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Focus on Tax Controversy

NEWSLETTER

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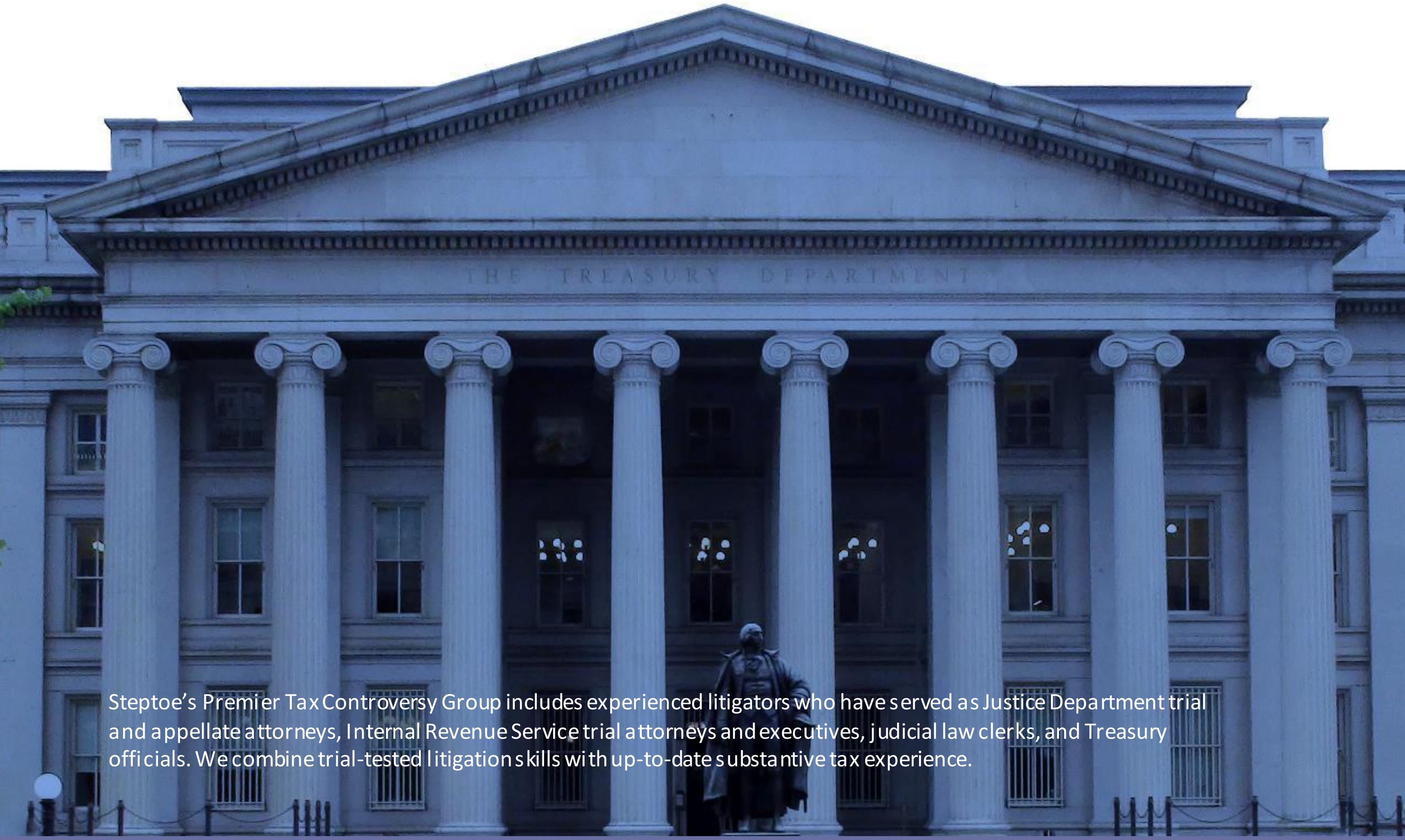

Steptoe's Premier Tax Controversy Group includes experienced litigators who have served as Justice Department trial and appellate attorneys, Internal Revenue Service trial attorneys and executives, judicial law clerks, and Treasury officials. We combine trial-tested litigation skills with up-to-date substantive tax experience.

TABLE OF CONTENTS

ARTICLES

SUPREME COURT LIMITS SCOPE OF THE ANTI-INJUNCTION ACT

On May 17, 2021 the Supreme Court in *CIC Services, LLC v. IRS*[1] held, in a unanimous decision, that the Anti-Injunction Act (AIA), which provides that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person,"[2] does not prevent federal courts from enjoining the IRS's enforcement of Notice 2016-66.

Both the district court and the Sixth Circuit[3] concluded that the Anti-Injunction Act prohibited the taxpayer from challenging the IRS's procedures when issuing Notice 2016-66, which created a penalty-backed requirement for taxpayer and advisors to report micro-captive insurance transactions, concluding that the federal court lacked subject matter jurisdiction. CIC Services sued the IRS, alleging that the agency had issued its guidance unlawfully in violation of the requirements of the Administrative Procedures Act (APA). The Supreme Court's decision is significant and may provide a pathway for taxpayers to challenge the validity of IRS notices that require the reporting of information, which inflict costs separate and apart from any statutory tax penalty.

BACKGROUND

In 2016, the Service issued IRS Notice 2016-66 (the Notice). In the Notice, the IRS expressed concern that "micro-captive transactions" had the potential for tax avoidance or evasion and classified these transactions as "transactions of interest" for the purposes of 26 C.F.R. § 1.6011-4 and 26 U.S.C. §§ 6011 and 6012. Based on this classification, the Notice directs that: (1) "[p]ersons entering into these transactions on or after November 2, 2006, must disclose the transaction" to the IRS; and (2) "[m]aterial advisors who make a tax statement on or after November 2, 2006, with respect to transactions entered into on or after November 2, 2006, have disclosure and maintenance obligations under §§ 6111 and 6112" of the Internal Revenue Code. The Notice further provides that taxpayers and material advisors are required to file a disclosure statement regarding these transactions prior to January 30, 2017, and that persons who fail to make required disclosures "may be subject to . . . penalty" under 26 U.S.C. §§ 6707(a), 6707A, and 6708(a).

In 2017, CIC, a manager of captive insurance companies, and Ryan, a consulting and tax services corporation (Taxpayers), which managed captive insurance companies, brought suit in the district court asserting that they are subject to the Notice 2016 – 66 disclosure requirements for material advisors and that complying with the Notice's disclosure requirements will force them to incur significant costs. Taxpayers assert, however, that Notice 2016 – 66 (1) constitutes a "legislative-type rule" that fails to comply with mandatory notice-and-comment requirements under the APA, 5 U.S.C. § 553, et seq.; (2) is "arbitrary and capricious and

[1] __ U.S. __, 141 S. Ct. 1582 (May 17, 2021) (No. 19-930).
[2] 26 U.S.C. § 7421.
[3] *CIC Servs. v. IRS*, 925 F.3d 247 (6th Cir. 2019), *cert granted* (May 4, 2020).

ultra vires in nature"; and (3) fails to comply with the requirements of the Congressional Review of Agency Rule-Making Act, 5 U.S.C. § 801, because the IRS failed to submit it to Congress and the Comptroller General. Based on these allegations, Taxpayers sought, among other things, a declaration under the Declaratory Judgment Act (DJA)[4], that the Notice is invalid and an injunction prohibiting the IRS from enforcing the disclosure requirements set forth in the Notice based on the IRS's failure to comply with the APA's notice-and comment requirements. The IRS moved to dismiss the claims, arguing, among other things, that the Court lacks subject-matter jurisdiction based the AIA.

THE AIA

The AIA provides that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed."[5] The Service argued that the Taxpayers' claims and their requested injunction violate the AIA because any ruling in the Taxpayer's favor will necessarily operate to restrain tax assessment and collection.

