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JUDICIAL UPDATE

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1. **Transferee Liability.**

   a. ***U.S. v. Marshall*, No. 12-20804 (5th Cir. 11/10/14).** The case involved gifts made by the late J. Howard Marshall, but did not involve his marriage to Anna Nichole Smith. The procedural issue of interest in the case deals with a donee's liability for transfer taxes due on a gift "to the extent of the value of such gift under Section 6324(b) and if that amount can surpass the value of the original gift because of interest. In a convoluted transaction, the taxpayers reached an agreement that a gift had been made on which no gift tax had been paid. The donees paid the tax, but the IRS wanted to be able to collect interest also. The relevant portion of Section 6324(b) states "if the tax is not paid, when due, the donee of any gift shall be personally liable for such tax to the extent of the value of the gift". The 5th Circuit held that the IRS could not only collect tax, but also interest.

   b. ***U.S. v. McFarland*, No. 3:14cv29 (S.D. Miss. 12/15/14).** Southern District of Mississippi denied the Government's motion to dismiss a taxpayer's son's action for quiet title on property the IRS was trying to foreclose its liens upon for the father's taxes based on nominee theory; the Government argued that Sections 6325(b)(4) and Section 7426(b)(4) relating to some expedited lien remedies were the only remedies available to the taxpayer. The Court disagreed, holding those were available remedies, but did not foreclose a quiet title action under 28 USC 2410.

   c. ***Kardash v. Commissioner*, T.C. Memo. 2015-51 (3/18/15).** The Tax Court ruled that William Kardash Sr. and Charles Robb were liable for a portion of the $120 million in deficiencies, penalties and interest owed in federal taxes by Florida Engineered Construction Products Corp. (FECP), because some distributions by the company to Kardash and Robb were fraudulent transfers under applicable Florida law. The court found that dividends paid to Kardash and Robb during 2005 through 2007 were fraudulent transfers, because the payments were made after the company became insolvent and with the intent of the controlling shareholders to hinder, delay or defraud the IRS. However, payments to Kardash and Robb during 2003 and 2004 were not fraudulent transfers, because they were compensation for services performed, approximately equivalent to bonuses paid to the men in prior years, and made while the company was still solvent. Kardash was an engineer who owned 8.65 percent of the company and was primarily involved in its operations. Robb managed the sales team and owned 1.13 percent of the company. John Stanton and Ralph Hughes owned equal shares of the remainder of the company. When the company was no longer obligated to produce audited financial statements after it paid off a line of credit in 2001, "Hughes and Stanton began to systematically transfer all of the company's pretax profits to themselves," the court said. The company did not file accurate income tax returns for 2003 and 2004 and did not file any returns for 2005, 2006 and 2007. The court said Hughes' and Stanton's intent to defraud the IRS should not be imputed to Kardash and Robb, because the company was experiencing unprecedented growth during the years at issue. Kardash and Robb contributed to that success "and they likely would have become suspicious if they had not been compensated fairly." The court also said that the existence of an installment agreement between the IRS and FECP—and the IRS's failure to exhaust collection efforts against the company, Hughes and Stanton—did not preclude the IRS from pursuing collection against Kardash and Robb.

2. Accounting Method.

a. ***Shea Homes v. Commissioner*, 142 T.C. No. 3 (02/12/14).** In a Method of Accounting case, the Tax Court held that under Section 460 the taxpayer, a family owned homebuilding business that also had planned communities, was entitled to defer income from the sale of homes until 95% of the total costs were incurred or the development was completed or accepted. The Court said that homebuyers in planned communities are not contracting merely for the single home, but instead for the "entire lifestyle of the development and its amenities".

b. ***The Howard Hughes Co., LLC v. Commissioner*, 142 T.C. No. 20 (06/02/14).** The taxpayer was in the residential land development business. The taxpayer generally sold land through bulk sales, pad sales, finished lot sales, and custom lot sales. In bulk sales, it developed raw land into villages and sold an entire village to a builder. In pad sales, it developed villages into parcels and sold the parcels to builders. In finished lot sales, it developed parcels into lots and sold whole parcels of finished lots to builders. In custom lot sales, it sold individual lots to individual purchasers or custom home builders, who then constructed homes. The taxpayer never constructed any residential dwelling units on the land it sold. The taxpayer reported income from purchase and sale agreements under the § 460 completed contract method of accounting—generally when it had incurred 95 percent of the estimated costs allocable to each sales agreement. The IRS took the position that the land sales contracts were not home construction contracts within the meaning of § 460(e) and that the bulk sale and custom lot contracts were not long-term construction contracts eligible for the percentage of completion method of accounting under § 460. (The IRS conceded that the other contracts were long-term construction contracts.) The Tax Court (Judge Wherry) held that the bulk sale and custom lot contracts were long-term construction contracts under § 460(f)(1), and the taxpayer could report gain or loss from those contracts on the appropriate long-term method of accounting to the extent it had not completed the contracts within a year of entering into them. The contracts included more than just the sale of lots. The costs incurred for a custom lot contract are not really different from the costs for the finished lot sales. The contracts included development of things such as water service, traffic signals, landscaping, and construction of parks, which did not necessarily occur prior to the closing. Completion of the contract thus occurred upon final completion and acceptance of the improvements the cost of which was allocable to the custom lot contracts. However, none of the contracts qualified as home construction contracts eligible for the completed contract reporting method under § 460(e). In relevant part, § 460(e)(6) defines a home construction contract as follows:

(A) Home construction contract. -- The term "home construction contract" means any construction contract if 80 percent or more of the estimated total contract costs (as of the close of the taxable year in which the contract was entered into) are reasonably expected to be attributable to activities referred to in paragraph (4) with respect to —

(i) dwelling units (as defined in section 168(e)(2)(A)(ii)) contained in buildings containing 4 or fewer dwelling units (as so defined), and
(ii) improvements to real property directly related to such dwelling units and located on the site of such dwelling units.

The taxpayer argued the costs met the "80 percent test" applied to determine whether the land sales contracts met the definition in § 460(e)(6). At the end of a long analysis of the statutory language, the regulations, and the legislative history, Judge Wherry concluded that the contracts did not qualify as home construction contracts. The taxpayer's costs were, if anything, common improvement costs. The taxpayer did not incur any costs with respect to any home's "structural, physical construction." The costs were not "costs for improvements 'located on' or 'located at' the site of the homes. Accordingly, the costs could not be included in testing whether 80 percent of their allocable contract costs are attributable to the dwelling units and real property improvements directly related to and located on the site of the yet to be constructed dwelling units.

Our Opinion today draws a bright line. A taxpayer's contract can qualify as a home construction contract only if the taxpayer builds, constructs, reconstructs, rehabilitates, or installs integral components to dwelling units or real property improvements directly related to and located on the site of such dwelling units. It is not enough for the taxpayer to merely pave the road leading to the home, though that may be necessary to the ultimate sale and use of a home. If we allow taxpayers who have construction costs that merely benefit a home that may or may not be built, to use the completed contract method of accounting, then there is no telling how attenuated the costs may be and how long deferral of income may last.

3. Employment Taxes.

a. ***Lee v. Commissioner*, 144 TC No. 3 (2015).** The Tax Court denied summary judgment to the IRS in an employment tax case because the Service could not establish when a notice letter was served on the taxpayer. The court ruled that there was a genuine dispute of material fact as to whether the IRS ever served on the taxpayer Letter 1153, Proposed Assessment of trust Fund Recovery Penalty, which was required under Section 6672(b). Although the IRS claimed the Letter 1153 was served on the taxpayer during a meeting, the IRS transcript only showed that the taxpayer met with the agent.

b. ***American Airlines v. Commissioner*, 144 TC No. 2 (2015).** The tax court ruled that the IRS had made a determination regarding AA's tax liability for 2003 and 2004, which provided a basis for the court's jurisdiction over a case involving employment taxes. The case involves remuneration pay to foreign flight attendants by AA's foreign branches. The court found that although the IRS had not issued a notice of determination of worker classification, the court had jurisdiction under Section 7436(a).

c. ***TFT Galveston Portfolio, Ltd. v. Commissioner*, 144 T.C. No. 7 (2/26/15).** The Tax Court ruled in a division opinion that TFT Galveston Portfolio Ltd., a Tomball, Texas, limited partnership whose sole business activity was operating apartment properties, owed unreported employment taxes for the fourth quarter of tax year 2004. The company was deemed not responsible for several other years of unpaid federal employment taxes and penalties as a successor in interest to six other limited partnerships involved in the apartment complex business. Walter J. Teachworth, the only owner of the petitioning partnerships who was actively involved in operating the apartment complexes during the years at issue, hired apartment managers, leasing agents, security personnel, a maintenance supervisor and general maintenance workers to maintain the partnership's complexes. Teachworth didn't require the workers he hired to fill out any applications before securing their positions, nor did the workers sign written agreements for the work they performed. The partnerships didn't deposit any employment taxes for tax years 2000 to 2004. The IRS, which had previously audited the Forms 1065, U.S. Return of Partnership Income, for the partnerships, learned that the petitioners were treating the workers in question as independent contractors, and then deducting the compensation on Forms 1065. In October 2011, the IRS issued TFT Galveston a notice of determination, explaining that its workers were to be classified as employees, and that the partnership was responsible for those employment taxes, additions and Section 6656 penalties. Between September and October 2011, six additional notices were sent to TFT Galveston stating that, as successor in interest to the six other limited partnerships, it owed additional unpaid employee taxes, additions and penalties. The IRS argued that "because the uniform imposition and collection of employment taxes is a significant Federal interest, we should disregard State law and adopt the broader parameters of Federal common law in determining successor liability in employment tax cases." The court disagreed, saying that the IRS had offered case law that appeared "to have little or no application outside of" environment liability or labor law disputes. The court added that there was no evidence, as the IRS had suggested, that TFT Galveston's business structure was "anything other than a valid reorganization." "TFT Galveston Portfolio did not expressly assume the liabilities of the other six partnerships," the court said. "Accordingly, under Texas law, TFT Galveston Portfolio is not a successor in interest to the six partnerships listed on the notices." Regarding the 2004 fourth-quarter employment taxes owed, TFT Galveston argued that the individuals hired were independent contractors, and that it wasn't responsible for withholding employment taxes. The court disagreed, citing Teachworth's controlling of nearly every aspect of work performed by the apartment workers as evidence that the workers should be classified as employees. "Although some of the workers had some latitude in how they performed their duties, ultimately Mr. Teachworth was the boss and had final authority on all work performed at the properties," the court said. The workers had little financial investment in TFT Galveston's business, were never at risk of suffering a personal financial loss and never had an opportunity for financial profit other that their salaries, the court said, ruling that the workers were to be classified as employees for tax purposes. In addition to owing that portion of employee taxes, the court ruled that TFT Galveston hadn't established reasonable cause for not filing the employment taxes, and owed tax code Section 6651(a)(1) additions to tax, as well as Section 6656 penalties.

4. **Criminal Tax.**

a. ***U.S. v. Jacobs,* (Mass).** A chiropractor, Jacobs, was sentenced to 9 months in prison for bribing an IRS agent. In August 2013, an IRS auditor met with Jacobs to examine numerous issues with his federal income tax forms for 2011. During the initial interview, the auditor advised Jacobs that two $5,000 payments were not allowable deductions after Jacobs admitted that each was a payment to two different women after they accused him of touching them inappropriately during medical treatments. Jacobs told the auditor that he paid the women because he was concerned that they would report him to the police or to the chiropractic board. Jacobs admitted that he began kissing one woman's feet while he was treating her. He also admitted to other inappropriate contact when he was giving the second woman a massage. Jacobs asked the IRS auditor if there was anything he could do to "just deal with this…" When the agent said he could not "just deal with this," Jacobs became agitated and combative, ultimately threatening the agent that he would "ruin [his] career." The following month, after several electronically monitored discussions regarding his non-deductible expenses, Jacobs offered to bribe the auditor in exchange for terminating the examination, saying, ". . . you want a bribe? You want me to pay you? . . ." The auditor, acting under the direction of law enforcement, then accepted Jacobs's offer of $5,000 to give Jacobs a favorable audit letter showing no additional tax for one year and a small refund for the next year. Jacobs paid the auditor $5,000 in cash for the favorable treatment. The electronically monitored discussions included an email in which Jacobs opened the opportunity for a bribe: "You want a bribe? You want me to pay you?"

b. ***United States v. Hendrickson*, E.D. Mich., No. 2:13-cr-20371 (4/8/15).** The wife of Peter Eric Hendrickson, who wrote "Cracking the Code: The Fascinating Truth About Taxation in America," was sentenced to 18 months in prison followed by one year of supervised release According to the government, the Hendricksons filed federal income tax returns for 2002 and 2003 on which they falsely claimed they earned zero wages. Based on those returns, the IRS issued tax refunds that the couple was not entitled to. Peter Hendrickson was convicted in 2009 of filing multiple false income tax returns—including the returns filed with his wife, Doreen Hendrickson—and was sentenced to prison. Doreen Hendrickson was convicted of criminal contempt in July 2014, after a jury found she violated a judge's injunction by failing to file amended 2002 and 2003 tax returns, and by filing a false income tax return in 2008. The Hendrickson's returns were based on "Cracking the Code" which argues that federal tax withholding and income taxes on wages do not apply to everyone.

c. ***United States v. Johnson*, 2015 U.S. App. LEXIS 5446 (6th Cir. 2015).** Pursuant to a Government concession that an indictment was one day late, the Court dismissed the indictment. Defendant filed his 2006 federal individual income return on February 17, 2007. On April 16, 2013, a grand jury returned an indictment charging defendant with one count of willfully filing a false 2006 federal individual income tax return, in violation of 26 U.S.C. § 7206(1). Section 6531 provides a six-year statute of limitations for various criminal offenses, including § 7206(1), tax perjury. Tax perjury relates to the filing of the return. So, the six-year period would, logically, commence on the date the return was filed. A return filed before the due date for the return is deemed filed on the due date of the return. In this case, the return was filed on February 17, 2007, thus clearly invoking § 6513(a) and was deemed filed on the due date of the return, April 15, 2007. Focusing only on the due date of the return, the subsequent indictment on April 16, 2013 was untimely. What confused the Government and the trial court was the application of § 7503 which provides that, where the due date falls on a weekend or holiday, a return filed on the next succeeding business day is "considered timely." In the present case, April 15, 2007 fell on a Saturday, thus making returns filed on April 17, 2007, a Monday, "considered timely." But, from a statutory interpretation standpoint, it did not change the statutorily imposed due date for the return. Accordingly, the Government conceded on appeal that Johnson's early filed return was deemed filed on the due date pursuant to § 6513(a). The result would be different had § 7503 provided that the due date is extended where the original due date falls on a weekend or a holiday. So, the bottom line, the defendant walked away from a criminal conviction because of a statute of limitations footfault. The order of restitution of $531,000 was also vacated.

d. ***United States v. Ducey*, S.D. Ind., No. 1:13-cr-00189, (4/27/15).** Three Indiana brothers pleaded guilty to charges they participated in a $145 million scheme involving the sale of fraudulent biodiesel incentives. The brothers pleaded guilty to charges of conspiracy, false claims against the Internal Revenue Service, wire fraud and lying to the Environmental Protection Agency and the Internal Revenue Service. Craig Ducey also pleaded guilty to a related $58.9 million securities fraud. The Duceys admitted that they bought biodiesel fuel from two New Jersey companies, Caravan Trading Co. LLC and CIMA Green LLC, and resold it through their own company, Middletown, Ind.-based E-biofuels LLC, along with fraudulent renewable identification numbers (RINs), which are used to track credits issued for biodiesel under the Energy Independence and Security Act (Pub. L. No. 110-140). Joseph Furando, who operated Caravan Trading and CIMA Green, also pleaded guilty for his role in the scheme, admitting that he and co-conspirator Katirina Tracy sold RIN-stripped B99, a blended biodiesel that isn't eligible for tax incentives, to E-biofuels. The conspirators fraudulently sold more than 35 million gallons of fuel for more than $145 million and realized more than $55 million in profits as a result. The Duceys claimed E-biofuels produced biodiesel from renewable sources, when in fact it produced no fuel of its own but simply resold biodiesel that had already been used to claim federal incentives.

5. Bankruptcy.

a. ***Wolff v. U.S*, No. 13-2116 (4th Cir. 12/12/14).** The issue and holding, whether the trustee in bankruptcy may reclaim as property of the debtor the approximately $28 million transferred by the debtor to the IRS during the 90 days preceding the filing of the bankruptcy petition. The bankruptcy court and the district court held that, as a matter of law, the debtor lacked an equitable interest in the funds paid over to the IRS. The Fourth Circuit found that the property lacked the prerequisite of being the debtor's property, because under applicable state law it held the funds in express trust and had no interest in the assets or discretion to use those funds for anything other than paying the government.

b. ***Mallo v. U.S.*, No. 1464 (10th Cir. 12/29/14).** The 10th Circuit ruled that taxes owed on late-filed tax returns cannot be discharged in bankruptcy. This ruling is consistent with a 5th Circuit ruling in 2012. The 10th Circuit case involved individuals who did not file tax returns in 2000 and 2001. The IRS filed SFRs in 2006 and assessed the tax. The taxpayers filed the tax returns in 2007 and sought bankruptcy protection in 2010. By that time, the tax debt would have been old enough for discharge had the tax returns been filed on time. The 10th Circuit opinion relied on the "plain" language of the statue in concluding that a late-filed return is not a return for purposed of Section 523(a). The court said it was "reasonable for Congress to limit dischargeability of tax debt reflected in late-filed returns." previous rulings regarding the discharge of a tax liability when the taxpayer does not file a tax return.

c. ***Fahey v. Mass. Dep't of Revenue* (*In re Fahey*), 1st Cir., No. 14-01328, 2/18/15).** U.S. Court of Appeals for the First Circuit followed the 10th Circuit and 5th Circuit in interpreting the so-called hanging paragraph inserted in Section 523(a) of the Bankruptcy Code by amendments in 2005. The First Circuitt, however, wasn't unanimous. The majority opinion by Judge William J. Kayatta Jr. was exceeded in length by a dissent from Judge O. Rogeriee Thompson. The lower courts in the First Circuit were divided on the issue, involving Massachusetts state taxes. Some bankruptcy judges and the circuit's Bankruptcy Appellate Panel ruled that a late-filed return was no bar to dischargeability. A Boston district judge took the opposite position. Kayatta said it wasn't unfathomable, draconian or absurd to believe Congress intended that a debt survive if the bankrupt never paid the tax and was also late in filing a claim. Kayatta said the statute isn't "materially ambiguous." The outcome of the case turned on an unnumbered subparagraph providing that a "return" must "satisfy the requirements of applicable nonbankruptcy law (including applicable filings requirements)."Kayatta said it is "more plausible that Congress intended to settle the dispute over late-filed tax returns against the debtor (who both fails to pay taxes and fails to file a return as required by law)."

d. ***In Re: Vaughn*, 2014 U.S. App. LEXIS 16417 (10th Cir. 2014).** The Court denied Vaughn a discharge of his tax debt arising from a BLIPS tax shelter. The bankruptcy court and district court said that under 11 U.S.C § 523 (a)(1)(B), a taxpayer may not be discharged in bankruptcy for a tax debt if: (1) "with respect to which the debtor made a fraudulent return" or (2) the debtor "willfully attempted in any manner to evade or defeat such tax."

e. ***Running v. Miller*, No. 13-3682, (8th Cir. 2/13/15).** Section 522(b)(3)(C) of the Bankruptcy Code exempts from property of the estate and the fate of liquidation "retirement funds to the extent that those funds are in a fund or account that is exempt from taxation under sections 401, 403, 408, 408A, 414, 457," or tax code Section 501(a). To qualify as a tax-exempt "individual retirement annuity" under tax code Section 408(b), the annual premium on behalf of any individual may not exceed the dollar amount in effect under tax code Section 219(b)(1)(A). The dollar amount in effect under 219(b)(1)(A) for the tax year at issue was $6,000. Nonetheless, Joseph Matthias Miller purchased an annuity from Minnesota Life Insurance Company in 2009 for a lump-sum "purchase payment" of $267,319, using funds from his individual retirement account. In return, Minnesota Life agreed to make an annual "income payment" of $40,498 to Miller for the next eight years. Subsequently, when Miller filed a Chapter 7 bankruptcy case and claimed the annuity as exempt from property of the bankruptcy estate, the Chapter 7 trustee objected. She argued that the debtor's contributions, which were in the amount of $267,319 in the year in which he purchased the annuity, exceeded the statutorily prescribed limit. The debtor said the funds he had used were not a premium. Concluding that "Miller has the better of this argument," the court excluded, from the definition of premium, funds that were a rollover contribution from an IRS-qualified plan. According to the court, annual premiums, as capped by 219(b)(1)(A), concern retirement contributions being made for the first time, not the disposition of retirement contributions made in the past. Significantly, the trustee had conceded that the debtor purchased his annuity using a rollover contribution, which allowed the court to rely on In re LeClair 2011 BL 132793 (Bankr. D. Mass., 2011), to make the distinction between using funds from a qualified plan to purchase an annuity and paying premiums. The trustee's final argument that the annuity must require multiple, annual premiums to qualify for tax exemption was similarly rejected. The court held that tax code Section 408(b) does not mandate the payment of an annual premium for an unspecified number of years; rather it requires that the annuity contract limit the funds being contributed in the first instance. The debtor's annuity accomplished this by providing that the annual premium may not exceed $2,000 or such other maximum amount as may be allowed by law. By limiting the debtor's ability to pay an annual premium in this manner, the annuity contract complied with Section 408(b). Accordingly, the debtor's annuity, purchased with one lump-sum payment from assets rolled over from an IRS-qualified plan, was tax-exempt and exempt from the Chapter 7 bankruptcy estate.

