RECENT DEVELOPMENTS IN FEDERAL INCOME TAXATION

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

By

Bruce A. McGovern
Professor of Law and Director, Tax Clinic
South Texas College of Law Houston
Houston, Texas 77002
Tele: 713-646-2920
e-mail: bmcgovern@stcl.edu

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Note: This outline was prepared jointly with Cassady V. ("Cass") Brewer, Professor of Law Emeritus, Georgia State University College of Law, Atlanta, GA, and James M. Delaney, Centennial Distinguished Professor of Law at the University of Wyoming College of Law, Laramie, WY.

I. ACCOUNTING

II. BUSINESS INCOME AND DEDUCTIONS

A. Income

B. Deductible Expenses versus Capitalization

C. Reasonable Compensation

D. Miscellaneous Deductions

1. Standard mileage rates for 2025. Notice 2025-5, 2025-3 I.R.B. 426 (12/19/24). The standard mileage rate for business miles in 2025 goes up to 70 cents (from 67 cents in 2024) and the medical/moving rate is 21 cents per mile (unchanged from 2024). The charitable mileage rate remains fixed by § 170(i) at 14 cents. The portion of the business standard mileage rate treated as depreciation goes up to 33 cents per mile (from 30 cents in 2024). The maximum standard automobile cost may not exceed $61,200 (*down* from $62,000 in 2024) for passenger automobiles (including trucks and vans) for purposes of computing the allowance under a fixed and variable rate (FAVR) plan.

- The notice reminds taxpayers that (1) the business standard mileage rate cannot be used to claim an itemized deduction for unreimbursed employee travel expenses because, in the 2017 Tax Cuts and Jobs Act, Congress disallowed miscellaneous itemized deductions for 2025, and (2) the standard mileage rate for moving has limited applicability for the use of an automobile as part of a move during 2025 because, in the 2017 Tax Cuts and Jobs Act, Congress disallowed the deduction of moving expenses for 2025 (except for members of the military on active duty who move pursuant to military orders incident to a permanent change of station, who can still use the standard mileage rate for moving).

The following table summarizes the optional standard mileage rates:

Category	2023	2024	2025
Business miles	65.5 cents	67 cents	70 cents
Medical/moving	22 cents	21 cents	21 cents
Charitable mileage	14 cents	14 cents	14 cents

E. Depreciation & Amortization

F. Credits

G. Natural Resources Deductions & Credits

H. Loss Transactions, Bad Debts, and NOLs

I. At-Risk and Passive Activity Losses

III. INVESTMENT GAIN AND INCOME

IV. COMPENSATION ISSUES

V. PERSONAL INCOME AND DEDUCTIONS

VI. CORPORATIONS

VII. PARTNERSHIPS

A. Formation and Taxable Years

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

1. ♫♪ A long, long time ago . . . I can still remember how [those proposed recourse debt allocation regs] used to make me smile. ♪♫ T.D. 10014, Recourse Partnership Liabilities and Related Party Rules, 89 F.R. 95108 (12/2/24). Perhaps anticipating a pending regulatory freeze under the new administration, Treasury and the IRS have finalized amendments to regulations under § 752 concerning partnership recourse liabilities. Proposed regulations were published way back in 2013. *See* REG-136982-12, 78 F.R. 76092 (12/16/13). The now-final amendments primarily make technical changes and corrections to existing regulations concerning the § 752 economic risk of loss analysis for allocating recourse debt among partners, including corresponding rules pertaining to tiered partnerships and related persons. The preamble to the newly-issued final regulations acknowledges Treasury's and the IRS's delay (and perhaps implicitly acknowledges the sudden urgency) in finalizing Reg. § 1.752-2, stating in part:

> The Treasury Department and the IRS are mindful that the proposed regulations were issued approximately eleven years ago. However, no intervening legislative changes regarding allocations of partnership liabilities have been made, no subsequent changes to regulatory rules concerning allocations of partnership liabilities address the issues in the proposed regulations, and the issues raised by the commenters continue to remain relevant. For these reasons, the Treasury Department and the IRS have determined that a new notice of proposed rulemaking or a further opportunity for public comment would be unlikely to generate different comments. *Furthermore, issuing the same rules again as a notice of proposed rulemaking would unnecessarily delay further this rulemaking to the continued detriment of taxpayers desiring to apply these rules to allocate their partnership liabilities*.

89 F.R. at 95109 (emphasis added).

Brief background. Generally, of course, subchapter K requires partnerships and partners to take into account liabilities in determining outside basis and for certain other purposes. For instance, § 752 operates in tandem with §§ 722 and 733 to adjust a partner's outside basis up or down, respectively, for an increase or decrease, respectively, in the partner's share of partnership liabilities. Reg. § 1.752-1(a)(4) defines liabilities for this purpose in existing Reg. § 1.752-1(a)(4) as obligations that (i) create or increase the basis of any of the obligor's assets (including cash); (ii) give rise to an immediate deduction to the obligor; or (iii) give rise to an expense that is not deductible in computing the obligor's taxable income and is not properly chargeable to capital. Traditional bank debt is a classic "liability" that partnerships and partners must take into account for outside basis and other purposes under subchapter K. Furthermore, a partner's share of a partnership's liabilities under subchapter K depends upon whether the liability is recourse or nonrecourse for federal income tax purposes. A "recourse" liability is one for which any partner or "related person" (as defined) bears an "economic risk of loss" ("EROL," as defined), while a "nonrecourse" liability is one for which no partner or "related person" (as defined) bears an EROL. *See* Reg. § 1.752-1(a)(1) & (2).

Final regulations. The final regulations reiterate the general rule (as discussed above) in the existing regulations: "[a] partner's share of recourse partnership liability equals the portion of that liability, if any, for which the partner or related person bears the economic risk of loss." Reg. § 1.752-2(a)(1). In other respects, the final regulations make only a few changes from the proposed regulations. The modifications in the final regulations are highly technical, responding to comments from only two practitioners. At face value, the modifications appear to be taxpayer-favorable (or at least taxpayer-neutral). We summarize below the most consequential—in our opinion—aspects of the final regulations: (i) correcting an oversight in the proposed regulations by listing in one section of the final regulations those situations where a person <u>directly</u> bears the EROL [Reg. § 1.752-2(a)(3)]; (ii) resolving overlapping EROL among multiple partners [Reg. § 1.752-2(a)(2)]; and (iii) providing a new ordering rule clarifying how the "proportionality rule" (discussed below) interacts with the multiple partner rule and related partner exception [Reg. § 1.752-4(e)]. The final regulations, like the proposed regulations, also provide guidance for determining EROL in tiered partnership structures (see Reg. § 1.752-2(i)) and in circumstances where partners are related to a lender or other person (or deemed not related à la *IPO II v. Commissioner*, 122 T.C. 295 (2004), due to the exception in Reg. § 1.752-4(b)(2)); however, we leave the detailed examination of those aspects of the regulations to our readers' discretion.

Reg. § 1.752-2(a)(3) comprehensive listing of situations where a person directly bears the EROL. As noted above, the final regulations correct what Treasury describes as an "oversight" in the proposed regulations by listing in one section the circumstances under which a person directly bears the EROL. Specifically, new Reg. § 1.752-2(a)(3) provides as follows to identify and define EROL for partnership recourse liabilities:

> For purposes of this section and § 1.752-4, a person directly bears the economic risk of loss for a partnership liability if that person has a payment obligation under [existing Reg. § 1.752–2(b)] (except as provided in [existing Reg. § 1.752–2(d)(2), de minimis exception] for certain partner guarantees), is a lender as provided in [existing § 1.752–2(c) (except as provided in [existing Reg. § 1.752–2(d)(1), de minimis exception] for certain partner loans), guarantees payment of interest on a partnership nonrecourse liability as described in [existing Reg. § 1.752–2(e)], or pledges property as a security as provided in [existing Reg. § 1.752–2(h)].