PROCEDURAL HISTORY

The district court concluded that although Notice 2016 – 66 provides that persons who fail to comply with it will be subject to "penalty" under 26 U.S.C. §§ 6707(a), 6707A, and 6708(a), the plain language of governing statutes establishes that such a "penalty" is a "tax" within the AIA's prohibition against injunctive relief. Accordingly, the district court concluded that it lacked subject-matter jurisdiction over Taxpayers' claims because they are barred by the AIA. On appeal, the Sixth Circuit panel affirmed, with one judge dissenting. The Court held that it did not have subject matter jurisdiction and rejected Taxpayers' claim that their complaint did not fall within the purview of the AIA. Of note, the Sixth Circuit followed the reasoning adopted by the DC Circuit in *Florida Bankers*,[6] written by then-Judge Kavanaugh. The Court was persuaded to follow *Florida Bankers* because the case similarly addressed the meaning of "tax" and "for the purpose of" as used in the AIA. While ruling against the Taxpayers, the Sixth Circuit acknowledged the "jurisprudential chaos" that exists regarding the AIA's meaning and scope because at times, the Supreme Court has given the AIA "literal force," without regard to the character of the tax, the characterization of the preemptive challenge to it, or other non-textual factors,[7] while at other times, the Supreme Court has given the AIA "almost literal" force, considering such factors with an eye towards furthering the AIA's underlying purposes.[8]

SUPREME COURT DECISION

Justice Kagan writing for a unanimous court concluded that a suit to enjoin Notice 2016-66 does not trigger the AIA even though a violation of the Notice may result in a tax penalty. Of significant import to the Court was the complaint filed by CIC. The Court agreed that the Taxpayer's goal was not to thwart the tax penalty but to invalidate the Notice and thus eliminate its onerous reporting requirements, finding that the "[c]omplaint contest the legality of Notice 2016-66, not of the statutory tax penalty that serves as one way to enforce it. CIC alleges that the Notice is procedurally and substantively flawed: it brings no legal claim against the separate statutory tax. And CIC's complaint asks for injunctive relief from the Notice's reporting rules, not from any impending or eventual tax obligation" The Court found "three aspects of the [Notice], taken in combination, refute [the Government's contention] that this is a tax action in disguise."

First, the Notice imposes affirmative reporting obligations, inflicting costs separate and apart from

[4] 28 U.S.C. § 2201

[5] 26 U.S.C. § 7421.

[6] *Florida Bankers Ass'n v. U.S. Dep't of the Treasury*, 799 F.3d 1065 (DC Cir. 2015).

[7] *Id.* at 250, citing *Bob Jones Univ. v. Simon,* 416 U.S. 725, 742 (1974).

[8] *Id*. at 250.

the statutory tax penalty. "Here, for example, CIC estimates that it will have to spend 'hundreds of hours of labor and in excess of $60,000 per year' to comply with the Notice." "Costs of that kind may well exceed, or even dwarf, the tax penalties for a violation." The Court concluded that CIC's suit was brought to "get out from under the (non tax) burdens of a (non tax) reporting obligation." In short, the suit targeted the Notice's reporting mandates, and not the suit's after-effect, of the tax penalty.

Second, the Notice's reporting rule and the statutory tax penalty are several steps removed from each other. The Court noted that a tax liability will only attach if CIC Services withholds the information, the IRS determines that a violation has occurred, and the agency makes a discretionary decision to impose a penalty. "CIC stands nowhere near the cusp of tax liability: Between the upstream Notice and the downstream tax, the river runs long," the opinion says. "So, it is again hard to characterize this suit's purpose as enjoining a tax." Third, the fact that noncompliance with the notice can result in criminal penalties under section 7203 for willful failure "clinches the case for treating a suit brought to set aside the Notice as different from one brought to restrain its back-up tax."

For these reasons, the Supreme Court concluded that the purpose of CIC's suit was not to restrain the assessment or collection of a tax. "The complaint, and particularly the relief sought, targets the Notice's reporting rules, asking that it be set aside as a violation of the APA." The Court rejected the Government's claim that a "wave of pre-enforcement actions will follow" if CIC could bring this suit now, where "tax litigation will shift from refund actions to pre-enforcement suits." The Court concluded that the Government's concerns were overstated because CIC's action challenges "a regulatory mandate – a reporting requirement – separate from any tax." Thus, CIC's suit is not a suit "for the purpose of restraining the [IRS's] assessment or collection" of a tax and so does not trigger the AIA.

Justice Sotomayor issued a concurring opinion to highlight that the answer might be different if CIC Services were a taxpayer instead of a tax advisor. She noted that "Taxpayers who are subject to reporting requirements backed by tax penalties face a choice: (1) provide information about their own finances to the Internal Revenue Service (IRS), which may in turn use that information to calculate the taxpayers' liability more accurately, or (2) refuse to provide such information and pay a noncompliance penalty, which Congress has deemed a tax. For a given taxpayer, then, a tax on noncompliance may operate as a rough substitute for the tax liability she has evaded by withholding required information." In addition, she noted that taxpayers may incur less expense in collecting and reporting their own financial information. "Hence, while it will often be correct to conclude that a tax advisor challenging an IRS reporting requirement is not doing so "for the purpose of restraining" a tax on noncompliance, the analysis may be different when it comes to taxpayers."

NEXT CHAPTER

CIC Services has been remanded back to District Court, where Taxpayer's will argue that Notice 2016-66 should be declared invalid. The crux of that suit will be whether the IRS may impose penalties by issuing notices, rather than following the formal notice and comment rulemaking procedure set forth in the Administrative Procedure Act.

Richard A. Nessler

9TH CIRC. ADDS PRESSURE TO REJECT SUBSTANCE OVER FORM[9]

In *Mazzei v. Commissioner of Internal Revenue*, the US Court of Appeals for the Ninth Circuit joined the US Court of Appeals for the First Circuit, US Court of Appeals for the Second Circuit and US Court of Appeals for the Sixth Circuit in rejecting the substance-over-form doctrine for transactions involving a Roth IRA and a domestic international sales corporation or foreign service corporation, or FSC.[10]

The Ninth Circuit opinion is notable because it represents a reversal of the US Tax Court's 2018 opinion, authored by Judge Michael Thornton, that found no economic substance for the transaction. Judge Thornton's opinion was met with a vociferous dissent by Judge Mark Holmes, which prompted an uncharacteristic rebuke by Judge Thornton.[11]

With four circuits now ruling that the substance-over-form doctrine is inapplicable where the congressionally mandated statutory scheme provides an explicit tax treatment, it remains to be seen whether the Tax Court will acquiesce in the face of these appellate decisions or continue to disfavor tax-advantaged transactions, even those explicitly provided for under the Internal Revenue Code.[12]

OVERVIEW — TRANSACTION STRUCTURE

Mazzei involved the contribution of a family-owned agriculture company's FSC commissions to Roth IRAs. The Mazzei family invested in a prepackaged plan intended to avoid taxes by shifting commissions from its family business to a Bermuda FSC and into personal Roth IRAs.

The Mazzeis' S corporation, Mazzei Injector Corp., which revolved around a unique chemical injection process, was formed in 1978 by Angelo Mazzei and his wife, Mary Mazzei. The Mazzeis' daughter, Celia, later became involved with the business as well.

In 1998, Injector entered into a program provided by the Western Growers Association, in which the association provided a Bermuda FSC for a participant's business that distributed its commissions into the participants' Roth IRAs. As

[9] This article was original published in *Law360* (August 2, 2021).
[10] *Mazzei v. Commissioner*, 998 F.3d 1041 (9th Cir. 2021); *Summa Holdings Inc. v. Commissioner*, 848 F.3d 779 (6th Cir. 2017); *Benenson v. Commissioner*, 887 F.3d 511 (1st Cir. 2018); *Benenson v. Commissioner*, 910 F.3d 690 (2d Cir. 2018).
[11] See Lawrence M. Hill and Kevin Platt, "*Mazzei Case Educed An Unusual Tax Court Response*," Law360 (June 5, 2018).
[12] Under *Golsen v. Commissioner*, 54 T.C. 742 (1970), the Tax Court is bound only by decisions of the circuit court to which the case is appealable. Unless otherwise stated, all section references herein are to the applicable sections of the Internal Revenue Code of 1986, as amended and the Treasury Regulations promulgated thereunder.

part of the program, each of the Mazzeis formed his or her own self-directed Roth IRA, contributing the maximum $2,000 for the year.

Generally, although yearly contributions are limited, income that accrues in a Roth IRA — including dividend income from the Roth IRA's investments — can be distributed tax-free.[13] Contributions in excess of the yearly limit are subject to an excise tax.[14]

Each of the Mazzeis' Roth IRAs purchased 33 1/3 shares of the FSC, and the combined 100 shares were attributed to a separate account in the FSC. Under the FSC rules then in effect, a separate FSC account is treated as a separate corporation.[15]

FSCs were tax-advantaged in that they allowed a domestic exporting business to attribute a set percentage of eligible sales commissions to the FSC — the business's so-called exempt foreign trade income, a percentage of which was excluded from US taxable income.[16]

From 1998 to 2002, Injector provided the FSC management company with its foreign sales numbers for the period, and management computed the maximum commission payment allowed. During this period, $533,057 was paid to the FSC as commissions after-tax, and the total sum was then distributed as dividends to the Roth IRAs tax-free.

