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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I. ACCOUNTING

II. BUSINESS INCOME AND DEDUCTIONS

A. Income

B. Deductible Expenses versus Capitalization

C. Reasonable Compensation

D. Miscellaneous Deductions

E. Depreciation & Amortization

F. Credits

1. You can't "fuel" the IRS: cost of goods sold includes fuel excise taxes *net* of credits, not gross excise tax expenses. Growmark, Inc. v. Commissioner, 160 T.C. No. 11 (5/16/23). Readers will recall that taxpayers determine gross income under § 61(a)(3) by subtracting the cost of goods sold ("COGS") from gross inventory sales. *See* Reg. § 1.61-3(a) (stating in part that "'gross income' means the total sales, less the cost of goods sold"). *See also*

Reg. § 1.263A-1(e)(3)(ii)(L) (indirect COGS include taxes otherwise allowable as a deduction to the extent such taxes are attributable to labor, materials, supplies, equipment, land, or facilities used in production or resale activities). Although the genesis of this case involved fuel excise taxes, the ultimate dispute centered on a fundamental federal income tax question of first impression before the Tax Court. To wit, in determining COGS under § 263A, may taxpayers include their gross fuel excise tax expenses under § 4081, or may taxpayers include only their net fuel excise tax expenses after considering corresponding tax credits under § 6426? On its original federal income tax returns for the years in issue (2009 and 2010), the corporate taxpayer in this case included in COGS only its *net* fuel excise tax expenses under § 4081 (after accounting for credits under § 6426). Then, after an IRS audit, notice of deficiency, and Tax Court litigation over other issues (*see Growmark, Inc. v. Commissioner*, T.C. Memo. 2019-161), the only remaining dispute was whether the taxpayer should be allowed to include the gross amount of its fuel excise tax expenses under § 4081 in COGS without taking into account credits under § 6426. If the taxpayer were allowed to increase its COGS by the gross, as opposed to net, amount of its fuel excise tax expense, the taxpayer's overall deficiency for the years in issue would be less. The taxpayer supported its position with highly-technical arguments under the federal fuel excise tax and credit regime of §§ 4081 and 6426, including related federal income tax credits allowable under §§ 6427(e) and 34(a)(3). Essentially, the taxpayer argued that allowing only the net fuel excise tax as part of COGS "devalue[s]" the credit for taxpayers who claim the credit under § 6426 (as the taxpayer had) instead of § 6427(e) or § 34(a)(3). (We will not burden our readers—or ourselves—with a protracted discussion of the inner workings of the fuel excise tax and credit regime applicable to the taxpayer.) The IRS, of course, disagreed with the taxpayer, urging the Tax Court to follow the reasoning of three Court of Appeals decisions that were similar, but not identical, to the case at hand. *See Exxon Mobil Corp. v. United States*, 43 F.4th 424 (5th Cir. 2022); *Delek US Holdings, Inc. v. United States*, 32 F.4th 495 (6th Cir. 2022), *aff'g* 515 F. Supp. 3d 812 (M.D. Tenn. 2021); *Sunoco, Inc. v. United States*, 908 F.3d 710 (Fed. Cir. 2018), *aff'g* 129 Fed. Cl. 322 (2016). Judge Paris, who wrote the decision for the Tax Court, was persuaded by the IRS's arguments and the reasoning of the Court of Appeals decisions cited above. Judge Paris wrote, "the Court concludes that the words 'allowed as a credit against the tax imposed,' as used in section 6426, refer to a reduction of the tax liability [under § 4081] as opposed to an independent payment of the liability." The Tax Court also relied upon the legislative history of §§ 4081 and 6426 to support its analysis. Thus, in Judge Paris's opinion, only the net amount of the taxpayer's fuel excise tax expense under § 4081 (after offset by the credit under § 6426) is allowed to be taken into account as part of COGS under § 263A and Reg. § 1.263A-1(e)(3)(ii)(L).

G. Natural Resources Deductions & Credits

H. Loss Transactions, Bad Debts, and NOLs

I. At-Risk and Passive Activity Losses

III. INVESTMENT GAIN AND INCOME

A. Gains and Losses

1. The taxpayer's virtual currency assets may have been completely wiped out in 2020 with resulting losses, but this does not mean the government is estopped from taxing the taxpayer's gains realized in virtual currency transactions in earlier years. Kim v. Commissioner, T.C. Memo. 2023-91 (7/20/23). For the years 2013-2017, the IRS received information reports from Coinbase, a virtual currency exchange. They reported the proceeds of the taxpayer's transactions in various virtual currencies, including Bitcoin, Litecoin, and Etherium. The taxpayer timely filed federal income tax returns for 2013-2016 but reported no gains or losses from the virtual currency transactions. On his timely-filed 2018 income tax return, the taxpayer reported on Schedule D $18.6 million of gross proceeds from virtual currency transactions but reported a basis in the assets sold that resulted in a gain of $42,069. The IRS audited the taxpayer's 2013-2017 returns and, when the taxpayer did not supply a computation of his gains and losses from virtual currency transactions, the revenue agent used records from Coinbase to reconstruct them using a first-in, first-out method. Based on these calculations, the revenue agent determined that the taxpayer had short-term capital gain of $75,400 for 2013, short-term capital gain of just over $4 million for 2017, and long-term capital gain of $74,565 for 2017. The IRS issued a notice of deficiency and, in response, the taxpayer filed a petition in the Tax Court. In the Tax Court, the taxpayer did not contest the amount or character of the gains calculated by the IRS. Rather, he argued that, in 2020, the virtual currency assets that produced these gains had been wiped out during the early stages of the COVID-19 pandemic, that he had been forced to liquidate his virtual currency positions with resulting large losses, and

> that the actions (or inaction) of the U.S. Government in response to the COVID epidemic "directly caused [that] harm" and that, "under the Clean Hands doctrine of US law," the IRS should be estopped from collecting tax on his 2013 and 2017 gains.