Reg. § 1.752-2(a)(2) regarding overlapping EROL. Suppose partners bear overlapping EROL with respect to the same recourse liability. In that case, the final regulations (like the proposed regulations) take the liability into account only once, and if the total amount of EROL borne by the partners exceeds the total amount of the liability, the final regulations use the following formula to determine the share of such liability allocated to each partner for purposes of subchapter K: multiply (i) the total amount of the recourse liability by (ii) a fraction determined by dividing (a) the amount of a partner's EROL by (b) the sum of EROL borne by all partners.

> **Example:** A and B are unrelated equal members of limited liability company, AB. AB is treated as a partnership for Federal tax purposes. AB borrows $1,000 from Bank. A guarantees payment for the entire amount of AB's $1,000 liability, and B guarantees payment of up to $500 of the liability, if any amount of the full $1,000 liability is not recovered by Bank. Under [existing Reg. § 1.752-2(b)(1)], A bears $1,000 of economic risk of loss for AB's liability, and B bears $500 of economic risk of loss for AB's liability. A and B have not entered into a loss-sharing agreement addressing their status as co-guarantors, and local law does not clearly establish responsibility as between them for the liability. Because the aggregate amount of A's and B's economic risk of loss under [amended Reg. § 1.752-2(a)(1)] ($1,500) exceeds the amount of AB's liability ($1,000), the economic risk of loss borne by each of A and B is determined under [amended Reg. § 1.752-2(a)(2)]. Under [amended Reg. § 1.752-2(a)(2)], A's economic risk of loss equals $1,000

multiplied by $1,000/$1,500, or $667, and B's economic risk of loss equals $1,000 multiplied by $500/$1,500, or $333. *See* Reg. 1.752-2(f) Ex. 9.

Reg. § 1.752-4(e) ordering rule. Before amendments made by the final regulations, the proposed regulations under § 752 were unclear regarding the order in which the numerous rules therein apply to allocate liabilities for related and unrelated parties. In particular, the proportionality rule in Prop. Reg. § 1.752-2(a) addressed when partners have overlapping EROL, the related partner exception in Prop. Reg. § 1.752-4(b)(2) described when partners with direct EROL are not treated as related to other partners, and the multiple partner rule in Prop. Reg. § 1.752-4(b)(3) provided how EROL is shared when multiple partners are related to a person who is a lender or has a payment obligation. Treasury agreed with one commenter that the interaction of these rules was confusing. Accordingly, new Reg. § 1.752-4(e) provides a three-step ordering rule. The first step is to determine whether any partner (direct or indirect) directly bears the EROL (under amended Reg. § 1.752-2(a)(3)) for the partnership liability and then apply the related partner exception in Reg. § 1.752-4(b)(2) (which treats partners as unrelated in certain circumstances). After applying the related partner exception (if relevant), the next step is to determine the amount of EROL each partner is considered to bear under Reg. § 1.752-4(b)(3) when multiple partners are related to a person that directly bears the EROL for a partnership liability. The final step is to apply the proportionality rule in Reg. § 1.752-2(a)(2) to determine the amount of EROL that each partner is considered to bear when the amount of EROL that multiple partners bear exceeds the amount of the partnership liability. Reg. § 1.752-4(f) contains a helpful example illustrating the application of the new ordering rules.

Effective dates. Generally, the amendments made by the final regulations are effective as of the date of publication in the federal register (12/2/24). Commenters, though, had concerns, desiring under certain circumstances to apply the final regulations to pre-existing recourse liabilities and, in other circumstances, to grandfather modified or refinanced recourse debt under pre-amendment regulations. Treasury accommodated these commenters' concerns, providing a somewhat complicated effective date provision for pre-existing, modified, or refinanced recourse liabilities in Reg. § 1.752-5(a) (which, again, we leave to our readers' discretion).

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

VIII. TAX SHELTERS

IX. EXEMPT ORGANIZATIONS AND CHARITABLE GIVING

X. TAX PROCEDURE

A. Interest, Penalties, and Prosecutions

B. Discovery: Summonses and FOIA

C. Litigation Costs

D. Statutory Notice of Deficiency

E. Statute of Limitations

F. Liens and Collections

1. Third Circuit Holds the Tax Court has jurisdiction to review a taxpayer's tax liabilities regardless of the IRS's attempted use of refund offsets to moot the taxpayer's case. Zuch v. Commissioner, 97 F.4th 81 (3rd Cir. 3/22/24). In this case, in an opinion by Judge Jordan, the U.S. Court of Appeals for the Third Circuit vacated the Tax Court's decision to dismiss as moot the taxpayer's petition to review a determination by the IRS's Office of Appeals in a collection due process (CDP) hearing. The main issue was whether, during the course of a Tax Court proceeding, the IRS can deprive the Tax Court of jurisdiction by taking the taxpayer's refunds in later years and applying them to her tax liability in an earlier year that is the subject of the Tax Court proceeding.

Background on deficiency proceedings versus collection due process proceedings. This case is heavy on tax procedure leading us to include a brief review of the difference between Tax Court deficiency proceedings and CDP proceedings. With respect to a deficiency proceeding, when the IRS asserts that a taxpayer owes more than what was reflected on his or her tax return, the IRS will provide the taxpayer with a notice of deficiency. The taxpayer may then choose to file a petition in the Tax Court to dispute what they owe. If the Tax Court determines that the deficiency is less than the amount the taxpayer has paid, then pursuant to § 6512(b)(1), the court may order a refund of any overpayment. Alternatively, with respect to CDP proceedings, if a taxpayer does not pay the amount the IRS has calculated is due, the IRS may levy (seize and sell) a taxpayer's property. § 6331(a). However, prior to seizing and selling a taxpayer's property, the IRS must provide notice of its intent to levy and give the taxpayer 30 days to request a CDP hearing with IRS Appeals. § 6330(a)(3)(B). In a CDP hearing, a taxpayer may raise "any relevant issue relating to the ***unpaid tax*** or the proposed levy." § 6330(c)(2)(A). Further, a taxpayer may challenge the existence or amount of his or her underlying ***tax liability*** for any period if he or she did not receive any notice of deficiency for such liability or did not otherwise have an opportunity to dispute such tax liability. § 6330(c)(2)(B). In essence, if the taxpayer had no opportunity to commence a deficiency proceeding, the CDP hearing provides an opportunity to challenge the *unpaid tax*, the proposed levy, *and* the underlying ***tax liability***.