Prior to entering these transactions, the Mazzeis presented the plan to their accountant for confirmation. Additionally, in each year at issue, the Mazzeis fully disclosed the arrangement on their individual tax returns.

TAX COURT OPINION

In a divided opinion, the Tax Court rejected the form of the Mazzeis' transactions, stating that in substance, the dividends from the FSC were actually dividends to the Mazzeis, rather than dividends to their Roth IRAs, followed by contributions by the individuals in excess of their annual limits.

The case had been tried before Judge Holmes, but after Judge Holmes circulated his proposed opinion within the Tax Court, the full Tax Court decided to rule on the matter. By a vote of 12 to 4, the Tax Court ultimately upheld the IRS' assessment of excise taxes against the Mazzeis for contributions to their Roth IRAs exceeding their statutory contribution limits. However, the court unanimously set aside all the penalties.

In making its determination, the Tax Court concluded that purchase of the FSC stock by the Roth IRAs did not reflect the so-called underlying reality because the "Roth IRAs effectively paid nothing for the FSC stock, put nothing at risk, and from an objective perspective, could not have expected any benefits" from that ownership.[17] The court therefore disregarded the purchase and treated the Mazzeis as "the owners of the FSC stock for federal tax purposes at all relevant times."[18]

That meant that the payments from the FSC were recharacterized as dividends from the FSC to the Mazzeis.[19] As a result, the court ruled the payments into the Roth IRAs were made by the Mazzeis and were, therefore, excess contributions to the Roth IRAs by the Mazzeis.[20]

The Tax Court acknowledged the Sixth Circuit's 2017 seemingly contrary holding in *Summa Holdings Inc. v. Commissioner*, but reasoned that because the case was appealable to the Ninth Circuit, under the Golsen rule the Tax Court was not bound by the Sixth Circuit's Summa Holdings Sixth decision.[21]

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[13] Section 4973.
[14] Sections 408 and 408A.
[15] Section 4973.
[16] Former Section 927(g).
[17] See prior Sections 921 through 927

[18] 150 T.C. 138, 167–68 (2018).
[19] *Id.* at 168.
[20] *Id.*
[21] *Id. Summa Holdings Inc. v. Commissioner*, 848 F.3d 779 (6th Cir. 2017); *Golsen v. Comm'r*, 54 T.C. 742 (1970).

Judge Holmes dissenting opinion noted that certain entities are intended solely to be taxpayer-favorable, such as domestic international sales corporations, FSCs and Roth IRAs. Additionally, these entities by their nature do not have economic substance; rather, they are simply shells set up for tax advantages provided by the IRC.

In referencing the similarities to Summa Holdings, the dissent notes:

[T]he Sixth Circuit — in the course of reversing our decision in a case nearly identical to this one — warned that a court that construes the Tax Code against its language and in favor of judge-made doctrine acts like Caligula, who famously posted tax laws in fine print and so high that Romans could not read them. It is our custom to reconsider an issue when a circuit court reverses us. And today we have to choose either a well-reasoned opinion by a highly respected judge in America's heartland, or Caligula. We pick Caligula.[22]

In turn, Judge Thornton's majority opinion harshly criticizes the dissent, devoting more than four pages to its response. At one point, the majority remarks, the "dissent does not explain why our analysis is incorrect. Its entire argument relates to why we should not sham the entities, which in fact, we do not do."[23]

NINTH CIRCUIT OPINION

The Ninth Circuit sided with the Tax Court's dissenting opinion, explaining:

Because we conclude that the unusual statutory provisions at issue here expressly elevated form over substance in the relevant respects, the Tax Court erred by invoking substance-over-form principles to effectively reverse that Congressional judgment and to disallow what the statute plainly allowed.[24]

The court reasoned that Congress expressly decreed that FSCs can engage in transactions with related entities that lack any economic substance and have valuation formulas that "bear no relationship to any underlying real-world valuation."[25] Under the FSC statutory scheme, Congress had abrogated the substance-over-form doctrine.[26]

> "[T]he Sixth Circuit — in the course of reversing our decision in a case nearly identical to this one — warned that a court that construes the Tax Code against its language and in favor of judge-made doctrine acts like Caligula, who famously posted tax laws in fine print and so high that Romans could not read them."

The Ninth Circuit identified a number of flaws in the Tax Court's opinion, explaining:

[It] makes no sense to ask whether the formal owner of the FSC would ... be exposed to any risk as a result of that ownership because the statute ... explicitly authorizes the establishment of a FSC as a shell corporation that will not conduct any

[22] 150 T.C. at 184.
[23] Id. at 173.
[24] 998 F.3d at 1043.
[25] Id. at 1055.
[26] Id.

operations itself. ... Moreover, it makes even less sense to ask, as the Tax Court did, "what benefits an independent holder of the FSC stock could realistically have expected" ... [because] a FSC typically will not be owned by an 'independent' entity; it will be owned by 'a person described in section 482.'"[27]

The Ninth Circuit concluded that recharacterization of the transaction is inappropriate where such a transaction was explicitly authorized by statute. It "is not our role to save the Commissioner from the inescapable logical consequence of what Congress has plainly authorized."[28]

The decisions in *Mazzei* and *Summa Holdings* provide an appropriate admonition to the IRS, as well as the courts, to show more deference to Congress' role as legislator, as well as a reminder, that it is the IRS' role to administer and enforce the law and the courts' to interpret and apply the law. Perhaps these circuit court decisions will result in more reflection on the part of the IRS and the courts when it comes to congressionally favored tax incentives in other areas of the tax law.

One interesting example is microcaptive insurance transactions. While no taxpayer has yet prevailed in a microcaptive insurance case, it follows that, a taxpayer must, in appropriate circumstances, be able to claim the tax benefits provided by Section 831(b), otherwise the statute would be a nullity.

The IRS, to date, though has failed to provide any instructive guidance as to what would constitute a valid 831(b) microcaptive transaction. One may logically infer that the Tax Court's application of common law notions of insurance, such as the breadth of risk distribution, which appropriately apply in the case of large captive insurers, are perhaps inapposite when it comes to a creature of statute designed specifically for mom and pop insurers. Mazzei contains some helpful elucidation on this point, noting that under the statute, a small FSC was not required to meet certain requirements that would otherwise be applicable.[29] If a small FSC is able to receive congressionally created tax benefits, it stands to reason that a captive insurer under Section 831(b) should be able to do so, under appropriate circumstances, as well.

Mazzei is representative of a refreshing trend of the federal courts of appeal to respect the form of tax-favored transactions, where such form is consistent with the plain intent of Congress. The substance over form doctrine is inoperative to abrogate Congress' express wishes. It exists, only to override form, where the substance of the transaction is contrary to congressional intent.

Lawrence Hill and Caitlin Tharp

[27] Id. at 1056-1057 (citing former section 925(a)).
[28] Id. at 1061.
[29] 998 F.3d at 1048 n.6.

STEPTOE CO-AUTHORS AMICUS BRIEF FILED WITH THE US SUPREME COURT ON BEHALF OF THE AMERICAN COLLEGE OF TAX COUNSEL TO REVIEW PRIVILEGE CLAIM

On May 13, 2021, Taylor Lohmeyer filed a petition for writ of certiorari to the US Supreme Court requesting a review of a decision of the United State Court of Appeals for the Fifth Circuit[30] which affirmed a decision of the United States District Court for the Western District of Texas[31] which granted the Government's cross-petition to enforce a John Doe summons over Taylor Lohmeyer Law Firm PLLC's (Firm) objection that the attorney-client privilege protects responsive documents.