6. Summons.

a. ***U.S. v. Titan International*, No. 14-3263 (C.D. Ill. 12/12/14).** The IRS sought to obtain enforcement of its summons looking for the company's 2009 airplane flight logs and general ledger in connection with its 2010 audit. The taxpayer objected, as the IRS had previously audited its 2009 return, and reviewed the requested documents. The taxpayer attempted to rely upon Section 7605(b), which generally states taxpayers do not have to hand over their books and records multiple times for the same year. The IRS argued it needed the documents to verify a 2010 deduction, and did not intend to review 2009 again. The Court found the testimony and reasoning of the IRS valid, and enforced the summons.

b. ***Amazon.Com Inc. v. Commissioner*, T.C. Memo 2014-245 (2014).** A trial subpoena served on the CEO of Amazon.Com, Jeff Bezos, was quashed for various reasons. The IRS did not include the CEO on its list of individuals it wanted to depose before trial and multiple witnesses had already testified on the subjects about which the IRS sought to question the CEO. After balancing the burden on the subpoenaed party against the value of the information sought, the court determined that the subpoena imposed an undue burden on the CEO.

c. ***Jewell v. United States*, 749 F.3d (10th Cir. 04/28/14).** The 10th Circuit held that when the IRS issues a third party records summons, under Section 7609, is must comply with the requirements of 7609, including the requirement that the taxpayer be given 23 days' notice of the summons.

d. ***United States v. Clarke*, No. 13-301 (U.S. Supreme Court 06/19/14).** The Supreme Court reversed the Eleventh Circuit, holding "that a bare allegation of improper purpose" on the part of the IRS in issuing a summons "does not entitle a taxpayer to examine IRS officials. Rather, the taxpayer has a right to conduct that examination when he points to specific facts or circumstances plausibly raising an inference of bad faith.

e. ***United States v. McEligot*, No. 3:14-cv-05383, (N.C. Cal. 4/6/15).** A federal district court in California denied an accountant's motion to dismiss a petition to enforce an IRS summons ordering him to testify and produce redacted documents that were part of a civil tax audit. The IRS issued the CPA a summons to testify regarding the investigation of the taxpayer. The CPA attended the hearing, but would not answer questions because the IRS refused to allow the taxpayer's counsel to be present. The U.S. subsequently brought forward a petition to enforce the summons, and the district court directed the CPA to show cause why he should not be compelled to appear and provide documents and testimony as required by the summons. The taxpayer filed a motion to intervene before the court in the summons enforcement proceedings, which the government did not oppose. The CPA then filed a motion to dismiss the petition, asserting that his only objection to complying with the summons stemmed from the government's refusal to allow the taxpayer to be present at the IRS proceedings, which he now claimed rendered the petition "moot" since the taxpayer's representative had intervened as a party. After the U.S. argued that the taxpayer's counsel should not be present during the questioning of a third-party witness, the court decided the question to resolve was "whether the taxpayer has a right to be present at the IRS proceedings." "[A] taxpayer does not have an absolute right to be present at a third party IRS summons proceeding concerning the taxpayer's liabilities," the Court said. "In order to determine whether a taxpayer should be permitted to be present at such a hearing, a court must engage in '[t]he usual process of balancing opposing equities.'" The court ruled that the equities did not weigh in favor of permitting the taxpayer to be present at the IRS proceedings, and that the government had a legitimate interest in obtaining the information regarding the taxpayer's tax liabilities. The court refused the CPA's motion to dismiss or order the IRS to permit the taxpayer or his counsel to be present at the summons proceeding, and instead ordered the CPA to appear and testify before the IRS.

7. Midco Transactions.

a. ***Andrew v. United States*, No. 1:10-cv-00090, (M.D.N.C. 2/12/15).** The U.S. District Court for Middle District of North Carolina ruled in a memorandum opinion that a total of \$3.82 million transferred to the shareholders of GNC Investors Club Inc. in exchange for their shares was not a fraudulent transfer under applicable North Carolina law. The judge then concluded that the GNC shareholders were not liable under tax code Section 6901 for \$1.16 million in federal taxes that was not paid by the purchaser of their shares, Battery Street Inc., and \$231,626 in penalties. The judge said that even if she considered loan documents and bank records that she had found inadmissible, "there is no evidence that any plaintiff had actual knowledge of Battery Street's post-closing plans. No plaintiff knew at the time GNC's stock was sold to Battery Street that Battery Street would cause GNC not to pay its taxes." In the spring of 2000, the shareholders began to consider alternative business models that would allow them to avoid the double-taxation resulting from the C corporation status of GNC, which was formed in 1957. In fall 2000, a local attorney suggested selling GNC through MidCoast Credit Corp., which had expressed an "interest in acquiring the stock of C corporations and paying its shareholders a premium in excess of the amount they would otherwise receive from liquidation" The shareholders agreed to sell their shares to Battery Street, a newly formed corporation, after confirming that MidCoast had favorable references with Dun & Bradstreet and that Battery Street was an existing company. GNC liquidated its publicly traded stock for $5 million. Battery Street then agreed to buy all of the GNC shares for $3.82 million. The stock purchase agreement required Battery Street to pay GNC's federal tax liabilities of $1.21 million and state tax liabilities of $267,790 for the tax year ending April 1, 2001. Unbeknownst to the GNC shareholders, Battery Street borrowed the purchase funds from Southeast Acquisition Partners (SEAP) under the condition that the loan be repaid within 24 hours. Battery Street never paid the taxes. In 2008, the IRS proposed assessments against the original shareholders. The shareholders paid the collective deficiency and sued for a refund. The ruling follows the government's decision to drop an appeal of the U.S. Tax Court opinion in Julia R. Swords Trust v. Commissioner, after the heirs of the founder of the Reynolds Metals Co. succeeded in having the case transferred to the U.S. Court of Appeals for the Fourth Circuit from the U.S. Court of Appeals for the Sixth Circuit (15 DTR K-1, 1/23/15). In Julia R. Swords Trust, the IRS sought to have transferee liability applied to the Reynolds heirs after the purchaser of their shares in a personal holding company offset its gain on the sale of the holding company's assets in a Son-of-BOSS (bond option sales strategy) transaction. Regarding Julia R. Swords Trust, Timothy M. Todd, an assistant professor of law at Liberty University in Lynchburg, Va., told Bloomberg BNA Jan. 21, "The Fourth Circuit is one court that has consistently rejected the IRS's argument."

b. ***Feldman v. Commissioner*, No. 12-03144, (7th Cir. 2/24/15).** The U.S. Court of Appeals for the Seventh Circuit affirmed a 2011 U.S. Tax Court decision, finding that the former shareholders of a Wisconsin dude ranch were liable for the corporation's unpaid taxes following what was in substance a liquidation. As with most midco transactions, the taxpayers held shares in a closely held C corporation—Woodside Ranch Resort Inc.—which held greatly appreciated assets and was formed before passthrough entities became a viable alternative. The taxpayers were descendents of William Feldman, the founder of the Woodside, and decided in 2002 that they wanted to sell the ranch but were concerned about the double tax liability that could be incurred. The taxpayers found a buyer, but that buyer insisted on an asset sale that would result in taxable capital gain of $1.8 million. While the asset sale was pending, Woodside's accountant introduced the taxpayers to representatives of MidCoast Credit Corp. and Midcoast Acquisition Corp. (collectively, Midcoast), which "specialized in structured transactions designed to avoid or minimize tax liabilities," the court said. Midcoast arranged a transaction following the asset sale, in which the shareholders sold their Woodside stock to Midcoast with cash from the asset sale ultimately being transferred from Woodside's accounts to a limited liability company owned by the former Woodside shareholders. The transaction included a purported loan from one of the owners of Midcoast and some provisions regarding unknown future personal-injury claims and a statement that Midcoast would pay Woodside's tax liabilities. Ultimately, however, Woodside was left with not enough cash in its accounts or other assets to meet those tax liabilities. The law firm of Foley & Lardner LLP served as escrow agent for the cash transfers. Foley and another law firm earned a total of approximately $38,000 in professional fees on the deal. The typical midco planning precautions were not present. First, the corporate assets were sold before the stock sale (while the original shareholders still owned the target's stock) so that all the target owned at the time of the stock sale was cash. Instead of a third party—typically a bank—financing of the stock purchase price, cash was circled from seller to buyer and back to seller. Further, the buyer's plan to use a questionable tax shelter was revealed to the sellers. The 7th Circuit affirmed the Tax Court's application of "both the substance-over-form principle and the economic-substance doctrine to conclude that the stock sale should be recast as a liquidation." The 7th Circuit said the Woodside shareholders effectively liquidated "the corporation without absorbing the financial consequences of the tax liability. The taxes were never paid." The court found that the transaction resulted in a fraudulent transfer under Wisconsin law, because of the broad definition of "transfer" under the state's version of the Uniform Fraudulent Transfer Act. The 7th Circuit said that in finding whether there is liability under tax code Section 6901, independent determinations of transferee status are required under the tax code and under the applicable state fraudulent transfer law. The court agreed with the precedent of the four other U.S. Courts of Appeals that have addressed the issue—the First, Second, Fourth and Ninth Circuits—in ruling that independent determinations were required. The Seventh Circuit joined those other circuits in rejecting the IRS's position that transferee status need only be determined once by recharacterizing or collapsing a transaction to determine transferee status under Section 6901 and then determining substantive liability "by applying state law to the transaction as recast under federal law." The court said that while there was no conflict between the federal tax doctrine and state law in this case, an independent state-law inquiry will make a difference in the outcome "when there is a conflict between the applicable federal tax doctrine and the state law that determines substantive liability."

c. ***Stuart v. Commissioner*, 144 T.C. No. 12 (4/1/15).** In a series of four consolidated cases, the Tax Court found that several former shareholders in a Nebraska corporation were transferees, owing the corporation's unpaid tax liability for 2003. The Court ruled that the shareholders each were individually liable as transferees with respect to their respective shares equaling $58,842 of Little Salt Development Co.'s unpaid taxes. The IRS determined and assessed a deficiency in Little Salt's 2003 taxes in the amount of $145,923, as well as an accuracy-related penalty of $58,369, which Little Salt had not paid at the time of trial. The shareholders were each notified by separate notices of liability that they owed Little Salt's unpaid taxes to the extent of the net value of the assets, ranging from around $60,000 to $120,000, that each had received from the now dissolved corporation. In 2003 Little Salt had sold 160 acres of saline wetlands to the city of Lincoln, Neb., and received $471,111 from the sale, realizing a gain of $432,148 on the sale of the land. After the sale, the company didn't engage in any business activity anymore. In April 2003, MidCoast Investments Inc. proposed an acquisition of all of Little Salt's outstanding shares in a letter to the each shareholder. The letter also contained MidCoast's covenant that it would cause Little Salt to pay the deferred tax liability to the extent that the deferred tax liability is due given the company's post-closing business activities. All shareholders signed the letter, although some testified that they "may have very briefly skimmed it." On Aug. 6, 2003, MidCoast transferred an agreed-upon $358,826 into an account controlled by the Little Salt shareholders, with the agreement becoming effective the next day, and the pro rata shares distributed to each shareholder on August 8, 2003. In December 2003 Little Salt filed its corporate tax return, and in February 2005 filed its 2004 corporate taxes. The IRS examined both the 2003 and 2004 returns, and disallowed both a 2004 bad debt deduction that had been claimed, and the loss carried back to, and deducted for, 2003, and it assessed the corporation with its deficiency and penalty. Little Salt failed to timely petition the Tax Court; however, once all the shareholders were served with notices of their liability as transferees by the IRS, they timely petitioned the court again disputing the notices. The Little Salt shareholders argued that after receiving the distributions in liquidation of their Little Salt shares, "Little Salt could no longer exist," for purposes of filing a tax return for 2004. The Court disagreed, and not only ruled that the shareholder's understanding of the corporation's obligation was wrong, but further ruled that Little Salt's transferring of funds to their controlled account causing the company to become solvent was fraudulent, and affirmed the IRS's determination that each shareholder was a transferee within the meaning of tax code Section 6901, owing their respective shares of the 2003 unpaid corporate tax.

8. <u>Hobby Loss</u>.

a. ***<u>Burnett Ranches, Ltd. v. United States</u>*****<u>, 753 F.3d 143 (5th Cir. 05/22/14)</u>.** Burnett Ranches operated two cattle and horse breeding operations and reported on the cash method. The principal owner, beneficial owner, and the manager, of Burnett Ranches, Anne Burnett Windfohr Marion, interposed an S corporation between herself and one of the two major ranch properties (6666, the Four Sixes) and had a direct interest in and was a beneficiary of a trust that held an interest in the other major ranch property (Dixon Creek). The IRS took the position that Burnett Ranches was a "farming syndicate" required by § 464 to use the accrual method of accounting. Speaking generally, § 464 requires farming partnerships to use the accrual method if they are either (1) syndicated or (2) more than 35 percent of losses are attributable to limited partners. But because it is targeted at late twentieth century tax shelters, it has a number of exceptions that cover "family farms." The taxpayer maintained that the exception in § 464(c)(2)(A) for active management by an individual holding an interest (even if as a limited partner) applied. The government conceded that (1) Ms. Marion did "actively participate" in the management of Burnett Ranches' agricultural business for not less than five years previously, and (2) her interest in Burnett Ranches is "attributable to" her active participation, but argued that the interposition of the S corporation between the entity owning the ranch and Ms. Marion rendered the exception inapplicable. The District Court granted judgment in favor of the taxpayer, and, in an opinion by Judge Wiener, the Fifth Circuit affirmed. The court rejected the government's argument that the interest of the individual actively managing the farm or ranch had to be held by direct legal title for the exception to apply. Focusing on the language of § 464(h)(2)(A), which describes the excepted interest as "In the case of any individual who has actively participated (for a period of not less than five years) in the management of any trade or business of farming, any interest in a partnership or other enterprise which is attributable to such active participation," the court reasoned that by using the language "interest ... attributable to such active participation," "Congress did not restrict sub-subsection (A)'s particular exception to interests of which such an actively participating manager holds legal title in his or her name."

b. ***Tolin v. Commissioner*, T.C. Memo. 2014-65 (04/09/14).** The taxpayer, who lived in Minnesota, established that he had devoted sufficient hours to a thoroughbred breeding and racing activity based in Louisiana, through a combination of: (1) credible testimony of his employees and agents regarding the time they spent annually in telephone calls with the taxpayer, coupled with the taxpayer's telephone records establishing that the calls had been made (300 hours); (2) the amount of time that the IRS stipulated that the taxpayer had spent in Louisiana, coupled with the taxpayer's testimony and the testimony of third party witnesses regarding the taxpayer's workday activities, even though credit card records showed that he engaged in some nonbusiness activity while in Louisiana (150-180 hours); and (3) his preparation and mailing of the promotional breeding packages (the voluminous contents of which were stipulated by the parties) and the miscellaneous administrative tasks he completed (enough hours to reach 500). Thus, the Tax Court (Judge Gale) held that the breeding and racing activity was not a passive activity, and the taxpayer's deductions for losses related to the activity were not limited by § 469.

c. ***R Price III v. Commissioner*, T.C. Memo 2014-253 (2014).** Married individuals who owned and operated several vehicle dealerships and a horse breeding facility were not entitled to deduction from the horse-related activity as it was not engaged in for profit during the 3 years at issue. The court rejected that the taxpayers claim that, for purposes of Section 183, their vehicle and horse-related undertaking constituted a single activity. In addition, in reviewing the factors under the Section 183, the court found that the horse-related undertaking was not conducted for profit. The court held for the taxpayers on penalties, finding that the taxpayers took the horse-related activity seriously, relied on a tax professional, and made good-faith efforts to assess their tax liability. They demonstrated reasonable cause and good faith for their position.

d. ***Shah v. Commissioner*, T.C. Memo. 2015-31, (2/25/15).** The U.S. Tax Court o found that the taxpayer's activities were not operated for a profit, because they did not satisfy any of the factors set forth under tax code Section 183. The court said that the husband's information technology, financial management, consulting and real estate rental activities were not engaged in with a profit motive, because the husband:

i. neither sought nor received compensation for services, which were provided only to family members and their businesses;
ii. had not spent significant time studying financial markets, investing or real estate, and wasn't licensed to provide those services;
iii. did not show how much time or effort he spent in the activities;
iv. did not show what assets he had in the businesses or that they would appreciate;
v. was not successful in other areas;
vi. had a history of losses from his activities;
vii. did not have even occasional profits; and
viii. appeared to be supported by his wife's income as a physician.

The court affirmed a 20 percent accuracy-related penalty under tax code Section 6662(a) and (b)(1) and (2).

e. ***Metz v. Commissioner*, T.C. Memo. 2015-54 (3/23/15).** The Tax Court ruled that the taxpayers, owners of Silver Maple Farm (SMF), had established the requisite qualities of business-owners who intend to garner a profit from their venture. In 1989, the taxpayers, who owned a baking business before becoming involved in horse breeding, received $10 to $12 million when a Belgian sugar company took on a major interest in their baking business. SMF was started in 1991 and registered in Iowa as an S corporation. The couple worked full time on the horse business—the wife covered advertising and promotion while the husband served as the company's vice president and treasurer. The business was run out of Sioux City, Iowa, but moved to Naples, Fla., in 1995 after a string of annual losses. The move did not yield the profits the couple had anticipated, however, so they moved to the Santa Ynez Valley in California in 2003. SMF continued to struggle, burning through millions of dollars between 1999 and 2009, but the couple still remained optimistic about the company's future. The IRS audited the taxpayers starting in 2005. The audit was expanded to 2004 through 2009, with the IRS issuing a notice of deficiency for 2004 to 2007 in 2010, and for 2008 to 2009 in 2011, which disallowed SMF's passthrough losses, net operating loss carryforwards and investment interest deductions. The court ruled that the couple had kept records in a businesslike manner, had legitimate recorded business plans, presented professional-quality promotional material and acquired professional help when needed to satisfy tax code Section 183 requirements for operating a business with the subjective intent of making a profit. "A taxpayer must demonstrate expertise and attempts to improve results in a money-losing business. The Metzes plainly meet that requirement".

9. **Passive v. Active.**

a. ***Wade v. Commissioner*, T.C. Memo. 2014-169 (08/20/14).** The husband and wife taxpayers owned stock in two S corporations that passed through to them losses. The IRS disallowed the losses as passive activity losses subject to § 469. The record established that Mr. Wade spent "over 100 hours participating in TSI and Paragon during 2008, and his participation consisted primarily of non-management and noninvestment activities, while his son managed the day-to-day operations of the companies. Mr. Wade focused on product development and customer retention. The Tax Court found that Mr. Wade's "efforts were continuous regular, and substantial ... Mr. Wade brought something to [the companies] that no one else could have, and they could not have continued to operate without his contacts and expertise." Accordingly, pursuant to the "facts and circumstances" test in Reg. § 1.469-5T(a)(7), which requires participation on a "regular, continuous, and substantial basis" during the year, Mr. Wade materially participated in the companies' activities. That the record did not establish that Mrs. Wade actively participated in the companies was irrelevant because Reg. § 1.469-5T(f)(3) provides that participation by a married taxpayer is treated as participation by his or her spouse. Thus, Mr. Wade's material participation in the companies was sufficient to establish material participation for Mrs. Wade.

b. ***Lamas v. Commissioner*, T.C. Memo. 2015-59, (3/25/15).** The Tax Court found that a Florida real estate businessman had "materially participated" in two businesses, rendering the passive loss limitation of tax code Section 469 inapplicable to losses incurred for 2008. The court ruled that the taxpayers, who in 2008 claimed substantial losses from two real estate entities as tentative carryback adjustment to 2006, had met material participation requirements and labeled the losses as "not passive." The taxpayers ran a successful lumber company starting in 1997, selling the company in 2007. The husband's father had created three businesses for his children to run, structuring each business with one child as the majority owner, and with the other two children holding the remaining percentage. The Taxpayers owned the majority share of Adrimar Investments Corp. and a minority share in Shoma Development Corp., which later formed a company called Greens at Doral LLC, a condominium conversion project. Throughout 2008, The taxpayers worked on behalf of Shoma and Greens to restore corporate assets to Shoma and to find additional investors to Shoma's projects to fill Shoma's capital needs. In early 2008, the husband—along with his sister—initiated a derivative lawsuit on behalf of Shoma against their brother-in-law for stealing business opportunity away from Shoma. The case was eventually settled in April 2008 after extensive negotiations. The IRS began auditing the Taxpayers' 2006 and 2008 returns and eventually determined a deficiency for 2006 that was solely attributable to carrybacks from 2008. The Taxpayers cooperated with various IRS requests, while the IRS said the couple failed to cooperate with requests for two information documents. The IRS deficiency for 2006 totaled nearly $5 million, and recharacterized the Taxpayers' 2008 claimed net operating losses from Shoma and Greens as passive instead of nonpassive.