Background on unpaid tax versus tax liability. In this case, the Third Circuit examined the issue of and clarified the difference between "unpaid tax" and "tax liability." A tax liability is the "total amount of tax owed to the IRS after the allowance of any credits." Citing, *Tax Liability, West's Tax Law Dictionary* § T830. The court then gave a simple example to illustrate the difference: if a taxpayer owed $20 to the IRS and the taxpayer has already paid that $20, his or her tax liability is $0. Thus, a challenge by a taxpayer to an IRS determination of *tax liability* means the taxpayer disputes the IRS's determination of what he or she owes. § 6330(c)(2)(B). Alternatively, an issue relating to *unpaid tax* does not directly concern the amount or existence of the liability. § 6330(c)(2)(A). Rather, such an issue concerns the IRS's proposed collection activity. In this regard, the court provided a second example: if the IRS assesses $20 in taxes, then the unpaid tax is the $20 the IRS asserts is owed. However, in a further proceeding the amount of unpaid tax might change. Thus, if a CDP hearing establishes that a taxpayer should have been credited $5 toward the $20 balance, the taxpayer's unpaid tax becomes $15.

Facts. In 2010, the taxpayer and her then husband made a $20,000 estimated tax payment. The taxpayer filed for divorce later in 2010 and elected married-filing-separately status. In 2011, the taxpayer's ex-husband made an additional $30,000 estimated tax payment for the 2010 tax year. However, when the taxpayer and her ex-husband made both of these estimated payments, they did not specify how they wanted the IRS to apply the payments in relation to each of their separate tax liabilities. Thereafter, the IRS notified the taxpayer's ex-husband that it had applied all $50,000 of the estimated payments to the tax liability on the ex-husband's separate 2010 tax return. In 2012, the taxpayer amended her 2010 return to include additional income from a retirement distribution which resulted in $27,682 of additional tax due. In relation to this additional tax, the taxpayer claimed the benefit of the $50,000 of estimated tax payments that the IRS had applied to her ex-husband's separate 2010 tax return. However, the IRS did not credit the $50,000 of estimated tax payments to the taxpayer. Instead, the IRS took the position that the taxpayer still owed the $27,682 of additional tax. In 2013, the taxpayer's ex-husband amended his 2010 separate return and included a statement to the IRS that the $50,000 of estimated tax payments should be allocated to the taxpayer consistent with the taxpayer's 2010 request on her amended tax return. Instead of crediting the taxpayer, however, the IRS notified the ex-husband again that it had credited the full $50,000 to the ex-husband's account. In 2013, the IRS notified the taxpayer that it intended to levy on her property to collect unpaid tax.

In challenging the levy at the agency level, the taxpayer argued that she and her ex-husband had prepaid the tax that the IRS claimed was due in relation to her 2010 amended income tax return. The IRS Office of Appeals disagreed with the taxpayer and issued a notice of determination sustaining the levy. In September of 2014, the taxpayer challenged the notice of determination by filing a petition in the Tax Court. During the pendency of the Tax Court proceeding, the IRS withheld tax refunds that were owed to the taxpayer for the years between and including 2013 through 2019. The IRS applied the refunds to the taxpayer's 2010 liability until it was reduced to zero. With no unpaid tax remaining on the taxpayer's 2010 tax year upon which to execute a levy, the IRS moved for, and the Tax Court granted, dismissal of the case.

Third Circuit's analysis: credit set-offs. The court initially found that the taxpayer's claim was not moot because the IRS's set-offs were invalid. In general, the IRS must refund any tax payments in excess of a taxpayer's tax liability. IRC § 6402(a). The IRS is also allowed to apply a refund amount as a set-off against a taxpayer's unpaid tax. The IRS argued here that § 6512(b)(4) deprives the Tax Court of jurisdiction to review any reduction made by the IRS under § 6402 and that § 6512(b)(4) specifically blocks the Tax Court's jurisdiction to review set-offs and that this denial of jurisdiction extends to the Tax Court power to review set-offs in a CDP case. The court declined to agree with the IRS's argument, reasoning that, while Congress did not affirmatively grant the Tax Court power to review set-offs, it did implicitly grant the Tax Court authority to review set-offs in CDP cases. In coming to this conclusion, the court agreed with the Tax Court's finding that § 6402(a) contains a statutory counterpart to the common law right to offset. *Boyd v. Comm'r*, 124 T.C. 296, 300 (2005). The common law of set-offs provides for judicial review of a claim being raised as an offset of government debt. *Agility Pub. Warehousing Co. K.S.C.P. v. U.S.*, 969 F.3d 1355, 1365 (Fed. Cir. 2020). Because § 6402 continues the common law rules of set-offs, the Tax Court has the power to review set-offs in a CDP proceeding. Having concluded that the Tax Court may review set-offs, the court then held that the IRS violated common law when it offset the taxpayer's later refunds against her original 2010 tax liability. The court followed the reasoning of the U.S. Court of Appeals for the seventh Circuit, which indicated that set-offs are only allowed when debts are mutual. *Soo Line R.R. Co. v. Escanaba & Lake Superior R.R. Co*., 840 F.2d 546, 551 (7th Cir. 1988). Regardless of the fact that § 6402 allows the IRS to credit overpayments to "any liability" of the taxpayer, the court adopted the taxpayer's argument that she did not have any tax liability. The IRS cannot simply declare that a taxpayer does have a tax liability and then say it is allowed to effect a set-off. The court found the IRS's actions here as an affront to the purposes of a CDP hearing and that the IRS's setoffs in this case violated Article III mootness principles. The IRS cannot unilaterally deprive the Tax Court of jurisdiction where a defendant, such as the taxpayer in this case, still has an avenue of relief. That this is true even if the IRS had the taxpayer's estimated tax payments in their possession.

Third Circuit's analysis: §6330(c)(2)(B). The court then turned back to § 6330(c)(2)(B) and came to the same conclusion that the taxpayer's claim is not moot because the Tax Court retained jurisdiction to review her tax liability. The court reasoned that the taxpayer's claim under § 6330(c)(2)(B) allows her to also challenge at the CDP hearing the existence or amount of the tax liability. Thus, if a taxpayer does not receive a statutory notice of deficiency, she may contest the tax liability in the CDP hearing. In this regard the court noted that its conclusions are at odds with those of the Fourth Circuit and the D.C. Circuit. *See Mclane v. Comm'r*, 24th F.4th 316, 319 (4th

Cir. 2022) (the phrase "underlying tax liability" in § 6330(c)(2)(B) must be read in the specific context of the of the IRS's attempt to collect via lien or levy); *Willson v. Comm'r*, 805 F.3d 316, 321 (D.C. Cir. 2015) ("all the relief that § 6330 authorizes the Tax Court to grant" is relief from levy and that, consequently, there is "no appropriate course of action for the Tax Court to take but to dismiss [a case] as moot" when the IRS withdraws its proposed levy). The court then concluded that, after the IRS Office of Appeals considers a taxpayer's claims in a CDP hearing and issues its notice of determination concerning a levy and the taxpayer's liability, the Tax Court obtains jurisdiction to review those determinations. Thus, the court concluded, a taxpayer's challenge to the tax liability at issue in a § 6330(c)(2)(B) action cannot be rendered moot where the IRS unilaterally applies refunds to the tax liability at issue as it did in this case.