Both lower courts rejected Taylor Lohmeyer's argument that the attorney-client privilege protected client identities. Taylor Lohmeyer's petition to the Supreme Court raises the following question: "When the Government is aware of a citizen's confidential communication with legal counsel or the motive for seeking advice, but is unaware of the citizen's identity, are documents that reflect the client's identity protected by the attorney client privilege?" The American College of Tax Counsel filed an amicus brief in support of Taylor Lohmeyer's writ of certiorari petition.[32] Lawrence M. Hill of Steptoe & Johnson LLP, who represents the American College of Tax Counsel, was quoted in Law360 stating that "the Fifth Circuit's decision enabling the IRS to obtain the identities of law firm clients through summons threatens to erode the time-honored confidentiality of communications between lawyers and clients. Uniformity of law is necessary to ensure that all client communications with their lawyers are treated similarly," he said.[33] "Leaving the circuits split on this issue would lead to inconsistent protections for clients and fundamental systemic unfairness."[34]

"Uniformity of law is necessary to ensure that all client communications with their lawyers are treated similarly"

[30] 125 AFTR 2d 2020-1844 (5th Cir. 2020), *aff'g* 385 F. Supp. 3d 548 (W.D. Tx. 2019).
[31] 385 F. Supp. 3d 548 (W.D. Tx. 2019).
[32] Lawrence M. Hill of Steptoe & Johnson is counsel to the American College of Tax Counsel. Richard Nessler of Steptoe & Johnson assisted in the preparation of the amicus brief.
[33] *Justices Asked to Uphold Attorney Privilege In Tax Client List Row*, Law360 (June 17, 2021)
[34] *Id.*

BACKGROUND

In *Taylor Lohmeyer*, the Fifth Circuit denied the Firm protection when it sought to shield the identities of its clients under the auspices of the attorney-client privilege. The IRS had served the Firm with a John Doe summons,[35] seeking documents for unnamed taxpayers "who, at any time . . . used the services of [the Firm] . . . to acquire, establish, maintain, operate, or control (1) any foreign financial account or other asset; (2) any foreign corporation, company, trust, foundation or other legal entity; or (3) any foreign or domestic financial account or other asset in the name of such foreign entity."[36] This broad demand was part of an IRS investigation to determine the "identity and correct federal income tax liability of US taxpayers for whom [the Firm] acquired or formed any foreign entity, opened or maintained any foreign financial account, or assisted in the conduct of any foreign financial transaction."[37]

This IRS investigation arose in the wake of an audit conducted on a specific client of the Firm. The client, the IRS found, had used the Firm to form offshore entities in tax haven jurisdictions for the purpose of assigning income to those entities, avoiding income tax. The client eventually reached a settlement with the IRS in which the client admitted to earning unreported income in excess of five million dollars, resulting in an unpaid income tax liability of more than two million dollars. With this in mind, the IRS targeted other clients for which the Firm created or maintained foreign bank accounts or foreign entities, with the suspicion that such entities and accounts also may not have been properly disclosed on tax returns.

The Firm moved to quash the summons on the grounds that the identities of its clients are protected by the attorney-client privilege. The courts below, narrowly construing the privilege doctrine, ultimately ruled in favor of the IRS and enforced the summons.

CERTIORARI PETITION

In support of its certiorari petition, Taylor Lohmeyer presented five principal arguments: (i) The Supreme Court has never decided the circumstances under which attorneys are required to withhold requests for information concerning the identities of their clients; (ii) The Fifth Circuit's decision in this case is incorrect and conflicts with other Fifth Circuit decisions; (iii) The Fifth Circuit's decision conflicts with decisions of other United States courts of appeals; (iv) The Fifth Circuit's reliance on the Seventh Circuit's *United States v. BDO Seidman* decision is misplaced, and (v) The question presented has significant import and should be decided. The Firm contends that the IRS already knew the content of the legal advice that the Firm afforded its clients. Thus, the identity of the clients, it argued, would provide the "essence" of the confidential communication when combined with the already-revealed substance of the communication.

IDENTITY PRIVILEGE

While the identity of a client is generally not privileged, the circuit courts — including up to now the Fifth Circuit — have consistently held that the attorney-client privilege protects disclosures of client identities when the Government knows or suspects it knows the unknown client's motive for hiring the attorney.[38] The privilege applies when an identity is "*connected inextricably* with a privileged communication", such that disclosure of the identity reveals the "confidential purpose" for

[35] *See* IRC Section 7609(f). A John Doe summons may only be issued if (1) the summons relates to the investigation of a particular person or ascertainable group or class of persons; (2) the IRS has a reasonable basis for believing that such person or group or class of persons may fail or may have failed to comply with any provision of any internal revenue law; and (3) the information sought to be obtained from the examination of the records or testimony (and the identity of the person or persons with respect to whose liability the summons is issued) is not readily available from other sources.

[36] *Taylor Lohmeyer Law Firm PLLC*, 125 AFTR 2d at 2020-1845.

[37] *Id*.

[38] *United States v. Jones*, 517 F.2d 666, 673-674, 674-675 (5th Cir. 1975)

which the client consulted the attorney.[39] The privilege also applies when so much of the actual communication between client and attorney has been established that disclosure of the client's name would disclose the "essence" of a confidential communication.[40]

This protection applies even if the Government does not know the specific, substantive legal advice that was provided to the client. Prior Fifth Circuit decisions followed the holding of the seminal case on this issue, *Baird v. Koerner*[41], which held that "if the identification of the client conveys information which ordinarily would be conceded to be part of the usual privileged communication between attorney and client, then the privilege should extend to such identification in the absence of other factors." Taylor Lohmeyer asserts that the Fifth Circuit's decision is at odds with this settled precedent and risks eroding the protections of the attorney-client privilege.

In addition, Taylor Lohmeyer noted that if the federal common law were what the Fifth Circuit has embraced here—that the Government can enforce a broad John Doe summons to seek out law firm clients' identities by simply downplaying in its supporting affidavit the extent of its actual knowledge about the legal advice given—law firms' and clients' privileged and confidential consultations will be in peril. Taylor Lohmeyer asserts that "this will surely disincentivize citizens to seek out legal advice about important and sensitive problems for fear that if they follow advice that the Government believes may have been incorrect, they will be the target of the next investigation."

On August 16, the Government filed its opposition brief asserting that the clients' identities are not privileged because disclosure would do no more than inform the IRS that the clients participated in at least one of the transactions described in the summons. Moreover, the Government dismissed the firm's argument that the Fifth Circuit had adopted an unprecedented rule that the IRS must know the full substance and content of the specific legal advice for the privilege to apply. A decision from the Supreme Court on the certiorari petition is not expected until sometime this fall.

IRS SERVES JOHN DOE SUMMONSES RELATED TO PANAMANIAN OFFSHORE SERVICE PROVIDERS

On July 29, 2021, a federal district court judge in the Southern District of New York entered an order authorizing the IRS to issue 10 John Doe summonses requiring multiple couriers and financial institutions to produce information about US taxpayers who may have used the services of Panama Offshore Legal Services POLS) and its associates to evade federal income taxes. Specifically, the IRS summonses seek to trace courier deliveries and electronic fund transfers between the POLS Group and its clients, in order to identify the POLS Group's US taxpayer clients who have used the POLS Group's services to create or control foreign assets and entities to avoid compliance with their US tax obligations.

The John Doe summonses will be served on Federal Express; FedEx Ground Package System, Inc.; DHL Express; United Parcel Service, Inc.; the Federal Reserve Bank of New York; The Clearing House Payments Company LLC; HSBC Bank USA, N.A.; Citibank, N.A.; Wells Fargo Bank, N.A.; and Bank of America, N.A. There is no allegation that the summons recipients have engaged in any wrongdoing. Rather, the IRS has issued the John Doe summonses to obtain information about possible violations of internal revenue laws by individuals whose identities are unknown. The John Doe summonses direct these couriers and financial entities to produce records that will enable the IRS to identify US taxpayers who have used the POLS Group's services, along with other

[39] *Id*. (emphasis in original) (citing *Reyes-Requena II*, 926 F.2d at 1431).

[40] *Id*. (citing *United States v. Liebman*, 742 F.2d 807, 809 (3rd Cir. 1984)).

[41] 279 F.2d 623, 631-632 (9th Cir. 1960).

documents relating to the POLS Group's business. IRS Commissioner Charles P. Rettig said: "These court-ordered summonses should put on notice every individual and business seeking to avoid paying their fair share of taxes by hiding assets in offshore accounts and companies. These records will empower the IRS and the Department of Justice to find those attempting to skirt their tax obligations and ensure their compliance with the US tax laws."[42]

Federal tax law requires US taxpayers to pay taxes on all income earned worldwide. US taxpayers must also disclose certain foreign financial accounts and assets.

Richard A. Nessler

[42] Press release from the United States Attorney's Office for the Southern District of New York (July 29, 2021)

DISTRICT COURT UPHOLDS IRS NOTICE FROM APA ATTACK

In *Mann Construction v. United States*[43], a federal district court rejected a taxpayer's claim that an Internal Revenue Service (IRS) revenue notice (Notice 2007-83), requiring the taxpayer to disclose a potentially abusive transaction, was issued without notice and comment in violation of the Administrative Procedure Act (APA).[44]

The district court granted the Government's motion and dismissed the taxpayer's refund suit.