The brother-in-law had made inconsistent statements as a witness in the IRS investigations about the taxpayer husband's work for Shoma. However, 10 witnesses at trial credibly testified that the Taxpayer Husband had made significant efforts working for Shoma, Greens, and other projects during 2008 that the Court said qualified the Taxpayer Husband as having "materially participated" in Shoma and Greens during 2008.

c. ***Williams v. Commissioner*, T.C. Memo. 2015-76, (4/16/15).** More than $100,000 in income from real estate that a Texas couple received through an S corporation for tax years 2009 and 2010 should be characterized as nonpassive income. The Tax Court Judge Joseph W. Nega ruled that the taxpayers could not offset income they received from a rental property with passive losses. The taxpayers owned 100 percent of BEK Real Estate Holdings LLC, an S corporation, and 100 percent of BEK Medical Inc., a C corporation. The taxpayer husband worked full time for BEK Medical during 2009 and 2010, but did not participate in the activities of BEK Real Estate or the rental of commercial real estate to BEK Medical. In 2009 and 2010, BEK Real Estate leased commercial real estate to BEK Medical, which BEK Medical used in its business activities. The property yielded rental income of $54,285 and $48,657 for BEK Real Estate in 2009 and 2010, respectively, which the taxpayers listed on their Schedules E (Form 1040), Supplemental Income and Loss, for the two years. The taxpayers offset the amounts with passive losses from other S corporations, partnerships and personally owned rental properties. The IRS reclassified BEK Real Estate's rental income as nonpassive, and disallowed the taxpayers' passive losses that were claimed in excess of their adjusted passive income for the two tax years. At trial, the IRS argued that because the taxpayers received income through BEK Real Estate from property that was rented to BEK Medical, in which the taxpayer materially participated in, the income should be classified as nonpassive. The taxpayers argued that tax code Section 469 did not apply to S corporations. The court agreed with the taxpayers that Section 469 did not specifically refer to S corporations. However, the court found that Section 469 still applied to the taxpayers' S corporation activity in determining the character of income received from BEK Real Estate. "The Court has previously recognized that income and losses from passthrough entities are subject to section 469, even though passthrough entities are not specifically included in the list of 'taxpayers' to whom section 469 is applicable," the court said.

10. Estate and Gift Tax.

a. ***Bross Trucking, Inc. v. Commissioner*, T.C. Memo. 2014-107 (06/05/14).** For many years Mr. Bross had owned and operated Bross Trucking, Inc., using leased vehicles. Bross Trucking's principal customers were three businesses owned by other Bross family members. Bross Trucking did not have any formal written service agreements with its customers, relying instead on Mr. Bross's close personal relationships with the owners of the customer businesses. Due to violations of state regulatory law, Bross Trucking was in danger of losing its hauling authority. As a result, Bross's sons—who were owners of Bross

Trucking's customers—formed a new trucking company, LWK Trucking, 98.2 percent of which was owned by Bross's sons' self-directed IRAs and the remainder of which was owned by an unrelated third party. Mr. Bross was not involved in managing LWK Trucking. LWK Trucking hired several Bross Trucking employees and leased trucks that formerly had been leased to Bross Trucking. Until the vehicles were repainted (or magnetic signs installed) they bore the Bross Trucking logo. The IRS asserted that Bross Trucking had distributed "its operations," including "(1) goodwill; (2) established revenue stream; (3) developed customer base; (4) transparency of the continuing operations between the entities; (5) established workforce including independent contractors; and (6) continuing supplier relationships," all of which the court collectively described as "goodwill" to Mr. Bross, triggering gain to the corporation (which did not liquidate until several years later) under § 311(b) and that Mr. Bross in turn had made a taxable gift of that goodwill to his sons. The Tax Court (Judge Paris), based on analogizing the facts in the instant case to the differences in the facts and results in Martin Ice Cream Co. v. Commissioner, 110 T.C. 189 (1998) and Solomon v. Commissioner, T.C. Memo. 2008-102, concluded that except for workforce in place Bross Trucking had no goodwill at the time of the "alleged transfer." Although it "might have had elements of corporate goodwill at some point ... through various regulatory infractions Bross Trucking lost any corporate goodwill because of an impending suspension and the negative attention brought by the Bross Trucking name." Judge Paris went on to find that "The remaining attributes assigned to Bross Trucking's goodwill all stem from Mr. Bross's personal relationships. Bross Trucking's established revenue stream, its developed customer base, and the transparency of the continuing operations were all spawned from Mr. Bross's work in the road construction industry."

A company does not have any corporate goodwill when all of the goodwill is attributable solely to the personal ability of an employee. See MacDonald v. Commissioner, 3 T.C. 720, 727 (1944); Norwalk v. Commissioner, T.C. Memo. 1998-279. Unlike the taxpayer's products in Solomon v. Commissioner, T.C. Memo. 2008-102, Bross Trucking's products did not contribute to developing the goodwill.

Furthermore, "Mr. Bross did not transfer any goodwill to Bross Trucking through an employment contract or a noncompete agreement." No other Bross Trucking intangible assets were transferred because Bross Trucking's prior customers became LWK's customers and no longer wanted to deal with Bross Trucking due to its regulatory problems, and "LWK Trucking did not benefit from any of Bross Trucking's assets or relationships. LWK Trucking was independently licensed and developed a wholly new trucking company."

b. ***Estate of Belmont v. Commissioner*, 144 T.C. No. 6, (2/19/15).** The Tax Court ruled in a division opinion that the estate of Eileen S. Belmont should have anticipated that funds set aside for the Columbus Jewish Foundation (CJF) might be depleted because of "ongoing and future litigation" over a Santa Monica, Calif., condominium. Belmont, who died in April 2007, instructed in her will that the majority of her real, personal and intangible property be left to her mother, Wilma, if she were still alive at the time of Belmont's death. Because Belmont's mother predeceased her, the will provided that the property become part of the estate's residue, with $50,000 going to her brother David, and the remainder to the CJF. At the time of Belmont's death she owned two properties, a personal Ohio residence and the condo in Santa Monica. After the sale of the Ohio property, and including a retirement fund controlled by Belmont, the estate had $285,009 as of March 31, 2008, in its checking account. On Form 1041, U.S. Income Tax Return for Estates and Trusts, the estate reported income of $241,184 from Belmont's retirement account, $721 of interest income and a $3,000 long-term capital loss. The estate claimed deductions of $21,604 in miscellaneous expenses and a charitable contribution in the amount of $219,580, for the taxable period ending March 31, 2008. The charitable contribution was based on Belmont's will leaving the residue of her estate to the foundation; however, as of July 17, 2008, when the return was filed, no charitable contribution had been made to the foundation. The funds intended for the foundation also weren't separated from the other estate checking account funds that were used to pay claims and administrative expenses. An ancillary estate was opened in California to administer the California condo and the estate hired a California probate administration law firm, Hoffman, Sabban & Watenmaker, to handle the affairs surrounding the property. David sought to exchange the $50,000 his sister left him in her will for a life tenancy interest in the Santa Monica condo. The CJF refused, asking him to vacate the condo in exchange for a $10,000 stipend, because it didn't want "to hold real estate as an investment." Eventually, David hired legal counsel contesting a life tenancy in the Santa Monica condo he thought was owed to him as part of an oral agreement between him, Belmont and their mother. The estate incurred various expenses resulting from the litigation and appeals that ensued concerning the condo starting in 2011 at trial and ending in 2013. To pay the expenses, the estate depleted some of the $219,580 that had been set aside for the foundation, leaving approximately $185,000 in the checking account. The IRS disallowed the charitable deduction claimed on the estate's 2008 return, arguing that the estate had not permanently set aside the money as a charitable contribution as required by the tax code. The estate argued that during the taxable year ending March 31, 2008, it had set aside $219,580. The Court agreed with the IRS, ruling that the funds had not been permanently set aside. The estate "should have known that there was more than a 'negligible chance' that it would have to apply some of the funds" to cover administrative costs as probate continued. "The estate faced the possibility that David would engage in prolonged and expensive litigation over his interest in the Santa Monica condo," the Court said in the opinion. "All of these events occurred and were known to the estate before July 17, 2008, when the estate claimed a $219,540 charitable contribution deduction on its Form 1041." According to the opinion, "An amount will not be deemed 'permanently set aside' for a charitable purpose under section 642(c)(2) 'unless under the terms of the governing instrument and the circumstances of the particular case the possibility that the amount set aside, or to be used, will not be devoted to such purpose or use is so remote as to be negligible.' ”

c. ***Mikel v. Commissioner*, T.C. Memo. 2015-64, (4/6/15).** A trust clause requiring that any dispute over interpretation be submitted to a faith-based arbitration panel did not negate a per-individual gift tax exclusion. The Tax Court ruled that a trust provision requiring that any dispute over interpretation of the trust be submitted to an Orthodox Jewish arbitration panel—called a beth din—did not invalidate the immediate demand clause, and, thus, preserved the gift tax exclusions for 60 individual beneficiaries. The court found that a provision requiring that interpretation disputes be brought before a beth din did not limit a beneficiary's right for a limited period of time to withdraw an amount equal to the annual gift tax exclusion from a “Crummey trust.” “A beneficiary would suffer no adverse consequences from submitting his claim to a beth din,” and the IRS did not explain why the provision was not sufficient enforcement to protect a beneficiary's withdrawal right. The court found that the demand provision in the irrevocable inter vivos trust was substantially similar to the type of trust often called a Crummey trust. The IRS attempted to distinguish the trust from a Crummey trust by arguing that a beneficiary's absolute withdrawal right was “illusory,” because the beneficiary would be intimidated from attempting to enforce his right before a beth din. The court said if the beneficiary were to seek enforcement of withdrawal rights in state court, trust provisions causing the beneficiary to forfeit his rights for opposing a distribution would not apply.

11. Tax Professionals.

a. ***Loving v. Internal Revenue Service*, 742 F. 3d 1013 (D.C. Cir. 2014).** The district court enjoined the IRS from regulating otherwise “unregulated” tax return preparers because they are not representative and do not practice before the IRS. The D.C. Circuit agreed that tax preparation is not “practice before the IRS” and said it was unreasonable for the IRS to require tax return preparers to pass character, competency and continuation requirements. The IRS did not appeal the decision.

b. ***Ridgely v. Lew, et al.*, No. 1:12-cv-00565 (D.C. D.C. 07/16/14).** In a case that follows Loving, the district court held that the IRS does not have the authority to regulate a tax return preparer’s contingent fee arrangement in the preparation of an ordinary refund claim.

c. ***Sexton v. Hawkins*, No. 2:13-cv-00893 (D.Nev. 10/30/14).** The court granted an injunction against Karen Hawkins, Director of the Office of Professional Responsibility, barring Hawkins from suspending or curtailing the plaintiff’s ability to electronically file tax returns on behalf of clients of his employer. The court further ordered that the plaintiff and his employer are not required to produce documents or respond to inquiries regarding the IRS’s investigation of the plaintiff or his employer.

12. Captive Insurance.

a. ***Rent-A-Center, Inc. v. Commissioner*, 142 T.C. No. 1 (01/14/14).** The parent of an affiliated group of domestic corporations (RAC) conducted its business through stores owned and operated by its subsidiaries. The parent established a Bermudian insurance company (Legacy) and the operating subsidiaries entered into insurance contracts with Legacy pursuant to which each subsidiary paid Legacy an amount, determined by actuarial calculations and an allocation formula, relating to workers' compensation, automobile, and general liability risks. Legacy, in turn, reimbursed a portion of each subsidiary's claims relating to these risks. Although the parent corporation was a listed policyholder, no premium was attributable to it because it did not own stores, have employees, or operate vehicles. RAC paid the premiums relating to each policy. The operating subsidiaries deducted, as insurance expenses, the payments to Legacy. In addition, in a complex arrangement RAC guaranteed up to $25 million of Legacy's liabilities, and the guaranty was treated as an asset of Legacy by the Bermudian insurance regulators. The IRS issued a deficiency notice based on the position that the payments by the operating subsidiaries to Legacy were not deductible as insurance premiums. The Tax Court (Judge Foley) held that the payments were deductible as insurance premiums. First, in forming Legacy, RAC "made a business decision premised on a myriad of significant and legitimate nontax considerations." Second, the flow of funds was not circular. Third, Legacy was not a "sham," but "was a bona fide insurance company." Legacy "charged actuarially determined premiums; was subject to the BMA's regulatory control; met Bermuda's minimum statutory requirements; paid claims from its separately maintained account; and, as respondent's expert readily admitted, was adequately capitalized." Finally, the payments were insurance premiums, because the policies shifted risk between RAC's operating subsidiaries and Legacy. Under the principles of *Humana Inc. & Subs. v. Commissioner*, 881 F.2d 247 (6th Cir. 1989), aff'g in part, rev'g in part and remanding, 88 T.C. 197 (1987), because the subsidiaries owned no stock in the captive insurance company, risk was shifted and distributed. The court expressly rejected adoption of the IRS's "economic family theory," *see* Rev. Rul. 77-316, 1977-2 C.B. 53, as have other courts that have examined the issue. Judge Foley found RAC's guarantee of up to $25 million of Legacy's liabilities not to be relevant. Legacy's guaranty did not affect the balance sheets or net worth of the operating subsidiaries insured by Legacy.

b. ***Securitas Holdings Inc. v. Commissioner*, T.C. Memo 2014-225 (10/29/14).** The court found that the taxpayer had established a captive insurance arrangement among its U.S. holdings and was entitled to premium expense deductions. The court ruled that the captive arrangement in the affiliated group adequately shifted risks, distributed risks and constituted insurance in the commonly accepted sense to allow premium expense deductions under Section 162.

13. **Valuation.**

a. ***Estate of Elkins v. Commissioner*, No. 13-60472 (5th Cir. 09/15/14).** The 5th Circuit reversed the Tax Court and recognized the fractional-ownership discount. The case involved numerous valuable artworks which were retained by the decedent individually or held in a GRIT for the decedent's benefit for life. Upon the death of Mr. Elkins, the second to die, the estate claimed a 44.57% discount on the art because the decedent owned a fractional interest. Despite no expert report from the IRS, the Tax Court determined a 10% discount should apply. The 5th Circuit concluded that the evidence offered by the estate was credible and that the Tax Court could not, without expert testimony, conclude the 10% discount was more reasonable.

14. **Attorney's Fees.**

a. ***Larry J. Austin v. Commissioner*, T.C. Memo 2014-245 (2014).** The IRS prevailed in showing it was substantially justified in its position regarding foreign interest on accounts held in the name of the taxpayer, even though the interest was not actually taxable to the taxpayer. Although the taxpayer prevailed on the item and amount in controversy, and met the financial thresholds for fees, the Service position was reasonable enough to prevent the imposition of costs. A qualified offer was presumably not provided in this matter; although, there was a stipulated settlement, so the Service could have argued the concession was not the taxpayer prevailing, perhaps making such an offer useless.

b. ***P. Milligan v. Commissioner, T.C. Memo 2014-259 (2014)*.** An individual was not permitted to recover administrative costs. The government position was substantially justified because the IRS Appeals office conceded the case. When the IRS finally took a position with respect to the taxpayer's claim, it allowed the claim. The court recognized that the taxpayer incurred some cost and stress; however, she was not able to recover any administrative costs.

c. ***U.S. v. Banker*, No. 1:13-cv-00213 (D.N.H. 1/8/15).** The court ruled that the federal government owed attorneys' fees to the defendant because the suit against her was not "substantially justified". The court granted the taxpayer's motion for fees related to a property tax lien case she had been involved in with her ex-husband. The government argued that the motion should be denied because its decision to sue the taxpayer was substantially justified. The taxpayer had acquired property from her ex-husband pursuant to a divorce decree, which the government attempted to force the sale of, based on tax liens obtained against the ex-husband. The court said that because the ex-husband had no interest in the property when the tax liens accrued, the liens did not apply to the property.

d. ***Carriker v. Dep't of Treasury*, No. 3:14-cv-00154,(W.D.N.C. 2/5/15).** A board member for a nonprofit medical clinic could pursue a claim for his legal fees and court costs after the IRS conceded he wasn't liable for the clinic's employment taxes. The U.S. District Court for the Western District of North Carolina denied the government's motion to dismiss a claim for court costs by board member and certified public accountant Phillip Duane Carriker in his challenge to an assessment against him by the IRS for the clinic's payroll tax liability. The IRS conceded to Carriker's claims for abatement of penalties, return of funds held by the IRS and interest, but it moved to dismiss Carriker's claims for court costs, costs in defending his license in a state board proceeding and his own efforts involved in the case. The court said the government failed to show that U.S. Court of Appeals for the Fourth Circuit had "the seeming per se rule" of the U.S. Court of Appeals for the Ninth Circuit that the government's conduct was reasonable if it conceded the case. Conrad said district courts in the Fourth Circuit must consider "all of the facts and circumstances surrounding the proceeding." The Court granted the government's motion to dismiss Carriker's claims for his costs before the state licensing board—which Carriker said resulted from the IRS's actions—because the state board proceeding wasn't "an administrative or court proceeding brought by or against the United States in connection with the disputed penalty." Carriker wasn't entitled to reimbursement for his own time, because in the Fourth Circuit, "a person's own time does not 'incur' any debt to pay."

e. ***Aloe Vera of Am. Inc. v. United States*, D. Ariz., No. 2:99-cv-01794, 2/11/15.** The U.S. District Court for the District of Arizona ruled that Aloe Vera of America Inc., its sole shareholder Rex Maughan, and Maughan's business partner Gene Yamagata were entitled to statutory damages of $1,000 each for the IRS's unauthorized disclosure of return information to the Japanese tax authority. The ruling is the latest in a long-running dispute between the two men and the U.S. government over a disclosure by the IRS to the Japanese National Tax Administration that was both false and unauthorized under tax code Section 6103. An IRS examiner suspected that Forever Living hadn't reported royalty income for 1991 and 1992 totaling approximately $32 million. The Japanese press subsequently reported this information, which Maughan and Yamagata said damaged Forever Living's reputation in Japan. Forever Living obtained a bilateral transfer pricing and study, and the competent authorities for the U.S. and Japan eventually agreed that Aloe Vera of America charged Forever Living the correct market price. The court concluded "that the NTA leaked information to the Japanese media concerning the NTA assessments." The court said "the media reports had a statistically significant negative effect upon FLPJ's sales beginning in October and November 1997, which negatively affected AVA's sales as well as commissions paid to Maughan and Yamagata. This negative effect lasted until 2003." The judge found that the information was provided to the NTA by the IRS. "The IRS had no basis whatsoever for its estimate that there was $32 million of unreported income. The uncontroverted testimony of Smith, the former IRS international examiner, shows that this figure was an unfounded guess for which Smith knew there was no basis," the court said. The court ordered damages of

$1,000 each be paid by the government to Maughan, Yamagata and Aloe Vera of America. Teilborg also found that Maughan, Yamagata, their respective holding companies and Aloe Vera of America were entitled to costs and possibly attorneys' fees.

f. ***Estate of Fenta v. Commissioner*, Docket # 13425-13S (2015).** The Tax Court found the taxpayer was not entitled to litigation and administrative costs, as the IRS was substantially justified. The Lakeside Lounge appears to be a dive bar that earned a substantial portion of its income from the sale of booze, largely in cash transactions. In a fact pattern that would not be surprising to any IRS agent, it was believed that the bar was not reporting all of its income. The taxpayer was not excited to hand over the books and records, and after a few summonses, the IRS determined the business was not keeping adequate books and records. Using the invoices for the alcohol purchased by the bar, the IRS applied the "percentage-markup" analysis to determine the under reporting of the income. This is one of the methods used by the IRS during audits of cash intensive businesses. For bars, this is calculated by taking "liquor purchases divided by average drinks per bottle times average price per drink with allowance for spillage." The IRS issued its notice of deficiency, and the taxpayer petitioned the court. Prior to a hearing, the matter was largely settled and a stipulated settlement was filed with the court. The Tax Court did a Section 7430(c)(4)(A) review to determine if the taxpayer substantially prevailed. The IRS largely argued that it was substantially justified in its position because Mr. Fenta failed to provide various receipts until after he filed his petition. Once the Service received those items, it settled. The Court agreed with the Service. The Court did not indicate whether the IRS argued that the settlement precluded fees.

g. ***Baldwin v. Commissioner*, T.C. Memo. 2015-66, (4/6/15).** A taxpayer who ultimately prevailed in Tax Court was not entitled to litigation and administrative costs, because he failed to timely provide documentation supporting his position. The court ruled that the taxpayer was not entitled to costs under Section 7430, because the IRS was substantially justified in maintaining its position in the administrative proceedings and well into the Tax Court case based on the information in its possession. The IRS issued the taxpayer a deficiency notice for 2007 after he failed to substantiate claimed unreimbursed employee expenses incurred while working as a sales representative. The IRS increased the deficiency for 2007 after it learned the taxpayer had received, but not reported, a $10,000 settlement from a former employer. The taxpayer only produced receipts substantiating his claimed 2007 expenses in 2013—more than three years after filing a petition with the Tax Court—when a pro bono attorney completed a full analysis of the taxpayer's documents. The attorney also informed the IRS that the taxpayer was insolvent when he received the settlement and did not actually receive the settlement until 2008. The court concluded that the IRS's administrative and litigating positions had a reasonable basis in fact and law.