The Tax Court (Judge Lauber) ruled in favor of the government. The taxpayer's argument, the court stated, had no legal basis. The court observed that "[t]he doctrine of estoppel can be invoked against the United States only in the rarest of circumstances." Further, the "unclean hands" principle, the court concluded, did not apply because that principle withholds equitable relief from a party who has acted improperly, and the government in this case was not seeking equitable relief but rather was seeking to recover taxes due from the taxpayer under the Internal Revenue Code. Further, the court reasoned, the annual accounting principle "dictates that a taxpayer's income for a particular year be calculated on the basis of events occurring during that year." Although Congress has allowed corporations to carry capital losses both forward and back under § 1212(a)(1), it has chosen to allow individual taxpayers to carry capital losses realized in 2020 only forward, which means that losses the taxpayer might have realized in 2020 are irrelevant in determining his liabilities for 2013-2017.

B. Interest, Dividends, and Other Current Income

C. Profit-Seeking Individual Deductions

D. Section 121

E. Section 1031

F. Section 1033

G. Section 1035

H. Miscellaneous

IV. COMPENSATION ISSUES

A. Fringe Benefits

B. Qualified Deferred Compensation Plans

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

D. Individual Retirement Accounts

V. PERSONAL INCOME AND DEDUCTIONS

VI. CORPORATIONS

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**

G. **Miscellaneous**

1. Hot penalty relief for "hot asset" reporting by partnerships with respect to 2023 § 751(a) exchanges. Notice 2024-19, 2024-5 IRB 627 (1/11/24). This notice announces penalty relief under § 6722 (failure to furnish correct payee statements) for partnerships that missed the January 31, 2024, deadline for providing a copy of the recently revised IRS Form 8308 (Report of a Sale or Exchange of Certain Partnership Interests) to the transferor and transferee of a "751(a) exchange" occurring during calendar year 2023. Form 8308 is required to be filed as an attachment to a partnership's Form 1065 (U.S. Return of Partnership Income) for the taxable year of the partnership that includes the last day of the calendar year in which the "§ 751(a) exchange" took place. Form 8308 is due at the time for filing the partnership return, *including extensions*; however, Form 8308 was revised in October of 2023, and new Part IV of Form 8308 requires a partnership to report, among other items, the partnership's and the transferor partner's share of § 751 gain and loss, collectibles gain under § 1(h)(5), and unrecaptured § 1250 gain under § 1(h)(6). The newly released Part IV of Form 8308 prompted concerns from tax advisors that the affected partnerships might not have the information required by Part IV of Form 8308 by the January 31, 2024, due date. These concerns ultimately resulted in the penalty relief announced in Notice 2024-19. By way of background, a "751(a) exchange" within the meaning of the notice is defined as "a sale or exchange of an interest in the partnership (or portion thereof) in which any money or other property received by a transferor from a transferee in exchange for all or part of the transferor's interest in the partnership is attributable to § 751 property." As readers undoubtedly know, § 751 property of a partnership consists of so-called "hot assets" -- unrealized receivables or inventory items described in § 751(a). Code § 6050K and Reg. § 1.6050K-1 generally require a partnership with § 751 property to provide information to each transferor and transferee of a sale or exchange of an interest in the partnership (or portion thereof). The required information is contained in a properly completed IRS Form 8308, including Part IV thereof, which ordinarily should be attached to the partnership's Form 1065 for the year of the 751(a) exchange. Reg. § 1.6050K-1(c)(1) further provides that each partnership required to file a Form 8308 must furnish a statement to the transferor and transferee by the later of (a) January 31 of the year following the calendar year in which the § 751(a) exchange occurred, or (b) 30 days after the partnership has received notice of the exchange as specified under Code § 6050K and Reg. § 1.6050K-1. A partnership must use a copy of the completed Form 8308 as the required statement unless the Form 8308 contains information for more than one § 751(a) exchange. Reg. § 1.6050K-1(c)(1) provides that if the partnership does not use a copy of the Form 8308 as the required statement, the partnership must furnish a statement that includes the information required to be shown on the Form 8308 with respect to the § 751(a) exchange to which the person to whom the statement is furnished is a party. Subject to a reasonable cause exception in § 6724, Code § 6722 imposes a penalty for failure to furnish correct payee statements on or before the required date, and for any failure to include the information required to be shown on the statement or the inclusion of incorrect information. For this purpose, "payee statements" include statements required to be furnished to transferors and transferees under § 6050K. *See* § 6724(d)(2)(P). The penalty relief from § 6722 announced in Notice 2024-19 is subject to certain conditions as follows:

- The relief only applies to failure to timely furnish a copy of the Form 8308 (or the required information contained therein) to the transferor and transferee as required by § 6722. The notice does not provide penalty relief under § 6721 for failure to timely file Form 8308 as an attachment to a partnership's Form 1065.

- The relief applies solely for failure to furnish Form 8308 with a completed Part IV by the due date specified in § 1.6050K-1(c)(1) for a partnership that (1) timely and correctly furnishes to the transferor and transferee a copy of Parts I, II, and III of Form 8308, or a statement that includes the same information, by the later of (a) January 31, 2024, or (b) 30 days after the partnership is notified of the § 751(a) exchange, and (2) furnishes to the transferor and transferee a copy of the complete Form 8308, including Part IV, or a statement that includes the same information and any additional information required under Reg. § 1.6050K-1(c), by the later of (a) the due date of the partnership's Form 1065 (including extensions), or (b) 30 days after the partnership is notified of the § 751(a) exchange.