SECTION 6707A

In 2004 Congress passed the American Jobs Creation Act of 2004, which created section 6707A. Section 6707A laid the statutory foundation for the new reporting regime by establishing penalties for nondisclosure and defining "reportable transaction" and "listed transaction" by reference to Treasury regulations.[45] Since the passage of section 6707A, the IRS has identified many listed transactions by notice, in effect requiring taxpayers to disclose their participation or face substantial penalties under section 6707A. One of these revenue notices, the subject of the *Mann* litigation, is Notice 2007-83.

NOTICE 2007-83

On November 5, 2007, the IRS published Notice 2007-83 entitled "Abusive Trust Arrangements Utilizing Cash Value Life Insurance Policies Purportedly to Provide Welfare Benefits."[46] The Notice explained that the IRS is aware of certain trust arrangements claiming to be welfare benefit funds and involving cash value life insurance policies that are being promoted to and used by taxpayers to improperly claim federal income and employment tax benefits. The Notice informs taxpayers and their representatives that the tax benefits claimed for these arrangements are not allowable for federal tax purposes. The Notice notified taxpayers of their duty to report their participation in this transaction or "substantially similar" transaction to the Office for Tax Shelter Analysis (OTSA) by filing a Form 8886.

DBT/RPT TRANSACTION

When filing its Form 1120S for tax year 2013, Mann Construction included a Form 8275 (Disclosure Statement) and a supporting document, where it disclosed its contributions to the Mann Construction, Inc. Death Benefit Trust and Restricted Property Trust (DBT/RPT) and provided its legal rationale for the tax treatment. However, Mann Construction and its owners, failed to file form 8886 with the OTSA.

On May 9, 2019, the IRS issued a proposed adjustment to Mann Construction's Form 1120S, disallowing deductions for Mann Construction's contributions to the DBT/RPT for tax years 2013 to 2017. The IRS subsequently imposed a section

[43] 2021 WL 1923412 (May 13, 2021)
[44] 5 U.S.C. § 551 *et seq*.
[45] *See* 26 U.S.C. § 6707A
[46] I.R.S. Notice 2007-83, 2007-2 C.B. 960.

6707A penalty on Mann Construction and its owners for years 2013 to 2017 for failure to disclose participation in the DBT/RPT. Plaintiffs paid the 6707A penalties for year 2013 and filed a Form 843 requesting a refund of the amount paid. Plaintiffs later filed a refund action alleged four counts in their Complaint: three purported violations of the APA and one claim for a refund. Specifically, Plaintiffs alleged that the Notice was an "unauthorized agency action" (Count I); that the Notice was "arbitrary and capricious" (Count II); that the Notice was improperly issued without public notice and comment (Count III); and that the DBT/RPT was not a listed transaction or substantially similar to one (Count IV).

ANALYSIS

The issue in this case was whether the IRS was required to provide public notice and an opportunity for comment under the APA[47] before promulgating Notice 2007-83. The Court noted that "not all agency rules' must be issued through the notice-and-comment process . . . [T]he notice-and-comment requirement 'does not apply' to 'interpretative rules, general statements of policy, or rules of agency organization, procedure, or practice.'"[48] The Government argued, in part, that Congress authorized the IRS to promulgate the Notice without the notice and comment period required by the APA. The Court agreed and concluded that Congress intended for the IRS to occupy an exceptional role with respect to tax shelter reporting — a role that allows it to identify listed transactions without compliance with APA procedure.

The Court concluded that the text, structure, and history of section 6707A and related Treasury regulations "express [Congress's] clear intent that APA notice and comment procedures need not be followed."[49] The Court stated:

> when Congress enacted section 6707A, it did so with the understanding that compliance with tax shelter regulations had become "a joke."[50] The old regulatory framework was obsolete and the IRS needed a new set of tools to detect and combat abusive transactions. Accordingly, senior IRS officials came and sat before Congress and asked for penalties to enforce their new reporting regime — penalties . . . Congress responded with section 6707A, which not only added penalties for the failure to disclose reportable transactions, but defined "listed transaction" by reference to Treasury regulations that allow the IRS to identify listed transactions by "notice, regulation, or other form of published guidance."[51] This reference is significant because revenue notices, like revenue rulings and procedures, are normally issued without the notice and comment required by the APA. Had Congress intended to limit the IRS to ordinary rulemaking, it could have qualified its reference to the regulations prescribed under section 6011.

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[47] The APA establishes the procedures federal administrative agencies use for "rule making," defined as the process of "formulating, amending, or repealing a rule." [47] Under the APA, "[a] person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute, is entitled to judicial review thereof."[47] The APA further empowers federal courts to set aside unlawful agency action.

[48] *Id*. at 96 (quoting 5 U.S.C. § 553(b)).

[49] Citing *Asiana Airlines*, 134 F.3d at 398.

[50] *See Corporate Tax Shelters: Looking Under the Roof: Hearing Before the S. Comm. on Finance*, 107th Cong., 2 (2002) (statement of Sen. Max Baucus, Chairman, S. Comm. on Fin.).

[51] Section 6707A; Treas. Reg. § 1.6011-4.

The Court rejected taxpayer's argument that the IRS should comply with the APA because section 6707A and the related regulations are not "irreconcilable" with it. The Court found that Congress established procedures so clearly different from those required by the APA that it must have intended to displace the norm." The Court said that "while the IRS *could* operate the listed transaction regime through ordinary rulemaking, doing so would undermine one of the principal purposes of the regime: '[i]dentifying questionable transactions early…, in some cases before the transactions even show up on tax returns.'" Thus, rather than prescribing an ordinary regulatory system, "Congress, through its enactment of section 6707A, endorsed the flexible reporting regime that the IRS had already developed." For these reasons, this Court held that Congress authorized the IRS to promulgate Notice 2007-83 without APA notice and comment.

Richard A. Nessler

TAXPAYER LACKS STANDING TO CHALLENGE TRANSITION TAX REGULATIONS UNDER SECTION 965

On March 28, 2021, the United States Tax Court in Silver v. Internal Revenue Service52 held that the taxpayer lacked standing to pursue his claim that the IRS and Department of Treasury violated the Regulatory Flexibility Act (RFA)53, the Paperwork Reduction Act (PRA), and the Administrative Procedure Act (APA), in promulgating the final regulations implementing section 965.

Taxpayer Silver sought relief to the extent permissible by law, for a stay of enforcement of the final regulations and sections 965 and 962 against him and other small businesses, and that the final regulations should be set aside, declared unlawful, and sent back to the agencies pending compliance with the FFA.

SECTION 965 AND THE TRANSITION TAX

Under the Tax Cuts and Jobs Act, Pub. L. No. 115-97, 131 Stat. 2054 (2017) (TCJA or the Act) section 965, as amended by the Act, was intended to act as a transition provision between the international tax rules in place before the Act and those enacted by the Act. Prior to the TCJA, a US corporation could defer foreign income from taxation by retaining earnings indefinitely through a foreign subsidiary. The corporation paid US tax only when the foreign earnings were distributed to the domestic corporation. Under the rules enacted by the TCJA, to encourage repatriation of foreign income, "domestic corporations are in most circumstances entitled to a 100-percent deduction for any dividends received from their foreign subsidiaries, which eliminates any US tax liability on the dividend."[54] However, to prevent a windfall, "whereby a domestic corporation could distribute

[52] 2021 WL 1180081 (D.D.C. March 28, 2021)

[53] Enacted in 1980, the RFA "obliges federal agencies to assess the impact of their regulations on small businesses." *U.S. Cellular Corp. v. FCC*, 254 F.3d 78, 88 (DC Cir. 2001). The RFA "is a procedural statute setting out precise, specific steps the agency must take[,]" *Aeronautical Repair Station Ass'n, Inc. v. FAA*, 494 F.3d 161, 178 (DC Cir. 2007), to "ensur[e] that agency rules . . . tak[e] into account the size and nature of the regulated businesses," *Mid-Tex Elec. Coop., Inc. v. FERC*, 773 F.2d 327, 342 (DC Cir. 1985) The RFA provides that whenever an agency is required to publish a notice of proposed rulemaking, it must first determine whether the regulation under consideration would "have a significant economic impact on a substantial number of small entities." 5 U.S.C. § 605(b). "Only if the proposed regulation would have such an impact do the statute's two primary procedural obligations attach." *N.C. Fisheries Ass'n, Inc.*, 518 F. Supp. 2d at 73. "Those obligations are the preparation first of an initial and then of a final regulatory flexibility analysis, commonly referred to as an IRFA and a FRFA." *Id.* (citing 5 U.S.C. §§ 603-604)

[54] *See* TCJA (citing section 245A).

its historical pre-Act earnings tax free to the United States, the Act included section 965 to treat those historical earnings as repatriated to the United States under the pre-Act rules, before the new rules took effect."[55] Thus, section 965 imposes a one-time tax on US shareholders of certain "specified foreign corporations" with "deferred foreign earnings[,] by deeming those earnings to be repatriated and included in the US person's income" for the 2017 tax year.[56] A specified foreign corporation is defined as "(A) any controlled foreign corporation, and (B) any foreign corporation with respect to which one or more domestic corporations is a United States shareholder."[57]

Finally, subsection 965(o) directs the Secretary of the Treasury to "prescribe such regulations or other guidance as may be necessary or appropriate to carry out the provisions of th[e] section."[58] These regulations are the subject of Silver's lawsuit.