15. Income.

a. ***Evans v. Commissioner*, T.C. Memo 2015-12 (2015).** An oil drilling company employee, who worked in Russia, could not claim the foreign earned income exclusion, because he could not show that his tax home was in Russia. The court found that the taxpayers' abode was in the US, even though he split his time while in the US between his own residence and his parents' residence, because he had stronger economic, family and personal ties in the US than he is in Russia where the drilling rig he supervised was located. The court noted 1) Evans never established a residence in Russia, 2) his first and second wives and his daughter remained in Louisiana and 3) his mother managed his finances while he was abroad.

b. ***P. Mottahedeh v. Commissioner*, T.C. Memo 2014-258 (2014).** The IRS used a permissible method to reconstruct the unreported income of a couple who operated a business organizing conference on how to avoid paying federal income taxes. The IRS used average pending statistics and the couple's annual spending estimates. The IRS also determined that one-half of the income for each of the tax years at issue was attributable to the husband and one-half to the wife, according to the community property laws of the state where the couple resided. Although the couple had an agreement in which the wife disclaimed any community-property right to income earned by her husband, the agreement had no provision regarding ownership of income generated by the couple's joint efforts.

c. ***LE Ebert v. Commissioner*, T.C. Memo 2015-5 (2015).** A couple disputed the amount of dividend income they received. The IRS' determination that the taxpayers had unreported dividend income was not sustained. The husband testified that neither he nor his wife received the disputed dividend payments in the tax year at issue nor had they received a Form 1099-DIV reporting those payments. In addition, the husband did not recall having negotiated any checks. The IRS relied on a letter from a 3rd party that stated the disputed dividend payments had been made. The taxpayers did not dispute they owned shares of stock in the tax year at issue, nor that the company issued quarterly dividends; however, they disputed that they received more than one of those payments. The husband devoted a substantial amount of time to contest the relatively small amount of tax liability at issue. He testified consistently, clearly and with considerable conviction in explaining that he did not receive the disputed dividend payments. He persuaded the court that he did not receive the disputed dividend payments.

d. ***Perez v. Commissioner*, 114 T.C. No. 4 (2015).** Money received by a woman for her egg donations is taxable as compensation for services performed and is not damages excludable from gross income under Section 104(a)(2). The taxpayer argued that the $20,000 she received from The Donor Source, a for-profit company, for two separate procedures to extract her eggs for potential use by infertile couple was an exchange for pain, suffering and physical injuries as a result of the egg retrieval process and should not be taxed. The IRS contended that the money was compensation for services rendered. In finding for the IRS, the court said "We completely believe Perez's utterly sincere and credible testimony that the series of medical procedures that culminated in the retrieval of her eggs was painful and dangerous to her present and future health. But what matters is that she voluntarily signed a contract to be paid to endure them. This means the money she received was not 'damages.'"

e. ***SI Boo, LLC v. Commissioner*, T.C. Memo. 2015-19 (2015).** Tax lien purchasers held properties acquired by tax deed primarily for sale in the ordinary course of their business and earned ordinary income from the sale of those properties. The Tax Court held that a group of entities that purchased Illinois real property tax liens primarily to earn income from the penalty percentage paid by the owners when the liens were redeemed were also in the trade or business of holding those properties for sale when they acquired the tax deeds. The court said the related entities, S.I. Securities LLC, Sabre Group LLC and SI Boo LLC, couldn't treat income from the sale of the real properties they acquired by tax deed as short- or long-term capital gain as the entities had reported on their 2007 and 2008 tax returns. The entities reported for the 2007 and 2008 tax years a combined ordinary business loss of $1.5 million, short-term capital gain of $2.73 million, long-term capital gain of $1.04 million and installment sale income of $353,922. The entities argued that the gain from the sale of properties shouldn't be treated as ordinary income, because the sales weren't frequent compared to the number of certificates of purchase of tax liens they acquired. The IRS said the property sales were frequent and regular without any trend to holding the properties as investments. The court agreed with the IRS. "The entities' own accounting records, as well as the testimony presented at trial, showed that the entities desired to dispose of the real properties quickly and frequently and with the intent to make a profit and were successful." "Frequent, regular, and substantial sales of real property are indicative of sales being made in the ordinary course of a trade or business, whereas infrequent sales of these properties are more indicative of real property held for investment purposes," the judge said. The sales of the properties were integral components in the entities' "respective trades or businesses, permitting them to profit from both the acquisition of the certificates of purchase of tax lien and the sales of properties if those certificates were not redeemed." The court further found that the entities couldn't use installment sales method of accounting under tax code Section 453, because the sales were "dealer dispositions" under Section 453(b)(2)(A). In addition, the court ruled that "the entities should have included the income in their reported net earnings from self-employment" under tax code Section 1401(a) and (b).

f. ***Sabolic v. Commissioner*, T.C. Memo. 2015-32, (2/26/15).** The Tax Court ruled that the taxpayer's method of recording his daily tips was more accurate than the IRS's method of reconstructing his tip income, through which the IRS determined that the taxpayer had underreported his income by $19,729, $19,000 and $20,284 for tax years 2009 through 2011, respectively. The taxpayer, who had worked as a bartender for over 20 years, was employed at the Zuri Lounge at the MGM Grand Hotel and Casino during the tax years at issue when he opted not to participate in the IRS's Gaming Industry Compliance Agreement Program. The taxpayer “felt that the automatic tip rate was too high given the economic conditions at the time,” the court said. The IRS obtained the taxpayer’s sales records for the years at issue to reach the far larger computation of the taxpayer’s tips than the taxpayer had reported. The IRS argued that the taxpayer’s logs were inaccurate, because the logs:

- showed daily tip amounts in whole dollar amounts without change;
- did not show how much the barbacks were tipped out;
- appeared to be missing days; and
- did not precisely match Sabolic's Forms W-2, Wage and Tax Statement.

The court said that using whole numbers and not having kept track of barback tips did not make the taxpayer’s records inaccurate. In addition, the court found the taxpayer credibly testified to taking vacation days to account for the missing days and that he produced evidence of regular malfunctions in the MGM Grand system that tracked tips to account for W-2 discrepancies. Given the taxpayer’s “habitual careful recordkeeping, we find that his logs are a substantially accurate account of his tip income for the tax years at issue,” the court said.

g. ***Chai v. Commissioner*, T.C. Memo. 2015-42, (3/11/15).** The Tax Court ruled that a taxpayer, who was compensated millions of dollars for his involvement in the tax shelter scheme, had failed to prove that a $2 million payment he received from one of the shelter entities was not subject to self-employment tax. The taxpayer, an operator of a successful architecture business in New York, met the creator of the tax shelter scheme, Andrew Beer, in college. Beer created and marketed several tax shelters directed to wealthy individuals that were designed to offset large tax liabilities for his clients. He formed several entities to aid in the scheme, including Delta Currency Trading LLC, Bricolage Capital LLC and Counterpoint Capital LLC. The taxpayer was approached by Beer in 2002 about participating in a new tax strategy he had developed, which he explained he intended to market to wealthy individuals to become clients of Delta and its affiliated companies. Beer told the taxpayer that he would serve as a conduit and that the potential clients' tax liabilities would be transferred to him. When the taxpayer raised concerns about the transactions, Beer assured him that the structures had been vetted by attorneys and accountants. After agreeing to participate in the transactions, and a $100,000 annual salary, the taxpayer participated in at least 131 tax shelters, reporting more than $3.2 billion in noneconomic income allocated to him by the tax shelters on his 2000 and 2001 income tax returns. In 2003, the taxpayer received a $2 million payment from Delta. The taxpayer had discussed the payment with Delta's chief financial officer, Helen Del Bove, who told the taxpayer that the amount he was receiving would be reported on his Forms 1099-MISC, Miscellaneous Income. The taxpayer did not report the payment from Delta as taxable income, however, claiming that it was a return of capital from his investments. The CPA who prepared the taxpayer’s return for 2003, believed that the Delta payment had been included on the taxpayer's Schedule K-1, and was not told about the taxpayer's correspondence with Del Bove. At trial, the taxpayer argued that the $2 million payment from Delta should be considered either a return of capital or a gift from Beer to him; the IRS argued that the payment should be considered non-employee compensation subject to self-employment tax. The court agreed with the IRS, saying that the taxpayer had a significant role in the tax shelter transactions as an accommodating party, for which he received the payment. "There is neither discernible reason nor persuasive justification for treating the 2003 payment differently," the court said, adding that Del Bove had "unequivocally" notified him that Delta intended to report the payment on Form 1099 for 2003. The court also affirmed the IRS imposed tax code Section 6662(a) penalties, saying the taxpayer "cannot demonstrate good-faith reliance because he knew, or should have known, that Ellspermann's advice was based on incomplete information and an unreasonable assumption."

h. ***Speer v. Commissioner*, 144 T.C. No. 14, (4/16/15).** Payments received by a retired police officer for unused leave accrued during temporary disability were income even though payments equivalent to salary received during the disability were nontaxable workmen's compensation. The Tax Court said that the retired Los Angeles Police Department Detective must include in gross income payments he received when cashing out his unused vacation and sick leave that was accrued while he was on temporary disability. The court found "that the leave payments, which compensated [the taxpayer] for his failure to take the vacation with pay that he had earned or the sick leave that similarly he had earned (even if in part traceable to benefits accrued during periods of disability leaves of absence), were not paid as workmen's compensation" and were not excludable from gross income. The payments equivalent to salary made under the Los Angeles Administrative Code to a police officer disabled while performing his professional duties were nontaxable workers' compensation under tax code Section 104(a)(1). The taxpayer argued that because the payments equivalent to his salary that he received while on disability were deemed nontaxable workers' compensation, payments for the leave time that accrued while he was on disability but remained unused upon his retirement also were not taxable. However, the accrual of vacation and sick leave while on temporary disability did not provide the taxpayer with any immediate benefit that he could use for support while on leave. "The fringe benefit represented by the accrual was, thus, fundamentally different from the normal temporary disability allowance," the court said. In addition, the court found that the taxpayer failed to substantiate which portion of the accrued leave was attributable to the period he was temporary disabled.

i. ***Methvin v. Commissioner*, T.C. Memo. 2015-81, (4/27/15).** The Tax Court ruled that the taxpayers's income from the working interests was income from a partnership of which he was a member under the "broad definition," rendering him liable for self-employment tax on the net income he received from those interests. The taxpayer, who was the chief executive officer of a computer company, did not have any knowledge or expertise in the oil and gas industry, but in the early 1970s acquired working interests in several oil and gas ventures. These interests were no more than 2 to 3 percent in any single venture, and were not part of a business organization owned by the taxpayer. However, the taxpayer's working interests were governed by a purchase and operation agreement entered into with Varn Petroleum Co., of Wichita, Kan., who later transferred the rights of operation to Egan Resources Inc. During 2011, the taxpayer's working interests under various agreements generated $10,797 in revenues, with Egan reporting $4,037 in expenses incurred from Methvin's projects. Egan identified the revenues as non-employee compensation and issued the taxpayer a Form 1099-MISC, Miscellaneous Income, relating to his working interests. The taxpayer reported $6,760 of net income from his working interests as "other income" on his Form 1040, U.S. Individual Tax Return for 2011. The IRS determined that the taxpayer's income from his working interests was subject to self-employment tax, and issued a notice of deficiency on Sept. 3, 2013. The IRS argued that the taxpayer's profits from his oil and gas working interests were subject to the tax as income from a trade or business carried on by a partnership or a joint venture taxable as a partnership or through an agent. The taxpayer countered that he was not engaged in a trade or business, and was not a partner in a partnership, arguing that "his minority working interests were merely investments and that his activity in connection with them does not rise to the level of a trade or business." The court disagreed, ruling that a pool or joint venture for operation of the oil and gas wells had been created, and that the taxpayer's income from those working interests was income from a "partnership," under tax code Section 7701(a)(2) that is subject to the self-employment tax.

16. USVI.

a. ***Estate of Sanders v. Commissioner*, 144 T.C. No. 5 (2015).** The Tax Court held that a taxpayer who lived on a vessel in St. Thomas and was employed by a consulting firm based in the US Virgin Islands was a bona fide resident of the Virgin Islands. The court said the taxpayer was a resident of the USVI cased on the taxpayer's intent, physical presence, relationships and his own representations. As a bona fide resident, the taxpayer met federal tax filing requirements by filing his federal tax returns with the USVI Bureau of Internal Revenue, was entitled to have his gross income excluded from federal taxation, and was not subject to additions to tax for not filing.

b. ***Patterson v. USVI*, No. 14-01621 (3rd Cir. 2015).** The Third Circuit ruled that the taxpayer could not show that the VIBIR had specific monies he claimed he was entitled to, and that if a refund were available, it would be from the IRS, not the VBIR. The taxpayer filed an extension to file both his US and USVI tax returns, but made a payment only with his US extension.

c. ***United States v. Bailey*, 2015 U.S. App. LEXIS 1681 (3d Cir. 2015).** The Third Circuit affirmed the convictions of two persons -- Bailey and Haddow -- for conspiring to defraud the United States [Klein conspiracy] and to evade the U.S. Virgin Islands of taxes [offense conspiracy]. The defendants were principals in a Virgin Islands company that billed U.S. taxpayers for "services" never rendered and then, after the customers paid, returned most of the amounts to the taxpayers. The U.S. taxpayers deducted the payments for "services" and treated the amounts returned as "gifts." The defraud conspiracy charged related to this conduct. The VI company also claimed certain tax credits against its VI tax liability that it was not entitled to. The offense conspiracy charge related to this conduct. The Court first determined that, although the defendants tried had not been specifically identified at trial as the defendants named in the indictment, there was sufficient evidence to satisfy that requirement. The Court held that the evidence was sufficient to prove that Bailey had the required mental state for conspiracy and that Haddow joined the conspiracy. The Court next rejected the defendants' claim that the 5-year statute of limitations normally applying to conspiracies under Title 18 Section 371 applied to the conspiracies they were charged with. The Court held that the timely filing was not affected because the indictment was filed under seal for some period of time. The Court acknowledged that there could be a problem if the defendants could establish "substantial prejudice," but they had not done so in this case. The Court held that venue, a constitutional requirement, was proper in the Virgin Islands. Although a constitutional requirement, proper venue can be waived. Here, Bailey waived venue by not timely raising the issue. The Court rejected a constructive amendment argument. The argument was that a conspiracy was charged, but among the Government's proof was proof of a substantive tax crime committed in the course of the conspiracy. The Court sustained the trial court's willfulness instruction. The Court affirmed the district court's calculation of restitution. The trial court relied upon the fees charged the U.S. taxpayers which were designed to be included as deductions on their returns and then, apparently, applied a conservative tax rate to estimate the loss.

d. ***Cooper v. Commissioner*, T.C. Memo. 2015-72, (4/8/15).** A husband and wife who each asserted that they were residents of the Virgin Islands during 2002 and 2003 failed to prove it to the U.S. Tax Court. The court rejected a motion for summary judgment set forth by the taxpayers, both U.S. citizens, saying the two did not prove that they "in good faith" believed they were bona fide residents of the Virgin Islands when they neglected to file tax returns for 2002 and 2003. The taxpayers filed joint territorial income tax returns with the Virgin Islands Bureau of Internal Revenue, and claimed entitlement to income tax benefits under tax code Section 932. The IRS received copies of the couple's tax returns filed with the Virgin Islands, and after examining the returns, determined they did not qualify for the gross income exclusion. The taxpayers filed a petition with the Tax Court arguing that they were both bona fide residents of the Virgin Islands during 2002 and 2003, and that they were required to file their income tax returns with that nation's revenue bureau. The taxpayers filed a motion for summary judgment asserting that because they each believed they were bona fide residents, the IRS is required to accept their belief. The court found that the taxpayers had not "presented objective evidence to corroborate their purported belief," and because the taxpayers had not met their burden of proof, denied their motion for summary judgment. The Court also ruled that a trial would be required to determine whether the Section 6501 period of limitations had expired before the IRS mailed the notice of deficiency.

17. **Deductions and Credits.**

a. ***Geosyntec Consultants Inc. v. U.S.*, No. 14-11107 (11th Cir 2015).** The 11th Circuit affirmed a District Court ruling that the taxpayer was not eligible for the tax credits because its research had been funded by a third party.

b. ***Moneygram International Inc. v. Commissioner,* 144 T.C. No. 1 (1/7/15).** A money services business was not allowed ordinary loss deductions on the disposition of certain securities because such ordinary loss treatment under Section 583 is only available to banks, and the taxpayer's business did not have the essential characteristics of a bank.

c. ***O.B. McClenllan v. Commissioner*, T.C. Memo 2014-257 (2014).** Since a former attorney and his wife had no principal place of employment during three tax years, their tax home was their personal residence in Mississippi; thus, they could deduct rent and utilities that they paid for an apartment in NYC that they used for their call center consulting business.

d. ***T. M. Peterson v. Commissioner*, T.C. Memo 2015-1 (2015).** An attorney's airplane-related expenses were restricted because under the requirements imposed by Section 274, the taxpayer failed to demonstrate a business purpose for any other flights that he classified as business flights, training flights or maintenance flights. The evidence established that the taxpayer enjoyed flying and considered becoming an instrument-rated pilot a personal accomplishment. The taxpayer was also ineligible to elect Section 179 treatment for the plain because his business use did not exceed 50% in either of the tax years at issue.

e. ***Fresenius Medical Care Holdings, Inc. v. United States*, 2014 U.S. App. LEXIS 15536 (08/13/14).** The First Circuit held that silence in a False Claims Act settlement agreement regarding potential tax consequences did not preclude the company from deducting some of the payments under the agreement. In general, no deduction is allowed for a fine or penalty paid to the government for any violation of the law – See 162(f). Compensatory damages are not included as a fine or penalty, though, and may be deductible.

f. ***Palmer v. Commissioner*, T.C. Memo. 2015-30, (2/25/15).** The Tax Court ruled that the taxpayer, who did not file tax returns for 2008 or 2009, could not deduct moving expenses related to his wife, and because he could not offer any reasonable cause for his failing to file, owed nearly $30,000 in addition to his $84,478 in tax deficiencies. The taxpayer, who moved his wife, her two children from a previous marriage and his wife's mother between Minnesota and South Carolina, spent nearly $10,000 on the three moves, and claimed he was entitled to deduct those expenses. The court said the taxpayer could not deduct expenses based on moves between two homes within Minneapolis under tax code Section 217, and that moving costs between South Carolina and Minnesota could not be deducted because the household goods and personal effects that were moved were not from the taxpayer's own residence. The court affirmed all of the IRS-imposed additions to the taxpayer’s tax liability. The taxpayer said his failure to file returns was due to reasonable cause and not willful negligence. The court rejected that argument, rendering the taxpayer liable for the additions “subject to post-opinion computations.”

g. ***Pittman v. Commissioner*, T.C. Memo. 2015-44 (3/16/15).** The Tax Court ruled that the taxpayer could not claim the credit under tax code Section 36(c), because the benefits and burdens of ownership of the property never shifted to her. The taxpayer entered into a lease and an option contract for the property located in Jacksonville, Fla. She paid a $1,250 option fee and an additional $150 per month to be applied to the purchase price if the option was exercised. The taxpayer resided at the residence temporarily and provided a cable bill as evidence. However, the taxpayer never exercised the option before the owner filed for Chapter 7 bankruptcy. The taxpayer filed an adversary complaint in the bankruptcy court, but it was dismissed because she had not exercised the option. Nevertheless, the taxpayer claimed a first-time homebuyer credit of $7,500, which the IRS disallowed. The court said an option to purchase in Florida doesn't “give the optionee an equitable interest in realty until the option is exercised.” The judge noted that Florida case law provides that a lease with an option to purchase remains an ordinary lease until the option is exercised. The rights of the parties remain those of tenant and landlord.

h. ***Mass. Mut. Life Ins. Co. v. United States*, No. 14-05019, (Fed. Cir. 4/9/15).** The government has lost its appeal at the Federal Circuit challenging Massachusetts Mutual Life Insurance Co.'s victory at the U.S. Court of Federal Claims regarding its deduction of policyholder dividends that totaled more than $200 million. The First Circuit agreed with the lower court's decision, saying that because “we find that MassMutual's and ConnMutual's policyholder dividends were fixed in the year the dividends were announced, that the dividends in question are premium adjustments, and that premium adjustments are rebates, thereby satisfying the recurring item exception, we affirm”. Both parties agreed that the dividend payments could be deducted at some point, but the government argued that because the dividends had not been paid yet, the obligations could not be deducted until the following year since a “a liability must be fixed before it can be deducted.” The original claim brought by MassMutual was to recover funds it had overpaid when the IRS disallowed certain policyholder dividend deductions made under board resolutions. The resolutions established a minimum amount of dividends that would be paid out to certain policyholders the following year, known as dividend guarantees. MassMutual claimed its liability for the guaranteed amount satisfied the requirements of the “all events test” laid out in tax code Section 461, a claim the lower court agreed with. On appeal, the government argued that because the liability to pay the dividends at issue is contingent on other events, such as a policyholder's decision to maintain his or her policy through the policy's anniversary date, the liability has not been established in the year the dividends were determined, rendering the liabilities not fixed for purposes of being deductible. “The government alleges that MassMutual's disclosures to state regulators do not change the reality that these promises were revocable, because MassMutual never informed the policyholders of these dividends," the court opinion said. The Federal Circuit disagreed, finding that MassMutual's policyholder dividends were fixed in the year that the dividends were announced. The Court also ruled, in affirming the lower court's decision, that "the plain and ordinary meaning of the terms rebate and refund include premium adjustments distributed to policyholders in the form of dividends," and that "The Court of Federal claims thoroughly considered these questions" posed by the government, finding no error in the manner the lower court did so.