VIII. TAX SHELTERS

IX. EXEMPT ORGANIZATIONS AND CHARITABLE GIVING

A. Exempt Organizations

B. Charitable Giving

1. After 2022, syndicated conservation easements are on life support if not DOA. A well-hidden provision of the SECURE 2.0 Act, Division T, Title VI, § 605 of the Consolidated Appropriations Act, 2023, amended Code § 170(h) to add a new subsection (7) severely restricting charitable deductions for "qualified conservation contributions" by partnerships, S corporations, and other pass-through entities. "Qualified conservation contributions" are defined by § 170(h)(1) to include (but are not limited to) conservation easements granted to charitable organizations in connection with syndicated conservation easements. As described in Notice 2017-10, 2017-4 I.R.B. 544, a typical syndicated conservation easement involves a promoter offering prospective investors the possibility of a charitable contribution deduction in exchange for investing in a partnership. The partnership subsequently grants a conservation easement to a qualified charity, allowing the investing partners to claim a charitable contribution deduction under § 170.

New "2.5 times" proportionate outside basis rule will limit the charitable deduction for conservation contributions by pass-through entities. New § 170(h)(7)(A) generally provides that a partner's charitable contribution deduction for a qualified conservation contribution by a partnership (whether via a direct contribution or as an allocable share from a lower-tier partnership) cannot exceed "2.5 times the sum of [such] partner's relevant basis" in the partnership. The term "relevant basis" is defined by new § 170(h)(7)(B)(i) to mean that portion of a partner's "modified basis" which is allocable (under rules similar to those used under § 755) to the real property comprising the qualified conservation contribution. "Modified basis" (defined in § 170(h)(7)(B)(ii)) essentially refers to a partner's outside basis exclusive of the partner's share of partnership liabilities under § 752. Thus, reading between the lines and subject to further guidance, relevant basis appears to equate to an investor's cash investment (a/k/a initial tax and book capital account) in a syndicated conservation easement partnership. Many syndicated conservation easement partnerships claim that investors may secure a charitable deduction that is five times their cash investment. New § 170(h)(7)(A) thus limits the charitable deduction to "2.5 times" an investor's cash contribution, making a syndicated conservation easement much less attractive. New § 170(h)(7) also contains three exceptions: (i) partnerships making conservation easement contributions after a three-year holding period applicable at the partnership- and partner-level, including through tiered partnerships; (ii) "family partnerships" (as defined) making conservation easement contributions; and (iii) partnerships making conservation easement contributions relating to historic structures. *See* IRC §§ 170(f)(19), 170(h)(7)(C)-(E). Moreover, new § 170(h)(7)(F) authorizes Treasury to issue regulations applying similar rules to S corporations and other pass-through entities. Related provisions of the legislation make dovetailing amendments to (i) § 170(f) (charitable contribution substantiation and reporting requirements); (ii) §§ 6662 and 6664 (underpayment penalties attributable to valuation misstatements); (iii) § 6011 (reportable transactions); and (vi) §§ 6235 and 6501 (statute of limitations). New § 170(h)(7) applies to qualified conservation contributions made by partnerships and other pass-through entities after December 29, 2022.

Some welcome news for non-syndicated conservation easement donors? In an uncodified provision (*see* § 605(d)), the legislation directs Treasury to publish "safe harbor deed language for extinguishment clauses and boundary line adjustments" relating to qualified conservation contributions (whether via partnerships or otherwise). Treasury is directed to publish such safe harbor deed language within 120 days of the date of enactment of new § 170(h)(7) (i.e., by April 28, 2023), and donors have 90 days after publication of the safe harbor language to execute and file corrective deeds. This special, uncodified relief provision seems to be targeted toward donors like those who lost battles with the IRS over highly technical language in their conservation easement deeds. *See Oakbrook Land Holdings LLC v. Commissioner*, 154 T.C. 180 (5/12/20) (deed's extinguishment clause violated the proportionate benefit rule), *aff'd*, 28 F.4th 700 (6th Cir. 3/14/22), and *Pine Mountain Preserve, LLLP v. Commissioner*, T.C. Memo. 2018-214 (12/27/18) (deed improperly allowed substituted property), *rev'd in part, aff'd in part, and vacated and remanded*, 978 F.3d 1200 (5th Cir. 10/22/20). Importantly, however, the foregoing uncodified relief provision does not apply to syndicated conservation easements as described in Notice 2017-10 or to conservation easement cases (and related penalty disputes) docketed in the federal courts before the date a corrective deed is filed.

a. Safe harbor conservation easement deed language published by the IRS with a short (now passed) deadline to file amended deeds. Notice 2023-30, 2023-17 I.R.B. 766 (4/10/23). As directed by Congress, the IRS has published safe harbor deed language for extinguishment and boundary line adjustment clauses relating to conservation easements.