In this case, the Tax Court had dismissed the taxpayer's case as moot because there was no unpaid liability in relation to the taxpayer's year at issue upon which a levy could be based. In reaching this conclusion, the Tax Court overruled the Tax Court's prior holding in *Green-Thapedi v. Comm'r*, 126 T.C. 1 (2006). In *Greene-Thapedi*, on facts very similar to this case, the Tax Court relied on its prior precedents. See *Chocallo v. Comm'r*, T.C.M. 2004-152, *Gerakios v. Comm'r*, T.C.M. 2004-203. However, recently, in *Vigon v. Comm'r*, 149 T.C. 97 (2017), the Tax Court held that the IRS cannot unilaterally moot a case by withdrawing a proposed collection activity where the Tax Court had already obtained jurisdiction of a liability challenge when the petition was filed. *Vigon*, 149 T.C. at 107. The Tax Court reasoned that the case could not be rendered moot because the issue of liability remained even after collection issues had been resolved. *Id*. However, the Third Circuit distinguished *Vigon* from *Greene-Thapedi* because it involved a liability that had not been satisfied. The *Vigon* court reasoned that once jurisdiction to resolve a liability has been obtained, the Tax Court cannot be deprived of jurisdiction simply because the IRS decides to satisfy the asserted liability with the taxpayer's own funds. Finally, the Third Circuit held that the Tax Court is not required to have repayment or refund jurisdiction for a live dispute to be present. The Third Circuit adopted the analysis in a leading tax-procedure treatise which stated and explained the following:

> "[A] taxpayer's full payment of the previously unpaid tax liability should not render the entire case "moot" if the Tax Court otherwise has jurisdiction over the underlying liability. Full payment does not necessarily resolve the dispute as the Tax Court held.

Michael I. Saltzman & Leslie Book, IRS Practice & Procedure, para. 14B.16[4][a](West 2023).

Conclusion. The Third Circuit held that, in order to show mootness, the IRS has the burden of proving that the taxpayer here could not receive relief in any form if the Tax Court were to declare that she had a right to the estimated payments that she made. Further, in order to carry this burden, the IRS must prove that a determination by the Tax Court of the taxpayer's rights in her CDP case would not have preclusive effect on a future refund claim. While the IRS argued that such a determination would not have preclusive effect, the court found this argument to be unpersuasive citing a Chief Counsel notice indicating that "[a] judicial determination in a CDP case of taxpayer's underlying tax liability for a taxable year (which may be less than the taxpayer's payments for that year) may be subject to estoppel principles in a subsequent refund action[.]" I.R.S. Notice CC-2006-005 (Nov. 21, 2005), see also I.R.S. Notice CC-2009-010 (Feb. 13, 2009). Accordingly, the court vacated the Tax Court's order of dismissal and remanded the case to the Tax Court to determine whether the taxpayer is entitled to receive credit for the $50,000 of estimated payments that the taxpayer requested to have credit to her account.

2. The government can collect unpaid FBAR penalties from an individual's monthly Social Security benefits and need not provide a CDP hearing before doing so, says the Tax Court. Jenner v. Commissioner, 163 T.C. No. 7 (10/22/24). The government assessed penalties against the petitioners, a married couple, for their alleged failure to file foreign bank account reports (FBARs) for 2005 through 2009. Each petitioner received a letter from the Treasury Department's Bureau of the Fiscal Service (BFS) informing them that the Treasury Offset Program would withhold funds from their monthly Social Security benefits. The letters directed the petitioners to contact BFS's Debt Management Servicing Center to prevent the collection from taking place. The petitioners requested a collection due process (CDP) hearing by submitting Forms 12153 to the Debt Management Servicing Center. Subsequently, the IRS informed the petitioners by letter that they did not qualify for a CDP hearing because the FBAR penalties that had been assessed were not "taxes" and therefore the procedural protection of the CDP hearing, which is authorized by § 6330, did not apply. In response, the petitioners filed a petition in the Tax Court. The Tax Court (Judge Foley) granted the government's motion to dismiss for lack of jurisdiction. The court agreed with the government that FBAR penalties are not taxes and that the court therefore had no jurisdiction to hear the cases. The court observed that section 6330(a)(1) requires the government to issue a notice before levying for the taxable period to which the "unpaid tax" relates. Similarly, § 6330(a)(3) requires the notice to inform the taxpayer of "the amount of unpaid tax." Section 6330(c)(1) permits the taxpayer to raise at the CDP hearing "any relevant issue relating to the unpaid tax." FBAR penalties, however, are imposed by 31 U.S.C. § 5321(a)(5), a provision outside of title 26 of the United States Code, and are not a "tax" and no lien or levy is authorized to collect the penalties. Because FBAR penalties are not a tax and no lien or levy is available to the government to collect them, the procedural protection of a CDP hearing is not available. The Tax Court is a court of limited jurisdiction and, pursuant to § 6330(d)(1), has jurisdiction to review any determination made by the IRS following a CDP hearing. The court observed that it had consistently held that the issuance of a valid notice of determination is required in order for the court to have jurisdiction pursuant to § 6330(d)(1). *See Goza v. Commissioner*, 114 T.C. 176, 182 (2000). Further, the court explained, it has jurisdiction under § 6330(d)(1) to review a petition only "where the administrative determination concerns a tax over which the Court generally has jurisdiction." *Id.* Because the government had not issued a valid notice of determination concerning a tax in this case, the court held, it had no jurisdiction to hear the petitioner's case.

G. Innocent Spouse

H. Miscellaneous

1. ♪♫Signed, sealed, delivered [the Tax Court has jurisdiction]♫♪. The Tax Court has rejected the government's argument that the court has no jurisdiction to hear petitions created using the court's online petition generator because they lack a handwritten signature. Donlan v. Commissioner, 164 T.C. No. 3 (2/19/25). After the IRS issued a notice of deficiency, the taxpayers timely filed a petition electronically with the Tax Court. The taxpayers were pro se, i.e., they represented themselves in the Tax Court. They created their petition using the court's online petition generator. The online petition generator became available to pro se taxpayers on July 31, 2024. (A similar option became available to practitioners on September 15, 2024.) Before the online petition generator became available, taxpayers had the option of creating their own petition or using a Form (Form 2) provided by the Tax Court. Both options required a handwritten signature. The online petition generator does not require a handwritten signature. Instead, it asks petitioners to answer a series of questions and automatically generates a Tax Court petition that has a signature block that states the name and contact information of each taxpayer. The IRS filed a motion to dismiss for lack of jurisdiction. In the motion, the government argued that the "document filed as a petition in this case was not signed by either taxpayer to which the notice of deficiency for tax year 2024 was issued" and that "[t]he Tax Court does not have jurisdiction to review a petition unless it is signed by the taxpayer, or someone lawfully authorized to act as petitioner's counsel." The Tax Court (Judge Buch) denied the government's motion to dismiss. Rule 23(a)(3) of the Tax Court's Rules of Practice and Procedure state: "A person's name on a signature block on a paper that the person authorized to be filed electronically, and that is so filed, constitutes the person's signature." This rule applies to petitions by virtue of Rule 34, which governs petitions and states in paragraph (e): "For the signature requirement of petitions filed electronically, see Rule 23(a)(3) and the Court's electronic filing instructions on the Court's website." The court's electronic filing instructions for pro se taxpayers state:

> If the document you are filing requires a signature: The combination of DAWSON username (email address) and password serves as the signature of the individual filing the document. … If you chose to autogenerate a Petition in DAWSON and your spouse has authorized you to file an electronic petition, then the signature block on the petition autogenerated by DAWSON will serve as your spouse's signature.

U.S. Tax Court, Self-Represented (Pro Se) Electronic Filing Instructions at 42. Thus, under the Tax Court's Rules of Practice and Procedure and its instructions for electronic filing, a taxpayer's name on a signature block of a document that the taxpayer authorized to be filed electronically is deemed to be the taxpayer's signature. Petitions created using the court's online petition generator satisfy this requirement. Because the taxpayers in this case created their petition using the court's online petition generator, the petition was validly signed and the court denied the government's motion to dismiss.