18. Penalties.

a. ***S.A. Sodipo v. Commissioner*, T.C. Memo 2015-3 (2015).** An individual had unreported income and was subject to penalties for the 3 years at issue. The taxpayer was a pharmacist until his arrest and the revocation of his license for drug-related crimes during the second of the years at issue. He controlled several business entities. The taxpayer filed a return for the first year, with respect to which he was convicted of filing a false return, but did not file returns or pay taxes for the other years.

b. ***Banister v. Commissioner*, T.C. Memo 2015-10 (2015).** A former IRS criminal division investigator, who promoted arguments for not paying federal income taxes, was found liable for failure to file, frivolous argument and fraud penalties on his own tax liability.

c. ***Specht v. U.S.*, No. 1:13-cv-00705 (SD Ohio 2015).** An estate cannot escape late-filing penalties caused by the attorney's illness and malpractice. The court criticized the IRS for not waiving late-filing penalties, but said the law makes clear the responsibility for filing rests with the executor.

d. ***Shalom Jacobs v. Commissioner*, T.C. Summary Op. 2015-3, (2015).** The Tax Court, in a summary opinion sustaining accuracy-related penalties, held that a truck driver was not entitled to a depreciation expense deduction for a truck he sold in the prior year and that he was not entitled to travel expense deductions because he was an itinerant worker or "tax turtle" who carried his tax home with him on the road.

e. ***Estate of John R.H. Thouron v. United States*, 752 F.3d 311 (3d Cir. 05/13/14).** John R.H. Thouron, KBE, the widower of Esther du Pont Thouron, died leaving a substantial estate. The estate tax return was due on 11/6/07. The estate timely filed a request for an automatic 6-month extension of time to file and made a payment of $6.5 million, less than the $20 million ultimately owed. The estate did not request an extension of time to pay, allegedly because of advice from its tax attorney concerning the estate's ability to elect under § 6166 to pay a portion of its estate tax liability in installments over several years. The estate filed its return in May 2008 and at that time requested an extension of time to pay. The estate did not make the election under § 6166 because it had concluded that it did not qualify. The IRS denied as untimely the request for an extension of time to pay and imposed a late payment penalty under § 6651(a)(2) of $999,072 plus interest. The estate contested the penalty on the basis that § 6651(a)(2) grants relief from the penalty when the failure to pay is "due to reasonable cause and not due to willful neglect." The District Court granted summary judgment to the government, but the Third Circuit, in an opinion by Judge Ambro, reversed and remanded. The court relied on Reg. § 301.6651-1(c)(1) for the proposition that a taxpayer demonstrates reasonable cause by establishing that "he exercised ordinary business care and prudence in providing for payment of his tax liability and was nevertheless either unable to pay the tax or would suffer an undue hardship . . . if he paid on the due date." Judge Ambro examined the Supreme Court's opinion in *United States v. Boyle*, 469 U.S. 241 (1985) and concluded that, although Boyle addresses establishing reasonable cause for failure to timely file a return, its holding also applies to establishing reasonable cause for failure to timely pay tax. In *Boyle*, Judge Ambro stated, the Supreme Court identified three distinct categories of cases: (1) those in which "a taxpayer relies on an agent for the ministerial task of filing or paying," (2) those in which "'in reliance on the advice of his accountant or attorney, the taxpayer files a return after the actual due date but within the time the adviser erroneously told him was available,'" and (3) those in which "'an accountant or attorney advises a taxpayer on a matter of tax law.'" Judge Ambro concluded that the facts of Boyle fell into the first category and that the Supreme Court had not addressed the remaining two categories. Thus, according to Judge Ambro, a taxpayer cannot establish reasonable cause by relying on an agent for the ministerial act of filing or paying, as in Boyle, but "a taxpayer's reliance on the advice of a tax expert may be reasonable cause for failure to pay by the deadline if the taxpayer can also show either an inability to pay or undue hardship from paying at the deadline." Because there was a genuine issue of material fact as to the estate's reliance on a tax expert's advice, the Third Circuit reversed and remanded for further proceedings.

f. ***Bobrow v. Commissioner*, T.C. Memo 2014-21 (01/28/14).** In *Bobrow*, a tax lawyer in rolling over an IRA, followed the procedures set forth in IRS Publication 590 that allowed access to the funds. The IRS disagreed with the manner which the taxpayer used and said it not only a taxable event, it was also subject to a negligence penalty. In finding in favor of the IRS, on both the substantive issue and the application of penalties, the Tax Court said, (1) IRS guidance is not binding precedent or even "substantive authority" and (2) a taxpayer is not excused from penalties if he follows the IRS guidance and the IRS interpretation of the tax law turns out to be wrong. The IRS has reissued Publication 590 to be consistent with the decision.

g. ***Prosser v. Commissioner*, 2d Cir., No. 13-04526, (2/4/15).** A physician, his wife and his practice were subject to an increased accuracy related penalty because they failed to report their participation in a "Benistar 419" tax shelter because it was a listed transaction. The Second Circuit affirmed a U.S. Tax Court decision that the Benistar 419 Plan in which the Prossers and the clinic participated was substantially similar to the listed tax-avoidance transaction identified in Notice 95-34. The appeals panel also affirmed the Tax Court ruling that the Prossers were liable for the 30 percent penalty, instead of the 20 percent accuracy-related penalty under tax code Section 6662A, because they failed to report their participation in the Benistar Plan. The Benistar Plan purported to allow taxpayers to make tax-free contributions for life insurance policies on "key" employees above what was required to cover potential death benefits of the policies. Plan promoters claimed the plan fell within the exemption from deduction limits under tax code Section 419A(f)(6). The Tax Court held that the contributions weren't deductible because they weren't "ordinary and necessary" business expenses under tax code Section 162. Droney said the plan was substantially similar to the tax avoidance transaction described in Notice 95-34, because:

- the tax-free contributions far exceeded the cost of maintaining the underlying coverage,
- there was individual funding and control of the policies, and
- the policies could be retrieved with minimal expense.

The court said that the Prossers had fair warning of the increased penalty, because the relevant statutes, regulations and the notice were all in effect before the end of the relevant tax years.

h. ***<u>436, Ltd. v. Commissioner</u>*, <u>T.C. Memo. 2015-28, (2/18/15)</u>.** The Tax Court ruled that the Taxpayer was liable for the 40 percent gross valuation misstatement penalty, because he reported his basis in the property in the transaction—involving an option straddle and Canadian currency—by well over 10,000 percent of the actual value. The Court further found that the Taxpayer could not claim good faith reliance on the advice of an attorney, who was the promoter of the Son-of-BOSS (bond and options sales strategy) and to whom the Taxpayer paid a fee to coordinate the transaction. In 2001, the Taxpayer sold a portion of his business for $4 million. The Taxpayer was worried about the tax liability from the deal and was introduced to the attorney who proposed a Son-of-BOSS transaction to avoid such liability. Although the Taxpayer's regular tax and financial advisers declined to recommend the transaction, the Taxpayer proceeded to engage the attorney to coordinate the deal. The attorney formed three entities:

- 8252 LLC as a disregarded entity for federal tax purposes with the Taxpayer as its sole member,
- 94 LLC with the Taxpayer as its sole member, and
- 436 Ltd. with the Taxpayer as 99 percent limited partner and 94 LLC as a general partner and 1 percent limited partner.

The Court found that the Taxpayer should be treated as owning all of 436 Ltd., because 94 LLC never elected to be classified as a corporation and, thus, was also a disregarded entity. In addition, the Court disregarded 436 Ltd., because its only purpose "was to carry out a tax-avoidance scheme." The Court said "[The Taxpayer] never intended to run businesses under the umbrella of 436." Because

436 could be disregarded for tax purposes, the Court deemed its activities to be engaged in by its purported partner—the Taxpayer.

i. ***McKnight v. Commissioner*, T.C. Memo. 2015-47 (3/16/15).** An IRS levy on the taxpayer's bank account after he deposited the proceeds distributed to him from the retirement plan did not constitute an IRS levy on retirement account funds that would qualify for exception from the 10 percent early distribution tax. The taxpayer received Forms 1099-R, Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., reporting taxable distributions of more than $211,000 during 2011, as well as withholding of more than $48,000. The taxpayer reported the $48,000 figure as the amount of his taxable distribution on his 2011 income tax return. After the retirement plan distributions were deposited in his checking account, the IRS was paid more than $32,000 from the funds as a result of a levy on the account. "IRS records and petitioner's bank statements show that the IRS took action to collect his 2007 and 2008 tax liabilities by levying, not on his retirement plan, but on his checking account with Wachovia Bank/Wells Fargo," the judge wrote in concluding the 10 percent early distribution tax would apply.

j. ***Howard v. Commissioner*, T.C. Memo. 2015-38, (3/9/15) .** The Tax Court ruled that a taxpayer could not deduct per diem expenses and a hotel expense not reimbursed by his employer, because the taxpayer "bore no expenses in maintaining a home. He paid no money for rent, utilities, or any other household expenses during" the tax year. The taxpayer was not liable for a negligence penalty under tax code Section 6662, because the taxpayer's "incorrect interpretation of what constitutes a tax home under section 162 was an honest misunderstanding of the law, especially in consideration of the facts that he had a State law requirement to maintain a residence for his commercial driver's license and that residence also resulted in his being called for jury duty".

k. ***Musa v. Commissioner*, T.C. Memo. 2015-58, (3/25/15).** A restaurant owner's actions indicated multiple badges of fraud making him liable for the 75 percent fraud penalty on the entire amount of his $1.6 million underpayment. The Tax Court ruled that the restaurant owner demonstrated fraudulent intent to underpay his taxes on income from his restaurant during tax years 2006 through 2010 when, among other actions, he did not deposit most of his cash receipts in a bank account. In addition to dealing extensively in cash, the Court found the Taxpayer's following actions supported a finding of fraudulent intent:

- underreporting his income;
- maintaining inadequate records relating to cash receipts and amounts paid to family members and other workers;
- concealing income and assets from both his accountants and the IRS;
- failing to file Forms W-2 and Forms 1099-MISC for amounts paid to family members, belly dancers, DJs and cleaners hired off the street;
- filing false documents, including false tax returns, and making false payroll reports and a false loan application; and

- failing to make estimated tax payments for every tax year at issue.

The Taxpayer's failure to cooperate with revenue agents, forcing the IRS to issue numerous information document requests, and his "inconsistent and implausible explanations to the IRS and to the Court for his behavior" also supported imposition of the fraud penalties under tax code Section 6663.

l. ***CNT Investors, LLC v. Commissioner*****, 144 T.C. No. 11, (3/23/15).** The Tax Court ruled in a division opinion that penalties did not apply to a Son-of-Boss transaction. The taxpayer and his long-time attorney were persuaded by Erwin Mayer, an attorney with the now defunct law firm of Jenkens & Gilchrist, to enter into a Son-of-BOSS (bond and options sales strategy) transaction to avoid tax on gain from the distribution of real estate from the taxpayer's S corporation to the taxpayer and his two daughters. The Court determined that the gross valuation misstatement penalty under tax code Section 6662(h) did not apply to the taxpayer, because he had shown reasonable cause and good faith reliance under tax code Section 6664. The judge said, "when the reasonable cause defense rests on the partnership's actions, we may entertain the defense at the partnership level, taking into account the state of mind of the general partner." The Court found that the taxpayer's attorney had reasonably relied on Mayer and that the taxpayer had relied on his attorney. The Court said the taxpayer's attorney, who had competently advised him for 30 years in business and regulatory matters, "would have appeared ideal, not simply competent, to advise him on the feasibility and implications of the basis boost transaction." "On the record before us, we decline to find that [the taxpayer] knew or should have known that the promised results of the Son-of-BOSS transaction were too good to be true," the Court said.

m. ***Jacoby v. Commissioner*****, T.C. Memo. 2015-67, (4/6/15).** A Florida finance and marketing business owner has won his case in the U.S. Tax Court disputing more than $2 million in IRS assessed tax deficiencies and fees. The court ruled that the taxpayer, who worked as a licensed securities broker and account executive before starting his own financial strategies company, had not intended to evade tax through concealing, misleading or otherwise preventing the collection of his taxes owed. The court said the IRS could not prove any fraudulent intent by the taxpayer and, because the deficiencies occurred on tax returns filed 15 years ago, the limitations period for collecting the taxes owed has expired.

n. ***Heers v. Parsons*****, 2015 BL 107621, B.A.P. 9th Cir., No. NV-14-1468, (4/15/15).** An attorney inexperienced in probate law incurred a nondischargeable debt for being 13 months late in filing a decedent's estate tax return. The lawyer took on the role of an estate's administrator even though "she was not competent to perform" the work, according to the court. The estate was assessed $440,000 in interest and penalties for filing a tax return 13 months late. The probate court surcharged the administrator for the interest and penalties. The administrator then filed for bankruptcy, to be met by a complaint seeking to have the debt declared nondischargeable as a defalcation while acting in a fiduciary capacity under Section 523(a)(4) of the Bankruptcy Code. Based on the probate court's decision and uncontested facts, the bankruptcy judge found the debt not discharged. The Ninth Circuit said there is neither a "strict liability" nor a "no fault" basis for a nondischargeable debt for defalcation while acting in a fiduciary capacity. The court said it remains "not so clear" where to draw the line. The court said the administrator "consciously and recklessly disregarded" the risks of filing a late tax return. She was grossly negligent, the judge said, and thus the debt was not discharged.

o. ***Kaufman v. Commissioner*, 1st Cir., No. 14-01863, (4/24/15).** The First Circuit affirmed a Tax Court decision imposing the gross valuation misstatement penalties on the taxpayers for claiming deductions on their 2003 and 2004 tax returns without making a good faith investigation into the valuation upon which their deductions were based. The court said the Tax Court's determination of lack of good faith was a factual finding that the appeals court could overturn only with a showing of clear error. "After a careful review of the record, we cannot say that the Tax Court's finding that the [the taxpayers] failed to make a good faith investigation into the value of the easement was clearly erroneous. Indeed, the conclusion was well supported by the evidence," the court said. The court was persuaded to affirm the Tax Court's finding based on the taxpayers' decision to claim the deduction after receiving an e-mail from the donee organization reassuring them that the easement donation—valued by the appraiser at 12 percent of the value of the property—would not hurt the value of the residence. The court said the e-mail "should have immediately raised red flags as to whether the value of the easement was zero." The case was the taxpayers' second appeal to the First Circuit regarding the deductions totaling $220,800. In the first appeal, the court found that the Tax Court erred in disallowing the deductions as a matter of law and vacated both the Tax Court finding regarding the deductions and its decision not to impose additional penalties. On remand, the Tax Court not only sustained the IRS's complete disallowance of the deductions, but unlike in the original 2010 decision, also assessed a 40 percent gross misstatement of valuation penalty under tax code Section 6662(h). In their second appeal, the taxpayers did nott ask the First Circuit to reconsider the easement valuation issue. They did, however, argue that they showed reasonable cause and good faith with respect to their claimed deductions. The taxpayers argued that at the time they took the deduction, there was limited information available about the effect of a facade easement, and the consensus was that such an easement reduced the value of an encumbered property. The court said a "good faith investigation" did not mean an exhaustive investigation. "It merely required that the [taxpayers] do some basic inquiry into the validity of an appraisal whose result was squarely contradicted by other available evidence glaringly in front of them." Both the Tax Court and First Circuit credited the taxpayers with a high level of sophistication that should have prompted them to inquire further about the valuation. The taxpayer wife was a company president with a Ph.D., and the taxpayer husband was an emeritus professor of statistics at MIT. "The [taxpayers] were highly intelligent, very well-educated people," whom the Tax Court reasonably found should have been alerted by the appraisal that they needed to make further investigation.

p. ***Morris v. Commissioner*, T.C. Memo. 2015-82, (4/27/15).** The Tax Court found a son liable for tax on the full amount of an individual retirement account inherited from his father that he later shared with his two siblings. The taxpayer told the court he checked the box not to have federal income tax withheld from the distribution, because the paralegal, who did most of the work settling the estate of the father, informed him that there would be no tax due on the distribution. The court said the paralegal "evidently meant that there would be no Federal estate tax or Michigan inheritance tax due. But petitioner understood her to mean that no tax of any kind would be due." After receiving the distribution, the taxpayer issued checks totaling $37,000 to his two siblings based on what he believed were his father's wishes. Although the taxpayer "acted honorably in executing what he believed to be his father's wishes, his good conduct has no bearing on whether the IRA distributions were includible in his gross income," the court said. The court added that the advice the taxpayer thought he received from the law firm "might have affected his liability for the accuracy-related penalty."

19. Foreign Related.

a. ***U.S. v. Bank Leumi Le-Israel B.M*, C.D. Cal., No. 14-cr-00731, deferred prosecution agreement 12/22/14) .** In a deferred prosecution agreement filed December 22nd in the US District Court for the Central District of California, Bank Leumi admitted it had conspired to aid US taxpayers in falsifying tax returns by concealing income and assets in bank accounts in Israel and elsewhere. To the settle the tax evasion investigation, by the US authorities, the Israeli bank agreed to pay $400 million.

b. ***United States v. Zwerner*, No. 1:13-cv-22082 (S.D. Fla.).** In *Zwerner*, the taxpayer failed to disclose his foreign bank accounts to the IRS that he had with a Swiss bank since the 1960s that were held in the name of a Liechtenstein Foundation. In addition, the taxpayer did not file FBARs. In 2009, the taxpayer tried to participate in the IRS Offshore Voluntary Disclosure Program, but was rejected because the government already had information about the taxpayer and his account. After assessing a 50% account balance account for 4 years, the government filed a lawsuit to enforce the penalty. A jury found that the taxpayer's actions were willful for 3 of the 4 years and agreed with the 50% penalty for those 3 years. Although the highest account balance during the years at issue was $1.5 million, the penalty would be almost $2.5 million. In the face of an excessive penalty challenge, the government settled for payment of $1.5 million.

c. ***Moore v. United States*, Case 2:13-cv-02063 (WD Wash. 2015).** The IRS imposed 4 years of maximum nonwillful penalties against the taxpayer after he opted out of the OVDI.. The record before the court was inconclusive as to precisely why the IRS chose to impose 4 years of nonwillful penalties and why to max out the nonwillful penalties. In the *de novo* proceeding in the district court, the court determined that the taxpayer was liable for the nonwillful penalties.

d. ***U.S. v. Lanegger*, No. 15-cr-00032 (S.D.N.Y. 2015).** A Connecticut business executive pleaded guilty to willfully failing to report Swiss bank accounts holding up to $8.4 million to the IRS. Part of the plea agreement included a civil penalty of more than $4.2 million and more than $71,000 in back taxes.

e. ***Al-Soufi v. Commissioner*, T.C. Memo. 2015-68, (4/7/15).** The Tax Court has affirmed IRS-imposed tax deficiency determinations and a penalty against a Virginia taxpayer who was denied a deduction he took on his 2010 tax return relating to interest on a mortgage for property he owned in Syria. The Court ruled that the taxpayer, who has a degree in financial management and has lived in the U.S. for 35 years, was negligent when he prepared his 2010 tax return and included a $73,619 deduction for home mortgage interest. The taxpayer, a dual citizen of Syria and the U.S., purchased a residence in Syria, and obtained a mortgage secured by the property through HARN Mortgage in Syria. He was the obligor on the mortgage note, but his sister who lived in Syria made the mortgage payments—totaling $73,619 at the relevant exchange rate in 2010—on his behalf. According to the taxpayer, the property was damaged or destroyed during a civil war in 2011, and all documents relating to the purchase and ownership of the property were destroyed. Because the taxpayer did not provide the IRS or the court with a certificate of title to the property, a copy of the mortgage note or a loan amortization schedule, determining the owner of the property, the amount of the mortgage and who would be liable for the mortgage was a difficult task for the court. The taxpayer did offer a letter from an official of HARN Mortgage, certifying that "HARN mortgage has received on behalf of Mr. Saad Al-Soufi a total of $73,619.19 in mortgage payments for the calendar year 2010." The court, however, found the letter "suspect," as it was dated more than two months after the IRS issued a deficiency notice. "Petitioners have not proven that they met the requirements for deducting 'qualified residence interest' for 2010," the court said.

