not persuaded by Seaview's arguments. Judge Waterford, writing on behalf of the ten-judge majority, reasoned that, although the Code, regulations, and instructions for Form 1065 did not dictate where delinquent tax returns (or copies thereof) should be filed, limitation statutes barring the collection of taxes are strictly construed in favor of the government. Thus, a taxpayer's "meticulous compliance" with return filing requirements is necessary to start the statute of limitations running against the IRS. The court reasoned that the failure of the IRS agent and attorney to forward copies of Seaview's 2001 Form 1065 to the Ogden Service Center according to IRS policy did not relieve Seaview of its return filing obligations. Judge Waterford concluded:

> Because Seaview did not meticulously comply with the regulation's place-for-filing requirement, it is not entitled to claim the benefit of the three-year limitations period. Having never properly filed its return, Seaview is instead subject to the provision allowing taxes attributable to partnership items to be assessed "at any time."

*Dissenting opinion of Judge Bumatay*. Judge Bumatay dissented, arguing that the majority's decision "throws our tax system into disarray" by allowing "bureaucrats," not law, to control when a return filing starts the statute of limitations running against the IRS. Judge Bumatay reasoned that, in the absence of clear regulations or other published guidance, the IRS should be bound by its stated policy directing IRS personnel to forward "accepted" but delinquent returns to the appropriate IRS Service Center. Therefore, in Judge Bumatay's view, a late partnership return should be considered "filed" for statute-of-limitations purposes

> when (1) an IRS representative authorized to obtain and receive delinquent returns informs a partnership that a tax return is missing and requests that tax return, (2) the partnership responds by giving the IRS representative the tax return in the manner requested, and (3) the IRS representative receives the tax return.

### F. <u>Liens and Collections</u>

### G. <u>Innocent Spouse</u>

### H. Miscellaneous

**1. Surely, it's not constitutional for the government to revoke or refuse to issue an individual's passport just for having a seriously delinquent tax debt? Isn't there some sort of fundamental right to travel? Don't pack your bags just yet.** Franklin v. United States, 49 F.4th 429 (5th Cir. 9/15/22). Section 7345, which addresses the revocation or denial of passports for seriously delinquent tax debts, was enacted in 2015 as section 32101(a) of the Fixing America's Surface Transportation Act, Pub. L. 114-94 (Dec. 4, 2015) (FAST Act). It provides that, if the IRS certifies that an individual has a "seriously delinquent tax debt," the Secretary of the Treasury must notify the Secretary of State "for action with respect to denial, revocation, or limitation of a passport." § 7345(a). In general, a seriously delinquent tax debt is an unpaid tax liability in excess of $50,000 for which a lien or levy has been imposed. § 7345(b)(1). A taxpayer who seeks to challenge such a certification may petition the Tax Court or bring an action in a U.S. District Court to determine if the certification was made erroneously. § 7345(e)(1). If the Tax Court or U.S. District Court concludes the certification was either made in error or that the IRS has since reversed its certification, the court may order the Secretary of the Treasury to notify the State Department that the certification was erroneous. § 7345(e)(2).

The IRS assessed $421,766 in penalties for the plaintiff's failure to file accurate tax returns and failure to report a foreign trust of which he was the beneficial owner. The IRS began collection efforts in 2018. These included issuing a notice of federal tax lien and levying on his Social Security benefits. 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 State Department then revoked his passport. The plaintiff attempted to eliminate his liability by submitting two separate offers-in-compromise for doubt as to liability, both of which were rejected by the IRS. He then brought an action in the U.S. District Court for the Northern District of Texas. Among other claims, he asserted various claims related to the IRS's alleged failure to obtain supervisory approval of the penalties as required by § 6751(b). He also challenged the constitutionality of the State Department's revocation of his passport and argued that the revocation violated his rights under the Fifth Amendment. The District Court dismissed the plaintiff's claims under § 6751(b) for lack of subject matter jurisdiction and concluded that, although it had subject matter jurisdiction over his constitutional claim, that claim did not have merit because the passport-revocation scheme of the FAST Act was constitutional under a rational-basis review.