XI. WITHHOLDING AND EXCISE TAXES

A. Employment Taxes

1. IRS updates guidance regarding employment taxes and Section 530 relief to reflect statutory changes made since 1986 and to amplify a 1985 revenue procedure. Rev. Proc. 2025-10, 2025-4 I.R.B. 492 (1/8/25) and Rev. Rul. 2025-3, 2025-4 I.R.B. 443 (1/8/25). These two recent sources of IRS guidance address so-called "Section 530 relief" in the context of withholding and employment tax controversies. Rev. Proc. 2025-10 modifies and supersedes Rev. Proc. 85-18, 1985-1 C.B. 518, to reflect amendments made to Section 530 since 1986. Rev. Proc. 2025-10 also amplifies the guidance originally provided in Rev. Proc. 85-18 concerning the definition of employee, the Section 530 requirement for filing required returns, the reasonable basis safe harbor rules found in Section 530(a)(2), and the criteria for assessing a taxpayer's past "treatment" of a worker as an independent contractor rather than as an employee. The second item, Rev. Rul. 2025-3, illustrates the application of amended Section 530 in five situations set forth in the ruling. The new guidance is effective as of the date of publication (1/8/25) and is comprehensive. For details, see the extensive discussion below.

Background. Section 530 of the Revenue Act of 1978, entitled "Controversies Involving Whether Individuals are Employees for Purposes of Employment Taxes," provides relief from federal employment tax obligations (including back taxes, interest, and penalties) for taxpayers meeting certain requirements set forth in the statute. Section 530 relief is available to taxpayers at any stage in the administrative or judicial review process if its requirements are met. *See* Rev. Proc. 2025-10 § 1.05. Section 530 principally applies to a taxpayer undergoing an employment tax audit where the IRS contends that the taxpayer misclassified workers as independent contractors rather than as employees. Section 530 does not grant relief to an individual worker himself or herself (who may, for instance, be held liable for unpaid income and self-employment taxes notwithstanding Section 530 relief granted to a taxpayer-payor). *See* Rev. Proc. 2025-10 § 2.02. Section 530 is not part of the Internal Revenue Code, but subsection (e)(3) of the statute requires the IRS to consider whether a taxpayer qualifies for Section 530 relief in an employment tax audit before reclassifying an individual worker's status from independent contractor to employee. *See also* Rev. Proc. 2025-10 § 3.05. Congress enacted Section 530 to "alleviate what it perceived as the 'overly zealous pursuit and assessment of taxes'" against employers who have, in good faith, classified their workers as independent contractors. *Ewens and Miller, Inc. v. Commissioner*, 117 T.C. 263, 276 (2001) (quoting *Boles Trucking, Inc. v. United States*, 77 F.3d 236, 239 (8th Cir.1996)). Although initially intended to be temporary, Section 530 relief was extended indefinitely by the Tax Equity & Fiscal Responsibility Act of 1982, Pub. L. 97–248, § 269(c), 96 Stat. 324, 552. In addition, Section 530 has been amended three times since it became permanent in 1982. Section 530(d) (exception for certain technical workers) was added by the Tax Reform Act of 1986, Pub. L. No. 99-514, Title XVII, § 1706(a), 100 Stat. 2085. Section 530(e) (burden of proof and other special rules) was added by the Small Business Job Protection Act of 1996, Pub. L. No. 104-188, Title I, § 1122(a), 110 Stat. 1755, 1766. Section 530(f) (test room supervisors and proctors for college entrance exams) was added by the Pension Protection Act of 2006, Pub. L. No. 109-280, Title VIII, § 864(a), 120 Stat. 780, 1024.

Rev. Proc. 2025-10 and Section 530 in general. Section 530(a)(1)(A)-(B) generally provide that, for purposes of the employment taxes under subtitle C of the Code, if a taxpayer "did not treat an individual as an employee for any period," then the individual will be deemed not to be an employee for that period unless "the taxpayer had no reasonable basis for not treating the individual as an employee." Put differently (i.e., *in more understandable and less double-negative words*), if a taxpayer (i) has been entirely consistent in treating an individual worker as an independent contractor for employment tax purposes and (ii) had a reasonable basis for doing so, Section 530 may relieve the taxpayer from an IRS assessment of unpaid employment taxes (including interest and penalties) that otherwise would result if the IRS successfully reclassified a taxpayer's worker as an employee. The legislative history states that the phrase "reasonable basis . . . for not treating the individual as an employee" is to "be construed liberally" by the IRS and the courts. *See* Rev. Proc. 2025-10 § 6.05. Nevertheless, a taxpayer's "reasonable basis" must exist before the taxpayer decides to treat a worker as a non-employee for employment tax purposes. *See* Rev. Proc. 2025-10 § 6.02. For this purpose, as detailed further below, a taxpayer may rely upon certain "reasonable basis" safe harbors specified in Section 530(a)(2) or upon some other legitimate grounds. For any period after December 31, 1978, relief applies only if, pursuant to section 530(a)(1)(B), all federal tax returns (including information returns) required to be filed by the taxpayer with respect to the individual for the period are filed on a basis consistent with the taxpayer's treatment of the individual as a non-employee, and pursuant to section 530(a)(3), the taxpayer has not treated any individual holding a substantially similar position as an employee for purposes of employment taxes for any period beginning after December 31, 1977. *See* Rev. Proc. 2025-10 § 2.03. Regardless, Section 530(d) provides that relief is not available with respect to specified third-party arrangements concerning technical workers (engineers, designers, drafters, computer programmers, systems analysts, or other similarly skilled workers engaged in a similar line of work). Thus, the usual common law rules (not Section 530) determine whether an individual retained by a taxpayer-payor providing such technical services to a third-party client is an employee or independent contractor of the taxpayer-payor. *See also* Rev. Proc. 2025-10 § 3.09. Moreover, Section 530 relief is not available to taxpayers that are federal agencies, and special considerations apply to "dual-status" workers (i.e., individuals separately compensated for providing services distinct from services provided as an employee). *See* Rev. Proc. 2025-10 §§ 3.07-.08 & 3.11.

Defining "employee" for purposes of Section 530. Rev. Proc. 2025-10 § 3.02 provides that the term "employee" for purposes of Section 530 includes:

(1) an officer of a corporation under §§ 3121(d)(1), 3306(i), or 3401(c) of the Code;

(2) an individual, who under the common law rules, has the status of an employee under §§ 3121(d)(2) or 3306(i);

(3) agent-drivers, commission-drivers, full-time life insurance salespersons, home workers, or traveling or city salespersons under §§ 3121(d)(3) (statutory employees) or 3306(i);

(4) an individual who performs services that are included under an agreement pursuant to Section 218 or Section 218A of the Social Security Act (218 Agreement) under § 3121(d)(4) of the Code; and

(5) an officer, employee or elected official of a State, or any political subdivision thereof, or the District of Columbia, or any agency or instrumentality of the foregoing under § 3401(c).

"Treatment" as an employee. Pursuant to Rev. Proc. 2025-10 § 3.03, the IRS will apply the following guidelines to determine whether the taxpayer's past and continuing "treatment" of an individual worker as an employee (as opposed to treating the worker as an independent contractor) disqualifies the taxpayer from Section 530 relief:

(1) The withholding of income tax or FICA taxes from any payments made to an individual, whether or not the tax is paid to the IRS, indicates "treatment" of the individual as an employee.