REGULATIONS IMPLEMENTING THE TRANSITION TAX

On August 9, 2018, Treasury published in the Federal Register a Notice of Proposed Rulemaking under section 965, as well as related proposed regulations under sections 962 and 986. Pursuant to the RFA, the Notice of Proposed Rulemaking contained a certification by the Secretary of the Treasury that the proposed regulations would not "have a significant economic impact on a substantial number of small entities," and thus "an initial regulatory flexibility analysis" was not performed. The RFA certification was based on several factors: (i) the IRS estimated the average burden of compliance with the regulations to be five hours, which was "minimal"; (ii) "the [information collection] requirements appl[ied] only if a taxpayer cho[se] to make an election or [to] rely on a favorable rule"; (iii) "the collections of information appl[ied] to the owners of specified foreign corporations," not "the specified foreign corporations themselves," and thus "a small entity would not be subject to the collections of information" and (iv) "the collection of information requirements in th[e] regulation appl[ied] primarily to persons that are United States shareholders of foreign corporations."

Treasury received a number of comment letters in response to the proposed regulations, but only three comments addressed the Regulatory Flexibility Act analysis. Although given notice of the proposed regulations by the IRS, the Small Business Administration (SBA) did not issue any public comments.

On February 5, 2019, Treasury published the final regulations in the Federal Register. The final regulations primarily finalized the proposed regulations, with certain changes based on comments received. Like the proposed regulations, the final regulations do not contain a Regulatory Flexibility Analysis. After reviewing the comments, Treasury determined and certified that the final regulations would not have a significant economic impact on a substantial number of small entities within the meaning of section 601(6) of the RFA.

The final regulations also addressed comments received in response to the Notice of Proposed Rulemaking.[59] With regard to comments from Plaintiff Silver and like-minded individuals about the economic impact of the regulations on small businesses, Treasury wrote: "The comments received regarding the economic impact of the proposed regulations principally focus on burdens imposed by the statute (i.e., the tax due as a result of section 965) rather than any additional burdens resulting from the proposed regulations."[60] Therefore, the certification explained, "the Treasury Department and the IRS [] determined that the final regulations w[ould] not have a significant economic impact on a substantial number of small entities."[61]

[55] *Id*.
[56] 26 U.S.C. § 965(a).
[57] 26 U.S.C. § 965(e)(1).
[58] 26 U.S.C. § 965(o).

[59] *See* A.R. at 3136-164 (addressing comments throughout).
[60] *Id*. at 3172.
[61] *Id*.

FACTS

Plaintiff Silver, a US citizen, and his business Monte Silver Limited, is a company based in Israel. Silver reported Monte Silver Limited as a controlled foreign corporation. Silver claimed to be unduly burdened by the final regulations, and challenged the procedures by which the IRS and the Department of Treasury promulgated the final regulations implementing section 965. Specifically, Silver alleged that the IRS and Treasury failed to assess the economic impact the regulation would have on small businesses, as required by the RFA, 5 U.S.C. §§ 601-612. The Government moved to dismiss, contending that Silver lack standing to litigate these claims.

ANALYSIS

Standing varies depending on whether the plaintiff seeks prospective or retrospective relief, and the party involving standing bears the burden of showing that he has standing for each type of relief sought. Accordingly, the Court considered whether Silver had standing based on his demand for both prospective and retrospective relief. The Court first considered Silver's claim for retrospective relief.

RETROSPECTIVE RELIEF

The Court noted that a plaintiff seeking retrospective relief satisfies the injury-in-fact requirement if he has suffered a past injury that is concrete and particularized.[62] The IRS did not dispute that Silver established an injury in fact in the form of past compliance costs associated with the transition tax regulations. However, the Court concluded that Silver's claim for retrospective relief was not sufficient to satisfy standing burden stating:

> Both parties overlook an essential element of standing: redressability… As discussed, courts have held that the redressability requirement for standing is "relaxed" in procedural rights cases. *See WildEarth Guardians*, 738 F.3d at 305; *see also, e.g., Lujan,* 504 U.S. at 572 n.7; *Ctr. for Law & Educ.*, 396 F.3d at 1159. But "relaxed" does not mean "eliminated.' *See Ctr. for Law & Educ.,* 396 F.3d at 1157… Decisions in this Circuit and others confirm that a court must look at the underlying concrete interest when assessing redressability of a procedural injury. *Nat'l Wildlife Fed'n,* 170 F. Supp. 3d at 15… If the court were to grant the retrospective relief Plaintiffs seek—declaring unlawful the agency's failure to perform an RFA analysis and remanding to conduct the analysis—such relief would do nothing to redress Plaintiffs' claimed concrete injury. Plaintiffs have already incurred the compliance costs associated with the one-time transition tax, and Silver declares that "neither [he] nor Limited ended up owing any Transition tax at all." Silver Decl. ¶ 18. Granting the requested retrospective relief therefore would do nothing to undo the compliance costs Plaintiffs already have incurred. Thus, the only way Plaintiffs can satisfy the redressability prong of the standing analysis, even for retrospective relief, is if they have some future injury from the transition tax regulations that the agency could possibly alleviate on remand. In this way, the redressability inquiry for retrospective relief, in this case, dovetails with the injury-in-fact requirement for prospective relief.

PROSPECTIVE RELIEF

To seek injunctive relief, the Court said that Silver must show that he is suffering a continuing injury or that he is under a real and immediate threat of being injured in the future.[63] The IRS argued that Silver will not incur future compliance costs as a result of the section 965 regulations because Plaintiffs have no future transition tax liability - with no future transition tax liability Plaintiffs will

[62] *See Adarand Constructors, Inc. v. Pena*, 515 U.S. 200, 210-11 (1995).

[63] *See Lyons*, 461 U.S. at 101-02.

incur no future compliance costs. The Court agreed and rejected declarations submitted by Silver to demonstrate standing, concluding that none of the declarations rise above the level of "conclusory allegations" on the topic of injury. The Court concluded that the declarations merely contained arguments of counsel, not factual averments, which the court could rely upon at the summary judgment stage to establish standing.

Accordingly, because Silver failed to provide facts sufficiently specific to rise above the level of "conclusory allegations" to show that they face ongoing or imminent future injury, Silver lack standing to seek injunctive relief. In addition, the Court concluded that because taxpayers also must show ongoing or imminent future injury to satisfy the redressability requirement for retrospective relief, Silver similarly lack standing to assert his claim for declaratory relief and a remand. Thus, the Court concluded that it lacks jurisdiction over Silver's claims in their entirety.

Richard A. Nessler

NEW IRS OFFICE OF PROMOTER INVESTIGATIONS EXPANDS

Lois Deitrich, the acting chief of the IRS's new Office of Promoter Investigations (OPI) will be expanding the OPI team, which has begun to investigate research and development credits, monetized installment sales, and charitable remainder annuity trusts, among others," Deitrich said on June 24 at a virtual conference sponsored by the New York University School of Professional Studies.

The OPI team has already targeted micro-captive insurance arrangements and syndicated conservation easements.

OPI is positioned within the Small Business/Self-Employed Division. However, according to Deitrich, OPI will coordinate across other IRS offices and divisions, including the Criminal Investigation division (CI) and the Office of Fraud Enforcement, to identify and investigate promoters of abusive transactions. OPI will use data analytics and other resources to more quickly identify promoters and the OPI team will include cross-divisional economists, statisticians, social scientists, and other "think-tank gurus," as well as a dedicated team SB/SE attorneys to support the realigned promoter and preparer groups.

No stone will remain unturned, "no matter the abuse or noncompliance and where it happens, OPI has a playbook to identify, examine, and end the promotion," Deitrich said. "We will be getting more efficient in identifying and working those cases by leveraging our data tools and coordinating our in-house efforts."