Extinguishment Clauses. *Section 1.04* of the notice sets forth the IRS's litigating position with respect to extinguishment clauses in conservation easement deeds. The IRS's litigating position is that, upon destruction or condemnation of conservation easement property and the collection of any proceeds therefrom, Reg. § 1.170A-14(g)(6)(ii) (the "extinguishment regulation") requires the charitable donee to share in the proceeds according to a "proportionate benefit fraction" set forth in the conservation easement deed. (Keep in mind, however, that the validity of the extinguishment regulation has been called into question. The Eleventh and Sixth Circuits have reached opposite conclusions regarding whether Treasury and the IRS complied with the Administrative Procedures Act in promulgating the regulation. *Compare Hewitt v. Commissioner*, 21 F.4th 1336 (11th Cir. 12/29/21) (extinguishment regulation invalid) *with Oakbrook Land Holdings, LLC v. Commissioner*, 28 F.4th 700 (6th Cir. 3/14/22) (extinguishment regulation valid). Thus far, the Supreme Court of the United States has declined to resolve the circuit split. See *Oakbrook Land Holdings, LLC v. Commissoner*, ___ U.S. ___, 143 S. Ct. 626 (1/9/2023).) The IRS's view of the allowed language in the conservation easement deed has been fairly narrow, requiring that the proportionate benefit fraction be fixed and unalterable *as of the date of the donation* according to the following ratio: the value of the conservation easement as compared to the total value of the property subject to the conservation easement. Therefore, according to the IRS and as upheld by several court decisions, if the conservation easement deed either (i) allows the donor to reclaim from the charitable donee any portion of the donated conservation easement property in exchange for substitute property of equivalent value or (ii) grants the donor credit for the fair market value of subsequent improvements to the donated conservation easement property, the proportionate benefit fraction language in the deed is flawed and the charitable deduction must be disallowed. *See, e.g., Pine Mountain Preserve, LLLP v. Commissioner*, 151 T.C. 247 (2018), including its companion case, *Pine Mountain Preserve, LLLP v. Commissioner*, T.C. Memo. 2018-214 (deed allowed substituted property), *aff'd in part, vac'd in part, rev'd in part*, 978 F.3d 1200 (11th Cir.

2020); *PBBM Rose Hill, Ltd. v. Commissioner*, 900 F.3d 193 (2018) (deed reduced charitable donee's benefit for subsequent improvements made by taxpayer donor); *Coal Property Holdings, LLC v. Commissioner*, 153 T.C. 126 (2019). *Section 4.01* of Notice 2023-30 then sets forth what the IRS considers acceptable language regarding the proportionate benefit fraction as is relates to extinguishment clauses in conservation easement deeds.

Boundary Line Adjustment Clauses. *Section 4.02* of Notice 2023-30 provides sample boundary line adjustment clause language. Unlike the background discussion relating extinguishment clauses in conservation easement deeds, the notice does not explain why Congress determined that the IRS should publish sample boundary line adjustment clause language. The IRS acknowledges in Notice 2023-30 that "[n]either the Code nor the regulations specifically address boundary line adjustments."

Amendments. Section 3 of the Notice sets forth the process and timeline for amending an original "flawed" (in the eyes of the IRS) conservation easement deed to adopt the IRS-approved proportionate benefit fraction or boundary line adjustment language. Corrective, amended deeds must be properly executed by the donor and the donee, must be recorded by July 24, 2023, and must relate back to the effective date of the original deed.

b. Proposed Regulations Issued. REG–112916–23, Statutory Disallowance of Deductions for Certain Qualified Conservation Contributions Made by Partnerships and S Corporations, 88 F.R. 80910 (11/20/23). The Treasury Department and the IRS have issued proposed regulations under amended Code § 170(h)(7) and the related information reporting rule of Code § 170(f)(19). The proposed regulations affect partnerships and S corporations that claim qualified conservation contributions, and partners and S corporation shareholders that receive a distributive share or pro rata share, as applicable, of a noncash charitable contribution. More specifically, the proposed regulations provide further guidance regarding the statutory disallowance rule of § 170(h)(7), including definitions, appropriate methods to calculate the "relevant basis" of a partner or an S corporation shareholder, the three statutory exceptions, and related reporting requirements. In addition, the proposed regulations provide new requirements for partners and S corporation shareholders that receive a distributive share or pro rata share of any noncash charitable contribution made by a partnership or S corporation, regardless of whether the contribution is a qualified conservation contribution (and regardless of whether the contribution is of real property or other noncash property). The substantive portions of the proposed regulations relating primarily to § 170(h)(7) (§§ 1.170A–14(j) through (n), 1.706–3, and 1.706–4) are proposed to apply retroactively to contributions made after December 29, 2022 (because the regulations were issued within 18 months of the enactment of Code § 170(h)(7)). *See* IRC § 7805(b)(1)-(2) (promptly issued regulations). Other provisions of the proposed regulations relating to more general reporting requirements for noncash contributions of partnerships and S corporations (§ 1.170A–16) are proposed to apply after the date of publication (November 20, 2023).

X. TAX PROCEDURE

A. Interest, Penalties, and Prosecutions

1. Tax Court holds IRS does not need written supervisory approval to apply the 6% excise tax of § 4973 to excess contributions to an IRA. Couturier v. Commissioner, T.C. Memo. 2024-6 (1/17/24). In general, under § 7491(c), the IRS has the burden of production with respect to "any penalty, addition to tax, or additional amount." To satisfy this burden, § 6751(b)(1) requires the IRS to prove that "the initial determination of [the] assessment … [of any penalty was] personally approved (in writing) by the immediate supervisor of the individual making such determination." *See, e.g., Frost v. Commissioner*, 154 T.C. 23, 34-35 (2020). Pursuant to § 6751(c), the term "penalties" as used in § 6571 includes "any addition to tax or any additional amount."

In this case, the taxpayer, a corporate executive, participated in several deferred compensation arrangements. These included shares in an employee stock ownership plan (ESOP) (a qualified retirement plan) and several compensatory plans, none of which was a qualified plan. In 2004, as part of a corporate reorganization, the taxpayer accepted a $26 million buyout from his company, which took the form of a $12 million cash payment to the taxpayer's IRA and a $14 million promissory note payable to his IRA, which the company satisfied in 2005. On his 2004 federal income tax return, he characterized the $26 million as a tax-free "rollover contribution" to his IRA. He left blank line 59, "Additional tax on IRAs, other qualified retirement plans, etc." Similarly, he filed his tax returns for 2005 through 2014 leaving blank line 59. He also did not attach to any of his returns Form 5329, "Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts."