(2) Except as provided in paragraphs (6) and (7) below, the filing of an original or amended employment tax return (including a Form 940 "Employer's Annual Federal Unemployment Tax Return," 941 "Employer's Quarterly Federal Tax Return," 943 "Employer's Annual Tax Return for Agricultural Employees," or 944 "Employer's ANNUAL Federal Tax Return"), with respect to an individual, whether or not tax was withheld from the payments made to the individual, indicates "treatment" of the individual as an employee.

(3) The filing of Schedule H (Form 1040), Household Employment Taxes, with respect to an individual, whether or not tax was withheld from the payments made to the individual, indicates "treatment" of the individual as an employee.

(4) The filing of a Form W-2 "Wage and Tax Statement" with respect to an individual, or the furnishing of a Form W-2 to an individual, whether or not tax was withheld from the payments made to the individual, indicates "treatment" of the individual as an employee.

(5) Contracting with a third party to perform acts required of employers with respect to an individual, whether or not tax is withheld or paid to the IRS or the third party otherwise satisfies the terms of the contract, indicates "treatment" of the individual as an employee.

(6) The filing of a delinquent or amended employment tax return for a particular tax period with respect to an individual as a result of IRS collection or examination activities or other compliance procedures, does not indicate "treatment" of the individual as an employee for that period. IRS correspondence that merely advises the taxpayer that no return has been filed and requests information from the taxpayer is not a compliance procedure. However, if the taxpayer takes any of the actions identified [above] with respect to those individuals in a later period (for example, the taxpayer withholds employment taxes or files employment tax returns with respect to those individuals for the periods following the period audited), those actions indicate "treatment" of the individuals as employees for those later periods.

(7) A return prepared by the IRS under § 6020(b) (returns prepared or executed by the Secretary of the Treasury) for a period is not "treatment" of an individual as an employee for that period.

Prima facie case for Section 530 relief. Pursuant to Section 530(e)(4) and Rev. Proc. 2025-10 § 7, a taxpayer can establish a prima facie case for Section 530 relief, thereby shifting the burden of proof to the IRS, if the taxpayer meets three conditions: (i) the reporting consistency requirement; (ii) the substantive consistency requirement; and (iii) one of the reasonable basis safe harbors enumerated in Section 530(a)(2)(A), (B), and (C).

(1) *Reporting Consistency Requirement of Section 530(a)(1)(B)*. The reporting consistency requirement is intended to ensure that a taxpayer acted in good faith in treating individuals as non-employees. Reporting consistency requires a taxpayer to file all required federal tax returns with respect to an individual for a relevant period on a basis consistent with the good faith treatment of the individual by the taxpayer as a non-employee. For instance, if a taxpayer's position is that an individual was an independent contractor for a taxable period, the taxpayer must have filed all required Forms 1099 consistent with the taxpayer's position that the individual was an independent contractor for the period. Reporting consistency must be satisfied on a period-by-period basis. If a taxpayer filed information returns for one period but did not file information returns for a prior or subsequent period, the reporting consistency requirement is met only for the period for which the taxpayer filed information returns.

> *Example:* If a taxpayer whose position is that an individual was an independent contractor did not file Forms 1099-NEC "Nonemployee Compensation," in year 1, but did file Forms 1099-NEC in year 2, the taxpayer is not entitled to Section 530 relief in year 1 but may be entitled to Section 530 relief for year 2 if it otherwise meets the requirements of Section 530 for that year.

Further, the reporting consistency requirement must be satisfied on an individual-by-individual basis. A taxpayer filing information returns for some individual workers but not others may satisfy the reporting consistency requirement only for the individuals for whom it filed information returns.

> *Example*: If a taxpayer takes the position that individual workers A, B, and C in year 1 were independent contractors and filed Forms 1099-NEC for those workers in year 1, but did not file Forms 1099-NEC for individual workers D, E, and F in year 1, the taxpayer is not entitled to Section 530 relief for individuals D, E, and F for year 1. The taxpayer may be entitled to Section 530 relief for individual workers A, B, and C in year 1 if it otherwise meets the requirements for Section 530 relief for that year. If the taxpayer files Forms 1099-NEC for all the individuals in year 2, the taxpayer may be entitled to Section 530 relief for all the individuals in year 2 if it otherwise meets the requirements for Section 530 relief for that year.

Finally, a taxpayer will not fail the reporting consistency requirement if the taxpayer, in good faith, mistakenly files the wrong type of information return or, as long as the return demonstrates a good faith attempt to accurately report the amount paid, reports an inaccurate amount paid. Moreover, a taxpayer will not fail the reporting consistency requirement if the taxpayer was not required to file an information return because, for example, the taxpayer paid the individual less than the threshold amount required to file a Form 1099.

(2) *Substantive Consistency Requirement of Section 530(a)(3)*. The substantive consistency requirement is intended to ensure that Section 530 relief applies only to a taxpayer who has consistently treated all individuals holding substantially similar positions as non-employees. Substantive consistency prevents a taxpayer from changing its treatment of employees to non-employees in order to qualify for Section 530 relief, including through reincorporation, reorganization, name change, or otherwise. More specifically, substantive consistency means that a taxpayer or a predecessor has not treated an individual, or any individual holding a substantially similar position, as an employee for any period beginning after December 31, 1977. Pursuant to Section 530(e)(6), the determination of whether an individual holds a position substantially similar to a position held by another individual includes consideration of the relationship between the taxpayer and the individual. Accordingly, a substantially similar position exists if the job functions, duties, and responsibilities are substantially similar and the control and supervision of those duties and responsibilities are substantially similar. In determining if a taxpayer has treated an individual, or any individual holding a substantially similar position, as an employee for purposes of the substantive consistency requirement, the IRS will apply the same guidelines as described above regarding "treatment" of a worker as an independent contractor or employee. On the one hand, "treatment" of an individual, or an individual holding a substantially similar position, as an employee in a period subsequent to the period under audit will not cause a taxpayer to fail the substantive consistency requirement for the period under audit or prior periods under audit. On the other hand, entering into a Classification Settlement Program (CSP) or Voluntary Classification Settlement Program (VCSP) agreement with the IRS with respect to an individual will be considered "treatment" of the individual as an employee for substantive consistency purposes from the effective date of the agreement.

(3) *Reasonable Basis Requirement of Section 503(a)(2)*. The reasonable basis requirement is intended to ensure that the taxpayer adequately considered the worker classification status of the individual as an employee or non-employee before making the classification decision. Reasonable basis requires a taxpayer to demonstrate that it reasonably relied on one of the safe harbors in Section 530(a)(2). (As as explained further below, however, a taxpayer who does not fall within one of the safe harbors may still satisfy the reasonable basis requirement for the year under audit. The taxpayer may do so by demonstrating through facts and circumstances that for the year under audit it considered and relied upon another legitimate reason before deciding to classify an individual as an independent contractor for employment tax purposes.) The IRS considers the following when determining whether there was reasonable reliance on a safe harbor:

(1) *First safe harbor*. Judicial precedent or published rulings, whether or not relating to the particular industry or business in which the taxpayer is engaged, or technical advice, a letter ruling, or a determination letter issued to the taxpayer under audit.

   (a) Reliance on judicial precedent or published rulings requires that the taxpayer reasonably relied upon the judicial precedent or published rulings at the time it began treating the individual as a non-employee for the tax period under audit.