*Section 6751(b) claims.* Section 6751(b)(1) requires that the "initial determination" of the assessment of a penalty be "personally approved (in writing) by the immediate supervisor of the individual making such determination." The Fifth Circuit concluded that the District Court had correctly dismissed the plaintiff's claims for lack of subject matter jurisdiction. Subject to certain exceptions, the full payment rule established by *Flora v. United States*, 362 U.S. 145 (1960), requires that a taxpayer pay the full amount of tax that the IRS seeks to collect and then seek a refund. A federal district court lacks jurisdiction to hear the claims of a taxpayer who seeks a refund of tax but who has not complied with the full-payment rule (or qualified under an exception to it). Further, the Anti-Injunction Act, 26 U.S.C. §7421(a) (AIA), bars lawsuits filed "for the purpose of restraining the assessment or collection of any tax" by the IRS. The Fifth Circuit concluded that each of the plaintiff's claims under § 6751(b) implicitly challenged the validity of the penalties the IRS had assessed and therefore violated the AIA. The court recognized that, in *CIC Services, LLC v. IRS*, 141 S. Ct. 1582 (2021), the U.S. Supreme Court had held that a challenge to a reporting requirement could proceed even if failure to comply with the reporting requirement resulted in penalties. But the Court in *CIC Services*, the Fifth Circuit observed, had reaffirmed that a challenge to the assessment or collection of a tax or penalty is still barred by the AIA. The plaintiff's claims in this case based on the IRS's alleged failure to obtain supervisory approval of the penalties as required by § 6751(b), the court concluded, implicitly challenged the validity of the penalties and were therefore barred by the AIA.

*Constitutional claims*. The Fifth Circuit also affirmed the District Court's dismissal of the plaintiff's constitutional challenge for failure to state a claim on which relief can be granted. The plaintiff argued that the State Department's revocation of his passport violated his rights under the Due Process Clause of the Fifth Amendment. Specifically, the court concluded that international travel is not a fundamental right that must be reviewed under so-called strict scrutiny. If the court's standard of review were strict scrutiny, then any legislative infringement of a fundamental right must be narrowly tailored to serve a compelling government interest. Instead, the court held, because international travel is not a fundamental right, the constitutionality of § 7345 must be determined under either a rational basis standard of review or under so-called intermediate scrutiny. Under a rational basis standard, the court observed, "the restriction at issue survives as long as it is 'rationally related to a legitimate government interest.'" *Reyes v. N. Tex. Tollway Auth.*, 861 F.3d 558 (5th Cir. 2017); *see also FCC v. Beach Comm'cns, Inc.*, 508 U.S. 307, 313 (1993). Under an intermediate-scrutiny standard, "the challenged restriction 'must serve important governmental objectives and must be substantially related to achievement of those objectives.'" *Craig v. Boren*, 429 U.S. 190 (1976). The Fifth Circuit declined to decide whether the passport-revocation scheme must be judged under rational-basis review or instead intermediate scrutiny because, the court held, even under the higher standard of intermediate scrutiny, the statute is constitutional. The federal government's interest in collecting taxes, the court concluded, "is undoubtedly an important one." The passport-revocation scheme, the court held, is substantially related to achieving the government's objective:

> The passport-revocation scheme is also clearly connected to that goal: delinquent taxpayers will be well-incentivized to pay the government what it is owed to secure return of their passports, and those same taxpayers will find it much more difficult to squirrel away assets in other countries if they are effectively not allowed to legally leave the country.