20. Conservation Easement.

a. ***Mitchell v. Commissioner*, No. 13-9003 (10th Cir. 2015).** The Tenth Circuit held that a conservation easement that was subject to an unsubordinated mortgage was not protected in perpetuity and therefore did not qualify for a charitable contribution deduction.

b. ***Kaufman v. Commissioner*, T.C. Memo. 2014-52 (03/31/14).** On remand, after evaluating all of the evidence, including multiple appraisers' reports, Judge Halpern held that the facade easement had no fair market value. The deduction for the contribution of the facade easement was disallowed. Because there was no record of sales of comparable easements, the before-and-after valuation method of Reg. § 170A-14(h)(3)(i) was applicable. He found that "the typical buyer would find the restrictions of the preservation agreement no more burdensome than the underlying South End Standards and Criteria [and] … the post-contribution value of the property was equal to its pre-contribution value … ." Negligence and substantial understatement accuracy related penalties were sustained. The mere fact that the taxpayers obtained an appraisal valuing the facade easement at

$220,800 did not in and of itself constitute a reasonable basis for claiming that the facade easement was worth $220,800 when its value was in fact "nil." The taxpayers failed to show a reasonable basis for claiming the deduction.

c. ***Chandler v. Commissioner*, 142 T.C. No. 16 (05/14/14).** The taxpayers donated conservation easements on two residences in Boston's South End historic district to the National Architectural Trust and claimed charitable contribution deductions of $191,400 and $371,250. Because of relevant limitations, the values of the easements were deducted in varying amounts from 2004 through 2006. The Tax Court (Judge Goeke) disallowed the deduction even though the conservation easements were more restrictive than local law with respect to architectural changes. Applying the reasoning of *Kaufman v. Commissioner*, T.C. Memo. 2014-52, which held that an NAT easement on a property in the South End Historic District did not reduce the value of a residence, the court disallowed the deduction entirely. The differences between the NAT restrictions and local law "do not affect property values, because buyers do not perceive any difference between the competing sets of restrictions." Under § 6662(h) the valuation misstatements were gross valuation misstatements triggering a 40 percent penalty. However, a novel issue regarding the taxpayer's right to raise a reasonable cause defense for their 2006 underpayment was presented because a portion of the 2006 underpayment resulted from the carryover of charitable contribution deductions they first claimed on their 2004 return, which was filed before the Pension Protection Act of 2006 eliminated the § 6664(c) good faith and reasonable cause defense for gross valuation misstatements of charitable contribution property (unless certain conditions, which were not met in this case, were met). The court rejected the taxpayer's argument that denying their right to raise a reasonable cause defense with respect to the 2006 understatement attributable to deductions carried forward from 2004 would amount to retroactively applying the Pension Protection Act of 2006 amendment to § 6664(c). "When taxpayers file a return that includes carry-forward information, they essentially reaffirm that information. The amended reasonable cause rules were in effect when petitioners filed their 2006 return, which reaffirmed the Claremont easement's grossly misstated value. Applying those rules does not amount to retroactive application." Ironically, however, with respect to the 2004 and 2005 deductions, the taxpayers did establish a reasonable cause defense. They had "followed the NPS's suggestion for choosing an appraiser and relied on his report. The report was not so deficient on its face that petitioners should have reasonably discounted it. They obtained their accountant's assurances before they claimed the easement deductions."

d. ***Scheidelman v. Commissioner*, 755 F.3d 148 (2d Cir. 06/18/14), aff'g T.C. Memo. 2013-18.** In a *per curiam* opinion by Judge Newman, the Second Circuit affirmed the Tax Court's decision denying the taxpayer's claimed deduction for contribution of an historic facade conservation easement to the National Architectural Trust on the ground that the contribution did not result in any diminution in the value of the property. The burdened property was in the Fort Greene Historic District, which is designated (1) a "registered historic district" by the Secretary of the Interior through the National Park Service, pursuant to § 47(c)(3)(B); and (2) a historic district by New York City's Landmarks Preservation Commission. In New York City it is unlawful to alter, reconstruct, or demolish a building in a historic district without the prior consent of the LPC. The Court noted:

[N]either the Tax Court nor any Circuit Court of Appeals has held that the grant of a conservation easement effects a per se reduction in the fair market value. To the contrary, the regulations provide that an easement that has no material effect on the obligations of the property owner or the uses to which the property may be put "may have no material effect on the value of the property." Treas. Reg. § 1.170A-14(h)(3)(ii). And sometimes an easement "may in fact serve to enhance, rather than reduce, the value of property. In such instances no deduction would be allowable." Substantial evidence supports the Tax Court's conclusion that the easement had no value for charitable contribution purposes.

e. ***Seventeen Seventy Sherman Street, LLC v. Commissioner*, T.C. Memo. 2014-124 (06/19/14).** The taxpayer contributed both exterior and interior facade conservation easements restricting the use of the burdened historic property, which was listed on a National Register of Historic Properties, to a qualified donee. Because the property was a designated landmark, proposed structural changes or material renovations to its exterior were subject to the approval of the Denver Landmark Preservation Commission. However, designation as a landmark did not obligate property owners to rehabilitate deteriorating structures, did not prohibit building demolition, and did not protect the interior of the building. Thus, the conservation easement provided stronger protections, such as building monitoring and prohibition of demolition, than designation as a landmark. The Tax Court (Judge Marvel) found that the conservation easements were granted in consideration of the City of Denver granting zoning changes and variances and approving a development plan for the property, and denied the deduction in its entirety—even though the IRS would have allowed a $400,000 deduction, not the $7,150,000 deduction claimed by the taxpayer. The taxpayer had not reported the receipt of any consideration for the contribution and did not treat it as a bargain sale. Accordingly, Judge Marvel reasoned that "when a taxpayer grants a conservation easement as part of a quid pro quo transaction and fails to identify or value all of the consideration received in the transaction, the taxpayer is not entitled to any charitable contribution deduction with respect to the grant of the conservation easement because he has failed to comply with section 170 and the regulations thereunder." Because the taxpayer "failed to value all of the consideration ... received in the quid pro quo exchange," the court did not reach a conclusion on the value of the interior and exterior easements. Although the § 6662(h) gross valuation misstatement penalty asserted by the IRS was not upheld, because the IRS failed to establish that the value of the conservation easements claimed on the return (i.e., $7,150,000) exceeded 400% of the correct value of the easements, a § 6662 negligence penalty was sustained, because the taxpayer did not follow its advisor's advice to reduce the amount of the contribution to reflect the value of the consideration it received.

f. ***Zarlengo v. Commissioner*, T.C. Memo. 2014-161 (08/11/14).** The taxpayers executed a conservation easement deed to the National Architectural Trust in 2004, but the deed was not recorded until 2005. They claimed a charitable contribution deduction for 2004. The Tax Court (Judge Vasquez) held that the deduction was not allowed in 2004 because the conservation easement was not protected in perpetuity, as required by § 170(h)(2), until January 26, 2005, when the deed was recorded. Under the relevant state law (New York), an instrument purporting to create, convey, modify, or terminate a conservation easement is not effective unless recorded. The court went on to determine the value of the contribution, which was deductible in 2005, after evaluating the ubiquitous battle of the appraisers, and, because as usually happens the deduction allowed was much, much less than that claimed, § 6662 accuracy related penalties were sustained.

g. ***Balsam Mountain Invs., LLC v. Commissioner*, T.C. Memo. 2015-43, (3/12/15).** The Tax Court ruled that Balsam Mountain Investments LLC was not entitled to a deduction under tax code Section 170(h) for a conservation easement it granted encumbering a 22-acre parcel in North Carolina, because Balsam reserved the right to make "minor alterations" to the easement boundary for up to five years. The court cited *Belk v. Commissioner* which held that "a conservation easement is not a 'qualified real property interest' of the type described in section 170(h)(2)(C) if the easement agreement permits the grantor to change what property is subject to the easement." The court said "an interest in real property is a 'qualified real property interest' of the type described in section 170(h)(2)(C) only if it is an interest in an identifiable, specific piece of real property." Balsam argued that *Belk* was distinguishable because the easement in that case allowed for the complete substitution of the land initially granted. In the alternative, Balsam asked the court to overturn *Belk*. The court said *Belk* was not distinguishable and declined to overturn the case.

21. Like-Kind Exchanges.

a. ***N. Cent. Rental & Leasing, LLC v. United States*, No. 13-03411, (8th Cir. 3/2/15) .** The Eighth Circuit said North Central Rental & Leasing LLC improperly claimed nonrecognition treatment in a like-kind exchange transaction to sell used equipment and purchase replacement inventory from Caterpillar, because it was a prohibited related party transaction. The Court said the transaction was structured to avoid related-party exchange restrictions under tax code Section 1031(f) and resulted in the equivalent of a six-month, interest-free loan from Caterpillar to North Central's parent, Butler Machinery Co. The decision affirmed a 2013 findings of fact, conclusions of law and order for judgment by a magistrate judge of the U.S. District Court for the District of North Dakota. During the 2004 through 2006 tax years, North Central sold used equipment to a third party through a like-kind exchange intermediary. At about the same time as the sales, Butler purchased replacement equipment from Caterpillar and then transferred the equipment to North Central through the intermediary. The IRS increased North Central's gains from sales or exchanges of property by a total of $42.5 million after determining that the exchanges with the intermediary did not qualify for nonrecognition of gains under Section 1031, according to Forms 886-A, Explanation of Items, attached to the Notices of Final Partnership Administrative Adjustments sent to North Central by the IRS. The Court said that before Butler formed North Central or began the like-kind exchange transactions, Caterpillar advised Butler that the transactions would enable Butler to take full advantage of a Caterpillar financing program that gave Butler up to six months to pay for the equipment. "In other words, Butler Machinery essentially received an up-to-six-month, interest-free loan from each exchange," the Court said. The Court found that Butler's involvement was not necessary to the transaction and its only purpose was to hold the interest-free cash. "Both the Eleventh Circuit and the Ninth Circuit have affirmed determinations that transactions were structured to avoid the purposes of § 1031(f) when unnecessary parties participated in the transactions and when a related party ended up receiving cash proceeds," the Court said. The Court cited *Ocmulgee Fields, Inc. v. Commissioner*, 613 F.3d 1360, 2010 BL 187207 (11th Cir. 2010) and *Teruya Bros. v. Commissioner*, 580 F.3d 1038, 2009 BL 191516 (9th Cir. 2009). North Central attempted to distinguish these cases, arguing that Butler didn't have indefinite access to the sales proceeds. "Even so, that fact does not change our analysis, and we simply cannot ignore the significant and continuous financial benefits Butler Machinery derived from these hundreds of de facto interest-free loans," the Court said.

22. Tax Cases Related to Family Law.

a. ***Hampers v. Commissioner*, T.C. Memo. 2015-27, (2/18/15).** The Tax Court ruled that the Taxpayer could not deduct as alimony future attorneys' fees incurred by his ex-wife that he was obligated to pay under the final divorce decree. The Court said under tax code Section 71(b)(1), a payment only qualifies as deductible alimony if "there is no liability to make any payment for any period after the death of the payee spouse." The final divorce decree was silent as to whether the attorneys' fees obligation would terminate upon the ex-wife's death, so New Hampshire law, which governed the divorce proceedings, would control. The Court concluded "that New Hampshire law does not plainly show that petitioner's liability for future attorney's fees of [the ex-wife] would terminate upon her death." Accordingly, the Taxpayer could not deduct "paid legal fees incurred by [the ex-wife] of $14,012, $38,113, and $123,394 in 2009, 2010, and 2011, respectively."

b. ***G. McBride v. Commissioner*, T.C. Memo 2015-6 (2015).** An individual was not entitled to dependency exemptions for his children or grandchild, and was not entitled to head of household filing status. The taxpayer lived with his son and daughter, both adults, and the minor child of his daughter. The taxpayer's daughter claimed her child on her own tax return. The taxpayer's children were adults, and no evidence indicated that they were students under 24 years old. Further, no evidence indicated that the taxpayer had paid over half of his children's support. Neither of the taxpayer's children, therefore, was a qualifying child, and so the taxpayer could not claim them as dependents. Since his daughter claimed her child as a dependent, that child was not a qualifying child or qualifying relative of the taxpayer.

c. ***Langley v. Commissioner*, T.C. Memo 2015-11(2015).** The taxpayer could not use the U.S. Tax Court of the IRS Appeals procedure to claim as a theft loss more than $400,000 allegedly misappropriated by her ex-husband and others in the divorce proceedings. The court said that the taxpayer's dissatisfaction with the judicial proceedings in her divorce were the result of unreasonable expectations and demands, and did not impact the origin and nature of her claimed loss.

d. ***Milbourn v. Commissioner*, T.C. Memo 2015-13 (2015).** The Tax Court affirmed an IRS determination that a taxpayer could not claim $37,000 in alimony deductions because the taxpayer and his ex-wife had not created a marital dissolution agreement that would have entitled him to deduct thousands of dollars in payments made to her in 2006.

e. ***Abdi v. Commissioner*, T.C. Memo. 2015-41, (3/11/15).** The Tax Court ruled that even though the taxpayer's brother, who lived in the same apartment, could potentially be a "qualifying child," the taxpayer's niece could not qualify for purposes of the EITC because she did not live with him in 2011. The taxpayer filed his 2011 tax return as single, and reported wages and gross income of $38,060, along with the EITC of $608. The IRS issued the taxpayer a notice of deficiency in February 2013, disallowing the EITC. At trial, the taxpayer admitted that at all times during 2011 his niece resided in a different apartment than his own. Consequently, the court said, the taxpayer's niece is not a "qualifying child" for 2011 as per Section 32, which requires that a "qualifying child" have "the same principal place of abode as the taxpayer for more than one-half of the taxable year." According to Section 32(a)(1), a taxpayer who doesn't file jointly and has earned income of more than $36,052 isn't eligible for the EITC unless the taxpayer has at least two "qualifying children." The court denied the taxpayer the EITC, and did not review the merits of the taxpayer's brother being a "qualifying child" because the taxpayer still would not meet the required number of "qualifying children."

23. Statute of Limitations.

a. ***Hartland Mgmt. Servs., Inc. v. Commissioner*, T.C. Memo 215-8 (2015).** The taxpayers and the IRS intended to extend the statute of limitation for tax years under examination despite executing an extension agreement listing an inapplicable year. Upon discovering the problem, the IRS sent the taxpayers corrected forms, which the taxpayers did not sign. The court said there was a mutual mistake and "reformed" the agreement to conform to the parties' intent. The court said the taxpayers conduct following the execution of the original forms was consistent with an intent to extend the limitations periods, because they acted as if the period of limitations had been extended and negotiated through counsel with the IRS for months and months regarding the disputed years.

b. ***Estate of Rubinstein v. U.S.*, 1:09-cv-00291 (Court of Fed. Claims 2015).** An estate could not rely on the financial disability exception to the refund claim statute of limitations when a doctor's post-death mental diagnosis contradicted a pre-death report. The estate was seeking a refund for a $48,489 overpayment reported on the decedent's 2001 tax return because the decedent failed to file the return before his death in 2005. The estate was attempting to prove a financial disability exception to the three-year statute of limitations for a refund claim with a report prepared by the decedent's physician in 2006 at the request of the estate. The report said the decedent was suffering from progressive memory loss of the type associated with Alzheimer's disease. In denying the claim, the court found the 2006 report contradicted a report made by the same physician to the Maryland Motor Vehicle Administration a few months prior to the date of death. In addition, the court noted that in the years prior to his death, the decedent had successfully engaged in a sophisticated bank demutualization investment strategy entirely on his own that "made him a millionaire several times over."

c. ***BASR Partnership v. United States*, 113 Fed. Cl. 181 (09/30/13).** The case involves the application of the statute of limitations of assessment in a TEFRA setting. The Court of Federal Claims found that under Section 6229(c)(2), fraud by the tax professional, in this case the tax attorney who structured the tax shelter, was not sufficient to extend the statute of limitations. The Court said that under the TEFRA rules, the statute of limitations can only be extended if the IRS can show that the partner had the intent to evade taxes. The decision is currently being appealed.

d. ***LeCompte v. Commissioner*, T.C. Memo. 2015-39, (3/10/15).** The Tax Court denied summary judgment to Benjamin B. LeCompte III as to whether the statute of limitations had run for the IRS to assess the doctor for his contribution to a multiemployer benefit plan later deemed an illegal tax shelter by the IRS. The IRS sought to assess LeCompte for unreported income arising from the transfer of a life insurance policy from the multiemployer plan to a qualified single-employer plan in 2004, 2005, 2006 or 2007. LeCompte conceded that notices for the tax years at issue were timely issued but argued that the statute of limitations should have begun to run in 1990 when the original plan acquired the policy with a stated value of about $7.8 million. The doctor argued that if the original plan was an illegal tax shelter, then the policy should have been included in his income when the plan acquired it. The court said that LeCompte instead appeared to be raising an estoppel defense. Judicial estoppel would not apply, because no court had determined whether the doctor realized gross income on the basis of the contribution of the policy. Equitable estoppel would not apply, because the IRS did not make a false representation or a wrongful misleading silence when it did not charge LeCompte with additional income in 1990. There was a genuine issue of material fact as to whether and when LeCompte became the true, fully vested owner of the policy within the meaning of Treasury Regulations Section 1.83-3(b).

24. Capital or Ordinary Loss.

a. ***Pilgrim's Pride Corp. v. Commissioner*, No. 14-60295, (5th Cir. 2/25/15).** The Fifth Circuit ruled that Section 1234A(1) only applies to the termination of contractual and derivative rights, and not to the abandonment of capital assets. The government had argued on brief that the appeals court should affirm the December 2013 Tax Court decision that Section 1234A applied to prevent Pilgrim's Pride from taking an ordinary abandonment loss deduction of $98.6 million for shares its predecessor was obligated to purchase after the issuer's public offering fell through. Pilgrim's Pride contested that the section did not apply to the abandoned securities, "because the property underlying the Securities is not, nor would be on acquisition, a capital asset. "Pilgrim's Pride argued that the legislative history of Section 1234A indicated that Congress intended to limit the scope and not "treat any disposition of a capital asset, including an abandonment, as a sale or exchange." The IRS countered that Pilgrim's Pride's "interpretation of Section 1234A would lead to the absurd result of having that provision apply only to the termination of a derivative that relates to another separate underlying capital asset, but not to the termination of a right or obligation that is itself a capital asset." The government said that "the legislative history supports the Tax Court's interpretation of Section 1234A, as it reflects Congress's long-standing efforts to prevent tax avoidance by taxpayers seeking to create fully deductible ordinary losses on dispositions of capital assets." The primary question on appeal, the 5th Circuit said, was whether Section 1234A(1) applied to a taxpayer's abandonment capital asset. "The answer is no," the Court said. "By its plain terms, § 1234A(1) applies to the termination of rights or obligations with respect to capital assets," she said. "It does not apply to the termination of ownership of the capital asset itself." The 5th Circuit said that if Congress had intended a varying result, "there were far easier and clearer ways to do so." The court assumed the ordinary meaning of the statute's language "expresses the legislative purpose." The government argued that Section 165(g) requires Pilgrim's Pride's abandonment loss to be treated as capital. The Court disagreed, ruling that neither section would classify the losses in question as capital loss.

25. Gain on Sale of Home.

a. ***Villegas v. Commissioner*, T.C. Memo. 2015-33, (2/26/15).** The Tax Court ruled that the taxpayers could not exclude from income under tax code Section 121 their gain on the sale of a four-bedroom house in Diamond Bar, Calif., because the taxpayers did not use the property as their primary residence for an aggregate of two years during the five-year period preceding the 2007 sale date. The court found that the taxpayers did not live or reside at the house operated as a group home doing business as L. Marillac Group Home, because none of their employees saw them live there, a relative told an IRS agent that they did not live there, and school records for the taxpayers' children showed the family did not live there. "Finally, we are not persuaded by Mrs. Villegas' claim that she stayed overnight at the Diamond Bar house because the room that Mrs. Villegas claimed to use as her bedroom was known to Marillac employees as an office. Moreover, Mrs. Villegas' credibility is diminished by her testimony at trial and her conduct during a hearing with the Court," the court said. The court said the taxpayers could not increase their basis in the property—sold for $600,000—beyond the $200,000 they paid for it in 1994, because they failed to establish that the handwritten amounts for home improvements shown on a "table were in fact paid in connection with the Diamond Bar property." The taxpayers were not entitled to any business expense deductions for 2007, because they "failed to link the invoices, receipts, and bank records that they produced with the amounts of expenses they reported," the court said. The court noted that the taxpayers produced to the IRS "636 pages of records, including invoices, bank records, a payroll register, and receipts." The taxpayers "ignored our specific instructions to link their evidence to respondent's adjustments. We need not (and will not) undertake the task of sorting through the voluminous evidence petitioners have provided in an attempt to see what is, and what is not, adequate substantiation of the items on their returns," the court said. The court also found the taxpayers liable for additions to tax for 2007 under tax code Sections 6651 and 6654 for failure to timely file a tax return, timely pay tax and timely pay estimated tax. "A taxpayer's mistaken belief that he or she need not file a return is not reasonable cause," the court said in response to the taxpayers' argument that they did not think they owed tax. The taxpayers also argued that they could not timely file their 2007 return, because the buyer did not send a Form 1099-MISC, Miscellaneous Income, until 2008. The court was not persuaded, saying as cash-method taxpayers, the taxpayers had a responsibility to report income as they earned it. The court noted the taxpayers did not file their 2007 return until after the IRS had prepared a substitute for return.