   (b) Thus, a taxpayer does not meet this first safe harbor if the judicial precedent that the taxpayer relied on was issued after the tax period for which the taxpayer treated the individual as a non-employee.

(2) *Second safe harbor*. A past IRS audit that resulted in no assessment of employment taxes attributable to the employment status reclassification of individuals holding positions substantially similar to the position held by the individual.

   (a) If a taxpayer is relying on the results of an audit that began *before 1997*, the audit does not have to have been an audit of whether the same individuals, or individuals holding substantially similar positions, should have been treated as employees of the taxpayer, so long as the prior audit did not result in an assessment of employment taxes attributable to the IRS's reclassification of the same individuals, or individuals holding substantially similar positions.

   (b) If a taxpayer is relying on the results of an audit that began *after 1996*, the audit must have been an employment tax examination of the same individuals, or individuals holding substantially similar positions, that did not result in a reclassification of the same individuals or individuals holding substantially similar positions.

   (c) A taxpayer does not meet this second safe harbor if, in the conduct of the prior audit, a proposed assessment attributable to the IRS's reclassification of the individual was offset by other claims asserted by the taxpayer.

   (d) A taxpayer does not meet this second safe harbor if the relationship between the taxpayer and the individuals during the period under audit is different from that which existed at the time of the prior audit.

(e) A taxpayer does not meet this second safe harbor if the prior audit began after 1996 and was only for purposes of determining a taxpayer's liability for failure to subject a reportable payment to backup withholding, as required by § 3406 of the Code and accompanying regulations, if the workers' underlying classification was not examined, since the imposition of backup withholding liabilities does not involve the reclassification of workers by the IRS.

(3) *Third safe harbor*. A long-standing recognized practice of a significant segment of the industry in which the individual was engaged.

(a) Reliance on industry practice requires that the taxpayer reasonably relied upon the industry practice at the time it began treating the individual as a non-employee for the tax period under audit.

(b) An industry generally consists of businesses located in the same geographic or metropolitan area that compete for the same customers. However, if the area includes only one or a few businesses in the same industry, or if the business competes in regional or national markets, the geographic area may be expanded.

(c) 25 percent of the taxpayer's industry (determined by not taking into account the taxpayer) is deemed to be a significant segment of the industry. A lower percentage may be a significant segment, depending on the facts and circumstances.

(d) A practice that has existed for 10 years is deemed to be long-standing. A shorter period may be long-standing, depending on the facts and circumstances.

(4) *Other reasonable basis grounds.* Outside the above safe harbors, a taxpayer must demonstrate by other facts and circumstances that it relied on another legitimate ground for treating the individual as a non-employee. Although the reasonable basis requirement should be construed liberally in favor of the taxpayer, the reporting consistency and substantive consistency requirements for obtaining section 530 relief are not liberally construed. Failure to satisfy the reporting consistency or substantive consistency requirements for section 530 relief is not cured by the application of liberal construction of the reasonable basis requirement. Moreover, the shift in the burden of proof does <u>not</u> apply with respect to the reasonable basis requirement if the taxpayer relied on a non-safe-harbor ground for treating the individual as a non-employee. *See* Section 530(e)(4)(B) and Rev. Proc. 2025-10 § 7.02. Furthermore, consistent with the legislative history of Section 530, a taxpayer is not considered to have a reasonable basis for its treatment of individuals as non-employees if the facts and circumstances indicate negligence, intentional disregard of rules and regulations, or fraud. *See* Rev. Proc. 2025-10 § 6.06. If the taxpayer's reasonable basis falls outside the safe harbors, the taxpayer and the IRS may consider whether, during the years under audit, the taxpayer:

(1) claimed income tax deductions, or treated payments made to or on behalf of the individual as excludable from income, under provisions of the Code that are applicable only to employees, including under §§ 62(a)(2)(A), 105, 106, 117(d), 119, 127, 129, 132 (portions thereof), or 137 of the Code;

(2) claimed employer credits such as credits for paid sick and/or family leave under sections 7001 and/or 7003 of the Families First Coronavirus Response Act or §§ 3131 through 3133 of the Code, the Employee Retention Credit under either § 2301 of the Coronavirus Aid, Relief, and Economic Security Act or § 3134 of the Code, or any other credits specified in future guidance that are calculated with respect to wages or compensation paid to an employee;

(3) complied with federal or state labor law including minimum wage and overtime pay rules with respect to the individual that are applicable to employees or treated workers as employees for purposes of state or non-tax federal laws;

(4) treated the individual as an employee for purposes of collectively bargained agreements entered into by the taxpayer;

(5) permitted participation of the individual in any qualified pension, profit-sharing, or stock bonus plan;

(6) permitted participation of the individual in any nonqualified deferred compensation plan if such participation is limited to employees of the taxpayer;

(7) provided state unemployment insurance or worker's compensation insurance coverage for such individual if the requirements for obtaining such state unemployment or worker's compensation insurance is that coverage is limited to individuals performing services for the taxpayer as common law employees under the common law rules or persons that would qualify as employees for federal employment tax purposes.

Rev. Rul. 2025-3 illustrates the application of Section 530. Rev. Rul. 2025-3 contains five situations (which are in substance variations on one fact pattern) illustrating the application of Section 530 considering the updated guidance announced in Rev. Proc. 2025-10. The five illustrations further clarify that Section 530 relief is not applicable to a dispute involving the proper characterization of particular payments where the IRS is not seeking to reclassify a worker from independent contractor to employee status. *See also* Rev. Proc. 2025-10 § 3.06. In other words, Section 530 does not apply to controversies concerning whether a particular type of remuneration (e.g., a bonus in addition to regular compensation) paid to a taxpayer's properly treated and classified "employee" constitutes "wages" as defined under FICA, FUTA, or income tax withholding provisions. The five illustrations also elaborate on whether a taxpayer failing to qualify for Section 530 relief from unpaid employment taxes (including interest and penalties) may be eligible for limited relief under § 3509 or Tax Court review under § 7436.

Code § 3509(a) allows an employer to remit unpaid taxes at reduced rates if an employer fails to deduct and withhold income tax or the employee's share of FICA tax with respect to any of its employees because the employer improperly treated the worker as a non-employee. Pursuant to § 3509(c), the reduced rates do not apply to the determination of the employer's liability for income tax withholding or the employee portion of FICA tax if such liability is due to the employer's intentional disregard of the requirement to deduct and withhold such taxes. For purposes of § 3509, the concept of "treatment" of an individual as a non-employee or employee is the same as the analysis under Section 530 (as discussed above). Thus, like Section 530, if a taxpayer treated and classified an individual as an employee, § 3509 will not apply since the worker is not being reclassified from non-employee to employee. Accordingly, also like Section 530, § 3509 is not applicable if the IRS determines that other or additional remuneration paid to an employee constitutes "wages" under FICA, FUTA, or income tax withholding provisions.

Code § 7436 provides that the Tax Court may review two types of employment tax determinations made by the IRS and the proper amount of employment tax, penalties, and additions to tax resulting from those determinations. To obtain Tax Court review under § 7436, the following elements must be met:

(1) an examination in connection with the audit of any person;

(2) a determination that —

  (a) one or more individuals performing services for such person are employees of such person for purposes of subtitle C, or

(b) such person is not entitled to relief under Section 530 with respect to such an individual;

(3) an "actual controversy" involving the determination as part of an examination; and

(4) the filing of an appropriate pleading in the Tax Court.