OPI's focus will not be limited to the promoter and will investigate all suspected enablers of an abusive transaction. "If we find evidence of [enablers] knowingly pushing false statements as to the federal tax benefit of a transaction, we will pursue any and all applicable compliance paths." In addition, Deitrich explained that OPI will work with external stakeholders, including state and local taxing authorities, state attorney general offices, or other state government offices to identify and investigate tax shelter promoters.

CI DIVISION REALIGNMENT

At the same NYU conference, Guy Ficco of the CI announced that CI is undergoing a realignment at the same time as the Office of Fraud Enforcement (OFE) explores new ways to share criminal investigative leads. According to Ficco, a new CI executive position has been created to oversee investigative analytics, which will allow the division to increase the staffing and tools available to its data analytics efforts. Increasingly, CI has used data analytics in its case selection process as part of its nationally coordinated investigations unit (NCIU). The NCIU applies analytics tools to large data sets and develops case leads that are sent to field special agents for further investigation. CI and OFE will continue to coordinate their data analytics efforts, according to Ficco.

Richard A. Nessler

CRYPTOCURRENCY IN IRS CROSSHAIRS

In *Harper v. Rettig*[64], a federal district court dismissed a taxpayer's lawsuit which accused the IRS of illegally seizing his cryptocurrency account data resulting from the IRS's enforcement of a John Doe third-party summons.

The Justice Department moved to dismiss the case, asserting that Harper's suit was barred by section 7421(a) of the Anti-Injunction Act (AIA), which precludes judicial review of lawsuits seeking to restrain the government's ability to assess and collect taxes. The district court agreed that the case was barred by the AIA and dismissed Harper's suit.

Harper, a resident of New Hampshire, filed a lawsuit in 2020 claiming that his constitutional rights were violated when the IRS obtained his cryptocurrency account data without having a "particularized suspicion" that he had violated any tax laws. The IRS obtained Harper's cryptocurrency account data from lawfully issued John Doe summonses issued to Coinbase and Abra. Based on the information collected, the IRS sent Harper a letter informing him that it had information and that "he may have additional tax liability." Harper sought a court order requiring the IRS to expunge his cryptocurrency account data from its records.

In response to the motion to dismiss, Harper asserted that the AIA was inapplicable because his suit was not a tax collection claim, a refund or recalculation of his tax liability and, because his suit sought non-monetary damages for wrongful action by an agency or its officers or employees, the government had waived sovereign immunity under the Administrative Procedure Act.

ANALYSIS

The Court rejected Harper's contention that his suit fell outside the AIA's scope because he was not seeking a refund or recalculation of his tax liability. The Court concluded that the effect of Harper's requested declaratory and injunctive relief would be to prevent the IRS from assessing Harper's taxes using the information it has obtained through the John Doe third-party process.

The court also dismissed Harper's claim that the AIA did not bar his lawsuit because he had no other remedy. The Court said that Harper, who was a target of a John Doe summons, had the right to intervene and challenge enforcement of the summons. In addition, the Court noted that if the IRS determines that Harper does have additional tax liability related to his cryptocurrency account data, additional processes are available to Harper to challenge the IRS's deficiency determination.

JOHN DOE SUMMONSES ISSUED TO KRAKEN & CIRCLE INTERNET FINANCIAL

In an unrelated proceeding, a federal district court in California granted the government's petition to serve an IRS John Doe summons on cryptocurrency exchange Kraken and its subsidiaries.[65] Before issuing the order, the magistrate judge issued an order to show cause to the government, wanting proof that the IRS had narrowed the John Doe summons to be consistent with the John Doe summons served on Coinbase. The IRS's response to the show cause order eliminated the original request for account-related correspondence and refined the description of records the IRS seeks

[64] 2021 WL 1109254 (D.N.H. March 23, 2021)
[65] *In the Matter of the Tax Liabilities of John Does*, 2021 WL 1222862 (N.D. CA March 21, 2021).

from Payward Ventures Inc., the parent company of Kraken. The Court was satisfied with the IRS's narrowed request and granted the IRS permission to issue the section 7609(j) summons. The Court left open the possibility that Kraken or its users may make their own arguments in motions to quash the John Doe summons.

One day after the Court's order involving the IRS summons to Kraken, a federal district court in Massachusetts approved a cryptocurrency exchange John Doe summons issued to Circle Internet Financial Inc.[66] The Court was satisfied that the IRS's summons to Circle Internet Financial Inc. satisfied the requirements of section 7609(f).

The IRS's ex parte petition requested Circle to produce six categories of records on US account holders whose transactions were worth at least $20,000 in any year from 2016 through 2020. Those categories are account registration records, know-your-customer due diligence, account-related correspondence, anti-money-laundering exception reports, records of account activity, and records of account funding. The IRS alleged that there are several reasons for believing that Circle customers have not properly reported their cryptocurrency transactions to the IRS. The arguments in support of the summons issued to Circle were nearly identical to the IRS's assertions made to the US District Court for the Northern District of California for account records held by digital currency exchange Kraken. Interestingly, the Massachusetts district court did not raise the same concern whether the summons was "narrowly tailored", which was raised by the district court that approved the John Doe summons issued to Kraken.

[66] *In the Matter of the Tax Liabilities of John Does*, 2021 US District LEXIS 109077 (D. Mass, April 1, 2021).

IRS ANNOUNCES PPP LOAN RELIEF

In Revenue Procedure 2021-20, the IRS announced that deductions for business expenses covered by forgiven loans under the Coronavirus Aid, Relief and Economic Security Act (CARES Act) can be claimed on a business' subsequent federal tax return.

Earlier guidance issued by the IRS and the Treasury Department (Notice 2020-23 and Rev. Proc. 2020-27) barred businesses from taking deductions on CARES Act expenses if their loans were forgiven. However, Congress reversed that guidance in a year-end spending bill passed in December (COVID-related Tax Relief Act of 2020). Because of Congress' late reversal, many businesses did not deduct expenses covered by the forgiven Paycheck Protection Program loans on their tax 2020 return because they were relying on earlier IRS guidance. Those expenses can now be deducted on the businesses' subsequent federal tax return. Accordingly, businesses (Covered Taxpayer) do not need to file amended tax returns for tax year 2020 or file administrative adjustment requests to claim the expense deduction.

The Rev. Proc. defines a "Covered Taxpayer" as a taxpayer that satisfies all of the following:

(1) The taxpayer received an original PPP covered loan;

(2) The taxpayer paid or incurred original eligible expenses during the taxpayer's 2020 taxable year;

(3) On or before December 27, 2020, the taxpayer timely filed, including extensions, a federal income tax return or information return, as applicable, for the taxpayer's 2020 taxable year; and

(4) On the taxpayer's Federal income tax return or information return, as applicable, the taxpayer did not deduct the original eligible expenses because-

(a) The expenses resulted in forgiveness of the original PPP covered loan; or

(b) The taxpayer reasonably expected at the end of the 2020 taxable year that the expenses would result in such forgiveness.

To make a valid election to claim the deductions on the subsequent tax return, the Covered Taxpayer must satisfy the following conditions:

(1) Election deadline. A Covered Taxpayer must make the election by attaching the statement described in the revenue procedure to the Covered Taxpayer's timely filed, including extensions, federal income tax return or information return, as applicable, for the Covered Taxpayer's first taxable year following the Covered Taxpayer's 2020 taxable year in which the original eligible expenses were paid or incurred.

(2) Requirements for statement. The statement required by section 3.04(1) of this revenue procedure must be titled 'Revenue Procedure 2021-20 Statement" (and named RevProc2021-20.pdf for e-file attachments) and include the following information:

(a) The Covered Taxpayer's name, address, and social security number or taxpayer identification number;

(b) A statement that the Covered Taxpayer is applying the safe harbor provided by section 3.01 of this revenue procedure;

(c) The amount and date of disbursement of the taxpayer's original PPP covered loan; and

(d) A list, including descriptions and amounts, of the original eligible expenses paid or incurred by the Covered Taxpayer during the Covered Taxpayer's 2020 taxable year that are reported on the federal income tax return or information return, as applicable, for the Covered Taxpayer's first taxable year following that 2020 taxable year

IRS EXTENDS RESPONSE PERIOD TO INFORMATION DOCUMENT REQUESTS

On June 16, 2021, the IRS Large Business and International Division (LB&I) issued an updated memorandum67 which further extended the approval period to deviate from the standard information document request procedures through September 30, 2021.

The LB&I memo extends the approval period to deviate from IDR enforcement procedures and applies to the IDR enforcement process for taxpayers who are unable, due to the COVID-19 pandemic, to respond timely to an IDR. However, LB&I managers retain discretion to continue with the IDR enforcement process when in their judgment the interests of tax administration warrant, for example cases with short statues or fraud development.