**a. This taxpayer apparently didn't get the memo about *Franklin* or *Ruesch* (see above and below), but regardless, the Tax Court determines that its jurisdiction under § 7345 is limited to deciding whether the IRS's certification is erroneous and does not extend to hearing substantive challenges to assessed taxes or constitutional claims.** Adams v. Commissioner, 160 T.C. No. 1 (1/24/23). The taxpayer in this case owed more than $1.2 million in federal income taxes, penalties, and interest accumulated across eight taxable years. The taxpayer failed to file federal income tax returns for the relevant years, and the IRS prepared substitute returns for each year under § 6020(b). The IRS also filed a notice of federal tax lien for each year under § 6323(f) and had notified the taxpayer of his right to a collection due process (CDP) hearing under § 6320. The taxpayer did not request a CDP hearing for any of the years in issue and the time for doing so had passed. The IRS's subsequent collection efforts against the taxpayer failed, so the IRS issued the certification (via the Treasury Department) under § 7345(a) to the Secretary of State for purposes of denying, revoking, or limiting the taxpayer's passport. Later, the taxpayer apparently lost his passport and applied to the State Department for a replacement. The Secretary of State refused to issue a replacement passport due to the outstanding § 7345 certification of the taxpayer's "seriously delinquent tax debt" and so notified the taxpayer. Thereafter, the taxpayer petitioned the Tax Court, as permitted under § 7345(e)(1), to determine if the IRS's certification was erroneous. The taxpayer made two arguments that the IRS's § 7345 certification was erroneous. The taxpayer's first argument was that he did not have a "seriously delinquent tax debt" because "as a matter of law [the IRS] has failed to prove that any of the taxes [for the relevant years] were *properly assessed*." (Emphasis added.) Giving the *pro se* taxpayer the benefit of the doubt, the Tax Court liberally construed the taxpayer's first argument to raise two alternative positions: (1) that he should be allowed to substantively challenge his tax liabilities underlying the § 7345(a) certification in Tax Court or (2) that § 7345 requires the underlying tax liabilities to be "properly assessed," not merely "assessed," before the IRS certification can be issued. The Tax Court (Judge Toro) held that, as determined in *Ruesch v. Commissioner***,** 154 T.C. 289 (6/25/20), *aff'd in part but vacated and remanded in part on other grounds* 25 F.4th 67 (2d Cir. 1/27/22), the Tax Court lacks jurisdiction under § 7345(e)(1) to review the tax liabilities underlying the certification of a "seriously delinquent tax debt." Moreover, Judge Toro noted that plain language of § 7345(e)(1), which allows the taxpayer to petition the Tax Court, only requires that the tax liability be "assessed" by the IRS. Here, the IRS clearly had "assessed" the tax liabilities against the taxpayer. Furthermore, the taxpayer had ample prior opportunity (either via a deficiency proceeding or a collection due process hearing) to substantively challenge the IRS's assessment. The taxpayer's second argument was identical to the taxpayer's argument in *Franklin v. United States*, 49 F.4th 429 (5th Cir. 9/15/22), but again Judge Toro relied upon the plain language of § 7345(e)(1). Judge Toro reasoned that § 7345(e)(1) does not grant the Tax Court jurisdiction to hear constitutional challenges relating to the refusal of the Department of State to issue a passport. Given its limited jurisdiction, the Tax Court does not have authority over the Secretary of State. Only a federal district court potentially has jurisdiction to hear the taxpayer's constitutional arguments against § 7345 and possibly compel the Department of State to issue a passport notwithstanding the IRS certification. Instead, the Tax Court's jurisdiction is limited, as § 7345(e)(1) provides, to correcting an erroneous IRS certification of a "seriously delinquent tax debt." Judge Toro did note, though, that a constitutional challenge to § 7345 was unsuccessful in *Franklin v. United States*, 49 F.4th 429 (5th Cir. 9/15/22).

**b. ♪♫"Let's call the whole thing off."♫♪ Yet another Tax Court reviewed decision concerning IRC § 7345.** Pugh v. Commissioner, 161 T.C. No. 2 (8/14/23). In this case under § 7345, the taxpayer applied for renewal of her passport after the IRS had certified (via the Treasury Department) to the Secretary of State that she had a "seriously delinquent tax debt." Accordingly, the Department of State declined to renew the taxpayer's passport. Thereafter, the *pro se* taxpayer petitioned the Tax Court under § 7345(e)(1). After clearing some procedural hurdles, the IRS moved for summary judgment against the taxpayer. The taxpayer never responded to the IRS's motion, even after two separate Tax Court orders were issued for her to do so. Eventually, the taxpayer filed a motion to dismiss her case, but failed to indicate whether the requested dismissal was with or without prejudice. The IRS initially objected to the taxpayer's motion to dismiss, but then consented. The Tax Court (Judge Copeland) construed the taxpayer's motion as one to dismiss without prejudice; however, the court then had to determine whether, as a matter of first impression, a taxpayer is permitted to withdraw without prejudice a petition filed under § 7345(e)(1). On the one hand, Judge Copeland noted that, in deficiency proceedings under § 6213, the Tax Court cannot grant taxpayer motions to dismiss without prejudice. *See Estate of Ming v. Commissioner*, 62 T.C. 519 (1974). On the other hand, Judge Copeland reasoned that, where the Tax Court's jurisdiction has been expanded, taxpayer motions to dismiss without prejudice have been allowed. See, e.g., *Wagner v. Commissioner*, 118 T.C. 330 (2002) (collection due process); *Davidson v. Commissioner*, 144 T.C. 273 (2015) (innocent spouse relief); *Jacobson v. Commissioner*, 148 T.C. 68 (2017) (whistleblower claim). Judge Copeland then looked to the Federal Rules of Civil Procedure for further guidance. The Federal Rules of Civil Procedure generally allow courts to grant motions to dismiss without prejudice unless dismissal would inflict "clear legal prejudice" on the non-moving party. Because the IRS consented to the dismissal, Judge Copeland determined that the IRS would not be harmed, and therefore granted the taxpayer's § 7345(e)(1) motion to dismiss without prejudice. Finally, Judge Copeland ruled that the IRS's prior summary judgment motion was moot and should be dismissed as well.

## XI. WITHHOLDING AND EXCISE TAXES

## XII. TAX LEGISLATION

### A. Enacted

## XIII. TRUSTS, ESTATES & GIFTS

### A. Gross Estate

### B. Deductions

### C. Gifts

### D. Trusts