See American Airlines Inc. v. Commissioner, 144 T.C. 24, at 32 (2015). When the first three elements are met, the IRS will issue a § 7436 Notice. A taxpayer satisfies the fourth element by filing a timely petition for review of the § 7436 Notice with the Tax Court. Rev. Proc. 2022-13, 2022-6 I.R.B. 477, superseding Notice 2002-5, 2002-1 C.B. 320, provides further guidance concerning when and how the IRS will issue a § 7436 Notice thereby allowing a taxpayer to petition for Tax Court review. The IRS will not issue a § 7436 Notice if the taxpayer has agreed to the employment tax liabilities. Generally, an agreement is accomplished using Form 2504-T "Agreement to Assessment and Collection of Additional Employment Tax and Acceptance of Overassessment (Employment Tax Adjustments Subject to § 7436)."

Situation 1. Taxpayer (TP) hires individuals who provide services to TP during the year. For those services, TP pays each individual a weekly fixed amount and a weekly bonus amount. TP does not withhold or pay federal employment taxes with regard to any of the payments and reports the total amount of the fixed weekly amounts and the weekly bonus amounts on Form 1099-NEC "Nonemployee Compensation." During an audit of TP by the IRS for the year, the IRS determines (1) that TP does not meet the statutory requirements for Section 530 relief, and (2) that the individuals are employees of TP. The IRS proposes to assess federal employment taxes on the weekly fixed amounts and the weekly bonus amounts, which the IRS asserts should have been reported as wages on Form 941 "Employer's QUARTERLY Federal Tax Return," and Forms W-2 "Wage and Tax Statement." TP claims it satisfies the statutory requirements for Section 530 relief and does not agree that the individuals are its employees.

- *Held*. Section 530 applies because TP did not treat the individuals as employees, and the IRS is reclassifying the individuals as employees. Whether TP is entitled to Section 530 relief depends on whether TP satisfies the substantive consistency, reporting consistency, and reasonable basis requirements. If Section 530 does not apply, § 3509 of the Code may be applicable because TP treated the individuals as non-employees and did not deduct and withhold federal employment taxes from the weekly fixed amounts and bonus amounts that it paid to the individuals, and the IRS is attempting to reclassify the individuals as employees. Whether TP is entitled to §3509 reduced rates depends upon whether it meets the other statutory requirements of § 3509. The IRS will issue TP a § 7436 Notice at the conclusion of the audit or after Appeals consideration if no agreement is reached. A § 7436 Notice will be issued because (1) there was an examination in connection with an audit, (2) there were determinations that (a) the individuals were employees of TP, and (b) TP was not entitled to relief under Section 530 with respect to these individuals, and (3) the IRS and TP disagree on the employment status of the workers and whether the statutory requirements for Section 530 relief have been met (there is an actual controversy involving the determination as part of the audit).

Situation 2. The facts are substantially the same as Situation 1 except that TP treats the individuals as employees for withholding and employment tax purposes with respect to the weekly payments but not the weekly bonus amounts. TP does not withhold or pay employment taxes with regard to the bonus amounts but does report the bonus amounts on Forms 1099-NEC. TP claims it satisfies the statutory requirements for Section 530 relief with respect to the bonus amounts and does not agree that the bonus amounts are wages.

- *Held*. Section 530 is not applicable to this situation because the IRS is not reclassifying the individuals as employees. TP treated the individuals as employees for the services they performed and paid additional wages in the form of bonuses for the same services; there is no controversy over whether the individuals are employees or independent contractors with respect to their services. (That is, the controversy concerns whether the bonuses are "wages" subject to withholding and employment taxes, not the proper classification of the workers as employees or independent contractors.) The reduced rates under § 3509 of the Code are not applicable for the same reason. The IRS will issue TP a § 7436 Notice at the conclusion of the audit or after Appeals consideration if no agreement is reached. A § 7436 Notice will be issued because (1) there was an examination in connection with an audit, (2) a determination was made that TP was not entitled to relief under Section 530 with respect to the bonuses paid to the individuals, and (3) the IRS and TP disagree on whether the statutory requirements for Section 530 relief have been met (there is an actual controversy involving the determination as part of the audit).

Situation 3. The facts are the same as Situation 2 except TP does not report the weekly bonus amounts on Forms 1099-NEC or any other information return.

- *Held*. Neither Section 530 nor § 3509 are applicable to this situation for the same reasons stated in Holding 2. (That is, the controversy concerns whether the bonuses are "wages" subject to withholding and employment taxes, not the proper classification of the workers as employees or independent contractors.) The IRS will issue TP a § 7436 Notice at the conclusion of the audit or after Appeals consideration if no agreement is reached. A § 7436 Notice will be issued because (1) there was an examination in connection with an audit, (2) a determination was made that TP was not entitled to relief under Section 530 with respect to the bonuses paid to the individuals, and (3) the IRS and TP disagree on whether the statutory requirements for Section 530 relief have been met (there is an actual controversy involving the determination as part of the audit).

Situation 4. The facts are the same as Situation 2 except TP does not report the weekly bonus amounts on Forms 1099-NEC or any other information return and does not claim it satisfies the statutory requirements for Section 530 relief with respect to the bonus amounts.

- *Held*. Neither Section 530 nor § 3509 are applicable to this situation for the same reasons stated in Holding 2. (That is, the controversy concerns whether the weekly and bonus payments are "wages" subject to withholding and employment taxes, not the proper classification of the workers as employees or independent contractors.)The IRS will not issue TP a § 7436 Notice at the conclusion of the audit or after Appeals consideration if no agreement is reached because TP did not claim that TP was entitled to relief under Section 530 concerning the bonuses paid to the individuals, and there is no controversy over whether the individuals are employees or independent contractors.

Situation 5. TP employs individuals who perform services during the year. TP enters into a contract with a third party (3P) to pay each individual a weekly salary, withhold and pay federal employment taxes, and file federal employment tax returns. 3P pays the weekly salaries, withholds, pays federal employment taxes, and reports the weekly salaries and taxes on Form 941 and Forms W-2 using its own employer identification number (EIN). In December of that same year, TP pays a year-end bonus amount directly to each individual for the individual's services during the year but does not treat the year-end bonus amounts as wages. TP does not withhold or pay any federal employment taxes or report the bonus amounts on any information return. During an audit of TP by the IRS for the year, the IRS concludes that the bonus amounts are wages. The IRS proposes to assess federal employment taxes on the bonus amounts, which should have been reported as wages on Form 941 and Forms W-2. TP claims it satisfies the statutory requirements for Section 530 relief with respect to the bonus amounts and does not agree the bonus amounts are wages.

- *Held*. Section 530 is not applicable to this situation because the IRS is not reclassifying the individuals as employees. The year-end bonus amounts are additional wages for the same services performed by the individuals who were treated as employees by TP. The reduced rates under § 3509 of the Code are not applicable for the same reason. The IRS will issue TP a § 7436 Notice at the conclusion of the audit or after Appeals consideration if no agreement is reached. A § 7436 Notice will be issued because (1) there was an examination in connection with an audit, (2) a determination was made that TP was not entitled to relief under Section 530 with respect to the year-end bonus amounts paid to the individuals, and (3) the IRS and TP disagree on whether the statutory requirements for Section 530 relief have been met (there is an actual controversy involving the determination as part of the audit).

B. Self-employment Taxes

C. Excise Taxes

XII. TAX LEGISLATION

XIII. TRUSTS, ESTATES & GIFTS