26. Jurisdiction.

a. ***Med. Weight Control Specialist v. Commissioner*, T.C. Memo. 2015-52, (3/18/15).** The Tax Court ruled that it did not have jurisdiction over a petition filed by a company within the 90-day period after the IRS mailed a notice of deficiency, because California had suspended the company's corporate privileges more than nine years before the petition was filed. The court said that *David Dung Le, M.D., Inc. v. Commissioner*, 114 T.C. 268 (2000), aff'd, 22 Fed. Appx. 837 (9th Cir. 2001), "bears a striking similarity to the case at hand." In that case, the court concluded that a corporation suspended under California law can't prosecute or defend an action while it is suspended. The fact that the California Franchise Tax Board issued the taxpayer company a certificate of revivor and a certificate of relief from contract voidability almost a year after the petition was filed did not make the company's case distinguishable from David Dung Le, M.D. "This Court's jurisdiction is statutory, not contractual, and a party may not confer jurisdiction on this Court by agreement or concession," the court said. The court said the 90-day period for filing a petition following a deficiency notice under tax code Section 6213(a) was a condition "on the waiver of the Federal Government's sovereign immunity and must be strictly construed." The notice of deficiency applied to tax years 2009 through 2011 and listed deficiencies totaling more than $1 million. The company's corporate privileges were suspended in 2004.

b. ***Bedrosian v. Commissioner*, 144 T.C. No. 10 (3/17/15).** The Tax Court ruled in a division opinion that it had jurisdiction to consider whether the taxpayers could deduct $525,000 in professional fees incurred in setting up their investment in a Son-of-BOSS tax shelter. The court then declined to grant leave to the taxpayers to file an untimely motion for reconsideration of whether they could claim the deduction disallowed by the IRS after determining the Son-of-BOSS partnership was a sham. The court said it had jurisdiction, because the deductibility of the professional fees was a factual affected partner-level item. The judge noted that if the deductibility of the fees were a computational item, the court would not have jurisdiction. Despite having jurisdiction, the court denied the motion for reconsideration because the court was bound by partnership-level determinations, including the determination that the partnership was a sham. Because the partnership was a sham, related fees were not deductible for lack of a business purpose.

c. ***Leodis C. Matthews, APC v. Commissioner*, T.C. Memo. 2015-78 (4/23/15).** A law firm could not file a challenge to a deficiency notice with the Tax Court, because its corporate powers were suspended until after the petition deadline had passed. The court ruled that the California law firm was barred by the statute of limitations from filing a petition with the Tax Court to challenge a $1.9 million deficiency and a $382,934 penalty for a substantial understatement of income tax. The firm's corporate powers were suspended by the state of California in May 2013 for failure to pay state taxes. The IRS mailed the deficiency notice on June 30, 2014. The firm had 90 days after the deficiency notice to file a Tax Court petition under tax code Section 6213(a). The firm filed its Tax Court petition on Oct. 1, 2014, but California did not reinstate the firm's corporate powers until Nov. 26, 2014. The firm argued that its petition should be validated retroactively. The court disagreed, saying the statute of limitations for filing a lawsuit is substantive and not a procedural act that could be validated retroactively by a corporate revival.

27. Controlled Foreign Corporation.

a. ***BMC Software, Inc. v. Commissioner*, 5th Cir., No. 13-60684, (3/13/15).** In overturning a decision of the U.S. Tax Court, the Fifth Circuit found no support for the IRS's position that it could retroactively treat accounts receivable as indebtedness under the Section 965. Neither the plain language of statute nor the language of the closing agreement that established the accounts receivable allow for the IRS's "overly broad" interpretation, the court said. "The Commissioner makes much of the fact that in the 99-32 Closing Agreement, BMC agreed to backdate the accounts receivable," the appeals court said. "This is an incorrect interpretation of the testing-period requirements of §965. The fact that the accounts receivable are backdated does nothing to alter the reality that they did not exist during the testing period." Section 965 was enacted to encourage corporations to repatriate offshore funds. The statute provided a one-time tax deduction equal to 85 percent of eligible dividends paid by controlled foreign corporations to their U.S.-based parents, but it also included an exception, under

Section 965(b)(3), to prevent U.S. corporations from making loans to foreign subsidiaries to fund the repatriation. Under Section 965(b)(3), the amount of repatriated dividends otherwise eligible for the deduction must be reduced by the amount of any increase in related-party indebtedness that occurs during the testing period, which extended from the effective date of the provision, Oct. 3, 2004, through the end of the tax year in which the dividend was paid—in this case, March 31, 2006.

28. Basis.

a. ***AmerGen Energy Co., LLC v. United States*, Fed. Cir., No. 14-05067, (3/11/15).** The U.S. Court of Appeals for the Federal Circuit ruled that the U.S. Court of Federal Claims had correctly decided that the economic performance requirements of tax code Section 461(h) apply in determining when an accrual method taxpayer, such as AmerGen, incurs future nuclear decommissioning liabilities for purposes of calculating the tax basis of an acquired nuclear plant and associated assets. AmerGen, an indirect subsidiary to Exelon Corp., bought the three plants—Three Mile Island Unit 1, Clinton Power Station and Oyster Creek Nuclear Generating System—in 1999 and 2000 for $93 million, and assumed future decommissioning liabilities for each. AmerGen argued that its true cost in acquiring the three nuclear plants plus securities was fair market value of $974 million and not the $93 million "cost" under Section 1012. The IRS said AmerGen "seeks to circumvent the statutory scheme by claiming that future decommissioning costs associated with existing nuclear plants it purchased are immediately includible in its 'cost' basis, which would give rise to a corresponding amount of deductions and offsets long before any decommissioning activity commences." The claims court had considered whether AmerGen incurred the decommissioning liabilities at the time of purchase, but concluded that because AmerGen would not decommission its nuclear power plants until years later, it did not incur the decommissioning liabilities and thus could not include them in the basis of the acquired assets at the time of purchase. The Court disagreed with AmerGen's argument that the economic performance requirement codified in Section 461(h) is inapplicable in calculating the basis of purchased assets, adding that AmerGen's argument claiming the term "all events test" in the section has certain "historical limitations" that preclude its application in calculating basis to be "unavailing."

29. Interest Abatement.

a. ***King v. Commissioner*, T.C. Memo 2015-36 (3/9/15).** The Tax Court ruled that a taxpayer, lawyer for more than 40 years, had shown that interest that accrued on the taxes he owed between April and June 2009 were excessive. The taxpayer was required to file Forms 941, Employer's Quarterly Federal Tax Return, and remit payments for employment tax liabilities for various quarters between 2002 and 2008, which he failed to do. Throughout an IRS examination, the taxpayer disputed IRS records in regard to missing payments and returns, and documented that he had filed Forms 941 in a timely manner for various quarters. While the

IRS accepted some of the taxpayer's proposed tax liability, the IRS said the taxpayer still owed about $49,000 including penalties. The taxpayer was unable to pay the amount in a lump sum, and requested an installment payment plan that would require monthly payments. The IRS did not respond to the letter, and sent the taxpayer a notice of its intent to levy on certain assets in May 2009. The taxpayer argued that the IRS had abused its discretion by failing to abate penalties and additions to his tax liability, and that the IRS had abused its discretion by failing to abate interest because of a delay in processing his installment agreement request. The IRS argued that there was no abuse of discretion on the part of the commissioner. The Court found that the IRS's failure to communicate to the taxpayer the deficiencies of his proposed installment agreement was unfair to the taxpayer under the circumstances. "The Court is satisfied that, had respondent timely communicated with petitioner about the proposal, petitioner would have perfected his proposal within a reasonable time". "The Court is further satisfied that, but for respondent's delay in communicating with petitioner, petitioner would have paid his employment tax liabilities earlier."

30. <u>Disguised Sale</u>.

a. ***<u>SWF Real Estate, LLC v. Commissioner</u>*, <u>T.C. Memo. 2015-63, (4/2/15)</u>.** The transfer of state land preservation tax credits for cash in exchange for a purported membership interest was a disguised sale. The Tax Court ruled that SWF Real Estate LLC engaged in a disguised sale under tax code Section 707 when it allocated excess Virginia land preservation tax credits to another entity at 53 cents per dollar of the tax credits for a nonvoting minority interest in SWF. However, the Court largely upheld SWF's valuation of the 2005 conservation easement that generated the tax credits and reduced the claimed charitable contribution deduction of about $7.4 million under Section 170(h) by only $48,333, to $7.35 million. SWF held a 675-acre farm—known as Sherwood Farm—just south of Charlottesville, Va. Prior to the conservation easement, Yellowfish Investments Inc., an S corporation, was the sole member of SWF, and John L. Lewis IV owned 100 percent of the shares of Yellowfish. The conservation easement greatly limited any future development of the property. Lewis anticipated that SWF would not be able to use all of the $3.7 million in Virginia tax credits that the easement would generate. SWF agreed to transfer $3.4 million of the tax credits to Virginia Conservation Tax Credit Fund LLLP in exchange for a $1.8 million in cash characterized as a capital contribution. The Court concluded that the Virginia tax credits were property transferred for money, making the transaction a disguised sale under Section 707(a)(2)(B). The tax credits were property because Virginia Conservation had the right to sell and did sell the credits in the state tax credit marketplace. The transfer was a sale because Virginia Conservation wouldn't have transferred the $1.8 million but for the corresponding transfer of $3.4 million in tax credits. The Court said there was a sale because Virginia Conservation:

- could determine with reasonable certainty the timing and amount of the transfer;

- had a legally enforceable right to subsequently transfer the credits;
- had the right to receive the credits or a refund; and
- would receive a disproportionately large share of the credits (92 percent) in relationship to its 1 percent membership interest in SWF; and
- would have the right to freely use or transfer the credits.

SWF argued that some of the proceeds should be income for 2006. The Court disagreed, finding the proceeds were income to SWF in 2005, because in that tax year:

- legal title passed to Virginia Conservation;
- transactional documents showed the parties intended the transaction to be effective on or before Dec. 31, 2005;
- Virginia Conservation acquired an equity interest in the credits;
- SWF had a present obligation to execute and deliver a deed, and Virginia Conservation had a present obligation to make payments;
- the right of possession of the credits vested in Virginia Conservation; and
- Virginia Conservation would receive any profits from the sale of the credits.

The Court said the economic benefit theory applied instead of the doctrine of constructive receipt, because a fixed sum of money was irrevocably set aside for SWF's sole benefit and only ministerial duties remained until the funds not paid in 2005 were released in 2006.

31. Reasonable Compensation.

a. ***Midwest Eye Center, S.C. v. Commissioner*, T.C. Memo. 2015-53, (3/23/15) .** Midwest Eye Center S.C. failed to produce any comparable salary data or provide the methodology for computing the 2007 bonus payments made to its sole shareholder in order to demonstrate that the amount was reasonable. The court upheld more than $320,000 in tax delinquencies along with a $62,000 penalty assessed by the IRS. The sole shareholder received a salary of $30,000 every two weeks, and was responsible for about one-third of the company's billings. On its 2007 Form 1120, Midwest reported gross receipts exceeding $7 million, and claimed a compensation deduction for salary and bonuses paid the sole shareholder of more than $2.7 million, but claimed a tax loss. Using a net operating loss carryforward, it reported zero taxable income for 2008, despite gross receipts in excess of $6 million for that tax year. The IRS contended $1 million of the $2 million bonus paid for 2007 was a disguised dividend rather than bonus compensation, and the court agreed. "Petitioner produced no evidence of comparable salaries. Instead, petitioner argues that there are no 'like enterprises' under 'like circumstances' from which to draw comparisons," the court wrote. It rejected Midwest's contention that the large bonus was reasonable under the circumstances. Despite the varied managerial and medical roles played by the sole shareholder in Midwest's business, and the increased workload undertaken as other surgeons left the practice, the court said Midwest "did not provide any methodology to show how the sole shareholder's bonus was determined in relation to these responsibilities." As the burden fell on Midwest to show the bonus was reasonable, the court upheld the deficiency determinations, as well as the accuracy-related penalty for 2007. The company failed to provide the identity of its return preparer or evidence on whether it relied on the preparer's judgment, so it was not entitled to penalty relief on that basis.

32. <u>Excise Tax</u>.

a. ***<u>Bombardier Aerospace Corp. v. United States</u>*, <u>No. 3:12-cv-01586, (ND Tex. 3/20/15)</u>.** The U.S. District Court for the Northern District of Texas ruled that Bombardier Aerospace Corp. (BAC), which was audited by the IRS for unpaid taxes on monthly management fees (MMFs) for tax years 2006 and 2007, had received sufficient notice of the taxes owed. BAC filed suit under tax code Sections 6511 and 6415 to recover and abate the assessed excise taxes the IRS imposed under Section 4261, which imposes a tax on "taxable transportation." For the two tax years, BAC received three types of fees; the MMFs, variable rate fees (VRFs) and fuel surcharge fees (FSFs). BAC paid taxes on the VRFs and FSFs, but not on the MMFs based on two audits of federal excise tax returns by the IRS prior to the tax years at issue that stated Bombardier didn't owe MMFs. The IRS audited BAC for the unpaid MMFs in 2006 and 2007, assessing federal excise taxes on the fees. BAC argued in its petition for a refund of the paid taxes that it is entitled to summary judgment because the excise taxes could not legally be imposed on flights conducted by fractional aircraft owners who utilized its services because BAC's obligation to collect and remit the excise taxes on the MMFs was "vague and speculative." The government argued that BAC should have been clear on its tax liability based on a February 2004 IRS technical advice memorandum (TAM) notifying BAC that all fees received by the manager in BAC's program were subject to federal excise taxes. The court agreed with the government, stating that "a reasonable trier of fact could only find from the summary judgment evidence that BAC was given notice of a precise and clear duty to collect FET on MMF." The court also held that BAC lacked standing to recover any excise taxes it collected and paid on the VRFs and FSFs because it failed to establish it either repaid the amount of the federal excise taxes on the fees it collected, or that it obtained the consent of its clients to allow the refund. BAC's argument that it doesn't provide "taxable transportation" as a "non-U.S. citizen" was also rejected by the court, which said that the grounds for which BAC opposed the government's motion for summary judgment "lack merit."

33. <u>TEFRA Rules</u>.

a. ***<u>Brumbaugh v. Commissioner</u>*, <u>T.C. Memo. 2015-65, (4/6/15)</u>.** The Tax Court rejected claims of two petitioners that their partnership was not subject to the TEFRA, ruling that they could not claim entitlement to additional passthrough losses from the partnership. The court ruled that the taxpayers, who claimed entitlement to additional flowthrough losses from 4200 Panorama LLC (Panorama), a partnership they were involved with, could not satisfy the small partnership exception to TEFRA in claiming losses. The court ruled that Panorama was a TEFRA partnership because it could not satisfy the small partnership exception as it had one passthrough partner in 2007 named Lynx. The taxpayers argued that Lynx held a nominal interest of .02 percent, however court explained that neither the IRC, nor the regulations, provide a "de minimis exception" that would allow such a small interest to be allowed.

34. Refund Claim.

a. ***Butts v. Commissioner*, T.C. Memo. 2015-74, (4/15/15).** Taxpayers were not entitled to a refund for an overpayment made more than two years before the IRS issued a notice of deficiency, because they did not file a return until after the notice. The Tax Court ruled that a two-year look-back period applied to a 2007 overpayment made by the taxpayers because they had not yet filed a return when the IRS issued a notice of deficiency for that year. The taxpayers could have been deemed to have made a refund claim under tax code Section 6512 on either June 13, 2011, when the IRS mailed the notice of deficiency to the taxpayer husband, or Oct. 16, 2012, when it mailed a notice of deficiency to the taxpayer wife. However, because the couple did not file their 2007 joint return until February 2013, the Tax Court did not have jurisdiction under Sections 6511(b)(2)(A) and 6512(b)(3)(B) to order a refund of taxes paid any more than two years prior to whichever deficiency notice would be applicable. "Under section 6513(b)(1), income tax deducted and withheld from an employee's wages is deemed to have been paid on April 15 of the following tax year—that is, in petitioners' case, April 15, 2008," the court said. "Because the 2007 overpayment was paid, in its entirety, on April 15, 2008, well before the date of either notice of deficiency, we lack jurisdiction to order a refund of any portion of it," the court said. The three-year look-back period under Sections 6511(b)(2)(A) and 6512(b)(3)(B) did not apply, because those sections only allow for a three-year look-back if the return was filed before the notice of deficiency. In a footnote, the court said that the addition to tax under Section 6511(a)(1) for late filing did not apply, because neither party had addressed the issue in a stipulation of settled issues. Because the IRS drafted the stipulation, and the taxpayers were unrepresented, the court construed the ambiguity against the IRS.

35. Miscellaneous.

a. ***Wei Ding v. Commissioner*, T.C. Memo 2015-20 (2015).** The U.S. Tax Court denied an IRS motion for summary judgment in a case involving a taxpayer who had been in China caring for sick family members while her tax liabilities were investigated. Because a genuine dispute of material fact still existed in the case, the court could not decide the issue as a matter of law in favor of the IRS. The taxpayer, a real estate professional, filed her tax returns late for 2003 to 2005, with the IRS finding after examination that she was deficient in her taxes by over $600,000 plus penalties and additions. After a notice of tax lien was sent to the taxpayer's sister in New Jersey, her CPA filed a request for a collection due process hearing. The CPA, taxpayer's sister and an IRS settlement officer (SO) met in August 2012. The SO explained that the taxpayer could not dispute the tax liabilities because she had neglected to pursue an opportunity to dispute the determination after she was sent a Letter 950, 30 Day Letter-Straight Deficiency or Over-Assessment, from 2010. The sister and CPA denied ever receiving the letter, which prompted the SO to inform them that if that were the case, the taxpayer would be eligible to petition the determinations. The SO subsequently received several documents from the taxpayer's legal and financial representatives relating to the 2003 to 2005 audit adjustments. In March 2013, the appeals officer (AO) who reviewed the documents reported that the taxpayer's tax deficiencies should be significantly lowered, and that she defaulted because she had been outside of the country. The taxpayer's new balance for the years at issue turned to $930,867, including accrued interest, and later the taxpayer petitioned that balance for review with the Tax Court. She contended that the IRS had incorrectly determined her "self-employment taxes and/or capital gains taxes," and that the IRS had improperly determined the penalties and additions for the tax years at issue "inasmuch as 'there does exist reasonable cause' for her late filings and omissions." At trial, the IRS argued that the taxpayer is precluded from challenging her tax liability because she had received a notice of deficiency, and she neglected to petition the court. The IRS offered a copy of a U.S. Postal Service Form 3877, which included a tracking number establishing a notice of deficiency had, in fact, been mailed to the taxpayer on Oct. 12, 2012, at her New Jersey address. The IRS also argued that no genuine dispute concerning any material fact remained and that the SO had not abused her discretion in declining to offer the taxpayer a collection alternative. The court disagreed, stating, "Construing the facts of records and inferences drawn from them in the light most favorable to petitioner, we conclude that there is a genuine dispute of material fact as to whether she actually received the notice of deficiency."