For listed transactions, LB&I agents are directed to continue to follow the Interim Guidance memo on "Exceptions to IRM 4.46.4 Regarding Examinations of Listed Transactions and Transactions of Interest"[68] where the mandatory LB&I IDR Enforcement procedure in IRM 4.46.4.6.3 is not required.[69] LB&I examiners have been directed to follow the Service's summons procedures detailed in IRM 25.5.[70]

The Service has directed LB&I examiners and managers to consider all factors including the status of the taxpayer's business operations, the geographic location of its employees

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[67] LB&I 04-0621-0005

[68] LB&I 04-0220-0004

[69] IRM 4.46.4.6.3 provides:

1. IDRs must be in compliance with the general IDR procedures of IRM 4.46.4.6.1 before the IRS can issue a summons based on the IDR and later seek summons enforcement. The process for enforcing delinquent IDRs from delinquency to summons issuance has three graduated steps:
   - A. a Delinquency Notice
   - B. a Pre-Summons Letter
   - C. a Summons

   This process is mandatory and has limited exceptions. It requires LB&I managers at all levels to be actively involved early in the process and ensures that Counsel is prepared to support IDRs through the issuance of a summons when necessary. If, during the discussion of an IDR, a taxpayer indicates that the requested information will not be provided without a summons, then the IDR enforcement procedures do not apply and the IRS should move directly to issue a summons.

[70] IRM 25.2 covers the following topics regarding a summons:

- Preparation and Use;
- Description of Summoned Party;
- Description of Information Requested;
- Chief Counsel Participation in Summoned Interviews.

involved in the audit, and any other circumstances brought to light by the taxpayer or employee when scheduling appointments and IDR response dates and in deciding whether to deviate from the IDR Enforcement Process as outlined in IRM Exhibit 4.46.4-2. The memo notes that "all LB&I employees to be sensitive to the individual circumstances of taxpayers and provide them with the appropriate tax administrative actions commensurate with the taxpayer's situation." Accordingly, relief may be granted by the IRS if a taxpayer cannot timely respond to an outstanding IDR request.

EMPLOYMENT TAXES PENALTY RELIEF

The IRS recently issued Notice 2021-24, which amplifies the guidance in Notice 2020-22 that provided penalty relief under section 6656 for an employer's failure to timely deposit employment taxes with the Internal Revenue Service.

Notice 2021-24 provides, in part, that an employer will not be subject to a penalty under section 6656 for failing to deposit employment taxes in a calendar quarter if—

(1) The employer paid Qualified Leave Wages, Qualified Health Plan Expenses, or Qualified Collectively Bargained Contributions with respect to the period beginning on April 1, 2021, and ending on September 30, 2021, to its employees in the calendar quarter prior to the time of the required deposit,

(2) The amount of employment taxes that the employer does not timely deposit is less than or equal to the amount of the employer's anticipated credits under sections 7701 and 7003 of the Families First Act or sections 3131 and 3132 of the Code for the calendar quarter as of the time of the required deposit, and

(3) The employer did not seek payment of an advance credit by filing Form 7200 with respect to the anticipated credits it relied upon to reduce its deposits.

Accordingly, under Notice 2021-24 an employer may reduce without a penalty under section 6656 the amount of a deposit of employment taxes by the amount of the paid sick or family leave credit anticipated for the calendar quarter prior to the required deposit, as long as the employer does not also seek an advance credit with regard to the sick or family leave amount.

Notice 2021-24 also provides that an employer may further reduce, without a penalty under section 6656, the amount of the deposit of employment taxes by the amount of the employer's employee retention credit and employer's COBRA continuation coverage premium assistance credit anticipated for the calendar quarter prior to the required deposit, as long as the employer does not also seek an advance credit with regard to the same amount.

GOOD NEWS FOR PURCHASERS OF PLUG-IN ELECTRIC VEHICLES

The IRS recently added vehicle models to its index of eligible vehicles for section 30D credit for qualified plug-in electric motor vehicles.

The new vehicles eligible for the credit are the 2022 BMW 745e xDrive, the 2022 MINI Cooper S E Countryman ALL4, the 2022 MINI Cooper S E Hardtop, and the 2021 Porsche Taycan EV. Select EV vehicles manufactured by other car companies, including, Audi, Ford, Mercedes-Benz, Subaru, Toyota, Tesla, Volvo and Volkswagen also qualify for the credit.

Internal Revenue Code Section 30D provides a credit for Qualified Plug-in Electric Drive Motor Vehicles including passenger vehicles and light trucks. For vehicles acquired after December 31, 2009, the credit is equal to $2,500 plus, for a vehicle which draws propulsion energy from a battery with at least 5 kilowatt hours of capacity, $417, plus an additional $417 for each kilowatt hour of battery capacity in excess of 5 kilowatt hours. The total amount of the credit allowed for a vehicle is limited to $7,500.

The credit begins to phase out for a manufacturer's vehicles when at least 200,000 qualifying vehicles manufactured by that manufacturer have been sold for use in the United States (determined on a cumulative basis for sales after December 31, 2009).

ABOUT STEPTOE'S TAX CONTROVERSY PRACTICE

Steptoe's Tax Controversy Group combines trial-tested litigation skills with up-to-date substantive tax experience.

The team includes includes experienced litigators who have served as Justice Department trial and appellate attorneys, judicial law clerks, and Treasury officials. This combination enables us to take on the most challenging cases and achieve outstanding results for our clients. Over their careers, our lawyers have litigated cases on a wide variety of federal and international tax issues, including transfer pricing, foreign tax credits, insurance taxation, various tax incentives such as research credits, as well as numerous other substantive and procedural issues.

Our lawyers have proven skills and extensive experience in all aspects of tax controversy and litigation, including managing IRS audits, filing and presenting protests to IRS Appeals, negotiating litigation settlements, trying cases, and arguing appeals.

Our active controversy and litigation docket keeps us at the cutting edge of evolving administrative and judicial practice and procedures, strategy, and tactics.

Steptoe also represents clients with respect to international tax controversy matters before the IRS, the US Department of the Treasury, the US Congress, and foreign tax authorities. Our tax controversy lawyers have proven experience at the IRS and in court across a broad range of subjects. Our efforts include:

- Advocating positions effectively throughout the IRS administrative process and in the courts
- Working with experts to develop the facts and documentation necessary to prepare and defend positions
- Achieving success in demonstrating the infirmities in expert work performed for the government in tax controversies

For more informsion on Steptoe's Tax Controversy practice, click here.

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ABOUT STEPTOE'S TAX PRACTICE

The tax practice at Steptoe brings clients decades of advisory, transactional, and advocacy experience in federal and state taxation.

Clients rely on us for practical and creative solutions to issues that span the spectrum of tax law through all stages of the business lifecycle.

- Tax Controversies & Litigation
- Tax Policy
- International Tax
- Private Client
- Trusts & Estates
- Transactional Tax
- State & Local Tax
- Employee Benefits & Executive Compensation
- Insurance Tax
- Exempt Organizations

Our team includes an extraordinary group of professionals, including former senior government officials from Congressional offices, the IRS, Treasury, and Justice Department, who have vast experience in sophisticated tax planning, audit, and controversy work. Our clients include some of the world's largest corporations and tax-exempt organizations, as well as high-net-worth individuals, and we advise them with respect to their most important tax matters.

Our strength is to be as effective advocates for our clients. We represent them before the IRS, the Treasury Department, the courts, and in Congress, as well as before foreign tax authorities, for example through competent authority proceedings. We advise clients on the tax aspects of mergers, acquisitions, joint ventures, financings, and investment arrangements and draw on our deep understanding of corporate, partnership, and international tax, as well as our extensive experience in evolving judicial practice and procedures, strategy, and tactics.

Widely respected in the field of tax law, our lawyers contribute to its development. We regularly speak on important tax subjects, teach in educational institutions and institutes, author respected texts and articles on tax subjects, and participate in leadership roles in leading tax professional organizations.

RESOURCES

NEWS & PUBLICATIONS

EVENTS

MEET THE TEAM

ABOUT STEPTOE

In more than 100 years of practice, Steptoe has earned an international reputation for vigorous representation of clients before governmental agencies, successful advocacy in litigation and arbitration, and creative and practical advice in structuring business transactions. Steptoe has more than 500 lawyers and other professional staff across offices in Beijing, Brussels, Chicago, Hong Kong, London, Los Angeles, New York, San Francisco, and Washington.

Visit steptoe.com for more information.