The IRS audited the taxpayer and ultimately issued two notices of deficiency, one for 2004 through 2008 and another for 2019 through 2014. The IRS asserted that, of the $26 million contributed to the taxpayer's IRA, $25.1 million was attributable to his relinquishment of his rights in the non-ESOP deferred compensation plans, which were not eligible for treatment as a tax-free rollover. The IRS's position in the notices of deficiency was that this $25.1 million was an "excess contribution" subject to the 6% excise tax of § 4973(a). Further, under § 4973(b)(2), the excise tax continues to apply for future years until the original excess contribution is distributed to the taxpayer and included in income. Therefore, according to the IRS, the taxpayer owed for the years involved an excise tax in the aggregate amount of approximately $8.5 million. In response to the notices of deficiency, the taxpayer petitioned the Tax Court. He subsequently filed an amended petition in which he argued that the 6% excise tax imposed by § 4973(a) is a penalty subject to the supervisory approval requirement of § 6751(b)(1) and that the IRS was precluded from assessing the penalty because it had failed to comply with the supervisory approval requirement. In the Tax Court, the IRS moved for partial summary judgment and argued that the exaction imposed by § 4973(a) is a "tax" and not a "penalty" and that the supervisory approval requirement of § 6751(b)(1) therefore did not apply.

The Tax Court (Judge Lauber) held that the § 4973(a) exaction is a "tax" and not a "penalty." Because it is a "tax," the court held, it is not subject to the § 6751(b)(1) written supervisory approval requirement. In reaching this conclusion, Judge Lauber relied primarily on the language of § 4973. He noted that the flush language of § 4973(a) refers to the exaction four times and describes it in each case as a "tax." The term "penalty," Judge Lauber observed, "appears nowhere in section 4973(a) or in any of the provision's other six subsections." The court further relied on the placement of § 4973 in the Code. Congress placed § 4973 in Subtitle D, chapter 43 of the Code. Subtitle D, the court pointed out, is captioned "Miscellaneous Excise Taxes" and chapter 43, captioned "Qualified Pension, Etc., Plans," contains 18 Code sections that impose excise taxes on various actions. The court emphasized that, in several prior decisions, it had "held that an exaction constitutes a tax where Congress used the term 'tax' in the Code provision imposing it and situated that provision in a chapter of the Code that provides for 'taxes.' *See, e.g., Grajales v. Commissioner*, 156 T.C. 55 (2021) (holding that the 'additional tax' imposed by section 72(t) is a 'tax' and not a 'penalty' for section 6751(b) purposes), *aff'd*, 47 F.4th 58 (2d Cir. 2022)." In contrast, the court noted, Congress has generally situated penalties in Subtitle F of the Code, captioned "Procedure and Administration." The court also reviewed the legislative history of § 4973 and prior judicial decisions in which a taxpayer's failure file Form 5329 to report the exaction imposed by § 4973 had resulted in an "addition to tax" under § 6651(a)(1) for failure to timely file a return or under § 6651(a)(2) for failure to timely pay tax. "These precedents show that the exaction imposed by section 4973 is "a tax"; otherwise, no "additions to the tax" could have been sustained. No provision of the Code authorizes the imposition of "additions to the tax" with respect to penalties." Finally, the court emphasized that interpreting the exaction imposed by § 4973(a) as a tax is supported by common sense. Congress's purpose in enacting § 6751(b), the court stated, was to help ensure that IRS revenue agents did not threaten penalties to induce taxpayers to settle. A revenue agent, the court observed, could not plausibly assert an excise tax under § 4973(a) at the conclusion of an income tax audit to induce settlement. The court rejected the taxpayer's arguments that (1) in determining whether an exaction is a penalty, the court should look past the statutory text and engage in a functional analysis that treats as penalties all exactions that function as penalties, i.e., that are punitive in nature, (2) the placement of provisions such as § 4973 in the Code is irrelevant in determining whether they impose a penalty because § 7806(b) provides that "[n]o inference, implication, or presumption of legislative construction shall be...made by reason of the location...of any particular [Code] section," and (3) the exaction imposed by § 4973 is an "additional amount" within the meaning of § 6751(c) and therefore a penalty within the meaning of § 6751(b)(1). Accordingly, the court granted the IRS's motion for summary judgment on the issue of whether the supervisory approval requirement of § 6751(b)(1) applied.

B. Discovery: Summonses and FOIA

C. Litigation Costs

D. Statutory Notice of Deficiency

E. Statute of Limitations

1. The limitations period for the IRS to assess the 6% excise tax imposed by § 4973(a) on excess contributions to an IRA is six years if the taxpayer does not file Form 5329, but only for returns filed on or after December 29, 2022. For returns filed before that date without Form 5329, the limitations period never begins to run. Couturier v. Commissioner, 162 T.C. No. 4 (2/28/24) (reviewed). In this case, the taxpayer, a corporate executive, participated in several deferred compensation arrangements. These included shares in an employee stock ownership plan (ESOP) (a qualified retirement plan) and several compensatory plans, none of which was a qualified plan. In 2004, as part of a corporate reorganization, the taxpayer accepted a $26 million buyout from his company, which took the form of a $12 million cash payment to the taxpayer's IRA and a $14 million promissory note payable to his IRA, which the company satisfied in 2005. On his 2004 federal income tax return, he characterized the $26 million as a tax-free "rollover contribution" to his IRA. He left blank line 59, "Additional tax on IRAs, other qualified retirement plans, etc." Similarly, he filed his tax returns for 2005 through 2014 leaving blank line 59. He also did not attach to any of his returns Form 5329, "Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts."