b. ***Na v. Commissioner*, T.C. Memo 2015-21 (2015).** The Tax Court has cleared a Los Angeles taxpayer of nearly $1 million in tax deficiencies for 2008, while still imposing accuracy-related penalties. The Court ruled that the taxpayer, a Korean woman who had limited English-language skills, had established by a preponderance of the evidence that she had received deposits on behalf of her boss as a mere conduit for payment, and that the majority of the income the IRS found her to be liable for was not her responsibility. In 2008 she timely filed her tax return, which had been prepared by a CPA who had done the taxpayer's taxes for more than 10 years. The return reported taxable interest income of $3,138, gambling winnings of $1,421,385 and net business income of $65,236. During the time she filed her return, the taxpayer had two accounts at Hanmi Bank, a checking and money market account, which the IRS examined starting in May 2010. After the agent completed the investigation, the IRS mailed the taxpayer a notice of deficiency on July 12, 2012, informing her of a $1,013,769.61 adjustment to her reported 2008 income, along with over $70,000 in tax code Section 6662(a) penalties for "negligence, or disregard of rules and regulations." The judge, who described the trial's stakes as "relatively high," explained that the court was responsible for determining taxpayer's tax liability, which at the moment exceeded her typical annual income by more than 300%. While the court found that the IRS had established its evidentiary burden of the deposits to the taxpayer's bank accounts, he eventually found for the taxpayer as to the source and explanation of the deposits. The taxpayer explained at trial that the money was never hers, and that she received and dispersed the funds as an agent for boss, who had instructed her to make the deposits, and that she feared she would lose her job if she didn't listen. The court explained that it had previously found that "if a taxpayer receives and disperses funds strictly as an intermediary for transactions between other parties and receives no material benefit from the funds, the taxpayer need not include the funds in his or her gross income." The taxpayer offered as evidence statements for, and canceled checks written on, the Hanmi Bank accounts during 2008, along with a schedule for what she contended were payments she made on behalf of her boss that totaled more than $1 million. On one occasion, the taxpayer testified, her boss had given her funds to deposit and then instructed her to write a check to Artmonde LLC, a second company owned by the boss. The taxpayer also explained that the gambling winnings were from the boss, who had asked her to provide her own Social Security number at the casinos to claim the winnings. The judge wrote that the taxpayer's testimony and bank records were consistent with her explanation, and that the evidence strongly suggested the boss was funneling money through the taxpayer's accounts. The IRS argued that the taxpayer's testimony was "incredible" and claimed that she "offered no evidence beyond that testimony to prove she received unreported deposits to her Hanmi Bank accounts as an informal agent or trustee or acted as a mere conduit for the funds." The court disagreed, saying the record didn't support the IRS's assertions. The taxpayer was still unable to offer any evidence or argument as to $2,266.81 of the funds she received, with the court holding her accountable for that amount, plus additions that constituted net earnings from self-employment that would be subject to self-employment tax that totaled $78,452.51. The court also criticized the taxpayer's record keeping, particularly given the fact that she had commingled her own funds with the boss's in the two Hanmi accounts, and he affirmed the IRS's penalties.

c. ***United States v. Barrett*, 113 A.F.T.R.2d 2014-79 (D. Colo. 01/23/14).** The district court approved an IRS request that employed little used Section 7402(a) that allows a court to order a taxpayer to either pay a balance due or give up his passport until either arrangements to pay have been agreed upon or full payment has been made.

d. ***Onyango v. Commissioner*, 142 T.C. No. 24 (2014).** The Court held that an individual who received the certified mail notification that would/should have led that individual to go to the post office and pick up the notice of deficiency had, for purposes of I.R.C. 6330(c)(2)(B), received the notice of deficiency. Instead of timely going to the post office, the individual made no effort, or no timely effort, to go to the post office to pick up the notice and the Court determined that this failure precluded the individual from contesting the merits of his tax liability through the CDP statute even though he never "had" the opportunity to do so prior to the assessment.

e. ***Hill v. United States*, No. 12-390T (Ct. Fed. Cl. 09/20/14).** A prisoner named Mark Hill whose $1,182 tax refund check was stolen and cashed by another prisoner with the same name after the prison system mistakenly delivered an IRS letter relating to the refund check to the wrong Mark Hill. With time on his hands, but no check, the right Mark Hill sought justice in the form of a new check. After getting the runaround from the IRS, the right Mr. Hill sued the IRS to force it to issue a new refund check, plus interest and punitive damages. The Court awarded interest, but not damages.

Joel N. Crouch

Partner

Mr. Crouch is a partner with Meadows, Collier, Reed, Cousins, Crouch & Ungerman, L.L.P., specializing in civil and criminal tax controversies. He represents a broad range of clients, including individual taxpayers, closely-held business enterprises, estates, corporations and tax advisors in all stages of federal civil and criminal tax proceedings. In over 20 years of practice, he has helped his clients resolve hundreds of civil and criminal tax matters, many of which involved sophisticated and complex legal and tax issues, both domestic and international.

Mr. Crouch has extensive experience in resolving tax matters at all stages of a tax dispute including IRS examinations, administrative appeals, and if necessary, litigation in the U.S. Tax Court, the U.S. Court of Federal Claims and U.S. District Courts. Mr. Crouch has tried civil cases in the U.S. District Court, the U. S. Court of Claims and U.S. Tax Court. He has also successfully argued cases at the U.S. Court of Appeals for the Fifth Circuit and represented clients in tax cases before the United States Supreme Court. Mr. Crouch has also tried criminal cases in the U. S. District Court. In partnership litigation, he has been involved in challenging IRS positions on the enforceability of several federal regulations, the applicable statute of limitations and application of penalties.

As a board certified tax lawyer by the Texas Board of Legal Specialization, Mr. Crouch has intimate knowledge of the tax laws, regulations, accounting standards and developments within the IRS and other federal government agencies. His specialized knowledge and experience allows him to effectively advocate on behalf of his clients in litigation against the federal government. He has represented accountants and attorneys in civil promoter examinations and criminal investigations arising from their involvement in structured transactions. He has successfully navigated these investigations so that his clients' exposure to penalties and criminal prosecution has been eliminated or significantly reduced.

Mr. Crouch has been recognized as one of the best in his field by *Texas Monthly* and *Law and Politics* magazines by being named a Texas Super Lawyer from 2003 through 2011. He has also been named one of the Best Lawyers in Dallas by D Magazine. He is a frequent speaker on both substantive and procedural tax issues for both legal and accounting professionals. Topics include Tax Shelter Defense, IRS Examinations, Appeals, Litigation and Collection Strategies, IRS Criminal Investigations, IRS Offshore Activities, IRS Focus on Tax Professionals, Employment Classification, IRS Penalties, and Litigating Partnership Tax Cases. Mr. Crouch has published various articles re: the IRS & tax procedures.

AREAS OF PRACTICE

- Income Tax Litigation
- Estate and Gift Tax Litigation
- White Collar and Government Regulatory Litigation
- Commercial Litigation

Education

J.D., University of Texas School of Law, 1988
B.A., Southern Methodist University, 1985

Bar Admissions

State Bar of Texas

Professional Associations and Memberships

American Bar Association, Taxation
- Member, Court Procedure and Practice Committee
- Member, Standards of Tax Practice Committee
- Member, Civil and Criminal Penalties Committee
- Member, Administrative Practice and Procedures Committee

State Bar of Texas
- Member, Section of Taxation

Dallas Bar Association
- Member, Tax Advisory Council, 2014-2016

Dallas Bar Foundation
- Fellow

Collin County Bar Association
- Member

Plano Symphony Orchestra
- Board of Directors, Secretary and Treasurer

St. Andrews United Methodist Church –
- Chairman, Building Committee
- Administrative Council

Willow Bend Lakes Home Owners Association
- Board Member
- Secretary

Publications

"Understand the IRS Voluntary Disclosure Program", April 2012, *Texas Lawyer*

"Is Three Times a Charm? The IRS Announces a Third Offshore Voluntary Disclosure Initiative", February 2012, *BarTabs* published by the Collin Country Bar Association

"6 Keys to Avoiding Section 6701 Penalties", *The Value Examiner*, May/June 2006 Issue, National Association of Certified Valuation Analysts

"Take Two: IRS Voluntary Disclosures and The Offshore Disclosure Initiatives", April 2011, *BarTabs* published by the Collin County Bar Association

"Avoiding Criminal Tax Problems: Voluntary Disclosure", Originally published in *Headnotes*, Vol. 36, No. 5, May 1, 2011, page 9 (published monthly by the Dallas Bar Association)

Honors and Awards

The Best Lawyers in America©, 2015, Tax Law

2013 Top Rated Lawyer in White Collar Criminal Defense Law by ALM as published in *The American Lawyer, Corporate Counsel & The National Law Journal*, October 2013

Texas Super Lawyers-Tax as listed in Texas *Super Lawyers Magazine* and *Texas Monthly*, 2003 through 2014

Best Lawyers in Dallas, D Magazine, 2012: Tax Litigation

Joel N. Crouch

Partner

2014 Speaking Engagements

American Association of Attorney-CPAs, "Self Employment Tax Issues for LLCs and S Corps" – 1/24/14

Corpus Christi Chapter/TSCPA 56th Annual Tax Conference, "Self Employment Tax for LLCs and S Corps" – 1/29/14

First Bank & Trust East Texas Seminar, Lufkin, "Judicial Update" – 4/25/14

Texas Bank & Trust Seminar, Tyler, "Self-Employment Tax for LLCs and S Corps" – 5/6/14

Texas Bank & Trust Seminar, Longview, "Self-Employment Tax for LLCs and S Corps" – 5/15/14

East Texas Chapter/TSCPA Annual CPE Expo, Tyler, "Judicial Update" – 5/19/14

Brazos Valley Chapter/TSCPA, College Station, Recent Developments in Federal Income Taxation" – 5/22/14

16th Annual 2014 San Antonio CPA CE Symposium, San Antonio, "What to Expect from a Rapidly Changing IRS in 2014" – 8/15/14

Panhandle Chapter/TSCPA 2014 Tax Institute, Amarillo, "What to Expect in 2014 from a Rapidly Changing IRS" – 8/27/14

Advanced Tax Law Course 2014 sponsored by TexasBarCLE, Dallas, "Foreign Asset Reporting Obligations to the IRS" – 8/28/14

16th Annual Meadows Collier Taxation Conference, Dallas – 10/28/14

Austin Chapter/TSCPA Annual Tax Conference, Austin – 11/17/14

TSCPA CPE Expo, Houston "What is Happening to Taxpayers in Court?" – 12/4/14

TSCPA CPE Expo, San Antonio "What is Happening to Taxpayers in Court?" – 12/8/14

2013 Speaking Engagements

Corpus Christi Chapter/TSCPA 55th Annual Tax Conference, Corpus Christi, "What Can We Expect From the IRS in 2013" – 2/1/13

Dallas Bar Association - Tax Section, Dallas, "Conservation and Facade Easements: Are They for Real or a Facade?" – 4/1/13

Texas Bank and Trust Seminar, Tyler, "What We Can Expect from the IRS in 2013" – 5/1/13

Convergence 2013 sponsored by the Dallas CPA Society, Dallas, "Panelists - Criminal Tax" – 5/8/13

Texas Bank and Trust Seminar, Longview, "What We Can Expect from the IRS in 2013" – 5/16/13

North American Petroleum Accounting Conference (NAPAC), Dallas, "Self-Employment and Employment Tax Issues in LLCs and S Corporations" – 5/17/13

Wichita Falls Chapter/TSCPA Free CPE Seminar, Wichita Falls, "What We Can Expect from the IRS in 2013" and "Self-Employment and Employment Tax Issues in LLCs and S Corporatons" – 5/22/13

Central Texas Chapter/TSCPA CPE Expo, Waco, "What We Can Expect from the IRS in 2013" – 5/29/13

2013 Speaking Engagements (cont.)

Dallas Bar Association - Real Property Section, Dallas, "Conservation and Facade Easements: Are They for Real or a Facade?" – 7/8/13

UT Law 2013 LLCs, LPs and Partnerships Conference, Austin, "Dysfunctional Family Limited Partnerships" – 7/11/13

Brazos Valley Chapter/TSCPA, College Station, "What We Can Expect from the IRS in 2013" – 6/12/13

Fort Worth Chapter/TSCPA Tax Institute, Fort Worth, “Offers in Compromise: Is the IRS Really Becoming Kinder and Gentler”, – 8/2/13

Texas Association of Certified Public Accountants, Houston, “What to Expect from a Rapidly Changing IRS”, – 8/16/13

15th Annual Meadows Collier Taxation Conference, Dallas, “Judicial Update:, 10/29/13

Accounting Continuing Professional Education Network (ACPEN), Dallas, “Procedural Issues in Partnership Audits and Litigation, Return Preparer Penalties and Hot Litigation Topics”, – 10/30/13

TSCPA CPE Expo, San Antonio – 12/10/13 and Houston – 12/17/13, “What to Expect in 2014 from a Rapidly Changing IRS”

2012 Speaking Engagements

Corpus Christi Chapter/TSCPA, Corpus Christi, "How to Make Sure Your Client Does Not Have IRS Employment Tax Problems" – 1/13/12

Montgomery Coscia Greilich LLP, Dallas, “Current Trends in IRS Examinations and Appeals” – 4/23/12

Texas Bank and Trust Seminar, Tyler, "Civil and Criminal Fraud Audits and Investigations" – 5/2/12

Texas Bank and Trust Seminar, Longview, "The Valuator/Appraiser: Perspectives and Guidance in Navigating Through Valuation Engagements" – 5/8/12

Dallas Bar Association Health Law Section, Dallas, "Health Care and Independent Contractors: How to Avoid Being A Target" – 5/16/12

North American Petroleum Accounting Conference (NAPAC), Dallas, "Compliance Issues for U.S. Partnerships with Foreign Partners and U.S. Partners with Foreign Partnerships" – 5/17/12

Corpus Christi Estate Planning Council, Corpus Christi, "Using Family Limited Partnerships and What to Expect from the IRS" – 5/18/12

Dallas Bar Association Small & Solo Practice Section, Dallas, "What Every Attorney Should Know About the IRS" – 8/1/12

Law Review CLE, Dallas, "Worker Classification" – 8/9/12

Fort Worth Chapter/TSCPA Tax Institute, Fort Worth, "Worker Classification" – 8/10/12

Panhandle Chapter/TSCPA Tax Institute, Amarillo, "IRS Priority #1: Foreign Transactions, Entities and Bank Accounts" – 8/23/12

Dallas CPA Society's Member Appreciation Series, Dallas, "IRS Exams and Collections" – 9/19/12

Joel N. Crouch

Partner

2012 Speaking Engagements (cont.)

14th Annual Meadows Collier Taxation Conference, Dallas, “Judicial Update” – 10/30/12

Austin Chapter/TSCPA Annual Tax Conference, Austin, "Judicial Update" – 11/8/12

TSCPA CPE Expo, San Antonio, "What We Can Expect from the IRS in 2013" – 12/3/12

TSCPA CPE Expo, Houston, "What We Can Expect from the IRS in 2013" – 12/10/12

2011 Speaking Engagements

Denton Bar Association, Denton, "Divorce and Separation: A 'Taxing' Experience" – 1/4/11

Dallas Bar Association Tax Section, Dallas, "The Changing Relationship Between Taxpayers and the IRS Examination Division" – 2/7/11

Dallas Collaborative Law Group, Dallas, "Tax Issues in Divorce and Separation" –- 4/21/11

Taxation and Estate Planning Update for Professionals Seminar sponsored by Texas Bank and Trust, Tyler, "Don't Give Up on Family Limited Partnerships (FLPs)" – 5/4/11

Taxation and Estate Planning Update for Professionals Seminar sponsored by Texas Bank and Trust, Longview, "Don't Give Up on Family Limited Partnerships (FLPs)" – 5/18/11

Wichita Falls Chapter/TSCPA, Wichita Falls, "What are our Friends at the IRS Doing to us Now?" – 5/25/11

Dallas CPA Society's Continuing Education Day Conference, "Resolving Conflicts Through the IRS Taxpayer Advocate's Office" – 5/26/11

Fort Worth Chapter/TSCPA Tax Institute Fort Worth, "The IRS and the Tax Professional: Friends or Foes?" – 8/4/11

2010 Speaking Engagements

13th Annual Meadows Collier Taxation Conference, Dallas, "The Offshore Voluntary Disclosure Initiative is Done: Now What?" – 10/25/11

Accounting Continuing Professional Education Network (ACPEN) Live Webcast, Dallas – 10/26/11

Rio Grande Valley Chapter/TSCPA Expo, South Padre Island, "The Changing Relationship between Taxpayers and the IRS Examination Division" – 10/28/11

Dallas Bar Association - Tort & Insurance Practice Section, Dallas, "The CPAs Continuing Role in Family Limited Partnerships" and "Compliance

Issues for U.S. Partnerships with Foreign Partners and U.S. Partners in Foreign Partnerships" – 11/1/11

Austin Chapter/TSCPA Annual Tax Conference, Austin, "Practical Suggestions and Traps to Avoid When Working with the IRS" – 11/14/11

TSCPA CPE Expo, "The Evolving Relationship Amongst the IRS, Taxpayers and Tax Professionals" – 12/1/11- San Antonio, 12/5/11-Arlington and 12/8/11-Houston

2010 Speaking Engagements (cont.)

National Constitution Center Audio Conference, Dallas, "Tax Disputes Before the IRS: Audit, Appeal & Tax Litigation" – 2/17/10 & "IRS Criminal Tax Investigations: Successfully Representing Your Client" 6/15/10

San Angelo Chapter/TSCPA, San Angelo, "Circular 230" – 5/19/10

Central Texas Chapter/TSCPA CPE Expo, Waco, "Tax Disputes Before the IRS: Audit, Appeal and Tax Litigation" – 5/20/10

American Society of Women Accountants, Ft. Worth Chapter, Fort Worth,

"Tax Disputes Before the IRS: Audit, Appeal and Tax Litigation" – 5/26/10

Comerica Bank Counsel, Dallas, "Family Limited Partnership Update" – 8/5/10

Panhandle Chapter/TSCPA MIGI Conference, Amarillo, "Employment Tax Law" – 10/21/10

Meadows Collier Taxation Conference, Dallas, "IRS Alternative Resolution Options" – 10/26/10

National Constitution Center Audio Conferences, Dallas, "Tax Disputes Before the IRS: Audit, Appeal & Tax Litigation" – 11/3/10

Tax Executives Institute Dallas Chapter, Dallas, "The Changing Relationship Between Taxpayers and the IRS Examination Division" – 11/16/10

TSCPA CPE Expo, San Antonio, Houston & Arlington, "Judicial Update: What's Happening in the Courts?" – 12/3/10, 12/7/10 & 12/10/10

Civil Tax Controversies Representation Matters

Represented client in appeal to the U.S. Supreme Court regarding the IRS attempt to invoke a six year statute of limitations.

Represented client in an appeal to the U.S. Fifth Circuit regarding the IRS attempt to impose a substantial penalty.

Represented client in an appeal to the U.S. Fifth Circuit and successfully argued that the IRS cannot invoke a six year statute of limitations.

Represented client in a successful challenge to the IRS' attempt to retroactively apply a Treasury regulation.

Represented client in successfully resolving issues regarding unfiled payroll tax returns for multiple years.

Represented numerous clients through the IRS Offshore Voluntary Disclosure initiatives and other voluntary disclosure programs.

Represented family in challenge to IRS disallowance of tax benefits and prepared imposition of penalties.

Represented estate in an IRS challenge to the value of interest in a closely-held business. Successfully settled case for significantly less than the IRS’s proposed assessment.

Represented a client in IRS challenge to losses arising from investment in distressed assets.

Represented attorney in a challenge to IRS summons for records related to attorney’s client’s offshore activities.

Represented numerous clients in tax shelter examinations and civil litigation.

Joel N. Crouch

Partner

Civil Tax Controversies Representation Matters (cont.)

Represented clients in IRS attempt to reclassify losses associated with horse and cattle activities as hobby losses under IRC § 183.

Represented numerous clients in tax shelter examinations and civil litigation.

Represented clients in IRS attempt to reclassify losses associated with horse and cattle activities as hobby losses under IRC § 183.

Represented clients in IRS challenges to classification of independent contractors versus employees.

Represented numerous tax professionals under investigation for alleged ethical and IRS Circular 230 violations.

Represented large public company in an IRS challenge to deduction of expenses related to merger with competitor.

Represented owner and closely-held business in IRS examination of issues related to change in accounting method.

Represented client in IRS attempt to impose penalties during litigation of civil tax matter. Successfully convinced court that the government could not propose penalties.

Represented client in connection with IRS challenge to losses arising from failed tender offer for a foreign publicly-traded company.

Represented numerous estates in IRS challenges to the valuation of closely-held businesses and estate planning vehicles fractionalizing ownership and control.

Represented numerous estates in IRS challenges to family limited partnerships involving IRC §§ 2703, 2704 and 2036 and other substance-over-form attacks.

White Collar and Criminal Tax Controversies Representation Matters

Represented a CPA subject of an investigation by the Tax Inspector General's Office and negotiated a resolution involving no criminal charges.

Hired by client post-indictment in mail and wire fraud case and convinced the government to dismiss the indictment before trial.

Successfully avoided criminal prosecution and civil fraud penalties for numerous taxpayers in civil IRS examinations and IRS administrative proceedings with high risk of civil fraud penalties, criminal prosecution or both.

Represented numerous clients in making voluntary disclosures to the IRS regarding unfiled tax returns, substantiation tax issues and offshore activities to avoid criminal prosecution.

Represented large national corporation in investigation of potential environmental criminal violations. Convinced the government that no criminal charges should be brought.

Represented an attorney in an IRS investigation of failure to file tax returns.

Represented a hospital chain in a healthcare fraud investigation following the execution of search warrants based on allegations made by a qui tax relation.

White Collar and Criminal Tax Controversies Representation Matters (cont.)

Represented a real estate investor indicted for tax fraud associated with losses for investment in bank-related real estate. The client was acquitted on all counts.

Represented a banker indicted for allegedly failing to disclose relationship to borrowers who later defaulted on loan. The client was acquitted on all counts.