The IRS audited the taxpayer and ultimately issued two notices of deficiency, one for 2004 through 2008 and another for 2019 through 2014. The IRS asserted that, of the $26 million contributed to the taxpayer's IRA, $25.1 million was attributable to his relinquishment of his rights in the non-ESOP deferred compensation plans, which were not eligible for treatment as a tax-free rollover. The IRS's position in the notices of deficiency was that this $25.1 million was an "excess contribution" subject to the 6% excise tax of § 4973(a). Further, under § 4973(b)(2), the excise tax continues to apply for future years until the original excess contribution is distributed to the taxpayer and included in income. Therefore, according to the IRS, the taxpayer owed for the years involved an excise tax in the aggregate amount of approximately $8.5 million. The IRS issued the two notices of deficiency on June 16, 2016. In response to the notices of deficiency, the taxpayer petitioned the Tax Court.

The taxpayer filed a motion for summary judgment in which he argued that the period of limitations during which the IRS could assess the excise tax imposed by § 4973(a) had expired for the years 2004-2008 before the IRS issued the notice of deficiency for those years on June 16, 2016. (The taxpayer did not challenge the timeliness of the notice of deficiency for the years 2009-2014.)

Section 6501(a) provides that, subject to various exceptions, any tax imposed must be assessed within three years after the return was filed. For this purpose, § 6501(a) provides that "the term 'return' means the return required to be filed by the taxpayer." If the taxpayer does not file a return, then pursuant to § 6501(c)(3), the tax may be assessed at any time, i.e., there is no limitations period on the IRS's assessment of the tax. In prior decisions, the Tax Court had held that the limitations period for the IRS to assess the excise tax imposed by § 4973(a) begins to run only if the taxpayer files a return that includes sufficient information for the IRS to determine the taxpayer's liability for the excise tax. Specifically, the Tax Court previously had held that a taxpayer's filing of a return on Form 1040 does not start the running of the limitations period for the IRS to assess the § 4973(a) excise tax unless the taxpayer files Form 5329, "Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts," or provides the required information elsewhere on Form 1040. *Paschall v. Commissioner*, 137 T.C. 8, 16 (2011); *Mazzei v. Commissioner*, 150 T.C. 138, 149 n.15 (2018), *rev'd on other grounds*, 998 F.3d 1041 (9th Cir. 2021).

Section 6501(*l*)(4), enacted in 2022 as part of the Consolidated Appropriations Act, 2023, Pub. L. No. 117-328, provides:

> (A) For purposes of any tax imposed by section 4973 or 4974 in connection with an individual retirement plan, the return referred to in this section shall include the income tax return filed by the person on whom the tax under such section is imposed for the year in which the act (or failure to act) giving rise to the liability for such tax occurred.
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> …
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> (C) In any case in which the return with respect to a tax imposed by section 4973 is the individual's income tax return for purposes of this section, subsection (a) shall be applied by substituting a 6-year period in lieu of the 3-year period otherwise referred to in such subsection.

The effect of § 6501(*l*)(4) is that a three-year limitations period applies if the taxpayer files Form 5329, but a six-year limitations period will apply if the taxpayer files a return on Form 1040 but fails to attach Form 5329. When Congress enacted § 6501(*l*)(4), it specified that the amendment "shall take effect on the date of the enactment of this Act," which was December 29, 2022.

The question before the court was whether § 6501(*l*)(4) applied retroactively. The taxpayer filed timely returns on Form 1040 for the years 2004-2008 but, as discussed earlier, failed to attach Form 5329 to any of the returns. If § 6501(*l*)(4) applied retroactively, then the IRS had six years from the date of filing within which to assess the § 4973(a) excise tax and the notice of deficiency for 2004-2008, issued on June 16, 2016, was untimely.

In a reviewed opinion (7-5-2) by Judge Lauber (joined by Judges Kerrigan, Nega, Pugh, Ashford, Copeland, and Weller), the Tax Court held that § 6501(*l*)(4) applies prospectively only and therefore did not bar the IRS's assessment of the § 4973(a) excise tax for the taxpayer's 2004-2008 taxable years. In reaching this conclusion, the court rejected the taxpayer's argument that Congress intended § 6501(*l*)(4) to apply to all disputes pending with the IRS as of the date of enactment. When Congress had previously amended § 6501 to apply to returns filed before the date of enactment, the court observed, it had said so explicitly in the relevant effective date provision. Congress failed to do so in this instance. The most natural reading of the effective date provision for § 6501(*l*)(4), the court held, was that the new rule applies to returns filed on or after the effective date of December 29, 2022:

> In short, section 6501(*l*)(4) specifies the consequences of filing tax returns. Because Congress provided that this amendment "shall take effect on the date of the enactment," we think the amendment is logically read to apply to tax returns filed on or after the date of enactment.

Nevertheless, the court assumed for the sake of argument that the effective date provision was ambiguous and considered whether application of § 6501(*l*)(4) as the taxpayer proposed would have a retroactive effect. A statute has retroactive effect, the court stated, "if it 'would impair rights a party possessed when he acted.'" 162 T.C. No. 4, at 11 (quoting *Landgraf v. USI Film Products*, 511 U.S. 244, 280 (1994)). If a statute would have retroactive effect, the court observed, a court must determine whether "clear congressional intent" militates in favor of retroactive application. In making this determination, a court must apply a presumption that Congress did not intend for a statute to apply retroactively if the statute affects substantive rights because doing so "would contravene principles of fair notice, reasonable reliance, and settled expectations." In this case, the court held, the taxpayer's interpretation of § 6501(*l*)(4) would have retroactive effect and the presumption against retroactivity applied because applying the statute retroactively would alter the IRS's substantive rights to assess tax. When the IRS issued the notice of deficiency for 2004-2008 on June 16, 2016, the court noted, the notice was timely because, under the Tax Court's existing interpretation of § 6501, the taxpayer's failure to file Form 5329 meant that the limitations period on assessment never began to run. Further, pursuant to § 6503, the taxpayer's filing of a Tax Court petition suspended the running of the limitations period on assessment until 60 days after the Tax Court's decision became final. Applying § 6501(*l*)(4) as the taxpayer proposed, the court concluded, would contravene principles of fair notice, reasonable reliance, and settled expectations.

In summary, the court held that § 6501(*l*)(4) applies prospectively only and therefore did not bar the IRS's assessment of the § 4973(a) excise tax for the taxpayer's 2004-2008 taxable years.

Concurring opinion of Judge Toro. In a very lengthy concurring opinion, Judge Toro (joined by Judge Greaves and joined in part by Judges Buch and Urda) concurred in the result but heavily criticized the court's opinion. In Judge Toro's view, § 6501(*l*)(4) focuses on assessment of tax and can apply to returns filed before December 29, 2022, the date of enactment. Judge Toro concluded:

> Under my reading of section 313(b) of the Act, the Commissioner no longer possesses the authority to assess any taxes imposed by section 4973 if the taxpayer filed an income tax return more than six years ago (or was not required to file such a return, as provided in section 6501(l)(4)(B)) and a notice of deficiency with respect to those taxes is not issued within the six-year period (or the three-year period, for a taxpayer who was not required to file an income tax return). As relevant here, the only exception to this rule is for taxpayers (like Mr. Couturier) to whom notices of deficiency were already issued before December 29, 2022, and whose circumstances are governed by section 6503(a)(1).

Dissenting opinion of Judge Foley. In a brief dissenting opinion, Judge Foley (joined by Judge Marshall) argued that, because § 6501(*l*)(4) became effective on December 29, 2022, the IRS was required to send a notice of deficiency within six years after the taxpayer filed his returns for 2004-2008. Because the IRS failed to do so, he argued, the court should grant the taxpayer's motion for summary judgment.

F. Liens and Collections

G. Innocent Spouse

H. Miscellaneous

1. As grandpa said, "The more things change, the more they stay the same."

Ann. 2023-11, 2023-17 I.R.B. 798 (4/10/23). The IRS begrudgingly announces Treasury's issuance of proposed regulations, REG–109309–22, Micro-Captive Listed Transactions and Micro-Captive Transactions of Interest, 88 F.R. 21547 (4/11/23), "re-identifying" certain micro-captive insurance arrangements as "listed transactions" under §§ 6111 and 6112. For background, see below.

Background. Previously, both the Sixth Circuit and the Tax Court invalidated certain IRS notices that identified specific transactions as "listed transaction" under §§ 6111 and 6112. Both courts held that the IRS failed to comply with the Administrative Procedures Act ("APA") when issuing the notices in dispute. The Sixth Circuit, in Mann Construction, Inc. v. United States, 27 F.4th 1138 (6th Cir. 3/3/22), invalidated Notice 2007-83, 2007-2 C.B. 960, relating to cash value life insurance trust arrangements. The Tax Court, in Green Valley Investors, LLC v. Commissioner, 159 T.C. No. 5 (11/9/22), invalidated Notice 2017-10, 2017-4 I.R.B. 544, relating to syndicated conservation easements. *Green Valley Investors* was particularly troublesome for the IRS because it was a Tax Court decision and undercut the IRS's longstanding battle against syndicated conservation easement transactions. In response to the Tax Court's holding in *Green Valley Investors*, Treasury issued proposed regulations (complying with the APA) to "re-identify" syndicated conservation easement transactions as "listed transactions." *See* REG-106134-22, Syndicated Conservation Easements as Listed Transactions, 87 F.R. 75185 (12/8/2022). For further discussion, see Bruce A. McGovern and Cassady V. ("Cass") Brewer, *Recent Developments in Federal Income Taxation: The Year 2022*, 76 Tax Law. 645 (2023).

The impetus for Ann. 2023-11. Meanwhile, in *CIC Services, LLC v. IRS*, 592 F.Supp.3d 677 (E.D. Tenn 3/21/22), a federal district court within the Sixth Circuit invalidated Notice 2016-66, 2016-47 I.R.B. 745, relating to the identification of certain micro-captive insurance arrangements as "listed transactions." Consequently, as announced in Ann. 2023-11, Treasury has responded to the district court's holding in *CIC Services*, LLC by issuing proposed regulations "re-identifying" certain micro-captive insurance arrangements as "listed transactions." *See* REG–109309–22, Micro-Captive Listed Transactions and Micro-Captive Transactions of Interest, 88 F.R. 21547 (4/11/2023). Ann. 2023-11 also states, though, that Treasury and the IRS continue to "disagree with the recent court decisions holding that listed transactions cannot be identified by notice or other subregulatory guidance." Thus, we likely have not heard the last of this dispute concerning APA requirements and IRS "listed transaction" notices.

2. Anti-abuse judicial doctrines create confusion and headaches for everybody. GSS Holdings (Liberty) Inc. v. United States, 81 F.4th 1378 (Fed. Cir. 9/21/23), vacating and remanding 154 Fed. Cl. 481 (2021). This somewhat esoteric 2-1 opinion from the Court of Appeals for the Federal Circuit vacating a decision by the Claims Court and remanding the case for further proceedings is not, in our opinion, a "must read" for tax advisors. In fact, we are unsure whether a firm conclusion can be drawn from the court's opinion. The case concerns whether the Claims Court conflated and therefore misapplied the judicially created economic substance and step-transaction anti-abuse doctrines. If we count Judge Bruggink's Claims Court's opinion and the dissenting opinion of Judge Newman against the two-judge majority opinion of the Court of Appeals for the Federal Circuit, we have a tie. Perhaps, though, the case offers some lessons: one practical and one academic, as explained further below.

Facts: The background of the case is complicated, involving multiple parties entering numerous contracts and related financial transactions across tax years 2006 through 2011. The essential facts, though, concern 2011 and are as follows. The taxpayer, GSS Holdings (Liberty) Inc. was a member of a limited liability company treated as a partnership for federal income tax purposes. Under a contract originally executed by the LLC-partnership in 2006 but amended and closed in 2011, the LLC-partnership was compelled for financial and regulatory reasons to dispose of certain assets. The assets consisted of (i) a promissory note with a par value and basis higher than the note's fair market value plus (ii) cash that the LLC-partnership had to "rebate" to compensate the buyer for acquiring the devalued promissory note at its par value (instead of its fair market value). The total loss suffered by the LLC-partnership from the transaction with the buyer was approximately $22.5 million. The loss was allocated entirely to the taxpayer via the LLC-partnership. On the one hand, in the view of the IRS (and as originally reported by the LLC-partnership on its 2011 Form 1065), the loss derived from a § 165 sale or exchange of a capital asset (the promissory note, coupled with the rebate of cash) and because the loss arose from a sale or exchange with a related party, the loss must be disallowed under § 707(b)(1). On the other hand, in the view of the taxpayer (and as subsequently reported on an amended return and refund claim filed in 2013), the loss was ordinary and stemmed solely from the cash that the LLC-partnership had to "rebate" to the buyer in a transaction separate and distinct from the disposition of the promissory note. Thus, the fundamental dispute was whether the transaction with the buyer consisted of one sale of assets (a promissory note and the cash rebate) resulting in a disallowed capital loss or, instead, two separate transactions: a sale of the promissory note at par value (no gain or loss) and a separate, independent § 165 ordinary loss "rebate" of cash to the buyer. (Again, we could spend pages explaining the entire factual background and the reasons that the promissory note was acquired from the LLC-partnership by the buyer at its par value along with cash "rebated" to the buyer, but suffice it to say that the case involves complex financial transactions and relationships that are not critical to the appeals court's reversal of the lower court.)

Claims Court Decision: The Claims Court (Judge Bruggink) found for the IRS, denying the taxpayer's refund claim on the basis that the disposition of the promissory note and cash late in 2011 was a single sale or exchange transaction. Judge Bruggink reasoned that the disposition of the promissory note and the rebate of the cash were inextricably linked. Therefore, economic substance as well as the step transaction doctrine mandated sale or exchange treatment as argued by the IRS.

Federal Circuit Decision: The majority of the three-judge panel of the Court of Appeals for the Federal Circuit (Judges Cunningham and Reyna) disagreed, holding that Judge Bruggink of the Claims Court "erred by applying a hybrid legal standard that improperly conflated the step transaction doctrine and the economic substance doctrine." 81 F.4th at 1381. In the opinion of the majority, Judge Bruggink should not have mixed the economic substance and step transaction doctrines in his analysis. Instead, Judge Bruggink should have applied the so-called "end result" test (examining and collapsing a multi-step transaction from the outset based upon the intent of the taxpayer) of the step transaction doctrine by determining which was the first step of the transaction: 2006 (the date the contract originally was executed) or 2011 (when the contract was amended and the transaction closed)? Although the majority vacated Judge Bruggink's decision and remanded the case for further proceedings, Judge Cunningham's majority opinion also stated, "We are not suggesting any particular outcome; we are simply instructing the Claims Court to apply the correct legal standard." 81 F.4th at 1383.

Dissenting Opinion: The dissent, written by Judge Newman, would have upheld the Claims Court's decision. In Judge Newman's opinion, the economic substance and step transaction doctrines are subsumed by longstanding "substance over form" principles, so Judge Bruggink's analysis did not improperly conflate the two doctrines.

Practical Lesson—File Consistently: Yet again we see a case where a taxpayer took a position on an originally filed return followed by a different position taken on a subsequently filed amended return. An IRS audit and ensuing litigation almost seem certain when this happens.

Academic Lesson—What's the Law?: The traditional anti-abuse judicial doctrines (substance over form, economic substance, and step transaction) employed by the courts in some federal income tax cases do not have clear boundaries, and the decisions applying these doctrines are confusing. Predicting whether and how such doctrines apply to particular circumstances is all but impossible. To wit, the majority and dissenting opinions in *GSS Holdings (Liberty) Inc. v. United States* cited the same precedent as support for their differing analyses: *Falconwood Corp. v. United States*, 422 F.3d 1339 at 1349 (Fed. Cir. 2005) which, quoting an earlier case, states:

> The step transaction doctrine is a judicial manifestation of the more general tax law ideal that effect should be given to the substance, rather than the form, of a transaction, "by ignoring for tax purposes, steps of an integrated transaction that separately are without substance."

XI. WITHHOLDING AND EXCISE TAXES

A. <u>Employment Taxes</u>

B. Self-employment Taxes

C. Excise Taxes

XII. TAX LEGISLATION

A. Enacted